

**TEST BANK**



**MICROECONOMICS**  
HUBBARD GARNETT LEWIS O'BRIEN  
2ND EDITION

ALWAYS LEARNING

PEARSON

# Test Item File 1

Ratha Ramoo

*Diablo Valley College*

# MICROECONOMICS

*Second Edition*

R. Glenn Hubbard  
Anthony O'Brien



Upper Saddle River, New Jersey 07458

**VP/Editorial Director:** Natalie Anderson  
**Acquisitions Editor:** David Alexander  
**Assistant Editor:** Christina Volpe  
**Associate Managing Editor:** Suzanne DeWorken  
**Senior Operations Specialist:** Arnold Vila

---

Copyright © 2009 by Pearson Education, Inc., Upper Saddle River, New Jersey, 07458. Pearson Prentice Hall. All rights reserved. Printed in the United States of America. This publication is protected by Copyright and permission should be obtained from the publisher prior to any prohibited reproduction, storage in a retrieval system, or transmission in any form or by any means, electronic, mechanical, photocopying, recording, or likewise. For information regarding permission(s), write to: Rights and Permissions Department.

**Pearson Prentice Hall™ is a trademark of Pearson Education, Inc.**



10 9 8 7 6 5 4 3 2 1

ISBN-13: 978-0-13-813279-8  
ISBN-10: 0-13-813279-8

## Preface

---

Edward Scahill of the University of Scranton prepared the test bank to accompany microeconomics. This test bank includes 2,000 multiple-choice questions, true/false, short-answer, and graphing questions. There are questions to support each key feature in the book. Test questions are annotated with the following information:

- Difficulty: 1 for straight recall, 2 for some analysis, 3 for complex analysis
- Type: multiple-choice, true/false, short-answer, essay
- Topic: the term or concept the question supports
- Skill: fact, definition, analytical, conceptual
- Learning objective
- AACSB (see below)
- Page number
- Special feature in the main book: chapter-opening business example, *Economics in Your Life*, *Solved Problem*, *Making the Connection*, *Don't Let this Happen to You!* and *An Inside Look*.

### **The Association to Advance Collegiate Schools of Business (AACSB)**

The test bank authors have sought connected select test bank questions to the general knowledge and skill guidelines found in the AACSB standards.

### **What is the AACSB?**

AACSB is a not-for-profit corporation of educational institutions, corporations, and other organizations devoted to the promotion and improvement of higher education in business administration and accounting. A collegiate institution offering degrees in business administration or accounting may volunteer for AACSB accreditation review. The AACSB makes initial accreditation decisions and conducts periodic reviews to promote continuous quality improvement in management education. Pearson Education is a proud member of the AACSB and is pleased to provide advice to help you apply AACSB Learning Standards.

### **What are AACSB Learning Standards?**

One of the criteria for AACSB accreditation is the quality of the curricula. Although no specific courses are required, the AACSB expects a curriculum to include learning experiences in such areas as:

- Communication
- Ethical Reasoning
- Analytic Skills
- Use of Information Technology
- Multicultural and Diversity
- Reflective Thinking

These six categories are AACSB Learning Standards. Questions that test skills relevant to these standards are tagged with the appropriate standard. For example, a question testing the moral questions associated with externalities would receive the Ethical Reasoning tag.

### **How Can Instructors Use the AACSB Tags?**

Tagged questions help you measure whether students are grasping the course content that aligns with AACSB guidelines noted above. In addition, the tagged questions may help instructors identify potential applications of these skills. This in turn may suggest enrichment activities or other educational experiences to help students achieve these skills.

The test bank was checked for accuracy by Rachael Small of the University of Colorado, Boulder.

### **TestGen**

The computerized TestGen package allows instructors to customize, save, and generate classroom tests. The test program permits instructors to edit, add, or delete questions from the test banks; edit existing graphics and create new graphics; analyze test results; and organize a database of tests and student results. This software allows for extensive flexibility and ease of use. It provides many options for organizing and displaying tests, along with search and sort features. The software and the test banks can be downloaded from the Instructor's Resource Center ([www.prenhall.com/hubbard](http://www.prenhall.com/hubbard)).



# Contents

---

Chapter 1	Economics: Foundations and Models .....	1
Chapter 2	Trade-offs, Comparative Advantage, and the Market System .....	51
Chapter 3	Where Prices Come From: The Interaction of Demand and Supply.....	104
Chapter 4	Economic Efficiency, Government Price Setting, and Taxes.....	153
Chapter 5	Externalities, Environmental Policy, and Public Goods .....	204
Chapter 6	Elasticity: The Responsiveness of Demand and Supply .....	262
Chapter 7	Firms, the Stock Market, and Corporate Governance.....	318
Chapter 8	Comparative Advantage and the Gains from International Trade.....	356
Chapter 9	Consumer Choice and Behavioral Economics .....	405
Chapter 10	Technology, Production, and Costs.....	457
Chapter 11	Firms in Perfectly Competitive Markets .....	512
Chapter 12	Monopolistic Competition: The Competitive Model in a More Realistic Setting.....	569
Chapter 13	Oligopoly: Firms in Less Competitive Markets .....	621
Chapter 14	Monopoly and Antitrust Policy .....	670
Chapter 15	Pricing Strategy .....	717
Chapter 16	The Markets for Labor and Other Factors of Production .....	764
Chapter 17	The Economics of Information .....	812
Chapter 18	Public Choice, Taxes, and the Distribution of Income.....	850





# Chapter 1

## Economics: Foundations and Models

### 1.1 Three Key Economic Ideas

1) Consider the following two statements:

- a. A study conducted by Forrester Research estimates that between 2000 and 2015, 3.3 million jobs in the United States will have been outsourced.
- b. Over this same period, the number of jobs expected to be created is more than 450 million and the number of jobs due to all causes is estimated at 430 million.

These statements suggest that

- A) the unemployment rate in the United States will be increasing between 2000 and 2015.
- B) the likelihood that the average person will lose her job due to outsourcing is very large compared to the likelihood of her losing her job due to other causes.
- C) the likelihood that the average person will lose her job due to outsourcing is very small compared to the likelihood of her losing her job due to other causes.
- D) the United States is not creating jobs fast enough to offset jobs lost due to outsourcing and other causes.

Answer: C

Diff: 2      Page Ref: 3/3

Topic: Three key economic ideas

Skill: Analytical

Objective: LO1: Explain these three key economic ideas: People are rational. People respond to incentives. Optimal decisions are made at the margin.

AACSB: Reflective Thinking

Special Feature: Economics in YOUR Life!: Are You Likely to Lose Your Job to Outsourcing?

2) The study of economics arises due to

- A) money.
- B) scarcity.
- C) greed.
- D) resources.

Answer: B

Diff: 1      Page Ref: 4

Topic: Three key economic ideas

Skill: Conceptual

Objective: LO1: Explain these three key economic ideas: People are rational. People respond to incentives. Optimal decisions are made at the margin.

AACSB: Reflective Thinking

Special Feature: None

3) Which of the following statements is true about scarcity?

- A) Scarcity refers to the situation in which unlimited wants exceed limited resources.
- B) Scarcity is not a problem for the wealthy.
- C) Scarcity is only a problem when a country has too large a population.
- D) Scarcity arises when there is a wide disparity in income distribution.

Answer: A

Diff: 1 Page Ref: 4/4

Topic: Three key economic ideas

Skill: Definition

Objective: LO1: Explain these three key economic ideas: People are rational. People respond to incentives. Optimal decisions are made at the margin.

AACSB: Reflective Thinking

Special Feature: None

4) The basic economic problem of scarcity

- A) has always existed and will continue to exist.
- B) will eventually disappear as technology continues to advance.
- C) is a problem only in developing economies.
- D) does not apply to the wealthy in society.

Answer: A

Diff: 1 Page Ref: 4/4

Topic: Three key economic ideas

Skill: Conceptual

Objective: LO1: Explain these three key economic ideas: People are rational. People respond to incentives. Optimal decisions are made at the margin.

AACSB: Reflective Thinking

Special Feature: None

5) By definition, economics is the study of

- A) how to make money in the stock market.
- B) how to make money in a market economy.
- C) the choices people make to attain their goals, given their scarce resources.
- D) supply and demand.

Answer: C

Diff: 1 Page Ref: 4/4

Topic: Three key economic ideas

Skill: Definition

Objective: LO1: Explain these three key economic ideas: People are rational. People respond to incentives. Optimal decisions are made at the margin.

AACSB: Reflective Thinking

Special Feature: None

6) What is an economic model?

- A) It is a description of an economic issue that includes all possible related information.
- B) It is a description of an economic issue based on official government information.
- C) It is a detailed version of some aspect of economic life used to analyze an economic issue.
- D) It is a simplified version of some aspect of economic life used to analyze an economic issue.

Answer: D

Diff: 1 Page Ref: 4/4

Topic: Three key economic ideas

Skill: Definition

Objective: LO1: Explain these three key economic ideas: People are rational. People respond to incentives. Optimal decisions are made at the margin.

AACSB: Reflective Thinking

Special Feature: None

7) Where do economic agents such as individuals, firms and nations, interact with each other?

- A) in public locations monitored by the government
- B) in any arena that brings together buyers and sellers
- C) in any physical location where people can physically get together for selling goods, such as shopping malls
- D) in any location where transactions can be monitored by consumer groups and taxed by the government

Answer: B

Diff: 1 Page Ref: 4/4

Topic: Three key economic ideas

Skill: Conceptual

Objective: LO1: Explain these three key economic ideas: People are rational. People respond to incentives. Optimal decisions are made at the margin.

AACSB: Reflective Thinking

Special Feature: None

8) The term "market" in economics refers to

- A) a place where money changes hands.
- B) a legal institution where exchange can take place.
- C) a group of buyers and sellers of a product and the arrangement by which they come together to trade.
- D) an organization which sells goods and services.

Answer: C

Diff: 1 Page Ref: 4/4

Topic: Three key economic ideas

Skill: Definition

Objective: LO1: Explain these three key economic ideas: People are rational. People respond to incentives. Optimal decisions are made at the margin.

AACSB: Reflective Thinking

Special Feature: None

- 9) Economists assume that individuals
- A) behave in unpredictable ways.
  - B) will never take actions to help others.
  - C) prefer to live in a society that values fairness above all else.
  - D) are rational and respond to incentives.

Answer: D

Diff: 1 Page Ref: 5/5

Topic: Three key economic ideas

Skill: Conceptual

Objective: LO1: Explain these three key economic ideas: People are rational. People respond to incentives. Optimal decisions are made at the margin.

AACSB: Reflective Thinking

Special Feature: None

- 10) Which of the following best describes an assumption economists make about human behavior?
- A) They assume that individuals act rationally all the time in all circumstances.
  - B) They assume that rational behavior is useful in explaining choices people make even though people may not behave rationally all the time.
  - C) They assume that people take into account the question of fairness in all decisions they make.
  - D) They assume that individuals act randomly.

Answer: B

Diff: 2 Page Ref: 5/5

Topic: Three key economic ideas

Skill: Conceptual

Objective: LO1: Explain these three key economic ideas: People are rational. People respond to incentives. Optimal decisions are made at the margin.

AACSB: Reflective Thinking

Special Feature: None

- 11) Economists assume that rational people do all of the following *except*
- A) use all available information as they act to achieve their goals.
  - B) undertake activities that benefit others and hurt themselves.
  - C) weigh the benefits and costs of all possible alternative actions.
  - D) respond to economic incentives.

Answer: B

Diff: 2 Page Ref: 5/5

Topic: Three key economic ideas

Skill: Conceptual

Objective: LO1: Explain these three key economic ideas: People are rational. People respond to incentives. Optimal decisions are made at the margin.

AACSB: Reflective Thinking

Special Feature: None

- 12) Your roommate, Serafina, a psychology major, said, "The problem with economics is that it assumes that consumers and firms always make the correct decision. But we know that everyone's human, and we all make mistakes." Do you agree with her comment?
- A) Yes, I agree with her. One cannot make predictions about economic behavior because in reality people make incorrect choices in many situations.
  - B) I disagree with her. Economics does not study correct or incorrect behaviors but rather it assumes that economic agents behave rationally, meaning they make the best decisions given their knowledge of the costs and benefits.
  - C) Yes, I agree with her. Economic theory should allow for irrational behavior so that we can have more reliable predictions.
  - D) I disagree with her. If we cannot assume that decisions are correct, then we will not be able to examine the moral implications of these decisions.

Answer: B

Diff: 2 Page Ref: 5/5

Topic: Three key economic ideas

Skill: Analytical

Objective: LO1: Explain these three key economic ideas: People are rational. People respond to incentives. Optimal decisions are made at the margin.

AACSB: Analytic Skills

Special Feature: None

- 13) Consider the following statements:
- a. Car owners purchase more gasoline from a gas station that sells gasoline at a lower price than other rival gas stations in the area.
  - b. Banks do not take steps to increase security since they believe it is less costly to allow some bank robberies than to install expensive security monitoring equipment.
  - c. Firms produce more of a particular DVD when its selling price rises.

Which of the above statements demonstrates that economic agents respond to incentives?

- A) a only.
- B) b only.
- C) c only.
- D) a and b.
- E) a, b, and c.

Answer: E

Diff: 3 Page Ref: 5/5

Topic: Three key economic ideas

Skill: Conceptual

Objective: LO1: Explain these three key economic ideas: People are rational. People respond to incentives. Optimal decisions are made at the margin.

AACSB: Analytic Skills

Special Feature: None

- 14) In the first six months of 2003, branches of Commerce Bank in New York City were robbed 14 times. The New York City Police recommended steps the bank could take to deter robberies, including the installation of plastic barriers called "bandit barriers." The police were surprised the bank did not take their advice. According to a deputy commissioner of police, "Commerce does very little of what we recommend. They've told our detectives they have no interest in ever putting in the barriers."

It would seem that Commerce bank would have a strong incentive to install "bandit barriers" to deter robberies. Why wouldn't they do it?

- A) The banks would rather delay installation of any theft deterring equipment in anticipation of new lower cost innovations in the security devices market.
- B) The banks must have weighed the cost of installing bandit barriers against the benefits and decided that they have "no interest in ever putting in the barriers".
- C) The banks are concerned that "bandit barriers" would send the wrong message to customers -- that the bank is unsafe.
- D) The banks probably resent any interference from the police department.

Answer: B

Diff: 2 Page Ref: 5/5

Topic: Three key economic ideas

Skill: Conceptual

Objective: LO1: Explain these three key economic ideas: People are rational. People respond to incentives. Optimal decisions are made at the margin.

AACSB: Reflective Thinking

Special Feature: None

- 15) Over the past decade, health plans have sought to contain rising health care costs by raising premiums and encouraging the use of lower-cost generic drugs. Recently, some health insurers have implemented plans that involve lowering or eliminating co-payments on medications for chronic illnesses.

Source: Vanessa Fuhrmans, "New Tack on Copays: Cutting Them", *Wall Street Journal*, Tuesday, May 8 2007, Page D1.

Which of the following best explains why employers and health insurers might choose to adopt this radical approach?

- A) These health plans are trying to persuade employers and consumers to bear a greater share of rising health care costs.
- B) They believe that this will give consumers incentives to take better care of their health which in turn, will enable health plans to save even more money by preventing costly health crises down the road.
- C) Health insurers have an incentive to institute plans that promote equity.
- D) Health insurers are finally recognizing that many, especially the elderly, are not getting the care they need.

Answer: B

Diff: 2 Page Ref: 5/5

Topic: Three key economic ideas

Skill: Analytical

Objective: LO1: Explain these three key economic ideas: People are rational. People respond to incentives. Optimal decisions are made at the margin.

AACSB: Analytic Skills

Special Feature: None

- 16) In Austria, per child, an Austrian woman can get up to 48 months of pension benefits and is guaranteed a maternity allowance two months before and after she gives birth. Further, the Austrian government gives monthly payouts ranging from \$132 to \$547, depending on the age of offspring and offers generous tax benefits for families with children. How will these benefits affect a woman's decision to have children?
- A) These incentives will have no effect on having children; the decision to have children is a social and psychological decision, not an economic decision.
  - B) These incentives will encourage only less educated women to have more children.
  - C) These incentives will encourage only women with high opportunity costs to have more children.
  - D) These incentives will encourage women to have children and increase the birth rate.

Answer: D

Diff: 2 Page Ref: 5/5

Topic: Three key economic ideas

Skill: Analytical

Objective: LO1: Explain these three key economic ideas: People are rational. People respond to incentives. Optimal decisions are made at the margin.

AACSB: Analytic Skills

Special Feature: Making the Connection: Will Women Have More Babies if the Government Pays Them To?

- 17) In the United States and in most European countries, aging populations and declining birthrates threaten public finances. As the population ages, there are fewer workers paying taxes relative to the number of retired people receiving government benefits. Which of the following government policies would *not* help reduce the pressure on public finances?
- A) offer financial incentives to increase the birthrate
  - B) reduce taxes paid by current workers so that they can save for their future
  - C) reduce retiree benefit payments
  - D) raise the retirement age

Answer: B

Diff: 2 Page Ref: 5/5

Topic: Three key economic ideas

Skill: Analytical

Objective: LO1: Explain these three key economic ideas: People are rational. People respond to incentives. Optimal decisions are made at the margin.

AACSB: Analytic Skills

Special Feature: Making the Connection: Will Women Have More Babies if the Government Pays Them To?

- 18) What does the term "marginal" mean in economics?
- A) the edge of a market
  - B) an additional or extra
  - C) illegal
  - D) secondary
  - E) trivial

Answer: B

Diff: 1 Page Ref: 6/6

Topic: Three key economic ideas

Skill: Definition

Objective: LO1: Explain these three key economic ideas: People are rational. People respond to incentives. Optimal decisions are made at the margin.

AACSB: Reflective Thinking

Special Feature: None



- 19) A grocery store sells a bag of potatoes at a fixed price of \$2.30. Which of the following is a term used by economists to describe the money received from the sale of an additional bag of potatoes?
- A) marginal revenue
  - B) gross earnings
  - C) pure profit
  - D) marginal costs
  - E) net benefit

Answer: A

Diff: 1 Page Ref: 7/7

Topic: Three key economic ideas

Skill: Conceptual

Objective: LO1: Explain these three key economic ideas: People are rational. People respond to incentives. Optimal decisions are made at the margin.

AACSB: Reflective Thinking

Special Feature: None

- 20) Economics promote which of the following as the way to make the best decision?
- A) Continue an enjoyable activity as long as you do not have to pay for it.
  - B) Continue an enjoyable activity until it is no longer enjoyable.
  - C) Continue an enjoyable activity until you cannot afford to pursue it.
  - D) Continue an enjoyable activity up to the point where its marginal benefit equals its marginal cost.

Answer: D

Diff: 2 Page Ref: 7/7

Topic: Three key economic ideas

Skill: Conceptual

Objective: LO1: Explain these three key economic ideas: People are rational. People respond to incentives. Optimal decisions are made at the margin.

AACSB: Reflective Thinking

Special Feature: None

- 21) Marginal analysis involves undertaking an activity
- A) until its marginal costs start declining.
  - B) only when its marginal benefits are positive.
  - C) until its marginal benefits equal marginal costs.
  - D) only if its marginal costs are greater than its marginal benefits.

Answer: C

Diff: 1 Page Ref: 7/7

Topic: Three key economic ideas

Skill: Conceptual

Objective: LO1: Explain these three key economic ideas: People are rational. People respond to incentives. Optimal decisions are made at the margin.

AACSB: Reflective Thinking

Special Feature: None

- 22) The revenue received from the sale of an additional unit of a product
- A) is a marginal benefit to the firm.
  - B) is called profit.
  - C) is called gross sales.
  - D) is called a net gain.

Answer: A

Diff: 2 Page Ref: 7/7

Topic: Three key economic ideas

Skill: Definition

Objective: LO1: Explain these three key economic ideas: People are rational. People respond to incentives. Optimal decisions are made at the margin.

AACSB: Reflective Thinking

Special Feature: None

- 23) Making optimal decisions "at the margin" requires
- A) making decisions according to one's whims and fancies.
  - B) making consistently irrational decisions.
  - C) weighing the costs and benefits of a decision before deciding if it should be pursued.
  - D) making borderline decisions.

Answer: C

Diff: 1 Page Ref: 7/7

Topic: Three key economic ideas

Skill: Conceptual

Objective: LO1: Explain these three key economic ideas: People are rational. People respond to incentives. Optimal decisions are made at the margin.

AACSB: Reflective Thinking

Special Feature: None

- 24) If the marginal cost of producing a television is constant at \$200, then a firm should produce this item
- A) only if the marginal benefit it receives is greater than \$200 plus an acceptable profit margin.
  - B) as long as the marginal benefit it receives is just equal to or greater than \$200.
  - C) as long as its marginal cost does not rise.
  - D) until the marginal benefit it receives reaches zero.

Answer: B

Diff: 2 Page Ref: 7/7

Topic: Three key economic ideas

Skill: Conceptual

Objective: LO1: Explain these three key economic ideas: People are rational. People respond to incentives. Optimal decisions are made at the margin.

AACSB: Reflective Thinking

Special Feature: None

- 25) Making "how much" decisions involve
- A) calculating the total benefits of the activity and determining if you are satisfied with that amount.
  - B) calculating the total costs of the activity and determining if you can afford to incur that expenditure.
  - C) calculating the average benefit and the average cost of an activity to determine if it is worthwhile undertaking that activity.
  - D) determining the additional benefits and the additional costs of that activity.

Answer: D

Diff: 2 Page Ref: 6/6

Topic: Three key economic ideas

Skill: Conceptual

Objective: LO1: Explain these three key economic ideas: People are rational. People respond to incentives. Optimal decisions are made at the margin.

AACSB: Reflective Thinking

Special Feature: None

- 26) Which of the following is an example of a "how much" decision?
- A) The Pleasantville movie theatre is open only in the evenings. The theatre's manager is debating whether to add daily matinee shows.
  - B) The Zhous have demolished their old home and are debating whether to build a ranch-style house or a Craftsman home.
  - C) You're planning to hold a graduation party and must decide between having your party catered or having a pot-luck.
  - D) Chelsea has withdrawn from the swim team to take up a full-time job.

Answer: A

Diff: 2 Page Ref: 6/6

Topic: Three key economic ideas

Skill: Conceptual

Objective: LO1: Explain these three key economic ideas: People are rational. People respond to incentives. Optimal decisions are made at the margin.

AACSB: Reflective Thinking

Special Feature: None

- 27) The extra cost associated with undertaking an activity is called
- A) net loss.
  - B) marginal cost.
  - C) opportunity cost.
  - D) foregone cost.

Answer: B

Diff: 1 Page Ref: 7/7

Topic: Three key economic ideas

Skill: Definition

Objective: LO1: Explain these three key economic ideas: People are rational. People respond to incentives. Optimal decisions are made at the margin.

AACSB: Reflective Thinking

Special Feature: None

- 28) Cassie's Quilts alters, reconstructs and restores heirloom quilts. Cassie has just spent \$800 purchasing, cleaning and reconstructing an antique quilt which she expects to sell for \$1,500 once she is finished. After having spent \$800, Cassie discovers that she would need some special period fabric that would cost her \$200 in material and time in order to complete the task. Alternatively, she can sell the quilt "as is" now for \$900. What is her marginal benefit if she sells the quilt "as is" now?
- A) \$100
  - B) \$900
  - C) She makes a marginal loss of \$600, not a marginal benefit.
  - D) The marginal benefit cannot be determined.

Answer: B

Diff: 2 Page Ref: 7/7

Topic: Three key economic ideas

Skill: Analytical

Objective: LO1: Explain these three key economic ideas: People are rational. People respond to incentives. Optimal decisions are made at the margin.

AACSB: Analytic Skills

Special Feature: None

- 29) Cassie's Quilts alters, reconstructs and restores heirloom quilts. Cassie has just spent \$800 purchasing, cleaning and reconstructing an antique quilt which she expects to sell for \$1,500 once she is finished. After having spent \$800, Cassie discovers that she would need some special period fabric that would cost her \$200 in material and time in order to complete the task. Alternatively, she can sell the quilt "as is" now for \$900. What is the marginal cost of completing the task?
- A) \$200
  - B) \$500
  - C) \$1,000
  - D) \$1,000 plus the value of her time

Answer: A

Diff: 2 Page Ref: 7/7

Topic: Three key economic ideas

Skill: Analytical

Objective: LO1: Explain these three key economic ideas: People are rational. People respond to incentives. Optimal decisions are made at the margin.

AACSB: Analytic Skills

Special Feature: None

- 30) Cassie's Quilts alters, reconstructs and restores heirloom quilts. Cassie has just spent \$800 purchasing, cleaning and reconstructing an antique quilt which she expects to sell for \$1,500 once she is finished. After having spent \$800, Cassie discovers that she would need some special period fabric that would cost her \$200 in material and time in order to complete the task. Alternatively, she can sell the quilt "as is" now for \$900. What should she do?
- A) She should cut her losses and sell the quilt now.
  - B) It does not matter what she does; she is going to take a loss on her project.
  - C) She should purchase the period fabric, complete the task and then sell the quilt.
  - D) She should not do anymore work on the quilt because she has already spent too much time on it and has not been paid for that time.

Answer: C

Diff: 3 Page Ref: 7/7

Topic: Three key economic ideas

Skill: Analytical

Objective: LO1: Explain these three key economic ideas: People are rational. People respond to incentives. Optimal decisions are made at the margin.

AACSB: Analytic Skills

Special Feature: None

### Scenario 1-1

Suppose a cell phone manufacturer currently sells 20,000 cell phones per week and makes a profit of \$5,000 per week. A manager at the plant observes, "Although the last 3,000 cell phones we produced and sold increased our revenue by \$6,000 and our costs by \$6,700, we are still making an overall profit of \$5,000 per week so I think we're on the right track. We are producing the optimal number of cell phones."

- 31) *Refer to Scenario 1-1.* Using marginal analysis terminology, what is another economic term for the incremental revenue received from the sale of the last 3,000 cell phones?
- A) gross earnings
  - B) marginal revenue
  - C) sales revenue
  - D) gross profit

Answer: B

Diff: 1 Page Ref: 7/7

Topic: Three key economic ideas

Skill: Definition

Objective: LO1: Explain these three key economic ideas: People are rational. People respond to incentives. Optimal decisions are made at the margin.

AACSB: Reflective Thinking

Special Feature: None

32) **Refer to Scenario 1-1.** Using marginal analysis terminology, what is another economic term for the incremental cost of producing the last 3,000 cell phones?

- A) marginal cost
- B) operating cost
- C) explicit cost
- D) Any of the above terms are correct.

Answer: A

Diff: 1 Page Ref: 7/7

Topic: Three key economic ideas

Skill: Definition

Objective: LO1: Explain these three key economic ideas: People are rational. People respond to incentives. Optimal decisions are made at the margin.

AACSB: Reflective Thinking

Special Feature: None

33) **Refer to Scenario 1-1.** Had the firm not produced and sold the last 3,000 cell phones, would its profit be higher or lower, and if so by how much?

- A) Its profit will be \$6,700 higher.
- B) Its profit will be \$700 higher.
- C) Its profit will be \$700 lower.
- D) Its profit will be \$6,000 lower.

Answer: B

Diff: 2 Page Ref: 7/7

Topic: Three key economic ideas

Skill: Analytical

Objective: LO1: Explain these three key economic ideas: People are rational. People respond to incentives. Optimal decisions are made at the margin.

AACSB: Analytic Skills

Special Feature: None

Table 1-1

<i>Hours Open</i>	<i>Total Revenue (Dollars)</i>
1	\$35
2	60
3	80
4	92
5	100
6	105

Eva runs a small bakery in the village of Roggerli. She is debating whether she should extend her hours of operation. Eva figures that her sales revenue will depend on the number of hours the bakery is open as shown in the table above. She would have to hire a worker for those hours at a wage rate of \$12 per hour.

- 34) *Refer to Table 1-1.* Using marginal analysis, determine how many hours should Eva extend her bakery's hours of operations?
- A) 2 hours
  - B) 3 hours
  - C) 4 hours
  - D) 5 hours
  - E) 6 hours

Answer: C

Diff: 3 Page Ref: 7/7

Topic: Three key economic ideas

Skill: Analytical

Objective: LO1: Explain these three key economic ideas: People are rational. People respond to incentives. Optimal decisions are made at the margin.

AACSB: Analytic Skills

Special Feature: None

- 35) *Refer to Table 1-1.* What is Eva's marginal benefit if she decides to stay open for two hours instead of one hour?
- A) \$25
  - B) \$36
  - C) \$60
  - D) \$95

Answer: A

Diff: 2 Page Ref: 7/7

Topic: Three key economic ideas

Skill: Conceptual

Objective: LO1: Explain these three key economic ideas: People are rational. People respond to incentives. Optimal decisions are made at the margin.

AACSB: Analytic Skills

Special Feature: None

36) *Refer to Table 1-1.* What is Eva's marginal cost if she decides to stay open for two hours instead of one hour?

- A) \$12
- B) \$24
- C) \$36
- D) \$71

Answer: A

Diff: 2 Page Ref: 7/7

Topic: Three key economic ideas

Skill: Conceptual

Objective: LO1: Explain these three key economic ideas: People are rational. People respond to incentives. Optimal decisions are made at the margin.

AACSB: Analytic Skills

Special Feature: None

37) Soo Jin shares a one-bedroom apartment with her classmate. Her share of the rent is \$700 per month. She is considering moving to a studio apartment which she will not have to share with anyone. The studio apartment rents for \$950 per month. Recently, you ran into Soo Jin on campus and she tells you that she has moved into the studio apartment. Soo Jin is as rational as any other person. As an economics major, you rightly conclude that

- A) Soo Jin did not have a choice; her roommate was a slob.
- B) Soo Jin figures that the additional benefit of having her own place (as opposed to sharing) is at least \$250.
- C) Soo Jin figures that the benefit of having her own place (as opposed to sharing) is at least \$950.
- D) the cost of having one's own space outweighs the benefits.

Answer: B

Diff: 2 Page Ref: 7/7

Topic: Three key economic ideas

Skill: Analytical

Objective: LO1: Explain these three key economic ideas: People are rational. People respond to incentives. Optimal decisions are made at the margin.

AACSB: Analytic Skills

Special Feature: None

38) All economic questions arise from the fact that resources are scarce.

Answer: TRUE

Diff: 1 Page Ref: 4/4

Topic: Three key economic ideas

Skill: Conceptual

Objective: LO1: Explain these three key economic ideas: People are rational. People respond to incentives. Optimal decisions are made at the margin.

AACSB: Reflective Thinking

Special Feature: None



39) Scarcity is a problem that will eventually disappear as technology advances.

Answer: FALSE

Diff: 1 Page Ref: 4/4

Topic: Three key economic ideas

Skill: Conceptual

Objective: LO1: Explain these three key economic ideas: People are rational. People respond to incentives. Optimal decisions are made at the margin.

AACSB: Reflective Thinking

Special Feature: None

40) The term "market" refers only to trading arrangements that have been approved by the government.

Answer: FALSE

Diff: 1 Page Ref: 4/4

Topic: Three key economic ideas

Skill: Conceptual

Objective: LO1: Explain these three key economic ideas: People are rational. People respond to incentives. Optimal decisions are made at the margin.

AACSB: Reflective Thinking

Special Feature: None

41) The sales revenue a seller receives from the sale of an additional unit of goods is called the marginal benefit.

Answer: TRUE

Diff: 1 Page Ref: 7/7

Topic: Three key economic ideas

Skill: Definition

Objective: LO1: Explain these three key economic ideas: People are rational. People respond to incentives. Optimal decisions are made at the margin.

AACSB: Reflective Thinking

Special Feature: None

42) Marginal benefit is the benefit that your activity provides to someone else.

Answer: FALSE

Diff: 1 Page Ref: 7/7

Topic: Three key economic ideas

Skill: Definition

Objective: LO1: Explain these three key economic ideas: People are rational. People respond to incentives. Optimal decisions are made at the margin.

AACSB: Reflective Thinking

Special Feature: None

43) If it costs Sinclair \$300 to produce 3 suede jackets and \$420 to produce 4 suede jackets, then the difference of \$120 is the marginal cost of producing the 4th suede jacket.

Answer: TRUE

Diff: 1 Page Ref: 7/7

Topic: Three key economic ideas

Skill: Conceptual

Objective: LO1: Explain these three key economic ideas: People are rational. People respond to incentives. Optimal decisions are made at the margin.

AACSB: Reflective Thinking

Special Feature: None

- 44) Suppose the extra cost to Apple Computer of producing another iPod is \$270. Then, Apple should not produce this unit if it can only sell it for \$270.

Answer: FALSE

Diff: 2 Page Ref: 7/7

Topic: Three key economic ideas

Skill: Analytical

Objective: LO1: Explain these three key economic ideas: People are rational. People respond to incentives. Optimal decisions are made at the margin.

AACSB: Analytic Skills

Special Feature: Solved Problem: Apple Computer Makes a Decision at the Margin

- 45) Assume that Apple computer can earn an additional \$81 million of revenue from making 300,000 more iPods. What must the additional cost of producing these 300,000 be to make the additional output economically rational?

Answer: The additional cost of the 300,000 extra iPods must be no more than \$81 million to make the production of these extra units economically rational.

Diff: 2 Page Ref: 7/7

Topic: Three key economic ideas

Skill: Conceptual

Objective: LO1: Explain these three key economic ideas: People are rational. People respond to incentives. Optimal decisions are made at the margin.

AACSB: Analytic Skills

Special Feature: Solved Problem: Apple Computer Makes a Decision at the Margin

- 46) Identify three factors that limit the number of jobs that can move from developed countries to countries such as India and China.

Answer: The factors include:

1. Relatively few workers in India and China are qualified for and capable of working for multinational firms.
2. Poor protection of intellectual property in these countries limits the willingness of firms to locate in developing nations.
3. Poor infrastructure limits a firm's ability to run their operations efficiently. For example, many potential workers live in isolated areas far removed from major cities and airports.

Diff: 2 Page Ref: 18-9/18-9

Topic: Three key economic ideas

Skill: Analytical

Objective: LO1: Explain these three key economic ideas: People are rational. People respond to incentives. Optimal decisions are made at the margin.

AACSB: Analytic Skills

Special Feature: An Inside Look: Should the United States Worry about High-Tech Competition from India and China?

## 1.2 The Economic Problem That Every Society Must Solve

- 1) The three fundamental questions that any economy must address are:
- A) What will be the prices of goods and services; how will these goods and services be produced; and who will receive them?
  - B) What goods and services to produce; how will these goods and services be produced; and who receives them?
  - C) Who gets jobs; what wages do workers earn; and who owns what property?
  - D) How much will be saved; what will be produced; and how can these goods and services be fairly distributed?

Answer: B

Diff: 1 Page Ref: 8/8

Topic: The economic problem that every society must solve

Skill: Conceptual

Objective: LO2: Discuss how an economy answers these questions: What goods and services will be produced? How will the goods and services be produced? Who will receive the goods and services?

AACSB: Reflective Thinking

Special Feature: None

- 2) Every society faces economic trade-offs. This means
- A) some people live better than others do.
  - B) not everyone can have enough goods to survive.
  - C) producing more of one good means less of another good can be produced.
  - D) society's output cannot be made available to all.

Answer: C

Diff: 1 Page Ref: 8/8

Topic: The economic problem that every society must solve

Skill: Definition

Objective: LO2: Discuss how an economy answers these questions: What goods and services will be produced? How will the goods and services be produced? Who will receive the goods and services?

AACSB: Reflective Thinking

Special Feature: None

- 3) Society faces a trade-off in all of the following situations *except*
- A) when deciding who will receive the goods and services produced.
  - B) when deciding what goods and services will be produced.
  - C) when deciding how goods and services will be produced.
  - D) when some previously unemployed workers find jobs.

Answer: D

Diff: 2 Page Ref: 8/8

Topic: The economic problem that every society must solve

Skill: Conceptual

Objective: LO2: Discuss how an economy answers these questions: What goods and services will be produced? How will the goods and services be produced? Who will receive the goods and services?

AACSB: Reflective Thinking

Special Feature: None

- 4) Which of the following statements is *false*?
- A) Anytime you have to decide which action to take you are facing an economic trade-off.
  - B) Trade-offs do not apply when the consumers purchase a product for which there is excess supply, such as a stock clearance sale.
  - C) Every individual, no matter how rich or poor, is faced with making trade-offs.
  - D) Economics is a social science that studies the trade-offs we are forced to make because of scarcity.

Answer: B

Diff: 2 Page Ref: 8/8

Topic: *The economic problem that every society must solve*

Skill: *Conceptual*

Objective: *LO2: Discuss how an economy answers these questions: What goods and services will be produced? How will the goods and services be produced? Who will receive the goods and services?*

AACSB: *Reflective Thinking*

Special Feature: *None*

- 5) Which of the following is not an example of an economic trade-off that a firm has to make?
- A) whether it is cheaper to produce with more machines or with more workers
  - B) whether it is to outsource the production of a good or service
  - C) whether or not consumers will buy its products
  - D) whether it should produce more of its product

Answer: C

Diff: 1 Page Ref: 8/8

Topic: *The economic problem that every society must solve*

Skill: *Conceptual*

Objective: *LO2: Discuss how an economy answers these questions: What goods and services will be produced? How will the goods and services be produced? Who will receive the goods and services?*

AACSB: *Reflective Thinking*

Special Feature: *None*

- 6) Opportunity cost is defined as
- A) the benefit of an activity.
  - B) the monetary expense associated with an activity.
  - C) the highest valued alternative that must be given up to engage in an activity.
  - D) the total value of all alternatives that must be given up to engage in an activity.

Answer: C

Diff: 1 Page Ref: 8/8

Topic: *The economic problem that every society must solve*

Skill: *Definition*

Objective: *LO2: Discuss how an economy answers these questions: What goods and services will be produced? How will the goods and services be produced? Who will receive the goods and services?*

AACSB: *Reflective Thinking*

Special Feature: *None*

7) The Coffee Nook, a small cafe near campus, sells cappuccinos for \$2.50 and Russian tea cakes for \$1.00 each. What is the opportunity cost of buying a cappuccino?

- A) 2 1/2 Russian tea cakes
- B) 2/5 of a Russian tea cake
- C) \$2.50
- D) \$1.00

Answer: A

Diff: 1 Page Ref: 8/8

Topic: *The economic problem that every society must solve*

Skill: *Conceptual*

Objective: *LO2: Discuss how an economy answers these questions: What goods and services will be produced? How will the goods and services be produced? Who will receive the goods and services?*

AACSB: *Reflective Thinking*

Special Feature: *None*

8) Ted quits his \$60,000-a-year job to be a stay-at-home dad. What is the opportunity cost of his decision?

- A) 0 since he will no longer be earning a salary
- B) depends on the "going rate" for stay-at-home dads
- C) at least \$60,000
- D) the value he attributes to the joy of parenting

Answer: C

Diff: 1 Page Ref: 8/8

Topic: *The economic problem that every society must solve*

Skill: *Conceptual*

Objective: *LO2: Discuss how an economy answers these questions: What goods and services will be produced? How will the goods and services be produced? Who will receive the goods and services?*

AACSB: *Reflective Thinking*

Special Feature: *None*

9) The distribution of income primarily determines which of the fundamental economic questions?

- A) What goods and services are to be produced?
- B) How the goods and services are to be produced?
- C) Who will receive the goods and services produced?
- D) How to plan the economy?

Answer: C

Diff: 2 Page Ref: 8/8

Topic: *The economic problem that every society must solve*

Skill: *Conceptual*

Objective: *LO2: Discuss how an economy answers these questions: What goods and services will be produced? How will the goods and services be produced? Who will receive the goods and services?*

AACSB: *Reflective Thinking*

Special Feature: *None*

10) Which fundamental economic problem was 3Com, a leading U.S. high-tech firm, addressing when it decided to move its computer network switch manufacturing operations to China?

- A) Where to produce?
- B) How to produce?
- C) What to produce?
- D) For whom to produce?

Answer: B

Diff: 1 Page Ref: 8/8

Topic: The economic problem that every society must solve

Skill: Conceptual

Objective: LO2: Discuss how an economy answers these questions: What goods and services will be produced? How will the goods and services be produced? Who will receive the goods and services?

AACSB: Reflective Thinking

Special Feature: Chapter Opener: What Happens When U.S. High-Technology Firms Move to China?

11) Automobile manufacturers produce a range of automobiles such as sports utility vehicles, luxury sedans, pickup trucks and compact cars. What fundamental economic question are they addressing by making this range of products?

- A) How to produce goods that consumers want?
- B) Why produce a variety of automobiles?
- C) What to produce?
- D) Who to produce automobiles for?

Answer: C

Diff: 1 Page Ref: 8/8

Topic: The economic problem that every society must solve

Skill: Conceptual

Objective: LO2: Discuss how an economy answers these questions: What goods and services will be produced? How will the goods and services be produced? Who will receive the goods and services?

AACSB: Reflective Thinking

Special Feature: None

12) Consider the following economic agents:

- a. the government
- b. consumers
- c. producers

Who, in a modern mixed economy, decides what goods and services will be produced with the scarce resources available in that economy?

- A) the government
- B) producers
- C) consumers
- D) consumers and producers
- E) the government, consumers and producers

Answer: E

Diff: 1 Page Ref: 9/9

Topic: The economic problem that every society must solve

Skill: Definition

Objective: LO2: Discuss how an economy answers these questions: What goods and services will be produced? How will the goods and services be produced? Who will receive the goods and services?

AACSB: Reflective Thinking

Special Feature: None

- 13) The decision about what goods and services will be produced made in a market economy is made by
- A) lawmakers in the government voting on what will be produced.
  - B) workers deciding to produce only what the boss says must be produced.
  - C) producers deciding what society wants most.
  - D) consumers and firms choosing which goods and services to buy or produce.
  - E) consumers dictating to firms what they need most.

Answer: D

Diff: 1 Page Ref: 9/9

Topic: *The economic problem that every society must solve*

Skill: *Definition*

Objective: LO2: *Discuss how an economy answers these questions: What goods and services will be produced? How will the goods and services be produced? Who will receive the goods and services?*

AACSB: *Reflective Thinking*

Special Feature: *None*

- 14) Which of the following is correct about the economic decisions consumers, firms, and the government have to make?
- A) Governments may face the problem of shortages but not scarcity in making economic decisions.
  - B) Only individuals face scarcity; firms and the government do not.
  - C) Firms and the government face scarcity, individuals only face shortages.
  - D) Each faces the problem of scarcity which necessitates trade-offs in making economic decisions.

Answer: D

Diff: 1 Page Ref: 9/9

Topic: *The economic problem that every society must solve*

Skill: *Conceptual*

Objective: LO2: *Discuss how an economy answers these questions: What goods and services will be produced? How will the goods and services be produced? Who will receive the goods and services?*

AACSB: *Reflective Thinking*

Special Feature: *None*

- 15) Why is it necessary for all economic systems to not only provide people with goods and services, but also restrict them from getting as much of these goods and services as they wish?
- A) Failure to do this could reduce the efficiency of the system by producing some goods and services that are not as highly valued as others.
  - B) Failure to do this could lead to an inequitable allocation of goods and services produced.
  - C) Failure to do this could lead to drastic shortages of good and services.
  - D) Failure to do this could reduce efficiency and leads to an inequitable allocation of output.

Answer: A

Diff: 3 Page Ref: 10/10

Topic: *The economic problem that every society must solve*

Skill: *Analytical*

Objective: LO2: *Discuss how an economy answers these questions: What goods and services will be produced? How will the goods and services be produced? Who will receive the goods and services?*

AACSB: *Analytic Skills*

Special Feature: *None*

- 16) How does a market system prevent people from getting as many goods and services as they wish?
- A) Governments interfere with the market mechanism to influence the allocation of goods and services.
  - B) In a market system, firms can charge any price they want, thus preventing poor people from getting as many goods and services as they wish.
  - C) The market system allocates goods and services to those who are able to pay for those products and therefore income is a limiting factor.
  - D) The government imposes taxes on those who earn beyond a certain amount of income.

Answer: C

Diff: 2 Page Ref: 10/10

Topic: *The economic problem that every society must solve*

Skill: *Conceptual*

Objective: *LO2: Discuss how an economy answers these questions: What goods and services will be produced? How will the goods and services be produced? Who will receive the goods and services?*

AACSB: *Reflective Thinking*

Special Feature: *None*

- 17) Who receives the most of what is produced in a market economy?
- A) lawmakers and other politically favored groups
  - B) those who are willing and able to buy them
  - C) everyone receives an equal amount
  - D) people who earn the highest incomes

Answer: B

Diff: 1 Page Ref: 10/10

Topic: *The economic problem that every society must solve*

Skill: *Conceptual*

Objective: *LO2: Discuss how an economy answers these questions: What goods and services will be produced? How will the goods and services be produced? Who will receive the goods and services?*

AACSB: *Reflective Thinking*

Special Feature: *None*

- 18) How are the fundamental economic decisions determined in Cuba?
- A) Individuals, firms, and the government interact in a market to make these economic decisions.
  - B) These decisions are made by the country's elders who have had much experience in answering these questions.
  - C) The government decides because Cuba is a centrally planned economy.
  - D) The United Nations decides because Cuba is a developing economy.

Answer: C

Diff: 1 Page Ref: 9/9

Topic: *The economic problem that every society must solve*

Skill: *Factual*

Objective: *LO2: Discuss how an economy answers these questions: What goods and services will be produced? How will the goods and services be produced? Who will receive the goods and services?*

AACSB: *Reflective Thinking*

Special Feature: *None*



- 19) How are the fundamental economic questions answered in a market economy?
- A) The government alone decides the answers.
  - B) Individuals, firms, and the government interact in markets to decide the answers to these questions.
  - C) Households and firms interact in markets to decide the answers to these questions.
  - D) Large corporations alone decide the answers.

Answer: C

Diff: 2 Page Ref: 9/9

Topic: *The economic problem that every society must solve*

Skill: *Conceptual*

Objective: LO2: *Discuss how an economy answers these questions: What goods and services will be produced? How will the goods and services be produced? Who will receive the goods and services?*

AACSB: *Reflective Thinking*

Special Feature: *None*

- 20) Which of the following is a problem inherent in centrally planned economies?
- A) There are no problems and everyone, including consumers, is satisfied.
  - B) There is too much production of low-cost, high-quality goods and services.
  - C) Production managers are more concerned with satisfying government's orders than with satisfying consumer wants.
  - D) Unemployment is too high.

Answer: C

Diff: 2 Page Ref: 9/9

Topic: *The economic problem that every society must solve*

Skill: *Conceptual*

Objective: LO2: *Discuss how an economy answers these questions: What goods and services will be produced? How will the goods and services be produced? Who will receive the goods and services?*

AACSB: *Reflective Thinking*

Special Feature: *None*

- 21) All of the following contributed to the downfall of the Soviet Union in 1991 *except*
- A) public dissatisfaction with low living standards and political repression.
  - B) an inability to produce low-cost consumer goods that households wanted.
  - C) lack of high-quality goods and services.
  - D) lack of a strong dictator who can coordinate economic activities.

Answer: D

Diff: 2 Page Ref: 9/9

Topic: *The economic problem that every society must solve*

Skill: *Factual*

Objective: LO2: *Discuss how an economy answers these questions: What goods and services will be produced? How will the goods and services be produced? Who will receive the goods and services?*

AACSB: *Reflective Thinking*

Special Feature: *None*

- 22) When goods and services are produced at the lowest possible cost, \_\_\_\_\_ occurs.
- A) allocative efficiency
  - B) productive efficiency
  - C) equity
  - D) efficient central planning

Answer: B

Diff: 1 Page Ref: 10/10

Topic: *The economic problem that every society must solve*

Skill: *Definition*

Objective: *LO2: Discuss how an economy answers these questions: What goods and services will be produced? How will the goods and services be produced? Who will receive the goods and services?*

AACSB: *Reflective Thinking*

Special Feature: *None*

- 23) Productive efficiency is achieved when
- A) firms add a low profit margin to the goods and services they produce.
  - B) firms produce the goods and services that consumers value most.
  - C) firms produce goods and services at the lowest cost.
  - D) there are no shortages or surpluses in the market.

Answer: C

Diff: 1 Page Ref: 10/10

Topic: *The economic problem that every society must solve*

Skill: *Definition*

Objective: *LO2: Discuss how an economy answers these questions: What goods and services will be produced? How will the goods and services be produced? Who will receive the goods and services?*

AACSB: *Reflective Thinking*

Special Feature: *None*

- 24) When production reflects consumer preferences, \_\_\_\_\_ occurs.
- A) allocative efficiency
  - B) productive efficiency
  - C) equity
  - D) efficient central planning

Answer: A

Diff: 1 Page Ref: 10/10

Topic: *The economic problem that every society must solve*

Skill: *Definition*

Objective: *LO2: Discuss how an economy answers these questions: What goods and services will be produced? How will the goods and services be produced? Who will receive the goods and services?*

AACSB: *Reflective Thinking*

Special Feature: *None*

- 25) Allocative efficiency is achieved when
- A) goods and services are fairly distributed among consumers in an economy.
  - B) firms produce the goods and services that consumers value most.
  - C) firms produce goods and services at the lowest cost.
  - D) there are no shortages or surpluses in the market.

Answer: B

Diff: 1 Page Ref: 10/10

Topic: *The economic problem that every society must solve*

Skill: *Definition*

Objective: LO2: *Discuss how an economy answers these questions: What goods and services will be produced? How will the goods and services be produced? Who will receive the goods and services?*

AACSB: *Reflective Thinking*

Special Feature: *None*

- 26) Which of the following contributes to the efficiency of markets?
- A) Governments play an active role in the day-to-day operations of markets.
  - B) Markets are able to bring about an equitable distribution of goods and services.
  - C) Markets promote equal standards of living.
  - D) Markets promote competition and voluntary exchange.

Answer: D

Diff: 2 Page Ref: 10/10

Topic: *The economic problem that every society must solve*

Skill: *Conceptual*

Objective: LO2: *Discuss how an economy answers these questions: What goods and services will be produced? How will the goods and services be produced? Who will receive the goods and services?*

AACSB: *Reflective Thinking*

Special Feature: *None*

- 27) Which of the following statements is true about competition in a market?
- A) Competition forces firms to outsource the production of their labor-intensive products.
  - B) Competition forces firms to undercut their selling price, thus benefiting consumers who will be able to purchase products at the lowest price possible.
  - C) Competition forces firms to produce and sell products as long as the marginal benefit to consumers exceeds the marginal cost of production.
  - D) Competition forces firms to add only low profit margins to their costs of production.

Answer: C

Diff: 2 Page Ref: 10/10

Topic: *The economic problem that every society must solve*

Skill: *Conceptual*

Objective: LO2: *Discuss how an economy answers these questions: What goods and services will be produced? How will the goods and services be produced? Who will receive the goods and services?*

AACSB: *Reflective Thinking*

Special Feature: *None*

- 28) Voluntary exchange increases economic efficiency
- A) because neither the buyer nor the seller would agree to a trade unless they both benefit.
  - B) because voluntary exchange only takes place with government permission.
  - C) because it is free and consequently does not cost anything.
  - D) because it allows wealthy individuals to act altruistically and give to the poor.

Answer: A

Diff: 1 Page Ref: 10/10

Topic: The economic problem that every society must solve

Skill: Conceptual

Objective: LO2: Discuss how an economy answers these questions: What goods and services will be produced? How will the goods and services be produced? Who will receive the goods and services?

AACSB: Reflective Thinking

Special Feature: None

- 29) Which of the following generates productive efficiency?
- A) competition among sellers
  - B) competition among buyers
  - C) government inspectors
  - D) government production rules and regulations

Answer: A

Diff: 1 Page Ref: 10/10

Topic: The economic problem that every society must solve

Skill: Conceptual

Objective: LO2: Discuss how an economy answers these questions: What goods and services will be produced? How will the goods and services be produced? Who will receive the goods and services?

AACSB: Reflective Thinking

Special Feature: None

- 30) Which of the following generates allocative efficiency in a market economy?
- A) national government intervention
  - B) voluntary exchange between buyers and sellers
  - C) United Nations rules for competition
  - D) equity

Answer: B

Diff: 1 Page Ref: 10/10

Topic: The economic problem that every society must solve

Skill: Conceptual

Objective: LO2: Discuss how an economy answers these questions: What goods and services will be produced? How will the goods and services be produced? Who will receive the goods and services?

AACSB: Reflective Thinking

Special Feature: None

31) Which of the following is a result of a market economy?

- A) environmental protection
- B) an equal income distribution
- C) agreement on equity
- D) voluntary exchange

Answer: D

Diff: 1 Page Ref: 10/10

Topic: *The economic problem that every society must solve*

Skill: *Conceptual*

Objective: *LO2: Discuss how an economy answers these questions: What goods and services will be produced? How will the goods and services be produced? Who will receive the goods and services?*

AACSB: *Reflective Thinking*

Special Feature: *None*

32) Selling tickets to graduation ceremonies has long been a tradition among students at institutions that limit the number of guests. Suppose your classmate, Heidi purchased two tickets for \$40 each. Is this transaction economically efficient?

- A) No, people should never be allowed to sell items they received for free.
- B) Yes, it was a voluntary exchange that benefited both parties.
- C) No, Heidi paid too much for the tickets.
- D) Yes, it is efficient only from the perspective of the seller and not from the perspective of the buyer.

Answer: B

Diff: 2 Page Ref: 10/10

Topic: *The economic problem that every society must solve*

Skill: *Conceptual*

Objective: *LO2: Discuss how an economy answers these questions: What goods and services will be produced? How will the goods and services be produced? Who will receive the goods and services?*

AACSB: *Analytic Skills*

Special Feature: *None*

33) In economics, the term "equity" means

- A) everyone has an equal standard of living.
- B) the hardest working individuals consume all they want.
- C) only elected officials have high standards of living.
- D) economic benefits are distributed fairly.

Answer: D

Diff: 1 Page Ref: 10/10

Topic: *The economic problem that every society must solve*

Skill: *Definition*

Objective: *LO2: Discuss how an economy answers these questions: What goods and services will be produced? How will the goods and services be produced? Who will receive the goods and services?*

AACSB: *Reflective Thinking*

Special Feature: *None*

- 34) Which of the following is motivated by an equity concern?
- A) Some U.S. colleges have cut back on merit scholarships since these programs siphon money from need-based programs, thus harming lower-income students with greater financial need.
  - B) Following the removal of subsidies in urban water use, household demand for water decreased quite significantly in Bogor, Indonesia.
  - C) In November 2003, the Federal Communications Commission implemented the "local number portability" rule which gives cell phone customers the option of keeping their number when they switch carriers within the same geographic region.
  - D) The United States protects intellectual property rights, allowing inventors to prevent others from using their inventions without payment.

Answer: A

Diff: 3 Page Ref: 10/10

Topic: *The economic problem that every society must solve*

Skill: *Conceptual*

Objective: *LO2: Discuss how an economy answers these questions: What goods and services will be produced? How will the goods and services be produced? Who will receive the goods and services?*

AACSB: *Reflective Thinking, Ethical Reasoning*

Special Feature: *None*

- 35) Which of the following is motivated by an efficiency concern?
- A) In December 2006, the Bush administration restarted a short-term housing assistance program for victims of Hurricane Katrina.
  - B) Each year, the University of Notre Dame conducts a lottery to parcel out the 30,000 seats available to contributors, former athletes and parents in the 80,000-seat stadium.
  - C) The United Network for Organ Sharing advocates a system of rationing scarce kidneys that would favor young patients over old in an effort to wring more life out of donated organs.
  - D) The federal government's housing choice voucher program assists very low-income families, the elderly, and the disabled to afford decent, safe, and sanitary housing in the private market.

Answer: C

Diff: 3 Page Ref: 10/10

Topic: *The economic problem that every society must solve*

Skill: *Conceptual*

Objective: *LO2: Discuss how an economy answers these questions: What goods and services will be produced? How will the goods and services be produced? Who will receive the goods and services?*

AACSB: *Reflective Thinking, Ethical Reasoning*

Special Feature: *None*

- 36) Which of the following is *not* an example of an efficiency–equity trade–off faced by economic agents?
- A) According to an article by in the American Journal of Public Health by Edward Kaplan and Michael Merson of Yale University School of Medicine, the federal government's current method of allocating HIV–prevention resources is not cost–effective. Instead of allocating resources to states in proportion to reported AIDS cases, resources should flow first to those activities that prevent more infections per dollar and then to less and less effective combinations of programs and populations until funds are exhausted, even if it means that some populations would be left without any prevention services.
  - B) Concerned about the falling birth rate, the French government has pledged more money for families with three children, in an effort to encourage working women to have more babies.
  - C) The growing demand for corn by ethanol producers has led to a surge in the price of tortillas, a staple in the Mexican diet. To quell public outcry over rising tortilla prices, the Mexican government released government corn stocks at prices well below the market, and pressured states to impose price ceilings on tortillas.
  - D) Some US colleges cut back on merit scholarships since these programs siphon money from need–based programs, thus harming lower–income students with greater financial need.

Answer: B

Diff: 3 Page Ref: 10/10

Topic: *The economic problem that every society must solve*

Skill: *Analytical*

Objective: LO2: *Discuss how an economy answers these questions: What goods and services will be produced? How will the goods and services be produced? Who will receive the goods and services?*

AACSB: *Analytic Skills, Ethical Reasoning*

Special Feature: *None*

- 37) Which of the following correctly describes the relationship between economic efficiency and economic equity?
- A) They are both automatically achieved in a free market economy.
  - B) They always call for opposite outcomes.
  - C) There is no conflict between the two goals.
  - D) There is often a trade–off between the two.

Answer: D

Diff: 2 Page Ref: 10/10

Topic: *The economic problem that every society must solve*

Skill: *Conceptual*

Objective: LO2: *Discuss how an economy answers these questions: What goods and services will be produced? How will the goods and services be produced? Who will receive the goods and services?*

AACSB: *Reflective Thinking*

Special Feature: *None*

- 38) The government makes all economic decisions in a centrally planned economy.

Answer: TRUE

Diff: 1 Page Ref: 9/9

Topic: *The economic problem that every society must solve*

Skill: *Conceptual*

Objective: LO2: *Discuss how an economy answers these questions: What goods and services will be produced? How will the goods and services be produced? Who will receive the goods and services?*

AACSB: *Reflective Thinking*

Special Feature: *None*

39) When voluntary exchange takes place, both parties gain from the exchange.

Answer: TRUE

Diff: 1 Page Ref: 10/10

Topic: *The economic problem that every society must solve*

Skill: *Conceptual*

Objective: *LO2: Discuss how an economy answers these questions: What goods and services will be produced? How will the goods and services be produced? Who will receive the goods and services?*

AACSB: *Reflective Thinking*

Special Feature: *None*

40) A college must decide if it wants to offer more evening and weekend classes. This decision involves answering the economic question of "for whom to produce."

Answer: FALSE

Diff: 1 Page Ref: 9/9

Topic: *The economic problem that every society must solve*

Skill: *Conceptual*

Objective: *LO2: Discuss how an economy answers these questions: What goods and services will be produced? How will the goods and services be produced? Who will receive the goods and services?*

AACSB: *Reflective Thinking*

Special Feature: *None*

41) One desirable outcome of a market economy is that it leads to a more equitable distribution of income.

Answer: FALSE

Diff: 1 Page Ref: 10/10

Topic: *The economic problem that every society must solve*

Skill: *Conceptual*

Objective: *LO2: Discuss how an economy answers these questions: What goods and services will be produced? How will the goods and services be produced? Who will receive the goods and services?*

AACSB: *Reflective Thinking*

Special Feature: *None*

42) What is the difference between economic efficiency and equity?

Answer: Economic efficiency is concerned with maximizing the value of output that can be generated by a given resource base while equity deals with the distribution of society's total output among the sectors and individuals of society.

Diff: 2 Page Ref: 10/10

Topic: *The economic problem that every society must solve*

Skill: *Definition*

Objective: *LO2: Discuss how an economy answers these questions: What goods and services will be produced? How will the goods and services be produced? Who will receive the goods and services?*

AACSB: *Reflective Thinking*

Special Feature: *None*



43) Define productive efficiency. Does productive efficiency imply allocative efficiency? Explain.

Answer: Productive efficiency is an efficiency criterion that describes a situation in which goods and services are produced at the lowest possible cost. It does not imply allocative efficiency which is a criterion associated with producing goods and services that consumers value most. For example, a manufacturer may be able to produce typewriters at the lowest possible cost of say, \$200 but this does not necessarily mean that consumers are willing to pay \$200 for a typewriter.

Diff: 3      Page Ref: 10/10

Topic: *The economic problem that every society must solve*

Skill: *Definition, Conceptual*

Objective: *LO2: Discuss how an economy answers these questions: What goods and services will be produced? How will the goods and services be produced? Who will receive the goods and services?*

AACSB: *Analytic Skills*

Special Feature: *None*

44) Define allocative efficiency. Explain the significance of this concept in economics?

Answer: Allocative efficiency is an efficiency criterion that describes a situation where the marginal benefit (or marginal valuation) of the last unit purchased is equal to the marginal cost of producing that unit. In other words, allocative efficiency occurs when production reflects consumer preferences. This is a significant concept in that all societies face scarcity which necessitates that societies make choices about what goods and services to produce. To maximize society's wealth, resources must flow to their highest valued use. This value is determined by consumers.

Diff: 3      Page Ref: 10/10

Topic: *The economic problem that every society must solve*

Skill: *Definition, Conceptual*

Objective: *LO2: Discuss how an economy answers these questions: What goods and services will be produced? How will the goods and services be produced? Who will receive the goods and services?*

AACSB: *Reflective Thinking*

Special Feature: *None*

### 1.3 Economic Models

1) Economic models do all of the following *except*

- A) answer economic questions.
- B) portray reality in all its minute details.
- C) make economic ideas explicit and concrete for use by decision makers.
- D) simplify some aspect of economic life.

Answer: B

Diff: 1      Page Ref: 11/11

Topic: *Economic Models*

Skill: *Definition*

Objective: *LO3: Understand the role of models in economic analysis*

AACSB: *Reflective Thinking*

Special Feature: *None*

- 2) Which of the following is part of an economic model?
- A) assumptions
  - B) norms
  - C) opinions
  - D) preferences of economic agents

Answer: A

Diff: 1 Page Ref: 11/11

Topic: Economic Models

Skill: Definition

Objective: LO3: Understand the role of models in economic analysis

AACSB: Reflective Thinking

Special Feature: None

- 3) Which of the following statements about positive economic analysis is *false*?
- A) Positive analysis uses an economic model to estimate the costs and benefits of different course of actions.
  - B) There is much more disagreement among economists over normative economic analysis than over positive economic analysis.
  - C) There is much more disagreement among economists over positive economic analysis than over normative economic analysis.
  - D) Unlike normative economic analysis, positive economic analysis can be tested.

Answer: C

Diff: 2 Page Ref: 14/14

Topic: Economic Models

Skill: Conceptual

Objective: LO3: Understand the role of models in economic analysis

AACSB: Reflective Thinking

Special Feature: None

- 4) Which of the following is a positive economic statement?
- A) Everyone should live at the same standard of living.
  - B) If the price of gasoline rises, a smaller quantity of it will be bought.
  - C) The government should close income tax loopholes.
  - D) U.S. firms should not be allowed to outsource production of goods and services.

Answer: B

Diff: 2 Page Ref: 14/14

Topic: Economic Models

Skill: Conceptual

Objective: LO3: Understand the role of models in economic analysis

AACSB: Reflective Thinking

Special Feature: None

5) Which of the following is a positive economic statement?

- A) People should not buy SUVs.
- B) The government should mandate electric automobiles.
- C) Scarcity necessitates that people make trade-offs.
- D) Foreign workers should not be allowed to work for lower wages than the citizens of a country.

Answer: C

Diff: 2 Page Ref: 14/14

Topic: Economic Models

Skill: Conceptual

Objective: LO3: Understand the role of models in economic analysis

AACSB: Reflective Thinking

Special Feature: None

6) Which of the following is a normative economic statement?

- A) Rising global demand for diesel and heating oil has led to increases in the price of crude oil.
- B) With falling home prices and rising mortgage interest rates, the amount of foreclosures has increased.
- C) The federal government is considering raising the gasoline tax to promote the use of public transportation.
- D) Fashion designers should be allowed to copyright designs to promote innovation.

Answer: D

Diff: 2 Page Ref: 14/14

Topic: Economic Models

Skill: Conceptual

Objective: LO3: Understand the role of models in economic analysis

AACSB: Ethical Reasoning

Special Feature: None

7) Which of the following is a normative economic statement?

- A) The price of gasoline is too high.
- B) The current high price of gasoline is the result of strong worldwide demand.
- C) When the price of gasoline rises, the quantity of gasoline purchased falls.
- D) When the price of gasoline rises, transportation costs rise.

Answer: A

Diff: 2 Page Ref: 14/14

Topic: Economic Models

Skill: Conceptual

Objective: LO3: Understand the role of models in economic analysis

AACSB: Reflective Thinking

Special Feature: None

- 8) Which of the following statements best characterizes the disagreements between Paul Samuelson and Jagdish Bhagwati in the debate over outsourcing?
- A) Their disagreements are grounded in positive economic analysis. They disagree about the model and the assumptions used in the model.
  - B) Their disagreements are grounded in positive economic analysis. They disagree about the relevant economic statistics used in the model.
  - C) Their disagreements are grounded in normative economic analysis. They disagree over how to interpret the relevant economic statistics.
  - D) Their disagreements are grounded in normative economic analysis. They disagree over the types of jobs lost to outsourcing.

Answer: C

Diff: 2 Page Ref: 13/13

Topic: Economic Models

Skill: Analytical

Objective: LO3: Understand the role of models in economic analysis

AACSB: Analytic Skills

Special Feature: Making the Connection: When Economists Disagree: A Debate over Outsourcing

- 9) The economic analysis of minimum wage involves both normative and positive analysis. Consider the following consequences of a minimum wage:
- a. The minimum wage law causes unemployment.
  - b. A minimum wage law benefits some groups and hurts others.
  - c. In some cities such as San Francisco and New York, it would be impossible for low-skilled workers to live in the city without minimum wage laws.
  - d. The gains to winners of a minimum wage law should be valued more highly than the losses to losers because the latter primarily comprises businesses.

Which of the consequences above are positive statements and which are normative statements?

- A) a, b, and c are positive statements and d is a normative statement.
- B) a and b are positive statements, c and d are normative statement.
- C) Only a is a positive statement, b, c and d are normative statements.
- D) a and c are positive statements, b and d are normative statements

Answer: B

Diff: 2 Page Ref: 14/14

Topic: Economic Models

Skill: Analytical

Objective: LO3: Understand the role of models in economic analysis

AACSB: Analytic Skills

Special Feature: Don't Let This happen to YOU!: Don't Confuse Positive Analysis with Normative Analysis

- 10) "A decrease in the price of digital cameras will decrease the demand for camera film." This statement is an example of a positive economic statement.

Answer: TRUE

Diff: 1 Page Ref: 14/14

Topic: Economic Models

Skill: Conceptual

Objective: LO3: Understand the role of models in economic analysis

AACSB: Reflective Thinking

Special Feature: None

- 11) "The distribution of income should be left to the market" is an example of a positive economic statement.

Answer: FALSE

Diff: 1 Page Ref: 14/14

Topic: Economic Models

Skill: Conceptual

Objective: LO3: Understand the role of models in economic analysis

AACSB: Reflective Thinking

Special Feature: None

- 12) Policies based on normative economic ideas tend to increase economic efficiency and improve equity.

Answer: FALSE

Diff: 2 Page Ref: 14/14

Topic: Economic Models

Skill: Conceptual

Objective: LO3: Understand the role of models in economic analysis

AACSB: Reflective Thinking

Special Feature: None

- 13) What is the difference between positive economic analysis and normative economic analysis? Give one example each of a positive and normative economic issue or question or statement.

Answer: Positive economic analysis is concerned with what is. Positive economic analysis reaches conclusions based on verifiable statements. Normative economic analysis, on the other hand, is concerned with what ought to be. Normative analysis reaches conclusions based on opinions. (Students will give many different examples.)

Diff: 2 Page Ref: 14/14

Topic: Economic Models

Skill: Definition, Conceptual

Objective: LO3: Understand the role of models in economic analysis

AACSB: Reflective Thinking

Special Feature: None

## 1.4 Microeconomics and Macroeconomics

- 1) Which of the following is a microeconomics question?
- A) How much will be saved and how much will be produced in the entire economy?
  - B) What will the level of economic growth be in the entire economy?
  - C) What factors determine the price of carrots?
  - D) What determines the average price level and inflation?

Answer: C

Diff: 2 Page Ref: 15/15

Topic: Microeconomics and Macroeconomics

Skill: Conceptual

Objective: LO4: Distinguish between microeconomics and macroeconomics

AACSB: Reflective Thinking

Special Feature: None

2) The branch of economics which studies how households and firms make choices, interact in markets and how government attempts to influence their choices is called

- A) macroeconomics.
- B) microeconomics.
- C) positive economics.
- D) normative economics.

Answer: B

Diff: 1 Page Ref: 15/15

Topic: Microeconomics and Macroeconomics

Skill: Definition

Objective: LO4: Distinguish between microeconomics and macroeconomics

AACSB: Reflective Thinking

Special Feature: None

3) Which of the following is a macroeconomics question?

- A) What determines the inflation rate?
- B) What determines the production of DVDs?
- C) What factors determine the price of carrots?
- D) What determines the wage of auto workers?

Answer: A

Diff: 2 Page Ref: 15/15

Topic: Microeconomics and Macroeconomics

Skill: Conceptual

Objective: LO4: Distinguish between microeconomics and macroeconomics

AACSB: Reflective Thinking

Special Feature: None

4) The branch of economics which studies the behavior of entire economies and policies that affect the economy as a whole is called

- A) public economics.
- B) microeconomics.
- C) macroeconomics.
- D) normative economics.

Answer: C

Diff: 1 Page Ref: 15/15

Topic: Microeconomics and Macroeconomics

Skill: Definition

Objective: LO4: Distinguish between microeconomics and macroeconomics

AACSB: Reflective Thinking

Special Feature: None

5) Examining the conditions that could lead to a recession in an economy is an example of macroeconomics topic.

Answer: TRUE

Diff: 1 Page Ref: 15/15

Topic: Microeconomics and Macroeconomics

Skill: Conceptual

Objective: LO4: Distinguish between microeconomics and macroeconomics

AACSB: Reflective Thinking

Special Feature: None

- 6) According to a Wall Street Journal article, there are nearly 75,000 patients in the U.S. awaiting kidney transplants. To move more people off the wait list, economists along with computer experts and surgeons are developing a market for kidney swapping. This is an example of a macroeconomics topic.

*Source: Laura Meckler, "Kidney Swaps Seen as a Way to Ease Donor Shortage", Wall Street Journal, page A1, Oct 15, 2007.*

Answer: FALSE

Diff: 1 Page Ref: 15/15

Topic: *Microeconomics and Macroeconomics*

Skill: *Conceptual*

Objective: *LO4: Distinguish between microeconomics and macroeconomics*

AACSB: *Reflective Thinking*

Special Feature: *None*

- 7) How does the study of microeconomics differ from that of macroeconomics? Give one example each of an issue studied in microeconomics and in macroeconomics.

Answer: Microeconomics is the study of how household and businesses make choices, how they interact in markets, and how the government attempts to influence their choices while macroeconomics is the study of the economy as a whole including topics like unemployment, inflation and economic growth. (Students will give many different examples.)

Diff: 2 Page Ref: 15/15

Topic: *Microeconomics and Macroeconomics*

Skill: *Definition, Conceptual*

Objective: *LO4: Distinguish between microeconomics and macroeconomics*

AACSB: *Reflective Thinking*

Special Feature: *None*

## 1.5 A Preview of Important Economic Terms

- 1) Which of the following statements is true about profit?
- A) Profit refers to the revenue received from the sale of a quantity of goods.
  - B) Profit is calculated by multiplying price and quantity sold.
  - C) The terms "accounting profit" and "economic profit" can be used interchangeably.
  - D) Profit is the difference between revenue and cost.

Answer: D

Diff: 2 Page Ref: 16/16

Topic: *A Preview of some important economic terms*

Skill: *Definition*

Objective: *LO5: Become familiar with important economic terms*

AACSB: *Reflective Thinking*

Special Feature: *None*

- 2) Human capital refers to
- A) the money people have.
  - B) the machines workers have to work with.
  - C) the accumulated skills and training workers have.
  - D) the wealth people have.

Answer: C

Diff: 1 Page Ref: 16/16

Topic: A Preview of some important economic terms

Skill: Definition

Objective: LO5: Become familiar with important economic terms

AACSB: Reflective Thinking

Special Feature: None

- 3) Which of the following is an example of an activity undertaken by an entrepreneur?
- A) designing your landscaping for your new home
  - B) holding a position as the president of a liberal arts college
  - C) running for the president of the United States
  - D) starting your own pet sitting business

Answer: D

Diff: 1 Page Ref: 16/16

Topic: A Preview of some important economic terms

Skill: Definition

Objective: LO5: Become familiar with important economic terms

AACSB: Reflective Thinking

Special Feature: None

- 4) Which of the following is counted as "capital" in economics?
- A) the money people have
  - B) the machines workers have to work with
  - C) the accumulated skills and training workers have
  - D) the wealth people have

Answer: B

Diff: 2 Page Ref: 16/16

Topic: A Preview of some important economic terms

Skill: Conceptual

Objective: LO5: Become familiar with important economic terms

AACSB: Reflective Thinking

Special Feature: None

- 5) Technology is defined as
- A) the process of developing and revising models.
  - B) new innovations and creations.
  - C) the processes used to produce goods and services.
  - D) the process of recycling products.

Answer: C

Diff: 1 Page Ref: 16/16

Topic: A Preview of some important economic terms

Skill: Definition

Objective: LO5: Become familiar with important economic terms

AACSB: Reflective Thinking

Special Feature: None



6) Which of the following statements about economic resources is *false*?

- A) Economic resources include financial capital and money.
- B) Economic resources are also called factors of production.
- C) Economic resources are used to produce goods and services.
- D) Some economic resources are human-made while others are found in nature.

Answer: A

Diff: 1 Page Ref: 16/16

Topic: A Preview of some important economic terms

Skill: Definition

Objective: LO5: Become familiar with important economic terms

AACSB: Reflective Thinking

Special Feature: None

7) In the market for factors of production, firms earn income by selling goods and services to households.

Answer: FALSE

Diff: 1 Page Ref: 16/16

Topic: A Preview of some important economic terms

Skill: Conceptual

Objective: LO5: Become familiar with important economic terms

AACSB: Reflective Thinking

Special Feature: None

8) One example of human capital is the amount of savings that you have.

Answer: FALSE

Diff: 1 Page Ref: 16/16

Topic: A Preview of some important economic terms

Skill: Conceptual

Objective: LO5: Become familiar with important economic terms

AACSB: Reflective Thinking

Special Feature: None

9) What is the difference between an invention and an innovation?

Answer: An invention is the development of a new good or a new process for making a good. An innovation is the practical application of an invention. Innovation could also refer to any significant improvement in a good or in the means of producing a good.

Diff: 1 Page Ref: 15/15

Topic: A Preview of some important economic terms

Skill: Conceptual

Objective: LO5: Become familiar with important economic terms

AACSB: Reflective Thinking

Special Feature: None

## 1.6 Appendix: Using Graphs and Formulas

- 1) If a graph has a line that shows the amount of outsourcing in the last ten years, it is known as
- A) a pie chart.
  - B) a time-series graph.
  - C) a demand curve for outsourcing.
  - D) a supply curve of outsourcing.

Answer: B

Diff: 1 Page Ref: 26/26

Topic: Appendix: Using Graphs and Formulas

Skill: Definition

Objective: Appendix: Review the use of graphs and formulas

AACSB: Reflective Thinking

Special Feature: None

- 2) Two-dimensional graphs have a horizontal and a vertical axis and are used in economics to illustrate
- A) relationships between two economic variables.
  - B) one variable.
  - C) a flow chart.
  - D) a pie chart.

Answer: A

Diff: 1 Page Ref: 27/27

Topic: Appendix: Using Graphs and Formulas

Skill: Definition

Objective: Appendix: Review the use of graphs and formulas

AACSB: Reflective Thinking

Special Feature: None

- 3) If a straight line passes through the point  $x = 14$  and  $y = 3$  and also through the point  $x = 4$  and  $y = 10$ , the slope of this line is
- A) negative 11 divided by 6.
  - B) seven tenths.
  - C) negative seven tenths.
  - D) 6 divided by 11.

Answer: C

Diff: 2 Page Ref: 27/27

Topic: Appendix: Using Graphs and Formulas

Skill: Analytical

Objective: Appendix: Review the use of graphs and formulas

AACSB: Reflective Thinking

Special Feature: None

- 4) How can the influence of a third variable be shown on a two-dimensional graph?
- A) by allowing the relationship to be nonlinear
  - B) by allowing the position of the relationship line or curve to shift on the graph
  - C) by drawing a third axis coming out of the two axes
  - D) by super-imposing the third variable on the two-dimensional graph

Answer: B

Diff: 3 Page Ref: 28/28

Topic: Appendix: Using Graphs and Formulas

Skill: Conceptual

Objective: Appendix: Review the use of graphs and formulas

AACSB: Analytic Skills

Special Feature: None

- 5) Which of the following statements is *false*?
- A) An inverse relationship has a negative slope value.
  - B) A direct relationship has a positive slope value.
  - C) A curved line has slope values that change at every point.
  - D) A straight line has a slope of zero.

Answer: D

Diff: 2 Page Ref: 28/28

Topic: Appendix: Using Graphs and Formulas

Skill: Conceptual

Objective: Appendix: Review the use of graphs and formulas

AACSB: Reflective Thinking

Special Feature: None

- 6) The relationship between sales and revenue is
- A) an inverse relationship.
  - B) a direct relationship.
  - C) a negative relationship.
  - D) independent.

Answer: B

Diff: 1 Page Ref: 28/28

Topic: Appendix: Using Graphs and Formulas

Skill: Conceptual

Objective: Appendix: Review the use of graphs and formulas

AACSB: Reflective Thinking

Special Feature: None

- 7) Suppose when the price of laptops fall, college students buy more laptops. This implies that
- A) there is a positive relationship between laptop prices and quantities purchased by college students.
  - B) there is a negative relationship between laptop prices and quantities purchased by college students.
  - C) there is a direct relationship between laptop prices and quantities purchased by college students.
  - D) there is a one-to-one relationship between laptop prices and quantities purchased by college students.

Answer: B

Diff: 1 Page Ref: 28/28

Topic: Appendix: Using Graphs and Formulas

Skill: Conceptual

Objective: Appendix: Review the use of graphs and formulas

AACSB: Reflective Thinking

Special Feature: None

- 8) If the price of gasoline was \$1.25 a gallon and it is now \$2.25 a gallon, what is the percentage change in price?
- A) 4.4 percent
  - B) 8 percent
  - C) 44 percent
  - D) 80 percent

Answer: D

Diff: 1 Page Ref: 33/33

Topic: Appendix: Using Graphs and Formulas

Skill: Analytical

Objective: Appendix: Review the use of graphs and formulas

AACSB: Reflective Thinking

Special Feature: None

- 9) In 2001, Hooverville consumed 205,000 tons of sugar. In 2002, sugar consumption rose to 245,000 tons. Calculate the percentage change in sugar consumption.
- A) 8.37%
  - B) 11.95%
  - C) 19.51%
  - D) 26.33%

Answer: C

Diff: 1 Page Ref: 33/33

Topic: Appendix: Using Graphs and Formulas

Skill: Conceptual

Objective: Appendix: Review the use of graphs and formulas

AACSB: Reflective Thinking

Special Feature: None

- 10) At a recent company meeting, Geraldine Erwin, sales manager of Dastoria, a flavored beverage producer announced, "We have increased our sales by 8 percent in just six months." Suppose six months ago, its sales amounted to \$452,000, what is the value of its sales today?
- A) \$36,160  
 B) \$415,840  
 C) \$488,160  
 D) \$565,000

Answer: C

Diff: 1 Page Ref: 33/33

Topic: Appendix: Using Graphs and Formulas

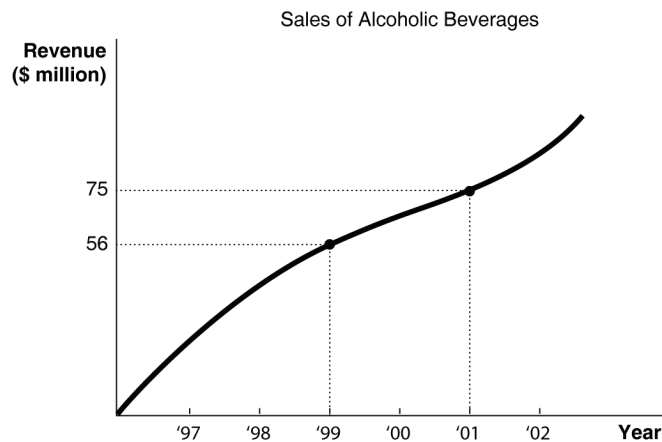
Skill: Conceptual

Objective: Appendix: Review the use of graphs and formulas

AACSB: Reflective Thinking

Special Feature: None

Figure 1-1



- 11) Refer to Figure 1-1. Using the information in the figure above, calculate the percentage change in sales of alcoholic beverages between 1999 and 2001.
- A) 33.9%  
 B) 25.3%  
 C) 19%  
 D) 13.4%

Answer: A

Diff: 1 Page Ref: 33/33

Topic: Appendix: Using Graphs and Formulas

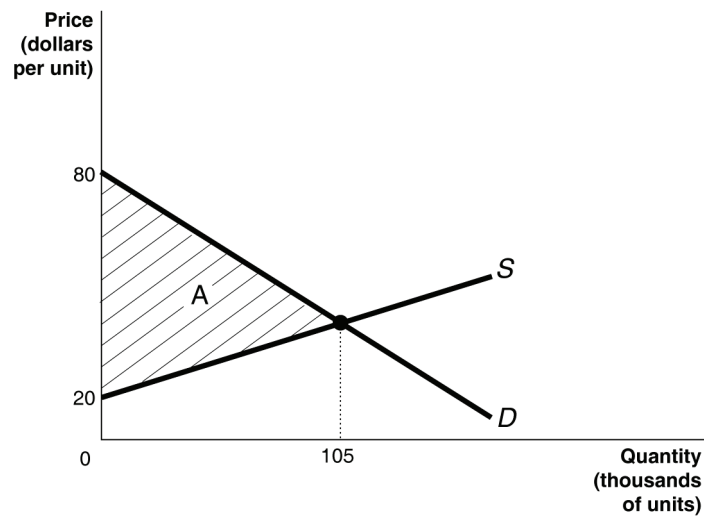
Skill: Conceptual

Objective: Appendix: Review the use of graphs and formulas

AACSB: Reflective Thinking

Special Feature: None

Figure 1-2



- 12) Refer to Figure 1-2. Calculate the area of the triangle A.
- A) \$8.4 million
  - B) \$6.3 million
  - C) \$3.15 million
  - D) \$2.1 million

Answer: C

Diff: 1 Page Ref: 33/33

Topic: Appendix: Using Graphs and Formulas

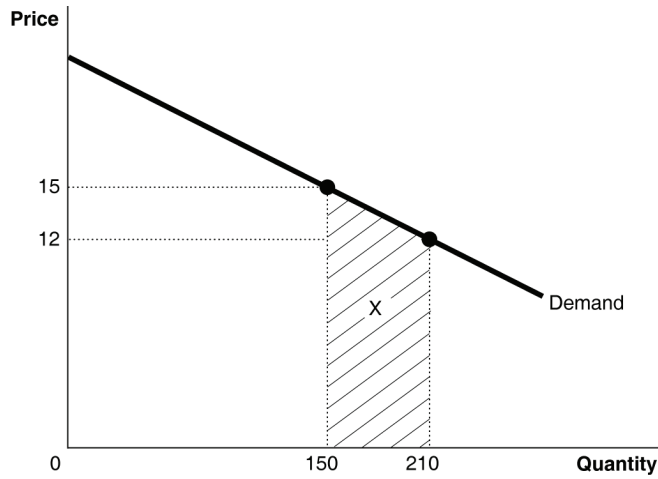
Skill: Conceptual

Objective: Appendix: Review the use of graphs and formulas

AACSB: Analytic Skills

Special Feature: None

Figure 1-3



- 13) Refer to Figure 1-3. Calculate the area of the trapezoid X.
- A) \$270
  - B) \$720
  - C) \$810
  - D) \$2,520

Answer: C

Diff: 2 Page Ref: 33/33

Topic: Appendix: Using Graphs and Formulas

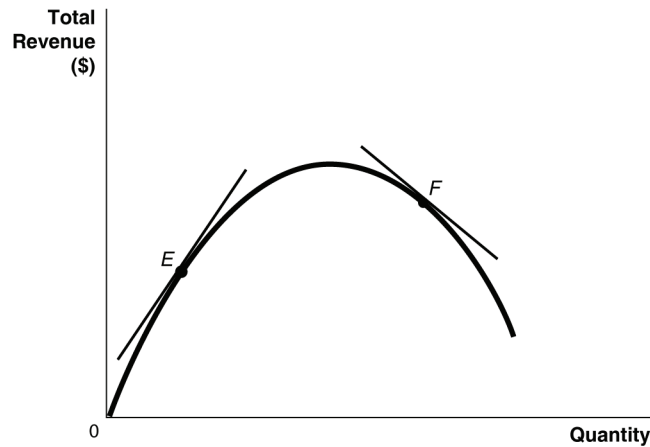
Skill: Conceptual

Objective: Appendix: Review the use of graphs and formulas

AACSB: Analytic Skills

Special Feature: None

Figure 1-4



- 14) Refer to Figure 1-4. Which of the following statements is true?
- A) The slope of the tangent at *E* is positive and the slope of the tangent at *F* is negative.
  - B) The slope of the tangent at *E* is negative and the slope of the tangent at *F* is positive.
  - C) The slope of the tangent at *E* and the slope of the tangent at *F* are negative.
  - D) The slope of the tangent at *E* and the slope of the tangent at *F* are positive.

Answer: A

Diff: 1 Page Ref: 31/31

Topic: Appendix: Using Graphs and Formulas

Skill: Conceptual

Objective: Appendix: Review the use of graphs and formulas

AACSB: Analytic Skills

Special Feature: None

- 15) What is the "omitted variable" problem in determining cause and effect?
- A) It is a problem that arises when an insignificant variable is given too much weight in an economic analysis leading to skewed conclusions about cause and effect.
  - B) It is a problem that arises when a significant variable is not given enough weight in an economic experiment leading to skewed conclusions about cause and effect.
  - C) It is a problem that arises when an insignificant economic variable that should have been omitted is included in an economic experiment leading to false conclusions about cause and effect.
  - D) It is a problem that arises when an economic variable that affects other variables is omitted from an analysis and its omission leads to false conclusions about cause and effect.

Answer: D

Diff: 1 Page Ref: 30/30

Topic: Appendix: Using Graphs and Formulas

Skill: Definition

Objective: Appendix: Review the use of graphs and formulas

AACSB: Reflective Thinking

Special Feature: None



- 16) What is the "reverse causality" problem in determining cause and effect?
- A) It is a problem that occurs when one concludes that a change in variable  $X$  caused a change in variable  $Y$  when in actual fact, it is a change in variable  $Z$  that caused a change in variable  $Y$ .
  - B) It is a problem that occurs when one observes that a change in variable  $X$  caused a change in variable  $Y$  which caused a change in variable  $Z$  and concludes that a change in variable  $X$  caused a change in variable  $Z$ .
  - C) It is a problem that occurs when one concludes that a change in variable  $X$  caused a change in variable  $Y$  when in actual fact, it is a change in variable  $Y$  that caused a change in variable  $X$ .
  - D) It is a problem that arises when two variables are inter-connected so that a change in variable  $X$  causes a change in variable  $Y$ , and a change in variable  $Y$  causes a change in variable  $X$ .

Answer: C

Diff: 1 Page Ref: 30/30

Topic: Appendix: Using Graphs and Formulas

Skill: Definition

Objective: Appendix: Review the use of graphs and formulas

AACSB: Reflective Thinking

Special Feature: None

- 17) The prevalence of Alzheimer's dementia is very high among residents living in nursing homes. A student concludes that it is likely that living in nursing home causes Alzheimer's dementia. What is the flaw in the student's reasoning?
- A) The student has failed to take into account other causes of Alzheimer's disease.
  - B) The student is drawing a false conclusion; he is confusing cause and effect.
  - C) The student is using an inadequate sample size.
  - D) The student is drawing a false conclusion by making the mistake of omitting critical variables such as the age and gender of the residents.

Answer: B

Diff: 2 Page Ref: 30/30

Topic: Appendix: Using Graphs and Formulas

Skill: Conceptual

Objective: Appendix: Review the use of graphs and formulas

AACSB: Analytic Skills

Special Feature: None

- 18) You explain to your friend Haslina, who runs a catering service called "Meals in a Zip", about an economic theory which asserts that consumers will purchase less of a product at higher prices than they will at lower prices. She contends that the theory is incorrect because over the past two years she has raised the price of her catered meals and yet has seen a brisk increase in sales. How would you respond to Haslina?
- A) Haslina is right; she has evidence to back her claim. The theory must be erroneous.
  - B) I will explain to her that she is making the error of reverse causality: it is the increase in demand that has enabled her to raise her prices
  - C) I will explain to her that there are some omitted variables that have contributed to an increase in her sales such as changes in income.
  - D) Haslina is making the mistake of assuming that correlation implies causation.

Answer: C

Diff: 2 Page Ref: 30/30

Topic: Appendix: Using Graphs and Formulas

Skill: Conceptual

Objective: Appendix: Review the use of graphs and formulas

AACSB: Reflective Thinking

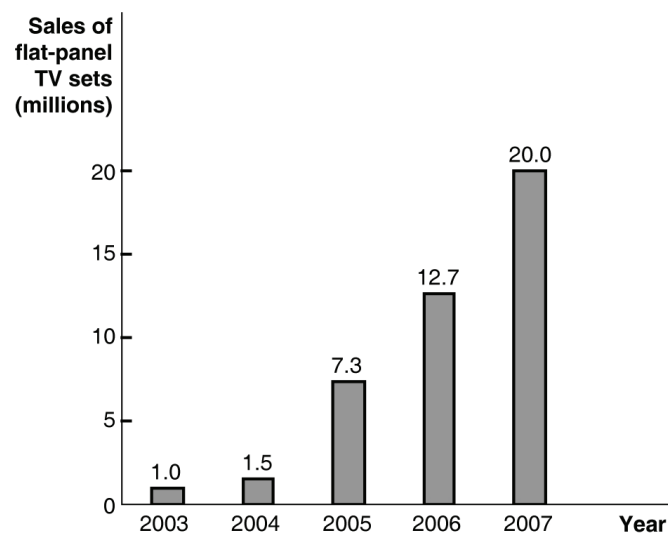
Special Feature: None

*Table 1-2*

<i>Year</i>	<i>Flat-panel TV sets (millions)</i>
2003	1.0
2004	1.5
2005	7.3
2006	12.7
2007	20.0

19) *Refer to Table 1-2.* The table above shows the sales of flat-panel television sets in North America. Present the information using a bar graph.

Answer:



*Diff: 1*      *Page Ref: 25/25*

*Topic: Appendix: Using Graphs and Formulas*

*Skill: Conceptual*

*Objective: Appendix: Review the use of graphs and formulas*

*AACSB: Analytic Skills*

*Special Feature: None*