Multiple Choice

1. The quantity supplied of a good depends on ______.
   a) the wages of workers  
   b) the cost of raw materials  
   c) the prices of inputs  
   d) all of the above

   Ans: d  
   Section: 2.1 Demand, Supply and Market Equilibrium  
   LO: 1  
   Difficulty: Easy

2. Market equilibrium signifies that ______.
   a) suppliers are satisfied with the price of a good and the quantity sold  
   b) consumers are satisfied with the price and quantity demanded  
   c) both consumers and suppliers are satisfied with the market price and quantity demanded and sold  
   d) a shortage or surplus exists for a particular good or service within a market

   Ans: c  
   Section: 2.1 Demand, Supply and Market Equilibrium  
   LO: 1  
   Difficulty: Medium

3. Increases in both supply and demand would result in ______.
   a) a higher equilibrium quantity and always a higher price  
   b) a lower equilibrium quantity and lower price  
   c) a lower equilibrium quantity but a higher price  
   d) a higher equilibrium quantity but the new price could increase, decrease, or remain nearly the same

   Ans: d
Section: 2.1 Demand, Supply and Market Equilibrium
LO: 2
Difficulty: Hard

4. A market is characterized along all of the dimensions except for ______.
   a) time  
   b) products 
   c) commodities  
   d) geography

Ans: b
Response: The three dimensions include time, geography, and commodities where commodities consist of products bought and sold.

Section: 2.1 Demand, Supply and Market Equilibrium
LO: 1
Difficulty: Medium

5. Market demand ______.
   a) always consists of the total demand for a good 
   b) focuses on products, not services 
   c) will never include direct sources of demand 
   d) could consist of both direct and derived demand

Ans: d
Response: Market demand can consist of direct demand and derived demand. For example, distributors and final consumers may demand corn. Simultaneously, certain producers such as ethanol providers and soft drink companies may need corn because of the demand for ethanol and soft drinks. The latter is an example of derived demand.

Section: 2.1 Demand, Supply and Market Equilibrium
LO: 1
Difficulty: Hard

6. The law of supply indicates that ______.
   a) there is a positive relationship between price and quantity supplied assuming all of the factors that affect supply are fixed 
   b) there is a positive relationship between price and quantity supplied assuming all of the factors that affect supply are variable 
   c) there is an inverse relationship between price and quantity supplied assuming all of the factors that affect supply are fixed 
   d) the quantity supplied increases as more labor and raw materials are added to production

Ans: a
Response: There is a direct or positive relationship between price and quantity supplied assuming all other factors are fixed and held constant.

Section: 2.1 Demand, Supply and Market Equilibrium
LO: 1
Difficulty: Medium

7. If excess supply exists within a market ______.
   a) the quantity demanded exceeds quantity supplied and the price must decrease to reach the point of market equilibrium
b) the quantity supplied exceeds the quantity demanded and price must increase to reach the point of market equilibrium

c) the quantity supplied exceeds quantity demanded and the price must decrease to reach the point of market equilibrium

d) the quantity demanded exceeds quantity supplied and the price must increase to reach the point of market equilibrium

Ans: b
Response: If there is a surplus (i.e. excess supply), the quantity supplied is greater than the quantity demanded. Suppliers are unable to sell as much of a product or service as they would like to and this creates pressure for the price to decrease.

Section: 2.1 Demand, Supply and Market Equilibrium
LO: 1
Difficulty: Medium

8. Which of the following does not meet the laws of supply and demand?
   a) A decrease in supply and an unchanged demand curve can result in a higher equilibrium price and a smaller equilibrium quantity
   b) A increase in demand and an unchanged supply curve can result in a higher equilibrium price and a larger equilibrium quantity
   c) A decrease in demand and an unchanged supply curve can result in a lower equilibrium price and a smaller equilibrium quantity
   d) A increase in supply and an unchanged demand curve can result in a higher equilibrium price and a larger equilibrium quantity

Ans: d
Response: An increase in supply and an unchanged demand curve would result in a larger equilibrium quantity, but we would expect a lower equilibrium price.

Section: 2.1 Demand, Supply and Market Equilibrium
LO: 2
Difficulty: Hard

9. Which of the following demand curves does NOT obey the law of demand?
   a) Q = 100 + P
   b) Q = 100 - P
   c) Q = 100/P

Ans: a
Response: The law of demand states that the demand curve must have a negative slope. The slope of function (b) is -1. Function (c) is a constant elasticity demand function, with a negative slope. This can be read from the function by noting that the exponent of price is negative (Q = 100P^{-1}). Try plugging in numbers (P=1, P=2) and see how quantity changes as price changes. If a rise in price causes a fall in quantity demanded, then the law of demand is satisfied.

Section: 2.1 Demand, Supply and Market Equilibrium
LO: 2
Difficulty: Medium

10. Which of the following supply functions obeys the law of supply, where Q is quantity, P is price and I is income?
   a) Q = 10P
   b) Q = 10 + 2P
   c) Q = 10 - 2P
   d) Q = 10 - P + .5I
11. Which of the following would cause an unambiguous increase in the equilibrium price in a market?
   a) An increase (shift out) in supply and an increase (shift out) in demand.
   b) An increase (shift out) in supply and a decrease (shift in) in demand.
   c) A decrease (shift in) in supply and an increase (shift out) in demand.
   d) A decrease (shift in) in supply and a decrease (shift in) in demand.
   Ans: c
   Response: Draw a demand and supply graph with intersection point e. Now shift the curves as indicated in the question. An increase in supply and demand could cause a fall in the intersection point (say, if supply shifts out a lot). An increase in supply and a decrease in demand would cause price to fall. A decrease in supply and an increase in demand causes price to rise. Finally, a decrease in supply and a decrease in demand can cause price to fall.
   Section: 2.1 Demand, Supply and Market Equilibrium
   LO: 2
   Difficulty: Medium

12. The price elasticity of demand measures ______.
   a) how the quantity demanded of a good increases with a price change
   b) how the quantity demanded of a good decreases with a price change
   c) how sensitive the quantity demanded is to any price change
   d) how the quantity demanded does not adjust to any price change
   Ans: c
   Section: 2.2 Price Elasticity of Demand
   LO: 3
   Difficulty: Easy

13. Suppose a company wanted to increase their revenue and the demand for the good was elastic. To increase total revenue, the company should ______.
   a) lower price
   b) increase the quantity sold while lowering price
   c) increase price
   d) increase price while increasing the quantity available for sale
   Ans: a
   Section: 2.2 Price Elasticity of Demand
   LO: 5
   Difficulty: Medium

14. If we examine consumer choices and competitive brands, we would typically find that:
   a) demand is highly elastic at the brand level
   b) demand is slightly elastic at the brand level
   c) demand is inelastic at the brand and total market level
   d) demand is slightly elastic at the brand and total market level
15. If a good has a price elasticity of demand of -1.4, with a 10% increase in price, what would be the percentage change in the quantity demanded?

a) 14% - quantity decreases
b) 7% - quantity decreases
c) 14% - quantity increases
d) 10% - quantity decreases

Ans: c
Response: Applying the elasticity equation, \( \varepsilon_{Q,P} = \frac{\% \Delta Q}{\% \Delta P} \), \( \varepsilon_{Q,P} = -1.4 = \frac{\% \Delta Q}{0.10} \) and \( \% \Delta Q = 14 \) or 14%. The quantity decreases because of the inverse relationship between price and quantity demanded and quantity demanded is relatively sensitive to price due to the value of \( \varepsilon_{Q,P} \) (between -1 and \(-\infty\)).

16. Which of the following statements is NOT correct?

a) If supply is unit elastic, a one percent change in price will elicit a one percent change of the opposite sign in the quantity demanded.
b) If demand is inelastic, a one percent change in price will elicit a one percent change of the opposite sign in the quantity demanded.
c) If demand is elastic, a one percent change in price will elicit a greater than one percent change of the opposite sign in the quantity demanded.
d) At the choke price, a linear demand curve is elastic.
e) A linear demand is unit elastic when \( Q = bP \), for \( b \) a constant.

Ans: b
Response: Analogously to the case of demand, a supply curve can be elastic, unit-elastic or inelastic. (a) is, in fact, the definition of unit elasticity and so is correct. Statement (c) is the definition of elastic demand, and so is correct. At the choke price, \( Q = 0 \) so that the elasticity of a linear demand curve \( Q = a - bP \) is given by \( \varepsilon_{Q,P} = -b \left( \frac{P}{0} \right) \% \), so that the demand is infinitely elastic and (d) is correct. At \( Q = bP \) we have \( P/Q = 1/b \) so that \( \varepsilon_{Q,P} = -b(1/b) = -1 \) and (e) is correct.

17. What would be the formula for the elasticity of demand with respect to weather, where \( Q \) is quantity and \( W \) is weather?

a) \( \frac{\Delta Q}{\Delta W} \)
b) \( \frac{(\Delta Q/W)(Q/W)}{\Delta W} \)
c) \( \frac{(\Delta Q/\Delta W)(Q/W)}{\Delta W/\Delta Q} \)
d) \( \frac{\Delta W/\Delta Q}{\Delta Q} \)
e) \( \frac{(\Delta Q/W)(\Delta W/Q)}{\Delta Q} \)

Ans: c
Response: In fact, expression (a) or (c) could be correct, depending on the units we measure \( Q \) and \( W \) in. We would define this elasticity as any other elasticity: the percentage change in quantity with respect to a
percentage change in (whatever). In this case, "whatever" is weather. Expression (c) uses the definition of percentage change $\% \Delta X = \Delta X / X$. Note that if $Q$ is expressed in percents, then (a) would be correct as well.

Section: 2.2 Price Elasticity of Demand
LO: 4
Difficulty: Medium

18. If demand is elastic, an increase in price
a) will increase total revenue
b) will decrease total revenue
c) will have an indeterminate effect on total revenue
d) will decrease total profit.

Ans: b
Response: If demand is elastic, then we know that $\varepsilon_{Q,P} = (\Delta Q / \Delta P)(P/Q) < -1$. Hence, we know that $\Delta QP < -(\Delta PQ)$ or $\Delta QP + (\Delta PQ) < 0$. But, using the definition of revenue as Revenue = $PQ$, we can write the change in revenue due to a change in price as $\Delta \text{Revenue} = \Delta (PQ) = \Delta PQ + \Delta QP < 0$ if demand is elastic.

Section: 2.2 Price Elasticity of Demand
LO: 5
Difficulty: Easy

19. The elasticity of demand for Carlsberg beer is likely to be ____ the elasticity of demand for all beer.
   a) more elastic than
   b) less elastic than
   c) the same as
   d) less negative than.

Ans: a
Response: Anything that tends to make quantity demanded more responsive to price tends to make demand more elastic. Since consumers tend to move their consumption to other brands of the same good more readily than to other goods altogether, brand level elasticity tends to be higher than product level elasticity.

Section: 2.2 Price Elasticity of Demand
LO: 7
Difficulty: Medium

20. When a linear demand curve can be expressed as $Q = a - bP$, which region corresponds to the elastic portion of the demand curve?
   a) Price ranges from $(a/b)$ to $(a/2b)$
   b) Price ranges from $(a/2b)$ to 0
   c) Quantity ranges from $(a/2)$ to a
   d) Only where quantity equals $(a/2)$.

Ans: a
Response: The elasticity for this linear demand curve is $\varepsilon_{Q,P} = (\Delta Q / \Delta P)(P/Q) = -bP/Q$, and this must be less than -1 for demand to be elastic. At $P = 0$, we have $\varepsilon_{Q,P} = 0$. At $P = a/b$, we have $\varepsilon_{Q,P} = -b(a/b)/0 = -\infty$. At $P = (a/2b)$, we have $\varepsilon_{Q,P} = -b(a/2b)/(a/2) = -1$. At $Q = a/2$, we have $\varepsilon_{Q,P} = -b(a/2b)/(a/2) = -1$. Hence, (a) is correct since elasticity varies from minus infinity to -1 over this range. In the range specified by (b), we have elasticity varying from -1 to 0, so that demand is inelastic. In the range specified by (c), we have elasticity between -1 and 0 as well, so demand is inelastic. In (d), elasticity is -1. This is a point of unit elasticity.

Section: 2.2 Price Elasticity of Demand
LO: 6
21. The price of good A falls and the demand for good B decreases (shifts in). Goods A and B appear to be:
   a) cannot be determined
   b) substitutes
   c) complements
   d) normal goods

   Ans: b
   Response: If the price of good A falls, then consumers would be expected to switch their consumption into
   good A and away from other substitute goods. This would make the demand for other substitute goods
   shift in. Hence, B appears to be a substitute for good A. If B were a complement to A, then its
   consumption would increase as A’s consumption increased due to the fall in A’s price. Hence, B’s demand
   would shift out. If an increase in income causes the optional consumption level of a good to increase, it is
called a normal good. Here, B’s demand has decreased.
   Section: 2.3 Other Elasticities
   LO: 8
   Difficulty: Easy

22. A measurement of the sensitivity of the percentage change in the quantity of one good compared to
    the percentage change in the price of another good is called the ______.
    a) price elasticity of demand
    b) income elasticity of demand
    c) cross elasticity of demand
    d) constant elasticity of demand

   Ans: c
   Response: The cross elasticity of demand compares the effects of a percentage change in the price of one
   good upon the percentage change in quantity demanded of another good. If the cross-elasticity is
   positive, the goods are substitutes. If the cross-elasticity is negative, the goods are complements.
   Section: 2.3 Other Elasticities
   LO: 8
   Difficulty: Easy

23. In the long run, we would expect for ______.
    a) consumers to find it difficult to make adjustments in their purchasing decisions in response to
       price changes
    b) consumers to find it easier to make adjustments in their purchasing decisions in response to
       price changes of durables such as automobiles
    c) consumers to fully adjust their purchasing decisions in response to price changes
    d) sellers to avoid making any adjustments in the production decision in response to price changes

   Ans: c
   Response: In the long run, consumers will find it easier to fully adjust their purchasing decisions, habits,
   etc.; price elasticity is greater in the long run versus the short run.
   Section: 2.4 Elasticity in the Long Run versus the Short Run
   LO: 9
   Difficulty: Easy
24. Economists can use certain techniques to fit demand and supply curves to real world market data if _____.
   a) price information is only available
   b) quantity demanded information is available
   c) information related to price, quantity, and the responsiveness of quantity demanded to changes in price is available
   d) information related to the quantity supplied is available

Ans: c
Response: The process of identifying demand and supply curves and relating them to real world market data requires the examination of the price, the quantity, and the sensitivity of the quantity demanded to changes in price. If \( Q^* \) and \( P^* \) are known values of quantity and price, and \( \varepsilon_{Q,P} \) is the estimated value of the price elasticity of demand, the formula for the price elasticity of demand for a linear demand function is: 
\[
\varepsilon_{Q,P} = -b \left( \frac{P^*}{Q^*} \right);
\]
an interrelationship exists.
Section: 2.5 Back-of-the-Envelope Calculations
LO: 10
Difficulty: Medium

25. Suppose that war breaks out in the Persian Gulf disrupting oil supplies. If the price of oil rises greatly but the quantity of oil traded per month (and presumably consumed on world markets) remains roughly the same, we can say that
   a) the demand for oil is highly elastic
   b) the supply curve has shifted to the right
   c) the demand curve has shifted to the right
   d) the demand for oil is highly inelastic

Ans: d
Response: The supply curve for oil on world markets has shifted to the left. The market clearing quantity remains the same, telling us the demand curve must be near vertical or the equilibrium quantity would change. The drastic increase in price also gives us a hint that the demand curve must be near vertical.
Section: 2.5 Back-of-the-Envelope Calculations
LO: 10
Difficulty: Easy

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