BUSINESS

2023/2024

TEST AND REVIEW QUESTIONS

LESSON 1

1. Suppose that annual demand in a market can be expressed as Q_D=10-P, and the supply as Qs=2+P. Q_D is the quantity demanded, Qs equals the quantity supplied, and P is the price. Which is the equilibrium price?

2. Assume that the demand function for a particular good is given by Q_D =180-4P and the supply function is given by Q_S =90+2P. At which price there will be a shortage of 30 units?

3. Our society has faced a so-called "health-economics dilemma" due to the pandemic, particularly during confinement. Explain this dilemma in the economic terms learned during the course.

4. You won a free ticket to see a Bruce Springsteen concert (which has no resale value). Madonna is performing on the same night and is your next-best alternative activity. Tickets to see Madonna cost €90. Usually, you would be willing to pay up to €100 to see Madonna (because she is so cool!). Assume there are no other costs of seeing either performer. What is the opportunity cost of seeing Bruce Springsteen?

   Based on Ferraro, P. J., and L. O. Taylor. 2005. Do economists recognize an opportunity cost when they see one? A dismal performance from the dismal science. Contributions to Economic Analysis & Policy 4(1).

   1. €0
   2. €10
   3. €90
   4. €100

5. In the circular flow of income...

   1. Firms are consumers of goods and services and suppliers of factors of production.
   2. Household economies are consumers of goods and services and suppliers of factors of production .
   3. Household economies are consumers of factors of production and suppliers of goods and services..
   4. None of above is correct.

6. Robinson Crusoe and Friday live on the same deserted island. There are two activities each man can undertake to obtain food: fishing and gathering coconuts. Robinson Crusoe is able to catch 40 fish per hour or gather 10 coconuts per hour. Friday is able to catch 10 fish per hour or gather 8 coconuts per hour. Who is more efficient in each activity? Could either or both of them benefit from meeting and deciding to form a trading relationship? Explain *intuitively*.

   (Based on: Brickley, J. A., Smith, C. W., & Zimmerman, J. L. (2007). Managerial economics and organizational architecture. Boston: McGraw-Hill Irwin).

7. A well-known economist was asked what he did with his "free time". He responded by saying that he had "no free time". Explain his answer.

8. Suppose that there are 190 million people in US at working-age at a given point of time, from which only 120 million are actually employed. For the rest, 10 million do not search a job because they have given up (discouraged workers), and another 45 million people are not interested in working. Calculate the active population, activity rate and unemployment rate.

9. Explain in non-technical language the following piece of news regarding the increase in the interest rate decided last year by ECB. How could it impact the different macroeconomic variables? Why are there concerns about its effectiveness?

   Additionally, explain the (second) piece of news below regarding the evolution of these measures this year 2023.

> The European Central Bank on Thursday announced its largest-ever increase in interest rates (three-quarters of a percentage point), as officials confront a nightmare scenario of soaring inflation coupled with an economy that appears to be stalling.
> Europe faces a multiyear fight to bring rising prices under control, Christine Lagarde said, even as the bank's forecast calls for output in the euro area to "stagnate" for the next six months.
> Historically high inflation has disturbed almost every advanced economy over the past year. As consumers and businesses resumed normal activities and pandemic restrictions eased, strong demand for goods and services collided with persistent supply shortages, sending prices higher.
> Major central banks have responded by lifting interest rates from ultralow levels, aiming to slow economic activity by raising the cost of borrowing.
> Each central bank is grappling with a slightly different inflation challenge.
> The Fed is trying to cool off an overheated labor market, where there are two job openings for every unemployed person. In Europe, by contrast, there are three job seekers for every vacant position and the chief problem is a lack of adequate supplies of natural gas, Lagarde said.
> "Inflation in the U.S. is largely driven by demand. In the euro area, it is largely driven by supply," she added.
> Yet as higher energy bills infect other parts of the economy, Europe's inflation woes are spreading. Core inflation, excluding volatile energy and food prices, rose 4.3 percent in August compared with 1.6 percent in the same month in 2021, according to the ECB.
> "The energy shock is not staying in energy," said David Page, head of macroeconomic research at AXA Investment Managers in London.
> "These inflation levels imply a dramatic decline in real wages (5% or so) in [the euro area] in 2022," economist Jacob Kirkegaard of the Peterson Institute for International Economics said in an email. "This is unprecedented."
> While higher interest rates are expected to slow the economy and thus ease pressure on prices, they also could make an increasingly gloomy economic outlook even darker.
> "They are in an impossible situation," said Eric Winograd, senior economist with Alliance Bernstein in New York. "They are confronting a shock to which there is no good policy response."
> The weaker euro is only making inflation worse. Oil and other energy products that trade globally are priced in dollars. So the falling euro effectively makes them more expensive for European customers.
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> Based on: European Central Bank raises rates despite slowdown fears - The Washington Post

> The European Central Bank raised interest rates for the ninth straight time Thursday in its yearlong campaign to stamp out painfully high inflation and kept the door open to further hikes despite increasing fears of recession.
> ECB President Christine Lagarde said that if the bank pauses raising interest rate, "it would not necessarily be for an extended period of time." Decisions could vary from one meeting to the next, she said, but insisted that the ECB is "very strongly rooted in our determination to break the back of inflation."
> U.S. Federal Reserve Chair Jerome Powell was similarly noncommittal about whether more rate increases might be coming after the Fed on Wednesday raised its key rate for the 11th time in 17 months.
> Central banks around the world have been raising borrowing costs to combat inflation unleashed by higher energy prices after Russia invaded Ukraine and supply chain backups as the global economy recovered from the coronavirus pandemic.
> Inflation in the 20 countries that use the euro currency has fallen from its peak of 10.6% in October to 5.5% in June — still well above the bank's target of 2% considered best for the economy.
> Households and businesses are facing a double hit from price spikes and higher rates, which make it more expensive for people to get loans to buy homes and cars or for companies to get new equipment or build facilities.
> Rates are working their way through the economy, weighing on home prices and construction activity. But they can also weigh on economic growth, and the eurozone already has seen back-to-back quarters of contraction.

The ECB has raised its benchmark deposit rate from minus 0.5% to 3.75% in one year, the fastest credit tightening since the euro was launched in 1999.
Lagarde acknowledged that “the economic outlook for the euro area has deteriorated” and will stay weak in the short run. But she said inflation is expected to fall and incomes to rise, helping the economy recover.
The rate hikes are already working: Home prices have started to decline after a yearslong rally, and business loans are at their lowest level since statistics started in 2003.
Fears about recession are focusing on Germany, Europe’s industrial powerhouse and largest economy. It is the only developed economy that the International Monetary Fund expects to shrink this year.
The German economy is going through a “slowcession” — “stuck in the twilight zone between stagnation and recession,” Brzeski says (chief eurozone economist at ING Bank).
ECB officials say getting tough on inflation now avoids even more drastic credit restrictions later if inflation becomes ingrained through expectations for higher wages and prices.

Based on: European Central Bank hikes interest rates to combat inflation and leaves door open to more | Economy and Business | EL PAÍS English (elpais.com)