

Microeconomics, externalities, final exam practice problems

(The attached PDF file has better formatting.)

*Question 1.1: Positive Externalities

Which of the following is true regarding positive externalities?

- A. The Coase theorem posits that externalities can be priced by the private market.
- B. Firms which create positive externalities generally pay lower wages.
- C. Social marginal cost is less than private marginal cost if a firm creates positive externalities.
- D. If a firm creates positive externalities, it produces too little in a perfectly competitive market.
- E. Efficiency is maximized if the government pays firm to produce positive externalities.

Answer 1.1: C

Competitive behavior results in underproduction, since it does not consider the gains created by the externalities.

*Question 1.2: Positive Externalities

Which of the following is an example of positive externalities?

- A. Job training for immigrants reduces the likelihood of criminal behavior by their children.
- B. Free abortions reduces the cost of raising children.
- C. Dental insurance reduces the likelihood of rotting teeth.
- D. Attainment of an FSA eliminates the need for continual study.
- E. Incentive stock options increase the likelihood of good performance.

Answer 1.2: A

Job training for immigrants provides income for them and increases social welfare by their work and contributions to society (like taxes). A side effect is that children of employed parents are less likely to engage in criminal behavior.