



Test Version _____A_____

Name _____

I, the student, keep the spare key to make house/apartment hidden
_____, and am typically not home during the hours of
_____.

Exam 2 contains 33 multiple choice questions which should be answered on both the scantron and the test. Questions 34 and 35 are math/graphing questions which can only be answered on the test. For the multiple choice questions, the answers you write on the scantron will be considered the official answers. Make absolutely sure to write your name on this test booklet and the scantron sheet.

Make absolutely sure that under "course number" on the scantron sheet you write in the correct version corresponding to the test version you receive

Test Version Course Number

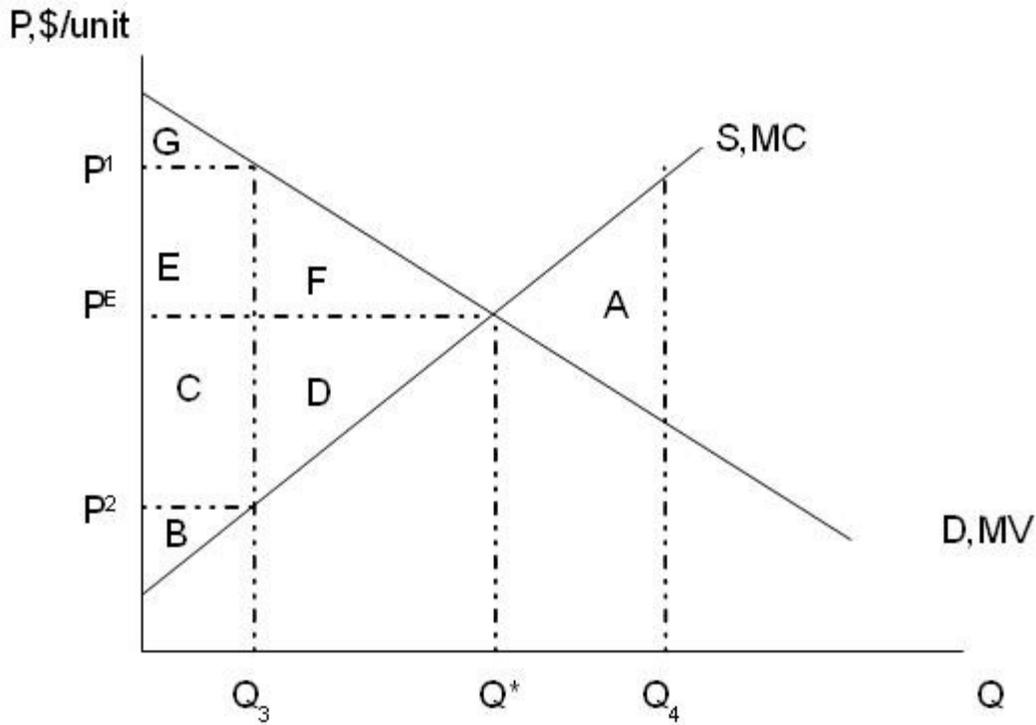
Test Version A – 1111

Test Version B – 1112

Test Version C – 1113

Test Version D – 1114

Use the illustration below to answer Questions 1-3.



(1) In a free-market with no governmental interference, what will be the total surplus that represents the benefit society receives from consuming the good of interest.

- (a) $B+C+E+G$ (c) $B+C+D+E+F+G + A$ (e) $B+C+D+E+F+G$
 (b) B (d) $B+C+D+E+F+G - A$

(2) Suppose that a price ceiling is established by the government, dictating that price cannot under any circumstances exceed P^2 . What is the corresponding total surplus?

- (a) $B+C+E+G$ (c) $B+C+D+E+F+G + A$ (e) $B+C+D+E+F+G$
 (b) B (d) $B+C+D+E+F+G - A$



(3) Suppose that the government subsidizes consumption of the good by giving consumers a certain amount of extra money each time they purchase a unit of the good. Suppose further this subsidy increases consumption of the good to Q_4 . What is the corresponding total surplus?

- (a) $B+C+E+G$ (c) $B+C+D+E+F+G + A$ (e) $B+C+D+E+F+G$
(b) B (d) $B+C+D+E+F+G - A$

(4) A subsidy encourages more production and consumption, giving people more “stuff” to enjoy. Isn't this a good thing?

- (a) yes, this is why subsidies increase household wealth (c) no, because people give up consumption of other goods they value more to pay for the subsidy (e) a,b
(b) yes, this is why businesses regularly lobby for subsidies (d) no, because consumers often go into debt to purchase the “stuff”, which decreases their purchasing power in the future

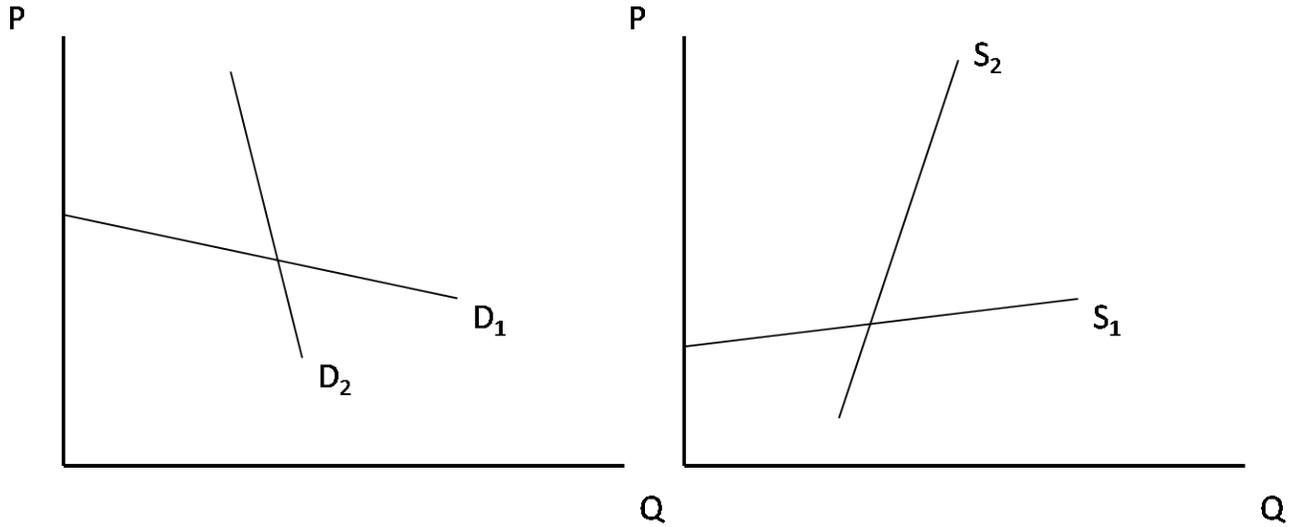
(5) A government who is considering enacting a price ceiling for gasoline (meaning the government forbids businesses from charging a price higher than the price ceiling) should bear in mind that...

- (a) the price ceiling will reduce the total wealth of the economy (c) everyone will benefit from the low prices, but the benefit will be small (e) c,d
(b) consumers will want less than sellers want to provide, creating waiting lines (d) some units will be produced where the cost of the good is greater than its value

(6) Suppose that sales of a product decrease from 50,000 per year to 35,000 per year. What is the percentage change in sales?

- (a) 43% (c) -43% (e) 0.30%
(b) 0.43% (d) -30%

Use the following illustration to answer Questions 10 and 11.



(10) The demand curve D_2 is best described as an _____ demand, and the supply curve S_2 is best described as an _____ supply.

- | | |
|--------------------------|------------------------|
| (a) inelastic, elastic | (c) elastic, elastic |
| (b) inelastic, inelastic | (d) elastic, inelastic |

(11) Of the four curves (D_1, D_2, S_1, S_2), which curves are most likely to be the long-run supply and long-run demand curves?

- | | |
|----------------|----------------|
| (a) D_1, S_1 | (c) D_1, S_2 |
| (b) D_2, S_2 | (d) D_2, S_1 |

(12) The demand for eggs in general is most likely to be _____, while the demand for a single variety of eggs is most likely to be _____.

- | | |
|--------------------------|------------------------|
| (a) inelastic, elastic | (c) elastic, elastic |
| (b) inelastic, inelastic | (d) elastic, inelastic |



(13) Suppose that more stringent federal regulations increase the cost of production, acting like a tax and thereby decreasing the supply of the good. If the demand for the good is very elastic, these regulations will _____ a lot but _____ only a little.

- (a) increase price, decrease quantity
- (b) increase price, increase quantity
- (c) decrease quantity, decrease price
- (d) decrease quantity, increase price

(14) Suppose that the government taxes high quality health care plans. You may assume that the demand for these plans is inelastic while the supply is elastic. Who pays the majority of this tax, consumers or insurance companies, and why?

- (a) consumers will pay most of the tax because the price will increase almost as much as the tax
- (b) consumers will pay most of the tax because most of them will switch to low quality health care plans.
- (c) insurance companies will pay most of the tax because they will be unable to pass the tax onto consumers in the form of a higher price
- (d) insurance companies will pay most of the tax because, as consumers switch to lower quality plans in large numbers, they will lose the profits from those high quality plans.

(15) Suppose that gasoline prices rise, and this price rise is sustained over a long period. How will consumers respond to this price rise in the long-run and short-run.

- (a) demand will be more elastic in the long-run than the short-run
- (b) in the short-run, consumers will purchase roughly the same amount of gas, but over time they will identify feasible ways to curtail their gas consumption, and in the long-run will decrease their purchases by a larger amount.
- (c) in the short-run consumers will overreact to the price change and curtail their consumption greatly, but in the long-run they will return to their previous level of gasoline purchases.
- (d) both a and b
- (e) both a and c



(16) Which distinguishes the long-run from the short-run?

- | | | |
|---|---|--|
| (a) firms can avoid more regulations in the short-run | (c) marginal costs are subject to axomorony in the long-run but not the short-run | (e) marginal costs for a firm are lower in the short-run than the long-run |
| (b) the number of firms is fixed in the short-run, but can be changed in the long-run | (d) fixed costs are lower in the short-run than the long-run | |

(17) Politicians favor taxing cigarettes because the tax appears to raise significant revenues when it is initially administered. Being an economist, you think the politician would be interested to know that...

- | | |
|--|--|
| (a) demand is more elastic in the long-run, and hence the tax revenues will be less in the future | (c) the tax will force some sellers out of business, leading to mergers and monopoly power in the cigarette industry |
| (b) the tax will force some sellers out of business, causing price to rise even higher than the amount of the tax, thereby increasing tax revenues further | (d) demand is more inelastic in the long-run, and hence tax revenues will be even greater in the future |

(18) In the long-run, how will an increase in demand affect the price and quantity of a good in a constant cost industry.

- | | | |
|--|--|---|
| (a) price will remain the same, quantity will fall | (c) price will fall, quantity will remain the same | (e) price will rise, quantity will rise |
| (b) price will remain the same, quantity will rise | (d) price will rise, quantity will remain the same | |

(19) Suppose that, today, it costs a farmer a minimum of \$80 per cwt to raise cattle and cattle is a constant cost industry. Then, suppose that the demand for cattle rises and this demand increase is sustained over time. Which of the following best describes the industry transition to a new long-run equilibrium?

- (a) new firms will enter the market to capture profits, increasing supply, and thereby decreasing price back to its original level
- (b) new firms will enter the market, increasing supply and increasing the market price further
- (c) price will initially rise, discouraging firms and causing them to exit the industry
- (d) firms will exit the industry, causing price to remain high

(20) Milk prices are currently unusually high, bestowing dairy producers with large profits. Why would an economist naturally suspect that these prices and profits will be temporary?

- (a) because all the fixed costs that are ignored in the short-run become variable costs in the long-run
- (b) because profits induce new dairy farms to be built, increasing milk supplies and decreasing price
- (c) because there is a coordination problem between costs and price, and high prices are universally followed by higher costs
- (d) because at high prices consumers will consume less milk, decreasing demand and hence dairy profits

(21) The Three I's of Economic Theory are...

- (a) invest, interest rate, increase
- (b) incentives, interactions, and indifference
- (c) interest, incentives, innovation
- (d) indifference, interstate, intertake

(22) Which of the following are incentives which economists have determined humans respond to?

- (a) regions with higher beer taxes have lower rates of child abuse and child homicide rates
- (b) every capital punishment execution deters eight murders that would have occurred
- (c) corporate mergers rarely benefit stockholders, but CEO's pursue them because it gives them more power and more money
- (d) Matadors behave more dangerously as hospitals' ability to repair injuries improve
- (e) all of the above



involving *Wren the Farmer* in the textbook, in the section regarding farm subsidies. You may assume that Wren is just like thousands of other people, there is a large market for industry labor that pays \$45,000 regardless of how many people leave the industry to farm or leave farming to work in the industry. Assume that land is plentiful, and that there are plenty of additional acres available to farm that are currently not being farmed. You may also assume that most farmers rent their land. Suppose that the government begins giving farmers an annual \$10,000 subsidy. How will this subsidy affect farmers?

- | | |
|--|--|
| (a) It will not benefit farmers. As people leave industry to become farmers they will simply bid up the price of land until the extra rent farmers pay is exactly equal to the \$10,000 subsidy they receive. | (c) It will benefit farmers. Landowners cannot be expected to become aware of the subsidy, and will therefore not increase the price they charge for land rent. Thus, the farmer does receive the subsidy in full, with no offsetting losses. |
| (b) It will not benefit farmers. As people leave industry to become farmers they will keep producing more and more crops, until the price of those crops fall just enough so that the profit decline exactly offsets the \$10,000 subsidy. | (d) It will benefit farmers. As landowners scramble to increase their rents they will end up spending more money trying to obtain government subsidies than the subsidies themselves. This discourages landowners from increasing rents, allowing the farmer to collect the subsidy in full with no offsetting losses. |

(27) How did the Oakland A's become such an awesome team around the year 2000?

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|---|--|
| (a) they utilized the Indifference Principle to pay each player a higher salary than the baseball league "officially" allowed | (c) they collected secret, unique data on baseball player performance, enabling them to better determine which players were the best |
| (b) they arbitrated by paying more for players with a high on-base percentage and paying less for players with a high slugging percentage | (d) their investments were made at a lower discount rate, allowing them to pay higher salaries in 2000, but they would have to pay less in later years |



(28) Suppose that wheat is grown in both Dodge City (DC) and Kansas City (KC). Assume that wheat is “utilized” in both DC and KC, meaning at both locations wheat is processed into a consumer item. Suppose that we know the price in KC is \$4.50 per bu, and the cost of transporting wheat between DC and KC is \$0.20 per bushel. Then, if the Force of One Price holds, circle the one appropriate answer

- (a) the price in DC must be \$4.30
- (b) the price in DC must be \$4.70
- (c) the price in DC must be equal to or between \$4.30 and \$4.70
- (d) the price in DC must be less than or equal to \$4.30
- (e) the price in DC must be less than or equal to \$4.70
- (f) none of the above

(29) Suppose that wheat is grown in both Dodge City (DC) and Kansas City (KC). Assume that all wheat produced in both regions is ultimately utilized in KC and only in KC, meaning all DC wheat must find its way to KC. Suppose that we know the price in KC is \$4.50 per bu, and the cost of transporting wheat between DC and KC is \$0.20 per bushel. Then, if the Force of One Price holds, circle the one appropriate answer

- (a) the price in DC must be \$4.30
- (b) the price in DC must be \$4.70
- (c) the price in DC must be equal to or between \$4.30 and \$4.70
- (d) the price in DC must be less than or equal to \$4.30
- (e) the price in DC must be less than or equal to \$4.70
- (f) none of the above



Fall Semester, 2009
Exam 2

(34) [Worth 3 Points] You are a seed business that currently charges \$5,000 for each ton of seed you sell, and at that price you sell 100,000 tons. The elasticity of demand for your seeds, economic consultants tell you, is -0.6. Your variable costs of production are \$3,200 for each ton.

Should you raise the price of your good to \$6,000 per unit? Show your work in case we decide to reward partial credit (which we may or may not do).

Your Answer: (circle one) YES / NO . If the price is increased to \$6,000, my profits would

(circle one) INCREASE / DECREASE by \$_____.



(35) The graph below illustrates the behavior of crop prices between harvests. Illustrate how the graph would change if storage costs rose. Clearly depict the new behavior of prices by drawing in a new trend lines between harvests.

