

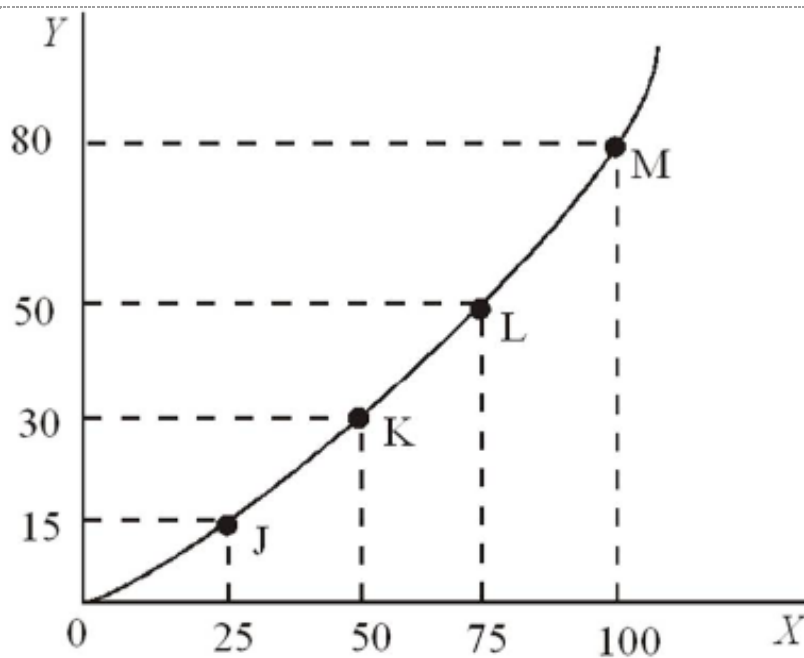
1.

A city's decision to limit smoking in public areas is an example of

- ☐ The invisible hand at work.
- ☐ The market mechanism at work.
- ☐ Market success.
- ☒ Government intervention.

Governments can sometimes improve market outcomes.

2.



**Figure 1.9**

In Figure 1.9, the slope of the line between points K and L is

- ☐ 1.25.
- ☒ 0.80.
- ☐ 0.75.
- ☐ 0.60.

The slope is calculated as the change in the vertical variable divided by the change in the horizontal variable ( $0.80 = 20/25$ ).

3.

If market signals result in pollution beyond the optimal level, then

- ☐ The economy experiences government failure.
- ☐ A laissez faire approach will reduce the level of pollution.
- ☒ The market mechanism has failed to achieve social efficiency.
- ☐ The government is allocating resources inefficiently.

Government intervention could improve on the market outcome.

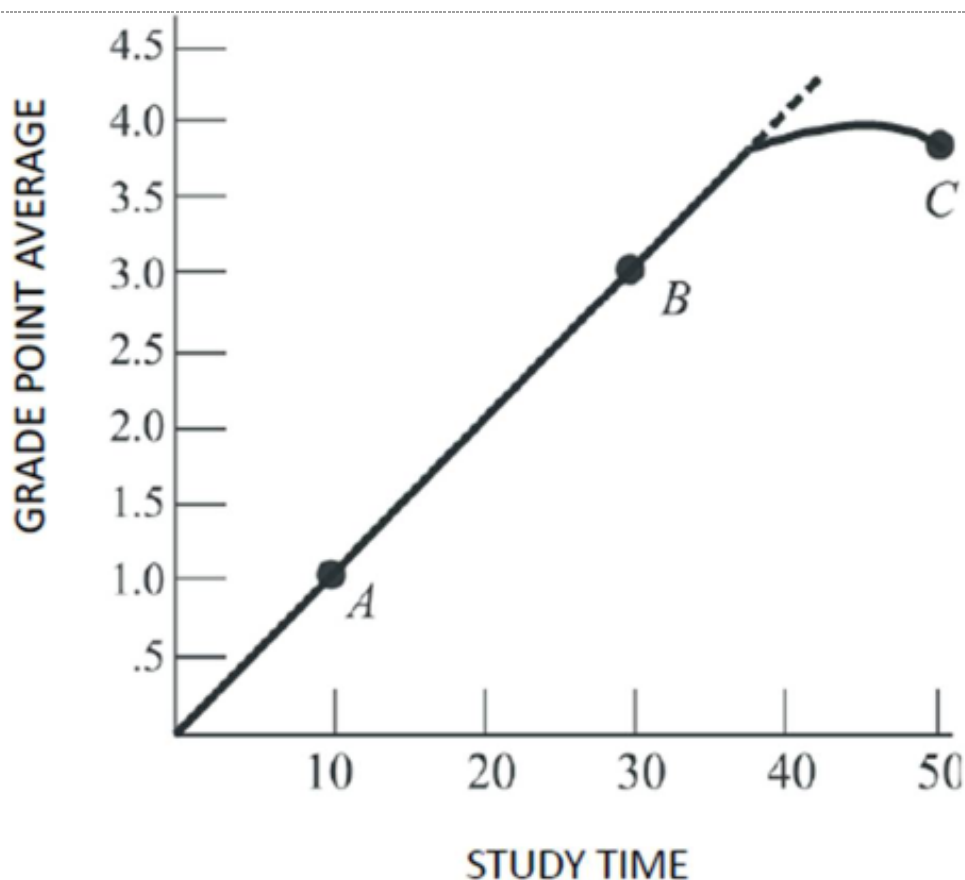
4.

Which of the following is an example of government failure?

- ☐ Bureaucratic delays.
- ☐ Required use of pollution control technology that is obsolete.
- ☐ Inefficient incentives.
- ☒ All of the choices are correct.

There are costs to government action, which in this case prevent an improvement in the outcome.

5.



**Figure 1.8**  
**Relating Grades and Hours Studied**

Refer to Figure 1.8. If the university decides to lower grading standards, then

- ☐ This curve will shift rightward.
- ☒ This curve will pivot up and to the left.
- ☐ The curve will begin to bend downward at an earlier point.
- ☐ We will slide up the curve from point B to point C.

We would expect grades to be higher with less study time required, all else equal.

6.

If an economy is producing inside the production possibilities curve, then

- ☐ There is full employment of resources.
- ☐ It is operating efficiently.
- ☒ It can produce more of one good without giving up some of another good.
- ☐ There are not enough resources available to produce more output.

No goods must be given up to move from an inefficient to an efficient level of production. Hence, there is no sacrifice or opportunity cost.

7.

Economic growth would best be represented by a

- ☒ Shift outward of the production possibilities curve.
- ☐ Shift inward of the production possibilities curve.
- ☐ Movement from inside the production possibilities curve to a point on the production possibilities curve.
- ☐ Movement from the production possibilities curve to a point inside the production possibilities curve.

Economic growth allows more of both goods.

8.

Which of the following is not a factor of production?

- ☐ A psychiatrist.
- ☒ The \$100,000 used to start a new business.
- ☐ A bulldozer.
- ☐ Six thousand acres of farmland.

Land, labor, capital, and entrepreneurship are the factors of production. Money does not fall under any category of the factors of production. Factors of production are what are needed on a camping trip. Money is not needed on a camping trip.

9.

The fundamental problem of economics is

- ☐ The law of increasing opportunity costs.
- ☒ The scarcity of resources relative to human wants.
- ☐ How to get government to operate efficiently.
- ☐ How to create employment for everyone.

Wants will always exceed resources.

10.

*The invisible hand* refers to

- ☐ Intervention in the economy by the government bureaucrats we do not see and over whom we have no control.
- ☐ Undiscovered natural resources.
- ☒ The allocation of resources by market forces.
- ☐ The person who has the responsibility to coordinate all the markets in a market economy.

Resources are allocated efficiently as if directed by an unseen force.

11.

In providing a legal framework, the government

- ☐ Protects patents to encourage entrepreneurship.
- ☐ Protects copyrights to encourage textbook protection.
- ☐ Protects the ownership of private property to encourage the private sector.
- ☒ All of the choices are correct.

Without guarantees from both buyer and seller as established in contracts, many market activities would cease to exist, thereby harming the economy.

12.

Per capita GDP will definitely fall if

- ☐ The population falls.
- ☐ The rate of economic growth falls.
- ☒ The rate of economic growth is less than the rate of population growth.
- ☐ There is a decrease in the size of the labor force.

In countries with high population growth rates, living standards will fall if GDP growth does not keep pace.

13.

If population growth is less than output growth for a country,

- ☐ Real GDP has decreased.
- ☐ Average living standards will decrease.
- ☐ GDP must have fallen at a fairly rapid rate.
- ☒ The per capita living standard will increase.

If the percentage change in the numerator (real GDP) increases faster than the percentage change in the denominator (population), the per capita living standard will increase.

14.

Which of the following is considered a service in the calculation of GDP?

- ☐ Reclining chairs.
- ☐ Photographs.
- ☒ Tax preparation.
- ☐ Automobiles.

Any consumption spending on intangibles is for services.

15.

Which of the following is likely to be most capital-intensive?

- ☐ Farming in developing countries.
- ☐ Production of apparel by the Chinese.
- ☒ Oil refining in the United States.
- ☐ None of the choices are correct.

Capital-intensive means there is a high ratio of capital to labor used in production.

16.

If output growth exceeds population growth for a country,

- ☒ Average living standards will increase.
- ☐ GDP must have fallen at a very rapid rate.
- ☐ Per capita GDP will decrease.
- ☐ This country must have overcome the problem of scarcity.

Growth in output is important for economic growth.

17.

Which of the following statements is true concerning income inequality?

- ☐ Income is equally distributed in poor countries.
- ☐ Developed countries have greater income inequality than developing countries.
- ☐ The government has no way to alter income inequality.
- ☒ The free market produces an unequal distribution of income.

Income inequality will vary depending on how active the government is in the economy.

18.

Which of the following will increase the level of human capital in an economy?

- ☐ An increase in land mass.
- ☒ An increase in literacy rates.
- ☐ An increase in factory capacity.
- ☐ A decrease in the population.

Education, training, and skills count as human capital.

19.

The best definition of GDP is

- ☐ The sum of the physical amounts of goods and services in the economy.
- ☒ A dollar measure of final output produced during a given time period.
- ☐ A measure of the per capita economic growth rate of the economy.
- ☐ A physical measure of the capital stock of the economy.

GDP is a measure of how well a nation is doing economically, especially in terms of its production.

20.

The United States has a larger real GDP than China because

- ☒ The U.S. population is smaller but works in capital-intensive jobs.
- ☐ The U.S. population is smaller but works in labor-intensive jobs.
- ☐ The U.S. population is larger but works in capital-intensive jobs.
- ☐ The U.S. population is larger but works in labor-intensive jobs.

Real GDP is simply the product of (average productivity per capita) \* (population). The U.S. product is larger than the China product.

21.

Which of the following statements about markets is *not* true?

- ☒ Markets necessarily have a physical location.
- ☐ Markets have both a demand side and a supply side.
- ☐ The two types of markets include the factor and product markets.
- ☐ Every market transaction involves an exchange of money for goods or resources or a direct exchange of goods or resources without money called barter.

Markets exist wherever and whenever an exchange takes place, even in cyberspace.

22.

*Ceteris paribus*, which of the following is most likely to cause a decrease in the supply of skateboards?

- ☐ An increase in the price of skateboards.
- ☒ An increase in the cost of materials used to produce skateboards.
- ☐ An improvement in skateboard-making technology.
- ☐ All of the choices are correct.

An increase in costs of production causes supply to decrease. An increase in price causes a decrease in the *quantity* supplied, whereas an improvement in skateboard-making technology would *increase* supply.

23.

Which panel of Figure 3.3 represents the changes in the market for textbooks when the cost of paper decreases and the government increases the number of student loans it grants?

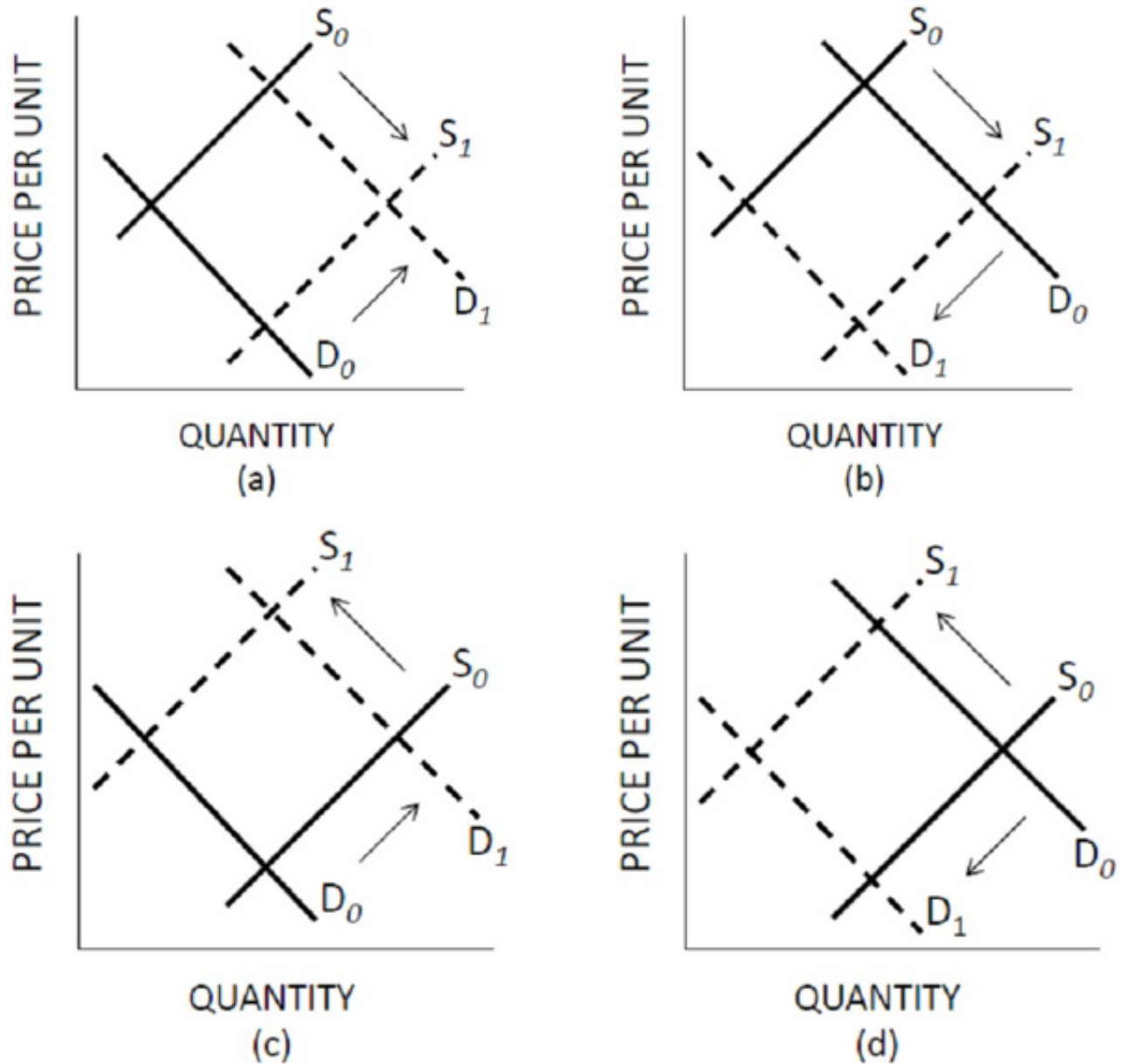


Figure 3.3  
Shifts of Supply and Demand

- ☒ A.  
☐ B.  
☐ C.  
☐ D.

A decrease in the cost of production, such as lower paper prices, will cause supply to increase, and the increase in students will cause the demand to increase.



24.

If a price ceiling is to be binding or effective, it should be set

- ☒ Below the equilibrium price, and it will create a market shortage.
- ☐ Below the equilibrium price, and it will create a market surplus.
- ☐ Above the equilibrium price, and it will create a market shortage.
- ☐ Above the equilibrium price, and it will create a market surplus.

Price ceilings set above the equilibrium price will not be binding or effective because the market price will tend toward the equilibrium price. Therefore, in order for a price ceiling to be binding, it must be set below the equilibrium price.

25.

*Ceteris paribus*, which of the following is most likely to cause an increase in the quantity supplied of perfume?

- ☐ An improvement in perfume-making technology.
- ☐ An increase in the salaries paid to perfume makers.
- ☒ An increase in the price of perfume.
- ☐ An increase in the number of sellers of perfume.

If the price of a product is the only variable changing, then we can track changes in quantity supplied along the supply curve.

26.

An increase in the price of gasoline above equilibrium will

- ☐ Shift the gasoline supply curve to the right.
- ☐ Shift the gasoline demand curve to the right.
- ☒ Cause a surplus of gasoline.
- ☐ Cause a shortage of gasoline.

An increase in the price of gasoline above equilibrium will cause a surplus. It will not move the respective supply and demand lines.

27.

*Ceteris paribus*, if buyers expect the price of airline tickets to fall in the future, then right now there should be

- ☐ An increase in the demand for airline tickets.
- ☐ A decrease in the supply of airline tickets.
- ☒ A decrease in the demand for airline tickets.
- ☐ No change in the supply of or demand for airline tickets because the price is not changing right now.

Expectations that prices will fall will cause consumers to buy fewer tickets now and wait to purchase airline tickets later, when the price actually falls.

28.

Which panel of Figure 3.3 represents the changes in the market for cigarettes when the government increases subsidies for the production of tobacco and at the same time bans smoking in public buildings?

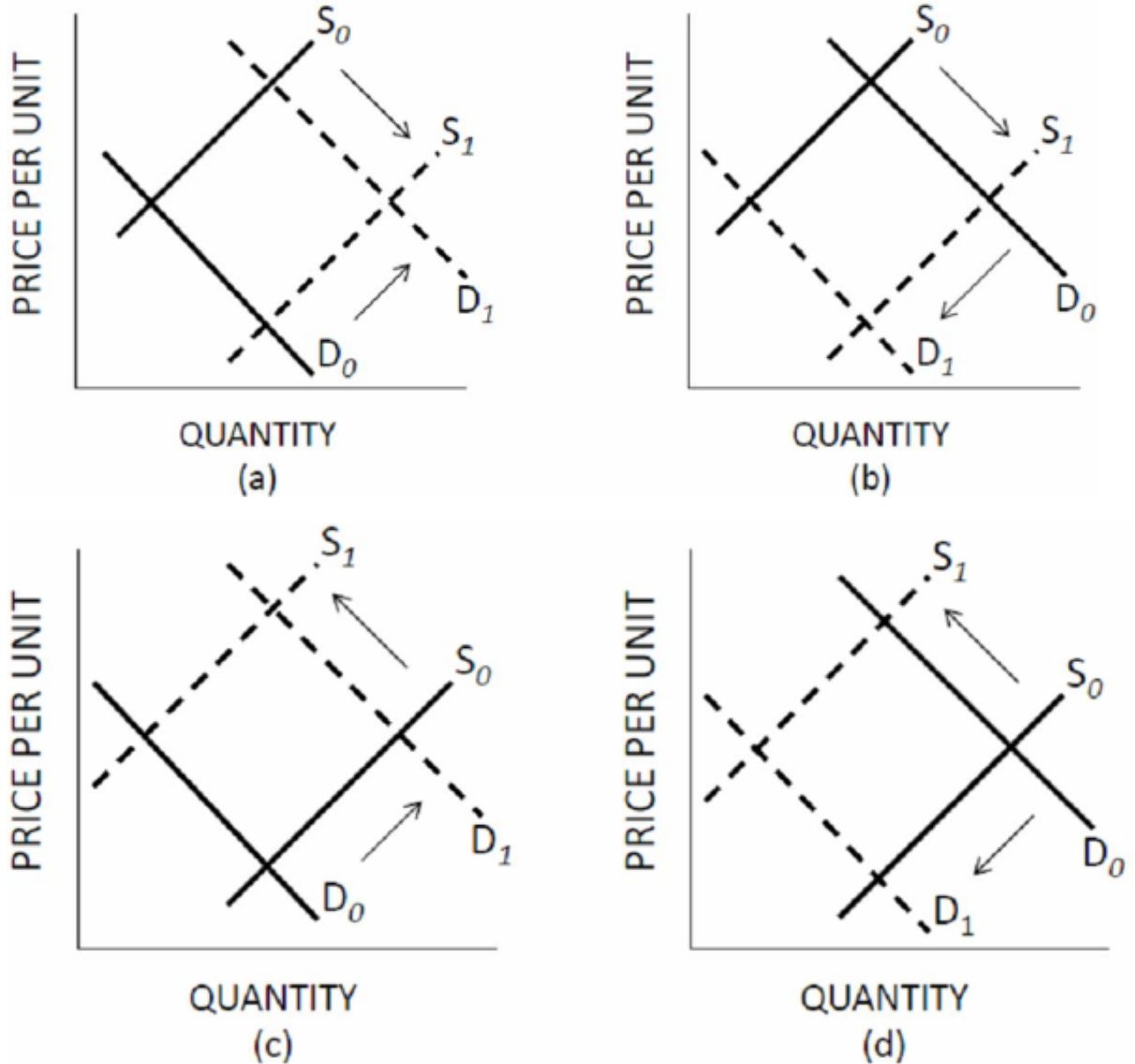


Figure 3.3  
Shifts of Supply and Demand

- ☐ A.  
☒ B.  
☐ C.  
☐ D.

A subsidy will encourage more production, causing supply to increase, and the ban on smoking will cause a decrease in demand.

29.

Choose the letter of the diagram in Figure 3.1 that best describes the type of shift that would occur in each situation for the market listed on the left, *ceteris paribus*.

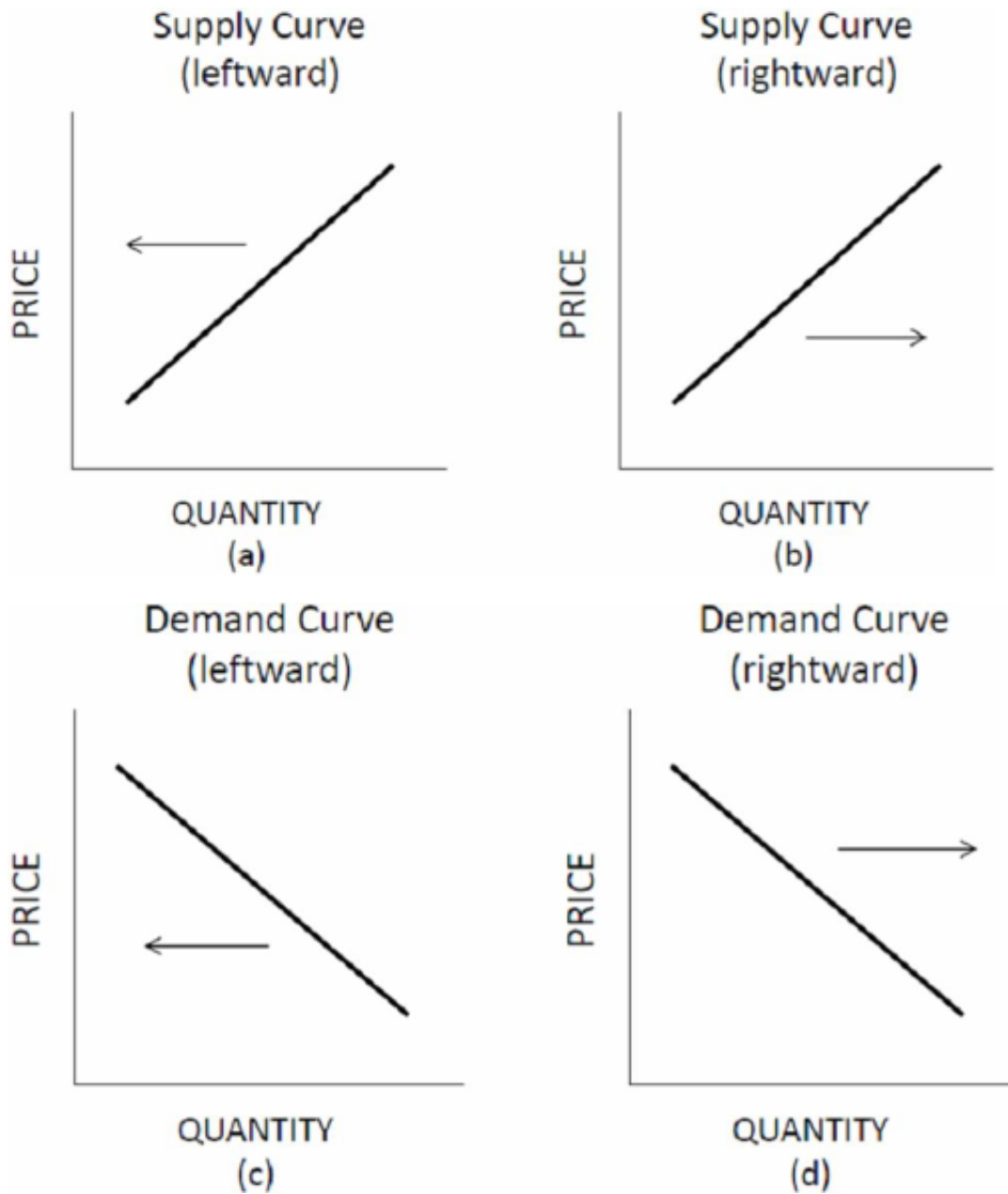


Figure 3.1  
Shifts of Supply and Demand

Candy bars: People become more health-conscious and prefer power bars instead of candy bars.

- ☐ A.
- ☐ B.
- ☒ C.
- ☐ D.

A change in tastes and preferences away from candy bars causes demand to decrease.

30.

A lower quantity demanded of a good reflects, *ceteris paribus*,

- ☐ Lower income.
- ☐ A downward shift of the supply curve.
- ☐ A higher price of the good.
- ☐ Fewer units actually purchased.

Quantity demanded of an item and price of the same item are inversely related.

31.

In 2007 a company sold 35,000 MP3 players at \$150 each. In 2008 the same company sold 40,000 MP3 players at \$170 each. This information suggests that

- ☐ The supply of MP3 players increased from 2007 to 2008.
- ☐ The demand for MP3 players increased from 2007 to 2008.
- ☐ The price of MP3 players increased because the costs of production increased from 2007 to 2008.
- ☐ From 2007 to 2008, the demand curve for MP3 players was upward-sloping because of improved technology.

An increase in demand causes equilibrium price and equilibrium quantity to increase.

32.

Assume that steel is used to produce monkey wrenches. *Ceteris paribus*, if the price of steel rises, then

- ☐ The supply curve for monkey wrenches will shift to the left.
- ☐ The supply curve for monkey wrenches will shift to the right.
- ☐ There will be a leftward movement along the initial supply curve for monkey wrenches.
- ☐ There will be a rightward movement along the initial supply curve for monkey wrenches.

When steel prices increase, the costs to produce monkey wrenches increase. As costs increase, profit margins decrease, making it less profitable to produce monkey wrenches at all price levels.

33.

If the price of "X" increases and you buy less "Y," then

- ☐ "X" and "Y" are complements, and the price of "Y" will increase.
- ☐ "X" and "Y" are complements, and the price of "Y" will decrease.
- ☐ "X" and "Y" are substitutes, and the price of "Y" will increase.
- ☐ "X" and "Y" are substitutes, and the price of "Y" will decrease.

When the price of "X" goes up (such as cars) and you buy less "Y" (such as gasoline), that means these goods are complements.

34.

From an economic standpoint, government intervention is justified

- ☒ When the market mechanism fails to achieve the optimal mix of output.
- ☐ Because the government will encourage the production of private goods.
- ☐ Because the government can increase the level of market power of private businesses.
- ☐ When the private sector is larger than public sector.

The government may be able to push market outcomes closer to the ideal when the market fails to yield optimal outcomes.

35.

Local governments provide law enforcement, which benefits society, but if the costs of law enforcement exceed the benefits, the result is a situation of

- ☐ Market failure.
- ☐ Efficiency as long as there is some benefit.
- ☒ Government failure.
- ☐ Public choice theory.

Government failure means that government intervention fails to move us closer to our optimal outcomes. Additional public sector activity is desirable only if the benefits from the activity exceed the cost.

36.

The federal government's role as the provider of national defense is justified by considerations of

- ☐ Inequity.
- ☒ Public goods.
- ☐ Private goods.
- ☐ None of the choices are correct.

National defense is a public good because consumption by one does not exclude consumption by others.

37.

When the economy experiences unemployment,

- ☐ There is government failure.
- ☒ There is macro instability.
- ☐ There is micro instability.
- ☐ No market failure occurs.

Historically, the marketplace has experienced periods of both unemployment and inflation, which demonstrated macro instability.

38.

Governments usually build highways because it is difficult to exclude individuals who don't pay for the highways from using them. What type of market failure is involved?

- ☐ Inequity.
- ☒ Public goods.
- ☐ Externalities.
- ☐ Market power.

A public good is a good or service whose consumption by one person does not exclude consumption by others.

39.

Which of the following is the best description of the U.S. tax system?

- ☐ The federal income tax is regressive, but sales, property, and other taxes tend to be progressive.
- ☐ The U.S. tax system is consistently progressive.
- ☒ The federal income tax is progressive, but sales, property, and other taxes tend to be regressive.
- ☐ The U.S. tax system is consistently regressive.

The federal income tax is progressive, but sales, property, and other taxes tend to be regressive.

40.

The development of market power by a firm is considered to be a market failure because firms with market power will

- ☐ Produce more and charge a lower price than what would be socially optimal.
- ☐ Tend to ignore external costs.
- ☒ Produce less and charge a higher price than what would be socially optimal.
- ☐ Not respond to consumer demand.

Market power allows one or more producers to attain discretionary power over the market's response to price signals. Firms may use that discretion to enrich themselves by keeping output low and prices high.

41.

The government's role in limiting smoking in many buildings is justified by considerations of

- ☐ Inequity.
- ☒ Externalities.
- ☐ Market power.
- ☐ Government failure.

Because smoking imposes health risks on nonsmokers, government involvement can be justified.

# 42.

Which of the following is treated differently in computations of GNP as compared with GDP?

- ☐ Sales in the underground economy.
- ☒ Goods produced by U.S. firms located in foreign countries.
- ☐ Intermediate goods.
- ☐ The value of services performed by housewives.

GDP includes production within the political borders, while GNP measures production by U.S.-owned factors of production regardless of where they may be located.



43.

Expenditures for consumer goods and services	\$4,565
Exports	\$740
Government purchases of goods and services	\$1,465
Social Security taxes	\$510
Net investment	\$225
Indirect business taxes	\$520
Imports	\$825
Gross investment	\$865
Corporate income taxes	\$185
Personal income taxes	\$750
Corporate retained earnings	\$45
Net foreign factor income	\$20
Government transfer payments to households	\$690
Net interest payments to households	\$0

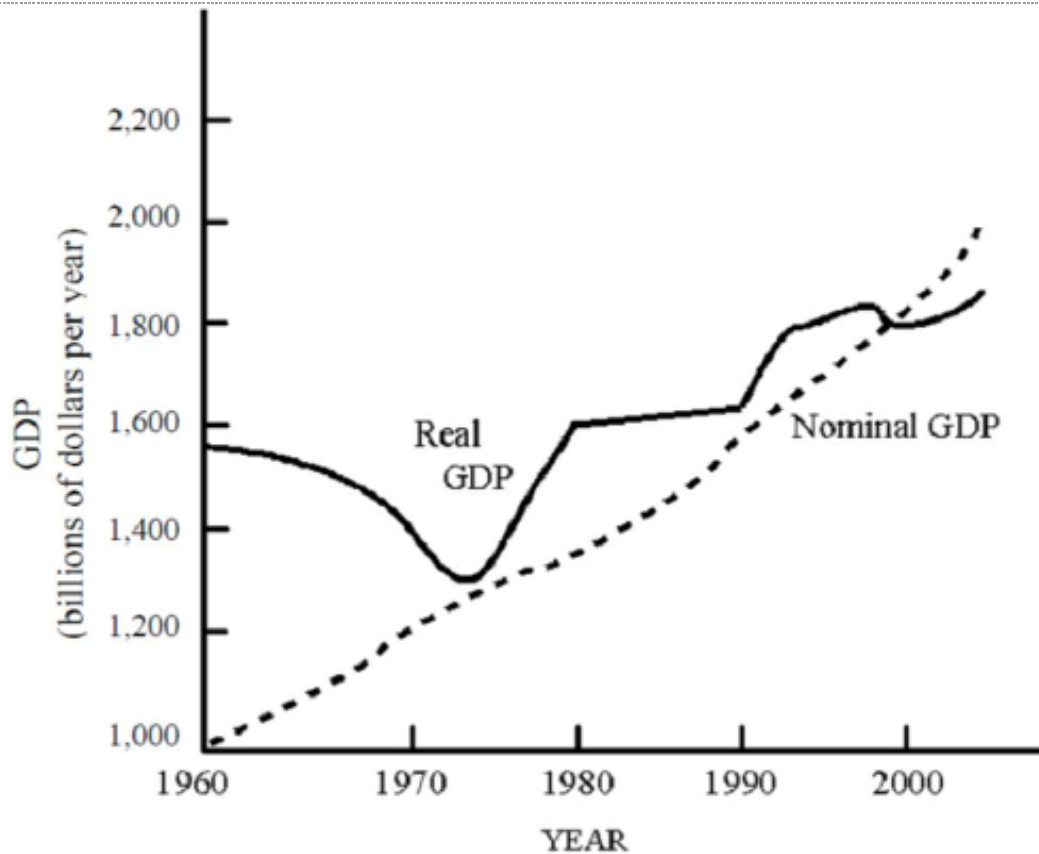
**Table 5.1**  
**National Income Accounts (dollar figures are in billions)**

On the basis of Table 5.1, net domestic product is

- ☐ \$6,340 billion.
- ☒ \$6,170 billion.
- ☐ \$6,995 billion.
- ☐ \$7,080 billion.

NDP is equal to GDP less depreciation.  $\$4,565 + \$225 + \$1,465 + (\$740 - \$825)$ .

44.



**Figure 5.1**

In Figure 5.1, during the 1980-1990 time periods, real GDP was relatively constant but nominal GDP increased. This can be explained by

- ☐ Lower average price levels.
- ☒ Inflation.
- ☐ Higher levels of production.
- ☐ A decrease in production per capita.

Real GDP can be constant and nominal GDP can be increasing. But this must be due to a change in the price level and not actual production.

45.

An economy's production possibilities are most likely to expand if

- ☐ Net investment is negative.
- ☐ Net investment is zero.
- ☒ Gross investment is greater than depreciation.
- ☐ Depreciation is greater than gross investment.

Depreciation represents capital that is worn out; if it is replaced through investment, and there is additional investment above that, then our production possibilities will increase.

46.

In periods of rising prices, percentage increases in nominal GDP will

- ☒ Exceed percentage increases in real GDP.
- ☐ Equal percentage increases in real GDP.
- ☐ Be less than percentage increases in real GDP.
- ☐ Not change in relationship to real GDP.

Nominal GDP shows more growth than there really is because it is reflecting changes in the price level as well.

47.

The increase in the market value of a good at a particular stage of production is known as

- ☐ Profit.
- ☒ Value added.
- ☐ Cost based accounting.
- ☐ The input price.

The value added is equal to the sales price minus the cost of intermediate goods.

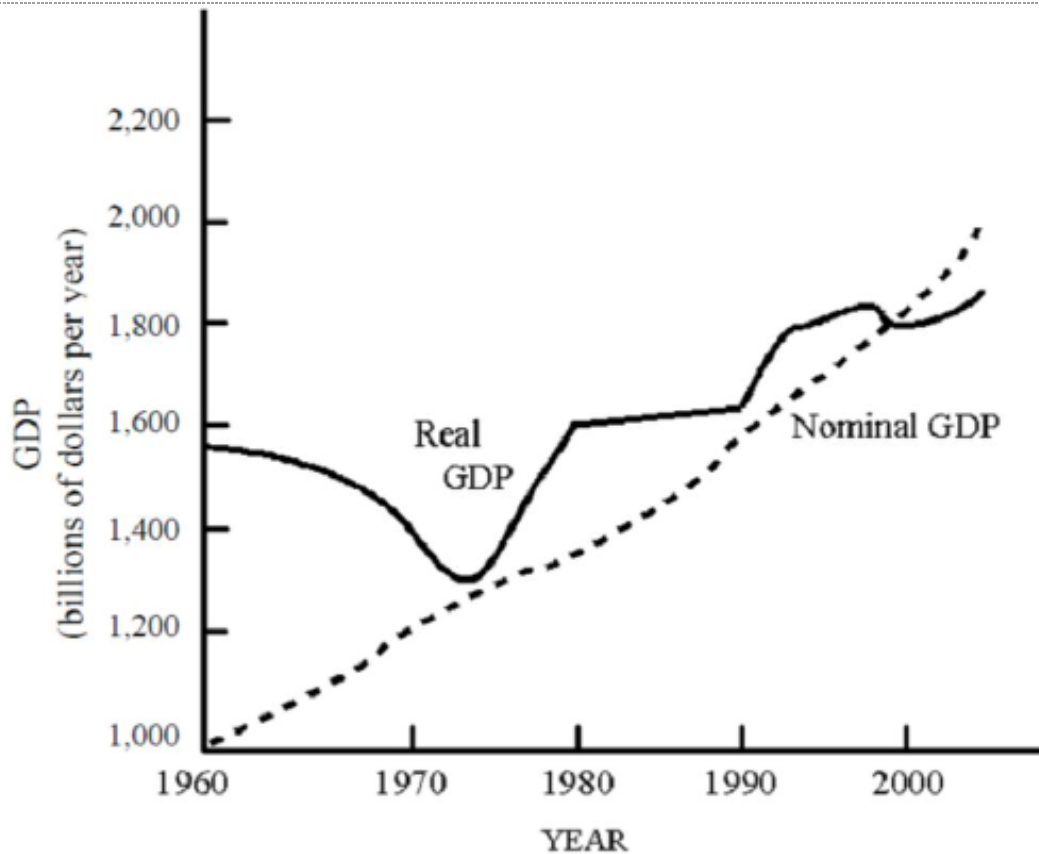
48.

Transfer payments are part of personal income but not national income because

- ☒ They are a payment for which no goods or services are exchanged.
- ☐ Personal income is an earnings concept.
- ☐ National income is a receipts concept.
- ☐ They represent a payment to factors of production.

National income is an efficiency concept with market exchange and thereby does not include transfer payments. Transfer payments are government actions to influence inequity. Transfer payments are added to national income to get personal income.

49.



**Figure 5.1**

In Figure 5.1, during the period between the early 1970s and 1980, real GDP grew at a faster rate than nominal GDP. This is an indication that

- ☒ Average price levels decreased.
- ☐ Production increased at a faster rate than average price increased.
- ☐ Production increased at a slower rate than average price increased.
- ☐ Average price levels increased.

Nominal GDP can grow more slowly than real GDP if the prices are falling and production is rising; the economy is actually doing well, but nominal GDP suggests it is not.

50.

A nation's production possibilities curve should, *ceteris paribus*, shift

- ☐ Inward if gross investment exceeds depreciation.
- ☐ Inward if net investment is zero.
- ☒ Outward if net investment is positive.
- ☐ Outward if gross investment is positive.

As long as our gross investment is more than enough to replace worn-out capital and build new capital, our production possibilities will increase.

51.

Which of the following is investment, according to an economist?

- ☐ The purchase of U.S. savings bonds.
- ☐ A collection of rare coins.
- ☒ An increase in business inventories.
- ☐ The purchase of a new family car.

Purchases of consumer durables and the allocation of one's personal wealth are not considered investment, according to an economist.

Expenditures for consumer goods and services	\$2,850
Exports	\$300
Government purchases of goods and services	\$810
Social Security taxes	\$295
Net investment	\$510
Indirect business taxes	\$445
Imports	\$450
Gross investment	\$700
Corporate income taxes	\$190
Personal income taxes	\$875
Corporate retained earnings	\$210
Net foreign factor income	\$0
Government transfer payments to households	\$780
Net interest payments to households	\$20

**Table 5.2****National Income Accounts (dollar figures are in billions)**

On the basis of Table 5.2, GDP is

- ☐ \$2,090 billion.
- ☒ \$4,210 billion.
- ☐ \$4,400 billion.
- ☐ \$4,020 billion.

GDP is the sum of consumption, investment, government expenditures, and net exports, which is  $\$2,850 + \$700 + \$810 + (\$300 - \$450) = \$4,210$ .