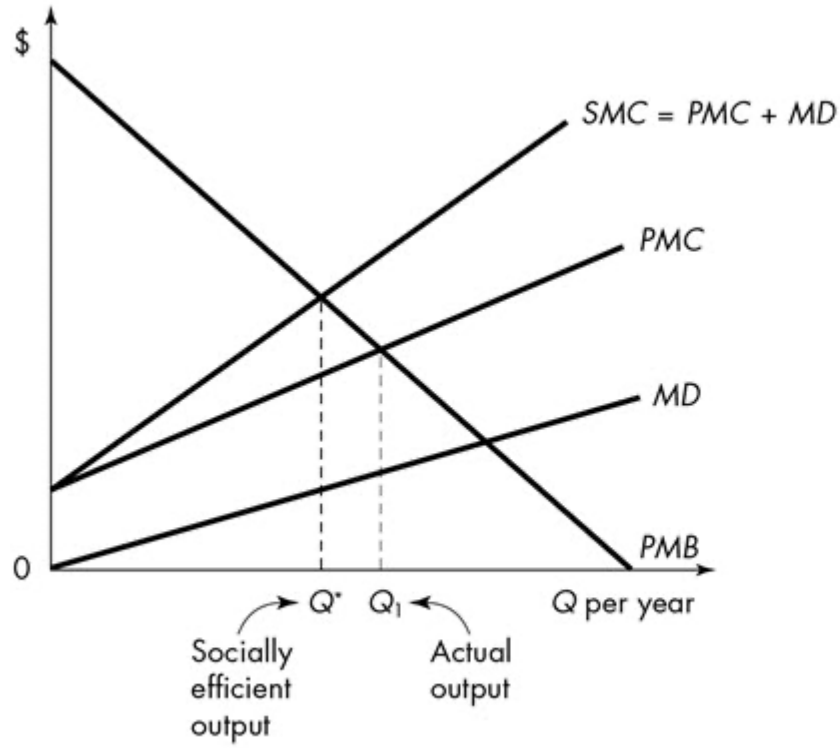
1) An externality occurs when the activity of one entity directly affects the welfare of another that is transmitted by market prices.
   A) True
   B) False

2) When an activity produces a positive externality, too much of it is produced relative to the efficient level.

A) True
B) False

3) In the following figure, if the marginal damages line did not originate at 0,



A) it would mean that marginal damages did not exist.
B) there is no way to find SMC.
C) SMC would not originate at the same intercept as PMC.
D) Both PMC and SMC would not originate at the same intercept as PMC.

4) Private individuals acting on their own may avoid the inefficiencies of externalities through:

A) avoiding bargaining between disputing parties.

B) not internalizing externalities.

C) establishing social conventions.

D) avoiding the costs of bargaining.

1) B
2) B
3) C
4) C