

Name _____ Class _____ Date _____
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True / False

1. Scarcity means that there is less of a good or resource available than people wish to have.

- a. True
- b. False

ANSWER: True

2. Economics is the study of how evenly goods and services are distributed within society.

- a. True
- b. False

ANSWER: False

3. Economics is the study of how society allocates its unlimited resources.

- a. True
- b. False

ANSWER: False

4. Because resources are scarce, a society cannot give all individuals the standard of living to which each aspires.

- a. True
- b. False

ANSWER: True

5. Equality means distributing society's resources in the most efficient manner.

- a. True
- b. False

ANSWER: False

6. Economists study how people make decisions.

- a. True
- b. False

ANSWER: True

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

- a. True
- b. False

ANSWER: False

8. Choosing not to attend a concert so that you can study for your exam is an example of a tradeoff.

- a. True
- b. False

ANSWER: True

9. The classic tradeoff between "guns and butter" states that when a society spends more on national defense, it has less to spend on consumer goods to raise the standard of living.

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- a. True
- b. False

ANSWER: True

10. Efficiency means everyone in the economy should receive an equal share of the goods and services produced.

- a. True
- b. False

ANSWER: False

11. Equality refers to how the pie is divided, and efficiency refers to the size of the economic pie.

- a. True
- b. False

ANSWER: True

12. Government policies that improve equality usually increase efficiency at the same time.

- a. True
- b. False

ANSWER: False

13. Using income tax revenue to fund the welfare system illustrates the conflict between efficiency and equality.

- a. True
- b. False

ANSWER: True

14. An individual deciding how to allocate her limited time is dealing with both scarcity and trade-offs.

- a. True
- b. False

ANSWER: True

15. The cost of an action is measured in terms of foregone opportunities.

- a. True
- b. False

ANSWER: True

16. Tuition is the single-largest cost of attending college for most students.

- a. True
- b. False

ANSWER: False

17. If wages for accountants rose, then accountants' leisure time would have a lower opportunity cost.

- a. True
- b. False

ANSWER: False

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18. A marginal change is a small incremental adjustment to an existing plan of action.

- a. True
- b. False

ANSWER: True

19. An increase in the marginal cost of an activity necessarily means that people will no longer engage in any of that activity.

- a. True
- b. False

ANSWER: False

20. If the average cost of transporting a passenger on the train from Chicago to St. Louis is \$75, it would be irrational for the railroad to allow any passenger to ride for less than \$75.

- a. True
- b. False

ANSWER: False

21. The fact that people are willing to pay much more for a diamond, which is not needed for survival, than they are willing to pay for a cup of water, which is needed for survival, is an example of irrational behavior.

- a. True
- b. False

ANSWER: False

22. A rational decisionmaker takes an action if and only if the marginal cost exceeds the marginal benefit.

- a. True
- b. False

ANSWER: False

23. Suppose one county in Missouri decides it wants to reduce alcohol consumption, so the county passes a law that raises the price of a bottle of beer by \$1. As a result, people drive to other counties to drink alcohol, which results in an increase in drunk driving. This illustrates the principle that people respond to incentives.

- a. True
- b. False

ANSWER: True

24. A tax on gasoline is an incentive that encourages people to drive smaller more fuel-efficient cars.

- a. True
- b. False

ANSWER: True

25. To say people respond to incentives means that people may alter their decisions when the costs and benefits of an action change.

- a. True
- b. False

ANSWER: True

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26. One of the effects of gas prices rising from about \$2 to about \$4 per gallon was airlines ordering new, fuel-efficient aircraft.

- a. True
- b. False

ANSWER: True

27. Trade allows each person to specialize in the activities he or she does best, thus increasing each individual's productivity.

- a. True
- b. False

ANSWER: True

28. Trade with any nation can be mutually beneficial.

- a. True
- b. False

ANSWER: True

29. Trade can make everyone better off except in the case where one person is better at doing everything.

- a. True
- b. False

ANSWER: False

30. The invisible hand ensures that economic prosperity is distributed equally.

- a. True
- b. False

ANSWER: False

31. A market economy cannot produce a socially desirable outcome because individuals are motivated by their own selfish interests.

- a. True
- b. False

ANSWER: False

32. Communist countries worked on the premise that government officials were in the best position to allocate the economy's scarce resources.

- a. True
- b. False

ANSWER: True

33. The government can potentially improve market outcomes if market inequalities or market failure exists.

- a. True
- b. False

ANSWER: True

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34. One way that governments can improve market outcomes is to ensure that individuals are able to own and exercise control over their scarce resources.

- a. True
- b. False

ANSWER: True

35. Market failure refers to a situation in which the market does not allocate resources efficiently.

- a. True
- b. False

ANSWER: True

36. Market power and externalities are two possible causes of market failure.

- a. True
- b. False

ANSWER: True

37. Market failure occurs when no individual has the ability to substantially influence market prices.

- a. True
- b. False

ANSWER: False

38. Productivity is defined as the quantity of goods and services produced from each unit of labor input.

- a. True
- b. False

ANSWER: True

39. Inflation is the primary determinant of a country's living standards.

- a. True
- b. False

ANSWER: False

40. Inflation increases the value of money.

- a. True
- b. False

ANSWER: False

41. Inflation measures the increase in the quantity of goods and services produced from each hour of a worker's time.

- a. True
- b. False

ANSWER: False

42. The goal of President Obama's stimulus package and increased government spending following the deep economic downturn in 2008 and 2009 was to reduce inflation.

- a. True

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b. False

ANSWER: False

43. Variations in the standard of living across countries is due almost entirely to differences in each nation's total output of goods and services.

a. True
b. False

ANSWER: False

44. In the short-run, society faces a tradeoff between inflation and unemployment.

a. True
b. False

ANSWER: True

45. In the long run the primary effect of increasing the quantity of money is higher prices.

a. True
b. False

ANSWER: True

46. The business cycle refers to fluctuations in economic activity such as employment and production.

a. True
b. False

ANSWER: True

47. The opportunity cost of working one hour is the sum of the values you would have received from all other activities you could have done in that hour.

a. True
b. False

ANSWER: False

48. The opportunity cost of working out for one hour is the value of the next-best activity that you could have done in that hour.

a. True
b. False

ANSWER: True

49. Inflation and unemployment both increase as the money supply increases.

a. True
b. False

ANSWER: False

50. A rational decision maker takes an action if and only if the marginal benefit exceeds the marginal cost.

a. True
b. False

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ANSWER: True

51. The "invisible hand" influences market behavior through trade.

- a. True
- b. False

ANSWER: False

Subjective Short Answer

52. Economics is the study of _____ .

ANSWER: how society manages its scarce resources.

53. The term _____ refers to the size of the economic pie, and the term _____ refers to how the pie is divided.

ANSWER: efficiency; equality

54. Explain how government policies that redistribute income from the rich to the poor might reduce efficiency.

ANSWER: They reduce the reward for working hard. As a result, people work less and produce fewer goods and services.

Scenario 1-1

You have the afternoon free. You have a choice between going to the movies with a friend or studying economics for three hours. If you go to the movies, you will spend \$8.00 on a ticket and \$4.50 on popcorn. If you choose to study economics for three hours, you will raise your exam grade by 10 points.

55. **Refer to Scenario 1-1.** What is your opportunity cost of going to the movies?

ANSWER: \$12.50 and 10 points on your exam grade

56. **Refer to Scenario 1-1.** What is your opportunity cost of studying economics?

ANSWER: The enjoyment you would have received from going to the movies with your friend.

Scenario 1-2

Suppose that you have a choice between going to the movies with a friend for two hours or working at your job. If you go to the movies, you will spend \$7 on a ticket and \$5 on popcorn. If you choose to work, you will earn \$10 an hour.

57. **Refer to Scenario 1-2.** What is your opportunity cost of going to the movies?

ANSWER: \$32

58. **Refer to Scenario 1-2.** What is your opportunity cost of working?

ANSWER: The enjoyment you would have received from going to the movies with your friend.

59. Debbie quits her job, which pays \$30,000 a year, to finish her college degree. Her annual college expenses are \$10,000 for tuition, \$2,000 for books, and \$700 for food. What is her opportunity cost of attending college for the year?

ANSWER: \$42,000

60. Zack quits his job at a consulting firm, which pays \$40,000 a year, to enroll in a two-year graduate program. His annual school expenses are \$30,000 for tuition, \$2,000 for books, and \$600 for food. What is his opportunity cost of attending the two-year graduate program?

ANSWER: \$144,000

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61. Give an example of a trade-off faced by society.

ANSWER: Efficiency and equality; a clean environment and a high level of income; guns and butter (national defense and consumer goods)

Scenario 1-3

It costs a company \$35,000 to produce 700 graphing calculators. The company's cost will be \$35,070 if it produces an additional graphing calculator. The company is currently producing 700 graphing calculators.

62. **Refer to Scenario 1-3.** What is the company's average cost?

ANSWER: \$50

63. **Refer to Scenario 1-3.** What is the company's marginal cost?

ANSWER: \$70

64. **Refer to Scenario 1-3.** A customer is willing to pay \$60 for the 701th calculator. Should the company produce and sell it? Explain.

ANSWER: No, because the marginal cost (\$70) is less than the marginal benefit (\$60).

65. **Refer to Scenario 1-3.** What is the minimum price the company will charge for the 701th calculator?

ANSWER: \$70

Scenario 1-4 You have the afternoon free. You have a choice between going to the movies with a friend or studying economics for three hours. If you go to the movies, you will spend \$12.00 on a ticket and \$4.75 on popcorn. If you choose to study economics for three hours, you will raise your exam grade by 15 points.

66. **Refer to Scenario 1-4.** What is your opportunity cost of going to the movies?

ANSWER: \$16.75 and 15 points on your exam grade

67. **Refer to Scenario 1-4.** What is your opportunity cost of studying economics?

ANSWER: The enjoyment you would have received from going to the movies with your friend.

68. What is another word for "marginal"?

ANSWER: incremental; additional

69. The term _____ refers to a small incremental adjustment to an existing plan of action.

ANSWER: Marginal change

Scenario 1-5

Suppose that you have a choice between going to the movies with a friend for three hours or working at your job. If you go to the movies, you will spend \$12 on a ticket and \$6 on popcorn. If you choose to work, you will earn \$10 an hour.

70. **Refer to Scenario 1-5.** What is your opportunity cost of going to the movies?

ANSWER: \$48

71. **Refer to Scenario 1-5.** What is your opportunity cost of working?

ANSWER: The enjoyment you would have received from going to the movies with your friend.

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Scenario 1-6

It costs a company \$30,000 to produce 600 heart rate monitors. The company's cost will be \$30,070 if it produces an additional heart rate monitor. The company is currently producing 600 heart rate monitors.

72. **Refer to Scenario 1-6.** What is the company's average cost?

ANSWER: \$50

73. **Refer to Scenario 1-6.** What is the company's marginal cost?

ANSWER: \$70

74. **Refer to Scenario 1-6.** A customer is willing to pay \$60 for the 601st heart rate monitor. Should the company produce and sell it? Explain.

ANSWER: No, because the marginal cost (\$70) exceeds the marginal benefit (\$60).

75. **Refer to Scenario 1-6.** What is the minimum price that would induce this company to produce the 601st heart rate monitor?

ANSWER: \$70

76. Tracy quits her job, which pays \$25,000 a year, to finish her college degree. Her annual college expenses are \$12,000 for tuition and fees and \$1,000 for books. What is her opportunity cost of attending college for the year?

ANSWER: \$38,000

77. Melinda quits her job at a bank, which pays \$30,000 a year, to enroll in a two-year graduate program. Her annual school expenses are \$22,000 for tuition and fees and \$2,000 for books. What is her opportunity cost of attending the two-year graduate program?

ANSWER: \$108,000

78. What does the term "marginal change" mean?

ANSWER: A small incremental adjustment to a plan of action

79. Rational people make decisions "at the margin" by comparing _____.

ANSWER: marginal costs and marginal benefits

80. In a centrally-planned economy, economic activity is guided by _____.

ANSWER: the government

81. Explain how trade with other countries is beneficial.

ANSWER: Trade allows countries to specialize in what they do best, which increases total output.

82. What are the two basic types of economies?

ANSWER: Centrally planned economies and market economies

83. What is the main difference between a centrally planned economy and a market economy?

ANSWER: In a market economy, decisions are guided by prices and individual self-interest. In a centrally planned economy, economic activity is guided by the government.

84. Invisible hand is a term used by the economist _____ to describe how the decisions of households and firms lead to

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desirable market outcomes.

ANSWER:

Adam Smith

85. Economists use the term _____ to refer to a situation in which the market on its own fails to produce an efficient allocation of resources.

ANSWER:

market failure

86. What are the two possible causes of market failure?

ANSWER:

Externality and market power

87. Explain the concept of externality and give an example.

ANSWER:

The impact of one person's actions on the well-being of a bystander; pollution

88. What are the two reasons for the government to intervene in a market?

ANSWER:

To promote efficiency and equality

89. What does the "invisible hand" refers to?

ANSWER:

How the decisions of self-interested households and firms lead to desirable market outcomes.

90. Invisible hand is a term used by the economist _____ in his 1776 book *An Inquiry into the Nature and Causes of the Wealth of Nations*.

ANSWER:

Adam Smith

91. What do prices reflect in a market economy?

ANSWER:

The value of a good to society and the cost to society of making the good

92. Explain the concept of market failure.

ANSWER:

Market failure is a situation in which the market on its own fails to produce an efficient allocation of resources.

93. Economists use the term _____ to refer to the ability of a single person (or a small group) to have a substantial influence on market prices.

ANSWER:

market power

94. Give an example of government intervention that is intended to reduce an externality.

ANSWER:

Laws that restrict the smoking of cigarettes in public places

95. Give an example of government intervention that is intended to improve equality.

ANSWER:

The income tax; the welfare system

96. Economists use the term _____ to refer to an increase in the overall level of prices in the economy.

ANSWER:

Inflation

97. In the short run, an increase in the money supply is likely to lead to _____ inflation and _____ unemployment.

ANSWER:

higher; lower

98. Economists use the term _____ to refer to fluctuations in economic activity, such as employment and production.

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ANSWER: business cycle

99. Consider two countries, Muria and Zenya. In Muria total annual output is worth \$800 million and people work 40 million hours. In Zenya total annual output is worth \$900 million and people work 50 million hours. In which country is productivity higher?

ANSWER: In Muria

100. Suppose that in Germany total annual output is worth \$600 million and people work 40 million hours. In France total annual output is worth \$700 million and people work 50 million hours. In which country do people enjoy a higher standard of living?

ANSWER: In Germany. Almost all variation in the standard of living across countries is due to differences in productivity.

101. What are the two short-run effects of increasing the quantity of nation's money?

ANSWER: Higher inflation and lower unemployment

102. How does the study of economics depend upon the phenomenon of scarcity?

ANSWER: Because economics is the study of how society allocates its scarce resources, if there were no scarcity, there would be no need for economics. Everyone could have all the goods and services they wanted. No one would have to make decisions based on tradeoffs, because there would be no opportunity cost associated with the decision. (It is difficult to conceive of a situation where time is not scarce, however).

103. One tradeoff society faces is between efficiency and equality. Define each term. If the U.S. government redistributes income from the rich to the poor, explain how this action affects equality as well as efficiency in the economy.

ANSWER: Efficiency is the property of society getting the most it can from its scarce resources. Equality is defined as the property of distributing economic prosperity evenly 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. Policies aimed at achieving a more equal distribution of economic well-being, 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.

104. Define opportunity cost. What is the opportunity cost to you of attending college? What was your opportunity cost of coming to class today?

ANSWER: Whatever must be given up to obtain some item is its opportunity cost. Basically, this would be a person's second choice. The opportunity cost of a person attending college is the value of the best alternative use of that person's time, as well as the additional costs the person incurs by making the choice to attend college. For most students this would be the income the student gives up by not working plus the cost of tuition and books, and any other costs they incur by attending college that they would not incur if they chose not to attend college. A student's opportunity cost of coming to class was the value of the best opportunity the student gave up. (For most students, that seems to be sleep.)

105. With the understanding that people respond to incentives, outline the possible outcome for teachers if the K-12 school year is extended to 11 months per year instead of the existing 9 months per year.

ANSWER: The concept of working longer per year would be perceived by many teachers as a definite increase in the cost of teaching. Even with additional compensation, many teachers look at summers off as a major benefit of the education profession. If this benefit were eliminated or diminished, some teachers may perceive that the marginal cost of teaching would now be greater than the marginal benefit and would choose to leave

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teaching.

106. Under what conditions might government intervention in a market economy improve the economy's performance?

ANSWER: If there is a market failure, such as an externality or monopoly, government regulation might improve the well-being of society by promoting efficiency. If the distribution of income or wealth is considered to be unfair by society, government intervention might achieve a more equal distribution of economic well-being.

107. Explain how an attempt by the government to lower inflation could cause unemployment to increase in the short-run.

ANSWER: To lower inflation, the government may choose to reduce the money supply in the economy. When the money supply is reduced, prices don't adjust immediately. Lower spending, combined with prices that are too high, reduces sales and causes workers to be laid off. Hence, the lower price level is associated with higher unemployment.