

Student name: _____

TRUE/FALSE - Write 'T' if the statement is true and 'F' if the statement is false.

1) Market economies use capital goods because they improve productive efficiency.

- true
- false

2) Money functions as a medium of exchange by eliminating the need for a coincidence of wants.

- true
- false

3) Consumer sovereignty means that legislation now protects the rights of consumers to dispose of their incomes as they see fit.

- true
- false

4) Specialization may expand total output even though the individuals involved may have identical abilities.

- true
- false

5) The wants of consumers are expressed in the product market with "dollar votes."

- true
- false

6) Costs can be defined as total payments made to workers, landowners, and capital suppliers *less* payments to the entrepreneur for organizing and combining the other resources used to produce a good.

- true
- false

7) Continued losses in an industry will cause some firms to reduce output or eventually leave the industry.

- true
- false

8) The guiding function of prices tends to keep resources flowing toward their most highly valued uses.

- true
- false

9) The invisible hand refers to the many indirect controls that the federal government imposes in a market system.

- true
- false

10) Central planning in the Soviet Union and pre-reform China emphasized expanding the production of consumer goods to raise the domestic standard of living.

- true
- false

11) Central planning often suffers from a coordination problem and an incentive problem.

- true
- false

12) A market system is characterized by the private ownership of resources and the use of prices to coordinate economic activity.

- true
- false

13) Most market economies, such as the U.S. and the U.K., allow government policies and actions aimed at promoting economic growth and stability.

- true
- false

14) In a command economy, the head of each household makes the fundamental economic choices such as what to produce and how to produce output.

- true
- false

15) The economy of the United States can best be described as *laissez-faire* capitalism.

- true
- false

16) Property rights give to some people the right to coerce others into giving up their property.

- true
- false

17) Property rights give the government the right to own, use, and dispose of resources in an economy.

- true
- false

18) Selfishness and self-interest are identical concepts in economics.

- true
- false

19) An important aspect of the market system is that producers and consumers always have to consider the public interest in making production and consumption decisions.

- true
- false

20) If people tried to produce most of what they need on their own, then this would lead to a more efficient use of the economy's resources.

- true
- false

21) Even with the use of money, exchange and trade cannot occur if there is no coincidence of wants.

- true
- false

22) One of the most important economic resources is money.

- true
- false

23) In a market system, the distribution of goods and services largely depends on the distribution of income and people's preferences.

- true
- false

24) The fundamental economic question regarding the distribution of output in the economy is equivalent to the question of who will produce the output.

- true
- false

25) The concept of consumer sovereignty refers to the situation where consumers have the right to vote for the board of directors of large corporations.

- true
- false

26) In analyzing a market system, economists often assume that firms will choose the production techniques that will give them maximum revenues.

- true
- false

27) Economic efficiency entails producing a certain output with the minimum number of units of inputs.

- true
- false

28) The choice of the most efficient production technique is not affected by how much buyers want to buy the product.

- true
- false

29) In a market system, a consumer's ability to pay-but *not* necessarily his willingness to pay—is largely based on his income.

- true
- false

30) Even if prices are fixed and competition is restricted by the government, the invisible hand will still work in the economy and lead to economic efficiency.

- true
- false

31) In a competitive market economy, firms and resource suppliers seeking to further their own self-interest will end up, as though guided by an invisible hand, promoting the public interest.

- true
- false

32) The problems of central planning become less complex as an economy expands over time.

- true
- false

33) Profits are the primary "success indicator" for firms in a centrally planned economy.

- true
- false

34) Quantitative measures of managerial success, such as production targets or quotas, are highly foolproof and are thus ideal to use in increasing economic efficiency.

- true
- false

35) In the circular flow model, households act as buyers in the resource markets.

- true
- false

36) In a market system, entrepreneurs start businesses in order to earn a high salary.

- true
- false

37) In a market system, the income earned by owners of natural resources is called interest income.

- true
- false

38) A corporation is a type of business firm where the debt of the firm is considered its owners' personal responsibility.

- true
- false

39) According to the circular flow model of the market system, firms get their ability to pay for their costs of production from the revenues that they receive for their products.

- true
- false

40) According to the circular flow model of the market system, when resource-owners' money income is rising, then the costs to business firms that employ their resources must be falling.

- true
- false

41) Having a high fixed salary is what motivates entrepreneurs to make prudent decisions in dealing with business risk.

- true
- false

42) Government bailouts of failing businesses, like banks during the 2008 financial crisis, will tend to reduce the motivation among entrepreneurs to make prudent decisions in dealing with business risk.

- true
- false

43) College graduates who dislike business risk will mostly seek to be hired by firms as labor, rather than starting their own firms as entrepreneurs.

- true
- false

44) When somebody buys an insurance policy, that person is seeking to transfer risk away from herself and pass it on to the insurance company.

- true
- false

45) (Consider This) Low-cost production is not important for Bitcoin miners since Bitcoin is intangible and exists only in cyberspace.

- true
- false

46) (Consider This) South Korea has always been more prosperous than North Korea, even before 1953.

- true
- false

47) (Consider This) Without government subsidized property insurance, people are more likely to be cognizant of the risks of building and living in fire-prone or flood-prone areas because their insurance costs will be higher.

- true
- false

MULTIPLE CHOICE - Choose the one alternative that best completes the statement or answers the question.

48) Which of the following is *not* a typical characteristic of a market system?

- A) freedom of choice
- B) competition in product and resource markets
- C) consumer sovereignty
- D) lack of incentives to produce new products
- E) profit as a success indicator

49) Private property

- A) does everything indicated in the other choices.
- B) encourages owners to maintain or improve their property to preserve or enhance value.
- C) discourages innovation as people are often afraid to risk losing their own property.
- D) discourages cooperation because people don't want to part with what they own.

50) Which of the following is one of the Five Fundamental Questions?

- A) Which products should be subsidized?
- B) How will the goods and services be produced?
- C) How much should society save?
- D) Which products should be taxed?

51) Answer the question based on the following information: Suppose 30 units of product A can be produced by employing just labor and capital in the four ways shown below. Assume the prices of labor and capital are \$4 and \$3, respectively.

	Production Techniques			
	I	II	III	IV
Labor	4	3	2	5
Capital	2	3	5	1

Which technique is economically most efficient in producing A?

- A) III
- B) II
- C) I
- D) IV

52) Answer the question based on the following information: Suppose 10 units of product X can be produced by employing just labor and capital in the three ways shown below. Assume the prices of labor and capital are as shown.

	Resource price	Production Technique I	Production Technique II	Production Technique III
Labor	\$2	4	3	2
Capital	\$3	3	3	3

Which technique is the most economically efficient?

- A) Technique I with total costs of \$18
- B) Technique I with total costs of \$17
- C) Technique III with total costs of \$13
- D) Technique II with total costs of \$15

53) Answer the question based on the following information: Suppose 10 units of product A can be produced by employing just labor and capital in the four ways shown below. Assume the prices of labor and capital are \$2 and \$3, respectively.

	Production Techniques			
	I	II	III	IV
Labor	4	3	2	5
Capital	2	3	5	1

If the price of product A is \$1.00, and the firm is producing efficiently the firm will realize

- A) Economic profit of \$10.
- B) Economic profit of \$23.
- C) Economic loss of \$13.
- D) Economic loss of \$3.
- E) Economic profit of \$3.

54) [MISSING IMAGE: ,]Refer to the diagram. Flow 1 represents

- A) wage, rent, interest, and profit income.
- B) consumer expenditures.
- C) land, labor, capital, and entrepreneurial ability.
- D) goods and services.

55) Which of the following statements about self-interest in a market system is false?

- A) Self-interest applies only to consumers, not to entrepreneurs.
- B) Self-interest of entrepreneurs implies seeking maximum profits or minimum losses.
- C) Self-interest usually motivates an individual to deliver something of value to others.
- D) In a market system, self-interest motivates property owners to try to get the highest rent or price for their property.

56) If the total costs of producing 1,500 units of output is \$12,000 and this output sold to consumers for a total of \$15,000, then the firm would earn economic profits of

- A) \$15,000.
- B) \$18,000.
- C) \$3,000.
- D) \$12,000.
- E) \$27,000.

57) Which of the following is a characteristic of a corporation?

- A) It is an independent legal entity on its own.
- B) The owners bear all the responsibility of the business's debts.
- C) It is owned and managed by one person.
- D) The 2 owners pool their business talents to run the business.

58) Which of the following is a distinguishing feature of a command system?

- A) private ownership of all capital
- B) central planning
- C) heavy reliance on markets
- D) widespread dispersion of economic power

59) Which of the following is a distinguishing feature of laissez-faire capitalism?

- A) public ownership of all capital
- B) central planning
- C) minimal government intervention
- D) a circular flow of goods, resources, and money

60) Examples of command economies are

- A) the United States and Japan.
- B) Sweden and Norway.
- C) Mexico and Brazil.
- D) Cuba and North Korea.

61) Of the following countries, which one best exhibits the characteristics of a market economy?

- A) Canada
- B) Cuba
- C) North Korea
- D) Belarus

62) The French term "laissez-faire" means

- A) "there is no free lunch."
- B) "let it be."
- C) "circular flow."
- D) "public ownership."

63) An economic system

- A) requires a grouping of private markets linked to one another.
- B) is a particular set of institutional arrangements and a coordinating mechanism used to respond to the economizing problem.
- C) requires some sort of centralized authority (such as government) to coordinate economic activity.
- D) is a plan or scheme that allows a firm to make money at some other firm's expense.

64) The term "laissez-faire" suggests that

- A) land and other natural resources should be privately owned, but capital should be publicly owned.
- B) land and other natural resources should be publicly owned, but capital should be privately owned.
- C) government should not interfere with the operation of the economy.
- D) government action is absolutely necessary if the economy is to achieve full employment and full production.

- 65)** Economic systems differ according to which two main characteristics?
- A) who owns the factors of production and the methods used to coordinate economic activity
 - B) the technology used in production and the quantity and quality of natural resources
 - C) how goods are produced and who gets them
 - D) the political system in place and the degree of scarcity facing the economy
- 66)** Command systems are also known as
- A) market systems.
 - B) pure capitalism.
 - C) laissez-faire capitalism.
 - D) communism.
- 67)** A fundamental difference between the command system and laissez-faire capitalism is that, in command systems,
- A) the division of output is decided by central planning rather than by individuals operating freely through markets.
 - B) all economic decisions are made by the government, whereas there is no government in laissez-faire capitalism.
 - C) scarcity does not exist, whereas it does in laissez-faire capitalism.
 - D) money is not used, whereas it is in laissez-faire capitalism.
- 68)** Which of the following is *not* a typical characteristic of a market system?
- A) private property
 - B) freedom of enterprise
 - C) government ownership of most property resources
 - D) competition in product and resource markets

- 69) Which of the following is a fundamental characteristic of the market system?
- A) property rights
 - B) central planning by government
 - C) unselfish behavior
 - D) government-set wages and prices
- 70) Property rights are important because they
- A) ensure an equal distribution of income.
 - B) encourage cooperation by improving the chances of mutually agreeable transactions.
 - C) guarantee that any exchange will make all parties better off than prior to the exchange.
 - D) allow the government to control how resources are allocated.
- 71) Private property
- A) discourages cooperation because people don't want to part with what they own.
 - B) discourages innovation, as people are often afraid to risk losing their own property.
 - C) encourages owners to maintain or improve their property to preserve or enhance value.
 - D) does everything indicated by the other answers.
- 72) Copyrights and trademarks are examples of
- A) capital goods.
 - B) human capital.
 - C) property rights.
 - D) public goods.
- 73) Freedom of enterprise

- A) is a characteristic that is common to most economic systems.
- B) in a market system means that entrepreneurs can obtain and use economic resources without any legal restraint.
- C) allows businesses, within broad limits, to choose what goods to produce.
- D) refers primarily to the right of consumers to purchase what they want.

74) The main mechanism that regulates the market system is

- A) self-interest.
- B) private property.
- C) competition.
- D) freedom of enterprise and choice.

75) Broadly defined, competition involves

- A) private property and freedom of expression.
- B) independently acting buyers and sellers and freedom to enter or leave markets.
- C) increasing opportunity costs and diminishing marginal utility.
- D) capital goods and division of labor.

76) Competition means that

- A) sellers can manipulate market price by causing product scarcities.
- B) there are independently acting buyers and sellers in each market.
- C) a product can be purchased at a number of different prices.
- D) there is more than one seller in a market.

77) The division of labor means that

- A) labor markets are geographically segmented.
- B) unskilled workers outnumber skilled workers.
- C) workers specialize in various production tasks.
- D) each worker performs a large number of tasks.

78) Specialization in production is important primarily because it


- A) results in greater total output.
- B) allows society to avoid the coincidence-of-wants problem.
- C) allows society to trade by barter.
- D) allows society to have fewer capital goods.

79) Specialization—the division of labor—enhances productivity and efficiency by

- A) allowing workers to take advantage of existing differences in their abilities and skills.
- B) avoiding the time loss involved in shifting from one production task to another.
- C) allowing workers to develop skills by working on one, or a limited number, of tasks.
- D) all of the means identified in the other answers.


80) Specialization in production is economically beneficial primarily because it

- A) allows everyone to have a job that he or she likes.
- B) permits the production of a larger output with fixed amounts of resources.
- C) facilitates trade by bartering.
- D) guarantees full employment.

81)  On the basis of the information, it can be said that

The diagram for question 81 consists of three boxes. The top box is labeled 'Michigan' and contains the text 'Has Surplus Autos' and 'Wants Lettuce'. Below it are two boxes: the left one is labeled 'Texas' and contains 'Has Surplus Lettuce' and 'Wants Apples'; the right one is labeled 'Washington' and contains 'Has Surplus Apples' and 'Wants Autos'.

- A) no coincidence of wants exists between any two states.
- B) a coincidence of wants exists between Michigan and Washington.
- C) a coincidence of wants exists between Texas and Washington.
- D) a coincidence of wants exists between Michigan and Texas.

82)  On the basis of the information, and assuming trade occurs between the three states, we can expect

The diagram for question 82 is identical to the one for question 81, showing Michigan, Texas, and Washington with their respective surpluses and wants.

- A) Washington to exchange apples with Texas and receive money in return.
- B) Washington to exchange apples with Michigan and receive money in return.
- C) Texas to exchange lettuce with Michigan and receive autos in return.
- D) Texas to trade lettuce directly for Washington apples.



83) Given the information, and assuming trade occurs between the three states, we can expect

- A) that there is no means by which Michigan can obtain lettuce while specializing in the production of autos.
- B) that money will not be needed to accomplish the desired exchanges.
- C) money to flow counter-clockwise from Michigan to Texas to Washington.
- D) money to flow clockwise from Michigan to Washington to Texas.

84) Barter

- A) is the major means of exchange in centrally planned economies.
- B) accounts for over 30 percent of the dollar volume of all exchange in the U.S. economy.
- C) entails the exchange of goods for goods.
- D) is used to circumvent the problem of a lack of coincidence of wants among potential buyers and sellers.

85) The "coincidence of wants" problem associated with barter refers to the fact that

- A) for exchange to occur, each seller must have a product that some buyer wants.
- B) money must be used as a medium of exchange or trade will never occur.
- C) specialization is restricted by the size or scope of a market.
- D) buyers in resource markets and sellers in product markets can never engage in exchange.

86) The use of money contributes to economic efficiency because

A) governmental direction of the production and distribution of output can be avoided by using money.

B) roundabout production could not occur without the availability of money.

C) it is necessary for the creation of capital goods.

D) it promotes specialization by overcoming the problems with barter.

87) The presence of market failures implies that

A) money is not an effective tool for exchange in a market system.

B) there is an active role for government, even in a market system.

C) individuals and firms should strive to be self-sufficient rather than specialize.

D) command systems are superior to market systems in the allocation of resources.

88) Which of the following characteristics is *least* unique to a market system?

A) private ownership of property resources

B) competition among buyers and sellers pursuing monetary returns

C) the widespread use of money

D) freedom of enterprise and choice

89) Which of the following is one of the Five Fundamental Questions?

A) Which products will be in scarce supply and which in excess supply?

B) Who should appoint the head of the central bank?

C) How much should society save?

D) What goods and services will be produced?

90) If competitive industry Z is making substantial economic profit, output will

- A) fall in industry Z and firms will likely leave the market.
- B) fall in all industries except industry Z.
- C) expand in industry Z, as more resources will move to that industry.
- D) expand in industry Z, but no new firms will enter the market.

91) From society's point of view, the economic function of profits and losses is to

- A) promote the equal distribution of real assets and wealth.
- B) achieve full employment and price level stability.
- C) contribute to a more equal distribution of income.
- D) reallocate resources from less-desired to more-desired uses.

92) In a market economy, a significant change in consumers' desire for product X will

- A) alter the profits or losses received by suppliers of product X.
- B) cause a reallocation of scarce resources.
- C) cause some industries to expand and others to contract.
- D) do all the things mentioned in the other answers.

93) Economic profits in an industry suggest the industry

- A) can earn more profits by increasing product price.
- B) should be larger to better satisfy consumers' desire for the product.
- C) has excess production capacity.
- D) is the size that consumers want it to be.

94) Economic profits and losses

- A) are both considered by economists to be a part of production costs.
 - B) are essential to the reallocation of resources from less desired to more desired goods.
 - C) have no influence on the composition of domestic output.
 - D) equalize the distribution of income in the long run.
- 95) If consumer desire for product X increases, all of the following will occur *except*
- A) an increase in the profits of industry X.
 - B) an increase in the quantity of resources employed by industry X.
 - C) an increase in the output of industry X.
 - D) a decrease in the quantity of resources employed in industry X.
- 96) An increase in consumer desire for strawberries is most likely to
- A) increase the number of strawberry pickers needed by farmers.
 - B) reduce the supply of strawberries.
 - C) reduce the number of people willing to pick strawberries.
 - D) reduce the need for strawberry pickers.
- 97) If competitive industry Y is incurring substantial losses, output will
- A) expand as resources move toward industry Y.
 - B) contract as resources move toward industry Y.
 - C) contract as resources move away from industry Y.
 - D) expand as resources move away from industry Y.
- 98) The economic function of profits and losses is to

- A) bring about a more equal distribution of income.
- B) signal that resources should be reallocated.
- C) eliminate small firms and reduce competition.
- D) tell government which industries need to be subsidized.

99) If a competitive industry is neither expanding nor contracting, we would expect

- A) total revenue to be zero.
- B) economic profits to be zero.
- C) total opportunity cost to be zero.
- D) more resources to flow to that industry.

100) The competitive market system

A) encourages innovation because government provides tax breaks and subsidies to those who develop new products or new productive techniques.

B) discourages innovation because it is difficult to acquire additional capital in the form of new machinery and equipment.

C) discourages innovation because firms want to get all the profits possible from existing machinery and equipment.

D) encourages innovation because successful innovators are rewarded with economic profits.

101) In a market economy, the distribution of output will be determined primarily by

- A) consumer needs and preferences.
- B) the quantities and prices of the resources that households supply.
- C) government regulations that provide a minimum income for all.
- D) a social consensus as to which distribution of income is most equitable.

102) The most efficient combination of resources in producing a given output is the combination that

- A) comes closest to using the same quantities of land, labor, capital, and entrepreneurial ability.
- B) minimizes the cost per unit of output.
- C) uses the smallest total quantity of all resources.
- D) conserves most on the use of labor.

103) Firms are motivated to minimize production costs because

- A) it is the most environmentally friendly way to produce goods.
- B) least-cost production techniques use the smallest total quantity of resources.
- C) competitive pressures in the market will drive out higher-cost producers.
- D) the government provides tax credits and subsidies to low-cost producers.

104) Answer the question using the following data, which show all available techniques for producing 20 units of a particular commodity.

Resource	Resource prices	Possible Production Techniques				
		#1	#2	#3	#4	#5
Land	\$4	2	4	2	4	4
Labor	3	1	2	4	1	3
Capital	3	5	2	3	1	2
Entrepreneurial Ability	2	3	1	1	4	1

In view of the indicated resource prices, the economically most efficient production technique(s) is (are) technique(s)

- A) 1.
- B) 2 and 4.
- C) 3.
- D) 1 and 3.

105) Answer the question using the following data, which show all available techniques for producing 20 units of a particular commodity.

Resource	Resource prices	Possible Production Techniques				
		#1	#2	#3	#4	#5
Land	\$4	2	4	2	4	4
Labor	3	1	2	4	1	3
Capital	3	5	2	3	1	2
Entrepreneurial Ability	2	3	1	1	4	1

Assuming the firm is motivated by self-interest and that the 20 units that can be produced with each technique can be sold for \$2 per unit, the firm will

- A) realize an economic profit of \$10.
- B) realize an economic profit of \$4.
- C) not earn any economic profit.
- D) shut down rather than incur a loss by producing.

106) Answer the question using the following data, which show all available techniques for producing 20 units of a particular commodity.

Resource	Resource prices	Possible Production Techniques				
		#1	#2	#3	#4	#5
Land	\$4	2	4	2	4	4
Labor	3	1	2	4	1	3
Capital	3	5	2	3	1	2
Entrepreneurial Ability	2	3	1	1	4	1

If a new production technique is developed that enables a firm to produce 20 units of output with 3 units of land, 3 of labor, 1 of capital, and 2 of entrepreneurial ability, this technique would

- A) not be adopted because, although it reduces production costs, it does not increase profit.
- B) be adopted because it would lower production costs and increase economic profit.
- C) not be adopted because it entails higher production costs than other available techniques.
- D) be adopted, even though economic profits would be reduced slightly.

107) Answer the question based on the following information: Suppose 30 units of product A can be produced by employing just labor and capital in the four ways shown below. Assume the prices of labor and capital are \$2 and \$3, respectively.

	Production Techniques			
	I	II	III	IV
Labor	4	3	2	5
Capital	2	3	5	1

Which technique is economically most efficient in producing A?

- A) I
- B) II
- C) III
- D) IV

108) Answer the question based on the following information: Suppose 10 units of product X can be produced by employing just labor and capital in the three ways shown below. Assume the prices of labor and capital are as shown.

	Resource price	Production Technique I	Production Technique II	Production Technique III
Labor	\$ 2	4	3	2
Capital	\$ 3	2	3	5

Which technique is the most economically efficient?

- A) Technique I with total costs of \$14
- B) Technique II with total costs of \$15
- C) Technique III with total costs of \$14
- D) Technique I with total costs of \$19

109) Answer the question based on the following information: Suppose 30 units of product A can be produced by employing just labor and capital in the four ways shown below. Assume the prices of labor and capital are \$2 and \$3, respectively.

	Production Techniques
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	I	II	III	IV
Labor	4	3	2	5
Capital	2	3	5	1

If the price of product A is \$0.50, the firm will realize

- A) an economic profit of \$4.
- B) an economic profit of \$2.
- C) an economic profit of \$6.
- D) a loss of \$3.

110) In a competitive market economy, firms select the least-cost production technique because

- A) such choices will result in full employment of available resources.
- B) to do so will maximize the firms' profits.
- C) this will prevent new firms from entering the industry.
- D) "dollar voting" by consumers mandates such a choice.

111) The market system's answer to the fundamental question "What will be produced?" is essentially

- A) "Goods and services that are profitable."
- B) "Low-cost goods and services."
- C) "Goods and services that can be produced using large amounts of capital."
- D) "Goods and services that possess lasting value."

112) The market system's answer to the fundamental question "How will the goods and services be produced?" is essentially

- A) "With as much machinery as possible."
- B) "Using the latest technology."
- C) "By exploiting labor."
- D) "In ways that minimize the cost per unit of output."

113) The market system's answer to the fundamental question "Who will get the goods and services?" is essentially

- A) "Those most willing and able to pay for them."
- B) "Those who physically produced them."
- C) "Those who most need them."
- D) "Those who get utility from them."

114) The market system's answer to the fundamental question "How will the system accommodate change?" is essentially

- A) "Through government leadership and direction."
- B) "Through the guiding function of prices and the incentive function of profits."
- C) "Through training and retraining programs."
- D) "Through trial and error."

115) The market system's answer to the fundamental question "How will the system promote progress?" is essentially

- A) "Through government-funded research programs."
- B) "Through redistribution of income to promote greater equality."
- C) "Through training and retraining programs."
- D) "Through the profit potential that encourages development of new technology."

116) The advent of Netflix movie streaming and Redbox kiosks renting DVD and Blu-ray movies have virtually demolished the market for video rentals from brick and mortar stores such as Blockbuster. This is an example of

- A) creative destruction.
- B) derived demand.
- C) capital accumulation.
- D) the difference between normal and economic profits.

117) "Consumer sovereignty" refers to the

- A) fact that resource prices are higher than product prices in capitalistic economies.
- B) idea that the pursuit of self-interest is in the public interest.
- C) idea that the decisions of producers must ultimately conform to consumer demands.
- D) fact that a federal agency exists to protect consumers from harmful and defective products.

118) The dollar votes of consumers ultimately determine the composition of output and the allocation of resources in a market economy. This statement best describes the concept of

- A) derived demand.
- B) consumer sovereignty.
- C) the invisible hand.
- D) market failure.

119) Which of the following is *not* one of the five fundamental questions?

- A) What prices will be charged for goods and services?
- B) Who will get the goods and services?
- C) What goods and services will be produced?
- D) How will the system promote progress?

120) "Consumer sovereignty" means that

- A) buyers can dictate the prices at which goods and services will be offered.
- B) advertising is ineffective because consumers already know what they want.
- C) buyers control the quality of goods and services through regulatory agencies.
- D) buyers determine what will be produced based on their "dollar votes" for the goods and services offered by sellers.

121) Which of the following best describes the invisible-hand concept?

- A) The desires of resource suppliers and producers to further their own self-interest will automatically further the public interest.
- B) The inability to substitute resources creates a conflict between private and public interests and calls for government intervention.
- C) The market system is the best system for overcoming the scarce resources-unlimited wants problem.
- D) Central direction by the government will improve resource allocation in a capitalistic economy.

122) The invisible hand refers to the

- A) fact that the U.S. tax system redistributes income from rich to poor.
- B) notion that, under competition, decisions motivated by self-interest promote the social interest.
- C) tendency of monopolistic sellers to raise prices above competitive levels.
- D) fact that government controls the functioning of the market system.

123) The invisible hand concept suggests that

- A) market failures imply the need for a national economic plan.
- B) big businesses are inherently more efficient than small businesses.
- C) the competitiveness of a capitalistic market economy invariably diminishes over time.
- D) assuming competition, private and public interests will coincide.

124) Two major virtues of the market system are that it

- A) allocates resources efficiently and allows economic freedom.
- B) results in an equitable personal distribution of income and always maintains full employment.
- C) results in price-level stability and a fair personal distribution of income.
- D) eliminates discrimination and minimizes environmental pollution.

125) The market system

- A) produces considerable inefficiency in the use of scarce resources.
- B) effectively harnesses the incentives of workers and entrepreneurs.
- C) is not consistent with freedom of choice in the long run.
- D) has slowly lost ground to emerging command systems.

126) According to the concept of the "invisible hand," if Susie opens and operates a profitable childcare center, then

- A) government should regulate the business to ensure quality.
- B) the profit Susie earns indicates that she is overcharging for her services.
- C) she has served society's interests by providing a desired good or service.
- D) this demonstrates that consumer sovereignty is not present in this market.

127) The invisible hand promotes society's interests because

- A) individuals pursuing their self-interest will try to produce goods and services that people in society want and are willing to purchase.
- B) individuals will produce goods for others out of concern for their fellow human beings.
- C) it makes sure that everyone wins from competition in the market.
- D) government regulation pushes business into producing the right mix of goods and services.

128) The coordination problem in the centrally planned economies refers to the idea that

- A) planners had to direct required inputs to each enterprise.
- B) the price level and the level of employment were inversely related.
- C) the immediate effect of more investment was less consumption.
- D) exports had to be equal to imports for a central plan to work.

129) "Under central planning, some group has to decide how to get the necessary inputs produced in the right amounts and delivered to the right places at the right time. This is a nearly impossible task without markets and profits." This quotation best identifies the

- A) incentive problem under central planning.
- B) coordination problem under central planning.
- C) self-sufficiency dilemma under communism.
- D) resource overcommitment problem under communism.

130) "Because the outputs of many industries are the inputs to other industries, the failure of any single industry to fulfil the output quantities specified in the central plan caused a chain reaction of adverse repercussions on production." This quotation best identifies the

- A) incentive problem under central planning.
- B) self-sufficiency dilemma under communism.
- C) resource overcommitment problem under communism.
- D) coordination problem under central planning.

131) The incentive problem under communist central planning refers to the idea that

- A) planners had to direct required inputs to each enterprise.
- B) workers, managers, and entrepreneurs could not personally gain by responding to shortages or surpluses or by introducing new and improved products.
- C) the immediate effect of more investment was less consumption.
- D) exports had to be equal to imports for a central plan to work.

132) Suppose that an individual sees a tremendous opportunity to produce and sell a new product but dismisses the idea because there is no way to exploit this opportunity for personal gain. This situation best identifies the

- A) coordination problem under communist central planning.
- B) self-sufficiency dilemma under communism.
- C) asymmetric information problem under communism.
- D) incentive problem under communist central planning.

133) Innovation lagged in the centrally planned economies because

- A) there was too much domestic business competition.
- B) there was too much competition from foreign firms.
- C) enterprises resisted innovation in fear that their production targets would be raised.
- D) exports had to equal imports for the plan to work.

134) The fact that the major indicator of enterprise success in the Soviet Union and pre-reform China was the quantity of output implied that

- A) product quality was neglected.
- B) production costs were minimized.
- C) product mix met consumer needs.
- D) technological advance was too rapid.

135) Enterprise managers and workers in the Soviet Union often resisted innovations in production methods because

- A) production targets were often increased when innovation occurred.
- B) there was a chronic shortage of computers.
- C) workers could not be reallocated geographically.
- D) innovations ordinarily increased dependence on world markets.

136) If products were in short or surplus supply in the Soviet Union,

- A) price and profit signals eliminated those shortages and surpluses.
- B) price and profit signals intensified those shortages and surpluses.
- C) producers would not react because no price or profit signals occurred.
- D) the planners would immediately adjust production to achieve equilibrium.

137) In what type of business do the owners bear no personal financial responsibility for the company's debts and obligations?

- A) partnerships
- B) corporations
- C) sole proprietorships
- D) in all the businesses listed in the other answers

138) The simple circular flow model shows that

- A) households are on the buying side of both product and resource markets.
- B) businesses are on the selling side of both product and resource markets.
- C) households are on the selling side of the resource market and on the buying side of the product market.
- D) businesses are on the buying side of the product market and on the selling side of the resource market.

139) The two basic markets shown by the simple circular flow model are

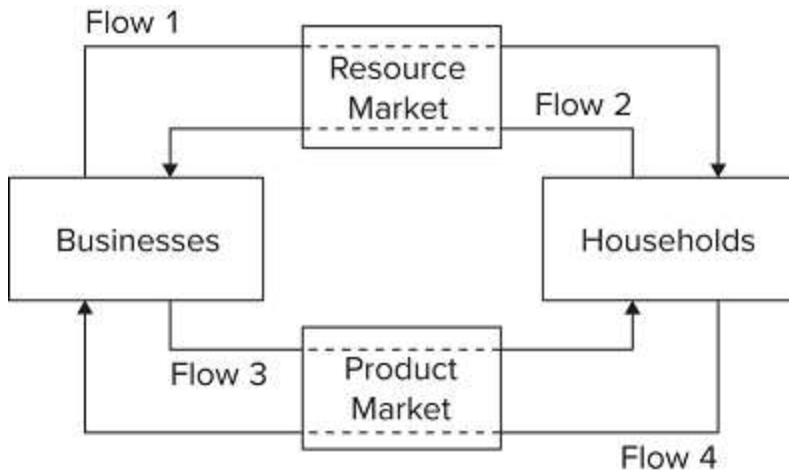
- A) capital goods and consumer goods.
- B) competitive and regulated.
- C) product and resource.
- D) household and business.

140) In the resource market,

- A) businesses borrow financial capital from households.
- B) businesses sell services to households.
- C) households sell resources to businesses.
- D) firms sell raw materials to households.

141) In the simple circular flow model,

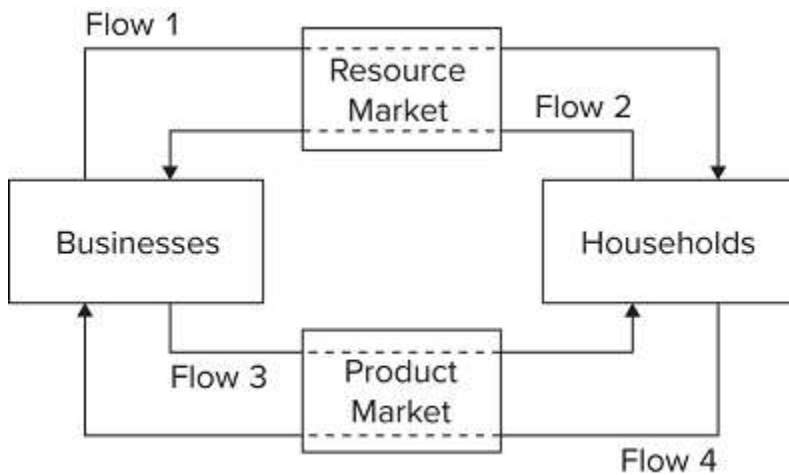
- A) households are buyers of resources.
- B) businesses are sellers of final products.
- C) households are sellers of final products.
- D) there are real flows of goods, services, and resources, but not money flows.



142) Flow 1 represents

Refer to the diagram. Flow

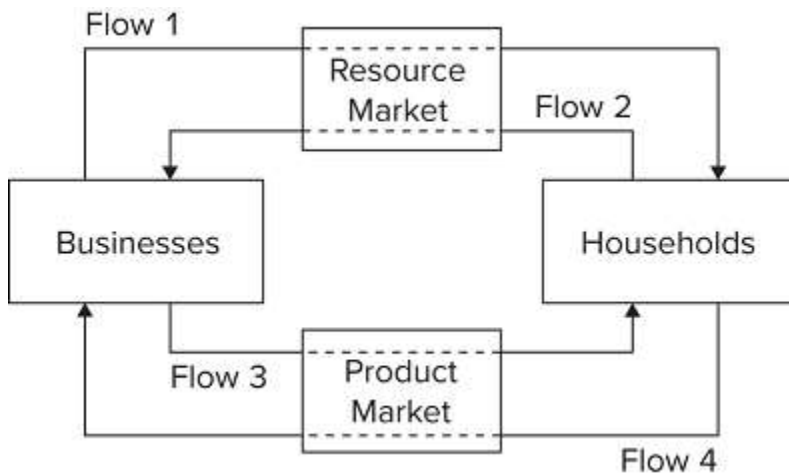
- A) wage, rent, interest, and profit income.
- B) land, labor, capital, and entrepreneurial ability.
- C) goods and services.
- D) consumer expenditures.



143) Flow 2 represents

Refer to the diagram. Flow

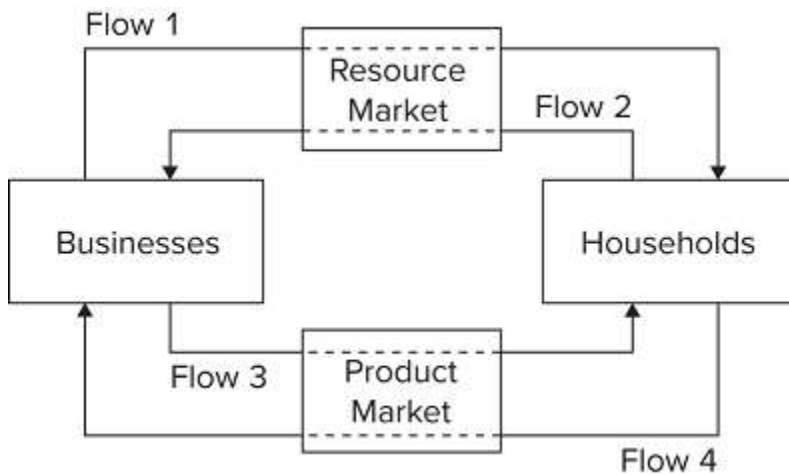
- A) wage, rent, interest, and profit income.
- B) land, labor, capital, and entrepreneurial ability.
- C) goods and services.
- D) consumer expenditures.



144)
3 represents

Refer to the diagram. Flow

- A) wage, rent, interest, and profit income.
- B) land, labor, capital, and entrepreneurial ability.
- C) goods and services.
- D) consumer expenditures.



145)
4 represents

Refer to the diagram. Flow

- A) wage, rent, interest, and profit income.
- B) land, labor, capital, and entrepreneurial ability.
- C) goods and services.
- D) consumer expenditures and business revenue.

146) In terms of the circular flow diagram, households make expenditures in the _____ market and receive income through the _____ market.

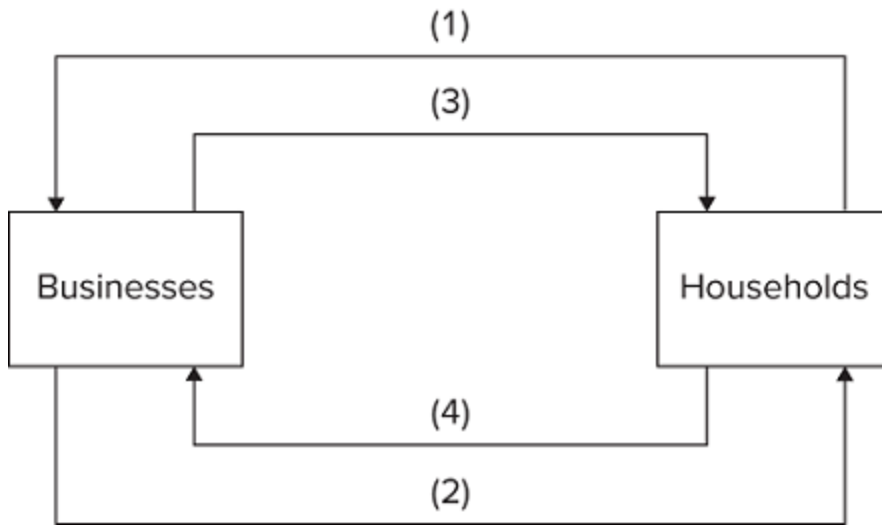
- A) product; financial
- B) resource; product
- C) product; resource
- D) capital; product

147) In terms of the circular flow diagram, businesses obtain revenue through the _____ market and make expenditures in the _____ market.

- A) product; financial
- B) resource; product
- C) product; resource
- D) capital; product

148) Households and businesses are

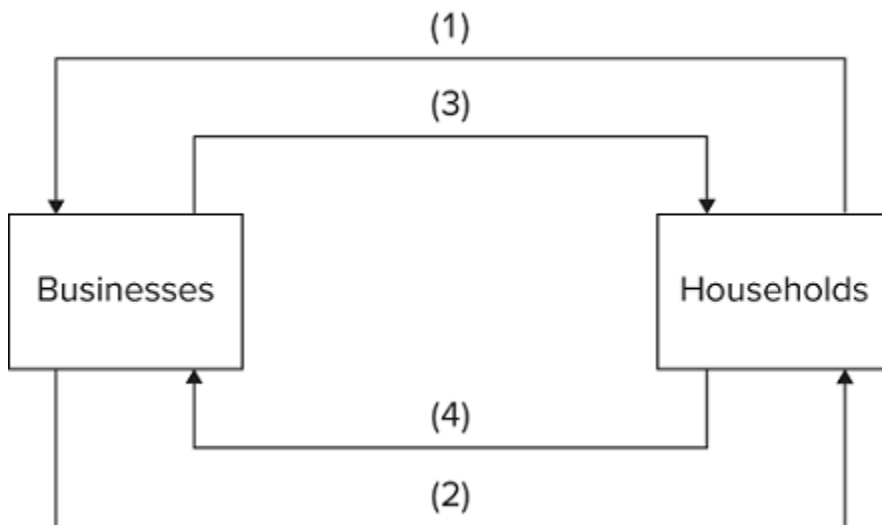
- A) both buyers in the resource market.
- B) both sellers in the product market.
- C) sellers in the resource and product markets respectively.
- D) sellers in the product and resource markets respectively.



149) Refer to the diagram. Arrows (1) and (2) represent

Refer to the

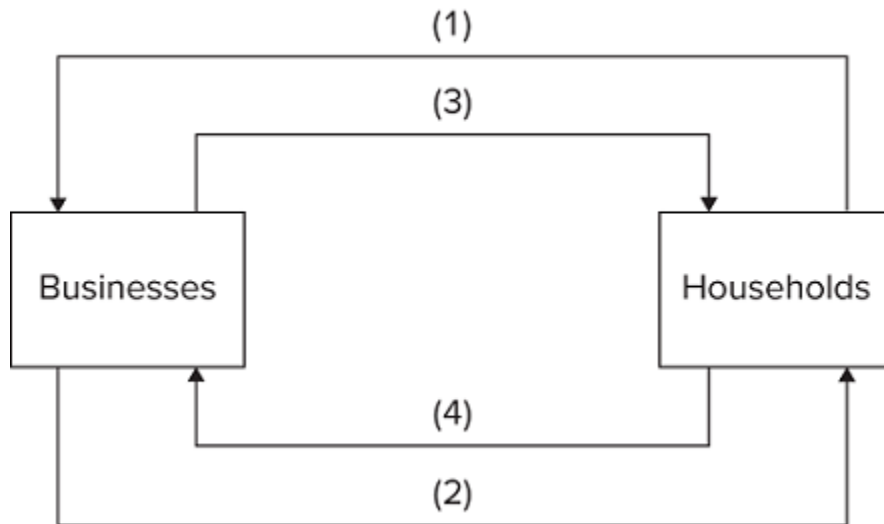
- A) goods and resources, respectively.
- B) money incomes and output, respectively.
- C) output and money incomes, respectively.
- D) resources and goods, respectively.



150) Refer to the diagram. Arrows (3) and (4) represent

Refer to the

- A) goods and services, respectively.
- B) incomes and consumer expenditures, respectively.
- C) resources and goods, respectively.
- D) consumer expenditures and income, respectively.



151) Refer to the diagram. Arrows (1) and (3) are associated with

- A) the money market.
- B) the resource market.
- C) the product market.
- D) international trade.

152) Which of the following best illustrates the circular flow model in action?

- A) Bobbie goes to work and builds cars; she uses the income she receives to buy food at the grocery store.
- B) Evan buys a new couch; the owner of the furniture store uses some of the money from the sale to pay her supplier and uses the rest to take her family out to dinner.
- C) Boeing experiences a surge in orders for new airplanes, prompting the company to hire more workers.
- D) All of these answers illustrate the workings of the circular flow model.

153) In a market system,

- A) firm owners and employees share business risk more or less equally.
- B) a firm's employees and suppliers are largely shielded from risk, relative to business owners.
- C) employees and suppliers face the greatest risks, because firms can shut down without notice and leave them unpaid.
- D) a firm's owners are largely shielded from risk because they can walk away from the business at any time.

154) In a market system, employees and suppliers

- A) are usually shielded from risk, but at the cost of not sharing in the profits of the firm.
- B) are usually shielded from risk and share in the profits of the firm.
- C) are generally subject to as much risk as firm owners but get to share in the profits.
- D) bear as much risk as firm owners but don't get to share in the profits.

155) A market system tends to restrict business risk to owners and investors. This results in which of the following benefits?

- A) a more stable macroeconomy with fewer recessions
- B) Firms are better able to attract inputs, as these inputs do not have to share the risk.
- C) Government agencies are better prepared to help when businesses fail.
- D) consistently lower prices for consumers

156) A market system tends to restrict business risk to owners and investors. This results in which of the following benefits?

- A) It encourages more people to become entrepreneurs.
- B) Firms have to pay more to attract inputs, as these inputs have to share the risk.
- C) Firms focus attention on prudent risk management, as it is profitable to manage risk.
- D) Income becomes more equally distributed.

157) Economic systems differ from one another based on who owns the factors of production and

- A) how many resources are available in the economy and where they are located.
- B) how economic activities are coordinated and directed.
- C) what kinds of products are produced in the economy and how they are sold.
- D) how big the population is and the makeup of the population.

158) The market system is an economic system that

- A) produces more consumer goods than capital goods.
- B) produces more capital goods than consumer goods.
- C) gives private individuals the right to own resources used in production.
- D) emphasizes the government's power to control markets and direct economic activity.

159) The market system is also known as ____, while the command system is also known as _____.

- A) capitalism; socialism
- B) socialism; communism
- C) central planning; laissez faire
- D) a production system; a planning system

160) Laissez-faire capitalism limits the government's economic functions to the following, *except*

- A) protecting private property rights.
- B) establishing a legal environment to enforce contracts among individuals.
- C) preventing individuals and firms from coercing others.
- D) setting prices of individual goods and services.

161) One major element of the command system is

- A) an emphasis on private ownership of resources.
- B) individual decentralized decision making.
- C) reliance on supply-and-demand forces to guide economic activity.
- D) central planning conducted by the government.

162) The government may impose industrial safety regulations and occupational licensing requirements in which of the following economic systems?

- A) the laissez-faire economy
- B) pure capitalism
- C) a mixed-market economy
- D) macroeconomic systems

163) In a command system,

- A) self-interest motivates and commands each business firm's decisions and actions.
- B) the head of each family decides and commands what to do with the family's resources.
- C) a government-appointed planning board makes production and allocation decisions.
- D) market traders command what outputs are produced and how they are allocated.

164) Which of the following would *not* be emphasized in a capitalist economy?

- A) private ownership of capital and other resources
- B) competition and decentralized decisions regarding production and consumption
- C) reliance on market forces to coordinate economic activity
- D) prevention of firms from exposing themselves to financial risk

165) The government may not implement policies intended to redistribute income in which of the following economic systems?

- A) laissez-faire capitalism
- B) command systems
- C) a mixed economy
- D) the market system

166) The economies of North Korea and Cuba are

- A) similar in that they are both basically command systems.
- B) similar in that they are both basically market systems.
- C) different in that North Korea has a command system, while Cuba has a market system.
- D) different in that Cuba has a command system, while North Korea has a market system.

167) *Laissez-faire* capitalism is characterized by

- A) a very limited government role in the economy.
- B) active government intervention in the economy.
- C) individuals and firms abiding by a government economic plan.
- D) the economic system of the United States today.

168) By freedom of enterprise, we mean that individual

- A) workers are free to look for jobs and work in whichever firm will hire them.
- B) firms are free to employ resources, to produce output, and to sell products.
- C) producers are free to produce whatever the government decides is needed by the society.
- D) consumers are free to buy whatever products will satisfy their needs the most.

169) Capitalism gets its name from the fact that capital resources are mostly

- A) owned by the state or government.
- B) given the highest priority in the economy's income distribution.
- C) treated as private property.
- D) in the form of money and financial resources.

170) The main characteristics of a modern market system include all of the following *except*

- A) entrepreneurs are free to obtain and use resources to produce goods and services.
- B) consumers are free to buy goods and services that their budgets allow.
- C) economic power is diffused by competition among economic units.
- D) government is restricted to national defense and does not intervene at all in various markets.

171) In a market system, self-interest is the motivating force that

- A) makes individuals unwilling to deliver anything of value to others.
- B) makes owners of resources always want to use their resources themselves.
- C) leads the economy to chaos and confusion, especially the larger economies.
- D) coordinates and creates consistency in the operations of various parts of the economy.

172) Which of the following statements about self-interest in a market system is false?

- A) Self-interest usually motivates an individual to deliver something of value to others.
- B) Self-interest of entrepreneurs implies seeking maximum profits or minimum losses.
- C) Self-interest applies only to capitalists and entrepreneurs, not to workers employed by others.
- D) In a market system, consumers are just like firms: self-interest is what motivates them.

173) Consumers express self-interest when they

- A) seek the lowest price for a product.
- B) reduce business losses.
- C) collect economic profits.
- D) exclude others in their thinking.

174) Private property and freedom of choice in a market system have the following implications, *except*

- A) individuals are free to take on the financial risks involved in a business.
- B) trades that take place in the economy are mutually agreeable transactions among individuals.
- C) economic agents can act in their own self-interest.
- D) large firms are allowed to coerce other firms and individuals.

175) Which of the following statements about the right to private ownership is false?

- A) It enables individuals to obtain, use, and dispose of land and capital resources as they see fit.
- B) It encourages investment and innovation, and thus fosters economic growth.
- C) It extends to intangibles such as pieces of music and computer programs.
- D) It weakens the incentive to maintain the property that one already owns.

- 176)** Competition is more likely to exist when
- A) there is easy entry into and exit out of industries.
 - B) a government-issued license is required to set up a firm in an industry.
 - C) the government purchases most goods and services.
 - D) economic power is concentrated among a few large firms.
- 177)** Competition in a market system denotes a condition where
- A) the diffusion of economic power limits its potential abuse.
 - B) any given product can be purchased at a wide range of prices.
 - C) contractual agreements among individual firms are restricted and avoided.
 - D) a few large, dominant sellers are constantly jostling for market share.
- 178)** Which of the following statements about markets and prices is correct?
- A) In a market system, buyers and sellers must be in face-to-face contact with each other.
 - B) Prices affect the distribution of goods in a market system, but not the allocation of resources.
 - C) In a market system, prices serve to ration goods and services to consumers.
 - D) The operation of a market system has little, if any, effect on the distribution of income in the economy.
- 179)** In a capitalist system, the decisions and actions of millions of consumers and firms are highly coordinated by
- A) the state governments.
 - B) markets and prices.
 - C) a central planning agency.
 - D) an international organization.

180) All of the following statements describe a market economy *except*

- A) government prescribes the market prices for goods and services.
- B) prices provide important signals to buyers and sellers.
- C) the allocation of resources is determined by their prices.
- D) the actions of buyers and sellers establish a product's price.

181) A characteristic of the market system is

- A) extensive use of direct or manual methods of production.
- B) a focus on labor, as opposed to capital resources.
- C) reliance on the use of capital goods in indirect modes of production.
- D) avoidance of producing goods that do not satisfy consumer wants directly.

182) Which of the following does not foster innovation and technological advance?

- A) competition in markets
- B) freedom of choice and enterprise
- C) self-interest and personal rewards
- D) fear and avoidance of risk

183) The Heritage Foundation in 2018 ranked which of the following economies to have the highest economic freedom?

- A) the United States
- B) Germany
- C) Japan
- D) Hong Kong

184) A production system where various workers concentrate on different specialized tasks to contribute toward a whole product is referred to as

- A) a coincidence of wants.
- B) roundabout production.
- C) freedom of enterprise.
- D) division of labor.

185) How does human specialization contribute toward increasing an economy's output?

- A) It exploits the differences in abilities.
- B) It is a process of creative destruction.
- C) It pushes each worker to master the whole product.
- D) It encourages people to be a "jack-of-all-trades."

186) With specialization in a market economy, individual

- A) firms produce a wide range of products.
- B) producers consume little or none of the products they produce.
- C) producers consume most of the output that they produce.
- D) consumers have to produce most of what they consume.

187) Which of the following is *not* a reason why specialization and trade are beneficial to society?

- A) The total output of economic goods may be increased even without any increase in resources.
- B) Scarce resources are utilized more efficiently by exploiting differences among them.
- C) Specialization fosters learning by doing, thus lowering the unit-costs of products.
- D) Firms and workers become less dependent on others for producing goods and services.

188) A required element for specialization to lead to an increase in the satisfaction of society's wants is

- A) a capitalist economy.
- B) exchange and trade.
- C) the use of money.
- D) a central plan.

189) Specialization is beneficial

- A) at the individual firm level, but not at the national and international levels.
- B) at the individual, regional, and even international levels.
- C) only if there are differences in the abilities of resources.
- D) only as long as money and capital goods are employed.

190) Which is an example of barter?

- A) a person trades a desk for a box of tools
- B) a person buys clothes at a used clothing store
- C) a gift of tuition money from parents to their children
- D) the purchase of stock on the New York Stock Exchange

191) An economic system in which money is *not* used as a medium of exchange is a

- A) planned economy.
- B) market economy.
- C) mixed economy.
- D) barter economy.

192) Which of the following is necessary to make a trade in a barter economy?

- A) money
- B) unlimited wants
- C) a medium of exchange
- D) a coincidence of wants

193) The use of money for exchange and trade

- A) increases the importance of barter.
- B) fosters more specialization in production.
- C) reduces consumer sovereignty.
- D) raises the need for a coincidence of wants.

194) Anything that is generally acceptable in trading for goods and services is a

- A) medium of exchange.
- B) capital good.
- C) store of value.
- D) resource.

195) Which of the following is the main problem with the barter system of exchange?

- A) It encourages self-interest.
- B) It fosters the division of labor.
- C) It requires a coincidence of wants.
- D) It undermines the right to bequeath.

196) International specialization and trade

- A) must be done on a barter system.
- B) often requires the exchange of currencies.
- C) does not illustrate the division of labor.
- D) requires active government regulation.

197) Why might a company use barter rather than money to make a trade?

- A) Barter trade is generally more efficient than money-based trade.
- B) Barter can enable two firms to trade when their cash flows are limited.
- C) Money requires a coincidence of wants; barter is more direct.
- D) Money is efficient only for large transactions, so barter is preferred for smaller transactions.

198) Which of the following is assumed to be most limited in scope under a market system?

- A) entrepreneurship
- B) self-interest
- C) specialization
- D) government

199) If a nation restricts trade with other nations, then the most likely effect is

- A) lower prices of goods and services in the nation.
- B) increased specialization of production.
- C) expanded economic wealth of the nation.
- D) consumers in the nation are made worse off.

200) Which is one of the five fundamental questions that need to be dealt with in any economic system?

- A) What makes the rate of unemployment low?
- B) Who will be the richest group in the economy?
- C) How will goods and services be produced?
- D) How high should the prices of goods and services be?

201) Which of the following is *not* one of the five fundamental questions that an economy must deal with?

- A) How will the goods and services be produced?
- B) Why should the goods and services be produced?
- C) Who is to receive the goods and services produced in the economy?
- D) In what ways will progress be promoted?

202) Consumer sovereignty and "dollar votes" guide the market system in dealing with which fundamental economic question?

- A) Which output will be produced?
- B) How is the output to be produced?
- C) How can the system accommodate change?
- D) Who is to receive the output?

203) The term *consumer sovereignty* means that

- A) government is responsible for protecting consumers' interests.
- B) what is produced is ultimately determined by what consumers buy.
- C) there are no limits on what consumers may buy in a market system.
- D) producers have strong control over what consumers buy.

204) The market system is said to be characterized by "consumer sovereignty." This is because

- A) a sovereign government determines which consumer goods will be produced.
- B) the prices of consumer goods are regulated by a sovereign government.
- C) firms must match their production decisions to the consumers' choices.
- D) consumer goods are considered to be more important than capital goods.

205) The term *dollar votes* in a market system means

- A) inflation will occur if consumers don't spend wisely.
- B) voters may be offered dollars to help elect certain political candidates.
- C) government is responsible for determining what will be considered legal tender.
- D) consumers "vote" for certain products to be produced by how they spend their incomes.

206) In a market system, the "What will be produced?" question is ultimately decided by

- A) profitability of products.
- B) costs of production.
- C) workers in the firms.
- D) industry analysts.

207) Payments that a firm makes to obtain needed resources comprise its

- A) costs.
- B) profits.
- C) capital.
- D) revenues.

208) In a market system, more resources will move toward an industry and expand its production if the industry has

- A) positive revenues.
- B) positive costs.
- C) $TC < TR$.
- D) $TC > TR$.

209) In a market system, if firms in an industry persistently earn total revenues that are less than total costs, then that industry will

- A) have some firms go out of business.
- B) attract more resources toward it.
- C) experience entry of new firms.
- D) get government protection from failure.

210) In a market system, which of the following will eliminate high-cost producers and allow only the low-cost producers to survive?

- A) competition
- B) money
- C) a sovereign government
- D) specialization

211) If the total costs of producing 1,500 units of output is \$15,000 and this output sold to consumers for a total of \$16,500, then the firm would earn economic profits of

- A) \$31,500.
- B) \$16,500.
- C) \$1,500.
- D) \$15,000.

212) The production technique that is most efficient is the one that produces a given amount of output

- A) using the least amount of labor resources.
- B) at the highest price per unit.
- C) at the lowest cost per unit.
- D) that yields the highest revenues.

213) Economic efficiency is the primary guide in answering which of the fundamental questions in a market economy?

- A) What will be produced?
- B) How will the output be produced?
- C) How can the system accommodate change?
- D) Who is to receive the output?

214) Suppose a firm can produce 70 units of a product, Zenia, by combining labor, land, capital, and entrepreneurial ability, as in the four alternative techniques shown in the table below. Assume further that the firm can hire labor at \$3 per unit, land at \$3 per unit, capital at \$6 per unit, and entrepreneurship at \$9 per unit.

	Techniques			
	A	B	C	D
Labor	4	10	6	5
Land	5	3	3	3
Capital	5	2	4	4
Entrepreneurship	1	1	1	1

Refer to the provided table. Which technique is the most economically efficient way of producing Zenia?

- A) A
- B) B
- C) C
- D) D

215) Suppose a firm can produce 70 units of a product, Zenia, by combining labor, land, capital, and entrepreneurial ability, as in the four alternative techniques shown in the table below. Assume further that the firm can hire labor at \$3 per unit, land at \$3 per unit, capital at \$6 per unit, and entrepreneurship at \$9 per unit.

	Techniques			
	A	B	C	D
Labor	4	10	6	5
Land	5	3	3	3
Capital	5	2	4	4
Entrepreneurship	1	1	1	1

Refer to the provided table, and suppose that the firm uses production technique D. If each of the 70 units of Zenia that are produced sells for \$1 apiece, then how much will be the total profits of the firm from 70 units of Zenia?

- A) \$70
- B) \$57
- C) \$13
- D) \$83

216) Suppose a firm can produce 70 units of a product, Zenia, by combining labor, land, capital, and entrepreneurial ability, as in the four alternative techniques shown in the table below. Assume further that the firm can hire labor at \$3 per unit, land at \$3 per unit, capital at \$6 per unit, and entrepreneurship at \$9 per unit.

	Techniques			
	A	B	C	D
Labor	4	10	6	5
Land	5	3	3	3
Capital	5	2	4	4
Entrepreneurship	1	1	1	1

Refer to the provided table. If the price of labor declines from \$3 to \$2 per unit, then what is the least costly way of producing Zenias?

- A) A
- B) B
- C) C
- D) D

217) The following table illustrates alternative production techniques for producing 18 widgets that can be sold for \$1 each, for a total revenue of \$18.

Resource	Price Per Unit of Resource	Techniques			
		(# of Units of Each Resource Required)			
		A	B	C	D
Labor	\$2	3	2	1	2
Land	1	2	1	3	1
Capital	4	1	2	2	3
Entrepreneurship	3	1	2	1	1

Based on the data given in the table, the most economically efficient production technique is

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

218) The following table illustrates alternative production techniques for producing 18 widgets that can be sold for \$1 each for a total revenue of \$18.

Resource	Price Per Unit of Resource	Techniques			
		(# of Units of Each Resource Required)			
		A	B	C	D
Labor	\$2	3	2	1	2
Land	1	2	1	3	1
Capital	4	1	2	2	3
Entrepreneurship	3	1	2	1	1

Using technique A will result in an

- A) economic loss of \$2.
- B) economic profit of \$1.
- C) economic profit of \$2.
- D) economic profit of \$3.

219) The following table illustrates alternative production techniques for producing 18 widgets that can be sold for \$1 each for a total revenue of \$18.

Resource	Price Per Unit of Resource	Techniques			
		(# of Units of Each Resource Required)			
		A	B	C	D
Labor	\$2	3	2	1	2
Land	1	2	1	3	1
Capital	4	1	2	2	3
Entrepreneurship	3	1	2	1	1

If the price per unit of labor were to increase from \$2 to \$3, the most efficient production technique would then be

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

220) The following table illustrates alternative production techniques for producing 18 widgets that can be sold for \$1 each for a total revenue of \$18.

Resource	Price Per Unit of resource	Techniques			
		(# of Units of Each Resource Required)			
		A	B	C	D
Labor	\$2	3	2	1	2
Land	1	2	1	3	1

Capital	4	1	2	2	3
Entrepreneurship	3	1	2	1	1

If the price of labor increases from \$2 to \$3, then the results of using Technique C will change from an economic

- A) loss of \$2 to a loss of \$1.
- B) profit of \$2 to a profit of \$1.
- C) profit of \$1 to a profit of \$2.
- D) loss of \$1 to a loss of \$2.

221) In a market system, the distribution of goods and services among consumers is largely determined by

- A) the willingness and ability of consumers to pay the prices.
- B) whoever needs the goods and services the most.
- C) whoever has the closest connection to firms and the government.
- D) a random factor that is almost impossible to predict.

222) "For whom is a given mix of goods and services to be produced? How, in other words, are the society's outputs to be distributed among its members?" In a market economy, this question is resolved primarily in the

- A) public sector through the mechanism of central planning.
- B) business sector through the mechanism of advertising.
- C) private sector through the earning and spending of income.
- D) money market through borrowing and saving by households and businesses.

223) The distribution of income in a market system is a primary factor that resolves which of the following fundamental economic questions?

- A) What will be produced?
- B) How will the output be produced?
- C) How will the system accommodate change?
- D) Who will get the output?

224) In a market economy, the incomes of consumers depend primarily upon

- A) government policies in setting wages and interest rates.
- B) the quantity and prices of resources that they possess.
- C) the amount of savings that they have accumulated.
- D) how closely connected they are to government and business leaders.

225) If economic profits in a particular industry increase, then we would expect

- A) resources to be diverted away from that industry.
- B) firms in that industry to produce less output.
- C) firms to enter that industry, thus expanding it.
- D) consumers to buy less from that industry.

226) In a market system, resources will move away from an industry when

- A) profits of firms in the industry are rising.
- B) demand for the industry's product is decreasing.
- C) the production of output in the industry is rising.
- D) profits of firms in other industries are falling.

227) "Creative destruction" in a market system is brought about by

- A) entrepreneurship.
- B) striking workers.
- C) regulation by the government.
- D) money-based trade.

228) An increase in the demand for a product and a reduction in its costs of production would

- A) decrease the profits of producers.
- B) encourage firms to leave an industry.
- C) encourage firms to enter an industry.
- D) cause a shortage of the product.

229) In a market system, as one industry expands while another contracts, resources will flow

- A) away from the expanding industry toward the contracting one.
- B) across industries, driven by the changes in resource prices paid by firms.
- C) toward the industry where the product demand is declining.
- D) because resource allocation will have to equalize between the two industries.

230) The market system communicates changes in market conditions and elicits appropriate responses from businesses and resource suppliers through changes in prices. This is known as the

- A) guiding function of prices.
- B) monetary function of prices.
- C) circular flow of income.
- D) market determination of prices.

231) The development of the digital video camera, which replaced film video cameras, is an example of

- A) roundabout production.
- B) derived demand.
- C) creative destruction.
- D) specialization.

232) Which of the following does *not* illustrate the idea of *creative destruction*?

- A) Digital downloads have shrunk the market for CDs and DVDs.
- B) Online retail sales have increased, while brick-and-mortar sales have slowed down.
- C) The opening of a new mall reduces the traffic in another mall.
- D) A firm has to destroy some of the expired products in its inventory.

233) The idea that the desires of resource suppliers and firms to further their own self-interest will automatically further the public interest is known as

- A) consumer sovereignty.
- B) the invisible hand.
- C) derived demand.
- D) creative destruction.

234) Which of the following best describes the "invisible hand" concept?

- A) Ample regulation of business by the government will maximize the public's best interests.
- B) The market system works best when resources are free to move from one use to another.
- C) The problem of scarcity can best be overcome in a system of mixed capitalism.
- D) Self-interest in a market system will automatically promote the public interest as well.

235) The highly influential book by Adam Smith, who brought up the "invisible hand" notion, is titled

- A) *Freakonomics*.
- B) *The Principles of Economics*.
- C) *The Age of the Economist*.
- D) *The Wealth of Nations*.

236) The "invisible hand" concept refers to the

- A) guiding function of prices in a market system.
- B) implicit influence that the government has on the actions of firms.
- C) regulatory structure that markets must operate in.
- D) underlying money flows that promote the trading of goods and services.

237) Businesses seeking higher profits and resource suppliers seeking higher incomes lead to changes in the allocation of resources among different firms and end up with

- A) consumers at the losing end.
- B) output that society wants.
- C) unnecessary conflict and turmoil.
- D) a need for government action.

238) The major virtues of the market system include all of the following, *except*

- A) it promotes an efficient allocation of resources.
- B) it leads to equality in the distribution of income.
- C) it provides incentives for greater production and higher incomes.
- D) it emphasizes the freedom to pursue self-interest.

239) The market economy is regarded as "efficient" in that

- A) it achieves the lowest rate of unemployment.
- B) it leads to the lowest level of poverty in the society.
- C) it directs resources toward products that the society wants most.
- D) it puts the best people in government positions.

240) One basic problem faced by central planners, but hardly present in a market system, has to do with

- A) determining the production goals or targets in a factory.
- B) having limited resources and trying to match them with unlimited wants.
- C) coordinating production in various industries so that bottlenecks do not develop.
- D) providing financial resources for increasing the real flows of products in the economy.

241) The major "success indicator" for business managers in command economies like the Soviet Union and China *in the past* was

- A) the quantity or volume of production.
- B) product quality and variety.
- C) the amount of profits a producer makes.
- D) morale of workers in a firm.

242) A characteristic of centrally planned economies is that

- A) the price is relatively unimportant in allocating resources.
- B) profits are the main measure of success of a firm.
- C) entrepreneurship is quite prevalent and highly rewarded.
- D) there are many incentives for innovation and hard work.

243) Which of the following is true of an economy that operates entirely through central planning?

- A) An individual's success in business is based on political savvy rather than economic profitability.
- B) There is relative ease in matching resource allocation to consumer demand by the central planners.
- C) Central planners receive market information and coordinate economic activity through the price mechanism.
- D) The system adapts easily to technological change, because there is a healthy entrepreneurial spirit.

244) In a command economy like the old Soviet Union, one is able to improve one's lot and get ahead in society largely through

- A) entrepreneurship and risk-taking.
- B) innovation and profits.
- C) participating in the political hierarchy.
- D) getting high prices for one's products and resources.

245) In the circular flow model of the market system, households' major role is to

- A) buy both products and resources.
- B) sell both products and resources.
- C) buy products and sell resources.
- D) sell products and buy resources.

246) In the circular flow model of the market system, business's major role is to

- A) buy products and resources.
- B) sell products and resources.
- C) buy products and sell resources.
- D) sell products and buy resources.

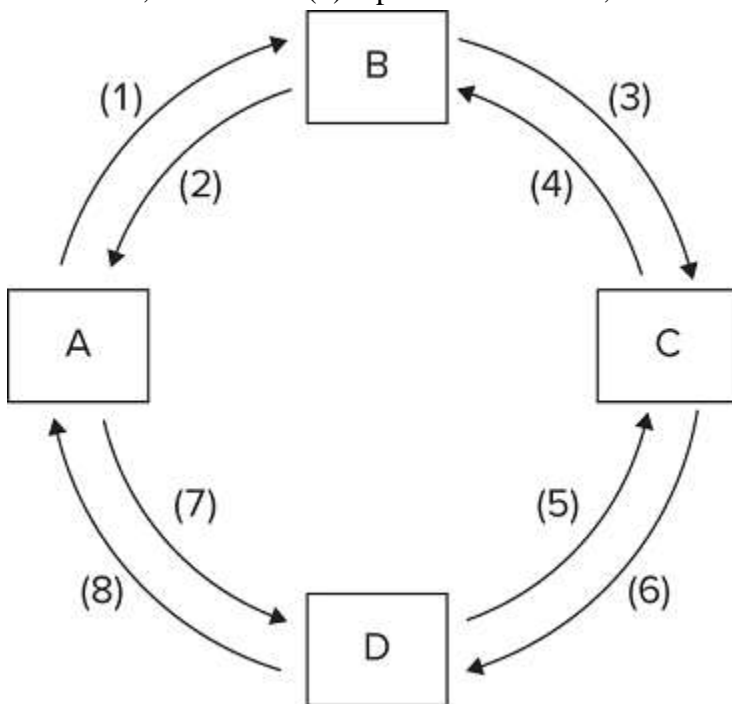
- 247) The circular flow model illustrates
- A) the importance of having a central plan for the economy.
 - B) how capital and other resources are created.
 - C) how money is created by the banking system.
 - D) the interdependence of businesses and consumers.
- 248) The simple circular flow model shows that workers and capital owners offer their services to firms through the
- A) product markets.
 - B) resource markets.
 - C) money markets.
 - D) financial markets.
- 249) In the circular flow model, households earn their incomes in the
- A) resource markets.
 - B) product markets.
 - C) capitalist markets.
 - D) money markets.
- 250) According to the circular flow model, product markets are where
- A) households earn their money incomes.
 - B) households acquire economic resources from businesses.
 - C) businesses acquire their inputs from households.
 - D) businesses earn their revenues from households.
- 251) The money income of households consists of all the following, *except*

- A) wages.
- B) profits.
- C) interest.
- D) revenues.

252) Which of the following would be primarily determined in the resource markets?

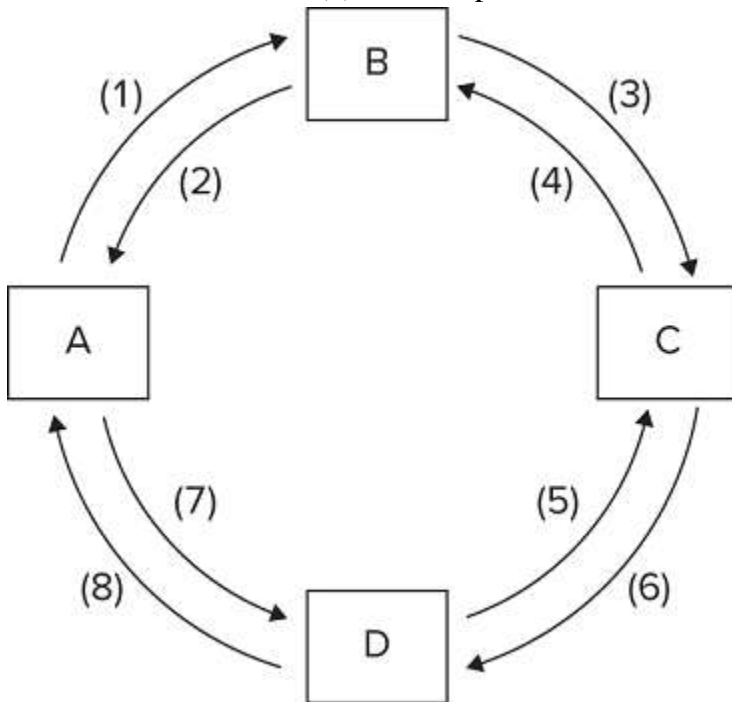
- A) the airfares charged by airlines for family vacations
- B) the wage rates for computer programmers and engineers
- C) the number of home-Internet connections installed
- D) the amount of money in circulation issued by the government

253) Refer to the provided figure. If box A represents households, B the product market, and C businesses, and if flow (3) represents revenues, then flow (1) would represent



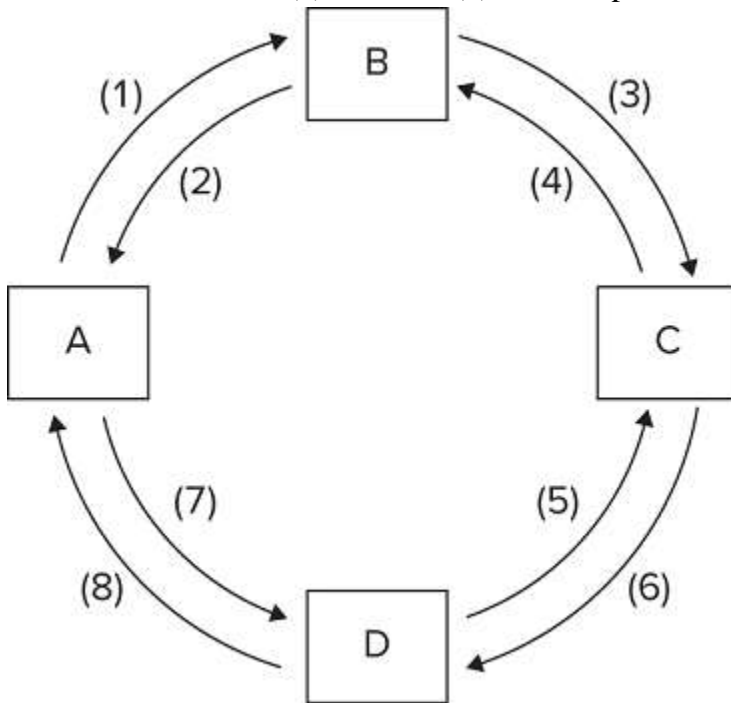
- A) costs.
- B) money income.
- C) consumption expenditures.
- D) resources.

254) Refer to the provided figure. If box A represents households, D the resource market, and C businesses, then flow (8) would represent ____, while flow (7) would represent ____.



- A) goods and services; consumption expenditures
- B) consumption expenditures; goods and services
- C) resources; money income
- D) money income; resources

255) Refer to the provided figure. If box A represents households, B the product market, and C businesses, then flow (2) and flow (4) would represent



- A) the flow of labor and other resources.
- B) the flow of goods and services.
- C) business spending revenues.
- D) money incomes and consumer spending.

256) Which of the following is not a major category of business structure?

- A) sole proprietorship
- B) partnership
- C) public agency
- D) corporation

257) In the circular flow diagram, households get their ability to pay for their consumption expenditures from the

- A) revenues they receive for their products.
- B) costs they incur for resources.
- C) incomes they earn for their resources.
- D) goods and services they get in the product markets.

258) In the circular flow diagram, firms get their ability to pay for the costs of production from the

- A) revenues they receive for their products.
- B) resources they acquire in the resource markets.
- C) incomes they earn for their resources.
- D) goods and services they get in the product markets.

259) In a market system, the task of assessing and managing the business risk of a firm is taken on by the firm's

- A) labor.
- B) capital suppliers.
- C) entrepreneurs.
- D) customers.

260) Which of the following guides sensible decisions regarding the management of business risk in a market system?

- A) the profit and loss system
- B) the "invisible hand"
- C) taxes and subsidies
- D) consumer sovereignty

261) In a market system, a firm's employees are typically shielded from business risk by

- A) profit-sharing agreements.
- B) wage contracts.
- C) the Social Security program.
- D) paid vacation leaves.

262) One essential trade-off involving business risk in a market system is reflected in which of the following statements?

- A) Access to the firm's profits and gains are open only to those who take on the business risk of the firm.
- B) Those who receive guaranteed payments from the firm are also guaranteed a share of the firm's profits.
- C) Those who make bad decisions regarding risk will suffer losses; those who decide wisely will gain profits.
- D) Those who bear the business risk of the firm are guaranteed to always gain profits.

263) In a market system, which of the following is a major benefit of making the firm's owners and investors exclusively shoulder the business risk?

- A) Those who deeply dislike business risk will not have anything to do with the business.
- B) This allows firms to more easily attract labor and other suppliers of inputs.
- C) This reduces the business risk in the economy.
- D) It makes it easier for the government to monitor and manage the business risk.

264) (Consider This) The Bitcoin currency is issued by

- A) the United States Federal Reserve.
- B) the United States Treasury.
- C) the World Bank.
- D) no government of any country.

265) (Consider This) Bitcoin mining operations tend to maximize profits by

- A) paying their labor minimum wage.
- B) using super computers.
- C) using low-cost electricity.
- D) operating in areas with little regulation.

266) (Consider This) Today, South Korea's economy

- A) produces a GDP per capita of \$1,700.
- B) is considered a command economy.
- C) has a lower GDP per capita than North Korea's economy.
- D) is more developed and prosperous, producing an average annual income of \$39,500.

267) (Consider This) Which of the following is *not* a consequence of government subsidized flood insurance?

- A) More people will choose to live in areas susceptible to flooding.
- B) Taxpayers will have to help pay for the rebuilding of flooded properties.
- C) It makes actual risks of flooding look artificially low.
- D) More people will choose to live and work on higher ground.

268) (Last Word) Today, Venezuela's economy is

- A) thriving, thanks to Bolivarian Socialism.
- B) expanding due to the clever idea of printing money to pay the government's bills.
- C) considered a laissez-faire economic system.
- D) ruined due to actions of incompetent political leaders.

269) (Last Word) Which of the following helps explain why the economy of Venezuela has collapsed?

- A) increased oil production due to government nationalization of the industry
- B) government price controls that increase competition among small businesses
- C) a substantial crackdown on corruption caused many companies to be put out of business
- D) hyperinflation caused by printing money to pay for government spending

270) Which of the following is a characteristic of a sole proprietorship?

- A) The owner bears no personal responsibility for the debts of the business.
- B) It is owned and managed by two or more people.
- C) It is an independent legal entity on its own.
- D) It is owned and managed by one person.

ESSAY. Write your answer in the space provided or on a separate sheet of paper.

271) Define the term economic system. Discuss the two ways in which economic systems can differ.

272) Explain the term "laissez faire capitalism."

273) Explain what is meant by a command economy.

274) List nine characteristics of the market system.

275) Why is the right of private property an essential characteristic of a market system?

276) What role does freedom play in capitalism? How important is it to the operation of a competitive market economy?

277) Explain the importance of self-interest in the operation of a market system.

- 278)** What conditions are necessary for economic competition to exist?
- 279)** Describe two types of specialization in production.
- 280)** Describe three ways that human specialization contributes to society's output.
- 281)** What advantage does a money economy have over a barter economy?
- 282)** What are the Five Fundamental Questions that every economy must answer?

283) How does 'consumer sovereignty' determine the types and quantities of the goods produced in an economy?

284) Adam Smith in his 1776 book the *Wealth of Nations* describes the concept of "an invisible hand." Explain what he means by an "invisible hand."

285) Describe the three major virtues of a market system.

286) What are the two main problems that have caused the demise of the command systems?

287) (Consider This) Explain the differences in economic systems between North and South Korea and the economic outcomes of the two systems.

288) What is the relationship between businesses and households in the circular flow diagram?

289) Explain the main characteristics of a corporation.

290) Discuss the benefits of restricting business risk to the owners.

Answer Key

Test name: chapter 2

- 1) TRUE
- 2) TRUE
- 3) FALSE
- 4) TRUE
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- 256) C
- 257) C
- 258) A
- 259) C
- 260) A
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- 263) B
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- 265) C
- 266) D

267) D

268) D

269) D

270) D

271) An economic system is a particular set of institutional arrangements and a coordinating mechanism for solving the economizing problem. Economic systems differ as to who owns the factors of production and the method used to motivate, coordinate, and direct economic activity.

272) This is a hypothetical economic system in which the government's economic role is limited to protecting private property and establishing a legal environment appropriate to the operation of markets in which only mutually agreeable transactions would take place between buyers and sellers. It is sometimes referred to as "pure capitalism."

273) A method of organizing an economy in which property resources are publicly owned and government uses central economic planning to direct and coordinate economic activities. It is also known as socialism or communism.

274) The nine key features are: (1) private property, (2) freedom of enterprise and choice, (3) self-interest, (4) competition, (5) markets and prices, (6) technology and capital goods, (7) specialization, (8) use of money, (9) active, but limited government.

275) This right of private property, along with the freedom to negotiate binding legal contracts, enables individuals and businesses to obtain, use, and dispose of property resources as they see fit. Property rights encourage investment, innovation, maintenance of property, and economic growth. Nobody would stock a store, build a factory, or clear land for farming if someone else, or the government, could take it away. Also, property rights encourage owners to maintain or improve their property to preserve or increase its value. Finally, property rights enable people to use their time and resources to produce more goods and services, rather than having to use them to protect and retain the property they already own.

276) Within legal limitations, freedom of enterprise and freedom of choice play a role in capitalism. Freedom of enterprise is important because it ensures that entrepreneurs and private businesses are free to obtain and use economic resources to produce their choice of goods and services and to sell them in their chosen markets. Freedom of choice is important because it allows owners to employ or dispose of their property and money as they see fit. It also allows workers to try to enter any line of work for which they are qualified. Finally, it ensures that consumers are free to buy the goods and services that best satisfy their wants and that their budgets allow.

277) Self-interest is important because it is the motivating force in a market system. Self-interest simply means that each economic unit tries to achieve its own particular goal. Entrepreneurs try to maximize profit or minimize loss. Property owners try to get the highest price for the sale or rent of their resources. Workers try to maximize their utility (satisfaction) by finding jobs that offer the best combination of wages, hours, benefits, and working conditions. Consumers try to obtain products at the lowest possible price. Self-interest provides direction and consistency to what might otherwise be a chaotic economy.

278) Broadly defined, competition requires two or more buyers and two or more sellers acting independently in a particular product or resource market. (Usually there are many more than two buyers and two sellers.) Also, necessary is the freedom of sellers and buyers to enter or leave (exit) markets, based on their economic self-interest.

279) One type of specialization is human specialization, which is sometimes referred to as the division of labor. This means the work required to produce a product has been divided into a number of different tasks. Then the workers that are best suited to each task will be assigned to it. Geographic specialization works on a regional or international basis when producers concentrate on producing only one or a few products that they are best suited for and exchanging their surplus to another region that has also specialized in production that they are best suited for. Both kinds of specialization increase efficiency in the use of limited resources.

280) Human specialization makes use of differences in abilities, which means that individuals can take advantage of the differences in their abilities and skills; fosters learning by doing, which means that as individuals devote time to a single task, they develop the skills required; and saves time, which means that as a person devotes time to a single task, that person avoids the loss of time incurred in shifting from one job to another.

281) In economies where people use money as the medium of exchange, trade is easier. Money is a convenient social invention that facilitates the exchange of goods and services. To serve as money, an item needs to pass only one test: Sellers must be willing to accept it as payment for their goods and services. Barter is the direct exchange of one good or service for another good or service. This is a problem because it requires a coincidence of wants between the buyer and the seller, the seller has to have what the buyer wants and the buyer has to have what the seller wants; if this coincidence of wants is missing, no trade takes place.

282) There are five fundamental questions that every economy must answer. What goods and services will be produced? How will the goods and services be produced? Who will get the output? How will the system accommodate change? How will the system promote progress?

283) Consumers register their preferences for the type and quantity of goods and services they want in the market when they buy something. The dollars spent are like voting for that product to continue to be produced. If the dollar votes for a certain product are great enough to create a profit, businesses will produce and sell that product. In contrast, if the dollar votes do not create sufficient revenues to cover costs, businesses will not produce the product. Thus, consumers collectively direct resources to industries that are meeting their wants and away from industries that are not meeting their wants.

284) Firms and resource suppliers, seeking to further their own self-interests and operating within the framework of a highly competitive market system, will simultaneously, as though guided by an "invisible hand," promote the public interest. Firms and resource suppliers have their own interests in mind, but competition forces them to consider other people's interests. The invisible hand of competition ensures that when firms maximize their own profits and resource suppliers maximize their own incomes, they also help to maximize society's output and income.

285) The three major virtues of the market system are efficiency, incentives, and freedom. Efficiency is realized as the market system promotes the efficient use of resources by guiding them into the production of the goods and services most wanted by society. It encourages the development and adoption of new and more efficient production techniques. Incentives found in the market system encourage skill acquisition, hard work, innovation, and entrepreneurship. Greater work skills and effort mean greater production and higher incomes, which usually translate into a higher standard of living. Successful innovations generate economic rewards. Lower-cost production raises profits while freeing up resources to be used elsewhere. Freedom is the major noneconomic argument for the market system in its emphasis on personal freedom. Unlike central planning, the market system coordinates economic activity without coercion. Entrepreneurs and workers are free to further their own self-interest, subject to the rewards and penalties imposed by the market system itself.

286) The first difficulty was the coordination problem. The central planners had to coordinate the millions of individual decisions by consumers, resource suppliers, and businesses. A lack of a reliable success indicator added to the coordination problem in the Soviet Union and China prior to its market reforms. The command economies also faced an incentive problem. Central planners determined the output mix. When they misjudged how many automobiles, shoes, shirts, and chickens were wanted at the government-determined prices, persistent shortages and surpluses of those products arose. Thus, many products were unavailable or in short supply, while other products were overproduced and sat for months or years in warehouses.

287) North Korea, under the influence of the Soviet Union, established a command economy that emphasized government ownership and central government planning. South Korea, protected by the United States, established a market economy based upon private ownership and the profit motive. Today, South Korea is far more prosperous, with South Koreans enjoying an average annual income (GDP per capita) of \$39,500 per year versus \$1,700 in North Korea. That differential is especially startling when you find out that North Korea was richer and more highly industrialized when the countries were separated in 1953.

288) Households buy the goods and services that businesses make available in the product market. Households obtain the income needed to buy those products by selling resources in the resource market. Businesses sell goods and services in the product market in order to obtain revenue, and they incur costs in the resource market when they purchase the labor, land, capital, and entrepreneurial ability that they need to produce their goods and services.

289) A corporation is an independent legal entity that can, on its own behalf, acquire resources, own assets, produce and sell products, incur debts, extend credit, sue and be sued, and otherwise engage in any legal business activity. The fact that a corporation is an independent legal entity means that its owners bear no personal financial responsibility for the corporation's debts and obligations. For instance, if a corporation has failed to repay a loan to a bank, the bank can sue the corporation but not its owners. Professional managers run most corporations. They are hired and supervised by a board of directors that is elected annually by the corporation's owners.

290) Many people deeply dislike risk and would not be willing to participate in a business venture if they were exposed to the possibility of losing money. Many workers just want to do their jobs and get paid twice a month without having to worry about whether their employer is doing well or not. The same is true for most suppliers, whose only concern is receiving full and prompt payment for the inputs they supply to businesses. This makes it much easier for firms to attract labor and other inputs, which in turn helps the economy innovate and grow. The profit system helps to achieve prudent risk management by focusing owners on the responsibility and the rewards for successfully managing risk. Owners can provide the risk-managing input of entrepreneurial ability themselves or hire it by paying a skilled manager. But either way, some individual's full-time job includes the specialized task of managing business risk.