

Managerial Economics GMS 402 Term Test II PREPARATION

SECTION 1 – TRUE / FALSE & MULTIPLE CHOICE (78 MARKS)

These are questions you can practice in preparation for term test II. There is no guarantee any of these questions will be on the second test – this set of questions does not necessarily cover all of the material covered in lectures.

True/False

- T 1. Explicit costs are those costs of production that a financial accountant attempts to record as data and are gathered for the firm's income statement.
- T 2. Fixed costs are costs that do not vary with the level of output in the short run.
- T 3. Variable costs are costs that increase or decrease as a firm's output increases or decreases.
- F 4. Variable costs are costs that increase as a firm's output increases but are constant as a firm's output decreases.
- T 5. Long-run total cost is the minimum economic cost of producing each possible level of output when the time period is sufficiently long to change all inputs of the firm's production function.
- T 6. Long-run average cost is equal to long-run total cost divided by the level of output.
- T 7. Total fixed cost is the private economic cost of the firm's fixed inputs in the short run.
- T 8. Short-run total variable cost is the sum of the private economic costs and the social costs of a firm that vary with its level of output in the short run.

- T 9. Short-run average variable cost is equal to short-run total variable costs divided by the level of output.
- T 10. Short-run average total cost is the cost per unit of output in the short run.
- T 11. Short-run marginal cost is the rate of change of short-run total cost as the level of output changes in the short run.
- T 12. Economies of scale are technological and organizational advantages that accrue to the firm as it increases output in the long run.
- T 13. Economic profit for a firm is equal to revenue minus total cost, where total cost includes all opportunity costs associated with the firm's activities.
- T 14. Marginal profit is the rate of change of total profit with respect to changes in the level of output.
- T 15. At the profit-maximizing level of output, the additional revenue to be gained from another unit of output must be equal to the additional cost the firm incurs by producing it.
- F 16. At the profit-maximizing level of output, the additional revenue to be gained from another unit of output must be greater than the additional cost the firm incurs by producing it.
- T 17. Marginal profit can be found by subtracting marginal cost from marginal revenue.
- F 18. Marginal profit can be found by subtracting total cost from total revenue.
- T 19. If a firm produces where marginal revenue is equal to marginal cost and price is less than average variable cost then the firm should not produce at all - even in the short run.

F 20. If a firm produces where marginal revenue is equal to marginal cost and price is less than average variable cost then the firm is maximizing profits.

 T 21. The unit contribution margin equals the price of a product less the firm's average variable costs.

 T 22. The unit contribution margin indicates the contribution that each unit sold will make toward covering fixed cost and, eventually, generating profit.

 F 23. The breakeven level of output of a firm occurs where marginal revenue is equal to marginal cost.

 T 24. Under perfect competition, there are many small firms, and the individual firm takes the market price as a given.

 F 25. Under perfect competition, even though there are many small firms, the individual firm has some influence over the market price.

 T 26. In a market that is characterized by free entry and exit, profit serves the function of drawing new firms into the industry when it is greater than normal and causing some firms to leave when it is less than normal.

 F 27. In a market that is characterized by free entry and exit, profit serves the function of drawing new firms into the industry when it is less than normal and causing some firms to leave when it is greater than normal.

 T 28. In the long run, because of the entry and exit of firms in the marketplace, a perfectly competitive firm can expect only normal profits.

 T 29. The demand curve for the homogeneous product of a perfectly competitive industry is determined by the preferences of consumers.

 T 30. An equilibrium price is one that equates quantity demanded in a market with quantity supplied so that there is no surplus or shortage of the product traded.

T 31. As long as the output of an individual firm in a perfectly competitive market is very small with respect to the total industry market for the product, the individual firm has no control over the price it charges for its product.

 T 32. The demand curve of the perfectly competitive firm is equal to its marginal revenue curve.

 T 33. The demand curve of the perfectly competitive firm is a horizontal line.

 T 34. Market conditions for the perfectly competitive firm can produce four possible short-run results including normal profit, greater than normal profit, operating loss, or cessation of operations.

 F 35. In the short run, as long as $SMC = MR = P$, if price is greater than average variable cost, the firm should shut down.

 T 36. The short-run supply curve of the perfectly competitive firm is that portion of its marginal cost curve (SMC) which lies above AVC.

 37. Even though the monopoly determines its own profit-maximizing output and therefore the appropriate price for its product, it is still at the mercy of market demand for its product.

 38. In the short run, the monopoly firm (just like the firm under perfect competition) can temporarily choose to cease production.

 39. Because a monopoly is the only firm in an industry, it can never operate at a loss.

 40. A monopoly would never be in a shut down situation like a firm in a purely competitive market.

 41. The lack of entry into a monopolistic market may also lead to inefficiency in production, since there is no assurance that the monopoly firm's profit-maximizing output will occur in an optimum-sized plant.

- _____ 42. Oligopoly is a market structure characterized by few sellers and interfirm rivalry.
- _____ 43. Oligopoly is the term economists have settled on to describe a market structure with numerous firms that sell slightly differentiated products.
- _____ 44. Product differentiation refers to a wide variety of activities, such as design changes and advertising that rival firms employ to attract consumers to their products.
- _____ 45. Product differentiation is the term economists have settled on to describe a market structure with numerous firms that sell slightly differentiated products.
- _____ 46. Under monopolistic competition, each seller firm is not particularly concerned about the relationship between its individual actions and those of other firms in the industry.
- _____ 47. Under monopolistic competition, each seller firm is usually very concerned about the relationship between its individual actions and those of other firms in the industry.
- _____ 48. Under monopolistic competition, each seller firm attempts to retain or increase its market share by differentiating its product from the output of other firms.
- _____ 49. Under monopolistic competition, each seller firm attempts to retain or increase its market share by engaging in fierce price competition with the other firms.
- _____ 50. The individual firm in monopolistic competition perceives the relevant portion of its demand curve to be highly, but not perfectly, elastic.
- _____ 51. Price rigidity can be an indication of collusive agreements in an industry.

_____ 52. The kinked demand curve model assumes that an oligopolistic firm recognizes its mutual interdependence with other firms and, while it does not collude with them, each firm acting independently, has determined that it can not gain by departing from the prevailing price.

_____ 53. A kinked demand curve consists of an elastic range for price increases and a less elastic range for price decreases.

_____ 54. Price leadership occurs when specific firms in an oligopolistic group (perhaps even one firm) sets a price that subsequently determines what other members of the group will charge.

Multiple Choice

Identify the letter of the choice that best completes the statement or answers the question. Answer each question on the scantron provided.

_____ 55. Omit this question typo

- a.
- b.
- c.
- d.
- e.

_____ 56. Long-run marginal cost:

- a. is the rate of change of long-run fixed cost as the level of output changes.
- b. is the rate of change of long-run total cost as the level of output changes.
- c. is always constant.
- d. is usually fixed over a given range of production.
- e. is the rate of change of long-run average cost as the level of output changes.

_____ 57. Average fixed costs:

- a. rise when production increases.
- b. rise when production decreases.
- c. rise when average variable costs increase.
- d. rise when total costs increase.
- e. never rise.

____ 58. Total profit will be maximized where:

- a. total revenue minus total cost is at its greatest positive level.
- b. total revenue minus total cost is at its lowest positive level.
- c. where long run average cost is at its lowest point.
- d. where total revenue is at its greatest point.
- e. where total cost is at its lowest point.

____ 59. Marginal profit is:

- a. the rate of change of total profit with respect to changes in the level of output.
- b. the average profit per unit sold.
- c. is equal to total profit divided by quantity of output.
- d. will be maximized where marginal revenue equals marginal cost.
- e. the price of a product less the firm's average variable costs.

____ 60. Total profit will be maximized:

- a. where total revenue is maximized.
- b. where total costs are minimized.
- c. where marginal revenue equals marginal cost.
- d. where marginal revenue equals zero.
- e. where marginal costs equal zero.

____ 61. Assuming price is greater than average variable cost in the short-run and that at higher output levels marginal revenue is less than marginal cost, the firm will maximize profit if:

- a. marginal revenue is maximized.
- b. marginal cost is minimized.
- c. marginal profit is maximized.
- d. marginal revenue is equal to marginal cost.
- e. total revenue is equal to total cost.

____ 62. Assuming price is greater than average variable cost in the short-run, the firm will maximize profit if:

- a. marginal profit is zero and marginal revenue is below marginal cost at higher output levels.
- b. marginal profit is zero and marginal revenue is greater than marginal cost at higher output levels.
- c. marginal profit is zero and marginal cost is decreasing.
- d. marginal profit is zero and marginal revenue is decreasing.
- e. marginal profit is zero.

____ 63. Assuming price is greater than long-run average cost in the long-run, the firm will maximize profit if:

- a. marginal profit is zero and marginal revenue is below marginal cost at higher output levels.
- b. marginal profit is zero and marginal revenue is greater than marginal cost at higher output levels.
- c. marginal profit is zero and marginal cost is decreasing.
- d. marginal profit is zero and marginal revenue is decreasing.
- e. marginal profit is zero.

____ 64. Assuming price is greater than long-run average cost and that at higher output levels marginal revenue is less than marginal cost, the firm will maximize profit in the long run if:

- a. marginal revenue is maximized.
- b. marginal cost is minimized.
- c. marginal revenue is equal to marginal cost.
- d. marginal profit is maximized.
- e. total revenue is equal to total cost.

_____ 65. The unit contribution margin refers to:

- a. the selling price of a product.
- b. the price of the product less its average variable cost.
- c. the cost of a product.
- d. the net profit generated by a product.
- e. the price of a product less its average fixed cost.

_____ 66. Which of the following is **NOT** a condition of a perfectly competitive market?

- a. A very large number of buyers and sellers.
- b. The products are homogeneous.
- c. All buyers and sellers have perfect knowledge of market conditions and of any changes in the market conditions that occur.
- d. Firms are able to get together and effectively agree on restricting quantity supplied and raising prices.
- e. There are no artificial interferences with the activities of the buyers and sellers.

_____ 67. As long as the output of an individual firm in a perfectly competitive market is very small with respect to the total market for the product:

- a. each individual firm can change price only by a small degree.
- b. each individual firm sells a slightly differentiated product.
- c. each individual firm takes the price as a "given".
- d. firms are able to get together and effectively agree on restricting quantity supplied and raising prices.
- e. depending on market conditions, the "given" price may be above or below the industry equilibrium price.

_____ 68. In a market that is characterized by free entry and exit, profit serves the function of:

- a. drawing new firms into the industry when profit is greater than normal.
- b. drawing new firms into the industry when profit is lower than normal.
- c. causing some firms to leave when profit is greater than normal.
- d. causing some firms to enter when profit is lower than normal.
- e. compensating owners with a higher than normal rate of return on investment.

____ 69. Market conditions for the perfectly competitive firm can produce all of the following short-run results **EXCEPT**:

- a. greater than normal price.
- b. normal profit.
- c. greater than normal profit.
- d. operating loss.
- e. cessation of operations.

____ 70. In the short run, a purely competitive firm can be expected to shut down if:

- a. price is less than short run average cost.
- b. price is less than average variable cost.
- c. price is less than average fixed cost.
- d. total costs exceed total revenue.
- e. short-term marginal cost is above average variable cost.

____ 71. A monopoly in the short run will try to produce where:

- a. revenue is maximized.
- b. costs are minimized.
- c. marginal revenue is greater than marginal cost.
- d. marginal revenue is equal to marginal cost as long as price is greater than average variable cost.
- e. marginal revenue is equal to marginal cost as long as price is greater than short run average cost.

_____ 72. In a monopoly, if price is greater than average variable cost but less than short-run average cost, then:

- a. the monopoly will be operating at a loss.
- b. the monopoly will be operating at a profit.
- c. the monopoly is in a shut down situation.
- d. its operating loss is greater than total fixed cost.
- e. its total revenue will be greater than total cost.

_____ 73. In a monopoly, if price is lower than average variable cost, then:

- a. the monopoly will be operating at a loss.
- b. the monopoly will be operating at a profit.
- c. the monopoly is in a shut down situation.
- d. its operating loss is greater than total fixed cost.
- e. its total revenue will be greater than total fixed cost.

_____ 74. If a monopoly produces where marginal revenue is equal to marginal cost then:

- a. if short run average cost is less than price, the monopoly will have a normal profit.
- b. if short run average cost is equal to price, the monopoly will have a normal profit.
- c. the monopoly is guaranteed to make a normal profit.
- d. if short run average cost is greater than price, the monopoly will have a normal profit.
- e. if average variable cost is greater than price, the monopoly will have be operating at a loss.

_____ 75. All of the following are characteristics of monopolistic competition **EXCEPT**:

- a. The use of advertising to differentiate products
- b. A relatively large number of sellers
- c. Each seller firm is not particularly concerned about the relationship between its individual actions and those of other firms in the industry.
- d. Collusive agreements which lead to the tendency for all firms in an industry to charge approximately the same price for a specific product over long periods of time.
- e. Each seller firm attempts to retain or increase its market share by differentiating its product from the output of other firms.

_____ 76. Price rigidity:

- a. refers to the inability for firms to change price because of consumer reaction.
- b. is usually an indication of collusive agreements in an industry.
- c. is the tendency for all firms in an industry to charge approximately the same price for a specific product over long periods of time.
- d. is the tendency for all firms in an industry to charge approximately the same price for a specific product over a short period of time even though prices may vary widely over long periods of time.
- e. is almost never an indication of collusive agreements in an industry.

_____ 77. The kinked demand curve model assumes that an oligopolistic firm recognizes its mutual interdependence with other firms and:

- a. while it does not collude with them, each firm acting independently, has determined that it can not gain by departing from the prevailing price.
- b. while it does not collude with them, each firm acting independently, has determined that it has much to be gained by departing from the prevailing price.
- c. collusive agreements in the industry lead to the tendency for all firms in an industry to charge approximately the same price for a specific product over long periods of time.
- d. collusive agreements in the industry lead to the tendency for all firms in an industry to charge approximately the same price for a specific product over a short period of time even though prices may vary widely over long periods of time.
- e. while it does not collude with them, each firm acting independently, has determined that it can not gain by departing from the prevailing price set by the industry leader.

_____ 78. The dominant firm case of price leadership is characterized by the following:

- a. A firm which can sustain losses for a period of time
- b. A firm which can establish a monopoly price based on the market demand curve
- c. A firm which has the ability to drive smaller rival firms from the market.
- d. The threat of action by the anti-trust division of the Justice Department under the predatory price cutting rules if it was felt that the dominant firm had cut its price to an unreasonably low level in order to eliminate competition.
- e. All of the above.

Answer Section

TRUE/FALSE

1. T
2. T
3. T
4. F
5. T
6. T
7. T
8. T
9. T
10. T
11. T
12. T
13. T
14. T

15. T
16. F
17. T
18. F
19. T
20. F
21. T
22. T
23. F
24. T
25. F
26. T
27. F
28. T
29. T
30. T
31. T
32. T
33. T

- 34. T
- 35. F
- 36. T
- 37. T
- 38. T
- 39. F
- 40. Fb b
- 41. T
- 42. T
- 43. F
- 44. T
- 45. F
- 46. T
- 47. F
- 48. T
- 49. F
- 50. T
- 51. T
- 52. T

53. T

54. T

MULTIPLE CHOICE

55. typo

56. B

57. B

58. A

59. A

60. C

61. D

62. A

63. A

64. C

65. B

66. D

67. C

68. A

69. A

70. B

- 71. D
- 72. A
- 73. C
- 74. B
- 75. D
- 76. C
- 77. A
- 78. E