

Fall 2009, Test 2

- I. Complete the sentence or provide the short answer on the answer sheet.
1. Business costs unrelated to how much output is produced are called **fixed** costs.
 2. Business costs that change as the amount of output changes are called **variable** costs.
 3. A business will continue to operate, even though it is not making a profit, as long as revenues exceed **variable** costs.
 4. When a firm initially expands output, its average costs **decline** as production can be done more efficiently at a larger scale.
 5. At high levels of output, expanding production even more usually lead to **higher** average costs for the firm due to the limitations of fixed inputs.
 6. For a business, profits = **total revenues** minus total costs.
 7. The concept of “price elasticity of demand” shows how **purchasing** by consumers of products (or services) changes in response to an increase or decrease in the price of the product (or service).
 8. If the demand curve for Pizza Ray’s pizzas is *elastic*, then purchases of his pizzas by customers are very **responsive** to changes in the price.
 9. Conversely, if the demand curve for Pizza Ray’s pizzas is *inelastic*, then purchases of his pizzas by customers are not very **responsive** to changes in the price.
 10. The demand curve for products or services called “necessities” is price **inelastic**.
 11. Except for two cases (agricultural producers and professional sports teams), collusive **oligopolies** are illegal in the U.S.
 12. The type of market structure where a business tries to “tweak”, or change, its product slightly so it will not be identical to competitors’ products and so it will have some control over the price it charges is called **monopolistic competition**.

13. Separating buyers by the shape of their demand curve and charging buyers different prices for the same product so as to increase profits is called **market segmentation (or price discrimination)**.
14. With the technique described in #13, buyers with an inelastic demand curve will be charged a **higher** price.
15. With the technique described in #13, buyers with an elastic demand curve will be charged a **lower** price.
16. Anything that causes demand to increase relative to supply will cause the price to **rise**.
17. Anything that causes demand to decrease relative to supply will cause the price to **fall**.
18. Continuing the situation in #16, when enough time elapses such that new firms can enter the industry, supply will increase and price will **fall**.
19. A government imposed price ceiling, that keeps the price below the equilibrium price, will create a **shortage** which may ultimately be eliminated by “non-price” factors like increased waiting time or underground markets.
20. A government imposed price floor, which keeps the price above the equilibrium price, will create a **surplus** that may result in the government storing some of the product.
21. The market structure where all firms sell the identical product is called **perfect competition**.
22. The market structure with only one firm is a **monopoly**.
23. A monopoly in the U.S. will have its price **regulated** by the government.

II. Work the problems and put the answers on the answer sheet.

Monthly Costs for Two Production Levels of Pizza

	<u>2500 pizzas</u>	<u>5000 pizzas</u>
Rent	\$5000	\$5000
Manager's salary	\$4000	\$4000
Electricity	\$1000	\$1000
Food	\$10,000	\$13,000
Hourly labor	\$6000	\$8000

24. What are the *fixed costs* for producing 2500 pizzas? **\$10,000**
25. What are the *fixed costs* for producing 5000 pizzas? **\$10,000**
26. What are the *variable costs* for producing 2500 pizzas? **\$16,000**
27. What are the *variable costs* for producing 5000 pizzas? **\$21,000**
28. What are the *total costs* for producing 2500 pizzas? **\$26,000**
29. What are the *total costs* for producing 5000 pizzas? **\$31,000**
30. If Pizza Ray's demand curve shows he sells 2500 pizzas per month when he charges \$20 per pizza, but he sells 5000 pizzas a month when he charges \$12 a pizza, what price should he charge to make the most profit? Use the cost information posted above. **\$12 (calculations below):**

2500 pizzas: $(\$20 \times 2500) - \$26,000 = \$24,000$ profit

5000 pizzas: $(\$12 \times 5000) - \$31,000 = \$29,000$ profit