1. The demand for a Ford Focus (a brand of compact car) is likely to be _____ elastic than the demand for a compact automobile because ________.
   A. Less, there are good substitutes for a Focus.
   B. Less, an auto accounts for a small part of a consumer’s budget.
   C. More, there are many different compact cars on the market.
   D. More, many drivers are loyal to the Ford brand.

2. An economically rational individual is the sole supplier of a special type of varnish that is used for finishing fine furniture. Which of the following would the supplier never do?
   A. Lower the price of the varnish.
   B. Sell varnish to different customers at different prices.
   C. Choose a price for the varnish that implied that demand was elastic.
   D. Choose a price for the varnish that implied that demand was inelastic.

3. An allocation of goods and services is not efficient if
   A. Trades are possible that make both parties better off.
   B. Consumer surplus is below its maximum possible level.
   C. The distribution of goods is highly unequal.
   D. The demand for an important consumer product is highly inelastic.

4. Which of the following is an example of a strategy that efficiently reallocates airline seats when a flight is overbooked?
   A. Deciding by roll of the dice who will forego their seats.
   B. Offering ticket vouchers to individuals who volunteer to give up their seats.
   C. Granting seats in the order that ticket holders arrive at the gate.
   D. Denying seats to those who paid the least amount for their tickets.

5. In Asheville, there are two sources of electric power. A hydroelectric plant produces power at a cost of $0.04 per KWH. A coal fired generator produces power at a cost of $0.07 per KWH. Which of the following describes an efficient policy for pricing electricity? The electricity price paid by Ashville customers should...
   A. Equal the average of the costs at the two production facilities.
   B. Equal the marginal cost of electricity at the plant that supplies them.
   C. Equal the lower price provided the hydroelectric plant can meet total customer demand.
   D. Equal the higher coal-fired plant price for all levels of customer demand.

6. Suppose that the price of a can of chicken soup is greater than the marginal cost of the can of soup. Which of the following must be true given that the soup industry is not perfectly competitive?
   A. The producer of the soup will raise her profits by increasing production.
   B. The producer of the soup will lower her profits by increasing production.
   C. Welfare improving trades between consumers and the soup producer are possible.
   D. Welfare improving trades between consumers and the soup producer are not possible.
7. Harris Teeter can buy orange juice from three growers. The following table shows the cost and capacity of each source including the cost to Harris Teeter of storing and selling the juice.

<table>
<thead>
<tr>
<th>Source</th>
<th>Capacity (thousands of gallons per day)</th>
<th>Cost per gallon</th>
</tr>
</thead>
<tbody>
<tr>
<td>Florida Farms</td>
<td>2</td>
<td>$2.50</td>
</tr>
<tr>
<td>Citrus Grove</td>
<td>3</td>
<td>$2.75</td>
</tr>
<tr>
<td>Sunny Days</td>
<td>2</td>
<td>$3.00</td>
</tr>
</tbody>
</table>

Each day, Harris Teeter sells 4 thousand gallons of juice at a price of 3.00. The allocation of orange juice that results is economically __________ because __________.
A. Inefficient, quantity supplied does not equal the quantity demanded.
B. Inefficient, because price is greater than marginal cost.
C. Efficient, quantity supplied equals the quantity demanded.
D. Efficient, price equals marginal cost.

8. Suppose there are no third party effects associated with production or consumption of good A. Which of the following reasons explains why levying a tax on good A creates an inefficient allocation of goods?
A. A tax levied on a good leads to under-consumption by consumers.
B. A tax levied on a good leads to over-consumption by consumers.
C. The tax causes the market price of the good to equal the marginal cost of the good.
D. The tax increases producer surplus.

9. John runs a business washing cars. Every week he spends $100 on supplies for his business and earns $400 washing cars. John’s economic profit is __________
A. $300 provided he has no other explicit costs to bear.
B. $300 which is the difference between his revenue and the cost of his supplies.
C. Unknown, because we do not know how many hours he spends washing cars.
D. Unknown, because we do not know what John could earn if he did not wash cars.

10. ABC Corp makes computer products. In 2006, it introduces a computer monitor that is a big improvement on the previous technology. The public likes the monitor and ABC Corp earns large economic profits in 2006. Which of the following statements correctly explains what is likely to happen to ABC’s profits in the coming years? Profits are likely to __________
A. Increase because demand for the monitor will be very price inelastic.
B. Decrease provided new firms can use the ABC technology and supply similar monitors.
C. Decrease because ABC will have to pay large legal fees to obtain a patent on the monitor.
D. Increase provided other firms develop similar monitors making the new technology more popular.

11. Mario leases five acres of vineyard from Fredo in Tuscany. With the grapes he grows on Fredo’s land, Mario makes wine. When Mario first started making his wine it was little known, sold for $20 per bottle and Mario made just enough profit to keep him in the business. Then, wine critic Robert Parker began recommending Mario’s wine and its price rose to $60 per bottle. As time passes, who will benefit from this good fortune?
A. Mario because entrepreneurs take the risks and earn the profits.
B. Fredo if the grapes grown in the vineyard are better than grapes grown elsewhere.
C. Fredo because land owners take the risks and earn the profits.
D. Mario if the grapes grown in the vineyard are better than grapes grown elsewhere.
12. Bill and Jill run a catering business out of their home. Each week they spend $500 on food, $100 on advertising and $50 to rent a truck. They earn $1200 a week in revenue. Suppose Bill and Jill use $5000 from their saving account to buy a catering truck. What is the effect of this decision on their economic profit? The decision to buy a catering truck ________
   A. Increases economic profit because it eliminates the weekly truck rental payment.
   B. Decreases economic profit because the implicit costs of the catering business have risen.
   C. Increases economic profit if Bill and Jill were earning less than $50 per week in interest on their $5000 saving balance.
   D. Decreases economic profit because Bill and Jill will no longer earn interest on their saving account.

13. By definition, a firm that manufactures squirt guns does not have market power if ________
   A. There are many different brands of squirt guns in the market.
   B. The firm perceives that it faces a downward-sloping demand schedule for squirt guns.
   C. The firm uses highly specialized inputs to make its squirt guns.
   D. The firm believes that raising the price of its squirt guns will result in the loss of all its sales.

14. The Moose Company is the only producer of hair gel in the United States. Moose sells hair gel for $3.00. A recent study revealed that the cost to Moose of one more bottle of gel is $3.00. How should Moose respond to the study? Moose should ______________
   A. Leave production unchanged because marginal revenue equals marginal cost.
   B. Decrease production because marginal revenue is greater than marginal cost.
   C. Increase production because marginal revenue is less than marginal cost.
   D. Decrease production because marginal revenue is less than marginal cost.

15. If a firm has market power, then its marginal revenue ______
   A. Is less than its price.
   B. Is negative at quantities where demand is elastic.
   C. Is zero at the quantity the firm chooses to produce.
   D. Remains constant as long as price remains above marginal cost.

16. Economists believe that depletion of cod fish in the Atlantic Ocean is a market failure which resulted from ________
   A. Poor management of fishing fleets.
   B. The free rider problem.
   C. The third party costs of pollution
   D. Failure to assign ownership rights.
17. Carla supplements her income as a teaching assistant by editing term papers for undergraduates. There are eight students (A-H) for whom she might edit, each with a reservation price given in the following table. None of the students has an alternative to Carla.

<table>
<thead>
<tr>
<th>Student</th>
<th>Reservation Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>$40</td>
</tr>
<tr>
<td>B</td>
<td>$38</td>
</tr>
<tr>
<td>C</td>
<td>$36</td>
</tr>
<tr>
<td>D</td>
<td>$34</td>
</tr>
<tr>
<td>E</td>
<td>$30</td>
</tr>
<tr>
<td>F</td>
<td>$28</td>
</tr>
<tr>
<td>G</td>
<td>$26</td>
</tr>
<tr>
<td>H</td>
<td>$24</td>
</tr>
</tbody>
</table>

Carla’s marginal revenue associated with editing a fifth paper is:
A. $14  
B. $18  
C. $28  
D. $32

18. Jamaica produces coffee and computers with production possibilities shown in the following diagram. Suppose that Jamaica is open to international trade and has chosen to produce at point C in the diagram. Because the world price of a computer is $500 and the world price of coffee is $10.00, Jamaica could obtain any point along the line EF. You have been asked to recommend a strategy that will provide maximum economic benefits to Jamaica. What advice do you give?

a. Keep producing at C and trade coffee for computers.  
b. Keep producing at C and trade computers for coffee.  
c. Increase production of computers to the point where the opportunity cost of computers is the same in production as it is in world prices.  
d. Increase production of coffee to point A to take advantage of Jamaica’s comparative advantage in coffee production.
Use the following table to answer the next two questions. Suppose a power plant is located on the banks of a river. The plant must decide how much hot water to discharge into the stream. If the power plant discharges a large amount of hot water, it is more valuable because it can cool its equipment at low private cost but the fishery is less valuable because the fish grow poorly. If it discharges a small amount of hot water, it is less valuable and the fishery is more valuable. The table gives the values of the power plant and the fishery as a function of the plant’s discharge decision.

<table>
<thead>
<tr>
<th>Hot Water Discharge Decision</th>
<th>Value of the Power Plant</th>
<th>Value of the Fishery</th>
</tr>
</thead>
<tbody>
<tr>
<td>High Discharge</td>
<td>$1,000,000.00</td>
<td>$10,000.00</td>
</tr>
<tr>
<td>Low Discharge</td>
<td>$990,000.00</td>
<td>$30,000.00</td>
</tr>
</tbody>
</table>

19. The socially optimal decision is a _______ discharge rate because ________.
   A. High, Much more value is created by the power plant than by the Fishery.
   B. High, It is very expensive for the plant to cool its equipment by other means.
   C. Low, low discharge triples the value of the fishery.
   D. Low, the social value of the power plant and fishery are higher when discharge is low.

20. Suppose there is no law against the plant discharging hot water into the stream. Provided that bargaining is not very expensive and outcomes are easily verified by all, what will happen when bargaining occurs?
   A. The fishery will pay somewhere between $10,000 and $20,000 to induce the power plant to choose a low discharge rate.
   B. The plant will pay the fishery something more than $10,000 to allow it to choose a high discharge rate.
   C. The power plant will decide that too much is at stake to bargain with the fishery.
   D. A tax on hot water discharge will be necessary to obtain the socially optimal outcome.

21. Externalities exist for goods that ________
   A. People tend to consume when they are together in a group.
   B. Have prices that are greater than the marginal social cost of the good.
   C. Represent a large use of social resources.
   D. Create costs that are experienced by people other than the buyers and sellers.

22. Which of the following is an example of a positive externality?
   A. Your neighbors enjoy listening to your garage band.
   B. Soot from a nearby power plant leads you to buy more window cleaner.
   C. The person next to you takes a cell phone call during a concert.
   D. Your family decides to eat more vegetarian meals.

23. Which of the following is the best example of economic rent?
   a. Profits earned by the owners of Manhattan apartment buildings.
   b. High wages earned by programmers who understand the latest programming software.
   c. Profits earned by an oil company by extracting oil from shale deposits.
   d. Higher than normal wages earned by a playwright on his copyrighted plays.
24. Ironworks is a company in Toledo Ohio that is currently producing 700 tons of sulfur dioxide (SO2) per year. The following table gives the marginal cost to Ironworks of reducing emission of SO2 by one ton. The table shows that the firm’s marginal cost increases as it undertakes more pollution reduction. The table also gives the Environmental Protection Agency’s estimates of the marginal social benefit of reducing SO2 emissions by Ironworks. The table shows that the marginal benefits decrease as more pollution reduction is achieved.

<table>
<thead>
<tr>
<th>SO2 Reduction In Tons</th>
<th>Marginal Cost per Ton of SO2 Reduction</th>
<th>Social Marginal Benefit per Ton of SO2 Reduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>0-100</td>
<td>$50</td>
<td>$250</td>
</tr>
<tr>
<td>100-200</td>
<td>$100</td>
<td>$200</td>
</tr>
<tr>
<td>200-300</td>
<td>$150</td>
<td>$150</td>
</tr>
<tr>
<td>300-400</td>
<td>$200</td>
<td>$100</td>
</tr>
<tr>
<td>400-500</td>
<td>$250</td>
<td>$50</td>
</tr>
</tbody>
</table>

The socially optimal level of SO2 reduction per year is ________ tons. To achieve the social optimum, government should pay Ironworks _______ for each ton of SO2 that it does not emit.
A.  200, $100  
B.  300, $150  
C.  400, $150  
D.  500, $100

25. If the exchange rate moves from 10 Mexican pesos per U.S. dollar to 8 Mexican pesos per U.S. dollar, then the Mexican peso has ______ and the U.S. dollar has _____.
A. Appreciated, appreciated.  
B. Appreciated, depreciated.  
C. Depreciated, appreciated.  
D. Depreciated, depreciated.

26. Holding all else constant, an increase in the preferences of US residents for Mexican goods will ______ the supply of dollars in the foreign exchange market and ______ the equilibrium Mexican peso per U.S. dollar exchange rate.
A. Increase; increase.  
B. Increase; decrease.  
C. Decrease; decrease.  
D. Decrease; increase.