

## Chapter 1 Ten Principles of Economics

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### MULTIPLE CHOICE

1. The English word that comes from the Greek word for "one who manages a household" is

- a. market.
- b. consumer.
- c. producer.
- d. economy.

ANS: D      PTS: 1      DIF: 1      REF: 1-0  
NAT: Analytic      LOC: The study of economics and definitions in economics  
TOP: Economy      MSC: Definitional

2. The word "economy" comes from the Greek word *oikonomos*, which means

- a. "environment."
- b. "production."
- c. "one who manages a household."
- d. "one who makes decisions."

ANS: C      PTS: 1      DIF: 1      REF: 1-0  
NAT: Analytic      LOC: The study of economics and definitions in economics  
TOP: Economy      MSC: Definitional

3. Resources are

- a. scarce for households but plentiful for economies.
- b. plentiful for households but scarce for economies.
- c. scarce for households and scarce for economies.
- d. plentiful for households and plentiful for economies.

ANS: C      PTS: 1      DIF: 1      REF: 1-0  
NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
TOP: Resources | Scarcity      MSC: Interpretive

4. In considering how to allocate its scarce resources among its various members, a household considers

- a. each member's abilities.
- b. each member's efforts.
- c. each member's desires.
- d. all of the above

ANS: D      PTS: 1      DIF: 1      REF: 1-0  
NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
TOP: Scarcity      MSC: Interpretive

5. Economics deals primarily with the concept of

- a. scarcity.
- b. money.
- c. poverty.
- d. banking.

ANS: A      PTS: 1      DIF: 1      REF: 1-0  
NAT: Analytic      LOC: The study of economics and definitions in economics  
TOP: Scarcity      MSC: Definitional

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6. Which of the following is correct?

- a. The word economy comes from the Greek word for “rational thinker.”
- b. Economists study the management of scarce resources.
- c. Because economists believe that people pursue their best interests, they are not interested in how people interact.
- d. All of the above are correct.

ANS: B      PTS: 1      DIF: 1      REF: 1-0  
 NAT: Analytic      LOC: The study of economics and definitions in economics  
 TOP: Economics      MSC: Definitional

7. The overriding reason why households and societies face many decisions is that

- a. resources are scarce.
- b. goods and services are not scarce.
- c. incomes fluctuate with business cycles.
- d. people, by nature, tend to disagree.

ANS: A      PTS: 1      DIF: 2      REF: 1-0  
 NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Scarcity      MSC: Interpretive

8. The phenomenon of *scarcity* stems from the fact that

- a. most economies’ production methods are not very good.
- b. in most economies, wealthy people consume disproportionate quantities of goods and services.
- c. governments restrict production of too many goods and services.
- d. resources are limited.

ANS: D      PTS: 1      DIF: 2      REF: 1-0  
 NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Scarcity      MSC: Interpretive

9. Approximately what percentage of the world's economies experience scarcity?

- a. 10%
- b. 40%
- c. 85%
- d. 100%

ANS: D      PTS: 1      DIF: 1      REF: 1-0  
 NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Scarcity      MSC: Interpretive

10. When a society cannot produce all the goods and services people wish to have, it is said that the economy is experiencing

- a. scarcity.
- b. surpluses.
- c. inefficiencies.
- d. inequalities.

ANS: A      PTS: 1      DIF: 2      REF: 1-0  
 NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Scarcity      MSC: Interpretive

11. Which of the following products would be considered scarce?

- a. automobiles
- b. baseballs autographed by Babe Ruth
- c. pickles
- d. All of the above are correct.

ANS: D      PTS: 1      DIF: 2      REF: 1-0  
 NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Scarcity      MSC: Interpretive

12. Economics is the study of

- a. production methods.
- b. how society manages its scarce resources.
- c. how households decide who performs which tasks.
- d. the interaction of business and government.

ANS: B                      PTS: 1                      DIF: 1                      REF: 1-0  
 NAT: Analytic            LOC: The study of economics and definitions in economics  
 TOP: Economics | Scarcity                      MSC: Definitional

13. In most societies, resources are allocated by

- a. a single central planner.
- b. a small number of central planners.
- c. those firms that use resources to provide goods and services.
- d. the combined actions of millions of households and firms.

ANS: D                      PTS: 1                      DIF: 1                      REF: 1-0  
 NAT: Analytic            LOC: The study of economics and definitions in economics  
 TOP: Resource allocation                      MSC: Interpretive

14. Oil is considered to be a non-renewable energy source. Oil

- a. is an unlimited resource.
- b. is a scarce resource.
- c. is not a productive resource.
- d. has no opportunity cost.

ANS: B                      PTS: 1                      DIF: 1                      REF: 1-0  
 NAT: Analytic            LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Scarcity            MSC: Applicative

15. Which of the following is *not* an example of scarcity?

- a. Only some people can afford to buy a Ferrari.
- b. Every individual in society cannot attain the highest standard of living to which he or she might aspire.
- c. Doug has an unlimited supply of apples in his orchard.
- d. Each member of a household cannot get everything he or she wants.

ANS: C                      PTS: 1                      DIF: 1                      REF: 1-0  
 NAT: Analytic            LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Scarcity            MSC: Applicative

16. Which of the following is a decision that economists study?

- a. how much people work
- b. what people buy
- c. how much money people save
- d. All of the above are correct.

ANS: D                      PTS: 1                      DIF: 1                      REF: 1-0  
 NAT: Analytic            LOC: The study of economics and definitions in economics  
 TOP: Economics            MSC: Interpretive

17. Which of the following is an example of something economists study?

- a. Kate chooses to work overtime to earn extra income for her family.
- b. Ryan sells his economics textbook from last semester to his roommate for half the price of a new textbook.
- c. The unemployment rate in the United States is at its highest level in over fifty years.
- d. All of the above are correct.

ANS: D                      PTS: 1                      DIF: 2                      REF: 1-0  
 NAT: Analytic            LOC: The study of economics and definitions in economics  
 TOP: Economics            MSC: Interpretive

## HOW PEOPLE MAKE DECISIONS

1. The adage, "There is no such thing as a free lunch," means

- a. even people on welfare have to pay for food.
- b. the cost of living is always increasing.
- c. people face tradeoffs.
- d. all costs are included in the price of a product.

ANS: C      PTS: 1      DIF: 1      REF: 1-1  
 NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Tradeoffs      MSC: Definitional

2. The adage, "There is no such thing as a free lunch," is used to illustrate the principle that

- a. goods are scarce.
- b. people face tradeoffs.
- c. income must be earned.
- d. households face many decisions.

ANS: B      PTS: 1      DIF: 2      REF: 1-1  
 NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Tradeoffs      MSC: Interpretive

3. The phrase "no such thing as a free lunch" means

- a. people must face tradeoffs.
- b. rational people think at the margin.
- c. people respond to incentives.
- d. trade can make everyone better off.

ANS: A      PTS: 1      DIF: 1      REF: 1-1  
 NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Tradeoffs      MSC: Interpretive

4. Which of the following statements best represents the principle represented by the adage, "There is no such thing as a free lunch"?

- a. Melissa can attend the concert only if she takes her sister with her.
- b. Greg is hungry and homeless.
- c. Brian must repair the tire on his bike before he can ride it to class.
- d. Kendra must decide between going to Colorado or Cancun for spring break.

ANS: D      PTS: 1      DIF: 3      REF: 1-1  
 NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Tradeoffs      MSC: Applicative

5. Which of the following examples does *not* illustrate the principle represented by the adage, "There is no such thing as a free lunch"?

- a. Joe needs to pay his rent and his electric bill.
- b. Pete must choose between buying a new flat screen television and buying his textbooks for this semester.
- c. Kevin must decide between studying for his economics exam and working at his part-time job.
- d. Lisa can spend her money on a new sweater or a pair of jeans.

ANS: A      PTS: 1      DIF: 3      REF: 1-1  
 NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Tradeoffs      MSC: Applicative

6. The principle that "people face tradeoffs" applies to

- a. individuals.
- b. families.
- c. societies.
- d. All of the above are correct.

ANS: D      PTS: 1      DIF: 1      REF: 1-1  
 NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Tradeoffs      MSC: Applicative

7. Sophia is planning her activities for a hot summer day. She would like to go to the local swimming pool and see the latest blockbuster movie, but because she can only get tickets to the movie for the same time that the pool is open she can only choose one activity. This illustrates the basic principle that

- a. people respond to incentives.
- b. rational people think at the margin.
- c. people face tradeoffs.
- d. improvements in efficiency sometimes come at the expense of equality.

ANS: C      PTS: 1      DIF: 1      REF: 1-1  
 NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Tradeoffs      MSC: Interpretive

8. Mitch has \$100 to spend and wants to buy either a new amplifier for his guitar or a new mp3 player to listen to music while working out. Both the amplifier and the mp3 player cost \$100, so he can only buy one. This illustrates the basic concept that

- a. trade can make everyone better off.
- b. people face trade-offs
- c. rational people think at the margin.
- d. people respond to incentives.

ANS: B      PTS: 1      DIF: 1      REF: 1-1  
 NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Tradeoffs      MSC: Interpretive

9. Guns and butter are used to represent the classic societal tradeoff between spending on

- a. durable and nondurable goods.
- b. imports and exports.
- c. national defense and consumer goods.
- d. law enforcement and agriculture.

ANS: C      PTS: 1      DIF: 1      REF: 1-1  
 NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Tradeoffs      MSC: Interpretive

10. A tradeoff exists between a clean environment and a higher level of income in that

- a. studies show that individuals with higher levels of income pollute less than low-income individuals.
- b. efforts to reduce pollution typically are not completely successful.
- c. laws that reduce pollution raise costs of production and reduce incomes.
- d. employing individuals to clean up pollution causes increases in employment and income.

ANS: C      PTS: 1      DIF: 2      REF: 1-1  
 NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Tradeoffs      MSC: Applicative

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11. While pollution regulations yield the benefit of a cleaner environment and the improved health that comes with it, the regulations come at the cost of reducing the incomes of the regulated firms' owners, workers, and customers.

This statement illustrates the principle that

- trade can make everyone better off.
- rational people think at the margin.
- people face tradeoffs.
- people respond to incentives.

ANS: C      PTS: 1      DIF: 2      REF: 1-1  
 NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Tradeoffs      MSC: Applicative

12. When society requires that firms reduce pollution, there is

- a tradeoff because of reduced incomes to the firms' owners and workers.
- a tradeoff only if some firms are forced to close.
- no tradeoff, since the cost of reducing pollution falls only on the firms affected by the requirements.
- no tradeoff, since everyone benefits from reduced pollution.

ANS: A      PTS: 1      DIF: 3      REF: 1-1  
 NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Tradeoffs      MSC: Applicative

13. Economists use the word *equality* to describe a situation in which

- each member of society has the same income.
- each member of society has access to abundant quantities of goods and services, regardless of his or her income.
- society is getting the maximum benefits from its scarce resources.
- society's resources are used efficiently.

ANS: A      PTS: 1      DIF: 2      REF: 1-1  
 NAT: Analytic      LOC: Efficiency and equity      TOP: Equality  
 MSC: Interpretive

14. Efficiency means that

- society is conserving resources in order to save them for the future.
- society's goods and services are distributed equally among society's members.
- society's goods and services are distributed fairly, though not necessarily equally, among society's members.
- society is getting the maximum benefits from its scarce resources.

ANS: D      PTS: 1      DIF: 1      REF: 1-1  
 NAT: Analytic      LOC: Efficiency and equity      TOP: Efficiency  
 MSC: Definitional

15. Efficiency

- and equality both refer to how much a society can produce with its resources.
- and equality both refer to how fairly the benefits from using resources are distributed between members of a society.
- refers to how much a society can produce with its resources. Equality refers to how evenly the benefits from using resources are distributed among members of society.
- refers to how evenly the benefits from using resources are distributed between members of society. Equality refers to how much a society can produce with its resources

ANS: C      PTS: 1      DIF: 2      REF: 1-1  
 NAT: Analytic      LOC: Efficiency and equity      TOP: Efficiency | Equality  
 MSC: Definitional

16. The terms equality and efficiency are similar in that they both refer to benefits to society. However they are different in that
- equality refers to uniform distribution of those benefits and efficiency refers to maximizing benefits from scarce resources.
  - equality refers to maximizing benefits from scarce resources and efficiency refers to uniform distribution of those benefits.
  - equality refers to everyone facing identical tradeoffs and efficiency refers to the opportunity cost of the benefits.
  - equality refers to the opportunity cost of the benefits and efficiency refers to everyone facing identical tradeoffs.

ANS: A      PTS: 1      DIF: 2      REF: 1-1  
 NAT: Analytic      LOC: Efficiency and equity      TOP: Efficiency | Equality  
 MSC: Definitional

17. Which of the following phrases best captures the notion of efficiency?

- absolute fairness
- equal distribution
- minimum waste
- equitable outcome

ANS: C      PTS: 1      DIF: 1      REF: 1-1  
 NAT: Analytic      LOC: Efficiency and equity      TOP: Efficiency  
 MSC: Interpretive

18. Which of the following words and phrases best captures the notion of *equality*?

- minimum waste
- maximum benefit
- sameness
- efficiency

ANS: C      PTS: 1      DIF: 1      REF: 1-1  
 NAT: Analytic      LOC: Efficiency and equity      TOP: Equality  
 MSC: Definitional

19. The property of society getting the most it can from its scarce resources is called

- equity.
- efficiency.
- equality.
- efficacy.

ANS: B      PTS: 1      DIF: 1      REF: 1-1  
 NAT: Analytic      LOC: Efficiency and equity      TOP: Efficiency  
 MSC: Definitional

20. A typical society strives to get the most it can from its scarce resources. At the same time, the society attempts to distribute the benefits of those resources to the members of the society in a fair manner. In other words, the society faces a tradeoff between

- guns and butter.
- efficiency and equality.
- inflation and unemployment.
- work and leisure.

ANS: B      PTS: 1      DIF: 1      REF: 1-1  
 NAT: Analytic      LOC: Efficiency and equity      TOP: Efficiency | Equality  
 MSC: Interpretive

21. Which of the following is true?

- a. Efficiency refers to the size of the economic pie; equality refers to how the pie is divided.
- b. Government policies usually improve upon both equality and efficiency.
- c. As long as the economic pie continually gets larger, no one will have to go hungry.
- d. Efficiency and equality can both be achieved if the economic pie is cut into equal pieces.

ANS: A      PTS: 1      DIF: 2      REF: 1-1  
 NAT: Analytic      LOC: Efficiency and equity      TOP: Efficiency | Equality  
 MSC: Interpretive

22. As a result of a successful attempt by government to cut the economic pie into more equal slices,

- a. the pie gets larger, and there will be more pie overall.
- b. the pie gets smaller, and there will be less pie overall.
- c. it increases the reward for working hard, resulting in people producing more goods and services.
- d. those who earn more income pay less in taxes.

ANS: B      PTS: 1      DIF: 3      REF: 1-1  
 NAT: Analytic      LOC: Efficiency and equity      TOP: Efficiency | Equality  
 MSC: Analytical

23. When the government redistributes income from the wealthy to the poor,

- a. efficiency is improved, but equality is not.
- b. both wealthy people and poor people benefit directly.
- c. people work less and produce fewer goods and services.
- d. the government collects more revenue in total.

ANS: C      PTS: 1      DIF: 2      REF: 1-1  
 NAT: Analytic      LOC: Efficiency and equity      TOP: Efficiency | Equality  
 MSC: Interpretive

24. When the government attempts to improve equality in an economy the result is often

- a. an increase in overall output in the economy.
- b. additional government revenue since overall income will increase.
- c. a reduction in equality.
- d. a reduction in efficiency.

ANS: D      PTS: 1      DIF: 2      REF: 1-1  
 NAT: Analytic      LOC: Efficiency and equity      TOP: Efficiency | Equality  
 MSC: Interpretive

25. When the government implements programs such as progressive income tax rates, which of the following is likely to occur?

- a. equality is increased and efficiency is increased.
- b. equality is increased and efficiency is decreased.
- c. equality is decreased and efficiency is increased.
- d. equality is decreased and efficiency is decreased.

ANS: B      PTS: 1      DIF: 2      REF: 1-1  
 NAT: Analytic      LOC: Efficiency and equity      TOP: Efficiency | Equality  
 MSC: Interpretive

26. A likely effect of government policies that redistribute income and wealth from the wealthy to the poor is that those policies

- a. enhance equality.
- b. reduce efficiency.
- c. reduce the reward for working hard.
- d. All of the above are correct.

ANS: D      PTS: 1      DIF: 2      REF: 1-1  
 NAT: Analytic      LOC: Efficiency and equity      TOP: Efficiency | Equality  
 MSC: Interpretive



27. Government policies designed to equalize the distribution of economic well-being include

- (i) the welfare system
- (ii) unemployment insurance
- (iii) progressive income tax
- a. (i) only
- b. (ii) only
- c. (i) and (ii) only
- d. (i), (ii), and (iii)

ANS: D      PTS: 1      DIF: 2      REF: 1-1  
 NAT: Analytic      LOC: Efficiency and equity      TOP: Efficiency | Equality  
 MSC: Applicative

28. Government policies resulting in reduced efficiency include

- (i) the welfare system
- (ii) unemployment insurance
- (iii) progressive income tax
- a. (i) only
- b. (ii) only
- c. (i) and (ii) only
- d. (i), (ii), and (iii)

ANS: D      PTS: 1      DIF: 2      REF: 1-1  
 NAT: Analytic      LOC: Efficiency and equity      TOP: Efficiency | Equality  
 MSC: Applicative

29. When government policies are enacted,

- a. equality can usually be enhanced without an efficiency loss, but efficiency can never be enhanced without a reduction in equality.
- b. efficiency can usually be enhanced without a reduction in equality, but equality can never be enhanced without an efficiency loss.
- c. it is always the case that either efficiency and equality are both enhanced, or efficiency and equality are both diminished.
- d. None of the above are correct.

ANS: D      PTS: 1      DIF: 2      REF: 1-1  
 NAT: Analytic      LOC: Efficiency and equity      TOP: Efficiency | Equality  
 MSC: Applicative

30. Senator Brown wants to increase taxes on people with high incomes and use the money to help the poor. Senator Johnson argues that such a tax will discourage successful people from working and will therefore make society worse off. An economist would say that

- a. we should agree with Senator Brown.
- b. we should agree with Senator Johnson.
- c. a good decision requires that we recognize both viewpoints.
- d. there are no tradeoffs between equity and efficiency.

ANS: C      PTS: 1      DIF: 2      REF: 1-1  
 NAT: Analytic      LOC: Efficiency and equity      TOP: Efficiency | Equality  
 MSC: Applicative

31. Senator Green argues that replacing the income tax with a national sales tax would increase the level of output. Senator Brown objects that this policy would benefit the rich at the expense of the poor.

- Both Senators' arguments are primarily about equality.
- Both Senators' arguments are primarily about efficiency.
- Senator Green's argument is primarily about equality, while Senator Brown's argument is primarily about efficiency.
- Senator Green's argument is primarily about efficiency, while Senator Brown's argument is primarily about equality.

ANS: D      PTS: 1      DIF: 1      REF: 1-1  
 NAT: Analytic      LOC: Efficiency and equity      TOP: Equality | Efficiency  
 MSC: Interpretive

32. Suppose the government taxes the wealthy at a higher rate than it taxes the poor and then develops programs to redistribute the tax revenue from the wealthy to the poor. This redistribution of wealth

- is more efficient and more equal for society.
- is more efficient but less equal for society.
- is more equal but less efficient for society.
- is less equal and less efficient for society.

ANS: C      PTS: 1      DIF: 2      REF: 1-1  
 NAT: Analytic      LOC: Efficiency and equity      TOP: Efficiency | Equality  
 MSC: Interpretive

33. The government has just passed a law requiring that all residents earn the same annual income regardless of work effort. This law is likely to

- increase efficiency and increase equality.
- increase efficiency but decrease equality.
- decrease efficiency but increase equality.
- decrease efficiency and decrease equality.

ANS: C      PTS: 1      DIF: 1      REF: 1-1  
 NAT: Analytic      LOC: Efficiency and equity      TOP: Efficiency | Equality  
 MSC: Interpretive

34. The opportunity cost of an item is

- the number of hours needed to earn money to buy the item.
- what you give up to get that item.
- usually less than the dollar value of the item.
- the dollar value of the item.

ANS: B      PTS: 1      DIF: 1      REF: 1-1  
 NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Opportunity cost      MSC: Definitional

35. In economics, the cost of something is

- the dollar amount of obtaining it.
- always measured in units of time given up to get it.
- what you give up to get it.
- often impossible to quantify, even in principle.

ANS: C      PTS: 1      DIF: 1      REF: 1-1  
 NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Opportunity cost      MSC: Definitional

36. What you give up to obtain an item is called your

- a. opportunity cost.
- b. explicit cost.
- c. monetary cost.
- d. direct cost.

ANS: A      PTS: 1      DIF: 1      REF: 1-1  
 NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Opportunity cost      MSC: Definitional

37. Which of the following is correct concerning opportunity cost?

- a. Except to the extent that you pay more for them, opportunity costs should not include the cost of things you would have purchased anyway.
- b. To compute opportunity costs, you should subtract benefits from costs.
- c. Opportunity costs and the idea of trade-offs are not closely related.
- d. Rational people should compare various options without considering opportunity costs.

ANS: A      PTS: 1      DIF: 1      REF: 1-1  
 NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Opportunity cost      MSC: Interpretive

38. High-school athletes who skip college to become professional athletes

- a. obviously do not understand the value of a college education.
- b. usually do so because they cannot get into college.
- c. understand that the opportunity cost of attending college is very high.
- d. are not making a rational decision since the marginal benefits of college outweigh the marginal costs of college for high-school athletes.

ANS: C      PTS: 1      DIF: 1      REF: 1-1  
 NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Opportunity cost      MSC: Applicative

39. When computing the opportunity cost of attending a concert you should include

- a. the price you pay for the ticket and the value of your time.
- b. the price you pay for the ticket, but not the value of your time.
- c. the value of your time, but not the price you pay for the ticket.
- d. neither the price of the ticket nor the value of your time.

ANS: A      PTS: 1      DIF: 2      REF: 1-1  
 NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Opportunity cost      MSC: Applicative

40. Denise decides to spend three hours working overtime rather than watching a video with her friends. She earns \$10 an hour. Her opportunity cost of working is

- a. the \$30 she earns working.
- b. the \$30 minus the enjoyment she would have received from watching the video.
- c. the enjoyment she would have received had she watched the video.
- d. nothing, since she would have received less than \$30 of enjoyment from the video.

ANS: C      PTS: 1      DIF: 3      REF: 1-1  
 NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Opportunity cost      MSC: Applicative

41. Ellie decides to spend two hours taking a nap rather than attending her classes. Her opportunity cost of napping is

- a. the value of the knowledge she would have received had she attended class.
- b. the \$24 she could have earned if she had worked at her job for those two hours.
- c. the value of her nap less the value of attending class.
- d. nothing, since she valued sleep more than attendance at class.

ANS: A      PTS: 1      DIF: 3      REF: 1-1  
 NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Opportunity cost      MSC: Applicative

42. Ed spends an hour studying instead of watching tv with his friends. The opportunity cost to him of studying is
- the improvement in his grades from studying for the hour.
  - the improvement in his grades from studying minus the enjoyment of watching tv.
  - the enjoyment he would have received if he had watched tv with his friends.
  - zero. Since Ed chose to study rather than to watch tv, the value of studying must have been greater than the value of watching tv.

ANS: C      PTS: 1      DIF: 3      REF: 1-1  
 NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Opportunity cost      MSC: Applicative

43. For most students, the largest single cost of a college education is
- the wages given up to attend school.
  - tuition, fees, and books.
  - room and board.
  - transportation, parking, and entertainment.

ANS: A      PTS: 1      DIF: 2      REF: 1-1  
 NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Opportunity cost      MSC: Interpretive

44. The opportunity cost of going to college is
- the total spent on food, clothing, books, transportation, tuition, lodging, and other expenses.
  - the value of the best opportunity a student gives up to attend college.
  - zero for students who are fortunate enough to have all of their college expenses paid by someone else.
  - zero, since a college education will allow a student to earn a larger income after graduation.

ANS: B      PTS: 1      DIF: 2      REF: 1-1  
 NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Opportunity cost      MSC: Interpretive

45. Which of the following is *not* an example of the opportunity cost of going to school?
- The money a student could have earned by working if he had not gone to college.
  - The nap a student could have enjoyed if he had not attended class.
  - The party a student could have enjoyed if he had not stayed in to study for his exam.
  - The money a student spends on rent for his apartment while attending school.

ANS: D      PTS: 1      DIF: 2      REF: 1-1  
 NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Opportunity cost      MSC: Applicative

46. For a college student who wishes to calculate the true costs of going to college, the costs of room and board
- should be counted in full, regardless of the costs of eating and sleeping elsewhere.
  - should be counted only to the extent that they are more expensive at college than elsewhere.
  - usually exceed the opportunity cost of going to college.
  - plus the cost of tuition, equals the opportunity cost of going to college.

ANS: B      PTS: 1      DIF: 2      REF: 1-1  
 NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Opportunity cost      MSC: Applicative

47. When you calculate your true costs of going to college, what portion of your room-and-board expenses should be included?
- Your full room-and-board expenses should always be included.
  - None of your room-and-board expenses should ever be included.
  - You should include only the amount by which your room-and-board expenses exceed the income you earn while attending college.
  - You should include only the amount by which your room-and-board expenses exceed the expenses for rent and food if you were not in college.

ANS: D      PTS: 1      DIF: 2      REF: 1-1  
 NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Opportunity cost      MSC: Applicative

48. Suppose after graduating from college you get a job working at a bank earning \$30,000 per year. After two years of working at the bank earning the same salary, you have an opportunity to enroll in a one-year graduate program that would require you to quit your job at the bank. Which of the following should *not* be included in a calculation of your opportunity cost?
- the cost of tuition and books to attend the graduate program
  - the \$30,000 salary that you could have earned if you retained your job at the bank
  - the \$45,000 salary that you will be able to earn after having completed your graduate program
  - the value of insurance coverage and other employee benefits you would have received if you retained your job at the bank

ANS: C      PTS: 1      DIF: 2      REF: 1-1  
 NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Opportunity cost      MSC: Applicative

49. For which of the following individuals would the opportunity cost of going to college be highest?
- a promising young mathematician who will command a high salary once she earns her college degree
  - a student with average grades who has never held a job
  - a famous, highly-paid actor who wants to take time away from show business to finish college and earn a degree
  - a student who is the best player on his college basketball team, but who lacks the skills necessary to play professional basketball

ANS: C      PTS: 1      DIF: 2      REF: 1-1  
 NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Opportunity cost      MSC: Applicative

50. Maureen's college raises the cost of room and board per semester. This increase raises Maureen's opportunity cost of attending college
- even if the amount she would have to pay for room and board if she didn't attend college rose by the same amount. An increase in opportunity cost reduces Maureen's incentive to attend college.
  - even if the amount she would have to pay for room and board if she didn't attend college rose by the same amount. An increase in opportunity cost increases Maureen's incentive to attend college.
  - only if the amount she would have to pay for room and board if she didn't attend college rose by less than the increase in the amount her college charges. An increase in opportunity cost reduces Maureen's incentive to attend college.
  - only if the amount she would have to pay for room and board if she didn't attend college rose by less than the increase in the amount her college charges. An increase in opportunity cost increases Maureen's incentive to attend college.

ANS: C      PTS: 1      DIF: 2      REF: 1-1  
 NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Opportunity cost      MSC: Interpretive

51. When calculating the cost of college, which of the following should you probably *not* include?

- a. The cost of tuition
- b. The cost of books required for college classes
- c. The income you would have earned had you not gone to college
- d. The cost of rent for your off-campus apartment.

ANS: D      PTS: 1      DIF: 2      REF: 1-1  
 NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Opportunity cost      MSC: Interpretive

52. When calculating the cost of college, which of the following should you probably include?

- a. The cost of your meal plan for the cafeteria.
- b. The cost of books required for college classes
- c. The income you earn at your part-time job.
- d. The cost of living in the dormitory.

ANS: B      PTS: 1      DIF: 2      REF: 1-1  
 NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Opportunity cost      MSC: Interpretive

53. Suppose your college institutes a new policy requiring you to pay for a permit to park your car in a campus parking lot.

- a. The cost of the parking permit is not part of the opportunity cost of attending college if you would not have to pay for parking otherwise.
- b. The cost of the parking permit is part of the opportunity cost of attending college if you would not have to pay for parking otherwise.
- c. Only half of the cost of the parking permit is part of the opportunity cost of attending college.
- d. The cost of the parking permit is not part of the opportunity cost of attending college under any circumstances.

ANS: B      PTS: 1      DIF: 3      REF: 1-1  
 NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Opportunity cost      MSC: Interpretive

54. You have driven 500 miles on a vacation and then you notice that you are only 25 miles from an attraction you hadn't known about, but would really like to see. In computing the opportunity cost of visiting this attraction you had not planned to visit, you should include

- a. both the cost of driving the first 500 and the next 25 miles.
- b. the cost of driving the first 500 miles, but not the cost of driving the next 25.
- c. the cost of driving the next 25 miles, but not the cost of driving the first 500.
- d. neither the cost of driving the first 500 miles nor the cost of driving the next 25 miles.

ANS: C      PTS: 1      DIF: 1      REF: 1-1  
 NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Opportunity cost      MSC: Analytical

55. Shane receives \$100 as a birthday gift. In deciding how to spend the money, he narrows his options down to four choices: Option A, Option B, Option C, and Option D. Each option costs \$100. Finally he decides on Option B.

The opportunity cost of this decision is

- a. the value to Shane of the option he would have chosen had Option B not been available.
- b. the value to Shane of Options A, C and D combined.
- c. \$50.
- d. \$100.

ANS: A      PTS: 1      DIF: 2      REF: 1-1  
 NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Opportunity cost      MSC: Applicative

56. College-age athletes who drop out of college to play professional sports

- a. are not rational decision makers.
- b. are well aware that their opportunity cost of attending college is very high.
- c. are concerned more about present circumstances than their future.
- d. underestimate the value of a college education.

ANS: B      PTS: 1      DIF: 2      REF: 1-1  
 NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Opportunity cost      MSC: Interpretive

57. A rational decisionmaker

- a. ignores marginal changes and focuses instead on “the big picture.”
- b. ignores the likely effects of government policies when he or she makes choices.
- c. takes an action only if the marginal benefit of that action exceeds the marginal cost of that action.
- d. takes an action only if the combined benefits of that action and previous actions exceed the combined costs of that action and previous actions.

ANS: C      PTS: 1      DIF: 2      REF: 1-1  
 NAT: Analytic      LOC: Marginal costs & benefits      TOP: Marginal changes  
 MSC: Interpretive

58. A rational decision maker takes an action only if the

- a. marginal benefit is less than the marginal cost.
- b. marginal benefit is greater than the marginal cost.
- c. average benefit is greater than the average cost.
- d. marginal benefit is greater than both the average cost and the marginal cost.

ANS: B      PTS: 1      DIF: 2      REF: 1-1  
 NAT: Analytic      LOC: Marginal costs & benefits      TOP: Marginal changes  
 MSC: Interpretive

59. A rational decisionmaker takes an action if and only if

- a. the marginal benefit of the action exceeds the marginal cost of the action.
- b. the marginal cost of the action exceeds the marginal benefit of the action.
- c. the marginal cost of the action is zero.
- d. the opportunity cost of the action is zero.

ANS: A      PTS: 1      DIF: 1      REF: 1-1  
 NAT: Analytic      LOC: Marginal costs & benefits      TOP: Marginal changes  
 MSC: Interpretive

60. Rational people make decisions at the margin by

- a. following marginal traditions.
- b. behaving in a random fashion.
- c. thinking in black-and-white terms.
- d. comparing marginal costs and marginal benefits.

ANS: D      PTS: 1      DIF: 1      REF: 1-1  
 NAT: Analytic      LOC: Marginal costs & benefits      TOP: Marginal changes  
 MSC: Interpretive

61. Making rational decisions “at the margin” means that people

- a. make those decisions that do not impose a marginal cost.
- b. evaluate how easily a decision can be reversed if problems arise.
- c. compare the marginal costs and marginal benefits of each decision.
- d. always calculate the dollar costs for each decision.

ANS: C      PTS: 1      DIF: 2      REF: 1-1  
 NAT: Analytic      LOC: Marginal costs & benefits      TOP: Marginal changes  
 MSC: Interpretive

62. A marginal change is a
- change that involves little, if anything, that is important.
  - large, significant adjustment.
  - change for the worse, and so it is usually a short-term change.
  - small, incremental adjustment.

ANS: D      PTS: 1      DIF: 1      REF: 1-1  
 NAT: Analytic      LOC: Marginal costs & benefits      TOP: Marginal changes  
 MSC: Definitional

63. People are willing to pay more for a diamond than for a bottle of water because
- the marginal cost of producing an extra diamond far exceeds the marginal cost of producing an extra bottle of water.
  - the marginal benefit of an extra diamond far exceeds the marginal benefit of an extra bottle of water.
  - producers of diamonds have a much greater ability to manipulate diamond prices than producers of water have to manipulate water prices.
  - water prices are held artificially low by governments, since water is necessary for life.

ANS: B      PTS: 1      DIF: 2      REF: 1-1  
 NAT: Analytic      LOC: Marginal costs & benefits      TOP: Marginal changes  
 MSC: Interpretive

64. It costs a company \$50,000 to produce 5000 beach towels. The company's cost will be \$50,009 if it produces an additional beach towel. If the company produces 5,000 beach towels then
- its average cost is greater than its marginal cost.
  - its average cost and its marginal cost are equal.
  - its average cost is less than its marginal cost.
  - there is insufficient information to compute average and marginal costs.

ANS: A      PTS: 1      DIF: 2      REF: 1-1  
 NAT: Analytic      LOC: Marginal costs & benefits      TOP: Marginal cost  
 MSC: Analytical

65. The marginal benefit Colin gets from eating a fourth slice of pizza is
- the total benefit Colin gets from eating four slices of pizza minus the total benefit Colin gets from eating three slices of pizza.
  - the same as the total benefit of eating four slices of pizza.
  - less than the marginal cost of eating the fourth slice of pizza since he chose to eat the fourth slice.
  - the total benefit Colin gets from eating five slices of pizza minus the total benefit Colin gets from eating four slices of pizza.

ANS: A      PTS: 1      DIF: 1      REF: 1-1  
 NAT: Analytic      LOC: Marginal costs & benefits      TOP: Marginal changes  
 MSC: Applicative

66. The marginal benefit Claire gets from purchasing a third pair of flip-flops is
- the same as the total benefit of purchasing three pairs of flip-flops.
  - more than the marginal cost of purchasing the third pair of flip-flops.
  - the total benefit Claire gets from purchasing three pairs of flip-flops minus the total benefit she gets from purchasing two pairs of flip-flops.
  - the total benefit Claire gets from purchasing four pairs of flip-flops minus the total benefit she gets from purchasing three pairs of flip-flops.

ANS: C      PTS: 1      DIF: 1      REF: 1-1  
 NAT: Analytic      LOC: Marginal costs & benefits      TOP: Marginal changes  
 MSC: Applicative



67. Caroline eats two bananas during a particular day. The marginal benefit she enjoys from eating the second banana
- can be thought of as the total benefit Caroline enjoys by eating two bananas minus the total benefit she would have enjoyed by eating just the first banana.
  - determines Caroline's marginal cost of the first and second bananas.
  - does not depend on how many bananas Caroline has already eaten.
  - All of the above are correct.

ANS: A      PTS: 1      DIF: 3      REF: 1-1  
 NAT: Analytic      LOC: Marginal costs & benefits      TOP: Marginal changes  
 MSC: Applicative

68. After much consideration, you have chosen Cancun over Ft. Lauderdale as your Spring Break destination this year. However, Spring Break is still months away, and you may reverse this decision. Which of the following events would prompt you to reverse this decision?
- The marginal benefit of going to Cancun increases.
  - The marginal cost of going to Cancun decreases.
  - The marginal benefit of going to Ft. Lauderdale decreases.
  - The marginal cost of going to Ft. Lauderdale decreases.

ANS: D      PTS: 1      DIF: 3      REF: 1-1  
 NAT: Analytic      LOC: Marginal costs & benefits      TOP: Marginal changes  
 MSC: Applicative

69. After much consideration, you have chosen Ireland over Spain for your Study Abroad program next year. However, the deadline for your final decision is still months away and you may reverse this decision. Which of the following events would prompt you to reverse this decision?
- The marginal benefit of going to Spain increases.
  - The marginal cost of going to Spain increases.
  - The marginal benefit of going to Ireland increases.
  - The marginal cost of going to Ireland decreases.

ANS: A      PTS: 1      DIF: 3      REF: 1-1  
 NAT: Analytic      LOC: Marginal costs & benefits      TOP: Marginal changes  
 MSC: Applicative

70. A barber currently cuts hair for 50 clients per week and earns a profit. He is considering expanding his operation in order to serve more clients. Should he expand?
- Yes, because cutting hair is profitable.
  - No, because he may not be able to sell more services.
  - It depends on the marginal cost of serving more clients and the marginal revenue he will earn from serving more clients.
  - It depends on the average cost of serving more clients and the average revenue he will earn from serving more clients.

ANS: C      PTS: 1      DIF: 2      REF: 1-1  
 NAT: Analytic      LOC: Marginal costs & benefits      TOP: Marginal changes  
 MSC: Applicative

71. The average cost per seat on the 75-passenger Get-There-Safe Bus company's trip from Milwaukee to Minneapolis, on which no refreshments are served, is \$37. In advance of a particular trip, three seats remain unsold. The bus company could increase its profit only if it
- charged any ticket price above \$0 for the three remaining seats.
  - charged at least \$18.50 for each of the three remaining seats.
  - charged at least \$37 for each of the three remaining seats.
  - paid three people to occupy the three remaining seats.

ANS: A      PTS: 1      DIF: 2      REF: 1-1  
 NAT: Analytic      LOC: Marginal costs & benefits      TOP: Marginal cost  
 MSC: Applicative

72. Bill is restoring a car and has already spent \$4000 on the restoration. He expects to be able to sell the car for \$5800. Bill discovers that he needs to do an additional \$2400 of work to make the car worth \$5800 to potential buyers. He could also sell the car now, without completing the additional work, for \$3800. What should he do?
- He should sell the car now for \$3800.
  - He should keep the car since it wouldn't be rational to spend \$6400 restoring a car and then sell it for only \$5800.
  - He should complete the additional work and sell the car for \$5800.
  - It does not matter which action he takes since the outcome will be the same either way.

ANS: A      PTS: 1      DIF: 3      REF: 1-1  
 NAT: Analytic      LOC: Marginal costs & benefits      TOP: Marginal changes  
 MSC: Analytical

73. Bill is restoring a car and has already spent \$4000 on the restoration. He expects to be able to sell the car for \$6200. Bill discovers that he needs to do an additional \$2400 of work to make the car worth \$6200 to potential buyers. He could also sell the car now, without completing the additional work, for \$3800. What should he do?
- He should sell the car now for \$3800.
  - He should keep the car since it wouldn't be rational to spend \$6400 restoring a car and then sell it for only \$6200.
  - He should complete the additional work and sell the car for \$6200.
  - It does not matter if Bill sells the car now or completes the work and then sells it at the higher price because the outcome will be the same either way.

ANS: D      PTS: 1      DIF: 3      REF: 1-1  
 NAT: Analytic      LOC: Marginal costs & benefits      TOP: Marginal changes  
 MSC: Analytical

74. Mark is refinishing an antique china cabinet and has already spent \$180 on the restoration. He expects to be able to sell the cabinet for \$360. Mark discovers that he needs to do an additional \$200 of work to make the cabinet worth \$360 to potential buyers. He could also sell the cabinet now, without completing the additional work, for \$100. What should he do?
- He should sell the cabinet now for \$100.
  - He should keep the cabinet since it wouldn't be rational to spend \$380 restoring a cabinet and then sell it for only \$360.
  - He should complete the additional work and sell the cabinet for \$360.
  - It does not matter which action he takes since the outcome will be the same either way.

ANS: C      PTS: 1      DIF: 3      REF: 1-1  
 NAT: Analytic      LOC: Marginal costs & benefits      TOP: Marginal changes  
 MSC: Analytical

75. Katie is planning to sell her house, and she is considering making two upgrades to the house before listing it for sale. Replacing the carpeting will cost her \$2,500 and replacing the roof will cost her \$9,000. Katie expects the new carpeting to increase the value of her house by \$3,000 and the new roof to increase the value of her house by \$7,000.
- She should make both improvements to her house.
  - She should replace the carpeting but not replace the roof.
  - She should replace the roof but not replace the carpeting.
  - She should not make either improvement to her house.

ANS: B      PTS: 1      DIF: 1      REF: 1-1  
 NAT: Analytic      LOC: Marginal costs & benefits      TOP: Marginal changes  
 MSC: Applicative

76. Bridget drinks three sodas during a particular day. The marginal benefit she enjoys from drinking the third soda
- can be thought of as the total benefit Bridget enjoys by drinking three sodas minus the total benefit she would have enjoyed by drinking just two sodas.
  - determines Bridget's willingness to pay for the third soda.
  - is likely different from the marginal benefit provided to Bridget by the second soda.
  - All of the above are correct.

ANS: D      PTS: 1      DIF: 3      REF: 1-1  
 NAT: Analytic      LOC: Marginal costs & benefits      TOP: Marginal changes  
 MSC: Applicative

77. A construction company has built 30 houses so far this year at a total cost to the company of \$7.5 million. If the company builds a 31<sup>st</sup> house, its total cost will increase to \$7.76 million. Which of the following statements is correct?
- For the first 30 houses, the average cost per house was \$250,000.
  - The marginal cost of the 31<sup>st</sup> house, if it is built, will be \$260,000.
  - If the company can experience a marginal benefit of \$275,000 by building the 31<sup>st</sup> house, then the company should build it.
  - All of the above are correct.

ANS: D      PTS: 1      DIF: 3      REF: 1-1  
 NAT: Analytic      LOC: Marginal costs & benefits  
 TOP: Marginal cost | Marginal benefit      MSC: Applicative

78. A construction company has built 25 houses so far this year at a total cost to the company of \$7.2 million. If the company builds a 26<sup>th</sup> house, its total cost will increase to \$7.5 million. Which of the following statements is correct?
- For the first 25 houses, the average cost per house was \$288,000.
  - The marginal cost of the 26<sup>th</sup> house, if it is built, will be equal to the average cost per house.
  - If the company can experience a marginal benefit of \$288,000 by building the 26<sup>th</sup> house, then the company should build it.
  - All of the above are correct.

ANS: A      PTS: 1      DIF: 3      REF: 1-1  
 NAT: Analytic      LOC: Marginal costs & benefits  
 TOP: Marginal cost | Marginal benefit      MSC: Applicative

79. Suppose the cost of operating a 100 room hotel for a night is \$10,000 and there are 5 empty rooms for tonight. If the marginal cost of operating one room for one night is \$30 and a customer is willing to pay \$60 for the night, the hotel manager should
- rent the room because the marginal benefit exceeds the marginal cost.
  - rent the room because the marginal benefit exceeds the average cost.
  - not rent the room because the marginal benefit is less than the marginal cost.
  - not rent the room because the marginal benefit is less than the average cost.

ANS: A      PTS: 1      DIF: 2      REF: 1-1  
 NAT: Analytic      LOC: Marginal costs & benefits      TOP: Marginal costs and benefits  
 MSC: Applicative

80. Suppose the cost of operating a 75 room hotel for a night is \$6,000 and there are 5 empty rooms for tonight. The marginal cost per room per night
- is \$40.
  - is \$80.
  - is \$120.
  - cannot be determined from the information given.

ANS: D      PTS: 1      DIF: 2      REF: 1-1  
 NAT: Analytic      LOC: Marginal costs & benefits      TOP: Marginal costs and benefits  
 MSC: Applicative

81. Suppose the cost of operating a 75 room hotel for a night is \$6,000 and there are 5 empty rooms for tonight. If the marginal cost of operating one room for one night is \$40, the hotel manager should rent one of the empty rooms only if a customer is willing to pay
- more than \$40, as the average benefit will exceed the marginal cost.
  - more than \$40, as the marginal benefit will exceed the marginal cost.
  - more than \$80, as the average benefit will exceed the marginal cost.
  - more than \$80, as the marginal benefit will exceed the marginal cost.

ANS: B      PTS: 1      DIF: 3      REF: 1-1  
 NAT: Analytic      LOC: Marginal costs & benefits      TOP: Marginal costs and benefits  
 MSC: Applicative

82. George has spent \$600 purchasing and repairing an old fishing boat, which he expects to sell for \$900 once the repairs are complete. George discovers that, in addition to the \$600 he has already spent, he needs to make an additional repair, which will cost another \$400, in order to make the boat worth \$900 to potential buyers. He can sell the boat as it is now for \$400. What should he do?
- He should sell the boat as it is now for \$400.
  - He should keep the boat since it would not be rational to spend \$1,000 on repairs and then sell the boat for \$900.
  - He should complete the repairs and sell the boat for \$900.
  - It does not matter which action he takes; the outcome is the same either way.

ANS: C      PTS: 1      DIF: 3      REF: 1-1  
 NAT: Analytic      LOC: Marginal costs & benefits      TOP: Marginal cost  
 MSC: Analytical

83. Betty's Bakery bakes fresh bread every morning. Any bread not sold by the end of the day is thrown away. A loaf of bread costs Betty \$2.00 to produce, and she prices loaves of bread at \$3.50 per loaf. Suppose near the end of one day Betty still has 12 loaves of bread on hand. Which of the following is correct?
- Betty should only sell the remaining bread for \$3.50 per loaf since that is the regular price.
  - Betty should only sell the remaining bread for \$2.00 per loaf or more since that is what the bread costs to make.
  - Betty should be willing to sell the remaining bread for any price above \$0 per loaf since she will have to throw it away if she does not sell it for something.
  - Betty should just throw the bread away and change the price of her bread starting tomorrow to make sure she sells all of her bread each day.

ANS: C      PTS: 1      DIF: 2      REF: 1-1  
 NAT: Analytic      LOC: Marginal costs & benefits      TOP: Marginal changes  
 MSC: Analytical

84. A bagel shop sells fresh baked bagels from 5 a.m. until 7 p.m. every day. The shop does not sell day-old bagels, so all unsold bagels are thrown away at 7 p.m. each day. The cost of making and selling a dozen bagels is \$1.00; there are no costs associated with throwing bagels away. If the manager has 8 dozen bagels left at 6:30 p.m. on a particular day, which of the following alternatives is most attractive?
- Lower the price of the remaining bagels, even if the price falls below \$1.00 per dozen.
  - Lower the price of the remaining bagels, but under no circumstances should the price fall below \$1.00 per dozen.
  - Throw the bagels away and produce 8 fewer dozen bagels tomorrow.
  - Starting tomorrow, lower the price on all bagels so they will all be sold earlier in the day.

ANS: A      PTS: 1      DIF: 3      REF: 1-1  
 NAT: Analytic      LOC: Marginal costs & benefits      TOP: Marginal changes  
 MSC: Analytical

85. Rick buys a 1966 Mustang for \$3,000, planning to restore and sell the car. He goes on to spend \$9,000 restoring the car. At this point he can sell the car for \$10,000. As an alternative, he can spend an additional \$3,000 replacing the engine. With a new engine the car would sell for \$13,000. Rick should
- complete the repairs and sell the car for \$13,000.
  - sell the car now for \$10,000.
  - never try such an expensive project again.
  - be indifferent between (i) selling the car now and (ii) replacing the engine and then selling it.

ANS: D      PTS: 1      DIF: 3      REF: 1-1  
 NAT: Analytic      LOC: Marginal costs & benefits      TOP: Marginal cost  
 MSC: Analytical

86. Catherine buys and sells real estate. Two weeks ago, she paid \$300,000 for a house on Pine Street, intending to spend \$50,000 on repairs and then sell the house for \$400,000. Last week, the city government announced a plan to build a new landfill on Pine Street just down the street from the house Catherine purchased. As a result of the city's announced plan, Catherine is weighing two alternatives: She can go ahead with the \$50,000 in repairs and then sell the house for \$290,000, or she can forgo the repairs and sell the house as it is for \$250,000. She should
- keep the house and live in it.
  - go ahead with the \$50,000 in repairs and sell the house for \$290,000.
  - forgo the repairs and sell the house as it is for \$250,000.
  - move the house from Pine Street to a more desirable location, regardless of the cost of doing so.

ANS: C      PTS: 1      DIF: 3      REF: 1-1  
 NAT: Analytic      LOC: Marginal costs & benefits      TOP: Marginal cost  
 MSC: Analytical

87. You are considering staying in college another semester so that you can complete a major in economics. In deciding whether or not to stay you should
- compare the total cost of your education to the total benefits of your education.
  - compare the total cost of your education to the benefits of staying one more semester.
  - compare the cost of staying one more semester to the benefits of staying one more semester.
  - compare the total benefits of your education to the cost of staying one more semester.

ANS: C      PTS: 1      DIF: 1      REF: 1-1  
 NAT: Analytic      LOC: Marginal costs & benefits      TOP: Marginal cost  
 MSC: Applicative

88. Kyle is planning to take a roadtrip. After he makes his plans, he has to make some unexpected auto repairs. Also, he sees the price of gas has gone up. Which of these two events should Kyle consider in deciding if it is still worthwhile to go on the trip?

- the unexpected repairs and the increase in the price of gas
- the unexpected increase for repairs, but not the increase in the price of gas
- the increase in the price of gas, but not the unexpected repairs
- neither the unexpected increase in the price of gas nor the unexpected repairs

ANS: C      PTS: 1      DIF: 2      REF: 1-1  
 NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Marginal costs and benefits      MSC: Analytical

89. You have eaten two bowls of ice cream at Sundae School Ice Cream store. You consider eating a third. As a rational consumer you should make your choice by comparing
- the benefits from eating all three bowls of ice cream to how much three bowls of ice cream costs.
  - the benefits from eating all three bowls of ice cream to how much one more bowl of ice cream costs.
  - the benefits from eating one more bowl of ice cream to how much three bowls of ice cream costs.
  - the benefits from eating one more bowl of ice cream to how much one more bowl of ice cream costs.

ANS: D      PTS: 1      DIF: 2      REF: 1-1  
 NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Marginal costs and benefits      MSC: Applicative

90. Olivia was accepted to Notre Dame and another college. She is trying to decide where to go. Which of the following should she include in making her decision?
- how much she spent applying to Notre Dame, and the difference between living expenses at Notre Dame and the other college
  - how much she spent applying to Notre Dame, but not the difference between living expenses at Notre Dame and the other college
  - the difference between living expenses at Notre Dame and her second choice, but not how much she spent applying to Notre Dame
  - neither how much she spent applying to Notre Dame nor the difference between living expenses at Notre Dame and her second choice

ANS: C      PTS: 1      DIF: 2      REF: 1-1  
 NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Marginal costs and benefits      MSC: Applicative

91. You go to the movieplex where movies ordinarily cost \$10. You are intending to see a movie for which you have a \$3 off coupon good for only that movie at that time. However, when you get there you see a friend who asks if you would rather see a new release. Both movies start and end at the same time. If you decide to see the new release with your friend, what is your opportunity cost?
- the amount you value the first movie + \$3
  - the amount you value the first movie + \$10
  - \$3
  - \$10

ANS: A      PTS: 1      DIF: 3      REF: 1-1  
 NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Opportunity cost      MSC: Analytical

92. Max and Maddy charge people to park on their lawn while attending a nearby craft fair. At the current price of \$10, seven people park on their lawn. If they raise the price to \$15, they know that only five people will want to park on their lawn. Whether they have seven or five cars parked on their lawn does not affect their costs. From this information it follows that
- they should leave the price at \$10.
  - it does not matter if they charge \$10 or \$15.
  - they would do better charging \$15 than \$10.
  - they should raise the price even more.

ANS: C      PTS: 1      DIF: 2      REF: 1-1  
 NAT: Analytic      LOC: Marginal costs & benefits      TOP: Marginal costs and benefits  
 MSC: Analytical

93. Your professor loves her work, teaching economics. She has been offered other positions in the corporate world that would increase her income by 25 percent, but she has decided to continue working as a professor. Her decision would not change unless the marginal
- cost of teaching increased.
  - benefit of teaching increased.
  - cost of a corporate job increased.
  - benefit of a corporate job decreased.

ANS: A      PTS: 1      DIF: 2      REF: 1-1  
NAT: Analytic      LOC: Marginal costs & benefits      TOP: Marginal changes  
MSC: Interpretive

94. Suppose your management professor has been offered a corporate job with a 30 percent pay increase. He has decided to take the job. For him, the marginal
- cost of leaving was greater than the marginal benefit.
  - benefit of leaving was greater than the marginal cost.
  - benefit of teaching was greater than the marginal cost.
  - All of the above are correct.

ANS: B      PTS: 1      DIF: 2      REF: 1-1  
NAT: Analytic      LOC: Marginal costs & benefits      TOP: Marginal changes  
MSC: Interpretive

95. Economists are particularly adept at understanding that people respond to
- laws.
  - incentives.
  - punishments more than rewards.
  - rewards more than punishments.

ANS: B      PTS: 1      DIF: 1      REF: 1-1  
NAT: Analytic      LOC: The role of incentives      TOP: Incentives  
MSC: Interpretive

96. People are likely to respond to a policy change
- only if they think the policy is a good one.
  - only if the policy change changes the costs of their behavior.
  - only if the policy change changes the benefits of their behavior.
  - if the policy changes either the costs or benefits of their behavior.

ANS: D      PTS: 1      DIF: 1      REF: 1-1  
NAT: Analytic      LOC: The role of incentives      TOP: Incentives  
MSC: Interpretive

97. Government policies can change the costs and benefits that people face. Those policies have the potential to
- alter people's behavior.
  - alter people's decisions at the margin.
  - produce results that policymakers did not intend.
  - All of the above are correct.

ANS: D      PTS: 1      DIF: 2      REF: 1-1  
NAT: Analytic      LOC: The role of incentives      TOP: Incentives  
MSC: Interpretive

98. Ralph Nader's book *Unsafe at Any Speed* caused Congress to require

- a. safety glass in all new cars.
- b. seat belts in all new cars.
- c. air bags in all new cars.
- d. stricter drunk driving laws in all states.

ANS: B                      PTS: 1                      DIF: 1                      REF: 1-1  
NAT: Analytic              LOC: The role of incentives                      TOP: Incentives  
MSC: Interpretive

99. Following the implementation of laws requiring automobiles to have seat belts, which of the following occurred?

- a. An individual's probability of surviving an auto accident rose.
- b. There was an increase in pedestrian deaths.
- c. There was an increase in automobile accidents.
- d. All of the above are correct.

ANS: D                      PTS: 1                      DIF: 2                      REF: 1-1  
NAT: Analytic              LOC: The role of incentives                      TOP: Incentives  
MSC: Interpretive

100. U.S. laws requiring that drivers wear seat belts have resulted in

- a. a reduction in both driver deaths and pedestrian deaths.
- b. fewer accidents and fewer deaths per accident.
- c. fewer driver deaths, fewer accidents and fewer pedestrian deaths.
- d. little change in the number of driver deaths, but more accidents and more pedestrian deaths.

ANS: D                      PTS: 1                      DIF: 2                      REF: 1-1  
NAT: Analytic              LOC: The role of incentives                      TOP: Incentives  
MSC: Interpretive

101. Evidence indicates that seat belt laws have led to

- a. fewer pedestrian deaths.
- b. fewer automobile accidents.
- c. fewer deaths per automobile accident.
- d. All of the above are correct.

ANS: C                      PTS: 1                      DIF: 1                      REF: 1-1  
NAT: Analytic              LOC: The role of incentives                      TOP: Incentives  
MSC: Definitional

102. One effect of the government-imposed seat belt law in the U.S. has been

- a. a dramatic decrease in the number of pedestrian deaths.
- b. safer driving.
- c. an increase in the number of accidents.
- d. a dramatic decrease in the number of driver deaths.

ANS: C                      PTS: 1                      DIF: 2                      REF: 1-1  
NAT: Analytic              LOC: The role of incentives                      TOP: Incentives  
MSC: Interpretive

103. Based on the available evidence, which of the following groups benefits most from mandatory seat belt laws?

- a. automakers
- b. pedestrians
- c. drivers
- d. owners of collision-repair shops

ANS: D                      PTS: 1                      DIF: 3                      REF: 1-1  
NAT: Analytic              LOC: The role of incentives                      TOP: Incentives  
MSC: Analytical



104. Which of the following can policy do?

- a. alter incentives
- b. alter trade-offs
- c. change opportunity costs
- d. All of the above are correct.

ANS: D PTS: 1 DIF: 1 REF: 1-1  
 NAT: Analytic LOC: The role of incentives | Scarcity, tradeoffs, and opportunity cost  
 TOP: Opportunity cost | Tradeoffs | Incentives MSC: Interpretive

105. Suppose the state of Massachusetts passes a law that increases the tax on alcoholic beverages. As a result, residents in Massachusetts start purchasing their alcohol in surrounding states. Which of the following principles does this best illustrate?

- a. People respond to incentives
- b. Rational people think at the margin
- c. Trade can make everyone better off
- d. Markets are usually a good way to organize economic activity

ANS: A PTS: 1 DIF: 1 REF: 1-1  
 NAT: Analytic LOC: The role of incentives TOP: Incentives  
 MSC: Applicative

106. Suppose the state of Illinois passes a law that bans smoking in restaurants. As a result, residents of Wisconsin who do not like breathing second-hand smoke begin driving across the border to Illinois to eat at restaurants there. Which of the following principles does this best illustrate?

- a. People respond to incentives
- b. Rational people think at the margin
- c. Trade can make everyone better off
- d. Markets are usually a good way to organize economic activity

ANS: A PTS: 1 DIF: 1 REF: 1-1  
 NAT: Analytic LOC: The role of incentives TOP: Incentives  
 MSC: Applicative

107. In the former Soviet Union, producers were paid for meeting output targets, not for selling products. Under those circumstances, what were the economic incentives for producers?

- a. to produce good quality products so that society would benefit from the resources used
- b. to conserve on costs, so as to maintain efficiency in the economy
- c. to produce enough to meet the output target, without regard for quality or cost
- d. to produce those products that society desires most

ANS: C PTS: 1 DIF: 2 REF: 1-1  
 NAT: Analytic LOC: The role of incentives TOP: Incentives  
 MSC: Interpretive

108. Which of the following principles is *not* one of the four principles of *individual* decisionmaking?

- a. People face tradeoffs.
- b. Trade can make everyone better off.
- c. People respond to incentives.
- d. Rational people think at the margin.

ANS: B PTS: 1 DIF: 1 REF: 1-1  
 NAT: Analytic  
 LOC: Scarcity, tradeoffs, and opportunity cost | Marginal costs & benefits | The role of incentives  
 TOP: Tradeoffs | Trade | Marginal changes MSC: Definitional

109. Which of the following statements exemplifies a principle of individual decisionmaking?

- a. Trade can make everyone better off.
- b. Governments can sometimes improve market outcomes.
- c. The cost of something is what you give up to get it.
- d. All of the above are correct.

ANS: C      PTS: 1      DIF: 2      REF: 1-1  
 NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Opportunity cost      MSC: Interpretive

110. According to a recent study of Chilean bus drivers, drivers who are paid by the number of passengers they transport have higher productivity than drivers who are paid by the hour. This result is an example of which principle of economics?

- a. People face tradeoffs.
- b. The cost of something is what you give up to get it.
- c. Rational people think at the margin.
- d. People respond to incentives.

ANS: D      PTS: 1      DIF: 2      REF: 1-1  
 NAT: Analytic      LOC: The role of incentives      TOP: Incentives  
 MSC: Interpretive

111. Which of the following is *not* an example of a group responding to an incentive?

- a. Students attend class because of an attendance policy that reduces their grade for absences.
- b. Consumers buy more of a product when it is on sale at a reduced price.
- c. Universities offer fewer online classes when they generate more revenue than traditional classes.
- d. Employees work harder to earn higher commissions.

ANS: C      PTS: 1      DIF: 2      REF: 1-1  
 NAT: Analytic      LOC: The role of incentives      TOP: Incentives  
 MSC: Applicative

## HOW PEOPLE INTERACT

1. Which of the following is a principle concerning how people interact?

- a. Markets are usually a good way to organize economic activity.
- b. Rational people think at the margin.
- c. People respond to incentives.
- d. All of the above are correct.

ANS: A      PTS: 1      DIF: 2      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Markets      MSC: Interpretive

2. Which is the most accurate statement about trade?

- a. Trade can make every nation better off.
- b. Trade makes some nations better off and others worse off.
- c. Trading for a good can make a nation better off only if the nation cannot produce that good itself.
- d. Trade helps rich nations and hurts poor nations.

ANS: A      PTS: 1      DIF: 2      REF: 1-2  
 NAT: Analytic      LOC: Gains from trade, specialization and trade  
 TOP: Trade      MSC: Interpretive

3. The principle that "trade can make everyone better off" applies to interactions and trade between
- families.
  - states within the United States.
  - nations.
  - All of the above are correct.

ANS: D      PTS: 1      DIF: 1      REF: 1-2  
 NAT: Analytic      LOC: Gains from trade, specialization and trade  
 TOP: Trade      MSC: Applicative

4. The principle that trade can make everyone better off applies to
- individuals.
  - families.
  - countries.
  - All of the above

ANS: D      PTS: 1      DIF: 1      REF: 1-2  
 NAT: Analytic      LOC: Gains from trade, specialization and trade  
 TOP: Gains from trade      MSC: Interpretive

5. Which of the following statements about trade is false?
- Trade increases competition.
  - With trade, one country wins and one country loses.
  - Bulgaria can benefit, potentially, from trade with any other country.
  - Trade allows people to buy a greater variety of goods and services at lower cost.

ANS: B      PTS: 1      DIF: 2      REF: 1-2  
 NAT: Analytic      LOC: Gains from trade, specialization and trade  
 TOP: Trade      MSC: Interpretive

6. Trade between the United States and India
- benefits both the United States and India.
  - is a losing proposition for the United States because India has cheaper labor.
  - is a losing proposition for India because capital is much more abundant in the U.S. than in India.
  - is a losing proposition for India because U.S. workers are more productive.

ANS: A      PTS: 1      DIF: 2      REF: 1-2  
 NAT: Analytic      LOC: Gains from trade, specialization and trade  
 TOP: Trade      MSC: Interpretive

7. England can benefit from trade
- only with nations that can produce goods England cannot produce.
  - only with less developed nations.
  - only with nations outside of Europe.
  - with any nation.

ANS: D      PTS: 1      DIF: 2      REF: 1-2  
 NAT: Analytic      LOC: Gains from trade, specialization and trade  
 TOP: Trade      MSC: Interpretive

8. If Germany chooses to engage in trade, it
- will only benefit if it trades with countries that produce goods Germany cannot produce.
  - cannot benefit if it trades with less developed countries.
  - should first attempt to produce the good itself.
  - can benefit by trading with any other country.

ANS: D      PTS: 1      DIF: 2      REF: 1-2  
 NAT: Analytic      LOC: Gains from trade, specialization and trade  
 TOP: Trade      MSC: Interpretive

9. If the United States decides to trade with Mexico, we know that
- Mexico will benefit, but trade with a less developed country could not benefit the United States.
  - it will not benefit Mexico because workers in the United States are more productive.
  - Mexico and the United States can both benefit.
  - it will not benefit either country because their cultural differences are too vast.

ANS: C      PTS: 1      DIF: 2      REF: 1-2  
 NAT: Analytic      LOC: Gains from trade, specialization and trade  
 TOP: Trade      MSC: Interpretive

10. Kevin is the CEO of a large firm and a homeowner who pays a landscaper to maintain his lawn rather than do it himself. Kevin has determined that he can earn more in the hour it would take him to work on his lawn than he must pay his landscaper. This scenario is an example of which principle of economics?

- Trade can make everyone better off.
- Markets are usually a good way to organize economic activity.
- Governments can sometimes improve market outcomes.
- Prices rise when the government prints too much money.

ANS: A      PTS: 1      DIF: 2      REF: 1-2  
 NAT: Analytic      LOC: Gains from trade, specialization and trade  
 TOP: Trade      MSC: Applicative

11. Brenda is an excellent baker and Floyd has a plentiful farm. If Floyd trades eggs and butter to Brenda for some of Brenda's bread and pastries,

- only Floyd is made better off by trade.
- only Brenda is made better off by trade.
- both Floyd and Brenda are made better off by trade.
- neither Floyd nor Brenda are made better off by trade.

ANS: C      PTS: 1      DIF: 1      REF: 1-2  
 NAT: Analytic      LOC: Gains from trade, specialization and trade  
 TOP: Trade      MSC: Interpretive

12. Penny is piano teacher and Dan is a tile layer. If Penny teaches Dan's daughter to play the piano in exchange for Dan tiling her kitchen floor,

- only Penny is made better off by trade.
- only Dan is made better off by trade.
- both Penny and Dan are made better off by trade.
- neither Penny nor Dan are made better off by trade.

ANS: C      PTS: 1      DIF: 1      REF: 1-2  
 NAT: Analytic      LOC: Gains from trade, specialization and trade  
 TOP: Trade      MSC: Interpretive

13. Senator Bright, who understands economic principles, is trying to convince workers in her district that trade with other countries is beneficial. Senator Bright should argue that trade can be beneficial

- only if it allows us to obtain things that we couldn't make for ourselves.
- because it allows specialization, which increases total output.
- to us if we can gain and the others involved in the trade lose.
- in only a limited number of circumstances because others are typically self-interested.

ANS: B      PTS: 1      DIF: 2      REF: 1-2  
 NAT: Analytic      LOC: Gains from trade, specialization and trade  
 TOP: Trade      MSC: Interpretive

14. Suppose that a country that has a high level of output per person agrees to trade with a country that has a low level of output per person. Which country can benefit?
- only the one with a low level of output per person.
  - only the one with a high level of output per person.
  - both
  - neither

ANS: C      PTS: 1      DIF: 1      REF: 1-2  
 NAT: Analytic      LOC: Gains from trade, specialization and trade  
 TOP: Trade      MSC: Interpretive

15. Suppose that a country that has a high average wage level agrees to trade with a country that has a low average wage level. Which country can benefit?
- only the one with a low level of output per person.
  - only the one with a high level of output per person.
  - both
  - neither

ANS: C      PTS: 1      DIF: 1      REF: 1-2  
 NAT: Analytic      LOC: Gains from trade, specialization and trade  
 TOP: Trade      MSC: Interpretive

16. Suppose Country A has a high average wage level and a high level of output per person, while Country B has a low average wage level and a low level of output per person. Which country can benefit from trade?
- Only Country A can benefit.
  - Only Country B can benefit.
  - Both Country A and Country B can benefit.
  - Neither Country A nor Country B can benefit.

ANS: C      PTS: 1      DIF: 1      REF: 1-2  
 NAT: Analytic      LOC: Gains from trade, specialization and trade  
 TOP: Trade      MSC: Interpretive

17. Trade between countries tends to
- reduce both competition and specialization.
  - reduce competition and increase specialization.
  - increase competition and reduce specialization.
  - increase both competition and specialization.

ANS: D      PTS: 1      DIF: 2      REF: 1-2  
 NAT: Analytic      LOC: Gains from trade, specialization and trade  
 TOP: Trade      MSC: Definitional

18. Trade
- allows specialization, which increases costs.
  - allows specialization, which reduces costs.
  - reduces specialization, which increases costs.
  - reduces specialization, which reduces costs.

ANS: B      PTS: 1      DIF: 1      REF: 1-2  
 NAT: Analytic      LOC: Gains from trade, specialization and trade  
 TOP: Gains from trade      MSC: Interpretive

19. Trade makes costs

- a. higher and reduces the variety of goods and services available.
- b. higher but raises the variety of goods and services available.
- c. lower but reduces the variety of goods and services available.
- d. lower and raises the variety of goods and services available.

ANS: D      PTS: 1      DIF: 1      REF: 1-2  
 NAT: Analytic      LOC: Gains from trade, specialization and trade  
 TOP: Gains from trade      MSC: Interpretive

20. When the France trades with Russia,

- a. both countries are likely made better off.
- b. only Russia benefits since France can produce all goods at a higher level of quality than Russia.
- c. only France benefits since Russia's low wages guarantee profitable firms in Russia regardless of trade.
- d. neither country will benefit since France is more efficient than Russia at producing all goods.

ANS: A      PTS: 1      DIF: 2      REF: 1-2  
 NAT: Analytic      LOC: Gains from trade, specialization and trade  
 TOP: Gains from trade      MSC: Applicative

21. Benefits from trade would *not* include

- a. the ability of people and nations to specialize.
- b. a greater variety of goods and services becoming available.
- c. less competition.
- d. lower prices.

ANS: C      PTS: 1      DIF: 2      REF: 1-2  
 NAT: Analytic      LOC: Gains from trade, specialization and trade  
 TOP: Trade      MSC: Interpretive

22. Central planning refers to

- a. markets guiding economic activity. Today many countries that had this system have abandoned it.
- b. markets guiding economic activity. Today many countries that did not have this system have implemented it.
- c. government guiding economic activity. Today many countries that had this system have abandoned it.
- d. government guiding economic activity. Today many countries that did not have this system have implemented it.

ANS: C      PTS: 1      DIF: 1      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Markets      MSC: Definitional

23. In communism, central planners decide which of the following?

- a. what goods and services will be produced
- b. how much will be produced
- c. who produced and consumed the goods and services
- d. All of the above are correct.

ANS: D      PTS: 1      DIF: 1      REF: 1-2  
 NAT: Analytic      LOC: The role of government TOP: Communism  
 MSC: Definitional

24. One advantage market economies have over centrally-planned economies is that market economies
- provide an equal distribution of goods and services to households.
  - establish a significant role for government in the allocation of resources.
  - solve the problem of scarcity.
  - are more efficient.

ANS: D      PTS: 1      DIF: 2      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Market economies      MSC: Interpretive

25. The basic principles of economics suggest that
- markets are seldom, if ever, a good way to organize economic activity.
  - government should become involved in markets when trade between countries is involved.
  - government should become involved in markets when those markets fail to produce efficient or fair outcomes.
  - All of the above are correct.

ANS: C      PTS: 1      DIF: 1      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities | The role of government  
 TOP: Markets | Government | Trade      MSC: Interpretive

26. Which of the following statements best characterizes a basic difference between market economies and centrally-planned economies?
- Society relies more upon prices to allocate resources when the economy is centrally-planned than when it is market-based.
  - The self-interest of households is reflected more fully in the outcome of a centrally-planned economy than in the outcome of a market economy.
  - Government plays a larger role in the economic affairs of a market economy than in the economic affairs of a centrally-planned economy.
  - None of the above are correct.

ANS: D      PTS: 1      DIF: 2      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Market economies      MSC: Interpretive

27. Market economies are distinguished from other types of economies largely on the basis of
- the political affiliations of government officials.
  - the process by which government officials are elected or appointed.
  - the ways in which scarce resources are allocated.
  - the number of retail outlets available to consumers.

ANS: C      PTS: 1      DIF: 2      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Market economies      MSC: Interpretive

28. The collapse of communism in the Soviet Union and Eastern Europe took place mainly in the
- 1960s.
  - 1970s.
  - 1980s.
  - 1990s.

ANS: C      PTS: 1      DIF: 1      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Communism      MSC: Definitional

29. The economy of the former Soviet Union is best described as a

- a. primitive economy.
- b. market economy.
- c. hybrid economy.
- d. centrally-planned economy.

ANS: D      PTS: 1      DIF: 1      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Market economies      MSC: Definitional

30. Communist countries worked under the premise that

- a. markets were the best way to organize economic activity.
- b. central planners were in the best position to determine the allocation of scarce resources in the economy.
- c. households and firms, guided by an “invisible hand,” could achieve the most efficient allocation of scarce resources.
- d. allowing the market forces of supply and demand to operate with no government intervention would achieve the most efficient allocation of scarce resources.

ANS: B      PTS: 1      DIF: 2      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Markets      MSC: Interpretive

31. Prior to the collapse of communism, communist countries worked on the premise that economic well-being could be best attained by

- a. a market economy.
- b. a strong reliance on prices and individuals’ self-interests.
- c. a system of large privately-owned firms.
- d. the actions of government central planners.

ANS: D      PTS: 1      DIF: 2      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Communism      MSC: Interpretive

32. The idea that only the government can organize economic activity in a way that promotes economic well-being for a country as a whole

- a. is a basic principle regarding individual decisionmaking.
- b. amounts to a denial of one of the basic principles regarding interactions among people.
- c. supports the idea that the “invisible hand” should guide economic activity.
- d. was promoted by the economist Adam Smith in a well-known 1776 book.

ANS: B      PTS: 1      DIF: 2      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Markets      MSC: Interpretive

33. Which of the following statements about markets is most accurate?

- a. Markets are usually a good way to organize economic activity.
- b. Markets are usually inferior to central planning as a way to organize economic activity.
- c. Markets fail and are therefore not an acceptable way to organize economic activity.
- d. Markets are a good way to organize economic activity in developed nations, but not in less developed nations.

ANS: A      PTS: 1      DIF: 1      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Markets      MSC: Interpretive



34. Which of the following observations was made famous by Adam Smith in his book *The Wealth of Nations*?

- a. There is no such thing as a free lunch.
- b. People buy more when prices are low than when prices are high.
- c. No matter how much people earn, they tend to spend more than they earn.
- d. Households and firms interacting in markets are guided by an "invisible hand" that leads them to desirable market outcomes.

ANS: D      PTS: 1      DIF: 1      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Invisible hand      MSC: Definitional

35. The term "invisible hand" was coined by

- a. Adam Smith.
- b. David Ricardo.
- c. Karl Marx.
- d. Benjamin Franklin.

ANS: A      PTS: 1      DIF: 1      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Invisible hand      MSC: Definitional

36. The famous observation that households and firms interacting in markets act as if they are guided by an "invisible hand" that leads them to desirable market outcomes comes from whose 1776 book?

- a. David Ricardo
- b. Thorstein Veblen
- c. John Maynard Keynes
- d. Adam Smith

ANS: D      PTS: 1      DIF: 1      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Markets      MSC: Interpretive

37. Adam Smith's book *The Wealth of Nations* was published in

- a. 1692.
- b. 1776.
- c. 1816.
- d. 1936.

ANS: B      PTS: 1      DIF: 1      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Invisible hand      MSC: Definitional

38. Both *The Wealth of Nations* and the Declaration of Independence share the point of view that

- a. every person is entitled to life, liberty, and the pursuit of happiness.
- b. individuals are best left to their own devices without the government guiding their actions.
- c. the government plays a central role in organizing a market economy.
- d. because of human nature a strong legal system is necessary for a market system to survive.

ANS: B      PTS: 1      DIF: 2      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Invisible hand      MSC: Interpretive

39. The "invisible hand" directs economic activity through

- a. advertising.
- b. prices.
- c. central planning.
- d. government regulations.

ANS: B      PTS: 1      DIF: 2      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Invisible hand      MSC: Interpretive

40. The invisible hand refers to

- a. how central planners made economic decisions.
- b. how the decisions of households and firms lead to desirable market outcomes.
- c. the control that large firms have over the economy.
- d. government regulations without which the economy would be less efficient.

ANS: B                      PTS: 1                      DIF: 1                      REF: 1-2  
 NAT: Analytic            LOC: Markets, market failure, and externalities  
 TOP: Invisible hand                      MSC: Definitional

41. The invisible hand's ability to coordinate the decisions of the firms and households in the economy can be hindered by

- a. government actions that distort prices.
- b. increased competition in markets.
- c. enforcement of property rights.
- d. too much attention paid to efficiency.

ANS: A                      PTS: 1                      DIF: 2                      REF: 1-2  
 NAT: Analytic            LOC: Markets, market failure, and externalities  
 TOP: Invisible hand                      MSC: Interpretive

42. When the "invisible hand" guides economic activity, prices of products reflect

- a. only the values that society places on those products.
- b. only the costs to society of producing those products.
- c. both the values that society places on those products and the costs to society of producing those products.
- d. none of the above; when the "invisible hand" guides economic activity, prices of products are set by the government in a manner that is thought to be "fair."

ANS: C                      PTS: 1                      DIF: 2                      REF: 1-2  
 NAT: Analytic            LOC: Markets, market failure, and externalities  
 TOP: Invisible hand | Markets                      MSC: Interpretive

43. The invisible hand works to promote general well-being in the economy primarily through

- a. government intervention.
- b. the political process.
- c. people's pursuit of self-interest.
- d. altruism.

ANS: C                      PTS: 1                      DIF: 1                      REF: 1-2  
 NAT: Analytic            LOC: Markets, market failure, and externalities  
 TOP: Invisible hand                      MSC: Interpretive

44. According to Adam Smith, the success of decentralized market economies is primarily due to

- a. the basic benevolence of society.
- b. society's legal system.
- c. individuals' pursuit of self-interest.
- d. partnerships that are forged between business and government.

ANS: C                      PTS: 1                      DIF: 2                      REF: 1-2  
 NAT: Analytic            LOC: Markets, market failure, and externalities  
 TOP: Invisible hand                      MSC: Interpretive

45. The self-interest of the participants in an economy is guided into promoting general economic self-interest by

- a. the invisible hand.
- b. market power.
- c. government intervention.
- d. *oikonomos*.

ANS: A                      PTS: 1                      DIF: 1                      REF: 1-2  
 NAT: Analytic            LOC: Markets, market failure, and externalities  
 TOP: Invisible hand                      MSC: Interpretive

46. In an economy in which decisions are guided by prices and individual self-interest, there is
- the potential to achieve efficiency in production.
  - a strong need for government intervention in the market.
  - less efficiency than would be observed in a centrally-planned economy.
  - more need for a strong legal system to control individual greed than would be needed in a centrally-planned economy.

ANS: A      PTS: 1      DIF: 2      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Market economies      MSC: Interpretive

47. In a market economy, who makes the decisions that guide most economic activity?
- firms only
  - households only
  - firms and households
  - government

ANS: C      PTS: 1      DIF: 1      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Markets      MSC: Definitional

48. In a market economy, economic activity is guided by
- the government.
  - corporations.
  - central planners.
  - self-interest and prices.

ANS: D      PTS: 1      DIF: 1      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Market economies      MSC: Definitional

49. In a market economy,
- households decide which firms to work for and what to buy with their incomes.
  - firms decide whom to hire and what to make.
  - a central planner makes decisions about production and consumption.
  - Both a and b are correct.

ANS: D      PTS: 1      DIF: 1      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Markets      MSC: Definitional

50. Which of the following statements does *not* apply to a market economy?
- Firms decide whom to hire and what to produce.
  - The “invisible hand” usually maximizes the well-being of society as a whole.
  - Households decide which firms to work for and what to buy with their incomes.
  - Government policies are the primary forces that guide the decisions of firms and households.

ANS: D      PTS: 1      DIF: 2      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Market economies      MSC: Interpretive

51. The decisions of firms and households are guided by prices and self-interest in a
- command economy.
  - centrally-planned economy.
  - market economy.
  - All of the above are correct.

ANS: C      PTS: 1      DIF: 1      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Market economies      MSC: Definitional

52. For markets to work well, there must be

- a. market power.
- b. a central planner.
- c. property rights.
- d. abundant, not scarce, resources.

ANS: C      PTS: 1      DIF: 2      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Markets | Property rights      MSC: Interpretive

53. Prices usually reflect

- a. only the value of a good to society.
- b. only the cost to society of making a good.
- c. both the value of a good to society and the cost to society of making the good.
- d. neither the value of a good to society nor the cost to society of making the good.

ANS: C      PTS: 1      DIF: 1      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Markets      MSC: Definitional

54. Prices direct economic activity in a market economy by

- a. influencing the actions of buyers and sellers.
- b. reducing scarcity of the goods and services produced.
- c. eliminating the need for government intervention.
- d. allocating goods and services in the most equitable way.

ANS: A      PTS: 1      DIF: 2      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Market economies      MSC: Interpretive

55. A friend of yours asks you why market prices are better than government-determined prices. Because you understand economic principles, you say that market-determined prices are better because they generally reflect

- a. the value of a good to society, but not the cost of making it.
- b. the cost of making a good to society, but not its value.
- c. both the value of a good to society and the cost of making it.
- d. neither the value of a good to society nor the cost of making it.

ANS: C      PTS: 1      DIF: 2      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Markets | Prices      MSC: Interpretive

56. If the price of visiting a doctor were fixed below the current price, then we would expect

- a. an increase in the number of visits people want to make and an increase in the number of visits health care providers want to provide.
- b. an increase in the number of visits people want to make and a decrease in the number of visits health care providers want to provide.
- c. a decrease in the number of visits people want to make and an increase in the number of visits health care providers want to provide.
- d. a decrease in the number of visits people want to make and a decrease in the number of visits health care providers want to provide.

ANS: B      PTS: 1      DIF: 2      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Markets      MSC: Applicative

57. If the rent for apartments in New York City were fixed below the current price, then we would expect
- an increase in the number of people wanting to rent apartments in New York City.
  - a decrease in the number of people wanting to rent apartments in New York City.
  - an increase in the number of apartments available for rent in New York City.
  - None of the above is correct.

ANS: A      PTS: 1      DIF: 1      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Markets      MSC: Applicative

58. If the price of a dozen eggs were fixed above the current price, then we would expect
- an increase in the number of eggs people want to buy and an increase in the number of eggs farmers want to sell.
  - an increase in the number of eggs people want to buy and a decrease in the number of eggs farmers want to sell.
  - a decrease in the number of eggs people want to buy and an increase in the number of eggs farmers want to sell.
  - a decrease in the number of eggs people want to buy and a decrease in the number of eggs farmers want to sell.

ANS: C      PTS: 1      DIF: 2      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Markets      MSC: Applicative

59. If the wage for unskilled labor were fixed above the current wage, then we would expect
- an increase in the number of unskilled jobs available.
  - a decrease in the number of unskilled jobs available.
  - a decrease in the number of workers wanting unskilled jobs.
  - None of the above is correct.

ANS: B      PTS: 1      DIF: 2      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Markets      MSC: Applicative

60. When the government prevents prices from adjusting naturally to supply and demand,
- it equates the amount buyers want to buy with the amount sellers want to sell.
  - it adversely affects the allocation of resources.
  - it improves equality and efficiency.
  - it improves efficiency but reduces equality.

ANS: B      PTS: 1      DIF: 2      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities | The role of government  
 TOP: Prices | Government      MSC: Applicative

61. One reason we need government, even in a market economy, is that
- there is insufficient market power in the absence of government.
  - property rights are too strong in the absence of government.
  - the invisible hand is not perfect.
  - Both a and b are correct.

ANS: C      PTS: 1      DIF: 2      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities | The role of government  
 TOP: Market economies | Government      MSC: Interpretive

62. The government enforces property rights by
- requiring property owners to pay property taxes.
  - providing police and courts.
  - forcing people to own property.
  - providing public parks and recreation facilities.

ANS: B PTS: 1 DIF: 2 REF: 1-2  
 NAT: Analytic LOC: The role of government TOP: Government | Property rights  
 MSC: Interpretive

63. A company that formerly produced software went out of business because too many potential customers bought illegally-produced copies of the software instead of buying the product directly from the company. This instance serves as an example of
- market power.
  - inefficient trade.
  - inadequate enforcement of property rights.
  - the invisible hand at work.

ANS: C PTS: 1 DIF: 2 REF: 1-2  
 NAT: Analytic LOC: The role of government TOP: Property rights  
 MSC: Interpretive

64. For which of the following problems can well-designed public policy enhance economic efficiency?
- both externalities and market power
  - externalities, but not market power
  - market power, but not externalities
  - neither externalities nor market power

ANS: A PTS: 1 DIF: 2 REF: 1-2  
 NAT: Analytic LOC: Markets, market failure, and externalities  
 TOP: Public policy | Market failure MSC: Interpretive

65. Public policies
- may be able to improve either economic efficiency or equality.
  - may be able to improve economic efficiency but cannot improve equality.
  - may be able to improve equality but cannot improve economic efficiency.
  - cannot improve either equality or economic efficiency.

ANS: A PTS: 1 DIF: 2 REF: 1-2  
 NAT: Analytic LOC: Efficiency and equity  
 TOP: Public policy | Efficiency | Equality MSC: Interpretive

66. To say that government intervenes in the economy to promote efficiency is to say that government is attempting to
- create a more fair distribution of income.
  - change the way in which the economic pie is divided.
  - enlarge the economic pie.
  - All of the above are correct.

ANS: C PTS: 1 DIF: 2 REF: 1-2  
 NAT: Analytic LOC: The role of government TOP: Efficiency | Government  
 MSC: Interpretive

67. Which of the following could reduce economic efficiency?
- laws that encourage lawsuits
  - policies that redistribute income
  - policies that impose significant restrictions on international trade
  - All of the above are correct

ANS: D PTS: 1 DIF: 1 REF: 1-2  
 NAT: Analytic LOC: Efficiency and equity TOP: Efficiency  
 MSC: Applicative

68. The term used to describe a situation in which markets do not allocate resources efficiently is
- economic meltdown.
  - market failure.
  - equilibrium.
  - the effect of the invisible hand.

ANS: B PTS: 1 DIF: 1 REF: 1-2  
 NAT: Analytic LOC: Markets, market failure, and externalities  
 TOP: Market failure MSC: Definitional

69. A rationale for government involvement in a market economy is
- markets sometimes fail to produce a fair distribution of economic well-being.
  - markets sometimes fail to produce an efficient allocation of resources.
  - property rights have to be enforced.
  - All of the above are correct.

ANS: D PTS: 1 DIF: 1 REF: 1-2  
 NAT: Analytic LOC: The role of government TOP: Government | Markets  
 MSC: Interpretive

70. The term market failure refers to
- a situation in which the market on its own fails to allocate resources efficiently.
  - an unsuccessful advertising campaign which reduces demand for a product.
  - a situation in which competition among firms becomes ruthless.
  - a firm which is forced out of business because of losses.

ANS: A PTS: 1 DIF: 2 REF: 1-2  
 NAT: Analytic LOC: Markets, market failure, and externalities  
 TOP: Market failure MSC: Definitional

71. Which of the following is *not* generally regarded by economists as a legitimate reason for the government to intervene in a market?
- to promote efficiency
  - to promote equality
  - to enforce property rights
  - to protect an industry from foreign competition

ANS: D PTS: 1 DIF: 2 REF: 1-2  
 NAT: Analytic LOC: The role of government TOP: Government | Markets  
 MSC: Interpretive

72. Which of the following can lead to market failure?
- externalities and market power
  - externalities but not market power
  - market power but not externalities
  - neither externalities nor market power

ANS: A PTS: 1 DIF: 1 REF: 1-2  
 NAT: Analytic LOC: Markets, market failure, and externalities  
 TOP: Externalities | Market power MSC: Definitional

73. Causes of market failure include
- externalities and market power.
  - market power and incorrect forecasts of consumer demand.
  - externalities and foreign competition.
  - incorrect forecasts of consumer demand and foreign competition.

ANS: A PTS: 1 DIF: 2 REF: 1-2  
 NAT: Analytic LOC: Markets, market failure, and externalities  
 TOP: Market failure MSC: Interpretive

74. Market failure can be caused by

- a. low consumer demand.
- b. equilibrium prices.
- c. externalities and market power.
- d. high prices and foreign competition.

ANS: C      PTS: 1      DIF: 2      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Market failure      MSC: Interpretive

75. Thousands of people develop lung cancer from second-hand exposure to cigarette smoke. This is an example of

- a. a market failure caused by an externality.
- b. a market failure caused by market power.
- c. a market failure caused by equality.
- d. There is no market failure in this case.

ANS: A      PTS: 1      DIF: 2      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Market failure      MSC: Applicative

76. When a species of fish dies off due to pollution in a river where it once lived, this is an example of

- a. a market failure caused by an externality.
- b. a market failure caused by market power.
- c. a market failure caused by equality.
- d. There is no market failure in this case.

ANS: A      PTS: 1      DIF: 2      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Market failure      MSC: Applicative

77. The term "market failure"

- a. means the same thing as "market power."
- b. refers to the dissolution of a market when firms decide to quit producing a certain product.
- c. refers to the failure of a market to produce an efficient allocation of resources.
- d. refers to government's failure to enforce the property rights of households or firms that participate in a certain market.

ANS: C      PTS: 1      DIF: 2      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Market failure      MSC: Interpretive

78. If an externality is present in a market, economic efficiency may be enhanced by

- a. government intervention.
- b. a decrease in foreign competition.
- c. fewer market participants.
- d. weaker property rights.

ANS: A      PTS: 1      DIF: 2      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Externalities | Efficiency      MSC: Interpretive

79. An example of an externality is the impact of

- a. bad weather on the income of farmers.
- b. the personal income tax on a person's ability to purchase goods and services.
- c. pollution from a factory on the health of people in the vicinity of the factory.
- d. increases in health care costs on the health of individuals in society.

ANS: C      PTS: 1      DIF: 2      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Externalities      MSC: Interpretive



80. Which of the following is an example of an externality?

- a. Annie purchases a handbag.
- b. Bob's dog barks loudly during the night waking his neighbors.
- c. Clark sells a book to Calvin.
- d. David watches a scary movie.

ANS: B      PTS: 1      DIF: 2      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Externalities      MSC: Interpretive

81. The willingness of citizens to pay for vaccinations does not include the benefit society receives from having vaccinated citizens who cannot transmit an illness to others. This extra benefit society gets from vaccinating its citizens is known as

- a. productivity.
- b. an externality.
- c. market power.
- d. property rights.

ANS: B      PTS: 1      DIF: 2      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Externalities      MSC: Applicative

82. If a paper factory does *not* bear the entire cost of the pollution it emits, it will

- a. not emit any pollution so as to avoid the entire cost of the pollution.
- b. emit lower levels of pollution.
- c. emit an acceptable level of pollution.
- d. emit too much pollution.

ANS: D      PTS: 1      DIF: 2      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Externalities      MSC: Interpretive

83. Laws that restrict the smoking of cigarettes in public places are examples of government intervention that is intended to reduce

- a. efficiency.
- b. equality.
- c. externalities.
- d. productivity.

ANS: C      PTS: 1      DIF: 2      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Externalities | Government      MSC: Applicative

84. Which of these activities will most likely impose an external cost?

- a. An athlete works out at a gym.
- b. A secretary smokes a cigarette in a crowded break room.
- c. A young mother pushes her baby in a stroller.
- d. A construction worker eats a hotdog during his lunch break.

ANS: B      PTS: 1      DIF: 2      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Externalities      MSC: Interpretive

85. Which of these activities will most likely impose an external cost?

- a. Betty plants flowers in her garden.
- b. Bonnie gets a flu vaccine.
- c. Bridget drives her car after having too much alcohol to drink.
- d. Becky buys a new flat screen television.

ANS: C      PTS: 1      DIF: 1      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Externalities      MSC: Interpretive

86. Which of these activities will most likely result in an external benefit?

- a. A college student buys a deck of cards to play solitaire in her dorm room.
- b. An elderly woman plants a flower garden on the vacant lot next to her house.
- c. An executive purchases a book to read on a business trip.
- d. A ten-year-old uses his allowance to buy new Nike shoes.

ANS: B      PTS: 1      DIF: 2      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Externalities      MSC: Interpretive

87. Which of these activities will most likely result in an external benefit?

- a. Jake purchases a dilapidated house and cleans up the yard and exterior of the house.
- b. John purchases an iPhone and downloads new apps.
- c. Jack purchases a new SUV and drives it to work every day.
- d. Joe purchases a suit and wears it on his interviews.

ANS: A      PTS: 1      DIF: 2      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Externalities      MSC: Interpretive

88. When a single person (or small group) has the ability to influence market prices, there is

- a. competition.
- b. market power.
- c. an externality.
- d. a lack of property rights.

ANS: B      PTS: 1      DIF: 1      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Market power      MSC: Definitional

89. Market power refers to the

- a. power of a single person or small group to influence market prices.
- b. ability of a person or small group to successfully market new products.
- c. power of the government to regulate a market.
- d. importance of a certain market in relation to the overall economy.

ANS: A      PTS: 1      DIF: 1      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Market power      MSC: Definitional

90. Which of the following firms is likely to have the greatest market power?

- a. an electric company
- b. a farmer
- c. a grocery store
- d. a local electronics retailer

ANS: A      PTS: 1      DIF: 2      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Market power      MSC: Applicative

91. Which of the following firms is most likely to have market power?

- a. a grocery store in a metropolitan area
- b. a gas station in a suburb
- c. a pub in a college town
- d. the only hotel in a rural area

ANS: D      PTS: 1      DIF: 2      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Market power      MSC: Interpretive

92. An example of a firm with market power is a

- a. delicatessen in New York.
- b. cable TV provider in St. Louis.
- c. clothing store in Los Angeles.
- d. family farm in Illinois.

ANS: B      PTS: 1      DIF: 2      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Market power      MSC: Interpretive

93. The price of diamonds is high, in part because the majority of the world's diamonds are controlled by a single firm.

This is an example of

- a. a market failure caused by an externality.
- b. a market failure caused by market power.
- c. a market failure caused by equality.
- d. There is no market failure in this case.

ANS: B      PTS: 1      DIF: 2      REF: 1-2  
 NAT: Analytic      LOC: Markets, market failure, and externalities  
 TOP: Market failure      MSC: Applicative

94. The ability of an individual to own and exercise control over scarce resources is called

- a. market failure.
- b. property rights.
- c. externality.
- d. market power.

ANS: B      PTS: 1      DIF: 1      REF: 1-2  
 NAT: Analytic      LOC: The study of economics and definitions in economics  
 TOP: Property rights      MSC: Definitional

## HOW THE ECONOMY AS A WHOLE WORKS

1. In 2008, the average American earned about \$47,000 while the average Nigerian earned about \$1,400. Which of the following statements is likely?

- a. The average American purchases more televisions than the average Nigerian.
- b. The average American has better nutrition and healthcare than the average Nigerian.
- c. The average American has a longer life expectancy than the average Nigerian.
- d. All of the above are correct.

ANS: D      PTS: 1      DIF: 1      REF: 1-3  
 NAT: Analytic      LOC: Productivity and growth      TOP: Income  
 MSC: Interpretive

2. In the United States, incomes historically have grown about 2 percent per year. At this rate, average income doubles every
- 15 years.
  - 25 years.
  - 35 years.
  - 45 years.

ANS: C      PTS: 1      DIF: 2      REF: 1-3  
 NAT: Analytic      LOC: Productivity and growth TOP: Income  
 MSC: Interpretive

3. In the United States, incomes have historically grown
- about 0.5 percent per year.
  - about 2 percent per year.
  - about 4 percent per year.
  - about 6 percent per year.

ANS: B      PTS: 1      DIF: 1      REF: 1-3  
 NAT: Analytic      LOC: Productivity and growth TOP: Income  
 MSC: Definitional

4. Over the past century, the average income in the United States has risen about
- twofold.
  - fivefold.
  - eightfold.
  - tenfold.

ANS: C      PTS: 1      DIF: 1      REF: 1-3  
 NAT: Analytic      LOC: Productivity and growth TOP: Income  
 MSC: Definitional

5. The term "productivity"
- means the same thing as "efficiency."
  - is seldom used by economists, as its meaning is not precise.
  - refers to the quantity of goods and services produced from each unit of labor input.
  - refers to the variety of goods and services from which households can choose when they shop.

ANS: C      PTS: 1      DIF: 1      REF: 1-3  
 NAT: Analytic      LOC: Productivity and growth TOP: Productivity  
 MSC: Definitional

6. Productivity is defined as the
- amount of goods and services produced from each unit of labor input.
  - number of workers required to produce a given amount of goods and services.
  - amount of labor that can be saved by replacing workers with machines.
  - actual amount of effort workers put into an hour of working time.

ANS: A      PTS: 1      DIF: 2      REF: 1-3  
 NAT: Analytic      LOC: Productivity and growth TOP: Productivity  
 MSC: Definitional

7. The amount of goods and services produced from each unit of labor input is called
- opportunity cost.
  - productivity.
  - externality.
  - marginal benefit.

ANS: B      PTS: 1      DIF: 1      REF: 1-3  
 NAT: Analytic      LOC: Productivity and growth TOP: Productivity  
 MSC: Definitional

8. What is the most important factor that explains differences in living standards across countries?

- a. the quantity of money
- b. the level of unemployment
- c. productivity
- d. equality

ANS: C      PTS: 1      DIF: 1      REF: 1-3  
 NAT: Analytic      LOC: Productivity and growth TOP: Productivity  
 MSC: Interpretive

9. Almost all variation in living standards is attributable to differences in countries'

- a. population growth rates.
- b. productivity.
- c. systems of public education.
- d. taxes.

ANS: B      PTS: 1      DIF: 2      REF: 1-3  
 NAT: Analytic      LOC: Productivity and growth TOP: Standard of living  
 MSC: Interpretive

10. The income of a typical worker in a country is most closely linked to which of the following?

- a. population
- b. productivity
- c. market power
- d. government policies

ANS: B      PTS: 1      DIF: 2      REF: 1-3  
 NAT: Analytic      LOC: Productivity and growth TOP: Productivity | Income  
 MSC: Interpretive

11. A direct or positive relationship exists between a country's

- a. productivity and its standard of living.
- b. amount of government spending and its productivity.
- c. total population and its average citizen's income.
- d. rate of population growth and the extent of its trade with other countries.

ANS: A      PTS: 1      DIF: 2      REF: 1-3  
 NAT: Analytic      LOC: Productivity and growth  
 TOP: Productivity | Standard of living      MSC: Interpretive

12. The primary determinant of a country's standard of living is

- a. the country's ability to prevail over foreign competition.
- b. the country's ability to produce goods and services.
- c. the total supply of money in the economy.
- d. the average age of the country's labor force.

ANS: B      PTS: 1      DIF: 2      REF: 1-3  
 NAT: Analytic      LOC: Productivity and growth TOP: Standard of living  
 MSC: Interpretive

13. The historical rise in living standards of American workers is primarily a result of

- a. the influence of labor unions in America.
- b. tariff protection imposed by the American government.
- c. the enactment of minimum-wage laws in America.
- d. the rise in American productivity.

ANS: D      PTS: 1      DIF: 2      REF: 1-3  
 NAT: Analytic      LOC: Productivity and growth  
 TOP: Productivity | Standard of living      MSC: Interpretive

14. The fact that different countries experience different standards of living is largely explained by differences in those countries'
- populations.
  - productivity levels.
  - locations.
  - None of the above is correct. Economists are puzzled by differences in standards of living around the world.

ANS: B      PTS: 1      DIF: 1      REF: 1-3  
 NAT: Analytic      LOC: Productivity and growth  
 TOP: Standard of living | Productivity      MSC: Interpretive

15. Suppose that the average income of a Costa Rican is higher than the average income of a Guatemalan. You might conclude that
- Costa Rican firms are faced with stricter government regulations than Guatemalan firms.
  - total income is divided among fewer workers in Costa Rica since it has a smaller labor force than Guatemala.
  - Guatemala's climate allows for longer growing seasons and therefore Guatemala can produce large quantities of grain and other crops.
  - productivity in Costa Rica is higher than in Guatemala.

ANS: D      PTS: 1      DIF: 2      REF: 1-3  
 NAT: Analytic      LOC: Productivity and growth      TOP: Productivity | Income  
 MSC: Applicative

16. The slow growth of U.S. incomes during the 1970s and 1980s can best be explained by
- unstable economic conditions in Eastern Europe.
  - increased competition from abroad.
  - a decline in the rate of increase in U.S. productivity.
  - a strong U.S. dollar abroad, hurting U.S. exports.

ANS: C      PTS: 1      DIF: 3      REF: 1-3  
 NAT: Analytic      LOC: Productivity and growth      TOP: Productivity | Income  
 MSC: Applicative

17. Slow growth in US incomes during the 1970s and 1980s was primarily due to
- slow productivity growth in the US.
  - increased competition from Japan.
  - increased competition from European countries.
  - a rapid decrease in the quantity of money in the economy.

ANS: A      PTS: 1      DIF: 2      REF: 1-3  
 NAT: Analytic      LOC: Productivity and growth      TOP: Productivity  
 MSC: Applicative

18. Suppose a typical worker in India can produce 32 units of product in an eight-hour day, while a typical worker in Bangladesh can produce 30 units of product in a 10-hour day. We can conclude that
- worker productivity in Bangladesh is higher than in India.
  - the standard of living will likely be higher in India than in Bangladesh.
  - productivity is 4 units per hour for the worker in Bangladesh and 3 units per hour for the worker in India.
  - there will be no difference between the standard of living in India and Bangladesh.

ANS: B      PTS: 1      DIF: 3      REF: 1-3  
 NAT: Analytic      LOC: Productivity and growth  
 TOP: Productivity | Standard of living      MSC: Applicative

19. Suppose that in Ireland total annual output is worth \$600 million and people work 30 million hours. In Canada total annual output is worth \$800 million and people work 50 million hours. Productivity is higher
- in Ireland. Most variation in the standard of living across countries is due to differences in productivity.
  - in Ireland. Differences in productivity explain very little of the variation in the standard of living across countries.
  - in Canada. Most variation in the standard of living across countries is due to differences in productivity.
  - in Canada. Differences in productivity explain very little of the variation in the standard of living across countries.

ANS: A PTS: 1 DIF: 2 REF: 1-3

NAT: Analytic LOC: Productivity and growth

TOP: Productivity | Standard of living MSC: Analytical

20. According to a recent study of Chilean bus drivers, drivers who are paid by the number of passengers they transport have higher productivity than drivers who are paid by the hour. If Chilean bus drivers are paid by the number of passengers they transport and Colombian bus drivers are paid by the hour, we can conclude that
- Chilean bus drivers likely have a higher standard of living than Colombian bus drivers.
  - Colombian bus drivers likely have a higher standard of living than Chilean bus drivers.
  - Chilean and Colombian bus drivers likely have the same standard of living.
  - Chilean and Colombian bus drivers likely have a higher standard of living than US bus drivers.

ANS: A PTS: 1 DIF: 3 REF: 1-3

NAT: Analytic LOC: Productivity and growth TOP: Productivity

MSC: Applicative

21. US citizens have better nutrition, better healthcare, and a longer life expectancy than citizens of Ghana. Which of the following conclusions can be drawn from this statement?
- Average income in the US is higher than the average income in Ghana.
  - The US has a higher standard of living than Ghana.
  - Productivity in the US is higher than productivity in Ghana.
  - All of the above are correct.

ANS: D PTS: 1 DIF: 2 REF: 1-3

NAT: Analytic LOC: Productivity and growth TOP: Productivity

MSC: Applicative

22. In a particular country in 1998, the average worker needed to work 25 hours to produce 40 units of output. In that same country in 2008, the average worker needed to work 40 hours to produce 68 units of output. In that country, the productivity of the average worker
- decreased by 1.7 percent between 1998 and 2008.
  - remained unchanged between 1998 and 2008.
  - increased by 4.75 percent between 1998 and 2008.
  - increased by 6.25 percent between 1998 and 2008.

ANS: D PTS: 1 DIF: 3 REF: 1-3

NAT: Analytic LOC: Productivity and growth TOP: Productivity

MSC: Analytical

23. In a particular country in 2000, the average worker needed to work 40 hours to produce 55 units of output. In that same country in 2008, the average worker needed to work 30 hours to produce 45 units of output. In that country, the productivity of the average worker
- decreased by about 6 percent between 2000 and 2008.
  - remained unchanged between 2000 and 2008.
  - increased by about 9 percent between 2000 and 2008.
  - increased by about 18 percent between 2000 and 2008.

ANS: C      PTS: 1      DIF: 3      REF: 1-3  
 NAT: Analytic      LOC: Productivity and growth TOP: Productivity  
 MSC: Analytical

24. In a particular country in 1998, the average worker needed to work 40 hours to produce 100 units of output. In that same country in 2008, the average worker needed to work 36 hours to produce 72 units of output. In that country, the productivity of the average worker
- decreased between 1998 and 2008, so we would expect the standard of living to have decreased accordingly.
  - increased between 1998 and 2008, so we would expect the standard of living to have increased accordingly.
  - decreased between 1998 and 2008, so we would expect inflation to have decreased accordingly.
  - increased between 1998 and 2008, so we would expect inflation to have increased accordingly.

ANS: A      PTS: 1      DIF: 3      REF: 1-3  
 NAT: Analytic      LOC: Productivity and growth  
 TOP: Productivity | Standard of living      MSC: Analytical

25. In a particular country in 1999, the average worker had to work 20 hours to produce 55 units of output. In that same country in 2009, the average worker needed to work 28 hours to produce 77 units of output. In that country, the productivity of the average worker
- increased by 2 percent between 1999 and 2009.
  - increased by 5 percent between 1999 and 2009.
  - remained unchanged between 1999 and 2009.
  - decreased by 3 percent between 1999 and 2009.

ANS: C      PTS: 1      DIF: 3      REF: 1-3  
 NAT: Analytic      LOC: Productivity and growth TOP: Productivity  
 MSC: Analytical

26. A worker in Equador can earn \$3 per day making cotton cloth on a hand loom. A worker in the United States can earn \$70 per day making cotton cloth with a mechanical loom. What accounts for the difference in wages?
- U.S. textile workers belong to a union.
  - There is little demand for cotton cloth in Equador and great demand in the U.S.
  - Labor is more productive making cotton cloth with a mechanical loom than with a hand loom.
  - Equador has a low-wage policy to make its textile industry more competitive in world markets.

ANS: C      PTS: 1      DIF: 3      REF: 1-3  
 NAT: Analytic      LOC: Productivity and growth TOP: Productivity  
 MSC: Applicative

27. To promote good economic outcomes, policymakers should strive to enact policies that
- enhance productivity.
  - enhance individuals' market power.
  - result in a rapidly-growing quantity of money.
  - All of the above are correct.

ANS: A      PTS: 1      DIF: 2      REF: 1-3  
 NAT: Analytic      LOC: Productivity and growth  
 TOP: Productivity | Market power | Inflation      MSC: Applicative



28. To raise productivity, policymakers could

- a. increase spending on education.
- b. provide tax credits to firms for capital improvements.
- c. fund research and development.
- d. All of the above are correct.

ANS: D      PTS: 1      DIF: 3      REF: 1-3  
 NAT: Analytic      LOC: Productivity and growth TOP: Productivity | Government  
 MSC: Applicative

29. To increase living standards, public policy should

- a. ensure that workers are well educated and have the necessary tools and technology.
- b. make unemployment benefits more generous.
- c. move workers into jobs directly from high school.
- d. ensure a greater degree of equality, taking all income-earners into account.

ANS: A      PTS: 1      DIF: 2      REF: 1-3  
 NAT: Analytic      LOC: Productivity and growth  
 TOP: Productivity | Standard of living      MSC: Applicative

30. The increase in living standards of American workers over the past century is primarily due to

- a. the success of labor unions.
- b. minimum-wage laws.
- c. improvements in productivity.
- d. None of the above are correct.

ANS: C      PTS: 1      DIF: 2      REF: 1-3  
 NAT: Analytic      LOC: Productivity and growth TOP: Productivity  
 MSC: Applicative

31. To improve living standards, policymakers should

- a. impose restrictions on foreign competition.
- b. formulate policies designed to increase productivity.
- c. impose tougher immigration policies.
- d. provide tax breaks for the middle class.

ANS: B      PTS: 1      DIF: 2      REF: 1-3  
 NAT: Analytic      LOC: Productivity and growth  
 TOP: Productivity | Standard of living      MSC: Applicative

32. Incomes of U.S. households in the 1970s and 1980s

- a. grew rapidly, due to the widespread success of labor unions in pushing up wages during those decades.
- b. grew rapidly, due to several increases in the minimum wage during those decades.
- c. grew rapidly, due to government policies that discouraged the importation of foreign products during those decades.
- d. grew slowly, due to slow growth of the output of goods and services per hour of U.S. workers' time during those decades.

ANS: D      PTS: 1      DIF: 2      REF: 1-3  
 NAT: Analytic      LOC: Productivity and growth TOP: Productivity | Income  
 MSC: Applicative

33. An increase in the overall level of prices in an economy is referred to as

- a. the income effect.
- b. inflation.
- c. deflation.
- d. the substitution effect.

ANS: B      PTS: 1      DIF: 1      REF: 1-3  
 NAT: Analytic      LOC: Unemployment and inflation      TOP: Inflation  
 MSC: Definitional

34. Inflation is defined as

- a. a period of rising productivity in the economy.
- b. a period of rising income in the economy.
- c. an increase in the overall level of output in the economy.
- d. an increase in the overall level of prices in the economy.

ANS: D                      PTS: 1                      DIF: 1                      REF: 1-3  
NAT: Analytic            LOC: Unemployment and inflation            TOP: Inflation  
MSC: Definitional

35. In the early 1920s,

- a. Germany experienced a very high rate of inflation.
- b. the quantity of German money was declining rapidly.
- c. the value of German money remained almost constant.
- d. All of the above are correct.

ANS: A                      PTS: 1                      DIF: 2                      REF: 1-3  
NAT: Analytic            LOC: Unemployment and inflation            TOP: Inflation | Money  
MSC: Interpretive

36. During the early 1920s in Germany, prices

- a. doubled annually.
- b. doubled monthly.
- c. tripled monthly.
- d. tripled annually.

ANS: C                      PTS: 1                      DIF: 2                      REF: 1-3  
NAT: Analytic            LOC: Unemployment and inflation            TOP: Inflation  
MSC: Definitional

37. In less than two years in the early 1920s, the cost of a German newspaper rose from 0.30 marks to 70,000,000 marks. This is a spectacular example of

- a. market power caused by a change in the country's standard of living.
- b. market power caused by a single firm controlling the newspaper production.
- c. inflation caused by increased productivity in the economy.
- d. inflation caused by an increase in the quantity of money in the economy.

ANS: D                      PTS: 1                      DIF: 2                      REF: 1-3  
NAT: Analytic            LOC: Unemployment and inflation            TOP: Inflation  
MSC: Applicative

38. One of the 20th century's worst episodes of inflation occurred in

- a. the United States in the 1960s.
- b. Italy in the 1950s.
- c. Russia in the 1930s.
- d. Germany in the 1920s.

ANS: D                      PTS: 1                      DIF: 1                      REF: 1-3  
NAT: Analytic            LOC: Unemployment and inflation            TOP: Inflation  
MSC: Definitional

39. In the United States, the overall level of prices more than doubled during the

- a. 1950s.
- b. 1960s.
- c. 1970s.
- d. 1980s.

ANS: C                      PTS: 1                      DIF: 1                      REF: 1-3  
NAT: Analytic            LOC: Unemployment and inflation            TOP: Inflation  
MSC: Definitional

40. President Gerald Ford referred to inflation as

- a. a blight on our nation's economy.
- b. a necessary evil to combat high unemployment.
- c. public enemy number one.
- d. a fly in the ointment.

ANS: C      PTS: 1      DIF: 2      REF: 1-3  
 NAT: Analytic      LOC: Unemployment and inflation      TOP: Inflation  
 MSC: Interpretive

41. The U.S. president who referred to inflation as “public enemy number one” was

- a. Richard Nixon.
- b. Gerald Ford.
- c. Jimmy Carter.
- d. Ronald Reagan.

ANS: B      PTS: 1      DIF: 1      REF: 1-3  
 NAT: Analytic      LOC: Unemployment and inflation      TOP: Inflation  
 MSC: Interpretive

42. In which of the following decades was there both high inflation and rapid money supply growth in the US?

- a. the 1970's and the 1990's
- b. the 1970's but not the 1990's
- c. the 1990's but not the 1970's
- d. neither the 1970's nor the 1990's

ANS: B      PTS: 1      DIF: 2      REF: 1-3  
 NAT: Analytic      LOC: The role of money      TOP: Inflation  
 MSC: Definitional

43. In the 1990s, inflation in the United States was

- a. very close to zero.
- b. about 3 percent per year.
- c. about 6 percent per year.
- d. commonly referred to as “public enemy number one.”

ANS: B      PTS: 1      DIF: 2      REF: 1-3  
 NAT: Analytic      LOC: Unemployment and inflation      TOP: Inflation  
 MSC: Interpretive

44. Large or persistent inflation is almost always caused by

- a. excessive government spending.
- b. excessive growth in the quantity of money.
- c. foreign competition.
- d. higher-than-normal levels of productivity.

ANS: B      PTS: 1      DIF: 2      REF: 1-3  
 NAT: Analytic      LOC: Unemployment and inflation      TOP: Inflation  
 MSC: Interpretive

45. Which of the following would a permanent increase in the growth rate of the money supply change permanently?

- a. inflation
- b. unemployment
- c. both inflation and unemployment
- d. neither inflation nor unemployment

ANS: A      PTS: 1      DIF: 2      REF: 1-3  
 NAT: Analytic      LOC: Unemployment and inflation  
 TOP: The short-run trade-off between inflation and unemployment  
 MSC: Applicative

46. Most economists believe that an increase in the quantity of money results in
- an increase in the demand for goods and services.
  - lower unemployment in the short run.
  - higher inflation in the long run.
  - All of the above are correct.

ANS: D                      PTS: 1                      DIF: 3                      REF: 1-3  
 NAT: Analytic                      LOC: Unemployment and inflation  
 TOP: Money | Inflation | Unemployment                      MSC: Applicative

47. In the short run, which of the following rates of growth in the money supply is likely to lead to the lowest level of unemployment in the economy?
- 3 percent per year
  - 5 percent per year
  - 7 percent per year
  - 9 percent per year

ANS: D                      PTS: 1                      DIF: 2                      REF: 1-3  
 NAT: Analytic                      LOC: Unemployment and inflation                      TOP: Inflation | Unemployment  
 MSC: Analytical

48. In the short run, which of the following rates of growth in the money supply is likely to lead to the highest level of unemployment in the economy?
- 1 percent per year
  - 2 percent per year
  - 3 percent per year
  - 4 percent per year

ANS: A                      PTS: 1                      DIF: 2                      REF: 1-3  
 NAT: Analytic                      LOC: Unemployment and inflation                      TOP: Inflation | Unemployment  
 MSC: Analytical

49. In the short run, an increase in the money supply is likely to lead to
- lower unemployment and lower inflation.
  - lower unemployment and higher inflation.
  - higher unemployment and lower inflation.
  - higher unemployment and higher inflation.

ANS: B                      PTS: 1                      DIF: 2                      REF: 1-3  
 NAT: Analytic                      LOC: Unemployment and inflation                      TOP: Inflation | Unemployment  
 MSC: Applicative

50. Suppose that the Federal Reserve Bank announces that it will be making a change to a key interest rate to increase the money supply. This is likely because
- the Federal Reserve Bank is worried about inflation.
  - the Federal Reserve Bank is worried about unemployment.
  - the Federal Reserve Bank is hoping to reduce the demand for goods and services.
  - the Federal Reserve Bank is worried that the economy is growing too quickly.

ANS: B                      PTS: 1                      DIF: 2                      REF: 1-3  
 NAT: Analytic                      LOC: Unemployment and inflation                      TOP: Unemployment  
 MSC: Applicative

51. Low rates of inflation are generally associated with

- a. low rates of government spending.
- b. small or nonexistent government budget deficits.
- c. low rates of productivity growth.
- d. low rates of growth of the quantity of money.

ANS: D      PTS: 1      DIF: 2      REF: 1-3  
 NAT: Analytic      LOC: Unemployment and inflation      TOP: Inflation  
 MSC: Interpretive

52. Which of the following is the most correct statement about the relationship between inflation and unemployment?

- a. In the short run, falling inflation is associated with falling unemployment.
- b. In the short run, falling inflation is associated with rising unemployment.
- c. In the long run, falling inflation is associated with falling unemployment.
- d. In the long run, falling inflation is associated with rising unemployment.

ANS: B      PTS: 1      DIF: 2      REF: 1-3  
 NAT: Analytic      LOC: Unemployment and inflation  
 TOP: Inflation | Unemployment | Tradeoffs      MSC: Applicative

53. Which of the following is an important cause of inflation in an economy?

- a. increases in productivity in the economy
- b. the influence of positive externalities on the economy
- c. lack of property rights in the economy
- d. growth in the quantity of money in the economy

ANS: D      PTS: 1      DIF: 2      REF: 1-3  
 NAT: Analytic      LOC: Unemployment and inflation      TOP: Inflation  
 MSC: Interpretive

54. The mainstream view among economists is that

- a. society faces a tradeoff between unemployment and inflation, but only in the short run.
- b. society faces a tradeoff between unemployment and inflation, but only in the long run.
- c. society faces a tradeoff between unemployment and inflation, both in the short run and in the long run.
- d. no tradeoff exists between unemployment and inflation, either in the short run or in the long run.

ANS: A      PTS: 1      DIF: 2      REF: 1-3  
 NAT: Analytic      LOC: Unemployment and inflation  
 TOP: Inflation | Unemployment | Tradeoffs      MSC: Applicative

55. Which of the following claims is consistent with the views of mainstream economists?

- a. If we increase the rate of inflation from 3 percent to 6 percent, then the rate of unemployment will temporarily fall.
- b. If we increase the rate of inflation from 3 percent to 6 percent, then the rate of unemployment will temporarily rise.
- c. If we increase the rate of inflation from 3 percent to 6 percent, then the rate of unemployment will permanently fall.
- d. If we increase the rate of inflation from 3 percent to 6 percent, then the rate of unemployment will permanently rise.

ANS: A      PTS: 1      DIF: 2      REF: 1-3  
 NAT: Analytic      LOC: Unemployment and inflation  
 TOP: Inflation | Unemployment | Tradeoffs      MSC: Applicative

56. For a very long time Treeland has had an inflation rate of 9%. Suddenly its inflation rate drops to 3%. The drop in the inflation rate

- a. could be due to slower money supply growth. We would expect unemployment to be higher.
- b. could be due to slower money supply growth. We would expect unemployment to be lower.
- c. could be due to higher money supply growth. We would expect unemployment to be higher.
- d. could be due to higher money supply growth. We would expect unemployment to be lower.

ANS: A PTS: 1 DIF: 2 REF: 1-3

NAT: Analytic LOC: Unemployment and inflation

TOP: The short-run trade-off between inflation and unemployment

MSC: Applicative

57. For a number of years country A had inflation of 3% but for the last five years has had inflation of 6%. Country B had inflation of 4% for many years, but very recently inflation unexpectedly rose to 9%. Other things the same, in which of the countries would the higher inflation rate be more likely to reduce unemployment?

- a. both country A and country B
- b. neither country A nor country B
- c. country A but not country B
- d. country B but not country A

ANS: D PTS: 1 DIF: 3 REF: 1-3

NAT: Analytic LOC: Unemployment and inflation

TOP: Short-run trade-off between inflation and unemployment MSC: Interpretive

58. In the early 1980s, U.S. economic policy was directed toward reducing inflation. What would you have expected to observe during this short period of time?

- a. Inflation fell and unemployment fell.
- b. Inflation and unemployment were both unaffected.
- c. Inflation fell and unemployment increased.
- d. Inflation fell and unemployment was unchanged.

ANS: C PTS: 1 DIF: 2 REF: 1-3

NAT: Analytic LOC: Unemployment and inflation

TOP: Inflation | Unemployment | Tradeoffs MSC: Applicative

59. The relatively low inflation experienced in the United States in the 1990s is attributable to

- a. slow growth of U.S. productivity during the 1990s.
- b. slow growth of the quantity of money in the U.S. in the 1990s.
- c. low levels of government spending in the U.S. in the 1980s and 1990s.
- d. the eight-year presidency of William Jefferson Clinton during the 1990s.

ANS: B PTS: 1 DIF: 2 REF: 1-3

NAT: Analytic LOC: Unemployment and inflation

TOP: Inflation | Money

MSC: Interpretive

60. During the 1990s, the United Kingdom experienced low levels of inflation while Turkey experienced high levels of inflation. A likely explanation of these facts is that

- a. the United Kingdom has a better education system than Turkey.
- b. the rate of growth of the quantity of money was slower in the United Kingdom than in Turkey.
- c. workers in Turkey are more productive than workers in the United Kingdom.
- d. there are more instances of market power in Turkey than in the United Kingdom.

ANS: B PTS: 1 DIF: 2 REF: 1-3

NAT: Analytic LOC: Unemployment and inflation

TOP: Inflation | Money

MSC: Interpretive

61. The tradeoff between inflation and unemployment

- a. implies that policies designed to reduce unemployment also reduce inflation.
- b. was eliminated by improved economic policies in the 1900s.
- c. is a long-run tradeoff, persisting for decades, according to most economists.
- d. None of the above are correct.

ANS: D PTS: 1 DIF: 2 REF: 1-3  
 NAT: Analytic LOC: Unemployment and inflation  
 TOP: Inflation | Unemployment | Tradeoffs MSC: Interpretive

62. Germany could have avoided the high inflation that it experienced in the 1920s by

- a. not directing so many of its resources toward preparation for World War II.
- b. not increasing taxes so much on the German middle class.
- c. not allowing the quantity of money to increase so rapidly.
- d. using government policies to stimulate the economy more so than what was done.

ANS: C PTS: 1 DIF: 2 REF: 1-3  
 NAT: Analytic LOC: Unemployment and inflation TOP: Inflation | Money  
 MSC: Applicative

63. In the short run, which of the following is *not* correct?

- a. Increasing the money supply increases the demand for goods and services.
- b. Increasing the money supply encourages firms to hire more workers.
- c. Lowering the money supply leads to a higher level of unemployment.
- d. Policies that encourage higher employment will also induce a lower rate of inflation.

ANS: D PTS: 1 DIF: 2 REF: 1-3  
 NAT: Analytic LOC: Unemployment and inflation TOP: Inflation | Unemployment  
 MSC: Interpretive

64. In response to the deep economic downturn in the US in 2008 and 2009, the US

- a. reduced taxes.
- b. increased government spending.
- c. increased the supply of money.
- d. All of the above are correct.

ANS: D PTS: 1 DIF: 2 REF: 1-3  
 NAT: Analytic LOC: Unemployment and inflation TOP: Inflation | Unemployment  
 MSC: Interpretive

65. The combination of President Obama's strategies and the Federal Reserve's reaction to the deep economic downturn in the US in 2008 and 2009

- a. intended to reduce unemployment.
- b. may lead to excessive inflation over time.
- c. resulted in higher taxes and an increased supply of money.
- d. Both a and b are correct.

ANS: D PTS: 1 DIF: 2 REF: 1-3  
 NAT: Analytic LOC: Unemployment and inflation TOP: Inflation | Unemployment  
 MSC: Interpretive

66. The short-run tradeoff between inflation and unemployment implies that, in the short run,
- a decrease in the growth rate of the quantity of money will be accompanied by an increase in the unemployment rate.
  - an increase in the growth rate of the quantity of money will be accompanied by an increase in the unemployment rate.
  - policymakers are able to reduce the inflation rate and, at the same time, reduce the unemployment rate.
  - policymakers can influence the inflation rate, but not the unemployment rate.

ANS: A      PTS: 1      DIF: 3      REF: 1-3  
 NAT: Analytic      LOC: Unemployment and inflation  
 TOP: Inflation | Unemployment | Tradeoffs      MSC: Applicative

67. The business cycle is the
- relationship between unemployment and inflation.
  - irregular fluctuations in economic activity.
  - positive relationship between the quantity of money in an economy and inflation.
  - predictable changes in economic activity due to changes in government spending and taxes.

ANS: B      PTS: 1      DIF: 1      REF: 1-3  
 NAT: Analytic      LOC: Unemployment and inflation      TOP: Business cycle  
 MSC: Definitional

68. The business cycle is measured by the
- production of goods and services.
  - number of people employed.
  - the interest rate.
  - Both a and b are correct.

ANS: D      PTS: 1      DIF: 2      REF: 1-3  
 NAT: Analytic      LOC: Unemployment and inflation      TOP: Business cycle  
 MSC: Definitional

69. Irregular fluctuations in economic activity are known as the
- business cycle.
  - broken window fallacy.
  - tradeoff between inflation and unemployment.
  - ten principles of economics.

ANS: A      PTS: 1      DIF: 1      REF: 1-3  
 NAT: Analytic      LOC: Unemployment and inflation      TOP: Business cycle  
 MSC: Definitional

70. Both the production of goods and services and the unemployment rate are used to measure
- the business cycle.
  - productivity.
  - the interest rate.
  - inflation.

ANS: A      PTS: 1      DIF: 2      REF: 1-3  
 NAT: Analytic      LOC: Unemployment and inflation      TOP: Business cycle  
 MSC: Definitional



71. The “broken window fallacy”

- a. explains why inflation is so high.
- b. is a justification for the government to print more money.
- c. is illustrated when a government program is justified not on its merits but on the number of jobs it will create.
- d. has nothing to do with public policy.

ANS: C      PTS: 1      DIF: 1      REF: 1-3  
 NAT: Analytic      LOC: The role of government TOP: Broken window fallacy  
 MSC: Definitional

72. When a government program is justified not on its merits but on the number of jobs it will create,

- a. the program is an efficient use of taxpayer dollars.
- b. it should be approved only if the unemployment rate is low.
- c. taxes should be raised to fund the program.
- d. it is known as the “broken window fallacy.”

ANS: D      PTS: 1      DIF: 1      REF: 1-3  
 NAT: Analytic      LOC: The role of government TOP: Broken window fallacy  
 MSC: Definitional

73. It once took 90 percent of our population to grow our food. It now takes only 3 percent of the population to grow our food. Which of the following statements is true?

- a. This loss of jobs has been detrimental to our economy.
- b. The government should provide subsidies to encourage more people to become farmers.
- c. This reduction in the number of farmers explains the increase in the price of food.
- d. This is progress because freed-up labor that is used to produce other goods.

ANS: D      PTS: 1      DIF: 1      REF: 1-3  
 NAT: Analytic      LOC: The role of government TOP: Broken window fallacy  
 MSC: Definitional

74. Congressman Dearthmark justified spending \$3 million on a new entertainment complex in his district because it will create 450 new jobs for his residents. As a student of economics, you know that

- a. this is a case of the “broken window fallacy.”
- b. this is a great use of taxpayer dollars.
- c. this policy diverts money from spending somewhere else in the economy.
- d. Both a and c are correct.

ANS: D      PTS: 1      DIF: 2      REF: 1-3  
 NAT: Analytic      LOC: The role of government TOP: Broken window fallacy  
 MSC: Applicative

### TRUE/FALSE

1. Scarcity means that there is less of a good or resource available than people wish to have.

ANS: T      PTS: 1      DIF: 1      REF: 1-0  
 NAT: Analytic      LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Scarcity      MSC: Definitional

2. Economics is the study of how evenly goods and services are distributed within society.

ANS: F      PTS: 1      DIF: 1      REF: 1-0  
 NAT: Analytic      LOC: The study of economics and definitions in economics  
 TOP: Economics      MSC: Definitional

3. Economics is the study of how society allocates its unlimited resources.

ANS: F      PTS: 1      DIF: 1      REF: 1-0  
 NAT: Analytic      LOC: The study of economics and definitions in economics  
 TOP: Economics      MSC: Definitional

4. Because resources are scarce, a society cannot give all individuals the standard of living to which each aspires.

ANS: T                      PTS: 1                      DIF: 1                      REF: 1-0  
 NAT: Analytic            LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Scarcity            MSC: Interpretive

5. Equality means distributing society's resources in the most efficient manner.

ANS: F                      PTS: 1                      DIF: 1                      REF: 1-0  
 NAT: Analytic            LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Scarcity            MSC: Definitional

6. Economists study how people make decisions.

ANS: T                      PTS: 1                      DIF: 1                      REF: 1-0  
 NAT: Analytic            LOC: The study of economics and definitions in economics  
 TOP: Economics        MSC: Interpretive

7. With careful planning, we can usually get something that we like without having to give up something else that we like.

ANS: F                      PTS: 1                      DIF: 2                      REF: 1-1  
 NAT: Analytic            LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Tradeoffs        MSC: Interpretive

8. Choosing not to attend a concert so that you can study for your exam is an example of a tradeoff.

ANS: T                      PTS: 1                      DIF: 2                      REF: 1-1  
 NAT: Analytic            LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Tradeoffs        MSC: Applicative

9. The classic tradeoff between "guns and butter" states that when a society spends more on national defense, it has less to spend on consumer goods to raise the standard of living.

ANS: T                      PTS: 1                      DIF: 1                      REF: 1-1  
 NAT: Analytic            LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Tradeoffs        MSC: Applicative

10. Efficiency means everyone in the economy should receive an equal share of the goods and services produced.

ANS: F                      PTS: 1                      DIF: 2                      REF: 1-1  
 NAT: Analytic            LOC: Efficiency and equity                      TOP: Equality  
 MSC: Definitional

11. Equality refers to how the pie is divided, and efficiency refers to the size of the economic pie.

ANS: T                      PTS: 1                      DIF: 2                      REF: 1-1  
 NAT: Analytic            LOC: Efficiency and equity                      TOP: Equality | Efficiency  
 MSC: Definitional

12. Government policies that improve equality usually increase efficiency at the same time.

ANS: F                      PTS: 1                      DIF: 1                      REF: 1-1  
 NAT: Analytic            LOC: Efficiency and equity                      TOP: Efficiency | Equality  
 MSC: Interpretive

13. Using income tax revenue to fund the welfare system illustrates the conflict between efficiency and equality.

ANS: T                      PTS: 1                      DIF: 3                      REF: 1-1  
 NAT: Analytic            LOC: Efficiency and equity                      TOP: Equality  
 MSC: Applicative

14. An individual deciding how to allocate her limited time is dealing with both scarcity and trade-offs.

ANS: T                      PTS: 1                      DIF: 1                      REF: 1-1  
 NAT: Analytic              LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Opportunity cost                      MSC: Interpretive

15. The cost of an action is measured in terms of foregone opportunities.

ANS: T                      PTS: 1                      DIF: 1                      REF: 1-1  
 NAT: Analytic              LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Opportunity cost                      MSC: Interpretive

16. Tuition is the single-largest cost of attending college for most students.

ANS: F                      PTS: 1                      DIF: 1                      REF: 1-1  
 NAT: Analytic              LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Opportunity cost                      MSC: Interpretive

17. If wages for accountants rose, then accountants' leisure time would have a lower opportunity cost.

ANS: F                      PTS: 1                      DIF: 1                      REF: 1-1  
 NAT: Analytic              LOC: Scarcity, tradeoffs, and opportunity cost  
 TOP: Opportunity cost                      MSC: Applicative

18. A marginal change is a small incremental adjustment to an existing plan of action.

ANS: T                      PTS: 1                      DIF: 1                      REF: 1-1  
 NAT: Analytic              LOC: Marginal costs & benefits                      TOP: Marginal changes  
 MSC: Definitional

19. An increase in the marginal cost of an activity necessarily means that people will no longer engage in any of that activity.

ANS: F                      PTS: 1                      DIF: 2                      REF: 1-1  
 NAT: Analytic              LOC: Marginal costs & benefits                      TOP: Marginal changes  
 MSC: Applicative

20. If the average cost of transporting a passenger on the train from Chicago to St. Louis is \$75, it would be irrational for the railroad to allow any passenger to ride for less than \$75.

ANS: F                      PTS: 1                      DIF: 2                      REF: 1-1  
 NAT: Analytic              LOC: Marginal costs & benefits                      TOP: Marginal changes  
 MSC: Applicative

21. The fact that people are willing to pay much more for a diamond, which is not needed for survival, than they are willing to pay for a cup of water, which is needed for survival, is an example of irrational behavior.

ANS: F                      PTS: 1                      DIF: 2                      REF: 1-1  
 NAT: Analytic              LOC: Marginal costs & benefits                      TOP: Marginal changes  
 MSC: Interpretive

22. A rational decisionmaker takes an action if and only if the marginal cost exceeds the marginal benefit.

ANS: F                      PTS: 1                      DIF: 2                      REF: 1-1  
 NAT: Analytic              LOC: Marginal costs & benefits                      TOP: Marginal changes  
 MSC: Interpretive

23. Suppose one county in Missouri decides it wants to reduce alcohol consumption, so the county passes a law that raises the price of a bottle of beer by \$1. As a result, people drive to other counties to drink alcohol, which results in an increase in drunk driving. This illustrates the principle that people respond to incentives.

ANS: T                      PTS: 1                      DIF: 2                      REF: 1-1  
 NAT: Analytic              LOC: The role of incentives                      TOP: Incentives  
 MSC: Applicative

24. A tax on gasoline is an incentive that encourages people to drive smaller more fuel-efficient cars.

ANS: T                      PTS: 1                      DIF: 1                      REF: 1-1  
 NAT: Analytic              LOC: The role of incentives                      TOP: Incentives  
 MSC: Applicative

25. To say people respond to incentives means that people may alter their decisions when the costs and benefits of an action change.

ANS: T                      PTS: 1                      DIF: 1                      REF: 1-1  
 NAT: Analytic              LOC: The role of incentives                      TOP: Incentives  
 MSC: Interpretive

26. One of the effects of gas prices rising from about \$2 to about \$4 per gallon was airlines ordering new, fuel-efficient aircraft.

ANS: T                      PTS: 1                      DIF: 1                      REF: 1-1  
 NAT: Analytic              LOC: The role of incentives                      TOP: Incentives  
 MSC: Applicative

27. Trade allows each person to specialize in the activities he or she does best, thus increasing each individual's productivity.

ANS: T                      PTS: 1                      DIF: 2                      REF: 1-2  
 NAT: Analytic              LOC: Gains from trade, specialization and trade  
 TOP: Trade | Productivity                      MSC: Interpretive

28. Trade with any nation can be mutually beneficial.

ANS: T                      PTS: 1                      DIF: 2                      REF: 1-2  
 NAT: Analytic              LOC: Gains from trade, specialization and trade  
 TOP: Trade                      MSC: Interpretive

29. Trade can make everyone better off except in the case where one person is better at doing everything.

ANS: F                      PTS: 1                      DIF: 1                      REF: 1-2  
 NAT: Analytic              LOC: Gains from trade, specialization and trade  
 TOP: Trade                      MSC: Interpretive

30. The invisible hand ensures that economic prosperity is distributed equally.

ANS: F                      PTS: 1                      DIF: 2                      REF: 1-2  
 NAT: Analytic              LOC: Markets, market failure, and externalities  
 TOP: The invisible hand                      MSC: Definitional

31. A market economy cannot produce a socially desirable outcome because individuals are motivated by their own selfish interests.

ANS: F                      PTS: 1                      DIF: 2                      REF: 1-2  
 NAT: Analytic              LOC: Markets, market failure, and externalities  
 TOP: Market economies                      MSC: Interpretive

32. Communist countries worked on the premise that government officials were in the best position to allocate the economy's scarce resources.

ANS: T                      PTS: 1                      DIF: 1                      REF: 1-2  
 NAT: Analytic              LOC: The role of government TOP: Communism  
 MSC: Definitional

33. The government can potentially improve market outcomes if market inequalities or market failure exists.

ANS: T                      PTS: 1                      DIF: 2                      REF: 1-2  
 NAT: Analytic              LOC: Markets, market failure, and externalities | The role of government  
 TOP: Government | Market economies                      MSC: Interpretive

34. One way that governments can improve market outcomes is to ensure that individuals are able to own and exercise control over their scarce resources.

ANS: T                      PTS: 1                      DIF: 2                      REF: 1-2  
 NAT: Analytic              LOC: Markets, market failure, and externalities | The role of government  
 TOP: Property rights                      MSC: Interpretive

35. Market failure refers to a situation in which the market does not allocate resources efficiently.

ANS: T                      PTS: 1                      DIF: 1                      REF: 1-2  
 NAT: Analytic              LOC: Markets, market failure, and externalities  
 TOP: Market failure                      MSC: Definitional

36. Market power and externalities are two possible causes of market failure.

ANS: T                      PTS: 1                      DIF: 1                      REF: 1-2  
 NAT: Analytic              LOC: Markets, market failure, and externalities  
 TOP: Market failure                      MSC: Definitional

37. Market failure is the ability of a single person to have a substantial influence on market prices.

ANS: F                      PTS: 1                      DIF: 1                      REF: 1-2  
 NAT: Analytic              LOC: Markets, market failure, and externalities  
 TOP: Market failure                      MSC: Definitional

38. Productivity is defined as the quantity of goods and services produced from each unit of labor input.

ANS: T                      PTS: 1                      DIF: 1                      REF: 1-3  
 NAT: Analytic              LOC: Productivity and growth TOP: Productivity  
 MSC: Definitional

39. Inflation is the primary determinant of a country's living standards.

ANS: F                      PTS: 1                      DIF: 2                      REF: 1-3  
 NAT: Analytic              LOC: Productivity and growth  
 TOP: Productivity | Standard of living                      MSC: Interpretive

40. Inflation increases the value of money.

ANS: F                      PTS: 1                      DIF: 2                      REF: 1-3  
 NAT: Analytic              LOC: Unemployment and inflation                      TOP: Inflation  
 MSC: Interpretive

41. Inflation measures the increase in the quantity of goods and services produced from each hour of a worker's time.

ANS: F                      PTS: 1                      DIF: 1                      REF: 1-3  
 NAT: Analytic              LOC: Unemployment and inflation                      TOP: Inflation | Productivity  
 MSC: Definitional

42. The goal of President Obama's stimulus package and increased government spending following the deep economic downturn in 2008 and 2009 was to reduce inflation.

ANS: F                      PTS: 1                      DIF: 1                      REF: 1-3  
 NAT: Analytic              LOC: Unemployment and inflation                      TOP: Inflation | Unemployment  
 MSC: Applicative

43. Variations in the standard of living across countries is due almost entirely to differences in each nation's total output of goods and services.

ANS: F                      PTS: 1                      DIF: 2                      REF: 1-3  
 NAT: Analytic              LOC: Productivity and growth TOP: Standard of living  
 MSC: Interpretive

44. In the short-run, society faces a tradeoff between inflation and unemployment.

ANS: T                      PTS: 1                      DIF: 1                      REF: 1-3  
 NAT: Analytic              LOC: Unemployment and inflation              TOP: Inflation  
 MSC: Interpretive

45. In the long run the primary effect of increasing the quantity of money is higher prices.

ANS: T                      PTS: 1                      DIF: 2                      REF: 1-3  
 NAT: Analytic              LOC: Unemployment and inflation              TOP: Inflation  
 MSC: Interpretive

46. The business cycle refers to fluctuations in economic activity such as employment and production.

ANS: T                      PTS: 1                      DIF: 1                      REF: 1-3  
 NAT: Analytic              LOC: Unemployment and inflation              TOP: The business cycle  
 MSC: Definitional

47. The broken window fallacy states that when a window breaks and someone spends money to repair it, they have created new economic activity that would not have otherwise taken place.

ANS: T                      PTS: 1                      DIF: 2                      REF: 1-3  
 NAT: Analytic              LOC: The role of government              TOP: Broken window fallacy  
 MSC: Definitional

## SHORT ANSWER

1. How does the study of economics depend upon the phenomenon of scarcity?

ANS:

Because economics is the study of how society allocates its scarce resources, if there were no scarcity, there would be no need for economics. Everyone could have all the goods and services they wanted. No one would have to make decisions based on tradeoffs, because there would be no opportunity cost associated with the decision. (It is difficult to conceive of a situation where time is not scarce, however).

PTS: 1                      DIF: 2                      REF: 1-1                      NAT: Analytic  
 LOC: Scarcity, tradeoffs, and opportunity cost              TOP: Economics | Scarcity  
 MSC: Applicative

2. One tradeoff society faces is between efficiency and equality. Define each term. If the U.S. government redistributes income from the rich to the poor, explain how this action affects equality as well as efficiency in the economy.

ANS:

Efficiency is the property of society getting the most it can from its scarce resources. Equality is defined as the property of distributing economic prosperity evenly among the members of society. Often, these two goals conflict. When the government redistributes income from the rich to the poor, it reduces the reward for working hard. Fewer goods and services are produced and the economic pie gets smaller. When the government tries to cut the economic pie into more equal slices, the pie gets smaller. Policies aimed at achieving a more equal distribution of economic well-being, such as the welfare system, try to help those members of society who are most in need. The individual income tax asks the financially successful to contribute more than others to support the government.

PTS: 1                      DIF: 2                      REF: 1-1                      NAT: Analytic  
 LOC: Scarcity, tradeoffs, and opportunity cost | Efficiency and equity  
 TOP: Tradeoffs | Efficiency | Equality              MSC: Interpretive

3. Define opportunity cost. What is the opportunity cost to you of attending college? What was your opportunity cost of coming to class today?

ANS:

Whatever must be given up to obtain some item is its opportunity cost. Basically, this would be a person's second choice. The opportunity cost of a person attending college is the value of the best alternative use of that person's time, as well as the additional costs the person incurs by making the choice to attend college. For most students this would be the income the student gives up by not working plus the cost of tuition and books, and any other costs they incur by attending college that they would not incur if they chose not to attend college. A student's opportunity cost of coming to class was the value of the best opportunity the student gave up. (For most students, that seems to be sleep.)

PTS: 1 DIF: 2 REF: 1-1 NAT: Analytic  
LOC: Scarcity, tradeoffs, and opportunity cost TOP: Opportunity cost  
MSC: Interpretive

4. With the understanding that people respond to incentives, outline the possible outcome for teachers if the K-12 school year is extended to 11 months per year instead of the existing 9 months per year.

ANS:

The concept of working longer per year would be perceived by many teachers as a definite increase in the cost of teaching. Even with additional compensation, many teachers look at summers off as a major benefit of the education profession. If this benefit were eliminated or diminished, some teachers may perceive that the marginal cost of teaching would now be greater than the marginal benefit and would choose to leave teaching.

PTS: 1 DIF: 3 REF: 1-1 NAT: Analytic  
LOC: The role of incentives TOP: Incentives MSC: Analytical

5. Under what conditions might government intervention in a market economy improve the economy's performance?

ANS:

If there is a market failure, such as an externality or monopoly, government regulation might improve the well-being of society by promoting efficiency. If the distribution of income or wealth is considered to be unfair by society, government intervention might achieve a more equal distribution of economic well-being.

PTS: 1 DIF: 2 REF: 1-2 NAT: Analytic  
LOC: Markets, market failure, and externalities | The role of government  
TOP: Market economies | Government MSC: Applicative

6. Explain how an attempt by the government to lower inflation could cause unemployment to increase in the short-run.

ANS:

To lower inflation, the government may choose to reduce the money supply in the economy. When the money supply is reduced, prices don't adjust immediately. Lower spending, combined with prices that are too high, reduces sales and causes workers to be laid off. Hence, the lower price level is associated with higher unemployment.

PTS: 1 DIF: 2 REF: 1-3 NAT: Analytic  
LOC: Unemployment and inflation | Efficiency and equity  
TOP: Inflation | Unemployment | Tradeoffs MSC: Applicative