Economics 01 Practice Final Exam Fall 2011
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Multiple Choice : Choose the best answer given.

1. *Compared with a monopolist, a perfectly competitive industry:*

a) *Produces a smaller output*
b) *Charges a higher price*
c) *Typically earns economic profits even in the long run*
d) *None of the above*

2. *With the kinked demand curve model of oligopoly:*

a) *A small change of the marginal cost curve will not change the tacitly collusive price*

b) *If a tacitly colluding partner is going to raise its price, other firms will not follow suit*

c) *If a tacitly colluding partner is going to lower the price, other firms will also lower their prices*

d) *All of the above*

3. *If drivers decide to make phone calls without considering the costs imposed on others:*

a) *The number of phone calls made while driving will be above the*

socially optimal quantity
b) The number of phone calls made while driving will be below the socially optimal quantity
c) The marginal social cost curve will lie below the marginal private cost curve
d) The marginal social cost curve will be the same as the marginal private cost curve

4. Country A is supposed to have a comparative advantage in producing good X if:

a) The opportunity cost of producing good X is higher for country A than for other countries
b) The opportunity cost of producing good X is lower for country A than for other countries
c) Consumers in country A like good X better than other consumers in other countries
d) None of the above

5. Individuals can internalize externalities:

a) Only with government interventions
b) Among themselves privately even with costly delays in bargaining
c) Among themselves privately if transaction costs are sufficiently low
d) None of the above

6. A monopolistically competitive firm :

a) faces a downward sloping supply curve
b) makes positive economic profits in the long run
c) produces standardized products
d) None of the above

7. When demand is perfectly inelastic,

a) A one percent change in price leads to less than one percent change in quantity demanded
b) Changes in price have no effect on total revenue
c) A one percent change in price leads to less than one percent change in quantity supplied
d) The demand curve is vertical

8. The Coase theorem shows that:

a) to reduce pollution to the socially optimal level always requires government policies
b) The legal rights of different parties will stop an efficient outcome from being attained in the face of externalities
c) A policy of using tradable emission permit is as efficient as imposing an environmental standard
d) None of the above

9. In oligopolistic industries:

a) Strategic interdependence is an important feature
b) There are only a few producers
c) How competitive the industry is can be measured by the Herfindhal-Hirshmann index
d) All of the above

10. Sources of comparative advantage include:

a) Differences in climate
b) Differences in technology
c) Differences in factor endowment
d) All of the above

11. In some industries, monopolists persist because:

a) There are barriers to entry
b) There are significant economies of scale
c) The government grants exclusive right to only one firm
d) All of the above

12. When demand is unit-elastic,

a) A one percent change in price leads to less than one percent change in quantity demanded
b) Changes in price have no effect on total revenue
c) A one percent change in price leads to less than one percent change in quantity supplied
d) A rise in price decreases total revenue

13. The characteristics of a monopolistically competitive industry includes:

a) Free entry and exit in the long run
b) Firms produce differentiated products
c) There are many producers
d) All of the above

14. If we have two goods that are perfect substitutes, then

a) the indifference curves are L-shaped
b) the indifference curves are horizontal
c) at the point where total utility is maximized, the slope of the budget line is generally not the same as the slope of the indifference curve
d) there is no optimal consumption bundle since the goods are substitutes that are perfect

15. In the short run, a monopolistically competitive firm can:

a) make economic profits
b) make economic losses
c) make zero economic profits
e) all of the above

Short Answer Questions

1.a) In the 2012 Democratic Primary, President Obama and candidate Hilary Clinton can be analyzed as duopolists. They have two strategies: to cooperate with each other (smear candidate Romney but not each other) or to fight each other (smear each other). Suppose their payoff matrix is similar to one of prisoner dilemma. Illustrate the Clinton-Obama game below. Write down a hypothetical payoff matrix. Which equilibrium will the two candidates choose? Why? Is there a dominant strategy?

b).Suppose Obama and Clinton will play the game repeatedly (they can and will run for the White House repeatedly), which outcome may emerge? Why?

2.a) Draw and label a graph showing a monopolistically competitive firm making economic losses in the short run. What is the price chosen by the monopolistically competitive firm ? How big are the economic losses? Indicate in your graph.

b) Draw and label a graph showing a monopolistically competitive firm in long run equilibrium. What is the profit-maximizing price? How big are the profits? Why do monopolistically competitive firms exhibit excess capacity in the long run?

3.a) Suppose the production of a chemical good generates external costs. Draw and label a graph showing how without government intervention, the private market produces the quantity of the chemical good that is higher than the socially optimal quantity. Is the marginal social cost curve higher or lower than the private marginal cost curve? Why?

b) Indicate in a separate graph showing how an optimal Pigouvian tax to the chemical good producers can lead to the production of the chemical good to be at the socially optimal quantity. What happens to the price facing the producers and what happens to the price facing the consumers after the tax is imposed? Indicate in your graph.

4.Draw and label a graph showing the total surplus with a perfectly competitive industry. Assume that the marginal cost is constant and there are no fixed costs. In a separate graph, show the total surplus under a monopoly. Assume that the marginal cost is the same as in the perfectly competitive case. Compare the total surplus in your graph under perfect competition and the graph under a monopoly, which one has a higher amount of total surplus? Show in your graph the deadweight loss. Why do economists view monopoly unfavorably?

5) In a supply and demand diagram, draw the shift of the demand curve for hamburgers in your hometown due to the following events. In each case, show the effect on equilibrium price and quantity.

a) The price of tacos increases

b) All hamburger sellers raise the price of their french fries

c) Income falls in town. Assume that hamburgers are a normal good for most people

d) Income falls in town. Assume that hamburgers are an inferior good for most people

e) Hot dog stands cut the price of hot dogs

6. Suppose there are two plants that are emitting sulphur dioxide into the air and polluting the environment. One plant has a higher marginal benefit curve than the other. Draw and label a graph illustrating the impact of imposing a uniform environmental standard on the two plants. In a separate graph, show the effects of imposing an emission tax on the two plants. Which policy is more economically efficient and why?