

This review sheet is intended to cover everything that could be on the exam. However, it is possible that I may have inadvertently overlooked something. You are still responsible for everything in the chapters covered except anything that I explicitly say you are not responsible for. Therefore, if I left something off of this sheet, it can still be on the exam. There will be no multiple-choice questions. Most of the questions will be like the ones on the homework assignments, and possibly a few definition questions. I am more likely to ask questions that make you use definitions rather than have you recite them. I will probably ask one of the questions from the book at the end of the chapters.

The review session for this class will be at a time to be determined, probably Monday, 9/17.

Note that some semesters this was taught MWF. Therefore, your test will be longer than those tests. Unfortunately for you, the material for this test was not in the old textbook, so old exams will not help.

Chapter 1: What is meant by **real GDP per capita**? Why do we use it as a measure of how well off a country is? What are some problems with doing this? What is meant by **property rights** and why are they so important? Know what the following terms mean: **capitalism, state capitalism, socialism, communism, crony capitalism, and kleptocracy**. Why do **democracies** normally do better than countries with **totalitarian governments**? What is meant by **multi-national corporation (MNC)** and **globalization**? *Note that because **incentives** are an important part of economics, that word should be in a fair number of answers from all chapters, especially the more theoretical chapters like those on this exam.*

Chapter 2: What do **comparative economics** and **fixed country effects** mean? We gauge economic systems by their “**institutions**.” There are six types of rules for the institutions. Understand how each of these rules are enforced. I put the enforcement mechanism in parentheses. **Convention (self enforcing), ethical (self commitment), customs (informal social control), private rule (organized private enforcement), state rule (organized state enforcement), and anarchy (none)**. *Note that these are straight forward, so are easier than they appear.* The five institutions we are concerned with are: **1) property rights, 2) decision making organization, 3) market vs. planned economy, 4) incentive mechanisms, and 5) procedures for public choice**. For 1), understand how **private ownership, public (state) ownership, and collective ownership** differ. How do they affect the economy? For 2), who makes the decisions? Understand how **the principal-agent problem, moral hazard, and adverse selection** affects the optimality of the production. For 3), understand the differences between planned economies and market economies (ignore what I said about Coase in class.) What role does **consumer sovereignty** play in the economy? For 4) understand the differences between **material incentives and moral incentives**. For 5) understand what a **public good** is. *They are **non-rival and non-exclusive**.* Understand why police protection, fire protection, and roads are **not** public goods even though the book calls some of them public goods. (They are more properly called pseudo-public goods, near public goods, or semi-public goods.) *I will not ask you to list the five institutions. Rather I will ask questions about them like in homework assignment #2.*

Chapter 3: What is meant by **economic outcomes**? Note they are dependent upon the **economic system, the environment and policies**. Why is it hard to tell what caused a particular outcome? Hint: **ceteris paribus**. There are five outcomes we will be most worried about are **1) economic growth, 2) efficiency, 3) income distribution, 4) stability, and 5) long-run viability**. For 1), the growth rates depend upon **initial conditions** and do not necessarily relate to happiness. For 2), we look at three types of efficiency. **Static efficiency** is whether or not we are on the **production possibilities frontier (PPF)**. **Dynamic efficiency** is whether we are moving towards the PPF or not. **Dead weight loss** is basically are we producing what people want us to produce? *(For example, we could be producing only albums by The*

*Lead and nothing else. We could be doing so well that we are on the PPF, but do we really want all those CDs?)* For 3), we looked at the **Lorenz Curve** and the corresponding **Gini Coefficient**. Know what those mean and how to estimate the Gini Coefficient. Why are too large a Gini Coefficient and too small of a Gini Coefficient bad for the economy? For 4), what happens to **unemployment** when the economy is unstable? What is meant by **underemployment** and why does it mean that unemployment statistics are not as useful as we would like? (*All statistics have problems especially in economics.*) What problems does a “**jobs rights**” economy have? For 5) Why is long-run viability important? *It may not be viable if the environment is destroyed, people are downtrodden so much that they revolt, etc.* Now that we have five outcomes, how do we get a “score” for the economy? Do we do a **weighted average** or use **social norms**? What are the problems with each method? Why might improving one of the outcomes require a **trade-off**, a.k.a. **opportunity cost**, of hurting another outcome? *For example, if an economy is too stable, then inefficient firms are not weeded out which hurts the economy in the long run.* Because of these trade-offs, economics is doing a **constrained maximization**. How are North & South Korea, East & West Germany, and Cuba & Latin America **natural experiments**? Why is it both important and hard to measure **freedom** (especially **business freedom**), **corruption**, and **effective governance**?

Chapter 5: Understand how technology (especially the **information revolution**), **globalization** (including **FDI**), and **rising living standards** have caused economic systems to change. Understand how policy changes like **lowering trade barriers** and **deregulation** affect the economy. What is meant by **import substitution** and **export orientation**? Which is normally a better policy to follow? How do **privatization** and **nationalization** affect the economy? When or why would you want to do each? What is the downside of government regulation of business and **corruption**? *When you are doing your research on the countries, you will want to check out the Heritage Foundation’s economic freedom (which includes corruption and several other freedoms related to business) at <http://www.heritage.org/index/ranking>.* What are the good and bad aspects of **income redistribution**? How can you tell a **regressive tax**, **proportional tax**, and **progressive tax**? Why do we care about the **tax source**? Why does a country going from socialist to capitalist have to have improved planning, organization reform, and decentralization?

Even though we will have started Chapter 6, it will **not** be on Exam #1.

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This is the nongraded Assignment #3A that will be reviewed with Assignment #3.

- 1) (15 points) According to the Heritage Foundation, Sri Lanka has a “Freedom from Corruption” score of 34 on a scale of 0 - 100, where 100 is best. Why is such a low score bad?
- 2) (15 points) Why is it important to know the source of the tax revenue?
- 3) (20 points) The Heritage Foundation has a score for how secure property rights are. What does that mean? How does that relate to privatization and/or nationalization? Why is a high score important?
- 4) (20 points) What is meant by “FDI”? How does it help the two countries involved.
- 5) (15 points) Why do a lot of economists feel that “import substitution” is a bad idea? Make sure you define it.
- 6) (15 points) What is meant by “deregulation”? How can it help an economy? (Note: not all deregulation is bad.)