ECO 3033, Exam 2 Sample Objective Questions

PART I. True/False

___ 1. The breakeven level of output of a firm occurs where gross profit contribution is zero.

___ 2. Under perfect competition, there are many small firms, and each individual firm gets to deviate as much as it wishes from the market price.

___ 3. Normal profit is never considered to be an economic cost of production.

___ 4. In a market that is characterized by free entry and exit, economic loss serves a resource allocation function by causing some firms to leave the industry in the long run.

___ 5. The demand curve of the perfectly competitive firm is the same as its average revenue curve.

___ 6. Under perfect competition in the short run, as long as SMC = MR = P, if price is greater than average variable cost, the firm should operate with Q > 0.

___ 7. The market demand curve in a perfectly competitive market can be expected to be downward-sloping.

___ 8. Because a monopoly is the only firm in an industry, it can never operate at a loss.

___ 9. In the absence of government regulation, a monopoly firm can indefinitely sustain greater than normal profits.

___ 10. Price rigidity refers to the inability for firms to change price because of rival's reactions.

PART II. Multiple Choice

___ 1. All of the following are characteristics of monopolistic competition EXCEPT:
   a. The use of advertising to differentiate products
   b. A relatively large number of buyers
   c. Each seller firm is not particularly concerned about the relationship between its individual actions and those of other firms in the industry.
   d. Firms' fear of rival reactions.
   e. Each seller firm attempts to retain or increase its market share by differentiating its product from the output of other firms.

___ 2. If a monopoly produces where marginal revenue is equal to marginal cost then:
   a. if short run average cost is less than price, the monopoly will have a normal profit.
   b. if short run average cost is less than price, the monopoly will have a greater-than-normal profit.
   c. the monopoly is guaranteed to make a normal profit.
   d. if short run average cost is greater than price, the monopoly will have a normal profit.
   e. if average variable cost is greater than price, the monopoly will produce output but be operating at a loss.
5. Break-even analysis is:
   a. a more complex type analysis than profit maximization analysis.
   b. based on a linear TR and a linear TVC.
   c. always used in the long run analysis of firms because of its accuracy.
   d. the preferred method even when the firm knows its quantity demanded depends on price.
   e. never used by businesses today.

6. Birdie heaven is a miniature golf course in Minneapolis. When winter comes, it is rational for the firm to temporarily shut down because:
   a. its fixed costs will rise dramatically.
   b. golf clubs break when they are cold.
   c. it will not be able to cover its variable costs.
   d. the cross elasticity of demand between golf and football is negative.
   e. its profit contribution will be positive, but not sufficient.

7. A monopoly will have only normal profit in the long run if:
   a. it maximizes total revenue.
   b. its price is greater than AFC.
   c. it operates where LAC is minimum.
   d. \( P = \text{LAC} \) where its rising LMC crosses MR.
   e. \( \text{LMC} = \text{MR} \) and \( P > \text{LAC} \).

8. A perfectly competitive firm is operating where marginal cost is \$5.50 and rising, average fixed cost and average variable cost are each \$1.50 per unit of output, and it is charging the market price of \$5.50. To maximize profit, it should:
   a. reduce output and raise its price.
   b. increase output and lower its price.
   c. increase output and keep its price the same.
   d. shut down until price increases.
   e. make no change in its output.

9. A firm that is in monopolistic competition (not monopoly) differs from one in perfect competition because:
   a. it faces a horizontal demand curve.
   b. it has no concept of marginal cost.
   c. it always has increasing returns to scale.
   d. it decides on its own price.
   e. it has a great deal of monopoly power.

10. Suppose an oligopolistic firm is operating in the short run where MR = MC, price is greater than AVC, and marginal profit is zero and falling. It should:
    a. temporarily shut down.
    b. raise price.
    c. cut price to sell more.
    d. make no change in price or quantity sold.
    e. keep price constant and reduce quantity.

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Answer Section

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