

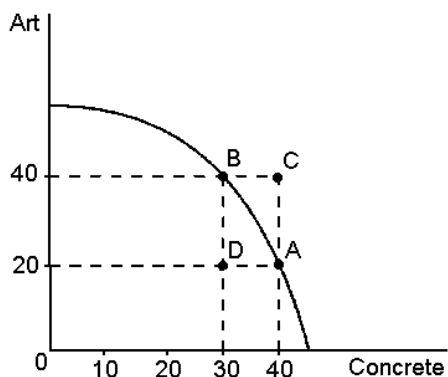
CHAPTER 2—Thinking like an economist

TRUE/FALSE

1. The single most important purpose of an economics principles text and course is to help students learn the economist's way of thinking.
ANS: T PTS: 1 DIF: Easy TOP: Introduction
2. While the scientific method is applicable to studying natural sciences, it is not useful in studying an economic system.
ANS: F PTS: 1 DIF: Easy TOP: The scientific method: Observation, theory and more observation
3. Most economic theories have been developed and tested by using controlled experiments.
ANS: F PTS: 1 DIF: Easy TOP: The scientific method: Observation, theory and more observation
4. The difference between natural scientists and economists is that natural scientists do not use simplifying assumptions in their models.
ANS: F PTS: 1 DIF: Moderate TOP: The role of assumptions
5. Understanding how an economic system works is aided by the use of many complex and rigorous, true assumptions.
ANS: T PTS: 1 DIF: Easy TOP: The role of assumptions
6. The art in scientific thinking is in deciding which assumptions to make.
ANS: T PTS: 1 DIF: Easy TOP: The role of assumptions
7. An economic model can accurately explain how the economy is organised because it is designed to include every feature of the real world.
ANS: F PTS: 1 DIF: Easy TOP: Economic models
8. Scientific models are designed to simplify reality because they are built with simplifying assumptions.
ANS: T PTS: 1 DIF: Easy TOP: Economic models
9. All scientific models, including economic models, simplify reality in order to improve our understanding of it.
ANS: T PTS: 1 DIF: Easy TOP: Economic models
10. A circular-flow diagram is a simple, equation-based model of how an economy is organised.
ANS: F PTS: 1 DIF: Easy TOP: Our first model: The circular-flow diagram
11. In a circular-flow diagram, the relationships shown are only those that involve the flow of real goods and services.
ANS: F PTS: 1 DIF: Easy TOP: Our first model: The circular-flow diagram
12. In a simple circular-flow diagram, firms have to hire or purchase factors of production from households in order to produce goods and services.
ANS: T PTS: 1 DIF: Easy TOP: Our first model: The circular-flow diagram
13. In a simple circular-flow diagram, the two types of markets in which households and firms interact are the markets for goods and services and the markets for factors of production.
ANS: T PTS: 1 DIF: Easy TOP: Our first model: The circular-flow diagram

14. In the markets for goods and services, as in the markets for the factors of production, households are buyers and firms are sellers.
ANS: F PTS: 1 DIF: Easy TOP: Our first model: The circular-flow diagram
 15. In a circular-flow diagram, one loop shows the flow of real goods and services and the other loop shows the corresponding flow of dollars.
ANS: T PTS: 1 DIF: Moderate TOP: Our first model: The circular-flow diagram
 16. In a circular-flow diagram, spending on goods and services flows from households to firms and income flows from firms to households.
ANS: T PTS: 1 DIF: Easy TOP: Our first model: The circular-flow diagram
 17. In the circular-flow diagram, the only return households get from supplying factors of production to firms are wages.
ANS: F PTS: 1 DIF: Easy TOP: Our first model: The circular-flow diagram
 18. A production possibilities frontier is a graph that shows the various combinations of outputs the economy can possibly produce, given its factors of production and technology.
ANS: T PTS: 1 DIF: Easy TOP: Our second model: The production possibilities frontier
 19. The production possibilities frontier illustrates that it is not feasible for an economy to produce an output that is outside the frontier.
ANS: T PTS: 1 DIF: Easy TOP: Our second model: The production possibilities frontier
 20. An efficient outcome in economics is one in which the economy is conserving the largest possible amount of resources, while still meeting the needs of society.
ANS: F PTS: 1 DIF: Moderate TOP: Our second model: The production possibilities frontier
 21. The efficient production points for the production possibilities frontier, all lie on the actual frontier itself.
ANS: T PTS: 1 DIF: Easy TOP: Our second model: The production possibilities frontier
 22. An economy is being efficient if it is impossible to produce more of one good without producing less of another.
ANS: T PTS: 1 DIF: Moderate TOP: Our second model: The production possibilities frontier
 23. Points inside the production possibilities frontier represent inefficient outcomes for the economy.
ANS: T PTS: 1 DIF: Easy TOP: Our second model: The production possibilities frontier
- NARRBEGIN: 2-1**

Graph 2-1



NARREND

24. Refer to Graph 2-1. In the graph shown, points A, B and C represent feasible or attainable outcomes for society.
ANS: F PTS: 1 DIF: Easy TOP: Our second model: The production possibilities frontier NAR 2-1
25. Refer to Graph 2-1. In the graph shown, points A, B and D represent efficient outcomes for society.
ANS: F PTS: 1 DIF: Moderate TOP: Our second model: The production possibilities frontier NAR 2-1
26. Refer to Graph 2-1. In the graph shown, the opportunity cost to the economy of moving from point A to point B is 10 units of concrete.
ANS: T PTS: 1 DIF: Moderate TOP: Our second model: The production possibilities frontier NAR 2-1
27. Refer to Graph 2-1. In the graph shown, the opportunity cost of moving from point D to point B is 20 pieces of art.
ANS: F PTS: 1 DIF: Moderate TOP: Our second model: The production possibilities frontier NAR 2-1
28. Refer to Graph 2-1. In the graph shown, the opportunity cost of more art increases as more art is produced.
ANS: T PTS: 1 DIF: Moderate TOP: Our second model: The production possibilities frontier NAR 2-1
29. An economy will always operate at some point on its production possibilities curve.
ANS: F PTS: 1 DIF: Easy TOP: Our second model: The production possibilities frontier
30. If computers become easier to produce because of technological improvements, then producing more computers will mean a larger trade-off in the production of other goods.
ANS: F PTS: 1 DIF: Easy TOP: Our second model: The production possibilities frontier
31. Given a two-good production possibilities frontier, a technological improvement in the production of one good will cause the frontier to pivot outward.
ANS: T PTS: 1 DIF: Easy TOP: Our second model: The production possibilities frontier
32. The circular-flow diagram and the production possibilities frontier both illustrate such concepts as opportunity cost, economic growth and efficiency.
ANS: F PTS: 1 DIF: Moderate TOP: Our second model: The production possibilities frontier
33. Microeconomics is the study of decision making at the level of the individual household and firm, while macroeconomics is the study of the economy as a whole.
ANS: T PTS: 1 DIF: Easy TOP: Microeconomics and macroeconomics

34. The effect of a pollution tax is an economic issue most likely to be analysed by a microeconomist.
ANS: T PTS: 1 DIF: Easy TOP: Microeconomics and macroeconomics
35. Normative statements describe how the world is, while positive statements prescribe how the world should be.
ANS: F PTS: 1 DIF: Easy TOP: Microeconomics and macroeconomics
36. Australia harvests five to seven million kangaroos a year. Consider the statement 'Australia would be better off if the harvest of kangaroos was banned'. This is an example of a normative statement.
ANS: T PTS: 1 DIF: Moderate TOP: Positive versus normative analysis
37. Consider the statement 'banning the export of live parrots from Australia has resulted in the black market price for cockatoos rising and an increase in poaching'. This is an example of a normative statement.
ANS: F PTS: 1 DIF: Moderate TOP: Positive versus normative analysis
38. When economists are trying to explain the world they are acting as scientists and when they are trying to improve it, they are policymakers.
ANS: T PTS: 1 DIF: Easy TOP: Positive versus normative analysis
39. Normative statements are essentially value judgements about the issue being considered.
ANS: T PTS: 1 DIF: Easy TOP: Positive versus normative analysis
40. The main objective of economic science is to develop policies for the government.
ANS: F PTS: 1 DIF: Moderate TOP: Economists in government
41. An economist who says that all policy decisions are easy is an economist not to be trusted.
ANS: T PTS: 1 DIF: Easy TOP: Economists in government
42. The degree of agreement among economists on policy matters is usually greater than it appears to the public.
ANS: T PTS: 1 DIF: Easy TOP: Economists in government
43. Sometimes economists who have the same positive views about how the economy works give conflicting advice on policy because they have different values.
ANS: T PTS: 1 DIF: Easy TOP: Economists in government
44. Economists may disagree on how the government can reduce unemployment.
ANS: T PTS: 1 DIF: Easy TOP: Economists in government
45. The parameters chosen by economists may be a reason why differences of judgements result from the same issue.
ANS: F PTS: 1 DIF: Medium TOP: Differences in scientific judgements
46. Economists all agree that the government's carbon tax is the best way to reduce pollution emissions
ANS: F PTS: 1 DIF: Easy TOP: Differences in scientific judgements

47. Treating everyone equitably is a common value shared by all economists.

ANS: F PTS: 1 DIF: Easy TOP: Differences in values

48. Almost all economists oppose barriers to free trade.

ANS: T PTS: 1 DIF: Easy TOP: Perception versus reality

49. A survey of business, government and academic economists revealed widespread disagreement on ten propositions about economic policy.

ANS: F PTS: 1 DIF: Moderate TOP: Perception versus reality

MULTIPLE CHOICE

1. Which is the best statement about the way economists study the economy?

- A. they study the past but do not try to predict the future
- B. they devise theories, collect data, then analyse the data to test the theories
- C. they use a probability approach based on correlations between economic events
- D. they use controlled experiments in much the same way a biologist or physicist does

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

2. The scientific method can best be defined as:

- A. the use of modern laboratory equipment to discover scientific laws
- B. the careful design of controlled experiments to test theories about how the world works
- C. the unbiased development of and testing of theories about how the world works
- D. the selective and deliberate search for evidence that supports preconceived theories of how the world works

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

3. Sir Isaac Newton's development of the theory of gravity after observing an apple fall from a tree is an example of:

- A. controlled experiments used to develop scientific theories
- B. being in the right place at the right time
- C. an idea whose time had come
- D. the interplay between observation and theory in science

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

4. Economics differs from some of the natural sciences like physics because:

- A. experimentation is difficult to perform on an economic system where the researcher is unable to control for the influence of many of the variables
- B. it is difficult to evaluate the results of an economic experiment
- C. physicists get much larger research grants than economists
- D. economists don't have economic laws to test

ANS: A PTS: 1 DIF: Moderate TOP: The scientific method:
Observation, theory and more observation

5. Because it is difficult for economists to use experiments to generate economic data, they:

- A. do without them
- B. use whatever data the world gives them
- C. make up the data
- D. ask policymakers to conduct experiments for them

ANS: B PTS: 1 DIF: Easy TOP: The scientific method:
Observation, theory and more observation

6. Data to test economic theories generally come from:
- A. laboratory experiments undertaken in strict, controlled conditions
 - B. personal introspection
 - C. public opinion surveys
 - D. observations from previous episodes of economic change

ANS: D PTS: 1 DIF: Easy TOP: The scientific method:
Observation, theory and more observation

7. The rationale for using assumptions in economics is:
- A. it avoids having to collect any data
 - B. it is a useful way to ensure models are as realistic as possible
 - C. because economics is not a science
 - D. that it makes the world easier to understand

ANS: D PTS: 1 DIF: Easy TOP: The role of assumptions

8. The art of scientific thinking involves:
- A. deciding which assumptions to make
 - B. understanding every scientific field: physics, biology and economics
 - C. knowing how the major organs of the human body work
 - D. being able to mathematically express natural forces

ANS: A PTS: 1 DIF: Easy TOP: The role of assumptions

9. If an economist develops a theory about international trade based on the assumption that there are only two countries and two goods:
- A. the theory can be useful only in situations involving two countries and two goods
 - B. it is a total waste of time, since the actual world has many countries trading many goods
 - C. the theory can be useful in helping economists understand the complex world of international trade involving many countries and many goods
 - D. the theory can be useful in the classroom, but has no use in the real world

ANS: C PTS: 1 DIF: Easy TOP: The role of assumptions

10. In constructing models, economists must:
- A. employ simplifying assumptions
 - B. include as much detail as possible
 - C. use very complex mathematical equations
 - D. use very large datasets

ANS: A PTS: 1 DIF: Easy TOP: The role of assumptions

11. Economic models:
- A. are of limited use because they cannot be tested empirically
 - B. are limited to variables that are positively related to one another
 - C. emphasise basic economic relationships by abstracting from the complexities of the real world
 - D. are unrealistic and therefore of no practical consequence

ANS: C PTS: 1 DIF: Easy TOP: Economic models

12. Economists use models in order to:
- A. develop insights into how the economy works
 - B. develop insights into mathematical theorems
 - C. make economics hard for students to understand
 - D. help businesses decide what investments will be profitable

ANS: A PTS: 1 DIF: Easy TOP: Economic models

13. A model:

- A. simplifies reality
- B. can explain how the economy is organised
- C. assumes away irrelevant details
- D. does all of the above

ANS: D PTS: 1 DIF: Easy TOP: Economic models

14. Economic models are generally constructed with:

- A. tubes and valves
- B. assumptions only
- C. plastic pieces
- D. diagrams and equations

ANS: D PTS: 1 DIF: Easy TOP: Economic models

15. Which of the following is the most accurate statement about economic models?

- A. economic models attempt to mirror reality exactly
- B. economic models are useful, but should not be used for policymaking
- C. economic models cannot be used in the real world because they omit details
- D. economic models omit many details to allow us to see what is truly important

ANS: D PTS: 1 DIF: Moderate TOP: Economic models

16. The foundation stones from which economic models are built are:

- A. economic policies
- B. the legal system
- C. assumptions
- D. statistical forecasts

ANS: C PTS: 1 DIF: Easy TOP: The role of assumptions

17. The circular-flow diagram is a type of simple model that:

- A. illustrates the carbon-cycle in forestry economic models
- B. illustrates how an economy is organised between key sectors
- C. shows how fish stocks grow and replenish from harvest
- D. shows the money flows that are managed by the banking system

ANS: B PTS: 1 DIF: Easy TOP: Our first model: The circular-flow diagram

18. Factors of production are:

- A. inputs into the production process
- B. weather, social and political conditions that affect production
- C. the physical relationships between economic inputs and outputs
- D. the mathematical calculations firms make to determine production

ANS: A PTS: 1 DIF: Easy TOP: Our first model: The circular-flow diagram

19. The circular-flow diagram has two loops to illustrate the flows of:

- A. goods and the flow of dollars
- B. energy and wastes
- C. dollars and the flow of services
- D. dollars and the flow of goods and services

ANS: D PTS: 1 DIF: Easy TOP: Our first model: The circular-flow diagram

20. In a circular-flow diagram:

- A. taxes flow from households to firms, and transfer payments flow from firms to households
- B. income payments flow from firms to households, and sales revenue flows from

- households to firms
- C. resources flow from households to firms, and goods and services flow from firms to households
- D. both B and C occur

ANS: D PTS: 1 DIF: Easy TOP: Our first model: The circular-flow diagram

21. In the circular-flow diagram:
- A. firms are sellers in the resource market and the product market
- B. households are sellers in the resource market
- C. firms are buyers in the product market
- D. spending on goods and services flow from firms to households

ANS: B PTS: 1 DIF: Easy TOP: Our first model: The circular-flow diagram

22. The circular flow diagram illustrates the:
- A. flow of goods and services from households to firms
- B. flow of spending on goods and services from households to firms
- C. flow of factors of production from firms to households
- D. flow of spending on goods and services flows from firms to households

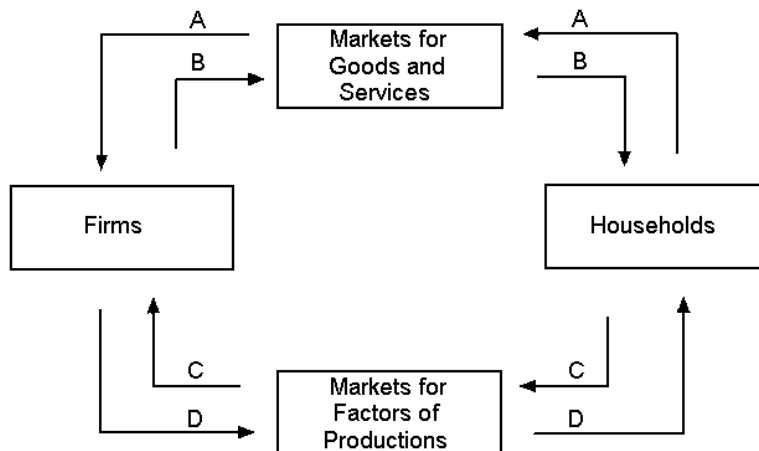
ANS: B PTS: 1 DIF: Easy TOP: Our first model: The circular-flow diagram

23. The revenue from sales that firms have left after paying for the factors of production is:
- A. rent
- B. wages
- C. interest
- D. profit

ANS: D PTS: 1 DIF: Easy TOP: Our first model: The circular-flow diagram

NARRBEGIN: 2-2

Graph 2-2



NARREND

24. Refer to Graph 2-2. In the circular-flow diagram shown, which arrow shows the flow of goods and services?
- A. A

- B. B
- C. C
- D. D

ANS: B PTS: 1 DIF: Easy TOP: Our first model: The circular-flow diagram NAR: 2-2

25. Refer to Graph 2-2. In the circular-flow diagram shown, which arrow shows the flow of spending by households?

- A. A
- B. B
- C. C
- D. D

ANS: A PTS: 1 DIF: Moderate TOP: Our first model: The circular-flow diagram NAR: 2-2

26. Refer to Graph 2-2. In the circular-flow diagram shown, which arrow shows the flow of the factors of production?

- A. A
- B. B
- C. C
- D. D

ANS: C PTS: 1 DIF: Moderate TOP: Our first model: The circular-flow diagram NAR: 2-2

27. Refer to Graph 2-2. In the circular-flow diagram shown, which arrow shows the flow of income payments?

- A. A
- B. B
- C. C
- D. D

ANS: D PTS: 1 DIF: Moderate TOP: Our first model: The circular-flow diagram NAR: 2-2

28. The production possibilities frontier is a:

- A. graph that shows the various combinations of output the economy can possibly produce, given the available resources and technology
- B. graph that shows the various combinations of resources the economy can possibly produce, given the available output
- C. graph that shows the various combinations of concrete the economy can possibly produce, given the available agricultural land
- D. graph that shows the various combinations of wheat the economy can possibly produce, given the available cement

ANS: A PTS: 1 DIF: Easy TOP: Our second model: The production possibilities frontier

29. Which of the following is the most accurate statement about production possibilities?

- A. an economy can produce only on the production possibilities frontier
- B. an economy can produce at any point inside or outside a production possibilities frontier
- C. an economy can produce at any point on or inside the production possibilities frontier, but not outside the frontier
- D. an economy can produce at any point inside the production possibilities frontier, but not on or outside the frontier

ANS: C PTS: 1 DIF: Easy TOP: Our second model: The

production possibilities frontier

30. An economic outcome is said to be efficient if the economy is:
- A. using all of the resources it has available
 - B. conserving resources and not using all it has
 - C. getting all it can from the scarce resources it has available
 - D. producing only the goods and services consumers need the most

ANS: C PTS: 1 DIF: Easy TOP: Our second model: The production possibilities frontier

31. On a production possibilities frontier, production is inefficient if the production point is:
- A. inside the frontier
 - B. outside the frontier
 - C. on or outside the frontier
 - D. on the frontier

ANS: A PTS: 1 DIF: Easy TOP: Our second model: The production possibilities frontier

32. An economy is said to be efficient if it is:
- A. possible to produce more of all goods
 - B. possible to produce more of one good without producing less of another
 - C. not possible to produce more of one good without producing less of another
 - D. not possible to produce more of one good at any cost

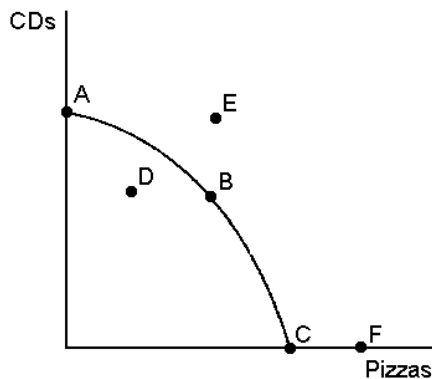
ANS: C PTS: 1 DIF: Easy TOP: Our second model: The production possibilities frontier

33. Which of the following concepts is illustrated by the production possibilities frontier?
- A. equity
 - B. conservation
 - C. efficiency
 - D. liquidity

ANS: C PTS: 1 DIF: Easy TOP: Our second model: The production possibilities frontier

NARRBEGIN: 2-3

Graph 2-3



NARREND

34. Refer to Graph 2-3. On the production possibilities frontier shown, at which point or points is it possible for this economy to produce?
- A. A, B, C, D
 - B. A, B, C, F

- C. A, B, C, D, E, F
- D. D

ANS: A PTS: 1 DIF: Easy TOP: Our second model: The production possibilities frontier NARR: 2-3

35. Refer to Graph 2-3. On the production possibilities frontier shown, which point represents the maximum possible production of CDs?
- A. A
 - B. B
 - C. C
 - D. D

ANS: A PTS: 1 DIF: Moderate TOP: Our second model: The production possibilities frontier NARR: 2-3

36. Refer to Graph 2-3. On the production possibilities frontier shown, at which point or points is it NOT possible for this economy to produce?
- A. D
 - B. E, F
 - C. A, B, C
 - D. D, E, F

ANS: B PTS: 1 DIF: Moderate TOP: Our second model: The production possibilities frontier NARR: 2-3

37. Refer to Graph 2-3. On the production possibilities frontier shown, at which point or points is the economy efficient?
- A. A, B, C
 - B. A, C, F
 - C. E
 - D. D

ANS: A PTS: 1 DIF: Moderate TOP: Our second model: The production possibilities frontier NARR: 2-3

38. Refer to Graph 2-3. On the production possibilities frontier shown, at which point or points is the economy inefficient?
- A. A, B, C
 - B. E, F
 - C. B
 - D. D

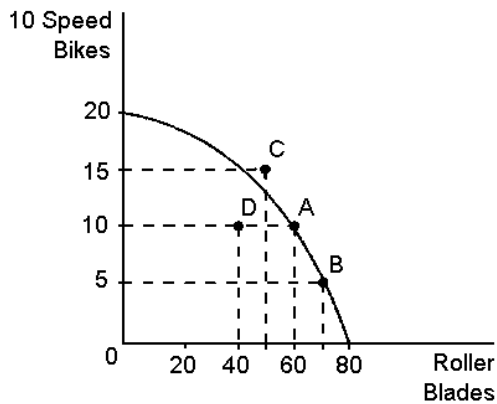
ANS: D PTS: 1 DIF: Moderate TOP: Our second model: The production possibilities frontier NARR: 2-3

39. The opportunity cost of obtaining more of one good is shown on the production possibilities frontier as the:
- A. amount of the other good that must be given up
 - B. market price of the additional amount produced
 - C. amount of resources that must be devoted to its production
 - D. number of dollars that must be spent to produce it

ANS: A PTS: 1 DIF: Moderate TOP: Our second model: The production possibilities frontier

NARRBEGIN: 2-4

Graph 2-4



NARREND

40. Refer to Graph 2-4. On the production possibilities frontier shown, the opportunity cost to the economy of getting 10 additional roller blades by moving from point A to point B is:
- A. 15 bikes
 - B. 10 bikes
 - C. five bikes
 - D. impossible to know without knowing the cost of the resources used to produce the additional roller blades

ANS: C PTS: 1 DIF: Moderate TOP: Our second model: The production possibilities frontier NAR: 2-4

41. Refer to Graph 2-4. On the production possibilities frontier shown, the opportunity cost of getting five additional bikes by moving from point A to point C is:
- A. 15 roller blades
 - B. 10 roller blades
 - C. five roller blades
 - D. it is impossible for the economy to move from point A to point C

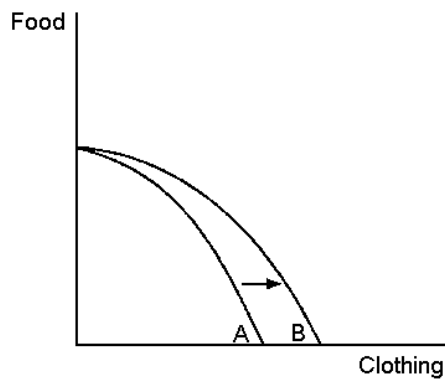
ANS: D PTS: 1 DIF: Moderate TOP: Our second model: The production possibilities frontier NAR: 2-4

42. Refer to Graph 2-4. On the production possibilities frontier shown, the opportunity cost of moving from point A to point D is:
- A. five bikes and 40 roller blades
 - B. zero bikes and 20 roller blades
 - C. five bikes and 20 roller blades
 - D. zero bikes and 40 roller blades

ANS: B PTS: 1 DIF: Difficult TOP: Our second model: The production possibilities frontier NAR: 2-4

NARRBEGIN: 2-5

Graph 2-5



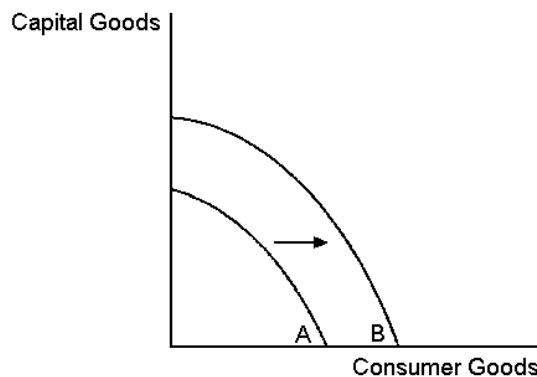
NARREND

43. Refer to Graph 2-5. In the production possibilities frontier shown, the shift of the frontier from A to B was most likely caused by which of the following?
- A. more capital available in the economy
 - B. more labour available in the economy
 - C. a general technological breakthrough
 - D. technological improvement in the production of clothing

ANS: D PTS: 1 DIF: Moderate TOP: Our second model: The production possibilities frontier NAR: 2-5

NARRBEGIN: 2-6

Graph 2-6



NARREND

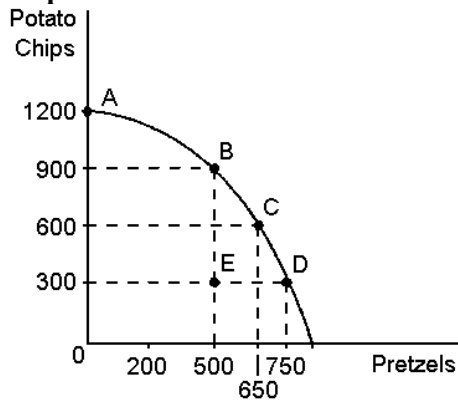
44. Refer to Graph 2-6. According to the graph, the shift of the production possibilities frontier from frontier A to frontier B was most likely caused by which of the following?
- A. an improvement in the technology of producing capital goods
 - B. an improvement in the technology of producing consumer goods
 - C. a general improvement in technology
 - D. a reduction in the availability of resources

ANS: C PTS: 1 DIF: Moderate TOP: Our second model: The production possibilities frontier NAR: 2-6

45. Refer to Graph 2-6. In the graph shown, the movement from frontier A to B can best be described as:
- A. economic growth
 - B. a disaster for society
 - C. an improvement in income distribution
 - D. an improvement in the allocation of resources

ANS: A PTS: 1 DIF: Moderate TOP: Our second model: The production possibilities frontier NAR: 2-6
NARRBEGIN: 2-7

Graph 2-7



NARREND

46. Refer to Graph 2-7. What is the opportunity cost to society of the movement from point C to point B, given the production possibilities frontier shown?
- 650 pretzels
 - 500 pretzels
 - 300 pretzels
 - 150 pretzels

ANS: D PTS: 1 DIF: Moderate TOP: Our second model: The production possibilities frontier NAR: 2-7

47. Refer to Graph 2-7. In the production possibilities frontier shown, what is the opportunity cost to society of moving from point C to point E?
- 150 pretzels
 - 300 potato chips
 - both A and B
 - zero

ANS: C PTS: 1 DIF: Moderate TOP: Our second model: The production possibilities frontier NAR: 2-7

48. Refer to Graph 2-7. In the production possibilities frontier shown, the movement from point C to point E was most likely caused by:
- an increase in society's preference for pretzels
 - a decrease in society's preference for potato chips
 - unemployment
 - both A and B

ANS: C PTS: 1 DIF: Moderate TOP: Our second model: The production possibilities frontier NAR: 2-7

NARRBEGIN: Table 2-1

Table 2-1

Production possibilities for Erehwon	
Computers	Cheese (kg)
250	0

200	500
150	900
100	1200
50	1400
0	1500

NARREND

49. Refer to Table 2-1. What is the opportunity cost to Erewhon of increasing the production of computers from 150 to 200?
- A. 300 kg cheese
 - B. 500 kg cheese
 - C. 400 kg cheese
 - D. as the production costs for computers and cheese are unknown, it is not possible to tell

ANS: C PTS: 1 DIF: Moderate TOP: Our second model: The production possibilities frontier NAR: Table 2-1

50. Refer to Table 2-1. What is the opportunity cost of increasing the production of cheese from 900 kg to 1200 kg?
- A. 150 computers
 - B. 100 computers
 - C. 50 computers
 - D. as the production costs for computers and cheese are unknown, it is not possible to tell

ANS: C PTS: 1 DIF: Moderate TOP: Our second model: The production possibilities frontier NAR: Table 2-1

51. Refer to Table 2-1. What is the most accurate statement about the opportunity cost of producing an additional 50 computers in Erewhon?
- A. the opportunity cost of an additional 50 computers is 300 kg of cheese
 - B. the opportunity cost of an additional 50 computers is 200 kg of cheese
 - C. it is impossible to determine the opportunity cost of an additional 50 computers
 - D. the opportunity cost of an additional 50 computers increases as more computers are produced

ANS: D PTS: 1 DIF: Difficult TOP: Our second model: The production possibilities frontier NAR: Table 2-1

52. The concept of opportunity cost is best represented by the:
- A. shift of a production possibilities curve frontier
 - B. shift of a production possibilities frontier inwards
 - C. movement along a production possibilities frontier from one point to another
 - D. movement from point on a production possibilities frontier to a point inside the same curve

ANS: C PTS: 1 DIF: Easy TOP: Our second model: The production possibilities frontier

53. Macroeconomics approaches the study of economics from the viewpoint of:
- A. consumer behaviour
 - B. the labour market
 - C. government taxation and spending policies
 - D. the entire economy

ANS: D PTS: 1 DIF: Easy TOP: Microeconomics and macroeconomics

54. Select the microeconomic statement from the following:

- A. real domestic output was \$100 billion last year
- B. employment levels grew by two per cent in the last six months
- C. fish prices rose in response to increases in fuel costs
- D. the inflation rate was 1.8 per cent in the last quarter

ANS: C PTS: 1 DIF: Easy TOP: Microeconomics and macroeconomics

55. Select the statement below that is an example of a microeconomic issue?

- A. the effect of inflation on GDP growth rates
- B. the effect of a reduction in the fishing harvest on the price of fish
- C. the relation between inflation and money growth
- D. the relation between unemployment and inflation

ANS: B PTS: 1 DIF: Easy TOP: Microeconomics and macroeconomics

56. For economists, statements about the world are of two types:

- A. assumptions and theories
- B. true statements and false statements
- C. specific statements and general statements
- D. positive statements and normative statements

ANS: D PTS: 1 DIF: Easy TOP: Positive versus normative analysis

57. For economists, positive statements are:

- A. descriptive, making a claim about how the world is
- B. optimistic, putting the best possible interpretation on things
- C. affirmative, justifying existing economic policy
- D. prescriptive, making a claim about how the world ought to be

ANS: A PTS: 1 DIF: Easy TOP: Positive versus normative analysis

58. Normative statements are:

- A. descriptive, making a claim about how the world is
- B. statements about the normal condition of the world
- C. prescriptive, making a claim about how the world ought to be
- D. statements which establish production goals for the economy

ANS: C PTS: 1 DIF: Easy TOP: Positive versus normative analysis

59. Which of the following is an example of a positive statement?

- A. if welfare payments increase, the world will be a better place
- B. prices rise when the government prints too much money
- C. inflation is more harmful to the economy than unemployment
- D. the benefits to the economy of improved equity are greater than the costs of reduced efficiency

ANS: B PTS: 1 DIF: Easy TOP: Positive versus normative analysis

60. Which of the following is an example of a normative statement?

- A. the quantity supplied of a good will fall if the price falls
- B. reducing pollution is too important to worry about the costs
- C. technological progress will increase the potential growth rate of the economy
- D. none of the above are normative statements

ANS: B
analysis

PTS: 1

DIF: Easy

TOP: Positive versus normative

61. Which is the best statement about the roles of economists?

- A. economists are best viewed as policymakers
- B. economists are best viewed as scientists
- C. in trying to explain the world, economists are scientists; in trying to improve the world, they are policymakers
- D. in trying to explain the world, economists are policymakers; in trying to improve the world, they are scientists

ANS: C

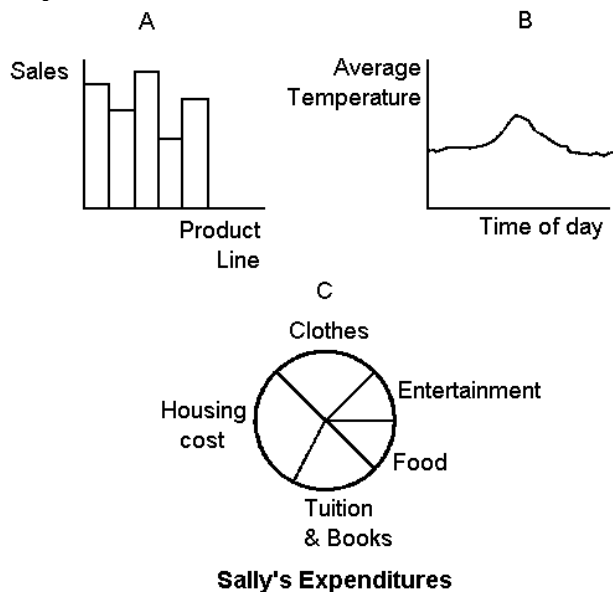
PTS: 1

DIF: Easy

TOP: Economists in government

NARRBEGIN: 2-8

Graph 2-8



NARREND

62. Refer to Graph 2-8. Which of the graphs shown is a time series graph?

- A. A
- B. B
- C. C
- D. A and B

ANS: B

PTS: 1

DIF: Easy

TOP: Graphs of a single variable

NAR: 2-8

63. Refer to Graph 2-8. Which of the graphs shown is a bar graph?

- A. A
- B. B
- C. C
- D. A and B

ANS: A

PTS: 1

DIF: Easy

TOP: Graphs of a single variable

NAR: 2-8

64. An ordered pair is:

- A. the process of checking calculations twice before placing them on a graph
- B. two numbers that can be represented by a point on a graph
- C. the inventory system used to keep track of right and left shoes, etc.
- D. two halves of a whole

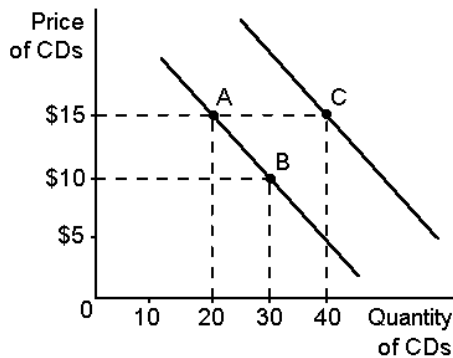
ANS: B PTS: 1 DIF: Easy TOP: Graphs of two variables: The coordinate system

65. Which of the following statements is correct?
- A. the x -coordinate tells us the horizontal location of a point on a graph, and the y -coordinate tells us the vertical location of the point
 - B. the origin of a graph is the point with both a maximum x -coordinate and a maximum y -coordinate
 - C. the x -coordinate tells us the vertical location of a point on a graph, and the y -coordinate tells us the horizontal location of the point
 - D. the origin of a graph is represented by an x -coordinate equal to 1 and a y -coordinate equal to 1

ANS: A PTS: 1 DIF: Easy TOP: Curves in the coordinate system

NARRBEGIN: 2-9

Graph 2-9



NARREND

66. Refer to Graph 2-9. In the graph, the curves shown are:
- A. cost curves
 - B. supply curves
 - C. demand curves
 - D. production possibilities frontiers

ANS: C PTS: 1 DIF: Easy TOP: Curves in the coordinate system NAR: 2-9

67. Refer to Graph 2-9. In the graph shown, the movement from point A to point B is:
- A. a shift of the curve
 - B. a change in preferences
 - C. a movement along the curve
 - D. all of the above

ANS: C PTS: 1 DIF: Moderate TOP: Curves in the coordinate system NAR: 2-9

68. Refer to Graph 2-9. In the graph shown, the movement from point A to point C is a:

- A. change in price
- B. shift of the curve
- C. movement along the curve
- D. change in costs to the firm

ANS: B PTS: 1 DIF: Moderate TOP: Curves in the coordinate system NAR: 2-9

69. Refer to Graph 2-9. In the graph shown, the slope of the curve between points A and B is:

- A. -2
- B. -1/2
- C. 1/2
- D. 2

ANS: B PTS: 1 DIF: Moderate TOP: Curves in the coordinate system NAR: 2-9

70. Refer to Graph 2-9. In the graph shown, the movement from point A to point C could have been caused by:

- A. inflation
- B. a change in income
- C. a change in the price of CDs
- D. a change in the cost of producing CDs

ANS: B PTS: 1 DIF: Moderate TOP: Curves in the coordinate system NAR: 2-9

71. The slope of a line is defined as:

- A. the ratio of the horizontal distance covered to the vertical distance covered as we move along the line
- B. the rise divided by the run
- C. the ratio of the vertical distance covered to the horizontal distance covered as we move along the line
- D. both B and C

ANS: D PTS: 1 DIF: Easy TOP: Slope and elasticity

72. The slope of a line is calculated as:

- A. (change in y) / (change in x)
- B. (change in x) / (change in y)
- C. x / y
- D. $x + y$

ANS: A PTS: 1 DIF: Easy TOP: Slope and elasticity

73. Making the argument that because empty alcohol containers are found at many accidents, containers therefore cause accidents, is an example of:

- A. reverse causality
- B. omitted variables
- C. sound logic
- D. slope

ANS: B PTS: 1 DIF: Moderate TOP: Omitted variables

74. A normative statement is one that:

- A. is based upon value judgements
- B. pertains only to microeconomics
- C. pertains only to macroeconomics
- D. is based on the law of averages

ANS: A PTS: 1 DIF: Easy TOP: Positive versus normative

analysis

75. Dean says that, 'the imposition of a tax on beer will raise its price'. Kylie argues that, 'taxes should be imposed on beer because university students drink too much'. We can conclude that:
- A. Dean's statement is normative, but Kylie's is positive
 - B. Kylie's statement is normative, but Dean's is positive
 - C. both statements are normative
 - D. both statements are positive

ANS: B PTS: 1 DIF: Easy TOP: Positive versus normative analysis

76. The demand curve demonstrates:
- A. there is a fixed price of the product
 - B. there is a cause and effect
 - C. the coordinates of the tastes and preferences of consumers
 - D. all of the above

ANS: B PTS: 1 DIF: Moderate TOP: Cause and effect

77. The policy results from economic modelling:
- A. focus on the cheapest price option
 - B. focus on the fairest result for everyone
 - C. tend to be aimed at winning the most political votes
 - D. none of the above

ANS: D PTS: 1 DIF: Moderate TOP: Differences in values

78. Economic analysis can generate different outputs as:
- A. All of the above
 - B. There is a great deal of valid data that can enable a number of conclusions
 - C. Differing opinions exists on the validity of certain parameters chosen
 - D. Different variables are taken into consideration in the model

ANS: A PTS: 1 DIF: Moderate TOP: Differences in scientific judgements

SHORT ANSWER

1. What is a controlled experiment and why do economists make little use of them?

ANS:

A controlled experiment is one where the researcher can determine how many variables to change and by how much. Typically the researcher holds many variables constant and changes just a few. Economists make little use of them because many economic variables cannot be changed or made constant during research.

PTS: 1 DIF: Moderate TOP: The scientific method: Observation, theory and more observation

2. If we know an assumption about an economic system is not true, what is the justification for keeping this assumption in a model?

ANS:

The goal of a model is how to understand an economic system. Assumptions are usually false because they simplify the system. Simpler systems are easier to make valid scientific inferences from.

PTS: 1 DIF: Moderate TOP: The role of assumptions

3. What is the purpose of models in economics? What are the two economic models presented in chapter two?

ANS:

Economic models are designed to illustrate the important features of an economy. They are built from assumptions, and are most often composed of diagrams and equations. Like all useful models, economic models simplify reality in order to improve our understanding of it. The two economic models presented in chapter two are the circular-flow diagram and the production possibilities frontier.

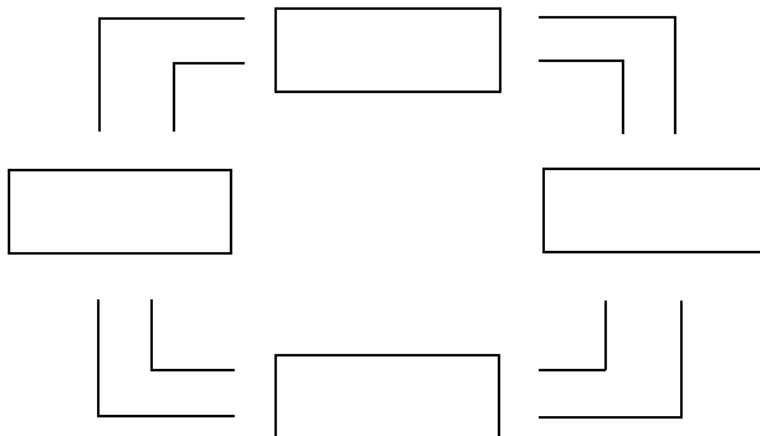
PTS: 1

DIF: Easy

TOP: The role of assumptions

4. Using this outline (Graph 2-10), insert arrows and complete the circular-flow diagram representing the interactions between households and firms in a simple economy. Explain briefly the various parts of the diagram.

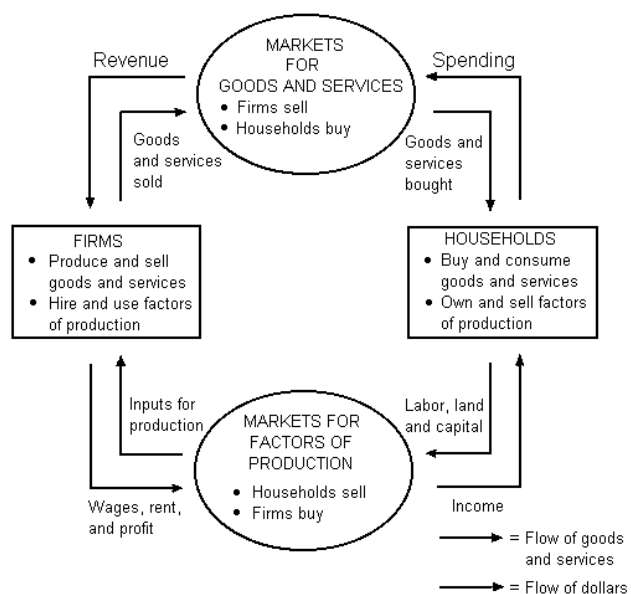
Graph 2-10



ANS:

This diagram should duplicate the essential characteristics of the diagram in the text, with an explanation of the meaning of each flow and each market. It is important that the student understands that the inner loop represents the flow of real goods and services, and that the outer loop represents the corresponding flow of payments.

Graph 2-10 answer



PTS: 1

DIF: Easy

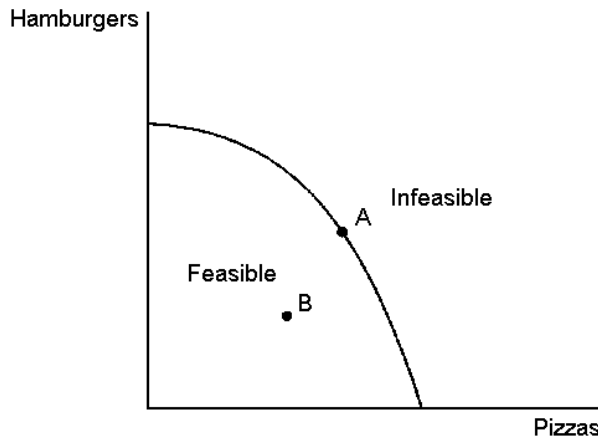
TOP: Our first model: The circular-flow diagram

5. Draw a production possibilities frontier for the production of hamburgers and pizzas. On the graph, identify the area of feasible outcomes and the area of infeasible outcomes. Now locate and label an efficient point A and an inefficient point B.

ANS:

This graph should duplicate the essential features of the graph in the text. The production possibilities frontier should be bowed outward. The feasible area is the frontier and the area inside the frontier, while the infeasible area is the area outside the frontier. Point A should be on the frontier and point B should be inside the frontier.

Graph 2-11 answer



PTS: 1

DIF: Easy

TOP: Our second model: The production possibilities frontier

6. Show how each of the following concepts can be illustrated using a production possibilities frontier:
- efficiency.
 - opportunity cost.
 - economic growth.

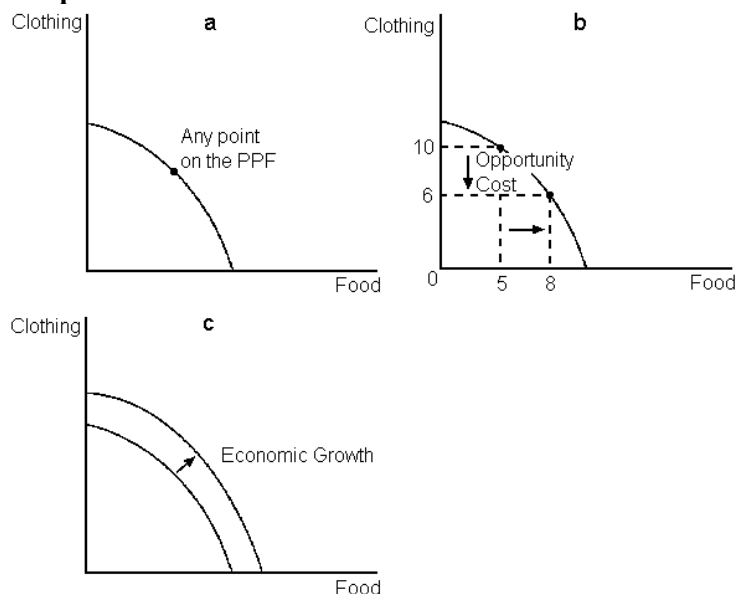
ANS:

a. efficiency is any point on the production possibilities frontier (graph a)

b. graph b

c. graph c

Graph 2-12 answer



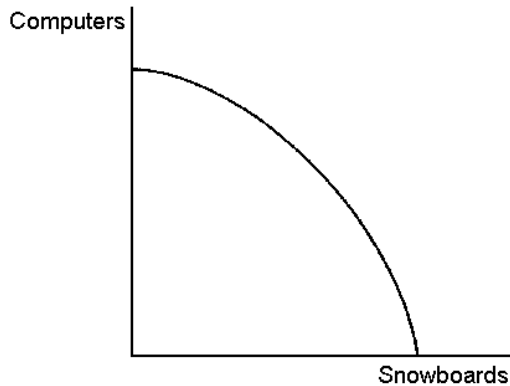
PTS: 1
frontier

DIF: Moderate

TOP: Our second model: The production possibilities

7. Refer to Graph 2-13. For the production possibilities frontier illustrated in the graph shown:

Graph 2-13



- how would you measure the opportunity cost of obtaining more computers?
- how does that opportunity cost change as society chooses to produce and consume more computers?
- why does the opportunity cost change that way?

ANS:

- The opportunity cost of obtaining more computers is the number of snowboards that have to be given up to get more computers.
- As the production and consumption of computers increases, the opportunity cost of each new computer (the number of snowboards which must be given up) also increases.
- As the economy produces more and more computers, the resources best suited to making computers are used up and resources better suited to producing snowboards must be used. When this happens, the production of snowboards is reduced a lot for each new computer produced.

PTS: 1

DIF: Moderate

TOP: The production possibilities frontier

8. Suppose an economy produces two products. These are fish and logs. If fish stocks become depleted by over-fishing, what would happen to the production possibilities frontier?

ANS:

This means the economy has suffered a loss in the available resources. The production possibilities frontier would pivot inwards. The maximum level of log production would be unchanged. The maximum level of fish production would move closer to the origin.

PTS: 1

DIF: Moderate

TOP: The production possibilities frontier

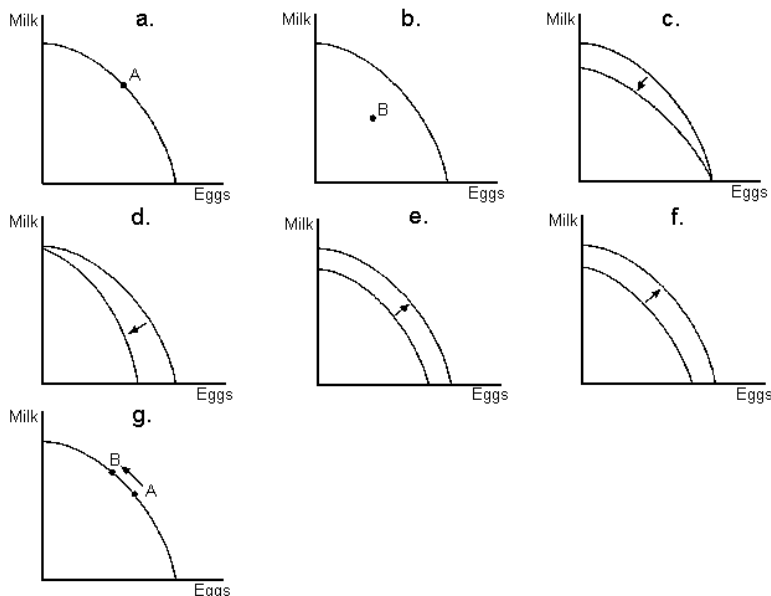
9. Draw a production possibilities frontier representing the economy's possible production of milk and eggs. Now show what will happen to the frontier or the production point under each of the following circumstances. Use a separate graph to illustrate each situation.

- the outcome for the economy is efficient, with society choosing approximately equal amounts of milk and eggs
- a recession causes a significant percentage of the labour force to become unemployed
- some cows are found to be infected with mad cow disease and many of the cows must be destroyed
- chickens are infected with a rare disease and egg-laying is reduced
- improvements in animal nutrition raise the general productivity of cows and chickens
- the cow and chicken populations increase
- the Surgeon General announces that drinking milk prolongs life

ANS:

Refer to Graph 2-14 for answers.

Graph 2-14 answer



PTS: 1 DIF: Difficult TOP: The production possibilities frontier

10. Suppose an economy produces two products. These are fish and logs. If technology is introduced that improves the efficiency of logging what would occur to the production possibilities frontier?

ANS:

The economy has improved its ability to produce logs. The production possibilities frontier would pivot outwards, where the maximum number of logs that can be produced increases. The maximum level of fish production would be unchanged. The maximum level of log production would move away from the origin.

PTS: 1 DIF: Moderate TOP: The production possibilities frontier

11. Identify each of the following topics as being part of *microeconomics* or *macroeconomics*.
- the impact of a decrease in consumer income on the purchase of lobster
 - the effect of a change in the price of digital cameras on the purchase of film cameras
 - the impact of the budget deficit on the rate of inflation in Australia
 - factors influencing the rate of economic growth
 - factors influencing the demand for digital cameras
 - the impact of tax policy on the trade deficit
 - the effect of carbon taxes on the Australian forestry sector
 - the degree of competition in the retail banking sector
 - the effect of exchange rate policies on economic stability
 - the impact of minimum wages laws on the labour market

ANS:

a, b, e, g, h, and j are microeconomic topics. c, d, f, and i are macroeconomic topics.

PTS: 1 DIF: Easy TOP: Microeconomics and macroeconomics

12. Which of the following statements are positive, and which are normative?
- The minimum wage creates unemployment among young and unskilled workers.
 - The minimum wage ought to be increased.
 - If there is a reduction in competition in a market, then other things being equal, prices will increase.
 - A little bit of unemployment is worse for society than a little bit of inflation.
 - There is a trade-off between inflation and unemployment in the short run.
 - Endangered species would be better off if the trade in wildlife was stopped.
 - If interest rates increase, forestry plantings will decrease.
 - If welfare benefits were reduced, the country would be better off.

ANS:

a, c, e, f, and g are positive statements. b, d, and h are normative statements.

PTS: 1 DIF: Moderate TOP: Positive versus normative analysis

13. Why do economists use graphs?

ANS:

Graphs serve two purposes. You've heard the old saying 'A picture is worth a thousand words'. Graphs offer a way to express ideas visually that might be less clear if described with equations or words. Also, graphs provide a way of finding how variables are in fact related in the world. Graphs provide one way of expressing the relationship among variables.

PTS: 1 DIF: Moderate TOP: Graphing – a brief review

14. What is the difference between a movement along a curve and a shift of a curve? What is the simplest way to tell when it is necessary to shift a curve?

ANS:

When there is a change from one point to another point on the same curve that is a movement along the curve. This is caused by a change in a variable represented on either the x -axis or the y -axis. A shift of a curve occurs when the entire curve moves (either to the right or to the left for a demand curve). This would occur because a variable that affects the curve but is not represented on either the x -axis or y -axis has changed. The simplest way to tell is to look at the variables represented on the x -axis and y -axis.

PTS: 1 DIF: Moderate TOP: Curves in the coordinate system

15. If the y -axis label is price, and the x -axis label is quantity, what would occur, if there was a change in price?

ANS:

As the variable that has changed is one of the axis labels there is a movement along the curve.

PTS: 1 DIF: Moderate TOP: Curves in the coordinate system

16. If the y -axis label is price, and the x -axis label is quantity, what would occur, if there was a change in tastes and preferences?

ANS:

As the variable that has changed is on not on one of the axis labels, there is a shift of the curve.

PTS: 1 DIF: Moderate TOP: Curves in the coordinate system

17. If the y -axis label is price, and the x -axis label is quantity, what would occur if there was a change in the cost of producing the good/service?

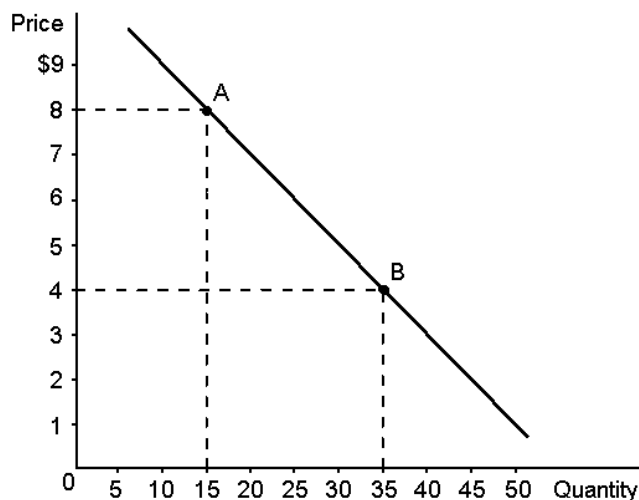
ANS:

As the variable that has changed is on not on one of the axis labels, there is a shift of the curve.

PTS: 1 DIF: Moderate TOP: Curves in the coordinate system

18. Use the demand curve below to answer the following questions.

Graph 2-15



- How would point A be represented as an ordered pair?
- What type of curve is this?
- Does this curve show a positive or negative correlation between price and quantity?
- Compute the slope of the curve between points A and B.

ANS:

- (15, 8).
- a demand curve
- a negative correlation between price and quantity
- $-4/20 = -1/5$.

PTS: 1 DIF: Moderate TOP: Curves in the coordinate system

19. Describe two problems that economists should consider when dealing with graphs.

ANS:

1. Omitted variables: It is difficult to hold everything else constant when measuring how one variable affects another. It is possible that a person seeing the graph might decide that one variable on the graph is causing changes in the other variable when actually those changes are caused by a third variable not pictured on the graph. This could lead to a wrong conclusion.

2. Reverse causality. This occurs when a person decides that event A causes event B to occur, when in fact event B causes event A to occur. An example given in the text is the correlation between police numbers and crime levels.

PTS: 1 DIF: Moderate TOP: Omitted variables

20. Both of the main political parties in Erewhon employ economists. When formulating a carbon tax policy, the economists disagree. Explain why this may be the case.

ANS:

Advocates of a carbon tax believed that the introduction would encourage polluters to minimise their carbon emissions by reducing their output, or invest in cleaner technology, as there would be a financial penalty for emitting carbon into the atmosphere. Those against the carbon tax believe that households would suffer, as the cost of driving cars and using electricity would increase, and that the households with least choice would be affected greatly.

These two groups of economists held (and continue to hold) different views about the carbon tax system because they have different positive views about the responsiveness of the tax incentives.

PTS: 1 DIF: Difficult TOP: Differences in scientific judgements