CHAPTER 1—Ten lessons from economics

TRUE/FALSE

1. The word 'economy' comes from the Greek word for 'one who manages the government'.

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

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

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

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

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

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

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

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

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

6. The phrase 'there's no such thing as a free lunch' refers to the concept of scarcity.

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

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

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

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

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

9. Pollution regulations make society better off by raising incomes.

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

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

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

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

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

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

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

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

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

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

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

15. A marginal change is a large and significant change to an existing plan of action.

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

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

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

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

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

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

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

19. Australian government policies announcing when changes to child benefits would occur had no effect on the decision around timing of some Australian families to have babies.

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

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

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

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

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

22. Trade is about countries competing to export the most goods.

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

23. An employee outsourcing his own job is an example of an unexpected loss from trade.

ANS: F PTS: 1 DIF: Easy TOP: In the news: Outsourcing your own job

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

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

25. In a market economy a central agency decides how much goods and services should cost.

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

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

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

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

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

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

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

29. A monopolist has limited market power.

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

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

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

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

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

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

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

33. The growth rate of a nation's productivity determines the growth of its average inflation rate.

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

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

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

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

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

36. Inflation increases the value of money.

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

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

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

38. The Phillips curve shows that at least in the short term, reductions in the inflation rate must be accompanied by increases in unemployment.

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

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

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

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

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

MULTIPLE CHOICE

1. The word ‘economy’ comes from the Greek word for:
   A. ‘one who manages a household’
   B. ‘one who participates in a market’
   C. ‘environment’
   D. ‘conservation’

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

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

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

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

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

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

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

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

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

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

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

7. Which of the following resources is *least* likely to meet the definition of scarcity?
   A. whales

B. air
C. ice-cream
D. computers

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

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

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

9. Which of the following is a major area of study for economists?
A. how people make decisions
B. the design of nuclear power plants
C. the best way to design a nature reserve
D. how countries choose national leaders

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

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

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

11. An 'increase in efficiency' suggests that an economy:
A. is using more costly production techniques
B. has decided to produce more luxury goods
C. is able to get less goods and services from a given amount of resources
D. is able to get more goods and services from a given amount of resources

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

12. What does the adage 'There is no such thing as a free lunch' mean?
A. the government taxes firms that sell lunches
B. food prices have risen as a consequence of increased taxes
C. lunches are not free
D. we usually have to give up something, in order to get something else we like

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

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

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

14. If stricter regulations are used to reduce pollution then:
    A. everyone will benefit so there is no trade-off
    B. only firms that polluted will be affected
    C. there will be no trade-off as the firms can afford to reduce pollution
    D. incomes of these firm's owners, workers and customers will be affected, and this means a trade-off must result

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

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

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

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

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

17. An equitable outcome is one where:
    A. rich people give more to charities
    B. it can be described as fair
    C. it can be described as efficient
    D. everyone has the same income

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

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

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

19. The classic trade-off between guns and butter refers to:
    A. The fact that if we spend money on national defence we won't spend money on social

welfare
B. The fact that government welfare reduces the incentive for people to work
C. The more we spend on national defence, the more we will be able to produce commodities
D. The more we spend on national defence, the less we can spend on personal goods

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

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

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

21. The opportunity cost of going to university is:
A. the total spent on food, clothing, books, transportation, tuition, lodging and other expenses
B. zero for students who are fortunate enough to have all of their university expenses paid by someone else
C. the value of the best opportunity a student gives up to attend university
D. zero, since a university education will allow a student to earn a higher income after graduation

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

22. For most students, from an economic point of view, the largest single cost of a university education is:
A. transportation, parking and entertainment
B. tuition fees and books
C. the wages given up to attend university
D. room and board

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

23. From an accounting point of view, the largest single cost of a university education for most students is:
A. transportation, parking and entertainment
B. tuition fees and books
C. the wages given up to attend university
D. room and board

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

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

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

25. Lee decides to go to the zoo with her friends on Saturday instead of photographing a wedding for $1000. The opportunity cost she places on photographing the wedding is:
   A. the $1000 she would earn
   B. the enjoyment of spending the day with her friends at the zoo
   C. the $1000 less the enjoyment she would have received from being at the zoo with her friends
   D. nothing, as she wasn't going to earn any money at the zoo

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

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

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

27. Whenever a person gives up one resource to obtain an item it is called:
   A. cost-benefit analysis
   B. opportunity decision
   C. opportunity price
   D. opportunity cost

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

28. People make decisions at the margin by:
   A. following tradition
   B. comparing costs and benefits
   C. experience
   D. calculating dollar costs

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

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

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

30. A rational decision maker takes an action only if the:
   A. marginal benefit is greater than the marginal cost
   B. marginal benefit is less than the marginal cost

C. average benefit is greater than the average cost
D. marginal benefit is greater than both the average cost and the marginal cost

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

31. You have spent \$500 purchasing and repairing an old car which you expect to sell for \$700 once the repairs are complete. You discover that you need an additional part, which will cost \$500, including labour, in order to complete the repairs. You can sell the car as it is now for \$300. What should you do?
A. you should never sell something for less than it costs
B. you should cut your losses and take the \$300
C. you should complete the repairs and sell the car
D. it doesn't matter which action you take; the outcome is the same either way

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

32. Economists have recognised that people respond to:
A. the aspirations of policymakers
B. incentives
C. regulations rather than prices
D. poverty rather than pollution

ANS: B PTS: 1 DIF: Easy TOP: Lesson 4: People respond to incentives

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

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

34. Aaron has bought a new television for \$2000. He has just learnt that in a push to reduce household waste the government is giving \$500 to people who have their televisions fixed, instead of throwing them out when they break and buying a new one. What might Aaron do?
A. Nothing, his television is working fine
B. Break his television and have it fixed so he can get the \$500
C. Break his television and have it fixed if it will cost less than \$500 to fix
D. Wait until he has used the television for a while and then break it

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

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

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

36. Trade can benefit a family:
    A. by increasing the variety of goods and services they can buy at a lower cost
    B. by requiring each person to perform a wide range of tasks, including those they are not very productive in
    C. only if the government provides them with a subsidy
    D. both A and B

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

37. International trade:
    A. prevents countries from specialising in what they do best
    B. restricts the variety of goods a country can enjoy
    C. always creates winners and losers
    D. is a threat to national security

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

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

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

39. Australia can benefit from trade if it
    A. trades with all other countries
    B. does not trade with countries that make the same goods as Australia
    C. does not trade with any country with lower wages than Australia
    D. trades only with countries that have higher wages than Australia

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

40. If Australia is better than the US at producing wheat, but the US is better than Australia at producing cars, the US should:
    A. impose a tariff on Australian wheat in order to protect jobs in the US car industry
    B. sell cars to Australia, and buy Australian wheat
    C. subsidise its wheat industry so that it can compete with Australian wheat
    D. put a quota on the amount of Australian wheat imported

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

41. Which of the following is the best statement about markets?
    A. markets are usually a good way to organise economic activity
    B. markets are usually inferior to central planning as a way to organise economic activity
    C. markets are flawed and are therefore not an acceptable way to organise economic activity
    D. markets are a good way to organise economic activity in developed nations, but not in less-developed nations

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

42. In a market economy:
    A. firms decide whom to hire and what to produce
    B. profit and self-interest guide the decisions of firms and households
    C. households decide which firms to work for and what to buy with their incomes
    D. all of the above are true

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

43. Coordination of economic activity in a market economy is achieved by:
    A. government regulations
    B. banks and other financial intermediaries
    C. planning agencies within government
    D. prices

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

44. One example of a centrally planned market is:
    A. the toothbrush market
    B. the market for Toyota cars
    C. many self-interested agents making decisions
    D. a law requiring flour to be sold at $3 per kilo

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

45. Which of the following observations was made famous by Adam Smith in his book *The Wealth of Nations*?
    A. There is no such thing as a free lunch
    B. People buy more when prices are low than when prices are high
    C. No matter how much people earn, they tend to spend more than they earn
    D. Households and firms interacting in markets are guided by an ‘invisible hand’ that leads them to desirable market outcomes

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

46. Prices:
    A. Reflect the value of a good to society and its value to the central planner
    B. Reflect the value of a good to society and its cost to the central planner
    C. Reflect the cost of the good to the central planner and its value to society
    D. Reflect the value of a good to society and the cost to society of making it

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

47. The main motivation behind the ‘invisible hand’ is:
    A. the threat of government intervention
    B. business ethics

C. self-interest
D. the legal system

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

48. A market economy is guided by:
A. a central planner
B. people’s decisions to buy and sell goods
C. people’s decisions on whether to pay taxes or not
D. people’s ability to produce things that other people are willing to pay for

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

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

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

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

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

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

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

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

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

53. An externality is the impact of:
A. society’s decisions on the well-being of society

B. a person’s actions on that person’s well being
C. society’s decisions on the well-being of one person
D. one person’s actions on the wellbeing of a bystander

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

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

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

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

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

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

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

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

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

58. If paper-pulp factories generate too much water pollution with their discharge, which kills local fish stocks then:
A. the government will not be able to do anything to stop this
B. the factories will be concerned about the loss of fish and reduce their pollution
C. the government can treat the water for pollution and restock the river
D. the government can use environmental regulations to reduce the pollution and improve economic well being

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

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

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

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

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

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

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

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

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

63. What is one situation in which the government can improve the market outcome?
  A. A farmer decides not to grow crops for fear they will be stolen
  B. Prices adjust to influence supply and demand
  C. Two people bargain with each other to exchange goods
  D. Two people decide to study different university degrees

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

64. What ultimately determines a country's standard of living?
  A. its ability to produce goods and services that people want to buy
  B. the level of oil reserves it has
  C. the quantity of natural resources, like forests and gold mines
  D. the level of trade barriers to protect domestic industries and local workers

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

65. The income of a typical worker in a country is most closely linked to which of the following?
A. population
B. labour unions
C. productivity
D. government policies

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

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

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

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

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

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

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

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

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

70. The country's standard of living is generated by its:
A. government's industrial policies
B. level of natural resources available
C. population growth rates
D. productivity

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

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

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

72. To increase living standards, the most appropriate public policy measure is to:
A. accelerate the conversion of natural forests to farmland
B. make unemployment benefits more generous
C. encourage workers to become more educated and have the necessary tools and technology
D. require all workers to belong to unions and set high minimum wages

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

73. Concern among economists about their country’s budget deficit is based largely on the:
A. likelihood that the deficit will cause the country to go bankrupt
B. deficit’s adverse impact on productivity
C. fact that part of the deficit is covered by borrowing from foreigners
D. fact that the deficit is covered by printing money

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

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

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

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

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

76. Periods of high, persistent inflation are almost always caused by:
A. rising taxes
B. low productivity
C. aggressive wage increases
D. rapid and sustained growth in the quantity of money

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

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

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

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

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

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

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

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

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

81. In the early 1980s, US economic policy was directed toward reducing inflation. What would you assume about inflation and unemployment during this period?
    A. inflation fell and unemployment increased
    B. inflation and unemployment were both unaffected
    C. inflation fell and unemployment fell
    D. inflation fell and unemployment was unchanged

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

82. In the recent Global Financial Crisis, the US economy went from a situation of full employment to 12 per cent unemployment. What do you assume happened to prices?
    A. prices were unaffected
    B. prices fell and the economy experienced deflation
    C. prices rose and the economy experienced inflation
    D. it is impossible to guess what happened to prices from the information given

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

SHORT ANSWER

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

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

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

2. What are some differences between a centrally planned economy and a market economy?

    ANS:
    Market economies are economies that allocate resources through the decentralised decisions of many firms and households as they interact in markets for goods and services. Goods and services in a market economy are allocated through prices, which arise due to the market forces of supply and demand and as such they represent the value people place on the goods. Centrally planned economies have a single authority placing value on goods. While this can sometimes be more equitable, it will most often impose a price on goods and services that does not reflect how people really value them.

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

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

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

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

4. What would happen to the study of economics if scarcity disappeared?

    ANS:
    Since economics is the study of how society allocates its scarce resources, if there was 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. (It is difficult to conceive of a situation where time is not scarce, however.)

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

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

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

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

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

ANS:
The first policy is aimed at increasing the incentive to study medicine and thus to increase the supply of doctors in the economy. This will mean more patients can be seen because there are more doctors to see them. The second policy is aimed at making current doctors more productive, so that more patients will be seen per hour by the same number of doctors.
PTS: 1 DIF: Moderate TOP: Lesson 4: People respond to incentives

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

12. Stan buys a 1966 Mustang with the intention of repairing, restoring and selling it. He anticipates that it will cost him $10 000 to purchase, repair and restore the car, and that he can sell the finished car for $13 000. When he has spent a total of $10 000 on the project, he discovers that he needs to replace the engine. It will cost Stan $4000 to replace the engine. He can sell the car without the new engine for $9000. What should he do?

    ANS:
    Stan should be indifferent about finishing the project and also about selling the car now. The marginal cost of finishing the project is $4000 and the marginal benefit of finishing the project is $13 000, for a net marginal benefit of $9000. The marginal cost of stopping the project now is zero and the marginal benefit is the $9000 he can obtain from selling the car as is. Hence, the net marginal benefit from stopping the project now is also $9000.

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

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

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

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

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

    ANS:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

19. Adam Smith used the term 'invisible hand' in his 1776 book *The Wealth of Nations*. Prices are the instrument with which the 'invisible hand' directs economic activity in a market economy. Explain.

ANS:
Because households and firms look at prices when deciding what to buy and sell, they subconsciously take into account the social benefits and costs of their actions. As a result, prices guide these individual decision makers to reach outcomes that maximise the welfare of society as a whole.

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

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

ANS:
While pollution creates an external cost to society, there is also a cost to society of eliminating the pollution. A law that prohibits pollution considers the marginal benefit to society of eliminating pollution but not the marginal cost. Hence the enforcement of the law could actually harm society, if the cost of eliminating the pollution were greater than the benefit. In fact, such a law would eliminate all people, because people emit CO_2, a greenhouse gas.

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

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

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

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

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

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

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

23. Both Japan and the Philippines were badly damaged by the Second World War. Wages in Japan however, quickly overtook those of the Philippines in the post-war period. What is the fundamental cause of this difference?

ANS:
The main cause of wage levels is productivity. Productivity must have been lower in the Philippines relative to Japan and hence, living standards have stayed lower.

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

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

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

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

25. What is inflation and why can it be a problem?

ANS:
Inflation is an increase in the overall level of prices in the economy. One of the causes is the government printing money. If a government prints large quantities of money, the value of the money falls, increasing the prices of goods and services. This can be a problem because it creates uncertainty for long-term decision-making, as people do not want to save their money for fear it will reduce in value. Inflation also causes real wages to fall, since prices rise but wage policies often lag behind.

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

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

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

PTS: 2 DIF: Difficult TOP: Lesson 10: Society faces a short-term trade-off between inflation and unemployment

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

ANS:

When the money supply is reduced, lower spending combined with prices that are too high reduces sales and causes workers to be laid off. Previously employed workers may have to re-train.

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