

Second Midterm (November 2013)

Instructions: Please fill in your name and student number on every page of the exam questionnaire and on the Answer Sheet provided. Use the Answer Sheet to answer the Multiple Choice questions. There are 43 questions in total -- 40 multiple choice plus 3 short answers. This exam has 12 pages -- check that this copy has all of them. You may use a non-programmable calculator. Good luck !!

Multiple Choice Questions (80 points -- 2 points per question)

Identify the letter of the choice that best completes the statement or answers the question.

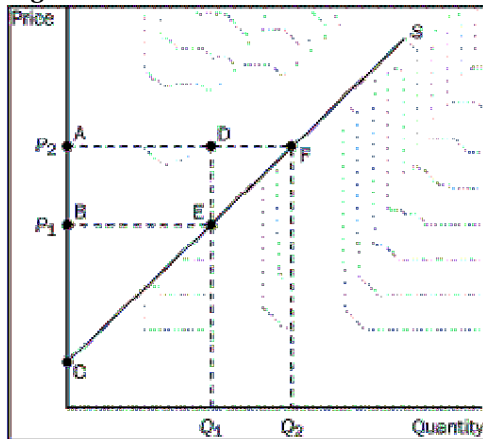
1. What does the "invisible hand" refer to?
 - a. the automatic maximization of consumer surplus in free markets
 - b. the marketplace guiding the self-interests of market participants into promoting general economic well-being
 - c. the marketplace as a place where government looks out for the interests of individual participants in the market
 - d. the equity that results from market forces allocating the goods produced in the market

Table 7-3

Seller	Cost
Dale	\$1,500
Jill	\$1,200
Denise	\$1,000
Catherine	\$750
Jackson	\$500

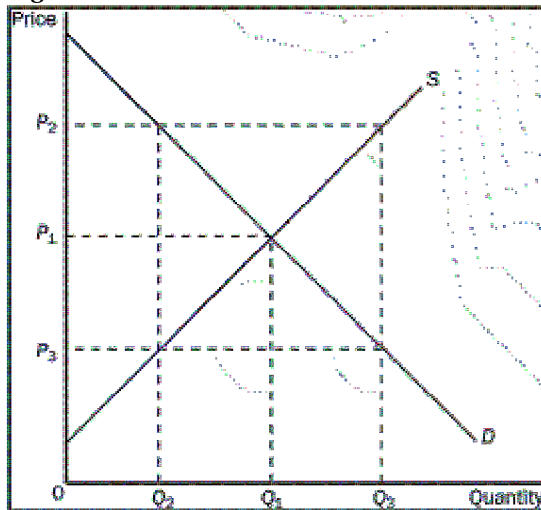
2. **Refer to Table 7-3.** If the market price is \$1,000, what is the total cost in the market?
 - a. \$3,700
 - b. \$2,700
 - c. \$2,250
 - d. \$1,500
3. What would a simultaneous increase in both the demand for and the supply of radios imply?
 - a. Both the value of radios to consumers and the cost of producing radios has increased.
 - b. The value of radios to consumers has increased and the cost of producing radios has decreased.
 - c. The value of radios to consumers has decreased and the cost of producing radios has increased.
 - d. Both the value of radios to consumers and the cost of producing radios has decreased.
4. When markets fail, what can public policy do?
 - a. potentially remedy the problem and increase economic efficiency
 - b. in theory, remedy the problem, but in practice, public policy has proven to be ineffective
 - c. always remedy the problem and increase economic efficiency
 - d. nothing to improve the situation

Figure 7-3



5. Refer to Figure 7-3. Which area represents producer surplus at a price of P_2 ?
- DEF
 - BCE
 - ABED
 - ACF

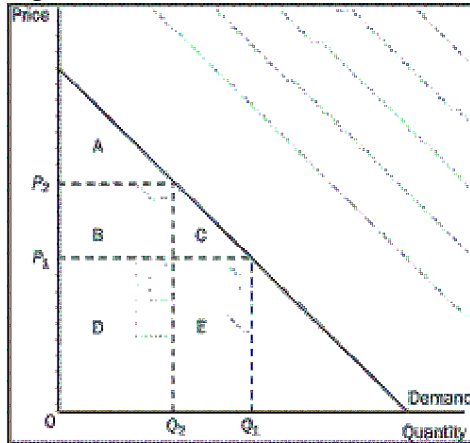
Figure 7-9



6. Refer to Figure 7-9. What happens at the quantity Q_2 ?
- The value to buyers is greater than the cost to sellers.
 - The value to buyers is less than the cost to sellers.
 - The market is in equilibrium.
 - Consumer surplus plus producer surplus is maximized.

7. If the price of oak lumber increases, what happens to consumer surplus in the market for oak cabinets?
- It decreases.
 - It increases.
 - It does not change, but producer surplus will change.
 - It will increase, then decrease.

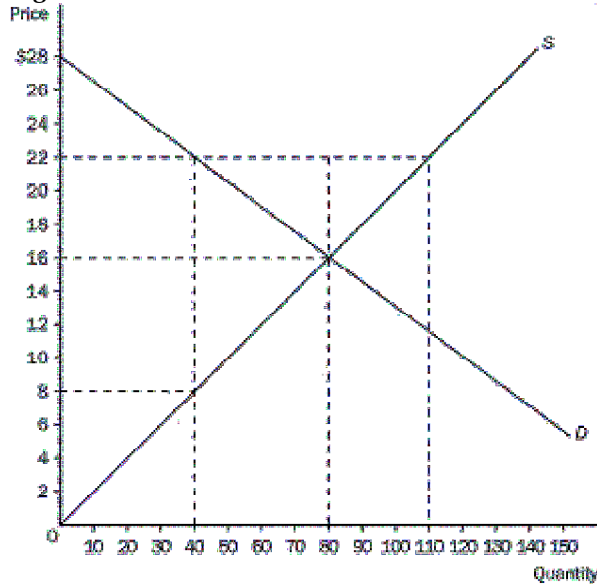
Figure 7-1



8. Refer to Figure 7-1. When the price rises from P_1 to P_2 , what happens to consumer surplus?
- It increases by an amount equal to $B + C$.
 - It decreases by an amount equal to C .
 - It decreases by an amount equal to $B + C$.
 - It increases by an amount equal to A .
9. When a good is taxed, who is worse off?
- Only buyers are worse off because they ultimately pay the majority of the tax.
 - Only sellers are worse off because the government holds them responsible for collecting the tax.
 - Neither buyers nor sellers are worse off, since tax revenue is used to provide goods and services that would otherwise not be provided by the market.
 - Both buyers and sellers are worse off.
10. Suppose consumer income increases. If grass seed is an inferior good, what happens to the equilibrium price of grass seed and producer surplus in the market for grass seed?
- The equilibrium price will increase, and producer surplus will decrease.
 - They both increase.
 - They both decrease.
 - The equilibrium price will decrease, and producer surplus will increase.

11. How is the amount of deadweight loss that will result from a tax determined?
 - a. by the percentage of the purchase price that the tax represents
 - b. by the number of buyers of the product in the market
 - c. by the number of suppliers of the product in the market
 - d. by the price elasticity of demand and supply

Figure 7-7

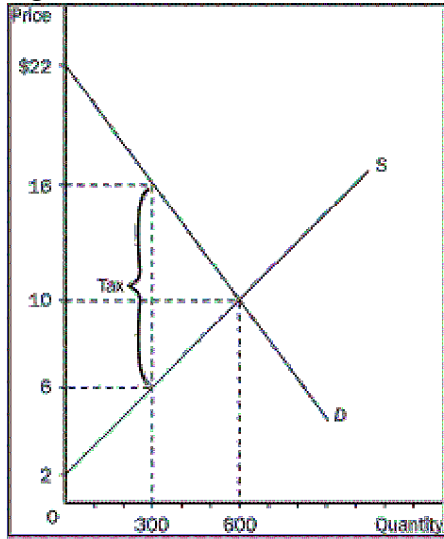


12. **Refer to Figure 7-7.** Assume demand increases and as a result, equilibrium price increases to \$22 and equilibrium quantity increases to 110. What would be the increase in producer surplus due to new producers entering the market?
 - a. \$90
 - b. \$210
 - c. \$360
 - d. \$480

13. Assume that a tax is levied on a good and that the government uses the revenue to clean up lethal toxic waste that would cause irreparable harm to a large number of people. In this case, which of the following outcomes would NOT occur?
 - a. a decrease in producer surplus to producers of the taxed good
 - b. a probable increase in the total economic welfare of society
 - c. a decrease in the total economic welfare of society
 - d. a decrease in consumer surplus to consumers of the taxed good

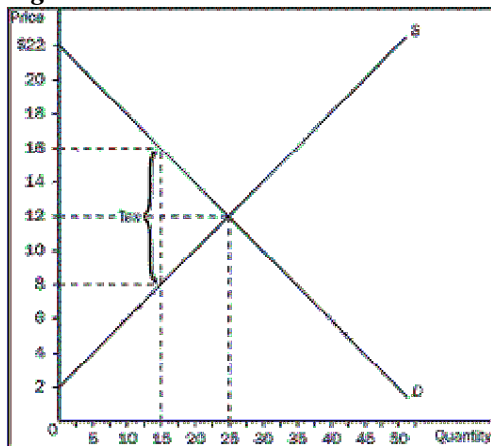
14. When will buyers of a product pay the majority of a tax placed on a product?
 - a. when the tax is placed on the seller of the product
 - b. when the tax is placed on the buyer of the product
 - c. when supply is more elastic than demand
 - d. when demand is more elastic than supply

Figure 8-5



15. Refer to Figure 8-5. If the tax is imposed on the buyer, what would be the price sellers would receive for their product?
- \$2
 - \$6
 - \$10
 - \$16

Figure 8-6



16. Refer to Figure 8-6. What would the total surplus with the tax levied on the seller be?
- \$210
 - \$220
 - \$230
 - \$240

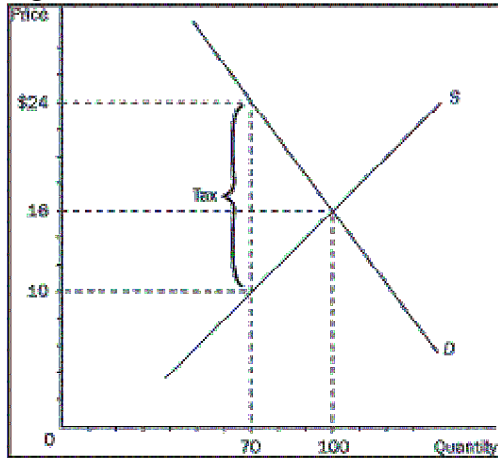
Scenario 8-2

Sheila offers to do Heidi's housework for \$20 per week. Heidi's opportunity cost of doing housework is \$30 per week, and Sheila's opportunity cost of doing housework is \$10 per week.

17. **Refer to Scenario 8-2.** What will be Sheila's gain in producer surplus as a result of the proposed transaction?
 - a. Sheila will gain no producer surplus.
 - b. Sheila will gain \$10 per week
 - c. Sheila will gain \$20 per week
 - d. Sheila will gain \$30

18. Which of the following is the most correct statement about tax burdens?
 - a. A tax burden falls most heavily on the side of the market that is inelastic.
 - b. A tax burden falls most heavily on the side of the market that is closer to unit elastic.
 - c. A tax burden falls most heavily on the side of the market that is elastic.
 - d. A tax burden is distributed independently of relative elasticities of supply and demand.

Figure 8-3

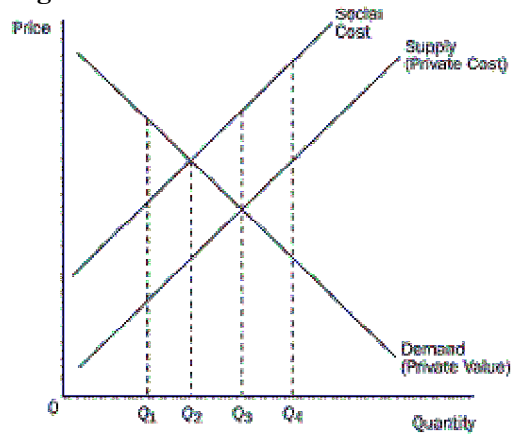


19. **Refer to Figure 8-3.** What is the per unit burden of the tax on the sellers?
 - a. \$6
 - b. \$8
 - c. \$14
 - d. \$16

20. Suppose that the equilibrium quantity in the market for widgets has been 200 per month. Then a tax of \$5 per widget is imposed. The price paid by buyers increases by \$2 and the after-tax price received by sellers falls by \$3. The government is able to raise \$750 per month in revenue from the tax. What is the deadweight loss from the tax?
 - a. \$50
 - b. \$75
 - c. \$125
 - d. \$250

21. Which of the following examples illustrates the concept of a negative externality?
- A flood wipes out a farmer's entire corn crop.
 - A janitor eats fast-food during his lunch break.
 - A college professor plays a vigorous game of racquet ball with the racquet he recently purchased.
 - A college student plays his new stereo system in the residence at 2:00 a.m.

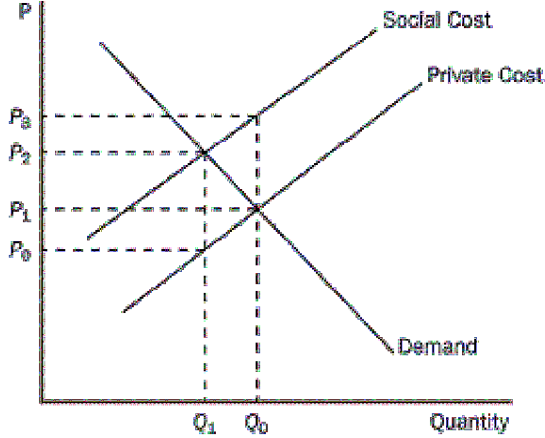
Figure 10-3



22. Refer to Figure 10-3. At Q_3 , which of the following is correct?
- The marginal consumer values this product more than the private cost.
 - The marginal consumer values this product less than the social cost of producing it.
 - The cost to society is equal to the value to society.
 - Every consumer values this product less than the social cost of producing it.
23. What will a positive externality cause a market to produce?
- more than is socially desirable
 - less than is socially desirable
 - less than is market optimal
 - more than is market optimal
24. Since almost all forms of transportation produce some type of pollution, what should be done?
- The government should ban all transportation.
 - Society has to weigh the cost and benefits and decide how much pollution to allow.
 - The government should tax the types of transportation that pollute most.
 - Corporations should voluntarily reduce pollution levels with new car models.
25. If it is illegal for a biochemical manufacturer to release its waste into a nearby stream, what is this an example of?
- transaction costs
 - a market-based policy
 - pollution permits
 - a command-and-control policy

26. According to the Coase theorem, when will private markets solve externality problems and allocate resources efficiently?
- as long as private parties can bargain without cost
 - as long as businesses determine an appropriate level of production
 - as long as government assigns property rights to the harmed party
 - as long as the externalities that are present are positive and not negative
27. Nancy loves to landscape her yard, but her neighbour Lee places a low value on his landscaping. When Lee's grass is neglected and gets long, Nancy will mow it for Lee. What is this an example of?
- improper allocation of resources
 - an exploitation of a common resource
 - a private solution to a negative externality problem
 - a situation in which the Coase theorem fails to explain the lawn mowing arrangement

Figure 10-5



28. Refer to Figure 10-5. Which of the following statements is correct?
- The marginal benefit of the positive externality is measured by $P_3 - P_1$.
 - The marginal cost of the negative externality is measured by $P_3 - P_2$.
 - The marginal cost of the negative externality is measured by $P_3 - P_0$.
 - The marginal cost of the negative externality is measured by $P_3 - P_1$.
29. Which of the following statements about a market that is affected by a positive externality is correct?
- The optimum level of output is greater than the free market level of output and the optimum price is greater than the free market price.
 - The optimum level of output is greater than the free market level of output and the optimum price is less than the free market price.
 - The optimum level of output is less than the free market level of output and the optimum price is greater than the free market price.
 - The optimum level of output is less than the free market level of output and the optimum price is less than the free market price.

30. Which of the following would be considered a common resource good?
- bottled natural mineral water
 - uncongested toll roads
 - cable television
 - fish in the ocean
31. What characteristics do public goods and common resources have in common?
- Both goods are nonexcludable.
 - Both goods are excludable.
 - Both goods are rival.
 - Both goods are nonrival.
32. For what reason does the government provide public goods?
- Markets are always better off with some government oversight.
 - Free-riders make it difficult for private markets to supply the socially optimal quantity.
 - Private markets are incapable of producing public goods.
 - External benefits will occur to private producers.
33. Why are most lighthouses operated by the government?
- because lighthouses are no longer valued by society
 - because most lighthouses are only tourist attractions in provincial and national parks
 - because shipping companies would not be able to afford lighthouse upkeep
 - because of the free-rider problem
34. The Ogallala aquifer is a large underground pool of fresh water under several western states in the United States. Any farmer with land above the aquifer can at present pump water out of it. Which of the following statements about the aquifer is most likely correct?
- The aquifer is a common property resource, which will be overused if nobody owns it.
 - The aquifer is a public good that must be publicly owned to be used efficiently.
 - The aquifer is a private good that must be privately owned to be used efficiently.
 - The aquifer is a natural monopoly that should be left as it is.
35. Suppose that you want to put on a fireworks display in your home town of 1,000 people. The cost of the display is \$6,000 and each person values the display at \$5. After a month, you have only sold 50 tickets at \$5 each. What is the result?
- The local government will put on the display but you will not.
 - Neither you nor the local government would put on the display.
 - You will still put on the display but the local government would not.
 - This question cannot be answered without knowing the amount of tax the local government would charge for the display.
36. How can the Tragedy of the Commons be corrected?
- by providing more of the resource for public use
 - by assigning property rights to individuals
 - by providing government subsidies for the resource
 - by making certain everyone in the economy has access to the resource

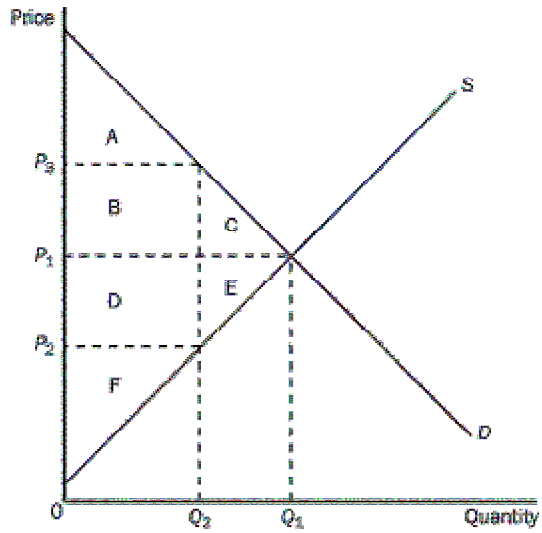
37. Suppose that installing an overhead pedestrian walkway would cost a college town \$100,000. If the walkway is expected to reduce the risk of fatality by 2 percent and the cost of a human life was estimated at \$10 million, what would the town do?
- The town would install the walkway because the estimated benefit equals the cost.
 - The town would not install the walkway, since the cost is twice the estimated benefit.
 - The town would install the walkway because the estimated benefit is twice the cost.
 - The town would install the walkway, since the cost of even a single life is too great.
38. Which of the following statements is MOST accurate in the market for a good like ice-cream cones?
- The price established in the market will not reflect the value of ice cream cones to consumers.
 - Price adjusts to balance supply and demand.
 - The sum of producer surplus and consumer surplus is minimized.
 - An inefficient number of ice-cream cones will be produced.
39. Four friends decide to meet at a Chinese restaurant for dinner. They decide that each person will order an item off the menu and they will share all dishes. They also decide that, when the final bill for the meal comes, they will split the cost evenly among each of the people at the table. When the food is delivered to the table, each person faces incentives similar to which of the following?
- production of a private good
 - consumption of a natural monopoly good
 - production of a public good
 - consumption of a common resource good
40. To most economists, what is the best solution to the overcrowding problem at Banff National Park?
- to place daily quotas on the number of vehicles that enter the park
 - to temporarily close down damaged sections of the park
 - to increase financial aid from the government
 - to increase entrance fees to the park

Short Answer Questions (20 points)

Answer in the space provided.

41. (4 points) The Coase theorem suggests that efficient solutions to externalities can be arrived at through bargaining by private parties. Under what circumstances does this fail to produce a solution?

42. (6 points) Use the following graph shown to fill in the table that follows.



	Without Tax	With Tax	Change
Consumer surplus			
Producer surplus			
Tax revenue			
Total surplus			

43. (10 points) Using a supply and demand diagram, discuss how a negative externality in production leads to market inefficiency. Identify the size of the market inefficiency on the diagram and explain what it means. How might the government help to eliminate this inefficiency?