

Public Sector Microeconomic Analysis

ECO 2110A

C. Théoret

Practice Exam #1

Coverage: Rosen Chapters 1-4

1. Public finance
 - a. is not like public economics.
 - b. develops principles for understanding the economic role of government.
 - c. only works for local and state governments.
 - d. is all of the above.

2. The real cost of government-produced goods and services is
 - a. money.
 - b. taxes.
 - c. the value of private goods and services foregone.
 - d. inflation.

3. Government output is hard to account for because government
 - a. is so large.
 - b. provides goods that have no resale value.
 - c. keeps secrets about what it produces.
 - d. goods are generally not sold or produced in easily measurable units.

4. Normative economics
 - a. does not depend on market interactions.
 - b. only looks at the best parts of the economy.
 - c. examines how the economy actually works (as opposed to how it should work).
 - d. embodies value judgments.

5. The substitution effect
 - a. is when individuals consume more of one good and less of another.
 - b. is associated with changes in relative prices.
 - c. will have no effect if goods are unrelated.

- d. is all of the above.
6. Government goods and services are usually
- not rationed by prices.
 - sold in markets.
 - made available to persons according to their willingness and ability to pay.
 - financed by revenue obtained from sales.
7. A point on a contract curve is
- always efficient but not necessarily fair
 - always fair but not necessarily efficient
 - neither fair nor efficient
 - None of these answers.
8. Under the First Fundamental Theorem of Welfare Economics, an efficient allocation of resources emerges when (A= Apples; B = Bananas where A and B are private goods)
- $MRS_{AB}^{JOHN} = MRS_{AB}^{MARY}$
 - maximization of $(MRS_{AB}^{JOHN} + MRS_{AB}^{MARY})$
 - minimization of $(MRS_{AB}^{JOHN} + MRS_{AB}^{MARY})$
 - $MRS_{AB}^{JOHN} = MRS_{AB}^{MARY} = 0$
9. Positive economics
- makes recommendations designed to achieve certain goals.
 - establishes cause and effect relationships between economic variables.
 - is based on value judgments.
 - can never be used to make predictions.
10. If the marginal social benefit of a good exceeds its marginal social cost at the current output, then
- it will be possible to make buyers of the good better off without harming sellers of the good.
 - it will be possible to make sellers of the good better off without harming buyers of the good.
 - either (a) or (b).
 - a reduction in monthly output will be required for efficiency.
11. Points on a utility possibility curve represent
- a given distribution of well-being between two persons.
 - an efficient allocation of resources.
 - the maximum well-being of any one person given resources available and the well-being of another person.
 - all of the above.
12. If efficiency has been attained
- it will be possible to make any one person better off without harming another.
 - it will not be possible to make any one person better off without harming another.
 - perfect competition must exist.
 - the opportunity cost of any change in resource use must be zero.

13. A reallocation of resources where the gains achieved by those who are made better off exceed the losses sustained by those who are made worse off is called
- Pareto efficient.
 - a Pareto improvement.
 - a potential Pareto improvement.
 - a Lindhal equilibrium.
14. Diamonds are sold by a monopoly firm that maximizes profits. It follows that
- the marginal social benefit of diamonds exceeds its marginal social cost.
 - the marginal social cost of diamonds exceeds its marginal social benefit.
 - the price of diamonds equals its marginal social cost.
 - the price of diamonds exceeds its marginal social benefit.
 - both (c) and (d).
15. The efficiency condition (two persons) with the variable production of two private goods or services is
- $MRS_{xy}^{JOE} = MRS_{xy}^{JANE} = MRT_{xy}$
 - $MRS_{xy}^{JOE} + MRS_{xy}^{JANE} = MRT_{xy}$
 - $MRS_{xy}^{JOE} + MRT_{xy}^{JANE} = MST_{xy}$
 - $MRT_{xy}^{JOE} = MRS_{xy}^{JANE} = MST_{xy}$
16. The efficiency condition (two persons) with the variable production of two public goods or services is
- $MRS_{xy}^{JOE} = MRS_{xy}^{JANE} = MRT_{xy}$
 - $MRS_{xy}^{JOE} + MRS_{xy}^{JANE} = MRT_{xy}$
 - $MRS_{xy}^{JOE} + MRT_{xy}^{JANE} = MST_{xy}$
 - $MRT_{xy}^{JOE} = MRS_{xy}^{JANE} = MST_{xy}$
17. The efficiency condition requires that relative prices be equal to the ratio of marginal costs.
- True; b) False.
18. The marginal cost of providing a certain quantity of a pure public good to an additional consumer after it is provided to any one consumer is
- zero.
 - positive and increasing.
 - positive and decreasing.
 - positive and constant.
19. The non-rival property of pure public goods implies that
- the benefits enjoyed by existing consumers decline as more consumers enjoy a given quantity of the good.
 - the benefits enjoyed by existing consumers are unaffected as more consumers enjoy a given quantity of the good.
 - the good cannot be priced.
 - the marginal cost of producing the good is zero.
20. The efficient output of a pure public good is achieved at the point at which
- the marginal benefit obtained by each consumer equals the marginal social cost of producing the good.

- b. the sum of the marginal benefits of all consumers equals the marginal social cost of producing the good.
 - c. the marginal benefit of each consumer equals zero.
 - d. the marginal social cost of producing the good is zero.
 - e. both (c) and (d).
21. The monthly rental rate for a satellite dish antenna is \$200. The maximum marginal benefit that any resident of a condominium community will obtain per month from the antenna is \$50. There are 100 residents in the community, none of whom values the antenna at less than \$25 per month. Assuming that the antenna is a pure public good for residents of the community
- a. each resident of the community will rent his own antenna.
 - b. it is inefficient for the community to rent an antenna.
 - c. It is efficient for the members of the community to rent an antenna for their common use.
 - d. it is efficient for each resident to rent his own antenna.
22. John is willing to trade 3 bottles of beer for 1 bottle of wine while Mary is willing to trade 2 bottles of beer for 1 bottle of wine. The ratio of prices (beer for wine) in John's case is
- a. 3.
 - b. 0.333.
 - c. 2.
 - d. 0.66667.
 - e. 5.
23. The demand curve for a pure public good is
- a. a horizontal line.
 - b. obtained by adding the prices individual consumers would be willing to pay at each possible quantity.
 - c. obtained by adding the quantities that individual consumers would be buy at each possible price.
 - d. does not exist.
24. Cable TV programming is an example of a
- a. congestible public good.
 - b. price excludable public good.
 - c. pure public good.
 - d. pure private good.
25. A social welfare function depends on
- a) the MRT between two goods
 - b) the utilities of each of its members
 - c) whether the goods or services are produced by the private or public sector
 - d) whether the allocation of resources is efficient.
26. Adverse selection is the problem of
- a. hidden action
 - b. moral hazard
 - c. risk pooling
 - d. hidden information

27. Moral hazard is the problem of
- hidden action
 - moral hazard
 - risk pooling
 - hidden information
28. With regard to income, the First Fundamental Theorem of Welfare Economics requires
- producers and consumers to be price takers.
 - that there be a market for every commodity.
 - that the economy operate at some point on the utility possibility curve.
 - all of the above.
29. The marginal rate of substitution is
- the slope of the indifference curve.
 - the slope of the contract curve.
 - the slope of the utility possibilities curve.
 - none of the above.
30. A movement from an inefficient allocation to an efficient allocation in the Edgeworth Box **could [assume a two-person society]**
- increase the utility of both persons.
 - increase the utility of one person and decrease the utility of the other person.
 - decrease the utility of both persons.
 - Answers a), b) and c).
 - Neither answer a), nor b) nor c).
31. Pareto efficiency is achieved when
- the gain from an exchange outweighs the loss.
 - all parties are made better off by an exchange.
 - at least one party is made better off by an exchange.
 - no party can be made better by an exchange without making at least one other party worse off.
32. In a two-good world the optimal combination of the goods to consume is that combination where
- the marginal rate of substitution (MRS) is minimized.
 - the marginal rate of substitution (MRS) equals the ratio of the prices of the two goods.
 - the budget line is flattest.
 - the consumer's preference is concave.
33. Equity in taxation can be characterized according to
- Pigouvian taxes and subsidies
 - horizontal and vertical equity
 - the benefit principle and ability to pay
 - the presence of free riders.
34. Marginal benefits are downward sloping when
- there are no total benefits.

- b. total benefits are decreasing at an increasing rate.
 - c. total benefits are increasing at a decreasing rate.
 - d. marginal costs are upward sloping.
35. The total social benefit of automobiles equals the total social cost at current annual output. Then it follows that:
- a. the annual output of automobiles is efficient.
 - b. the annual output of automobiles exceeds the efficient amount.
 - c. less than the efficient annual output of automobiles is produced.
 - d. it is not possible to make buyers of automobiles better off without harming sellers.
 - e. both (a) and (d)

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<u>Questions</u>	<u>Answers</u>
1	b
2	c
3	d
4	d
5	d
6	a
7	a
8	a
9	b
10	c
11	d
12	b
13	c
14	a
15	a
16	b
17	a
18	a
19	b
20	b
21	c
22	a
23	b
24	a
25	b
26	d
27	a
28	d
29	a
30	d
31	d
32	b
33	c
34	c
35	d