

TEST BANK

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PRINCIPLES OF
MACROECONOMICS

FOURTH EDITION



Chapter 1

Ten Principles of Economics

MULTIPLE CHOICE

1. The word that comes from the Greek word for “one who manages a household” is
- market.
 - consumer.
 - producer.
 - economy.

ANSWER: d. economy.

TYPE: M SECTION: 1 DIFFICULTY: 1

2. The word economy comes from the Greek word for
- “environment.”
 - “one who manages a household.”
 - “one who participates in a market.”
 - “conservation.”

ANSWER: b. “one who manages a household.”

TYPE: M SECTION: 1 DIFFICULTY: 1

3. Households and economies have each of the following in common EXCEPT both
- must allocate scarce resources.
 - face many decisions.
 - must allocate the goods and services they produce.
 - must have a central decisionmaker.

ANSWER: d. must have a central decisionmaker.

TYPE: M SECTION: 1 DIFFICULTY: 2

4. Economics deals primarily with the concept of
- scarcity.
 - poverty.
 - change.
 - power.

ANSWER: a. scarcity.

TYPE: M SECTION: 1 DIFFICULTY: 1

5. Which of the following is NOT included in the decisions that every society must make?
- what goods will be produced
 - who will produce goods
 - what determines consumer preferences
 - who will consume the goods

ANSWER: c. what determines consumer preferences

TYPE: M SECTION: 1 DIFFICULTY: 2

6. Both households and societies face many decisions because
- resources are scarce.
 - populations may increase or decrease over time.
 - wages for households and therefore society fluctuate with business cycles.
 - people, by nature, tend to disagree.

ANSWER: a. resources are scarce.

TYPE: M SECTION: 1 DIFFICULTY: 2

7. A good is considered scarce in a society when
- more output of the good is possible.
 - everyone in that society cannot have all they want of the good.
 - the government restricts production of the good.
 - only the richest people in the economy can buy all they want of the good.

ANSWER: b. everyone in that society cannot have all they want of the good.

TYPE: M SECTION: 1 DIFFICULTY: 2

8. Scarcity exists when
- there is less than an infinite amount of a resource or good.
 - society can meet the wants of every individual.
 - there is less of a good or resource available than people wish to have.
 - the government fails to produce goods.

ANSWER: c. there is less of a good or resource available than people wish to have.

TYPE: M SECTION: 1 DIFFICULTY: 2

9. Which of the following would NOT be true in a world without scarcity?
- There would be no need for the science of economics.
 - Everyone would have all the goods and services they wanted.
 - There would have to be an infinite supply of every resource.
 - There would be opportunity costs.

ANSWER: c. There would have to be an infinite supply of every resource.

TYPE: M SECTION: 1 DIFFICULTY: 2

10. Approximately what percentage of the world's economies experience scarcity?
- 25%
 - 50%
 - 75%
 - 100%

ANSWER: d. 100%

TYPE: M SECTION: 1 DIFFICULTY: 1

11. When a society cannot produce all the goods and services people wish to have it is said that the economy is experiencing
- scarcity.
 - communism.
 - externalities.
 - market failure.

ANSWER: a. scarcity.

TYPE: M SECTION: 1 DIFFICULTY: 1

12. For society, a good is not scarce if
- at least one individual in society can obtain all he or she wants of the good.
 - firms are producing at full capacity.
 - all members of society can have all they want of it.
 - those who have enough income can buy all they want of the good.

ANSWER: c. all members of society can have all they want of it.

TYPE: M SECTION: 1 DIFFICULTY: 2

13. Which product would be considered scarce?
- Nike shoes
 - Monet paintings
 - 1-carat diamonds
 - All of the above are correct.

ANSWER: d. All of the above are correct.

TYPE: M SECTION: 1 DIFFICULTY: 2

14. Which of the following goods best meets the definition of scarcity?

- a. air
- b. water in the ocean
- c. water in a city
- d. wood in a forest

ANSWER: c. water in a city

TYPE: M SECTION: 1 DIFFICULTY: 2

15. Economics is defined as the study of

- a. business.
- b. how society manages its scarce resources.
- c. central planning.
- d. government regulation.

ANSWER: b. how society manages its scarce resources.

TYPE: M SECTION: 1 DIFFICULTY: 1

16. Economics is the study of

- a. how society manages its scarce resources.
- b. the government's role in society.
- c. how a market system functions.
- d. how to increase production.

ANSWER: a. how society manages its scarce resources.

TYPE: M SECTION: 1 DIFFICULTY: 1

17. In most societies, resources are allocated by

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

ANSWER: d. the combined actions of millions of households and firms.

TYPE: M SECTION: 1 DIFFICULTY: 2

18. Economists study all of the following EXCEPT

- a. how people make decisions.
- b. how people interact with one another.
- c. the forces and trends that affect the economy as a whole.
- d. how societies change over time.

ANSWER: d. how societies change over time.

TYPE: M SECTION: 1 DIFFICULTY: 2

19. Which of the following is NOT a major area of study for economists?

- a. how people make decisions
- b. how countries choose national leaders
- c. how people interact with each other
- d. how forces and trends affect the overall economy

ANSWER: b. how countries choose national leaders

TYPE: M SECTION: 1 DIFFICULTY: 2

20. The adage, "There is no such thing as a free lunch," is used to illustrate the concept of

- a. tradeoffs.
- b. scarcity.
- c. productivity.
- d. efficiency.

ANSWER: a. tradeoffs.

TYPE: M SECTION: 1 DIFFICULTY: 2

21. The adage, "There is no such thing as a free lunch," means
- even people on welfare have to pay for food.
 - the cost of living is always increasing.
 - to get something we like, we usually have to give up another thing we like.
 - all costs are included in the price of a product.

ANSWER: c. to get something we like, we usually have to give up another thing we like.

TYPE: M SECTION: 1 DIFFICULTY: 2

22. Economists use the phrase "There is no such thing as a free lunch," to illustrate
- how inflation increases prices.
 - that to get one thing, we must give up something else.
 - that nothing is free in a market economy.
 - that if something looks too good to be true, it probably is.

ANSWER: b. that to get one thing, we must give up something else.

TYPE: M SECTION: 1 DIFFICULTY: 2

23. Which best represents the concept represented by the adage, "There is no such thing as a free lunch"?
- Melissa can only attend the concert if she takes her sister with her.
 - Greg is hungry and homeless.
 - Brian must repair the tire on his bike before he can ride it to class.
 - Kendra must decide between going to Colorado or Cancun for spring break.

ANSWER: d. Kendra must decide between going to Colorado or Cancun for spring break.

TYPE: M SECTION: 1 DIFFICULTY: 3

24. Guns and butter are used to represent the classic societal tradeoff between spending on
- durable and nondurable goods.
 - imports and exports.
 - national defense and consumer goods.
 - law enforcement and agriculture.

ANSWER: c. national defense and consumer goods.

TYPE: M SECTION: 1 DIFFICULTY: 2

25. Henry decides to spend two hours playing golf rather than working at his job which pays \$8 per hour. Henry's tradeoff is
- the \$16 he could have earned working for two hours.
 - nothing, because he enjoys playing golf more than working.
 - the increase in skill he obtains from playing golf for those two hours.
 - nothing, because he spent \$16 for green fees to play golf.

ANSWER: a. the \$16 he could have earned working for two hours.

TYPE: M SECTION: 1 DIFFICULTY: 2

26. When society requires that firms reduce pollution, there is
- a tradeoff because of reduced incomes to the firms' owners, workers, and customers.
 - no tradeoff, since everyone benefits from reduced pollution.
 - no tradeoff for society as a whole, since the cost of reducing pollution falls only on the firms affected by the requirements.
 - a tradeoff only if some firms are forced to close.

ANSWER: a. a tradeoff because of reduced incomes to the firms' owners, workers, and customers.

TYPE: M SECTION: 1 DIFFICULTY: 3

27. Daniel decides to spend the last two hours of the night before his economics exam studying instead of sleeping. For Daniel, his tradeoff would be
- nothing, since no dollar value can be put on sleep.
 - nothing, since studying would be more beneficial than sleep.
 - the six hours of sleep he could have had if he had gone to bed before midnight.
 - the two hours of rest he would have gotten.

ANSWER: d. the two hours of rest he would have gotten.

TYPE: M SECTION: 1 DIFFICULTY: 2

28. A tradeoff exists between a clean environment and a higher level of income in that
- studies show that individuals with higher levels of income actually pollute less than low-income individuals.
 - to pay for pollution clean-up, the government must increase taxes which lowers income.
 - laws that reduce pollution raise costs of production and reduce incomes.
 - by employing individuals to clean up pollution, employment and income both rise.

ANSWER: c. laws that reduce pollution raise costs of production and reduce incomes.

TYPE: M SECTION: 1 DIFFICULTY: 3

29. Which of the following would NOT be a result of laws that require firms to reduce pollution?
- lower spending by government
 - higher prices to consumers
 - lower wages to workers
 - smaller profit to firms

ANSWER: a. lower spending by government

TYPE: M SECTION: 1 DIFFICULTY: 2

30. Pollution regulations will
- increase profit to firms.
 - impose a tradeoff on society.
 - allow firms to raise workers' wages.
 - lower prices for consumers.

ANSWER: b. impose a tradeoff on society.

TYPE: M SECTION: 1 DIFFICULTY: 2

31. Which of the following best defines efficiency?
- absolute fairness
 - equal distribution
 - minimum waste
 - consumer sovereignty

ANSWER: c. minimum waste

TYPE: M SECTION: 1 DIFFICULTY: 1

32. Which of the following is true?
- Efficiency refers to the size of the economic pie; equity refers to how the pie is divided.
 - Fortunately, government policies are designed to promote both equity and efficiency.
 - As long as the economic pie continually gets larger, no one will have to go hungry.
 - Efficiency and equity can both be achieved if the economic pie is cut into equal pieces.

ANSWER: a. Efficiency refers to the size of the economic pie; equity refers to how the pie is divided.

TYPE: M SECTION: 1 DIFFICULTY: 3

33. Efficiency means that
- society is conserving resources in order to save them for the future.
 - society's goods and services are distributed fairly among society's members.
 - society has lessened its dependence on foreign energy sources.
 - society is getting the most it can from its scarce resources.

ANSWER: d. society is getting the most it can from its scarce resources.

TYPE: M SECTION: 1 DIFFICULTY: 2

34. Economists use the word equity to describe a situation in which
- each member of society has the same income.
 - society is getting the most it can from its scarce resources.
 - those in society who have the least will receive the most.
 - the benefits of society's resources are distributed fairly among society's members.

ANSWER: d. the benefits of society's resources are distributed fairly among society's members.

TYPE: M SECTION: 1 DIFFICULTY: 2

35. One definition of equity would be
- equality.
 - efficiency.
 - fairness.
 - similarity.

ANSWER: c. fairness.

TYPE: M SECTION: 1 DIFFICULTY: 1

36. When government policies are being designed,
- there is usually a tradeoff between equity and efficiency.
 - equity and efficiency goals are usually independent of each other.
 - equity can usually be achieved without an efficiency loss.
 - increasing efficiency usually results in more equity.

ANSWER: a. there is usually a tradeoff between equity and efficiency.

TYPE: M SECTION: 1 DIFFICULTY: 2

37. When government policies such as the welfare system try to help the most needy members of society, it
- increases equity and reduces efficiency.
 - reduces charitable contributions in an economy.
 - increases the productivity of the needy in the society.
 - causes market failure to occur.

ANSWER: a. increases equity and reduces efficiency.

TYPE: M SECTION: 2 DIFFICULTY: 2

38. When the government implements programs such as progressive income tax rates, which of the following is likely to occur?
- Equity is increased and efficiency is increased.
 - Equity is increased and efficiency is decreased.
 - Equity is decreased and efficiency is increased.
 - Equity is decreased and efficiency is decreased.

ANSWER: b. Equity is increased and efficiency is decreased.

TYPE: M SECTION: 2 DIFFICULTY: 2

39. When the government attempts to cut the economic pie into more equal slices,
- it is easier to cut the pie, and therefore the economy can produce a larger pie.
 - the government can more easily allocate the pie to those most in need.
 - the pie gets smaller, and there will be less pie for everyone.
 - the economy will spend too much time cutting and loses the ability to produce enough pie for everyone.

ANSWER: c. the pie gets smaller, and there will be less pie for everyone.

TYPE: M SECTION: 2 DIFFICULTY: 3

40. When the government attempts to improve equity in an economy the result is often
- an increase in overall output in the economy.
 - additional government revenue since overall income will increase.
 - an actual reduction in equity.
 - reduced efficiency in the economy.

ANSWER: d. reduced efficiency in the economy.

TYPE: M SECTION: 2 DIFFICULTY: 2

41. When the government redistributes income from the rich to the poor,
- efficiency is improved, but equity is not.
 - both rich people and poor people benefit directly.
 - people work less and produce fewer goods and services.
 - rich people consume fewer goods, but poor people consume more goods, resulting in no real change.

ANSWER: c. people work less and produce fewer goods and services.

TYPE: M SECTION: 1 DIFFICULTY: 2

42. In economics, the cost of something is
- the dollar amount of obtaining it.
 - always measured in units of time given up to get it.
 - what you give up to get it.
 - usually higher than people think it will be.

ANSWER: c. what you give up to get it.

TYPE: M SECTION: 1 DIFFICULTY: 1

43. What you give up to obtain an item is called your
- opportunity cost.
 - explicit cost.
 - true cost.
 - direct cost.

ANSWER: a. opportunity cost.

TYPE: M SECTION: 1 DIFFICULTY: 1

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

ANSWER: b. the value of the best opportunity a student gives up to attend college.

TYPE: M SECTION: 1 DIFFICULTY: 2

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

ANSWER: a. the wages given up to attend school.

TYPE: M SECTION: 1 DIFFICULTY: 2

46. The largest single cost of going to college is usually
- books.
 - room and board.
 - tuition.
 - lost wages.

ANSWER: d. lost wages.

TYPE: M SECTION: 1 DIFFICULTY: 1

47. The opportunity cost of an item is
- the number of hours needed to earn money to buy it.
 - what you give up to get that item.
 - usually less than the dollar value of the item.
 - the dollar value of the item.

ANSWER: b. what you give up to get that item.

TYPE: M SECTION: 1 DIFFICULTY: 1

48. Mallory decides to spend 3 hours working overtime rather than watching a video with her friends. She earns \$8 an hour. Her opportunity cost of working is
- the \$24 she earns working.
 - the \$24 minus the enjoyment she would have received from watching the video.
 - the enjoyment she would have received had she watched the video.
 - nothing, since she would have received less than \$24 of enjoyment from the video.

ANSWER: c. the enjoyment she would have received had she watched the video.

TYPE: M SECTION: 1 DIFFICULTY: 3

49. Russell spends an hour studying instead of playing tennis. The opportunity cost to him of studying is
- the improvement in his grades from studying for the hour.
 - the difference between the improvement in his grades from studying minus the enjoyment of playing tennis.
 - the enjoyment and exercise he would have received had he played tennis.
 - zero. Since Russell chose to study rather than to play tennis, the value of studying must have been greater than the value of playing tennis.

ANSWER: c. the enjoyment and exercise he would have received had he played tennis.

TYPE: M SECTION: 1 DIFFICULTY: 2

50. College-age athletes who drop out of college to play professional sports
- are not rational decision makers.
 - are well aware that their opportunity cost of attending college is very high.
 - are concerned more about present circumstances than their future.
 - underestimate the value of a college education.

ANSWER: b. are well aware that their opportunity cost of attending college is very high.

TYPE: M SECTION: 1 DIFFICULTY: 2

51. People make decisions at the margin by
- following tradition.
 - experience.
 - calculating dollar costs.
 - comparing costs and benefits.

ANSWER: d. comparing costs and benefits.

TYPE: M SECTION: 1 DIFFICULTY: 1

52. The word "margin" means
- edge.
 - distance.
 - space.
 - measure.

ANSWER: a. edge.

TYPE: M SECTION: 1 DIFFICULTY: 1

53. Making decisions "at the margin" means that people
- make those decisions that do not impose a marginal cost.
 - evaluate how easily a decision can be reversed if problems arise.
 - compare the marginal costs and marginal benefits of each decision.
 - always calculate the marginal dollar costs for each decision.

ANSWER: c. compare the marginal costs and marginal benefits of each decision.

TYPE: M SECTION: 1 DIFFICULTY: 2

54. A marginal change is a
- long-term trend.
 - large, significant adjustment.
 - change for the worse, and so is usually short-term.
 - small incremental adjustment.

ANSWER: d. small incremental adjustment.

TYPE: M SECTION: 1 DIFFICULTY: 1

55. Which of the following is the best example of a marginal change?
- After graduating college, Audrey's income increases from \$500 per month to \$3,000 per month.
 - Morgan gets a raise at her part-time job and is now paid \$7.25 per hour instead of \$7.00.
 - Housing prices in an area increase by 40% when a new interstate is built in a small town.
 - A hard freeze wipes out half of the orange crop in Florida and the price of orange juice doubles.

ANSWER: b. Morgan gets a raise at her part-time job and is now paid \$7.25 per hour instead of \$7.00.

TYPE: M SECTION: 1 DIFFICULTY: 3

56. Which of the following is the best example of a marginal change?
- The price of housing rose in Seattle by 5% in last year.
 - Kim gets a big promotion at work. She also gets a raise from \$25,000 per year to \$40,000 per year.
 - Mark graduates from college and takes a job. His income increases from \$10,000 per year to \$50,000 per year.
 - A drought hits the upper Midwest and the price of wheat increases from \$4.00 per bushel to \$8.00 per bushel.

ANSWER: a. The price of housing rose in Seattle by 5% in last year.

TYPE: M SECTION: 1 DIFFICULTY: 3

57. A marginal change is illustrated by which of the following?
- Nancy retires and takes a part-time job. She was working 40 hours per week and now works 10 hours per week.
 - State University has announced that due to state budget deficits, tuition must rise by 25% next year.
 - Ryan moved to a new apartment and now pays 40% more rent than before.
 - Arizona, which usually receives 10 inches of rain per year, received 11 inches last year.

ANSWER: d. Arizona, which usually receives 10 inches of rain per year, received 11 inches last year.

TYPE: M SECTION: 1 DIFFICULTY: 3

58. After much consideration, you have chosen Cancun over Ft. Lauderdale for your Spring Break trip this year. For this decision to change, which of the following must occur?
- The marginal benefit of Cancun must increase.
 - The marginal cost of Cancun must decrease.
 - The marginal benefit of Ft. Lauderdale must increase.
 - The marginal cost of Ft. Lauderdale must increase.

ANSWER: c. The marginal benefit of Ft. Lauderdale must increase.

TYPE: M SECTION: 1 DIFFICULTY: 3

59. The average cost per seat on the 50-passenger Floating-On-Air Bus company's trip from Kansas City to St. Louis is \$40. If no refreshments are served and 3 seats are empty, the bus company could increase its profit only if it
- charged no less than \$40 for the 3 remaining seats.
 - charged more than \$40 for the 3 remaining seats.
 - charged any ticket price above \$0 for the remaining seats.
 - left the seats empty.

ANSWER: c. charged any ticket price above \$0 for the remaining seats.

TYPE: M SECTION: 1 DIFFICULTY: 2

60. A rational decision maker takes an action only if the
- marginal benefit is less than the marginal cost.
 - marginal benefit is greater than the marginal cost.
 - average benefit is greater than the average cost.
 - marginal benefit is greater than both the average cost and the marginal cost.

ANSWER: b. marginal benefit is greater than the marginal cost.

TYPE: M SECTION: 1 DIFFICULTY: 2

61. Mike has spent \$500 purchasing and repairing an old fishing boat, which he expects to sell for \$800 once the repairs are complete. He discovers that he needs an additional repair, which will cost \$400, in order to complete the repairs. He can sell the boat as it is now for \$300. What should he do?
- He should cut his losses and take the \$300.
 - He should never sell something for less than it cost.
 - He should complete the repairs and sell the boat.
 - It doesn't matter which action he takes; the outcome is the same either way.

ANSWER: c. He should complete the repairs and sell the boat.

TYPE: M SECTION: 1 DIFFICULTY: 3

62. Stan buys a 1966 Mustang, which he plans to restore and sell. He anticipates that the cost of the car and the repairs will be \$10,000 and that he can sell it for \$13,000. When he has spent \$10,000, he discovers he needs to replace the engine, which will cost \$4,000. He can sell the car without the new engine for \$9,000. Stan should
- complete the repairs and sell the car for \$13,000.
 - cut his losses and sell the car now for \$9,000.
 - never try such an expensive project again.
 - be totally indifferent between finishing the project and selling the car now.

ANSWER: d. be totally indifferent between finishing the project and selling the car now.

TYPE: M SECTION: 1 DIFFICULTY: 3

63. A donut shop sells fresh baked donuts from 5 a.m. until 3 p.m. every day but Sunday. The cost of making and selling a dozen glazed donuts is \$1.00. Since this shop does not sell day-old donuts the next day, what should the manager do if he still has 10 dozen left at 2:30 p.m.?
- lower the price of the remaining donuts even if the price falls below \$1.00
 - lower the price of the remaining donuts as long as it's more than \$1.00
 - Lower the price on all donuts so they will all be sold earlier in the day
 - throw them away and produce 10 fewer dozen tomorrow

ANSWER: a. lower the price of the remaining donuts even if the price falls below \$1.00

TYPE: M SECTION: 1 DIFFICULTY: 3

64. Economists understand that people respond to
- laws.
 - incentives.
 - threats more than rewards.
 - positives, but not negatives.

ANSWER: b. incentives.

TYPE: M SECTION: 1 DIFFICULTY: 1

65. When policymakers make policies that change the costs and benefits that people face, they can
- alter behaviors.
 - make people ignore incentives.
 - create inflation.
 - reduce government revenue.

ANSWER: a. alter behaviors.

TYPE: SECTION: 1 DIFFICULTY: 2

66. Ralph Nader's book *Unsafe at Any Speed* caused Congress to require
- safety glass in all new cars.
 - seat belts in all new cars.
 - air bags in all new cars.
 - stricter drunk driving laws in all states.

ANSWER: b. seat belts in all new cars.

TYPE: M SECTION: 1 DIFFICULTY: 1

67. U.S. laws requiring that drivers wear seat belts have resulted in
- a reduction in both driver deaths and pedestrian deaths.
 - fewer accidents and fewer deaths per accident.
 - fewer driver deaths, fewer accidents and fewer pedestrian deaths.
 - little change in the number of driver deaths, but more accidents and more pedestrian deaths.

ANSWER: d. little change in the number of driver deaths, but more accidents and more pedestrian deaths.

TYPE: M SECTION: 1 DIFFICULTY: 2

68. One effect of a government-imposed seat belt law has been
- fewer pedestrian deaths.
 - safer driving.
 - an increase in the number of accidents.
 - that everyone now wears seat belts.

ANSWER: c. an increase in the number of accidents.

TYPE: M SECTION: 1 DIFFICULTY: 1

69. Which of the following does NOT result when seat belt laws alter a driver's cost-benefit calculation?
- Fewer drivers are killed.
 - More pedestrians are killed.
 - Drivers drive faster.
 - More accidents occur.

ANSWER: a. Fewer drivers are killed.

TYPE: M SECTION: 1 DIFFICULTY: 2

70. In the former Soviet Union, producers were paid for meeting output targets, not for selling products. Under those circumstances, what were the economic incentives for producers?
- to produce good quality products so that society benefits from the resources used
 - to conserve on costs, so as to maintain efficiency in the economy
 - to produce enough to meet the output target, without regard for quality or cost
 - to produce those products that society desires most

ANSWER: c. to produce enough to meet the output target, without regard for quality or cost

TYPE: M SECTION: 1 DIFFICULTY: 2

71. Your professor loves her work, teaching economics. She has been offered other positions in the corporate world making 25 percent more, but has decided to stay in teaching. Her decision would not change unless the marginal
- cost of teaching increased.
 - benefit of teaching increased.
 - cost of teaching decreased.
 - cost of a corporate job increased.

ANSWER: a. cost of teaching increased.

TYPE: M SECTION: 1 DIFFICULTY: 3

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

ANSWER: b. benefit of leaving was greater than the marginal cost.

TYPE: M SECTION: 1 DIFFICULTY: 3

73. When policymakers implement policies that alter incentives, they
- have carefully weighed the direct and indirect effects of the policy.
 - often do not always get the intended result.
 - have considered all possible effects of the incentive changes when they developed the policy, which will make the policy effective.
 - generally correctly anticipate the indirect effects, but often miss the direct effects.

ANSWER: b. often do not always get the intended result.

TYPE: M SECTION: 1 DIFFICULTY: 2

74. Trade can benefit a family
- by allowing the family to buy a greater variety of goods and services at a lower cost.
 - by allowing each person to specialize in the activities he or she does best.
 - only if the family is not in economic competition with other families.
 - All of the above are correct.
 - Both a and b are correct.

ANSWER: e. Both a and b are correct.

TYPE: M SECTION: 2 DIFFICULTY: 2

75. Which is the most accurate statement about trade?
- Trade can make every nation better off.
 - Trade makes some nations better off and others worse off.
 - Trading for a good can make a nation better off only if the nation cannot produce that good itself.
 - Trade helps rich nations and hurts poor nations.

ANSWER: a. Trade can make every nation better off.

TYPE: M SECTION: 2 DIFFICULTY: 2

76. Each of the following statements about trade is true EXCEPT
- Trade increases competition.
 - One country wins and one country loses.
 - The United States can benefit from trade with any country.
 - Trade allows people to buy a greater variety of goods and services at lower cost.

ANSWER: b. One country wins and one country loses.

TYPE: M SECTION: 2 DIFFICULTY: 2

77. Benefits from trade would NOT include
- the ability to specialize.
 - a greater variety of goods and services becoming available.
 - less competition.
 - lower prices.

ANSWER: c. less competition.

TYPE: M SECTION: 2 DIFFICULTY: 2

78. Trade between the United States and India
- benefits both the United States and India.
 - is a losing proposition for the United States because India has cheaper labor.
 - is like a sports contest: one side wins and the other side loses.
 - is a losing proposition for India because U.S. workers are more productive.

ANSWER: a. benefits both the United States and India.

TYPE: M SECTION: 2 DIFFICULTY: 2

79. Canada can benefit from trade
- only with nations which can produce goods Canada cannot produce.
 - with any nation.
 - with any nation not in economic competition with Canada.
 - only with less developed nations.

ANSWER: b. with any nation.

TYPE: M SECTION: 2 DIFFICULTY: 2

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

ANSWER: d. can benefit by trading with any other country.

TYPE: M SECTION: 2 DIFFICULTY: 2

81. If the United States decides to trade with Mexico, we know that
- Mexico will be better off, but trade with a less developed country could not help the United States.
 - it will not benefit Mexico because workers in the United States are more productive.
 - Mexico and the United States can both be better off.
 - it will not benefit either country because they are too different culturally.

ANSWER: c. Mexico and the United States can both be better off.

TYPE: M SECTION: 2 DIFFICULTY: 2

82. If France is better than Belarus at producing wine, but Belarus is better than France at producing crystal,
- Belarus should sell crystal to France, and should buy French wine.
 - Belarus should impose a tariff on French wine in order to protect jobs in the Belarusian crystal industry.
 - Belarus should subsidize its wine industry so that it can compete with French wine.
 - Belarus should put a quota on the amount of French wine imported.

ANSWER: a. Belarus should sell crystal to France, and should buy French wine.

TYPE: M SECTION: 2 DIFFICULTY: 3

83. Which of the following is the best statement about markets?
- Markets are usually a good way to organize economic activity.
 - Markets are usually inferior to central planning as a way to organize economic activity.
 - Markets fail and are therefore not an acceptable way to organize economic activity.
 - Markets are a good way to organize economic activity in developed nations, but not in less developed nations.

ANSWER: a. Markets are usually a good way to organize economic activity.

TYPE: M SECTION: 2 DIFFICULTY: 2

84. Which would NOT be true in a market economy?
- Firms decide whom to hire and what to produce.
 - Government policies do not affect the decisions of firms and households.
 - Households decide which firms to work for and what to buy with their incomes.
 - Profit and self-interest guide the decisions of firms and households.

ANSWER: b. Government policies do not affect the decisions of firms and households.

TYPE: M SECTION: 2 DIFFICULTY: 2

85. The decisions of firms and households are guided by profit and self-interest in a
- command economy.
 - traditional economy.
 - market economy.
 - All of the above are correct.

ANSWER: c. market economy.

TYPE: M SECTION: 2 DIFFICULTY: 1

86. In a market economy, economic activity is guided by
- the government.
 - corporations.
 - central planners.
 - prices.

ANSWER: d. prices.

TYPE: M SECTION: 2 DIFFICULTY: 2

87. The term used to describe a situation in which markets fail to allocate resources efficiently is called
- economic meltdown.
 - market failure.
 - corporate bankruptcy.
 - disequilibrium.

ANSWER: b. market failure.

TYPE: M SECTION: 2 DIFFICULTY: 1

88. In a market economy decisions are guided by individual self-interest. Hence, there is
- still the ability to achieve desirable economic well-being for society as a whole.
 - a strong need for government intervention in the market.
 - less efficiency in market economies than in command economies.
 - more need for a strong legal system to control individual greed.

ANSWER: a. still the ability to achieve desirable economic well-being for society as a whole.

TYPE: M SECTION: 2 DIFFICULTY: 3

89. Prices direct economic activity in a market economy by
- influencing the actions of buyers and sellers.
 - reducing scarcity of the goods and services produced.
 - eliminating the need for government intervention.
 - allocating goods and services produced in the most equitable way.

ANSWER: a. influencing the actions of buyers and sellers.

TYPE: M SECTION: 2 DIFFICULTY: 2

90. In a market economy, prices reflect the
- value of a good to society.
 - cost to society of making the good.
 - quantity society will ultimately choose to produce.
 - Both a and b are correct.

ANSWER: d. Both a and b are correct.

TYPE: M SECTION: 2 DIFFICULTY: 2

91. An example of market power is
- a fast food restaurant in a college town.
 - a wheat farmer in Kansas.
 - the last gas station in New Mexico for 100 miles.
 - a shoe store in Kentucky.

ANSWER: c. the last gas station in New Mexico for 100 miles.

TYPE: M SECTION: 2 DIFFICULTY: 2

92. An example of a firm with market power is a
- deli in New York.
 - cable TV provider in St. Louis.
 - clothing store in Los Angeles.
 - farmer in Illinois.

ANSWER: b. cable TV provider in St. Louis.

TYPE: M SECTION: 2 DIFFICULTY: 2

93. One advantage market economies have over central planning is that market economies
- provide an equal distribution of goods and services to consumers.
 - establish government economic control.
 - solve the problem of scarcity.
 - are more efficient.

ANSWER: d. are more efficient.

TYPE: M SECTION: 2 DIFFICULTY: 2

94. A market economy differs from a communist economy in that economic decisions are made by
- a central planner.
 - millions of firms and households.
 - primarily the government.
 - large corporations.

ANSWER: b. millions of firms and households.

TYPE: M SECTION: 2 DIFFICULTY: 1

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

ANSWER: c. 1980s

TYPE: M SECTION: 2 DIFFICULTY: 1

96. Prior to its collapse, communist countries worked on the premise that economic well-being could be organized only through/by
- a market economy.
 - government central planners.
 - government-imposed private monopolies.
 - increased competition.

ANSWER: b. government central planners.

TYPE: M SECTION: 2 DIFFICULTY: 2

97. Which of the following observations was made famous by Adam Smith in his book *The Wealth of Nations*?
- There is no such thing as a free lunch.
 - People buy more when prices are low than when prices are high.
 - No matter how much people earn, they tend to spend more than they earn.
 - Households and firms interacting in markets are guided by an "invisible hand" that leads them to desirable market outcomes.

ANSWER: d. Households and firms interacting in markets are guided by an "invisible hand" that leads them to desirable market outcomes.

TYPE: M SECTION: 2 DIFFICULTY: 2

98. The term “invisible hand” was coined by
- Adam Smith.
 - David Ricardo.
 - John Maynard Keynes.
 - Thomas Jefferson.

ANSWER: a. Adam Smith.

TYPE: M SECTION: 2 DIFFICULTY: 1

99. The “invisible hand” directs economic activity through
- advertising.
 - prices.
 - central planning.
 - government regulations.

ANSWER: b. prices.

TYPE: M SECTION: 2 DIFFICULTY: 2

100. The invisible hand’s ability to coordinate the decisions of the firms and households in the economy can be hindered by
- government actions that distort prices.
 - increased competition in the market.
 - extended periods of unemployment.
 - a dramatic reduction in consumer spending.

ANSWER: a. government actions that distort prices.

TYPE: M SECTION: 2 DIFFICULTY: 3

101. Adam Smith’s book *The Wealth of Nations* was published in
- 1692.
 - 1776.
 - 1816.
 - 1936.

ANSWER: b. 1776.

TYPE: M SECTION: 2 DIFFICULTY: 1

102. Both *The Wealth of Nations* and the Declaration of Independence share the point of view that
- every person is entitled to life, liberty, and the pursuit of happiness.
 - individuals are best left to their own devices without the government guiding their actions.
 - the government has a central role in organizing a market economy.
 - because of human nature a strong legal system is necessary for a market system to survive.

ANSWER: b. individuals are best left to their own devices without the government guiding their actions.

TYPE: M SECTION: 2 DIFFICULTY: 2

103. The invisible hand works to promote general well-being in the economy primarily through
- government intervention.
 - the political process.
 - self interest.
 - altruism.

ANSWER: c. self interest.

TYPE: M SECTION: 2 DIFFICULTY: 1

104. Taxes adversely affect the allocation of resources in society because
- they do not always fall more heavily on the rich.
 - the taxes collected are not enough to finance government spending.
 - not everyone pays taxes.
 - they distort prices and thus the decisions of households and firms.

ANSWER: d. they distort prices and thus the decisions of households and firms.

TYPE: M SECTION: 2 DIFFICULTY: 2

105. A primary function of prices in a market economy is to provide participants with
- economic information.
 - spending limits.
 - accounting capabilities.
 - an equitable distribution of goods.

ANSWER: a. economic information.

TYPE: M SECTION: 2 DIFFICULTY: 2

106. When the government prevents prices from adjusting naturally to supply and demand,
- it stabilizes the economy by reducing market uncertainties.
 - it adversely affects the allocation of resources.
 - the improvement in equity justifies the reduction in efficiency.
 - the improvement in efficiency justifies the reduction in equity.

ANSWER: b. it adversely affects the allocation of resources.

TYPE: M SECTION: 2 DIFFICULTY: 3

107. One component necessary for markets to work is
- government intervention.
 - a benevolent society.
 - property rights.
 - abundant resources.

ANSWER: c. property rights.

TYPE: M SECTION: 2 DIFFICULTY: 2

108. One necessary role of government in a market economy is to
- tax goods and services which are most desired by consumers.
 - maintain welfare programs for the poor.
 - provide services such as mail delivery.
 - enforce property rights.

ANSWER: d. enforce property rights.

TYPE: M SECTION: 2 DIFFICULTY: 2

109. The government enforces property rights by
- requiring property owners to pay property taxes.
 - providing police and courts.
 - allowing people to decide whether or not they wish to own property.
 - providing a system of recording property deeds.

ANSWER: b. providing police and courts.

TYPE: M SECTION: 2 DIFFICULTY: 1

110. Without government's protection of property rights
- businesses would have less incentive to provide goods and services.
 - there would be less government regulation of businesses and prices would be lower for consumers.
 - taxes would be lower causing less market inefficiencies.
 - businesses would have more freedom with production processes.

ANSWER: a. businesses would have less incentive to provide goods and services.

TYPE: M SECTION: 2 DIFFICULTY: 3

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

ANSWER: a. a situation in which the market on its own fails to allocate resources efficiently.

TYPE: M SECTION: 2 DIFFICULTY: 2

112. Which of the following is NOT a reason for the government to intervene in the market?
- to promote efficiency
 - to enforce property rights
 - to promote equity
 - to protect an industry

ANSWER: d. to protect an industry

TYPE: M SECTION: 2 DIFFICULTY: 2

113. Two reasons for a government to intervene in a market are to
- raise revenues and to promote stability.
 - promote equity and to promote efficiency.
 - promote equity and to promote stability.
 - promote efficiency and to promote stability.

ANSWER: b. promote equity and to promote efficiency.

TYPE: M SECTION: 2 DIFFICULTY: 2

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

ANSWER: a. externalities and market power.

TYPE: M SECTION: 2 DIFFICULTY: 2

115. Market failure can be caused by
- low consumer demand.
 - government intervention and price controls.
 - externalities and market power.
 - high prices and foreign competition.

ANSWER: c. externalities and market power.

TYPE: M SECTION: 2 DIFFICULTY: 2

116. An externality is the impact of
- one person's actions on the well-being of a bystander.
 - a person's actions on that person's well-being.
 - society's decisions on the well-being of society.
 - society's decisions on the well-being of one person in the society.

ANSWER: a. one person's actions on the well-being of a bystander.

TYPE: M SECTION: 2 DIFFICULTY: 1

117. An example of an externality is the impact of
- bad weather on the income of farmers.
 - the personal income tax on a person's ability to purchase goods and services.
 - pollution from a factory on the health of people in the vicinity of the factory.
 - increases in health care costs on the health of individuals in society.

ANSWER: c. pollution from a factory on the health of people in the vicinity of the factory.

TYPE: M SECTION: 2 DIFFICULTY: 2

118. Which of the following is most likely to generate an externality?
- Teachers at a local high school have pizza delivered every Friday for lunch.
 - A young man from a small town attends medical school to become a doctor.
 - A newlywed couple buys a TV for their family room.
 - John buys a tractor to mow his newly purchased 5-acre lot.

ANSWER: b. A young man from a small town attends medical school to become a doctor.

TYPE: M SECTION: 2 DIFFICULTY: 3

119. If an externality is present in a market, economic efficiency may be enhanced by
- government intervention.
 - increased competition.
 - better informed market participants.
 - more defined property rights.

ANSWER: a. government intervention.

TYPE: M SECTION: 2 DIFFICULTY: 2

120. If a copper refinery does NOT bear the entire cost of the smoke it emits, it will
- not emit any smoke so as to avoid the entire cost of the smoke.
 - emit lower levels of smoke.
 - emit an acceptable level of smoke.
 - emit too much smoke.

ANSWER: d. emit too much smoke.

TYPE: M SECTION: 2 DIFFICULTY: 2

121. A market economy rewards people according to
- their need for goods and services.
 - how willing they are to work.
 - their ability to produce things that other people are willing to pay for.
 - their ability to produce things of cultural importance.

ANSWER: c. their ability to produce things that other people are willing to pay for.

TYPE: M SECTION: 2 DIFFICULTY: 2

122. Which of these consumption activities will most likely impose an external cost?
- An executive plays a vigorous game of golf.
 - A student in a dorm plays her CDs at 120 decibels late at night.
 - A young mother exercises to an aerobics video.
 - A construction worker eats a sandwich during his lunch break.

ANSWER: b. A student in a dorm plays her CDs at 120 decibels late at night.

TYPE: M SECTION: 2 DIFFICULTY: 2

123. Which of these activities will most likely result in an external benefit?
- A college student buys a deck of cards to play solitaire in her dorm room.
 - An elderly woman plants a flower garden on the vacant lot next to her house.
 - An executive purchases a book to read on a business trip.
 - A ten-year-old buys new Nikes with his allowance money he has saved.

ANSWER: b. An elderly woman plants a flower garden on the vacant lot next to her house.

TYPE: M SECTION: 2 DIFFICULTY: 2

124. If education produces external benefits for society, which of the following might NOT be an appropriate policy for society to establish regarding education?
- tax incentives for schooling
 - mandatory minimum levels of education
 - programs which promote the hiring of high school dropouts
 - public subsidies of education

ANSWER: c. programs which promote the hiring of high school dropouts

TYPE: M SECTION: 2 DIFFICULTY: 2

125. If a sawmill creates too much air pollution,
- interference by the government will surely make the matter worse.
 - a sense of social responsibility will cause the owners of the mill to reduce pollution.
 - the government can raise economic well-being by providing health care to those affected by the pollution.
 - the government can raise economic well-being through environmental regulation.

ANSWER: d. the government can raise economic well-being through environmental regulation.

TYPE: M SECTION: 2 DIFFICULTY: 2

126. When a single entity has the ability to influence market prices, there is
- competition.
 - market power.
 - efficiency.
 - productivity.

ANSWER: b. market power.

TYPE: M SECTION: 2 DIFFICULTY:1

127. Market power refers to the
- power of a single person or group to influence market prices.
 - ability of a person or group of people to successfully market new products.
 - power of the government to regulate a market.
 - relative importance of a market to the overall economy.

ANSWER: a. power of a single person or group to influence market prices.

TYPE: M SECTION: 2 DIFFICULTY:1

128. An example of a monopoly would be
- a jewelry store in Miami, Florida.
 - a souvenir shop in Cancun, Mexico.
 - an electric company in Delight, Arkansas.
 - a doctor in Dallas, Texas.

ANSWER: c. an electric company in Delight, Arkansas.

TYPE: M SECTION: 2 DIFFICULTY: 2

129. Which of the following businesses most likely has market power?
- a furniture store in Greensboro, North Carolina.
 - a vineyard in the Napa Valley of California.
 - a maple sugar candy store in Burlington, Vermont.
 - a hospital in Kearney, Nebraska.

ANSWER: d. a hospital in Kearney, Nebraska.

TYPE: M SECTION: 2 DIFFICULTY: 2

130. Which is the most correct statement about the invisible hand?
- The invisible hand always ensures both equity and efficiency.
 - The invisible hand cannot ensure either equity or efficiency.
 - The invisible hand is more effective at ensuring efficiency than it is at ensuring equity.
 - The invisible hand is more effective at ensuring equity than it is at ensuring efficiency.

ANSWER: c. The invisible hand is more effective at ensuring efficiency than it is at ensuring equity.

TYPE: M SECTION: 2 DIFFICULTY: 3

131. According to Adam Smith, the success of decentralized market economies is primarily due to
- the basic benevolence of society.
 - society's justice (legal) system.
 - individuals' self-interest.
 - basic human survival instincts.

ANSWER: c. individuals' self-interest.

TYPE: M SECTION: 2 DIFFICULTY: 2

132. The self-interest of the participants in an economy is guided into promoting general economic self-interest by
- the invisible hand.
 - market power.
 - government intervention.
 - property rights.

ANSWER: a. the invisible hand.

TYPE: M SECTION: 2 DIFFICULTY: 1

133. In the United States, higher income tax rates on rich people could be justified on the basis of
- market efficiency.
 - the lack of other sources of government revenue.
 - equity for society.
 - government bias against the wealthy.

ANSWER: c. equity for society.

TYPE: M SECTION: 2 DIFFICULTY: 2

134. The primary determinant of a country's standard of living is
- the ability to reduce foreign competition.
 - its ability to produce goods and services.
 - the total supply of money in the economy.
 - the average age of the country's labor force.

ANSWER: b. its ability to produce goods and services.

TYPE: M SECTION: 3 DIFFICULTY: 2

135. In 2000 the average American had an income of about
- \$34,000.
 - \$29,000.
 - \$20,000.
 - \$15,000.

ANSWER: a. \$34,000.

TYPE: M SECTION: 3 DIFFICULTY: 1

136. In the United States, incomes have historically grown about 2% per year. At this rate incomes will double every
- 10 years.
 - 25 years.
 - 35 years.
 - 50 years.

ANSWER: c. 35 years.

TYPE: M SECTION: 3 DIFFICULTY: 2

137. The income of a typical worker in a country is most closely linked to which of the following?
- population
 - productivity
 - the number of labor unions
 - government policies

ANSWER: b. productivity

TYPE: M SECTION: 3 DIFFICULTY: 2

138. If the average income of an Australian is higher than the average income of a Russian, it is most likely because
- productivity is higher in Australia than in Russia.
 - Australia has a more industrial economy than Russia.
 - there is more competition in Australia than in Russia.
 - labor unions are more aggressive in Australia than in Russia.

ANSWER: a. productivity is higher in Australia than in Russia.

TYPE: M SECTION: 3 DIFFICULTY: 3

139. Suppose that the average income of a Kenyan is higher than the average income of a South African. You might conclude that
- South African firms are faced with stricter government regulations than Kenyan firms.
 - total income is divided among fewer workers in Kenya since it has a smaller labor force than South Africa.
 - Kenya's climate allows for longer growing seasons and therefore Kenya can produce large quantities of grain.
 - productivity in Kenya is higher than in South Africa.

ANSWER: d. productivity in Kenya is higher than in South Africa.

TYPE: M SECTION: 3 DIFFICULTY: 3

140. A typical worker in Italy can produce 24 units of product in an 8 hour day, where a typical worker in Poland produces 25 units of product in a 10 hour day. We can conclude that
- worker productivity in Poland is higher than in Italy.
 - the standard of living will be higher in Italy than in Poland.
 - productivity for the Polish worker is 3 units per hour and 2 1/2 units per hour for the Italian worker.
 - there will be no difference between the standard of living in Italy and Poland.

ANSWER: b. the standard of living will be higher in Italy than in Poland.

TYPE: M SECTION: 3 DIFFICULTY: 3

141. A worker in Bangladesh can earn \$1 per day making cotton cloth on a hand loom. A worker in the United States can earn \$100 per day making cotton cloth with a mechanical loom. What accounts for the difference in wages?
- U.S. textile workers belong to a union.
 - There is little demand for cotton cloth in Bangladesh and great demand in the U.S.
 - Labor is more productive making cotton cloth with a mechanical loom than with a hand loom.
 - Bangladesh has a low-wage policy to make its textile industry more competitive in world markets.

ANSWER: c. Labor is more productive making cotton cloth with a mechanical loom than with a hand loom.

TYPE: M SECTION: 3 DIFFICULTY: 3

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

ANSWER: c. eightfold.

TYPE: M SECTION: 3 DIFFICULTY: 1

143. In the United States, incomes have historically grown
- about 10 percent per year.
 - about 5 percent per year.
 - about 2 percent per year.
 - about 0.5 percent per year.

ANSWER: c. about 2 percent per year.

TYPE: M SECTION: 3 DIFFICULTY: 1

144. Almost all variation in living standards is attributable to differences in countries'
- population growth rates.
 - endowments of natural resources.
 - national government budgets.
 - productivity.

ANSWER: d. productivity.

TYPE: M SECTION: 3 DIFFICULTY: 2

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

ANSWER: a. amount of goods and services produced from each hour of a worker's time.

TYPE: M SECTION: 3 DIFFICULTY: 1

146. The amount of goods and services produced from each hour of a worker's time is called
- total output.
 - productivity.
 - marginal product.
 - efficiency.

ANSWER: b. productivity.

TYPE: M SECTION: 3 DIFFICULTY: 1

147. A direct or positive relationship exists between a country's
- productivity and its standard of living.
 - government spending and its tax rates.
 - total population and its per-capita income.
 - prices for its goods and services and its exports.

ANSWER: a. productivity and its standard of living.

TYPE: M SECTION: 3 DIFFICULTY: 2

148. The historical rise in living standards of American workers is primarily a result of
- the influence of labor unions.
 - tariff protection imposed by the U.S. government.
 - the enactment of minimum-wage laws.
 - the rise in labor productivity.

ANSWER: d. the rise in labor productivity.

TYPE: M SECTION: 3 DIFFICULTY: 2

149. If the government wanted to enact a policy to increase living standards in the country, it might
- allow corporate tax write-offs for money spent on worker safety.
 - make it more difficult to receive unemployment benefits.
 - increase educational opportunities for workers.
 - prohibit unions from organizing.

ANSWER: c. increase educational opportunities for workers.

TYPE: M SECTION: 3 DIFFICULTY: 2

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

ANSWER: c. a decline in the rate of increase in U.S. productivity.

TYPE: M SECTION: 3 DIFFICULTY: 2

151. To improve living standards, policymakers should
- impose restriction on foreign competition.
 - formulate policies designed to increase productivity.
 - impose tougher immigration policies.
 - provide tax breaks for the middle class.

ANSWER: b. formulate policies designed to increase productivity.

TYPE: M SECTION: 3 DIFFICULTY: 2

152. To increase living standards, public policy should
- ensure that workers are well educated and have the necessary tools and technology.
 - make unemployment benefits more liberal.
 - move workers into jobs directly from high school.
 - ensure that workers have access to union membership and benefits.

ANSWER: a. ensure that workers are well educated and have the necessary tools and technology.

TYPE: M SECTION: 3 DIFFICULTY: 2

153. To raise productivity, policymakers could
- increase spending on education.
 - provide tax credits to firms for capital improvements.
 - fund research and development.
 - Both a and c are correct.
 - All of the above are correct.

ANSWER: e. All of the above are correct.

TYPE: M SECTION: 3 DIFFICULTY: 2

154. An increase in the overall level of prices in an economy is referred to as
- economic growth.
 - inflation.
 - monetary policy.
 - supply shocks

ANSWER: b. inflation.

TYPE: M SECTION: 3 DIFFICULTY: 1

155. Inflation is defined as
- a period of rising productivity in the economy.
 - a period of rising income in the economy.
 - an increase in the overall level of output in the economy.
 - an increase in the overall level of prices in the economy.

ANSWER: d. an increase in the overall level of prices in the economy.

TYPE: M SECTION: 3 DIFFICULTY: 1

156. When the German government increased the quantity of money in the German economy in the 1920s,
- Germany experienced hyperinflation.
 - many people in Germany became rich.
 - unemployment increased.
 - Germany was able to repay all its foreign debts.

ANSWER: a. Germany experienced hyperinflation.

TYPE: M SECTION: 3 DIFFICULTY: 1

157. During the early 1920s in Germany, prices
- doubled annually.
 - doubled monthly.
 - tripled monthly.
 - tripled annually.

ANSWER: c. tripled monthly.

TYPE: M SECTION: 3 DIFFICULTY: 2

158. One of the worst episodes of inflation occurred in
- the United States in the 1960's.
 - Argentina in the 1950's.
 - Russia in the 1930's.
 - Germany in the 1920's.

ANSWER: d. Germany in the 1920s.

TYPE: M SECTION: 3 DIFFICULTY: 2

159. In the United States, the overall level of prices more than doubled during the
- 1950s.
 - 1960s.
 - 1970s.
 - 1980s.

ANSWER: c. 1970s.

TYPE: M SECTION: 3 DIFFICULTY: 1

160. Large or persistent inflation is almost always caused by
- an increase in demand for domestic production.
 - growth in the quantity of money.
 - foreign competition.
 - higher worker productivity.

ANSWER: b. growth in the quantity of money.

TYPE: M SECTION: 3 DIFFICULTY: 2

161. President Gerald Ford referred to inflation as
- the national thief.
 - a blight on our nation's economy.
 - public enemy number one.
 - a torpedo that could sink our economy.

ANSWER: c. public enemy number one.

TYPE: M SECTION: 3 DIFFICULTY: 2

162. The person who referred to inflation as public enemy number one was
- Gerald Ford.
 - Alan Greenspan.
 - Richard Nixon.
 - John F. Kennedy.

ANSWER: a. Gerald Ford.

TYPE: M SECTION: 3 DIFFICULTY: 1

163. In the 1990s, inflation in the United States
- was almost zero.
 - was about 3 percent per year.
 - approached double digits.
 - was caused by too much consumer spending.

ANSWER: b. was about 3 percent per year.

TYPE: M SECTION: 3 DIFFICULTY: 2

164. Inflation causes
- incomes to fall.
 - productivity to increase.
 - the government to lower taxes.
 - the value of money to fall.

ANSWER: d. the value of money to fall.

TYPE: M SECTION: 3 DIFFICULTY: 2

165. Which of the following is the most correct statement about the relationship between inflation and unemployment?
- In the short run, reducing inflation is associated with falling unemployment.
 - In the short run, reducing inflation is associated with rising unemployment.
 - In the long run, reducing inflation is associated with falling unemployment.
 - In the long run, reducing inflation is associated with rising unemployment.

ANSWER: b. In the short run, reducing inflation is associated with rising unemployment.

TYPE: M SECTION: 3 DIFFICULTY: 3

166. The curve that illustrates the tradeoff between inflation and unemployment is called the
- Laffer curve.
 - Lorenz curve.
 - Phillips curve.
 - Demand curve.

ANSWER: c. Phillips curve.

TYPE: M SECTION: 3 DIFFICULTY: 1

167. In the short run, the Phillips curve illustrates
- the tradeoff between inflation and unemployment.
 - the tradeoff between equity and efficiency.
 - labor productivity in an economy.
 - the level of government intervention in a market economy.

ANSWER: a. the tradeoff between inflation and unemployment.

TYPE: M SECTION: 3 DIFFICULTY: 2

168. Although the Phillips curve is controversial, most economists believe that
- society faces a tradeoff between unemployment and inflation in the short run only.
 - society faces a tradeoff between unemployment and inflation in the long run only.
 - no tradeoff exists between unemployment and inflation.
 - society faces a continuous tradeoff between unemployment and inflation.

ANSWER: a. society faces a tradeoff between unemployment and inflation in the short run only.

TYPE: M SECTION: 3 DIFFICULTY: 3

169. Policymakers can influence the combination of inflation and unemployment the economy experiences by adjusting each of the following EXCEPT
- taxes.
 - government spending.
 - the money supply.
 - market prices.

ANSWER: d. market prices.

TYPE: M SECTION: 3 DIFFICULTY: 2

170. In the early 1980s, U.S. economic policy was directed toward reducing inflation. What would you assume about inflation and unemployment during this period?
- Inflation fell and unemployment fell.
 - Inflation and unemployment were both unaffected.
 - Inflation fell and unemployment increased.
 - Inflation fell and unemployment was unchanged.

ANSWER: c. Inflation fell and unemployment increased.

TYPE: M SECTION: 3 DIFFICULTY: 3

171. Between 1929 and 1933, the U.S. economy went from a situation of full employment to one of 25 percent unemployment. What do you assume happened to prices?
- Prices were unaffected.
 - Prices fell as the economy experienced deflation.
 - Prices rose as the economy experienced inflation.
 - It is impossible to guess what happened to prices from the information given.

ANSWER: b. Prices fell as the economy experienced deflation.

TYPE: M SECTION: 3 DIFFICULTY: 3

172. The Phillips curve is important for understanding
- the business cycle.
 - supply and demand.
 - government spending.
 - money supply changes.

ANSWER: a. the business cycle.

TYPE: M SECTION: 3 DIFFICULTY: 1

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

ANSWER: b. irregular fluctuations in economic activity.

TYPE: M SECTION: 3 DIFFICULTY: 1

174. Senator Smith wants to increase taxes on people with high incomes and use the money to help the poor. Senator Jones argues that such a tax will discourage successful people from working and will therefore make society worse off. An economist would say that
- we should agree with Senator Smith.
 - we should agree with Senator Jones.
 - a good decision requires that we recognize both viewpoints.
 - there are no tradeoffs between equity and efficiency.

ANSWER: c. a good decision requires that we recognize both viewpoints.

TYPE: M SECTION: 1 DIFFICULTY: 2

175. Maurice receives \$100 as a birthday gift. In deciding how to spend the money, he narrows his options down to four choices, Option A, Option B, Option C and Option D. Each option costs \$100. Finally he decides on Option B. The opportunity cost of Option B is
- the value to him of the Option he would have chosen if Option B were not available.
 - the value to him of Options A, C and D combined.
 - \$300.
 - \$100.

ANSWER: a. the value to him of the Option he would have chosen if Option B were not available.

TYPE: M SECTION: 1 DIFFICULTY: 2

176. A furniture maker currently produces 100 tables per week and sells them for a profit. She is considering expanding her operation in order to make more tables. Should she expand?
- Yes, because making tables is profitable.
 - No, because she may not be able to sell the additional tables.
 - It depends on the marginal cost of producing more tables and the marginal revenue she will earn from selling more tables.
 - It depends on the average cost of producing more tables and the average revenue she will earn from selling more tables.

ANSWER: c. It depends on the marginal cost of producing more tables and the marginal revenue she will earn from selling more tables.

TYPE: M SECTION: 1 DIFFICULTY: 2

177. In the nation of Dictatorland, farmers traditionally feed grain to their livestock. Central planners, however, decided to increase the price of grain to make grain farmers happy and to reduce the price of bread made from that grain to make city dwellers happy. Now the price of bread is lower than the price of grain. We might now expect
- farmers to continue to feed grain to their livestock.
 - farmers to start feeding bread to their livestock.
 - city dwellers to start buying grain to make bread to eat.
 - city dwellers to start buying grain to make bread to sell.

ANSWER: b. farmers to start feeding bread to their livestock.

TYPE: M SECTION: 1 DIFFICULTY: 2

178. Senator Smart is trying to convince workers in her district that trade with other countries is beneficial. Senator Smart argues that trade can be beneficial
- only if it allows us to obtain things that we couldn't make for ourselves.
 - because it allows specialization, which increases total output.
 - to us if we can gain and the others involved in the trade lose.
 - in only a limited number of circumstances because others are typically self-interested.

ANSWER: b. because it allows specialization, which increases total output.

TYPE: M SECTION: 2 DIFFICULTY: 2

179. Adam Smith argued that in a market system, when people act in their own self-interest, they typically
- help only themselves.
 - harm others.
 - help others, but not as much as they would have if they were not self-interested.
 - help others even more than when they seek to help others.

ANSWER: d. help others even more than when they seek to help others.

TYPE: M SECTION: 2 DIFFICULTY: 2

180. A friend of yours asks you why market prices are better than government-determined prices. You say that market-determined prices are better because they generally reflect
- the value of a good to society, but not the cost of making it.
 - the cost of making a good to society, but not its value.
 - both the value of a good to society and the cost of making it.
 - neither the value of a good to society nor the cost of making it.

ANSWER: c. both the value of a good to society and the cost of making it.

TYPE: M SECTION: 2 DIFFICULTY: 1

181. Which of the following is NOT true?
- In the presence of a market failure, government action might not improve on the market outcome because sometimes public policies simply reward the politically powerful.
 - In the presence of a market failure, government action might not improve on the market outcome because some leaders are not fully informed about the effects of their actions.
 - In the presence of a market failure, government action can sometimes improve on the market outcome.
 - In the presence of a market failure, government action will always improve on the market outcome.

ANSWER: d. In the presence of a market failure, government action will always improve on the market outcome.

TYPE: M SECTION: 2 DIFFICULTY: 1

182. Which of the following is most likely to raise the average standard of living in the United States?
- an increase in investment in new capital
 - a continuation of the economic problems experienced by Japan, with whom the United States competes in world markets
 - an increase in the minimum legal wage
 - shortening the average work week

ANSWER: a. an increase in investment in new capital

TYPE: M SECTION: 3 DIFFICULTY: 1

183. During the 1990s, the United Kingdom experienced low levels of inflation while Turkey experienced high levels of inflation. The difference can best be explained by the fact that
- the United Kingdom is more industrialized than Turkey.
 - the United Kingdom printed money at a slower rate than Turkey.
 - workers in the United Kingdom are more productive than workers in Turkey.
 - there were more cases of market failure in Turkey than in the United Kingdom.

ANSWER: b. the United Kingdom printed money at a slower rate than Turkey.

TYPE: M SECTION: 3 DIFFICULTY: 1

184. Which of the following is consistent with the Phillips Curve?
- If we increase the rate of inflation from 3 percent to 6 percent, then the rate of unemployment will temporarily fall.
 - If we increase the rate of inflation from 3 percent to 6 percent, then the rate of unemployment will temporarily rise.
 - If we increase the rate of inflation from 3 percent to 6 percent, then the rate of unemployment will permanently fall.
 - If we increase the rate of inflation from 3 percent to 6 percent, then the rate of unemployment will permanently rise.

ANSWER: a. If we increase the rate of inflation from 3 percent to 6 percent, then the rate of unemployment will temporarily fall.

TYPE: M SECTION: 3 DIFFICULTY: 2

TRUE/FALSE

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

ANSWER: T TYPE: T SECTION: 1 RANDOM: Y

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

ANSWER: F TYPE: T SECTION: 1 RANDOM: Y

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

ANSWER: F TYPE: T SECTION: 1 RANDOM: Y

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

ANSWER: F TYPE: T SECTION: 1 RANDOM: Y

5. Equity refers to how the pie is divided, and efficiency refers to the size of the economic pie.

ANSWER: T TYPE: T SECTION: 1 RANDOM: Y

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

ANSWER: F TYPE: T SECTION: 1 RANDOM: Y

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

ANSWER: T TYPE: T SECTION: 1 RANDOM: Y

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

ANSWER: T TYPE: T SECTION: 1 RANDOM: Y

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

ANSWER: F TYPE: T SECTION: 1 RANDOM: Y

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

ANSWER: F TYPE: T SECTION: 1 RANDOM: Y

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

ANSWER: T TYPE: T SECTION: 2 RANDOM: Y

12. Trade with any nation can be mutually beneficial.

ANSWER: T TYPE: T SECTION: 2 RANDOM: Y

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

ANSWER: F TYPE: T SECTION: 2 RANDOM: Y

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

ANSWER: T TYPE: T SECTION: 2 RANDOM: Y

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

ANSWER: T TYPE: T SECTION: 2 RANDOM: Y

16. Since taxes affect only the price paid by the buyer, they cannot have an adverse impact on the allocation of society's resources.

ANSWER: F TYPE: T SECTION: 2 RANDOM: Y

17. Productivity is defined as the quantity of goods and services produced from each hour of a worker's time.

ANSWER: T TYPE: T SECTION: 3 RANDOM: Y

18. Productivity is the primary determinant of a country's living standards.

ANSWER: T TYPE: T SECTION: 3 RANDOM: Y

19. Inflation increases the value of money.

ANSWER: F TYPE: T SECTION: 3 RANDOM: Y

20. Government spending is the ultimate source of inflation.

ANSWER: F TYPE: T SECTION: 3 RANDOM: Y

21. The Phillips Curve shows the short-run tradeoff between inflation and economic growth.

ANSWER: F TYPE: T SECTION: 3 RANDOM: Y

SHORT ANSWER

APPLICATION/SCENARIO

1. What would happen to the study of economics if scarcity disappeared?

ANSWER: Since economics is the study of how society allocates its scarce resources, if there were no scarcity, there would be no need for economics. Everyone could have all the goods and services they wanted. No one would have to make decisions based on tradeoffs, because there would be no opportunity cost associated with the decision. (It is difficult to conceive of a situation where time is not scarce, however).

TYPE: S SECTION: 1 RANDOM: Y

2. One tradeoff society faces is between efficiency and equity. Define each term. If the U.S. government redistributes income from the rich to the poor, explain how this action affects equity as well as efficiency in the economy.
ANSWER: Efficiency is the property of society getting the most it can from its scarce resources. Equity is defined as the property of distributing economic prosperity fairly among the members of society. Often, these two goals conflict. When the government redistributes income from the rich to the poor, it reduces the reward for working hard. Fewer goods and services are produced and the economic pie gets smaller. When the government tries to cut the economic pie into more equal slices, the pie gets smaller. Policies aimed at achieving a more equal distribution of economic well-being, such as the welfare system, try to help those members of society who are most in need. The individual income tax asks the financially successful to contribute more than others to support the government.
TYPE: S SECTION: 1 RANDOM: Y
3. Define opportunity cost. What is the opportunity cost to you of attending college? What was your opportunity cost of coming to class today?
ANSWER: Whatever must be given up to obtain some item is its opportunity cost. Basically, this would be a person's second choice. The opportunity cost of a person attending college is the value of the best alternative use of that person's time. For most students this would be the income the student gives up by not working. A student's opportunity cost of coming to class was the value of the best opportunity the student gave up. (For most students, that seems to be sleep.)
TYPE: S SECTION: 1 RANDOM: Y
4. With the understanding that people respond to incentives, outline the possible outcome for teachers if the K-12 school year is extended to 11 months per year instead of the existing 9 months per year.
ANSWER: The concept of working longer per year would be perceived by many teachers as a definite increase in the cost of teaching. Even with additional compensation, many teachers look at summers off as a major benefit of the education profession. If this benefit were eliminated or even diminished, some teachers may perceive that the marginal cost of teaching would now be greater than the marginal benefit and would choose to leave teaching.
TYPE: S SECTION: 1 RANDOM: Y
5. Under what conditions might government intervention in an economy improve the market outcome?
ANSWER: If there is a market failure, such as an externality or monopoly, government regulation might improve the well-being of society by promoting efficiency. If the distribution of income or wealth is considered to be unfair by society, government intervention might achieve a more equitable distribution of economic well-being.
TYPE: S SECTION: 2 RANDOM: Y
6. Explain how an attempt by the government to lower inflation could cause unemployment to increase in the short-run.
ANSWER: To lower inflation, the government may choose to reduce the money supply in the economy. When the money supply is reduced, prices don't adjust immediately. Lower spending combined with prices, which are too high, reduces sales and causes workers to be laid off. Hence, the lower price level is associated with higher unemployment.
TYPE: S SECTION: 3 RANDOM: Y

Chapter 2

Thinking Like an Economist

MULTIPLE CHOICE

1. Which is the best statement about the way economists study the economy?
- They study the past, but do not try to predict the future.
 - They use a probabilistic approach based on correlations between economic events.
 - They devise theories, collect data, then analyze the data to test the theories.
 - They use controlled experiments much the same way a biologist or physicist does.

ANSWER: c. They devise theories, collect data, then analyze the data to test the theories.
TYPE: M SECTION: 1 DIFFICULTY: 2

2. Terms used by an economist would include
- vector spaces and axioms.
 - torts and venues.
 - ego and cognitive dissonance.
 - comparative advantage and elasticity.

ANSWER: d. comparative advantage and elasticity.
TYPE: M SECTION: 1 DIFFICULTY: 2

3. By scientific method we mean
- the use of modern electronic testing equipment to understand the world.
 - the dispassionate development and testing of theories about how the world works.
 - the use of controlled experiments in understanding the way the world works.
 - finding evidence to support preconceived theories about how the world works.

ANSWER: b. the dispassionate development and testing of theories about how the world works.
TYPE: M SECTION: 1 DIFFICULTY: 2

4. Who said, "The whole of science is nothing more than the refinement of everyday thinking."?
- Isaac Newton
 - Albert Einstein
 - Sigmund Freud
 - Benjamin Franklin

ANSWER: b. Albert Einstein
TYPE: M SECTION: 1 DIFFICULTY: 1

5. Albert Einstein once made the following observation about science:
- "The whole of science is nothing more than the refinement of everyday thinking."
 - "The whole of science is nothing more than an interesting intellectual exercise."
 - "In order to understand science, one must rely solely on abstraction."
 - "In order to understand science, one must transcend everyday thinking."

ANSWER: a. "The whole of science is nothing more than the refinement of everyday thinking."
TYPE: M SECTION: 1 DIFFICULTY: 2

6. Sir Isaac Newton's development of the theory of gravity after observing an apple fall from a tree is an example of
- controlled experiments used to develop scientific theories.
 - being in the right place at the right time.
 - an idea whose time had come.
 - the interplay between observation and theory in science.

ANSWER: d. the interplay between observation and theory in science.
TYPE: M SECTION: 1 DIFFICULTY: 2