

Chapter 1. Economics and Institutions: A Shift of Emphasis

TRUE/FALSE

1. Because other societies faced with the same problems have found different solutions, clearly some institutional arrangements are arbitrary.

ANS: T PTS: 1 DIF: Moderate NAT: Analytic
LOC: The study of economics, and definitions of economics
TOP: Institutional Arrangements: Preordained or Arbitrary?

2. Microeconomics asks how individuals create a set of economic institutions to maximize their self-interest.

ANS: T PTS: 1 DIF: Easy NAT: Analytic
LOC: The study of economics, and definitions of economics
TOP: Microeconomics: A Tool for Understanding Institutions

3. A statement that we should increase the minimum wage is an example of positive economics.

ANS: F PTS: 1 DIF: Moderate NAT: Reflective Thinking
LOC: The study of economics, and definitions of economics
TOP: The Problem of Allocating Resources

4. The optimal way for Santa Claus to allocate presents to children depends on the incremental happiness that each dollar allocated to a child brings.

ANS: T PTS: 1 DIF: Moderate NAT: Reflective Thinking
LOC: Marginal costs & benefits TOP: Allocation Strategies

5. The positive question of modern institutional economics is why we have the current set of institutions.

ANS: T PTS: 1 DIF: Easy NAT: Analytic
LOC: The study of economics, and definitions of economics
TOP: The Effect of Institutions on the Allocation Process

6. Conventions developed by a society to help it resolve recurrent economic problems are called economic models.

ANS: F PTS: 1 DIF: Moderate NAT: Analytic
LOC: The study of economics, and definitions of economics
TOP: Economic Institutions Defined

7. Economic models are abstract representations of reality that economists use to study economic and social phenomena.

ANS: T PTS: 1 DIF: Easy NAT: Analytic
LOC: Understanding and applying economic models TOP: Economic Models

8. The study of games of strategy and the strategic interactions that such games reveal is known as game theory.

ANS: T PTS: 1 DIF: Easy NAT: Analytic
 LOC: Understanding and applying economic models TOP: Analogies as Models

9. Laura Ramos developed an economic theory and tested it in a lab experiment. The lab data did not match the behavior predicted by her theory. Laura should rethink the validity of her theory.

ANS: T PTS: 1 DIF: Moderate NAT: Reflective Thinking
 LOC: Understanding and applying economic models
 TOP: Testing Theories--Economics as an Experimental Science

10. Property rights enhance the efficiency of economic activities by giving people the appropriate incentives to manage what would otherwise be common resources.

ANS: T PTS: 1 DIF: Moderate NAT: Analytic
 LOC: The role of incentives TOP: Property Rights

MULTIPLE CHOICE

1. Which of the following is not an example of an institution that shapes the life of an executive?
- expressways
 - happiness
 - insurance companies

ANS: B PTS: 1 DIF: Moderate NAT: Analytic
 LOC: The study of economics, and definitions of economics
 TOP: Microeconomics and Institutions

2. Which of the following questions is an example of institutional arrangements?
- Why does the government allow only one utility company to deliver electricity in an area?
 - Why do most committees make their decisions by a simple majority vote?
 - Why can't consumers in Washington state buy locally grown apples?
 - All of the answers is correct
 - None of the answers is correct

ANS: D PTS: 1 DIF: Easy NAT: Analytic
 LOC: The study of economics, and definitions of economics
 TOP: Institutional Arrangements: Preordained or Arbitrary?

3. Though different, Japanese and U.S. compensation systems serve the same purpose, which is
- to pay the highest salaries possible
 - to motivate employees at work
 - to pay the lowest bonuses possible

ANS: B PTS: 1 DIF: Moderate NAT: Analytic
 LOC: The role of incentives
 TOP: Institutional Arrangements: Preordained or Arbitrary?

4. How do individuals, in an attempt to maximize their own self-interest, create a set of economic institutions that structure their daily lives is a question for
- macroeconomics
 - fiscal policy economics
 - microeconomics

ANS: C PTS: 1 DIF: Moderate NAT: Analytic
LOC: The study of economics, and definitions of economics
TOP: Microeconomics: A Tool for Understanding Institutions

5. One type of institution is
- perfectly competitive markets
 - perfectly and imperfectly competitive markets
 - imperfectly competitive markets

ANS: B PTS: 1 DIF: Moderate NAT: Analytic
LOC: Markets, market failure, and externalities
TOP: Microeconomics: A Tool for Understanding Institutions

6. The type of economics that deals with prescriptive statements is
- positive
 - medical
 - normative (welfare)

ANS: C PTS: 1 DIF: Easy NAT: Analytic
LOC: The study of economics, and definitions of economics
TOP: The Problem of Allocating Resources

7. The type of economics that deals with descriptive statements is
- welfare
 - positive
 - normative

ANS: B PTS: 1 DIF: Easy NAT: Analytic
LOC: The study of economics, and definitions of economics
TOP: The Problem of Allocating Resources

8. Incremental happiness is
- an example of normative economics
 - impossible to achieve
 - the optimal economic way for parents to allocate their funds between their children

ANS: C PTS: 1 DIF: Hard NAT: Analytic
LOC: Marginal costs & benefits TOP: Allocation Strategies

9. Which of the following is an institutional process that a family could use to make allocation decisions?
- dictatorial
 - democratic
 - market-based
 - All the answers are correct

ANS: D PTS: 1 DIF: Easy NAT: Analytic
LOC: The study of economics, and definitions of economics
TOP: The Effect of Institutions on the Allocation Process

10. Which question is least important to institutional microeconomists?
- the allocative role of markets
 - how markets come into being in the first place
 - how markets can be designed to increase economic welfare

ANS: A PTS: 1 DIF: Moderate NAT: Reflective Thinking
LOC: The study of economics, and definitions of economics
TOP: The Effect of Institutions on the Allocation Process

11. Which of the following is not an institution?
- the practice of tipping the person who cuts your hair
 - a set of mathematical equations to represent each segment of an economy
 - the set of rules that specifying how your state legislature makes decisions

ANS: B PTS: 1 DIF: Moderate NAT: Reflective Thinking
LOC: The study of economics, and definitions of economics
TOP: Economic Institutions Defined

12. Economic institutions are
- sets of rules created to govern athletic games
 - a society's conventions that help resolve recurrent economic problems
 - abstract representations of reality that economists use in their studies

ANS: B PTS: 1 DIF: Moderate NAT: Analytic
LOC: The study of economics, and definitions of economics
TOP: Economic Institutions Defined

13. Abstract representations of reality used by economists to study economic and social phenomena are called
- fashion models
 - economic models
 - model homes

ANS: B PTS: 1 DIF: Easy NAT: Analytic
LOC: Understanding and applying economic models TOP: Economic Models

14. A type of economic model is a(n)
a. mathematical model
b. analogy
c. Both answers are correct

ANS: C PTS: 1 DIF: Easy NAT: Analytic
LOC: Understanding and applying economic models TOP: Economic Models

15. Equations that represent each segment of an economy and the interaction of the equations is known as a(n)
a. analogy
b. mathematical model
c. economic institution

ANS: B PTS: 1 DIF: Easy NAT: Analytic
LOC: Understanding and applying economic models TOP: Mathematical Models

16. To understand how Sony, Toshiba, and Panasonic use prices to compete in the consumer electronics market, economists might use
a. game theory
b. physics
c. international diplomacy

ANS: A PTS: 1 DIF: Moderate NAT: Reflective Thinking
LOC: Understanding and applying economic models TOP: Analogies as Models

17. The best measure of how good an economic theory is how
a. elegant its mathematics equations are
b. many people believe it
c. well it explains the real world

ANS: C PTS: 1 DIF: Moderate NAT: Analytic
LOC: Understanding and applying economic models
TOP: Testing Theories--Economics as an Experimental Science

18. One concern about using real-world data to estimate key parameters of economic models is that the data is collected by agencies that are
a. political
b. scientific
c. theoretical

ANS: A PTS: 1 DIF: Easy NAT: Reflective Thinking
LOC: Understanding and applying economic models
TOP: Testing Theories--Economics as an Experimental Science

19. If Mark Kimura develops an economic theory, but cannot observe the predicted behavior during lab experiments, he should
- ignore the results and stick with his idea
 - rethink the validity of the theory
 - keep running the lab experiments and hope for different results

ANS: B PTS: 1 DIF: Moderate NAT: Reflective Thinking
 LOC: Understanding and applying economic models
 TOP: Testing Theories--Economics as an Experimental Science

20. If social agents find all the food they need growing on trees and the only decision that the agents must make is how much time to spend picking fruit versus relaxing, the agents live in a(n)
- primitive state of confusion
 - primitive state of nature
 - industrialized state of nature

ANS: B PTS: 1 DIF: Moderate NAT: Reflective Thinking
 LOC: The study of economics, and definitions of economics
 TOP: Section 2: Preferences, Utilities, Demands, and Uncertainty

21. When Brenda takes out a mortgage and does not know if her house's price will go up or down, she faces
- certainty
 - a guaranteed way to get rich
 - uncertainty

ANS: C PTS: 1 DIF: Moderate NAT: Reflective Thinking
 LOC: Utility and consumer choice
 TOP: Section 2: Preferences, Utilities, Demands, and Uncertainty

22. Decisions that are typically made at one point in time are
- always easy
 - static
 - dynamic

ANS: B PTS: 1 DIF: Easy NAT: Analytic
 LOC: Understanding and applying economic models
 TOP: Section 4: Decision Theory--Static and Dynamic Decisions

23. A natural monopoly is a situation that occurs
- when an exotic plant kills off local plants
 - in industries where the cheapest way to obtain a given quantity of output is to have only one firm produce it
 - Both answers are correct

ANS: B PTS: 1 DIF: Easy NAT: Analytic
 LOC: Monopoly TOP: Section 5: Markets and Market Structures

24. If producers and consumers are not fully knowledgeable about the characteristics of all products produced and consumed in the economy, the people suffer from
- incomplete information
 - total ignorance
 - perfect information

ANS: A PTS: 1 DIF: Moderate NAT: Analytic
LOC: Markets, market failure, and externalities
TOP: Section 7: Breakdowns and Market Failure

25. In economics, a free ride is
- enjoying a public good paid for by others
 - jumping the turnstile at the subway
 - enjoying a private good paid for by others

ANS: A PTS: 1 DIF: Moderate NAT: Analytic
LOC: Markets, market failure, and externalities
TOP: Section 7: Breakdowns and Market Failure

SHORT ANSWER

1. An economics classroom has a very happy student. Every compliment from the professor makes this student exquisitely happy. There is also a morose student who rejects every compliment. What economic principle could the professor use to allocate compliments between these two students?

ANS:

Incremental happiness, also known as incremental utility or marginal utility, guides the optimal way to allocate compliments.

PTS: 1 DIF: Moderate NAT: Reflective Thinking
LOC: Marginal costs & benefits TOP: Allocation Strategies

2. What are the advantages of using analogies as economic models?

ANS:

For most students, narrative analogies are easier to understand than mathematical models. Game theory is easy to understand using analogies, or descriptions of the games. Narrative analogies are easier to test using laboratory experiments.

PTS: 1 DIF: Moderate NAT: Reflective Thinking
LOC: Understanding and applying economic models TOP: Analogies as Models

3. Why begin the study of market structures with perfect competition?

ANS:

Although an entrepreneur arising from a primitive state of nature will most likely be a monopolist, the study of competitive markets leads to optimal welfare results that provide a benchmark by which to compare other market structures. Also, it is conventional for textbooks to start with perfect competition.

PTS: 1 DIF: Hard NAT: Analytic
LOC: Markets, market failure, and externalities
TOP: Section 5: Markets and Market Structures

4. What problems are solved by the institution of a state?

ANS:

In a primitive state of nature, people obtain food by hunting and gathering and by stealing from one another. People defend their land by fighting with each other and might makes right. But time spent fighting and defending could be better spent gathering food. If peaceful people restrain from robbery, however, aggressive people will exploit the situation. Protective associations are a solution. The most efficient protective association encompasses the whole society and is called a state.

PTS: 1 DIF: Hard NAT: Analytic LOC: The role of government
TOP: The State

5. Should students accept the predictions of economic models?

ANS:

It is healthy to examine critically economic theories and laboratory experiments designed to test these theories. The consulting reports in the textbook demonstrate the fragility of economic models and their underlying assumptions. Economics is not a dead science in which all known problems have solutions, nor are all existing solutions effective.

PTS: 1 DIF: Moderate NAT: Reflective Thinking
LOC: Understanding and applying economic models TOP: Economic Consulting Firms