Chapter 07 Testbank

1. Perfectly competitive firms maximize profit when

   A. average costs are minimized
   B. total costs are minimized
   C. average costs equal price
   D. marginal costs equal price

2. If a perfectly competitive firm produces an output level where price is greater than marginal costs, then the firm should

   A. pay more to its variable factors of production.
   B. contract output to earn greater profits or smaller losses.
   C. expand output to earn greater profits or smaller losses.
   D. leave its output decision unchanged.

3. If a perfectly competitive firm produces an output level where price is less than marginal costs, then the firm should

   A. raise its price.
   B. contract output to earn greater profits or smaller losses.
   C. expand output to earn greater profits or smaller losses.
   D. leave its output decision unchanged.

4. An increase in the price the firm receives for its output will cause the firm to

   A. expand output and earn greater profits or smaller losses.
   B. leave output unchanged and earn greater profits.
   C. leave output unchanged and earn greater profits or smaller losses.
   D. contract output and earn greater profits.

5. A decrease in the price the firm receives for its output will cause the firm to

   A. expand output and earn smaller profits.
   B. cut wages and payments to factors of production.
   C. leave output unchanged and earn smaller profits.
   D. contract output and earn smaller profits or larger losses.

6. A firm's output price is $5 and the firm is producing 37 units with a marginal cost of $3. The firm should

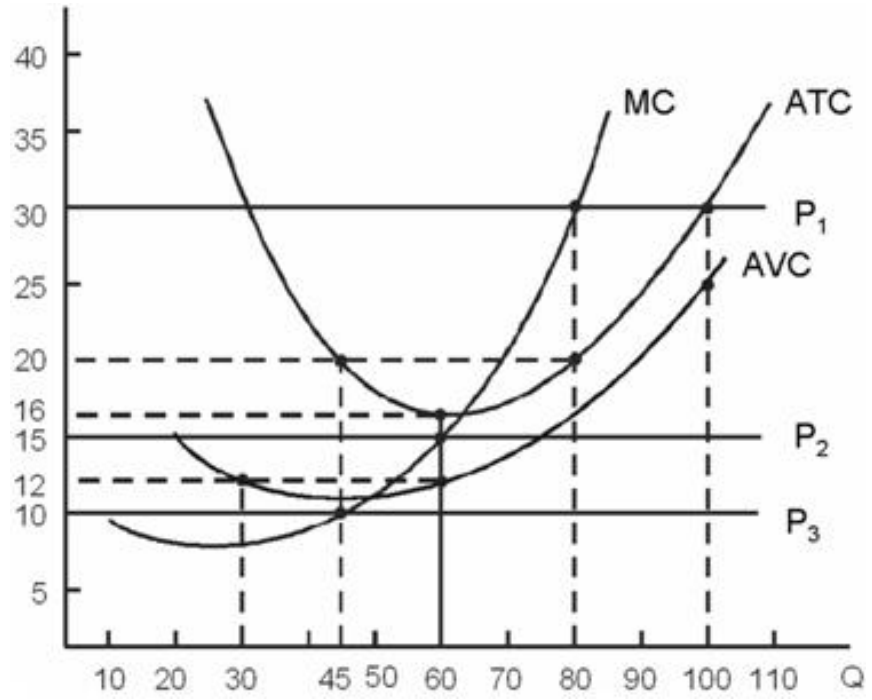
   A. lower its price.
   B. decrease production.
   C. increase production.
   D. raise its price.

7. A firm's output price is $8 and the firm is producing 77 units with a marginal cost of $11. The firm should

   A. lower its price.
   B. decrease production.
   C. increase production.
   D. raise its price.

8. A perfectly competitive firm's output price is $7 and the firm is producing 1,000 units with a marginal cost of $7. The firm should

   A. leave production and price unchanged.
   B. increase price to increase profits.
   C. increase production to increase profits.
   D. decrease production to lower losses.



9. Refer to the figure above. When the demand is P_1 = \$30, what is the profit maximizing output?

A. 30

B. 45

C. 60

D. 80

10. Refer to the figure above. When the demand is P_1 = \$30, what is the total revenue?

A. \$ 900

B. \$1350

C. \$800

D. \$2400

11. Refer to the figure above. When the demand is P_1 = \$30, what is the total cost?

    A. \$ 960
    B. \$ 1200
    C. \$ 1600
    D. \$ 2500

12. Refer to the figure above. When the demand is P_1 = \$30, how much profit is this producer earning?

    A. \$ 500
    B. \$ 800
    C. \$ 1200
    D. \$ 1600

13. Refer to the figure above. When the demand is P_2 = \$15, what is the profit maximizing output?

    A. 30
    B. 45
    C. 60
    D. 80

14. Refer to the figure above. When the demand is P_2 = \$15, this producer will earn a _____ of _____.

A. Loss, \$60
B. Profit, \$180
C. Loss, \$300
D. Loss, \$900

15. Refer to the figure above. When the demand is P_2 = \$15, this firm should _____

A. continue to operate in the short run and think about shutting down in the long run
B. discontinue operation in the short run since there is a loss when operating.
C. keep operating as long as loss is not greater than total cost
D. discontinue operation in the short run since average total cost is greater than price.

16. Assuming the firm is experiencing diminishing marginal returns to its variable factors of production, as output price rises the firm will

A. produce more.
B. earn profits.
C. produce less.
D. earn losses.

17. Firms will not produce if price is less than _____ costs, and so only the part of the _____cost curve above that point is the supply curve.

A. average total; marginal
B. average fixed; marginal
C. average variable; average
D. average variable; marginal

18. The statement, "price distributes goods and services to those that value them the most" refers to the _____ function of price.

A. allocative
B. multiplicative
C. store of value
D. rationing

19. The statement, "price directs resources across different sectors of the economy" refers to the _____ function of price.

A. allocative
B. store of value
C. rationing
D. transitivity

20. Which of the following would be an example of the rationing function of price?

A. Switching from a Ph.D. in economics to finance because finance salaries are higher
B. Carlos Slim purchasing the Mona Lisa for $5 billion
C. A firm attempting to lower its explicit costs
D. Government price controls

21. Which of the following would be an example of the allocative function of price?

A. A consumer deciding the price of steak is more than she wishes to pay
B. Losing $50 at a roadside rest stop
C. Switching from a Ph.D. in economics to finance because finance salaries are higher
D. Finding $50 that somebody lost at a rest stop

22. _____ work together to guide resources to their highest value.

A. The explicit cost and the implicit cost of a profit maximizing firm
B. The short run and long run supply curve
C. The rationing and allocative functions of price
D. The economic profit and accounting profit

23. Harvard University charges very high tuition while other private universities charge less. This illustrates the _____ function of price.

A. allocative
B. distributive
C. communicative
D. rationing

24. Generally, _____ motivate firms to enter an industry while _____ motivate firms to exit an industry.

A. economic profits; economic losses
B. accounting profits; accounting losses
C. accounting profits; economic losses
D. economic profits; accounting losses

Suppose last year Omar was a soybean farmer and Haytham was a corn farmer. This year high demand for ethanol, an automobile fuel made from corn, causes the price of corn to increase.

25. You would predict that this year Omar will

A. grow more soybeans.
B. switch to growing corn.
C. continue to grow the same amount of soybeans.
D. go out of business.

26. Relative to last year, the price of soybeans is likely to be _____ and the price of corn is likely to be _____.

A. higher; higher
B. higher; lower
C. lower, higher
D. the same; higher

27. Suppose all firms in a perfectly competitive industry are experiencing economic profits. One would expect that, over time, the number of firms will _____ and the market price will _____.

A. rise; fall
B. fall; rise
C. rise; rise
D. rise; stay the same

28. If all firms in a perfectly competitive industry earn a normal profit, then

A. new firms will enter the industry.
B. old firms will exit the industry.
C. the number of firms in the industry is stable.
D. market supply will shift to the left.

29. If all firms in a perfectly competitive industry are experiencing economic losses, then firms will

A. exit the industry, until economic profits are positive.
B. exit the industry, until accounting profits equal zero.
C. continue in the industry, hoping for better times.
D. exit the industry, until economic profits equal zero.

30. The signal for new firms to join an industry is

A. economic profits.
B. normal profits.
C. accounting profits.
D. economic losses.

31. For entry into a particular perfectly competitive industry to occur, which of the following must be true?

    A. Accounting profits = 0
    B. Accounting profits = Economic profits
    C. Economic profits > 0
    D. Economic profits = 0

32. In an industry with free entry and exit, economic profits

    A. indicate a market failure.
    B. can never occur.
    C. induce a reallocation of resources out of other industries and into the one with economic profits.
    D. can be sustained indefinitely.

33. Economic losses are

    A. less important than accounting losses.
    B. encountered only when total revenues are less than explicit costs.
    C. a signal that reallocation of resources out of the industry needs to occur.
    D. present if firms just earn a normal profit.

34. In a perfectly competitive industry over the long run,

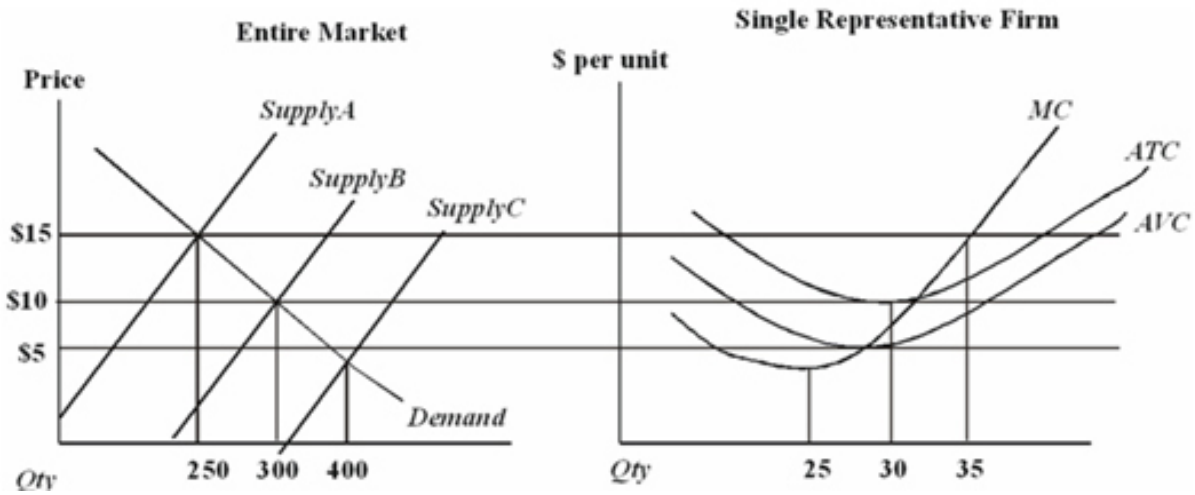
A. economic profits tend to persist.

B. the number of firms in an industry grows.

C. economic losses tend to persist.

D. economic profits and losses are driven towards zero by entry and exit.

Assume that all firms in this industry have identical cost functions.



35. The long-run equilibrium price in this industry is

A. $15

B. $10.

C. $5.

D. $5 for some firms and $10 for others.

36. The long-run equilibrium supply in this industry is

    A. Supply A.
    B. Supply B.
    C. Supply C.
    D. A Supply function that lies between Supply A and Supply B.

37. When price is $15 in this industry,

    A. the industry is in its long run equilibrium.
    B. it is because supply has shifted from Supply B to Supply A because firms that were not making a profit left the industry.
    C. new firms will be expected to enter.
    D. all firms are making zero economic profits.

38. Firms in this industry will shut down if the price is

    A. higher in the short run than in the long run.
    B. less than or equal to $15.
    C. less than or equal to $10.
    D. less than or equal to $5

39. The firm depicted in the graph on the right faces a demand curve that

    A. is horizontal at the market price.
    B. is downward sloping, and less than market demand curve.
    C. is the same as the marginal cost curve.
    D. is the same as the market demand curve.

40. In the long run, there will be _____ firms in this market.

A. 10
B. 15
C. 25
D. 50

41. An implication of entry and exit in response to the profit incentive is that, for perfectly competitive firms,

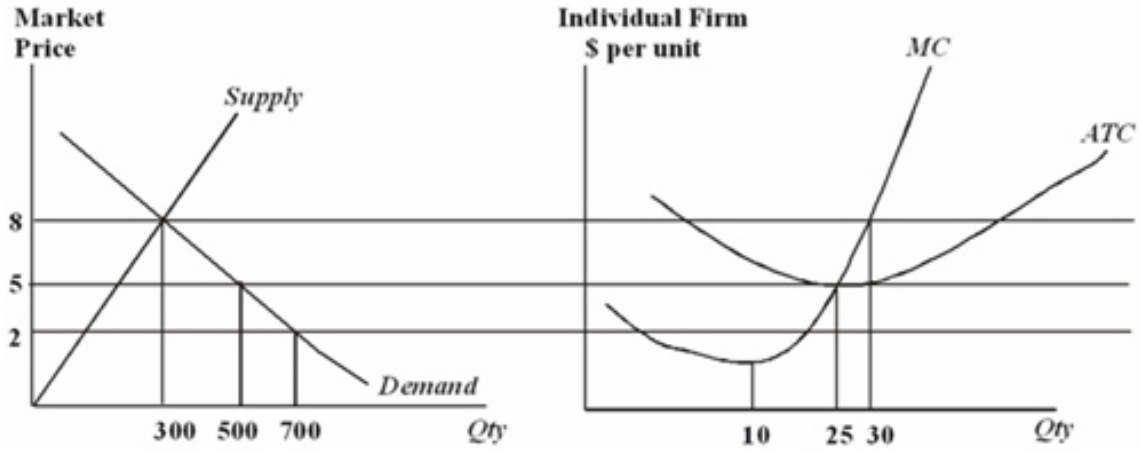
A. no firm accepts zero economic profits in the long run.
B. firms produce the quantity that minimizes average variable costs in the short run.
C. firms produce the quantity that minimizes average total costs in the long run.
D. demand is completely inelastic

42. One difference between the long run and the short run in a perfectly competitive industry is that

A. economic profits in the long run are always greater than they are in the short run.
B. economic profits in the short run are always greater than they are in the long run.
C. firms necessarily operate at the output level that minimizes average total cost only in the long run.
D. marginal revenue equals price only in the long run.

The following graphs depict a perfectly competitive firm and its market.

Assume that all firms in this industry have identical cost functions.



43. The long run equilibrium quantity in this industry is

A. 300.

B. 500

C. 700

D. more than 700.

44. Assume that the market is currently as shown in the graph on the left (i.e., price of $8). What is true of the number of firms?

A. There are currently 30 firms in the industry, and that number will remain stable until there is a change in demand or in technology.

B. There are currently ten firms in this industry, and that number will remain stable until there is a change in demand or in technology.

C. It is impossible to tell how many firms currently exist in this industry, but you can tell that the number of firms is likely to increase in the near future.

D. There are currently ten firms in this industry, and that number is likely to increase in the near future.

45. In the long run equilibrium in this market,

A. price will equal $5, and there will be 20 firms in the industry.
B. price will equal $5, and there will be 10 firms in the industry.
C. price will equal $8, and there will be 20 firms in the industry.
D. price will equal $5 and total output will equal 500 units, but there is not enough information to know how many firms there will be.

46. A starting assumption about this industry was that all of the firms had identical cost functions. This assumption

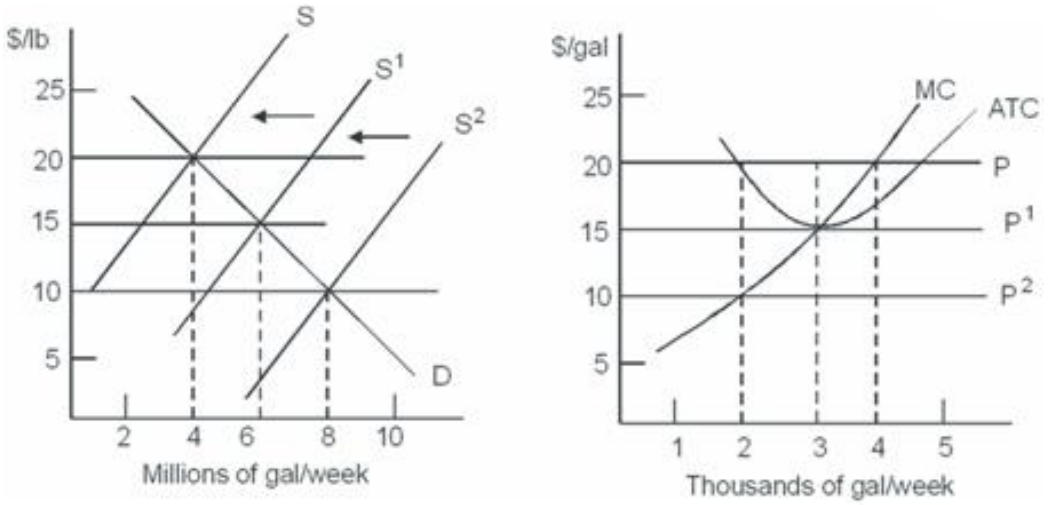
A. is unrealistic because all firms are unique.
B. is realistic because any cost advantage of one firm will be quickly adopted by the others.
C. is unrealistic because firms closely guard their production process secrets.
D. is unrealistic because competition forces all firms to seek the most efficient production processes.

47. Which ordering best describes how a perfectly competitive industry would respond to a sudden increase in popularity of the product? The market demand function will shift to the right causing the market

A. price to increase, and a new stable equilibrium to be established at a higher price and higher quantity.
B. price to increase, and all firms in the industry will earn higher profits at lower quantities of output.
C. price to increase. Increased profits will encourage new firms to enter shifting the market supply function to the right. Long-run market equilibrium will be at a higher quantity but at the same price as before the surge in popularity.
D. price and quantity supplied to increase. Increased profits will encourage new firms to enter shifting the market supply function upward. Long-run market equilibrium will be at a higher quantity and higher price than before the surge in popularity.

48. One assumption of the perfectly competitive model is that there are no barriers to entry. This assumption most directly leads to the implication that

A. firms will spend significant amounts of money on advertising.
B. positive economic profits will only be possible for a fairly short period of time.
C. firms will compete on the basis of better service and amenities rather than price.
D. price will equal marginal revenue.



49. Refer to the figure above. If S^2 is the short-run industry supply curve for a honey producer, the profit maximizing output for a single firm is _____ liters.

A. 500

B. 1000

C. 1500

D. 2000

50. Refer to the figure above. Suppose S^2 is the industry supply curve. At the profit maximizing quantity price will _____ the opportunity cost of the resources required to enter the market and firms will _____.

A. be less than; exit the market.

B. exceed; exit the market

C. exceed; enter market.

D. be less than; enter the market

51. Refer to the figure above. If S^2 is the short-run industry supply curve for a honey producer, what is the profit (loss) for this firm?

A. $10,000
B. $15,000
C. $20,000
D. $30,000

52. Refer to the figure above. Suppose S^2 is the industry supply curve and all firms are producing at the profit maximizing quantity. What will happen to the supply curve in the long run?

A. Quantity supplied will increase but stay on the S^2 curve.
B. Supply will shift to S^1.
C. Supply will shift to S.
D. Quantity supplied will decrease but stay on S^2 curve.

53. Refer to the figure above. In the long run equilibrium price is _____ and an individual firm's profit maximizing quantity is _____.

A. $20; 4 million
B. $15; 6 million
C. $15; 3 thousand
D. $10; 8 million

54. Refer to the figure above. What will be the long-run economic profit for this firm?

A. $0
B. $10,000
C. $15,000
D. $20,000

55. If buyers and sellers are free to pursue their own selfish interests, according to the invisible hand theory, the result would be

A. anarchy.
B. exploitation of workers and natural resources.
C. an equitable allocation of resources.
D. an efficient allocation of resources.

56. Suppose a remote community in Lebanon lacks broadband access to the Internet. A proponent of the invisible hand view would argue that

A. government regulation is necessary to ensure access.
B. the selfish pursuit of profit by Internet service providers will bring access to those willing to pay for it.
C. the consumers need to move to a large city.
D. the lack of access is the efficient allocation.

57. E-commerce and an Internet presence are important to many firms, requiring employees with specialized skills that are in short supply. The invisible hand solves the employment problem by

A. encouraging the government to set up new training programs.
B. giving selfish workers the incentive to acquire the skills in order to receive high wages.
C. allowing the few employees with the skills to exploit the firms.
D. moving slowly until the e-commerce craze ends.

58. In a free market economy the decisions of buyers and sellers are

A. random.
B. motivated by custom and tradition.
C. in need of coordination by the government.
D. guided by prices.

59. If resources are misallocated, then the presence of opportunities to profit

A. will exist and self interests will ensure someone will profit.
B. will exist but it is uncertain if someone will seek to profit.
C. may or may not exist.
D. will exist but no one will recognize their existence.

60. Barriers to entry

A. will be established by firms earning economic losses.
B. are forces that limit new firms from joining an industry.
C. have little impact on the ability of the invisible hand to allocate resources efficiently.
D. are uncommon today due to antitrust enforcement.

61. The ability of the invisible hand to allocate resources efficiently is

A. improved by the existence of barriers to entry.
B. rarely observed in practice.
C. reduced by the presence of barriers to entry.
D. an historic idea that has been disproven by modern economics.

62. Adam Smith claimed that an efficient allocation of resources was the byproduct of

A. selfish interests of sellers pursuing profit.
B. well intentioned government regulation.
C. selfish interests of buyers pursuing pleasure.
D. the involvement of self-interested buyers and sellers.

63. Economic rent is

A. the amount you pay for an apartment in a free market.
B. the payment made to suppliers of an input.
C. the difference between the payment made to the supplier of an input and the supplier's reservation price.
D. the same as the input supplier's reservation price.

64. Malika is willing to baby-sit for $6 an hour. Her neighbor called and asked her to baby-sit for $8 an hour. Malika will earn

A. consumer surplus of $2.
B. economic rent of $2
C. economic profit of $8.
D. accounting profit of $8, but economic profit of 0.

65. Economic rent

A. is always positive.
B. is driven towards zero.
C. can be positive, zero, or negative.
D. can never be negative.

66. Adel Imam's economic rent from starring in a movie is equal to the difference between

A. his initial offer and his final salary, including royalties.
B. his initial offer and the what he could earn in a different film.
C. his final salary and the average for leading actors.
D. his final salary and the least he would be willing to accept for a role.

67. Superstar professional athletes can sustain their economic rents because

A. team owners will pay anything to win the championship.
B. they have excellent union representation.
C. their opportunity costs of playing are high.
D. if their current team does not pay, they can take their unique talents to another team willing to pay.

68. Unlike economic profits, economic rents

A. can be less than zero.
B. can't be easily driven to zero by entry.
C. don't involve the idea of opportunity costs.
D. only apply to land.

69. Dani is a particularly highly skilled negotiator. The law firm that hires Dani is able to collect twice as much revenue per hour of Dani's time than it can for any other negotiator in town. The increased revenue will

A. be evenly split between Dani and the law firm to maximize surplus.
B. all go to the law firm because the firm bears the risk of running the business.
C. all go to Dani because if it didn't, another firm could hire Dani away.
D. be split, with 75% going to Dani and 25% going to the law firm.

70. If a single firm, belonging to a perfectly competitive industry in long run equilibrium, discovers a significant cost saving methodology, then

A. all firms will enjoy economic profits for a short period of time.
B. the rest of the industry will quickly adopt the new methodology.
C. the firm will enjoy economic profits forever.
D. the firm will lower its price to drive the rest of the industry out of business.

71. Suppose several Egyptian software design companies compete with each other in a perfectly competitive environment. If one company decides to move some of its offices to a low-wage country (i.e. India) in order to reduce operating costs

A. the other companies will still be able to remain profitable while operating solely in Egypt.
B. the company that moves to the lower-wage country will earn positive economic profits in the long run because it will keep a cost advantage.
C. the other companies will also move to the low wage country in order to remain in the industry.
D. the first company to move will charge a lower price than the companies remaining in Egypt.

72. Cost saving developments, e.g., a new production procedure that shortens a production process by two steps, in a perfectly competitive industry lead to

A. entry by new firms.
B. economic profits by new firms.
C. economic profits for a few firms for a short time.
D. a leftward shift of the supply curve.

73. In markets with regulated prices, the invisible hand

A. is irrelevant.
B. will guide resources on some basis other than the price that is regulated.
C. serves to allocate resources on the basis of price as in unregulated markets.
D. becomes truly invisible.

Suppose the city of Casablanca, Morocco chooses to regulate the number of street vendors operating downtown by requiring each vendor to own a permit in order to operate. The city gives permits to all existing vendors and announces that no new permits will ever be issued. Prior to regulation, the costs (including implicit costs) of operating were $85,000 and revenues were $150,000. The city ordinance allows the permits to be bought and sold without restriction. The permits have no expiration date. The interest rate is 10 percent.

74. Prior to the option of the ordinance, street vendors were earning

A. economic profits of zero.
B. accounting profits of $65,000.
C. a normal profit.
D. economic profits of $65,000.

75. If the regulation requiring permits had not been passed, one could predict

A. entry would have driven economic profits to zero.
B. street congestion would have fallen.
C. exit would have driven economic profits higher.
D. entry would have driven accounting profits to zero.

76. After the permits are issued and required,

A. no one will express interest in purchasing a permit.
B. nothing changes because the number of permits equals the previous number of vendors.
C. a market for the permits will rapidly develop.
D. a market for the permits will not develop.

77. The equilibrium price of permits is

A. $650,000.
B. $150,000.
C. $65,000.
D. $6,500.

78. After regulation, street vendors earn

A. accounting profit of zero.
B. economic profit.
C. economic rent of $65,000.
D. economic loss.

79. Marwan, one of the current street vendors, has gone from earning an economic profit to earning a normal profit because

A. his implicit costs have risen by $650,000.
B. his explicit costs have risen by $65,000.
C. his revenues have fallen by $65,000.
D. his implicit costs have risen by $65,000.

80. From the perspective of a current street vendor, the regulation requiring permits has had

A. a negative effect; his economic profits are now zero.
B. no effect; his $65,000 economic profit is now an economic rent.
C. a negative effect; the opportunity cost of continuing in the business has increased.
D. a positive effect; he is now guaranteed $65,000 per year whether he operates or sells his permit.

81. Which of the following groups had the strongest incentive to support the permit requirement?

A. Current street vendors
B. Buyers who shop the street vendors
C. Downtown shops
D. The local police

82. Suppose the interest rate falls from 10% to 9%. The price of a permit is now

A. $6.5 million.
B. $722,222.
C. $650,000.
D. $65,000.

83. Suppose the interest rate rises from 10% to 12%. The price of a permit is now

A. $722,222.
B. $650,000.
C. $541,666.
D. $78,000.

84. According to the textbook, when airlines were regulated with respect to airfares, they competed with each other on the basis of

A. frequent flyer miles.
B. safety record.
C. holiday travel discounts.
D. number of flights to and from a particular city.

85. During the era of regulated airfares,

A. economic profits were substantial.
B. consumer satisfaction was very high.
C. economic profits were efficiently driven towards zero.
D. economic profits were inefficiently driven towards zero.

86. Suppose the government grants grain subsidies to poor farmers to raise farm family incomes. In the long run,

A. poor farm families are made permanently better off.
B. as the profits of farming increase, new farmers will emerge from other sectors and drive profits to zero.
C. as new farmers enter, government will lessen the size of the subsidy.
D. the quality of grains will fall.

87. If firms are prevented from competing on the basis of price, they will

A. not be able to achieve equilibrium.
B. be able to sustain greater-than-normal profits in the long run.
C. exit the industry and enter an unregulated industry.
D. compete on the basis of customer service and other amenities.

88. Efforts to raise the incomes of those in a particular industry fail because of

A. poor management of the program.
B. cheating and corruption.
C. a lack of motivation among the workers.
D. the invisible hand moving workers out of other industries and into the government supported one.

89. The statement "If a deal is too good to be true, it probably is not true" is most closely related to which principle?

A. The low-hanging fruit principle
B. The no-cash-on-the-table principle
C. The cost-benefit principle
D. The diminishing marginal returns principle

90. The No Cash on the Table principle means unexploited opportunities

A. never exist.
B. cannot be exploited for long.
C. can exist in equilibrium but rarely do.
D. always exist in equilibrium.

91. Applying the No Cash on the Table principle to the stock market means new information

A. provides opportunities to the first few who act on it.
B. provides opportunities to all investors.
C. was already contained in the stock price.
D. fails to affect the market.

92. The founder of e-Bay has earned large economic profits. The No Cash on the Table principle suggests

A. starting a new Internet auction company today would result in economic profits as well.
B. starting a new Internet auction company today would result in, at best, a normal profit.
C. all profitable e-business ideas have been developed.
D. sooner or later, e-Bay will experience economic losses.

93. The Smart for One, Dumb for All principle indicates that

A. pursuing selfish interests always promotes social welfare.
B. if everyone is doing it, you should not.
C. pursuing selfish interests always lessens social welfare.
D. pursuing selfish interests sometimes conflicts with social welfare.

At your local bank, two lines are open, One and Two, and four customers are in the bank: A,B,C, and D. Suppose that all customers take exactly 5 minutes to conduct their business, and all of the customers know this. The time is 9:59:59 am, and tellers have just starting taking care of customers A and B. Jihane enters the bank at 10:00 am and Hamzah enters the bank at 10:03. Neither knows that Line Three will open up at 10:05 am. Assume that all bank customers seek to shorten their time in line. Notes: 1) Conducting your own business is not included in waiting time to you and 2) It may prove useful to illustrate the positions of new customers in the table.

Line One	Line Two	Line Three
A	B	
C	D	

94. Jihane anticipates a wait time of _____, and Hamzah anticipates a wait time of _____.

A. 5 minutes in either line; 7 minutes in either line.

B. 10 minutes in either line; 7 minutes in the line without Jihane.

C. 5 minutes in either line, 10 minutes in either line.

D. 10 minutes in either line; 5 minutes in the line without Jihane.

95. Suppose that after a new line opens at 10:05 am Jihane switches to it. Hamzah is

A. better off if he stays put in his current line.

B. better off if he switches to the newly opened line.

C. better off if he switches to Jihane's old line.

D. equally well off whether he switches to the new line or stays put.

96. After a new line opens at 10:05 am,

A. an unexploited opportunity exists.
B. unexploited opportunities exist for both Jihane and Hamzah.
C. equilibrium waiting time is unchanged.
D. the bank will close one.

97. In this example, doing better than one's next best alternative means shortening the wait time by switching lines rather than staying in the line one started in. By this criteria, when the new line opened,

A. bank customers A, B, C, D, Jihane and Hamzah all experienced economic profit.
B. Jihane and Hamzah both received economic profit.
C. Hamzah received economic profit.
D. Jihane received economic profit.

98. Banks often have one line serving multiple teller stations. The next person in line is helped by the next teller available. Grocery stores typically have a separate line for each clerk. Why might that be?

A. Lines must move faster in a grocery store because frozen food will melt.
B. Banks allocate service using the first come, first served method and grocery stores allocate service using the price method.
C. Grocery stores are more interested in efficiency, and banks are more interested in customer service.
D. Bulky shopping carts make a single line impractical in a grocery store, but people waiting in line at the bank do not have to maneuver carts through the line.

99. When either the costs of production or the benefits of consumption to individuals differ from those of society,

A. the equilibrium output will be the socially optimal output.
B. the equilibrium is not efficient.
C. the allocation of resources remains correct.
D. the invisible had had completely failed.

100. Adam Smith believed that the individual pursuit of self-interest

A. was a basic human instinct that must be curbed in order for society to advance.
B. always worked to undermine social benefits.
C. always worked to advance social benefits.
D. sometimes worked to advance social benefits.

101. According to the textbook, individual incentives have led to

A. the optimal number of stock market analysts because it is a competitive market with no entry barriers.
B. too many stock market analysts because market analysis does not produce social benefits.
C. too many stock market analysts because the individual incentive to forecast faster exceeds the social benefit of a faster forecast.
D. too few stock market analysts because the efficient market hypothesis predicts that no analyst will do better than random chance in the long run.

Chapter 07 Testbank Key

1. Perfectly competitive firms maximize profit when

A. average costs are minimized

B. total costs are minimized

C. average costs equal price

D. marginal costs equal price

AACSB: Analytical Skills

Blooms: Knowledge

Frank - Chapter 07 #1

Learning Objective: 07-01 Determine a perfectly competitive firms profit maximizing output level and profit in the short run.

Section: Perfect Competition

2. If a perfectly competitive firm produces an output level where price is greater than marginal costs, then the firm should

A. pay more to its variable factors of production.

B. contract output to earn greater profits or smaller losses.

C. expand output to earn greater profits or smaller losses.

D. leave its output decision unchanged.

AACSB: Analytical Skills

Blooms: Understanding

Frank - Chapter 07 #2

Learning Objective: 07-01 Determine a perfectly competitive firms profit maximizing output level and profit in the short run.

Section: Perfect Competition

3. If a perfectly competitive firm produces an output level where price is less than marginal costs, then the firm should

A. raise its price.

B. contract output to earn greater profits or smaller losses.

C. expand output to earn greater profits or smaller losses.

D. leave its output decision unchanged.

AACSB: Analytical Skills
Blooms: Understanding
Frank - Chapter 07 #3
Learning Objective: 07-01 Determine a perfectly competitive firms profit maximizing output level and profit in the short run.
Section: Perfect Competition

4. An increase in the price the firm receives for its output will cause the firm to

A. expand output and earn greater profits or smaller losses.

B. leave output unchanged and earn greater profits.

C. leave output unchanged and earn greater profits or smaller losses.

D. contract output and earn greater profits.

AACSB: Analytical Skills
Blooms: Understanding
Frank - Chapter 07 #4
Learning Objective: 07-01 Determine a perfectly competitive firms profit maximizing output level and profit in the short run.
Section: Perfect Competition

5. A decrease in the price the firm receives for its output will cause the firm to

A. expand output and earn smaller profits.

B. cut wages and payments to factors of production.

C. leave output unchanged and earn smaller profits.

D. contract output and earn smaller profits or larger losses.

AACSB: Analytical Skills
Blooms: Understanding
Frank - Chapter 07 #5
Learning Objective: 07-01 Determine a perfectly competitive firms profit maximizing output level and profit in the short run.
Section: Perfect Competition

6. A firm's output price is $5 and the firm is producing 37 units with a marginal cost of $3. The firm should

A. lower its price.

B. decrease production.

C. increase production.

D. raise its price.

AACSB: Analytical Skills
Blooms: Application
Frank - Chapter 07 #6
Learning Objective: 07-01 Determine a perfectly competitive firms profit maximizing output level and profit in the short run.
Section: Perfect Competition

7. A firm's output price is $8 and the firm is producing 77 units with a marginal cost of $11. The firm should

A. lower its price.

B. decrease production.

C. increase production.

D. raise its price.

AACSB: Analytical Skills
Blooms: Application
Frank - Chapter 07 #7
Learning Objective: 07-01 Determine a perfectly competitive firms profit maximizing output level and profit in the short run.
Section: Perfect Competition

8. A perfectly competitive firm's output price is $7 and the firm is producing 1,000 units with a marginal cost of $7. The firm should

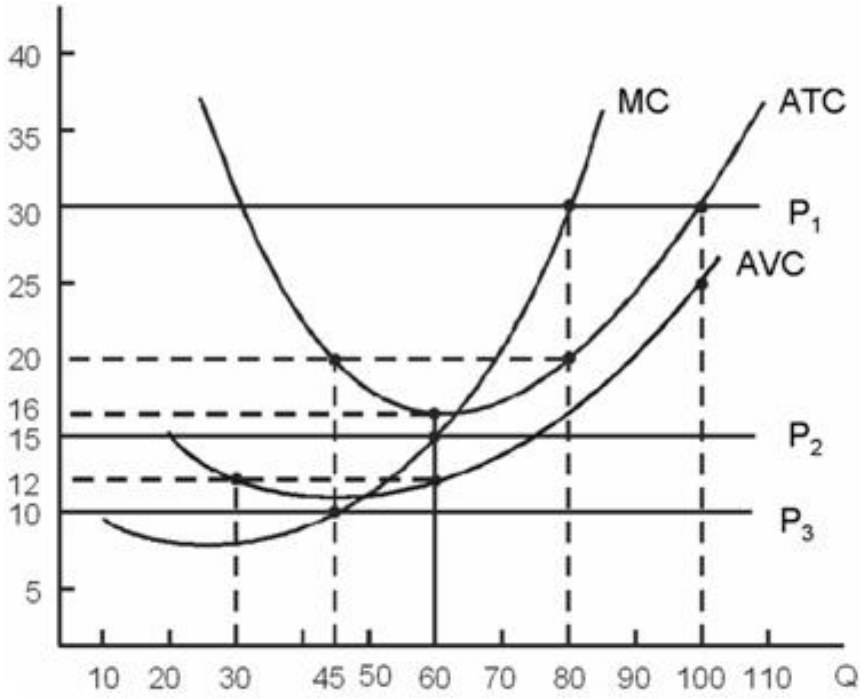
A. leave production and price unchanged.

B. increase price to increase profits.

C. increase production to increase profits.

D. decrease production to lower losses.

AACSB: Analytical Skills
Blooms: Application
Frank - Chapter 07 #8
Learning Objective: 07-01 Determine a perfectly competitive firms profit maximizing output level and profit in the short run.
Section: Perfect Competition



Frank - Chapter 07

9. Refer to the figure above. When the demand is P_1 = \$30, what is the profit maximizing output?

A. 30

B. 45

C. 60

D. 80

AACSB: Analytical Skills

Blooms: Application

Frank - Chapter 07 #9

Learning Objective: 07-01 Determine a perfectly competitive firms profit maximizing output level and profit in the short run.

Section: Perfect Competition

10. Refer to the figure above. When the demand is P_1 = \$30, what is the total revenue?

A. \$ 900

B. \$1350

C. \$800

D. \$2400

AACSB: Analytical Skills

Blooms: Application

Frank - Chapter 07 #10

Learning Objective: 07-01 Determine a perfectly competitive firms profit maximizing output level and profit in the short run.

Section: Perfect Competition

11. Refer to the figure above. When the demand is P_1 = \$30, what is the total cost?

A. \$ 960

B. \$ 1200

C. \$ 1600

D. \$ 2500

AACSB: Analytical Skills

Blooms: Application

Frank - Chapter 07 #11

Learning Objective: 07-01 Determine a perfectly competitive firms profit maximizing output level and profit in the short run.

Section: Perfect Competition

12. Refer to the figure above. When the demand is P_1 = \$30, how much profit is this producer earning?

A. \$ 500

B. \$ 800

C. \$ 1200

D. \$ 1600

AACSB: Analytical Skills
Blooms: Application
Frank - Chapter 07 #12
Learning Objective: 07-01 Determine a perfectly competitive firms profit maximizing output level and profit in the short run.
Section: Perfect Competition

13. Refer to the figure above. When the demand is P_2 = \$15, what is the profit maximizing output?

A. 30

B. 45

C. 60

D. 80

AACSB: Analytical Skills
Blooms: Application
Frank - Chapter 07 #13
Learning Objective: 07-01 Determine a perfectly competitive firms profit maximizing output level and profit in the short run.
Section: Perfect Competition

14. Refer to the figure above. When the demand is P_2 = $15, this producer will earn a _____ of _____.

A. Loss, $60

B. Profit, $180

C. Loss, $300

D. Loss, $900

AACSB: Analytical Skills
Blooms: Application
Frank - Chapter 07 #14
Learning Objective: 07-01 Determine a perfectly competitive firms profit maximizing output level and profit in the short run.
Section: Perfect Competition

15. Refer to the figure above. When the demand is P_2 = $15, this firm should _____

A. continue to operate in the short run and think about shutting down in the long run

B. discontinue operation in the short run since there is a loss when operating.

C. keep operating as long as loss is not greater than total cost

D. discontinue operation in the short run since average total cost is greater than price.

AACSB: Reflective Thinking Skills
Blooms: Analysis
Frank - Chapter 07 #15
Learning Objective: 07-01 Determine a perfectly competitive firms profit maximizing output level and profit in the short run.
Section: Perfect Competition

16. Assuming the firm is experiencing diminishing marginal returns to its variable factors of production, as output price rises the firm will

A. produce more.

B. earn profits.

C. produce less.

D. earn losses.

AACSB: Analytical Skills
Blooms: Understanding
Frank - Chapter 07 #16
Learning Objective: 07-01 Determine a perfectly competitive firms profit maximizing output level and profit in the short run.
Section: Perfect Competition

17. Firms will not produce if price is less than _____ costs, and so only the part of the _____cost curve above that point is the supply curve.

A. average total; marginal

B. average fixed; marginal

C. average variable; average

D. average variable; marginal

AACSB: Analytical Skills
Blooms: Understanding
Frank - Chapter 07 #17
Learning Objective: 07-01 Determine a perfectly competitive firms profit maximizing output level and profit in the short run.
Section: Perfect Competition

18. The statement, "price distributes goods and services to those that value them the most" refers to the _____ function of price.

A. allocative
B. multiplicative
C. store of value
D. rationing

AACSB: Analytical Skills
Blooms: Knowledge
Frank - Chapter 07 #18
Learning Objective: 07-02 Show how economic profit and economic loss affect the allocation of resources across industries.
Section: Perfect Competition

19. The statement, "price directs resources across different sectors of the economy" refers to the _____ function of price.

A. allocative
B. store of value
C. rationing
D. transitivity

AACSB: Analytical Skills
Blooms: Knowledge
Frank - Chapter 07 #19
Learning Objective: 07-02 Show how economic profit and economic loss affect the allocation of resources across industries.
Section: Perfect Competition

20. Which of the following would be an example of the rationing function of price?

A. Switching from a Ph.D. in economics to finance because finance salaries are higher

B. Carlos Slim purchasing the Mona Lisa for $5 billion

C. A firm attempting to lower its explicit costs

D. Government price controls

AACSB: Analytical Skills
Blooms: Understanding
Frank - Chapter 07 #20
Learning Objective: 07-02 Show how economic profit and economic loss affect the allocation of resources across industries.
Section: Perfect Competition

21. Which of the following would be an example of the allocative function of price?

A. A consumer deciding the price of steak is more than she wishes to pay

B. Losing $50 at a roadside rest stop

C. Switching from a Ph.D. in economics to finance because finance salaries are higher

D. Finding $50 that somebody lost at a rest stop

AACSB: Analytical Skills
Blooms: Understanding
Frank - Chapter 07 #21
Learning Objective: 07-02 Show how economic profit and economic loss affect the allocation of resources across industries.
Section: Perfect Competition

22. _____ work together to guide resources to their highest value.

A. The explicit cost and the implicit cost of a profit maximizing firm

B. The short run and long run supply curve

C. The rationing and allocative functions of price

D. The economic profit and accounting profit

AACSB: Analytical Skills

Blooms: Understanding

Frank - Chapter 07 #22

Learning Objective: 07-02 Show how economic profit and economic loss affect the allocation of resources across industries.

Section: Perfect Competition

23. Harvard University charges very high tuition while other private universities charge less. This illustrates the _____ function of price.

A. allocative

B. distributive

C. communicative

D. rationing

AACSB: Analytical Skills

Blooms: Understanding

Frank - Chapter 07 #23

Learning Objective: 07-02 Show how economic profit and economic loss affect the allocation of resources across industries.

Section: Perfect Competition

24. Generally, _____ motivate firms to enter an industry while _____ motivate firms to exit an industry.

A. economic profits; economic losses

B. accounting profits; accounting losses

C. accounting profits; economic losses

D. economic profits; accounting losses

AACSB: Analytical Skills

Blooms: Understanding

Frank - Chapter 07 #24

Learning Objective: 07-02 Show how economic profit and economic loss affect the allocation of resources across industries.

Section: Perfect Competition

Suppose last year Omar was a soybean farmer and Haytham was a corn farmer. This year high demand for ethanol, an automobile fuel made from corn, causes the price of corn to increase.

Frank - Chapter 07

25. You would predict that this year Omar will

A. grow more soybeans.
B. switch to growing corn.
C. continue to grow the same amount of soybeans.
D. go out of business.

AACSB: Analytical Skills
Blooms: Application
Frank - Chapter 07 #25
Learning Objective: 07-02 Show how economic profit and economic loss affect the allocation of resources across industries.
Section: Perfect Competition

26. Relative to last year, the price of soybeans is likely to be _____ and the price of corn is likely to be _____.

A. higher; higher
B. higher; lower
C. lower, higher
D. the same; higher

AACSB: Analytical Skills
Blooms: Application
Frank - Chapter 07 #26
Learning Objective: 07-02 Show how economic profit and economic loss affect the allocation of resources across industries.
Section: Perfect Competition

27. Suppose all firms in a perfectly competitive industry are experiencing economic profits. One would expect that, over time, the number of firms will _____ and the market price will _____.

A. rise; fall

B. fall; rise

C. rise; rise

D. rise; stay the same

AACSB: Analytical Skills
Blooms: Understanding
Frank - Chapter 07 #27
Learning Objective: 07-02 Show how economic profit and economic loss affect the allocation of resources across industries.
Section: Perfect Competition

28. If all firms in a perfectly competitive industry earn a normal profit, then

A. new firms will enter the industry.

B. old firms will exit the industry.

C. the number of firms in the industry is stable.

D. market supply will shift to the left.

AACSB: Analytical Skills
Blooms: Understanding
Frank - Chapter 07 #28
Learning Objective: 07-02 Show how economic profit and economic loss affect the allocation of resources across industries.
Section: Perfect Competition

29. If all firms in a perfectly competitive industry are experiencing economic losses, then firms will

A. exit the industry, until economic profits are positive.

B. exit the industry, until accounting profits equal zero.

C. continue in the industry, hoping for better times.

D. exit the industry, until economic profits equal zero.

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Blooms: Understanding
Frank - Chapter 07 #29
Learning Objective: 07-02 Show how economic profit and economic loss affect the allocation of resources across industries.
Section: Perfect Competition

30. The signal for new firms to join an industry is

A. economic profits.

B. normal profits.

C. accounting profits.

D. economic losses.

AACSB: Analytical Skills
Blooms: Knowledge
Frank - Chapter 07 #30
Learning Objective: 07-02 Show how economic profit and economic loss affect the allocation of resources across industries.
Section: Perfect Competition

31. For entry into a particular perfectly competitive industry to occur, which of the following must be true?

A. Accounting profits = 0
B. Accounting profits = Economic profits
C. Economic profits > 0
D. Economic profits = 0

AACSB: Analytical Skills
Blooms: Understanding
Frank - Chapter 07 #31
Learning Objective: 07-02 Show how economic profit and economic loss affect the allocation of resources across industries.
Section: Perfect Competition

32. In an industry with free entry and exit, economic profits

A. indicate a market failure.
B. can never occur.
C. induce a reallocation of resources out of other industries and into the one with economic profits.
D. can be sustained indefinitely.

AACSB: Analytical Skills
Blooms: Understanding
Frank - Chapter 07 #32
Learning Objective: 07-02 Show how economic profit and economic loss affect the allocation of resources across industries.
Section: Perfect Competition

33. Economic losses are

A. less important than accounting losses.

B. encountered only when total revenues are less than explicit costs.

C. a signal that reallocation of resources out of the industry needs to occur.

D. present if firms just earn a normal profit.

AACSB: Analytical Skills
Blooms: Understanding
Frank - Chapter 07 #33
Learning Objective: 07-02 Show how economic profit and economic loss affect the allocation of resources across industries.
Section: Perfect Competition

34. In a perfectly competitive industry over the long run,

A. economic profits tend to persist.

B. the number of firms in an industry grows.

C. economic losses tend to persist.

D. economic profits and losses are driven towards zero by entry and exit.

AACSB: Analytical Skills
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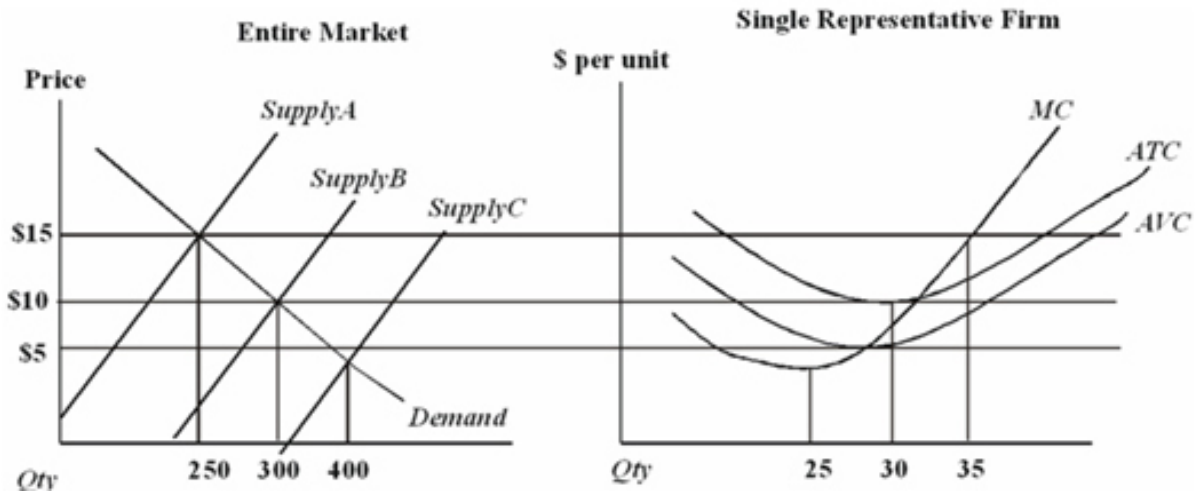
Frank - Chapter 07 #34
Learning Objective: 07-02 Show how economic profit and economic loss affect the allocation of resources across industries.
Section: Perfect Competition

Assume that all firms in this industry have identical cost functions.



Frank - Chapter 07

35. The long-run equilibrium price in this industry is

A. $15

B. $10.

C. $5.

D. $5 for some firms and $10 for others.

AACSB: Analytical Skills

Blooms: Application

Frank - Chapter 07 #35

Learning Objective: 07-02 Show how economic profit and economic loss affect the allocation of resources across industries.

Section: Perfect Competition

36. The long-run equilibrium supply in this industry is

A. Supply A.

B. Supply B.

C. Supply C.

D. A Supply function that lies between Supply A and Supply B.

AACSB: Analytical Skills

Blooms: Application

Frank - Chapter 07 #36

Learning Objective: 07-02 Show how economic profit and economic loss affect the allocation of resources across industries.

Section: Perfect Competition

37. When price is $15 in this industry,

A. the industry is in its long run equilibrium.

B. it is because supply has shifted from Supply B to Supply A because firms that were not making a profit left the industry.

C. new firms will be expected to enter.

D. all firms are making zero economic profits.

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Blooms: Application

Frank - Chapter 07 #37

Learning Objective: 07-02 Show how economic profit and economic loss affect the allocation of resources across industries.

Section: Perfect Competition

38. Firms in this industry will shut down if the price is

A. higher in the short run than in the long run.

B. less than or equal to $15.

C. less than or equal to $10.

D. less than or equal to $5

AACSB: Analytical Skills

Blooms: Application

Frank - Chapter 07 #38

Learning Objective: 07-02 Show how economic profit and economic loss affect the allocation of resources across industries.

Section: Perfect Competition

39. The firm depicted in the graph on the right faces a demand curve that

A. is horizontal at the market price.

B. is downward sloping, and less than market demand curve.

C. is the same as the marginal cost curve.

D. is the same as the market demand curve.

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Blooms: Application

Frank - Chapter 07 #39

Learning Objective: 07-02 Show how economic profit and economic loss affect the allocation of resources across industries.

Section: Perfect Competition

40. In the long run, there will be _____ firms in this market.

A. 10

B. 15

C. 25

D. 50

AACSB: Reflective Thinking Skills

Blooms: Analysis

Frank - Chapter 07 #40

Learning Objective: 07-02 Show how economic profit and economic loss affect the allocation of resources across industries.

Section: Perfect Competition

41. An implication of entry and exit in response to the profit incentive is that, for perfectly competitive firms,

A. no firm accepts zero economic profits in the long run.
B. firms produce the quantity that minimizes average variable costs in the short run.
C. firms produce the quantity that minimizes average total costs in the long run.
D. demand is completely inelastic

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Blooms: Analysis
Frank - Chapter 07 #41
Learning Objective: 07-02 Show how economic profit and economic loss affect the allocation of resources across industries.
Section: Perfect Competition

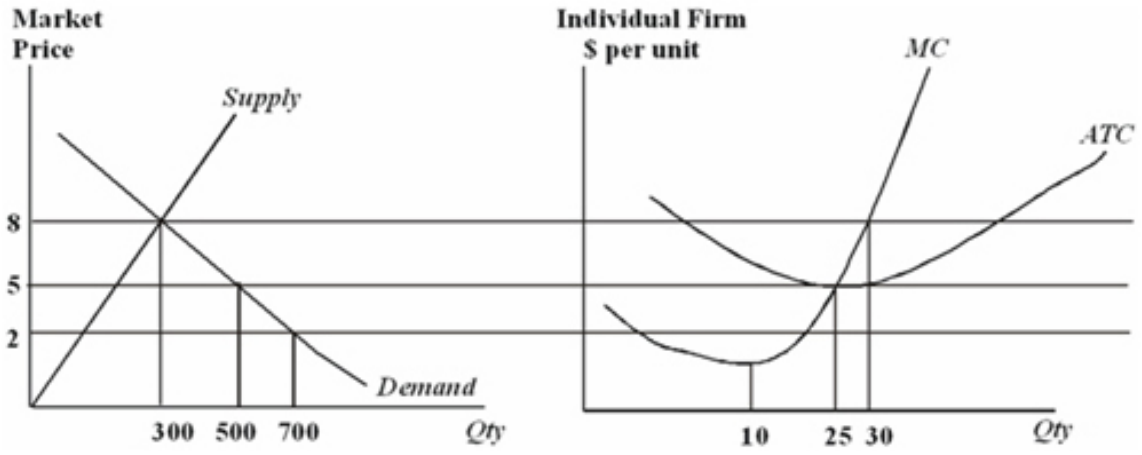
42. One difference between the long run and the short run in a perfectly competitive industry is that

A. economic profits in the long run are always greater than they are in the short run.
B. economic profits in the short run are always greater than they are in the long run.
C. firms necessarily operate at the output level that minimizes average total cost only in the long run.
D. marginal revenue equals price only in the long run.

AACSB: Analytical Skills
Blooms: Understanding
Frank - Chapter 07 #42
Learning Objective: 07-02 Show how economic profit and economic loss affect the allocation of resources across industries.
Section: Perfect Competition

The following graphs depict a perfectly competitive firm and its market.

Assume that all firms in this industry have identical cost functions.



Frank - Chapter 07

43. The long run equilibrium quantity in this industry is

A. 300.

B. 500

C. 700

D. more than 700.

AACSB: Analytical Skills

Blooms: Application

Frank - Chapter 07 #43

Learning Objective: 07-02 Show how economic profit and economic loss affect the allocation of resources across industries.

Section: Perfect Competition

44. Assume that the market is currently as shown in the graph on the left (i.e., price of $8). What is true of the number of firms?

A. There are currently 30 firms in the industry, and that number will remain stable until there is a change in demand or in technology.
B. There are currently ten firms in this industry, and that number will remain stable until there is a change in demand or in technology.
C. It is impossible to tell how many firms currently exist in this industry, but you can tell that the number of firms is likely to increase in the near future.
D. There are currently ten firms in this industry, and that number is likely to increase in the near future.

AACSB: Reflective Thinking Skills
Blooms: Analysis
Frank - Chapter 07 #44
Learning Objective: 07-02 Show how economic profit and economic loss affect the allocation of resources across industries.
Section: Perfect Competition

45. In the long run equilibrium in this market,

A. price will equal $5, and there will be 20 firms in the industry.
B. price will equal $5, and there will be 10 firms in the industry.
C. price will equal $8, and there will be 20 firms in the industry.
D. price will equal $5 and total output will equal 500 units, but there is not enough information to know how many firms there will be.

AACSB: Analytical Skills
Blooms: Application
Frank - Chapter 07 #45
Learning Objective: 07-02 Show how economic profit and economic loss affect the allocation of resources across industries.
Section: Perfect Competition

46. A starting assumption about this industry was that all of the firms had identical cost functions. This assumption

A. is unrealistic because all firms are unique.
B. is realistic because any cost advantage of one firm will be quickly adopted by the others.
C. is unrealistic because firms closely guard their production process secrets.
D. is unrealistic because competition forces all firms to seek the most efficient production processes.

AACSB: Reflective Thinking Skills
Blooms: Analysis
Frank - Chapter 07 #46
Learning Objective: 07-02 Show how economic profit and economic loss affect the allocation of resources across industries.
Section: Perfect Competition

47. Which ordering best describes how a perfectly competitive industry would respond to a sudden increase in popularity of the product? The market demand function will shift to the right causing the market

A. price to increase, and a new stable equilibrium to be established at a higher price and higher quantity.
B. price to increase, and all firms in the industry will earn higher profits at lower quantities of output.
C. price to increase. Increased profits will encourage new firms to enter shifting the market supply function to the right. Long-run market equilibrium will be at a higher quantity but at the same price as before the surge in popularity.
D. price and quantity supplied to increase. Increased profits will encourage new firms to enter shifting the market supply function upward. Long-run market equilibrium will be at a higher quantity and higher price than before the surge in popularity.

AACSB: Reflective Thinking Skills
Blooms: Analysis
Frank - Chapter 07 #47

Learning Objective: 07-02 Show how economic profit and economic loss affect the allocation of resources across industries.

Section: Perfect Competition

48. One assumption of the perfectly competitive model is that there are no barriers to entry. This assumption most directly leads to the implication that

A. firms will spend significant amounts of money on advertising.

B. positive economic profits will only be possible for a fairly short period of time.

C. firms will compete on the basis of better service and amenities rather than price.

D. price will equal marginal revenue.

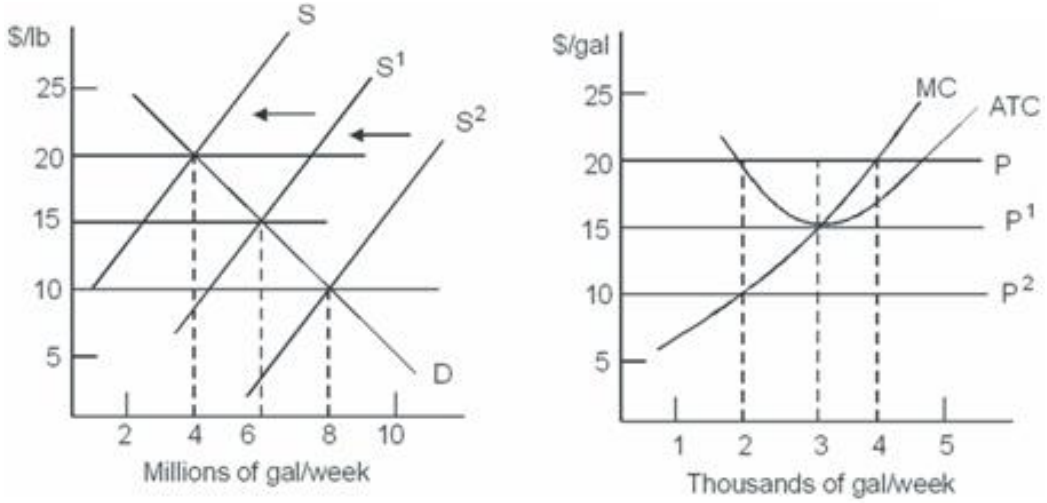
AACSB: Reflective Thinking Skills

Blooms: Analysis

Frank - Chapter 07 #48

Learning Objective: 07-02 Show how economic profit and economic loss affect the allocation of resources across industries.

Section: Perfect Competition



Frank - Chapter 07

49. Refer to the figure above. If S^2 is the short-run industry supply curve for a honey producer, the profit maximizing output for a single firm is _____ liters.

A. 500

B. 1000

C. 1500

D. 2000

AACSB: Analytical Skills

Blooms: Application

Frank - Chapter 07 #49

Learning Objective: 07-02 Show how economic profit and economic loss affect the allocation of resources across industries.

Section: Perfect Competition

50. Refer to the figure above. Suppose S^2 is the industry supply curve. At the profit maximizing quantity price will _____ the opportunity cost of the resources required to enter the market and firms will _____.

A. be less than; exit the market.

B. exceed; exit the market

C. exceed; enter market.

D. be less than; enter the market

AACSB: Analytical Skills

Blooms: Application

Frank - Chapter 07 #50

Learning Objective: 07-02 Show how economic profit and economic loss affect the allocation of resources across industries.

Section: Perfect Competition

51. Refer to the figure above. If S^2 is the short-run industry supply curve for a honey producer, what is the profit (loss) for this firm?

A. $10,000
B. $15,000
C. $20,000
D. $30,000

AACSB: Analytical Skills
Blooms: Application
Frank - Chapter 07 #51
Learning Objective: 07-02 Show how economic profit and economic loss affect the allocation of resources across industries.
Section: Perfect Competition

52. Refer to the figure above. Suppose S^2 is the industry supply curve and all firms are producing at the profit maximizing quantity. What will happen to the supply curve in the long run?

A. Quantity supplied will increase but stay on the S^2 curve.
B. Supply will shift to S^1.
C. Supply will shift to S.
D. Quantity supplied will decrease but stay on S^2 curve.

AACSB: Analytical Skills
Blooms: Application
Frank - Chapter 07 #52
Learning Objective: 07-02 Show how economic profit and economic loss affect the allocation of resources across industries.
Section: Perfect Competition

53. Refer to the figure above. In the long run equilibrium price is _____ and an individual firm's profit maximizing quantity is _____.

A. $20; 4 million

B. $15; 6 million

C. $15; 3 thousand

D. $10; 8 million

AACSB: Analytical Skills
Blooms: Application
Frank - Chapter 07 #53
Learning Objective: 07-02 Show how economic profit and economic loss affect the allocation of resources across industries.
Section: Perfect Competition

54. Refer to the figure above. What will be the long-run economic profit for this firm?

A. $0

B. $10,000

C. $15,000

D. $20,000

AACSB: Analytical Skills
Blooms: Application
Frank - Chapter 07 #54
Learning Objective: 07-02 Show how economic profit and economic loss affect the allocation of resources across industries.
Section: Perfect Competition

55. If buyers and sellers are free to pursue their own selfish interests, according to the invisible hand theory, the result would be

A. anarchy.
B. exploitation of workers and natural resources.
C. an equitable allocation of resources.
D. an efficient allocation of resources.

AACSB: Analytical Skills
Blooms: Understanding
Frank - Chapter 07 #55
Learning Objective: 07-02 Show how economic profit and economic loss affect the allocation of resources across industries.
Section: Perfect Competition

56. Suppose a remote community in Lebanon lacks broadband access to the Internet. A proponent of the invisible hand view would argue that

A. government regulation is necessary to ensure access.
B. the selfish pursuit of profit by Internet service providers will bring access to those willing to pay for it.
C. the consumers need to move to a large city.
D. the lack of access is the efficient allocation.

AACSB: Analytical Skills
Blooms: Application
Frank - Chapter 07 #56
Learning Objective: 07-02 Show how economic profit and economic loss affect the allocation of resources across industries.
Section: Perfect Competition

57. E-commerce and an Internet presence are important to many firms, requiring employees with specialized skills that are in short supply. The invisible hand solves the employment problem by

A. encouraging the government to set up new training programs.
B. giving selfish workers the incentive to acquire the skills in order to receive high wages.
C. allowing the few employees with the skills to exploit the firms.
D. moving slowly until the e-commerce craze ends.

AACSB: Analytical Skills
Blooms: Application
Frank - Chapter 07 #57
Learning Objective: 07-02 Show how economic profit and economic loss affect the allocation of resources across industries.
Section: Perfect Competition

58. In a free market economy the decisions of buyers and sellers are

A. random.
B. motivated by custom and tradition.
C. in need of coordination by the government.
D. guided by prices.

AACSB: Analytical Skills
Blooms: Understanding
Frank - Chapter 07 #58
Learning Objective: 07-02 Show how economic profit and economic loss affect the allocation of resources across industries.
Section: Perfect Competition

59. If resources are misallocated, then the presence of opportunities to profit

A. will exist and self interests will ensure someone will profit.

B. will exist but it is uncertain if someone will seek to profit.

C. may or may not exist.

D. will exist but no one will recognize their existence.

AACSB: Analytical Skills
Blooms: Understanding
Frank - Chapter 07 #59
Learning Objective: 07-02 Show how economic profit and economic loss affect the allocation of resources across industries.
Section: Perfect Competition

60. Barriers to entry

A. will be established by firms earning economic losses.

B. are forces that limit new firms from joining an industry.

C. have little impact on the ability of the invisible hand to allocate resources efficiently.

D. are uncommon today due to antitrust enforcement.

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Blooms: Understanding
Frank - Chapter 07 #60
Learning Objective: 07-02 Show how economic profit and economic loss affect the allocation of resources across industries.
Section: Perfect Competition

61. The ability of the invisible hand to allocate resources efficiently is

A. improved by the existence of barriers to entry.

B. rarely observed in practice.

C. reduced by the presence of barriers to entry.

D. an historic idea that has been disproven by modern economics.

AACSB: Analytical Skills

Blooms: Understanding
Frank - Chapter 07 #61
Learning Objective: 07-02 Show how economic profit and economic loss affect the allocation of resources across industries.
Section: Perfect Competition

62. Adam Smith claimed that an efficient allocation of resources was the byproduct of

A. selfish interests of sellers pursuing profit.
B. well intentioned government regulation.
C. selfish interests of buyers pursuing pleasure.
D. the involvement of self-interested buyers and sellers.

AACSB: Analytical Skills
Blooms: Understanding
Frank - Chapter 07 #62
Learning Objective: 07-02 Show how economic profit and economic loss affect the allocation of resources across industries.
Section: Perfect Competition

63. Economic rent is

A. the amount you pay for an apartment in a free market.
B. the payment made to suppliers of an input.
C. the difference between the payment made to the supplier of an input and the supplier's reservation price.
D. the same as the input supplier's reservation price.

AACSB: Analytical Skills
Blooms: Knowledge
Frank - Chapter 07 #63
Learning Objective: 07-03 Explain the difference between economic profit and economic rent.
Section: Economic Rent Versus Economic Profit

64. Malika is willing to baby-sit for $6 an hour. Her neighbor called and asked her to baby-sit for $8 an hour. Malika will earn

A. consumer surplus of $2.

B. economic rent of $2

C. economic profit of $8.

D. accounting profit of $8, but economic profit of 0.

AACSB: Analytical Skills
Blooms: Application
Frank - Chapter 07 #64
Learning Objective: 07-03 Explain the difference between economic profit and economic rent.
Section: Economic Rent Versus Economic Profit

65. Economic rent

A. is always positive.

B. is driven towards zero.

C. can be positive, zero, or negative.

D. can never be negative.

AACSB: Analytical Skills
Blooms: Understanding
Frank - Chapter 07 #65
Learning Objective: 07-03 Explain the difference between economic profit and economic rent.
Section: Economic Rent Versus Economic Profit

66. Adel Imam's economic rent from starring in a movie is equal to the difference between

A. his initial offer and his final salary, including royalties.

B. his initial offer and the what he could earn in a different film.

C. his final salary and the average for leading actors.

D. his final salary and the least he would be willing to accept for a role.

AACSB: Analytical Skills
Blooms: Understanding
Frank - Chapter 07 #66
Learning Objective: 07-03 Explain the difference between economic profit and economic rent.
Section: Economic Rent Versus Economic Profit

67. Superstar professional athletes can sustain their economic rents because

A. team owners will pay anything to win the championship.

B. they have excellent union representation.

C. their opportunity costs of playing are high.

D. if their current team does not pay, they can take their unique talents to another team willing to pay.

AACSB: Analytical Skills
Blooms: Understanding
Frank - Chapter 07 #67
Learning Objective: 07-03 Explain the difference between economic profit and economic rent.
Section: Economic Rent Versus Economic Profit

68. Unlike economic profits, economic rents

A. can be less than zero.

B. can't be easily driven to zero by entry.

C. don't involve the idea of opportunity costs.

D. only apply to land.

AACSB: Analytical Skills
Blooms: Understanding
Frank - Chapter 07 #68
Learning Objective: 07-03 Explain the difference between economic profit and economic rent.
Section: Economic Rent Versus Economic Profit

69. Dani is a particularly highly skilled negotiator. The law firm that hires Dani is able to collect twice as much revenue per hour of Dani's time than it can for any other negotiator in town. The increased revenue will

A. be evenly split between Dani and the law firm to maximize surplus.

B. all go to the law firm because the firm bears the risk of running the business.

C. all go to Dani because if it didn't, another firm could hire Dani away.

D. be split, with 75% going to Dani and 25% going to the law firm.

AACSB: Analytical Skills
Blooms: Application
Frank - Chapter 07 #69
Learning Objective: 07-03 Explain the difference between economic profit and economic rent.
Section: Economic Rent Versus Economic Profit

70. If a single firm, belonging to a perfectly competitive industry in long run equilibrium, discovers a significant cost saving methodology, then

A. all firms will enjoy economic profits for a short period of time.
B. the rest of the industry will quickly adopt the new methodology.
C. the firm will enjoy economic profits forever.
D. the firm will lower its price to drive the rest of the industry out of business.

AACSB: Analytical Skills
Blooms: Understanding
Frank - Chapter 07 #70
Learning Objective: 07-04 Use the theory of the invisible hand to analyze events in everyday life.
Section: Perfect Competition

71. Suppose several Egyptian software design companies compete with each other in a perfectly competitive environment. If one company decides to move some of its offices to a low-wage country (i.e. India) in order to reduce operating costs

A. the other companies will still be able to remain profitable while operating solely in Egypt.
B. the company that moves to the lower-wage country will earn positive economic profits in the long run because it will keep a cost advantage.
C. the other companies will also move to the low wage country in order to remain in the industry.
D. the first company to move will charge a lower price than the companies remaining in Egypt.

AACSB: Analytical Skills
Blooms: Understanding
Frank - Chapter 07 #71
Learning Objective: 07-04 Use the theory of the invisible hand to analyze events in everyday life.
Section: Perfect Competition

72. Cost saving developments, e.g., a new production procedure that shortens a production process by two steps, in a perfectly competitive industry lead to

A. entry by new firms.

B. economic profits by new firms.

C. economic profits for a few firms for a short time.

D. a leftward shift of the supply curve.

AACSB: Analytical Skills
Blooms: Understanding
Frank - Chapter 07 #72
Learning Objective: 07-04 Use the theory of the invisible hand to analyze events in everyday life.
Section: Perfect Competition

73. In markets with regulated prices, the invisible hand

A. is irrelevant.

B. will guide resources on some basis other than the price that is regulated.

C. serves to allocate resources on the basis of price as in unregulated markets.

D. becomes truly invisible.

AACSB: Analytical Skills
Blooms: Understanding
Frank - Chapter 07 #73
Learning Objective: 07-04 Use the theory of the invisible hand to analyze events in everyday life.
Section: Perfect Competition

Suppose the city of Casablanca, Morocco chooses to regulate the number of street vendors operating downtown by requiring each vendor to own a permit in order to operate. The city gives permits to all existing vendors and announces that no new permits will ever be issued. Prior to regulation, the costs (including implicit costs) of operating were $85,000 and revenues were $150,000. The city ordinance allows the permits to be bought and sold without restriction. The permits have no expiration date. The interest rate is 10 percent.

Frank - Chapter 07

74. Prior to the option of the ordinance, street vendors were earning

A. economic profits of zero.

B. accounting profits of $65,000.

C. a normal profit.

D. economic profits of $65,000.

AACSB: Analytical Skills
Blooms: Application
Frank - Chapter 07 #74
Learning Objective: 07-04 Use the theory of the invisible hand to analyze events in everyday life.
Section: Perfect Competition

75. If the regulation requiring permits had not been passed, one could predict

A. entry would have driven economic profits to zero.

B. street congestion would have fallen.

C. exit would have driven economic profits higher.

D. entry would have driven accounting profits to zero.

AACSB: Analytical Skills
Blooms: Application
Frank - Chapter 07 #75
Learning Objective: 07-04 Use the theory of the invisible hand to analyze events in everyday life.
Section: Perfect Competition

76. After the permits are issued and required,

A. no one will express interest in purchasing a permit.

B. nothing changes because the number of permits equals the previous number of vendors.

C. a market for the permits will rapidly develop.

D. a market for the permits will not develop.

AACSB: Analytical Skills

Blooms: Application
Frank - Chapter 07 #76
Learning Objective: 07-04 Use the theory of the invisible hand to analyze events in everyday life.
Section: Perfect Competition

77. The equilibrium price of permits is

A. $650,000.
B. $150,000.
C. $65,000.
D. $6,500.

AACSB: Analytical Skills
Blooms: Application
Frank - Chapter 07 #77
Learning Objective: 07-04 Use the theory of the invisible hand to analyze events in everyday life.
Section: Perfect Competition

78. After regulation, street vendors earn

A. accounting profit of zero.
B. economic profit.
C. economic rent of $65,000.
D. economic loss.

AACSB: Analytical Skills
Blooms: Application
Frank - Chapter 07 #78
Learning Objective: 07-04 Use the theory of the invisible hand to analyze events in everyday life.
Section: Perfect Competition

79. Marwan, one of the current street vendors, has gone from earning an economic profit to earning a normal profit because

A. his implicit costs have risen by $650,000.
B. his explicit costs have risen by $65,000.
C. his revenues have fallen by $65,000.
D. his implicit costs have risen by $65,000.

AACSB: Analytical Skills
Blooms: Application
Frank - Chapter 07 #79
Learning Objective: 07-04 Use the theory of the invisible hand to analyze events in everyday life.
Section: Perfect Competition

80. From the perspective of a current street vendor, the regulation requiring permits has had

A. a negative effect; his economic profits are now zero.
B. no effect; his $65,000 economic profit is now an economic rent.
C. a negative effect; the opportunity cost of continuing in the business has increased.
D. a positive effect; he is now guaranteed $65,000 per year whether he operates or sells his permit.

AACSB: Analytical Skills
Blooms: Application
Frank - Chapter 07 #80
Learning Objective: 07-04 Use the theory of the invisible hand to analyze events in everyday life.
Section: Perfect Competition

81. Which of the following groups had the strongest incentive to support the permit requirement?

A. Current street vendors

B. Buyers who shop the street vendors

C. Downtown shops

D. The local police

AACSB: Reflective Thinking Skills
Blooms: Analysis
Frank - Chapter 07 #81
Learning Objective: 07-04 Use the theory of the invisible hand to analyze events in everyday life.
Section: Perfect Competition

82. Suppose the interest rate falls from 10% to 9%. The price of a permit is now

A. $6.5 million.

B. $722,222.

C. $650,000.

D. $65,000.

AACSB: Analytical Skills
Blooms: Application
Frank - Chapter 07 #82
Learning Objective: 07-04 Use the theory of the invisible hand to analyze events in everyday life.
Section: Perfect Competition

83. Suppose the interest rate rises from 10% to 12%. The price of a permit is now

A. $722,222.

B. $650,000.

C. $541,666.

D. $78,000.

AACSB: Analytical Skills

Blooms: Application
Frank - Chapter 07 #83
Learning Objective: 07-04 Use the theory of the invisible hand to analyze events in everyday life.
Section: Perfect Competition

84. According to the textbook, when airlines were regulated with respect to airfares, they competed with each other on the basis of

A. frequent flyer miles.
B. safety record.
C. holiday travel discounts.
D. number of flights to and from a particular city.

AACSB: Analytical Skills
Blooms: Knowledge
Frank - Chapter 07 #84
Learning Objective: 07-04 Use the theory of the invisible hand to analyze events in everyday life.
Section: Perfect Competition

85. During the era of regulated airfares,

A. economic profits were substantial.
B. consumer satisfaction was very high.
C. economic profits were efficiently driven towards zero.
D. economic profits were inefficiently driven towards zero.

AACSB: Analytical Skills
Blooms: Application
Frank - Chapter 07 #85
Learning Objective: 07-04 Use the theory of the invisible hand to analyze events in everyday life.
Section: Perfect Competition

86. Suppose the government grants grain subsidies to poor farmers to raise farm family incomes. In the long run,

A. poor farm families are made permanently better off.

B. as the profits of farming increase, new farmers will emerge from other sectors and drive profits to zero.

C. as new farmers enter, government will lessen the size of the subsidy.

D. the quality of grains will fall.

AACSB: Analytical Skills
Blooms: Application
Frank - Chapter 07 #86
Learning Objective: 07-04 Use the theory of the invisible hand to analyze events in everyday life.
Section: Perfect Competition

87. If firms are prevented from competing on the basis of price, they will

A. not be able to achieve equilibrium.

B. be able to sustain greater-than-normal profits in the long run.

C. exit the industry and enter an unregulated industry.

D. compete on the basis of customer service and other amenities.

AACSB: Analytical Skills
Blooms: Understanding
Frank - Chapter 07 #87
Learning Objective: 07-04 Use the theory of the invisible hand to analyze events in everyday life.
Section: Perfect Competition

88. Efforts to raise the incomes of those in a particular industry fail because of

A. poor management of the program.
B. cheating and corruption.
C. a lack of motivation among the workers.
D. the invisible hand moving workers out of other industries and into the government supported one.

AACSB: Analytical Skills
Blooms: Understanding
Frank - Chapter 07 #88
Learning Objective: 07-04 Use the theory of the invisible hand to analyze events in everyday life.
Section: Perfect Competition

89. The statement "If a deal is too good to be true, it probably is not true" is most closely related to which principle?

A. The low-hanging fruit principle
B. The no-cash-on-the-table principle
C. The cost-benefit principle
D. The diminishing marginal returns principle

AACSB: Analytical Skills
Blooms: Understanding
Frank - Chapter 07 #89
Learning Objective: 07-04 Use the theory of the invisible hand to analyze events in everyday life.
Section: Perfect Competition

90. The No Cash on the Table principle means unexploited opportunities

A. never exist.

B. cannot be exploited for long.

C. can exist in equilibrium but rarely do.

D. always exist in equilibrium.

AACSB: Analytical Skills
Blooms: Understanding
Frank - Chapter 07 #90
Learning Objective: 07-04 Use the theory of the invisible hand to analyze events in everyday life.
Section: Perfect Competition

91. Applying the No Cash on the Table principle to the stock market means new information

A. provides opportunities to the first few who act on it.

B. provides opportunities to all investors.

C. was already contained in the stock price.

D. fails to affect the market.

AACSB: Analytical Skills
Blooms: Understanding
Frank - Chapter 07 #91
Learning Objective: 07-04 Use the theory of the invisible hand to analyze events in everyday life.
Section: Perfect Competition

92. The founder of e-Bay has earned large economic profits. The No Cash on the Table principle suggests

A. starting a new Internet auction company today would result in economic profits as well.
B. starting a new Internet auction company today would result in, at best, a normal profit.
C. all profitable e-business ideas have been developed.
D. sooner or later, e-Bay will experience economic losses.

AACSB: Analytical Skills
Blooms: Understanding
Frank - Chapter 07 #92
Learning Objective: 07-04 Use the theory of the invisible hand to analyze events in everyday life.
Section: Perfect Competition

93. The Smart for One, Dumb for All principle indicates that

A. pursuing selfish interests always promotes social welfare.
B. if everyone is doing it, you should not.
C. pursuing selfish interests always lessens social welfare.
D. pursuing selfish interests sometimes conflicts with social welfare.

AACSB: Analytical Skills
Blooms: Knowledge
Frank - Chapter 07 #93
Learning Objective: 07-05 Understand and explain the relationship between a market equilibrium and a social optimum.
Section: Perfect Competition

At your local bank, two lines are open, One and Two, and four customers are in the bank: A,B,C, and D. Suppose that all customers take exactly 5 minutes to conduct their business, and all of the customers know this. The time is 9:59:59 am, and tellers have just starting taking care of customers A and B. Jihane enters the bank at 10:00 am and Hamzah enters the bank at 10:03. Neither knows that Line Three will open up at 10:05 am. Assume that all bank customers seek to shorten their time in line. Notes: 1) Conducting your own business is not included in waiting time to you and 2) It may prove useful to illustrate the positions of new customers in the table.

Line One	Line Two	Line Three
A	B	
C	D	

Frank - Chapter 07

94. Jihane anticipates a wait time of _____, and Hamzah anticipates a wait time of _____.

A. 5 minutes in either line; 7 minutes in either line.

B. 10 minutes in either line; 7 minutes in the line without Jihane.

C. 5 minutes in either line, 10 minutes in either line.

D. 10 minutes in either line; 5 minutes in the line without Jihane.

AACSB: Analytical Skills
Blooms: Application
Frank - Chapter 07 #94
Learning Objective: 07-04 Use the theory of the invisible hand to analyze events in everyday life.
Section: Perfect Competition

95. Suppose that after a new line opens at 10:05 am Jihane switches to it. Hamzah is

A. better off if he stays put in his current line.

B. better off if he switches to the newly opened line.

C. better off if he switches to Jihane's old line.

D. equally well off whether he switches to the new line or stays put.

AACSB: Analytical Skills
Blooms: Application
Frank - Chapter 07 #95
Learning Objective: 07-04 Use the theory of the invisible hand to analyze events in everyday life.
Section: Perfect Competition

96. After a new line opens at 10:05 am,

A. an unexploited opportunity exists.

B. unexploited opportunities exist for both Jihane and Hamzah.

C. equilibrium waiting time is unchanged.

D. the bank will close one.

AACSB: Analytical Skills
Blooms: Application
Frank - Chapter 07 #96
Learning Objective: 07-04 Use the theory of the invisible hand to analyze events in everyday life.
Section: Perfect Competition

97. In this example, doing better than one's next best alternative means shortening the wait time by switching lines rather than staying in the line one started in. By this criteria, when the new line opened,

A. bank customers A, B, C, D, Jihane and Hamzah all experienced economic profit.
B. Jihane and Hamzah both received economic profit.
C. Hamzah received economic profit.
D. Jihane received economic profit.

AACSB: Analytical Skills
Blooms: Application
Frank - Chapter 07 #97
Learning Objective: 07-04 Use the theory of the invisible hand to analyze events in everyday life.
Section: Perfect Competition

98. Banks often have one line serving multiple teller stations. The next person in line is helped by the next teller available. Grocery stores typically have a separate line for each clerk. Why might that be?

A. Lines must move faster in a grocery store because frozen food will melt.
B. Banks allocate service using the first come, first served method and grocery stores allocate service using the price method.
C. Grocery stores are more interested in efficiency, and banks are more interested in customer service.
D. Bulky shopping carts make a single line impractical in a grocery store, but people waiting in line at the bank do not have to maneuver carts through the line.

AACSB: Reflective Thinking Skills
Blooms: Synthesis
Frank - Chapter 07 #98
Learning Objective: 07-04 Use the theory of the invisible hand to analyze events in everyday life.
Section: Perfect Competition

99. When either the costs of production or the benefits of consumption to individuals differ from those of society,

A. the equilibrium output will be the socially optimal output.

B. the equilibrium is not efficient.

C. the allocation of resources remains correct.

D. the invisible had had completely failed.

AACSB: Analytical Skills
Blooms: Knowledge
Frank - Chapter 07 #99
Learning Objective: 07-05 Understand and explain the relationship between a market equilibrium and a social optimum.
Section: Perfect Competition

100. Adam Smith believed that the individual pursuit of self-interest

A. was a basic human instinct that must be curbed in order for society to advance.

B. always worked to undermine social benefits.

C. always worked to advance social benefits.

D. sometimes worked to advance social benefits.

AACSB: Analytical Skills
Blooms: Knowledge
Frank - Chapter 07 #100
Learning Objective: 07-05 Understand and explain the relationship between a market equilibrium and a social optimum.
Section: Perfect Competition

101. According to the textbook, individual incentives have led to

A. the optimal number of stock market analysts because it is a competitive market with no entry barriers.
B. too many stock market analysts because market analysis does not produce social benefits.
C. too many stock market analysts because the individual incentive to forecast faster exceeds the social benefit of a faster forecast.
D. too few stock market analysts because the efficient market hypothesis predicts that no analyst will do better than random chance in the long run.

AACSB: Analytical Skills
Blooms: Knowledge
Frank - Chapter 07 #101
Learning Objective: 07-05 Understand and explain the relationship between a market equilibrium and a social optimum.
Section: Perfect Competition

Chapter 07 Testbank Summary

Category	*# of Questions*
AACSB: Analytical Skills	92
AACSB: Reflective Thinking Skills	9
Blooms: Analysis	8
Blooms: Application	43
Blooms: Knowledge	10
Blooms: Synthesis	1
Blooms: Understanding	39
Frank - Chapter 07	108
Learning Objective: 07-01 Determine a perfectly competitive firms profit maximizing output level and profit in the short run.	17
Learning Objective: 07-02 Show how economic profit and economic loss affect the allocation of resources across industries.	45
Learning Objective: 07-03 Explain the difference between economic profit and economic rent.	7
Learning Objective: 07-04 Use the theory of the invisible hand to analyze events in everyday life.	28
Learning Objective: 07-05 Understand and explain the relationship between a market equilibrium and a social optimum.	4
Section: Economic Rent Versus Economic Profit	7
Section: Perfect Competition	94