1. Command-and-control economic policies (USSR central planning or US oil allocation policies in 1973 and 1974) failed to allocate goods efficiently chiefly because (our authors argue) of problems of:
   A. demand and supply
   B. markets and prices
   C. resources and budgets
   D. information and incentives.

2. Our authors define a price as a --- wrapped up in a ---
   A. number - bar code
   B. binary digit - computer code
   C. dollar value - price book
   D. signal - incentive

3. Our authors point out that higher prices in the oil market had unexpected effects in:
   A. increasing the production of flowers in Kenya and raising the price of sugar.
   B. increasing the amount of gasoline bought in the United States.
   C. increasing expenditures on oil exploration in other countries.
   D. increasing the amount of asphalt produced to pave roads.

4. According to the text, increased ethanol production in Brazil resulted in higher sugar prices, because:
   A. Much of the sugar cane crop died of pollution from ethanol factories.
   B. Ethanol is the major ingredient in sugar production.
   C. Ethanol as well as sugar production uses sugarcane as an input, and the increased ethanol production meant less sugar production.
   D. More money for Brazilian workers meant that they increased their demand for sugar.

5. After a hurricane in Florida, the price of generators and building supplies increase sharply, leading to calls for price controls. Economists (including Cowen and Tabarrok in their textbook) generally:
   A. Agree that such controls are needed to allocate resources to their highest value use.
   B. Argue that such controls would divert resources away from their highest value use.
   C. Feel that such controls give firms the incentive to ship more generators and building supplies to Florida.
   D. Think that such controls would maximize total economic surplus in the country.

6. If speculators expect that the future price of oil will be higher due to a Mideast war, they will take actions which will:
   A. Raise the price of oil now, and lower it in the future.
   B. Lower the price of oil now, in order to raise it in the future
   C. Get them out of the oil market.
   D. Lead to losses of economic surplus over time.

7. Prediction markets are markets consciously designed so that the prices of their shares reflects the probabilities of specific outcomes. Such markets include all the following EXCEPT for:
   A. The New York Stock Exchange
   B. The Iowa Electronic Market for presidential elections.
   C. The Hollywood Stock Exchange
Answers, Chapter 7

1. D - The basic problem of command and control is the problem of gathering complete information about all the relationships of the economy, and providing people with incentives to act on them.

2. D - The economic function of price is a signal wrapped in an incentive. The other options may be characteristic of some prices, but cannot serve as a general definition.

3. A. The surprising web of impacts one economic change has on many economic actors is what makes it practically impossible to gather enough information for a complete command-control economic system to function efficiently.

4. C. The ability to shift from one product to another (from sugar production to ethanol production) is a striking example of the information and incentive role of prices.

5. B. The rising price of generators and building supplies, in the absence of controls, will get more generators and building supplies to Florida quickly. If the price does not rise, firms will have little incentive to move them to Florida, where they are most badly needed.

6. A. Speculators will buy oil right now (when they think it is cheap compared to the expected higher price in the future). Therefore the price of oil will increase right now due to the higher demand by speculators. In the future, when oil IS at a higher price still, they will sell their oil for a profit. Their sales will increase the total amount of oil supplied and therefore drive down price.

7. A. Although the stock market is a speculative market, the price of a share of stock is based not just on the expected future price but on expected future dividends as well. As a result, stock prices are not easy to translate into specific probabilities. The other two markets were designed with the purpose of prediction of specific outcomes (elections or movie revenues).