Question #1 of 45

If a good has elastic demand, a small percentage price increase will cause:

A) a smaller percentage increase in the quantity demanded.

B) a larger percentage increase in the quantity demanded.

C) a larger percentage decrease in the quantity demanded.

Explanation

If a good has elastic demand, a small price increase will cause a larger decrease in the quantity demanded. Demand is elastic when the percentage change in quantity demanded is larger than the percentage change in price.

(Study Session 4, Module 14.1, LOS 14.a)

Question #2 of 45

The law of diminishing returns states that for a given production process, as more and more of a resource (such as labor) are added, holding the quantities of other resources fixed:

A) output increases at a decreasing rate.

B) cost declines at a decreasing rate.

C) cost declines at an increasing rate.

Explanation

The law of diminishing returns states that for a given production process, as more and more resources (such as labor) are added holding the quantities of other resources fixed, output increases at a decreasing rate. This occurs because, at some point, adding more workers results in inefficiencies.

(Study Session 4, Module 14.2, LOS 14.d)

Question #3 of 45

Which of the following statements regarding diminishing marginal returns is *most* accurate?

A) The total cost curve arches downward.

B) As the quantity produced rises, costs begin to rise at an increasing rate.

C) As the quantity produced rises, costs begin to rise at a decreasing rate.

Explanation

At production levels that are consistent with decreasing marginal returns, costs will increase at an increasing rate as production rises.

(Study Session 4, Module 14.2, LOS 14.d)

Question #4 of 45

A firm that is experiencing diseconomies of scale should:

A) decrease output in the short run.

B) shut down in the long run.

C) decrease its plant size.

Explanation

If a firm is experiencing diseconomies of scale, it should decrease its plant size to the efficient scale, which is the size that minimizes long-run average total cost. Plant size can be adjusted in the long run but not in the short run.

(Study Session 4, Module 14.2, LOS 14.f)

Question #5 of 45

If quantity demanded increases 15% when the price drops 1%, demand for this good:

A) elastic, but not perfectly elastic.

B) perfectly elastic.

C) inelastic, but not perfectly inelastic.

Explanation

Whenever quantity demanded for a good changes by a greater percentage than price, the price elasticity of demand will be greater than 1.0 and demand for the product is considered to be elastic.

(Study Session 4, Module 14.1, LOS 14.a)

Question #6 of 45

If the price elasticity of demand is -1.5 and the price of the product increases 2%, the quantity demanded will:

A) decrease approximately 1.5%.

B) decrease approximately 0.75%.

C) decrease approximately 3%.

Explanation

If the price elasticity of demand is -1.5, and you increase the price of the product 2%, the quantity demanded will decrease approximately 3%. When the price elasticity is negative, it means that price and demand move in opposite directions. Given a price decrease, demand will increase and vice versa. The absolute value, 1.5, indicates that demand will move one-and-a-half times as much as price.

(Study Session 4, Module 14.1, LOS 14.a)

Question #7 of 45

Which of the following is *most likely* to cause a decrease in the consumption of a good in response to a decline in the price of the good?

A) Substitution effect.

B) Income effect.

C) Law of demand.

Explanation

The income effect can be negative if the good is an inferior good. The substitution effect is always positive and will cause consumption of a good to increase if the price declines. The law of demand assumes that a decrease in the price of a good will cause an increase in the quantity demanded.

(Study Session 4, Module 14.2, LOS 14.b)

Question #8 of 45

At a fixed level of capital, output increases as the quantity of labor increases, but at a decreasing rate. This phenomenon is an example of:

A) diminishing returns to capital.

B) diminishing costs to labor.

C) diminishing returns to labor.

Explanation

The law of diminishing returns states that at some point, as more and more of a resource (e.g., labor) is devoted to a production process, holding the quantity of other inputs constant, the output increases, but at a decreasing rate.

(Study Session 4, Module 14.2, LOS 14.d)

Question #9 of 45

The demand for a product tends to be price inelastic if:

A) few good substitutes for the product are available.

B) few good complements for the product are available.

C) people spend a large share of their income on the product.

Explanation

If a large price change results in a small change in quantity demanded, demand is inelastic. Cigarettes are an example of a good with inelastic demand.

(Study Session 4, Module 14.1, LOS 14.a)

Question #10 of 45

When demand for a good is inelastic, a higher price will:

A) fail to reduce the quantity demanded for the good.

B) have no impact on the demand for the good.

C) lead to an increase in total expenditures for the good.

Explanation

When demand is relatively inelastic, consumers do not reduce their quantity demanded very much when the price increases. That is, a given percentage increase in price results in a smaller percentage reduction in quantity demanded. Thus, total expenditures on the good increase. "Fail to reduce the quantity demanded for the good" is inaccurate because that would only be true if demand was *perfectly* inelastic.

(Study Session 4, Module 14.1, LOS 14.a)

Question #11 of 45

A good is *most likely* to demonstrate higher price elasticity of demand:

A) if it represents a small portion of the consumer's budget, than if it represents a large portion.

B) in the long run than the short run.

C) when there are few substitutes for the good, than when there are many good substitutes.

Explanation

A good is likely to show a high price elasticity of demand when there are good substitutes, it represents a large proportion of consumer spending, and in the long run as consumers make changes that take time to implement in response to price changes for the good.

(Study Session 4, Module 14.1, LOS 14.a)

Question #12 of 45

In the short run, if price is below average total cost (ATC) the firm will:

A) raise prices.

B) produce more.

C) keep running as long as it is covering its variable costs.

Explanation

In the short run, if the firm is covering its average variable costs and some of its fixed costs it will continue to operate as long as the situation is temporary.

(Study Session 4, Module 14.2, LOS 14.e)

Question #13 of 45

A distinction between Giffen goods and Veblen goods is that:

A) the substitution effect is positive for a Veblen good but negative for a Giffen good.

B) Giffen goods are inferior goods, while Veblen goods are not inferior goods.

C) demand curves for Giffen goods slope upward, while demand curves for Veblen goods slope downward.

Explanation

Giffen goods are inferior goods for which the quantity demanded decreases when the price decreases, because the negative income effect is larger than the positive substitution effect. Veblen goods are goods for which the quantity demand increases when the price increases, such as a high-status good for which the consumer gains utility from being seen to consume the good. Giffen goods and Veblen goods, if they exist, have demand curves that slope upward over at least some range of prices. The substitution effect is positive for all goods.

(Study Session 4, Module 14.2, LOS 14.c)

Question #14 of 45

If a good has elastic demand, a small price decrease will cause:

A) a larger decrease in the quantity demanded.

B) no change in the quantity demanded.

C) a larger increase in quantity demanded.

Explanation

If a good has elastic demand, a small price decrease will cause a larger increase in the quantity demanded.

(Study Session 4, Module 14.1, LOS 14.a)

Question #15 of 45

According to the law of diminishing returns, doubling the number of salespeople for a firm will *most likely* result in:

A) decreasing the total sales of the firm as a result of competition amongst salespeople.

B) doubling the total sales of the firm.

C) increasing the total sales of the firm and reducing the average sales per salesperson.

Explanation

The law of diminishing returns states that as more of a resource is added to a production process, holding other resource use constant, increases in output will eventually decrease. Therefore, as more salespeople are added they will generate more sales at a decreasing rate. Total sales will increase and the average sales per salesperson will decrease.

(Study Session 4, Module 14.2, LOS 14.d)

Question #16 of 45

A decrease in the price of Good Y can result in a decrease of the quantity of Good Y demanded by consumers if the substitution effect:

A) is positive and the income effect is negative and larger than the substitution effect.

B) and the income effect are negative.

C) is negative and larger than the positive income effect.

Explanation

If the price of Good Y decreases, the substitution effect will have a positive impact on the quantity demanded of Good Y. Thus, the only way that quantity demanded of Good Y can decrease is if there is a negative income effect that is greater in magnitude than the substitution effect; i.e., if Good Y is a Giffen good.

(Study Session 4, Module 14.2, LOS 14.c)

Question #17 of 45

For a linear demand curve, at the price where elasticity is -2.0, reducing prices will:

A) decrease total revenue and we are not at the point of maximum total revenue.

B) increase total revenue and we are not at the point of maximum total revenue.

C) increase total revenue and we are at the point of maximum total revenue.

Explanation

If the price elasticity of demand is -2.0, this indicates that the percentage change in quantity demanded is twice the percentage change in price. Thus, a decrease in price will be more than offset by the increase in quantity, and total revenue will increase. We are not at the point of maximum total revenue which is where elasticity is -1.0—the point of unit elastic demand.

(Study Session 4, Module 14.1, LOS 14.a)

Question #18 of 45

The primary factors that influence the price elasticity of demand for a product are:

A) the availability of substitute goods, the time that has elapsed since the price of the good changed, and the proportions of consumers' budgets spent on the product.

B) changes in consumers' incomes, the time since the price change occurred, and the availability of substitute goods.

C) the proportions of consumers' budgets spent on the product, the size of the shift in the demand curve for a product, and changes in consumers' price expectations.

Explanation

The three primary factors influencing the price elasticity of demand for a good are the availability of substitute goods, the proportions of consumers' budgets spent on the good, and the time since the price change. If there are good substitutes, when the price of the good goes up, some customers will switch to substitute goods. For goods that represent a relatively small proportion of consumers' budgets, a change in price will have little effect on the quantity demanded. For most goods, the price elasticity of demand is greater in the long run than in the short run.

(Study Session 4, Module 14.1, LOS 14.a)

Question #19 of 45

A firm in a perfectly competitive industry that seeks to maximize profit is *most likely* to continue production in the short run as long which of the following conditions exists? Price is equal to or greater than:

A) average fixed cost.

B) marginal cost.

C) average variable costs.

Explanation

If a firm is covering its average variable costs, it will continue to operate in the short run since it is covering some portion of its fixed costs.

(Study Session 4, Module 14.2, LOS 14.e)

Question #20 of 45

A good is considered an inferior good if it exhibits a negative:

A) elasticity of demand.

B) substitution effect.

C) income effect.

Explanation

The income effect is negative for an inferior good. An increase in income results in a decrease in the quantity demanded.

(Study Session 4, Module 14.2, LOS 14.c)

Question #21 of 45

The percent change in demand for a good divided by the percent change in the price of another good is known as the:

A) cross price elasticity of demand.

B) income elasticity of demand.

C) price elasticity of demand.

Explanation

$$\text{Cross price elasticity of demand} = \frac{\text{Percent change in quantity demanded}}{\text{Percent change in price of another good}}$$

(Study Session 4, Module 14.1, LOS 14.a)

Question #22 of 45

The upward sloping segment of a long-run average total cost curve represents the existence of:

A) efficiencies of scale.

B) diseconomies of scale.

C) economies of scale.

Explanation

Diseconomies of scale occur along the upward sloping segment of the long-run average total cost curve where costs rise as output increases. The flat portion at the bottom of the long-run average total costs curve represents constant returns to scale.

(Study Session 4, Module 14.2, LOS 14.f)

Question #23 of 45

When the price of a good decreases, how do the income effect and the substitution effect change the quantity demanded of the good?

A) The substitution effect increases the quantity demanded, but the income effect may increase or decrease the quantity demanded.

B) Both the income effect and the substitution effect increase the quantity demanded.

C) The income effect increases the quantity consumed, but the substitution effect may increase or decrease the quantity demanded.

Explanation

The substitution effect is a shift in consumption toward a larger quantity of a good that decreases in price. A decrease in the price of a good also has an income effect because the old bundle costs less. The income effect may result in consumption of a larger or smaller quantity of the good that has decreased in price, depending on whether it is a normal good or an inferior good.

(Study Session 4, Module 14.2, LOS 14.b)

Question #24 of 45

If the price elasticity of demand is –2 and the price of the product decreases by 5%, the quantity demanded will:

A) decrease 2%.

B) increase 5%.

C) increase 10%.

Explanation

If the price elasticity of demand is –2, and the price of the product decreases by 5%, the quantity demanded will increase 10%. The value, –2, indicates that the percentage increase in the quantity demanded will be twice the percentage decrease in price.

(Study Session 4, Module 14.1, LOS 14.a)

Question #25 of 45

If the demand curve for a given product is a straight line, this indicates that:

A) elasticity is constant along the demand curve.

B) demand is unit elastic.

C) demand is more elastic at higher prices.

Explanation

Elasticities will be greater (in absolute value) at higher prices.

(Study Session 4, Module 14.1, LOS 14.a)

Question #26 of 45

In the long run, if price is below average total cost (ATC) the firm will:

A) shut down.

B) cover its variable costs.

C) keep running.

Explanation

If the price is below ATC then the firm is losing money. If the firm believes the price will never exceed ATC the only way to eliminate fixed costs is to go out of business.

(Study Session 4, Module 14.2, LOS 14.e)

Question #27 of 45

Suppose a price-taker firm produces baseball bats that sell at a price of $100 each. This firm's average total cost at the current level of production is $150 per bat, and the average fixed cost is $40 per bat. Which of the following statements is *most* accurate regarding this firm? They should:

A) shut down in the short run because their average total cost is greater than their price.

B) shut down in the short run because their average variable cost is greater than their price.

C) continue producing baseball bats because they are covering their fixed costs.

Explanation

Variable costs = $150 (ATC) – $40 (AFC) = $110 (AVC). At a selling price of $100 the firm is not covering its variable costs and will have losses greater than its fixed costs if it stays in business.

(Study Session 4, Module 14.2, LOS 14.e)

Question #28 of 45

Income elasticity is defined as the:

A) percentage change in income divided by the percentage change in the quantity demanded.

B) change in quantity demanded divided by the change in income.

C) percentage change in the quantity demanded divided by the percentage change in income.

Explanation

Income elasticity is defined as the percentage change in quantity demanded divided by the percentage change in income. Normal goods have positive values for income elasticity and inferior goods have negative income elasticities.

(Study Session 4, Module 14.1, LOS 14.a)

Question #29 of 45

Price elasticity of demand is *most* accurately defined as the change in:

A) quantity demanded in response to a change in market price.

B) market price in response to a change in the quantity demanded.

C) quantity demanded in response to a change in income.

Explanation

$$\text{Price elasticity of demand} = \frac{\%\text{ change in quantity demanded}}{\%\text{ change in price}}$$

(Study Session 4, Module 14.1, LOS 14.a)

Question #30 of 45

The cross price elasticity of demand for a substitute good and the income elasticity for an inferior good are:

	Cross elasticity	Income elasticity
A)	< 0	> 0
B)	> 0	< 0
C)	< 0	< 0

Explanation

The cross price elasticity of substitutes is positive, and the income elasticity of an inferior good is negative.

(Study Session 4, Module 14.1, LOS 14.a)

Question #31 of 45

With respect to utility theory, the substitution effect for a decrease in the price of a good:

A) will decrease consumption of the good.

B) will increase consumption of the good.

C) may increase or decrease consumption of the good.

Explanation

In utility theory, if the price of one good decreases, the substitution effect causes consumption of that good to increase.

(Study Session 4, Module 14.2, LOS 14.b)

Question #32 of 45

If the price of World Cup Soccer tickets increases from $40 a ticket to $50 a ticket and the quantity demanded of tickets stays the same, demand for the tickets is:

A) perfectly inelastic.

B) elastic, but not perfectly elastic.

C) inelastic, but not perfectly inelastic.

Explanation

Since the quantity of tickets demanded stayed the same after the price changed, the demand curve would have to be vertical which is a perfectly inelastic demand curve.

(Study Session 4, Module 14.1, LOS 14.a)

Question #33 of 45

A good for which consumers exhibit a negative income effect that is smaller than the substitution effect is *most accurately* described as a(n):

A) Veblen good.

B) inferior good.

C) Giffen good.

Explanation

For an inferior good the income effect is negative. A Giffen good is an inferior good for which the negative income effect is larger than the positive substitution effect, resulting in a decrease in consumption in response to a decrease in price. A Veblen good is not an inferior good, but rather a good that provides more utility to a consumer at a higher price than it provides at a lower price because the status benefits of ownership are greater at higher prices.

(Study Session 4, Module 14.2, LOS 14.c)

Question #34 of 45

The law of diminishing returns states that at some point as:

A) more of a resource is devoted to production, holding the quantity of other inputs constant, the output will increase, but at a decreasing rate.

B) less of a resource are devoted to production, holding the quantity of other inputs constant, the output will decrease, but at an increasing rate.

C) more of a resource is devoted to production, holding the quantity of other inputs constant, at some point output will begin to decrease.

Explanation

At low levels of output, increasing marginal returns will exist corresponding to the downward sloping portion of the marginal cost curve. As marginal costs begin to increase diminishing marginal returns will occur.

(Study Session 4, Module 14.2, LOS 14.d)

Question #35 of 45

When household incomes go down and the quantity of a product demanded goes up, the product is:

A) a normal good.

B) an inferior good.

C) a Veblen good.

Explanation

When household incomes go down and the quantity demanded of a product goes up, the product is an inferior good. Inferior goods include things like bus travel and margarine.

(Study Session 4, Module 14.2, LOS 14.c)

Question #36 of 45

John Klement is a soybean farmer who harvests 125,000 bushels of soybeans annually. Klement's fixed costs are $200,000 and his variable costs are $5 per bushel. Soybeans are currently priced at $5.35 per bushel. Based on his estimates, Klement sees soybean prices being relatively stable for the next two years, then increasing to $7.00 per bushel due to increased demand from Japan. What action should Klement take? Klement should:

A) shut down for two years and then restart his business.

B) cut his production by 50% for the next two years and then resume full production.

C) continue operating his business as usual.

Explanation

Since Klement is selling soybeans, a common commodity, he is a price taker and therefore can not adjust the price. He should continue operating his business as normal as he is currently covering variable costs and part of fixed costs. In two years from now, he will be able to cover both fixed and variable costs and be able to make a substantial profit.

(Study Session 4, Module 14.2, LOS 14.e)

Question #37 of 45

Which of the following *most* accurately describes economies of scale? Economies of scale:

A) increase at a decreasing rate.

B) occur when long-run unit costs fall as output increases.

C) are dependent on short-run average costs.

Explanation

Economies of scale occur when the percentage increase in output is greater than the percentage increase in the cost of all inputs. Economies of scale occur over the range where the long-run average cost curve slopes downward.

(Study Session 4, Module 14.2, LOS 14.f)

Question #38 of 45

If the price elasticity of a linear demand curve is –1 at the current price, an increase in price will lead to:

A) no change in total revenue.

B) an increase in total revenue.

C) a decrease in total revenue.

Explanation

On a linear demand curve, demand is elastic at prices above the point of unitary elasticity, so a price increase will decrease total revenue.

(Study Session 4, Module 14.1, LOS 14.a)

Question #39 of 45

Gene Bawerk, an economics professor, is lecturing on the factors that influence the price elasticity of demand. He makes the following assertions:

> Statement 1: For most goods, demand is more elastic in the long run than the short run.
>
> Statement 2: Demand for a good becomes more elastic when a close substitute for it becomes available on the market.

With respect to Bawerk's statements:

A) only statement 2 is correct.

B) only statement 1 is correct.

C) both are correct.

Explanation

Both of these statements are accurate. Price elasticity for most goods is greater in the long run because individuals can make long-term decisions that require different quantities of the good, such as buying more fuel efficient vehicles to use less gasoline. Price elasticity is greater the better the available substitutes because an increase in price will lead more buyers to switch to the substitute products.

(Study Session 4, Module 14.1, LOS 14.a)

Question #40 of 45

If the price elasticity of demand is –1.5 and a change in the price of the product increases the quantity demanded by 4%, then what is the percent change in price?

A) –6.000%.

B) –0.375%.

C) –2.667%.

Explanation

Price elasticity of demand is calculated by dividing the percent change in quantity demanded by the percent change in price. The percent change in price is, therefore, the percent change in quantity demanded divided by the price elasticity of demand = 4 / –1.5 = –2.667.

(Study Session 4, Module 14.1, LOS 14.a)

Question #41 of 45

If the price elasticity of demand for a good is –4.0, then a 10% increase in price would result in a:

A) 40% decrease in the quantity demanded.

B) 4% decrease in the quantity demanded.

C) 10% decrease in the quantity demanded.

Explanation

Price elasticity of demand = (% change in Q demanded / % change in price). Given the price elasticity of demand and the percentage change in price, we can solve for the percentage change in quantity demanded = price elasticity of demand × percentage change in price. Here, –4.0 × 10% = –40%.

(Study Session 4, Module 14.1, LOS 14.a)

Question #42 of 45

Based on the concept of diminishing returns, as the quantity of output increases, the short-run marginal costs of production eventually:

A) rise at an increasing rate.

B) rise at a decreasing rate.

C) fall at a decreasing rate.

Explanation

The law of diminishing returns states that as more variable resources are a production process combined with a fixed input, output will eventually increase at a decreasing rate. In the short run, as the quantity produced rises, costs rise at an increasing rate.

(Study Session 4, Module 14.2, LOS 14.d)

Question #43 of 45

With respect to utility theory, the income effect for a decrease in the price of a good:

A) may increase or decrease consumption of the good. ✓

B) will decrease consumption of the good. ✗

C) will increase consumption of the good. ✗

Explanation

The income effect for a decrease in price may be positive (for a normal good) or negative (for an inferior good). Therefore, the income effect from a price decrease may be to increase or decrease consumption of a good.

(Study Session 4, Module 14.2, LOS 14.b)

Question #44 of 45

If quantity demanded increases 20% when the price drops 2%, this good exhibits:

A) inelastic, but not perfectly inelastic, demand. ✗

B) perfectly inelastic demand. ✗

C) elastic, but not perfectly elastic, demand. ✓

Explanation

If quantity demanded increases 20% when the price drops 2%, this good exhibits elastic demand. Whenever demand changes by a greater percentage than price, demand is considered to be elastic.

(Study Session 4, Module 14.1, LOS 14.a)

Question #45 of 45

Income elasticity is defined as the percentage change in:

A) quantity demanded divided by the percentage change in the price of the product. ✗

B) quantity demanded divided by the percentage change in income. ✓

C) income divided by the percentage change in the quantity demanded. ✗

Explanation

Income elasticity is defined as the percentage change in quantity demanded divided by the percentage change in income. Normal goods have positive values for income elasticity, and inferior goods have negative income elasticity.

(Study Session 4, Module 14.1, LOS 14.a)