Midterm Review Questions

1. Economics can be defined as the study of:
   A) For whom resources are allocated to increase efficiency.
   B) How society spends the income of individuals.
   C) How scarce resources are allocated to fulfill society's goals.
   D) What scarce resources are used to produce goods and services.

2. A consequence of the economic problem of scarcity is that:
   A) Choices have to be made about how resources are used.
   B) There is never too much of any good or service produced.
   C) The production of goods and services must be controlled by the government.
   D) The production-possibilities curve is bowed outward.

3. Factors of production are:
   A) Scarce in every society.
   B) Scarce only in United States.
   C) Scarce only in the poorest countries of the world.
   D) Unlimited in quantity.

4. Which of the following is not a factor of production?
   A) A teacher.
   B) A ballpoint pen.
   C) The $100,000 used to start a new business.
   D) Ten acres of forest.

5. The role of the entrepreneur in an economy is to:
   A) Bring the factors of production together and assume the risk of production.
   B) Work with government planners to determine what goods are produced.
   C) Arrange bank financing for the owners of new businesses.
   D) Ensure full employment of labor.

6. The concept of opportunity cost would become irrelevant if:
   A) The market mechanism functioned to allocate resources fairly.
   B) The government allocated resources.
   C) The production-possibilities curve bowed outward.
   D) Resources were no longer scarce.

7. Which of the following is an assumption under which the production-possibilities curve is drawn?
   A) There is significant unemployment.
   B) The supply of factors of production is fixed.
   C) The price level is changing.
   D) Technology is changing.

8. A point on a nation's production-possibilities curve represents:
   A) An undesirable combination of goods and services.
   B) Combinations of production that are unattainable, given current technology and resources.
   C) Levels of production that will cause both unemployment and inflation.
   D) The full employment of resources to achieve a particular combination of goods and services.
9. The production-possibilities curve illustrates that:
A) Society can always produce more of all goods simultaneously.
B) Constant opportunity costs always exist.
C) There are no opportunity costs in a wealthy economy.
D) If society is efficient, it can produce more of one good only if it reduces output of another good.

10. According to the law of increasing opportunity costs:
A) Greater production leads to greater inefficiency.
B) Greater production means factor prices rise.
C) Greater production of one good requires increasingly larger sacrifices of other goods.
D) Higher opportunity costs induce higher output per unit of input.

11. If an economy is producing inside the production-possibilities curve, then:
A) It does not have enough resources to be efficient.
B) It must give up some of one good to produce more of another good.
C) The curve needs to shift inward.
D) It is using its resources inefficiently.

12. The production-possibilities curve shifts outward in response to:
A) Better technology or fewer resources or both.
B) Better technology or more resources or both.
C) Declining technology or fewer resources or both.
D) Declining technology or more resources or both.

13. The market mechanism:
A) Allows buyers to communicate with producers indirectly.
B) Is directed by the government in order to promote efficiency.
C) Results in the misallocation of resources because producers seek to maximize profits.
D) Allocates goods in an equitable manner.

14. If market signals result in pollution beyond the optimal level then:
A) The economy experiences government failure.
B) A laissez-faire approach will reduce the level of pollution.
C) The market mechanism has failed.
D) The government is allocating resources inefficiently.

15. Macroeconomics focuses on the performance of:
A) Individual consumers.
B) Specific firms.
C) Government agencies.
D) The economy as a whole.

16. Microeconomics is concerned with issues such as:
A) The demand for CD players by individuals.
B) The level of inflation in the economy.
C) Maintaining a strong level of economic growth.
D) All of the above.
17. Using Figure 1.3, at point A:
A) There is inefficient use of available resources.
B) The available technology keeps production inside PP₁.
C) All available resources are being used efficiently.
D) An increase in the production of tanks would definitely require a decrease in the production of automobiles.

18. When society overallocates resources to the production of a product it means that the:
A) Investment in the product is declining.
B) Opportunity cost of the product is decreasing.
C) Marginal benefit is greater than the marginal cost.
D) Marginal benefit is less than the marginal cost.

19. The concept of “rational behavior” suggests that:
A) Positive economics is more important than normative economics.
B) Normative economics is more important than positive economics.
C) People make different choices because their circumstances and information differ.
D) People make the same decisions because there is only one logical choice in any given situation.

20. The *ceteris paribus* assumption:
A) Is necessary because of the complexity of the real economy.
B) Makes it easier to formulate economic theory and policy.
C) Increases the risk of errors in economic predictions.
D) All of the above are correct.

21. Which would be a positive economic statement?
A) Government should provide free housing shelter for the homeless.
B) The minimum wage should be increased to give people a decent wage.
C) Americans should buy American products to boost the national economy.
D) Stock prices rose to a new record last month for the fourth month in a row.
22. A lower quantity demanded of a good reflects, *ceteris paribus*:
   A) Lower income.
   B) A higher price of the good.
   C) A downward shift of the supply curve.
   D) All of the above.

23. Which of the following is *not* held constant along a given demand curve for a good?
   A) Price.
   B) Consumer's income.
   C) The price of substitutes.
   D) Consumer tastes.

24. *Ceteris paribus*, which of the following would you expect to cause a decrease in the demand for automobiles?
   A) A rise in the price of gasoline.
   B) Consumer expectation that the price of automobiles will be lower next year.
   C) Consumer expectation that a significant recession will develop and last for a year.
   D) All of the above.

25. Assume Pepsi and Coke are substitutes. An increase in the price of one will result in:
   A) A decrease in demand for the other.
   B) A decrease in the quantity demanded of the other.
   C) An increase in the demand for the other.
   D) An increase in the quantity demanded of the other.

26. Peanut butter and jelly are complements. An increase in the price of one will result in:
   A) A decrease in demand for the other.
   B) A decrease in the quantity demanded of the other.
   C) An increase in the demand for the other.
   D) An increase in the quantity demanded of the other.

27. Economists make a distinction between a change in "demand" and a change in the "quantity demanded":
   A) Because the supply curve shifts whenever there is a change in demand.
   B) Because the demand curve shifts whenever there is a change in quantity demanded.
   C) To distinguish a shift in the demand curve from a movement along the demand curve.
   D) To distinguish a shift in supply from a shift in demand.

28. A change in quantity supplied is the result of:
   A) A change in the price of the good.
   B) A change in technology.
   C) An increase in the number of sellers.
   D) All of the above.

29. Which of the following is a determinant of supply?
   A) Consumer tastes or preferences.
   B) Income.
   C) The prices of the factors of production.
   D) Number of buyers.
30. Market supply and market demand curves are similar in that both:
   A) Involve the willingness and ability of a supplier to sell a product or service.
   B) Involve the willingness and ability of a buyer to buy a product or service.
   C) Have price on the x-axis and quantity on the y-axis.
   D) Can be derived by adding horizontally all the curves of the individuals in the market.

31. Which of the following can change without shifting either demand or supply, *ceteris paribus*?
   A) The price of the good itself.
   B) Incomes.
   C) The prices of other goods.
   D) All of the above.

32. At the equilibrium price there are:
   A) Shortages.
   B) Surpluses.
   C) Excess inventories.
   D) No shortages or surpluses.

33. When a surplus exists for a product:
   A) Producers increase supply.
   B) Consumers increase demand.
   C) Government purchases decrease.
   D) Producers reduce the level of output and reduce price.

34. A rightward shift of the market demand curve for MP3 players, *ceteris paribus*, causes equilibrium:
   A) Price to increase and quantity to decrease.
   B) Price to increase and quantity to increase.
   C) Price to decrease and quantity to decrease.
   D) Price to decrease and quantity to increase.

35. An increase in the supply of gasoline, *ceteris paribus*, will cause equilibrium:
   A) Price to rise and quantity to fall.
   B) Price and quantity to rise.
   C) Price to fall and quantity to rise.
   D) Price and quantity to fall.

36. Suppose both the demand and supply of salsa increase (although not necessarily by the same amount). What can we conclude about changes in the price and quantity of salsa?
   A) Both the prices and quantity increase.
   B) The price increases but the change in the quantity cannot be determined.
   C) The quantity increases but the change in the price cannot be determined.
   D) Both the price and quantity decrease.

37. Which of the following is a predictable effect of price ceilings?
   A) A decrease in the quantity supplied.
   B) A market surplus.
   C) A decrease in the quantity demanded.
   D) All of the above.
38. Which of the following is a source of market failure?
   A) Private goods.
   B) Market power.
   C) Government intervention.
   D) All of the above.

39. Any imperfection in the market mechanism that prevents optimal outcomes is known as:
   A) Market failure.
   B) Government failure.
   C) External cost.
   D) Public cost.

**Figure 4.2**

40. Using Figure 4.2, suppose point D represents the optimal mix of output for a society. If market forces cause society to produce at point C then:
   A) Market failure occurs.
   B) There is government failure.
   C) The forces of supply and demand will return society to point D.
   D) Points B and E are unattainable with the given resources and technology.

41. The federal government's role as the provider of national defense is justified by considerations of:
   A) Inequity.
   B) Public goods.
   C) Private goods.
   D) Macro failure.

42. A public good:
   A) Is any good produced by the government.
   B) Causes government failure.
   C) Is overproduced by the market.
   D) Experiences the free-rider dilemma.
43. Externalities are:
A) The result of government failure.
B) The difference between social and private costs (benefits).
C) Outside costs that producers absorb.
D) The effects of government on the private sector.

44. The market will overproduce goods that have external costs because:
A) Producers experience lower costs than society.
B) Producers experience higher costs than society.
C) The government is not able to produce these goods.
D) Producers cannot keep these goods from consumers who do not pay so they have to produce greater amounts.

45. Which of the following is an example of market failure due to market power?
A) The overproduction and overpricing of goods and services.
B) The underproduction and underpricing of goods and services.
C) The overproduction and underpricing of goods and services.
D) The underproduction and overpricing of goods and services.

46. The federal government's role in providing aid to the poor and the aged is justified because of concerns about:
A) Market power.
B) Inequity.
C) Macro failure.
D) Restricted supply.

47. The term transfer payments refers to:
A) Federal income taxes.
B) Payments that society believes everyone is entitled to some minimal quantity of.
C) Payments to individuals which are not in exchange for current goods and services being produced.
D) Additional profits transferred to monopolies as a result of their market power.

48. According to cost-benefit analysis, a government project should be undertaken as long as the:
A) Opportunity costs exceed the welfare benefits.
B) Benefits exceed the opportunity costs.
C) Benefits equal the costs.
D) Voters approve the project.

49. Which of the following would support the theory of public choice?
A) The governor of the state vetoes a highway bill even though the highway would enhance the value of property he or she owns.
B) The local police chief fails to give the mayor a speeding ticket because the mayor might fire him.
C) The president of Colombia goes after drug traffickers in spite of death threats and the offer of bribes that could make him a rich man.
D) A college president eliminates wasteful departments and programs even though this will shorten her tenure and her political future.
50. Assume the price elasticity of demand has an absolute value of 4 for a particular good. This means that quantity demanded will decrease by:
A) 4 percent for each 1 percent increase in price, *ceteris paribus*.
B) 1 unit for each $4 increase in price, *ceteris paribus*.
C) 1 percent for each 4 percent increase in price, *ceteris paribus*.
D) 4 units for each $1 increase in price, *ceteris paribus*.

51. When the percentage change in quantity demanded is greater than the percentage change in price, *ceteris paribus*:
A) Demand is unitary elastic.
B) Demand is inelastic.
C) Demand is elastic.
D) Elasticity is impossible to calculate.

52. *Ceteris paribus*, as the number of substitutes for a good increase, the:
A) Price elasticity of demand should become smaller.
B) Price elasticity of demand should become larger.
C) Cross-price elasticity of demand should become negative.
D) Income elasticity of demand should become negative.

53. *Ceteris paribus*, the higher the ratio of price to income for a particular good, the:
A) More elastic the demand for the good.
B) Less elastic the demand for the good.
C) More unitary elastic the demand for the good.
D) Smaller the income elasticity for the good.

54. Which of the following causes demand to be more elastic with respect to price?
A) Longer periods of time to adjust to a change in price.
B) A lower ratio of price to income.
C) Fewer substitutes.
D) All of the above.

55. Suppose AAA Airlines is suffering from low revenues and profits. If the company wants to increase ticket revenue and the price elasticity of demand is \(-0.75\), the company should:
A) Increase the price of tickets.
B) Decrease the price of tickets.
C) Keep the price unchanged because if the price is either increased or decreased total revenues will fall.
D) Advertise. The only option the company has to raise total revenues is to advertise.

56. A price cut will increase the total revenue a firm receives, *ceteris paribus*, only if the demand for its product is:
A) Elastic.
B) Inelastic.
C) Unitary elastic.
D) Perfectly inelastic.
57. Suppose the income elasticity of demand for used automobiles is 3.0. If the level of income decreases by 1 percent, the number of used automobiles sold will, ceteris paribus:
A) Rise 0.33 percent.
B) Rise 3.0 percent.
C) Fall 0.33 percent.
D) Fall 3.0 percent.

58. Other things being equal, if income increases and as a result, the demand for good X decreases, then good X is:
A) An inferior good.
B) A normal good.
C) A substitute good.
D) A complementary good.

59. Other things being equal, if the price of good X increases and as a result, the demand for good Y decreases, goods X and Y are:
A) Inferior goods.
B) Normal goods.
C) Complementary goods.
D) Substitute goods.

60. Suppose the cross-price elasticity of demand for automobiles with respect to the price for gasoline is -0.10. If gasoline prices rise 20 percent, then automobile sales should, ceteris paribus:
A) Fall by 2 percent.
B) Fall by 50 percent.
C) Rise by 2 percent.
D) Rise by 50 percent.

61. The additional pleasure or satisfaction from a good declines as more of it is consumed in a given period. This is the definition of the:
A) Law of demand.
B) Law of diminishing marginal utility.
C) Law of diminishing total utility.
D) Total revenue rule.

62. As consumption increases, total utility must:
A) Fall.
B) Increase as long as marginal utility is positive.
C) Increase only if marginal utility increases.
D) Increase.

63. An indifference curve represents:
A) All combinations of two goods that are equally satisfying.
B) A constant level of utility.
C) A greater level of total utility the farther it is from the origin.
D) All of the above.
64. A budget line represents:
A) Consumption possibilities.
B) The combinations of goods giving equal utility to a consumer.
C) The combinations of price and quantity available to a consumer.
D) The amount of income that is required to purchase a given amount of a good.

65. The optimal consumption combination:
A) Maximizes total utility subject to a budget constraint.
B) Is the point of tangency between the budget constraint and an indifference curve.
C) Occurs when the marginal rate of substitution equals the ratio of the prices of the two goods.
D) All of the above.

Figure 5.7

66. Refer to Figure 5.7. If the price per unit of good X is $3, the consumer would maximize utility at point:
A) A.
B) B.
C) C.
D) D.

True/False Questions

1. All output combinations that lie on the production-possibilities curve are characterized by efficient use of resources.

2. If the economy is inside the production-possibilities curve, then more output can be produced using existing resources.
3. The Latin phrase *ceteris paribus* refers to holding other variables constant.

4. A change in price changes the quantity demanded and is represented by a movement along the demand curve.

5. When the number of buyers in a market changes, the market demand curve for goods and services also changes, even if individual demand curves do not shift.

6. When individual supply curves shift, *ceteris paribus*, the market supply curve shifts.

7. Market price is the same thing as equilibrium price.

8. There are never shortages or surpluses when the price in a market is equal to the equilibrium price for the market.

9. A public good is a good or service for which consumption by one person makes consumption by others impossible.

10. If your neighbors spray the weeds in their yard and this activity prevents weed seeds from blowing into your yard, the benefit you receive is a public good.

11. Social demand equals market demand plus externalities.

12. Transfer payments are payments to individuals for which nothing is currently rendered in return.

13. A demand curve is perfectly inelastic if consumers reduce their quantity demanded to zero when price rises by even the slightest amount.

14. A budget line shows all the combinations that provide the consumer with equal utility.

**Short Answer Questions**

1. Briefly describe two types of economic resources (factors of production). What sorts of items fall into each category?

2. Briefly explain the difference between a positive and a normative statement. If it helps, you may provide examples, but it will not count against you if you do not.

3. Graph equilibrium in the market for cereal. Now show what would happen if the following happen simultaneously:
   (1) The price of milk decreases (milk is a complement for cereal); and
   (2) Cereal producers expect the price of cereal to drop in the future.

   What will happen to the equilibrium quantity of cereal? What will happen to the equilibrium price of cereal? (Note that review of the out-of-class assignment will help with preparing for this type of question as well.)

4. Briefly explain the difference between quantity demanded and demand. Also identify three factors which may affect demand (be specific).

5. Briefly explain the difference between a normal good and an inferior good. (Extra Credit for relating this to the relevant elasticity measure.)
6. Describe two (2) determinants of the price elasticity of demand?

7. Briefly explain the difference between marginal utility (MU) and total utility (TU). Use numbers if it helps you.

8. Describe two (2) potential causes of market failure.

9. Describe one (1) potential source of government failure. (Don’t worry too much if you have a tendency to overlap sources in your explanation.)