

Commerce 394: Government and Business

Sample Midterm Exam

Name: _____

Time: 80 minutes

Marks: 85

Part I. True/False (9 questions, 45 total marks, 1.5 marks per part). There can be more than one true/false part per question.

1. Which of the following is true?

- a. The statement "Expo would not cost taxpayers a cent because any losses would be covered by the provincial lottery" illustrates a misunderstanding of opportunity cost.
- b. Setting output to the point where the total costs equals total revenues is an application of the marginalist principle.
- c. A reorganization of a manufacturing that allows the same amount of output to be produced with less inputs generates an increase in production efficiency.
- d. Adam Smith's views on the virtues of the private economy fails to take into account incentive effects.

2. A policy change is said to cause a potential Pareto improvement when:

- a. The sum of the benefits of the policy change exactly equals the sum of its costs.
- b. The sum of the benefits of the policy change outweigh the sum of its costs.
- c. More people are made better off than worse off by the policy change.
- d. The people made better off are able to compensate the losers and still be better off.

3. Which of the following is true about utilitarianism?

- a. Ethical actions are those that result in the greatest good for the majority of people.
- b. Potential Pareto improving actions are ethical.
- c. A utilitarian would advocate policies that increase total aggregate utility.

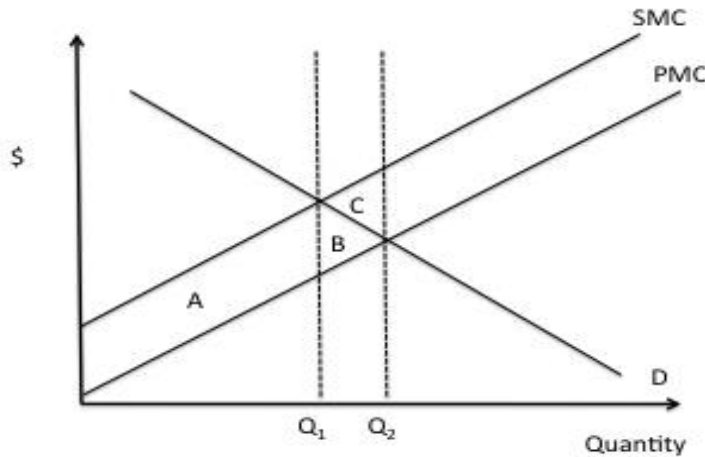
4. Which of the following would result in allocational efficiency?

- a. a monopolist that sets output such that $p=mc$.
- b. a monopolist that sets output such that $mr=mc$.
- c. a perfectly competitive firm that sets output such that $p=mc$.

5. Lobbying by an industry (not subject to market failure) that results in government allowing the industry to restrict output level below the competitive level:

- a. generates new wealth.
- b. is illegal in Canada.
- c. generates economic inefficiency.

6. Consider the following graph showing the private marginal costs (PMC), social marginal costs (SMC), and demand for an activity subject to negative externalities.



Which of the following is true?

- Q1 is the socially optimal level of output.
- Area B represents deadweight loss associated with the “uncorrected” negative externality.
- Area C represents deadweight loss associated with the “uncorrected” negative externality.

7. In the market for lemons:

- The presence of lemons leads to underpricing (i.e. the price offered is less than the true value) on the ‘good’ (i.e., non-lemon) goods
- Consumers rationally anticipate the presence of lemons, so there will be more ‘good’ (i.e., non-lemon) goods on the market
- A seller can develop a reputation to mitigate asymmetric information problems

8. To increase allocative efficiency government should:

- Fund a program more if, for that program, the $MB > MC$
- Fund a program more if, for that program, the $MSB > MSC$
- If it (government) is financially constrained, it should fund a program more if the $MSB/\$$ of this program is higher than the $MSB/\$$ of other programs
- If it (government) is financially constrained it should fund any new program exclusively by reduced spending on other programs or activities.

9. Examples of market failure that can happen in a free market economy include:

- Not enough public parks are provided by the market.
- A toy factory can emit too much pollution as it makes dolls for children.
- Not enough number of people take flu shots; taking a flu shot can benefit even those who do not take the flu shots by making them less exposed to flu virus.

Part II. True/False/Uncertain (4 questions, 10 points each)

Determine whether the following statements are true, false, or uncertain and briefly explain your answer (4-5 sentences). Your answer should explain aspects of the statement that are correct (if any) and aspects of the statement that are false (if any). For some questions, I have included background information. In writing your answer you should assume that statements in italics are factually correct.

1. Vancouver city government provision of bus transportation is best justified by the fact that bus transportation is a public good.
2. Part of the social responsibility of corporations is to make donations to community or charities?
3. Voluntary exchanges must increase the welfare of each person participating in the exchange or else they would not agree to the transaction. Thus, from a utilitarian standpoint, all voluntary exchanges are ethical.
4. *BC has instituted a 'pay-for-performance' model in emergency rooms where hospitals are given baseline time targets, from arrival to discharge, for different categories of patients. If the hospital meets its targets, it gets a cash bonus, which can be used to buy equipment or improve facilities.* The new program will result in improved patient care in British Columbia.