

Varsity Economics – Market Failure

- 1 **When producers do not have to pay the full cost of producing a product, they tend to**
 - A overproduce the product because of a demand-side market failure.
 - B underproduce the product because of a demand-side market failure.
 - C underproduce the product because of a supply-side market failure.
 - D overproduce the product because of a supply-side market failure.
- 2 **In a situation where an externality occurs, the "third party" refers to those who**
 - A buy the product from others.
 - B produce the product for others.
 - C trade the product with others outside the nation or community.
 - D are not directly involved in the transaction or activity.
- 3 **External benefits in consumption refer to benefits accruing to those**
 - A who are selling the product to the consumers.
 - B who bought and consumed the product.
 - C other than the ones who consumed the product.
 - D who are consuming the product abroad.
- 4 **Use the following information to answer the question below.**

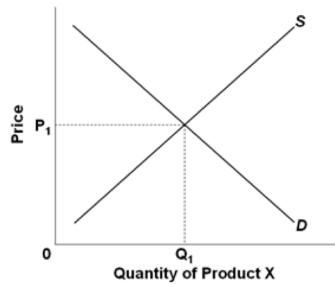
It is the custom for paper mills located alongside the Layzee River to discharge waste products into the river. As a result, operators of hydroelectric power-generating plants downstream along the river find that they must clean up the river's water before it flows through their equipment.

In the situation described above, we would expect an

 - A overproduction of paper in the mills.
 - B underproduction of paper in the mills.
 - C external cost resulting from the production of hydroelectric power.
 - D attainment of allocative efficiency in the market.
- 5 **A positive externality or spillover benefit (additional social benefit) occurs when**
 - A product differentiation increases the variety of products available to consumers.
 - B the benefits associated with a product exceed those accruing to people who consume it.
 - C a firm does not bear all of the costs of producing a good or service.
 - D firms earn positive economic profits.

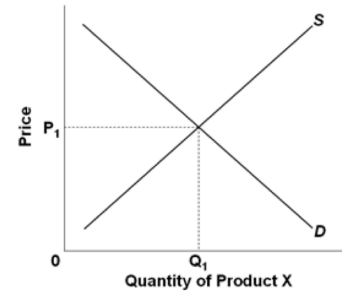
- 6 **A negative externality or spillover cost (additional social cost) occurs when**
 - A firms fail to achieve allocative efficiency.
 - B firms fail to achieve productive efficiency.
 - C the price of the good exceeds the marginal cost of producing it.
 - D the total cost of producing a good exceeds the costs borne by the producer.
- 7 **In a free-market economy, a product that entails a positive externality (additional social benefit) will be**
 - A overproduced.
 - B underproduced.
 - C produced at the optimal level.
 - D provided solely by the government.
- 8 **In a free-market economy, a product that entails a negative externality (additional social cost) will be**
 - A overproduced.
 - B underproduced.
 - C produced at the optimal level.
 - D provided solely by the government.
- 9 **Which of the following is an example of a negative externality (additional social cost)?**
 - A an increase in the value of land you own when a nearby development is completed
 - B the costs paid by a company to build an automated factory
 - C falling property values in a neighborhood where a disreputable nightclub is operating
 - D the higher price you pay when you buy a heavily advertised product
- 10 **Which of the following is an example of a positive externality (additional social benefit)?**
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 - B the costs paid by a company to build an automated factory
 - C falling property values in a neighborhood where a disreputable nightclub is operating
 - D the higher price you pay when you buy a heavily advertised product
- 11 **If some activity creates external benefits as well as private benefits, then economic theory suggests that the activity ought to be**
 - A taxed.
 - B prohibited.
 - C subsidized.
 - D left alone.

- 12 If there are external benefits associated with the consumption of a good or service
- A the private demand curve will overestimate the true demand curve.
 - B the private demand curve will underestimate the true demand curve.
 - C consumers will be willing to pay for all these benefits in private markets.
 - D the market demand curve will be the vertical summation of the individual demand costs.
- 13 If the consumption of a product or service involves external benefits, then the government can improve efficiency in the market by
- A providing a subsidy to correct for an overallocation of resources.
 - B providing a subsidy to correct for an underallocation of resources.
 - C imposing a corrective tax to correct for an overallocation of resources.
 - D imposing a corrective tax to correct for an underallocation of resources.
- 14 Where there are spillover (or external) benefits from having a particular product in a society, the government can make the quantity of the product approach the socially optimal level by doing the following except
- A subsidizing the buyers of the product.
 - B taxing the sellers of the product.
 - C subsidizing the sellers of the product.
 - D providing the product itself.
- 15 Use the following supply and demand graph for product X to answer the question below.



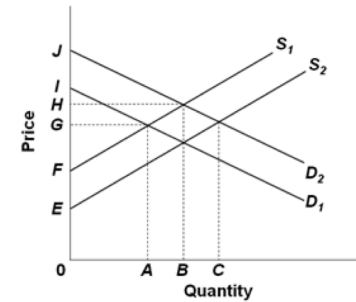
- If there are positive externalities from the consumption of product X, then the socially optimal demand curve would be
- A to the left of line D on the graph.
 - B to the right of line D on the graph.
 - C at the position of line D on the graph.
 - D an upward-sloping line.

- 16 Use the following supply and demand graph for product X to answer the question below.



What would happen if the government subsidized consumption of this product because it has positive externalities in consumption?

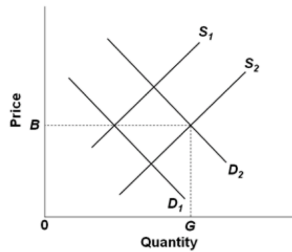
- A supply would increase
 - B demand would decrease
 - C demand would increase
 - D price would increase
- 17 Use the following supply and demand graph to answer the question below.



S1 and D1 represent the current market supply and demand, respectively. S2 and D2 represent the socially optimal supply and demand. One way that the government could shift demand to its socially optimal level is to

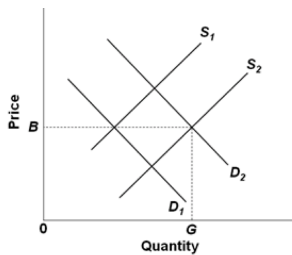
- A tax the sellers.
- B tax the buyers.
- C subsidize the sellers.
- D subsidize the buyers.

- 18 Use the following competitive market diagram for product Z to answer the question below.



Assume that the current market demand and supply curves for Z are D1 and S1. If there are substantial external consumption benefits associated with the production of Z, then

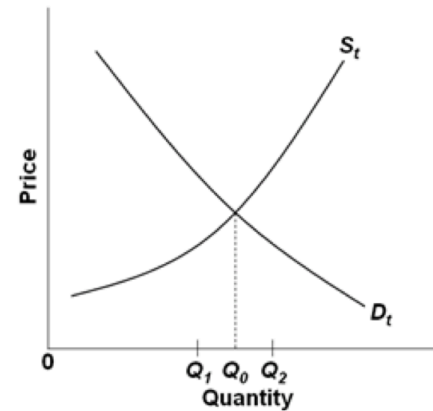
- A government can improve the allocation of resources by subsidizing consumers of Z.
 - B government can improve the allocation of resources by imposing a per-unit tax on Z.
 - C a government subsidy for producers of Z would ensure that consumers are paying directly for all of the benefits they receive from Z.
 - D consumers are paying too much for the good.
- 19 Use the following competitive market diagram for product Z to answer the question below.



Assume that the current market demand and supply curves for Z are D2 and S2. If there are substantial external benefits associated with the production of Z, then

- A efficient resource allocation occurs at output G and price B because the market mechanism does not measure all benefits.
- B an output smaller than G would improve resource allocation.
- C government should levy a per-unit excise tax on Z to shift the demand curve toward D1.
- D an output greater than G would result in a more efficient allocation of resources.

- 20 Use the following diagram of the market for product X to answer the question below.



Curve S_t embodies all costs (including externalities) and D_t embodies all benefits (including externalities) associated with the production and consumption of X. Assuming the market equilibrium output is Q_1 , we can conclude that the existence of external

- A costs has resulted in an overallocation of resources to X.
 - B benefits has resulted in an overallocation of resources to X.
 - C costs has resulted in an underallocation of resources to X.
 - D benefits has resulted in an underallocation of resources to X.
- 21 If a good that generates negative externalities were priced to take these negative externalities into account, its
- A price would decrease and its output would increase.
 - B output would increase but its price would remain constant.
 - C price would increase and its output would decrease.
 - D price would increase but its output would remain constant.
- 22 When the production of a good generates external costs, a firm's private supply curve will be
- A below the social supply curve.
 - B above the social supply curve.
 - C vertical.
 - D horizontal.

23 Use the following information to answer the question below.

It is the custom for paper mills located alongside the Layzee River to discharge waste products into the river. As a result, operators of hydroelectric power-generating plants downstream along the river find that they must clean up the river's water before it flows through their equipment.

Based on the preceding information, which of the following policies would be most appropriate for dealing with this problem?

- A Levy a tax on the consumers of paper products and use the tax revenues to conduct research on new energy sources.
- B Levy a tax on the consumers of electricity and use the tax revenues to subsidize the consumers of paper products.
- C Levy a tax on the producers of electricity and use the tax revenues to clean up the river.
- D Levy a tax on the producers of paper products and use the tax revenues to clean up the river.

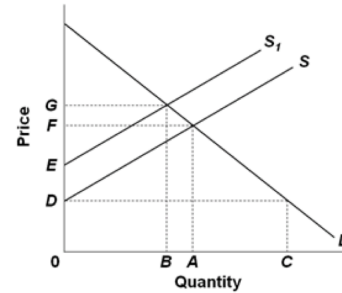
24 Use the following information to answer the question below.

It is the custom for paper mills located alongside the Layzee River to discharge waste products into the river. As a result, operators of hydroelectric power-generating plants downstream along the river find that they must clean up the river's water before it flows through their equipment.

If the government intervenes and corrects the externality in the situation described above, we would expect

- A the output of the paper mills to increase.
- B the price of paper from the mills to decrease.
- C production of the hydroelectric power plants to decrease.
- D production in the paper mills to decrease.

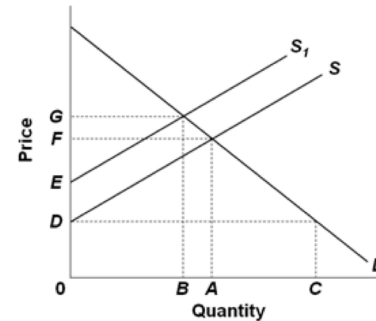
25 Use the following supply and demand graph to answer the question below.



In the graph, line S is the current supply of this product, while line S 1 is the optimal supply from the society's perspective. This figure suggests that there is (are)

- A external benefits from the production of this product.
- B external costs in the production of this product.
- C currently an underallocation of resources toward producing this good.
- D positive externalities from producing the good.

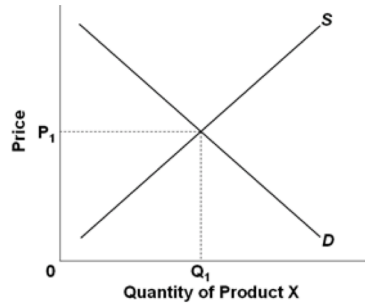
26 Use the following supply and demand graph to answer the question below.



In the graph, line S is the current supply of this product, while line S 1 is the optimal supply from the society's perspective. If government corrects this externality problem and shifts production to the socially optimal level, then the product price will be equal to

- A 0G.
- B 0F.
- C 0E.
- D 0D.

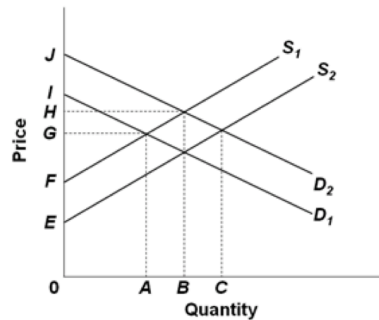
27 Use the following supply and demand graph for product X to answer the question below.



What would happen if the government taxed the producers of this product because it has negative externalities in production?

- A supply would increase
- B demand would decrease
- C supply would decrease
- D price would decrease

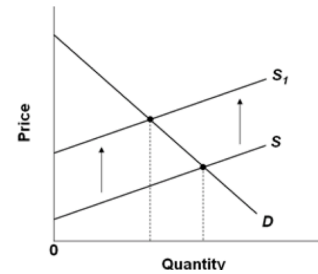
28 Use the following supply and demand graph to answer the question below:



S1 and D1 represent the current market supply and demand, respectively. S2 and D2 represent the socially optimal supply and demand. The positions of the graphs indicate that there is (are) external

- A benefits from production and external costs from consumption of the product.
- B costs from production and external benefits from consumption of the product.
- C benefits from production and consumption of the product.
- D costs from production and consumption of the product.

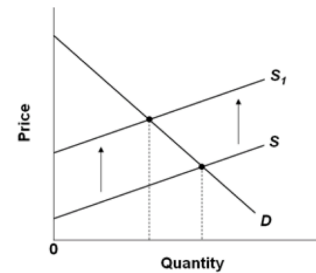
29 Use the following diagram in which S is the market supply curve and S1 is a supply curve comprising all costs of production, including external costs, to answer the question below.



Assume that the number of people affected by these external costs is large. Without government interference, this market will reach a(n)

- A optimal allocation of society's resources.
- B underallocation of resources to this product.
- C overallocation of resources to this product.
- D higher price than is consistent with an optimal allocation of resources.

30 Use the following diagram in which S is the market supply curve and S1 is a supply curve comprising all costs of production, including external costs, to answer the question below:



Assume that the number of people affected by these external costs is large. If the government wishes to establish an optimal allocation of resources in this market, it should

- A not intervene because the market outcome is optimal.
- B subsidize consumers so that the market demand curve shifts leftward.
- C subsidize producers so that the market supply curve shifts leftward (upward).
- D tax producers so that the market supply curve shifts leftward (upward).

- 31 31. What are the two characteristics that differentiate private goods from public goods?**
- A rivalry and excludability
 - B negative externality and positive externality
 - C marginal cost and marginal benefit
 - D ownership and usage
- 32 Among the following examples, the one that best illustrates a public good is a(n)**
- A laptop used by a student in a college or university.
 - B movie produced by a Hollywood company.
 - C bike path around a city or town.
 - D airline ticket bought by a vacationer.
- 33 A public good**
- A generally results in substantial negative externalities.
 - B can never be provided by a nongovernmental organization.
 - C costs essentially nothing to produce and is thus provided by the government at a zero price.
 - D can't be provided to one person without making it available to others as well.
- 34 Assume there is no way to prevent someone from using an interstate highway, regardless of whether or not he or she helps pay for it. This characteristic is called**
- A nonrivalry.
 - B nonexcludability.
 - C nontaxability.
 - D nondiscrimination.
- 35 The two main characteristics of a public good are**
- A production at constant marginal cost and rising demand.
 - B nonexcludability and production at rising marginal cost.
 - C nonrivalry and nonexcludability.
 - D nonrivalry and large negative externalities.
- 36 Unlike a private good, a public good**
- A has no opportunity costs.
 - B has benefits available to all, including nonpayers.
 - C produces no positive or negative externalities.
 - D is characterized by rivalry and excludability.

- 37 Which of the following is an example of a public good?**
- A a weather warning system
 - B a television set
 - C a sofa
 - D a bottle of soda
- 38 A public good**
- A can be profitably produced by private firms.
 - B is characterized by rivalry and excludability.
 - C produces no positive or negative externalities.
 - D is available to all and cannot be denied to anyone.
- 39 The market system does not produce public goods because.:**
- A there is no need or demand for such goods.
 - B private firms cannot stop consumers who are unwilling to pay for such goods from benefiting from them.
 - C public enterprises can produce such goods at lower cost than can private enterprises.
 - D their production seriously distorts the distribution of income.
- 40 If one person's consumption of a good does not preclude another's consumption, the good is said to be**
- A nonrival in consumption.
 - B rival in consumption.
 - C nonexcludable.
 - D excludable.