

## CHAPTER 1 – Ten principles of economics

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### TRUE/FALSE

1. Scarcity means that society has less to offer than people wish to have.

ANS: T                      PTS: 1                      DIF: Easy                      TOP: Introduction

2. Economics is the study of the circulation of money between banks, taxpayers and the government.

ANS: F                      PTS: 1                      DIF: Moderate                      TOP: Introduction

3. Economists study how individuals make decisions, how they interact with each other and the factors that affect the economy as a whole.

ANS: T                      PTS: 1                      DIF: Easy                      TOP: Introduction

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

ANS: F                      PTS: 1                      DIF: Easy                      TOP: Lesson 1: People face trade-offs

5. The phrase ‘there’s no such thing as a free lunch’ refers to the concept of scarcity.

ANS: F                      PTS: 1                      DIF: Moderate                      TOP: Lesson 1: People face trade-offs

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

ANS: F                      PTS: 1                      DIF: Moderate                      TOP: Lesson 1: People face trade-offs

7. People are likely to make good decisions only if they understand the options that are available to them.

ANS: T                      PTS: 1                      DIF: Easy                      TOP: Lesson 1: People face trade-offs

8. When the government redistributes income from the rich to the poor, society benefits since there are more poor than rich.

ANS: F                      PTS: 1                      DIF: Moderate                      TOP: Lesson 1: People face trade-offs

9. Efficiency refers to the size of the economic pie and equity refers to how the pie is divided.

ANS: T                      PTS: 1                      DIF: Easy                      TOP: Lesson 1: People face trade-offs

10. In economic policymaking, there is often a conflict between the goal of efficiency and the goal of equity.

ANS: T                      PTS: 1                      DIF: Easy                      TOP: Lesson 1: People face trade-offs

11. The opportunity cost of something refers to the price you pay to get it.

ANS: F                      PTS: 1                      DIF: Easy                      TOP: Lesson 2: The cost of something is what you give up to get it

12. The opportunity cost of consuming a unit of good X is the amount of resources that must be devoted to its production.

ANS: F                      PTS: 1                      DIF: Moderate                      TOP: Lesson 2: The cost of something is what you give up to get it

13. The marginal cost of something is what you give up to get one extra unit of a good.

ANS: T                      PTS: 1                      DIF: Moderate                      TOP: Lesson 3: Rational people think at the margin

14. Public policies to reduce emissions from cars do not affect the private costs and benefits of driving cars.

ANS: F                      PTS: 1                      DIF: Moderate                      TOP: Lesson 4: People respond to incentives

15. A higher price on a good is a disincentive to buying it.

ANS: T                      PTS: 1                      DIF: Moderate                      TOP: Lesson 4: People respond to incentives

16. In international trade, if one party gains, the other party loses.

ANS: F                      PTS: 1                      DIF: Easy                      TOP: Lesson 5: Trade can make everyone better off

17. A benefit of trade is that it permits two parties to specialise in those tasks in which they have the highest productivity.

ANS: T                      PTS: 1                      DIF: Easy                      TOP: Lesson 5: Trade can make everyone better off

18. If each person pursues their own self-interest through a market-institution, the resulting chaos would cause the market to collapse.

ANS: F                      PTS: 1                      DIF: Moderate                      TOP: Lesson 6: Markets are usually a good way to organise economic activity

19. While the 'invisible hand' cannot guarantee efficiency, it is better at guaranteeing equity.

ANS: F                      PTS: 1                      DIF: Easy                      TOP: Lesson 6: Markets are usually a good way to organise economic activity

20. The two broad reasons for a government to intervene in the economy are: to promote efficiency, and to promote equity.

ANS: T                      PTS: 1                      DIF: Easy                      TOP: Lesson 7: Governments can sometimes improve market outcomes

21. When markets allocate resources efficiently and there are no market failures, the government should intervene.

ANS: F                      PTS: 1                      DIF: Easy                      TOP: Lesson 7: Governments can sometimes improve market outcomes

22. A market economy rewards people according to their ability to produce things that other people are willing to pay for.

ANS: T                      PTS: 1                      DIF: Moderate                      TOP: Lesson 7: Governments can sometimes improve market outcomes

23. Monopoly power and income inequality are examples of market failure.

ANS: F                      PTS: 1                      DIF: Difficult                      TOP: Lesson 7: Governments can sometimes improve market outcomes

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

ANS: T                      PTS: 1                      DIF: Easy                      TOP: Lesson 8: A country's standard of living depends on its ability to produce goods and services

25. Better tools and technology can increase productivity and therefore living standards in countries.

ANS: T                      PTS: 1                      DIF: Easy                      TOP: Lesson 8: A country's standard of living depends on its ability to produce goods and services

26. Protecting domestic jobs from foreign competition is the best way to raise labour productivity.

ANS: F                      PTS: 1                      DIF: Moderate                      TOP: Lesson 8: A country's standard of living depends on its ability to produce goods and services

27. Inflation increases the value of money.

ANS: F                      PTS: 1                      DIF: Easy                      TOP: Lesson 9: Prices rise when the government prints too much money

28. If the government prints too much money, it will cause inflation.

ANS: T                      PTS: 1                      DIF: Moderate                      TOP: Lesson 9: Prices rise when the government prints too much money

29. Economists agree that monetary and fiscal policy, although not very powerful, are necessary instruments for controlling the economy.

ANS: F                      PTS: 1                      DIF: Moderate                      TOP: Lesson 10: Society faces a short-term trade-off between inflation and unemployment

30. Inflation in an economy is primarily caused by profiteering by greedy firms.

ANS: F                      PTS: 1                      DIF: Difficult                      TOP: Lesson 10: Society faces a short-term trade-off between inflation and unemployment

### MULTIPLE CHOICE

1. Society faces a trade-off between equity and efficiency because:
- A. something that is equitable is also always efficient
  - B. people always think about the consequences of decisions before they act
  - C. government wage policies reduce incentives to work
  - D. often it is not possible to distribute resources fairly

ANS: D                      PTS: 1                      DIF: Easy                      TOP: Lesson 1: People face trade-offs

2. The study of economics is concerned with:
- A. keeping private businesses from losing money
  - B. demonstrating that capitalist economies are superior to socialist economies
  - C. how society manages its scarce resources
  - D. determining the most equitable distribution of society's output

ANS: C                      PTS: 1                      DIF: Easy                      TOP: Introduction

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

ANS: B                      PTS: 1                      DIF: Moderate                      TOP: Introduction

4. When a society cannot produce all the resources that people wish to have, it is called:
- A. a trade-off
  - B. a market
  - C. efficiency
  - D. scarcity

ANS: D                      PTS: 1                      DIF: Moderate                      TOP: Introduction

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

ANS: A                      PTS: 1                      DIF: Moderate                      TOP: Introduction

6. Economics is defined as the study of:
- A. politics and business
  - B. central planning
  - C. government regulation
  - D. how society manages its scarce resources

ANS: D                      PTS: 1                      DIF: Easy                      TOP: Introduction

7. The scarcity problem:
- A. has been eliminated in the richest countries
  - B. persists only because countries have failed to eliminate unemployment
  - C. has been solved in all industrialised nations
  - D. persists because society cannot give every individual the highest standard of living to which he or she might aspire

ANS: D                      PTS: 1                      DIF: Easy                      TOP: Introduction

8. An 'increase in efficiency' suggests that an economy:
- A. is able to get more goods from a given amount of resources
  - B. is able to get more services from a given amount of resources
  - C. is able to get less goods and services from a given amount of resources
  - D. is able to get more goods and services from a given amount of resources

ANS: D                      PTS: 1                      DIF: Moderate                      TOP: Lesson 1: People face trade-offs

9. What does the adage 'There is no such thing as a free lunch' mean?
- A. the government taxes firms that sell lunches
  - B. lunches are indeed free
  - C. lunches are not free
  - D. every action involves an opportunity cost

ANS: D                      PTS: 1                      DIF: Easy                      TOP: Lesson 1: People face trade-offs

10. Daniel decides to spend an hour playing cricket rather than working at \$16 per hour. His trade-off is:
- A. nothing, because he enjoys playing cricket more than working
  - B. the increase in skill he obtains from playing cricket for that hour
  - C. the \$16 he could have earned
  - D. nothing, because he spent \$16 for admission into the sports complex to play cricket

ANS: C                      PTS: 1                      DIF: Moderate                      TOP: Lesson 1: People face trade-offs

11. An electronics store usually sells televisions for \$1000, but business has been slow and it needs to sell them before the new model comes out. The shop buys the televisions in bulk for \$550 each. The manager estimates they can only sell the old televisions for \$375 each. What should the store do?
- A. Never sell anything for less than they paid for it
  - B. Cut their losses and sell them for \$375
  - C. Sell the televisions back to the bulk seller
  - D. Give the televisions to their employees as a bonus

ANS: B                      PTS: 1                      DIF: Easy                      TOP: Lesson 2: Rational people think at the margin

12. Equity means that:
- A. all members of society have the same income
  - B. the benefits of society's resources are distributed fairly among its members
  - C. society's goods and services are distributed according to need
  - D. society is getting the most it can from its scarce resources

ANS: B                      PTS: 1                      DIF: Moderate                      TOP: Lesson 1: People face trade-offs

13. When government policies are being designed:
- A. equity and efficiency goals are usually independent of each other
  - B. there is usually a trade-off between equity and efficiency
  - C. equity can usually be achieved without an efficiency loss
  - D. increasing efficiency usually results in more equity

ANS: B                      PTS: 1                      DIF: Easy                      TOP: Lesson 1: People face trade-offs

14. In economics, the cost of something is:
- A. the out-of-pocket expense of obtaining it
  - B. what you give up to get it
  - C. always measured in units of time
  - D. always higher than people think

ANS: B                      PTS: 1                      DIF: Easy                      TOP: Lesson 2: The cost of something is what you give up to get it

15. The opportunity cost of going to university is:
- A. the total spent on food, clothing, books, transportation, tuition, lodging and other expenses
  - B. zero for students who have all of their university expenses paid by someone else
  - C. the value of the best opportunity a student gives up to attend university
  - D. zero, as a university education allows a student to earn more after graduation

ANS: C                      PTS: 1                      DIF: Moderate                      TOP: Lesson 2: The cost of something is what you give up to get it

16. Jack must decide whether to go skiing or work on the weekend. He decides to go skiing, which costs him \$500. His opportunity cost of going skiing is:
- A. the number of hours needed to earn money to pay for the ski trip
  - B. what else he could have done with his time if he was neither skiing nor working
  - C. the danger that he will get injured while skiing
  - D. how much he could have earned if he worked instead

ANS: D                      PTS: 1                      DIF: Easy                      TOP: Lesson 2: The cost of something is what you give up to get it

17. Tim decides to spend an hour looking at cat videos on YouTube instead of going to the gym. The opportunity cost of him looking at cat videos is:
- A. the improvement in his knowledge of the best cat videos on the internet
  - B. the fitness and fun he would have had at the gym
  - C. the money he would have spent on gym class
  - D. zero, since Tim chose to watch cat videos, which reflects his preferences

ANS: B                      PTS: 1                      DIF: Difficult                      TOP: Lesson 2: The cost of something is what you give up to get it

18. People make decisions at the margin by:
- A. following tradition

- B. comparing costs and benefits
- C. experience
- D. calculating dollar costs

ANS: B                      PTS: 1                      DIF: Moderate                      TOP: Lesson 3: Rational people think at the margin

19. Which of the following is most likely to be a marginal change?
- A. Working one day less a month
  - B. Getting a new job
  - C. Getting a pay increase of 50 per cent
  - D. Deciding to work part-time

ANS: A                      PTS: 1                      DIF: Moderate                      TOP: Lesson 3: Rational people think at the margin

20. A rational decision maker takes an action only if the:
- A. marginal benefit is greater than the marginal cost
  - B. marginal benefit is less than the marginal cost
  - C. average benefit is greater than the average cost
  - D. total benefit is greater than total cost

ANS: A                      PTS: 1                      DIF: Moderate                      TOP: Lesson 3: Rational people think at the margin

21. You have spent \$500 purchasing and repairing an old car which you expect to sell for \$700 once the repairs are complete. You discover that you need an additional part, which will cost \$500, including labour, in order to complete the repairs. You can sell the car as it is now for \$300. What should you do?
- A. you should never sell something for less than it costs
  - B. you should cut your losses and take the \$300
  - C. you should complete the repairs and sell the car
  - D. it does not matter, both actions lead to a loss

ANS: B                      PTS: 1                      DIF: Moderate                      TOP: Lesson 3: Rational people think at the margin

22. Which of the following is important for policymakers to consider when designing public policy?
- A. the possibility that policies might change behaviour
  - B. the direct effect of policies
  - C. the indirect effect of policies
  - D. all of the above

ANS: D                      PTS: 1                      DIF: Moderate                      TOP: Lesson 4: People respond to incentives

23. According to Peltzman, one effect of a government-imposed seatbelt law has been:
- A. fewer pedestrian deaths
  - B. safer driving
  - C. an increase in the number of accidents
  - D. that everyone now wears seatbelts

ANS: C                      PTS: 1                      DIF: Moderate                      TOP: Lesson 4: People respond to incentives

24. International trade:

- A. prevents countries from specialising in what they do best
- B. restricts the variety of goods a country can enjoy
- C. encourages countries to specialise in what they do best
- D. is a threat to national security

ANS: C                      PTS: 1                      DIF: Moderate                      TOP: Lesson 5: Trade can make everyone better off

25. Trade between Australia and New Zealand:

- A. is a losing proposition for New Zealand because Australian workers are more productive
- B. is a losing proposition for Australia because New Zealand has cheaper labour
- C. is like a sports contest – one side wins and the other side loses
- D. benefits both Australia and New Zealand

ANS: D                      PTS: 1                      DIF: Moderate                      TOP: Lesson 5: Trade can make everyone better off

26. If Australia is better than the US at producing wheat, but the US is better than Australia at producing cars, the US should:

- A. impose a tariff on Australian wheat in order to protect jobs in the US car industry
- B. sell cars to Australia, and buy Australian wheat
- C. subsidise its wheat industry so that it can compete with Australian wheat
- D. sell wheat to Australia and buy Australian cars

ANS: B                      PTS: 1                      DIF: Moderate                      TOP: Lesson 5: Trade can make everyone better off

27. Which of the following is the best statement about markets?

- A. markets are usually a good way to organise economic activity
- B. markets are usually inferior to central planning as a way to organise economic activity
- C. markets are flawed and are therefore not an acceptable way to organise economic activity
- D. markets are a good way to organise economic activity in developed nations, but not in less-developed nations

ANS: A                      PTS: 1                      DIF: Easy                      TOP: Lesson 6: Markets are usually a good way to organise economic activity

28. Coordination of economic activity in a market economy is achieved by:

- A. government regulations
- B. banks and other financial intermediaries
- C. planning agencies within government
- D. the guiding function of prices

ANS: D                      PTS: 1                      DIF: Easy                      TOP: Lesson 6: Markets are usually a good way to organise economic activity

29. Which of the following observations was made famous by Adam Smith in his book *The Wealth of Nations*?

- A. There is no such thing as a free lunch
- B. People buy more when prices are low than when prices are high
- C. No matter how much people earn, they tend to spend more than they earn
- D. Households and firms interacting in markets are guided as if by an 'invisible hand'



ANS: D                      PTS: 1                      DIF: Easy                      TOP: Lesson 6: Markets are usually a good way to organise economic activity

30. The main motivation behind the 'invisible hand' is:
- A. the threat of government intervention
  - B. business ethics
  - C. self-interest
  - D. the legal system

ANS: C                      PTS: 1                      DIF: Easy                      TOP: Lesson 6: Markets are usually a good way to organise economic activity

31. A market economy is guided by:
- A. a central planning department
  - B. people's decisions to buy and sell goods
  - C. people's decisions to pay taxes
  - D. people's ability to specialise

ANS: B                      PTS: 1                      DIF: Easy                      TOP: Lesson 6: Markets are usually a good way to organise economic activity

32. When the government prevents prices from adjusting naturally to supply and demand:
- A. it stabilises the economy
  - B. it adversely affects the allocation of resources
  - C. the improvement in equity justifies the reduction in efficiency
  - D. the reduced uncertainty associated with fixed prices is worth more than the cost in lower efficiency

ANS: B                      PTS: 1                      DIF: Moderate                      TOP: Lesson 7: Governments can sometimes improve market outcomes

33. Which of the following is an example of market failure?
- A. a firm becomes insolvent and is forced out of the market
  - B. a firm's research and development fails to develop a new product
  - C. a firm closes down a factory due to poor sales
  - D. a firm's pollution into a river reduces the number of fish that can be caught

ANS: D                      PTS: 1                      DIF: Easy                      TOP: Lesson 7: Governments can sometimes improve market outcomes

34. The two best reasons for a government to intervene in a market are to:
- A. raise revenues and to promote stability
  - B. promote equity and to raise revenues
  - C. promote efficiency and to raise revenues
  - D. promote equity and to promote efficiency

ANS: D                      PTS: 1                      DIF: Difficult                      TOP: Lesson 7: Governments can sometimes improve market outcomes

35. Two important causes of market failure are:
- A. externalities and market power
  - B. externalities and increases in prices
  - C. market power and increases in poverty

D. increases in poverty and increases in prices

ANS: A                      PTS: 1                      DIF: Moderate                      TOP: Lesson 7: Governments can sometimes improve market outcomes

36. An externality is the impact of:
- A. society's decisions on the well-being of society
  - B. a person's actions on that person's well being
  - C. society's decisions on the well-being of one person
  - D. one person's actions on the wellbeing of a bystander

ANS: D                      PTS: 1                      DIF: Easy                      TOP: Lesson 7: Governments can sometimes improve market outcomes

37. An example of an externality is:
- A. a drought reducing wheat production in Australia
  - B. an increase in the price of bread after a sales tax is imposed
  - C. a new road that increases noise levels in adjacent houses
  - D. a firm that loses market share after a new firm enters the market

ANS: C                      PTS: 1                      DIF: Moderate                      TOP: Lesson 7: Governments can sometimes improve market outcomes

38. If scientific research is not supported by patents and government subsidies then there is a risk that:
- A. pharmaceutical companies will not make enough profit
  - B. too much research will be done
  - C. universities will have to do all the research
  - D. not enough research will be done

ANS: D                      PTS: 1                      DIF: Moderate                      TOP: Lesson 7: Governments can sometimes improve market outcomes

39. A situation in which a market left on its own fails to allocate resources efficiently is known as:
- A. scarcity
  - B. opportunity cost
  - C. market failure
  - D. market power

ANS: C                      PTS: 1                      DIF: Moderate                      TOP: Lesson 7: Governments can sometimes improve market outcomes

40. Which of these consumption activities is most likely to cause an external cost?
- A. an executive plays a vigorous game of golf
  - B. a student in a flat plays her CDs at 120 decibels late at night
  - C. a young mother exercises to an aerobics video
  - D. a construction worker eats a sandwich during the lunch break

ANS: B                      PTS: 1                      DIF: Moderate                      TOP: Lesson 7: Governments can sometimes improve market outcomes

41. If paper-pulp factories generate too much water pollution with their discharge, which kills local fish stocks then:
- A. the government will not be able to do anything to stop this
  - B. the factories will be concerned about the loss of fish and reduce their pollution

- C. the government can treat the water for pollution and restock the river
- D. the government can use environmental regulations to reduce the

ANS: D                      PTS: 1                      DIF: Moderate                      TOP: Lesson 7: Governments can sometimes improve market outcomes

42. Market power refers to the:
- A. relative importance of a market to the overall economy
  - B. ability of a person or group of people to successfully market new products
  - C. power of the government to regulate a market
  - D. power of a small group of people to influence prices

ANS: D                      PTS: 1                      DIF: Easy                      TOP: Lesson 7: Governments can sometimes improve market outcomes

43. A good example of a monopoly is:
- A. a commercial fishing boat operating in the inshore fishery
  - B. an eco-tourist business that has sole rights to take visitors into a reserve
  - C. a large computer company with many business software products
  - D. a bookstore in a large city

ANS: B                      PTS: 1                      DIF: Easy                      TOP: Lesson 7: Governments can sometimes improve market outcomes

44. Which is the best example of an economic actor with market power?
- A. A café in Melbourne
  - B. A coffee producer in Colombia
  - C. A large supermarket in a small rural town
  - D. A coffee drinker

ANS: C                      PTS: 1                      DIF: Easy                      TOP: Lesson 7: Governments can sometimes improve market outcomes

45. In Australia, it would be possible to justify a higher income tax on the rich by potential gains in:
- A. efficiency
  - B. equity
  - C. market power
  - D. business ethics

ANS: B                      PTS: 1                      DIF: Moderate                      TOP: Lesson 7: Governments can sometimes improve market outcomes

46. What ultimately determines a country's standard of living?
- A. its ability to produce goods and services
  - B. its level of oil and gas reserves
  - C. the quantity of natural resources it has
  - D. the level of trade barriers to protect domestic industries

ANS: A                      PTS: 1                      DIF: Easy                      TOP: Lesson 8: A country's standard of living depends on its ability to produce goods and services

47. The income of a typical worker in a country is most closely linked to which of the following?
- A. population
  - B. labour unions

- C. productivity
- D. government policies

ANS: C                      PTS: 1                      DIF: Easy                      TOP: Lesson 8: A country's standard of living depends on its ability to produce goods and services

48. If Australian workers are more productive than New Zealand workers, one would expect:
- A. the two countries to trade with each other
  - B. Australia to have higher wages than New Zealand
  - C. Australia to have more trade barriers than New Zealand
  - D. Australia to provide aid to New Zealand

ANS: B                      PTS: 1                      DIF: Easy                      TOP: Lesson 8: A country's standard of living depends on its ability to produce goods and services

49. Productivity is defined as the:
- A. actual amount of effort workers put into an hour of working time
  - B. number of workers required to produce a given amount of goods and services
  - C. amount of labour that can be saved by replacing workers with machines
  - D. amount of goods and services produced from each hour of a worker's time

ANS: D                      PTS: 1                      DIF: Easy                      TOP: Lesson 8: A country's standard of living depends on its ability to produce goods and services

50. Domestic fishers in South-East Asia use small boats and nets while in New Zealand, fishers use large powered boats with modern navigation devices and large nets. New Zealand fishers earn more money. The difference in the incomes of the two groups of fishers is because:
- A. New Zealand fishers belong to powerful unions
  - B. labour is more productive with large modern boats using the latest technology
  - C. there is more demand for fish from New Zealand than for fish from South-East Asia
  - D. fish from New Zealand are worth more than fish from South-East Asia

ANS: B                      PTS: 1                      DIF: Moderate                      TOP: Lesson 8: A country's standard of living depends on its ability to produce goods and services

51. When a government thinks about how a policy will affect living standards, the key question it must consider is:
- A. how it will affect population growth rates
  - B. how it will affect our ability to produce goods and services
  - C. how it will affect the budget
  - D. how it will affect income distribution

ANS: B                      PTS: 1                      DIF: Moderate                      TOP: Lesson 8: A country's standard of living depends on its ability to produce goods and services

52. The historical rise in living standards of Australian workers is primarily a result of:
- A. the influence of labour unions
  - B. the rise in labour productivity
  - C. minimum-wage laws
  - D. tariff protection

ANS: B                      PTS: 1                      DIF: Easy                      TOP: Lesson 8: A country's standard of living depends on its ability to produce goods and services

53. To increase living standards, the most appropriate public policy measure is to:
- A. make unemployment benefits less generous
  - B. make unemployment benefits more generous
  - C. encourage workers to invest in education and training
  - D. require all workers to belong to unions and set high minimum wages

ANS: C                      PTS: 1                      DIF: Easy                      TOP: Lesson 8: A country's standard of living depends on its ability to produce goods and services

54. Which of the following tends to decrease productivity?
- A. budget deficits
  - B. education
  - C. competition
  - D. investment

ANS: A                      PTS: 1                      DIF: Moderate                      TOP: Lesson 9: Prices rise when the government prints too much money

55. Inflation is defined as:
- A. a period of rising productivity in the economy
  - B. an increase in the overall level of output in the economy
  - C. a period of rising income in the economy
  - D. an increase in the overall level of prices in the economy

ANS: D                      PTS: 1                      DIF: Easy                      TOP: Lesson 9: Prices rise when the government prints too much money

56. Which of the following is the most correct statement about the relationship between inflation and unemployment?
- A. In the long run, the value of money falls and productivity increases
  - B. In the short run, reducing inflation is associated with rising prices
  - C. In the long run, the Phillips curve does not describe the relationship between inflation and unemployment
  - D. In the long run, the Phillips curve does describe the relationship between inflation and unemployment

ANS: C                      PTS: 1                      DIF: Moderate                      TOP: Lesson 9: Prices rise when the government prints too much money

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

ANS: A                      PTS: 1                      DIF: Easy                      TOP: Lesson 10: Society faces a short-term trade-off between inflation and unemployment

58. The Phillips curve demonstrates:
- A. the relationship between supply and demand
  - B. the trade-off between equity and efficiency
  - C. the relationship between productivity and wages
  - D. the trade-off between inflation and unemployment

ANS: D                      PTS: 1                      DIF: Easy  
short-term trade-off between inflation and unemployment

TOP: Lesson 10: Society faces a

59. One explanation of the trade-off between inflation and unemployment is that:
- A. prices are flexible
  - B. prices are sticky
  - C. prices always tend to rise
  - D. unemployment increases demand

ANS: B                      PTS: 1                      DIF: Easy  
short-term trade-off between inflation and unemployment

TOP: Lesson 10: Society faces a

## SHORT ANSWER

1. What alternatives would you include when determining your opportunity cost of starting a university degree?

ANS:

You would include:

- what you could otherwise do with the time you will spend studying;
- how much your degree will cost and what you might otherwise be able to do with the money;
- whether your degree will attract a higher wage for you in the future and whether this would compensate you for the time, money and effort spent obtaining it.

PTS: 1                      DIF: Moderate                      TOP: Lesson 2: The cost of something is what you give up to get it

2. Households face many of the same decisions that societies face. Explain why this is true.

ANS:

Like households, societies must decide which members do which tasks and what each member gets in return for doing those tasks. Like societies, households must allocate their scarce resources among their members, given each member's abilities, efforts and desires.

PTS: 1                      DIF: Easy                      TOP: Introduction/ Lesson 1: People face trade-offs

3. There has been some discussion about changes to unemployment benefits that will result in recently graduated students not receiving payments until six months after they finish their studies. How might the changes affect people's decision-making on finishing university?

ANS:

Changes in the unemployment benefits system will change the opportunity cost of going to university. If university graduates receive unemployment benefits for the first six months after finishing university, they might allow themselves to take longer to find a job, but, since the opportunity cost of getting a job is higher (since they have a 'wage' coming in from the welfare system) they will look for higher-paying, more highly skilled jobs. If they receive no income from welfare while job searching they may settle for a more lowly-paid job since the opportunity cost of working is very low (any wage compared to nothing).

PTS: 1                      DIF: Moderate                      TOP: Lesson 2: The cost of something is what you give up to get it

4. The government is considering investing in two policies aimed at increasing the productivity of the healthcare system. The first policy reduces the cost of doing a medical degree. The second invests in a new IT system for managing patient records. What is the government trying to achieve with each policy? What incentives is it creating?

ANS:

The first policy is aimed at increasing the incentive to study medicine and thus to increase the supply of doctors in the economy. This will mean more patients can be seen because there are more doctors to see them. The second policy is aimed at making current doctors more productive, so that more patients will be seen per hour by the same number of doctors.

PTS: 1                      DIF: Moderate                      TOP: Lesson 4: People respond to incentives

5. A biscuit shop in a shopping centre is open from 9 a.m. to 5 p.m. Monday to Friday. The cost of making and selling biscuits averages \$0.50 per biscuit. At 5 p.m. on Friday evening, the owner still has several dozen unsold biscuits. The biscuits will not be saleable on Monday. What is the best price strategy for the biscuit shop to take? Justify your answer.

ANS:

The owner should continually reduce the price of the biscuits so that all the biscuits are sold by closing time, even if the price falls below \$0.50.

PTS: 1                      DIF: Moderate                      TOP: Introduction/ Lesson 1: People face trade-offs

6. One trade-off that society faces is between efficiency and equity. Define each term and explain this trade-off.

ANS:

Efficiency is the property of society getting the most it can from its scarce resources.

Equity is defined as the property of distributing economic prosperity fairly among the members of society. Often these two goals conflict. When the government redistributes income from the rich to the poor, it reduces the reward for working hard. Fewer goods and services are produced and the economic pie gets smaller. When the government tries to cut the economic pie into more equal slices, the pie gets smaller.

PTS: 1                      DIF: Easy                      TOP: Introduction/ Lesson 1: People face trade-offs

7. Define opportunity cost. What is the opportunity cost of a forestry company planting an area with seedlings?

ANS:

The value of the best alternative use of the resource. For a forestry company the opportunity cost is the income it gives up from using the land in an alternative, productive use (e.g. dairy farming).

PTS: 1                      DIF: Easy                      TOP: Lesson 3: Rational people think at the margin

8. What is the general rule for rational decision making?

ANS:

An action is taken only if the marginal benefit of the action exceeds the marginal cost.

PTS: 1                      DIF: Easy                      TOP: Lesson 3: Rational people think at the margin

9. A forestry company is trying to decide whether to harvest a plantation of pine trees or leave harvest for another year. How might it use marginal analysis to make a decision on timing?

ANS:

The company would have to consider whether waiting for the trees to grow for one more year creates enough additional benefit (higher revenue) to justify the additional cost (forgone profit from harvesting now). If the marginal benefit from waiting exceeds the marginal cost, they should wait.

PTS: 1                      DIF: Moderate              TOP: Lesson 3: Rational people think at the margin

10. What benefits can a family realise by choosing to trade instead of being self-sufficient?

ANS:

Trade allows each person to specialise in the activities he or she does best. By trading with others, people can buy a greater variety of goods and services at lower cost.

PTS: 1                      DIF: Moderate              TOP: Lesson 5: Trade can make everyone better off

11. New Zealand and Australia trade similar, but not identical, forestry products with each other. Why wouldn't each country choose to produce all the forestry products they need domestically?

ANS:

By trading, each country can specialise in the forestry products for which they have the lowest production costs. This means they can obtain the forestry products at a lower cost than if they tried to produce all these products by themselves.

PTS: 1                      DIF: Moderate              TOP: Lesson 5: Trade can make everyone better off

12. Why does Australia continue to trade with a country like Japan, which places tariffs and other barriers on Australian goods?

ANS:

Trade between Australia and Japan allows both countries to specialise in what they do best, and to purchase goods at lower costs than those at which they can produce the goods themselves. Although the tariffs and other barriers reduce the gains from trade, as long as trade between Australia and Japan takes place, both nations must be benefiting from trade. Japan must be able to produce some goods cheaper than Australia can.

PTS: 1                      DIF: Difficult              TOP: Lesson 5: Trade can make everyone better off

13. The Australian government redistributes income from the rich to the poor. Explain how this action affects equity as well as efficiency in the economy.

ANS:

Policies aimed at achieving a more equal distribution of economic wellbeing, such as the welfare system, try to help those members of society who are most in need. The individual income tax asks the financially successful to contribute more than others to support the government. When the government redistributes income from the rich to the poor, it reduces the reward for working hard. Fewer goods and services are produced and the economic pie gets smaller. As a result, equity increases and efficiency decreases.

PTS: 1                      DIF: Moderate              TOP: Lesson 7: Governments can sometimes improve market outcomes



14. You have recently noticed the government talking about reducing its spending, and a number of your colleagues have been laid off in the last few weeks. What might be happening? Will this be a long-term situation?

ANS:

This is a classic example of the Phillips Curve in action. A reduction of the quantity of money in the economy reduces overall spending. In addition, prices are sticky in the short-run, so the reduction in government spending will reduce the amount of goods and services that firms sell. Lower sales, in turn, will cause firms to lay off workers. This situation will not last forever, as prices adjust in the long-term, however, the conditions may last several years.

PTS: 1                      DIF: Difficult                      TOP: Lesson 10: Society faces a short-term trade-off between inflation and unemployment.

15. Lead used to be added to petrol to make the engine operate smoothly. Lead is also an atmospheric pollutant and it has been banned as an additive. Was there an economic justification for this ban by the government?

ANS:

Leaded petrol produced an externality (pollution) that is a source of market failure. Government regulation in this case can be justified to improve the market outcome.

PTS: 1                      DIF: Moderate                      TOP: Lesson 7: Governments can sometimes improve market outcomes

16. Suppose that the government enforces a law which prohibits the creation of any pollution. What effect do you think the enforcement of this law will have on the wellbeing of society?

ANS:

While pollution creates an external cost to society, there is also a cost to society of eliminating the pollution. A law that prohibits pollution considers the marginal benefit to society of eliminating pollution but not the marginal cost. Hence the enforcement of the law could actually harm society, if the cost of eliminating the pollution were greater than the benefit. In fact, such a law would eliminate all people, because people emit CO<sub>2</sub>, a greenhouse gas.

PTS: 1                      DIF: Moderate                      TOP: Lesson 7: Governments can sometimes improve market outcomes

17. Paid parental leave provides income to the mother to stay at home after having a baby. What might be the different incentives under a system providing benefits to the value of the minimum wage, compared to one where benefits are calculated as a portion of the mother's income?

ANS:

The different policies will have an effect on the decisions mothers with different incomes make. The two systems present different opportunity costs of having a baby. Under the minimum wage system, all women are paid the same to have a baby, so a mother with a higher income may wait longer in order to save more before having a baby. In contrast, a system based on the mother's wage may encourage wealthier women to have babies earlier, and to have more babies, as the opportunity cost of having children is lower.

PTS: 1                      DIF: Difficult                      TOP: Lesson 2: The cost of something is what you give up to get it

18. Public policies often alter the costs and benefits of private actions. Why is it important for policymakers to consider both the direct and indirect effects of public policies?

ANS:

If policymakers don't consider how behaviour might be changed both directly and indirectly, their policies can have effects that they did not intend. The example used in the text is the seatbelt law.

PTS: 1  
market outcomes

DIF: Easy

TOP: Lesson 7: Governments can sometimes improve

19. Russell learned in his economics class that income depends primarily on productivity. He took a summer job in construction, and worked very hard as a manual labourer for one month at \$8 per hour. His hard work and reliability led the foreman to give Russell a new responsibility, operating a steel roller at \$15 per hour. The new job required much less effort than the old job, and left Russell wondering why his income had increased when his effort had gone down. How can you explain this situation to Russell?

ANS:

Income is based on productivity, not effort. Russell was able to be more productive working with a machine than working with a shovel.

PTS: 1

DIF: Moderate

TOP: Lesson 8: A country's standard of living depends on its ability to produce goods and services

20. In what case can a government's attempt to lower inflation and promote increased barrier-free trade have long-term consequences on unemployment?

ANS:

When the money supply is reduced, lower spending combined with prices that are too high reduces sales and causes workers to be laid off. The market then accepts this price adjustment as the new, long-term price, and workers are permanently unemployed. Additionally, if the labour productivity overseas is higher, the employment can be permanently shifted overseas as barriers to trade have been reduced.

PTS: 2

DIF: Difficult

TOP: Lesson 10: Society faces a short-term trade-off between inflation and unemployment

21. In what case can a government's attempt to lower inflation have an effect on student numbers at TAFE/universities?

ANS:

When government spending is reduced, demand in the entire economy falls. This leads to lower production and lower sales. It also leads to a decrease in the demand for labour, so workers are laid off. Previously employed workers may have to retrain in order to find jobs when the economy finally picks up.

PTS: 1

DIF: Moderate

TOP: Lesson 10: Society faces a short-term trade-off between inflation and unemployment