

_____ 1a. The word economy comes from the Greek word for

- a. "environment."
- b. "one who manages a household."
- c. "one who participates in a market."
- d. "conservation."

ANS: B "one who manages a household."

- _____ 1b. Trade can benefit a family
- a. by allowing the family to buy a greater variety of goods and services at a lower cost.
 - b. by allowing each person to specialize in the activities he or she does best.
 - c. only if the family is not in economic competition with other families.
 - d. All of the above are correct.
 - e. Both a and b are correct.

ANS: E Both a and b are correct.

- _____ 1c. A budget deficit
- a. occurs when government receipts are less than spending.
 - b. occurs when government spending is less than receipts.
 - c. occurs when government receipts are equal to spending.
 - d. is the accumulation of years of government overspending.

ANS: A occurs when government receipts are less than spending.

- _____ 2. Total revenue equals
- a. total output multiplied by price per unit of output.
 - b. total output divided by profit.
 - c. (total output multiplied by sales price) - inventory surplus.
 - d. (total output multiplied by sales price) - inventory shortage.

ANS: A total output multiplied by price per unit of output.

- _____ 3. When adding another unit of labor leads to an increase in output that is smaller than increases in output that resulted from adding previous units of labor, we have the property of
- a. diminishing labor.
 - b. diminishing output.
 - c. diminishing marginal product.
 - d. negative marginal product.

ANS: C diminishing marginal product.

- _____ 4. Assume that a given firm experiences decreasing marginal product of labor with the addition of each worker regardless of the current output level: average fixed cost will be
- a. always rising.
 - b. always falling.
 - c. U-shaped.
 - d. constant.

ANS: B always falling.

- _____ 5. Economies of scale occur when
- a. long-run average total costs rise as output increases.
 - b. long-run average total costs fall as output increases.
 - c. average fixed costs are falling.
 - d. average fixed costs are constant.

ANS: B long-run average total costs fall as output increases.

- _____ 6. When a firm in a competitive market receives \$500 in total revenue, it has a marginal revenue of \$10. What is the average revenue, and how many units were sold?
- a. \$5 and 100
 - b. \$10 and 50
 - c. \$10 and 100
 - d. The answer cannot be determined from the information given.

ANS: B \$10 and 50

- _____ 6. If marginal cost exceeds marginal revenue, the firm
- a. is most likely to be at a profit-maximizing level of output.
 - b. should increase the level of production to maximize its profit.
 - c. must be experiencing losses.
 - d. may still be earning a profit.

ANS: D may still be earning a profit.

- _____ 7. As part of an estate settlement Mary received \$1 million. She decided to use the money to purchase a small business in Anywhere, USA. If Mary would have invested the \$1 million in a risk-free bond fund she could have made \$100,000 each year. She also quit her job with Lucky.Com Inc. to devote all of her time to her new business; her salary at Lucky.Com Inc. was \$75,000 per year.

At the end of the first year of operating her new business, Mary's accountant reported an accounting profit of \$150,000. What was Mary's economic profit?

- a. \$25,000 loss
- b. \$50,000 loss
- c. \$25,000 profit
- d. \$150,000 profit

ANS: A \$25,000 loss

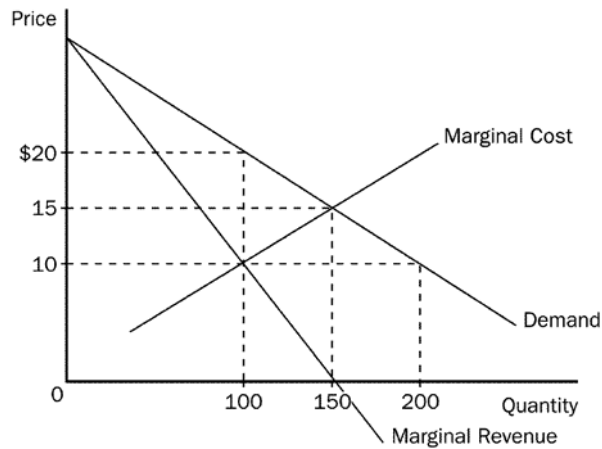
- _____ 8. Which of the following statements is correct?
- a. A competitive firm is a price maker and a monopoly is a price taker.
 - b. A competitive firm is a price taker and a monopoly is a price maker.
 - c. Both competitive firms and monopolies are price takers.
 - d. Both competitive firms and monopolies are price makers.

ANS: B A competitive firm is a price taker and a monopoly is a price maker.

- _____ 9. Competitive firms have
- a. downward-sloping demand curves and they can sell as much output as they desire at the market price.
 - b. downward-sloping demand curves and they can sell only a limited quantity of output at each price.
 - c. horizontal demand curves and they can sell as much output as they desire at the market price.
 - d. horizontal demand curves and they can sell only a limited quantity of output at each price.

ANS: C horizontal demand curves and they can sell as much output as they desire at the market price.

Figure 1



- ___ 10. Refer to Figure 1. The monopolist's maximum profit
- a. is \$800.
 - b. is \$1,000.
 - c. is \$1,250.
 - d. cannot be determined from the diagram.

ANS: D cannot be determined from the diagram.

- ___ 11. If a monopolist is able to perfectly price discriminate,
- a. consumer surplus is always increased.
 - b. total surplus is always decreased.
 - c. consumer surplus and deadweight losses are transformed into monopoly profits.
 - d. the price effect dominates the output effect on monopoly revenue.

ANS: C consumer surplus and deadweight losses are transformed into monopoly profits.

- ___ 12. Which of the following may eliminate some or all of the inefficiency that results from monopoly pricing?
- a. The government can regulate the monopoly.
 - b. The monopoly can be prohibited from price discriminating.
 - c. The monopoly can be forced to operate at a point where its marginal revenue is equal to its marginal cost.
 - d. All of the above are correct.

ANS: A The government can regulate the monopoly.

13. In a typical cartel agreement, the cartel maximizes profit when it
- behaves as a monopolist.
 - behaves as a duopolist.
 - is flexible in enforcing production targets.
 - behaves as a perfectly competitive firm.

ANS: A behaves as a monopolist.

Use the following information to answer question 14. Two cigarette manufacturers (Firm A and Firm B) are faced with lawsuits from states to recover the health care related expenses associated with cigarette smoking. Both cigarette firms have evidence that indicates that cigarette smoke causes lung cancer (and other related illness). State prosecutors do not have access to the same data used by cigarette manufacturers and thus will have difficulty recovering full costs without the help of at least one cigarette firm study. Each firm has been presented with an opportunity to lower their liability in the suit if they cooperate with attorneys representing the states.

Table 1

		Firm A	
		Concede that cigarette smoke causes lung cancer	Argue that there is no evidence that smoke causes cancer
Firm B	Concede that cigarette smoke causes lung cancer	Firm A profit = \$-20 b Firm B profit = \$-15 b	Firm A profit = \$-50 b Firm B profit = \$-5 b
	Argue that there is no evidence that smoke causes cancer	Firm A profit = \$-5 b Firm B profit = \$-50 b	Firm A profit = \$-10 b Firm B profit = \$-10 b

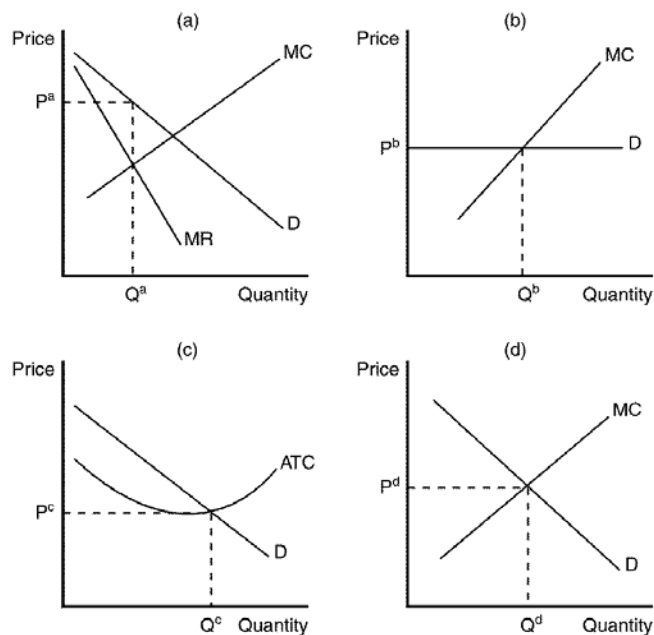
14. Refer to Table 1. Pursuing its own best interests, Firm A will concede that cigarette smoke causes lung cancer
- only if Firm B concedes that cigarette smoke causes lung cancer.
 - only if Firm B does not concede that cigarette smoke causes lung cancer.
 - regardless of whether Firm B concedes that cigarette smoke causes lung cancer.
 - none of the above; in pursuing its own best interests, Firm A will in no case concede that cigarette smoke causes lung cancer.

ANS: C regardless of whether Firm B concedes that cigarette smoke causes lung cancer.

15. Assume that Peach Computers has entered into a resale price maintenance agreement with Computer Super Stores Inc. (CSS Inc.) but not with CompuMart. In this case,
- The wholesale price of Peach computers will be different for CSS Inc. than it is for CompuMart.
 - Peach computers will never increase profits by having a resale price maintenance agreement with all retail outlets that sell its products.
 - CompuMart will benefit from customers who go to CSS Inc. for information about different computers.
 - CSS Inc. will sell Peach computers at a lower price than CompuMart.

ANS: C CompuMart will benefit from customers who go to CSS Inc. for information about different computers.

Figure 2



16. Refer to Figure 2. The firm depicted in panel b faces a horizontal demand curve. If panel b depicts a profit-maximizing firm,
- it could be operating in either a perfectly competitive market or in a monopolistically competitive market.
 - it would not have excess capacity in its production as long as it is earning zero economic profit.
 - it is able to choose the price at which it sells its product.
 - All of the above are correct.

ANS: B it would not have excess capacity in its production as long as it is earning zero economic profit.

- _____ 17. Since a firm in a monopolistically competitive market faces a
- a. downward-sloping demand curve, it will always operate with excess capacity.
 - b. downward-sloping demand curve, it will always operate at efficient scale.
 - c. perfectly elastic demand curve, it will always operate with excess capacity.
 - d. perfectly inelastic demand curve, it will always operate at efficient scale.

ANS: A downward-sloping demand curve, it will always operate with excess capacity.

- _____ 18a. Critics of vacation advertisements that depict "beautiful" human bodies on sun-drenched beaches as the primary focus of the message are likely to claim that the purpose of the advertisement is to
- a. provide helpful information about a tourist destination.
 - b. manipulate people's tastes through psychological messages.
 - c. inflame carnal desire.
 - d. encourage sun-bathing in general.

ANS: B manipulate people's tastes through psychological messages.

- _____ 18b. On a vacation to Cancun, Mexico, you find yourself eating every meal at the local McDonald's rather than having a hamburger from one of the street vendors. Your traveling companion claims that you are irrational, since you never eat McDonald's hamburgers when you are home and McDonald's hamburgers cost more than those prepared and sold by Cancun's street vendors. An economist would most likely explain your behavior by suggesting that
- a. your behavior is rational, but your friend's behavior is clearly irrational.
 - b. you are clearly irrational.
 - c. the McDonald's brand name guarantees consistent quality.
 - d. the advertising by McDonalds in Cancun is more persuasive than the advertising by McDonalds in your home town.

ANS: C the McDonald's brand name guarantees consistent quality.

Table 2

Number of Workers	Output	Marginal Product of Labor	Value of Marginal Product of Labor	Wage	Marginal-Profit
0	0				
1	100		\$1,000	\$500	\$500
2		80	\$ 800	\$500	
3		60		\$500	\$100
4	280		\$ 400	\$500	
5		20		\$500	

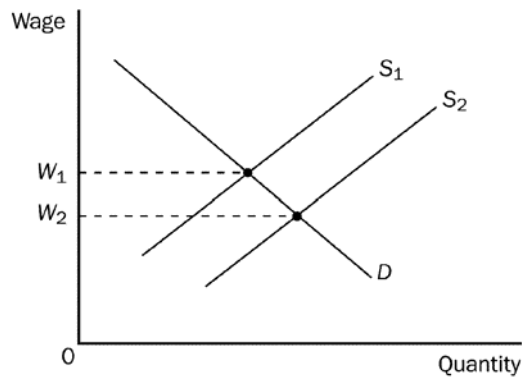
- ___ 19. Refer to Table 2. What is the marginal profit of the fourth worker?
- a. \$400
 - b. \$200
 - c. \$0
 - d. \$-100

ANS: D \$-100

- ___ 20. The opportunity cost of an hour of leisure is
- a. 60 minutes.
 - b. an hour of sleep.
 - c. an hour's worth of wear and tear on your TV, exercise equipment, etc.
 - d. your hourly wage.

ANS: D your hourly wage.

Figure 3



- ___ 21. Refer to Figure 3. Assume $W_1 = \$20$ and $W_2 = \$18$ and the market is always in equilibrium. Then the shift of the labor supply curve from S_1 to S_2
- a. increases the value of the marginal product of labor by \$2.
 - b. decreases the value of the marginal product of labor by \$2.
 - c. decreases the value of the marginal product of labor by more than \$2.
 - d. does not change the value of the marginal product of labor.

ANS: B decreases the value of the marginal product of labor by \$2.

- ___ 22. Because of diminishing returns, a factor in abundant supply has
- a. a high marginal product and a high rental price.
 - b. a high marginal product and a low rental price.
 - c. a low marginal product and a high rental price.
 - d. a low marginal product and a low rental price.

ANS: D a low marginal product and a low rental price.

- ___ 23. A recent law school graduate is considering two offers to practice law, one in California and one in Alabama. Rumor has it that it is very difficult to pass the Alabama bar exam and meet other certification requirements required by the Alabama Bar Association. Assuming all other things equal, the attorney would expect
- a. to be unable to predict the wage difference between Alabama and California.
 - b. to make a higher wage in California.
 - c. to make a higher wage in Alabama.
 - d. wages in California and Alabama to be identical.

ANS: C to make a higher wage in Alabama.

- _____ 24. Workers with more human capital on average earn substantially higher pay than workers with less human capital in
- a. most countries, but not in the United States.
 - b. the United States, but not in most other countries.
 - c. the United States and in most other countries.
 - d. None of the above are correct; the evidence fails to indicate that human capital is a significant factor in earnings anywhere in the world.

ANS: C the United States and in most other countries.

- _____ 25. If employers are profit-maximizers, then
- a. competition will always eventually eliminate employment discrimination.
 - b. employment discrimination may persist if consumers discriminate.
 - c. employment discrimination will persist because it is always profitable.
 - d. compensating differentials will not exist.

ANS: B employment discrimination may persist if consumers discriminate.