

S11Microeconomics, Exam 3 Answer Key

Instruction:

Exam 3 Student Name: \_\_\_\_\_

Microeconomics, several versions

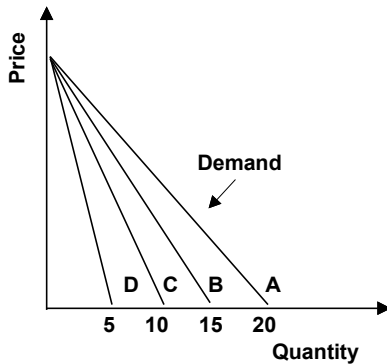
Early May, 2011

**Instructions:**

- I) On your Scantron card you **must** print three things:
    - 1) Full name clearly;
    - 2) Day and time of your section (for example MW 9:10);
    - 3) Notice the number I have written in ink in the upper right corner of your test? Write that number on the Scantron card. (This number tells me which version of the test you have. Without it your test cannot be graded properly and you get no credit for your answers.)
  - II) Answer on your Scantron card, using a #2 pencil.
  - III) Warning: **SOME QUESTIONS MUST BE ANSWERED SEVERAL TIMES!** Such questions will begin with a phrase such as this:  
**Repeat this answer on lines 37, 38 and 39.**  
Remember to do it!
  - IV) You must turn in this written exam along with your Scantron card to avoid zero credit.
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**Questions:**

Reference: Figure 12-1



Multiple Choice

1. **(Repeat answer on Scantron line 31.)** Refer to the graph above. Given the demand curve, the marginal revenue curve is:

- A) A.
- B) B.
- C) C.
- D) D.

Ans: C

Refer To: Figure 12-1

Difficulty: Hard

LO: 12-1

Page: 264

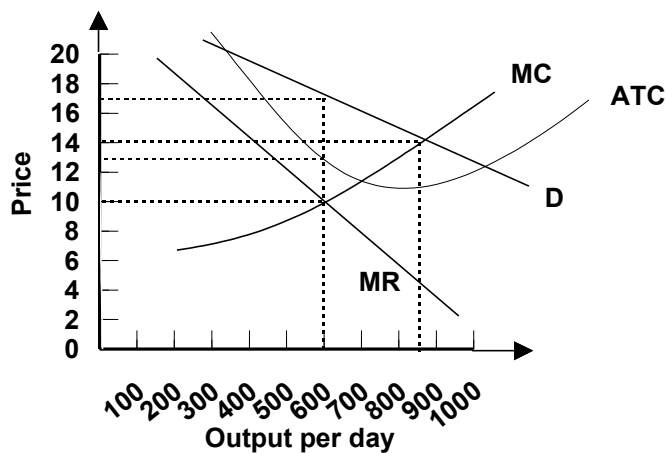
Skill: Application

Source: Old

Type: Graph

Feedback: The marginal revenue curve intersects the quantity axis at a point halfway between where the demand curve intersects the quantity axis and zero.

Reference: Figure 12-2



2. **(Repeat answer on Scantron line 32.)** Refer to the graph above. If the monopolist seeks to maximize profit, it should set a price equal to:

- A) \$17.
- B) \$14.

- C) \$13.
- D) \$10.

Ans: A

Refer To: Figure 12-2

Difficulty: Easy

LO: 12-3

Page: 265

Skill: Application

Source: Old

Type: Graph

Feedback: At this price, marginal revenue equals marginal cost so profits are maximized.

3. (**Repeat answer on Scantron line 33.**) Refer to the graph above. If the monopolist maximizes profit, the marginal cost of its product will be:

- A) \$17.
- B) \$14.
- C) \$13.
- D) \$10.

Ans: D

Refer To: Figure 12-2

Difficulty: Easy

LO: 12-3

Page: 265

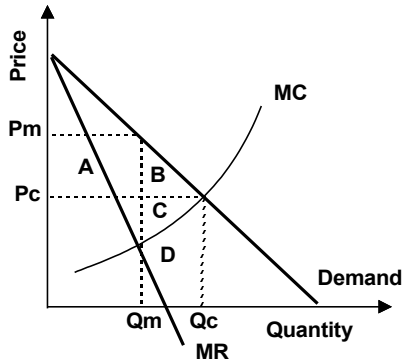
Skill: Application

Source: Old

Type: Graph

Feedback: This is the only point on the marginal cost curve at which marginal revenue equals marginal cost.

Reference: Figure 12-9



4. **(Repeat answer on Scantron line 34.)** Refer to the graph above. The areas which represent the net welfare loss of monopoly are:

- A) A and B.
- B) A and C.
- C) B and C.
- D) C and D.

Ans: C

Refer To: Figure 12-9

Difficulty: Medium

LO: 12-5

Page: 270

Skill: Application

Source: Old

Type: Graph

Feedback: These areas are the lost consumer surplus and the lost producer surplus caused by monopoly.

5. **(Repeat answer on Scantron line 35.)** Here is a challenging question. In 1997, the Federal government reinstated a 10% excise tax on airline tickets. The industry bid to pass on the full 10% ticket tax but were only able to boost fares by 4%. If the elasticity of supply for airline tickets is 4, then you can conclude that:

- A) the elasticity of demand for airline tickets is inelastic (not responsive to price at all).
- B) the supply of airline tickets is inelastic (not responsive to price at all).
- C) the demand for airline tickets is inelastic.
- D) the elasticity of demand for airline tickets is -6.
- E) no other answer is correct.

Ans: D

Difficulty: Medium

LO: 7-3

Page: 161

Skill: Application

Source: Old

Type: Calculation

Feedback: The airline industry could have passed along the entire 10% if demand were inelastic (zero). Since they could not, we know demand elasticity is greater than zero.

6. **(Repeat answer on Scantron line 36.)** The market structure in which many different firms supply similar, but slightly differentiated products, is:

A) monopoly.

B) oligopoly.

C) monopolistic competition.

D) perfect competition.

Ans: C

Difficulty: Medium

LO: 13-2

Page: 286

Skill: Recall

Source: Old

Type: Word problem

Feedback: Product differentiation provides monopolistically competitive firms with limited monopoly power.

7. An oligopolistic industry has:

A) many sellers in the industry.

B) only a few sellers in the industry.

C) no competition on the basis of price.

D) no barriers to entry.

Ans: B

Difficulty: Easy

LO: 13-4

Page: 291

Skill: Recall

Source: Old

Type: Word problem

Feedback: This is a characteristic of oligopoly.

8. A market structure in which there are few firms that engage in strategic pricing is called:
- A) monopolistic competition.
  - B) monopoly.
  - C) oligopoly.
  - D) perfect competition.

Ans: C

Difficulty: Easy

LO: 13-4

Page: 291

Skill: Comprehension

Source: Old

Type: Word problem

Feedback: See definition of oligopoly.

9. The profit-maximization assumption of economic theory is an imperfect fit for reality because:
- A) all real firms want to maximize long-term profits rather than short-run profits.
  - B) all real firms want to maximize their share of the market.
  - C) all real firms want to maximize their sales growth rate.
  - D) often the decision makers of a firm are not its owners, but are instead managers with their own priorities.

Ans: D

Difficulty: Medium

LO: 14-1

Page: 306

Skill: Recall

Source: Old

Type: Word problem

Feedback: The standard model assumes that firms, composed of self-seeking individuals, are profit maximizers while in reality, employees face many goals among which is maximizing profits.

10. As stated in lecture, if we wish to be completely accurate, the law of demand states that:
- A) sellers supply less of a good when its price increases.

- B) price and quantity demanded never change in the same direction.
- C) buyers buy less of a good when its price increases even if other demand determinants change at the same time.
- D) buyers buy less of a good when its price increases, provided all shift factors of demand are fixed.
- E) buyers buy less of a good when its price increases only if their income increases at the same time.

Ans: B

AP: yes

Difficulty: Easy

LO: 4-1

Page: 84

Skill: Recall

Type: Word problem

Feedback: The law of demand states that more of a good will be demanded the lower its price, other things constant, and less of a good will be demanded the higher its price, other things constant.

11. **(Repeat answer on Scantron line 37.)** Choose the best answer. The Wealth of Nations
- A) is the phrase used to stand for a crucial concept in economics, namely the economics of the growth, progress and development of nations.
  - B) is the title of a Table maintained by the International Bank for Cooperation and Development (usually called The World Bank). As mentioned in lecture, The Wealth of Nations table summarizes the standard of living in every nation in the world.
  - C) was published in 1776 and was written by John Kenneth Galbraith, and was the first book attempting to describe the fundamental principles of economics.
  - D) was published in 1776 and was written by the moral philosopher Adam Smith, and was the first book attempting to describe the fundamental principles of economics.
  - E) is the title of an important textbook in economics--the most important competitor to the text we are using in this course.

Ans: D

12. Decide which of the following would cause the supply of fax machines to increase immediately, and then select the best answer from A) through E) below.

- 1) An increase in the demand for fax machines.
- 2) A decrease in the demand for fax machines.
- 3) A decline in the price of printing mechanisms used inside fax machines.

4) An new expectation that the market price of fax machines will rise three weeks in the future.

- A) Only statements 1 and 3 are correct.
- B) Only statements 1, 3 and 4 are correct.
- C) Only statements 3 and 4 are correct.
- D) None of the other answers are correct.
- E) Only statement 3 is correct.

Ans: E

13. Consider each of the following statements about the "minimum wage laws" as discussed in lecture.

- 1) The minimum wage law results in higher income for those teenagers who are able to find work, but lower incomes for many teenagers who become unemployed because of the law.
- 2) The minimum wage law makes it easier for smart, reliable, well connected teenagers to steal jobs from poorly educated teenagers and minority teenagers.
- 3) The minimum wage law is an example of a price floor.

Then choose which of the following is most accurate:

- A) Only statements 1 and 3 are true.
- B) Only statements 2 and 3 are true.
- C) All the statements are true.
- D) Only statements 1 and 2 are true.
- E) None of the statements are true

Ans: C

14. Consider each of the following statements about international economics.

- 1) The exchange rate will tend to equal the trade currency ratios of internationally traded goods and claims.
  - 2) The foreign exchange markets exist because international exporters and importers wish to specialize in either exporting or importing, but not both.
  - 3) Suppose that the trade-currency ratios for internationally traded goods, for internationally traded "claims" (capital flows), and also the exchange rate, all start out equal to 2 Pesos per Lira. Next, suppose the trade-currency ratio for goods rises to 2.2 while the trade-currency ratio for claims falls to 1.8. Based on what we have learned in lecture, the exchange rate initially will probably rise toward 2.2 rather than decline toward 1.8.
- A) Only statements 1 and 2 are true.
  - B) Statements 1, 2 and 3 all are true.
  - C) Only statements 1 and 3 are true.
  - D) Only statements 2 and 3 are true.



E) Only statement 1 is true.

Ans: A

15. **(Repeat your answer on Scantron line 38.)** Evaluate the following statements having to do with the "Fundamental Theorem of Welfare Economics" and then select the best answer from among A) through E) below.

- 1) It implies that if society's goal is to have a just and fair society, then monopolies must be regulated.
  - 2) Roughly, it says that if all markets are competitive markets (each with many buyers and sellers), then the economy will be efficient.
  - 3) Roughly, it says that monopoly pricing, taxes, price ceilings, price floors and quotas all create welfare costs.
  - 4) It says that perfect competition will create a just and fair society.
- A) Statements 1) and 3) are correct.  
B) Statement 4) is correct, and all the others are misleading or wrong.  
C) None of A), B), D) or E) are good answers.  
D) Statement 2) is correct and all the others are misleading or wrong.  
E) Statements 2) and 4) are correct and all the others are misleading or wrong.

Ans: D

16. **(Repeat your answer on Scantron line 39.)** You are studying a "well-run firm" which produces electric motors. You know the price of rotors is \$2 per rotor, and the marginal product of rotors is 1 motor per rotor. You also know the firm uses electricians, and the salary of electricians is \$20 per hour. What is the marginal product of electricians in this firm?

- A) 5  
B) 10  
C) 15  
D) 20  
E) none of the above.

Ans: B

17. **(Repeat answer on Scantron line 40.)** Evaluate the following statements about "economic profit" as discussed in lecture:

1. A firm which is producing at a profit may be operating with a negative "economic profit".

2. If a firm's "economic profit" is zero, the firm will be satisfied to continue producing at the same rate.
3. Economists use the term "economic profit" to mean the profit of a business as calculated by accountants using "generally accepted accounting principles".
  - A) Only statement 3 is wrong.
  - B) Only statement 2 is wrong.
  - C) Only statement 1 is wrong.
  - D) All three statements are correct.
  - E) Only one of the three statements is correct.

Ans: A

18. **(Repeat your answer on Scantron line 41.)** Evaluate each of the following statements having to do with the international foreign exchange markets, then select the best answer from the lettered choices below.

- 1) Without the foreign exchange markets (by which citizens all over the world acquire the foreign money they need for purchases of the goods of foreign nations) international trade would not be possible.
- 2) The exchange rates in the international foreign exchange markets track the trade currency ratios of internationally traded claims more closely than the trade currency ratios of internationally traded goods.
  - A) Only statement 1 is true.
  - B) Only statement 2 is true.
  - C) Both statements 1 and 2 are true.
  - D) Neither statement 1 nor 2 is true.

Ans: B

Reference: Intl Trade Table 2

### **Current prices in two countries, Rahrah and Goofonia**

(The money of Goofonia is called the goofus, and the money of Rahrah is called the rah.

Prices in each country are expressed in its local currency.)

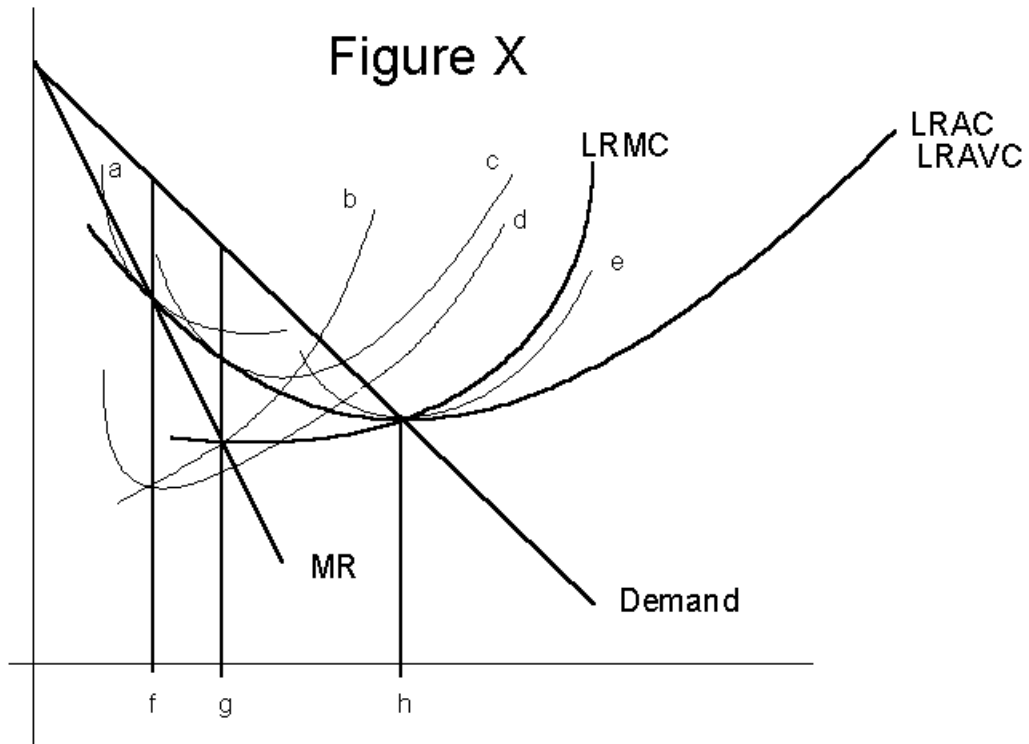
	<b>Good 1</b>	<b>Good 2</b>	<b>Good 3</b>	<b>Good 4</b>
<b>Rahrah prices (in rahs)</b>	<b>30</b>	<b>20</b>	<b>15</b>	<b>16</b>
<b>Goofonia prices (in goofuses)</b>	<b>15</b>	<b>20</b>	<b>5</b>	<b>4</b>

19. **(Repeat your answer on Scantron line 42.)** The numbers in the table represent current prices of four goods in two different nations, Rahrah and Goofonia. Each price is expressed in the local currency of that country, which is the "rah" in Rahrah and the "goofus" in Goofonia. These two countries have never traded with each other, but now they begin to trade. There will be no barriers to trade, no transport costs and no tariffs. Here are several statements which may or may not be true. Decide about each statement and then select the best answer below.
- 1) Good 4 definitely will be the first good exported from Goofonia to Rahrah.
  - 2) The first good to be traded from Rahrah to Goofonia will be Good 3, the lowest priced good in Rahrah.
  - 3) After trade has built up to its eventual equilibrium level, the equilibrium trade-currency ratio (measured in units of rahs per goofus) will definitely be higher than 3.
  - 4) Good 2 will definitely be exported by Rahrah.
  - 5) If a foreign exchange market comes into existence, the equilibrium exchange rate (measured in of rahs per goofus) will definitely be at least as large as 1, and no larger than 4, but we cannot be more accurate without more data.
- A) Only statements 2 and 3 are correct.
  - B) Only statements 1, 4 and 5 are correct.
  - C) Only statements 1 and 4 are correct.
  - D) Only statement 5 is correct.
  - E) Only statement 1 is correct.

Ans: B

Refer To: Intl Trade Table 2

Reference: Figure X monopolist



20. **(Repeat your answer on Scantron line 43.)** In Figure X, this monopolist will

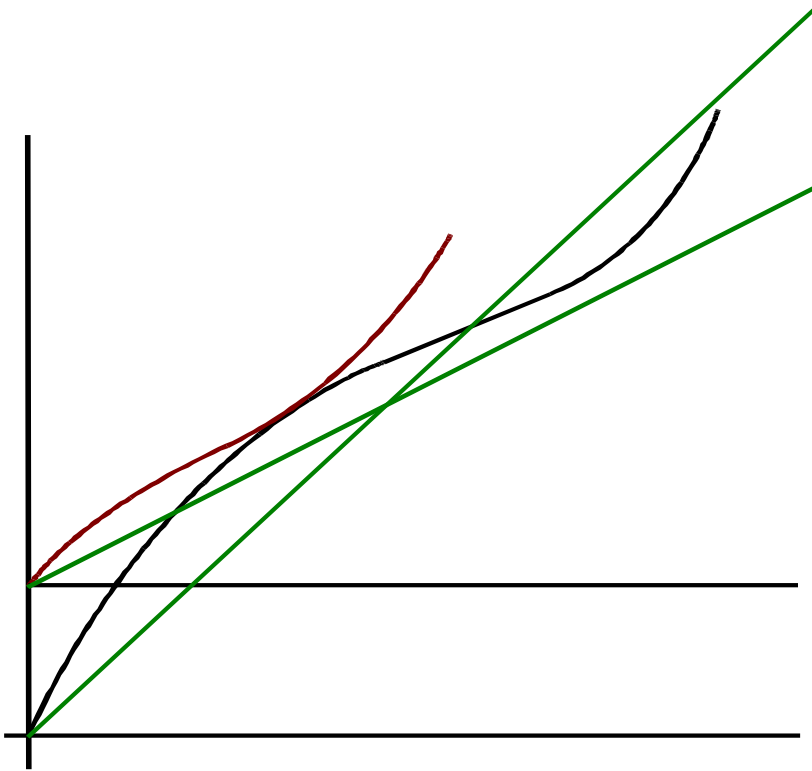
- 1) produce output "f".
  - 2) produce output "g".
  - 3) produce output "h".
  - 4) use short run average cost curve "a".
  - 5) use short run average cost curve "c".
  - 6) use short run average cost curve "e".
  - 7) keep operating in the long run.
- A) Only statements 1 and 4 correct.  
 B) Only statements 1, 4 and 7 are correct.  
 C) Only statements 2 and 5 are correct.  
 D) Only statements 2, 5 and 7 are correct.  
 E) Only statement 7 is correct.

Ans: D

Refer To: Figure X monopolist

Reference: Compet Firm, LR and SR

A Firm –Long Run and Short Run



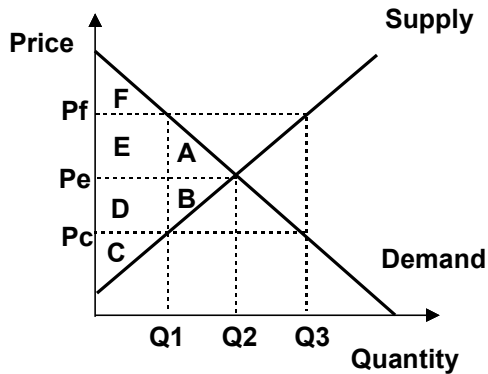
21. **(Repeat answer on Scantron line 44.)** Refer to the figure above. Evaluate the following statements, then choose the best answer.

1. This firm is definitely a competitive firm.
  2. This firm definitely should shut down in the long run.
  3. This firm definitely should operate in the short run.
- A) Only statement 1 is correct.  
B) Only statement 2 is correct.  
C) Only statement 3 is correct.  
D) All three statements are correct.  
E) Only statements 2 and 3 are correct.

Ans: A

Refer To: Compet Firm, LR and SR

Reference: Figure 7-17



22. **(Repeat answer on Scantron line 45.)** Refer to the graph above. Choose the best answer. The welfare loss associated with a price floor at  $P_f$  is:
- A) rectangles E and D.
  - B) rectangles C and F.
  - C) triangles A and B.
  - D) rectangle E and triangle A.
  - E) at least triangles A and B

Ans: E

Refer To: Figure 7-17

Difficulty: Medium

LO: 7-4

Page: 165

Skill: Comprehension

Source: New

Type: Graph

Feedback: These triangles are the dead weight loss from the price ceiling.

Other Questions, by Chapter:

Chapter Ch18

23. The Sherman Antitrust Act:

- A. explicitly prohibits monopolies.
- B. prohibits contracts and business combinations in restraint of trade.
- C. provides a clear definition of "restraint of trade."
- D. defines unfair business practices.

Ans: B

18-18: The Sherman Antitrust Act does not explicitly prohibit monopolies, just restraints of trade.

AACSB: Analytic

AACSB: Ethics

BLOOM'S TAXONOMY: Comprehension  
Difficulty: Medium  
Learning Objective: 18-2  
Topic: Antitrust Policy

24. The act that declared that price discrimination was illegal when it lessened competition was the:

- A. Sherman Antitrust Act of 1890.
- B. Clayton Antitrust Act.
- C. Federal Trade Commission Act.
- D. Merger Act.

Ans: B

18-24: See the discussion of the Clayton Antitrust Act in the textbook.

AACSB: Analytic  
AACSB: Ethics  
BLOOM'S TAXONOMY: Comprehension  
Difficulty: Easy  
Learning Objective: 18-2  
Topic: Antitrust Policy

25. Which of the following is not a result of government ownership of a firm?

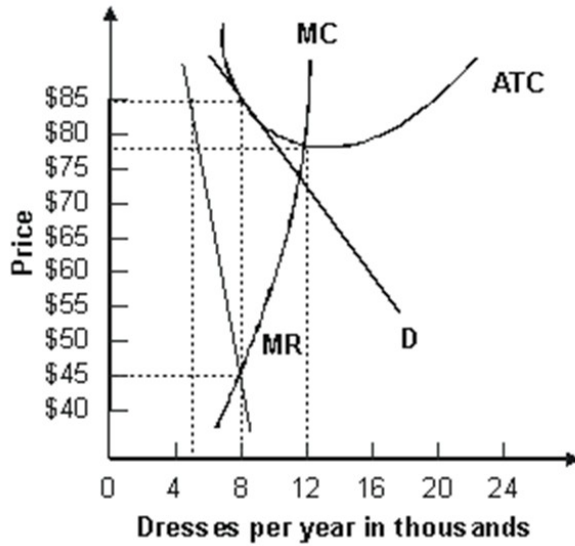
- A. Reduced incentive to keep costs low
- B. Higher prices than would be charged in a competitive market
- C. Reduced incentive to introduce new technology
- D. Lower wages earned by the employees of the firm

Ans: D

18-113: The text notes that workers in government-owned firms were guaranteed jobs and used political threats to hold their wages high.

AACSB: Analytic  
BLOOM'S TAXONOMY: Comprehension  
Difficulty: Medium  
Learning Objective: 18-7  
Topic: Industrial Policy

Chapter 16



xx. Refer to the graph above. If this monopolistically competitive firm maximizes profit it will:

- A. charge \$45 per dress.
- B. charge \$78 per dress.
- C. charge \$85 per dress.
- D. shutdown because it cannot cover its opportunity costs.

Ans: C

16-38: At this price, the output level is such that marginal revenue equals marginal cost.

AACSB: Analytic

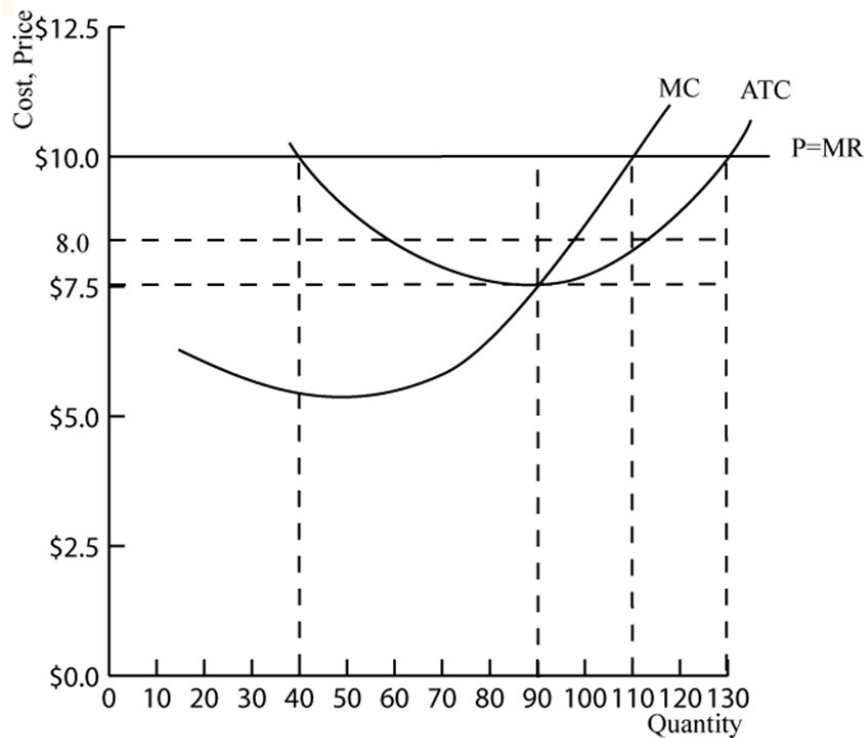
BLOOM'S TAXONOMY: Application

Difficulty: Medium

Learning Objective: 16-2

Topic: Conditions of Monopolistic Competition





26. Choose the best answer. Refer to the graph above depicting a perfectly competitive firm. When maximizing profit, the total profit earned by the firm represented is:
- A. \$220.
  - B. \$275.
  - C. \$330.
  - D. \$605.
  - E. \$220 plus the firm's "normal profit".

Ans: E

14-72: Since per unit economic profit is \$2.00 and the number of units supplied is 110, total economic profits equal \$2.00 times 110 or \$220, to which must be added the firm's normal profit, which is made even if economic profit is zero.

AACSB: Analytic

BLOOM'S TAXONOMY: Application

Difficulty: Medium

Learning Objective: 14-4

Topic: Profit Maximization

## Chapter 15 Monopoly

27. A significant difference between monopoly and perfect competition is that:
- A. free entry and exit is possible in a monopolized industry but impossible in a competitive industry.
  - B. competitive firms control market supply, but monopolies do not.
  - C. the monopolist's demand curve is the industry demand curve, while the competitive firm's demand curve is perfectly elastic.
  - D. economic profits are driven to zero in a monopolized industry, but may be positive in a competitive industry.

15-18: Since the monopolist is the only seller in a market, its demand curve must be the market demand curve and is downward sloping. Since competitive firms are too small to affect market price, their demand curves must be perfectly elastic or horizontal.

Ans: C

AACSB: Analytic

BLOOM'S TAXONOMY: Comprehension

Difficulty: Medium

Learning Objective: 15-1

Topic: Conditions of Monopoly

## Chapter 3

28. The Soviet socialist economy fell apart primarily because:
- A. it was based on barter rather than monetary exchange.
  - B. individuals are not motivated by self interest.
  - C. workers lacked incentives to work and production was inefficient.
  - D. markets failed to develop.

Ans: C

3-157: The Soviet socialist economy fell apart because there were no incentives for workers to produce, consumer goods were unavailable, and corruption was rampant. Individuals are always motivated by self-interest regardless of the economic system.

AACSB: Analytic

BLOOM'S TAXONOMY: Analysis

Difficulty: Medium

Learning Objective: 3-A

Topic: Soviet Socialism

29. A primary goal of the World Bank is to:
- A. channel low-interest loans to developing countries to foster economic growth.
  - B. work out repayment plans for developing countries with large international debt.
  - C. finance private investment projects around the world.
  - D. negotiate trade agreements between nations.

Ans: A

3-137: The World Bank is an international financial institution that works with developing countries to secure low-interest loans.

AACSB: Analytic

BLOOM'S TAXONOMY: Knowledge

Difficulty: Medium

Learning Objective: 3-7

Topic: Global Institution

## Chapter 9

30. When the U.S. imposed restrictions on imported steel in the 1950s and 1960s, the U.S. steel industry responded by:
- A. raising prices and investing more in steel production.
  - B. raising prices and channeling profits from their steel production into other activities.
  - C. lowering prices and investing more in steel production.
  - D. lowering prices and channeling profits from their steel production into other activities.

Ans: B

9-151: As a result of protective policies, the U.S. steel industry was still not internationally competitive by the 1970s.

AACSB: Reflective Thinking

BLOOM'S TAXONOMY: Knowledge

Difficulty: Medium

Learning Objective: 9-7

Topic: Trade Restrictions