THE INVESTMENT SOCIETY

ECON104 TUTORIAL TEST

Friday August 18th

4 - 5pm Rehua 620

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Multichoice Section

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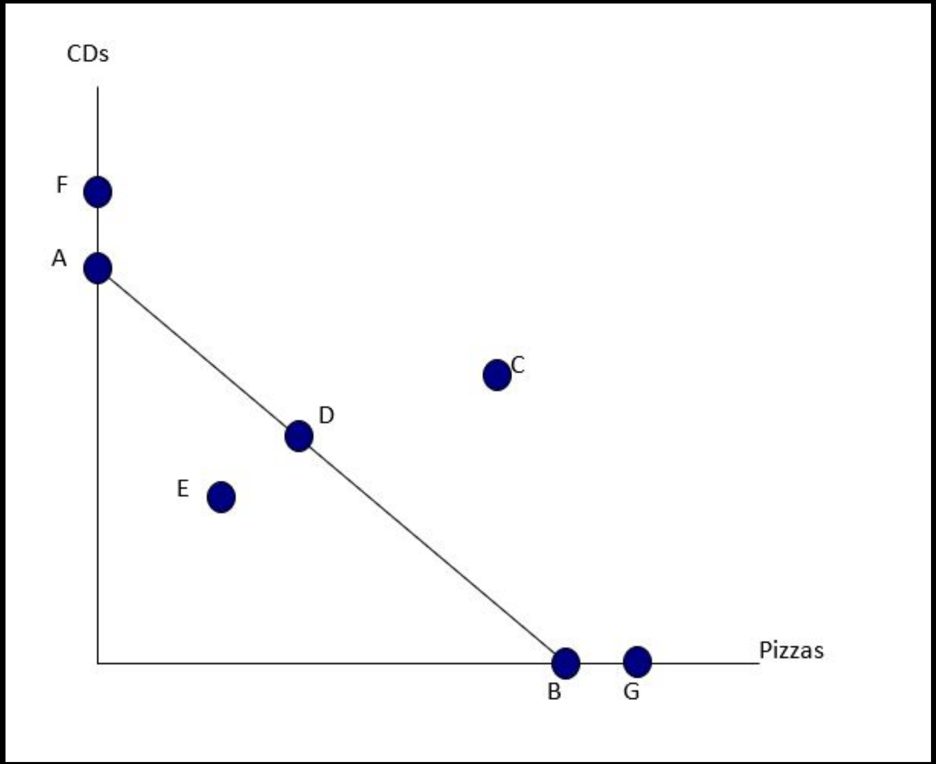
Production Possibilities Example Questions

On the production possibilities graph shown, which point represents the maximum possible production of pizzas given current resources and technology?

1. G.
2. B.
3. C.
4. D.



The most production efficient use of existing resources is represented by point

1. E.
2. D.
3. C.
4. G.

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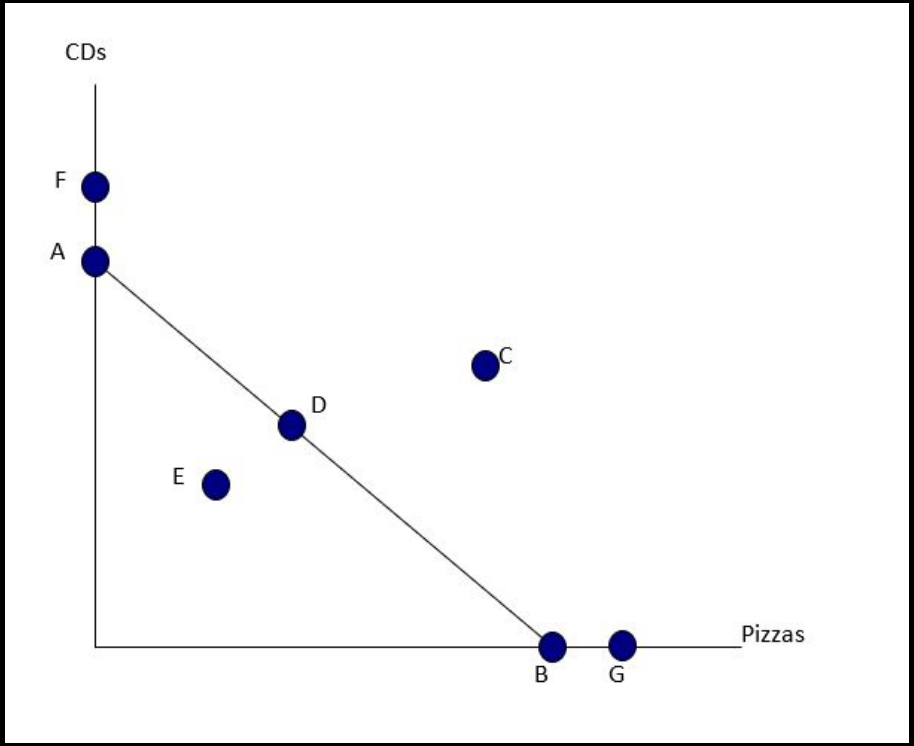

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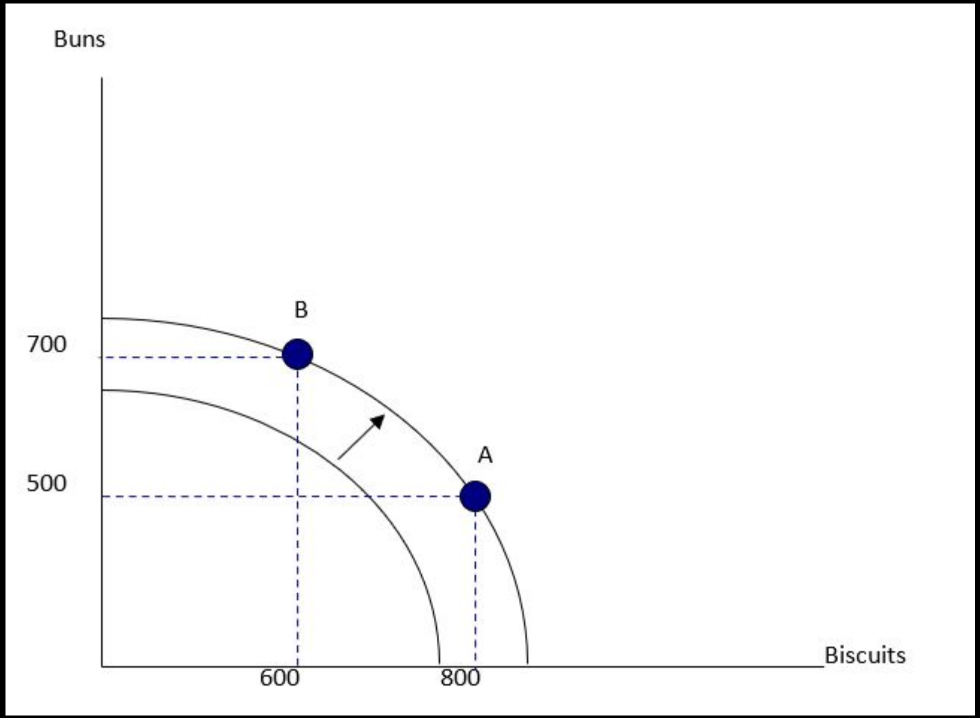
Production Possibilities Example Questions

In the production possibilities graph shown, what is the opportunity cost of the movement from point B to point A?

1. 200 biscuits.
2. 200 buns.
3. 800 biscuits.
4. 500 buns.



In the production possibilities graph shown, which of the following is the most likely cause of the outward shift of the production possibilities frontier?

1. The destruction of economic resources because of war.
2. Better technology in the production of buns and biscuits.
3. A decrease in society's preference for buns and biscuits.
4. An increase in society's preference for buns and biscuits.

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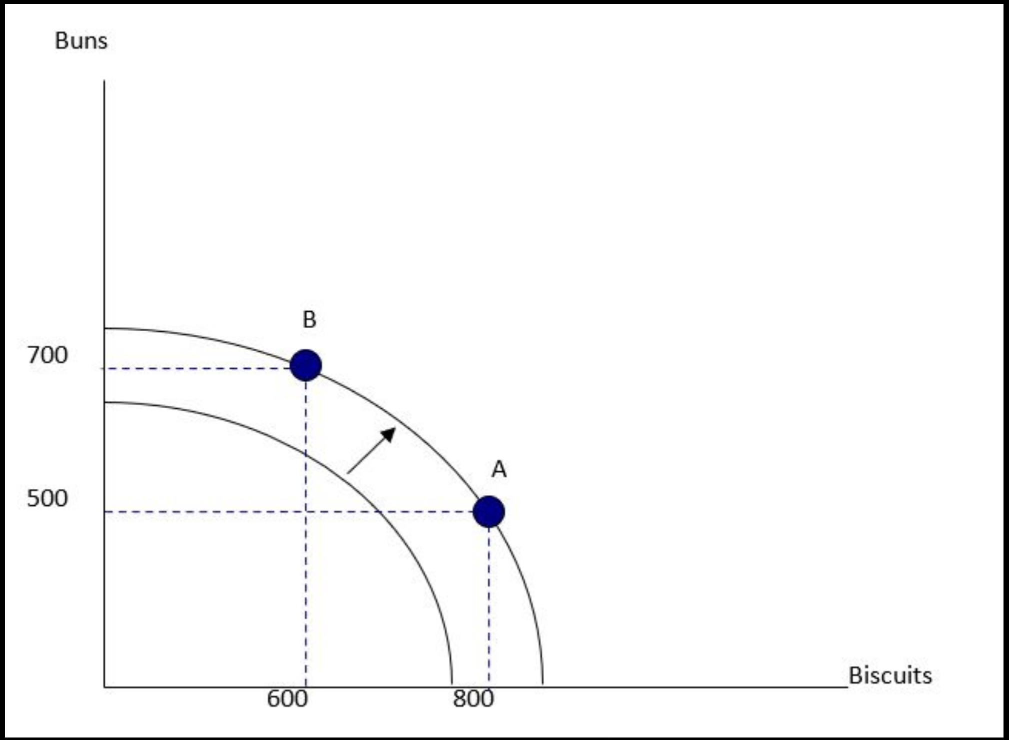

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Advantages Example Questions

Comparative advantage is based on

1. Absolute labour productivity.
2. Relative labour costs.
3. Relative opportunity costs.
4. Dollar price.

Absolute advantage is found by

1. Comparing relative opportunity cost.
2. Calculating the comparative advantage.
3. Comparing productivity of one nation to that of another.
4. None of the above is correct.

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Advantages Example Questions

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Trade Example Questions

Economists say that free trade is beneficial because

1. Goods are cheaper for consumers.
2. Producers export more.
3. Total surplus in the market will be increased.
4. Employment will be increased.

Assume India trades one T.V. with China in return for two toys.
The opportunity cost of producing one T.V. in India must be

1. Greater than two toys.
2. Less than two toys.
3. Measured in dollars.
4. All of the above.

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Elasticity Example Questions

Price elasticity of demand measures

1. How much the price of a good changes when there is a change in the quantity demanded.
2. How much the quantity demanded responds to a change in the price.
3. How much the price of a good changes when there is a change in the number of buyers.
4. How much the demand shifts for a given change in the price of the good.

Which of the following statements is **NOT** correct?

1. If buyers are relatively responsive to a change in price, demand is said to be elastic.
2. If buyers are relatively unresponsive to a change in price, demand is said to be inelastic.
3. If buyers have no good substitutes for a good, the demand for the good will tend to be inelastic.
4. If buyers consider the good a luxury good, the demand for the good will tend to be inelastic.

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Elasticity Example Questions

Demand is said to be elastic

1. If the price of the good responds only slightly to changes in the quantity demanded.
2. If the demand shifts only slightly when the price of the good changes.
3. If buyers respond substantially to changes in the price of the good.
4. If the quantity demanded changes only slightly when the price of the good changes.

Income elasticity of demand measures how

1. The quantity demanded changes as consumer income changes.
2. Consumer purchasing power is affected by a change in the price of a good.
3. The price of a good is affected when there is a change in consumer income.
4. Many units of a good a consumer can buy given a certain income level.

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Elasticity Example Questions

Canterbury University has decided to raise the price on parking permits to increase revenue. If the buyers of parking permits respond substantially to an increase in price, then

1. The planned price increase would not enhance revenue.
2. The planned price increase would enhance revenue.
3. Canterbury University should increase the price of parking permits a lot.
4. The price elasticity of demand for parking permits is inelastic.

If the price of wheat rises, incentives are created for

1. People to buy less wheat.
2. Farmers to grow more wheat.
3. Government to lower the price of wheat.
4. 1 and 2.

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Supply and Demand Diagrams and Long Answer Section

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Supply and Demand Functions Example Question

Assume the supply and demand functions for a pair of socks are as follows:
Qd = 12 – P
Qs = 2P - 6

1. Assuming price is in dollars calculate the equilibrium price and quantity for a pair of socks.

1. Using the demand function Qd = 12 – P calculate the price elasticity of demand at a price of $5.

1. What type of price elasticity of demand exists at a price of $5 according to your answer in **(ii)** above, and what should the firm do to price to increase their revenue?

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Supply and Demand Functions Example Question

Assume the supply and demand functions for a pair of socks are as follows:
Qd = 12 – P
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1. Assuming price is in dollars calculate the equilibrium price and quantity for a pair of socks.

$Q_d = Q_s$
$12 - P = 2P - 6$
$18 = 3P$
$P = 18/3$
$P = 6$

$Q_d = 12 - P$
$Q_d = 12 - 6$
$Q = 6$

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Supply and Demand Functions Example Question

Assume the supply and demand functions for a pair of socks are as follows:
Qd = 12 – P
Qs = 2P - 6

2. Using the demand function Qd = 12 – P calculate the price elasticity of demand at a price of $5.

$Q_d = 12 - 5 = 7$
$1 \times 5/7 = 0.71$

2. What type of price elasticity of demand exists at a price of $5 according to your answer in **(ii)** above, and what should the firm do to price to increase their revenue?

Inelastic as our answer above is less than 1, Increase price to increase revenue as the price is inelastic.

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Supply and Demand Changes Example Question

For each of the following state whether the supply or demand curve for **woollen socks** will shift, and whether it is an increase or a decrease.

a. A mystery disease affecting sheep results in the price of wool rising.
b. Woollen socks are found to be linked to skin disease.
c. The price of cotton socks falls.

Supply and Demand Changes Example Question

For each of the following state whether the supply or demand curve for **woollen socks** will shift, and whether it is an increase or a decrease.

a. A mystery disease affecting sheep results in the price of wool rising.

Supply will decrease as the cost of production (Wool) has increased

b. Woollen socks are found to be linked to skin disease.

Demand will decrease as people will choose to by other types of socks, put off by this disease

a. The price of cotton socks falls.

Demand will decrease as cotton socks are a substitute for woollen socks which are now cheaper making woollen socks relatively more expensive

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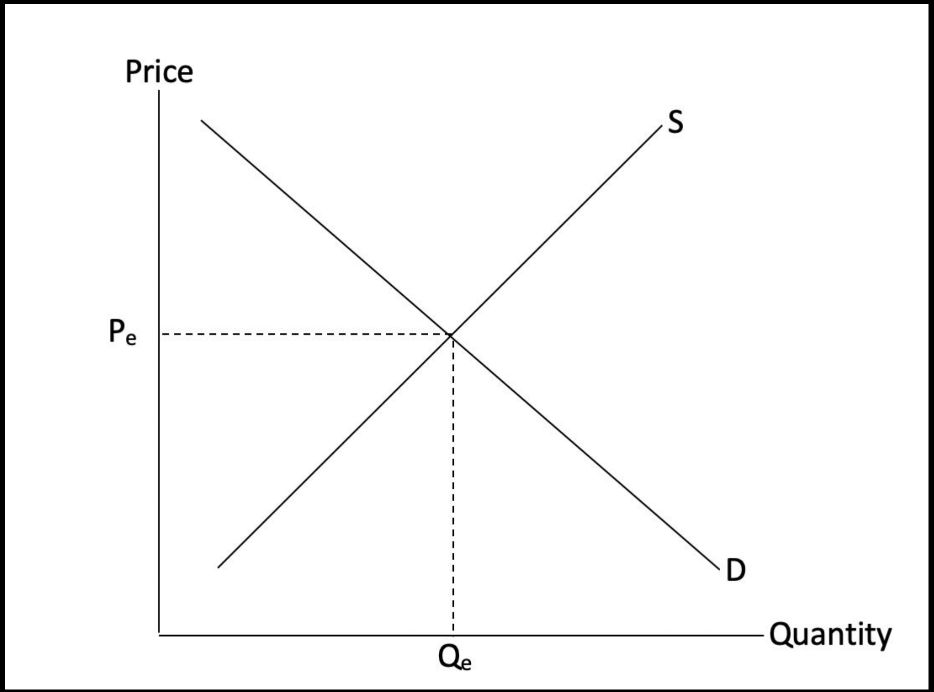
Demand and Supply Example Questions

If a government wants to help local producers of shoes, they could impose a minimum price above the current equilibrium price. In your answer booklet, draw a diagram showing the effect on the NZ shoe market of imposing a minimum price above the equilibrium price (assume there are no exports or imports in the market).



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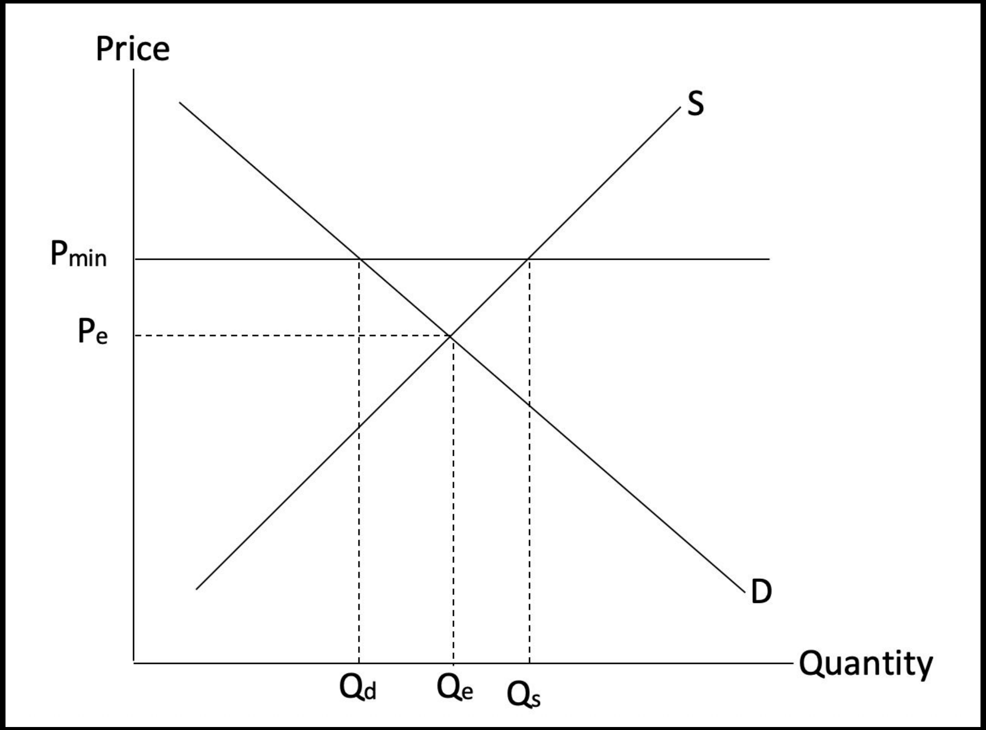


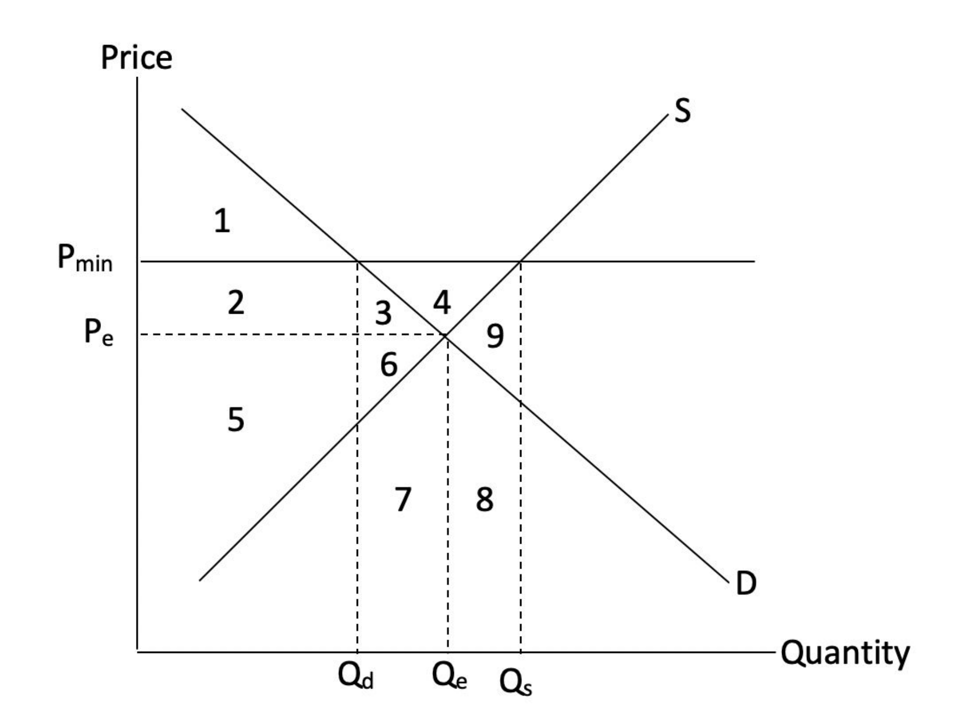
Don't Forget:

- Axis Labelled (Price and Quantity)
- Supply and Demand Curves labelled
- P_e, Q_e labelled
- P_{min}, Q_d, Q_s Labelled

Or if there are moves of a curve, label fully

Demand and Supply Example Questions

Label the areas in your previous diagram, and copy and complete the table below into your answer booklet.



	Equilibrium	With Minimum Price
Consumer Price		
Quantity Traded		
Consumer Surplus		
Producer Surplus		
Cost of Govt. Purchases	----	
Total Surplus		
Change in Surplus	----	

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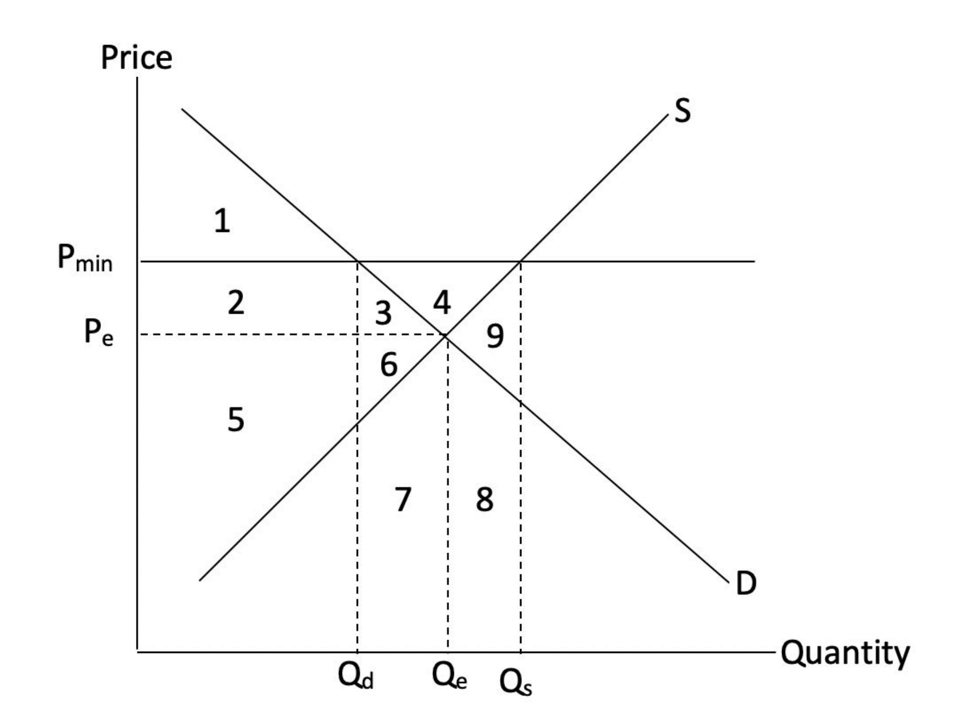

	Equilibrium	With Minimum Price
Consumer Price	P_e	P_{min}
Quantity Traded	Q_e	Q_d
Consumer Surplus	1,2,3	1
Producer Surplus	5,6	2,3,4,5,6
Cost of Govt. Purchases	----	3,4,6,7,8,9
Total Surplus	1,2,3,5,6	1,2,5,-7,-8,-9
Change in Surplus	----	3,6,7,8,9

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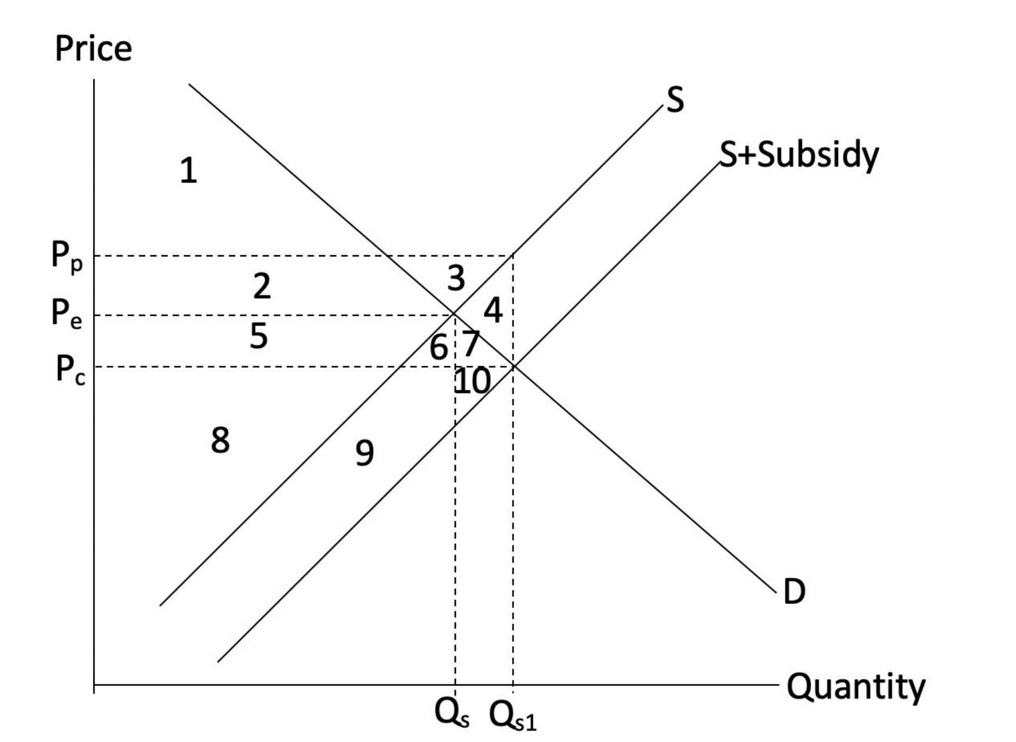
Demand and Supply (Subsidy) Example Questions

An alternative policy to a minimum price the government could impose is a subsidy. The diagram below shows the imposition of a subsidy on the show market in NZ.

Complete the table using the information shown in the diagram



	Equilibrium	With Subsidy
Consumer Price		
Quantity Traded		
Consumer Surplus		
Producer Surplus		
Govt. Cost of Subsidy	----	
Total Surplus		
Change in Surplus	----	

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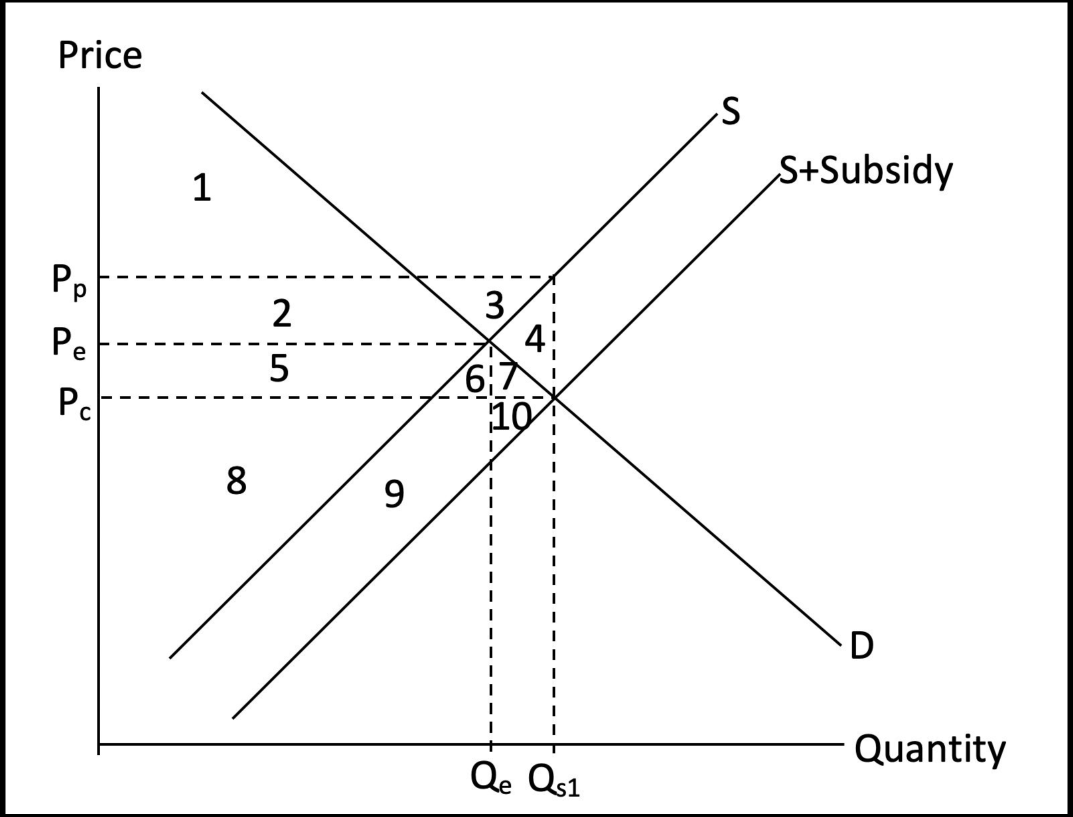

	Equilibrium	With Subsidy
Consumer Price	P_e	P_c
Quantity Traded	Q_e	Q_{s1}
Consumer Surplus	1,2	1,2,5,6,7
Producer Surplus	5,8	2,3,5,8
Govt. Cost of Subsidy	----	2,3,4,5,6,7
Total Surplus	1,2,5,8	1,2,5,8,-4
Change in Surplus	----	4

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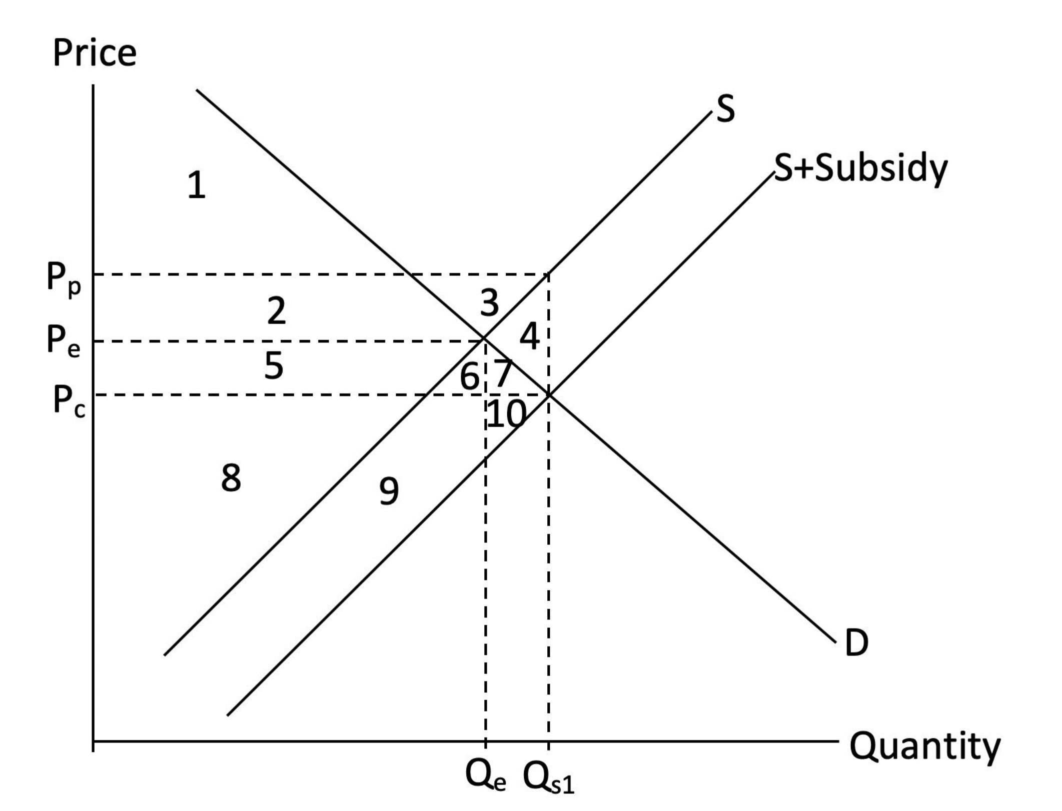
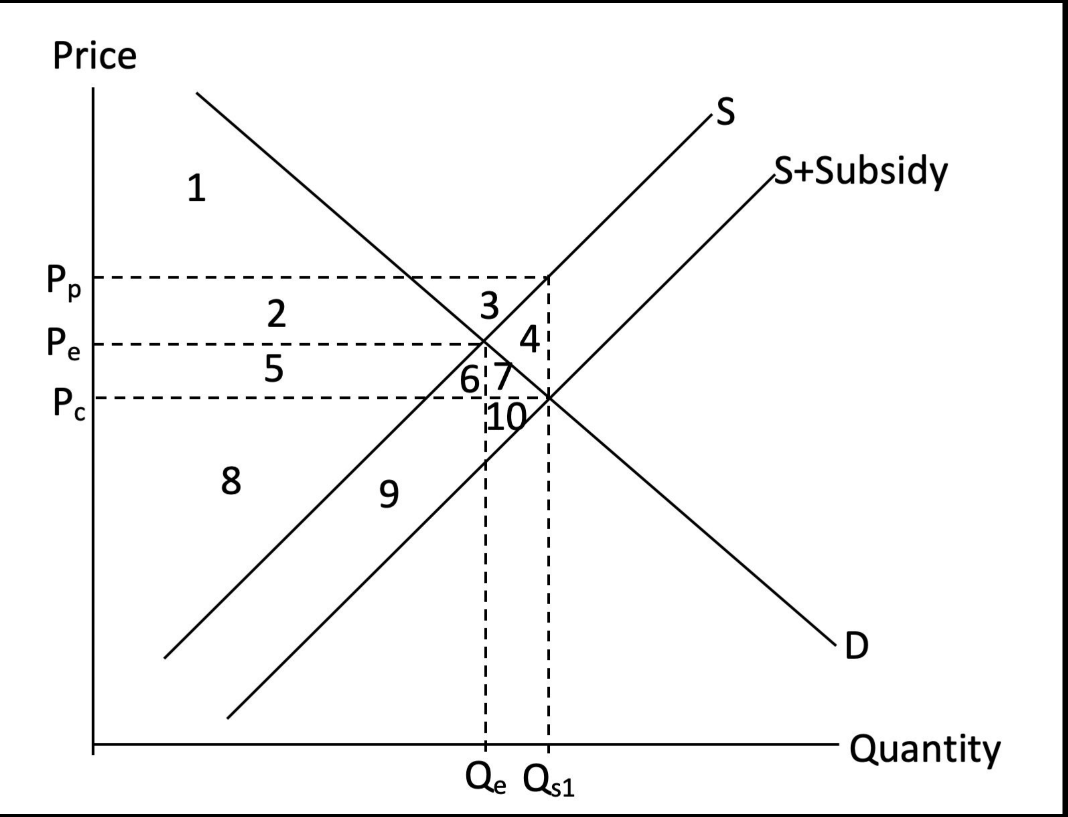
Demand and Supply (Subsidy) Example Questions



What do the following areas represent?

a) Area 5 after the subsidy
b) Area 9 after the subsidy
c) Area 2 before the subsidy

Demand and Supply (Subsidy) Example Questions



What do the following areas represent?

a) Area 5 after the subsidy

Producer Surplus, Consumer Surplus and cost of the Subsidy to the Government

b) Area 9 after the subsidy

Nothing

c) Area 2 before the subsidy

Consumer Surplus

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NOTE: You may also get asked about a Tax instead of a Subsidy where the supply curve becomes S + Tax and is left of the original Supply curve. Here the government will receive an income instead of the expense the subsidy incurs. Consumer and Producer surpluses are smaller and do not overlap like in the subsidy example.

You must know what each part of the Demand and Supply graph represents in terms of surpluses and government cost/income.

Demand and Supply (Tariff) Example Question

An import tariff is another example of a government policy. In a few sentence, explain how a tariff works and why one would be implemented. As part of your answer explain who wins from a tariff, who loses from a tariff, and why.

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An import tariff is another example of a government policy. In a few sentence, explain how a tariff works and why one would be implemented. As part of your answer explain who wins from a tariff, who loses from a tariff, and why.

A tariff raises the price of imports as it is a tax on imports aimed at increasing domestic producer profits by helping domestic firms compete with cheaper imports.
Consumers lose from a tariff as prices are higher for them.
Producers and government gain due to increased tax revenue for the government and increased profits/revenue for local producers.

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Thank You and Good Luck!

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