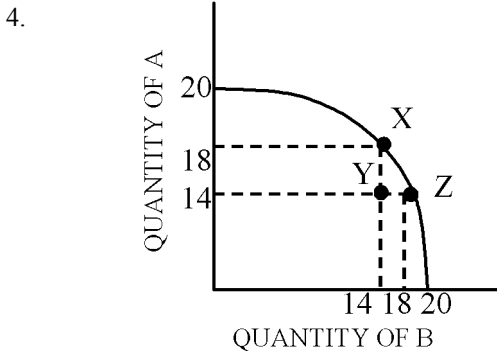


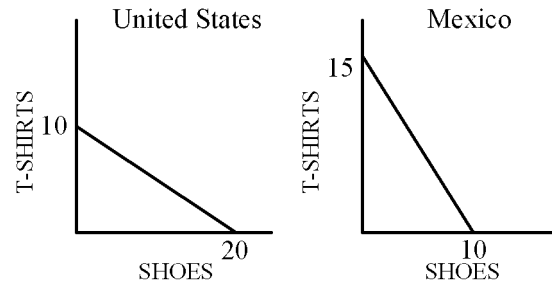
- Economics is most accurately defined as the study of
  - businesses and the production of goods and services
  - efficiency and the use of scarce resources
  - wealth distribution in society
  - money, its creation, and its destruction
  - policy choices and their effects on the business cycle
- The goal of specialization is to
  - establish norms by which entire industries can mimic production processes
  - provide every able worker in an economy with work
  - inhibit competition
  - allow inputs to be utilized in the most efficient way
  - force uncompetitive countries to be self-sufficient
- Microeconomics may best be defined as the study of
  - individual markets and small-scale human interaction
  - short run tradeoffs and comparative advantages
  - government policy and economic regulation
  - irrational decisions made because of scarcity
  - the relationship between unemployment and inflation



Referring to the above diagram of an economy's production possibilities frontier, which of the following statements are true?

- The opportunity cost of moving from point X to Z is 4 units of A
  - The opportunity cost of moving from point Z to X is 7 units of B
  - The opportunity cost of moving from point Y to Z is 4 units of B
- I only
  - II only
  - III only
  - I and III
  - II and III
- If a production possibilities curve is constructed to demonstrate the tradeoffs between a firm's two inputs, labor units and capital units, and the curve is a straight line, we can conclude that
    - labor and capital are perfect substitutes
    - the firm experiences diminishing returns to scale
    - labor and capital are virtually unlimited
    - both inputs are of equal average cost
    - the firm is allocatively efficient

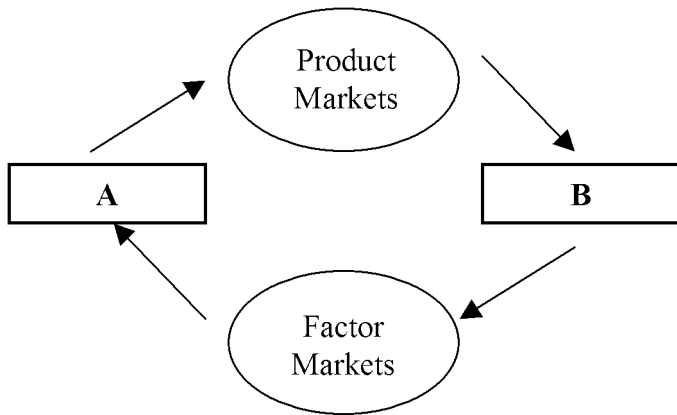
- If Xanadu can produce more wheat than Antilla even though both nations use the same amount of resources, it can be said that Xanadu has which of the following?
  - Absolute advantage in the production of wheat
  - Comparative advantage in the production of wheat
  - Monopoly in the market for wheat
  - Monopsony in the market for wheat
  - Lower prices for wheat
- Base your answer to the following question on the following graph. The lines represent the production possibility frontier for the given country.



Which of the following statements is correct?

- Mexico has a comparative advantage in t-shirts and should import t-shirts.
  - Mexico has a comparative advantage in t-shirts and should import shoes.
  - The US has a comparative advantage in t-shirts and should export t-shirts.
  - The US has a comparative advantage in t-shirts and should export shoes.
  - Mexico has a comparative advantage in both goods and should not trade.
- In 1999 Mr. Economicus bought a used car for \$5,000. The car was manufactured in 1997 and was initially sold in 1998 for \$20,000. How does Mr. Economicus's purchase of the car affect the GDP for 1999?
    - The GDP decreases by \$15,000.
    - The GDP remains unchanged.
    - The GDP increases by \$5,000.
    - The GDP increases by \$20,000.
    - The GDP increases by \$25,000.
  - Increased competition in input markets is likely to
    - shift product market supply curves to the right
    - shift product market supply curves to the left
    - have little effect on product market supply
    - create a movement up along the product market supply curve
    - create a movement down along the product market supply curve

Base your answers to questions 10 through 12 on the displayed circular flow diagram

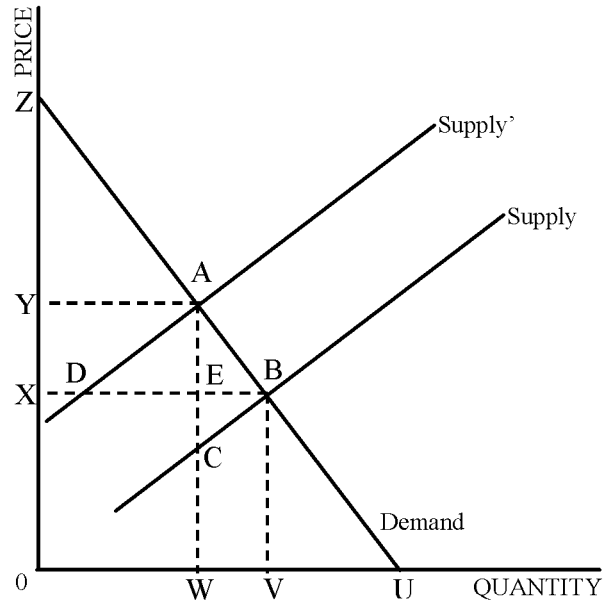


10. Which participant in the circular flow does A represent?
  - (A) Firms
  - (B) Government
  - (C) International Community
  - (D) Banks
  - (E) Households
  
11. All of the following are transferred from B to the factor markets EXCEPT
  - (A) wages
  - (B) rent
  - (C) interest
  - (D) revenues
  - (E) profits
  
12. What typically flows in the opposite direction of the arrows pictured?
  - (A) Equity
  - (B) Goods
  - (C) Land
  - (D) Money
  - (E) Labor
  


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13. Which of the following combinations best describes the effects of a consumer income increase on the market demand for a normal and an inferior good?
  - (A) Demand increases for the normal good, and demand decreases for the inferior good.
  - (B) Demand increases for the normal good, and demand does not change for the inferior good.
  - (C) Demand decreases for the normal good, and demand decreases for the inferior good.
  - (D) Demand does not change for the normal good, and demand increases for the inferior good.
  - (E) Demand does not change for the normal good, and demand does not change for the inferior good.
  
14. According to the law of diminishing marginal utility, as quantity consumed increases
  - (A) marginal utility increases
  - (B) total utility decreases
  - (C) marginal utility decreases
  - (D) both marginal and total utility increase
  - (E) both marginal and total utility increase

15. Base your answer to the following question on the graph below, which shows the market demand curve for a product and two different market supply curves.



Which of the following might have been a reason for the shift in supply from S to S'?

- (A) A decrease in the wage rate for workers who manufacture the product
  - (B) An increase in the price of capital goods
  - (C) A new innovation in production techniques
  - (D) A positive supply shock
  - (E) Increased consumer demand for the product
- 
16. Which of the following would NOT shift the labor demand curve for an industry?
    - (A) An increase in the final product price cuts sales in half.
    - (B) The government effectively increases the minimum wage.
    - (C) There is an increase in the price of other inputs.
    - (D) Businesses perceive a decrease in worker productivity.
    - (E) A new technological advancement is introduced to the industry.
  
  17. If A is a perfect substitute for B, and C is a complement for ONLY A, then which of the following best describes the likely result of a rise in the price of A?
    - (A) Increase in the demand for B, and decrease in the demand for C.
    - (B) Increase in the supply of B, and increase in the demand for C.
    - (C) Decrease in the demand for B, and increase in the demand for C.
    - (D) Decrease in the supply of B, and increase in the supply of C.
    - (E) No change in the demand for B, and decrease in the demand for C.

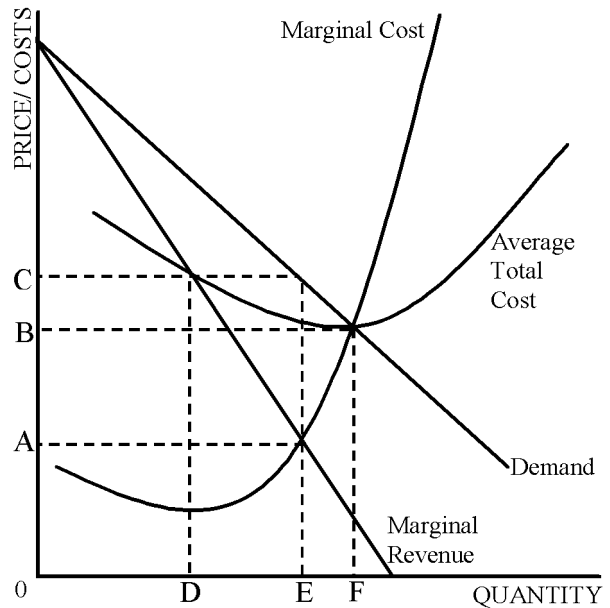
Base your answers to questions 18 through 20 on The following chart shows part of the supply and demand schedules for Firm X's most expensive automobile, the X-Racer.

Quantity Demanded	Price	Quantity Supplied
10	\$50,000	130
15	\$45,000	90
20	\$40,000	55
25	\$35,000	25
30	\$30,000	8

18. If the government installed a price floor of \$40,000 on this market for X-Racers, which of the following would most likely occur?  
 (A) Excess supply would create a surplus of 35 X-Racers. (C) Supply shortfall would create a surplus of 35 X-Racers.  
 (B) Excess demand would create a consumer surplus of \$5,000. (D) Supply shortfall would create a shortage of 35 X-Racers.  
 (E) Demand shortfall would create a producer surplus of \$5,000.
19. Which of the following price floors, if installed on this market, would be ineffective?  
 (A) \$30,001 (B) \$35,001 (C) \$40,001 (D) \$45,001 (E) \$50,001
20. An economist notes that there is a surplus of 75 X-Racers in this market. Which of the following best explains this occurrence?  
 (A) The price of X-Racers is \$45,000. (C) The price of X-Racers is lower than equilibrium.  
 (B) The price of X-Racers is at equilibrium. (D) The price of X-Racers is upwardly inflexible.  
 (E) The price of X-Racers is set by consumer demand.

21. If Product X sells for a higher price than before at all output levels, then  
 (A) the supply curve for Product X has shifted right  
 (B) the supply curve for Product X has shifted left  
 (C) the demand curve for Product X has shifted left  
 (D) there has been a movement along the demand curve for Product X  
 (E) there has been a movement along the demand curve for Product X
22. If an economy is producing the precise combination of goods and services that its individual components desire, then the economy is said to be  
 (A) Pareto efficient  
 (B) allocatively efficient  
 (C) productively efficient  
 (D) suffering from inflation  
 (E) generating positive externalities
23. To become allocatively efficient, an economy must determine which type of output combination  
 (A) maximizes economic growth  
 (B) minimizes opportunity costs  
 (C) maximizes social utility  
 (D) maximizes innovation and technological advances  
 (E) maximizes economic and accounting profits
24. The amount of workers a firm will hire is  
 (A) derived from a perfectly inelastic demand curve  
 (B) closely related to demand for the final product  
 (C) not affected by the wage rate  
 (D) subject to an upward sloping labor demand curve  
 (E) unrelated to the product market's fluctuations

25. Base your answer to the following question on the graph below, which shows the production function for an imperfectly competitive firm.

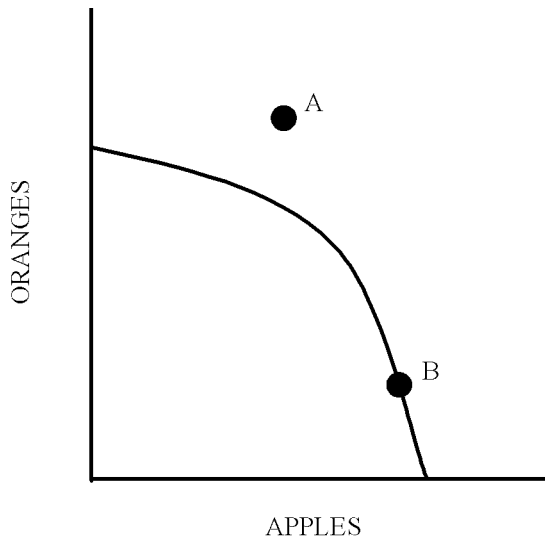


Which of the following represents the profit-maximizing price and output level for the firm?

- (A) Price 0C, quantity 0E (D) Price 0C, quantity 0F  
 (B) Price 0A, quantity 0E (E) Price 0A, quantity 0D  
 (C) Price 0B, quantity 0D
26. Rational producers seek to maximize their  
 (A) profits (D) revenues  
 (B) costs (E) utilities  
 (C) externalities

27. A profit-maximizing monopoly will have which of the following in the long run?
- I. Output greater than the  $MR = MC$  level  
 II. Economic profits  
 III. Normal profits
- (A) I only (D) II and III only  
 (B) I and II only (E) I, II, and III  
 (C) I and III only
28. Thomas Malthus had predicted that the amount of food available per person would decline as the population increased, resulting in widespread starvation. Which of the following explains the basis for Malthus's prediction?
- (A) The inputs used in the production of food are not specialized, therefore all land areas are equally suitable to agricultural use.  
 (B) There are increasing returns to scale in the production of food.  
 (C) There are constant returns to scale in the production of food.  
 (D) The marginal product of labor in the production of food declines as the population increases, because the amount agricultural land is limited.  
 (E) The population tends to grow arithmetically but the food supply tends to grow geometrically.
29. Florida experiences a very cold spring and loses much of its orange crop. That same year, the demand for season farm workers, who harvest the oranges, hits an all-time low. Which of the following concepts best explains this effect on the labor market?
- (A) Law of diminishing returns  
 (B) Substitution effect  
 (C) Income effect  
 (D) Supply shock  
 (E) Derived demand
30. Jarome makes \$7,000,000 per year playing professional ice hockey. If he wasn't playing hockey, he'd be working as a sales manager and making \$50,000 per year. Economists refer to the \$6,950,000 per year difference as Jarome's
- (A) economic rent (D) consumer surplus  
 (B) accounting profit (E) overtime pay  
 (C) marginal product
31. Which of the following is an example of a public good?
- (A) A courthouse (D) A barber shop  
 (B) A gas station (E) A private school  
 (C) A supermarket
32. Which of the following would NOT be considered a transfer payment?
- (A) Federal unemployment insurance  
 (B) Social Security  
 (C) Wages paid to federal employees  
 (D) Socialized health insurance  
 (E) Welfare support to the poor
33. If average worker productivity increases in a perfectly competitive industry, which of the following is NOT likely to be a consequence in the long run?
- (A) Demand for that industry's workers will increase.  
 (B) More of the product will be supplied at each price.  
 (C) Firms will substitute away from non-human inputs.  
 (D) Marginal revenue product of labor will exceed the wage rate.  
 (E) Workers who were laid off may be called back to their firms.
34. When the consumption of a product has a benevolent effect on an individual who is not the consumer, economists say that the product has generated
- (A) a negative externality (D) a Giffen good  
 (B) a positive externality (E) consumer surplus  
 (C) economic rent
35. The "legal cartel" theory of regulation argues that regulated industries
- (A) act monopolistically because regulation represents a barrier to entry  
 (B) cannot generate economic profits if collusion is made illegal  
 (C) eliminate deadweight loss even when a cartel is effective  
 (D) seek to become unregulated in order to form collusive pacts  
 (E) will only operate efficiently if all other related markets become regulated
36. When the government directly aids the production of a private good by providing payments to suppliers, the firms are said to be receiving
- (A) income taxes (D) tax deductions  
 (B) subsidies (E) positive externalities  
 (C) progressive taxes
37. Which of the following is NOT a non-price determinant of supply?
- (A) Input prices (D) Business expectations  
 (B) Innovation and technology (E) Number of consumers  
 (C) Supply shocks
38. Which of the following would NOT shift a perfectly competitive industry's supply curve?
- (A) A rise in the price of the product  
 (B) A government tax on producers  
 (C) Negative business cycle forecasts  
 (D) New technology or processes  
 (E) A change in the price of an input
39. The marginal cost of labor is equal to
- (A) the wage rate of the last worker hired  
 (B) the marginal product of labor  
 (C) the marginal revenue product of labor  
 (D) the average total cost of all inputs  
 (E) the average variable cost of all inputs

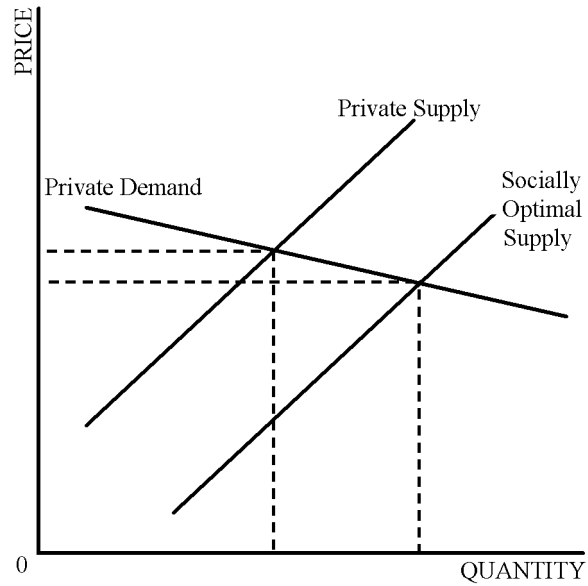
40. The following graph shows the production possibilities frontier for an economy.



How might it be possible for an economy to be producing at point B but consuming at point A?

- (A) The economy is open to trade with other economies and trades apples for oranges.
  - (B) The economy is open to trade with other economies and trades oranges for apples.
  - (C) The economy is permanently producing and consuming above its production possibilities frontier.
  - (D) The economy's capital stock is being overutilized in the production of apples.
  - (E) The economy is not using resources efficiently.
41. In general, technological improvements and industrial innovation will cause
- (A) the productivity of workers to decrease
  - (B) the supply curve for the industry to shift
  - (C) the demand curve for the industry to shift
  - (D) a movement along the industry supply curve
  - (E) a movement along the industry demand curve
42. A negative income elasticity of demand indicates that
- (A) the good is inferior
  - (B) the good is a luxury item
  - (C) the good has an inelastic demand curve
  - (D) the good is normal
  - (E) the good has an elastic demand curve
43. An effective price floor
- (A) is set below the equilibrium price for the product
  - (B) is set above the equilibrium price for the product
  - (C) changes the equilibrium quantity for the product
  - (D) shifts the supply and demand curves for the product
  - (E) changes the equilibrium price for the product

Base your answers to questions 44 through 46 on the graph below, which shows the market supply, private consumer demand, and socially optimal supply for Product X.



44. If the government attempted to change the supply of the good by taxing producers, which of the following would occur to the consumer and producer surpluses?
- (A) Both would increase, but total consumer surplus would increase more than total producer surplus.
  - (B) Both would decrease, but total consumer surplus would decrease more than total producer surplus.
  - (C) Both would decrease, but total producer surplus would decrease more than total consumer surplus.
  - (D) Both would increase equally.
  - (E) Both would decrease equally.
45. Which of the following statements about Product X is true?
- (A) The consumption of Product X generates a positive externality.
  - (B) The consumption of Product X generates a negative externality.
  - (C) The demand for Product X is relatively inelastic.
  - (D) The demand for Product X is perfectly elastic.
  - (E) The market for Product X demonstrates allocative efficiency.
46. Which of the following government actions would most likely ensure a shift in the supply of Product X to the socially optimal level?
- (A) Tax domestic producers of Product X
  - (B) Offer tax rebates to producers of Product X's main substitute
  - (C) Lower the personal income tax
  - (D) Grant subsidies to producers of Product X
  - (E) File an antitrust lawsuit against the producer of Product X

47. Long run economic profits
- (A) are not sufficient to keep all of an industry's firms operational
  - (B) only occur in the absence of normal profits
  - (C) will guarantee the entry of new firms into oligopolistic industries
  - (D) indicate that the industry is inefficient
  - (E) equal short run normal profits, adjusted for inflation
48. If there is a surplus of workers in a labor market that serves a perfectly competitive industry, which of the following are likely TRUE?
- I. There is an effective minimum wage law in place.
  - II. Other labor markets for equally-skilled workers are offering a higher wage.
  - III. The equilibrium wage rate is lower than what workers are currently making.
- (A) I
  - (B) II
  - (C) III
  - (D) I and II
  - (E) I and III
49. Many economists have argued that putting price floors on wages actually forces some firms to lay off workers. Which of the following is NOT a direct reason why an effective minimum wage might reduce the employment level?
- (A) Many workers' marginal revenue product may be less than the new wage rate.
  - (B) Firms can find relatively cheaper non-human inputs to use as substitutes.
  - (C) Higher wages will increase the supply of laborers.
  - (D) Firms can export piecework to other countries that have lower minimums and less regulation.
  - (E) The productivity of unskilled, employed workers is consistently higher than the minimum wage.
50. Firms that hire labor eventually reach a point where total output begins to decrease as new workers are hired. This phenomenon is explained by
- (A) the substitution effect
  - (B) the income effect
  - (C) the law of increasing costs
  - (D) the law of diminishing returns
  - (E) the law of comparative advantage
51. Which of the following statistical observations do economists often cite when determining the degree of market dominance exerted by an oligopoly?
- (A) Advertising cost variance
  - (B) Economic profit rate
  - (C) The payoff matrix
  - (D) The fair-return price
  - (E) Concentration ratio
52. A monopolized labor supplier is called a
- (A) trust
  - (B) monopsony
  - (C) union
  - (D) oligopoly
  - (E) duopoly
53. An example of economic rent would be
- (A) the difference between real wage paid to a worker and that worker's opportunity cost of labor
  - (B) the profit a firm earns as a direct result of government subsidization
  - (C) the value of a worker's marginal product of labor if the product generates positive externalities
  - (D) the interest paid on input resources that have perfectly elastic supply curves
  - (E) the value of the private property an entrepreneur's uses for loan collateral
54. Economic rent is the price that producers must pay
- (A) to secure a new non-worker resource
  - (B) to secure a resource that has perfectly inelastic supply
  - (C) to secure a resource that has perfectly elastic supply
  - (D) to employ a worker who is new to the labor force
  - (E) to change production from one output to another
55. When too little of a product is being produced at the market price, there is most likely
- (A) excess demand and a surplus
  - (B) excess supply and a shortage
  - (C) excess demand and a shortage
  - (D) excess supply and a surplus
  - (E) an effective price floor on the market
56. In their construction of supply and demand curves, economists assume that the primary variable responsible for defining equilibrium is
- (A) price
  - (B) preferences
  - (C) income
  - (D) wages
  - (E) expectations
57. Economic profits are equal to
- (A) total revenue minus explicit costs
  - (B) total revenue minus opportunity costs
  - (C) normal profits minus opportunity costs
  - (D) total revenue minus explicit and opportunity costs
  - (E) normal profits minus explicit and opportunity costs
58. A firm that is not producing the optimal amount of its goods is definitely NOT
- (A) minimizing average costs
  - (B) equating costs and revenues at the margin
  - (C) maximizing economic profits
  - (D) earning normal profits
  - (E) imperfectly competitive
59. A firm's short run supply curve is more inelastic than its long run supply curve because in the short run
- (A) at least some costs are fixed
  - (B) a portion of supply cannot be sold
  - (C) all inventories are unalterable
  - (D) perfect substitutes do not exist
  - (E) all goods act are Giffen goods

60. Increasing marginal costs necessarily mean that  
 (A) average total cost is increasing  
 (B) average variable cost is decreasing  
 (C) average fixed cost is constant  
 (D) average total cost may be increasing or decreasing  
 (E) average variable cost is increasing
61. Profits are maximized at the point where  
 (A) marginal revenue equals average revenue  
 (B) average total cost is at a minimum  
 (C) average variable cost equals marginal cost  
 (D) marginal cost equals marginal revenue  
 (E) average total cost equals average revenue
62. If a firm in a perfectly competitive market increases its price by 15%, revenues will  
 (A) increase by 15%  
 (B) increase by more than 15%  
 (C) increase by less than 15%  
 (D) decrease  
 (E) not change
63. In the long run, a perfectly competitive market  
 (A) experiences economic profits  
 (B) suffers from fixed costs  
 (C) will begin to create barriers to entry  
 (D) always generates positive externalities  
 (E) produces at the allocatively efficient level
64. If a market is monopolistically competitive, equilibrium output will  
 (A) sometimes be the most efficient output  
 (B) always be less than the most efficient output  
 (C) always be greater than the most efficient output  
 (D) always be greater than or equal to the most efficient output  
 (E) always be either less than or equal to the most efficient output
65. Consumers do not demand that work be done; rather, they demand the product made by the labor. For this reason, economists consider the labor market demand to be a  
 (A) derived demand (D) output demand  
 (B) normal demand (E) marginal demand  
 (C) inferior demand
66. If there was a positive supply shock in an industry, we would expect  
 (A) more of the industry's product to be available at all prices  
 (B) an increase in consumer demand for the product at all prices  
 (C) an increase in equilibrium price  
 (D) less of the industry's product to be available at all prices  
 (E) constant output and a decrease in product price

67. Which of the following are true of a resource demand curve for a profit-maximizing firm?  
 I. It is equivalent to the marginal revenue product curve for that resource.  
 II. It is downward sloping because of the law of diminishing returns.  
 III. It can be shifted by changes in the prices of substitute inputs.  
 (A) I only (D) II and III  
 (B) II only (E) I, II, and III  
 (C) I and II
68. Monopolies must lower their prices each time they sell an additional unit of output. As a result of this, the marginal revenue curve for a monopolist  
 (A) slopes upward  
 (B) lies below the market demand curve  
 (C) is equivalent to the market demand curve  
 (D) is equivalent to the marginal cost curve  
 (E) does not cross the marginal cost curve at the profit-maximizing point
69. It costs \$500 for a unit of labor, and \$2500 for a unit of capital. If the marginal revenue product of labor is \$1000, the marginal revenue product of capital is \$3000, and increasing output is not an option, which of the following actions should a profit-maximizing firm take?  
 (A) Hire more labor and use less capital.  
 (B) Hire more labor and hire more capital.  
 (C) Hire less labor and hire more capital.  
 (D) Hire less labor and use less capital.  
 (E) None of these actions
70. Base your answer to the following question on the chart below, which shows Firm X's total output and the number of workers employed in order to produce that output.

<u>Workers</u>	<u>Total Output</u>
1	8
2	16
3	23
4	28
5	30

If Firm X can sell all of its output at a price of \$1 per unit, and the equilibrium wage rate is \$4, how many workers should Firm X hire?

- (A) 1 (D) 4  
 (B) 2 (E) 5  
 (C) 3

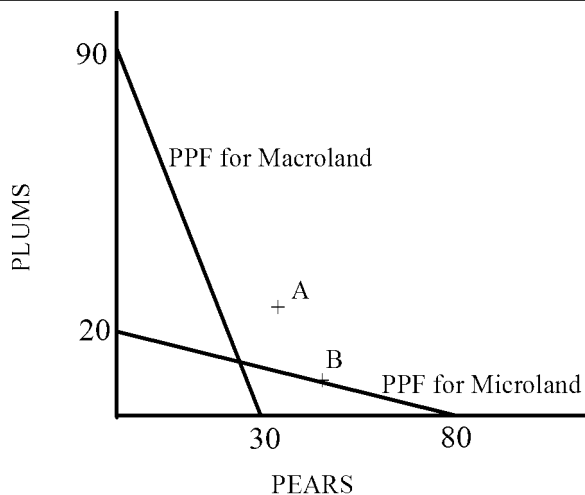
71. A tax of \$10 per unit is placed on sales of Product X. The price of Product X rises to \$85, and consumers bear the complete burden of the tax. (a) Sketch a correctly labeled supply and demand graph that accurately depicts the tax incidence. Be sure to indicate the following in your drawing. (i) The tax (ii) Price change (iii) Change in equilibrium quantity (iii) Deadweight loss (b) Will the consumption of Product X increase, decrease, or remain the same? How can you tell? (c) A firm sells 300 units of Product X. How much revenue will the government collect from the firm? (d) Suppose a new substitute for Product X is introduced into the market. Product Z, the substitute, is exempt from government taxation. (i) How will the demand curve for Product X change? (ii) How will government tax revenues change?
72. The Testing Company is an independent organization that certifies the safety of various products. Products not approved by the Testing Company often generate lower revenues for the firms that sell them.
- (a) Draw a correctly-labeled graph to show the effects on the market for Product X if the following events occur together in the short run.
- (i) The Testing Company issues a public statement that explains how Product X can be highly dangerous to consumers.  
(ii) The government levies a per-unit sales tax on Product X in order to protect consumers.
- (b) What will be the effects on Product X's equilibrium price and quantity after the changes described in part (a)?
- (c) Suppose that consumer demand for Product X was observed to be relatively elastic compared to supply. How does the government tax affect the following, and how are the magnitudes of the two changes related?
- (i) Consumer surplus  
(ii) Producer surplus
- (d) Suppose that the production of Product X is also dangerous. Despite these observed dangers, some consumers and some producers will still wish to exchange Product X. Show how an effective price floor on the market for Product X could be less efficient and more dangerous than a per-unit sales tax.
73. The following chart shows part of the utility function for Jessica's consumption of two different goods, M and K.

<u>Units of M</u>	<u>Total Utility from M</u>	<u>Units of K</u>	<u>Total Utility from K</u>
1	12	1	20
2	24	2	40
3	34	3	60
4	44	4	80
5	52	5	100
6	60	6	120

- (a) Calculate the marginal utility that Jessica gains from the following.
- (i) The second unit of M  
(ii) The fifth unit of K
- (b) Suppose Jessica has a fixed income of \$12, and she wishes to spend all of it on M and K. If the price of M is \$1 per unit, and the price of K is \$2 per unit, what combination of M and K will maximize Jessica's total utility?
- (c) Sketch Jessica's budget constraint when her income is \$12. Label your axes as indicated.
- (i) X-axis as "Units of M"  
(ii) Y-axis as "Units of K"
- (d) Suppose the price of M rises to \$3.
- (i) On your graph from part (c), show the change in Jessica's income constraint.  
(ii) What combination of goods would maximize Jessica's utility under these new price constraints?



74.



The production possibilities frontiers (PPF's) for Microland and Macroland are shown on the above graph.

- (a) How might it be possible for Microland to be currently producing at point B but consuming at point A?
- (b) How might it be possible for Microland to be producing at point A in the future?
- (c) Which nation has an absolute advantage in the production of plums?
- (d) Which nation has a comparative advantage in the production of pears?
- (e) Suppose that each nation can specialize in the production of either pears or plums. If trade is possible between Macroland and Microland, then which nation will export plums?
- (f) Give a specific example of terms of trade that both nations would accept.

75. Assume that in the hypothetical nation of Machina, there are two domestic producers of automobiles. Both firms, Autocorp and Car Co., earn economic profits. Machina has prohibitively high tariff rates that discourage foreign competition.

- (a) Draw a correctly labeled graph that shows how Autocorp maximizes profits. Be sure to indicate the following in your sketch.
  - (i) Profit-maximizing price
  - (ii) Profit-maximizing quantity
  - (iii) Area of total economic profit
- (b) Suppose that the government of Machina repeals all tariff laws, and that the foreign-made automobiles are significantly less expensive than cars made in Machina. Using two correctly labeled supply and demand graphs, show how the removal of trade barriers will effect both Machina's domestic market and the world market for automobiles.
- (c) Using your graph from part (b), identify and explain the effects of world trade on the following.
  - (i) Price of cars made in Machina
  - (ii) Quantity of cars produced in Machina
  - (iii) Quantity of cars consumed by people who are citizens of Machina
- (d) Identify and explain two methods by which Car Co. might be able to increase economic profits after the introduction of world trade.
- (e) Suppose the government of Machina decided to subsidize the domestic production of automobiles. How would this intervention affect the following?
  - (i) Quantity of cars produced in Machina
  - (ii) Price of domestically-produced cars in Machina
  - (iii) Quantity of foreign-made cars consumed by people in Machina
- (f) Identify one possible unintended consequence of the government's decision to subsidize the Machina firms.

Answer Key

- 1.   B
- 2.   D
- 3.   A
- 4.   A
- 5.   A
- 6.   A
- 7.   B
- 8.   B
- 9.   A
- 10.   A
- 11.   D
- 12.   D
- 13.   A
- 14.   C
- 15.   B
- 16.   B
- 17.   A
- 18.   A
- 19.   A
- 20.   A
- 21.   B
- 22.   B
- 23.   C
- 24.   B
- 25.   A
- 26.   A
- 27.   E
- 28.   D
- 29.   E
- 30.   A

- 31.   A
- 32.   C
- 33.   D
- 34.   B
- 35.   A
- 36.   B
- 37.   E
- 38.   A
- 39.   A
- 40.   A
- 41.   B
- 42.   A
- 43.   B
- 44.   C
- 45.   A
- 46.   D
- 47.   A
- 48.   E
- 49.   E
- 50.   D
- 51.   E
- 52.   C
- 53.   A
- 54.   B
- 55.   C
- 56.   A
- 57.   D
- 58.   A
- 59.   A
- 60.   D

Answer Key

61.   D    
 62.   D    
 63.   E    
 64.   A    
 65.   A    
 66.   A    
 67.   E    
 68.   B    
 69.   A    
 70.   D

71. (a) (Perfectly inelastic demand, otherwise a normal tax incidence graph)  
 (b) Consumption will remain the same because when demand for a product is perfectly inelastic, increases in price do not have any effect on revenues or consumption.  
 (c) \$3000  
 (d) (i) Shift to the left (ii) Decrease
72. (a) (i) (Demand shifts to the left) (ii) (Supply shifts to the left)  
 (b) Indeterminate price change, decrease in equilibrium quantity  
 (c) (i) Consumer surplus decreases (ii) Producer surplus decreases, and it decreases more than consumer surplus  
 (d) A price floor will create a surplus of dangerously-produced products. Also, no one will benefit from their creation, as the price will be too high above the equilibrium for transactions to take place. There will be a loss of inefficiency, as the market will not clear. However, the production of Product X will not be restrained like it would be if there was a sales tax.

73. (a) (i) 12 (ii) 20  
 (b) 4 units of M and 4 units of K  
 (c) (The constraint intersects the Y-axis at 6 units and the X-axis at 12 units.)  
 (d) (i) (The Y-intercept remains fixed, but the X-intercept of the constraint moves from 12 to 4.) (ii) 0 units of M and 6 units of K

74. (a) In order for Microland to be consuming at a point above its production possibilities frontier (PPF), its consumption possibilities frontier must lie above its PPF. This is possible if Microland can specialize in the production of one item and trade with other nations whose PPF's do not have the same slope as Microland's. In this particular case, if Microland is open to trade with Macroland, then it could trade pears for plums and thereby be producing at point B and consuming at point A.  
 (b) Economic growth would enable Microland to be producing at point A in the future. Some factors that would contribute to long-run economic growth include: a rise in the labor-force participation rate; a decline in the natural rate of unemployment; an increase in the stock of physical capital; an increase in human capital or workers' skill

- level; and an increase in the level of technological progress. For Microland to have the capacity to produce at point A, technological progress is only needed in the production of plums; technological advances in the production of pears are not necessary for Microland to be producing at point A.  
 (c) Macroland has an absolute advantage in the production of plums, because it has the capacity to produce a greater amount of plums than Microland.  
 (d) Microland has a comparative advantage in the production of pears, because the opportunity cost of producing each pear in Microland (.25 plums) is less than the opportunity cost of producing each pear in Macroland (3 plums).  
 (e) Microland has a comparative advantage in the production of plums, and Macroland has a comparative advantage in the production of pears. Thus, Microland would export plums, and import pears.  
 (f) The opportunity cost of producing each pear in Microland is .25 plums, and the opportunity cost of producing each plum in Macroland is .33 pears. Microland would want at least .25 plums for each pear it produces, and Macroland would be willing to give at most 3 plums for each pear it receives. Thus, examples of acceptable terms of trade can vary between .25 plums per pear to 3 plums per pear.
75. (a) (Basic monopolist's graph)  
 (b) (Demand shifts to the left for the domestic car market) (Demand shifts to the right for world auto market)  
 (c) (i) Decrease because the monopolistic competitors' demand curves shift down. (ii) Decrease because market demand reduces profit margin. (iii) Increase because consumers are substituting away from expensive domestic cars and towards foreign-made cars.  
 (d) Advertise; lower fixed costs in the long run; market the product in world markets to take advantage of economies of scope; lobby for subsidies; etc.  
 (e)(i) Increase (ii) Decrease (iii) Decrease  
 (f) (Answers will vary)

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### Displaying UNIT CHAPTER TOPIC SUBTOPIC QUESTION ID

1. I. Principles of Economics / 1. Foundations / A. Scarcity and Tradeoffs / 1. The Economizing Problem : 0001347
2. I. Principles of Economics / 1. Foundations / A. Scarcity and Tradeoffs / 1. The Economizing Problem : 0002001
3. I. Principles of Economics / 1. Foundations / A. Scarcity and Tradeoffs / 1. The Economizing Problem : 0002083
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5. I. Principles of Economics / 1. Foundations / A. Scarcity and Tradeoffs / 3. Production Possibilities : 0002112
6. I. Principles of Economics / 1. Foundations / B. Distribution and Trade / 2. Absolute Advantage : 0001711
7. I. Principles of Economics / 1. Foundations / B. Distribution and Trade / 3. Comparative Advantage : 0000907
8. I. Principles of Economics / 2. Supply and Demand / A. Goods and Services / 1. Normal Goods : 0000134
9. I. Principles of Economics / 2. Supply and Demand / A. Goods and Services / 5. Inputs : 0002050
10. I. Principles of Economics / 1. Foundations / B. Distribution and Trade / 4. Circular Flow : 0000363
11. I. Principles of Economics / 1. Foundations / B. Distribution and Trade / 4. Circular Flow : 0000364
12. I. Principles of Economics / 1. Foundations / B. Distribution and Trade / 4. Circular Flow : 0000365
13. I. Principles of Economics / 2. Supply and Demand / A. Goods and Services / 1. Normal Goods : 0001854
14. II. Microeconomics / 1. Individuals / B. Consumption Function / 1. Utility : 0002183
15. I. Principles of Economics / 2. Supply and Demand / B. Analysis / 1. Non-price Determinants : 0001873
16. I. Principles of Economics / 2. Supply and Demand / B. Analysis / 1. Non-price Determinants : 0002072
17. I. Principles of Economics / 2. Supply and Demand / B. Analysis / 1. Non-price Determinants : 0002225
18. I. Principles of Economics / 2. Supply and Demand / B. Analysis / 5. Price Floors : 0002229
19. I. Principles of Economics / 2. Supply and Demand / B. Analysis / 5. Price Floors : 0002230
20. I. Principles of Economics / 2. Supply and Demand / B. Analysis / 5. Price Floors : 0002231
21. I. Principles of Economics / 2. Supply and Demand / B. Analysis / 7. Equilibrium : 0002219
22. II. Microeconomics / 2. Firms / B. Efficiency / 1. Allocative Efficiency : 0002187
23. II. Microeconomics / 2. Firms / B. Efficiency / 1. Allocative Efficiency : 0002213
24. II. Microeconomics / 3. Market Types / C. Labor and Capital / 2. Derived Demand : 0001636
25. II. Microeconomics / 2. Firms / A. Profits / 3. Accounting Profit : 0001857
26. II. Microeconomics / 2. Firms / A. Profits / 3. Accounting Profit : 0002091
27. II. Microeconomics / 3. Market Types / A. Types of Competition / 2. Monopoly : 0001624
28. III. Macroeconomics / 6. Growth and Productivity / A. Investment / 2. Human Capital : 0000220
29. II. Microeconomics / 3. Market Types / C. Labor and Capital / 2. Derived Demand : 0001846
30. II. Microeconomics / 3. Market Types / C. Labor and Capital / 1. Economic Rent : 0001837
31. II. Microeconomics / 4. Society / A. Government Role / 1. Public Goods : 0002249
32. II. Microeconomics / 4. Society / A. Government Role / 2. Income Distribution : 0001510
33. II. Microeconomics / 3. Market Types / C. Labor and Capital / 4. Marginal Analysis : 0001954
34. II. Microeconomics / 4. Society / B. Market Failure / 1. Positive Externalities : 0002136
35. II. Microeconomics / 4. Society / B. Market Failure / 3. Antitrust Regulation : 0001516
36. II. Microeconomics / 4. Society / A. Government Role / 3. Tax Policy : 0001664
37. I. Principles of Economics / 2. Supply and Demand / B. Analysis / 1. Non-price Determinants : 0001690
38. I. Principles of Economics / 2. Supply and Demand / B. Analysis / 1. Non-price Determinants : 0001934
39. II. Microeconomics / 3. Market Types / C. Labor and Capital / 4. Marginal Analysis : 0002066
40. I. Principles of Economics / 1. Foundations / A. Scarcity and Tradeoffs / 3. Production Possibilities : 0000192
41. I. Principles of Economics / 2. Supply and Demand / B. Analysis / 1. Non-price Determinants : 0002218
42. I. Principles of Economics / 2. Supply and Demand / B. Analysis / 3. Income Elasticity : 0001698
43. I. Principles of Economics / 2. Supply and Demand / B. Analysis / 5. Price Floors : 0002162
44. II. Microeconomics / 4. Society / A. Government Role / 4. Tax Incidence : 0001595
45. II. Microeconomics / 4. Society / B. Market Failure / 1. Positive Externalities : 0001591
46. II. Microeconomics / 4. Society / B. Market Failure / 1. Positive Externalities : 0001592
47. II. Microeconomics / 2. Firms / C. Production Function / 3. Long Run, Short Run : 0002253
48. II. Microeconomics / 3. Market Types / C. Labor and Capital / 4. Marginal Analysis : 0001918
49. II. Microeconomics / 3. Market Types / C. Labor and Capital / 4. Marginal Analysis : 0001843
50. II. Microeconomics / 3. Market Types / C. Labor and Capital / 4. Marginal Analysis : 0001533
51. II. Microeconomics / 3. Market Types / B. Price Analysis / 5. Market Concentration : 0001447
52. II. Microeconomics / 3. Market Types / C. Labor and Capital / 3. Unions : 0001646
53. II. Microeconomics / 3. Market Types / C. Labor and Capital / 1. Economic Rent : 0002042
54. II. Microeconomics / 3. Market Types / C. Labor and Capital / 1. Economic Rent : 0001470
55. I. Principles of Economics / 2. Supply and Demand / B. Analysis / 6. Price Ceilings : 0001663
56. I. Principles of Economics / 2. Supply and Demand / B. Analysis / 7. Equilibrium : 0002120
57. II. Microeconomics / 2. Firms / A. Profits / 2. Economic Profit : 0002149

## Eduware Genealogy by Question

- 58. II. Microeconomics / 2. Firms / B. Efficiency / 2. Productive Efficiency : 0001437
- 59. II. Microeconomics / 2. Firms / C. Production Function / 3. Long Run, Short Run : 0002013
- 60. II. Microeconomics / 2. Firms / C. Production Function / 4. Cost Functions : 0001805
- 61. II. Microeconomics / 2. Firms / C. Production Function / 6. Marginal Analysis : 0001679
- 62. II. Microeconomics / 3. Market Types / A. Types of Competition / 1. Perfect Competition : 0001939
- 63. II. Microeconomics / 3. Market Types / A. Types of Competition / 1. Perfect Competition : 0002046
- 64. II. Microeconomics / 3. Market Types / A. Types of Competition / 4. Monopolistic Competition : 0002134
- 65. II. Microeconomics / 3. Market Types / C. Labor and Capital / 2. Derived Demand : 0002054
- 66. I. Principles of Economics / 2. Supply and Demand / B. Analysis / 1. Non-price Determinants : 0001999
- 67. II. Microeconomics / 3. Market Types / C. Labor and Capital / 2. Derived Demand : 0001676
- 68. II. Microeconomics / 3. Market Types / A. Types of Competition / 2. Monopoly : 0001342
- 69. II. Microeconomics / 3. Market Types / C. Labor and Capital / 4. Marginal Analysis : 0001396
- 70. II. Microeconomics / 3. Market Types / C. Labor and Capital / 4. Marginal Analysis : 0001723
- 71. II. Microeconomics / 5. Part II Questions / D. Society / 1. Government Role : 0001730
- 72. II. Microeconomics / 5. Part II Questions / B. Firms / 2. Efficiency : 0001325
- 73. II. Microeconomics / 5. Part II Questions / A. Individuals / 1. Consumption Function : 0001741
- 74. II. Microeconomics / 5. Part II Questions / B. Firms / 3. Production Function : 0001175
- 75. II. Microeconomics / 5. Part II Questions / B. Firms / 2. Efficiency : 0001729

## Eduware Genealogy by Category

- 3: I. Principles of Economics\1. Foundations\A. Scarcity and Tradeoffs\1. The Economizing Problem - (1, 2, 3)
- 3: I. Principles of Economics\1. Foundations\A. Scarcity and Tradeoffs\3. Production Possibilities - (4, 5, 40)
- 1: I. Principles of Economics\1. Foundations\B. Distribution and Trade\2. Absolute Advantage - (6)
- 1: I. Principles of Economics\1. Foundations\B. Distribution and Trade\3. Comparative Advantage - (7)
- 3: I. Principles of Economics\1. Foundations\B. Distribution and Trade\4. Circular Flow - (10, 11, 12)
- 2: I. Principles of Economics\2. Supply and Demand\A. Goods and Services\1. Normal Goods - (8, 13)
- 1: I. Principles of Economics\2. Supply and Demand\A. Goods and Services\5. Inputs - (9)
- 7: I. Principles of Economics\2. Supply and Demand\B. Analysis\1. Non-price Determinants - (15, 16, 17, 37, 38, 41, 66)
- 4: I. Principles of Economics\2. Supply and Demand\B. Analysis\5. Price Floors - (18, 19, 20, 43)
- 2: I. Principles of Economics\2. Supply and Demand\B. Analysis\7. Equilibrium - (21, 56)
- 1: I. Principles of Economics\2. Supply and Demand\B. Analysis\3. Income Elasticity - (42)
- 1: I. Principles of Economics\2. Supply and Demand\B. Analysis\6. Price Ceilings - (55)
- 2: II. Microeconomics\2. Firms\A. Profits\3. Accounting Profit - (25, 26)
- 2: II. Microeconomics\3. Market Types\A. Types of Competition\2. Monopoly - (27, 68)
- 3: II. Microeconomics\3. Market Types\C. Labor and Capital\1. Economic Rent - (30, 53, 54)
- 4: II. Microeconomics\3. Market Types\C. Labor and Capital\2. Derived Demand - (24, 29, 65, 67)
- 1: II. Microeconomics\4. Society\A. Government Role\1. Public Goods - (31)
- 1: II. Microeconomics\4. Society\A. Government Role\2. Income Distribution - (32)
- 7: II. Microeconomics\3. Market Types\C. Labor and Capital\4. Marginal Analysis - (33, 39, 48, 49, 50, 69, 70)
- 3: II. Microeconomics\4. Society\B. Market Failure\1. Positive Externalities - (34, 45, 46)
- 1: II. Microeconomics\4. Society\B. Market Failure\3. Antitrust Regulation - (35)
- 1: II. Microeconomics\4. Society\A. Government Role\3. Tax Policy - (36)
- 1: II. Microeconomics\1. Individuals\B. Consumption Function\1. Utility - (14)
- 1: II. Microeconomics\4. Society\A. Government Role\4. Tax Incidence - (44)
- 2: II. Microeconomics\2. Firms\C. Production Function\3. Long Run, Short Run - (47, 59)
- 1: II. Microeconomics\3. Market Types\B. Price Analysis\5. Market Concentration - (51)
- 1: II. Microeconomics\3. Market Types\C. Labor and Capital\3. Unions - (52)
- 2: II. Microeconomics\2. Firms\B. Efficiency\1. Allocative Efficiency - (22, 23)
- 1: II. Microeconomics\2. Firms\A. Profits\2. Economic Profit - (57)
- 1: II. Microeconomics\2. Firms\B. Efficiency\2. Productive Efficiency - (58)
- 1: II. Microeconomics\2. Firms\C. Production Function\4. Cost Functions - (60)
- 1: II. Microeconomics\2. Firms\C. Production Function\6. Marginal Analysis - (61)
- 2: II. Microeconomics\3. Market Types\A. Types of Competition\1. Perfect Competition - (62, 63)
- 1: II. Microeconomics\3. Market Types\A. Types of Competition\4. Monopolistic Competition - (64)
- 1: II. Microeconomics\5. Part II Questions\D. Society\1. Government Role - (71)
- 2: II. Microeconomics\5. Part II Questions\B. Firms\2. Efficiency - (72, 75)
- 1: II. Microeconomics\5. Part II Questions\A. Individuals\1. Consumption Function - (73)
- 1: II. Microeconomics\5. Part II Questions\B. Firms\3. Production Function - (74)
- 1: III. Macroeconomics\6. Growth and Productivity\A. Investment\2. Human Capital - (28)

AP Microeconomics Sample Exam

Name \_\_\_\_\_

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- 1. \_\_\_\_\_
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