

Economics 2
Winter 2009

your name _____
your TA's name _____
day and time of your discussion section _____

PRACTICE FIRST EXAM

DIRECTIONS: No calculators, books, or notes of any kind are allowed. All papers and notebooks must remain closed and on the floor at all times throughout the exam, and students are not allowed to leave the examination room until finished. Answer all questions in the space provided with the exam. 100 points are possible on this exam.

HINTS: Feel free to use either of the following formulas if you find them useful.

Area of a triangle = $(1/2)$ (base) (height)

Area of a trapezoid = $(1/2)$ (base1 + base2) (height)

PART I: MULTIPLE CHOICE—circle the correct answer (4 points each, 76 points total)

- 1.) A subsidy to the consumers of an item usually leads to
 - a.) an increase in producer surplus and an increase in total economic surplus
 - b.) a decrease in producer surplus and a decrease in total economic surplus
 - c.) a decrease in producer surplus and an increase in total economic surplus
 - d.) an increase in producer surplus and a decrease in total economic surplus

- 2.) Which policy is most efficient when dealing with overbooked airline flights?
 - a.) first-come, first-served
 - b.) compensation to customers who miss their flight
 - c.) price ceiling
 - d.) price floor

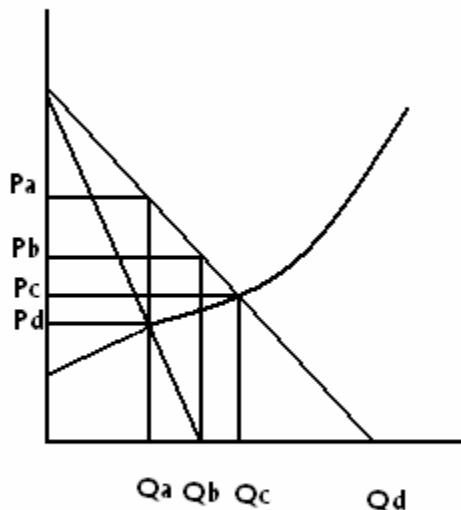
- 3.) If the supply curve for a good is perfectly elastic, which of the following statements best describes the burden of a tax on the good?
 - a.) the burden of the tax falls entirely on the producers
 - b.) the burden of the tax falls entirely on the consumers
 - c.) the burden of the tax is zero
 - d.) the burden of the tax is infinite

- 4.) Suppose you'd be willing to pay \$12 for an item, but you are able to buy it for \$10. Then your consumer surplus
 - a.) is more than \$10
 - b.) is exactly \$10
 - c.) is less than \$10, but positive
 - d.) is exactly 0

- 5.) Which of the following is not an example of the economic waste caused by a price ceiling?
 - a.) consumers may waste time waiting in line to try to get the product
 - b.) the product may not go to the people who value it the most
 - c.) too little of the good will be produced
 - d.) the marginal benefit to some customers may be less than the marginal cost of producing the good

- 6.) Which of the following statements is most accurate?
- a.) under perfect competition, the industry-wide demand curve slopes down and the individual firm demand curve slopes down
 - b.) under perfect competition, the industry-wide demand curve is virtually flat and the individual firm demand curve is virtually flat
 - c.) under perfect competition, the industry-wide demand curve is virtually flat and the individual firm demand curve slopes down
 - d.) under perfect competition, the industry-wide demand curve slopes down and the individual firm demand curve is virtually flat
- 7.) We would characterize a firm as functioning in an oligopoly when
- a.) it is the only firm in the entire market
 - b.) it is the only firm in a restricted geographical area
 - c.) it is one of only a few firms in the entire market
 - d.) it is one of a large number of firms in the entire market
- 8.) We would characterize a firm as functioning in a perfectly competitive market whenever
- a.) the firm believes that it could sell as much or as little as it wanted at a fixed price
 - b.) the firm must charge each customer exactly the same price
 - c.) competition forces the firm to charge each customer a different price
 - d.) the equilibrium price that the firm receives is just enough to cover its average cost per unit

Questions 9 and 10 refer to the following diagram which displays the marginal revenue, marginal cost, and demand curves for a monopolist. Assume that the monopolist must charge the same price to each customer.

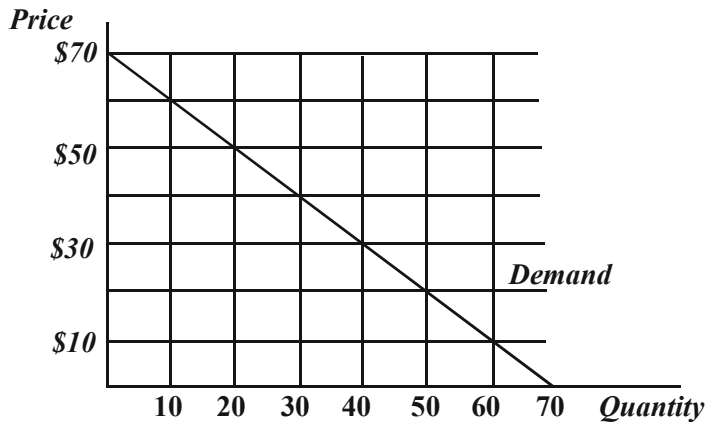


- 9.) If the monopolist were to produce at the level of output represented by Q_b , then
- marginal revenue would be greater than marginal cost
 - marginal revenue would be equal to marginal cost
 - marginal revenue would be less than marginal cost
 - it cannot be determined from the information given
- 10.) If the monopolist were to produce at the level of output represented by Q_a , then
- it could increase profit by producing more
 - it could increase profit by producing less
 - it could not increase profit
 - it cannot be determined from the information given
- 11.) We would characterize a firm as functioning in monopolistic competition if
- it behaves like a competitive firm even though it has a monopoly
 - it behaves like a monopoly even though it has many competitors
 - it is one of a large number of firms that produce similar, but not identical products
 - it operates at a point where marginal revenue is less than marginal cost
- 12.) A network economy arises when
- the product can be used by more than one person at a time
 - the product is cheaper to produce in larger volumes
 - the product is more desirable when other people also use it
 - the product has a large number of complementary goods
- 13.) Which of the following is most likely to result in increasing returns to scale?
- large fixed costs
 - there is only one seller in the market
 - there is only one buyer in the market
 - the government provides a subsidy to sellers in the amount of \$1 for every unit they sell
- 14.) Suppose a monopoly is created when John D. Monopolist buys up two different factories. For factory 1, the marginal cost of producing the 10th unit is \$2. For factory 2, the marginal cost of producing the 20th unit is also \$2. Which of the following would be an accurate characterization of the resulting marginal cost curve for the monopolist?
- the marginal cost of producing the 30th unit is \$4
 - the marginal cost of producing the 30th unit is \$2
 - the marginal cost of producing the 20th unit is \$4
 - the marginal cost of producing the 20th unit is \$2
- 15.) If a natural monopoly reduces the quantity of good it is producing,
- its average cost will increase
 - its average cost will stay the same
 - its average cost will decrease
 - its average cost may go up or down, but it will naturally have to reduce the price

- 16.) How would you compare the levels of total surplus and consumer surplus that result from the usual monopoly with those that result from a monopolist that practices perfect price discrimination?
- under perfect price discrimination, total surplus is bigger and consumer surplus is bigger
 - under perfect price discrimination, total surplus is smaller and consumer surplus is smaller
 - under perfect price discrimination, total surplus is smaller and consumer surplus is bigger
 - under perfect price discrimination, total surplus is bigger and consumer surplus is smaller
- 17.) Which of the following is not an example of price discrimination?
- different airline passengers pay a different price for tickets on the same flight
 - periodic sales and promotions
 - discounts for seniors
 - customers are charged a higher price for goods that are more costly to produce
- 18.) If a monopolist charges a price in excess of marginal cost, it must be the case that
- the firm is earning excess profits
 - the firm is not maximizing profits
 - the firm is a perfectly discriminating monopolist
 - none of the above
- 19.) Copyright protection is an example of monopoly that results from
- legal restrictions
 - fixed costs
 - mergers and acquisitions
 - network economies

PART II: FILL IN THE BLANK (24 points total)—credit for correct answer only (no partial credit)

- 20.) The diagram below shows the demand curves for a competitive market in which the supply is perfectly elastic at a price of \$40. Calculate the following (3 points each, 12 points total)
- producer surplus _____
 - consumer surplus _____



- Suppose now that the government requires consumers to pay a tax of \$10 per unit they buy. If such a tax is imposed on the above market, calculate what the following magnitudes would be:
- consumer surplus _____
 - the total tax revenue collected _____

21.) (3 points each, 12 points total). The following data describe the demand curve and total cost curve facing a monopolist. You are to answer the following four questions in the blanks provided:

- a.) If the monopolist must charge the same price to every customer, what price will it choose? _____
- b.) If the monopolist must charge the same price to every customer, what quantity will it choose? _____
- c.) If the monopolist must charge the same price to every customer, what would be its level of profits? _____
- d.) If the monopolist were able to perfectly discriminate and charge a different price to every customer, what quantity would it choose to produce? _____

Q	P	TC
1	10	6
2	9	8
3	8	10
4	7	12
5	6	14
6	5	16
7	4	18
8	3	20
9	2	22
10	1	24

ANSWERS:

1d 2b 3b 4c 5d 6d 7c 8a 9c 10c 11c 12c 13a 14b 15a 16d 17d 18d 19a

20a 0 b 450 c 200 d 200

21a 6 (full credit for 7) b 5 (full credit for 4) c 16 d 9