

# TEST BANK

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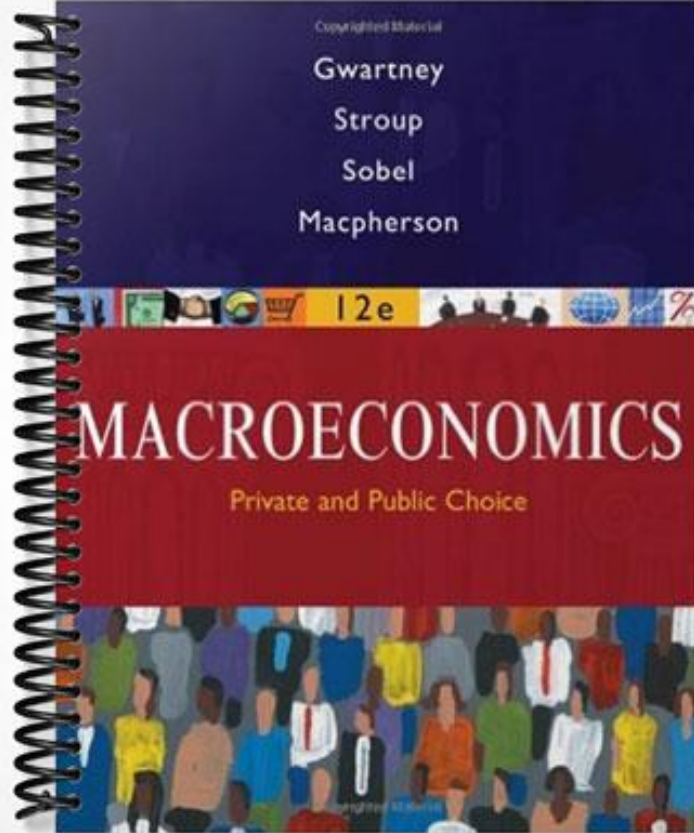
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# MACROECONOMICS

Private and Public Choice



# CHAPTER 2

## TOOLS OF THE ECONOMIST

### QUESTIONS 1 THROUGH 10 ARE A SUGGESTED CHAPTER QUIZ.

- Which of the following sayings best reflects the concept of opportunity cost?
  - “You can’t teach an old dog new tricks.”
  - “Time is money.”
  - “I have a baker’s dozen.”
  - “There’s no business like show business.”
- If an economy is operating at a point inside the production possibilities curve,
  - its resources are not being used efficiently.
  - the curve will begin to shift inward.
  - the curve will begin to shift outward.
  - This is a trick question because an economy cannot produce at a point inside the curve.
- The primary benefit that results when a nation employs its resources in accordance with the principle of comparative advantage is
  - an expansion in investment resulting from a reallocation of resources away from consumption.
  - a larger output resulting from a more efficient use of resources.
  - greater equality of income resulting from an increase in the number of workers.
  - an increase in the profitability of business enterprises resulting from an increase in investment.
- The price of an airline ticket from Denver to Washington, D.C. costs \$600. A bus ticket costs \$150. Traveling by plane takes 6 hours compared with 51 hours by bus. Other things constant, an individual would gain by choosing air travel if, and only if, his time were valued at more than
  - \$6 per hour.
  - \$8 per hour.
  - \$10 per hour.
  - \$15 per hour.
- Does voluntary exchange create wealth (value)?
  - No, exchange does not expand output.
  - No, if one person gains, the other party must lose an equal amount.
  - Uncertain: It does when it results in the creation of additional goods and services; otherwise, it does not.
  - Yes, trade generally permits the trading partners to gain more of what they value; this is why they agree to the terms of the exchange.
- “Now that Blake paints the broad surfaces and I do the trim work, we can paint a house in three-fourths the time that it took for each of us to do both.” This statement most clearly reflects
  - the importance of secondary effects.
  - the fallacy of composition.
  - the law of comparative advantage.
  - behavior inconsistent with economizing.

7. Which of the following will most likely occur under a system of clearly defined and enforced private property rights?
  - a. Resource owners will fail to conserve vital resources, even if they expect their supply to be highly limited in the future.
  - b. Resource owners will ignore the wishes of others, including others who would like to use the resource that is privately owned.
  - c. Resource owners will fail to consider the wishes of potential future buyers when they decide how to employ privately owned resources.
  - d. Resource owners will gain by discovering and employing their resources in ways that are highly valued by others.
8. Three basic decisions must be made by all economies. What are they?
  - a. how much will be produced, when it will be produced, and how much it will cost
  - b. what the price of each good will be, who will produce each good, and who will consume each good
  - c. what will be produced, how goods will be produced, and for whom goods will be produced
  - d. how the opportunity cost principle will be applied, if and how the law of comparative advantage will be utilized, and whether the production possibilities constraint will apply
9. If a firm or a nation desires to maximize its output, each productive assignment should be carried out by those persons who
  - a. have the highest opportunity cost.
  - b. have a comparative advantage in the productive activity.
  - c. can complete the productive activity most rapidly.
  - d. least enjoy performing the productive activity.
10. “The economic wealth of this country is primarily the result of the profit made by some individuals at the expense of others.” The person who made this statement
  - a. has failed to comprehend that mutual gains result from specialization and exchange.
  - b. has failed to comprehend the fallacy of composition.
  - c. has failed to understand the significance of the production possibilities constraint.
  - d. has utilized the economic way of thinking; the statement is essentially correct.

### ANSWER KEY 1 THROUGH 10

\*1. (b), 2. (a), 3. (b), 4. (c), 5. (d), 6. (c), 7. (d), 8. (c), 9. (b), 10. (a)

### WHAT SHALL WE GIVE UP?

11. The opportunity cost of an option
  - a. measures the undesirable aspects of the option.
  - b. includes only the monetary cost of the option.
  - \* c. is the highest-valued alternative that must be given up as the result of choosing the option.
  - d. is objective, and it will be the same for all individuals.
12. The opportunity cost of an alternative
  - a. includes only the direct monetary cost of whatever is chosen.
  - \* b. is subjective and can only be determined by the person who chooses the alternative.
  - c. is the value of all alternatives that must be forgone as the result of the choice.
  - d. is relevant only in cases where the choice involves alternatives that would be considered undesirable.

13. Opportunity cost is defined
- a. only in terms of money spent
  - b. as the value of all alternatives not chosen
  - \* c. as the value of the best alternative not chosen
  - d. as the difference between the benefits from a choice and the benefits from the next best alternative
  - e. as the difference between the benefits from a choice and the costs of that choice
14. The opportunity cost of an activity
- \* a. depends on the individual's subjective values and opinions
  - b. is the same for everyone
  - c. must be calculated and known before undertaking that activity
  - d. is irrelevant to decision making
  - e. is not influenced by time costs
15. The opportunity cost of an action is
- a. objective and will be the same for all individuals.
  - b. a measure of the undesirable aspects involved in the action.
  - c. applicable only to choices involving material goods like commodities.
  - \* d. the highest valued alternative forgone as the result of choosing an option.
16. Opportunity cost is
- a. the cost (in terms of the purchase price) when one buys an option contract.
  - b. the money one must pay for an attractive opportunity.
  - \* c. the value of the highest valued option forgone as the result of a choice.
  - d. the drudgery and undesirable aspects of an option.
17. The opportunity cost of choosing an alternative
- \* a. is the value of the highest valued alternative forgone as the result of the choice.
  - b. includes only the amount of time spent on whatever is chosen.
  - c. includes only the money cost of the option.
  - d. is irrelevant for most choices individuals face.
18. Hutch Technology makes computer monitors, which sell for \$500 each. What is the opportunity cost of producing ten monitors?
- a. \$5,000
  - \* b. the other goods that could be produced with the resources that produce the ten monitors
  - c. the profits that Hutch earns when it sells the ten monitors
  - d. the profits that Hutch loses if it does not produce the monitors
  - e. All of the above are correct.
19. A ticket to a concert costs \$45. You have a ticket and can resell it for \$75. Your opportunity cost of actually attending the concert is
- a. \$30.
  - b. \$45.
  - \* c. \$75.
  - d. \$120.
20. For most students attending state universities, the largest cost component of going to college is
- a. the cost of books and supplies.
  - b. the cost of room and board.
  - c. tuition.
  - \* d. the opportunity cost in terms of forgone current income from the time spent attending college.

21. Based on the idea of opportunity cost, which of the following students would be most likely to drop out of college before completing their degree?
- a. a senior mathematics major with a solid B average
  - b. a junior physical therapy student who has just read about the fantastic job offers available to students with degrees in her area
  - \* c. a star college football player in his junior year that just received a \$5 million offer from a professional team
  - d. a junior economics major who wants to attend graduate school
22. The opportunity cost of building a park in your hometown would be the
- a. money cost of constructing the park.
  - \* b. highest valued bundle of other goods and services that must be forgone because of the park construction.
  - c. necessary increase in tax revenues to finance the construction.
  - d. amount of time spent in leisure activities in the park once it is constructed.
23. Which of the following activities describes the opportunity cost of watching a play in a theater?
- a. the value of the time it takes to get to the play by car
  - b. the cost of the ticket to the play
  - \* c. the value of the highest valued alternative that must be forgone because of the time and money required to watch the play
  - d. the cost of gasoline used in driving to the play
24. “If I didn’t have a date tonight, I could save \$40 and spend this evening out with my friends.” The opportunity cost of the date is
- a. \$40.
  - \* b. \$40 plus the cost of forgoing a night out with friends.
  - c. dependent on how pleasant a time one has on the date.
  - d. the cost of forgoing a night with friends.
25. Recent legislation provides parents with a substantial reduction in their personal income tax liability for each child that they have. The economic way of thinking indicates that legislation of this type will
- a. make it more costly for parents to provide for their children.
  - b. reduce the value of children to their parents and, therefore, lead to a reduction in the birth rate.
  - \* c. reduce the after-tax cost of raising children and, therefore, increase the birth rate.
  - d. exert no impact on either the cost of raising children or the birth rate since having children is a not an economic activity.
26. Retired persons travel by bus and automobile more frequently than do business executives, who more commonly use air travel. An economic explanation for this would be that
- a. business executives have more time to travel.
  - b. it is more important for retired persons to save time.
  - \* c. business executives value their time more highly.
  - d. retired persons have more money than do business executives.

27. Statistical data provided by the U.S. Department of Transportation shows that the median income of individuals traveling on the nation's bus systems is \$18,000 compared to \$65,000 for those who normally travel by air. This finding is best explained by which of the following statements?
- \* a. Persons with high income are more likely to fly because the opportunity cost of their time is generally higher than those with lesser income.
  - b. Traditionally, lower income groups prefer slower methods of transportation.
  - c. Wealthy individuals own stock in the airlines and, therefore, receive preferential treatment.
  - d. Low-income groups are generally located near bus stations; wealthy groups congregate around airports.
28. The wages of house painters will tend to rise when
- a. more people recognize that house painters have very low incomes.
  - \* b. the alternative earning opportunities of house painters improve.
  - c. house painters can no longer find good paying alternatives for their labor.
  - d. unemployment in the economy is high and there are few alternative jobs available for house painters.
29. Land used to grow corn is also often used to grow soybeans. Thus, when the market price of corn rises, it will
- a. decrease the opportunity cost of producing soybeans.
  - \* b. increase the opportunity cost of producing soybeans.
  - c. have no effect on either the opportunity cost of producing soybeans or corn.
  - d. effect the opportunity cost of producing corn but not soybeans.
30. Because of a late night out with friends, Libby decided to sleep in rather than attend her 8 A.M. economics class. According to economic analysis, her choice was
- a. irrational, because economic analysis suggests you should always attend classes that you have already paid for.
  - b. irrational, because oversleeping is not in Libby's self-interest.
  - c. rational only if Libby has not missed any other classes.
  - \* d. rational if Libby values sleep more highly than the benefit she expects to receive from attending the class.
31. Your opportunity cost of attending a football game is
- a. the subjective value of the disappointment you will feel if your team loses.
  - b. the monetary cost of the drinks and food you purchase at the game.
  - c. the price of the ticket.
  - \* d. the highest valued alternative forgone because of the time and money required to attend the game.
32. Which of the following activities describes the opportunity cost of attending an economics class?
- a. the value of the time it takes to get to campus every day
  - b. the cost of the gasoline needed to drive a car to campus
  - \* c. the value of the highest valued alternative that must be forgone because of attending the class
  - d. transportation costs plus the cost of tuition and textbooks for the course
33. Which of the following most accurately reflects the opportunity cost to a sociologist who drives a taxi?
- a. the dollars spent on his previously acquired education in sociology
  - b. the revenue derived from operating the cab
  - c. zero if the sociologist received his education on a scholarship that paid his full tuition
  - \* d. the value of the sociologist's time in its highest valued use other than driving a cab

34. Which of the following is implied by the economic concept of opportunity cost?
- a. If the National Football League (NFL) allowed college freshmen and sophomores to be drafted and play in the NFL, the most talented football players would drop out of school to play professional football.
  - b. If the demand for computer programmers in the private sector was to rise, salaries for computer science professors would likely rise as well.
  - c. The cost of taking time off work to have children is higher for women in high-paying managerial positions than for women in low-paying clerical jobs.
  - \* d. All of the above are true.
35. Which of the following would likely raise your opportunity cost of attending a football game this Saturday night?
- a. On Friday, your history professor unexpectedly announces there will be a midterm exam on Monday morning worth half of your grade.
  - b. You are offered double-pay if you work Saturday night at the restaurant where you are employed.
  - c. A friend calls and offers you free tickets to a Saturday night concert by one of your favorite bands.
  - \* d. All of the above would likely raise the opportunity cost of attending the football game.
36. Which of the following would be most likely to increase your opportunity cost of attending college?
- a. a recession in the economy that made finding a job more difficult
  - \* b. receiving a very attractive offer to start a job today that would permit you to earn about 50 percent more than you expected to make after graduation
  - c. the retirement of your favorite professor under whom you hoped to study during the next semester
  - d. information indicating that salaries were declining and that there were very few openings for college graduates in your field
37. An airline ticket from Seattle to Miami costs \$760. A bus ticket costs \$360. Traveling by plane will take 6 hours, compared with 26 hours by bus. Other things constant, the minimum value of one's time that would induce a rational individual to fly rather than drive would be
- a. \$18 per hour.
  - \* b. \$20 per hour.
  - c. \$38 per hour.
  - d. \$44 per hour.
38. Air travel from New York to Miami costs \$300 and takes 6 hours. A bus ticket between the cities costs \$150 and takes 56 hours. Other things constant, the minimum value of one's time that would induce a rational individual to fly rather than drive would be
- a. \$1 per hour.
  - \* b. \$3 per hour.
  - c. \$5 per hour.
  - d. \$50 per hour.

39. Mr. Peters can drive or fly from Tallahassee, Florida to Savannah, Georgia, for a one-day business trip. If he drives, he will be able to work three hours once he arrives in Savannah, whereas traveling by plane will enable him to work eight hours. His expected income from each hour of work in Savannah is \$30. If Mr. Peters is a rational decision maker, he will fly if and only if the price differential (air cost minus driving cost) is less than
- a. \$30.
  - b. \$90.
  - \* c. \$150.
  - d. \$240.
40. Ms. Liebowitz has a choice of driving or flying from Morgantown, West Virginia to Washington, D.C. for a one-day business trip. If she travels by air, she will be able to work seven hours in D.C., while if she drives, she will only have time to work four hours once there. Her expected income from each hour of work in D.C. is \$40. If Ms. Liebowitz is a rational decision maker, she will chose to fly if and only if the price differential (air cost minus driving cost) is less than
- a. \$40.
  - \* b. \$120.
  - c. \$160.
  - d. \$280.
41. Ms. Moceanu owns a car that she does not plan to use next month. The car depreciates \$30 per month if it's not driven and \$60 per month if it is driven. A friend asks to rent the car for one month and agrees to pay for gas and maintenance. Assuming Ms. Moceanu is a rational decision maker, indicate the minimum monthly fee that would induce her to rent the car.
- a. \$.01, even a low price is better than leaving the car idle
  - \* b. \$30.01
  - c. \$60.01
  - d. \$90.01

## TRADE CREATES VALUE

42. Senator Smart, who understands economic principles, is trying to convince workers in her district that trade with other countries is beneficial. Senator Smart should argue that trade can be beneficial
- a. only if it allows us to obtain things that we couldn't make for ourselves.
  - \* b. because it allows specialization, which increases total output.
  - c. to us if we can gain and the others involved in the trade lose.
  - d. in only a limited number of circumstances because others are typically self-interested.
43. Does voluntary exchange create wealth (value)?
- a. No, exchange cannot increase wealth since it simply moves goods around rather than expanding the number of goods in existence.
  - b. No, if one person gains, the other party must lose an equal amount.
  - \* c. Yes, because both parties gain more of what they value.
  - d. only if the trade results in the creation of additional goods and services
44. In an informed and voluntary exchange,
- \* a. both parties receive something they value more than what they gave up.
  - b. both parties place an equal value on what they received and what they gave up.
  - c. neither party can gain more than the other.
  - d. one trader can gain only at the expense of the other.



45. In voluntary exchange, if the seller of a product gains,
- the buyer will generally lose an amount greater than the gain to the seller.
  - the buyer must lose an amount equal to what the seller gains.
  - someone else must lose an equal amount.
  - \* the buyer must also gain; mutual gain provides the foundation for exchange.
46. With voluntary exchange,
- \* both the buyer and seller will be made better off.
  - the buyer will be made better off, while the seller will be made worse off.
  - the seller will be made better off, while the buyer will be made worse off.
  - both the buyer and the seller will be made worse off.
47. Which of the following statements about exchange is *false*?
- The expectation of gain motivates people to engage in trade.
  - If a party to a potential exchange does not believe that it will lead to personal gain, he or she can choose not to engage in the trade.
  - Voluntary exchange is generally mutually advantageous to the trading partners.
  - \* If one trading partner gains, the other must lose.
48. If Matt trades two candy bars to Andy in exchange for one baseball card,
- Matt must have valued the baseball card more than the two candy bars.
  - Andy must have valued the two candy bars more than the baseball card.
  - Matt must lose an equal amount if Andy gains.
  - \* Both a and b are correct, c is incorrect.
49. Rebecca decides to buy a dress that Hillary has for sale; they agree on a price of \$20. Which of the following best describes who gains and who loses from the transaction?
- If the dress originally costs more than \$20, Rebecca gains and Hillary loses; if the dress originally costs less than \$20, Hillary gains and Rebecca loses.
  - If Hillary gains from the transaction, Rebecca must lose an equal amount.
  - \* Both parties expect to gain from this transaction.
  - Neither party will be able to gain from this transaction.
50. If Sean sells Tom a tennis racket for \$50, we would expect
- \* both parties to gain from this transaction.
  - Sean to gain from the transaction, while Tom loses.
  - Tom to gain from the transaction, while Sean loses.
  - the well-being of both parties to be unchanged.
51. If Harry Bartolini's Ford dealership sells Rosa Brown a new automobile for \$30,000, economic analysis indicates that
- \* both parties to the transaction will gain.
  - Mr. Bartolini will gain from the transaction, while Rosa Brown will lose.
  - Rosa Brown will gain from the transaction, while Mr. Bartolini will lose.
  - the well-being of both parties will be unchanged.
52. If a motorist is stranded in front of a pay phone and has only dollar bills, and he ends up buying a quarter from a passerby for \$1,
- the passerby was made better off at the expense of the stranded motorist.
  - economic theory cannot explain why the stranded motorist bought the quarter for \$1.
  - \* the stranded motorist valued the quarter more than he valued the dollar bill and made an economically sound decision; both people are better off.
  - the stranded motorist clearly doesn't understand that four quarters are worth \$1.

53. Steve values his boat at \$4,000, and Jennifer values it at \$9,000. If Jennifer buys it from Steve for \$7,000, which of the following is true?
- \* a. Steve gains \$3,000 of value, and Jennifer gains \$2,000 of value.
  - b. Steve gains \$7,000 of value, and Jennifer loses \$7,000 of value.
  - c. Steve gains \$7,000 of value, and Jennifer gains \$6,000 of value.
  - d. Steve and Jennifer both gain \$7,000 of value.
54. Steve values his Honda Accord at \$10,000, and Jennifer values it at \$14,000. If Jennifer buys it from Steve for \$11,000, which of the following is true?
- \* a. Steve gains \$1,000 of value, and Jennifer gains \$3,000 of value.
  - b. Steve gains \$11,000 of value, and Jennifer loses \$11,000 of value.
  - c. Steve gains \$10,000 of value, and Jennifer loses \$14,000 of value.
  - d. Steve and Jennifer both gain \$11,000 of value.
55. “Henry Ford made millions of dollars producing and marketing automobiles. Many workers and consumers must have suffered in order for Ford to amass such enormous wealth.” The person who made this observation
- a. has failed to understand the principle of opportunity cost.
  - b. has failed to comprehend the fallacy of composition.
  - \* c. has failed to understand that specialization and exchange generally result in mutual economic gain.
  - d. has utilized the economic way of thinking by thinking the gains of producers are made primarily at the expense of consumers and workers.
56. “Bill Gates has made billions of dollars producing and marketing computer software. Many workers and consumers must have suffered in order for Gates to amass such enormous wealth.” The person who made this observation
- a. has failed to understand the principle of opportunity cost.
  - b. has failed to comprehend the fallacy of composition.
  - \* c. has failed to understand that specialization and exchange generally result in mutual economic gain.
  - d. has utilized the economic way of thinking by thinking the gains of producers are made primarily at the expense of consumers and workers.
57. In the marketplace, John voluntarily sells his last two loaves of bread to Kelly for \$2. The economic way of thinking indicates that this will
- \* a. benefit both John and Kelly.
  - b. benefit Kelly but not John since these are John’s last two loaves of bread.
  - c. benefit Kelly, while imposing a cost on John equal to the benefit Kelly receives.
  - d. benefit neither John nor Kelly.
58. Which of the following most accurately states the economic significance of exchange?
- a. Physical goods have value because they exist; exchange can neither increase nor decrease their value.
  - b. Production of physical goods creates value; exchange merely redistributes this value.
  - \* c. Exchange creates value by moving goods from parties who value them less to parties who value them more.
  - d. Exchange reduces value since it consumes resources without adding to the physical supply of goods.

59. Which of the following is true?
- a. Trade does not produce anything new; therefore, it cannot create value.
  - b. The value of a good is determined by the cost of the material resources required for its production.
  - \* c. The value of a good generally depends on who uses it and circumstances such as when and where it is used.
  - d. None of the above are true.
60. In economics, the term that refers to the time, effort, and other resources needed to search out, negotiate, and consummate an exchange is
- \* a. transaction costs.
  - b. specialization costs.
  - c. pecuniary costs.
  - d. comparative costs.
61. In economics, transaction costs refer to the
- \* a. time, effort, and other resources needed to search out and negotiate an exchange.
  - b. dollar cost or price of the item traded.
  - c. cost an economy suffers when it allows specialization according to comparative advantage.
  - d. amount by which the price of an item increases due to the presence of a middleman.
62. High transaction costs will tend to
- \* a. reduce the number of mutually beneficial exchanges that occur.
  - b. allow easier specialization according to the law of comparative advantage.
  - c. increase the value created by exchanges in an economy.
  - d. increase the number of mutually beneficial exchanges that occur.
63. The existence of transaction costs (compared to a situation where transaction costs are zero)
- a. will reduce the volume of trade.
  - b. will reduce the gains from trade.
  - c. may lead some buyers and sellers to employ middlemen.
  - \* d. All of the above are correct.
64. Which of the following is true with regard to value and exchange?
- a. Exchange generally moves a good from a person who values it more to a person who values it less.
  - \* b. Transaction costs reduce our ability to gain from potentially advantageous trades.
  - c. Middlemen increase transaction costs and, thereby, reduce the potential gains derived from trade.
  - d. Physical goods have an objective value that is unrelated to time and the person of ownership.
65. A nation with cheap, efficient communications is likely to be
- \* a. richer, *ceteris paribus*, because transaction costs will be lower and trade greater.
  - b. richer only if production of goods is cheaper, too, since trade itself cannot create value.
  - c. poorer since it spends so much on communication instead of true productivity.
  - d. spending too much on communications, which adds nothing to the value of output.
66. If the Internet makes it easier for sellers to find buyers and makes it easier for buyers to learn about the products that are available for sale, we would expect that
- a. the volume of trade will decline.
  - b. transaction costs will rise.
  - \* c. the gains from trade will increase.
  - d. buyers and sellers will be worse off.

67. Internet sites such as eBay make it easier for sellers and buyers to find one another and, by doing so,  
\* a. reduce transactions costs.  
b. increase transaction costs.  
c. reduce the number of exchanges that occur.  
d. lower the value created by the goods and services available.
68. A middleman is a person who  
\* a. specializes in arranging trades and selling, guaranteeing, and servicing items traded.  
b. acts as a middle person between the top management of a business firm and the hourly employees who actually produce the goods and services.  
c. adds to the seller's expense and the buyer's buying price without providing a service to either.  
d. levies a tax on private sector activity and uses the funds to support government activities.
69. Middlemen are individuals who  
a. add to the buyer's expense without performing a useful function.  
b. add to the seller's cost without performing a useful function.  
\* c. provide services that reduce the cost of transactions and help achieve additional gains from trade.  
d. act as a middle person between the top management of a business firm and the hourly employees who actually produce the goods and services.
70. A middleman  
a. attempts to prevent buyers from finding sellers.  
\* b. promotes trade by lowering the transaction costs of buyers and sellers.  
c. acts as a liaison between top management and the hourly employees.  
d. adds to the seller's expense and the buyer's price without providing a service to either.
71. In economics, the term for a person who reduces transaction costs by arranging trades for buyers and sellers is  
a. an exchange broker.  
\* b. a middleman.  
c. a transactions specialist.  
d. an opportunity finder.
72. Which of the following is the best example of a middleman?  
a. a middle-level manager  
b. an engineer  
c. an electrician  
\* d. a real estate agent
73. Which of the following is the best example of a middleman?  
a. an accountant  
b. a college professor  
\* c. a stockbroker  
d. an astronaut
74. Which of the following most accurately states the function of middlemen?  
a. Middlemen add to the expense of buyers and sellers without providing any benefit.  
b. Our economy would work just as well without middlemen since they do not expand the availability of physical goods.  
c. Middlemen reduce the number of transactions since they increase the buyer's price and reduce the seller's net revenue.  
\* d. Middlemen create value by arranging trades and providing information to buyers and sellers.

75. Which of the following most accurately states the function of middlemen?
- \* a. Middlemen reduce transaction costs.
  - b. Middlemen add to the expense of buyers and sellers without providing any benefit.
  - c. Our economy would work just as well without middlemen since they do not expand the availability of physical goods.
  - d. Middlemen reduce the number of transactions since they increase the buyer's price and reduce the seller's net receipts.
76. Which of the following is true regarding value and exchange?
- a. Middlemen fail to create value since they do not expand the supply of physical goods.
  - b. A good or service has a given value regardless of who uses it or how it is used.
  - c. If it were not for middlemen, transaction costs would be zero.
  - \* d. Voluntary exchange creates value by channeling goods into the hands of people who value them most.
77. Which of the following is true regarding value, transaction costs, and exchange?
- \* a. Middlemen can be viewed as agents who create value by reducing transaction costs and, thereby, facilitating gains from exchange.
  - b. Middlemen fail to create value since they do not expand the supply of physical goods.
  - c. A good or service has a given value regardless of who uses it or how it is used.
  - d. Voluntary exchange reduces value by channeling goods into the hands of people who value them least.
78. "A real estate agent is a middleman who profits from the lack of information possessed by housing buyers and sellers. A real estate agent creates nothing of value." These two statements
- a. are essentially correct.
  - b. contain one error; contrary to the stated view, a real estate agent is not a middleman.
  - \* c. contain one error; real estate agents create value by arranging trades and providing scarce information.
  - d. contain two errors; a real estate agent is not a good example of a middleman, but real estate agents do create value by arranging trades and providing information.
79. "A used car dealer is a middleman who profits from the lack of information possessed by car buyers and sellers. A used car dealer creates value by reducing the transaction costs of buying and selling used cars." These two statements
- \* a. are essentially correct.
  - b. contain one error; contrary to the stated view, a used car dealer is not a middleman.
  - c. contain one error; used car dealers create nothing of value.
  - d. contain two errors; a used car dealer is not a good example of a middleman, and used car dealers create nothing of value.
80. Economic thinking suggests that a nation in which middlemen are considered to be unproductive seekers of profit, and where their activities are heavily restricted by law, will
- a. gain by channeling people's efforts away from unproductive middleman activity toward physical output.
  - \* b. lose the potential gains from trade that would result from lower transaction costs emanating from middleman activities.
  - c. find that it is richer because the added transaction costs normally imposed by middlemen will be reduced.
  - d. gain because the value of total output will rise.

81. Richer economies often have more middlemen. Economic thinking indicates that such economies
- a. suffer losses from these activities.
  - \* b. gain since the opportunity costs of arranging trades would be higher without middlemen.
  - c. become progressively more wasteful, and middlemen are one sign of the waste.
  - d. are unable to employ middlemen in any other way.
82. Kim has two tickets to a concert tonight. She, however, has a headache and decides not to go. Which of the following would best fit Kim's needs?
- \* a. a ticket service that will buy the tickets from her and resell them
  - b. a change in attitude because missing a concert is always irrational
  - c. a general flu epidemic that causes many people to miss the concert
  - d. a poor performance by the band, so Kim does not feel badly about missing the concert

## THE IMPORTANCE OF PROPERTY RIGHTS

83. The government enforces property rights by
- a. requiring property owners to pay property taxes.
  - \* b. providing police and courts.
  - c. forcing people to own property.
  - d. providing public parks and recreation facilities.
84. Private property rights involve
- a. the right to exclusive use of the property.
  - b. legal protection against those who would seek to use or abuse the property without the owner's permission.
  - c. the right to transfer, sell, exchange, or mortgage the property.
  - \* d. all of the above.
85. Which of the following is a private owner prohibited from doing?
- a. selling the property to another person
  - b. erecting a fence designed to keep others from using the property
  - c. painting the property a color that others do not like
  - \* d. using the property in a manner that invades or infringes on the property of another
86. When property rights are clearly defined and enforced, private owners will
- a. use their property for selfish ends because they have little or no incentive to consider the desires of others.
  - \* b. develop and direct their property toward uses that others value highly because the market will generally reward them for doing so.
  - c. have little or no incentive to take care of their property or conserve it for the future.
  - d. be unable to derive personal gain if they are sensitive to the desires of others when deciding how to use their property.
87. Which of the following is true regarding private ownership?
- a. Relative to common ownership, private ownership generally leads to less conservation of resources.
  - \* b. With private ownership, owners are held accountable for using their resources in a manner that harms the resources of others.
  - c. Private ownership generally gives the owner little incentive to find ways to use the resource wisely.
  - d. With private ownership, resource owners have little incentive to consider the preferences of others when deciding how to employ a resource.

88. Because private owners are held responsible for damages their property causes to the property of others, private owners have
- \* a. a strong incentive to take steps to reduce the chance that they will harm the property of others.
  - b. a strong incentive to use their property now rather than conserving it for the future.
  - c. little incentive to take good care of the property.
  - d. little incentive to consider the harm their property may do to the property of others.
89. When private ownership rights are well-defined and enforced, owners of capital assets
- a. have no incentive to consider the desires of others.
  - \* b. bear the opportunity cost of ignoring the wishes of others.
  - c. are not responsible if the use of their assets imposes harm on others.
  - d. have little incentive to take care of their assets.
90. Which of the following is true of private ownership?
- \* a. Private ownership links responsibility with the right of control.
  - b. Private owners have little incentive to conserve natural resources for the future.
  - c. Private owners have little incentive to develop and use their assets in ways others value.
  - d. Private owners can do anything they want with the things they own regardless of the damage it does to the property of others.
91. When private ownership of a resource is clearly defined and enforced, the private owner
- a. has little incentive to consider the wishes of others when deciding how to employ the resource.
  - b. has little incentive to take care of the resource.
  - \* c. has a strong incentive to use the resource wisely and to consider seriously the wishes of others when deciding how to employ the resource.
  - d. has a strong incentive to consume the resource during the period rather than conserving it for future use.
92. When private ownership of a resource is clearly defined and enforced, the private owner
- \* a. has a strong incentive to consider the wishes of others when deciding how to employ the resource.
  - b. has little incentive to use the resource wisely.
  - c. has a strong incentive to consume the resource during the period rather than conserving it for the future.
  - d. has little incentive to consider the wishes of others when deciding how to employ the resource.
93. When private ownership of a resource is clearly defined and enforced, the private owner
- a. has little incentive to consider the wishes of others when deciding how to employ the resource.
  - b. has little incentive to use the resource wisely.
  - c. has a strong incentive to consume the resource during the period rather than conserving it for the future.
  - \* d. has a strong incentive to use the resource wisely.
94. A private owner of a resource has a strong incentive to
- \* a. conserve the resource for the future, particularly if it is expected to increase in value.
  - b. use the resource today even if its value is expected to increase substantially in the future.
  - c. employ the resource in ways that impose harm on others.
  - d. ignore the wishes of others when deciding how to employ the resource.

95. When individuals reap the benefits of choices that increase the value of their resources and bear the costs of choices that reduce the value of their resources, decision makers have
- \* a. a strong incentive to use the resources wisely.
  - b. little incentive to use the resources wisely.
  - c. a strong incentive to use the resources now rather than conserve them for the future.
  - d. a strong incentive to seek the least efficient ways of using the resources.
96. When individuals reap the benefits of choices that increase the value of their resources and bear the costs of choices that reduce the value of their resources, decision makers have
- a. little incentive to acquire information about potential uses of the resources.
  - b. little incentive to use the resources wisely.
  - c. a strong incentive to use the resources now rather than conserve them for the future.
  - \* d. a strong incentive to search for more efficient ways of using the resources.
97. Which of the following will most likely occur under a system of clearly defined and enforced private property rights?
- a. Resource owners will tend to abuse resources and use them selfishly.
  - \* b. Resource owners will conserve vital resources for the future, particularly if they expect the resource to increase in value.
  - c. Resource owners will ignore the wishes of others, including those who would like to use the resource that is privately owned.
  - d. Resource owners ignore the wishes of others since there is little incentive to employ privately owned resources in ways that are beneficial to others.
98. Under a system of private property, could a 60-year-old owner of a tree farm benefit by planting and caring for a crop of Douglas firs, most of which will not be ready to cut for 50 years?
- a. No, the farmer will be dead before the crop will be ready for harvest.
  - b. No, the value of the farmer's land will decline since he is taking it out of production for the next 50 years.
  - \* c. Yes, the farmer will benefit because this action will increase the value of the land if and when the farmer decides to sell.
  - d. Yes, but only if the project is subsidized by the government or private conservation groups.
99. Todd owns a truck that he values at \$2,000. Susan, who does a lot of hauling, values the truck at \$6,000. If these two get together, which of the following will most likely occur?
- a. Todd will sell the truck for \$1,500.
  - b. Susan will buy the truck for \$7,000.
  - \* c. The truck will be sold at a price greater than \$2,000 but less than \$6,000, and both parties will benefit.
  - d. This is a trick question because the same truck cannot have different values to different people.
100. Given your knowledge of the incentives created by private ownership, which of the following would you expect to be *false*?
- a. People will take better care of their own personal automobile than they will a rental car.
  - b. People will take better care of a home they own than they will of a home they rent.
  - c. Property owned privately will tend to be better conserved and kept than public property or property owned in common.
  - \* d. People will be more likely to throw trash out onto their own lawn than they will be to throw it out onto the side of an interstate highway.



101. The student government associations at several universities have experimented with purchasing bicycles to leave around campus for everyone's use. Anyone who needs the bike can use it, and they are not allowed to lock the bike up or take it home, but rather must leave it on campus for someone else to use. Economic theory would predict that
- students will take better care of these commonly owned bicycles than they do their own bicycles.
  - students will take equally as good care of these commonly owned bicycles as they do their own bicycles.
  - \* students will not take as good of care of these commonly owned bicycles as they do their own bicycles.
  - because universities have a lot of money, these bikes will be better maintained than the ones owned privately by college students who tend to have little money.
102. The number of cattle slaughtered every year for meat far exceeds the number of elephants slaughtered every year for their ivory. Despite this, cows can be found everywhere while elephants are on the verge of extinction in some countries. Which of the following best explains this difference?
- \* Cows can be privately owned while in many countries elephants can not.
  - The demand for ivory far exceeds the demand for beef.
  - Animals slaughtered for their meat are generally better conserved by humans than animals slaughtered for nonfood uses.
  - People tend to protest more every year to prevent cow extinction than they do for elephant extinction.
103. In Zimbabwe and Botswana, elephants can be owned by local tribes and trade in ivory is legal, while in countries such as Kenya, it is illegal to trade in ivory and elephants cannot be privately owned but are protected by the government. Which of the following is true regarding the change in the elephant populations since 1979 in these countries?
- In Zimbabwe and Botswana, elephants are near the verge of extinction, while in Kenya, the population of elephants is growing rapidly.
  - There has been a similar decline in the population of elephants in all of these countries.
  - There has been a similar increase in the population of elephants in all of these countries.
  - \* In Zimbabwe and Botswana, elephant populations have more than doubled, while in Kenya, the population of elephants has fallen to less than one-third of its previous level.
104. In Africa, which of the following policies has been most successful at increasing elephant populations?
- banning the ivory trade (making the buying and selling of ivory illegal)
  - making elephants the common property of the people of the country through government ownership and control and making the killing of elephants illegal
  - \* allowing private ownership of elephants and making the ivory trade legal
  - When used together, the policies in a and b have been more successful than the policy in c.
105. Beginning in the early 1990s, private landowners in Zimbabwe have started fencing in large areas of land that contain black rhinos, which were on the verge of extinction. These private owners charge fees for a stay at the lodges on the property (eco-tourism) and also sell hunting safaris and photo safaris. As a result,
- the population of black rhinos has fallen substantially.
  - \* the population of black rhinos has increased.
  - many black rhinos are being poached.
  - the incomes of residents in Zimbabwe has fallen substantially.

106. In the fictitious country of Lebos, the government allows private ownership of pigs but not of cows. If the demand for pork and the demand for beef both permanently increased in Lebos, in the long run, we would expect
- \* a. the population of pigs to rise and the population of cows to fall.
  - b. the population of cows to rise and the population of pigs to fall.
  - c. the populations of both pigs and cows to increase.
  - d. both pigs and cows to become extinct in Lebos unless the government places the animals on the endangered species list.
107. Suppose that vegetarian lobby groups run large advertising campaigns that are successful in substantially lowering the consumption of beef. As a result of the substantially lower demand for beef, we would expect
- a. the price of beef to fall.
  - b. the profitability of being a cattle rancher to fall.
  - c. a reduction in the number and size of cattle herds—and thus the number of cows—in the long run.
  - \* d. all of the above.

## PRODUCTION POSSIBILITIES CURVE

108. Production possibilities curve are usually bowed outward. This is because
- a. the more resources a society uses to produce one good, the fewer resources it has available to produce another good.
  - b. it reflects the fact that the opportunity cost of producing a good decreases as more and more of that good is produced.
  - c. of the effects of technological change.
  - \* d. resources are specialized, that is, some are better at producing particular goods rather than other goods.
109. The difference between production possibilities curves that are bowed out and those that are straight lines is that
- a. bowed-out production possibilities curves apply to economies that face tradeoffs, whereas straight-line production possibilities curves apply to economies that do not face tradeoffs.
  - b. bowed-out production possibilities curves apply to economies in which resources are not specialized, whereas straight-line production possibilities curves apply to economies in which resources are specialized.
  - \* c. bowed-out production possibilities curves illustrate increasing opportunity cost, whereas straight-line production possibilities curves illustrate constant opportunity cost.
  - d. straight-line production possibilities curves illustrate real-world conditions, whereas bowed-out production possibilities curves illustrate more simplistic assumptions.
110. The reason that the production possibilities curve is usually a bow-shaped curve instead of a straight line is that
- a. it makes it easier to illustrate the concepts of scarcity and prices with a bow-shaped curve than it is with a straight line
  - b. early economists began drawing them in this way and the convention has continued throughout the years
  - c. output eventually reaches a maximum and then declines
  - \* d. resources are not perfectly adaptable to the production of all goods

111. When the production possibilities curve is bowed out, resources are
- a. equally well-suited to production of both goods.
  - b. not being used efficiently.
  - \* c. not equally suited to the production of both goods.
  - d. available in larger and larger quantities as more of one good is produced.
112. Which of the following most accurately indicates the implications of an economy's production possibilities curve?
- \* a. If all the resources of an economy are being used efficiently, more of one good can be produced only if less of another good is produced.
  - b. If all the resources of an economy are being used efficiently, it is generally possible to produce more of one good without having to sacrifice the production of other goods.
  - c. Over time, it is generally impossible for a country to expand its production of goods.
  - d. An economy will automatically move toward a point that lies outside of the production possibilities curve unless proper government policy constrains production.
113. The production possibilities curve illustrates the basic principle that
- a. an economy's capacity to produce is unrelated to its population.
  - b. if all the resources of an economy are being used efficiently, more of one good can be produced only if more of another good is produced.
  - c. an economy will automatically move toward a point at which all of its resources are being used inefficiently.
  - \* d. if all the resources of an economy are being used efficiently, more of one good can be produced only if less of another good is produced.
114. A production possibilities curve indicates that when resources are being used efficiently,
- a. you can only produce more of one good only if you lower its price.
  - b. you can only produce more of one good only if you produce more of another good.
  - \* c. you can only produce more of one good only if you produce less of another good.
  - d. it is impossible to expand the total output of goods over time.
115. Which of the following is true of the production possibilities curve?
- \* a. It assumes a fixed level of technology.
  - b. It assumes that the prices of the products considered are equal.
  - c. It assumes some inefficiency will result in the use of resources.
  - d. All of the above are correct.
116. Compare two economies A and B that start out with identical production possibilities curves. Economy A chooses an efficient point with 6 consumption goods and 3 capital goods, while economy B also chooses an efficient point, but with 4 consumption goods and 5 capital goods. *Ceteris paribus*, in the future we can expect that
- a. economy A will operate inefficiently.
  - b. economy B will operate inefficiently.
  - c. economy A and economy B will grow equally fast.
  - d. economy A will grow faster than economy B.
  - \* e. economy B will grow faster than economy A.
117. If production involves constant opportunity cost, the production possibilities curve
- a. is "bowed inward."
  - \* b. is a straight line.
  - c. is "bowed outward."
  - d. is a wavy line.
  - e. has an unpredictable shape.

118. If production involves decreasing opportunity cost, the production possibilities curve
- \* a. is "bowed inward."
  - b. is a straight line.
  - c. is "bowed outward."
  - d. is a wavy line.
  - e. has an unpredictable shape.
119. Increasing opportunity costs of producing goods imply that the production possibilities curve will be
- a. downward sloping.
  - b. upward sloping.
  - c. bowed inward.
  - \* d. bowed outward.
120. As a general rule, technological progress
- \* a. shifts the production possibilities curve outward, away from the origin.
  - b. reduces the slope of the production possibilities curve, making it flatter.
  - c. increases the slope of the production possibilities curve, making it steeper.
  - d. shifts the production possibilities curve inward, toward the origin.
121. Which of the following is true of the production possibilities curve?
- \* a. It assumes a fixed quantity of resources.
  - b. It assumes the prices of the products considered are equal.
  - c. A point inside the curve is efficient.
  - d. All of the above are correct.
122. Which of the following is true of a production possibilities curve?
- \* a. It reveals the maximum amount of any two goods that can be produced from a fixed quantity of resources.
  - b. It reveals the ideal level of technology for a country.
  - c. It assumes that the prices of the two products are equal.
  - d. For a country that could produce many different goods, it shows which two goods are most important to produce.
123. An economy produces only two goods, guns and butter. If the economy operates at a point on its production possibilities curve, it can produce more guns only if
- a. it also produces more butter.
  - b. it charges more for butter.
  - c. it shifts to a point inside its production possibilities curve.
  - \* d. it produces less butter.
124. If the resources of an economy are being used inefficiently, it would be
- \* a. possible to increase production of all goods simultaneously.
  - b. possible to increase production of one good at the expense of another.
  - c. not possible to increase production of any good.
  - d. not possible to increase economic growth.
  - e. possible to increase production with no effort.
125. "We need to be producing more computers in the United States rather than buying them from foreign countries." If resources are being used efficiently, we can produce more computers only if
- a. we produce more of all other goods and services as well.
  - \* b. we produce less of some other goods or services to free up the resources to produce computers.
  - c. computer production begins to require less technology.
  - d. the population of the United States were to be reduced.

126. Sally wishes to spend more time this week studying for her classes. Using the idea of a production possibilities constraint, and assuming Sally is currently spending all of her time efficiently, Sally can spend more time studying this week only if
- a. she also spends more time doing other things.
  - \* b. she spends less time doing other things.
  - c. Daylight Savings Time begins this week, so everyone moves their clocks ahead one hour.
  - d. none of the above.
127. A point outside the production possibilities curve represents a combination of goods that is
- a. inefficient.
  - b. efficient.
  - \* c. unattainable.
  - d. attainable.
128. If an economy operates at a point within its production possibilities curve,
- a. it lacks the resources necessary to reach the curve.
  - b. it is utilizing all of its resources efficiently.
  - c. it does not confront the problem of scarce goods relative to unlimited wants.
  - \* d. it is not efficiently using all of its resources.
129. If an economy uses its resources inefficiently, this situation would be illustrated on a production possibilities diagram as
- a. an inward shift of the production possibilities curve.
  - b. an outward shift of the production possibilities curve.
  - c. operating at a point outside the production possibilities curve.
  - \* d. operating at a point inside the production possibilities curve.
130. A production possibilities curve graphically represents the maximum quantities of two products produced when all resources in the economy are efficiently utilized. An economy that operates inside this production possibilities curve
- \* a. is using its resources inefficiently.
  - b. lacks the necessary technology to produce efficiently.
  - c. lacks the resources to produce goods efficiently.
  - d. is utilizing its available resources as efficiently as possible.
131. Which of the following will be most likely to cause the production possibilities curve for a country to shift inward?
- a. an increase in the labor force
  - b. an increase in unemployment
  - c. development of an improved technological method of production
  - \* d. a decrease in the stock of physical capital
132. In Europe during the 14th century, the Black Plague killed 24 million people or close to 37 percent of the population. How would this affect the production possibilities curves for the countries of Europe at that time?
- a. The production possibilities curves for these countries would have shifted outward.
  - \* b. The production possibilities curves for these countries would have shifted inward.
  - c. The production possibilities curves for these countries would have been unaffected.
  - d. This would have been illustrated by a movement along the production possibilities curves for these countries, but it would not have shifted them.

133. Which of the following would be least likely to cause the production possibilities curve to shift outward?
- a. a decreased desire for leisure by workers in the economy
  - b. an invention that requires fewer resources to produce a good
  - \* c. a shift in consumer preferences that causes expansion in the output of one product and a decline in output of other products
  - d. an expansion in the man-made productive resources available to the economy as the result of a high rate of investment
134. If the citizens of a country were to work harder and take less leisure time, it would
- \* a. shift the production possibilities curve outward.
  - b. cause an economy to operate inside its production possibilities curve.
  - c. shift the production possibilities curve inward.
  - d. This is a trick question, because work effort has nothing to do with the production possibilities curve.
135. Which of the following will most likely cause an outward shift in the production possibilities curve?
- a. a reduction in the man-made productive resources available to the economy as the result of a decline in investment
  - b. an increase in government payments to farmers for taking land out of production
  - \* c. an increase from 40 to 50 hours in the average number of hours worked per week
  - d. None of the above would cause an outward shift in the production possibilities curve.
136. Over time, an increase in a nation's stock of physical capital will
- a. shift the production possibilities curve inward.
  - b. cause an economy to operate inside its production possibilities curve.
  - \* c. shift the production possibilities curve outward.
  - d. eliminate the basic economic problem of scarcity.
137. With time, which one of the following strategies would most likely result in an outward shift in the production possibilities curve of an economy?
- a. passage of legislation reducing the workweek to 30 hours
  - b. instituting a tax policy encouraging consumption at the expense of investment
  - \* c. instituting a tax policy encouraging investment at the expense of consumption
  - d. an increase in the marginal income tax rate, which would reduce the work effort of individuals
138. Using a production possibilities curve, a technological advance that increases the amount of output for the same amount of inputs would be illustrated as
- a. a flattening of the curve.
  - b. a movement from one point to another point along the curve.
  - \* c. an outward shift of the curve.
  - d. a movement from a point on the curve to a point inside the curve.
139. An improvement in a country's legal system that enhanced the ability of citizens to protect their property rights and enforce contracts would result in which of the following changes to the country's production possibilities curve?
- a. a movement from a point on the curve to a point outside the curve
  - b. a movement from one point to another point along the curve
  - \* c. an outward shift of the curve
  - d. a movement from a point on the curve to a point inside the curve

140. Which of the following is true?
- a. The production possibilities curve indicates that it will be impossible to expand total output with the passage of time.
  - b. As long as resources are scarce, output cannot be increased.
  - c. The size of the economic pie is fixed, and therefore, if one individual has more income, others must have less.
  - \* d. Over time, the output of goods and services can be increased through human ingenuity and discovery of better ways of doing things.
141. With time, which one of the following strategies will most likely result in an outward shift in an economy's production possibilities curve?
- a. passage of legislation reducing the workweek to 30 hours
  - \* b. institution of a tax policy encouraging research that advances technology
  - c. institution of a tax policy encouraging consumption at the expense of investment
  - d. passage of a law requiring the minimum wage to double every year
142. A nation that protects its workers from unemployment by limiting the use (by employers) of technological improvements will
- a. grow more rapidly because the rate of unemployment will be lower.
  - b. grow more rapidly because investors prefer a stable business environment rather than the uncertainties that accompany technological change.
  - \* c. grow less rapidly because technological change is an important factor contributing to the growth of output.
  - d. grow just as much as nations that adopt more rapidly technological improvements.
143. Entrepreneurs are
- \* a. profit-seeking decision makers who decide which business projects to undertake.
  - b. people who loan money to other business decision makers.
  - c. managers who generally work for a salary because they are unwilling to take risks.
  - d. none of the above.
144. A profit-seeking decision maker who decides which business projects to undertake and how they should be undertaken is called
- a. a key man.
  - \* b. an entrepreneur.
  - c. a progressor.
  - d. a stakeholder.
145. Entrepreneurs have a strong incentive to
- a. discover new production techniques that reduce costs.
  - b. introduce new products that are highly valued relative to their cost.
  - c. produce goods that are valued more highly than the resources required for their production.
  - \* d. do all of the above.
146. In order to prosper, entrepreneurs must
- \* a. undertake projects that create wealth and increase the value of resources.
  - b. find ways to prevent technological change.
  - c. have at least \$50 million of their own wealth with which to finance projects that they want to undertake.
  - d. undertake projects that use resources that are more valuable than is the output they produce.

147. The creation of a new product or process, often facilitated by the knowledge of engineering and scientific relationships, is known as
- \* a. invention.
  - b. innovation.
  - c. application.
  - d. sublimation.
148. The successful introduction and adoption of a new product or process is known as
- a. invention.
  - \* b. innovation.
  - c. origination.
  - d. adaptation.
149. Suppose that country A produces mostly consumption goods and few investment goods, while country B produces mostly investment goods with few consumption goods. Other things constant, which of the following is most likely to happen in the future?
- a. The per capita income of country A will grow more rapidly than country B.
  - b. The population of country B will grow more rapidly than country A.
  - \* c. The production possibilities curve (PPC) of country B will shift out more rapidly than the PPC of country A.
  - d. The production possibilities curve (PPC) of country A will shift out more rapidly than the PPC of country B.
150. Other things constant, which of the following would you expect to increase the output growth rate of a country?
- a. an increase in the rate of taxation on personal income
  - \* b. an increase in the rate of investment as a share of total output
  - c. passage of regulations restricting international trade
  - d. passage of regulations restricting domestic trade
151. Creative destruction refers to the process where:
- \* a. new products and methods of production are continuously replacing old ones
  - b. producing more of one good causes you to produce less of another
  - c. everybody involved is made worse off
  - d. new ways to destroy buildings are employed
152. The process by which new products and methods of production are continuously replacing old ones is known as:
- a. The invisible hand theory
  - b. The production possibilities frontier
  - \* c. Creative destruction
  - d. The fallacy of composition

## TRADE, OUTPUT, AND LIVING STANDARDS

153. John takes 10 minutes to iron a shirt and 20 minutes to type a paper. Harry takes 10 minutes to iron a shirt and 30 minutes to type a paper. Which of the following statements is correct?
- \* a. Harry has a comparative advantage in ironing.
  - b. Harry has a comparative advantage in typing.
  - c. John has a comparative advantage in ironing.
  - d. Neither can gain from specialization and exchange.



154. Don can produce 10 pens or 20 pencils in one hour while Bob can produce 15 pens or 5 pencils in one hour. Which of the following statements is correct?
- a. Bob has a comparative advantage over Don in the production of pencils
  - \* b. Bob has a comparative advantage over Don in the production of pens
  - c. Don has a comparative advantage over Bob in the production of pens
  - d. Bob and Don cannot gain from specialization and exchange.
155. The notion that specialization in goods that one can produce at a low opportunity cost will make it possible for trading partners to produce a larger joint output is called
- a. the law of absolute advantage.
  - \* b. the law of comparative advantage.
  - c. the law of production possibilities.
  - d. the exchange maximum principle.
156. The economic principle that states that individuals or nations can gain by specializing in the production of goods that they produce cheaply and exchanging for other desired goods that they could only produce at a higher cost is
- a. the law of absolute advantage.
  - \* b. the law of comparative advantage.
  - c. the law of production possibilities.
  - d. the exchange maximum principle.
157. According to the law of comparative advantage, both individuals and nations will be able to produce a larger joint output if each productive activity is undertaken by
- a. the high opportunity cost producer.
  - \* b. the low opportunity cost producer.
  - c. the producer who is able to hire workers at the lowest wage.
  - d. the party that can complete the productive activity most rapidly.
158. The law of comparative advantage implies that a nation, individual, or region should produce those economic goods for which it
- a. has an absolute advantage.
  - \* b. is a low opportunity cost producer.
  - c. is a high opportunity cost producer.
  - d. pays the highest wage rate.
159. The law of comparative advantage implies that a nation, individual, or region should trade for those economic goods for which it
- a. has an absolute advantage.
  - b. has a comparative advantage.
  - c. is a low opportunity cost producer.
  - \* d. is a high opportunity cost producer.
160. According to the law of comparative advantage, if a firm or a nation desires to maximize its output, each productive assignment should be carried out by those who
- a. have the highest opportunity cost.
  - \* b. have the lowest opportunity cost.
  - c. have an absolute advantage in the productive activity.
  - d. can complete the productive activity most rapidly.

161. According to the law of comparative advantage,
- individuals and nations gain when they specialize in producing those goods they consume.
  - individuals and nations gain when they specialize in producing goods they can produce at a high opportunity cost and can exchange for other desired goods they can produce cheaply.
  - \* individuals and nations gain when they specialize in producing those items for which they are the low opportunity cost producers and exchange for other desired goods they can't produce as cheaply.
  - d. all of the above are true.
162. The "law of comparative advantage" suggests that
- curtailing U.S. trade with other countries would make U.S. consumers worse off.
  - everyone would be better off if they were self-sufficient.
  - countries will tend to export commodities that they can produce at a relatively low opportunity cost.
  - \* d. both answers a and c are correct.
163. The law of comparative advantage explains why
- \* a. specialization and exchange will make it possible for trading partners to expand their joint output.
  - b. there will be an inverse relationship between the price of a product and the quantity of it that will be demanded.
  - c. larger firms will have lower per unit costs than smaller firms.
  - d. an increase in the price of a good will lead to an expansion in the quantity supplied by business firms.
164. The law of comparative advantage applies to exchange between
- individuals.
  - regions.
  - nations.
  - \* d. all of the above.
165. Which of the following is an implication of the law of comparative advantage?
- Countries with small endowments of labor relative to capital should specialize in producing labor-intensive commodities.
  - Since workers in high-income countries utilize larger amounts of capital than workers in less developed nations, trade between capital-rich and capital-poor nations results in the exploitation of labor in the less developed countries.
  - Countries that are high cost producers of agricultural products should trade those products for goods they can produce only at a low opportunity cost.
  - \* d. Countries that are low opportunity cost producers of timber products should trade those products for goods they can produce only at a high opportunity cost.
166. Which of the following appropriately applies the law of comparative advantage?
- Countries with small endowments of labor relative to capital should specialize in producing labor-intensive commodities.
  - Since Mexican labor is cheaper than American labor, trade between the countries results in exploitation of American workers.
  - Since workers in countries such as the United States utilize larger amounts of capital than workers in less developed nations, trade between capital-rich and capital-poor nations results in the exploitation of labor in the less developed countries.
  - \* d. Countries that are low cost producers of agricultural products should trade those products for goods they can produce only at a high opportunity cost.

167. Kelly is an attorney and also an excellent typist. She can type 120 words per minute, but she is pressed for time because she has all the legal work she can handle at \$100 per hour. Kelly's friend Todd drives a taxi and would like some typing work but can only type 60 words per minute. According to the law of comparative advantage, Kelly should hire Todd to do her typing if and only if his wage rate is less than
- a. \$10 per hour.
  - \* b. \$50 per hour.
  - c. \$60 per hour.
  - d. \$100 per hour.
168. Kelly is an attorney and also an excellent typist. She can type 120 words per minute, but she is pressed for time because she has all the legal work she can handle at \$80 per hour. Kelly's friend Todd drives a taxi and would like some typing work but can only type 60 words per minute. The economic efficiency criterion indicates
- a. Kelly should do the typing.
  - b. Todd should do the typing, provided he is willing to do so for less than \$80 per hour.
  - \* c. Todd should do the typing, provided he is willing to do so for less than \$40 per hour.
  - d. Todd should do the typing, provided he is paid more than \$40 per hour.
169. Given freedom of movement for both goods and resources, if Florida producers specialize in oranges and Georgia producers specialize in peaches, it would be reasonable to conclude that
- a. the opportunity cost of growing oranges is higher in Florida than in Georgia.
  - b. Georgia has a comparative advantage in producing oranges.
  - \* c. Florida has a comparative advantage in producing oranges.
  - d. total output will be expanded when Georgia allocates more resources to producing oranges and Florida allocates more resources to producing peaches.
170. Opportunity costs differ among nations primarily because
- a. nations employ different currencies.
  - \* b. nations have different endowments of land, labor skills, capital, and technology.
  - c. nations have different religious, political, and economic institutions.
  - d. the work-leisure preferences of people vary considerably from one nation to another.
171. Which of the following observations is consistent with the law of comparative advantage?
- a. Gwen is a highly paid lawyer. She can type 80 words per minute, yet still hires a secretary who can only type 50 words per minute.
  - b. College-educated mothers are less likely to stay home with their children than are less educated women.
  - c. Sean earns a high salary as a computer software consultant. Even though Sean is a gourmet cook, he often eats out and rarely cooks.
  - \* d. All of the above are consistent with the law of comparative advantage.
172. "Here in East Abalone, we are proud of our ability to be self-sufficient. We do not trade with other nations." From an economic perspective, citizens of this (mythical) nation can be expected to
- a. gain materially from this policy because they can consume more goods over time than if they engaged in trade with foreigners.
  - \* b. produce less total value than they could if they specialized and engaged in trade with other nations.
  - c. gain from more rapid growth since home markets are reserved for home producers.
  - d. be just as well off without trade since the value of what is sent to other nations in trade just equals the value of what is received in trade.

173. Economic analysis suggests that gains from specialization and exchange
- a. will not be realized unless a central planning authority requires that all goods be produced by the low opportunity cost supplier.
  - \* b. will be realized if individuals are allowed to pursue goals that are in their own self-interest.
  - c. will not be realized unless business firms employ economists when making decisions about the proper combination of resources to utilize in the production process.
  - d. will be realized if individuals place the public interest above the pursuit of their own self-interest.
174. The most important source of gain from the division of labor is
- a. the repeal of the law of comparative advantage.
  - b. the reduction in work effort because incentives are adversely affected.
  - c. the increase in the number of jobs since more labor is used to produce goods.
  - \* d. the benefits that result from specialization, adoption of mass production techniques, and exchange.
175. Specialization in production is beneficial because
- a. it allows everyone to have a job that they like.
  - \* b. it permits people to expand production and achieve rates of output that would otherwise be unattainable.
  - c. it allows everyone to be self-sufficient.
  - d. it eliminates the need for the division of labor.
176. Which of the following most accurately states the economic significance of exchange?
- a. Physical goods have value because they exist; exchange can neither increase nor decrease their value.
  - b. Exchange creates value by permitting trading partners to expand total output as the result of specialization in areas where they have a comparative advantage.
  - c. Exchange creates value by moving goods from people who value the goods less to people who value the goods more.
  - \* d. Both b and c are true.
177. Trade creates value by
- a. moving goods from people who value the goods less to people who value the goods more.
  - b. permitting trading partners to expand output through specialization in areas where they each have a comparative advantage.
  - c. permitting trading partners to expand output through the adoption of mass production methods.
  - \* d. all of the above.
178. Which of the following statements about exchange is true?
- a. If everyone starts off with the same quantities of each good, it would be impossible to realize gains from trade.
  - \* b. Exchange tends to move each good toward those individuals who value the good more highly.
  - c. Exchange always results in one party being made better off and the other being made worse off.
  - d. For trade to occur, everyone must start off with the same value of the good that is traded.
179. Which of the following is true of exchange?
- a. The value of a good is determined by the cost of the resources required to produce the good.
  - \* b. Exchange makes it possible for trading partners to produce more goods through division of labor and adoption of mass production methods.
  - c. Nothing new is created by exchange; if one party to an exchange gains, the other must lose an equal amount.
  - d. Both a and b are true.

180. Which of the following is true of exchange?
- a. Exchange is a zero sum activity; if one party to an exchange gains, the other must lose an equal amount.
  - b. The exchange value of a good is determined by the cost of the resources required to produce the good.
  - c. The total output trading partners are able to produce is not influenced by whether the partners trade with each other.
  - \* d. Exchange permits trading partners to expand their total output of goods and services as the result of greater specialization in areas where each has a comparative advantage.
181. Why is trade an important source of economic progress?
- a. It allows the trading partners to produce a larger joint output through specialization in the areas where they have a comparative advantage.
  - b. It allows the trading partners to produce a larger joint output as the result of greater realization of cost reductions that accompany the adoption of mass production methods.
  - c. It makes it possible to realize gains from the discovery and dissemination of innovative products and production processes.
  - \* d. All of the above are correct.

## HUMAN INGENUITY AND THE CREATION OF WEALTH

182. When an entrepreneur like Bill Gates makes \$10 billion through creating and selling new products,
- a. there will be exactly \$10 billion less for other individuals in the economy.
  - \* b. the total size of the economic pie has been increased.
  - c. there will be more than \$10 billion in losses to other workers who lose their jobs.
  - d. it is likely that the new products are not as good as other products that are available in the market.
183. “The enormous wealth made by some individuals in our country is primarily the result of the profit made at the expense of others.” The person who made this statement
- \* a. has failed to comprehend that trade is mutually advantageous and that the overall size of the economic pie is not fixed.
  - b. has failed to comprehend the fallacy of composition.
  - c. has failed to understand the significance of the production possibilities constraint.
  - d. has utilized the economic way of thinking; the statement is essentially correct.

## ECONOMIC ORGANIZATION

184. What are the three basic questions faced by every economy?
- \* a. What, how, and for whom will goods be produced?
  - b. When, where, and how much will be produced?
  - c. Why, where, and when will goods be produced?
  - d. How, how much, and why will goods be produced?
185. Which of the following is not a basic question that each economy must answer?
- \* a. Which resources are scarce?
  - b. For whom shall the goods be produced?
  - c. How shall goods be produced?
  - d. What goods shall be produced?

186. Three basic decisions must be made by all economies. What are they?
- a. How much will be produced; when will it be produced; who will produce it?
  - \* b. What goods will be produced; how will goods be produced; for whom will goods be produced?
  - c. What will be consumed; how will goods be consumed; for whom will goods be consumed?
  - d. How will the opportunity cost principle be applied; if the law of comparative advantage will be utilized, how will it be utilized; will the production possibilities constraint apply?
187. Economic debates that focus on the distribution of a nation's income are generally associated with which basic economic question?
- a. How is production going to be organized?
  - b. What goods will be produced?
  - c. What resources will be utilized in the productive process?
  - \* d. For whom will the goods be produced?
188. In a market economy, what is produced is ultimately determined by
- \* a. consumers.
  - b. producers.
  - c. the government.
  - d. exporters.
189. Even countries that depend primarily on market forces to resolve the basic economic questions will usually rely on the collective decision-making process to
- a. determine the prices of goods and resources.
  - b. allocate goods that are essential to life.
  - c. determine the distribution of income among citizens.
  - \* d. define and enforce private-property rights and designate the acceptable forms of competitive economic behavior.
190. When collective decision making is utilized to resolve economic questions regarding the allocation of resources,
- a. decentralized decision making is inevitable.
  - \* b. central planning and political bargaining will replace market forces.
  - c. individual preferences are of no importance.
  - d. economic equality will result.
191. When collective decision making is utilized to resolve economic questions regarding the allocation of resources,
- \* a. the role of markets will be replaced by political decision making.
  - b. centralized decision making in all areas is inevitable.
  - c. the preferences of individuals are of no importance.
  - d. economic efficiency will be assured.
192. A form of economic organization that relies primarily on private ownership of productive assets, freedom of exchange, and market prices to allocate goods and resources is often called
- a. national socialism.
  - b. the welfare state.
  - c. a corporate economy.
  - \* d. capitalism.

193. A system of economic organization in which the ownership and control of productive capital assets rests with the state and in which resources are allocated through central planning and political decision making is called
- \* a. socialism.
  - b. a market economy.
  - c. a corporate economy.
  - d. capitalism.

## ADDENDUM—COMPARATIVE ADVANTAGE, SPECIALIZATION, AND GAINS FROM TRADE

Use the production possibilities data below for Lebos and Slavia to answer the following questions.

	Food	Clothing
Lebos	0	6
	2	4
	4	2
	6	0

	Food	Clothing
Slavia	0	9
	1	6
	2	3
	3	0

194. Which of the following is true?
- a. Lebos has the comparative advantage in both goods.
  - \* b. Lebos has the comparative advantage in food.
  - c. Slavia has the comparative advantage in food.
  - d. It would be impossible for Lebos and Slavia to gain from trade.
195. Which of the following would be a mutually agreeable rate of exchange?
- a.  $1F = 1C$
  - \* b.  $1F = 2C$
  - c.  $1F = 3C$
  - d. No exchange rate would be mutually agreeable.
196. According to the law of comparative advantage, both Lebos and Slavia could gain if
- a. Lebos produced all of the food and clothing and Slavia did not produce anything.
  - b. Lebos specialized in producing clothing, Slavia specialized in producing food, and they traded.
  - \* c. Lebos specialized in producing food, Slavia specialized in producing clothing, and they traded.
  - d. Slavia and Lebos were both self-sufficient and did not trade.

Use the production possibilities data below for Avokia and Baldonia to answer the following questions.

Avokia	Oranges	Apples
	0	16
	1	12
	2	8
	3	4
	4	0

Baldonia	Oranges	Apples
	0	8
	1	6
	2	4
	3	2
	4	0

197. Which of the following is correct?
- Avokia has the comparative advantage in both goods.
  - \* Baldonia has the comparative advantage in oranges.
  - Avokia has the comparative advantage in oranges.
  - It would be impossible for Avokia and Baldonia to gain from trade.
198. Which of the following would be a mutually agreeable rate of exchange?
- Baldonia trades one orange to Avokia for every one apple.
  - Baldonia trades one orange to Avokia for every two apples.
  - \* Baldonia trades one orange to Avokia for every three apples.
  - Baldonia trades one orange to Avokia for every four apples.
199. According to the law of comparative advantage, both Avokia and Baldonia could gain if
- Avokia produced all of the apples and oranges and Baldonia did not produce anything.
  - \* Avokia specialized in producing apples, Baldonia specialized in producing oranges, and they traded.
  - Avokia specialized in producing oranges, Baldonia specialized in producing apples, and they traded.
  - Baldonia and Avokia were both self-sufficient and did not trade.
200. Use the table below to choose the correct answer. The table outlines the production possibilities of Robinson Crusoe and Joe Friday.

Friday		Crusoe	
Good Y	Good X	Good Y	Good X
1	3	2	3
2	2	4	2
3	1	6	1

- If Crusoe and Friday want to maximize their consumption possibilities,
- Crusoe should specialize in producing good X and Friday in producing good Y, but no trade should be allowed.
  - Crusoe should specialize in producing good X and Friday in producing good Y; trade should occur to maximize joint consumption.
  - \* Crusoe should specialize in producing good Y and Friday in producing good X; trade should occur to maximize joint consumption.
  - Not enough information is provided to conclusively answer this question.



201. Use the table below to choose the correct answer. The table outlines the production possibilities of Robinson Crusoe and Joe Friday.

Friday		Crusoe	
Good Y	Good X	Good Y	Good X
2	3	1	3
4	2	2	2
6	1	3	1

If Crusoe and Friday want to maximize their consumption possibilities,

- Crusoe should specialize in producing good X and Friday in producing good Y, but no trade should be allowed.
- \* Crusoe should specialize in producing good X and Friday in producing good Y; trade should occur to maximize joint consumption.
- Crusoe should specialize in producing good Y and Friday in producing good X; trade should occur to maximize joint consumption.
- both individuals should strive for self-sufficiency, which always maximizes output.

Use the production possibilities data below to answer the following questions.

	Labor Hours Needed to Make 1 Pound of:		Pounds produced in 40 hours:	
	Meat	Potatoes	Meat	Potatoes
Farmer	8	2	5	20
Rancher	4	5	10	8

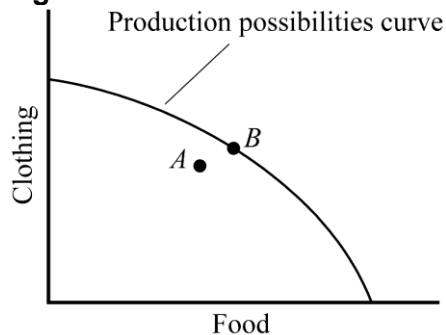
202. The opportunity cost of 1 pound of meat for the farmer is
- 1/4 hour of labor.
  - 4 hours of labor.
  - \* 4 pounds of potatoes.
  - 1/4 pound of potatoes.
203. The opportunity cost of 1 pound of meat for the rancher is
- 4 hours of labor.
  - 5 hours of labor.
  - \* 4/5 pounds of potatoes.
  - 5/4 pounds of potatoes.
204. The opportunity cost of 1 pound of potatoes for the farmer is
- 8 hours of labor.
  - 2 hours of labor.
  - 4 pounds of meat.
  - \* 1/4 pound of meat.
205. The opportunity cost of 1 pound of potatoes for the rancher is
- 5 hours of labor.
  - 4 hours of labor.
  - \* 5/4 pounds of meat.
  - 4/5 pound of meat.
206. The rancher has a comparative advantage in
- neither good, and the farmer has a comparative advantage in both goods.
  - both goods, and the farmer has a comparative advantage in neither good.
  - potatoes, and the farmer has a comparative advantage in meat.
  - \* meat, and the farmer has a comparative advantage in potatoes.

207. The farmer and the rancher both could benefit if the farmer were to specialize in
- a. meat and the rancher were to specialize in potatoes.
  - \* b. potatoes and the rancher were to specialize in meat.
  - c. neither good and the rancher were to specialize in both goods.
  - d. none of the above; they cannot both benefit by specialization and trade.
208. Suppose you can type a paper in two hours or mow the lawn in four hours, while it takes your friend Ann eight hours to type a paper or two hours to mow the lawn. Which of the following is true?
- \* a. You have a comparative advantage in typing.
  - b. You have a comparative advantage in mowing the lawn.
  - c. You and Ann could save time if you mowed her lawn while she typed your paper.
  - d. You and Ann cannot gain from specialization and trade.
209. If Shawn can produce donuts at a lower opportunity cost than Sue, then
- \* a. Shawn has a comparative advantage in the production of donuts.
  - b. Sue has a comparative advantage in the production of donuts.
  - c. Shawn should not produce donuts.
  - d. Shawn is capable of producing more donuts than Sue in a given amount of time.
210. If Shawn can produce more donuts in one day than Sue can produce in one day, then
- a. Shawn has a comparative advantage in the production of donuts.
  - b. Sue has a comparative advantage in the production of donuts.
  - \* c. Shawn has an absolute advantage in the production of donuts.
  - d. Shawn should produce donuts and Sue should spend her time on a different activity.
211. Two individuals engage in the same two productive activities. In which of the following circumstances would neither individual have a comparative advantage in either activity?
- a. One individual's production possibilities frontier is steeper than the other individual's production possibilities frontier.
  - b. One individual is faster at both activities than the other individual.
  - \* c. One individual's opportunity costs are the same as the other individual's opportunity costs.
  - d. None of the above is correct; one of the two individuals always will have a comparative advantage in at least one of the two activities.
212. The principle of comparative advantage does not provide answers to certain questions. One of those questions is as follows:
- a. Do specialization and trade benefit more than one party to a trade?
  - b. Is it absolute advantage or comparative advantage that really matters?
  - \* c. How are the gains from trade shared among the parties to a trade?
  - d. Is it possible for specialization and trade to increase total output of traded goods?
213. The principle of comparative advantage does not provide answers to certain questions. One of those questions is as follows:
- a. Is it possible for specialization and trade to benefit more than one party to a trade?
  - b. Is it possible for specialization and trade to increase total output of traded goods?
  - c. Do opportunity costs play a role in people's decisions to specialize in certain activities?
  - \* d. What determines the price at which trade takes place?

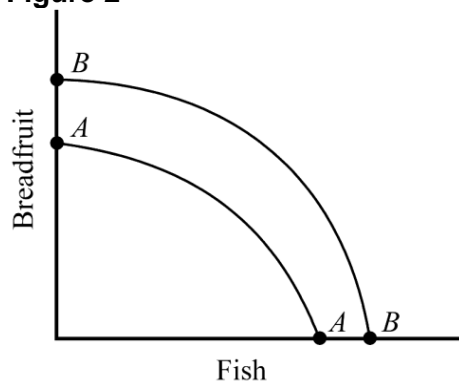
214. Suppose you can type a paper in two hours or mow the lawn in four hours. It takes your friend Ann eight hours to type a paper of the same length and five hours to mow the same size of lawn. Which of the following is true?
- Ann is the high-opportunity cost producer of both typing and mowing.
  - Since you can type papers and mow lawns faster than Ann, you and Ann cannot benefit from specialization and trade.
  - \* You and Ann could expand output and gain from trade if she specialized in mowing lawns and you specialized in typing papers.
  - You and Ann could expand output and gain from trade if she specialized in typing papers and you specialized in mowing lawns.
215. Sean can build sandboxes twice as fast as Matt. Sean can assemble swing sets three times as fast as Matt. The law of comparative advantage suggests that
- Sean can gain only at Matt's expense.
  - Matt can gain only at Sean's expense.
  - \* both can gain if Sean specializes in assembling swing sets and Matt in building sandboxes.
  - both can gain if Sean specializes in building sandboxes and Matt in assembling swing sets.
216. If Kim can either wash 10 cars or wax 2 cars during a day, and Vince can either wash 17 cars or wax 2 cars during a day, then according to the law of comparative advantage,
- Vince's opportunity cost of waxing a car is less than Kim's.
  - \* their total output can be expanded if Kim specializes in waxing and Vince in washing.
  - their total output can be expanded if Kim specializes in washing and Vince in waxing.
  - it would be impossible for Vince and Kim to increase their total output through specialization and mutual exchange.
217. If Kim can wash 10 cars or wax 2 cars during a day, and Susan can wash 8 cars or wax 2 cars during a day, then according to the law of comparative advantage,
- Susan's opportunity cost of waxing a car is greater than Kim's.
  - \* their total output can be expanded if Susan specializes in waxing and Kim in washing.
  - their total output can be expanded if Susan specializes in washing and Kim in waxing.
  - it is impossible to expand total output through specialization and mutual exchange in this case.

## GRAPHIC QUESTIONS

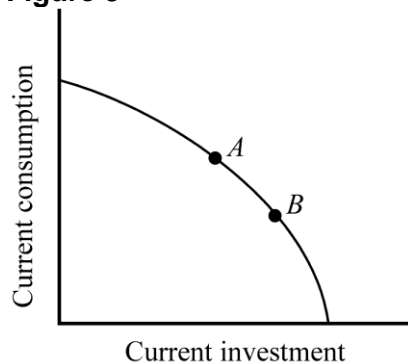
Figure 1



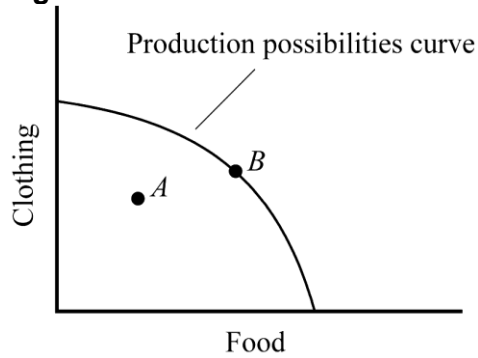
218. In Figure 1, point A is
- unattainable.
  - \* inefficient.
  - efficient.
  - preferable to point B.

**Figure 2**

219. Which of the following would most likely cause the production possibilities curve for breadfruit and fish to shift outward from *AA* to *BB* in Figure 2?
- a decrease in the labor force of the country
  - a sudden change in consumer preferences for more fish and less breadfruit
  - a major technological advance
  - a decrease in the capital stock

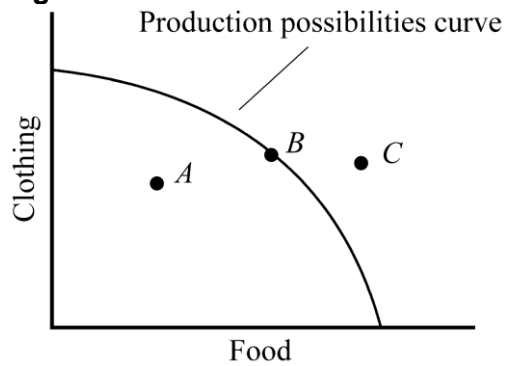
**Figure 3**

220. Points *A* and *B* in Figure 3 indicate consumption and investment for two economies. Other things constant, which of the economies is likely to grow more rapidly in the future?
- economy A
  - economy B
  - They can be expected to grow at the same rate.
  - This is uncertain since growth is not influenced by the factors indicated in this example.

**Figure 4**

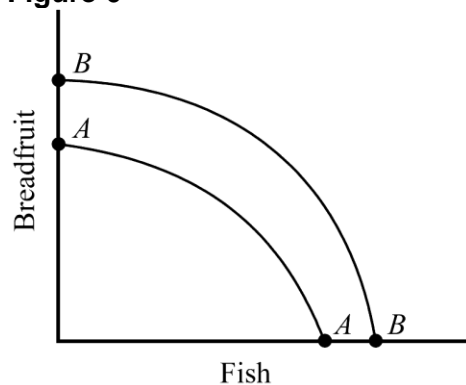
221. Which of the following is true of Figure 4?

- a. If the economy operates at point *A*, it is impossible to produce more of both food and clothing.
- \* b. If the economy operates at point *B*, it is impossible to increase the output of clothing without giving up food production.
- c. If the economy operates at point *A*, resources are being used efficiently.
- d. If the economy operates at point *B*, resources are being used inefficiently.

**Figure 5**

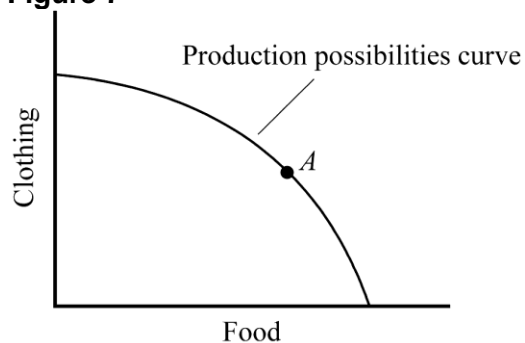
222. In Figure 5, which of the following is true?

- a. Point *A* is inefficient.
- b. Point *B* is efficient.
- c. Point *C* is unattainable.
- \* d. All of the above are true.

**Figure 6**

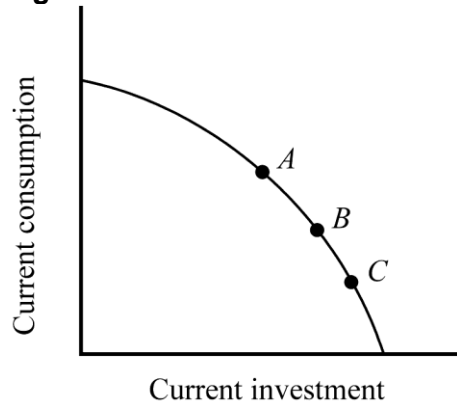
223. Which of the following will most likely shift the production possibilities curve for breadfruit and fish outward from *AA* to *BB* in Figure 6?

- \* a. an improvement in the form of economic organization
- b. lower investment and a reduction in the country's capital stock
- c. an increase in the price of breadfruit
- d. a decrease in the average number of hours worked

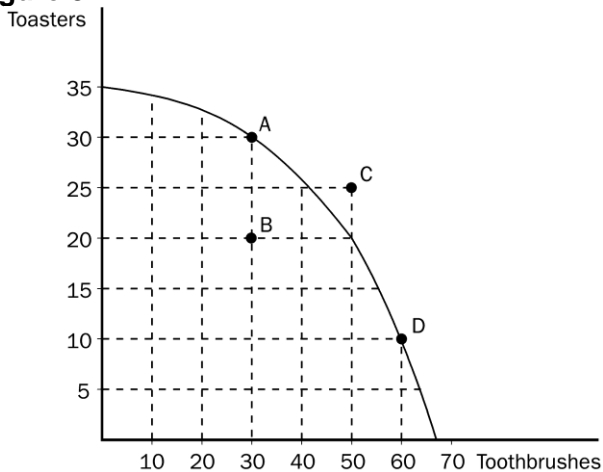
**Figure 7**

224. If an economy operates at point *A* on the production possibilities curve shown in Figure 7,

- a. to produce more food, it would have to reduce its production of clothing.
- b. to produce more clothing, it would have to reduce the production of food.
- c. it is operating efficiently.
- \* d. all of the above would be correct.

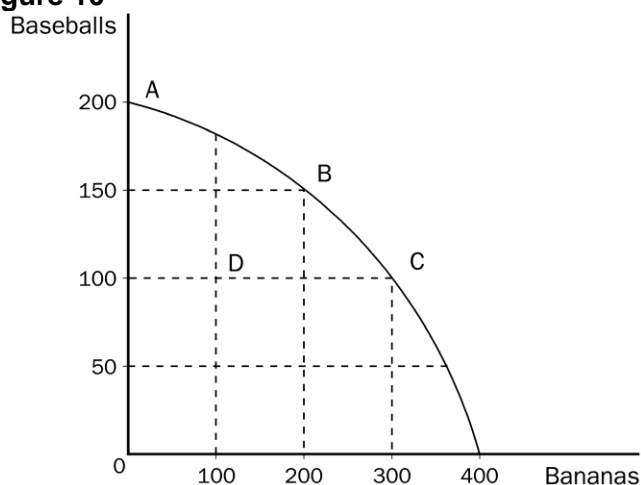
**Figure 8**

225. Points *A*, *B*, and *C* in Figure 8 indicate consumption and investment for three economies. Other things constant, which of the economies is likely to grow more rapidly in the future?
- economy *A*
  - economy *B*
  - economy *C*
- \* d. They would all be expected to grow at the same rate.

**Figure 9**

226. Refer to Figure 9. If the economy moves from point *A* to point *D*, the opportunity cost is
- 10 toasters.
  - 20 toasters.
  - 30 toasters.
  - 30 toothbrushes.
- \* 227. Refer to Figure 9. The opportunity cost of obtaining 15 additional toasters by moving from point *D* to point *C* is
- 10 toothbrushes.
  - 20 toothbrushes.
  - 30 toothbrushes.
- \* d. none of the above; the economy cannot move from point *D* to point *C*.

228. Refer to Figure 9. The opportunity cost of obtaining 10 additional toasters by moving from point B to point A is
- 10 toothbrushes.
  - 20 toothbrushes.
  - 30 toothbrushes.
  - zero, since the economy has the additional resources to produce 10 additional toasters.
- \* 229. Refer to Figure 9. Suppose the economy is producing at point B. Which of the following statements would best explain this situation?
- The economy lacks the resources to produce at a more desirable point.
  - The economy's available technology prevents it from producing at a more desirable point.
  - There is widespread unemployment in the economy.
  - Any of the above statements would be a legitimate explanation for this situation.

**Figure 10**

230. Refer to Figure 10. What is the opportunity cost to society of the movement from point A to point C?
- 50 baseballs
  - 100 baseballs
  - 100 bananas
  - 300 bananas
- \* 231. Refer to Figure 10. A movement from point C to point D could be caused by
- unemployment.
  - a decrease in society's preference for bananas.
  - fewer resources available for production of bananas.
  - All of the above are correct.
232. Refer to Figure 10. If this economy put all available resources into the production of bananas, it could produce
- 200 bananas and also 150 baseballs.
  - 300 bananas and also 100 baseballs.
  - 400 bananas and no baseballs.
  - It is impossible to know unless we know the quantity of resources available.



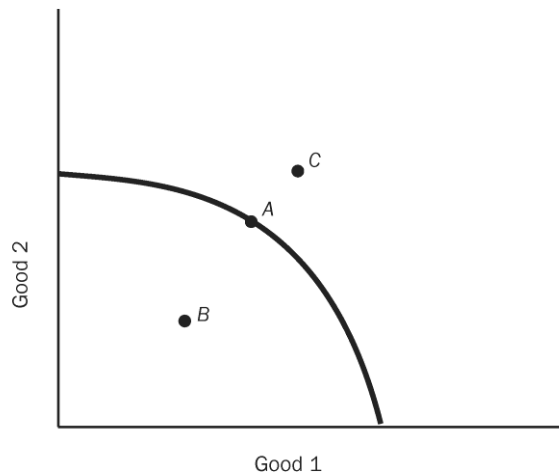
233. Refer to Figure 10. If the economy moves from point C to point B, then which of the following statements is correct?
- a. The economy benefited from a technological advance in the production of baseballs.
  - \* b. The opportunity cost of each additional baseball is 2 bananas.
  - c. The opportunity cost of each additional banana is 2 baseballs.
  - d. The move involves no opportunity cost; it simply reflects the desires of the economy's citizens.

## COURSEBOOK: MULTIPLE CHOICE QUESTIONS

234. The opportunity cost to the United States of placing a man on the moon was
- a. the loss of government revenues that were allocated to the mission.
  - b. the cost of all production involved in the space program.
  - \* c. the loss of utility from the highest valued bundle of products that had to be forgone because of the moon mission.
  - d. less than zero, because the long-run benefit of the project will be greater than the cost.
235. When Benjamin Franklin wrote, "Remember that time is money!" he understood
- a. the incentives created by property rights.
  - b. the law of comparative advantage.
  - \* c. the concept of opportunity cost.
  - d. that watches cost money.
236. An airline ticket from Seattle to Miami costs \$525. A bus ticket is \$325. Traveling by plane will take 5 hours, compared with 25 hours by bus. Thus, the plane costs \$200 more but saves 20 hours of time. (Hint: Note how we are "thinking at the margin" here by looking at the changes.) Other things constant, an individual will gain by choosing air travel if, and only if, each hour of her time is valued at more than
- \* a. \$10 per hour.
  - b. \$13 per hour.
  - c. \$20 per hour.
  - d. \$105 per hour.
237. Which of the following best describes the implications of the law of comparative advantage? If each person sells goods for which he or she has the greatest comparative advantage in production and buys those for which his or her comparative advantage is least, the
- \* a. total output available to each person can be expanded by specialization and exchange.
  - b. total output will fall.
  - c. buyers of goods will gain at the expense of sellers.
  - d. sellers of goods will gain at the expense of buyers.
238. Keri decided to sleep in today rather than attend her 9 a.m. economics class. According to economic analysis, her choice was
- a. irrational, because economic analysis suggests you should always attend classes that you have already paid for.
  - b. irrational, because oversleeping is not in Keri's self-interest.
  - c. rational if Keri has not missed any other classes.
  - \* d. rational if Keri values sleep more highly than the benefit she expects to receive from attending the class.

239. Which of the following is not one of the basic economic questions that all economies must answer?
- a. What will be produced?
  - b. To whom will the goods produced be allocated?
  - c. How will goods be produced?
  - \* d. Which government agency will set the prices of the goods produced?
240. The owners of private property will
- a. use their property for selfish ends, taking no account of the impact their behavior has on others.
  - \* b. use their property in ways that others value because the market will generally reward them with profits (or a higher selling price) if they do so.
  - c. find very little incentive to take care of the property or conserve it for the future.
  - d. lose profits when they take the wishes of others into consideration.
241. Ken values his boat at \$5,000, and Monica values it at \$8,000. If Monica buys it from Ken for \$7,000, which of the following is true?
- \* a. Ken gains \$2,000 of value, and Monica gains \$1,000 of value.
  - b. Ken gains \$7,000 of value, and Monica loses \$7,000 of value.
  - c. Ken gains \$7,000 of value, and Monica gains \$3,000 of value.
  - d. Ken and Monica both gain \$7,000 of value.
242. When collective decision making (the political process) is used to resolve economic questions regarding the allocation of resources,
- a. decentralized decision making is present.
  - \* b. central planning and political bargaining will replace market forces.
  - c. individual preferences are of no importance.
  - d. economic equality will result.
243. The law of comparative advantage suggests that
- \* a. individuals, states, and nations can all benefit if they trade with others.
  - b. free trade among nations is harmful to an economy.
  - c. each economy should strive to be self-sufficient.
  - d. each country should attempt to produce roughly equal amounts of all goods.
244. When resources are being used wastefully or inefficiently, the
- a. production possibilities curve shifts inward.
  - b. production possibilities curve shifts outward.
  - \* c. economy is operating at a point inside its production possibilities constraint.
  - d. economy is operating at a point outside its production possibilities constraint.
245. Which of the following is a transaction cost?
- a. price of a ticket to a concert
  - b. price of food eaten before a concert
  - \* c. time spent standing in line to buy the ticket
  - d. price of a T-shirt at the concert
246. Middlemen, such as grocers, stockbrokers, and Realtors,
- \* a. specialize in reducing transactions costs.
  - b. provide nothing of value to either the buyer or the seller.
  - c. have no effect on economic output in society.
  - d. do not exist in capitalist economies.

247. Private property rights exist when property rights are
- exclusively controlled by the owner or owners.
  - transferable to others.
  - protected by legal enforcement.
- \* d. all of the above.
248. When an economy is operating efficiently, the production of more of one good will result in the production of less of some other good because
- consumers do not want more of both goods.
- \* b. resources are limited (scarce) and efficiency implies that all are already in use.
- the production possibilities curve shifts inward as more of one good is produced.
  - technological improvement can only improve the production of a single good.
249. Which of the following would allow the production possibilities curve for an economy to shift outward?
- a better social organization of economic activity, such as conversion from socialism to capitalism
  - an increase in the labor force or resource base
  - more investment leading to better technology and more innovation
- \* d. all of the above
250. “If I didn’t have a date tonight, I would save \$10 and spend the evening playing tennis.” The opportunity cost of the date is
- the other things that could be purchased with the \$10.
- \* b. the other things that could be purchased with the \$10 plus the forgone value of a night of tennis.
- dependent upon how pleasant a time one has on the date.
  - the forgone value of a night of tennis.



251. Use the exhibit to answer the following question. In the above figure showing the production possibilities curve,
- A is efficient.
  - B is inefficient.
  - C is unattainable.
- \* d. all of the above are true.

252. Dr. Jones, a dentist, is choosing between driving and flying from Pittsburgh to New York City. If Jones drove, she would have to close her office four hours earlier than if she flew by airplane. Her expected income (after taxes) from her practice is \$50 per hour. Assuming all other factors are equal, if Jones was a rational decision maker, she would drive if the price differential (air cost minus driving) was greater than
- \$50.
  - \$100.
  - \$150.
  - \$200.

253. According to the law of comparative advantage,
- each producer should strive toward self-sufficiency in order to maximize the total production of the economy.
  - each product should be produced by the lowest opportunity cost producer in order to maximize output.
  - one should never compare one's abilities with those of another.
  - each product should be produced by the individual who can produce more of that product than any other individual.
254. "The economic wealth of this country was built primarily by some individuals profiting from a transaction, whereas others were harmed by that transaction." This statement indicates the speaker
- fails to comprehend the idea that all voluntary trades benefit both parties involved.
  - fails to comprehend the fallacy of composition.
  - fails to understand the significance of the production possibilities curve.
  - uses the economic way of thinking. The statement is essentially correct.

255. (I) When individuals engage in a voluntary exchange, both parties are made better off.
- (II) By channeling goods and resources to those who value them most, trade creates value and increases the wealth created by a society's resources.
- I is true; II is false.
  - I is false; II is true.
  - Both I and II are true.
  - Both I and II are false.

The next two questions relate to the material in the addendum to Chapter 2. Use the following production possibilities data for Lebos and Slavia to answer these questions.

Lebos		Slavia	
Food	Clothing	Food	Clothing
0	8	0	8
2	6	1	6
4	4	2	4
6	2	3	2
8	0	4	0

256. Which of the following is correct?
- In Lebos, the opportunity cost of producing one unit of food is equal to one unit of clothing.
  - In Slavia, the opportunity cost of producing one unit of food is equal to two units of clothing.
  - The opportunity cost of producing food in Lebos is less than the opportunity cost of producing food in Slavia.
  - All of the above are correct.

257. Which of the following is correct?
- a. Lebos has the comparative advantage in both goods.
  - b. Slavia has the comparative advantage in food.
  - \* c. Lebos has the comparative advantage in food.
  - d. Lebos has the comparative advantage in clothing.
258. The process by which new products and methods of production are continuously replacing old ones is known as:
- a. opportunity cost.
  - b. the production possibilities frontier.
  - \* c. creative destruction.
  - d. the fallacy of composition.

## ON-LINE PRACTICE QUESTIONS

259. Keri decided to sleep in today rather than attend her 9 a.m. economics class. According to economic analysis, her choice was
- a. irrational, because economic analysis suggests you should always attend classes that you have already paid for.
  - b. irrational, because oversleeping is not in Keri's self-interest.
  - c. rational if Keri has not missed any other classes.
  - \* d. rational if Keri values sleep more highly than the benefit she expects to receive from attending the class.
260. If a motorist is stranded in front of a pay phone and has only dollar bills, and he ends up buying a quarter from a passerby for \$1,
- a. the stranded motorist must not understand that four quarters are worth \$1.
  - b. economic theory is unable to explain this transaction.
  - \* c. both parties have gained from this exchange.
  - d. the passerby was made better off and the motorist worse off.
261. When private ownership rights are well-defined and enforced, owners
- a. can ignore the wishes of others, without bearing the cost.
  - b. have little incentive to take care of things.
  - c. can do anything they want with their property.
  - \* d. can be held accountable for damage to others through misuse of their property.
262. The production possibilities curve illustrates the basic principle that
- a. an economy's capacity to produce increases in proportion to its population.
  - \* b. if the resources of an economy are being used efficiently, more of one good can be produced only if less of another is produced.
  - c. an economy will automatically seek the output at which all of its resources are fully employed.
  - d. the distribution of income among households is the major determinant of the economic welfare of a nation.
263. Which of the following attributes of trade explain why it is important for economic prosperity?
- a. Trade moves goods from people who value them less to people who value them more.
  - b. Trade makes it possible to produce a larger output as a result of lower per unit costs that often accompany large-scale production.
  - c. Trade makes it possible to produce a larger output as a result of gains from division of labor and specialization.
  - \* d. All of the above.

264. The size of a country's "economic pie" is thought of as the total dollar value of all goods and services produced during some period of time. The economic pie
- a. is a fixed total waiting to be divided up among people.
  - b. determines how much wealth an individual can obtain.
  - \* c. is variable, not fixed, across time periods.
  - d. depends solely upon the natural resources of a country.
265. In a market economy,
- a. a larger income for one person means a smaller one for another.
  - b. the government answers all the basic economic questions.
  - \* c. a larger income for one person means it is possible for others to earn more too.
  - d. economic output shrinks as we discover better ways of doing things.
266. According to the law of comparative advantage, a particular task is performed most efficiently by the individual with the lowest
- a. wage rate.
  - b. tax liability.
  - c. net worth.
  - \* d. opportunity cost.
267. A production possibilities curve graphically represents the maximum quantities of two products produced when all resources in the economy are being used efficiently. If an economy operates at a point inside its production possibilities curve,
- a. it lacks the resources necessary to produce at full employment.
  - \* b. it is utilizing some resources inefficiently.
  - c. it does not confront the problem of scarce goods relative to unlimited wants.
  - d. it does not exist in the real world since it is impossible for an economy to operate inside its production possibilities curve.
268. Given freedom of movement for both goods and resources, if Florida producers specialize in oranges and Georgia producers specialize in peaches, then it would be reasonable to conclude that
- a. the opportunity cost of growing oranges is higher in Florida than in Georgia.
  - \* b. Georgia has a comparative advantage in producing peaches.
  - c. Florida has a comparative advantage in producing peaches.
  - d. total output will be expanded when Georgia allocates more resources to producing oranges and Florida allocates more resources to producing peaches.
269. The law of comparative advantage indicates that
- a. a group of people will reduce their output when each good or service is supplied by the low opportunity cost producer.
  - b. trading partners lose when they can acquire a good through trade cheaper than they can produce it.
  - c. trade is most effective when people trade only among those in their own nation.
  - \* d. a group of people can increase their output when each good or service is supplied by the low opportunity cost producer.
270. Kelly is an architect and she is trying to decide whether to hire Mike, a draftsman, to assist with her work. Kelly could hire Mike at \$20 per hour but it would take him three times as long to complete a task as it takes Kelly. Kelly is able to earn \$90 per hour and has more architectural jobs than she is able to handle. Which of the following is true?
- a. Kelly should not hire Mike because it would be faster for her to do the work herself.
  - b. Kelly should do the drafting work herself because she has the lower opportunity cost.
  - \* c. Mike should be hired at the \$20 per hour wage rate.
  - d. Mike should be hired, but only if he is paid more than \$30 per hour.

271. An airline ticket from Baltimore to Miami costs \$525. A bus ticket is \$325. Traveling by plane will take 5 hours, compared with 25 hours by bus. Thus, the plane costs \$200 more but saves 20 hours of time (Hint: Note how we are “thinking at the margin” here by looking at the changes). Other things constant, an individual will gain by choosing air travel if, and only if, each hour of her time is valued at more than
- \* a. \$10 per hour.
  - b. \$13 per hour.
  - c. \$20 per hour.
  - d. \$105 per hour.
272. Which of the following is *NOT* true of opportunity cost?
- a. Opportunity costs are subjective because they depend upon how the decision-maker values his or her options.
  - \* b. Opportunity costs are only the monetary costs of lost options.
  - c. Opportunity costs are the highest-valued alternative sacrificed in order to choose an option.
  - d. Only the decision-maker can determine his or her opportunity costs for any particular action.
273. Middlemen, such as grocers, stockbrokers, and realtors
- \* a. specialize in reducing transactions costs.
  - b. provide nothing of value to either the buyer or the seller.
  - c. have no effect on economic output in society.
  - d. do not exist in capitalist economies.

## CRITICAL THINKING QUESTIONS

274. A popular video program used to teach economics to primary school children defines opportunity cost as “what you give up to get something.” In light of your understanding of opportunity cost, how would you modify this definition?

**Answer**

*The video program always gives the children two choices; the choice forgone, therefore, is the opportunity cost. For children of this age and reasoning ability, this is probably a good approach. We know, however, that more than one option is relinquished once a decision has been made. A choice to take a 9 A.M. economics class will mean that you cannot take English, French, math, biology, or philosophy at that time. Our understanding of opportunity cost reveals that it is only the highest valued alternative forgone.*

275. After the terrorist attacks on September 11, 2001, the United States began devoting substantial resources toward the War on Terrorism, homeland security, and relief efforts. Use the production possibilities curve to demonstrate how this might affect the production of other goods in the United States.

**Answer**

*Increased resources devoted toward these efforts must come away from the production of other goods, reducing the production of these other goods.*

276. An economics professor points to a student in the front row and announces that “sitting in class is the thing you value most during this time period.” Is the professor correct? Why or why not?

**Answer**

*If the student is rational (and this is an assumption made in economics), he allocates time to its highest valued use. By attending class, the student has revealed that this activity was valued most during that time period. If this were not true, the student wouldn't be there.*

277. Explain the idea of capital investment by using the story of Robinson Crusoe. What is sacrificed, and what is gained?

**Answer**

*For Robinson Crusoe, engaging in capital investment involves producing tools now that would increase his consumption possibilities in the future. Examples might include making a net for fishing or constructing a tool that enables him to pick fruit faster. By engaging in these activities, he will not be able to use the time to fish and pick fruit for immediate consumption. He sacrifices consumption and gains the ability to consume more fish and more fruit in the future.*

278. The president of a large public university proclaims, “If we can get the state government to fund our new football stadium, it will not cost us anything.” Evaluate this view from an economic perspective.

**Answer**

*While it may not directly affect the university’s budget, the cost will be borne by taxpayers. Also, there will be opportunity costs brought about by diverting stadium funding from roads, hospitals, or primary schools. We also should not ignore the fact that the state may reduce its funding of the university in other areas, such as student financial aid, to compensate for the cost of the football stadium.*

279. Mark and John are 10-year-old twins who do not get along. They have opened separate lemonade stands and are competing with each other, selling lemonade on their block. Their mother observes that Mark is very good at making lemonade and John is an excellent young salesman. She suggests they both could make more money if they worked together. John counters that two stands will always make more money than one. Who is right? Why?

**Answer**

*The mother makes the point that gains from trade are possible and that the law of comparative advantage should apply. If the two stands operate separately, Mark might make quite a bit of lemonade but be unable to sell it. John might sell all he makes, but this is probably not very much. By working together, the two should be able to sell more lemonade than is possible if they operate two stands independently.*

280. A department store buys a wool coat for \$120 and sets its retail price at \$300. The coat costs \$85 to produce. When the coat doesn’t sell, the store marks the price down to \$200, then \$100, and finally \$70. At \$70, Amy buys the coat. What was the coat’s true value? Why?

**Answer**

*Since the coat sold for \$70, we would have to say that this is its value. In economics, the value of a product is assigned when a trade is made. Retail prices, costs of production, etc. are not relevant when assigning value. Goods are valued based on what individuals will give for them.*

281. Jim values his car at \$2,000, and Kelly values it at \$5,000. Can value be created in this situation? How? Suppose Jim refuses to sell for less than \$6,000. Is value destroyed? Why or why not?

**Answer**

*Value can be created in this situation. Jim can sell the car at more than \$2,000, and Kelly can buy it at \$5,000 or less. For example, suppose the car sells for \$3,000. Jim has given up a good worth \$2,000 to him in exchange for \$3,000. He is better off by \$1,000, a value created by the exchange. Similarly, Kelly is \$2,000 better off because she has something that is worth \$5,000 to her, and she only had to relinquish \$3,000 to acquire it. If Jim refuses to sell the car, no value will be created, but none will be destroyed either. While a possible gain is forgone, no one is made any worse off by a transaction not taking place.*



282. Market economies are often criticized for how they answer the basic question, “For whom are goods produced?” This criticism usually comes from people who believe that the distribution of income is not “fair.” Is there some way to separate production from distribution so that we can leave production just as it is but make the distribution of income “fairer”?

**Answer**

*Unfortunately, there is no way to totally separate the act of production from the way income is distributed. We know that incentives matter, and tying income to production gives people the incentive to produce. Fairness is a normative concept, and reasonable people will disagree over what distribution of income is more fair. Since incentives matter, any attempt to change the distribution of income is likely to destroy some of the incentives for production.*

283. It can be said that, ultimately, consumers are the driving force in answering the three basic economic questions. Explain the consumer’s role in providing these answers.

**Answer**

*What will be produced is determined by businesses, but they know that the only way to succeed is to offer products consumers find desirable. What they produce is determined by what consumers want. How the goods will be produced is determined by firms that continually seek lower costs of production. Since consumers are price conscious, they will buy the product that carries the lowest price, ceteris paribus. Firms that lower production costs can lower prices and attract more consumers. The goods are consumed by people who desire them and have the ability to pay. Since income is derived from production, those who produce more of what consumers value will have higher incomes. The consumer is at the heart of all three basic economic questions.*