Exam

Name____________________________________

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

1) Which of the following is an example of a long run production adjustment? 1) ________
A) Your university offers Saturday morning classes next fall.
B) Ford Motor Company lays off 2,000 assembly line workers.
C) A soybean farmer turns on the irrigation system after a month long dry spell.
D) Wal–Mart builds another Supercenter.

2) Which of the following is an implicit cost of production? 2) ________
A) the utility bill paid to water, electricity, and natural gas companies
B) rent that could have been earned on a building owned and used by the firm
C) wages paid to labor plus the cost of carrying benefits for workers
D) interest paid on a loan to a bank

3) If four workers can produce 27 chairs a day and five can produce 32 chairs a day, the marginal product of the fifth worker is 3) ________
A) 32 chairs. B) 59 chairs. C) 2 chairs. D) 5 chairs.

4) The law of diminishing marginal returns 4) ________
A) explains why the average total cost and marginal cost curves are U–shaped in the short run.
B) explains why the average total cost, average fixed cost and the marginal cost curves are U–shaped in the short run.
C) causes the difference between average total cost and average variable cost to get smaller as output increases.
D) causes average total costs to rise at a decreasing rate as output increases.

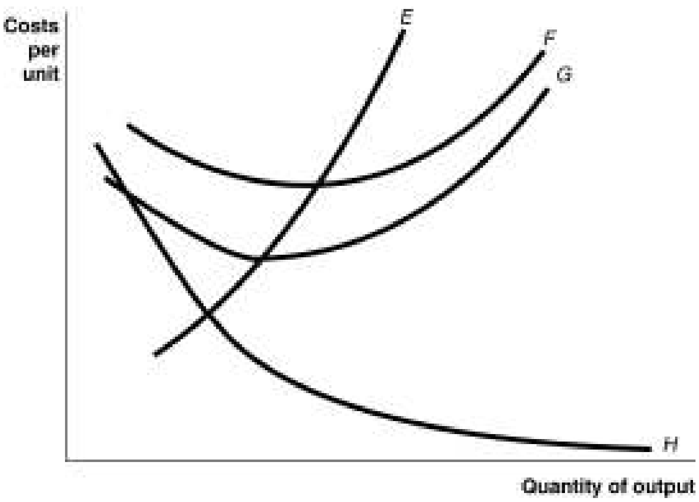
5) In the short run, if marginal product is at its maximum, then 5) ________
A) average variable cost is at its minimum. B) total cost is at its maximum.
C) average cost is at its minimum. D) marginal cost is at its minimum.

6) If the 15th unit of output has a marginal cost of $29.50 and the average cost of producing 14 units of output is $30.23, what will happen to the average cost of production if the 15th unit is produced? 6) ________
A) Average cost could increase or decrease depending on what happens to fixed cost.
B) Average cost could increase or decrease depending on what happens to variable cost.
C) Average cost increases as more is produced.
D) Average cost will fall.

7) Marginal cost is the 7) ________
A) additional cost of producing an additional unit of output.
B) change in average cost when an additional unit of output is produced.
C) the additional output when total cost is increased by one dollar.
D) change in the price of inputs if a firm buys more inputs to produce an additional unit of output.

8) Average variable cost can be calculated using any of the formulas below *except* 8) ________
A) $(TC - FC)/Q$. B) $(TC/Q) - AFC$. C) $TVC/Q$. D) $\Delta(TC - FC)/\Delta Q$.

*Figure 11–4*




9) ***Refer to Figure 11–4.*** Identify the curves in the diagram. 9) ________
   A) *E* = average fixed cost curve; *F* = variable cost curve; *G* = total cost curve, *H* = marginal cost curve
   B) *E* = marginal cost curve; *F* = total cost curve; *G* = variable cost curve, *H* = average fixed cost curve
   C) *E* = marginal cost curve; *F* = average total cost curve; *G* = average variable cost curve; *H* = average fixed cost curve.
   D) *E* = average fixed cost curve; *F* = average total cost curve; *G* = average variable cost curve, *H* = marginal cost curve

10) ***Refer to Figure 11–4.*** Curve *G* approaches curve *F* because 10) ________
   A) average fixed cost falls as output rises.
   B) marginal cost is above average variable costs.
   C) fixed cost falls as capacity rises.
   D) total cost falls as more and more is produced.

11) If the marginal cost curve is below the average variable cost curve, then 11) ________
   A) average variable cost is increasing.
   B) marginal cost must be decreasing.
   C) average variable cost could either be increasing or decreasing.
   D) average variable cost is decreasing.

12) If, when a firm doubles all its inputs, its average cost of production increases, then production displays 12) ________
   A) diseconomies of scale.
   B) diminishing returns.
   C) declining fixed costs.
   D) economies of scale.

13) When a firm's long–run average cost curve is horizontal for a range of output, then that range of production displays 13) ________
   A) increasing returns to scale.
   B) constant average fixed costs.
   C) decreasing returns to scale.
   D) constant returns to scale.

14) A very large number of small sellers who sell identical products imply 14) _______

A) chaos in the market.
B) a downward sloping demand for each seller's product.
C) a multitude of vastly different selling prices.
D) the inability of one seller to influence price.

15) In perfect competition 15) _______

A) the market demand curve is perfectly elastic while demand for an individual seller's product is perfectly inelastic.
B) the market demand curve is downward sloping while demand for an individual seller's product is perfectly elastic.
C) the market demand curve and the individual's demand are identical.
D) the market demand curve is perfectly inelastic while demand for an individual seller's product is perfectly elastic.

16) If the market price is $25, the average revenue of selling five units is 16) _______

A) $25. B) $125. C) $12.50. D) $5.

***Table 11–1***

| *Quantity* | *Total Cost (Dollars)* | *Variable Cost (Dollars)* |
|---|---|---|
| 0 | $1,000 | $0 |
| 100 | 1,360 | 360 |
| 200 | 1,560 | 560 |
| 300 | 1,960 | 960 |
| 400 | 2,760 | 1,760 |
| 500 | 4,000 | 3,000 |
| 600 | 5,800 | 4,800 |

Table 11–1 shows the short–run cost data of a perfectly competitive firm that produces plastic camera cases. Assume that output can only be increased in batches of 100 units.

17) ***Refer to Table 11–1.*** If the market price of each camera case is $8, what is the profit–maximizing quantity? 17) _______

A) 300 units B) 400 units C) 500 units D) 600 units

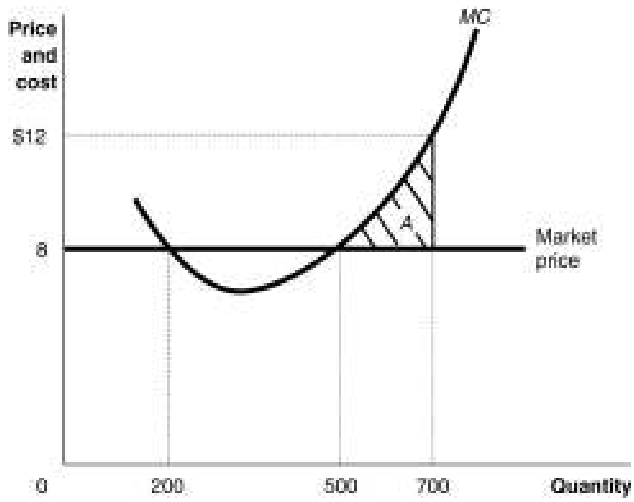
18) ***Refer to Table 11–1.*** What is the fixed cost of production? 18) _______

A) $0 B) $500
C) $1,000 D) It cannot be determined.

19) ***Refer to Table 11–1.*** If the market price of each camera case is $8 and the firm maximizes profit, what is the amount of the firm's profit or loss? 19) _______

A) $0 (it breaks even) B) loss of $1,000
C) profit of $440 D) loss of $440

*Figure 11-1*



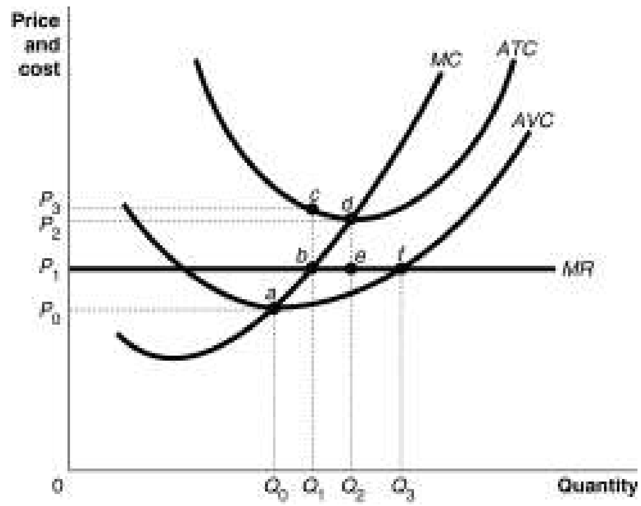

20) ***Refer to Figure 11-1.*** If the firm is producing 700 units, 20) _______

A) it is making a profit.
B) it is making a loss.
C) it should cut back its output to maximize profit.
D) it should increase its output to maximize profit.

21) If, for the last unit of a good produced by a perfectly competitive firm, MR > MC, then in producing it, the firm 21) _______

A) added more to total costs than it added to total revenue.
B) is maximizing marginal profit.
C) has minimized its losses.
D) added more to total revenue than it added to total costs.

*Figure 11–3*




22) ***Refer to Figure 11–3***. Suppose the prevailing price is $P_1$ and the firm is currently producing its loss–minimizing quantity. Identify the area that represents the loss. 22) _______

A) $P_2\ deP_1$ B) $0P_1\ bQ_1$ C) $P_3caP_0$ D) $P_3cbP_1$

*Figure 11–4*

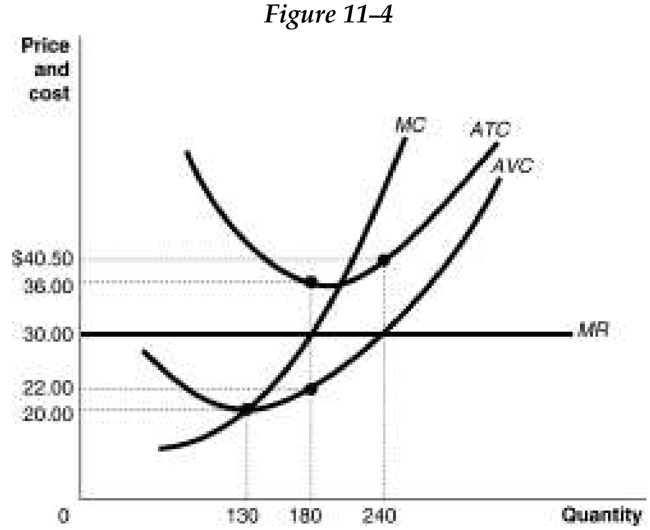



Figure 11–4 shows the cost and demand curves for a profit–maximizing firm in a perfectly competitive market.

23) ***Refer to Figure 11–4.*** If the market price is $30, the firm's profit maximizing output level is 23) _______

A) 0. B) 130. C) 180. D) 240.

24) ***Refer to Figure 11–4.*** If the market price is $30 and if the firm is producing output, what is the amount of its total variable cost? 24) _______

A) $7,200 B) $6,480 C) $5,400 D) $3,960

*Figure 11–6*

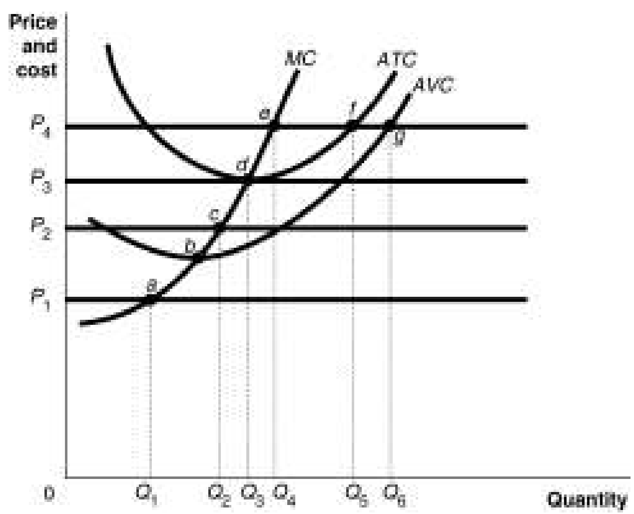



Figure 11–6 shows cost and demand curves facing a profit–maximizing perfectly competitive firm.

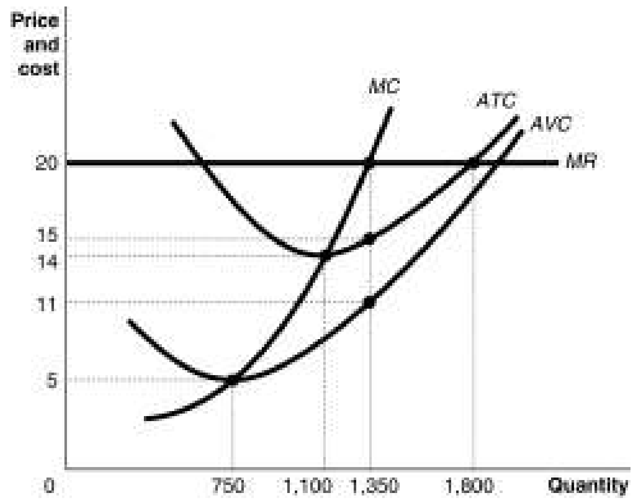
25) ***Refer to Figure 11–6.*** Identify the firm's short run supply curve. 25) _______

A) the marginal cost curve
B) the marginal cost curve from *a* and above
C) the marginal cost curve from *b* and above
D) the marginal cost curve from *d* and above

26) If, for a given output level, a perfectly competitive firm's price is less than its average variable cost, the firm 26) _______

A) should shut down.
B) should increase output.
C) should increase price.
D) is earning a profit.

*Figure 11-7*




27) ***Refer to Figure 11-7.*** Suppose the prevailing price is $20 and the firm is currently producing 1,350 units. In the long run equilibrium, 27) _______

A) there will be fewer firms in the industry and total industry output decreases.
B) there will be fewer firms in the industry but total industry output increases.
C) there will be more firms in the industry and total industry output increases.
D) there will be more firms in the industry and total industry output remains constant.

28) I the long-run average cost curve is U-shaped, the optimal scale of production from society's viewpoint is 28) _______

A) the minimum efficient scale.
B) where maximum economic profit is earned by producers.
C) where firm profit is large enough to finance research and development.
D) one which guarantees economic profit.

29) Which of the following characteristics is not common to both monopolistic competition and perfect competition? 29) _______

A) The market demand curve is downward -sloping.
B) Entry barriers into the industry are low.
C) Firms act to maximize profit.
D) Firms take market prices as given.

30) If the demand curve for a firm is downward-sloping, its marginal revenue curve 30) _______

A) is horizontal.
B) will lie above the demand curve.
C) will lie below the demand curve.
D) is coincident with the demand curve.

*Table 12–1*

| *Quantity* | *Price (Dollars)* | *Total Revenue (Dollars)* |
|---|---|---|
| 1 | $7.50 | $7.50 |
| 2 | 7.00 | 14.00 |
| 3 | 6.50 | 19.50 |
| 4 | 6.00 | 24.00 |
| 5 | 5.50 | 27.50 |
| 6 | 5.00 | 30.00 |

31) ***Refer to Table 12–1.*** What is the marginal revenue of the 3rd unit? 31) _______

A) $1.83 B) $0.50 C) $5.50 D) $6.50

32) ***Refer to Table 12–1.*** The Table shows 32) _______

A) a demand curve with an elastic segment of the demand curve from $7.50 to $6.50 followed by an inelastic segment.

B) an elastic segment of the demand curve.

C) an inelastic segment of the demand curve.

D) a demand curve with an inelastic segment of the demand curve from $7.50 to $6.50 followed by an elastic segment.

*Figure 12–3*

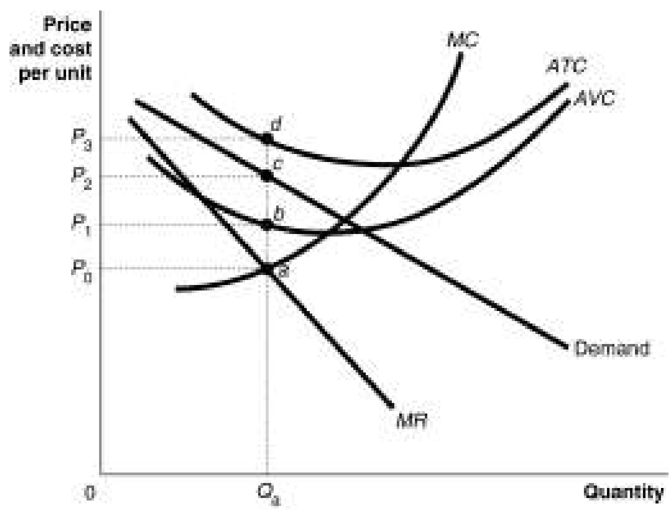



Figure 12–3 shows short run cost and demand curves for a monopolistically competitive firm in the market for designer watches.

33) ***Refer to Figure 12–3.*** If the firm represented in the diagram is currently producing and selling $Q_a$ units, what is the price charged? 33) _______

A) $$P_0$ B) $$P_1$ C) $$P_2$ D) $$P_3$

34) In the long run, what happens to the demand curve facing a monopolistically competitive firm that is earning short run profits? 34) _______

A) The demand curve will shift to the right and became less elastic throughout the relevant range of prices.
B) The demand curve will shift to the right and became more elastic throughout the relevant range of prices.
C) The demand curve will shift to the left and became less elastic throughout the relevant range of prices.
D) The demand curve will shift to the left and became more elastic throughout the relevant range of prices.

35) In the long run, if price is less than average cost, 35) _______

A) there is no incentive for the number of firms in the market to change.
B) there is an incentive for firms to exit the market.
C) there is profit incentive for firms to enter the market.
D) the market must be in long–run equilibrium.

36) How does the long run equilibrium of a monopolistically competitive industry differ from that of a perfectly competitive industry? 36) _______

A) A firm in monopolistic competition does not take full advantage of its economies of scale but a firm in perfect competition produces at the lowest average cost possible.
B) A firm in monopolistic competition produces an allocatively efficient output level while a firm in perfect competition produces a productively efficient output level.
C) A firm in monopolistic competition will earn economic profits but a firm in perfect competition earns zero profit.
D) A firm in monopolistic competition will charge a price higher than the average cost of production but a firm in perfect competition charges a price equal to the average cost of production.

37) Producing a homogeneous product occurs in which of the following industries? 37) _______

A) monopolistic competition and perfect competition
B) oligopoly and perfect competition
C) perfect competition only
D) oligopoly, monopolistic competition and perfect competition

38) A characteristic found only in oligopolies is 38) _______

A) breakeven level of profits.
B) interdependence of firms.
C) products that are slightly different.
D) independence of firms.

39) If an industry is made up of five identical firms, the four–firm concentration ratio is 39) _______

A) 5%.
B) 80%.
C) 100%.
D) 20%.

40) A dominant strategy 40) _______

A) is one that is the best for a firm, no matter what strategies other firms use.
B) is one that a firm is forced into following by government policy.
C) involves colluding with rivals to maximize joint profits.
D) involves deciding what to do after all rivals have chosen their own strategies.

*Table 13–1*

| | | Alistair's (A) Choices | |
|---|---|---|---|
| | | ***Increase advertising budget*** | ***Leave advertising budget as is*** |
| Baine's (B) Choices | ***Increase advertising budget*** | A: \$30,000 profit<br>B: \$30,000 profit | A: \$10,000 profit<br>B: \$50,000 profit |
| | ***Leave advertising budget as is*** | A: \$50,000 profit<br>B: \$10,000 profit | A: \$40,000 profit<br>B: \$40,000 profit |

Alistair Luggage and Baine Baggage are the only firms selling window treatments in the upscale town of Montecito. Each firm must decide on whether to increase its advertising spending to compete for customers. If one firm increases its advertising budget but the other does not, then the firm with the higher advertising budget will increase its profit. Table 13–1 shows the payoff matrix for this advertising game.

41) ***Refer to Table 13–1.*** If Alistair assumes that Baine would increase its advertising budget, what should it do? 41) _______

A) Alistair should keep its own budget the same and allow Baine to incur the higher cost.
B) Alistair should also increase its advertising spending.
C) Alistair should reduce its advertising spending.
D) Being a duopolist, Alistair is not affected by Baine's choices because it has a secure 50 percent market share.

*Table 13–2*

| | | Pepsi | |
|---|---|---|---|
| | | Low *Q* | High *Q* |
| Coke | Low *Q* | Coke earns \$20 million profits<br>Pepsi earns \$20 million profits | Coke earns \$10 million profits<br>Pepsi earns \$25 million profits |
| | High *Q* | Coke earns \$25 million profits<br>Pepsi earns \$10 million profits | Coke earns \$10 million profits<br>Pepsi earns \$10 million profits |

42) ***Refer to Table 13–2.*** Is there a dominant strategy for Coke and if so, what is it? 42) _______

A) There is no dominant strategy.
B) The dominant strategy is to produce a low quantity.
C) The dominant strategy is to collude with Pepsi.
D) The dominant strategy is to produce a high quantity.

43) ***Refer to Table 13–2.*** If each firm pursues its dominant strategy, what is the profit earned? 43) _______

A) Each earns a profit of $20 million.
B) Each earns a profit of $12.5 million.
C) Each earns a profit of $25 million.
D) Each earns a profit of $10 million.

44) ***Refer to Table 13–2.*** If Coke and Pepsi could collude, what would they do? 44) _______

A) Coke can produce a low quantity while Pepsi can produce a high quantity.
B) Both produce a high quantity.
C) Both produce a low quantity.
D) Coke can produce a high quantity while Pepsi can produce a low quantity.

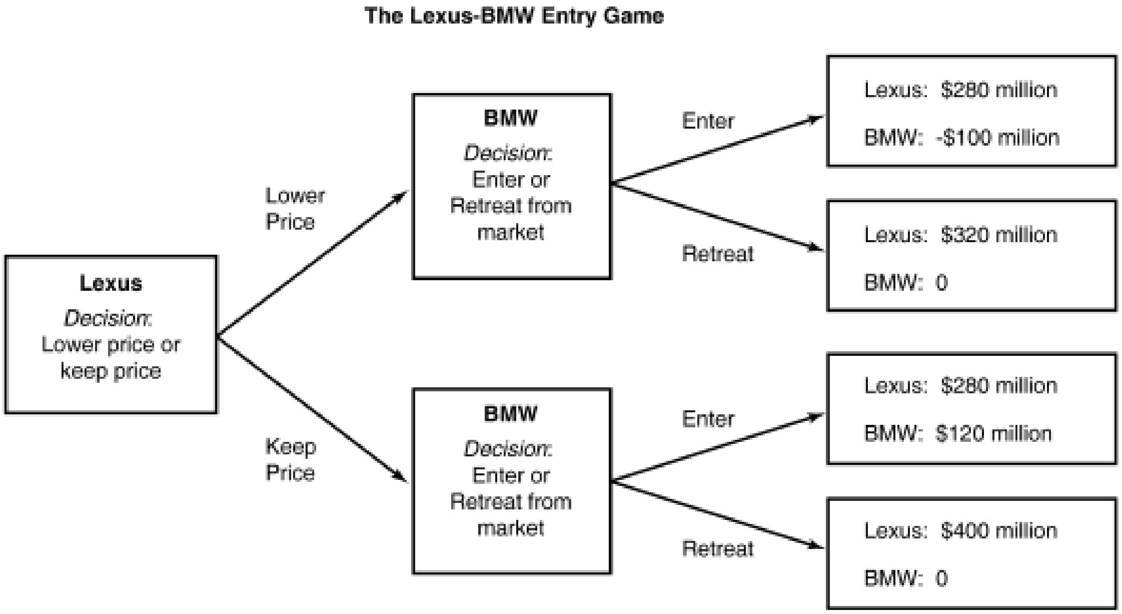
45) What is a prisoners' dilemma? 45) _______

A) a game that involves no dominant strategies
B) a game in which players act in rational, self–interested ways that leave everyone worse off
C) a game in which players collude to outfox authorities
D) a game in which prisoners are stumped because they cannot communicate with each other

46) Suppose two firms in a duopoly implicitly collude and charge a high price. How might each firm benefit from advertising that it will match the lowest price offered by its competitor? 46) _______

A) The offer to match prices is a way of deterring entry by other large firms, thereby keeping the market share of the existing firms intact.
B) The advertisement ensures that the other firm does not cheat. If a firm cheats on the agreement and charges the lower price, the rival firm will retaliate by doing the same.
C) The offer to match prices is a way of signaling to antitrust authorities that the firms are not engaged in illegal collusion.
D) The advertisement is meant to suggest to consumers that the offered price is actually the lowest price available.

*Figure 13–1*




Assume that Lexus (L) is the first automobile company to produce a luxury class hybrid automobile and is the only such company for the past four years. BMW is now considering producing its own luxury hybrid automobile and Lexus must decide whether or not to lower the price of its luxury hybrid to counter BMW's entry into the luxury hybrid niche.

47) ***Refer to Figure 13–1.*** Should Lexus to lower its price in order to deter BMW's entry into the luxury hybrid automobile market? 47) _______

A) No, because BMW will enter the market regardless of Lexus' decision about its price.
B) Yes, it will drive BMW out of the market.
C) In terms of profit earned, it makes no difference whether Lexus lowers its price or no; in either case it will make $280 million profit if BMW enters.
D) No, it should keep the same price and work to capitalize on its brand loyalty.

48) A monopoly is a seller of a product 48) _______

A) without a close substitute.
B) with a perfectly inelastic demand.
C) with many substitutes.
D) without a well–defined demand curve.

49) A monopolist faces 49) _______

A) a downward–sloping demand curve.
B) a perfectly inelastic demand curve.
C) a horizontal demand curve.
D) a perfectly elastic demand curve.

50) Compared to a monopolistic competitor, a monopolist faces 50) _______

A) a demand curve that has a price elasticity coefficient of zero.
B) a more elastic demand curve.
C) a more inelastic demand curve.
D) a more elastic demand curve at higher prices and a more inelastic demand curve at lower prices.

51) To maintain a monopoly, a firm must have 51) _______

A) few competitors.
B) marginal revenue equal to demand.
C) a perfectly inelastic demand.
D) an insurmountable barrier to entry.

52) What is a network externality? 52) _______

A) It refers to a product that requires connection to a network for it to be useful.
B) It means having a network of suppliers and buyers for a good or service.
C) It means lobbying to form a public enterprise.
D) It refers to a situation in which a product's usefulness increases with the number of people using it.

53) For a natural monopoly to exist 53) _______

A) a firm must have a government–imposed barrier.
B) a firm's long run average cost curve must exhibit economies of scale throughout the relevant range of market demand.
C) a firm's long run average cost curve must exhibit diseconomies of scale beyond the economically efficient output level.
D) a firm must continually buy up its rivals.

54) The demand curve for the monopoly's product is 54) _______

A) the market demand for the product.
B) more elastic than the market demand for the product.
C) more inelastic than the market demand for the product.
D) undefined.

***Figure 14–1***

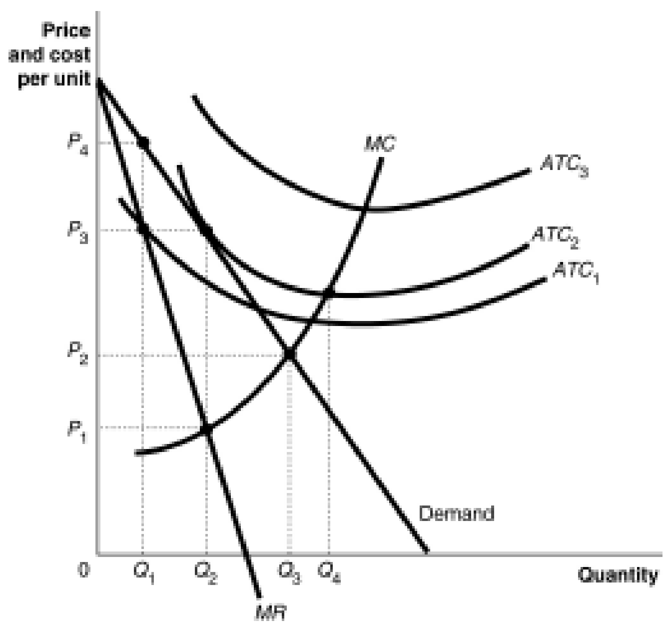



Figure 14–1 above shows the demand and cost curves facing a monopolist.

55) ***Refer to Figure 14–1***. To maximize profit, the firm will produce 55) _______

A) $Q_1$. B) $Q_2$. C) $Q_3$. D) $Q_4$.

56) ***Refer to Figure 14–1.*** If the firm's average total cost curve is $ATC_2$, the firm will 56) _______

A) make a profit. B) face competition.
C) suffer a loss. D) break even.

*Table 14–1*

| *Price per unit* | *Quantity Demanded (Units)* | *Total Cost of Production (Dollars)* |
|---|---|---|
| $85 | 10 | $400 |
| 80 | 11 | 500 |
| 75 | 12 | 550 |
| 70 | 13 | 560 |
| 65 | 14 | 575 |
| 60 | 15 | 595 |
| 55 | 16 | 625 |

A monopoly producer of a foreign language translation software faces a demand and cost structure as given in Table 14–1.

57) ***Refer to Table 14–1.*** What is the marginal revenue from the sale of the 12th unit? 57) ________

A) $20 B) $75 C) $50 D) –$5

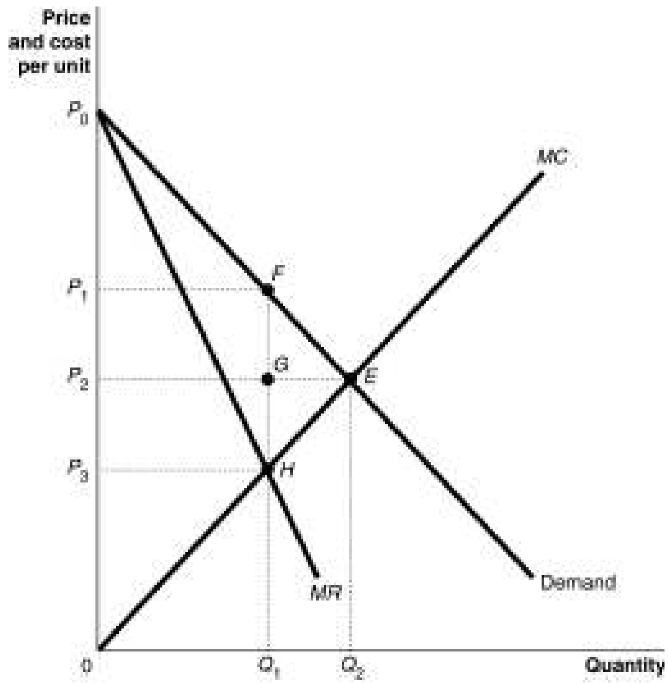
58) Economic efficiency in a free market occurs when 58) ________

A) price is as low as possible.
B) producer surplus is maximized.
C) the sum of consumer surplus and producer surplus is maximized.
D) consumer surplus is maximized.

59) Why does a monopoly cause a deadweight loss? 59) ________

A) because it appropriates a portion of consumer surplus for itself
B) because it increases producer surplus at the expense of consumer surplus
C) because it does not produce some output for which marginal benefit exceeds marginal cost
D) because it does not produce some output for which demand exceeds supply

*Figure 14–5*




60) ***Refer to Figure 14–5.*** The deadweight loss due to a monopoly is represented by the area 60) _______

A) $FQ_1Q_2E$. B) $FGE$. C) $FHE$. D) $GEH$.

61) ***Refer to Figure 14–5.*** What is the area that represents consumer surplus under a monopoly? 61) _______

A) the rectangle $P_1P_3HF$
B) the trapezium $P_1P_2EF$
C) the triangle $P_0P_1F$
D) the triangle $P_0P_2E$

1) D
2) B
3) D
4) A
5) D
6) D
7) A
8) D
9) C
10) A
11) D
12) A
13) D
14) D
15) B
16) A
17) B
18) C
19) C
20) C
21) D
22) D
23) C
24) D
25) C
26) A
27) C
28) A
29) D
30) C
31) C
32) B
33) C
34) D
35) B
36) A
37) C
38) B
39) B
40) A
41) B
42) D
43) D
44) C
45) B
46) B
47) B
48) A
49) A
50) C

51) D
52) D
53) B
54) A
55) B
56) D
57) A
58) C
59) C
60) C
61) C