Contemporary Microeconomic Issues: ECO1304A
November 28th, 2005: Third test
University of Ottawa
Professor: Louis Hotte

Calculators, MP3, Ipods, etc, are not allowed
Time allowed: 1h 30min

*The following questions are based on the material seen in this course. For each question, make sure to first read all five possible answer choices. Remember to write down your questionnaire letter on your answer sheet as follows: ECO1304AA. This questionnaire has **5** pages.* GOOD LUCK!

QUESTIONNAIRE A

(1) Coal-fired power plants (electricity producers) send smoke into the air which pollutes the country. In a free-market equilibrium, i.e. without any form of government intervention whatsoever, we would generally expect the price of electricity to be
   (a) inefficiently high from society's perspective.
   (b) inefficiently low from society's perspective. ♠
   (c) at the efficient level from society's perspective.
   (d) such that the firms loose money.
   (e) such that consumers of electricity are not happy.

(2) Generally, governments intervene in order to create a system of patent protection because
   (a) otherwise, there would be too much research and development.
   (b) otherwise, there would be too little research and development. ♠
   (c) otherwise, medicines would be too expensive for people.
   (d) otherwise, most discoveries would be socially useless.
   (e) otherwise, inventors would make too much profits.

(3) Which of the following situations denotes a private solution to an externality problem?
   (a) Jack accepts money from Tony in order for Jack to keep his dog from barking at night. ♠
   (b) A municipal bylaw imposes that trains blow their whistles at every railway crossing in the city.
   (c) The provincial government taxes firms for their discharges in the rivers.
   (d) The environmental protection agency requires that all new cars install an antipollution system.
   (e) An externality is an eminently public problem that can never be solved between private parties.

(4) As the newly appointed Minister of Finance, you are contemplating the imposition of a social insurance tax on salaries. Which of the following comment from your economic adviser is generally false?
   (a) If the tax is imposed on employers as a payroll tax, then employers will necessarily support a higher burden of the tax.
   (b) If the tax is imposed on workers, then workers will necessarily support a higher burden of the tax.
   (c) It is better to impose the tax on employers if they have a relatively inelastic demand for labor.
   (d) It is better to impose the tax on employers if they have a relatively elastic demand for labor.
   (e) All of the above are generally false.♠

(5) In Canada, the income tax system is considered progressive because

(a) The income tax that a relatively high-income person pays represents a larger share of its total income compared to a lower-income person.♠

(b) The income tax that a relatively high-income person pays represents a smaller share of its total income compared to a lower-income person.

(c) A relatively rich person pays more income taxes than a relatively poor person.

(d) A relatively rich person pays less income taxes than a relatively poor person.

(e) Firms have to pay a social insurance payroll tax.

(6) In the South of Spain, there is a dry region where the supply of irrigation water comes from a single creek. Some private firms will supply all of its water to agricultural use, regardless of the price. The introduction of a water tax on farmers would most likely

(a) increase the price paid by farmers.

(b) reduce the net price received by water suppliers.♠

(c) reduce the water consumption.

(d) result in an equal sharing of the burden of the tax.

(e) None of the above seems likely.

(7) Which of the following is false?

(a) In a way, taxing fuel to pay for highways is fair.

(b) In a way, making rich people pay more taxes than poor people is fair.

(c) It is clearly a good idea to tax capital owners very highly because they are generally richer than the rest.♠

(d) When it comes to taxation, fairness and efficiency often conflict with each other.

(e) One aim of the Canadian tax system is to achieve horizontal equity.

(8) In general, production quotas

(a) are inefficient because the price received by the producers is below the price paid by consumers.

(b) are inefficient because the output is too low due to positive externalities.

(c) are more efficient than the free market equilibrium.

(d) are efficient because the government always increases efficiency.

(e) are inefficient because the marginal cost of production is below the price paid by consumers.♠

(9) One main reason why a government will choose to impose a quotas is

(a) because firms generally benefit from it.♠

(b) because consumers generally benefit from it.

(c) because society generally benefits from it when there are positive externalities.

(d) because consumer welfare is more important than firm profits.

(e) because it is generally fair to do so.

(10) When demand is perfectly inelastic, the burden of a tax

(a) is split equally between producers and consumers.

(b) is split equally between consumers and the government.

(c) falls entirely on the government.

(d) falls entirely on firms.

(e) falls entirely on consumers.♠

(11) Which of the following is generally true?

(a) Taxes cause inefficiencies when the burden of the tax exceeds tax revenues.♠

   (b) Taxes cause inefficiencies when tax revenues exceeds the burden of the tax.

   (c) Taxes cause inefficiencies because the price paid by consumers is below the marginal cost of production.

   (d) Tax revenues constitute a deadweight loss to society.

   (e) It is always fairer to tax firms than consumers.

(12) Personal income tax was first introduced in Canada
   (a) in the middle of the 19th century.
   (b) at the end of the first world war.♠
   (c) at the end of the second world war.
   (d) In the 1960s.
   (e) In the 1980s.

(13) In Canada, the marginal tax rate for people who make well over 100 000 $ per year is about
   (a) 5%.
   (b) 25%.
   (c) 45%.♠
   (d) 65%.
   (e) There is no marginal tax rate in Canada.

(14) It can be possible for a government to improve efficiency while raising its revenues
   (a) by taxing goods that generates positive externalities.
   (b) by imposing a quota on goods that generates positive externalities.
   (c) by taxing goods that generates negative externalities.♠
   (d) by imposing a quota on goods that generates negative externalities.
   (e) When the government raises its revenues, efficiency always goes down.

(15) A tax on capital income generates inefficiencies because
   (a) with a lower interest rate, too many projects are undertaken.
   (b) at the interest rate paid by those who have projects, some people would be willing to supply more capital.♠
   (c) they create unemployment.
   (d) they lower the interest rate paid by capital owners.
   (e) taxes prevent those who have projects to lend money to those who don't have any project.

(16) Typically, we have an externality when
   (a) through its activities, an agent unintentionally affects the welfare of another.♠
   (b) people do not care about each other.
   (c) governments intervene in the economy to help firms only.
   (d) markets are free to function.
   (e) Tarzan loves Jane.

(17) According to the Coase theorem, in the presence of externalities, if transaction costs are negligible,
   (a) the government becomes irrelevant.
   (b) markets are inefficient.
   (c) all that is necessary to achieve fairness is for the government to allocate property rights to one party, no matter which one.
   (d) the initial allocation of property rights will not affect wealth distribution in society.

 (e) all that is necessary to achieve efficiency is for the government to allocate property rights to one party.♠

(18) In the presence of pollution, an implication of the Coase theorem is that the government should probably intervene more directly when
 (a) there is a large number of heterogeneously affected parties.♠
 (b) enforcing agreements is easy.
 (c) lawyer fees are low.
 (d) Tarzan and Jane get married.
 (e) According to the Coase theorem, the government should never intervene.

(19) Generally, a minimum wage law
 (a) reduces unemployment because at the minimum wage, more people would like to work while firms hire less people.
 (b) is inefficient because there exists a lower wage rate for which more workers would be happy to work while firms would like to hire them.♠
 (c) increases unemployment because by setting a minimum wage below the free-market wage, more people can work.
 (d) is fair because all workers see their wage increase compared to the free-market wage.
 (e) is unfair because the free-market wage rate is more efficient.

(20) Rent ceilings
 (a) deliver a fair result because they clearly benefit the poor.
 (b) can end up increasing the opportunity cost of housing.♠
 (c) deliver a fair result because they reduce discrimination between students and professionals.
 (d) increase efficiency because they reduce search costs.
 (e) create an excess supply of housing.

(21) Which of the following is generally false?
 (a) A merger between two firms may increase efficiency if one firm's activities generates negative externalities on the other.
 (b) A merger between two firms may increase efficiency if one firm's activities generates positive externalities on the other.
 (c) A contract between two firms may increase efficiency if one firm's activities generates negative externalities on the other.
 (d) In order to reduce pollution, economists prefer taxes over command and control regulation because taxes are more efficient.
 (e) In order to reduce pollution, economists prefer taxes over command and control regulation because taxes are fairer.♠

 Graphic 1 represents the market for cars, accounting for the fact that car production generates pollution. Curve D denotes the demand for cars, curve MC is the private marginal cost of car production, and curve MSC denotes the marginal social cost of producing cars. Answer questions 22, 23, 24 and 25 by referring to Graphic 1.

(22) The free-market equilibrium yields
 (a) 10 million cars and a price of 18 000 \$.
 (b) 10 million cars and a price of 20 000 \$.

    (c) 10 million cars and a price of 25 000 $.
    (d) 12 million cars and a price of 20 000 $.♠
    (e) 12 million cars and a price of 30 000 $.

(23) Which of the following situation is efficient?
    (a) The price paid by consumers is 30 000$ and 12 million cars are produced.
    (b) The price paid by consumers is 25 000$ and 8 million cars are produced.
    (c) The price paid by consumers is 20 000$ and 12 million cars are produced.
    (d) 10 millions cars are produced.♠
    (e) 8 million cars are produced.

(24) Which level of the tax per car imposed on producers would result in an efficient output level?
    (a) 0$
    (b) 2 000$
    (c) 5 000$
    (d) 7 000$♠
    (e) 10 000$

(25) The excess burden of the above tax is equal to
    (a) 0$.♠
    (b) 2 000$.
    (c) 3 000$.
    (d) 7 000$.
    (e) 8 000$.