Economics 103 F11 mid term 1 answer key

Part A

1 A	2 B	3 D	4 D	5 B	6 B	7 C
8 A	9 A	10 B	11 B	12 D	13 B	14 B
15 D	16 A	17 B	18 A	19 B	20 C	

Part B

1.

a) For Kristen the opportunity cost of a potholder is 7 wristbands (i.e. she must give up the production of 7 wristbands in order to produce one more potholder) For Anna the opportunity cost of a potholder is 6 wristbands.

(3 marks for Kristen and 3 marks for Anna)

b) Kristen has a comparative advantage in the production of wristbands because the opportunity cost (1/7 potholder) is lower for Kristen than it is for Anna (1/6 potholder).

(5 marks)

c) Kristen should completely specialize in wristband production and earn 280 x \$2 = \$560. Here, because of the price Anna should also specialize in wristband production and earn 360 x \$2 = \$720. To see why, examine what happens to total revenue for Kristen if she trades production of wristbands for potholders. In order to produce one more potholder she must give up the production of 7 wristbands. She would gain 1 x \$2 in revenue from increased potholder production and lose 7 x \$2 = \$14 in revenue from decreased wristband production. There would be a net loss in revenue of \$12. Similarly, for Anna to produce one more potholder (\$2 in revenue) she must give up the production of \$10.

(5 marks)

d) Their maximum joint revenue if they specialize is \$1280

(4 marks)

2.

a) The accompanying diagram illustrates the effect of this quota on the market for salmon: the quantity sold is 7 million kilograms, at a price of \$18 per kilogram.

For each pound of fish caught, each fisherman earns quota rent of \$6.

For the diagram: (1.5 mark) labeling supply, (1.5 mark) demand, (1.5 mark) Q of salmon, (1.5 mark) P of salmon, (1.5 mark) indicating where the quota is and (1.5 mark) for indicating the quota rent.

b) If an excise tax of \$6 per kilogram were introduced, this would similarly reduce the quantity bought and sold to 7 million kilograms, as illustrated in the accompanying diagram. (3 marks for finding the amount of the tax and 3 marks for labeling the diagram)



c) The fishermen are confusing who is responsible for paying the excise tax with the economic incidence of the tax: the burden of the tax is normally shared between consumers and producers. In this case, consumers pay \$4 more per pound than they would in an equilibrium without tax; and fishermen receive \$2 less per pound than they would in an equilibrium without tax. Both sides suffer from the missed opportunity to trade further amounts of fish. (5 marks)