

Chapter 2 – Scarcity, choice and economic interaction

1. The concept of scarcity, as used by economists, refers to
 - a. a situation where available resources satisfy the unlimited wants of society.
 - b. a situation in which an item is available only in very small quantities.
 - c. a situation where available resources satisfy the limited wants of society.
 - d. a situation where available resources do not satisfy the limited wants of society.
 - e. a situation where available resources do not satisfy the unlimited wants of society.

ANS: E PTS: 1 DIF: Moderate TOP: Introduction

2. The problems that flow from scarcity
 - a. are problems only for developing countries.
 - b. are problems only for developed countries.
 - c. are problems faced by all economies.
 - d. decrease as the economy grows.
 - e. increase as the economy grows.

ANS: C PTS: 1 DIF: Moderate TOP: Introduction

3. The basic economic problem is
 - a. unemployment and poverty.
 - b. unemployment and inequality.
 - c. poverty and inequality.
 - d. scarcity and choices.
 - e. unemployment and inflation.

ANS: D PTS: 1 DIF: Basic TOP: Introduction

4. Who faces the problem of scarcity?
 - a. Only the rich
 - b. Only the poor
 - c. Only people living next to rich people
 - d. Everyone
 - e. Only people living next to poor people

ANS: D PTS: 1 DIF: Moderate TOP: Introduction

5. A resource is not scarce if
 - a. there is more of the resource than people want.
 - b. there is less of the resource than people want.
 - c. people have enough money to pay for it.
 - d. it has a low opportunity cost.
 - e. its supply exceeds its demand.

ANS: A PTS: 1 DIF: Moderate TOP: Introduction

6. If a resource is always available when needed, then it
- will be more expensive than other resources.
 - is not scarce.
 - has a high opportunity cost.
 - has a low opportunity cost.
 - is scarce.

ANS: B PTS: 1 DIF: Basic TOP: Introduction

7. An important implication of scarcity is that
- it inhibits economic interaction.
 - people are unable to use all the available resources.
 - people must make choices.
 - people will always be poor.
 - it is a problem that is easily abolished.

ANS: C PTS: 1 DIF: Moderate TOP: Introduction

8. Economics is a study of how societies
- make decisions when resources are scarce.
 - overcome scarcity.
 - interact in order to avoid scarcity.
 - avoid scarcity by making choices.
 - make decisions when resources are rare.

ANS: A PTS: 1 DIF: Moderate TOP: Introduction

9. The main problem addressed by economics is how
- individuals make decisions to use scarce resources in order to satisfy their unlimited wants.
 - individuals make decisions to use scarce resources in order to satisfy their limited wants.
 - economies grow and develop.
 - society can eliminate scarcity.
 - society creates more resources in order to raise its standard of living.

ANS: A PTS: 1 DIF: Moderate TOP: Introduction

10. People are forced to choose because of
- social customs.
 - social mores.
 - scarce resources.
 - government decisions.
 - rare resources.

ANS: C PTS: 1 DIF: Moderate TOP: Introduction

11. Which of the following statements about economic interaction is *not* true?
- It is a fact of economic life.
 - It requires a market.
 - It can occur within a family.
 - It makes our lives better.
 - It occurs only among different countries.

ANS: E PTS: 1 DIF: Moderate TOP: Introduction

12. A market is

- a. a place where businesses meet to set prices.
- b. an arrangement by which economic exchanges take place.
- c. an organisation controlled by a government.
- d. a place where goods are produced.
- e. anywhere people come close to each other.

ANS: B

PTS: 1

DIF: Basic

TOP: Introduction

13. A budget constraint is a useful economic tool because it

- a. does not occur if there is scarcity.
- b. enables choices to be avoided.
- c. is a way to overcome scarcity.
- d. forces people to make choices.
- e. prohibits consumers from spending.

ANS: D

PTS: 1

DIF: Moderate

TOP: Consumer

decisions

14. People make decisions when choices involve

- a. limited resources.
- b. limited wants and needs.
- c. unlimited wants and needs.
- d. opportunity costs.
- e. unlimited resources.

ANS: D

PTS: 1

DIF: Moderate

TOP: Consumer

decisions

15. Choices are made based on

- a. scarcity.
- b. opportunity costs.
- c. producers.
- d. consumers.
- e. the budget constraint.

ANS: B

PTS: 1

DIF: Moderate

TOP: Consumer

decisions

16. The opportunity cost of making a choice is the

- a. cost associated with making a choice.
- b. value of the next best activity not chosen.
- c. monetary cost associated with making a choice.
- d. amount paid to purchase what is chosen.
- e. marginal cost associated with making a choice.

ANS: B

PTS: 1

DIF: Moderate

TOP: Consumer

decisions

17. Matthew has only one hour to either study for a history exam or complete an economics report. The opportunity cost of spending the hour writing the economics report is
- a lower grade in the history exam.
 - a higher grade in the history exam.
 - a lower grade in both the history exam and the economics report.
 - a higher grade in both the history exam and the economics report.
 - zero because history and economics are unrelated.

ANS: A PTS: 1 DIF: Moderate TOP: Consumer decisions

18. Matthew is a poor student who can afford either a computer or a Gold Coast holiday, both of which cost the same amount. Which of the following statements about Matthew's opportunity cost is correct?
- The opportunity cost of a Gold Coast holiday is the money Matthew pays for the holiday.
 - The opportunity cost of the holiday is the same as the opportunity cost of the computer, because Matthew can afford only one or the other.
 - There is nothing to say about the opportunity cost, because we do not know how much the computer or the Gold Coast holiday costs.
 - The opportunity cost of going on a holiday is the loss from not being able to buy the computer.
 - The opportunity cost of the computer is the total cost of the computer and the Gold Coast holiday.

ANS: D PTS: 1 DIF: Moderate TOP: Consumer decisions

19. Which of the following statements is *false*?
- There is an opportunity cost associated with any choice made.
 - If there is a budget constraint, there will be scarcity.
 - A financial budget constraint must exist for an opportunity cost to exist.
 - Opportunity costs occur because of scarce resources.
 - Because of scarcity, choices have to be made.

ANS: C PTS: 1 DIF: Moderate TOP: Consumer decisions

20. A good example of opportunity cost is
- the chocolate given up by a person who has diabetes.
 - for a professor of economics, the pleasure derived from teaching economics.
 - the Chinese food that you gave up when you chose to eat Italian food.
 - the course fees that you pay to attend university.
 - the price paid for a ticket when you go to the movies.

ANS: C PTS: 1 DIF: Moderate TOP: Consumer decisions

21. The opportunity cost of a student attending university
- is zero, because the return is always positive.
 - includes the skills learned while attending university.
 - is living expenses, which are the same whether or not a student attends university.
 - includes the lost wages the student would have earned.
 - includes scholarships for attending university.

ANS: D PTS: 1 DIF: Moderate TOP: Consumer decisions

22. Of the following people, who would bear the highest opportunity cost of going to university?
- A professional football player earning \$1 million a year
 - A high-school graduate without a job
 - A high-school dropout earning the minimum wage in a fast-food restaurant
 - A person recently laid off by a company
 - A high-school graduate with a job

ANS: A PTS: 1 DIF: Moderate TOP: Consumer decisions

23. When economic growth slows, it is often harder to find a job, so more people go to university. We can conclude that the opportunity cost of
- going to university decreases when the economy slows.
 - going to university increases when the economy slows.
 - employment increases when the economy is in recession.
 - employment decreases when the economy is in recession.
 - going to university is unchanged when the economy slows.

ANS: A PTS: 1 DIF: Challenging TOP: Consumer decisions

24. Zoe has two options at the end of the year: get a summer job that pays \$2000, or travel in China. The opportunity cost of the summer job is
- that Zoe can earn more than \$2000.
 - that Zoe can also travel in China.
 - that Zoe has to give up travelling in China.
 - that Zoe can save the money for travelling in China.
 - the \$2000 that Zoe would have earned.

ANS: C PTS: 1 DIF: Moderate TOP: Consumer decisions

Exhibit 2-1

Hours Spent on Economics	Economics Grade	Math Grade
0	30	95
1	70	85
2	80	55
3	90	15

25. Refer to Exhibit 2-1. Suppose that Jack has three hours to study for an economics exam and has another exam, in maths, on the same day. The amount of time he spends studying economics and its relation to his grade in the two classes are shown in the table. The opportunity cost of increasing the time spent on studying economics from one hour to two hours is
- 85 points on the maths grade.
 - 55 points on the maths grade.
 - 30 points on the maths grade.
 - 20 points on the maths grade.
 - zero.

ANS: C PTS: 1 DIF: Moderate TOP: Consumer decisions

26. Voluntary trade brings about gains because
- it reallocates goods between individuals.
 - it occurs in a household.
 - it reallocates goods between individuals in a way they both prefer.
 - it occurs in a market.
 - of the power involved.

ANS: C PTS: 1 DIF: Moderate TOP: Producer decisions

27. The voluntary exchange of second-hand consumer goods is beneficial to the economy because it
- leaves those engaging in the exchange better off.
 - changes the total quantity of goods produced.
 - reallocates existing goods.
 - reduces scarcity.
 - requires choice.

ANS: A PTS: 1 DIF: Moderate TOP: Producer decisions

Exhibit 2-2

Anne the Cook	Cook Full Time	Cook and Wait on Customers
Meals Cooked per Day	20	4
Customers Waited on per Day	0	4

Sam the Waiter	Wait Full Time	Cook and Wait on Customers
Meals Cooked per Day	0	4
Customers Waited on per Day	20	4

28. According to Exhibit 2-2, if Sam did all the cooking as well as waited on all the tables, how many customers would he be able to serve per day?

- a. Four
- b. Between two and 20 customers
- c. Zero
- d. 20
- e. Five

ANS: A PTS: 1 DIF: Moderate TOP: Producer decisions

29. According to Exhibit 2-2, if Anne spent all her time cooking, how many meals would she be able to prepare per day?

- a. 20
- b. Two
- c. Four
- d. 40
- e. Five

ANS: A PTS: 1 DIF: Moderate TOP: Producer decisions

30. According to Exhibit 2-2, if Anne and Sam each worked separately, how many meals would each of them serve per day?

- a. 40
- b. Four
- c. Two
- d. 20
- e. Five

ANS: B PTS: 1 DIF: Moderate TOP: Producer decisions

31. According to Exhibit 2-2, if Anne and Sam joined forces, with Anne doing all the cooking and Sam doing all the serving, the number of customers served per day would be
- a. 40.
 - b. four.
 - c. 20.
 - d. eight.
 - e. five.

ANS: C PTS: 1 DIF: Moderate TOP: Producer
decisions

32. According to Exhibit 2-2, if Anne and Sam joined forces, the number of meals served would increase by
- a. eight.
 - b. 20.
 - c. 12.
 - d. four.
 - e. five.

ANS: C PTS: 1 DIF: Moderate TOP: Producer
decisions

33. ____ must exist in order for gains from trade to be realised.
- a. Governments
 - b. Markets
 - c. Households
 - d. Interaction
 - e. Buyers and sellers

ANS: D PTS: 1 DIF: Moderate TOP: Producer
decisions

34. Worker specialisation facilitates
- a. the augmentation of scarcity.
 - b. the elimination of scarcity.
 - c. increased opportunity costs.
 - d. decreased opportunity costs.
 - e. the division of labour.

ANS: E PTS: 1 DIF: Basic TOP: Producer
decisions

35. Production can be increased whenever people
- a. engage in activities with a high opportunity cost.
 - b. specialise in whichever field they have a comparative advantage in.
 - c. specialise in whatever field they have an absolute advantage in.
 - d. engage in activities with a low opportunity cost.
 - e. engage in activities with a constant opportunity cost.

ANS: B PTS: 1 DIF: Moderate TOP: Producer
decisions

40. Suppose that an economy produces only movies and computers. If the economy at all times utilises all its resources and uses them efficiently, and then decides to use more of its available resources to produce more computers,
- the production of movies will drop.
 - the production of both movies and computers will drop.
 - the production of movies will rise.
 - the production of movies might drop.
 - the production of movies might rise.

ANS: A PTS: 1 DIF: Moderate TOP: The production possibilities curve

41. Which of the following does a straight production possibilities frontier best illustrate?
- The concept of constant opportunity costs
 - The concept of comparative advantage
 - The concept of increasing opportunity costs
 - The concept of comparative disadvantage
 - The concept of opportunity cost

ANS: A PTS: 1 DIF: Moderate TOP: The production possibilities curve

Exhibit 2-3

Production Possibilities for Computers and TV Sets		
Combination	Computers	TV Sets
A	0	6
B	15	5
C	25	4
D	33	3
E	39	2
F	42	1
G	43	0

42. Refer to Exhibit 2-3. The opportunity cost of producing the first television set is
- 15 units of computers.
 - five units of computers.
 - 43 units of computers.
 - 42 units of computers.
 - one unit of computers.

ANS: E PTS: 1 DIF: Moderate TOP: The production possibilities curve

43. Refer to Exhibit 2-3. The opportunity cost of producing the sixth television set is
- 15 units of computers.
 - five units of computers.
 - 43 units of computers.
 - 42 units of computers.
 - one unit of computers.

ANS: A PTS: 1 DIF: Moderate TOP: The production possibilities curve

Exhibit 2-4

Production Possibilities for Computers and TV Sets		
Combination	Computers	TV Sets
A	0	6
B	15	5
C	25	4
D	33	3
E	39	2
F	42	1
G	43	0

44. Refer to Exhibit 2-4. The production possibilities curve representing the given schedule would be a
- negatively sloped curve that bows outward.
 - negatively sloped straight line.
 - positively sloped curve that bows outward.
 - positively sloped curve that bows inward.
 - positively sloped straight line.

ANS: A PTS: 1 DIF: Moderate TOP: The production possibilities curve

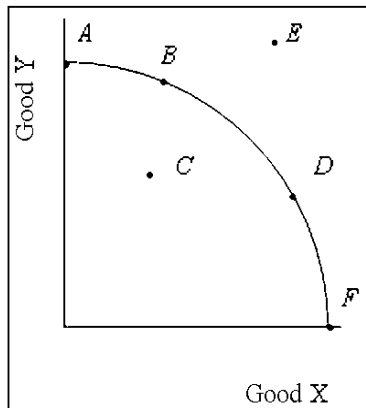
45. A production possibilities curve shows
- what happens to the amount of available resources if it is not possible to produce a good.
 - what can be produced with unlimited resources.
 - what happens as resources are moved from producing one good to another good.
 - the choice between producing some goods versus other goods with unlimited resources.
 - the different kinds of products that a business can produce.

ANS: C PTS: 1 DIF: Moderate TOP: The production possibilities curve

51. In the late 1960s, when Australia discovered it had vast reserves of iron ore
- the production possibilities curve became steeper.
 - the production possibilities curve shifted inward.
 - there was movement along the production possibilities curve.
 - the production possibilities curve became flatter.
 - the production possibilities curve shifted outwards.

ANS: E PTS: 1 DIF: Moderate TOP: The production possibilities curve

Exhibit 2-5



52. Refer to Exhibit 2-5. A movement from point B to point D indicates
- a gain in Good X and a loss in Good Y.
 - a gain in Good Y and a loss in Good X.
 - a gain in both Good X and Good Y.
 - a loss in both Good X and Good Y.
 - no change in the production of Good X or Good Y.

ANS: A PTS: 1 DIF: Moderate TOP: The production possibilities curve

53. Refer to Exhibit 2-5. The production possibilities curve indicates that
- it is possible to produce more of one good without sacrificing some of the other good only if production occurs at a point inside the production possibilities curve.
 - Good X is an input in the production of Good Y.
 - producing an additional unit of Good X requires producing an additional unit of Good Y.
 - more resources exist than the economy can efficiently use.
 - the economy is experiencing decreasing opportunity costs.

ANS: A PTS: 1 DIF: Moderate TOP: The production possibilities curve

54. Refer to Exhibit 2-5. Assume the economy is operating at point C. This indicates that
- the only way the economy could move toward a point such as D is by discovering new resources.
 - the economy is efficiently using all its resources.
 - there is no excess resource capacity in the economy.
 - it is possible for the economy to produce more of Good X and Good Y with the given resources.
 - it is possible for the economy to produce more of Good X only if it produces less of Good Y.

ANS: D PTS: 1 DIF: Moderate TOP: The production possibilities curve

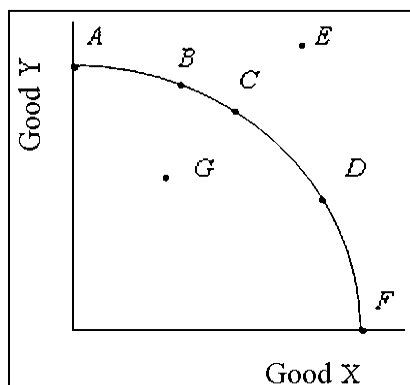
55. Refer to Exhibit 2-5. Point C
- occurs when resources are not efficiently allocated.
 - may be attained with a sufficient improvement in technology.
 - can be attained with existing resources.
 - is impossible to attain, even in the future.
 - shows the most efficient use of valuable resources.

ANS: A PTS: 1 DIF: Moderate TOP: The production possibilities curve

56. Refer to Exhibit 2-5. Point E
- occurs when resources are not efficiently allocated.
 - may be attained with a sufficient improvement in technology.
 - can be attained with existing resources.
 - is impossible to attain, even in the future.
 - shows the most efficient use of valuable resources.

ANS: B PTS: 1 DIF: Moderate TOP: The production possibilities curve

Exhibit 2-6



57. Refer to Exhibit 2-6. The optimal point for the economy is

- a. *D*.
- b. *C*.
- c. *B*.
- d. *E*.
- e. Not enough information is provided.

ANS: E PTS: 1 DIF: Challenging TOP: The production possibilities curve

58. Refer to Exhibit 2-6. Point *C* is more efficient than point

- a. *A*.
- b. *B*.
- c. *D*.
- d. *E*.
- e. *G*.

ANS: E PTS: 1 DIF: Moderate TOP: The production possibilities curve

59. Balanced economic growth can be shown by

- a. a shift of the production possibilities curve outward.
- b. movement towards the production possibilities curve.
- c. movement along the production possibilities curve.
- d. a shift of the production possibilities curve inward.
- e. changing the shape of the production possibilities curve.

ANS: A PTS: 1 DIF: Moderate TOP: The production possibilities curve

60. The economic question is best stated as

- a. what, how many and for whom?
- b. how, what and where?
- c. what, how and for whom?
- d. what, how much and for whom?
- e. where, how and for whom?

ANS: C PTS: 1 DIF: Basic TOP: Market economies and the price system

61. In North Korea, the what, how and for whom problems are determined by

- a. consumers.
- b. businesses.
- c. the government.
- d. government and businesses.
- e. markets.

ANS: C PTS: 1 DIF: Basic TOP: Market economies and the price system

62. The key elements of a market economy include all of the following, *except*

- a. freely determined prices.
- b. property rights.
- c. freedom to trade at home.
- d. freedom to trade abroad.
- e. strong government intervention.

ANS: E PTS: 1 DIF: Moderate TOP: Market economies
and the price system

63. In a market economy, prices are

- a. mainly transfer prices.
- b. mainly government-determined transfer prices.
- c. determined by the government.
- d. freely determined.
- e. determined solely by businesses and not by consumers.

ANS: D PTS: 1 DIF: Basic TOP: Market economies
and the price system

64. Establishing property rights

- a. is a characteristic of centrally planned economies.
- b. provides incentives.
- c. is not important in a market economy.
- d. is unimportant in a market economy.
- e. is another name for eminent domain.

ANS: B PTS: 1 DIF: Basic TOP: Market economies
and the price system

65. A government failure always results when

- a. the government allows a market failure to occur.
- b. the government establishes property rights.
- c. the market does not provide answers to the economic questions.
- d. government intervention is unable to correct a market failure.
- e. the government intervenes in a market economy.

ANS: D PTS: 1 DIF: Moderate TOP: Market economies
and the price system

66. *True or False.* Scarcity applies to everyone, regardless of income.

ANS: T PTS: 1 DIF: Moderate TOP: Introduction

67. *True or False.* Choices are made in order to avoid scarcity.

ANS: F PTS: 1 DIF: Moderate TOP: Introduction

68. *True or False.* The opportunity cost for a student to attend university is zero if the student receives a scholarship.

ANS: F PTS: 1 DIF: Moderate TOP: Consumer
decisions

78. *True or False.* Any point on the production possibilities curve represents the fact that resources are both allocatively and productively efficiently allocated.

ANS: T PTS: 1 DIF: Moderate TOP: The production possibilities curve

79. *True or False.* Moving from a point on the production possibilities curve to another point on the same curve implies a gain in production efficiency.

ANS: F PTS: 1 DIF: Moderate TOP: The production possibilities curve

80. *True or False.* The movement from a point inside a production possibilities curve to a point outside the curve is likely to result in no change in an economy's total production.

ANS: F PTS: 1 DIF: Moderate TOP: The production possibilities curve

81. *True or False.* The extent of government intervention in the economy varies among market economies.

ANS: T PTS: 1 DIF: Moderate TOP: Market economies and the price system

82. *True or False.* The government can improve market conditions in case of a market failure.

ANS: T PTS: 1 DIF: Basic TOP: Market economies and the price system

83. What is the relationship between economic interaction, specialisation, comparative advantage and gains from trade?

ANS:

Economic interaction enables people to exchange their goods and services. People can then specialise in whichever area they are most proficient. As a result, there is a division of labour. If this specialisation results in a producer producing one good or service with fewer resources than the other producers, then each producer who specialises has a comparative advantage in that task. This enables production to occur more efficiently, which means more will be produced.

PTS: 1 DIF: Moderate TOP: Producer decisions

84. Explain how trade between two different countries is similar to trade occurring within a country.

ANS:

Trade between two countries is similar to trade within a country because it enables people either to better satisfy their preferences for goods by trading or to better utilise their comparative advantage.

PTS: 1 DIF: Moderate TOP: Producer decisions

85. The table below depicts the choices George and Sarah face when deciding whether to cook, wait on tables, or both.

George the Cook	Cook Full Time	Cook and Wait on Customers
Meals Cooked per Day	25	6
Customers Waited on per Day	0	6
Sarah the Waitress	Wait Full Time	Cook and Wait on Customers
Meals Cooked per Day	0	4
Customers Waited on per Day	0	6

- (A) In which area, if any, does Sarah have a comparative advantage? In which area does George have a comparative advantage?
- (B) If George and Sarah do not join forces, how many customers will be served?
- (C) If George and Sarah do join forces, how many customers will be served? What will be the gain resulting from this exchange?

ANS:

- (A) Sarah has a comparative advantage in waiting tables. George has a comparative advantage in cooking.
- (B) A total of 10 customers will be served.
- (C) 25 customers will be served. The net gain from this exchange of services is 15 more meals being served.

PTS: 1 DIF: Challenging TOP: Producer decisions

86. Does the production possibilities curve represent an economy in which some people win only if others lose? Explain.

ANS:

There are two reasons why the production possibilities curve does not necessarily mean some people win only if others lose. First, if the production possibilities curve shifts outward, then it is possible to produce more of both goods. Secondly, if the economy is producing in the inefficient region, then more of both goods can be produced if the economy becomes more efficient.

PTS: 1 DIF: Challenging TOP: The production possibilities curve

87. Why are property rights so important in a market economy?

ANS:

Property rights enable people to keep what they earn and not be overly concerned about what they have being taken away by others. This enables people to allocate more time to production as opposed to protecting what they have.

Property rights also provide incentives, in the sense that they give people the right to their earnings from their work, as well as make them responsible for whatever losses they may incur in their endeavours.

PTS: 1 DIF: Moderate TOP: Market economies and the price system

88. Answer the questions below.

- (A) What three questions need to be answered to determine the best possible point along an economy's production possibilities curve?
- (B) What are the two different approaches to answering part (A), and how do these different approaches answer the question?

ANS:

- (A) The three questions that need to be answered are: (i) What goods and services are to be produced?; (ii) How are they to be produced?; (iii) For whom are they to be produced?
- (B) The two different approaches to answering these three questions are a market economy and a command (centrally planned) economy. In a market economy, answers to these questions result from the interaction of businesses, consumers, governments and other organisations in markets. In a command economy, these questions are answered by those who control the government.

PTS: 1 DIF: Challenging TOP: Market economies and the price system

89. What is the role of government in a market economy?

ANS:

There are three aspects to the government's role in a market economy. The first is to establish property rights. The second concerns addressing market failures. The third pertains to maintaining overall economic stability by, for instance, maintaining a stable price level and preventing unemployment from becoming too high.

PTS: 1 DIF: Moderate TOP: Market economies and the price system

90. Explain how a market economy works to enable the production and allocation of surfboards.

ANS:

Prices in the surfboard market are free to vary; people have property rights to the surfboards they buy; many people sell surfboards; the government does not regulate the use of surfboards; and surfboard production takes place within businesses with many workers. A higher price, for instance, will allocate surfboards to serious surfers and away from casual surfers.

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PTS: 1
system

DIF: Moderate

TOP: Market economies and the price