Final Exam Practice Multiple Choice Questions - ANSWER KEY

Which of the following statements is not correct?

a. Monopolistic competition is similar to monopoly because in each market structure the firm can charge a price above marginal costs.
b. Monopolistic competition is similar to perfect competition because both market structures are characterized by free entry.
c. **Monopolistic competition is similar to oligopoly because both market structures are characterized by barriers to entry.**
d. Monopolistic competition is similar to perfect competition because both market structures are characterized by many sellers.

In a market that is characterized by imperfect competition,

a. firms are price takers.
b. there are always a large number of firms.
c. **there are at least a few firms that compete with one another.**
d. the actions of one firm in the market never have any impact on the other firms' profits.

One way in which monopolistic competition differs from oligopoly is that

a. there are no barriers to entry in oligopolies.
b. **in oligopoly markets there are only a few sellers.**
c. all firms in an oligopoly eventually earn zero economic profits.
d. strategic interactions between firms are rare in oligopolies.

Which of the following goods are likely to be sold in a monopolistically competitive market?

a. **sweaters**
b. cola
c. corn
d. postage stamps

Which of the following goods are not likely to be sold in monopolistically competitive markets?

a. jeans
b. books
c. **tap water**
d. clocks

A monopolistically competitive industry is characterized by

a. many firms selling products that are similar but not identical.
b. many firms selling identical products.
c. a few firms selling products that are similar but not identical.
d. a few firms selling highly different products.
For a monopolistically competitive firm, at the profit-maximizing quantity of output,

**a. price exceeds marginal cost.**
b. marginal revenue exceeds marginal cost.
c. marginal cost exceeds average revenue.
d. price equals marginal revenue.

A firm in a monopolistically competitive market is similar to a monopoly in the sense that

(i) they both face downward-sloping demand curves.
(ii) they both charge a price that exceeds marginal cost.
(iii) free entry and exit determines the long-run equilibrium.

a. (i) only
b. (ii) only
c. (i) and (ii) only
d. (i), (ii), and (iii) only

Referring to the above figure drawn for a monopolistically competitive firm. The firm’s profit-maximizing level of output is

a. 8 units.
b. **12 units.**
c. 16 units.
d. 24 units.

Refer to the above figure. In order to maximize profit, the firm will charge a price of

a. $8.
b. $12.
c. $16.
d. **$18.**
Referring to the above figure depicting a situation in a monopolistically competitive market. At the profit-maximizing level of output, what is this firm’s total cost of production?

a. $1,200
b. **$1,400**
c. $1,600
d. $1,875
Refer to the figure at the bottom of the previous page. Which of the graphs depicts a short-run equilibrium that will encourage the entry of other firms into a monopolistically competitive industry?

a. panel a  
b. panel b  
c. panel c  
d. panel d

In general, game theory is the study of

a. how people behave in strategic situations.  
b. how people behave when the possible actions of other people are irrelevant.  
c. oligopolistic markets.  
d. all types of markets, including competitive markets, monopolistic markets, and oligopolistic markets.

In studying oligopolistic markets, economists assume that

a. there is no conflict or tension between cooperation and self-interest.  
b. it is easy for a group of firms to cooperate and thereby establish and maintain a monopoly outcome.  
c. each oligopolist cares only about its own profit.  
d. strategic decisions do not play a role in such markets.

Imagine a small town in which only two residents, Rochelle and Alec, own wells that produce safe drinking water. Each week Rochelle and Alec work together to decide how many gallons of water to pump. They bring the water to town and sell it at whatever price the market will bear. To keep things simple, suppose that Rochelle and Alec can pump as much water as they want without cost so that the marginal cost of water equals zero. The weekly town demand schedule and total revenue schedule for water is shown in the table below:

<table>
<thead>
<tr>
<th>Quantity (in gallons)</th>
<th>Price</th>
<th>Total Revenue (and Total Profit)</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>$60</td>
<td>$0</td>
</tr>
<tr>
<td>100</td>
<td>55</td>
<td>5,500</td>
</tr>
<tr>
<td>200</td>
<td>50</td>
<td>10,000</td>
</tr>
<tr>
<td>300</td>
<td>45</td>
<td>13,500</td>
</tr>
<tr>
<td>400</td>
<td>40</td>
<td>16,000</td>
</tr>
<tr>
<td>500</td>
<td>35</td>
<td>17,500</td>
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<tr>
<td>600</td>
<td>30</td>
<td>18,000</td>
</tr>
<tr>
<td>700</td>
<td>25</td>
<td>17,500</td>
</tr>
<tr>
<td>800</td>
<td>20</td>
<td>16,000</td>
</tr>
<tr>
<td>900</td>
<td>15</td>
<td>13,500</td>
</tr>
<tr>
<td>1,000</td>
<td>10</td>
<td>10,000</td>
</tr>
<tr>
<td>1,100</td>
<td>5</td>
<td>5,500</td>
</tr>
<tr>
<td>1,200</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>
Refer to Table on previous page. If Rochelle and Alec operate as a profit-maximizing monopoly in the market for water, how much profit will each of them earn?

- a. $8,750
- **b. $9,000**
- c. $12,000
- d. $18,000

Refer to Table on previous page. If the market for water were perfectly competitive instead of monopolistic, how many gallons of water would be produced and sold?

- a. 0
- b. 600
- c. 900
- **d. 1,200**

Because each oligopolist cares about its own profit rather than the collective profit of all the oligopolists together,

- a. **they are unable to maintain the same degree of monopoly power enjoyed by a monopolist.**
- b. each firm's profit always ends up being zero.
- c. society is worse off as a result.
- d. Both a and c are correct.

Two cigarette manufacturers (Firm A and Firm B) are faced with lawsuits from states to recover the healthcare related expenses associated with cigarette smoking. Both cigarette firms have evidence that indicates that cigarette smoke causes lung cancer (and other related illnesses). State prosecutors do not have access to the same data used by cigarette manufacturers and thus will have difficulty recovering full costs without the help of at least one cigarette firm study. Each firm has been presented with an opportunity to lower its liability in the suit if it cooperates with attorneys representing the states.

<table>
<thead>
<tr>
<th>Concede that cigarette smoke causes lung cancer</th>
<th>Argue that there is no evidence that smoke causes cancer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Firm A profit = $-20</td>
<td>Firm A profit = $-50</td>
</tr>
<tr>
<td>Firm B profit = $-15</td>
<td>Firm B profit = $-5</td>
</tr>
<tr>
<td>Firm A profit = $-5</td>
<td>Firm A profit = $-10</td>
</tr>
<tr>
<td>Firm B profit = $-50</td>
<td>Firm B profit = $-10</td>
</tr>
</tbody>
</table>
Referring to Table on previous page. Pursuing its own best interests, Firm A will concede that cigarette smoke causes lung cancer
a. only if Firm B concedes that cigarette smoke causes lung cancer.
b. only if Firm B does not concede that cigarette smoke causes lung cancer.
c. regardless of whether Firm B concedes that cigarette smoke causes lung cancer.
d. None of the above. In pursuing its own best interests, Firm A will in no case concede that cigarette smoke causes lung cancer.

Referring to Table on previous page. Pursuing its own best interests, Firm B will concede that cigarette smoke causes lung cancer
a. only if Firm A concedes that cigarette smoke causes lung cancer.
b. only if Firm A does not concede that cigarette smoke causes lung cancer.
c. regardless of whether Firm A concedes that cigarette smoke causes lung cancer.
d. None of the above; in pursuing its own best interests, Firm B will in no case concede that cigarette smoke causes lung cancer.

In a market economy, government intervention
a. will always improve market outcomes.
b. reduces efficiency in the presence of externalities.
c. may improve market outcomes in the presence of externalities.
d. is necessary to control individual greed.

The term market failure refers to
a. a market that fails to allocate resources efficiently.
b. an unsuccessful advertising campaign which reduces demand.
c. ruthless competition among firms.
d. a firm that is forced out of business because of losses.

Since restored historic buildings convey a positive externality, local governments may choose to
a. regulate the demolition of them.
b. provide tax breaks to owners who restore them.
c. increase property taxes in historic areas.
d. Both a and b are correct.

Which of the following is an example of an externality?
a. cigarette smoke that permeates an entire restaurant
b. a flu shot that prevents a student from transmitting the virus to her roommate
c. a beautiful flower garden outside of the local post office
d. All of the above are correct.
If a sawmill creates too much noise for local residents,
   a. noise restrictions will force residents to move out of the area.
   b. a sense of social responsibility will cause owners of the mill to reduce noise levels.
   **c. the government can raise economic well-being through noise-control regulations.**
   d. the government should avoid intervening because the market will allocate resources efficiently.

Refer to Above Figure. Each unit of plastics that is produced results in an external
   a. cost of $6.
   **b. cost of $8.**
   c. benefit of $6.
   d. benefit of $8.
Refer to Above Figure. This graph shows the market for pollution when permits are issued to firms and traded in the marketplace. The equilibrium price of pollution is
a. $50  
b. $500  
c. **$1,000**  
d. $2,000

Refer to Above Figure. This graph shows the market for pollution when permits are issued to firms and traded in the marketplace. The equilibrium number of permits is
a. **50**  
b. 100  
c. 1,000  
d. 2,000

For private goods allocated in markets,

a. **prices guide the decisions of buyers and sellers and these decisions lead to an efficient allocation of resources.**  
b. prices guide the decisions of buyers and sellers and these decisions lead to an inefficient allocation of resources.  
c. the government guides the decisions of buyers and sellers and these decisions lead to an efficient allocation of resources.  
d. the government guides the decisions of buyers and sellers and these decisions lead to an inefficient allocation of resources.
The provision of public goods gives rise to
a. no externalities.
   b. positive externalities.
   c. negative externalities.
   d. rivalries in consumption.

The provision of public goods gives rise to
a. positive externalities, as does the use of common resources.
   b. positive externalities, whereas the use of common resources gives rise to negative externalities.
   c. negative externalities, whereas the use of common resources gives rise to positive externalities.
   d. negative externalities, as does the use of common resources.

Goods that are excludable include both
a. club goods and public goods.
   b. public goods and common resources.
   c. common resources and private goods.
   d. private goods and club goods.

Both private goods and club goods are
a. rival in consumption.
   b. nonrival in consumption.
   c. excludable.
   d. nonexcludable.

Goods that are rival in consumption include both
a. club goods and public goods.
   b. public goods and common resources.
   c. common resources and private goods.
   d. private goods and club goods.
If a road is congested, then use of that road by an additional person would lead to a

a. negative externality.
b. positive externality.
c. Pigovian externality.
d. free-rider problem with rush hour drivers stuck in traffic.

Which of the following is not a public good?

a. national defense
b. patented technological knowledge
c. general knowledge
d. the elimination of poverty

When a country that imported a particular good abandons a free-trade policy and adopts a no-trade policy,

a. producer surplus increases and total surplus increases in the market for that good.
b. **producer surplus increases and total surplus decreases in the market for that good.**
c. producer surplus decreases and total surplus increases in the market for that good.
d. producer surplus decreases and total surplus decreases in the market for that good.

Trade enhances the economic well-being of a nation in the sense that

a. both domestic producers and domestic consumers of a good become better off with trade, regardless of whether the nation imports or exports the good in question.
b. the gains of domestic producers of a good exceed the losses of domestic consumers of a good, regardless of whether the nation imports or exports the good in question.
c. **trade results in an increase in total surplus.**
d. trade puts downward pressure on the prices of all goods.
Refer to the figure above. From the figure it is apparent that

a. Scotland will export wool if trade is allowed.
b. Scotland will import wool if trade is allowed.
c. Scotland has nothing to gain either by importing or exporting wool.
d. the world price will fall if Scotland begins to allow its citizens to trade with other countries.

Refer to the figure above. When trade in wool is allowed, producer surplus in Scotland

a. increases by the area $B + D$.
b. **increases by the area $B + D + G$.**
c. decreases by the area $C + F$.
d. decreases by the area $G$. 