

## CHAPTER 2—THINKING LIKE AN ECONOMIST

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### TRUE/FALSE

1. Economists try to address their subject with a scientist's objectivity.

ANS: T                      PTS: 1

2. Economists devise theories, collect data, and then analyse these data in an attempt to verify or refute their theories.

ANS: T                      PTS: 1

3. While the scientific method is applicable to studying natural sciences, it is not applicable to studying a nation's economy.

ANS: F                      PTS: 1

4. Good assumptions simplify a problem without substantially affecting the answer.

ANS: T                      PTS: 1

5. Economists often find it worthwhile to make assumptions that do not necessarily describe the real world.

ANS: T                      PTS: 1

6. Economic models omit many details to allow us to see what is truly important.

ANS: T                      PTS: 1

7. When economists are trying to explain the world, they are scientists, and when they are trying to help improve the world, they are policy advisers.

ANS: T                      PTS: 1

8. Normative statements describe how the world is, while positive statements prescribe how the world should be.

ANS: F                      PTS: 1

## MULTIPLE CHOICE

1. Which of the following is not correct?
  - a. Economists use some familiar words in specialised ways.
  - b. Economics has its own language and its own way of thinking, but few other fields of study do.
  - c. Supply, demand, elasticity, comparative advantage, consumer surplus, and deadweight loss are all terms that are part of the economist's language.
  - d. The value of the economist's language lies in its ability to provide you with a new and useful way of thinking about the world in which you live.

ANS: B

PTS: 1

2. Economists, like mathematicians, physicists and biologists,
  - a. make use of the scientific method.
  - b. try to address their subject with a scientist's objectivity.
  - c. devise theories, collect data, and then analyse these data in an attempt to verify or refute their theories.
  - d. All of the above are correct.

ANS: D

PTS: 1

3. The goal of an economist who formulates new theories is to
  - a. provide an interesting framework of analysis, whether or not the framework turns out to be of much use in understanding how the world works.
  - b. provoke stimulating debate in scientific journals.
  - c. contribute to an understanding of how the world works.
  - d. demonstrate that economists, like other scientists, can formulate testable theories.

ANS: C

PTS: 1

4. Economists regard events from the past as
  - a. irrelevant, since history is unlikely to repeat itself.
  - b. of limited interest, since those events seldom provide any useful economic data.
  - c. interesting but not particularly valuable, since those events cannot be used to evaluate present-day economic theories.
  - d. interesting and valuable, since those events are capable of helping us to understand the past, the present, and the future.

ANS: D

PTS: 1

5. With respect to how economists study the economy, which of the following statements is most accurate?
- a. Economists study the past, but they do not try to predict the future.
  - b. Economists use “rules of thumb” to predict the future.
  - c. Economists devise theories, collect data, and analyse the data to test the theories.
  - d. Economists use controlled experiments in much the same way that biologists and physicists do.

ANS: C

PTS: 1

6. Instead of conducting laboratory experiments to generate data to test their theories, economists often
- a. ask winners of the Nobel Prize in Economics to evaluate their theories.
  - b. argue that data is impossible to collect in economics.
  - c. gather data from historical episodes of economic change.
  - d. assume that data would support their theories.

ANS: C

PTS: 1

7. A simplifying assumption
- a. affects the important conclusions of an economic model.
  - b. increases the level of detail in an economic model.
  - c. limits the validity of an economic model's conclusion.
  - d. eliminates unnecessary details from an economic model.

ANS: D

PTS: 1

8. Economists make assumptions in order to
- a. mimic the methodologies employed by other scientists.
  - b. minimise the number of experiments that yield no useful data.
  - c. minimise the likelihood that some aspect of the problem at hand is being overlooked.
  - d. focus their thinking on the essence of the problem at hand.

ANS: D

PTS: 1

9. The ultimate purpose of an economic model is to
- a. explain reality as completely as possible.
  - b. establish assumptions that closely resemble reality.
  - c. help us to understand economic behaviour.
  - d. guide government policy decisions.

ANS: C

PTS: 1

10. An economic model
- a. uses equations to understand normative economic phenomena.
  - b. often omits crucial elements.
  - c. simplifies reality in order to focus on crucial elements.
  - d. cannot be proven wrong.

ANS: C                      PTS: 1

11. An endogenous variable
- a. is a variable whose value is determined outside the model.
  - b. is a variable whose value is determined within the model.
  - c. is a variable from another country.
  - d. cannot be proven wrong.

ANS: B                      PTS: 1

12. Which of the following statements about models is correct?
- a. The more details a model includes, the better the model.
  - b. Models assume away irrelevant details.
  - c. Models cannot be used to explain how the economy functions.
  - d. Models cannot be used to make predictions.

ANS: B                      PTS: 1

13. Which of the following activities would occur in a market for goods and services?
- a. Stefan mows his grass.
  - b. Toyota hires additional workers to run a third shift at a car factory.
  - c. Mafusi bakes biscuits for her son's birthday party.
  - d. Kudzai buys a ticket to a rugby match.

ANS: D                      PTS: 1

14. In building economic models, economists often omit
- a. assumptions.
  - b. theories.
  - c. details.
  - d. equations.

ANS: C                      PTS: 1

15. Models are also inherently unstable when they extend to
- long time periods.
  - short time periods.
  - no time periods.
  - micro periods of time.

ANS: A                      PTS: 1

16. \_\_\_\_\_ theory further tells us that even minor errors in measurements or assumptions can be amplified to a great extent, rendering forecasts useless.
- Deterministic
  - Micro
  - Macro
  - Chaos

ANS: D                      PTS: 1

17. A government minister states that wage rates in the country have risen by 2 per cent in the past year. The head of a trade union states that wage increases should have been higher. The minister's statement is a \_\_\_\_\_ economic statement, and the union leader's statement is a \_\_\_\_\_ economic statement.
- normative; normative
  - normative; positive
  - positive; normative
  - positive; positive

ANS: C                      PTS: 1

18. "An increase in interest rates will lower economic growth." This statement is
- a positive economic statement.
  - a normative economic statement.
  - untrue in every case.
  - controversial, and so not a valid economic issue.

ANS: A                      PTS: 1

19. The distinction between positive and normative economics
- is that positive economics applies only to microeconomic problems.
  - is that normative economics applies only to microeconomic problems.
  - explains why economics is not a social science but a natural science.
  - helps us to understand why economists sometimes disagree with one another.

ANS: D                      PTS: 1

20. Which of the following is most closely associated with positive economics?
- a. Determining the impact of government spending on the actual level of unemployment.
  - b. Determining the best level of immigration into a country.
  - c. Determining whether too many luxury goods are being produced.
  - d. Determining whether or not the government should reduce poverty.

ANS: A                      PTS: 1

21. Economists have helped modify the debate over the environment
- a. by pointing out that nature is invaluable.
  - b. by focusing discussion on issues of resource allocation.
  - c. by lobbying for pollution legislation.
  - d. by arguing against tradeable permits for pollution.

ANS: B                      PTS: 1

22. Policymaking in a representative democracy
- a. is straightforward and does not involve any disagreement.
  - b. benefits from the input of economists, even if their advice is not always followed.
  - c. is conducted without the input of economists.
  - d. is always based exclusively on the results of economic analysis.

ANS: B                      PTS: 1

23. Because economics is a science that is centred on \_\_\_\_\_, it is not always possible to conduct experiments in the same way in which as the physical sciences do.
- a. human behaviour
  - b. consumer behaviour
  - c. organisational behaviour
  - d. conjoint analysis

ANS: A                      PTS: 1

24. When an economist evaluates a positive statement, he or she is primarily
- a. examining evidence.
  - b. evaluating values as well as facts.
  - c. acting as a policy adviser.
  - d. concerned with making a sound decision on how the world ought to be.

ANS: A                      PTS: 1

25. A normative economic statement such as “The minimum wage should be abolished”
- a. would likely be made by an economist acting as a scientist.
  - b. would require values and data in order to be evaluated.
  - c. would require data but not values in order to be evaluated.
  - d. could not be evaluated by economists acting as policy advisers.

ANS: B                      PTS: 1

26. Normative conclusions
- a. come from positive analysis alone.
  - b. are based on ignorance of positive analysis.
  - c. involve value judgments.
  - d. reflect the economist’s role as scientist.

ANS: C                      PTS: 1

27. Which of the following is an example of a normative, as opposed to positive, statement?
- a. Petrol prices ought to be lower than they are now.
  - b. The government should raise taxes on wealthy people.
  - c. The social security system is a good system and it deserves to be preserved as it is.
  - d. All of the above are normative statements.

ANS: D                      PTS: 1

28. Which of the following is an example of a normative, as opposed to positive, statement?
- a. If the price of a product decreases, people’s willingness to buy that product will increase.
  - b. Reducing tax rates on the wealthy would benefit the nation.
  - c. If the national saving rate were to increase, so would the rate of economic growth.
  - d. The elimination of trade restrictions would increase an economy’s standard of living.

ANS: B                      PTS: 1

29. Which of the following is an example of a positive, as opposed to normative, statement?
- a. Income tax rates should not have been cut as they were a few years ago.
  - b. The quantity of money has grown too slowly in recent years.
  - c. When the quantity of money grows rapidly, inflation is a predictable consequence.
  - d. All of the above are positive statements.

ANS: C                      PTS: 1

30. A statement describing how the world is now
- is a normative statement.
  - is a positive statement.
  - would only be made by an economist speaking as a policy adviser.
  - would only be made by an economist employed by the government.

ANS: B                      PTS: 1

31. If money growth and inflation were strongly correlated in international data, the economist would become more \_\_\_\_\_ in a theory linking the two.
- doubtful
  - confident
  - anxious
  - concerned

ANS: B                      PTS: 1

32. If two variables tend to increase and decrease together, they are
- positively correlated.
  - negatively correlated.
  - uncorrelated.
  - quasi-correlated.

ANS: A                      PTS: 1

33. The number of rainy days in the year and annual sales of sun tan lotion are probably
- positively correlated.
  - negatively correlated.
  - uncorrelated.
  - quasi-correlated.

ANS: B                      PTS: 1

34. A student's final mark and amount of time spent studying for the module are generally
- positively correlated.
  - negatively correlated.
  - uncorrelated.
  - quasi-correlated.

ANS: A                      PTS: 1



35. Economists tend to disagree because of differences:
- a. only in scientific judgments.
  - b. only in value judgments.
  - c. in both value and scientific judgments.
  - d. None of the above.

ANS: C                      PTS: 1

36. Economists often disagree about the validity of \_\_\_\_\_ about how the world works.
- a. alternative collections
  - b. alternative norms
  - c. alternative judgements
  - d. alternative positive theories

ANS: D                      PTS: 1

37. Economists may have different values and, therefore, different \_\_\_\_\_ about what policy should try to accomplish.
- a. normative views
  - b. positive views
  - c. individual views
  - d. correlated views

ANS: A                      PTS: 1

38. History shows us that there have always been \_\_\_\_\_ among scientists about truth and reality.
- a. consistency
  - b. uniformity
  - c. agreements
  - d. disagreements

ANS: D                      PTS: 1

## SHORT ANSWER

1. Explain how economists can claim to act as scientists.

ANS:

Economists can act as scientists by using a scientist's objectivity. This involves observation, theory and more observation.

PTS: 1

2. What is the difference between rational thought and empirical thought?

ANS:

Rationality is a normative concept that refers to an economist's beliefs, whereas empirical thought is based upon evidence.

PTS: 1

3. What is feminist economics?

ANS:

Feminist economics questions many of the assumptions of the neo-classical school. Economic well-being, feminist economists argue, is not simply provided through market exchange, but also includes unpaid work carried out in the home. This housework, by both males and females, needs to have the recognition its significance to well-being deserves. Economic activity, therefore, needs to include a valuation of this unpaid work. Feminist economists also conduct research into other areas where there are gender and social inequalities, and would argue that it is not possible to have value-free analysis and research into economic issues.

PTS: 1

4. What is Marxist economics?

ANS:

Marxist economists present different explanations for essentially the same phenomena and has developed from the work of Karl Marx in the 19<sup>th</sup> century. Marx sought to analyse and understand the capitalist system, explain how and why production takes place, and examine the circumstances under which different groups in society have economic power. Marxist economists view firms and markets not as entities but as collections of humans, and it is these humans who make decisions.

PTS: 1

5. Explain some of the underlying assumptions of the Austrian School of economics?

ANS:

Austrian school economists look at the explanation for business cycles in the supply side of the economy rather than focusing on demand. Excess supply is what drives the economy into recession and this, in turn, can be caused by interest rates being too low, leading to too much investment and the availability of cheap money. This triggers inflation. For Austrian economists therefore, inflation is not the main problem or focus of policy; inflation is a symptom of imbalances in the financial sector of the economy. Economists from the Austrian school had been warning of too low interest rates and too high debt levels for many years in the early part of the 21<sup>st</sup> century, and there are those who argue that it was these economists who correctly predicted the global financial crisis of 2007–9 and not mainstream economists.

PTS: 1

6. Which of the following statements are positive statements?

- a. The minimum wage creates unemployment among young and unskilled workers.
- b. The minimum wage ought to be abolished.
- c. If the price of a product in a market decreases, then, other things equal, quantity demanded will increase.
- d. A little bit of inflation is worse for society than a little bit of unemployment.
- e. There is a trade-off between inflation and unemployment in the short run.
- f. If consumer income increases, then, other things equal, the demand for cars will increase.
- g. The South African income distribution is not fair.
- h. South African workers deserve more liberal unemployment benefits.
- i. If interest rates increase, then investment will decrease.
- j. If welfare benefits were reduced, then the country would be better off.

ANS:

a, c, e, f, and i are positive statements.

PTS: 1

7. Which of the following are normative statements?
- a. The minimum wage creates unemployment among young and unskilled workers.
  - b. The minimum wage ought to be abolished.
  - c. If the price of a product in a market decreases, then, other things equal, quantity demanded will increase.
  - d. A little bit of inflation is worse for society than a little bit of unemployment.
  - e. There is a trade-off between inflation and unemployment in the short run.
  - f. If consumer income increases, then, other things equal, the demand for cars will increase.
  - g. The South African income distribution is not fair.
  - h. South African workers deserve more liberal unemployment benefits.
  - i. If interest rates increase, then investment will decrease.
  - j. If welfare benefits were reduced, then the country would be better off.

ANS:

b, d, g, h, and j are normative statements.

PTS: 1

8. Why do economists disagree?

ANS:

Economists disagree about the validity of alternative theories or about the size of the effects of changes in the economy on the behaviour of households and firms. However, there are many things they agree upon. They also have differences in their values which represent the normative side of economics.

PTS: 1

9. Is it fair that people earning in excess of R1 500 000 a year should pay a much higher tax rate on income above this level? Explain your answer.

ANS:

There is no one correct answer because this question requires a normative answer that is based on an individual's personal values.

PTS: 1

10. If economic models have so many limitations, why do economists continue to use them?

ANS:

Economic models help us to simplify reality in order to increase our understanding. This is where the use of assumptions is helpful. A model will contain a number of variables, some of whose value is determined within the model and others whose value is determined outside the model. This allows the economist to look at the cause and the effect.

PTS: 1