

Old Exam Questions Which Cover Chapter 5 Topics

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

- 1) What is a market failure? 1) _____
- A) It refers to a breakdown in a market economy because of widespread corruption in government.
 - B) It refers to the inability of the market to allocate resources efficiently up to the point where marginal social benefit equals marginal social cost.
 - C) It refers to a situation where an entire sector of the economy (for example, the airline industry) collapses because of some unforeseen event.
 - D) It refers to the inability of the market to allocate resources efficiently up to the point where marginal social benefit equals marginal private cost.
- 2) A negative externality exists if 2) _____
- A) there are quantity controls in a market.
 - B) there are price controls in a market.
 - C) the marginal social cost of producing a good or service exceeds the private cost.
 - D) the marginal private cost of producing a good or service exceeds the social cost.

Article Summary

In a blog posting in the New York Times, Daniel Hamermesh cited a recent study conducted by researchers at Michigan State University which claims that states that repeal mandatory motorcycle helmet laws see an increase in organ donations from fatal motor vehicle accidents. According to the study, when states repeal mandatory motorcycle helmet laws, organ donations due to fatal accidents increase by 10 percent. The study estimates that for each death of a motorcyclist who was not wearing a helmet, 0.33 deaths are delayed or prevented among those on organ transplant waiting lists. In a conversation with colleagues prior to the state implementing a mandatory helmet law, a California surgeon stated "motorcycle fatalities are ...our number one source of organs".

Source: Richard S. Chang, "Motorcycle Helmets and Donor Organs," *New York Times*, June 22, 2009.

- 3) *Refer to the Article Summary.* Mandatory motorcycle helmet laws are designed to reduce the severity of injuries resulting from motorcycle involvement in traffic accidents, but they also have been shown to reduce the number of organs available for transplant. By decreasing the number of transplantable organs, these mandatory helmet laws produce 3) _____
- A) social benefits.
 - B) a positive externality.
 - C) a negative externality.
 - D) public goods.

Figure 5-2

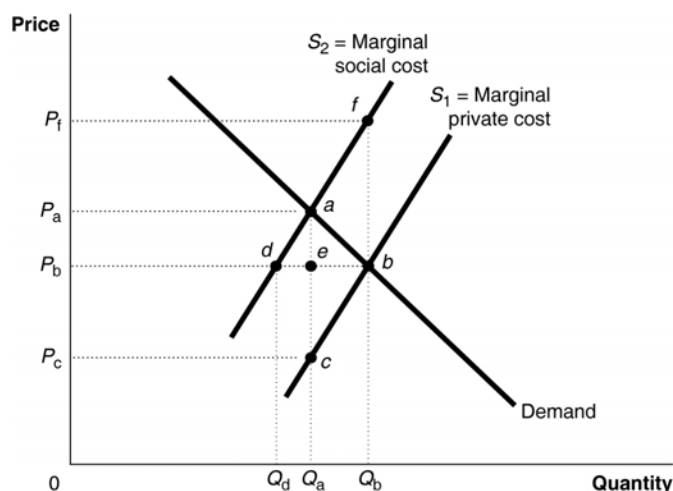
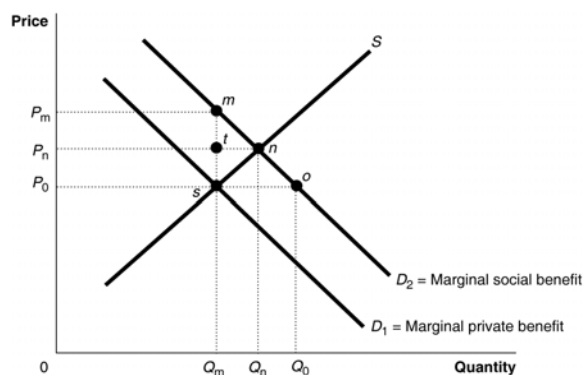


Figure 5-2 shows a market with a negative externality.

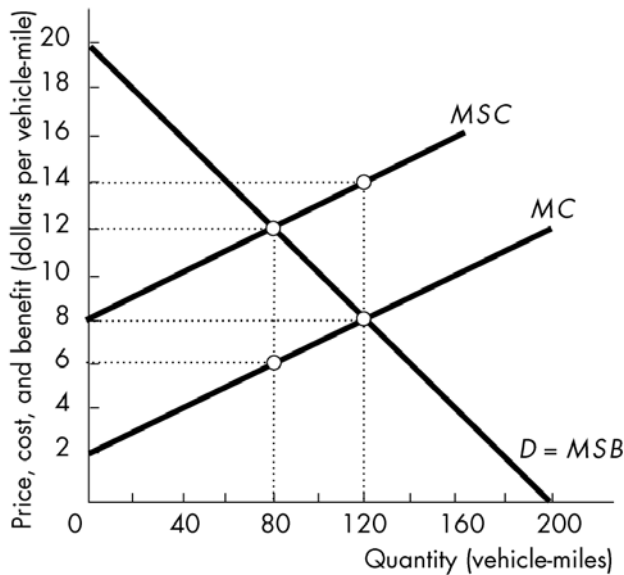
- 4) Refer to Figure 5-2. The efficient output level is
 A) Q_b . B) Q_a . C) $Q_b - Q_d$. D) Q_d . 4) _____
- 5) Refer to Figure 5-2. At the market outcome, the marginal benefit of the last unit produced is represented by _____
 A) P_a . B) P_b . C) P_c . D) P_f . 5) _____
- 6) Refer to Figure 5-2. At the market outcome, the true marginal cost of the last unit produced is represented by _____
 A) P_a . B) P_b . C) P_c . D) P_f . 6) _____
- 7) Refer to Figure 5-2. At the market outcome, the deadweight loss is represented by _____
 A) area abe B) $P_f - P_b$ C) area abf D) area abc E) $P_a - P_c$ 7) _____
- 8) A market supply curve reflects the
 A) external costs of producing a good or service.
 B) private costs of producing a good or service.
 C) external benefits of producing a good or service.
 D) social costs of producing a good or service. 8) _____
- 9) A market demand curve reflects the
 A) private benefits of consuming a product.
 B) social benefits of consuming a product.
 C) external benefits of consuming a product.
 D) the sum of private and social benefits of consuming a product. 9) _____

Figure 5-3



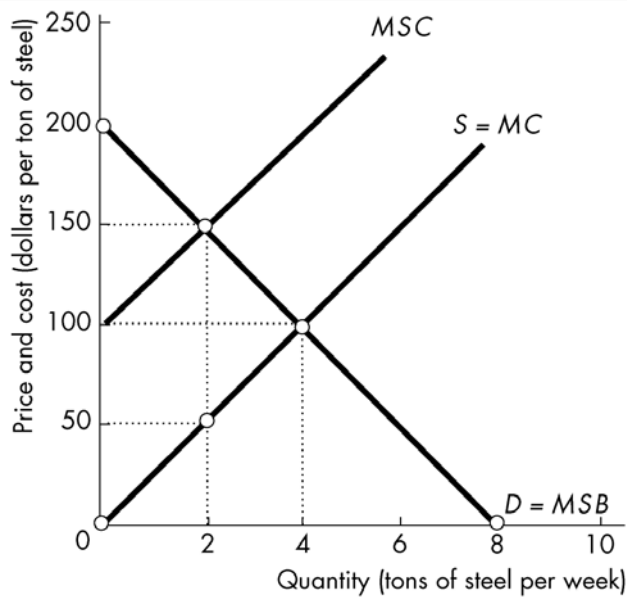
- 10) Refer to Figure 5-3. In the absence of any government intervention, the private market
 A) under produces by $Q_0 - Q_m$ units. B) over produces by $Q_0 - Q_m$ units.
 C) under produces by $Q_n - Q_m$ units. D) over produces by $Q_n - Q_m$ units. 10) _____
- 11) Refer to Figure 5-3. At the competitive market equilibrium, for the last unit produced,
 A) the size of the external cost is $P_n - P_0$. B) the size of the external benefit is $P_n - P_0$.
 C) the size of the external cost is $P_m - P_0$. D) the size of the external benefit is $P_m - P_0$. 11) _____
- 12) Refer to Figure 5-3. The size of marginal external benefits can be determined by
 A) $D_2 - D_1$ at each output level. B) the demand curve D_2 .
 C) $D_2 + D_1$ at each output level D) the demand curve D_1 . 12) _____
- 13) Refer to Figure 5-3. The deadweight loss due to the externality is represented by the area
 A) mso . B) nso . C) msn . D) mtn . 13) _____
- 14) Externalities 14) _____
 A) do become reflected in market prices, so they can be a source of economic inefficiency.
 B) may or may not become reflected in market prices, but do not have an impact on economic efficiency in either event.
 C) do become reflected in market prices, so they do not adversely affect economic efficiency.
 D) are not reflected in market prices, so they do not adversely affect economic efficiency.
 E) are not reflected in market prices, so they can be a source of economic inefficiency.
- 15) When a company engages in research and development (R&D), it often discovers things that are useful to other companies. Thus, we can say that there are _____ externalities associated with R&D, and that the free market will provide _____ R&D (relative to the economically efficient level). 15) _____
 A) positive ; too little
 B) negative ; too much
 C) negative ; too little
 D) positive ; too much
 E) negative ; the right amount of

- 16) Which of the following best summarizes the method of addressing externalities as described in the *Coase Theorem*? 16) _____
- A) Liability laws
 - B) Negotiation between private parties
 - C) Placing a "cap" on total pollution by the government
 - D) Taxing the parties responsible for the externality
- 17) Dry cleaning of clothing produces air pollutants. Therefore, in the market for dry cleaning services, equilibrium price 17) _____
- A) is too low to be optimal, and equilibrium quantity is too high.
 - B) is optimal, but there is an excess supply.
 - C) and output are too low to be optimal.
 - D) and output are too high to be optimal.
 - E) is too high to be optimal, and equilibrium quantity is too low.
- 18) The Coase theorem states that 18) _____
- A) government intervention is always needed if externalities are present.
 - B) a free market equilibrium is the best solution to address externalities.
 - C) if transactions costs are low, assignment of private property rights, and subsequent private bargaining will result in an efficient solution to the problem of externalities.
 - D) in the face of negative externalities, placing a tax on the good in question is the best option.
- 19) If there is a positive consumption externality, then: 19) _____
- A) $\text{marginal social benefit} = \text{marginal private benefit}$
 - B) $\text{marginal social benefit} > \text{marginal private benefit}$
 - C) $\text{marginal social benefit} < \text{marginal private benefit}$
 - D) $\text{marginal social cost} > \text{marginal private cost}$
 - E) $\text{marginal social cost} < \text{marginal private cost}$



- 20) The figure above shows the market for transportation services, which produces an external cost due to the air pollution that is created. (MC represents the marginal private costs.) If the market for transportation services is competitive and unregulated, the equilibrium quantity is _____ and the equilibrium price is _____.
 A) 80; \$12 B) 120; \$8 C) 120; \$14 D) 80; \$6
- 21) The figure above shows the market for transportation services, which produces an external cost due to the air pollution that is created. (MC represents the marginal private costs.) If the market for transportation services is competitive and unregulated, then for the last vehicle-mile driven, the marginal benefits to society are _____ the marginal costs to society.
 A) \$2 less than
 B) \$4 greater than
 C) \$6 less than
 D) \$2 greater than
 E) equal to
- 22) The figure above shows the market for transportation services, which produces an external cost due to the air pollution that is created. (MC represents the marginal private costs.) The efficient quantity of transportation services is _____ and the corresponding price is _____.
 A) 80; \$12 B) 80; \$6 C) 120; \$14 D) 120; \$8
- 23) The figure above shows the market for transportation services, which produces an external cost due to the air pollution that is created. (MC represents the marginal private costs.) This graph shows _____ and _____.
 A) no production externality ; a negative consumption externality
 B) a negative production externality ; a negative consumption externality
 C) a positive production externality ; no consumption externality
 D) a negative production externality ; no consumption externality
 E) no production externality ; a positive consumption externality

- 24) If children go to school and become productive members of society, 24) _____
 A) an externality is created that may be positive or negative.
 B) a negative externality is created by the schools.
 C) no externality is created by the schools.
 D) a positive externality is created by the schools.
- 25) If there is a positive consumption externality, and no externalities on the production side, then 25) _____
 marginal private benefit _____ marginal social benefit and marginal private cost _____ marginal social cost.
 A) = ; > B) = ; < C) > ; = D) < ; < E) < ; =
- 26) Assume that emissions from electric utilities contribute to pollution in the form of acid rain. Which 26) _____
 of the following describes how this affects the market for electricity? (Assume the market is unregulated.)
 A) The equilibrium in the market is not efficient; consumer surplus is equal to producer surplus.
 B) A deadweight loss occurs; at equilibrium the additional social cost of production is greater than the additional benefit to consumers.
 C) The equilibrium in the market is not efficient; because of the cost of the acid rain, economic efficiency would be greater if more electricity were produced.
 D) The equilibrium in the market is not efficient; the marginal benefit from electricity is greater than the marginal social cost.
- 27) Which of the following kinds of environmental policy does NOT give the polluter a marginal 27) _____
 incentive to continue to reduce pollution?
 A) Command and control policies setting limits on maximum allowable pollution
 B) Cap and trade policies
 C) Pigouvian per-unit tax on pollution
- 28) The Coase Theorem is the proposition that private negotiation is efficient if property rights exist, if 28) _____
 only a _____ number of parties are involved, and if transactions costs are _____.
 A) large; low B) small; high C) large; high D) small; low



- 29) The above figure shows the marginal social benefit, marginal private cost and marginal social cost of producing steel. There is a marginal external _____ of _____ per ton. 29) _____
- A) benefit; \$100
 B) cost; \$50
 C) benefit; \$50
 D) cost; \$100
 E) benefit; \$200
- 30) The above figure shows the marginal social benefit, marginal private cost and marginal social cost of producing steel. If the market is competitive and unregulated, the *equilibrium quantity* of steel is _____ tons and the *efficient quantity* of steel is _____ tons. 30) _____
- A) 4; 2
 B) 2; 2
 C) 2; 4
 D) None of the above answers is correct.
- 31) The above figure shows the marginal social benefit, marginal private cost and marginal social cost of producing steel. At the unregulated free market outcome, from society's perspective, the marginal cost of production is _____ the marginal benefit of production. 31) _____
- A) \$50 less than
 B) \$100 less than
 C) \$50 greater than
 D) \$100 greater than
 E) equal to

Answer Key

Testname: 201 CHAPTER 5 OLD EXAM QUESTIONS

- 1) B
- 2) C
- 3) C
- 4) B
- 5) B
- 6) D
- 7) C
- 8) B
- 9) A
- 10) C
- 11) D
- 12) A
- 13) C
- 14) E
- 15) A
- 16) B
- 17) A
- 18) C
- 19) B
- 20) B
- 21) C
- 22) A
- 23) D
- 24) D
- 25) E
- 26) B
- 27) A
- 28) D
- 29) D
- 30) A
- 31) D