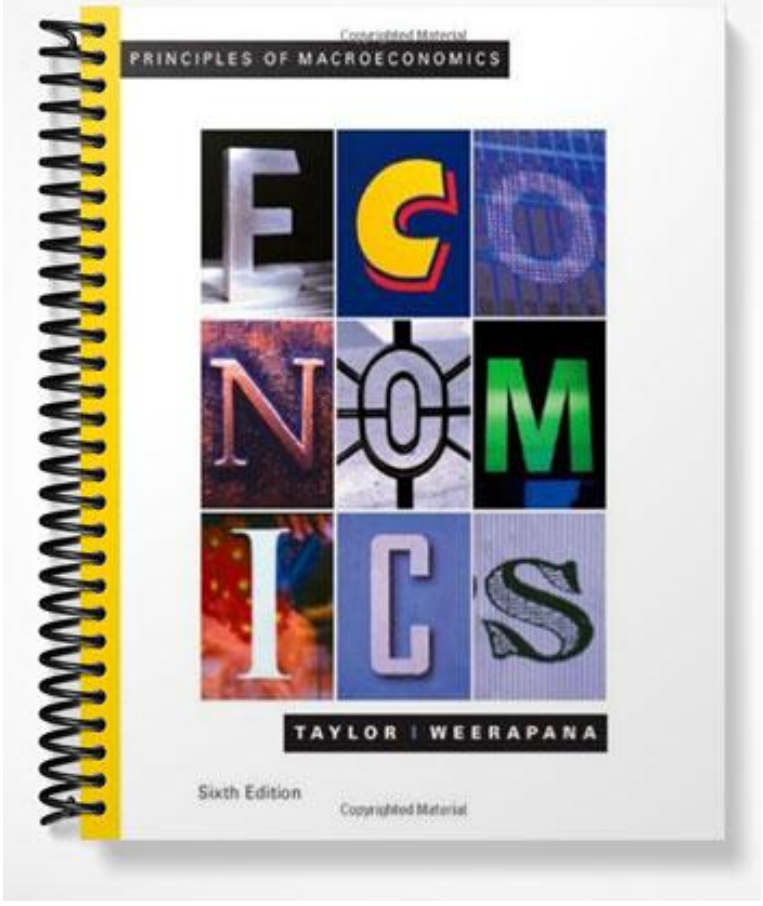
TEST BANK


Copyrighted Material
PRINCIPLES OF MACROECONOMICS
ECONOMICS
TAYLOR | WEERAPANA
Sixth Edition
Copyrighted Material

Test Bank

Principles of Macroeconomics

SIXTH EDITION

John B. Taylor

Stanford University

Akila Weerapana

Wellesley College

Eugenio D. Suarez

Trinity University

Houghton Mifflin Company BOSTON NEW YORK

Vice President, Executive Publisher: *George Hoffman*
Sponsoring Editor: *Kathleen Swanson*
Assistant Editor: *Megan Hoar*
Editorial Assistant: *Angela Lang*
Editorial Assistant: *Emily Meyer*
Senior Marketing Manager: *Nicole Hamm*
Marketing Assistant: *Tom DiGiano*

Printed in the U.S.A.

ISBN13: 978-0-618-97327-9
ISBN10: 0-618-97327-3

Contents

PREFACE v

REFERENCE GUIDE vi

CORRELATION CHART xxxi

CHAPTER 1 – THE CENTRAL IDEA 1

CHAPTER 2 – OBSERVING AND EXPLAINING THE ECONOMY 29

CHAPTER 2 APPENDIX – READING, UNDERSTANDING, AND CREATING GRAPHS 47

CHAPTER 3 – THE SUPPLY AND DEMAND MODEL 60

CHAPTER 4 – SUBTLETIES OF THE SUPPLY AND DEMAND MODEL: PRICE FLOORS, PRICE CEILINGS, AND ELASTICITY 86

MACRO CHAPTER 5 (ECONOMICS CHAPTER 17) – MACROECONOMICS: THE BIG PICTURE 114

MACRO CHAPTER 5 (ECONOMICS CHAPTER 17) APPENDIX – THE MIRACLE OF COMPOUND GROWTH 140

MACRO CHAPTER 6 (ECONOMICS CHAPTER 18) – MEASURING THE PRODUCTION, INCOME, AND SPENDING OF NATIONS 143

MACRO CHAPTER 7 (ECONOMICS CHAPTER 19) – THE SPENDING ALLOCATION MODEL 176

MACRO CHAPTER 8 (ECONOMICS CHAPTER 20) – UNEMPLOYMENT AND EMPLOYMENT 207

MACRO CHAPTER 9 (ECONOMICS CHAPTER 21) – PRODUCTIVITY AND ECONOMIC GROWTH 242

MACRO CHAPTER 9 (ECONOMICS CHAPTER 21) APPENDIX – DERIVING THE GROWTH ACCOUNTING FORMULA 271

MACRO CHAPTER 10 (ECONOMICS CHAPTER 22) – MONEY AND INFLATION 275

MACRO CHAPTER 11 (ECONOMICS CHAPTER 23) – THE NATURE AND CAUSES OF ECONOMIC FLUCTUATIONS 300

MACRO CHAPTER 11 (ECONOMICS CHAPTER 23) APPENDIX – DERIVING THE FORMULA FOR THE KEYNESIAN MULTIPLIER AND THE FORWARD-LOOKING CONSUMPTION MODEL 336

MACRO CHAPTER 12 (ECONOMICS CHAPTER 24) – THE ECONOMICS FLUCTUATIONS MODEL 353

MACRO CHAPTER 13 (ECONOMICS CHAPTER 25) – USING THE ECONOMIC FLUCTUATIONS MODEL 389

MACRO CHAPTER 14 (ECONOMICS CHAPTER 26) – FISCAL POLICY 421

MACRO CHAPTER 15 (ECONOMICS CHAPTER 27) – MONETARY POLICY 450

CHAPTER 16 – CAPITAL MARKETS 479

CHAPTER 16 APPENDIX – CAPITAL MARKETS 501

MACRO CHAPTER 17 (ECONOMICS CHAPTER 28) – ECONOMIC GROWTH AND GLOBALIZATION 504

MACRO CHAPTER 18 (ECONOMICS CHAPTER 29) – THE GAINS FROM INTERNATIONAL TRADE 526

MACRO CHAPTER 19 (ECONOMICS CHAPTER 30) – INTERNATIONAL TRADE POLICY 558

Preface

This Test Bank is designed to help instructors prepare exams that accurately reflect the content and approach of John B. Taylor and Akila Weerapana's *Economics,* Sixth Edition. With over 3,000 questions in each of two volumes (*Principles of Microeconomics* and *Principles of Macroeconomics*) we are certain that instructors will find this bank comprehensive and easy to use. If you are using the complete version of the text (*Economics*), see the chart for chapter number correlation.

The questions in the test bank are organized according to the section heads from the text. Within each major section there are multiple-choice and true-false questions. Short-answer questions and, where relevant, problems which focus on computations and analysis, are found at the end of most subsections. Also included is a set of parallel problems and parallel problem solutions for each chapter. These parallel problems match the end-of-chapter text problems one-for-one in terms of content coverage and approach. If you use the end-of-chapter problems in class and would like to test your students on the same concepts with different data, you'll find these parallel problems extremely useful.

The information that appears in the margin to the left of every question in the bank provides topic, type of question (factual or conceptual), answer, difficulty level (basic, moderate, or challenging), and chapter section. The chapter section indicates where the answer to the question can be found in the hierarchical structure of the chapter. The numbers and letters refer to the heading levels—the first (number) reflecting the major section heading, the second (letter) reflecting the next subhead level, and the third (number) denoting the next level (where it exists). See the Chapter Section Reference Guide in this test bank which has been annotated with the appropriate section numbers and letters for reference. We hope that this classification system makes the job of creating good, well-balanced tests a little easier.

Reference Guide

Use this annotated outline as a guide to the chapter sections listed in the margin notes for each test question. For example, the chapter section (Chp. Sec.) given for Question 32 in Chapter 1 is "1 a 2." Using this guide, you will see that 1 a 2 corresponds to the material covered within the first major chapter section, under the heading, "Gains from Trade: A Better Allocation."

Chapter 1: The Central Idea

(1) Scarcity and Choice for Individuals
- (a) Consumer Decisions
  - (1) Opportunity Cost
  - (2) Gains from Trade: A Better Allocation
- (b) Producer Decisions
  - (1) Gains from Trade: Greater Production
  - (2) Specialization, Division of Labor, and Comparative Advantage
- (c) International Trade

(2) Scarcity and Choice for the Economy as a Whole
- (a) Production Possibilities
- (b) Increasing Opportunity Costs
- (c) The Production Possibilities Curve
  - (1) Inefficient, Efficient, or Impossible?
  - (2) Shifts in the Production Possibilities Curve
  - (3) Scarcity, Choice, and Economic Progress

(3) Market Economies and the Price System
- (a) Key Elements of a Market Economy
  - (1) Freely Determined Prices
  - (2) Property Rights and Incentives
  - (3) Freedom to Trade at Home and Abroad
  - (4) A Role for Government
  - (5) The Role of Private Organizations
- (b) The Price System
  - (1) Signals
  - (2) Incentives
  - (3) Distribution

(4) Conclusion

ECONOMICS IN ACTION **Gains from Trade on the Internet**

ECONOMICS IN ACTION **Teaching Jobs and Graduate School Applications – Two Sides of the Same Coin**

ECONOMICS IN THE NEWS **Gains from Trade on the Radio**

Chapter 2: Observing and Explaining the Economy

(1) What Do Economists Do?

(2) The Fluctuating Price of Gasoline

(a) Describing an Economic Event

(b) Data Limitations

(3) Explaining an Economic Event

(1) Correlation versus Causation

(2) The Lack of Controlled Experiments in Economics

(a) Predicting the Impact of Future Changes

(1) Economics Models

(2) Microeconomic versus Macroeconomic Models

(3) An Example: A Model with Two Variables

(b) The *Ceteris Paribus* Assumption

(c) The Use of Existing Models

(d) The Development of New Models

(4) Recommending Appropriate Policies

(a) Positive versus Normative Economics

(b) Economics as a Science versus a Partisan Policy Tool

(c) Economics Is Not the Only Factor in Policy Issues

(d) Disagreement Between Economists

(5) Conclusion

ECONOMICS IN ACTION **An Economic Experiment to Study Discrimination**

ECONOMICS IN ACTION **Science or Persuasion?**

ECONOMICS IN THE NEWS **Young Economists at Work**

Appendix to Chapter 2: Reading, Understanding, and Creating Graphs

Chapter 3: The Supply and Demand Model

(1) Demand

(a) The Demand Curve

(b) Shifts in Demand

(1) Consumers' Preferences

(2) Consumers' Information

(3) Consumers' Incomes

(4) Number of Consumers in the Market
(5) Consumers' Expectations of Future Prices
(6) Prices of Closely Related Goods
(c) Movements Along versus Shifts of the Demand Curve
(2) Supply
(a) The Supply Curve
(b) Shifts in Supply
(1) Technology
(2) Weather Conditions
(3) The Price of Inputs Used in Production
(4) The Number of Firms in the Market
(5) Expectations of Future Prices
(6) Government Taxes, Subsidies, and Regulations
(c) Movements Along versus Shifts of the Supply Curve
(3) Market Equilibrium: Combining Supply and Demand
(a) Determination of the Market Price
(1) Finding the Market Price
(2) Two Predictions
(b) Finding the Equilibrium with a Supply and Demand Diagram
(c) Market Outcomes When Supply or Demand Changes
(1) Effects of a Change in Demand
(2) Effects of a Change in Supply
(3) When Both Curves Shift
(4) Conclusion

ECONOMICS IN THE NEWS **Why Roses Cost More on Valentine's Day**

ECONOMICS IN ACTION **Using the Supply and Demand Model to Analyze Real-World Issues**

Chapter 4: Subtleties of the Supply and Demand Model: Price Floors, Price Ceilings, and Elasticity

(1) Interference with Market Prices
(a) Price Ceilings and Price Floors
(b) Side Effects of Price Ceilings
(1) Dealing with Persistent Shortages
(2) Making Things Worse
(c) Side Effects of Price Floors
(1) Dealing with Persistent Surpluses
(2) Making Things Worse

(2) Elasticity of Demand
- (a) Defining the Price Elasticity of Demand
- (b) The Size of the Elasticity: High versus Low
- (c) The Impact of a Change in Supply on the Price of Oil

(3) Working with Demand Elasticities
- (a) Elasticity versus Slope
- (b) Calculating the Elasticity with a Midpoint Formula
- (c) Talking about Elasticities
  - (1) Elastic versus Inelastic Demand
  - (2) Perfectly Elastic versus Perfectly Inelastic Demand
- (d) Revenue and the Price Elasticity of Demand
- (e) What Determines the Size of the Price Elasticity of Demand?
  - (1) The Degree of Substitutability
  - (2) Big-Ticket versus Little-Ticket Items
  - (3) Temporary versus Permanent Price Changes
  - (4) Differences in Preferences
  - (5) Long-Run versus Short-Run Elasticity
- (f) Income Elasticity and Cross-Price Elasticity of Demand

(4) Elasticity of Supply
- (a) Working with Supply Elasticities
  - (1) Perfectly Elastic and Perfectly Inelastic Supply
  - (2) Why the Size of the Price Elasticity of Supply Is Important

(5) Conclusion

ECONOMICS IN ACTION	**How Policymakers Use Price Elasticity of Demand to Discourage Underage Drinking**
ECONOMICS IN THE NEWS	**Increasing School Enrollment in Africa**
ECONOMICS IN ACTION	**Predicting the Size of a Price Increase**
ECONOMICS IN ACTION	**Will an Increase in the Minimum Wage Benefit Poor Workers?**

Chapter 5: The Demand Curve and the Behavior of Customers

(1) Utility and Consumer Preferences
- (a) A Consumer's Utility Depends on the Consumption of Goods
- (b) Important Properties of Utility

(2) The Budget Constraint and Utility Maximization
- (a) The Budget Constraint
- (b) Maximizing Utility Subject to the Budget Constraint
- (c) Deriving the Individual's Demand Curve

(1) Effect of a Change in Income: A Shift in the Demand Curve
(2) Income and Substitution Effects of a Price Change
(3) Willingness to Pay and the Demand Curve
(a) Measuring Willingness to Pay and Marginal Benefit
(b) Graphical Derivation of the Individual Demand Curve
(c) The Price Equals Marginal Benefit Rule
(4) The Market Demand Curve
(a) Different Types of Individuals
(5) Consumer Surplus
(6) Conclusion

ECONOMICS IN ACTION **Peering Deeper into How Individuals Make Decisions**

ECONOMICS IN THE NEWS **Creating Surplus for the Poor**

Appendix to Chapter 5: Consumer Theory with Indifference Curves

Chapter 6: The Supply Curve and the Behavior of Firms

(1) Definition of a Firm
(a) Your Own Firm: A Pumpkin Patch
(b) Your Firm as a Price-Taker in a Competitive Market
(c) Other Types of Markets
(2) The Firm's Profits
(a) Total Revenue
(b) Production and Costs
(1) The Time Period
(2) The Production Function
(3) Costs
(4) Graphical Representation of Total Costs and Marginal Costs
(3) Profit Maximization and the Individual Firm's Supply Curve
(a) An Initial Approach to Derive the Supply Curve
(1) A Profit Table
(2) A Profit Graph
(b) The Marginal Approach to Derive the Supply Curve
(1) Finding the Quantity Supplied at Different Prices
(2) The Price Equals Marginal Cost Rule
(c) A Comparison of the Two Approaches to Profit Maximization
(4) The Market Supply Curve
(a) The Slope of the Supply Curve
(b) Shifts in the Supply Curve

(5) Producer Surplus
- (a) A Graphical Representation of Producer Surplus
- (b) What Is the Difference Between Profits and Producer Surplus?

(6) Conclusion

ECONOMICS IN ACTION **Green Pricing and Incentives**

ECONOMICS IN THE NEWS **Supply Shifts Caused by Natural Disaster**

Chapter 7: The Interaction of People in Markets

(1) Individual Consumers and Firms in a Market
- (a) The Hard Way to Process Information, Coordinate, and Motivate
- (b) The Easy Way to Process Information, Coordinate, and Motivate
- (c) The Competitive Equilibrium Model
  - (1) Individual Production and Consumption Decisions
  - (2) Adjustment to the Equilibrium Price

(2) Are Competitive Markets Efficient?
- (a) The Meaning of Efficient
  - (1) The Need for a More Precise Definition
  - (2) Three Conditions for Efficient Outcomes
- (b) Is the Market Efficient?
- (c) Efficiency and Income Inequality

(3) Measuring Waste from Inefficiency
- (a) Maximizing the Sum of Producer Plus Consumer Surplus
- (b) Deadweight Loss

(4) The Deadweight Loss from Price Floors and Ceilings
  - (a) The Deadweight Loss from a Price Floor
  - (b) The Deadweight Loss from a Price Ceiling

(5) The Deadweight Loss from Taxation
  - (a) A Tax Paid by a Producer Shifts the Supply Curve
  - (b) A New Equilibrium Price and Quantity
  - (c) Deadweight Loss and Tax Revenue

(6) Informational Efficiency

(7) Conclusion

ECONOMICS IN THE NEWS **Coordination Failure in Responding to a Famine**

ECONOMICS IN ACTION **Price Controls and Deadweight Loss in the Milk Industry**

Chapter 8: Costs and the Changes at Firms over Time

(1) Costs for an Individual Firm

(a) Total Costs, Fixed Costs, Variable Costs, and Marginal Cost
(1) The Short Run and the Long Run
(2) Marginal Cost
(b) Average Cost
(c) The Relationship Between a Firm's Costs and the Firm's Production Function
(1) The Production Function
(2) Cost Curves
(a) Marginal versus Average in the Classroom
(b) Generic Cost Curves
(3) The Production Decision in the Short Run
(a) The Profit or Loss Rectangle
(1) The Total Revenue Area
(2) The Total Costs Area
(3) Profits or Losses
(b) The Breakeven Point
(c) The Shutdown Point
(4) Costs and Production: The Long Run
(a) The Effect of Capital Expansion on Costs
(b) The Long-Run ATC Curve
(c) Capital Expansion and Production in the Long Run
(5) Economies of Scale
(a) Determining Whether a Firm Has Economies or Diseconomies of Scale
(b) Mergers and Economies of Scope
(6) Conclusion

ECONOMICS IN THE NEWS **A Dormant Mine Starts Up Again**

ECONOMICS IN ACTION **Expanding (and Shrinking) a Firm over Time**

ECONOMICS IN ACTION **Economist Finds Economies of Scale at Pin Factory**

Appendix to Chapter 8: Producer Theory with Isoquants

Chapter 9: The Rise and Fall of Industries

(1) Markets and Industries
(2) The Long-Run Competitive Equilibrium Model of an Industry
(a) Setting Up the Model with Graphs
(1) Entry and Exit
(2) Long-Run Equilibrium
(b) An Increase in Demand
(1) Short-Run Effects

(2) Toward a New Long-Run Equilibrium
(c) A Decrease in Demand
(1) Economic Profits versus Accounting Profits
(2) The Equilibrium Number of Firms
(3) Entry or Exit Combined with Individual Firm Expansion or Contraction
(d) Shifts in Cost Curves
(1) Average Total Cost Is Minimized
(2) Efficient Allocation of Capital among Industries
(3) External Economies and Diseconomies of Scale
(a) The Standard Assumption: A Flat Long-Run Industry Supply Curve
(b) External Diseconomies of Scale
(c) External Economies of Scale
(4) Conclusion

ECONOMICS IN THE NEWS **Entry and Exit in the DVD Rental Industry**

ECONOMICS IN ACTION **The Rise of Digital Cameras and the Death of Silver Halide Film**

ECONOMICS IN THE NEWS **Cycles in the Grape Industry**

Chapter 10: Monopoly

(1) A Model of Monopoly
(a) Getting an Intuitive Feel for the Market Power of Monopoly
(1) There Is No One to Undercut the Monopolist's Price
(2) The Impact of Quantity Decisions on the Price
(3) Showing Market Power with a Graph
(b) The Effects of a Monopoly's Decision on Revenues
(1) Total Revenue and Marginal Revenue
(2) Marginal Revenue Is Less than the Price
(3) Marginal Revenue and Elasticity
(4) Average Revenue
(c) Finding Output to Maximize Profits at the Monopoly
(1) Comparing Total Revenue and Total Costs
(2) Equating Marginal Cost and Marginal Revenue
(d) $MC = MR$ at a Monopoly versus $MC = P$ at a Competitive Firm
(1) Marginal Revenue Equals the Price for a Price-Taker
(2) A Graphical Comparison
(2) The Generic Diagram of a Monopoly and Its Profits
(a) Determining Monopoly Output and Price on the Diagram
(b) Determining the Monopoly's Profits

(3) Competition, Monopoly, and Deadweight Loss
- (a) Comparison with Competition
- (b) Deadweight Loss from Monopoly
  - (1) Consumer Surplus and Producer Surplus Again
  - (2) Meaningful Comparisons
- (c) The Monopoly Price Is Greater than Marginal Cost
  - (1) Marginal Benefit Is More than Marginal Cost
  - (2) The Price-Cost Margin

(4) Why Monopolies Exist
- (a) Natural Monopolies
- (b) Patents and Copyrights
- (c) Licenses
- (d) Attempts to Monopolize and Erect Barriers to Entry

(5) Price Discrimination
- (a) Consumers with Different Price Elasticities of Demand
- (b) Quantity Discounts

(6) Conclusion

ECONOMICS IN THE NEWS **The Decline of the Diamond Monopolist**

ECONOMICS IN ACTION **How Best to Ensure Access to Clean Water in Developing Countries**

Chapter 11: Product Differentiation, Monopolistic Competition, and Oligopoly

(1) Product Differentiation
- (a) Variety of Goods in a Market Economy
- (b) Puzzles Explained by Product Differentiation
  - (1) Intraindustry Trade
  - (2) Advertising
  - (3) Consumer Information Services
- (c) How Are Products Differentiated?
- (d) The Optimal Amount of Product Differentiation at a Firm

(2) Monopolistic Competition
- (a) A Typical Monopolistic Competitor
  - (1) The Short Run: Just like a Monopoly
  - (2) Entry and Exit: Just like Competition
- (b) The Long-Run Monopolistically Competitive Equilibrium
  - (1) Comparing Monopoly, Competition, and Monopolistic Competition
  - (2) Product Variety versus Deadweight Loss

(3) Oligopoly
- (a) An Overview of Game Theory
- (b) Applying Game Theory to Oligopolies
  - (1) Competition in Quantities versus Competition in Prices
  - (2) Comparison with Monopoly and Perfect Competition
  - (3) Collusion
  - (4) Incentives to Defect
- (c) Incentives to Cooperate: Repeated Games
  - (1) Secret Defections

(4) Conclusion

ECONOMICS IN ACTION **What's the Future of Product Differentiation?**

ECONOMICS IN THE NEWS **The Deliciousness of Product Differentiation**

ECONOMICS IN ACTION **A Duopoly Game**

Chapter 12: Antitrust Policy and Regulation

(1) Antitrust Policy
- (a) Attacking Existing Monopoly Power
  - (1) A Brief History: From Standard Oil to Microsoft
  - (2) Predatory Pricing
- (b) Merger Policy
  - (1) The "Herf"
  - (2) Price-Cost Margins
  - (3) Market Definition
  - (4) Horizontal versus Vertical Mergers
- (c) Price Fixing
- (d) Vertical Restraints

(2) Regulating Natural Monopolies
- (a) Methods of Regulating a Natural Monopoly
  - (1) Marginal Cost Pricing
  - (2) Average Total Cost Pricing
  - (3) Incentive Regulation

(3) To Regulate or Not to Regulate
- (a) Borderline Cases
- (b) Regulators as Captives of Industry
- (c) The Deregulation Movement

(4) Conclusion

ECONOMICS IN ACTION **The Issue: Are Mergers Good for the Economy?**

ECONOMICS IN THE NEWS **Price Fixing in the Ivy League**

Chapter 13: Labor Markets

(1) The Measurement of Wages
  (a) Measuring Workers' Pay
    (1) Pay Includes Fringe Benefits
    (2) Adjusting for Inflation: Real Wages versus Nominal Wages
    (3) The Time Interval: Hourly versus Weekly Measures of Pay
  (b) Wage Trends
(2) The Labor Market
(3) Labor Demand
  (a) A Firm's Employment Decision
    (1) From Marginal Product to Marginal Revenue Product
    (2) The Marginal Revenue Product of Labor Equals the Wage ($MRP = W$)
  (b) The Firm's Derived Demand for Labor
    (1) What If the Firm Has Market Power?
    (2) Market Demand for Labor
  (c) A Comparison of $MRP = W$ with $MC = P$
(3) Labor Supply
  (a) Work versus Two Alternatives: Home Work and Leisure
    (1) The Relationship Between Real Wages and Labor Productivity
    (2) The Shape of Supply Curves
  (b) Work versus Another Alternative: Getting Human Capital
(4) Explaining Wage Trends and Differences
  (a) Labor Productivity
    (1) The Relationship Between Real Wages and Labor Productivity
  (b) Wage Dispersion and Productivity
    (1) Compensating Wage Differentials
    (2) Discrimination
    (3) Minimum Wage Laws
    (4) Fixed Wage Contracts
    (5) Deferred Wage Payments
(5) Labor Unions
  (a) Union/Nonunion Wage Differentials
    (1) The Restricted Supply Explanation
    (2) The Increased Productivity Explanation
  (b) Monopsony and Bilateral Monopoly

(6) Conclusion and Some Advice

ECONOMICS IN THE NEWS	**Incentives to Work**
ECONOMICS IN ACTION	**Why It's Better Being an Economist**
ECONOMICS IN ACTION	**Does Productivity or Compensating Differentials Explain the Academic Wage Gap?**

Chapter 14: Taxes, Transfers, and Income Distribution

(1) The Tax System
- (a) The Personal Income Tax
  - (1) Computing the Personal Income Tax
  - (2) The Marginal Tax Rate
  - (3) Zero Tax on Low Incomes
- (b) Payroll Tax
- (c) Other Taxes
- (d) The Effects of Taxes
  - (1) The Effect of a Tax on a Good
  - (2) Effects of the Personal Income Tax
  - (3) The Effect of a Payroll Tax
  - (4) The Possibility of a Perverse Effect on Tax Revenue
- (e) Tax Policy and the Trade Payoff Between Efficiency and Equality

(2) Transfer Payments
- (a) Means Tested Transfer Programs
- (b) Incentive Effects
- (c) Social Insurance Programs
- (d) Mandated Benefits

(3) The Distribution of Income in the United States
- (a) The Personal Distribution of Income
- (b) The Lorenz Curve and Gini Coefficient
  - (1) Comparison with Other Countries
  - (2) Income Mobility
  - (3) Longer-Term Income Inequality
  - (4) Changing Composition of Households
  - (5) Distribution of Income versus Distribution of Wealth
- (c) Poverty and Measurement
- (d) Effects of Taxes and Transfers on Income Distribution and Poverty

(4) Conclusion

ECONOMICS IN THE NEWS	**The "Death Tax" Debate**

ECONOMICS IN THE NEWS	**Assessing the Success of the 1996 Welfare Reform a Decade Later**
ECONOMICS IN ACTION	**Should We Be Concerned about Income Inequality?**

Chapter 15: Public Goods, Externalities, and Government Behavior

(1) Public Goods
- (a) Nonrivalry and Nonexcludability
- (b) Free Riders: A Difficulty for the Private Sector
- (c) Avoiding Free-Rider Problems
- (d) Changes in Technology and Excludability
- (e) The Production of Goods by the Government
- (f) Cost-Benefit Analysis
  - (1) Marginal Cost and Marginal Benefit

(2) Externalities: From the Environment to Education
- (a) Negative Externalities
- (b) Positive Externalities
- (c) Externalities Spread Across Borders

(3) Remedies for Externalities
- (a) Private Remedies: Agreements Between the Affected Parties
  - (1) The Importance of Assigning Property Rights
  - (2) Transaction Costs
  - (3) The Free-Rider Problem Again
- (b) Command and Control Remedies
- (c) Taxes and Subsidies
  - (1) Emissions Taxes
  - (2) Why Is Command and Control Used More than Taxes?
- (d) Tradable Permits
- (e) Balancing the Costs and Benefits of Reducing Externalities

(4) Models of Government Behavior
- (a) Public Choice Models
- (b) The Voting Paradox
  - (1) Unanimity
  - (2) The Median Voter Theorem
  - (3) Convergence of Positions in a Two-Party System
  - (4) Voting Paradoxes
- (c) Special Interest Groups
  - (1) Concentrated Benefits and Diffuse Costs

(2) Wasteful Lobbying

(d) Incentive Problems in Government

(5) Conclusion

ECONOMICS IN ACTION	**Excludability, Rivalry, and the Classification of Goods and Services**
ECONOMICS IN THE NEWS	**Realizing the Positive Externalities of a New Cancer Vaccine**
ECONOMICS IN THE NEWS	**Environmental Economics**
ECONOMICS IN ACTION	**Advising the Government to Auction Off the Spectrum**

Chapter 16: Capital Markets

(1) The Distinction Between Physical Capital and Financial Capital

(2) Markets for Physical Capital

(a) Rental Markets

(1) The Demand Curve for Capital

(2) Demand for Factors of Production in General

(3) The Market Demand and Supply

(4) The Case of Fixed Supply: Economic Rents

(b) The Ownership of Physical Capital

(3) Markets for Financial Capital

(a) Stock Prices and Rates of Return

(b) Bond Prices and Rates of Return

(4) The Tradeoff Between Risk and Return

(a) Behavior Under Uncertainty

(b) Risks and Rates of Return in Theory

(c) Risk and Return in Reality

(d) Diversification Reduces Risk

(e) Efficient Market Theory

(5) Corporate Governance Problems

(a) Asymmetric Information: Moral Hazard and Adverse Selection

(b) Incentives to Overcome Adverse Selection and Moral Hazard Problems

(6) Conclusion

ECONOMICS IN THE NEWS	**Physical Capital Accumulation of Google**
ECONOMICS IN ACTION	**Understanding Stock and Bond Price Listings in Newspapers**
ECONOMICS IN THE NEWS	**Corporate Greed**

Appendix to Chapter 16: Present Discounted Value

Chapter 17: Macroeconomics: The Big Picture

(1) Measuring the "Size" of an Economy
  (a) Economic Growth: The Relentless Uphill Climb
  (b) Economic Fluctuations: Temporary Setbacks and Recoveries
    (1) A Recession's Aftermath
    (2) Recessions versus Depressions

(2) Unemployment, Inflation, and Interest Rates
  (a) Unemployment During Recessions
  (b) Inflation
  (c) Interest Rates
    (1) Different Types of Interest Rates and Their Behavior
    (2) The Concept of the Real Interest Rate

(3) Macroeconomic Theory and Policy
  (a) The Theory of Long-Term Economic Growth
    (1) The Production Function
  (b) Government Policy and Economic Growth
    (1) Fiscal Policy
    (2) Monetary Policy
  (c) The Theory of Economic Fluctuations
    (1) Aggregate Demand and Economic Fluctuations
  (d) Macroeconomic Policy and Economic Fluctuations
    (1) Fiscal Policy
    (2) Monetary Policy

(4) Conclusion

ECONOMICS IN THE NEWS **How Economic Growth Can Transform an Economy**

ECONOMICS IN ACTION **The Economic Impact of September 11**

Appendix to Chapter 17: The Miracle of Compound Growth

Chapter 18: Measuring the Production, Income, and Spending of Nations

(1) Measuring GDP
  (a) A Precise Definition of GDP
    (1) Prices Determine the Importance of Goods and Services in GDP
    (2) Intermediate Goods versus Final Goods
    (3) Stocks versus Flows
    (3) Three Ways to Measure GDP
  (b) The Spending Approach
    (1) Consumption

(2) Investment
(3) Government Purchases
(4) Net Exports
(5) Algebraic Summary

(c) The Income Approach
(1) Labor Income
(2) Capital Income
(3) Depreciation
(4) Taxes, Subsidies, and Transfers
(5) Net Income of Foreigners

(d) The Production Approach

(2) Saving
(a) Individual Saving
(b) National Saving

(3) Measuring Real GDP
(a) Adjusting GDP for Inflation
(1) Calculating Real GDP Growth Between
(2) A Year-to-Year Chain
(3) Obtaining the Values of Real GDP
(4) Real GDP versus Nominal GDP over Time
(b) The GDP Deflator
(c) Alternative Inflation Measures

(4) Shortcomings of the GDP Measure
(a) Revisions in GDP
(b) Omissions from GDP
(1) Home Work and Production
(2) Leisure Activity
(3) The Underground Economy
(4) Quality Improvements
(c) Other Measures of Well-Being

(5) Conclusion

ECONOMICS IN ACTION **Distinguishing Between Stocks and Flows**
ECONOMICS IN THE NEWS **The Monthly Release of GDP Data**
ECONOMICS IN ACTION **Measuring the Quality of Life Across Nations**

Chapter 19: The Spending Allocation Model

(1) The Spending Shares

(a) Defining the Spending Shares
(b) If One Share Goes Up, Another Must Go Down
(2) The Effect of Interest Rates on Spending Shares
(a) Consumption
(1) Consumption and the Real Interest Rate
(2) Movements Along versus Shifts of the Consumption Share Line
(b) Investment
(c) Net Exports
(1) The Interest Rate and the Exchange Rate
(2) The Exchange Rate and Net Exports
(3) Combining the Two Relationships
(d) Putting the Three Shares Together
(3) Determining the Equilibrium Interest Rate
(a) The Nongovernment Share of GDP
(b) The Government's Share of GDP and the Share of GDP Available for Nongovernment Use
(c) Finding the Equilibrium Interest Rate
(1) Analogy with Supply and Demand
(2) The Real Interest Rate in the Long Run
(4) The Relationship Between Saving and Investment
(a) A Shift in the Share Government Purchases
(5) Conclusion

ECONOMICS IN ACTION **Using the Spending Allocation Model to Analyze the Long-Run Implications of Shifts in Government Purchases and Consumption**

ECONOMICS IN THE NEWS **The "Twin Deficits"**

Chapter 20: Unemployment and Employment

(1) Unemployment and Other Labor Market Indicators
(a) How Is Unemployment Measured?
(1) Who Is Employed and Who Is Unemployed?
(2) The Labor Force and Discouraged Workers
(3) Part-Time Work
(b) Comparing Three Key Indicators
(c) Aggregate Hours of Labor Input
(d) Cyclical, Frictional, and Structural Unemployment
(2) The Nature of Unemployment
(a) Reasons People Are Unemployed
(1) Job Losers

(2) Job Leavers

(3) New Entrants and Re-entrants

(b) The Duration of Unemployment

(c) Unemployment for Different Groups

(3) Modeling the Labor Market

(a) Labor Demand and Labor Supply

(b) Explaining Labor Market Trends

(c) Why Is the Unemployment Rate Always Greater than Zero?

(1) Job Rationing

(2) Job Search

(3) Policies to Reduce the Unemployment

(4) Conclusion

ECONOMICS IN THE NEWS **Unemployment Each Month**

ECONOMICS IN ACTION **Unemployment among Young People Around the World**

Chapter 21: Productivity and Economic Growth

(1) Labor and Capital Without Technology

(a) Labor Alone

(1) Diminishing Returns to Labor

(b) Adding Capital

(1) Diminishing Returns to Capital

(2) Technology: The Engine of Growth

(a) What Is Technology?

(1) Invention, Innovation, and Diffusion

(2) Organization and Specialization

(3) Human Capital

(b) The Production of Technology: The Invention Factory

(c) Special Features of Technology

(3) Measuring Technology

(a) The Formula

(b) Using the Formula

(4) Technology Policy

(a) Policy to Encourage Investment in Human Capital

(b) Policy to Encourage Research and Innovation

(c) Technology Embodied in New Capital

(d) Is Government Intervention Appropriate?

(5) Conclusion: The Importance of Productivity Growth

ECONOMICS IN ACTION **The Role of Technology in Economic Growth**
ECONOMICS IN ACTION **Examples of Changes in Technology That Increased Productivity**
ECONOMICS IN ACTION **Two Invention Factories: Past and Present**
ECONOMICS IN ACTION **Growth Accounting in Practice**
ECONOMICS IN THE NEWS **Productivity Growth**
Appendix to Chapter 21: Deriving the Growth Accounting Formula

Chapter 22: Money and Inflation

(1) What Is Money?
(a) Three Functions of Money
(1) Medium of Exchange
(2) Store of Value
(3) Unit of Account
(b) Commodity Money
(c) From Coins to Paper Money to Deposits
(d) Measures of the Money Supply
(2) The Fed, the Banks, and the Link from Reserves to Deposits
(a) The Fed
(1) Board of Governors
(2) The District Federal Reserve Banks
(3) The Federal Open Market Committee (FOMC)
(b) The Banks
(c) The Link Between Reserves and Deposits
(1) A Formula Linking Reserves to Deposits
(2) Bank-by-Bank Deposit Expansion
(d) How the Fed Controls the Money Supply: Currency plus Deposits
(4) Money Growth and Inflation
(a) The Quantity Equation of Money
(b) Evidence
(1) Worldwide Inflation in the 1970s and 1980s
(2) Hyperinflations
(5) Conclusion
ECONOMICS IN THE NEWS **Counterfeit Money**
ECONOMICS IN ACTION **Hyperinflation and Too Much Money**

Chapter 23: The Nature and Causes of Economic Fluctuations

(1) Changes in Aggregate Demand Lead to Changes in Production

(a) Production and Demand at Individual Firms
(1) The Unemployment Rate and the Deviations of Real GDP from Potential GDP
(b) Could Economic Fluctuations Also Be Due to Changes in Potential GDP?
(2) Forecasting Real GDP
(a) A Forecast for Next Year
(b) Impact of a Change in Government Purchases
(3) The Response of Consumption to Income
(a) The Consumption Function
(1) The Marginal Propensity to Consume
(2) Which Measure of Income?
(b) What about Interest Rates and Other Influences on Consumption?
(4) Finding Real GDP When Consumption and Income Move Together
(a) The 45-Degree Line
(b) The Expenditure Line
(1) The Slope of the Expenditure Line
(2) Shifts in the Expenditure Line
(c) Determining Real GDP Through Spending Balance
(d) A Better Forecast of Real GDP
(5) Spending Balance and Departures of Real GDP from Potential GDP
(a) Stepping Away from Potential GDP
(6) Conclusion

ECONOMICS IN ACTION **Real-Life Examples of How Firms Respond to Demand**
ECONOMICS IN THE NEWS **Assessing the Macroeconomic Impact of a Terrorist Attack**
ECONOMICS IN ACTION **The Professional Forecasters**
ECONOMICS IN ACTION **Making *Time's* Top 100**

Appendix to Chapter 23: Deriving the Formula for the Keynesian Multiplier and the Forward-Looking Consumption Model

Chapter 24: The Economic Fluctuations Model

(1) The Aggregate Demand Curve
(a) Interest Rates and Real GDP
(1) Investment
(2) Net Exports
(3) Consumption
(4) The Overall Effect
(b) Interest Rates and Inflation
(1) Central Bank Interest Rate Policy

(2) How the Fed Changes the Interest Rate
(3) A Graph of the Response of the Interest Rate to Inflation
(4) A Good Simplifying Assumption

(c) Derivation of the Aggregate Demand Curve
(1) Movements Along the Aggregate Demand Curve
(2) Shifts of the Aggregate Demand Curve

(2) The Inflation Adjustment Line
(a) The Inflation Adjustment Line Is Flat
(1) Expectations of Continuing Inflation
(2) Staggered Price and Wage Setting
(b) The Inflation Adjustment Line Shifts Gradually When Real GDP Departs from Potential GDP
(c) Changes in Expectations or Commodity Prices Shift the Inflation Adjustment Line
(d) Does the Inflation Adjustment Line Fit the Facts?
(3) Combining the Aggregate Demand Curve and the Inflation Adjustment Line
(4) Conclusion

ECONOMICS IN THE NEWS **The Fed Raises and Then Lowers the Interest Rate**

Chapter 25: Using the Economic Fluctuations Model

(1) Changes in Government Purchases
(a) Real GDP and Inflation over Time
(b) Details on the Components of Spending
(1) Short Run
(2) Long Run
(c) The Return to Potential GDP after an Increase in Government Spending
(2) Changes in Monetary Policy
(a) The Volcker Disinflation
(b) Reinflation and the Great Inflation
(3) Price Shocks
(a) What Is a Price Shock?
(b) The Effect of Price Shocks
(1) Temporary Shifts in the Inflation Adjustment Line
(2) Stagflation
(4) Conclusion

ECONOMICS IN ACTION **Explaining the Recovery from the Great Depression**

ECONOMICS IN ACTION **The 2001 Recession and Recovery**

Chapter 26: Fiscal Policy

(1) The Government Budget
- (a) Setting the Annual Budget
  - (1) A Balanced Budget versus a Deficit or Surplus
  - (2) The Proposed Budget versus the Actual Budget
- (b) A Look at the Federal Budget
  - (1) The Deficit
  - (2) Taxes and Spending
- (c) The Federal Debt
  - (1) The Debt to GDP Ratio
- (d) State and Local Government Budgets

(2) Countercyclical Fiscal Policy
- (a) Impacts of the Instruments of Fiscal Policy
  - (1) Changes in Government Purchases
  - (2) Changes in Taxes
- (b) Countercyclical Fiscal Policy
  - (1) Discretionary Changes in the Instruments of Fiscal Policy
  - (2) Automatic Changes in the Instruments of Fiscal Policy
- (c) The Discretion versus Rules Debate for Fiscal Policy

(3) The Structural versus the Cyclical Surplus

(4) Conclusion

ECONOMICS IN ACTION **How Should Social Security Be Reformed?**

ECONOMICS IN THE NEWS **The Economic Report of the President**

Chapter 27: Monetary Policy

(1) Why Are Central Banks Independent?
- (a) The "Gain then Pain" Scenario
  - (1) The Phillips Curve
  - (2) The Political Business Cycle
  - (3) Time Inconsistency
- (b) Potential Disadvantages of Central Bank Independence

(2) Running Monetary Policy
- (a) Aggregate Demand: Just Right, Too Hot, or Too Cold?
  - (1) The Goldilocks Economy: Just Right
  - (2) A Misalignment: Aggregate Demand Is Too High
  - (3) Another Type of Misalignment: Aggregate Demand Is Too Low
- (b) Monetary Policy in 2006

(1) The Inherent Uncertainty in Monetary Policy
(2) Increased Transparency and Predictability
(3) Money and Other Instruments of Monetary Policy
(a) Money Demand, the Interest Rate, and Money Supply
(1) Money Demand
(2) The Interest Rate and the Quantity of Money
(3) What about Focusing on the Money Supply?
(b) Two Other Instruments of Monetary Policy
(1) The Discount Rate
(2) Reserve Requirements
(4) The Exchange Rate and Monetary Policy
(a) The Effects of a Fixed Exchange Rate System on Monetary Policy
(b) Interventions in the Exchange Market
(c) Why Fixed Exchange Rates?
(5) Conclusion
ECONOMICS IN THE NEWS **Anatomy of a Hump**

Chapter 28: Economic Growth and Globalization

(1) Catching Up or Not?
(a) Catch-up Within the United States
(b) Catch-up in the Advanced Countries
(c) Catch-up in the Whole World
(2) Economic Development
(a) Billions Still in Poverty
(b) Geographical Patterns
(c) Terminology of Economic Development
(3) Spreading and Using Technology
(a) Empowering Entrepreneurs
(b) Remaining Problems in Developing Countries
(1) Regulation and Legal Rights
(2) Lack of Human Capital
(4) Increasing Capital per Worker
(a) Population Growth
(b) National Saving
(c) Foreign Investment from the Advanced Economies
(5) Conclusion
ECONOMICS IN ACTION **The Millennium Corporate Challenge**

ECONOMICS IN ACTION **Is There a Global Savings Glut?**

Chapter 29: The Gains from International Trade

(1) Recent Trends in International Trade

(2) Comparative Advantage

(a) Getting a Gut Feeling for Comparative Advantage

(1) Opportunity Cost, Relative Efficiency, and Comparative Advantage

(2) From People to Countries

(b) Productivity in Two Countries

(1) An American Worker's View

(2) A Korean Worker's View

(c) Finding the Relative Price

(1) Relative Price Without Trade

(2) Relative Price with Trade

(d) Measuring the Gains from Trade

(1) One Country's Gain

(2) The Other Country's Gain

(3) Just like a New Discovery

(e) A Graphical Measure of the Gains from Trade

(1) Production Possibilities Curves Without Trade

(2) Production Possibilities Curves with Trade

(3) Increasing Opportunity Costs: Incomplete Specialization

(3) Reasons for Comparative Advantage

(a) Labor versus Capital Resources

(b) The Effect of Trade on Wages

(4) Gains from Expanded Markets

(a) An Example of Gains from Trade Through Expanded Markets

(1) Effects of a Larger Market

(2) Intraindustry Trade versus Interindustry Trade

(b) Measuring the Gains from Expanded Markets

(1) A Relationship Between Cost per Unit and the Number of Firms

(2) The Effect of the Size of the Market

(3) A Relationship Between the Price and the Number of Firms

(4) Equilibrium Price and Number of Firms

(5) Increasing the Size of the Market

(6) The North American Automobile Market

(5) Conclusion

ECONOMICS IN THE NEWS	**The Economic Impact of Outsourcing**
ECONOMICS IN ACTION	**Doing Politics and Economics**

Chapter 30: International Trade Policy

(1) Tariffs and Quotas
- (a) Tariffs
- (b) Quotas
- (c) The Cost of Trade Restrictions

(2) The History of Trade Restrictions
- (a) U.S. Tariffs
  - (1) From the Tariff of Abominations to Smoot-Hawley
  - (2) From the Reciprocal Trade Agreement Act to the WTO
  - (3) Antidumping Duties
  - (4) The Rise of Nontariff Barriers

(3) Arguments for Trade Barriers
- (a) High Transition Costs
  - (1) Phaseout of Trade Restrictions
  - (2) Trade Adjustment Assistance
- (b) The Infant Industry Argument
- (c) The National Security Argument
- (d) The Retaliation Argument
- (e) The Foreign Subsidies Argument
- (f) Environment and Labor Standards Arguments
- (g) The Political Economy of Protection

(4) How to Reduce Trade Barriers
- (a) Unilateral Disarmament
- (b) Multilateral Negotiations
  - (1) The Uruguay Round
  - (2) Most-Favored-Nation Policy
- (c) Regional Trading Areas
  - (1) Trade Diversion versus Trade Creation
  - (2) Free Trade Areas versus Customs Unions

(5) Conclusion

ECONOMICS IN ACTION	**From Steel to Shrimp: The Same Old Tariff Story**
ECONOMICS IN THE NEWS	**The End of the Multi-Fiber Agreement**
ECONOMICS IN ACTION	**Ending the Corn Laws**

Chapter Correlation Chart for
Taylor *Economics*, *Principles of Microeconomics*, and *Principles of Macroeconomics*
Sixth Edition

Taylor *Economics* Chapter	***Principles of Microeconomics***	***Principles of Macroeconomics***
PART 1 INTRODUCTION TO ECONOMICS	**PART 1**	**PART 1**
1. The Central Idea	1	1
2. Observing and Explaining the Economy *Appendix to Chapter 2, Reading, Understanding, and Creating Graphs*	2 2A	2 2A
3. The Supply and Demand Model	3	3
4. Subtleties of the Supply and Demand Model: Price Floors, Price Ceilings, and Elasticity	4	4
PART 2 PRINCIPLES OF MICROECONOMICS	**PART 2**	
5. The Demand Curve and the Behavior of Consumers *Appendix to Chapter 5, Consumer Theory with Indifference Curves*	5 5A	
6. The Supply Curve and the Behavior of Firms	6	
7. The Interaction of People in Markets	7	
PART 3 THE ECONOMICS OF THE FIRM	**PART 3**	
8. Costs and the Changes at Firms Over Time *Appendix to Chapter 8, Producer Theory with Isoquants*	8 8A	
9. The Rise and Fall of Industries	9	
10. Monopoly	10	
11. Product Differentiation, Monopolistic Competition, and Oligopoly	11	
12. Antitrust Policy and Regulation	12	
PART 4 MARKETS, INCOME DISTRIBUTION, AND PUBLIC GOODS	**PART 4**	
13. Labor Markets	13	
14. Taxes, Transfers, and Income Distribution	14	
15. Public Goods, Externalities, and Government	15	

Taylor *Economics* Chapter	***Principles of Microeconomics***	***Principles of Macroeconomics***
Behavior		
16. Capital Markets *Appendix to Chapter 16, Present Discounted Value*	16 16A	16: "Financial Markets" 16A
PART 5 PRINCIPLES OF MACROECONOMICS		**PART 2**
17. Macroeconomics: The Big Picture *Appendix to Chapter 17, The Miracle of Compound Growth*		5 5A
18. Measuring the Production, Income, and Spending of Nations		6
19. The Spending Allocation Model		7
20. Unemployment and Employment		8
21. Productivity and Economic Growth *Appendix to Chapter 21 Deriving the Growth Accounting Formula*		9 9A
22. Money and Inflation		10
PART 6 ECONOMIC FLUCTUATIONS AND MACROECONOMIC POLICY		**PART 3**
23. The Nature and Causes of Economic Fluctuations *Appendix to Chapter 23, Deriving the Formula for the Keynesian Multiplier and the Forward-Looking Consumption Model*		11 11A
24. The Economic Fluctuations Model		12
25. Using the Economic Fluctuations Model		13
26. Fiscal Policy		14
27. Monetary Policy		15
PART 7 TRADE AND GLOBAL MARKETS	**PART 5**	**PART 4**
28. Economic Growth and Globalization		17
29. The Gains from International Trade	17	18
30. International Trade Policy	18	19

CHAPTER 1

The Central Idea

Scarcity and Choice for Individuals

1. Economics is the study of how people cope with
   a) unlimited resources.
   b) greed.
   c) scarcity.
   d) limited human wants.
   e) political disputes.
   Ans: c Chp. sec.: preview Difficulty: basic Topic: scarcity Type: factual

2. The concept of scarcity, as used by economists, refers to
   a) a situation in which an item is very expensive.
   b) a situation in which an item is available only in very small quantities.
   c) a situation in which a resource is nonrenewable.
   d) shortages.
   e) a situation in which the available resources are not enough to satisfy the wants of the people.
   Ans: e Chp. sec.: preview Difficulty: moderate Topic: scarcity Type: factual

3. The problem of scarcity is
   a) a problem only for poor countries.
   b) a problem only for economies under complete government control.
   c) faced by all economies.
   d) eliminated as the economy grows.
   e) not faced by free market economies.
   Ans: c Chp. sec.: preview Difficulty: moderate Topic: scarcity Type: factual

4. The basic economic problem is
   a) lack of money.
   b) unemployment.
   c) poverty.
   d) scarcity.
   e) inflation.
   Ans: d Chp. sec.: preview Difficulty: basic Topic: scarcity Type: factual

5. Who faces the problem of scarcity?
   a) Only the rich
   b) Only the poor
   c) Only people living next to wealthy people
   d) Everyone
   e) Only people living next to poor people
   Ans: d 6th edition: yes Chp. sec.: preview Difficulty: moderate Topic: scarcity Type: factual

6. A resource is not scarce if
   a) there is more of this resource than people want.
   b) it can be found in any store.
   c) people have enough money to pay for it.
   d) it has a low opportunity cost.
   e) its supply exceeds its demand.
   Ans: a Chp. sec.: preview Difficulty: moderate Topic: scarcity Type: factual

7. If a resource is always available when needed, then it
   a) will be more expensive than other resources.
   b) is not scarce.
   c) has a high opportunity cost.
   d) is not tangible.
   e) is scarce.
   Ans: b 6th edition: yes Chp. sec.: preview Difficulty: basic Topic: scarcity Type: factual

8. An important implication of scarcity is that
   a) it inhibits economic interaction.
   b) people are not able to use all the available resources.
   c) people must make a choice.
   d) people will always be poor.
   e) it is a problem that is easily abolished.
   Ans: c Chp. sec.: preview Difficulty: moderate Topic: scarcity Type: conceptual

9. Economics is a study of
   a) choices and interactions among people when resources are scarce.
   b) how to overcome scarcity.
   c) how to make choices and interact in order to avoid scarcity.
   d) how to avoid scarcity by making choices.
   e) how to make money in stock markets.
   Ans: a 6th edition: yes Chp. sec.: preview Difficulty: moderate Topic: economics Type: factual

10. Economics deals with how
    a) individuals make decisions to use scarce resources in order to satisfy their unlimited wants.
    b) to run a business.
    c) individuals become rich.
    d) society can eliminate scarcity.
    e) society creates more resources in order to raise its standard of living.
    Ans: a Chp. sec.: preview Difficulty: moderate Topic: economics Type: factual

11. The reason, from an economic perspective, people are forced to choose is because of
    a) social custom.
    b) genetics.
    c) scarcity.
    d) government.
    e) religion.
    Ans: c Chp. sec.: preview Difficulty: basic Topic: scarcity Type: conceptual

12. Which of the following statements about economic interaction is *not* true?
    a) It is a fact of economic life.
    b) It requires a market.
    c) It can occur within a family.
    d) It makes our lives better.
    e) It occurs only among different countries.
    Ans: e Chp. sec.: preview Difficulty: moderate Topic: economic interaction Type: conceptual

13. Where do buyers and sellers meet?
    a) In a government
    b) Only in a face-to-face forum
    c) In a family
    d) In a market
    e) In a firm
    Ans: d 6th edition: yes Chp. sec.: preview Difficulty: moderate Topic: organizations Type: factual

14. A market is
    a) a place where firms meet to set prices.
    b) an arrangement by which economic exchanges take place.
    c) an organization controlled by a government.
    d) a place where goods are produced.
    e) anywhere people come close to each other.
    Ans: b 6th edition: yes Chp. sec.: preview Difficulty: basic Topic: market Type: factual

15. T F Economics is the study of how individuals become wealthy.
    Ans: False Chp. sec.: preview Difficulty: moderate Topic: economics Type: factual

16. T F Scarcity applies to everyone regardless of income.
    Ans: True Chp. sec.: preview Difficulty: moderate Topic: scarcity Type: conceptual

17. T F Choices are made in order to avoid scarcity.
    Ans: False Chp. sec.: preview Difficulty: moderate Topic: scarcity Type: conceptual

18. T F An economic transaction occurs only in a market
    Ans: True 6th edition: yes Chp. sec.: preview Difficulty: basic Topic: economic interaction Type: factual

19. A budget constraint
    a) does not occur if there is scarcity.
    b) enables choices to be avoided.
    c) is a way to overcome scarcity.
    d) forces people to make choices.
    e) prohibits consumers from spending.
    Ans: d Chp. sec.: 1 a Difficulty: moderate Topic: budget constraint Type: conceptual

20. People make decisions when choices involve
    a) no benefits.
    b) only benefits.
    c) nominal costs.
    d) opportunity costs.
    e) unlimited resources.
    Ans: d 6th edition: yes Chp. sec.: 1 a 1 Difficulty: moderate Topic: opportunity cost Type: conceptual

21. Choices are made based on
    a) scarcity.
    b) opportunity costs.
    c) producers.
    d) consumers.
    e) supply.
    Ans: b Chp. sec.: 1 a 1 Difficulty: moderate Topic: opportunity cost Type: conceptual

22. The opportunity cost of a choice is the
    a) cost associated with making a choice.
    b) value of the next best activity not chosen.
    c) fair market price of whatever is chosen.
    d) amount paid to purchase what is chosen.
    e) consequence associated with failure.
    Ans: b Chp. sec.: 1 a 1 Difficulty: moderate Topic: opportunity cost Type: factual

23. John has only one hour to study for an exam in history or to complete a written report in economics. The opportunity cost of spending the hour writing the economics report is
    a) a lower grade in the history exam.
    b) a higher grade in the history exam.
    c) a lower grade in both the history exam and the economics report.
    d) a higher grade in both the history exam and the economics report.
    e) none because history and economics are unrelated.
    Ans: a 6th edition: yes Chp. sec.: 1 a 1 Difficulty: moderate Topic: opportunity cost Type: factual

24. John's budget is such that he can afford either a computer or a Caribbean vacation, both of which cost the same. Which of the following statements about his opportunity cost is correct?
    a) The opportunity cost of a Caribbean vacation is the money John pays for the vacation.
    b) The opportunity cost of the vacation is the same as the opportunity cost of the computer because John can afford only one or the other.
    c) There is nothing to say about the opportunity cost because we don't know how much the computer or the Caribbean vacation costs.
    d) The opportunity cost of going on a vacation is the loss from not being able to buy the computer.
    e) The opportunity cost of the computer is the total cost of the computer and the Caribbean vacation.
    Ans: d Chp. sec.: 1 a 1 Difficulty: moderate Topic: opportunity cost Type: conceptual

25. Which of the following statements is *false*?
    a) There is an opportunity cost associated with any choice made.
    b) If there is a budget constraint, there will be scarcity.
    c) A financial budget constraint must exist for an opportunity cost to exist.
    d) Opportunity costs occur because of scarce resources.
    e) Because of scarcity, choices have to be made.
    Ans: c Chp. sec.: 1 a 1 Difficulty: moderate Topic: opportunity cost Type: conceptual

26. An example of opportunity cost
    a) is sweets given up by a person who would never eat them even if he or she could.
    b) for a professor of economics is the pleasure that he or she derives from teaching economics.
    c) is the Chinese food that you gave up when you chose to eat Italian food.
    d) is the tuition you pay to attend college.
    e) is the price paid for a ticket when you go to the movies.
    Ans: c Chp. sec.: 1 a 1 Difficulty: basic Topic: opportunity cost Type: conceptual

27. The opportunity cost of attending college
    a) is zero because the return is always positive.
    b) includes the skills earned from attending college.
    c) is the living expenses, which are the same whether the students attend college or not.
    d) includes the lost wages that would have been earned if the student had not attended college.
    e) includes the scholarships for attending college.
    Ans: d Chp. sec.: 1 a 1 Difficulty: moderate Topic: opportunity cost Type: conceptual

28. Of the following individuals, who bears the highest opportunity cost of going to college?
    a) A pro-football player earning $1 million a year
    b) A high school graduate without a job
    c) A high school dropout earning the minimum wage in a fast-food restaurant
    d) A person being laid off by a company
    e) A retiree
    Ans: a 6th edition: yes Chp. sec.: 1 a 1 Difficulty: moderate Topic: opportunity cost Type: conceptual

29. Kyle has two options to spend her school break in the summer: get a summer job that pays $2,000 or travel in Europe. The opportunity cost of the summer job is that Kyle
    a) can earn more than $2,000.
    b) can also travel in Europe.
    c) has to give up traveling in Europe.
    d) can save the money for traveling in Europe.
    e) has to work and travel at the same time.
    Ans: c 6th edition: yes Chp. sec.: 1 a 1 Difficulty: moderate Topic: opportunity cost Type: conceptual

Use the following to answer question 30:

Table 1.1

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

30. Refer to Table 1.1. Suppose that Jack has three hours to study for an exam in economics and another exam in math on the same day. The amount of time he spends studying economics and its relation to his grade in the two classes are shown in the table. The opportunity cost of increasing the time spent on studying economics from one hour to two hours is
    a) 85 points on the math grade.
    b) 55 points on the math grade.
    c) 30 points on the math grade.
    d) 20 points on the math grade.
    e) zero.
    Ans: c 6th edition: yes Chp. sec.: 1 a 1 Difficulty: moderate Topic: opportunity cost Type: conceptual

31. Gains from voluntary trade arise because
    a) it reallocates goods between individuals.
    b) it occurs in a household.
    c) it reallocates goods between individuals in a way they both prefer.
    d) it occurs in a market.
    e) of the power involved.
    Ans: c Chp. sec.: 1 a 2 Difficulty: moderate Topic: gains from trade Type: factual

32. A voluntary exchange of existing consumer goods is beneficial because it
    a) makes those engaging in the exchange better off.
    b) changes the total quantity of goods produced.
    c) reallocates existing goods.
    d) reduces scarcity.
    e) requires choice.
    Ans: a Chp. sec.: 1 a 2 Difficulty: basic Topic: gains from trade Type: factual

33. T F The opportunity cost for a student to attend college is zero if the student receives a scholarship.
    Ans: False Chp. sec.: 1 a 1 Difficulty: moderate Topic: opportunity cost Type: conceptual

34. T F A rich individual who can afford anything and everything does not need to be concerned with opportunity costs.
    Ans: False Chp. sec.: 1 a 1 Difficulty: moderate Topic: opportunity cost Type: conceptual

35. T F Gains from trade occur when there are differences in opportunity cost.
    Ans: True Chp. sec.: 1 a 2 Difficulty: moderate Topic: gains from trade Type: factual

36. T F A college student faces no opportunity cost if her parents pay her college tuition and her living expenses.
Ans: False 6th edition: yes Chp. sec.: 1 a 1 Difficulty: moderate Topic: opportunity cost Type: factual

37. T F Trade takes place when one party gains at the expense of another party.
Ans: False Chp. sec.: 1 a 2 Difficulty: moderate Topic: gains from trade Type: factual

Use the following to answer questions 38-42:

Table 1.2

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

38. According to Table 1.2, if Sam did all the cooking as well as waited on tables, how many customers would he be able to serve per day?
a) 4
b) Between 2 and 20 customers
c) 0
d) 20
e) 5
Ans: a Chp. sec.: 1 b Difficulty: moderate Topic: choices for individual producers Type: conceptual

39. According to Table 1.2 if Anne spent all her time cooking, how many meals would she be able to prepare per day?
a) 20
b) 2
c) 4
d) 40
e) 5
Ans: a Chp. sec.: 1 b Difficulty: moderate Topic: choices for individual producers Type: conceptual

40. According to Table 1.2, if Anne and Sam each worked separately, how many meals per day would be served by each of them?
a) 40
b) 4
c) 2
d) 20
e) 5
Ans: b Chp. sec.: 1 b Difficulty: challenging Topic: choices for individual producers Type: conceptual

41. According to Table 1.2 if Anne and Sam join forces, with Anne doing all the cooking and Sam doing all the serving, the number of customers served per day would be
    a) 40.
    b) 4.
    c) 20.
    d) 8.
    e) 5.
    Ans: c Chp. sec.: 1 b 1 Difficulty: moderate Topic: gains from trade Type: conceptual

42. According to Table 1.2, if Anne and Sam joined forces, the number of meals served would increase by
    a) 8.
    b) 20.
    c) 12.
    d) 4.
    e) 5.
    Ans: c Chp. sec.: 1 b 1 Difficulty: challenging Topic: gains from trade Type: conceptual

43. _____ must exist in order for gains from trade to be realized.
    a) Governments
    b) Markets
    c) Households
    d) Interaction
    e) Firms
    Ans: d Chp. sec.: 1 b 1 Difficulty: moderate Topic: gains from trade Type: factual

44. As a result of economic interaction,
    a) the number of available choices is reduced.
    b) scarcity is increased.
    c) opportunity costs increase.
    d) people are able to specialize.
    e) scarcity is eliminated.
    Ans: d Chp. sec.: 1 b 2 Difficulty: basic Topic: specialization Type: factual

45. The division of labor enables
    a) the augmentation of scarcity.
    b) the elimination of scarcity.
    c) opportunity costs.
    d) economic interaction.
    e) specialization.
    Ans: e Chp. sec.: 1 b 2 Difficulty: basic Topic: division of labor Type: factual

46. Production can be increased whenever people
    a) engage in activities with a high opportunity cost.
    b) specialize in whichever field they have a comparative advantage in.
    c) specialize in whatever interests them.
    d) choose to interact.
    e) make decisions.
    Ans: b Chp. sec.: 1 b 2 Difficulty: moderate Topic: comparative advantage Type: factual

47. If an individual is able to produce a good with relatively less time, effort, or resources than somebody else, then that individual has
    a) avoided opportunity costs.
    b) an interaction advantage.
    c) cornered the market.
    d) removed scarcity.
    e) a comparative advantage.
    Ans: e Chp. sec.: 1 b 2 Difficulty: moderate Topic: comparative advantage Type: conceptual

Use the following to answer question 48:

Table 1.3

John		Jack	
Candy Bars	Ice Cream Bars	Candy Bars	Ice Cream Bars
0	16	0	6
1	12	1	4
2	8	2	2
3	0	3	0

48. Refer to Table 1.3. Suppose John and Jack can produce the above combinations of candy bars and ice cream bars in one hour. John and Jack can maximize their total production if
    a) both produce candy bars.
    b) both produce ice cream bars.
    c) John produces both candy bars and ice cream bars, while Jack produces nothing.
    d) Jack produces both candy bars and ice cream bars, while John produces nothing.
    e) each of them produces what he has a comparative advantage in producing.
    Ans: e 6th edition: yes Chp. sec.: 1 b 2 Difficulty: moderate
    Topic: comparative advantage Type: conceptual

49. When people specialize in the activity in which they have a comparative advantage,
    a) there cannot be a division of labor, though production will increase.
    b) there will likely be a division of labor as well as an increase in output.
    c) there will be a gain from trade, but production will not be increased.
    d) there will likely be a division of labor, and output will stay the same.
    e) there will likely be a division of labor, and output will decline.
    Ans: b Chp. sec.: 1 b 3 Difficulty: moderate Topic: division of labor Type: factual

50. T F The goods individual producers specialize in are determined by absolute advantage.
    Ans: False Chp. sec.: 1 b 1 Difficulty: moderate Topic: choices for individual producers
    Type: factual

51. T F Trade enables people to specialize in activities in which they have a comparative advantage.
    Ans: True Chp. sec.: 1 b 2 Difficulty: moderate Topic: specialization Type: factual

52. T F A division of labor occurs when some workers do all tasks while others do nothing.
    Ans: False Chp. sec.: 1 b 3 Difficulty: basic Topic: division of labor Type: factual

53. T F It is impossible for two people to increase their total production if one has a comparative advantage in the production of one particular good.
    Ans: False 6th edition: yes Chp. sec.: 1 b 2 Difficulty: moderate
    Topic: comparative advantage Type: conceptual

54. Which of the following statements is *true*?
    a) There are no gains from trade between people in different countries because, with international trade, it's the countries that trade, and not its people, that realize the gains.
    b) Trade between people in different countries cannot occur.
    c) Trade between people in different countries can occur, but it will not result in an increase in consumer satisfaction.
    d) Trade between people in different countries can occur, but it will not lead them to better utilize their comparative advantage.
    e) Trade between people in different countries can occur, and the gains that occur are the same as the gains from trade within a country.
    Ans: e Chp. sec.: 1 c Difficulty: moderate Topic: international trade Type: factual

55. A country trades with other countries because
    a) it can gain in production and consumption.
    b) it wants to improve foreign relations.
    c) its government can earn taxes on imported goods.
    d) it has an excess production capacity.
    e) its residents always prefer imported goods to domestic goods.
    Ans: a Chp. sec.: 1 c Difficulty: basic Topic: international trade Type: factual

56. T F Trade always results in a gain for one or both participants.
    Ans: True Chp. sec.: 1 c Difficulty: basic Topic: international trade Type: factual

57. T F International trade exists only when a country can gain a trade advantage over another country.
    Ans: False Chp. sec.: 1 c Difficulty: basic Topic: international trade Type: factual

58. At its essence, what is economics the study of?
    Ans: Economics is the study of choices made when there is scarcity, as well as the interaction between people when they make these choices. Chp. sec.: preview Difficulty: basic Topic: economics Type: factual

59. What is the relationship among economic interaction, specialization, comparative advantage, and gains from trade?
    Ans: Economic interaction enables people to exchange their goods and services. People can then specialize in whichever area they are most proficient. As a result, there is a division of labor. If this specialization results in each of them producing one good or service with fewer resources than the others, then each person who specializes has a comparative advantage in that task. This enables production to occur more efficiently, which means more will be produced. Chp. sec.: 1 b 1 Difficulty: moderate Topic: gains from trade Type: conceptual

60. Explain how trade between two different countries is similar to trade occurring within a country.
    Ans: Trade between two countries is similar to trade within a country because it enables people either to better satisfy their preferences for goods by trading or to better utilize their comparative advantage. Chp. sec.: 1 c Difficulty: moderate Topic: international trade Type: conceptual

61. Why is it reasonable to assume that when trade is voluntary, those involved in the trade will gain?
    Ans: As long as the decision to trade is voluntary, it would not be rational for individuals to engage in trade unless the lives of those engaged in the exchange were somehow enhanced. Otherwise, they would not engage in trade. Chp. sec.: 1 a 2 Difficulty: basic Topic: gains from trade Type: conceptual

62. What is meant by a division of labor, and why is this a reason for economic interaction?
    Ans: A division of labor occurs when different workers specialize in different tasks. If workers produce the goods for which they have a comparative advantage, this specialization increases the gains from interaction. Chp. sec.: 1 b 2 Difficulty: basic Topic: division of labor Type: conceptual

63. What is meant by comparative advantage?
    Ans: An individual or a group has a comparative advantage in producing one good relative to another if it can produce it more efficiently (i.e., with less time, resources, or effort) than another individual or group. Chp. sec.: 1 b 2 Difficulty: moderate Topic: comparative advantage Type: factual

64. After purchasing a quart of milk from a convenience store, John complains that the store ripped him off because it charged too much for the milk. Comment.
    Ans: If John purchased the milk on a voluntary basis (in other words, nobody forced him to purchase the milk from the store), then the exchange of his money for the quart of milk had to be to his advantage. Otherwise, he would not have made the purchase. Chp. sec.: 1 a 2 Difficulty: challenging Topic: gains from trade Type: conceptual

65. Table 1.4 depicts the choices George and Sarah face when deciding whether to cook, wait on tables, or both.

Table 1.4

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

a. In which area, if any, does Sarah have a comparative advantage? In which area does George have a comparative advantage?
b. If George and Sarah do not get together, how many customers will be served?
c. If George and Sarah do get together, how many customers will be served? What will be the gain resulting from this exchange?

Ans:
a. Sarah has a comparative advantage in waiting tables. George has a comparative advantage in cooking.
b. A total of 10 customers will be served.
c. Twenty-five customers will be served. The net gain from this exchange of services is 15 more meals being served.
Chp. sec.: 1 b 1 Difficulty: challenging Topic: gains from trade Type: conceptual

Scarcity and Choice for the Economy as a Whole

66. Which of the following is *not* considered to be scarce for an economy as a whole?
a) Money
b) Workers
c) Land
d) Machinery
e) Factories
Ans: a Chp. sec.: 2 Difficulty: moderate Topic: resources Type: factual

67. Choices are made whenever
a) money is limited.
b) there are too many alternatives.
c) resources are limited relative to human wants.
d) the society has abundant resources.
e) different people in an economy want different things.
Ans: c Chp. sec.: 2 Difficulty: moderate Topic: scarcity Type: factual

68. T F Choices are necessary only for individuals but not for the economy as a whole.
Ans: False Chp. sec.: 2 Difficulty: moderate Topic: choice Type: factual

69. If available resources are being used efficiently,
    a) a society can increase the production of one good or service only by decreasing the production of some other good or service.
    b) society need no longer worry about tradeoffs.
    c) a society can increase the production of one good or service only by increasing the production of some other good or service.
    d) resources are no longer limited.
    e) scarcity is no longer a problem.
    Ans: a Chp. sec.: 2 a Difficulty: moderate Topic: production possibilities Type: conceptual

70. Suppose that an economy produces only two goods: computers and movies. If the economy at all times utilizes all its resources, and it decides to use more of its available resources to produce computers,
    a) the production of movies will drop.
    b) the production of both movies and computers will drop.
    c) the production of movies will rise.
    d) the production of movies will not change but the production of computers will increase.
    e) then will be no change in the production of either computers or movies.
    Ans: a 6th edition: yes Chp. sec.: 2 a Difficulty: moderate Topic: production possibilities Type: conceptual

71. Josie has two classes: English and math. She finds out that the grades for both classes has improved without spending more time studying. Using the production possibilities curve, Josie's situation can be represented by
    a) moving from a point on the production possibilities curve to a point inside the curve.
    b) a movement along the curve from the axis for English to the axis for math.
    c) a movement along the curve from the axis for math to the axis for English.
    d) an inward shift of the curve.
    e) an outward shift of the curve.
    Ans: e 6th edition: yes Chp. sec.: 2 a Difficulty: moderate Topic: production possibilities curve Type: conceptual

72. T F The production possibilities curve shows how an economy increases its output with more resources.
    Ans: False Chp. sec.: 2 a Difficulty: moderate Topic: production possibilities Type: conceptual

73. Which of the following does a production possibilities schedule best illustrate?
    a) The concept of achieving an impossible goal
    b) The concept of unlimited possibilities
    c) The concept of an opportunity cost
    d) The elimination of scarcity
    e) The concept of a good
    Ans: c Chp. sec.: 2 b Difficulty: basic Topic: opportunity cost Type: factual

74. If an economy produces only movies and computers, then the opportunity cost of producing more movies is
    a) the value of forgone computer production.
    b) the value of more computer production.
    c) the value of movie production minus the value of computer production
    d) the total value of movie and computer production.
    e) zero because computers and movies are unrelated.
    Ans: a 6th edition: yes Chp. sec.: 2 b Difficulty: basic Topic: opportunity cost Type: factual

75. If an economy produces only movies and computers, then producing more and more computers will most likely require
    a) giving up a decreasing amount of the production of movies.
    b) giving up an increasing amount of the production of movies.
    c) gaining an increasing amount of the production of movies.
    d) gaining a decreasing amount of the production of movies.
    e) no change in movie production.
    Ans: b 6th edition: yes Chp. sec.: 2 b Difficulty: moderate Topic: opportunity cost Type: factual

Use the following to answer questions 76-77:

Table 1.5

Production Possibilities for Computers and TV Sets

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

76. Refer to Table 1.5. The opportunity cost of producing the first television set is
    a) 15 units of computers.
    b) 5 units of computers.
    c) 43 units of computers.
    d) 42 units of computers.
    e) 1 unit of computers.
    Ans: e Chp. sec.: 2 b Difficulty: moderate Topic: opportunity cost Type: conceptual

77. Refer to Table 1.5. The opportunity cost of producing the sixth television set is
    a) 15 units of computers.
    b) 5 units of computers.
    c) 43 units of computers.
    d) 42 units of computers.
    e) 1 unit of computers.
    Ans: a Chp. sec.: 2 b Difficulty: moderate Topic: opportunity cost Type: conceptual

78. T F The typical production possibilities schedule shows that the opportunity cost for producing more of one good requires giving up an increasing amount of production of another good.
    Ans: True Chp. sec.: 2 b Difficulty: moderate Topic: opportunity cost Type: conceptual

Use the following to answer question 79:

Table 1.5

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

79. Refer to Table 1.5. The production possibilities curve representing the given schedule would be a
    a) negatively sloped curve that bows outward.
    b) negatively sloped straight line.
    c) positively sloped curve that bows outward.
    d) positively sloped curve that bows inward.
    e) positively sloped straight line.
    Ans: a Chp. sec.: 2 c Difficulty: moderate Topic: production possibilities curve Type: conceptual

80. A production possibilities curve shows
    a) what happens to the amount of available resources if it is not possible to produce a good.
    b) what can be produced with unlimited resources.
    c) what happens as available resources in an economy are moved from producing one type of good to another type, or vice versa.
    d) the choice between producing some goods versus other goods with unlimited resources.
    e) the different kinds of products that a firm can produce.
    Ans: c Chp. sec.: 2 c Difficulty: moderate Topic: production possibilities curve Type: factual

81. When an economy is operating on its production possibilities curve, more production of one good means less production of another because
    a) wants are unlimited.
    b) resources are limited.
    c) some resources are not employed.
    d) wants are limited.
    e) resources are not perfectly adaptable to alternative uses.
    Ans: b Chp. sec.: 2 c Difficulty: moderate Topic: production possibilities curve Type: conceptual

82. Which of the following is held constant when constructing a production possibilities curve for the economy?
    a) The opportunity cost
    b) The price level
    c) The amount of resources
    d) The combination of goods produced
    e) The amount of goods produced
    Ans: c Chp. sec.: 2 c Difficulty: moderate Topic: production possibilities curve Type: factual

83. A point lying inside the production possibilities curve
    a) indicates that resources are not being fully or efficiently used.
    b) illustrates resources being used to their fullest potential.
    c) requires more resources than are presently available.
    d) represents an increase in resources.
    e) is not an attainable combination.
    Ans: a Chp. sec.: 2 c 1 Difficulty: basic Topic: inefficient points Type: factual

84. Given a production possibilities curve for defense goods and nondefense goods, if a nation is producing at a point inside the production possibilities curve, then
    a) too many resources are being used for nondefense goods.
    b) only new technology will increase the production of defense or nondefense goods.
    c) too many resources are being used for defense goods.
    d) society is maximizing output from the limited number of resources.
    e) it is possible to increase defense goods production without sacrificing nondefense goods production.
    Ans: e Chp. sec.: 2 c 1 Difficulty: moderate Topic: inefficient points Type: conceptual

85. Inefficient use of a nation's resources would
    a) be depicted as a point inside or below a production possibilities curve.
    b) be depicted as a point on a production possibilities curve.
    c) shift a production possibilities curve outward.
    d) cause the economy's production possibilities curve to bow inward.
    e) be depicted as a point outside or above a production possibilities curve.
    Ans: a Chp. sec.: 2 c 1 Difficulty: basic Topic: inefficient points Type: factual

86. Given a production possibilities curve for defense goods and nondefense goods, a production point outside the curve
    a) cannot be attained with the current level of resources and technology.
    b) may be attained by shifting resources to defense goods.
    c) may be attained by acquiring new technology.
    d) may be attained if new resources are discovered.
    e) may be attained by acquiring both new technology and greater resources.
    Ans: b Chp. sec.: 2 c 1 Difficulty: moderate Topic: points outside the curve Type: factual

87. If a new labor-saving technology is discovered,
    a) the production possibilities curve remains unchanged.
    b) the production possibilities curve shifts inward.
    c) there is movement along the production possibilities curve.
    d) society does not face a new set of tradeoffs.
    e) points that were previously unattainable to society may now be attainable.
    Ans: e Chp. sec.: 2 c 2 Difficulty: moderate Topic: growth and the production possibilities curve Type: factual

Use the following to answer questions 88-89:

Table 1.5

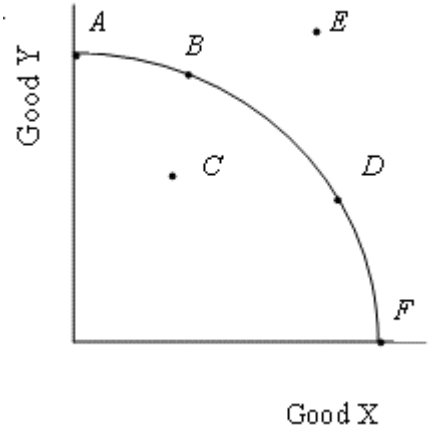
Production Possibilities for Computers and TV Sets		
Combination	Computers	TV Sets
A	0	6
B	15	5
C	25	4
D	33	3
E	39	2
F	42	1
G	43	0

88. Refer to the production possibilities schedule in Table 1.5. A combination of 20 units of computers and 2 television sets
    a) requires an infusion of technological know-how.
    b) illustrates underemployment of resources.
    c) is possible only with full and efficient use of all resources.
    d) is unattainable because it requires resources that are not available.
    e) cannot be produced with the current supply of resources.
    Ans: b Chp. sec.: 2 c 1 Difficulty: challenging Topic: inefficient points Type: conceptual

89. Refer to the production possibilities schedule in Table 1.5. A combination of 40 units of computers and 4 television sets
    a) cannot be produced with the current supply of resources.
    b) is possible only with full and efficient use of all resources.
    c) has never been and never will be produced.
    d) illustrates underemployment of resources.
    e) will not satisfy the consumers' demands.
    Ans: a Chp. sec.: 2 c 1 Difficulty: challenging Topic: impossible points Type: conceptual

Use the following to answer questions 90-94:

Figure 1.1



90. Refer to Figure 1.1. A movement from Point *B* to Point *D* indicates
    a) a gain in Good X and a loss in Good Y.
    b) a gain in Good Y and a loss in Good X.
    c) a gain in both Good X and Good Y.
    d) a loss in both Good X and Good Y.
    e) no change in the production of Good X or Good Y.
    Ans: a Chp. sec.: 2 c 1 Difficulty: moderate Topic: production possibilities curve
    Type: conceptual

91. Refer to Figure 1.1. The production possibilities curve indicates that
    a) it is possible to produce more of one good without sacrificing some of the other good only if production occurs at a point inside the production possibilities curve.
    b) Good X is an input in the production of Good Y.
    c) producing an additional unit of Good X requires producing an additional unit of Good Y.
    d) more resources exist than the economy can efficiently use.
    e) the economy is experiencing decreasing opportunity costs.
    Ans: a Chp. sec.: 2 c 1 Difficulty: moderate Topic: production possibilities curve
    Type: conceptual

92. Refer to Figure 1.1. Assume the economy is operating at Point *C*. This indicates that
    a) the only way the economy could move toward a point such as *D* is by discovering new resources.
    b) the economy is efficiently using all its resources.
    c) there is no excess resource capacity in the economy.
    d) it is possible for the economy to produce more of Good X and Good Y with the given resources.
    e) it is possible for the economy to produce more of Good X only if it produces less of Good Y.
    Ans: d Chp. sec.: 2 c 1 Difficulty: moderate Topic: production possibilities curve
    Type: conceptual

93. Refer to Figure 1.1. Point *C*
    a) occurs when resources are not efficiently allocated.
    b) may be attained with a sufficient improvement in technology.
    c) can be obtained with existing resources.
    d) is impossible to attain, even in the future.
    e) shows the most efficient use of valuable resources.
    Ans: a Chp. sec.: 2 c 2 Difficulty: moderate Topic: production possibilities curve
    Type: conceptual

94. Refer to Figure 1.1. Point *E*
    a) occurs when resources are not efficiently allocated.
    b) may be attained with a sufficient improvement in technology.
    c) can be attained with existing resources.
    d) is impossible to attain, even in the future.
    e) shows the most efficient use of valuable resources.
    Ans: b Chp. sec.: 2 c 2 Difficulty: moderate Topic: shifts in production possibilities curve
    Type: conceptual

Use the following to answer questions 95-96:

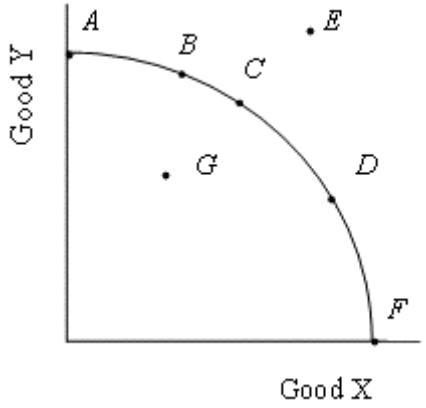


Figure 1.2

95. Refer to Figure 1.2. The optimal point for the economy is
    a) *D*.
    b) *C*.
    c) *B*.
    d) *E*.
    e) impossible to determine from the given information.
    Ans: e Chp. sec.: 2 c 1 Difficulty: challenging Topic: production possibilities curve Type: conceptual

96. Refer to Figure 1.2. Point *C* is more efficient than Point
    a) *A*.
    b) *B*.
    c) *D*.
    d) *E*.
    e) *G*.
    Ans: e Chp. sec.: 2 c 1 Difficulty: moderate Topic: production possibilities curve Type: conceptual

97. If society begins by producing 3 units of X and 4 units of Y and then alters production so that it is now producing 4 units of X and 4 units of Y, and we know that the quantity and quality of resources were unchanged and that technology did not change, then
    a) society has moved along the production possibilities curve.
    b) the combination of 3 units of X and 4 units of Y are best represented by a point inside the production possibilities curve.
    c) the combination of 3 units of X and 4 units of Y are best represented by a point outside the production possibilities curve.
    d) resources were being fully utilized at 3 units of X and 4 units of Y.
    e) resources were being efficiently utilized at 3 units of X and 4 units of Y.
    Ans: b Chp. sec.: 2 c 1 Difficulty: moderate Topic: production possibilities curve Type: factual

98. A point outside the production possibilities curve
    a) represents inefficient use of resources.
    b) may be due to unemployment.
    c) represents more resources than are currently available.
    d) is attainable if all resources are used efficiently.
    e) is not attainable regardless of the amount of resources.
    Ans: c Chp. sec.: 2 c 1 Difficulty: basic Topic: production possibilities curve Type: factual

99. Economic growth can be shown by
    a) a shift of the production possibilities curve outward.
    b) a point inside the production possibilities curve.
    c) movement along the production possibilities curve.
    d) a shift of the production possibilities curve inward.
    e) changing the shape of the production possibilities curve.
    Ans: a Chp. sec.: 2 c 2 Difficulty: moderate Topic: shifts in production possibilities curve Type: conceptual

100. For an economy to attain what is currently impossible is
    a) a problem involving choice and scarcity, the choice being between current consumption and investment.
    b) an economic problem but is never taken seriously.
    c) an economic problem of supply and demand.
    d) not an economic problem because one cannot choose something that does not exist.
    e) not an economic problem because future production is not a viable alternative to current production.
    Ans: a Chp. sec.: 2 c 3 Difficulty: moderate Topic: economic progress Type: conceptual

Use the following to answer questions 101-105:

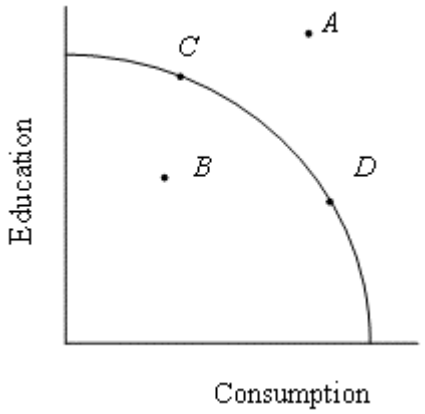


Figure 1.3

101. Refer to Figure 1.3. The attainment of Point *A* in the future
    a) is more likely to occur if the economy chooses more education.
    b) can occur, but why it can is not understood.
    c) is impossible.
    d) is more likely to occur if the economy initially moves to Point *B* to conserve resources.
    e) is more likely to occur if the economy chooses more consumption.
    Ans: a Chp. sec.: 2 c 3 Difficulty: moderate Topic: economic progress Type: factual

102. Refer to Figure 1.3. Which of the following is more likely to lead to the economy's attainment of Point *A*?
    a) A decrease in education expenditures
    b) Increased consumption
    c) An increase in the working-age population
    d) A depletion of resources
    e) None of the above because Point *A* is impossible to attain
    Ans: c Chp. sec.: 2 c 3 Difficulty: moderate Topic: economic progress Type: factual

103. Refer to Figure 1.3. Suppose the amount of energy available to the economy declines. Which of the following is the most likely to happen?
a) A movement from Point *D* to Point *C* along the curve
b) A movement from Point *C* to Point *D* along the curve
c) A shift to Point *B*
d) A shift to Point *A*
e) A shift from Point *A* to Point *B*
Ans: c Chp. sec.: 2 c 2 Difficulty: moderate Topic: shifts in production possibilities curve Type: conceptual

104. Refer to Figure 1.3. If the economy depicted is at Point *B*, then
a) more consumption can be produced, but at the expense of education.
b) any further increase in education will involve a decrease in consumption.
c) any further increase in consumption will involve a decrease in education.
d) any further increase in either consumption or education will benefit everyone.
e) any further increase in either consumption or education will hurt everyone.
Ans: d Chp. sec.: 2 c 3 Difficulty: moderate Topic: economic progress Type: conceptual

105. Refer to Figure 1.3. The tradeoff that will enable the economy to reach Point *A* from anywhere along the curve
a) will be either a win-win or lose-lose situation.
b) occurs when everyone can win.
c) cannot occur.
d) occurs when some people win only if others lose.
e) occurs when everyone loses.
Ans: b Chp. sec.: 2 c 3 Difficulty: moderate Topic: economic growth Type: conceptual

106. T F Any point on the production possibilities curve represents the fact that resources are efficiently allocated.
Ans: True Chp. sec.: 2 c 3 Difficulty: moderate Topic: production possibilities curve Type: conceptual

107. T F Moving from a point on the production possibilities curve to another point on the same curve implies a gain in production efficiency.
Ans: False Chp. sec.: 2 c 3 Difficulty: moderate Topic: production possibilities curve Type: conceptual

108. T F The production possibilities curve is immovable.
Ans: False Chp. sec.: 2 c 3 Difficulty: moderate Topic: growth Type: factual

109. T F Economic growth in the future can be encouraged by tradeoffs made today.
Ans: True Chp. sec.: 2 c 3 Difficulty: moderate Topic: growth Type: conceptual

110. T F The movement from a point inside a production possibilities curve to a point outside the curve is likely to result in no change in an economy's total production.
Ans: False Chp. sec.: 2 c 3 Difficulty: moderate Topic: growth Type: conceptual

111. What explains the occurrence of increasing opportunity costs?
Ans: Increasing opportunity costs occur because resources are better suited for one type of production compared to another. Chp. sec.: 2 b Difficulty: moderate Topic: opportunity cost Type: factual

112. Does the production possibilities curve represent the economy in which some people win only if others lose? Explain.
Ans: There are two reasons why the production possibilities curve does not necessarily mean some people win only if others lose. First, if the production possibilities curve shifts outward, then it is possible to produce more of both goods. In addition, if the economy is producing in the inefficient region, then more of both goods can be produced if the economy becomes more efficient. Chp. sec.: 2 c 3 Difficulty: challenging Topic: economic progress Type: conceptual

113. Is it possible for an economy to make tradeoffs in the present in order to attain what is currently unattainable? Explain.
Ans: Yes, it is possible for an economy to make tradeoffs today in order to attain what is currently unattainable. If an economy wants to grow, it might want to increase output of machinery and/or education at the expense of current consumption in order to have more resources in the future. Chp. sec.: 2 c 3
Difficulty: moderate Topic: economic progress Type: factual

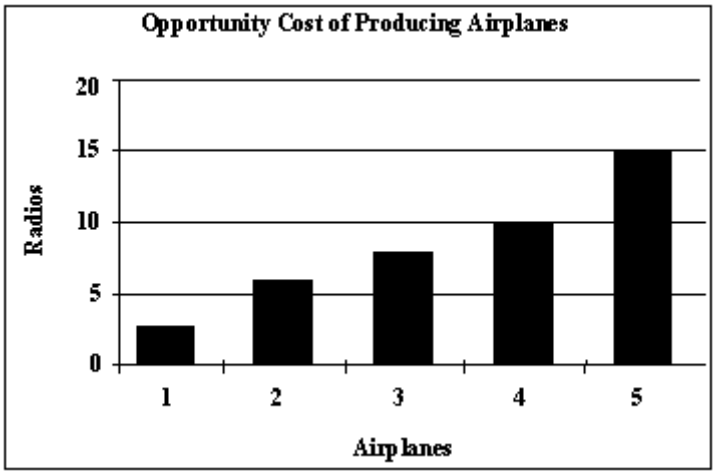
114. Suppose an economy can produce either radios or airplanes. The production possibilities for this economy are shown in Table 1.6 Show that this production possibilities schedule depicts increasing opportunity costs.

Table 1.6

Production Possibilities for Radios and Airplanes

Combination	Radios	Airplanes
A	0	5
B	15	4
C	25	3
D	33	2
E	39	1
F	42	0

Ans: A chart such as the one below shows that for each additional airplane produced, the amount of radios that needs to be given up increases as airplane production increases. Figure



1.4 Chp. sec.: 2 b
Difficulty: moderate Topic: opportunity cost Type: conceptual

115. Using the information in Table 1.6, draw a production possibilities curve.

Table 1.6

Production Possibilities for Radios and Airplanes

Combination	Radios	Airplanes
A	0	5
B	15	4
C	25	3
D	33	2
E	39	1
F	42	0

a. With this graph, depict the point that would show the combination of 30 radios and 1 airplane.

b. With this graph, depict the point that would show the combination of 25 radios and 5 airplanes.

c. With this graph, depict the point that would show the combination of 25 radios and 3 airplanes.

Ans: A production possibilities curve that is bowed out should be drawn. The answer to part a should show a point inside the curve. The answer to part b should show a point outside the curve. The answer to part c should show a point along the curve. Chp. sec.: 2 c 1 Difficulty: moderate
Topic: production possibilities curve Type: conceptual

Market Economies and the Price System

116. The three essential questions that every economy must solve are
a) what, how many, and for whom?
b) how, what, and where?
c) what, how, and for whom?
d) what, how much, and for whom?
e) where, how, and for whom?
Ans: c Chp. sec.: 3 a Difficulty: basic Topic: three essential questions Type: factual

117. In a pure market economy, the what, how, and for whom problems are determined by
a) consumers only.
b) firms only.
c) the government.
d) both consumers and firms.
e) no one.
Ans: d 6th edition: yes Chp. sec.: 3 a Difficulty: basic Topic: market economies
Type: factual

118. In a command economy, the what, how, and for whom problems are determined by
a) consumers.
b) firms.
c) the government.
d) both consumers and firms.
e) markets.
Ans: c 6th edition: yes Chp. sec.: 3 a Difficulty: basic Topic: command economy
Type: factual

119. Which of the following statements is *false*?
    a) In a centrally planned economy, decisions concerning the three essential questions are made by those who control the government.
    b) In a market economy, firms do not interact with consumers.
    c) The two alternative approaches to the three essential questions are market economies and command economies.
    d) In a market economy, decisions concerning the three essential questions result from interactions taking place in markets.
    e) In both centrally planned and market economies, the three essential economic questions are what, how, and for whom.
    Ans: b Chp. sec.: 3 a Difficulty: moderate Topic: market vs. command economy Type: factual

120. The key elements of a market economy include all of the following *except*
    a) freely determined prices.
    b) property rights.
    c) freedom to trade at home.
    d) freedom to trade abroad.
    e) strong government intervention.
    Ans: e 6th edition: yes Chp. sec.: 3 b 4 Difficulty: moderate Topic: role of government Type: factual

121. In a market economy, prices are
    a) mainly transfer prices.
    b) mainly government-determined transfer prices.
    c) determined by the government.
    d) freely determined.
    e) determined solely by firms and not by consumers.
    Ans: d Chp. sec.: 3 b 1 Difficulty: basic Topic: market price Type: factual

122. When a country like North Korea is characterized as a command economy, it's because most prices are
    a) determined in the market, and they usually lead to market failures.
    b) set by the government, which usually leads to inefficiencies.
    c) determined in the market, and they result in efficient outcomes.
    d) set by the government, and they result in efficient outcomes.
    e) determined in the market, and they usually lead to inefficiencies.
    Ans: b Chp. sec.: 3 b 1 Difficulty: moderate Topic: price determination Type: factual

123. Establishing property rights
    a) is a characteristic of most centrally planned economies.
    b) provides incentives.
    c) is not important in a market economy but is an important feature in a centrally planned economy.
    d) is not important in a market economy.
    e) is another name for eminent domain.
    Ans: b Chp. sec.: 3 b 2 Difficulty: basic Topic: property rights Type: factual

124. Without property rights,
    a) people would have more of an incentive to specialize, and the economy would become more efficient.
    b) there would be more inventions.
    c) people would not have an incentive to specialize.
    d) a market economy would become more efficient.
    e) people would have more of an incentive to specialize.
    Ans: c Chp. sec.: 3 b 2 Difficulty: moderate Topic: property rights Type: conceptual

125. Foreign trade
    a) benefits only small countries that cannot produce everything.
    b) benefits only large countries that have a comparative advantage in producing everything.
    c) can benefit no country.
    d) can benefit small or large countries.
    e) benefits only small countries that have a comparative disadvantage.
    Ans: d Chp. sec.: 3 b 3 Difficulty: basic Topic: foreign trade Type: conceptual

126. Market failure
    a) caused the collapse of centrally planned economies in Eastern Europe.
    b) is the consequence of government involvement in the economy.
    c) is something that never happens in a market economy.
    d) occurs when the market is unable to allocate resources correctly.
    e) occurs only when supply exceeds demand.
    Ans: d Chp. sec.: 3 b 4 Difficulty: basic Topic: market failure Type: factual

127. The role of government in a market system
    a) includes encouraging market failures.
    b) does not exist.
    c) is restricted to establishing property rights.
    d) includes improving situations that would otherwise result in a government failure.
    e) includes improving situations that would otherwise result in a market failure.
    Ans: e Chp. sec.: 3 b 4 Difficulty: moderate Topic: role of government Type: conceptual

128. A government failure results when
    a) the government allows a market failure to occur.
    b) the government establishes property rights.
    c) the market economy does not provide good answers to the three questions.
    d) government intervention is unable to correct a market failure.
    e) the government intervenes in a market economy.
    Ans: d Chp. sec.: 3 b 4 Difficulty: moderate Topic: government failure Type: factual

129. Transaction costs are the costs of
    a) bribing government officials.
    b) buying and selling in a market.
    c) doing something within an organization.
    d) avoiding any economic interactions.
    e) producing a product instead of buying it from someone else.
    Ans: b 6th edition: yes Chp. sec.: 3 b 5 Difficulty: basic Topic: transaction costs Type: factual

130. Economic interaction occurs in firms as opposed to markets
    a) because markets are too competitive.
    b) because this is what the government wants.
    c) in order to lower transaction costs.
    d) in order to increase transaction costs.
    e) if workers want to increase wages but not product prices.
    Ans: c Chp. sec.: 3 b 5 Difficulty: moderate Topic: transaction costs Type: factual

131. T F The degree of competition varies among market economies.
    Ans: True Chp. sec.: 3 b 1 Difficulty: basic Topic: competition Type: factual

132. T F Command economies discourage their citizens from purchasing foreign goods.
    Ans: True Chp. sec.: 3 b 3 Difficulty: basic Topic: foreign trade Type: factual

133. T F There is no legitimate role for government in a market economy.
    Ans: False Chp. sec.: 3 b 4 Difficulty: basic Topic: role of government Type: factual

134. T F The government can improve market conditions in case of a market failure.
Ans: True 6th edition: yes Chp. sec.: 3 b 4 Difficulty: basic Topic: market failure Type: factual

135. T F Property rights are not necessary for a market economy to function.
Ans: False 6th edition: yes Chp. sec.: 3 b 2 Difficulty: moderate Topic: property rights Type: factual

136. T F A centrally planned economy is also called a market economy.
Ans: False 6th edition: yes Chp. sec.: 3 a Difficulty: moderate Topic: market vs. command economy Type: factual

137. What does a market economy use to determine the what is produced, how, and for whom problems?
a) A price system
b) The government
c) An election
d) A tax system
e) Bribery
Ans: a 6th edition: yes Chp. sec.: 3 c Difficulty: basic Topic: signals Type: factual

138. To say that a change in taste causes prices to rise is to claim that
a) transfer prices are a more accurate gauge of economic activity than market prices.
b) prices are a signal.
c) the economy has full information.
d) prices would not change if people did not know the exact reason for the price change.
e) price changes cannot be predicted.
Ans: b Chp. sec.: 3 c 1 Difficulty: moderate Topic: signals Type: conceptual

139. If an increase in the price of lemonade causes more people to sell lemonade, then it can be argued that the price increase
a) acted as a transfer price.
b) caused a redistribution of income.
c) caused a market failure
d) reduced competition.
e) acted as an incentive.
Ans: e Chp. sec.: 3 c 2 Difficulty: moderate Topic: incentives Type: conceptual

140. If an increase in the price of lemonade results in people with lemonade stands having more income, then it can be argued that the price increase
a) acted as an incentive.
b) resulted in a redistribution of income.
c) acted as a transfer price.
d) reduced competition.
e) acted a signal.
Ans: b Chp. sec.: 3 c 3 Difficulty: moderate Topic: income distribution Type: conceptual

Parallel Problems

141. What role do property rights play in a market economy?
Ans: Property rights enable people to keep what they earn and not be overly concerned with what they have being taken away by others. This enables people to allocate more time to production as opposed to protecting what they have. Property rights also provide incentives in the sense that they give people the right to the earnings from their work, as well as making them responsible for whatever losses they may incur in their endeavors. Chp. sec.: 3 b 2 Difficulty: moderate Topic: property rights Type: factual

142. What does a publisher need to take into consideration when deciding whether to set up its own art department or to contract for artwork on its publications?
Ans: The publisher needs to consider transaction costs. These costs are incurred when trying to find a company to do artwork; they also include the cost associated with reaching an agreement on the price.
Chp. sec.: 3 b 5 Difficulty: moderate Topic: transaction costs Type: conceptual

143.
a. What three questions need to be answered to determine the best possible point along an economy's production possibilities curve?
b. What are the two different approaches to answering part (a), and how do these different approaches answer it?

Ans:
a. The three questions that need to be answered are what goods and services are to be produced? how are they to be produced? and for whom are they to be produced?
b. The two different approaches to answering these three questions are a market economy and a command (centrally planned) economy. Answers to these questions in a market economy result from the interaction of firms, consumers, governments, and other organizations in markets. In a command economy, these questions are answered by those who control the government.
Chp. sec.: 3 a Difficulty: challenging Topic: three questions Type: conceptual

144. What is the role of government in a market economy?
Ans: There are three aspects to the government's role in a market economy. The first is to establish property rights. The second concerns addressing market failures. The third pertains to maintaining overall economic stability, such as a stable price level and preventing unemployment from becoming too high.
Chp. sec.: 3 b 4 Difficulty: moderate Topic: the role of government Type: conceptual

145. Sharon has only $30 to spend for her weekend entertainment. She can go to a college football game for $30, or she can go to the movies for $10. Explain the problem of scarcity and choice in this context. What will Sharon consider as she decides whether to go to the football game or the movie?
Ans: The scarcity represented by the limited budget means that Sharon can either go to one football game or to the movies three times, and therefore a choice between them must be made. Sharon will consider how intense her preferences are to see the football game and compare this to the ticket price. She will compare the additional satisfaction per dollar spent on the football game versus going to the movies.
Chp. sec.: Text Problem 1 Difficulty: moderate Topic: opportunity cost Type: conceptual

146. James, a computer genius, who earned $2 million last year while working at a software company, said that he will enroll as an MBA student at Duke University. What is his opportunity cost of earning the graduate MBA degree? How does it compare to your opportunity cost of a year in college?
Ans: One of the opportunity costs of one more year of college is the yearly earnings one has to give up in order to attend college. Therefore, the opportunity cost for James, who has been earning $2 million a year, is higher than the opportunity cost of anyone earning much less. 6th edition: yes
Chp. sec.: Text Problem 2 Difficulty: moderate Topic: opportunity cost Type: conceptual

147. John is a high school student. He has ranked his three options of what he can do during the Christmas school break in the following order: (1) work in a fast-food restaurant full-time and earn $2,000; (2) work in a department store for the first two weeks of the break and earn $1,000, and spend the rest of the break traveling; and (3) work in his father's shoe factory full-time and earn $1,500. What is the opportunity cost of his choice?
Ans: John's first choice is to work full-time in a fast-food restaurant. His next best opportunity is working for part of the Christmas break and traveling for the remainder of the break. Therefore, the opportunity cost of his first choice is the $1,000 he would have received from working in a department store as well as the time he could have used for traveling. Chp. sec.: Text Problem 3 Difficulty: moderate Topic: opportunity cost Type: conceptual

148. Suppose you have two hotdog sausages and your friend has two hotdog buns. Explain how you can both gain from trade. Is this gain from trade through better allocation or greater production?
Ans: You can trade one of your hotdog sausages for one of your friend's hotdog buns. As a result, both you and your friend can gain from the exchange. This gain is through better allocation rather than greater production. 6th edition: yes Chp. sec.: Text Problem 4 Difficulty: moderate Topic: gains from trade Type: conceptual

149. Suppose Ashley and Allison can produce the following combinations of pizza and cakes in a day:

Ashley		Allison	
Pizza	Cakes	Pizza	Cakes
0	5	0	10
1	4	1	8
2	3	2	6
3	2	3	4
4	1	4	2
5	0	5	0

a. If Ashley and Allison are both currently producing 2 pizzas per day, how many cakes are they producing? What is the total production of pizzas and cakes between them?
b. Is there a possibility for increasing production? Why or why not?
c. Suppose that Ashley completely specializes in producing pizzas and Allison completely specializes in producing cakes. What will be the total production of pizzas and cakes?

Ans:
a. Ashley is producing 3 cakes and Allison is producing 6 cakes. Total production will be 4 pizzas and 9 cakes.
b. Gains from trade are possible because they have different comparative advantages and different relative efficiencies in the production of pizzas and cakes.
c. Total production will be 5 pizzas and 10 cakes per day.
Chp. sec.: Text Problem 5 Difficulty: moderate Topic: comparative advantage Type: conceptual

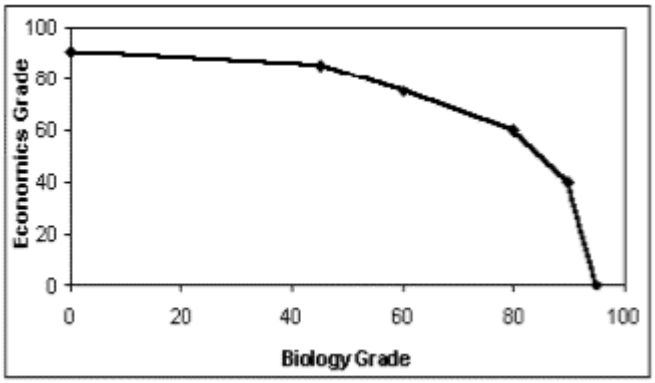
150. Suppose you must divide your time between studying for your biology final and writing a final paper for your economics class. The time and the grades in the two classes are as follows:

Fraction of Time Spent on Biology	Biology Grade	Economics Grade
100	95	0
80	90	40
60	80	60
40	60	75
20	45	85
0	0	90

a. Draw a tradeoff curve for the biology grade versus the economics grade.
b. What is the opportunity cost of increasing the time spent on biology from 60 to 80 percent? What is the opportunity cost of increasing the time spent on economics from 80 to 100 percent?
c. Are there increasing opportunity costs from spending more time on biology? Explain.

Ans:

a. A tradeoff curve for the biology grade versus the economic grade is shown in the following graph.



b. Twenty points on the biology grade; 45 points on the economics grade.
c. There are increasing opportunity costs from spending more time on biology because, as more time is spent on biology, an increasing number of economics points must be given up.

Chp. sec.: Text Problem 6 Difficulty: moderate Topic: tradeoffs Type: conceptual

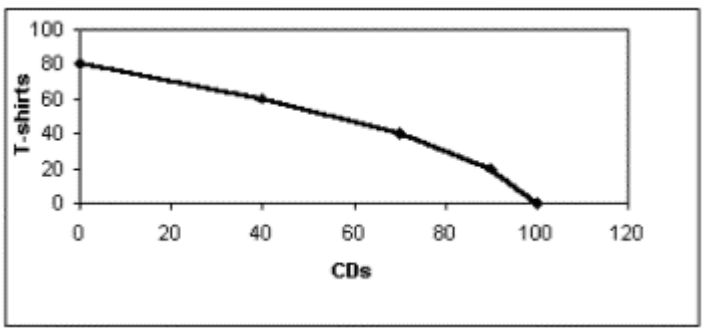
151. A small country produces only two goods, CDs and T-shirts. Given its limited resources, this country has the following production possibilities:

CDs	T-shirts
0	80
40	60
70	40
90	20
100	0

a. Draw the production possibilities curve.
b. Suppose this country improves its technology for producing CDs, but technology remains the same for the production of T-shirts. What happens to the production possibility curve? How does this change affect the opportunity cost of increasing T-shirt production?

Ans:

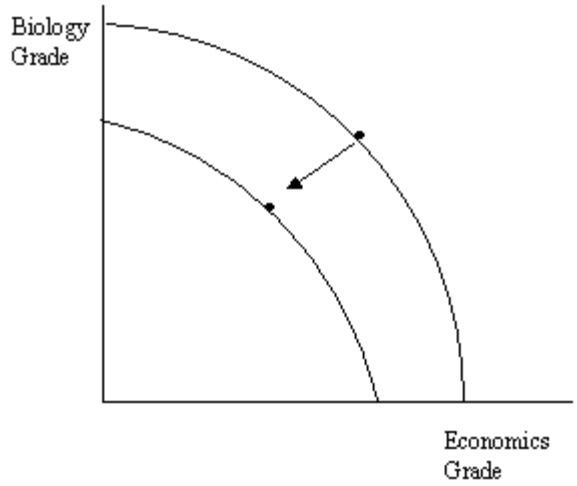
a.



b. The production possibilities curve shifts out in the direction of CDs, but the total quantity of T-shirts that can be produced remains the same. This change causes the production possibilities curve to be flatter when CD production is on the horizontal axis and therefore decreases the opportunity cost of increasing CD production.

Chp. sec.: Text Problem 7 Difficulty: moderate Topic: production possibilities curve Type: conceptual

152. Amy's parents tell her that the grades of the two courses (biology and economics) she takes will decline if she chooses to work a full-time job while going to college. How might this be possible? How would you represent this situation graphically using the production possibilities curve?
Ans: It is possible for Amy to have a lower grade in both biology and economics if she spends more time working and less time studying both subjects. This can be represented by a shift of the production possibilities curve inward.



Chp. sec.: Text Problem 8 Difficulty: moderate Topic: production possibilities curve Type: conceptual

153. Suppose increased production of CD players in Asia causes the price of CD players to decline all over the world. Explain how this change in price signals information to U.S. producers, provides incentives to U.S. producers, and affects the distribution of income.
Ans: A decrease in the price of CD players signals U.S. producers that CD players are now less scarce. A lower price decreases profits, thereby providing incentives for U.S. producers to produce fewer CD players. It also redistributes income away from U.S. producers and toward consumers.
Chp. sec.: Text Problem 9 Difficulty: moderate Topic: price signals Type: conceptual

154. Explain how a market economy works to enable the production and allocation of surfboards.
Ans: Prices in the surfboard market are free to vary, people have property rights to the surfboards they buy, many people sell surfboards, the government does not regulate the use of surfboards, and surfboard production takes place within firms with many workers. A higher price, for instance, will allocate surfboards to the serious surfers and away from the casual surfers. Chp. sec.: Text Problem 10 Difficulty: moderate Topic: market economies Type: conceptual

CHAPTER 2

Observing and Explaining the Economy

What Do Economists Do?

1. All of the following are what economists commonly do *except*
   a) describing economic events.
   b) explaining why economic events occur.
   c) making predictions for some economic events.
   d) eliminating scarcity in resources.
   e) making recommendations for economic policy.
   Ans: d 6th edition: yes Chp. sec.: 1 Difficulty: moderate Topic: economics
   Type: factual

2. Which of the following is *not* an economic issue?
   a) Why is college tuition so high?
   b) Why has health-care spending increased faster than the rest of the economy?
   c) How can one earn $1 million without working at all?
   d) How can one reduce the currently high levels of unemployment in Europe?
   e) Why are there so many types of dog food?
   Ans: c 6th edition: yes Chp. sec.: 1 Difficulty: moderate Topic: economics
   Type: factual

3. T F Explaining why gasoline prices have risen in recent years is one example of what economists do.
   Ans: True 6th edition: yes Chp. sec.: 1 Difficulty: basic Topic: economics
   Type: factual

4. To see whether the price of gasoline has risen compared to the prices of other goods and services, one would calculate
   a) gasoline spending divided by spending on all other goods and services.
   b) gasoline spending divided by total consumer spending.
   c) the trend in the price of gasoline.
   d) the price of gasoline divided by the overall price level.
   e) the price of gasoline divided by the rate of inflation.
   Ans: d 6th edition: yes Chp. sec.: 2 Difficulty: basic Topic: relative price
   Type: factual

5. T F The relative price of gasoline has increased since 2000 because we have paid more dollars for each gallon of gasoline.
   Ans: False 6th edition: yes Chp. sec.: 2 Difficulty: moderate Topic: relative price
   Type: factual

6. T F Economic data always give an accurate picture of what affects consumers.
   Ans: False 6th edition: yes Chp. sec.: 2 a Difficulty: basic Topic: data limitations
   Type: factual