

Practice exercises for the topics:

Introducing supply decisions, cost and supply, Perfect competition and pure monopoly (Test H)

A. Multiple choice questions

Instructions: Please fill in the table! Each question in section A is worth 2 points each. Choose the one alternative that best completes the statements or answers the question! (If there is seemingly more than one correct answer – the answer should be d or e.)

A/1	A/2	A/3	A/4	A/5	A/6	A/7	A/8	A/9	A/10	A/11	A/12	A/13	A/14	A/15

1. Which of the following corresponds most closely to the economists’ notion of ‘normal profit’?
 - a.) The level of profits a firm makes by setting $MC=MR$.
 - b.) The level of profits made by a typical firm in the industry.
 - c.) The level of profits needed to persuade a firm to stay in its current line of business.
 - d.) The rate of profits that ensures a comfortable standard of living for the entrepreneur.
 - e.) All of the above.

2. Which of the following statements about the short-run marginal cost curve is/are *not* true?
 - a.) Marginal cost is unaffected by changes in factor prices.
 - b.) Marginal cost will be rising under conditions of diminishing returns.
 - c.) When average cost is falling, marginal cost will be below average cost.
 - d.) All of the above are true.
 - e.) None of the above is true.

3. Which of the following situations characterize(s) a monopoly?
 - a.) Price equals marginal cost.
 - b.) Marginal revenue equals marginal cost.
 - c.) There are no barriers to entry.
 - d.) Average revenue is equal to marginal revenue
 - e.) All of the above.

4. Which of the following situations characterize(s) a perfectly competitive market?
 - a.) Price equals marginal cost.
 - b.) Marginal revenue equals marginal cost.
 - c.) There are no barriers to entry.
 - d.) Average revenue is equal to marginal revenue
 - e.) All of the above.

5. Which of the following conditions is/are necessary before the law of diminishing returns to a factor can be said to operate?
 - a.) Other factors are held constant.
 - b.) The state of technical knowledge does not change.
 - c.) All units of the variable factor are homogeneous.
 - d.) All of the above.
 - e.) None of the above.

6. Which of the following statements describes the law of diminishing returns? Suppose in each case that labour is a variable factor but capital is fixed. As more labour is used:
 - a.) Total output will fall because the extra units of labour will be of poorer quality than those previously employed.
 - b.) The relative shortage of capital will eventually cause increases in total product to become progressively smaller.
 - c.) After a while fewer units of labour will be needed in order to produce more output.
 - d.) The marginal revenue obtained from each additional unit produced will decline.
 - e.) None of the above.

7. In the short run ...
 - a.) a firm produces at a level of output that equates marginal revenue and marginal cost provided that at that level the price exceeds short-run average total cost.
 - b.) a firm produces at a level of output that equates marginal revenue and marginal cost provided that at that level the price exceeds short-run average fixed cost.
 - c.) a firm shuts down if at the level of output that equates MR and MC it cannot recoup at least the fixed costs.
 - d.) a firm will close down if price is less than average revenue.
 - e.) None of the above.

8. In the long run ...
 - a.) a firm never produces at a loss, it would always exit the industry if economic costs exceed total revenue.
 - b.) a firm would always produce if they can equate marginal costs and the market price, even if it makes a loss.
 - c.) a firm would always produce if they can equate marginal costs and the market revenue, even if it makes a loss.
 - d.) a firm will close down if price is less than average revenue.
 - e.) None of the above.

9. Suppose that there is an increase in the wage rate of workers in a certain industry. The industry is serviced by a monopolist firm. What happens to the firm's costs, revenue and output?
 - a.) The marginal cost (MC) curve will shift downwards and the profit-maximizing output increases.
 - b.) The MC curve will shift upwards and the profit-maximizing output decreases.
 - c.) The marginal revenue (MR) curve will shift downwards and the profit-maximizing output decreases.
 - d.) The MR curve will shift upwards and the profit-maximizing output increases.
 - e.) None of the above.

10. Suppose that there is a fall in market demand. The industry is serviced by a monopolist firm. What happens to the firm's costs, revenue and output?
- The marginal cost (MC) curve will shift downwards and the profit-maximizing output increases.
 - The MC curve will shift upwards and the profit-maximizing output decreases.
 - The marginal revenue (MR) curve will shift downwards and the profit-maximizing output decreases.
 - The MR curve will shift upwards and the profit-maximizing output increases.
 - None of the above.
11. Which of the following items would shift the SAFC schedule downwards?
- A rise in wages.
 - A rise in demand.
 - A rise in the rental rate of machines.
 - A rise in fixed costs.
 - None of the above.
12. Which of the following items would shift the MR schedule upwards?
- A rise in wages.
 - A rise in demand.
 - A fall in the rental rate of machines.
 - A rise in fixed costs.
 - None of the above.
13. Which of the following items would shift the LMC schedule upwards?
- A rise in wages.
 - A rise in demand.
 - A fall in the rental rate of machines.
 - A rise in fixed costs.
 - None of the above.
14. That level of profits which just pays the opportunity cost of the owners' money and time is called ...
- Supernormal profits.
 - Economic profits.
 - Accounting profits.
 - Normal profit.
 - None of the above.
15. Which of the following statements are valid?
- LAC is falling when LMC is less than LAC
 - LAC is rising when LMC is greater than LAC
 - LAC is at a minimum at the output level at which LAC and LMC cross.
 - All of the above are valid.
 - None of the above are valid.

B. True or false questions

Instructions: Please decide if the following statements are true ('T') or false ('F'), and fill in the table! Each question in section B is worth 1 point each.

B/1	B/2	B/3	B/4	B/5	B/6	B/7	B/8	B/9	B/10

1. Opportunity cost plus accounting cost equals economic cost.
2. Firms maximize *profits* by selling as much output as they can.
3. When a firm's demand curve slopes down, marginal revenue will fall as output rises.
4. Any firm wanting to maximize profits will minimize cost for any given level of output.
5. A fall in marginal revenue will cause profits to be maximized at a *higher* output level.
6. The long-run supply decision is *determined* by finding the level of output at which long-run marginal cost is equal to marginal revenue.
7. Holding labour constant while increasing capital input will lead to diminishing returns.
8. The short-run supply curve for a perfectly competitive firm is *flatter* than the long-run supply curve
9. Price is equal to marginal revenue for a firm under perfect competition.
10. Total revenue is maximized *when* average revenue is at a maximum.