Practice 5 & 6

1) An externality is
A) a benefit realized by the purchaser of a good or service.
B) a cost paid for by the producer of a good or service.
C) a benefit or cost experienced by someone who is not a producer or consumer of a good or service.
D) anything that is external or not relevant to the production of a good or service.

2) Which of the following activities create a negative externality?
A) cleaning up the sidewalk on your block
B) graduating from college
C) repainting the house you live in to improve its appearance
D) keeping a junked car parked on your front lawn

3) Which of the following represents the true economic cost of production when firms produce goods that cause negative externalities?
A) the private cost of production
B) the social cost of production
C) the external cost of production
D) the explicit cost of production

4) What is a "social cost" of production?
A) the cost of the natural resources used up in production
B) the total costs of producing a product, both implicit and explicit costs
C) the sum of all costs to individuals in society, regardless of whether the costs are borne by those who produce the products or consume the product
D) the cost of the environmental damage created by production

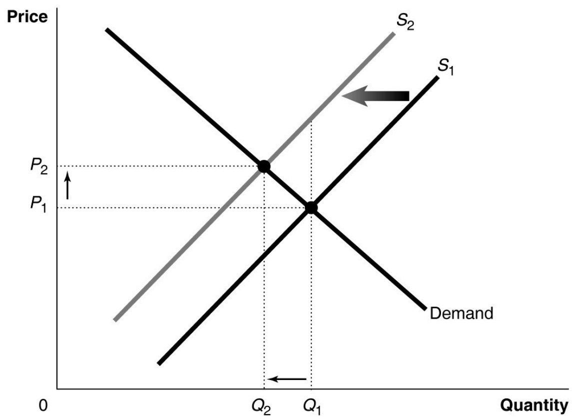


Figure 1 shows a market with an externality. The current market equilibrium output of Q_1 is not the economically efficient output. The economically efficient output is Q_2.

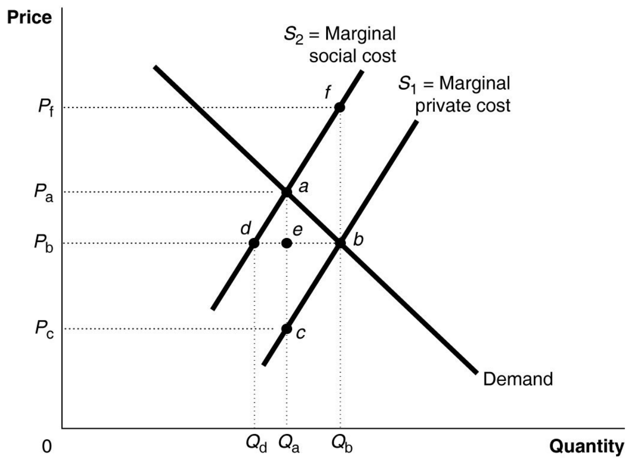
5) ***Refer to Figure 1.*** Suppose the current market equilibrium output of Q_1 is not the economically efficient output because of an externality. The economically efficient output is Q_2. In that case, the diagram shows

A) the effect of a positive externality in the production of a good.
B) the effect of a negative externality in the production of a good.
C) the effect of an external cost imposed on a producer.
D) the effect of an external benefit such as a subsidy granted to consumers of a good.

6) ***Refer to Figure 5-1***. If, because of an externality, the economically efficient output is Q_2 and not the current equilibrium output of Q_1, what does S_1 represent?
A) the market supply curve reflecting external cost
B) the market supply curve reflecting implicit cost
C) the market supply curve reflecting marginal social cost
D) the market supply curve reflecting marginal private cost

7) ***Refer to Figure 5-1***. If, because of an externality, the economically efficient output is Q_2 and not the current equilibrium output of Q_1, what does S_2 represent?
A) the market supply curve reflecting marginal private cost
B) the market supply curve reflecting marginal social cost
C) the market supply curve reflecting external cost
D) the market supply curve reflecting implicit cost

Figure 2 shows a market with a negative externality.



8) ***Refer to Figure 2.*** The efficient output level is
A) Q_d. B) Q_b.
C) Q_a. D) $Q_b - Q_d$.

9) ***Refer to Figure 2.*** The private profit-maximizing quantity for the firm is
A) Q_a. B) Q_b.
C) $Q_b - Q_d$. D) Q_d.

10) A market supply curve reflects the
A) external costs of producing a good or service.
B) external benefits of producing a good or service.

C) social costs of producing a good or service.
D) private costs of producing a good or service.

11) Suppose the value of the price elasticity of demand is -3. What does this mean?
A) A 1 percent increase in the price of the good causes quantity demanded to increase by 3 percent.
B) A 1 percent increase in the price of the good causes quantity demanded to decrease by 3 percent.
C) A 3 percent increase in the price of the good causes quantity demanded to decrease by 1 percent.
D) A $1 increase in price causes quantity demanded to fall by 3 units.

12) If demand is inelastic, the absolute value of the price elasticity of demand is
A) one. B) less than one.
C) greater than one. D) greater than the absolute value of the slope of the demand curve.

13) Perfectly inelastic demand is represented by a demand curve which is ________, and relatively inelastic demand is represented by a demand curve which is ________.
A) downward sloping; vertical
B) horizontal; downward sloping
C) vertical; downward sloping
D) upward sloping; horizontal

14) If, for a given percentage increase in price, quantity demanded falls by a proportionately smaller percentage, then demand is
A) unit elastic. B) perfectly elastic.
C) relatively inelastic. D) relatively elastic.

15) If a 35 percent increase in price of golf balls led to an 42 percent decrease in quantity demanded, then the demand for golf balls is
A) unit elastic. B) perfectly elastic.
C) relatively inelastic. D) relatively elastic.

16) If the demand for a life-saving drug was perfectly inelastic and the price doubled, the quantity demanded would
A) also double. B) decrease by 50%.
C) be cut in half. D) remain constant.

17) When there few close substitutes available for a good, demand tends to be
A) perfectly inelastic. B) perfectly elastic.
C) relatively inelastic. D) relatively elastic.

18) Rank these three items in terms of the elasticity of the demand for them at any given price, from most elastic to least elastic: hot beverages, coffee and Peet's Coffee.

A) hot beverages, coffee, Peet's Coffee B) Peet's Coffee, coffee, hot beverages
C) coffee, Peet's Coffee, hot beverages D) coffee, hot beverages, Peet's Coffee

19) Most people buy salt infrequently and in small quantities. Even a doubling of the price of salt is likely to result in a small decline in the quantity of salt demanded. Therefore,
A) the demand for salt will be perfectly inelastic.
B) salt is a normal good.
C) the demand for salt is relatively inelastic.
D) the price elasticity of demand for salt is greater than 1 (in absolute value).

20) Suppose a decrease in the supply of bottled water results in a decrease in revenue. This indicates that
A) the demand for bottled water is inelastic in the price range considered.
B) the demand for bottled water is elastic in the price range considered.
C) the supply of bottled water is inelastic in the price range considered.
D) the supply of bottled water is elastic in the price range considered.

21) Suppose the demand for milk is relatively inelastic. What happens to sales revenue if the government imposes a price floor above the free-market equilibrium price in the market for milk?
A) Sales revenue falls.
B) Sales revenue rises.
C) Sales revenue remains unchanged.
D) It cannot be determined without information on prices.

22) Which of the following statements is true?
A) Whenever a firm raises its price its total revenue will increase.
B) When a firm lowers its price its total revenue may either increase or decrease.
C) Whenever a firm increases its quantity sold its revenue will increase.
D) Total revenue will equal zero when the demand for a product is unit elastic.

23) If a firm raised its price and discovered that its total revenue fell, then the demand for its product is
A) perfectly inelastic. B) relatively inelastic.
C) perfectly elastic. D) relatively elastic.

24) Which of the following statements is true?
A) If the price of a good is lowered and total revenue decreases, demand is elastic.
B) If the price of a good is raised and total revenue does not change, demand is perfectly elastic.
C) If the price of a good is raised and total revenue increases, demand is inelastic.
D) If the price of a good is lowered and total revenue increases, demand is inelastic