

ECO 2201
Test 2
Spring 2002
Dr. Olsh

Name _____

ANSWER SHEET

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I. Multiple Choice

1. The rate of return that owners of capital must receive in order to induce them to continue supplying the capital is often referred to as
 - a. accounting profit.
 - b. the normal or market rate of return.
 - c. economic profit.
 - d. the accounting rate of return.

2. The long-run average total cost curve
 - a. is an envelope-shaped curve mapped out by the short-run average total cost curves for alternative plant sizes.
 - b. intersects the minimum point of each short-run average total cost curve.
 - c. rises throughout its entire range when increasing returns are present.
 - d. falls throughout its entire range due to the law of diminishing returns.

3. Which of the following is an example of a "sunk cost"?
 - a. the original purchase price of a house when deciding whether to repair fire damage or demolish the structure
 - b. the price of tickets that must be bought when deciding whether or not to go to a concert
 - c. the price you paid for a backyard swimming pool when deciding whether to fill in the pool and plant a garden
 - d. both a and c

4. Within the framework of the price-taker model, a price taker will always produce a quantity of output that
 - a. minimizes the per-unit cost of production.
 - b. is expected to provide the largest possible total revenue.
 - c. maximizes the difference between total revenue and total cost.
 - d. brings average total cost and price into equality.

5. In general, firms will produce at a rate of output such that marginal revenue equals marginal cost because this output rate will
- bring total revenue into equality with total cost.
 - maximize the **difference** between the revenue received from the last unit and the cost incurred in producing the last unit.
 - result in the lowest possible average total costs of production.
 - maximize the firm's profit.
6. When a competitive price-taker market is in long-run equilibrium,
- the firms in the market will earn zero economic profit.
 - the average total cost of the firms in the market will be minimized.
 - every unit of the relevant good that is valued more than its opportunity costs will be produced and sold.
 - all of the above are true.
7. If a price-searcher firm can sell nine units at a price of \$20, or it can sell ten units at a price of \$17, what is the marginal revenue of the tenth unit?
- minus \$10
 - \$10
 - \$17
 - \$20
8. Which of the following is true when long-run equilibrium conditions are present in price-taker and competitive price-searcher markets?
- $MR = ATC$ in both price-taker and competitive price-searcher markets.
 - $P = ATC$ in price-taker markets; $P = MC$ in competitive price-searcher markets.
 - $P = MC$ in both price-taker and competitive price-searcher markets.
 - $P = ATC$ in both price-taker and competitive price-searcher markets.
9. "A profit-maximizing firm with a secure monopoly in its market and no fear of regulation or new entrants will always charge a price on the inelastic portion of its demand curve." Economic theory suggests that this statement is
- correct.
 - incorrect because a monopolist could always gain by raising its price if it was operating on the inelastic portion of its demand curve.
 - incorrect, except when the demand for the firm's product is declining.
 - incorrect, except when the demand for the firm's product is increasing.

10. Which of the following conditions is true in long-run equilibrium for both a competitive price searcher and a competitive price taker, but not necessarily for a monopolist?
- a. $P = MC$
 - b. $P = ATC$
 - c. $MR = P$
 - d. $MR < P$
11. A profit-maximizing farmer will apply additional units of fertilizer until the marginal revenue product (MRP) of fertilizer is half the MRP of skilled labor when a unit of fertilizer
- a. costs twice as much as a unit of skilled labor.
 - b. costs half as much as a unit of skilled labor.
 - c. is half as productive, on average, as a unit of skilled labor.
 - d. is twice as productive, on average, as a unit of skilled labor.
12. The marginal revenue product of a resource equals the marginal product of the resource multiplied by the price of the product in a (an)
- a. monopolistic market.
 - b. oligopolistic market.
 - c. price-taker market.
 - d. price-searcher market.
13. Wages in the United States are higher than those in Italy primarily because
- a. a larger proportion of the labor force is unionized in the United States.
 - b. output per worker is higher in the United States.
 - c. the human and physical capital of American workers is lower than that of their Italian counterparts.
 - d. all of the above are correct.
14. Real income cannot continually increase unless the
- a. supply of money increases rapidly so that firms can pay the higher wages.
 - b. production of economic goods and services increases.
 - c. interest rate is kept high, so people will want to save.
 - d. interest rate is kept low, so firms will want to invest.

15. A cost-saving invention can even generate an increase in employment in the industry affected by the invention if the
- a. demand for the product is highly elastic.
 - b. demand for the product is highly inelastic.
 - c. supply of workers is inelastic.
 - d. supply of the product is inelastic.
16. If we make additional investments in machines that enhance our ability to produce goods and services,
- a. the owners of the investments must borrow funds.
 - b. the owners of the investments must reduce their current consumption.
 - c. someone will have to reduce current consumption.
 - d. future consumption will have to be reduced.
17. Which of the following statements is correct?
- a. Interest would not exist in a nonmonetary economy.
 - b. An increase in the demand for goods now compared with goods in the future would cause the interest rate to rise.
 - c. A "positive rate of time preference" means that an individual would rather save than consume.
 - d. During an extended inflationary period, the money (or nominal) interest rate will usually be lower than the real rate of interest.
18. If the long-term interest rate (on investments of similar risk) was 8 percent, how much would you be willing to pay for an asset that you expected to earn \$10,000 each year in the future?
- a. \$8,000
 - b. \$80,000
 - c. \$125,000
 - d. \$400,000
19. Which of the following would add to this year's GDP?
- a. the \$500 you won playing poker with your friends
 - b. your purchase of 100 shares of IBM stock
 - c. the payments you make for the rental of a five-year-old house
 - d. your purchase of a five-year-old car

20. An American-owned McDonald's opens in Russia. How would the net revenue earned by this restaurant affect the GDP and GNP of the United States?
- It would increase GNP and GDP.
 - It would increase GNP and leave GDP unchanged.
 - It would increase GDP and leave GNP unchanged.
 - It would leave both GDP and GNP unchanged.

II. Critical Analysis

- I am producing and selling 1000 widgets per week. In a price taker market I receive \$1.00 per widget. The sum of my average fixed cost and average variable cost equals \$1.00. My economic profit is zero. Using an appropriate, well-labelled diagram, reveal my current situation and advise me on a course of action. Note, my goal is to maximize profit.

4. **True or false and WH Y?**

Barriers to entry are, without question, bad. They produce monopoly-like conditions and, thereby, prevent the benefits of competition. [Hint: good answers will consider both a static **and** a dynamic assessment].

Please sign the following: I have neither given, nor received unauthorized aid on this piece of work, nor have I knowingly tolerated any violation of the Honor Code.
