Chapter 1 Ten Principles of Economics

MULTIPLE CHOICE

1.The word “economy” comes from the Greek word *oikonomos*, which means
   a. “environment.”
   b. “production.”
   c. “one who manages a household.”
   d. “one who makes decisions.”

ANS: C PTS: 1 DIF: 1 REF: 1-0

2. Resources are
   a. scarce for households but plentiful for economies.
   b. plentiful for households but scarce for economies.
   c. scarce for households and scarce for economies.
   d. plentiful for households and plentiful for economies.

ANS: C PTS: 1 DIF: 1 REF: 1-0

3. Economics deals primarily with the concept of
   a. scarcity.
   b. money.
   c. poverty.
   d. banking.

ANS: A PTS: 1 DIF: 1 REF: 1-0

4. The overriding reason why households and societies face many decisions is that
   a. resources are scarce.
   b. goods and services are not scarce.
   c. incomes fluctuate with business cycles.
   d. people, by nature, tend to disagree.

ANS: A PTS: 1 DIF: 2 REF: 1-0

5. The phenomenon of *scarcity* stems from the fact that
   a. most economies' production methods are not very good.
   b. in most economies, wealthy people consume disproportionate quantities of goods and services.
   c. governments restrict production of too many goods and services.
   d. resources are limited.

ANS: D PTS: 1 DIF: 2 REF: 1-0

6. Approximately what percentage of the world's economies experience scarcity?
   a. 10%
   b. 40%
   c. 85%
   d. 100%

ANS: D PTS: 1 DIF: 1 REF: 1-0

7. When a society cannot produce all the goods and services people wish to have, it is said that the economy is experiencing
   a. scarcity.
   b. surpluses.
   c. inefficiencies.
   d. inequalities.

ANS: A PTS: 1 DIF: 2 REF: 1-0

8.Oil is considered to be a non-renewable energy source. Oil
   a. is an unlimited resource.
   b. is a scarce resource.
   c. is not a productive resource.
   d. has no opportunity cost.

ANS: B PTS: 1 DIF: 1 REF: 1-0

HOW PEOPLE MAKE DECISIONS

1. The principle that "people face trade-offs" applies to

a. individuals.
b. families.
c. societies.
d. All of the above are correct.

ANS: D PTS: 1 DIF: 1 REF: 1-1

2. Guns and butter are used to represent the classic societal trade-off between spending on
a. durable and nondurable goods.
b. imports and exports.
c. national defense and consumer goods.
d. law enforcement and agriculture.

ANS: C PTS: 1 DIF: 1 REF: 1-1

3. When society requires that firms reduce pollution, there is
a. a trade-off because of reduced incomes to the firms' owners and workers.
b. a trade-off only if some firms are forced to close.
c. no trade-off, since the cost of reducing pollution falls only on the firms affected by the requirements.
d. no trade-off, since everyone benefits from reduced pollution.

ANS: A PTS: 1 DIF: 3 REF: 1-1

4. Economists use the word *equality* to describe a situation in which
a. each member of society has the same income.
b. each member of society has access to abundant quantities of goods and services, regardless of his or her income.
c. society is getting the maximum benefits from its scarce resources.
d. society's resources are used efficiently.

ANS: A PTS: 1 DIF: 2 REF: 1-1

5. Efficiency means that
a. society is conserving resources in order to save them for the future.
b. society's goods and services are distributed equally among society's members.
c. society's goods and services are distributed fairly, though not necessarily equally, among society's members.
d. society is getting the maximum benefits from its scarce resources.

ANS: D PTS: 1 DIF: 1 REF: 1-1

6. When the government attempts to improve equality in an economy the result is often
   a. an increase in overall output in the economy.
   b. additional government revenue since overall income will increase.
   c. a reduction in equality.
   d. a reduction in efficiency.

ANS: D PTS: 1 DIF: 2 REF: 1-1

7. A likely effect of government policies that redistribute income and wealth from the wealthy to the poor is that those policies
   a. enhance equality.
   b. reduce efficiency.
   c. reduce the reward for working hard.
   d. All of the above are correct.

ANS: D PTS: 1 DIF: 2 REF: 1-1

8. The opportunity cost of an item is
   a. the number of hours needed to earn money to buy the item.
   b. what you give up to get that item.
   c. usually less than the dollar value of the item.
   d. the dollar value of the item.

ANS: B PTS: 1 DIF: 1 REF: 1-1

9. A student spends an hour studying instead of watching television with his friends. The opportunity cost to him of studying is
   a. the improvement in his grades from studying for the hour.
   b. the improvement in his grades from studying minus the enjoyment of watching television.
   c. the enjoyment he would have received if he had watched television with his friends.
   d. zero. Since he chose to study rather than to watch television, the value of studying must have been greater than the value of watching television.

ANS: C PTS: 1 DIF: 3 REF: 1-1

10. A rational decision-maker
    a. ignores marginal changes and focuses instead on "the big picture."
    b. ignores the likely effects of government policies when he or she makes choices.
    c. takes an action only if the marginal benefit of that action exceeds the marginal cost of that action.
    d. takes an action only if the combined benefits of that action and previous actions exceed the combined costs of that action and previous actions.

ANS: C PTS: 1 DIF: 2 REF: 1-1

11. A woman eats two bananas during a particular day. The marginal benefit she enjoys from eating the second banana
    a. can be thought of as the total benefit she enjoys by eating two bananas minus the total benefit she would have enjoyed by eating just the first banana.
    b. determines her marginal cost of the first and second bananas.
    c. does not depend on how many bananas she has already eaten.
    d. All of the above are correct.

ANS: A PTS: 1 DIF: 3 REF: 1-1

12. Suppose the cost of operating a 100 room hotel for a night is $10,000 and there are 5 empty rooms for tonight. If the marginal cost of operating one room for one night is $30 and a customer is willing to pay $60 for the night, the hotel manager should
    a. rent the room because the marginal benefit exceeds the marginal cost.
    b. rent the room because the marginal benefit exceeds the average cost.
    c. not rent the room because the marginal benefit is less than the marginal cost.
    d. not rent the room because the marginal benefit is less than the average cost.

ANS: A PTS: 1 DIF: 2 REF: 1-1

13. Economists are particularly good at understanding that people respond to
    a. laws.
    b. incentives.
    c. punishments more than rewards.
    d. rewards more than punishments.

ANS: B PTS: 1 DIF: 1 REF: 1-1

14. Following the implementation of laws requiring automobiles to have seat belts, which of the following occurred?
    a. An individual's probability of surviving an auto accident rose.
    b. There was an increase in pedestrian deaths.
    c. There was an increase in automobile accidents.
    d. All of the above are correct.

ANS: D PTS: 1 DIF: 2 REF: 1-1

HOW PEOPLE INTERACT

1. Which of the following is a principle concerning how people interact?
    a. Markets are usually a good way to organize economic activity.
    b. Rational people think at the margin.
    c. People respond to incentives.
    d. All of the above are correct.

ANS: A PTS: 1 DIF: 2 REF: 1-2

2. Which is the most accurate statement about trade?
    a. Trade can make every nation better off.
    b. Trade makes some nations better off and others worse off.
    c. Trading for a good can make a nation better off only if the nation cannot produce that good itself.
    d. Trade helps rich nations and hurts poor nations.

ANS: A PTS: 1 DIF: 2 REF: 1-2

3. Suppose that a country that has a high level of output per person agrees to trade with a country that has a low level of output per person. Which country can benefit?
   a. Only the one with a low level of output per person.
   b. Only the one with a high level of output per person.
   c. Both.
   d. Neither.

ANS: C PTS: 1 DIF: 1 REF: 1-2

4. Suppose that a country that has a high average wage level agrees to trade with a country that has a low average wage level. Which country can benefit?
   a. Only the one with a low level of output per person.
   b. Only the one with a high level of output per person.
   c. Both.
   d. Neither.

ANS: C PTS: 1 DIF: 1 REF: 1-2

5. Trade
   a. allows specialization, which increases costs.
   b. allows specialization, which reduces costs.
   c. reduces specialization, which increases costs.
   d. reduces specialization, which reduces costs.

ANS: B PTS: 1 DIF: 1 REF: 1-2

6. Central planning refers to
   a. markets guiding economic activity. Today many countries that had this system have abandoned it.
   b. markets guiding economic activity. Today many countries that did not have this system have implemented it.
   c. government guiding economic activity. Today many countries that had this system have abandoned it.
   d. government guiding economic activity. Today many countries that did not have this system have implemented it.

ANS: C PTS: 1 DIF: 1 REF: 1-2

7. One advantage market economies have over centrally-planned economies is that market economies
   a. provide an equal distribution of goods and services to households.
   b. establish a significant role for government in the allocation of resources.
   c. solve the problem of scarcity.
   d. are more efficient.

ANS: D PTS: 1 DIF: 2 REF: 1-2

8. The term "invisible hand" was coined by
   a. Adam Smith.
   b. David Ricardo.
   c. Karl Marx.
   d. Benjamin Franklin.

ANS: A PTS: 1 DIF: 1 REF: 1-2

9. In a market economy, economic activity is guided by
   a. the government.
   b. corporations.
   c. central planners.
   d. self-interest and prices.

ANS: D PTS: 1 DIF: 1 REF: 1-2

10. For markets to work well, there must be
    a. market power.
    b. a central planner.
    c. property rights.
    d. abundant, not scarce, resources.

ANS: C PTS: 1 DIF: 2 REF: 1-2

11. If the price of a dozen eggs were fixed above the current price, then we would expect
    a. an increase in the number of eggs people want to buy and an increase in the number of eggs farmers want to sell.
    b. an increase in the number of eggs people want to buy and a decrease in the number of eggs farmers want to sell.
    c. a decrease in the number of eggs people want to buy and an increase in the number of eggs farmers want to sell.
    d. a decrease in the number of eggs people want to buy and a decrease in the number of eggs farmers want to sell.

ANS: C PTS: 1 DIF: 2 REF: 1-2

12. A company that formerly produced software went out of business because too many potential customers bought illegally-produced copies of the software instead of buying the product directly from the company. This instance serves as an example of
    a. market power.
    b. inefficient trade.
    c. inadequate enforcement of property rights.
    d. the invisible hand at work.

ANS: C PTS: 1 DIF: 2 REF: 1-2

13. Public policies
    a. may be able to improve either economic efficiency or equality.
    b. may be able to improve economic efficiency but cannot improve equality.
    c. may be able to improve equality but cannot improve economic efficiency.
    d. cannot improve either equality or economic efficiency.

ANS: A PTS: 1 DIF: 2 REF: 1-2

HOW THE ECONOMY AS A WHOLE WORKS

1. In the United States, incomes historically have grown about 2 percent per year. At this rate, average income doubles every
   a. 15 years.
   b. 25 years.
   c. 35 years.
   d. 45 years.

ANS: C PTS: 1 DIF: 2 REF: 1-3

2. The term "productivity"
   a. means the same thing as "efficiency."
   b. is seldom used by economists, as its meaning is not precise.
   c. refers to the quantity of goods and services produced from each unit of labor input.
   d. refers to the variety of goods and services from which households can choose when they shop.

ANS: C PTS: 1 DIF: 1 REF: 1-3

3. What is the most important factor that explains differences in living standards across countries?
   a. The quantity of money.
   b. The level of unemployment.
   c. Productivity.
   d. Equality.

ANS: C PTS: 1 DIF: 1 REF: 1-3

4. Suppose that the average income of a Costa Rican is higher than the average income of a Guatemalan. You might conclude that
   a. Costa Rican firms are faced with stricter government regulations than Guatemalan firms.
   b. total income is divided among fewer workers in Costa Rica since it has a smaller labor force than Guatemala.
   c. Guatemala's climate allows for longer growing seasons and therefore Guatemala can produce large quantities of grain and other crops.
   d. productivity in Costa Rica is higher than in Guatemala.

ANS: D PTS: 1 DIF: 2 REF: 1-3

5. According to a recent study of Chilean bus drivers, drivers who are paid by the number of passengers they transport have higher productivity than drivers who are paid by the hour. If Chilean bus drivers are paid by the number of passengers they transport and Colombian bus drivers are paid by the hour, we can conclude that
   a. Chilean bus drivers likely have a higher standard of living than Colombian bus drivers.
   b. Colombian bus drivers likely have a higher standard of living than Chilean bus drivers.
   c. Chilean and Colombian bus drivers likely have the same standard of living.
   d. Chilean and Colombian bus drivers likely have a higher standard of living than US bus drivers.

ANS: A PTS: 1 DIF: 3 REF: 1-3

6. To promote good economic outcomes, policymakers should strive to enact policies that
   a. enhance productivity.
   b. enhance individuals' market power.
   c. result in a rapidly-growing quantity of money.
   d. All of the above are correct.

ANS: A PTS: 1 DIF: 2 REF: 1-3

7. An increase in the overall level of prices in an economy is referred to as
   a. the income effect.
   b. inflation.
   c. deflation.
   d. the substitution effect.

ANS: B PTS: 1 DIF: 1 REF: 1-3

8. In the short run, an increase in the money supply is likely to lead to
   a. lower unemployment and lower inflation.
   b. lower unemployment and higher inflation.
   c. higher unemployment and lower inflation.
   d. higher unemployment and higher inflation.

ANS: B PTS: 1 DIF: 2 REF: 1-3

9. Which of the following is the most correct statement about the relationship between inflation and unemployment?
   a. In the short run, falling inflation is associated with falling unemployment.
   b. In the short run, falling inflation is associated with rising unemployment.
   c. In the long run, falling inflation is associated with falling unemployment.
   d. In the long run, falling inflation is associated with rising unemployment.

ANS: B PTS: 1 DIF: 2 REF: 1-3

10. The business cycle is measured by the
    a. production of goods and services.
    b. number of people employed.
    c. the interest rate.
    d. Both a and b are correct.

ANS: D PTS: 1 DIF: 2 REF: 1-3

12. It once took 90 percent of our population to grow our food. It now takes only 3 percent of the population to grow our food. Which of the following statements is true?
    a. This loss of jobs has been detrimental to our economy.
    b. The government should provide subsidies to encourage more people to become farmers.
    c. This reduction in the number of farmers explains the increase in the price of food.
    d. This is progress because freed-up labor that is used to produce other goods.

ANS: D PTS: 1 DIF: 1 REF: 1-3

TRUE/FALSE

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

ANS: F PTS: 1 DIF: 1 REF: 1-0

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

ANS: T PTS: 1 DIF: 1 REF: 1-0

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

ANS: F PTS: 1 DIF: 1 REF: 1-0

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: 2 REF: 1-1

5. The classic trade-off 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.

ANS: T PTS: 1 DIF: 1 REF: 1-1

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

ANS: F PTS: 1 DIF: 1 REF: 1-1

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

ANS: T PTS: 1 DIF: 1 REF: 1-1

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

ANS: T PTS: 1 DIF: 1 REF: 1-1

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

ANS: T PTS: 1 DIF: 2 REF: 1-2

10. Trade with any nation can be mutually beneficial.

ANS: T PTS: 1 DIF: 2 REF: 1-2

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

ANS: T PTS: 1 DIF: 2 REF: 1-2

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

ANS: F PTS: 1 DIF: 2 REF: 1-3

13. In the short-run, society faces a trade-off between inflation and unemployment.

ANS: T PTS: 1 DIF: 1 REF: 1-3

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

ANS: T PTS: 1 DIF: 1 REF: 1-3

15. Inflation measures the increase in the overall level of prices in an economy.

ANS: T PTS: 1 DIF: 2 REF: 1-3

SHORT ANSWER

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

ANS:
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 trade-offs, 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).

PTS: 1 DIF: 2 REF: 1-1

2. One trade-off society faces is between efficiency and equality. Define each term. If a government redistributes income from the rich to the poor, explain how this action affects equality as well as efficiency in the economy.

ANS:
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.

PTS: 1 DIF: 2 REF: 1-1

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

ANS:
Whatever must be given up to obtain some item it 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.)

PTS: 1 DIF: 2 REF: 1-1

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

ANS:

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.

PTS: 1 DIF: 2 REF: 1-2

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

ANS:

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.

PTS: 1 DIF: 2 REF: 1-3