

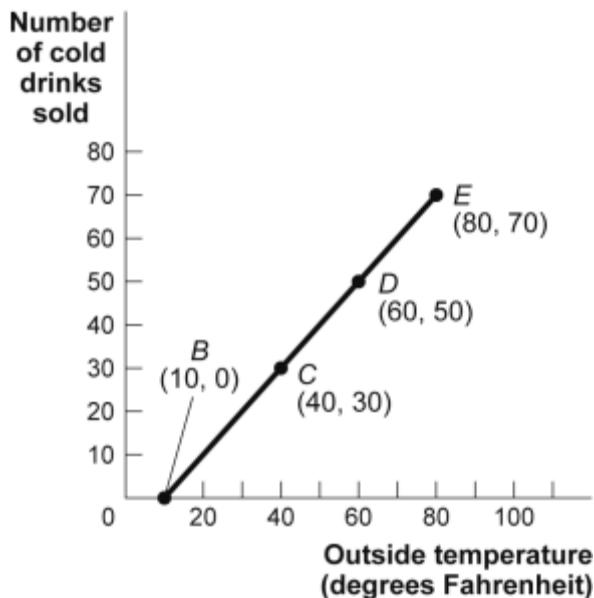
Name: \_\_\_\_\_ Date: \_\_\_\_\_

Version B with answers

1. How people choose among the alternatives available to them is:
  - A) not important.
  - B) the study of microeconomics.
  - C) not part of the study of economics.
  - D) impossible to describe.
  
2. Economic signals:
  - A) never provide adequate information to consumers.
  - B) guide decision makers in their transactions in the marketplace.
  - C) result in shortages and surpluses.
  - D) interfere with the trades that can be mutually beneficial.
  
3. An increase in demand, with no change in supply, will lead to \_\_\_\_\_ in equilibrium quantity and \_\_\_\_\_ in equilibrium price.
  - A) an increase; a decrease
  - B) a decrease; an increase
  - C) a decrease; a decrease
  - D) an increase; an increase
  
4. If the price of gasoline falls and stays low for an extended period of time, we expect people to:
  - A) use more public transportation.
  - B) ride bicycles.
  - C) buy larger and less fuel-efficient cars.
  - D) reduce their reliance on gasoline-powered cars.

Use the following to answer question 5:

**Figure: Cold Drinks Sold and Temperature**



5. (Figure: Cold Drinks Sold and Temperature) If we move from point C to point E in the figure, the outside temperature has \_\_\_\_\_ and the number of cold drinks sold has \_\_\_\_\_.
- A) increased by 30 degrees; increased by 30 units
  - B) decreased by 30 degrees; decreased by 30 units
  - C) increased by 40 degrees; increased by 40 units
  - D) increased by 20 degrees; increased by 20 units
6. In 2003, Congress passed a tax cut. Since taxes were reduced, the country did not incur any opportunity cost from this decision.
- A) True
  - B) False
7. Khalil is offered a free ticket to the opera. His opportunity cost of going to the opera is:
- A) the price listed on the ticket.
  - B) whatever Khalil would have done had he not gone to the opera.
  - C) the price listed on the ticket or whatever Khalil would have done had he not gone to the opera.
  - D) zero—the tickets were free.

An irrelevant issue, that some thought relevant, was whether Khalil had time to sell the ticket. The answer is C whether he had time to sell it or not. If he did not go to the Opera, selling the

ticket might have been one of the things he had **done**. Note that if he sold it, it would not necessarily have been for the sticker price.

8. A market equilibrium will always be efficient even if it is not equitable.
  - A) True
  - B) False
9. One of the controversies surrounding America's energy markets is the trade-off between energy production and clean air. Assuming clean air has value, the United States will be on its production possibility frontier if and only if:
  - A) resources used to create clean air and energy are being fully utilized.
  - B) the price of energy is relatively low.
  - C) resources used to create clean air and energy are not being fully utilized.
  - D) pollution is eliminated.
10. The demand curve for season tickets for the Miami Dolphins is the graphical representation of how many tickets consumers want to buy at any given price.
  - A) True
  - B) False

Use the following to answer question 11:

**Table: Willingness to Pay for Peanuts**

<b>Consumer</b>	<b>Willingness to Pay in Dollars</b>
Alvin	\$5
Theodore	3
Simon	6
Dave	2
George	10

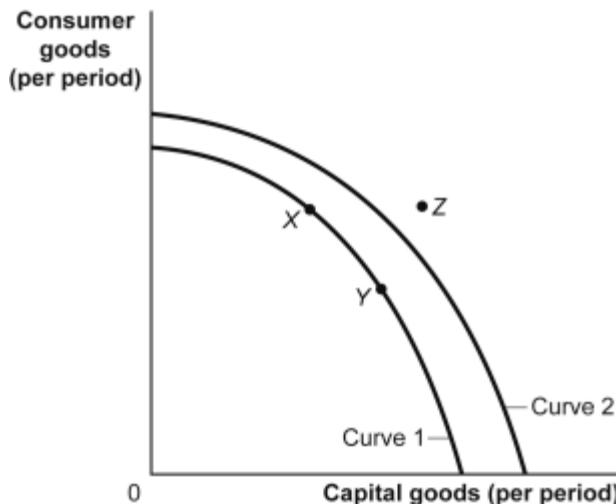
11. (Table: Willingness to Pay for Peanuts) If the price of a bag of peanuts is \$9, who will purchase a bag?
  - A) Dave
  - B) George
  - C) Alvin and Theodore
  - D) All of the consumers

12. A typical, bowed-out production possibility frontier between two goods—guns and butter—shows that the opportunity cost of butter in terms of guns increases as more butter is produced. This implies that the opportunity cost of guns in terms of butter decreases as more guns are produced.

- A) True
- B) False

Use the following to answer question 13:

**Figure: Consumer and Capital Goods**



13. (Figure: Consumer and Capital Goods) Technological improvements will likely:

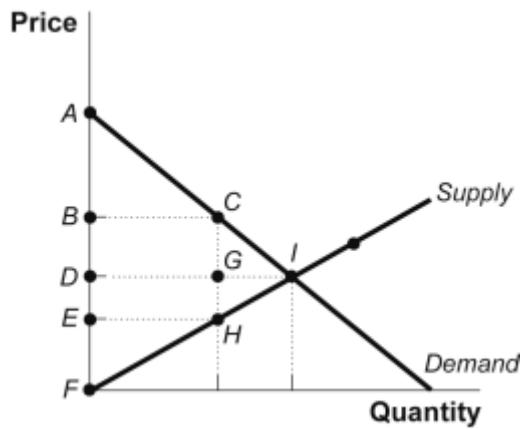
- A) lead to increased unemployment.
- B) shift the production possibility frontier inward to Curve 1.
- C) leave the production possibility frontier unchanged.
- D) shift the production possibility frontier outward to Curve 2.

14. If the government imposes a binding price ceiling in the market for grapefruit, total surplus:

- A) may change, but we cannot determine the change without more information.
- B) will not change.
- C) will increase.
- D) will decrease.

Use the following to answer question 15:

**Figure: Market in Equilibrium**



15. (Figure: Market in Equilibrium) At the equilibrium price, this market's consumer surplus is equal to the area:
- A) *DIF*.
  - B) *EHF*.
  - C) *ADI*.
  - D) *ABC*.

Use the following to answer question 16:

**Table: Workouts**

Number of Workouts (per week)	Willingness to Pay for Workouts
1	\$35
2	30
3	25
4	20
5	15
6	10
7	5

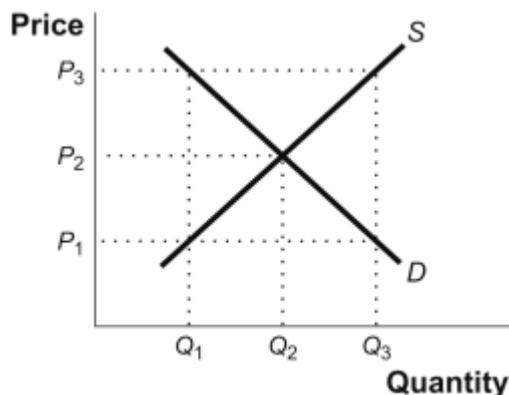
16. (Table: Workouts) Several times each week Eli works out at a local health club, but because he is not a member, he pays a price of \$10 each time he shows up to use the club facilities. The table shows Eli's willingness to pay for each use of the club. How many times will Eli use the health club for a workout, and how much consumer surplus does he receive?
- a. five times and a receive a consumer's surplus of \$75
  - b. six times and receive a consumer's surplus of \$70
  - c. six times and receive a consumer's surplus of \$75
  - d. five times and receive a consumer's surplus of \$70
17. A situation in which purchases do not occur because the value the potential seller places on the good exceeds the value a potential consumer places on the good will occur in:
- A) a centralized market system.
  - B) a market dominated by government regulation.
  - C) well-functioning markets.
  - D) a market made up of many buyers and sellers.
18. In one day, Kessy can bake 10 cookies or mix 15 glasses of lemonade. His friend, Ava, can make 10 cookies or 10 glasses of lemonade. His other friend, Ian, can make 10 cookies or 20 glasses of lemonade. Who has the lowest opportunity cost in cookie production?
- A) Ian
  - B) Kessy
  - C) Kessy and Ava have the same opportunity cost in cookie production.
  - D) Ava
19. An ambiguous change in price and a decrease in quantity are most likely caused by:
- A) a shift to the left in supply and a shift to the right in demand.
  - B) no shift in supply and a shift to the left in demand.
  - C) a shift to the left in supply and a shift to the left in demand.
  - D) a shift to the right in supply and a shift to the left in demand.

20. When the San Francisco city manager faces a complaint that the city council chamber podium is not accessible to individuals with disabilities, he responds that the one million dollar improvement will not happen because “that money could be spent building 70 curb ramps.” This statement best represents the economic concept of:
- A) when markets don't achieve efficiency, government intervention can improve society's welfare.
  - B) resources are scarce.
  - C) the real cost of something is what you must give up to get it.
  - D) “how much?” is a decision at the margin.
21. The U.S. production possibility frontier will \_\_\_\_\_ if all computers using Microsoft operating systems contracted a virus that deleted all information on those computers.
- A) not change
  - B) shift in
  - C) Cannot be determined from the information provided.
  - D) shift out
22. The market for gasoline is in equilibrium. You have heard that the price of crude oil is falling because of new oil discoveries. You are also aware that the number of car and truck drivers is steadily rising. Knowing this, you predict that the price of gasoline will \_\_\_\_\_ and the quantity of gasoline bought and sold will \_\_\_\_\_.
- A) rise if the demand decrease is larger than the supply decrease; fall
  - B) rise; rise
  - C) rise; rise if the demand increase is larger than the supply increase
  - D) fall if the supply increase is larger than the demand increase; rise
23. If consumer tastes for electric cars increase over the next 10 years, everything else remaining constant, we would see an increase in the demand for electric cars, higher electric car prices, and an increase in the equilibrium quantity of electric cars.
- A) True
  - B) False
24. Consider the market for iPods. What happens if a fantastic new alternative MP3 player is developed and, at the same time, a boat carrying a large shipment of iPods is attacked by sea monsters and sunk?
- A) Price increases and the change in quantity is indeterminate.
  - B) The change in price is indeterminate and quantity decreases.
  - C) Price decreases and quantity increases.
  - D) Price increases and quantity increases.

25. *Market failure* refers to a situation in which:
- A) markets fail to reach an efficient outcome.
  - B) market-determined wages are not high enough to raise all workers above the poverty line.
  - C) markets fail to reach a fair outcome.
  - D) markets establish a high price for necessities.

Use the following to answer question 26:

**Figure: Supply, Demand, and Equilibrium**



26. (Figure: Supply, Demand, and Equilibrium) In the figure, there will be an excess demand of the good at a price of  $P_3$ .

- A) True
- B) False

27. Market failure occurs when the pursuit of self-interest leads to bad results.

- A) True
- B) False

The question can be re-phrased as if A then B, where A= self interest leads to bad results, and B= market failure. The pursuit of self interest could result in a bad but that bad might or might not be inefficiency, it could be bad only in a unfair sense of the word. So, strictly speaking, the answer is False. That said, if “bad” is defined as inefficient, the answer is True. We accepted both answers.

28. If demand decreases and supply increases, the direction of change in the equilibrium quantity is unpredictable without first knowing the relative magnitudes of the demand and supply changes.

- A) True
- B) False

29. If the United States is more productive than Mexico in all lines of production, then the United States cannot benefit from trade with Mexico.
- A) True  
B) False
30. Suppose the state of Oklahoma decides to produce only two goods—oil and football helmets. As oil production increases, the production of football helmets will:
- A) decrease.  
B) increase.  
C) not sure.  
D) decrease at a decreasing rate.
31. A consumer's willingness to pay for a surfboard is the minimum price at which he or she would buy the surfboard.
- A) True  
B) False
32. Margo spends \$10,000 on one year's college tuition. The opportunity cost of spending one year in college for Margo is:
- A) whatever she would have earned had she not been in college.  
B) whatever she would have purchased with the \$10,000 and whatever she would have earned had she not been in college.  
C) whatever she would have purchased with the \$10,000 instead.  
D) \$10,000.
33. Because Casey can type reports faster and more accurately than Ahmet, Casey has a(n) \_\_\_\_\_ in typing reports.
- A) opportunity cost  
B) comparative advantage  
C) specialization  
D) absolute advantage
34. If every individual was required to be self-sufficient:
- A) living standards for some individuals would fall but, for others, they would rise.  
B) it's impossible to say how living standards would change.  
C) living standards would fall.  
D) living standards would rise.

35. Whenever a choice is made:
- A) the cost is easy to measure in dollar terms.
  - B) efficiency is improved.
  - C) scarcity is not the problem.
  - D) the cost of that choice could be referred to as opportunity cost.

Use the following to answer question 36:

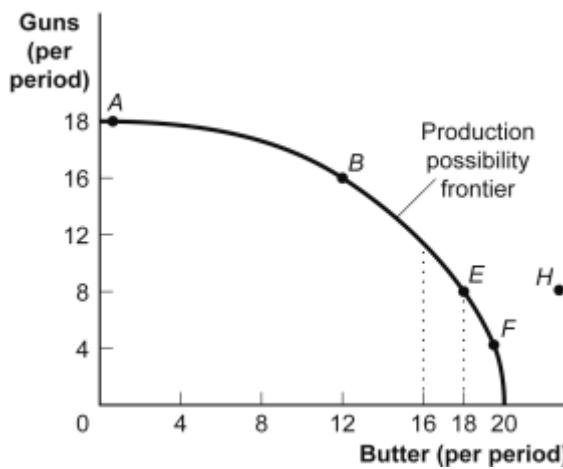
**Table: The Lemonade Market**

Price of Lemonade (per cup)	Number of Cups Demanded (Qd)	Number of Cups Supplied (Qs)
\$ .50	250	25
\$ .75	200	50
\$1.00	150	75
\$1.25	100	100
\$1.50	50	125
\$1.75	20	150

36. (Table: The Lemonade Market) If the price of a cup of lemonade is \$1.00, what will exist in the market?
- A) a shortage of 75 cups
  - B) equilibrium
  - C) a surplus of 75 cups
  - D) a shortage of 150 cups

Use the following to answer question 37:

**Figure: Guns and Butter**

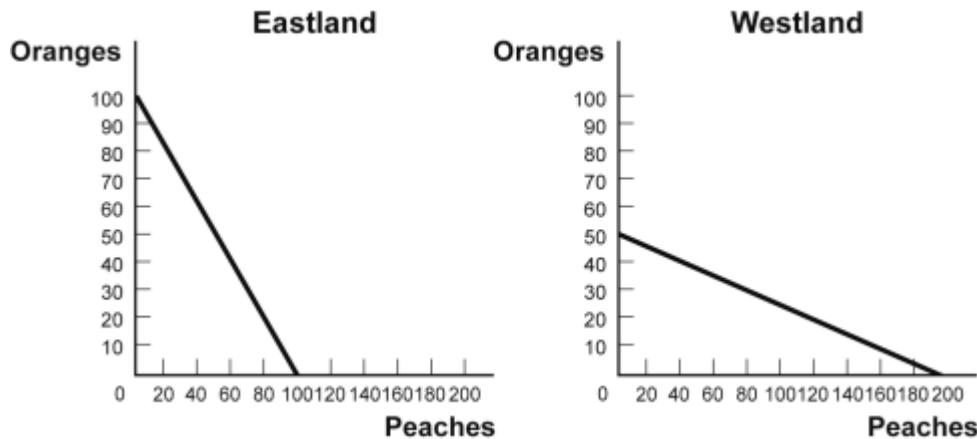


37. (Figure: Guns and Butter) If the economy were operating at point *B*, producing 16 units of guns and 12 units of butter per period, a decision to move to point *E* and produce 18 units of butter:
- A) makes it clear that this economy experiences decreasing opportunity costs.
  - B) involves a loss of 8 units of guns per period.
  - C) involves a loss of 4 units of guns per period.
  - D) indicates you can have more butter and guns simultaneously.
38. Economists say an economy is efficient when:
- A) output is distributed equitably.
  - B) all opportunities to make some people better off without making other people worse off have been taken.
  - C) all opportunities to make some people worse off without making other people better off have been taken.
  - D) the problem of scarcity is eliminated.

Use the following to answer question 39:

**Figure: Comparative Advantage**

Eastland and Westland produce only two goods, peaches and oranges, and this figure shows each nation's production possibility frontier for the two goods.



39. (Figure: Comparative Advantage) Eastland has a comparative advantage in producing:
- A) both oranges and peaches.
  - B) oranges only.
  - C) neither oranges nor peaches.
  - D) peaches only.

40. A market is composed of three individuals, Nicholas, Benjamin, and Alexander. Their individual demand schedules are given below and are as follows:

Nicholas		Benjamin		Alexander	
Price	Quantity Demanded	Price	Quantity Demanded	Price	Quantity Demanded
1	10	1	15	1	12
2	9	2	11	2	10
3	8	3	9	3	8

Based on this information, which of the following market demand schedules accurately portrays this market?

A)

Price	Quantity Demanded
1	25
2	30
3	10

B)

Price	Quantity Demanded
1	27
2	35
3	30

C)

Price	Quantity Demanded
1	20
2	15
3	25

D)

Price	Quantity Demanded
1	37
2	30
3	25

## **Answer Key**

1. B
  2. B
  3. D
  4. C
  5. C
  6. B
  7. B
  8. B
  9. A
  10. A
  11. B
  12. B
  13. D
  14. D
  15. C
  16. A or C
  17. C
  18. D
  19. C
  20. C
  21. B
  22. D
  23. A
  24. B
  25. A
  26. B
  27. A or B
  28. A
  29. B
  30. C
  31. B
  32. B
  33. D
  34. C
  35. D
  36. A
  37. B
  38. B
  39. B
  40. D
41. Times are tight and the supply of sugar is low. The government steps in and rations the purchasing of sugar by passing out 1 coupon to each family per month allowing them to buy one bag of sugar at the price set by the government. Naturally, a secondary market

develops for the coupons themselves. You decide to use your coupon to buy a bag of sugar rather than selling your coupon to some other family. Now, how much would your family be willing to pay to get a second coupon?

- a. Twice the market price
- b. The market price of one bag
- c. The consumer surplus you received buying the first bag
- d. The consumer surplus you would receive from buying the second bag
- e. The total consumer surplus from buying two bags

Answer d. You get a consumer's surplus from the first bag, which you bought with your first coupon, which was free, and are better off than if you had sold your coupon. Now you are considering acquiring a second bag of sugar. This requires that you buy a coupon in the coupon market. The maximum you would pay for the coupon is the value to you of a second bag of sugar to consume minus the government fixed price for the bag.

To buy the first bag of sugar, you could not sell your coupon on the market (you effectively "bought" it from yourself). What you pay to buy a second coupon will be no more than your wtp to have the option of buying a second bag at the fixed price.

42. According to US Law, the appropriate measure of damages used to compensate victims for the damages caused by those injuries is

- a. Willingness to accept: what those damaged would pay to restore the resource to its pre-injury state.
- b. Willingness to accept: what those damaged would have to be compensated to agree to not restore the resource to its pre-injury state.
- c. Willingness to pay: what those damaged would have to be compensated to agree to not restore the resource to its pre-injury state.
- d. Willingness to pay: what those damaged would pay to restore the resource to its pre-injury state.

Answer d. Note that *injuries* are the physical and biological effects on the resources and people. *Damages* are a measure of how people are affected by injuries. Knowing that it is the willingness to pay comes from Morey's lecture on 9/24. The law assumes that this willingness to pay is easier to estimate than willingness to accept. Willingness to pay is how much you would pay to restore the resource to its pre-injury state.

43. Would Paul and Robin agree, or disagree with the following statement: "The creation of a second-hand market for our textbook is efficiency increasing even though it makes Paul and Robin worse off."

- a. Yes
- b. No
- c. Maybe

Answer: they would say that the creation of the market had the potential to make everyone, including themselves, better off, so creating the second-hand market is efficiency increasing. To make everyone better off would have required that the buyers and sellers of the books throw some change their way, but this is not required for efficiency to increase. The creation of the market is what we will learn to call a *Potential Pareto Improvement*.

44. Consider the WTP of a student in our class for a second hardcopy of the KW textbook.  
Which of the following statements is most correct?

- a. His wtp for a second copy is likely zero
- b. We do not know his wtp for a second copy
- c. His wtp for a second copy is positive.

Answer: he might or might not have a positive wtp for the second copy; he might not even have a positive WTP for a first hard copy.

45. You convince me to lick your boots. This exchange is efficiency decreasing.

- a. Yes
- b. No
- c. Maybe.

Answer: it made you better off; otherwise you would not have convinced me. It made me better off than the alternative, or I would not have been convinced, so it also made me better off. So it is efficiency increasing, not decreasing.

46. If the market price of a good decreases, consumer's surplus cannot decrease.

- a. True
- b. False
- c. Maybe

Answer: I first wrote: "increases" rather than "cannot decrease" but decided it did not have to increase. Consider the following example where it would not decrease. Production costs are so high that at a price that would cover the production cost demand is zero. Then if the price declines but not by enough to make demand positive, consumer's surplus will remain at zero (not decrease, but also not increase).

47. You can buy a used copy of the text for \$30. Would your consumer's surplus from the book be higher if the answers to the exam questions were written in the back of the book?

- a. Yes
- b. No

Answer: the question is about you, so either answer is fine with me. Only you know whether having the answers makes you better or worse off. You would get a better grade on the exam, but you also might consider yourself a cheater.

48. My WTA for an additional ice-cream cone – I always like another ice-cream cone – is negative.

- a. **True**
- b. False
- c. Not clear.

Answer: WTA is how much money I would have to be given to consume an additional cone. Since an additional cone is, for me, a good, not a bad, my WTA is negative; I would pay, I would not have to be paid. This is a difficult question designed to separate the women from the girls.

49. I have a ton of old newspapers in my office – I like them there, Sally, my wife, does not. The current situation is inefficient because? Choose the best possible answer:

- a. It is not right for me to clutter up our home with yellowing newspapers
- b. Sally's WTP for their removal is less than my WTA their removal
- c. **Sally's WTP for their removal is more than my WTA their removal.**
- d. Sally's WTP for their removal is more than my WTP to keep them around

Answer: Answer a. is about what is right, and wrong, not about what is efficient. Wrt b.: if Sally's WTP for their removal is less than my WTA their removal then the current situation is efficient. Wrt c.: if she is willingness to pay more than I would need to be paid to voluntarily remove them, then keeping them around is inefficient. Wrt d: it is not clear.

50. I produced a ski trip to Vail and consumed the trip – I went skiing at Vail. Doing it made me better off. Choose the best way to complete the sentence, “I got

- a. A consumer's surplus because I consumed the trip.
- b. A producer's surplus because I produced the trip.
- c. A surplus from the trip

Answer: A surplus, but it is not informative to label it as either a consumer's surplus or a producer's surplus: I was both the producer and consumer.

51. That many poor people lack medical insurance is a failure of the market (*a market failure*).

- a. True
- b. False**

Answer: Poor people do not buy many things; this is because they lack money. This is the market working, not failing. Some might view it as unfair (inequitable) but it is likely efficient. The market says it is inefficient to consume product x if your WTP to consume it is less than the cost of producing it.

52. There is a downward sloping demand curve for widgets, but the supply of widgets is fixed (the supply does not depend on the price). The market for widgets is in equilibrium. Which of the following statements is correct and most informative?

- a. The supply curve is horizontal and the producer's surplus is zero, and the consumer's surplus is positive.
- b. Both the producer's surplus and the consumer's surplus are positive.
- c. **The supply curve is vertical, the producer's surplus is positive, and the consumer's surplus is positive.**

53. You and I both live 100 miles from Vail and we both have a season pass to ski Vail, so we face the same cost to ski Vail for the day. Which is the best answer?

- a. Probably yes
- b. Probably no**
- c. definitely yes
- d. definitely no

Answer: The cost of skiing Vail will likely be different for you and me even though we have to travel the same distance because the opportunity cost of your time is unlikely to equal the opportunity cost of my time (my next-best alternative is minimum wage at McDonalds, yours is charging guilty drug dealers \$300/hr. for your time) and the per-mile cost of operating your vehicle is likely to be different than the cost of my vehicle (you have a BMW, I have a scooter).

54. Mine tailing are polluting the Guber River; it used to be pristine but now the water is yellow and the fish are dying. Assume that the pollution makes you and others worse off. How would the U.S. government define how much the pollution damaged you in dollars?

- a. The government would use your WTP to have the Guber River returned to its pristine state
- b. The government would use how much you would have to be paid to agree not to have the river returned to its pristine state.
- c. These two amounts are the same thing. Professor Morey is simply trying to confuse me.

Answer: The first one, your WTP to eliminate the pollution injuries. The second one is your WTA the pollution injuries. Both are reasonable measures of damages but the U.S. government goes with the WTP measure because, as we discussed in class, the Government believes WTP is easier to reliably estimate.

55. Consider the estimation, based on data, of the aggregate demand function in Boulder for chocolate bars. For the last 100 years the price of chocolate bars in Boulder has been fixed, in real terms, at \$1/bar. Your estimation task is very difficult

- a. Yes, difficult, because one cannot see from the data, how price affects demand
- b. Yes, difficult, because one can easily see variation over time in the number bought without having to worry about the effect of price
- c. No, not difficult, because one can easily see variation over time in the number bought without having to worry about the effect of price
- d. No, not difficult, because one cannot see, from the data, how price affects demand

Explanation: Having an absolute advantage is not the same thing as having a comparative advantage. Even if an individual has an absolute disadvantage in producing both goods, he or she can't have a comparative advantage in producing both goods. An individual who has a comparative advantage in the production of one good, may or may not have an absolute advantage in the production of that good.

56. Let's assume in our economy there are 2 goods to be produced, good 1 and good 2, and two producers, you and Youngho. Which statement is correct, and most informative about gains from trade?

- a. If you have an absolute advantage in production of good 1, then you can gain from trade by specializing in production of good 1.
- b. If you have a comparative advantage in production of a good 1, then you can gain from trade by specializing in production of good 2.
- c. If you have an absolute advantage in production of good 1, then you can gain from trade by specializing in production of good 2.
- d. If you have a comparative advantage in production of a good 1, then you can gain from trade if you specialize in production of good 1.

Answer: d

Explanation: Gains from trade are possible when both parties specialize in producing the

good they have comparative advantage in.

57. Jane has a season pass to ski at Winter Park that cost \$200. Rufus invites Jane to ski Saturday at Winter Park, they will car pool up. Jane will have to pay \$10 in gas money and she knows she'll buy a hamburger for \$10 if she goes. Jane will accept the offer given she has nothing better to do, only if
- Skiing with Rufus is worth at least \$10 to her
  - Skiing with Rufus is worth at least \$220 to her
  - Skiing with Rufus is worth at least \$20 to her
  - Skiing with Rufus is worth at least \$180 to her

Answer: a or c

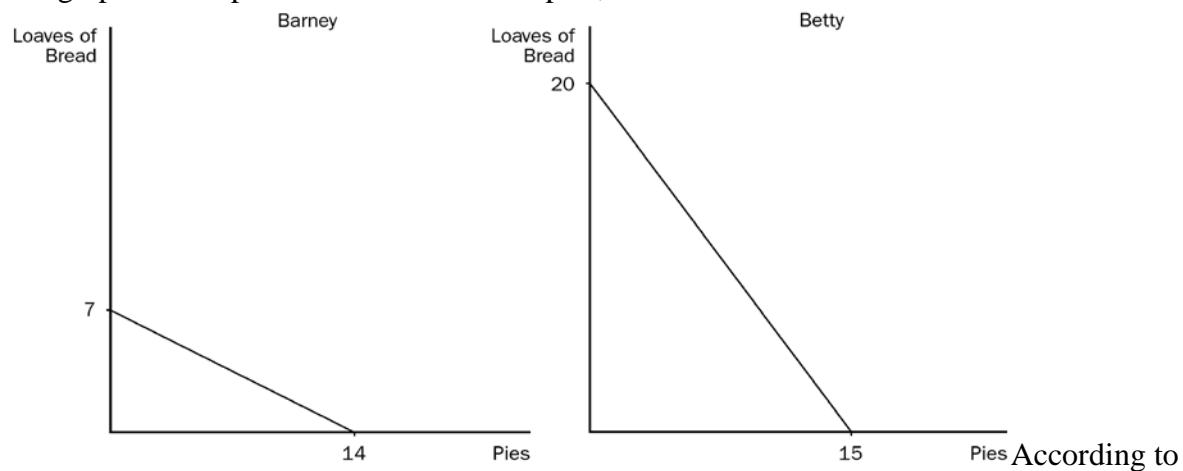
Explanation: Marginal analysis is appropriate. The \$200 dollars is a sunk cost; the only question is whether or not skiing Saturday with Rufus is worth more than her marginal cost. In this case, the \$10 of gas money is definitely part of the cost - she is required to pay it to ski. If she is constrained to buy the burger as part of the skiing with Rufus (he insists or she needs the calories to ski) then it is also part of the cost. So A or C depending how you interpret, "she knows she will buy a hamburger." Personally, I would say the hamburger is not part of the cost, but it is easy to get confused.

58. Ted has decided to buy a burger and fries at a restaurant but is considering whether to buy a drink as well. If the price of a burger is \$2.00, fries are \$1.00, drinks are \$1.00, and a value meal with all three costs \$3.40, the marginal cost to Ted of the drink is
- \$1.00
  - \$0.40
  - \$1.40
  - \$3.40

Answer: b

Explanation: Ted already has decided to have a burger and fries. If he made a decision to buy a drink as well, he should not buy all three separately, but choose a value meal cheaper. Therefore, the marginal costs according to buy a drink is the difference between value meal price(\$3.40) and price summation of a burger and fries(\$3.00) which is \$0.40

59. According to the followings graph for Barney's production of bread and pies, and Betty's graph for the production of bread and pies,



Barney has a comparative advantage in

- a. both goods and Betty has a comparative advantage in neither good.
- b. loaves of bread and Betty has a comparative advantage in pies.
- c. neither good and Betty has a comparative advantage in both goods.
- d. pies and Betty has a comparative advantage in loaves of bread.

Answer: d

Explanation: Barney's opportunity cost to produce one pie is  $\frac{1}{2}$  a loaf of bread. Betty has to give up  $\frac{4}{3}$  of a loaf to make one pie. Clearly Barney has the lower opportunity cost in baking pies, so by definition has comparative advantage. The opposite is true for Betty, giving her the lower opportunity cost to make bread, and thus the comparative advantage.

60. Bananas and apples are substitutes for consumers. When the price of bananas rises, the equilibrium quantity of apples will \_\_\_ and the equilibrium price of apples will \_\_\_.

- a. rise; rise
- b. rise; fall
- c. fall; rise
- d. fall; fall

Answer: a

Explanation: When the price of bananas is going up, the quantity of bananas demanded decreases. Since apples are substitutes, the demand curve for apples shifts to the right, but the supply curve for apples does not change. So, there is an increase in the equilibrium price and quantity of apples.