Texas A&M University (TAMU) ECON202 Practice Exam 2 (Sample)

Study Guide

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Questions

1. When the federal government orders firms to use particular methods to reduce pollution, it is said to be using?

   A. market incentives

   B. command and control policies

   C. cooperative strategies

   D. regulatory flexibility

2. In which town would it be easier to find parking, Freedonia or Meterville?

   A. Freedonia

   B. Meterville

   C. Both towns have the same availability

   D. Neither town has any parking

3. How does the imposition of a tax on a good or service affect its market?

   A. It generally encourages more sales

   B. It leads to an increase in supply

   C. It affects the market equilibrium

   D. It has no effect on demand

4. Which economic principle ensures that the last unit sold provides equal value to both consumers and producers?

   A. Marginal benefit

   B. Market equilibrium

   C. Deadweight loss

   D. Consumer demand

5. What economic principle explains the relationship between price and quantity demanded under a ceiling?

   A. Law of supply

   B. Law of demand

   C. Price elasticity

   D. Market equilibrium

6. What characterizes a market with elastic supply?

   A. Suppliers cannot easily change output

   B. Suppliers can increase production rapidly without a significant increase in costs

   C. Demand for the product is unresponsive to price changes

   D. Production costs are fixed over time

7. If Paul buys a tennis racket for $125 but was willing to pay $200, what is his consumer surplus?

   A. $25

   B. $50

   C. $75

   D. $100

8. Under what condition does a price ceiling not create a deadweight loss?

   A. When the ceiling price is above equilibrium price

   B. When the ceiling price is equal to equilibrium price

   C. When the equilibrium market price lies below the price ceiling

   D. When supply is perfectly inelastic

9. Is it true that if transaction costs are low, private bargaining will always result in an efficient solution to externalities?

   A. True

   B. False

   C. It depends on the extent of the externality

   D. None of the above

10. What typically happens to the equilibrium quantity of a good when a tax is imposed on it?

   A. The equilibrium quantity remains unchanged

   B. The equilibrium quantity decreases

   C. The equilibrium quantity increases

   D. The equilibrium quantity becomes zero

Answers

1. B
2. B
3. C
4. B
5. B
6. B
7. C
8. C
9. B
10. B

Explanations

1. When the federal government orders firms to use particular methods to reduce pollution, it is said to be using?

A. market incentives

B. command and control policies

C. cooperative strategies

D. regulatory flexibility

The federal government's approach to requiring firms to use specific methods to reduce pollution is referred to as command and control policies. This strategy involves the establishment of regulations that dictate what firms must do to comply with environmental standards, often prescribing particular technologies or practices. Command and control policies aim for direct regulation of environmental practices, allowing the government to specify the means to achieve pollution reduction. This can include mandates on emissions limits or requirements to install specific pollution control equipment. This regulatory framework is often viewed as a straightforward way to ensure compliance and achieve environmental goals, as it provides clear guidelines and responsibilities for firms. In contrast, market incentives tend to rely on economic tools to motivate firms to reduce pollution, such as tradable permits or taxes, while cooperative strategies might involve partnerships between government and industry for environmental improvement. Regulatory flexibility typically refers to policies that allow firms to choose how they meet regulations, rather than imposing specific methods. Thus, command and control stands out as a distinct approach that mandates firms to adhere to set directives for pollution control.

2. In which town would it be easier to find parking, Freedonia or Meterville?

A. Freedonia

B. Meterville

C. Both towns have the same availability

D. Neither town has any parking

Finding parking in a town often depends on several factors, including population density, land use, and the availability of public or open spaces designated for parking. Meterville is likely to be the correct choice because it suggests conditions such as a smaller population or less commercial activity compared to Freedonia. If Meterville has less congestion, fewer vehicles on the roads, or more space allocated for parking, it would inherently be easier for residents and visitors to find parking spots. This type of scenario aligns with typical economic principles: in towns with lower demand for parking spaces (such as populations that are smaller or less concentrated), finding parking becomes less of a challenge, leading to greater accessibility. In contrast, Freedonia may have higher demand for parking due to a denser population, more businesses, or limited space, which would make parking more difficult to find. Thus, conditions in Meterville would favor easier parking availability compared to Freedonia.

3. How does the imposition of a tax on a good or service affect its market?

A. It generally encourages more sales

B. It leads to an increase in supply

C. It affects the market equilibrium

D. It has no effect on demand

The imposition of a tax on a good or service affects its market by altering the market equilibrium, which is determined by the intersection of supply and demand curves. When a tax is levied, it increases the cost of production for suppliers, resulting in a decrease in supply at every price level. This shift in the supply curve leads to a new equilibrium price, where the quantity demanded may also change as consumers react to the higher prices caused by the tax. As the market adjusts to the tax, the equilibrium quantity of the good or service sold typically decreases because the tax burden can lead to higher prices for consumers or lower prices received by suppliers. Consequently, the market experiences a change from its previous equilibrium due to the tax's effect on supply and demand dynamics. The nature of the impact can vary depending on the elasticity of supply and demand, but overall, the introduction of a tax creates a new market scenario, hence affecting equilibrium. This is a key concept in understanding how fiscal policy can influence economic behavior.

4. Which economic principle ensures that the last unit sold provides equal value to both consumers and producers?

A. Marginal benefit

B. Market equilibrium

C. Deadweight loss

D. Consumer demand

The principle that ensures the last unit sold provides equal value to both consumers and producers is market equilibrium. At market equilibrium, the quantity of goods supplied equals the quantity demanded. This occurs at the equilibrium price, where the price consumers are willing to pay (the marginal benefit) matches the price producers are willing to accept (the marginal cost). In this state, the last unit sold reflects the highest price consumers are willing to pay, which is equal to the lowest price producers will accept. As a result, both parties derive the maximum benefit possible from the transaction, and no further transactions would increase the overall welfare. If the price deviates from this equilibrium, it would create either a surplus or a shortage, leading to inefficiencies in the market. Understanding market equilibrium helps explain how resources are allocated in a way that maximizes efficiency and satisfaction for both consumers and producers, with the last unit sold ideally reflecting this balance.

5. What economic principle explains the relationship between price and quantity demanded under a ceiling?

A. Law of supply

B. Law of demand

C. Price elasticity

D. Market equilibrium

The principle that explains the relationship between price and quantity demanded under a price ceiling is the Law of Demand. This law states that, all else being equal, there is an inverse relationship between the price of a good and the quantity demanded by consumers. When a price ceiling is implemented, it sets a maximum allowable price for a good or service, which often results in prices being lower than they would be in a free market. As the price decreases due to the ceiling, consumers are typically willing to purchase more of the good because it becomes more affordable. This increase in quantity demanded occurs because consumers respond to the lower price by buying more, demonstrating the fundamental concept of the Law of Demand. Thus, the correct answer clearly aligns with this economic principle, as it effectively captures how a price ceiling influences consumer behavior in regard to the quantity of a good demanded.

6. What characterizes a market with elastic supply?

A. Suppliers cannot easily change output

B. Suppliers can increase production rapidly without a significant increase in costs

C. Demand for the product is unresponsive to price changes

D. Production costs are fixed over time

A market with elastic supply is characterized by suppliers' ability to increase production rapidly without a significant increase in costs. This means that when the price of the product increases, suppliers can respond quickly by boosting output, which is a key feature of elasticity in supply. In such scenarios, suppliers have the necessary flexibility and resources, such as readily available labor and materials, to scale up their production in response to changing market conditions. This responsiveness to price changes allows markets with elastic supply to adjust more fluidly to shifts in demand. When the supply is elastic, even small changes in price can lead to substantial changes in the quantity supplied, making it advantageous for both suppliers and consumers in a market context.

7. If Paul buys a tennis racket for $125 but was willing to pay $200, what is his consumer surplus?

A. $25

B. $50

C. $75

D. $100

To calculate consumer surplus, consider the difference between what a consumer is willing to pay for a good and what they actually pay for it. In this scenario, Paul was willing to pay $200 for the tennis racket, but he only paid $125. The calculation for consumer surplus is straightforward: subtract the purchase price from the maximum price the consumer is willing to pay. So, consumer surplus = Willingness to pay - Purchase price = $200 - $125 = $75. This means that Paul experiences a consumer surplus of $75, which indicates the benefit he receives from purchasing the racket at a lower price than he was willing to pay. Consumer surplus reflects the additional value that consumers derive from transactions, capturing the difference between their maximum willingness to pay and the actual price they pay.

8. Under what condition does a price ceiling not create a deadweight loss?

A. When the ceiling price is above equilibrium price

B. When the ceiling price is equal to equilibrium price

C. When the equilibrium market price lies below the price ceiling

D. When supply is perfectly inelastic

A price ceiling is a legally established maximum price that can be charged for a good or service. When evaluating the impact of a price ceiling on market outcomes, particularly the creation of deadweight loss, it is important to consider its relationship with the equilibrium price. When the equilibrium market price lies below the price ceiling, the price ceiling is not constraining the market. Essentially, this means that sellers can still sell at the equilibrium price, and there is no restriction on how the market would naturally function. In this scenario, buyers are able to purchase the good at the market price, and sellers are willing to sell at that price, leading to an efficient allocation of resources. Since both buyers and sellers are operating at the equilibrium quantity, there is no surplus or shortage created that would lead to a loss of economic efficiency, therefore no deadweight loss occurs. In contrast, if the price ceiling were set below the equilibrium price, it would lead to a situation where the quantity demanded exceeds the quantity supplied, creating a shortage. This shortage would restrict transactions that would normally occur at the equilibrium price, leading to a deadweight loss. In summary, when the equilibrium market price is below the price ceiling, the market functions without distortion, allowing for efficient transactions and no

9. Is it true that if transaction costs are low, private bargaining will always result in an efficient solution to externalities?

A. True

B. False

C. It depends on the extent of the externality

D. None of the above

The assertion that private bargaining will always result in an efficient solution to externalities when transaction costs are low is not necessarily true, hence the correct response is that it is false. While low transaction costs can facilitate negotiations between parties affected by externalities, several conditions must also be met for private bargaining to lead to an efficient outcome. For effective bargaining, affected parties need to have clear property rights and the ability to negotiate without significant barriers. Furthermore, the nature and scope of the externality itself can affect the bargaining process. For example, if there are many parties involved, coordination becomes more challenging, and the potential for inefficiency increases despite low transaction costs. In addition, even when transaction costs are low, externalities can persist if one of the parties involved does not have adequately defined rights or if information asymmetries exist, which can hinder fair negotiation. Therefore, while low transaction costs are beneficial, they are not a guarantee of achieving an efficient solution through private bargaining alone.

10. What typically happens to the equilibrium quantity of a good when a tax is imposed on it?

A. The equilibrium quantity remains unchanged

B. The equilibrium quantity decreases

C. The equilibrium quantity increases

D. The equilibrium quantity becomes zero

When a tax is imposed on a good, it generally leads to an increase in the price that consumers pay and a decrease in the price that producers receive for that good. This discrepancy creates a wedge between the two prices, resulting in a reduction in the quantity demanded by consumers as they face a higher effective price. At the same time, producers may limit the quantity they supply because of the lower effective price they receive, reducing their incentive to produce more of the good. As a consequence, the overall equilibrium quantity—the point at which the quantity demanded by consumers equals the quantity supplied by producers—shifts to a lower level. This occurs because the higher consumer prices diminish demand while the lower prices received by producers discourage supply, aligning to a new equilibrium point where the fewer transactions occur in the market. Therefore, the imposition of a tax typically results in a decrease in the equilibrium quantity of the taxed good.