

TEST BANK

# Principles of Macroeconomics

SECOND EDITION

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# PREFACE

When was the last time you were pleased with the consistency and quality of the assessment supplements that come with introductory texts? If you are like most professors, you probably find that these assessment packages do not always meet your needs. To address this issue, Norton has collaborated with Valerie Shute (Florida State University) and Diego Zapata-Rivera (Educational Testing Services) to develop a methodology for delivering high-quality, valid, and reliable assessment supplements through our Test Banks and extensive suite of support materials.

## WHY A NEW APPROACH?

In evaluating the test banks that accompany introductory texts, we found four substantive problem areas associated with the questions:

1. Test questions were misclassified in terms of type and difficulty.
2. The prevalence of low-level and factual questions misrepresented the goals of the course.
3. Topics were unevenly distributed: Trivial topics were tested via multiple items, while important concepts were not tested at all.
4. Links to course topics were too general, thus preventing diagnostic use of the item information.

## STUDENT COMPETENCIES AND EVIDENCE-CENTERED DESIGN

In December 2007, Norton conducted a focus group with the brightest minds in educational testing to create a new model for assessment. A good assessment tool must:

1. define what students need to know and the level of knowledge and skills that constitute competence in the concepts they are learning about;
2. include test items that provide valid and reliable evidence of competence by assessing the material to be learned at the appropriate level; and
3. enable instructors to judge accurately what students know and how well they know it, thus allowing instructors to focus on areas where students need the most help.

## HOW DOES IT WORK?

The Test Bank authors started with a detailed concept summary that had been broken down into learning objectives. The authors then developed a concept map for each chapter that shows the relationships among these ideas. Once the concept maps were created, the authors developed six types of questions designed to test students' knowledge of each concept. By asking students questions that vary in both type and level of difficulty, instructors can gather different types of evidence, which will allow them to assess more effectively how well students understand specific concepts.

## SIX QUESTION TYPES

1. Remembering questions—test declarative knowledge, including textbook definitions and relationships between two or more pieces of information. Can students recall or remember the information in the same form it was learned?

2. Understanding questions—pose problems in a context different from the one in which the material was learned, requiring students to draw from their declarative and/or procedural understanding of important concepts. Can students explain ideas or concepts?
3. Applying questions—ask students to draw from their prior experience and use critical-thinking skills to take part in qualitative reasoning about the real world. Can students use learned information in another task or situation?
4. Analyzing questions—test students’ ability to break down information and see how different elements relate to each other and to the whole. Can students distinguish among the different parts?
5. Evaluating questions—ask students to assess information as a whole and frame their own argument. Can students justify a stand or decision?
6. Creating questions—pose questions or objectives that prompt students to put elements they have learned together into a coherent whole to generate new ideas. Can students create a new product or point of view based on data?

### THREE DIFFICULTY LEVELS

1. Easy questions—require a basic understanding of the concepts, definitions, and examples presented in the textbook.
2. Medium questions—direct students to use critical-thinking skills and to demonstrate an understanding of core concepts independent of specific textbook examples.
3. Difficult questions—ask students to synthesize textbook concepts with their own experience, making analytical inferences about economic topics and more.

### GENERAL RULES FOR NORTON ASSESSMENT

Each question measures and links explicitly to a specific competency and is written with clear, concise, and grammatically correct language that suits the difficulty level of the specific competency being assessed. To ensure the validity of the questions, no extraneous, ambiguous, or confusing material is included, and no slang expressions are used. In developing the questions, every effort has been made to eliminate bias (e.g., race, gender, cultural, ethnic, regional, disability, age, and so on) to require specific knowledge of the material studied, not general knowledge or experience. This ensures accessibility and validity.

### READING THE TEST ITEM NOTATION

Each question in the Test Bank is tagged with five pieces of information designed to help instructors create the most ideal mix of questions for their quizzes or exams. These tags are:

**ANS:** This is the correct answer for each question.

**DIF:** This is the difficulty assigned to the problem. Problems have been classified as Easy, Medium, or Difficult.

**REF:** This is the section in the textbook from which a question is drawn.

**OBJ:** This references the learning objective, taken from the chapter-opening concept map, that is tested by the question.

**MSC:** This is the knowledge type (see above) that the question is designed to test.

To ensure that the test bank material flows in the same order as the topics covered in the textbook, the questions have been numbered in order based on the “REF” field.

## **CHAPTER 1**

# Five Foundations of Economics

### **LEARNING OBJECTIVES**

- 1.1 What is economics?
- 1.2 What are five foundations of economics?

**MULTIPLE CHOICE**

1. In economics, choices are necessary because of the presence of
- a. luxuries.
  - b. inefficiency.
  - c. needs.
  - d. scarcity.
  - e. incentives.

ANS: D                      DIF: Easy                      REF: What Is Economics?  
OBJ: 1.1                      MSC: Understanding

2. Economics is the study of
- a. how to make money.
  - b. how to allocate resources to satisfy wants and needs.
  - c. capitalism.
  - d. how to make workers more productive and firms more profitable.
  - e. markets.

ANS: B                      DIF: Moderate                      REF: What Is Economics?  
OBJ: 1.1                      MSC: Understanding

3. Thomas Malthus's prediction of mass starvation failed to come true because of increases in
- a. population.
  - b. productivity.
  - c. temperature.
  - d. government involvement.
  - e. income.

ANS: B                      DIF: Moderate                      REF: What Is Economics?  
OBJ: 1.1                      MSC: Remembering

4. The basic goal of economics is to
- a. control the effects of government action.
  - b. determine how to distribute all that is produced in an economy.
  - c. address the scarcity problem created because the population's desire for goods exceeds the ability to produce them.
  - d. match limited resources to people's limited wants and needs.
  - e. control tastes and wishes so that there will be enough resources to produce all the goods and services that people want.

ANS: C                      DIF: Moderate                      REF: What Is Economics?  
OBJ: 1.1                      MSC: Understanding

5. An economist is an individual who would be LEAST able to answer which research question?
- a. how much of a product is purchased at a specific price
  - b. how the tastes and preferences of consumers are determined
  - c. what firms decide to produce
  - d. how goods and services are distributed to the population
  - e. how firms decide to produce a good or service

ANS: B                      DIF: Moderate                      REF: What Is Economics?  
OBJ: 1.1                      MSC: Understanding



6. The need to study economics would cease to exist if
- the government stopped controlling people's actions.
  - people were free to make decisions on their own.
  - people put forth the effort required to attain the goods and services they wanted.
  - people earned more than they spent.
  - there were enough resources to produce all the goods and services people would like to obtain.

ANS: E                    DIF: Moderate      REF: What Is Economics?  
 OBJ: 1.1                MSC: Understanding

7. As a discipline, economics is best described by which of the following?
- the study of how to control the effects of government actions
  - the study of how to control the preferences of consumers so that there will be enough resources to produce all the goods and services that consumers want
  - the study of how to use scarce resources to satisfy unlimited wants and needs
  - the study of how to dispose of excess goods and services that nobody wants
  - the study of how to maximize profits for firms

ANS: C                    DIF: Moderate      REF: What Is Economics?  
 OBJ: 1.1                MSC: Understanding

8. When Noah's parent tells him not to study economics because it is a pointless discipline, why is he or she INCORRECT?
- The government continues to play a role in our daily lives.
  - People have the freedom to do whatever they want, and economists have nothing to add to their decision-making process.
  - Economics is a tool used to understand what happens in a world where there are not enough resources to produce all the goods and services that are wanted and needed.
  - Economics has nothing to offer in terms of understanding the stock market.
  - Economics has nothing to offer in terms of understanding government programs like Social Security.

ANS: C                    DIF: Moderate      REF: What Is Economics?  
 OBJ: 1.1                MSC: Understanding

9. When consumers discard their gasoline-powered automobiles for electric-powered ones, this partially reflects the \_\_\_\_\_ of gasoline.
- scarcity
  - luxury
  - necessity
  - specialization
  - incentive

ANS: A                    DIF: Moderate      REF: What Is Economics?  
 OBJ: 1.1                MSC: Applying

10. As a new firm in the apple-picking business, Nicolette has considered adding an economist to her management team. This economist would be unable to help her managerial team determine
- the lowest cost way of picking apples.
  - how many apples consumers will purchase at different prices.
  - why people eat apples.
  - the effect government regulations would have on the price of apples.
  - the lowest cost way of distributing apples.

ANS: C                      DIF: Moderate              REF: What Is Economics?  
OBJ: 1.1                      MSC: Applying

11. A good is \_\_\_\_\_ if it takes even a small amount of time, energy, or money to acquire.
- abundant
  - in shortage
  - cheap
  - scarce
  - virtually free

ANS: D                      DIF: Moderate              REF: Trade-offs              OBJ: 1.1 | 1.2  
MSC: Understanding

12. Because of scarcity
- individuals and societies are allowed no choice about which wants and needs to satisfy.
  - individuals and societies must choose which wants and needs to satisfy.
  - all choices about wants and using resources must be made by the government.
  - choices can be made about which wants to satisfy, but not about which resources to use.
  - choices must be made about which resources to use, but not about which wants to satisfy.

ANS: B                      DIF: Moderate              REF: What Is Economics?  
OBJ: 1.1                      MSC: Understanding

13. Which of the following statements best represents the fact that Logan cannot put in extra hours of work because of scarcity?
- He doesn't have enough time for additional work because he needs to spend time with his family and there are only so many hours in the day.
  - He doesn't like going to work, so why would he work more than he has to?
  - He doesn't think that overtime pay is high enough.
  - He is worried that if he works extra hours, he will get bored with his job.
  - He doesn't want his coworkers to feel pressure to work more because he is working additional hours.

ANS: A                      DIF: Moderate              REF: Trade-offs              OBJ: 1.1 | 1.2  
MSC: Applying

14. Which scenario describes studying for an economics course without applying the scarcity principle?
- Mary studies two hours for every one hour she is in the classroom.
  - Jonah studies three afternoons a week until he understands the material or until dinner, whichever comes first.
  - Lucy studies with her roommate who is also taking the course, and they discuss economic concepts during any free time they can find.
  - Chloe studies for this course and does nothing else.
  - Rafael talks to an economist whenever he has a chance to do so.

ANS: D                      DIF: Moderate              REF: Trade-offs              OBJ: 1.1 | 1.2  
MSC: Applying

15. What is the strongest argument for why we need more economists today than ever before?
- We have a need for more wealth given the higher standard of living that individuals demand.
  - Economists are needed to address the allocation of scarce resources as a result of the world's growing population.
  - Economists are needed to make sure that firms continue to make profits.
  - Economists are needed to make sure that consumers are well informed about their possible purchase options and that they budget their finances appropriately.
  - Economists are needed to make sure that the government doesn't involve itself too much in the economy.

ANS: B                      DIF: Moderate      REF: What Is Economics?  
 OBJ: 1.1                    MSC: Evaluating

16. Macroeconomics is the study of
- the economic motives of voters and elected officials.
  - individual decision-making units such as households and businesses.
  - how government purchases affect specific markets.
  - the operation of the economy as a whole.
  - the interaction between the government and businesses.

ANS: D                      DIF: Easy              REF: Microeconomics and Macroeconomics  
 OBJ: 1.1                    MSC: Remembering

17. Which of the following is a macroeconomic question?
- How many textbooks should be published by a publisher?
  - How much should English majors earn after college?
  - How do members of a household decide whether to clean their own houses or hire someone else to do it?
  - What is the rate of unemployment?
  - What is the price of a new 40-inch television?

ANS: D                      DIF: Moderate      REF: Microeconomics and Macroeconomics  
 OBJ: 1.1                    MSC: Applying

18. Microeconomics is the study of
- how government activities affect the economy.
  - individual decision-making units.
  - collective decision making.
  - the operation of the economy as a whole.
  - the interaction between the government and businesses.

ANS: B                      DIF: Easy              REF: Microeconomics and Macroeconomics  
 OBJ: 1.1                    MSC: Remembering

19. Microeconomics is the branch of economics that focuses on the
- entire economy.
  - production side of the economy.
  - consumption side of the economy.
  - involvement of the government in the entire economy.
  - choices and decision making of individuals and firms.

ANS: E                    DIF: Easy                    REF: Microeconomics and Macroeconomics  
OBJ: 1.1                    MSC: Remembering

20. Which of the following is a microeconomic question?
- What are the total production levels in the economy?
  - How can we best encourage economic growth?
  - What is the overall price level in the economy?
  - What are the variables that determine the price of a specific good?
  - How can we reduce the unemployment rate among Hispanic men?

ANS: D                    DIF: Moderate                    REF: Microeconomics and Macroeconomics  
OBJ: 1.1                    MSC: Applying

21. Which of the following is NOT a type of incentive?
- positive
  - negative
  - complementary
  - indirect
  - direct

ANS: C                    DIF: Easy                    REF: Incentives                    OBJ: 1.2  
MSC: Remembering

22. The patent system
- acts as a direct positive incentive.
  - acts as a direct negative incentive.
  - acts as an indirect positive incentive.
  - acts as an indirect negative incentive.
  - does not provide an incentive.

ANS: A                    DIF: Difficult                    REF: Incentives                    OBJ: 1.2  
MSC: Applying

23. On which of the following concepts do economists focus their study when explaining how humans behave?
- fairness
  - money
  - emotions
  - incentives
  - justice

ANS: D                    DIF: Moderate                    REF: Incentives                    OBJ: 1.2  
MSC: Understanding

24. Entrepreneurs are willing to take risks because
- technology provides a way to sidestep the patent and copyright system.
  - the patent and copyright system provides an exclusive right to sell the product for a period of time.
  - the patent and copyright system guarantees a certain level of profit.
  - technology always increases costs and prevents competitors from entering the market.
  - the patent and copyright system guarantees that the risks taken will be rewarded.

ANS: B                    DIF: Moderate      REF: Incentives      OBJ: 1.2  
MSC: Understanding

25. Public buildings in the United States are required to be accessible to the disabled and, as a result, almost all have an elevator. What would be an example of a positive direct incentive for those who can use stairs?
- Using the stairs will make it seem that they care about their health and that they aren't lazy.
  - Using the stairs will increase the risk of tripping and falling.
  - Using the stairs will take more time than taking the elevator and will increase the risk of missing an important meeting.
  - Using the stairs will give them some exercise and make them healthier.
  - Using the stairs will put elevator repair professionals out of work.

ANS: D                    DIF: Moderate      REF: Incentives      OBJ: 1.2  
MSC: Applying

26. If the government wanted to give people a negative direct incentive not to save money, what would be the appropriate policy?
- providing individuals a subsidy to save their money
  - providing funding for an advertising campaign encouraging people to spend more money
  - informing individuals that saving money causes people not to spend money, which will cause them to lose their jobs
  - imposing a tax on individuals for saving their money
  - informing consumers about all that they could buy with their money with the hope that they spend more

ANS: D                    DIF: Moderate      REF: Incentives      OBJ: 1.2  
MSC: Applying

27. An example of a direct negative incentive is
- providing a commission for sales.
  - awarding a promotion for hard work.
  - threatening to fire those who do not perform well.
  - providing an orientation for new employees.
  - providing generous benefits and pay for employees.

ANS: C                    DIF: Moderate      REF: Incentives      OBJ: 1.2  
MSC: Applying

28. An example of a direct positive incentive is
- a prison sentence for committing a crime.
  - unemployment insurance for those who are laid off.
  - providing a workplace safety program.
  - providing a commission for sales.
  - threatening to fire those who do not perform well.

ANS: D                    DIF: Moderate      REF: Incentives      OBJ: 1.2  
MSC: Applying

29. Actions and activities are encouraged with which type of incentive?
- positive
  - negative
  - neutral
  - complementary
  - unintended

ANS: A                    DIF: Easy              REF: Incentives      OBJ: 1.2  
MSC: Remembering

30. A parent that pays a child an allowance for doing chores is providing a(n) \_\_\_\_\_ incentive.
- positive
  - negative
  - neutral
  - complementary
  - unintended

ANS: A                    DIF: Moderate      REF: Incentives      OBJ: 1.2  
MSC: Applying

31. Economics professors are well aware of the importance of incentives. Which of the following situations shows the use of a positive incentive?
- Students who show up late to class will not be allowed in the classroom.
  - Students who do not have a doctor's note will not be allowed to take an exam at a different time.
  - Students can choose whether they want to attend class—there is no attendance policy.
  - Students can choose to get a higher grade by doing extra credit work.
  - The professor decides to teach the class by reading out of the textbook to the entire class.

ANS: D                    DIF: Moderate      REF: Incentives      OBJ: 1.2  
MSC: Applying

32. A car insurance company is willing to offer accident-free drivers a discount. This is an example of
- a positive incentive.
  - a negative incentive.
  - an opportunity cost.
  - a comparative advantage.
  - scarcity.

ANS: A                    DIF: Moderate      REF: Incentives      OBJ: 1.2  
MSC: Applying

33. Many professors have a policy that punishes individuals if they don't come to class. Instead of punishing students who don't attend class, what could the professor do to provide a positive incentive to come to class?
- Those who come to class are given extra points.
  - Those who do not come to class have their grades reduced.
  - Those who come to class will be asked questions, and if they answer them incorrectly, their grades will be lowered.
  - Those who come to class will be ridiculed.
  - Those who do not come to class might be dropped from the course.

ANS: A                    DIF: Moderate        REF: Incentives        OBJ: 1.2  
MSC: Applying

34. Actions and activities are discouraged with
- positive incentives.
  - negative incentives.
  - direct incentives.
  - indirect incentives.
  - unintended consequences.

ANS: B                    DIF: Easy                REF: Incentives        OBJ: 1.2  
MSC: Remembering

35. A camera takes pictures of drivers who do not stop at a red light, and this practice is used to issue traffic tickets. These red light cameras can be understood as serving a(n)
- positive incentive to encourage individuals to stop at a red light.
  - negative incentive to discourage individuals from driving through a red light.
  - indirect incentive to encourage individuals to stop at a red light.
  - direct incentive to encourage individuals to stop at a red light.
  - negative incentive to encourage individuals to drive through a red light.

ANS: B                    DIF: Moderate        REF: Incentives        OBJ: 1.2  
MSC: Applying

36. The government places warnings on cigarette and liquor packages. These warnings serve as a(n)
- positive incentive.
  - negative incentive.
  - indirect incentive.
  - opportunity cost.
  - way to make cigarettes and liquor more scarce.

ANS: B                    DIF: Moderate        REF: Incentives        OBJ: 1.2  
MSC: Applying

37. When a ticket is given to a pedestrian for jaywalking, what type of incentive exists?
- positive
  - negative
  - neutral
  - complementary
  - unintended

ANS: B                    DIF: Moderate        REF: Incentives        OBJ: 1.2  
MSC: Applying

38. Google has started a project to scan all books and make those that are not copyrighted available to people free of charge. Why is it important that only books without a copyright are available?
- If all books were scanned and available free of charge, copyright holders would face a positive incentive to continue writing and publishing books.
  - If all books were scanned and available free of charge, copyright holders would face a negative incentive to continue writing and publishing books.
  - If only copyrighted texts were scanned and available free of charge, copyright holders would face an indirect incentive to continue writing and publishing books.
  - If only non-copyrighted books were scanned and available free of charge, copyright holders would face a negative incentive to continue writing and publishing books.
  - If only non-copyrighted books were scanned and available free of charge, copyright holders would face an indirect incentive to continue writing and publishing books.

ANS: B                      DIF: Difficult                      REF: Incentives                      OBJ: 1.2  
 MSC: Applying

39. The U.S. federal government offers homeowners a tax deduction for their home loan interest payments. This reduction in taxes serves as a(n) \_\_\_\_\_ incentive to buy a house.
- direct
  - indirect
  - neutral
  - complementary
  - unintended

ANS: A                      DIF: Moderate                      REF: Incentives                      OBJ: 1.2  
 MSC: Applying

40. In a growing number of cities, stores are required either not to make available plastic or paper bags or to do so only for an additional fee. What kind of incentive is this fee?
- direct
  - indirect
  - neutral
  - complementary
  - unintended

ANS: A                      DIF: Moderate                      REF: Incentives                      OBJ: 1.2  
 MSC: Applying

41. In a growing number of cities, stores are required either not to make available plastic or paper bags or to do so only for an additional fee. If this fee can be refunded when someone recycles the bag, the refund acts as a(n) \_\_\_\_\_ incentive.
- direct
  - indirect
  - neutral
  - complementary
  - unintended

ANS: A                      DIF: Moderate                      REF: Incentives                      OBJ: 1.2  
 MSC: Applying

42. If Alexander doesn't like changing the oil in his car and pays his father to do it for him, he has provided his father with a(n) \_\_\_\_\_ incentive.
- direct
  - indirect
  - neutral
  - complementary
  - unintended

ANS: A                      DIF: Moderate                      REF: Incentives                      OBJ: 1.2  
 MSC: Applying



43. A health insurance company may offer its policyholders a discount on their premiums if they prove that they have stopped smoking. What type of incentive is the health insurance company offering?
- direct
  - indirect
  - neutral
  - complementary
  - unintended

ANS: A            DIF: Moderate    REF: Incentives    OBJ: 1.2  
MSC: Applying

44. Indirect incentives create \_\_\_\_\_ consequences.
- positive
  - negative
  - indirect
  - direct
  - unintended

ANS: E            DIF: Easy            REF: Incentives    OBJ: 1.2  
MSC: Remembering

45. The government controls for some indirect incentives in safety net social programs by
- limiting payment to a specified time period.
  - providing only a partial payment.
  - allowing individuals to apply to only a certain number of safety net social programs.
  - requiring individuals to repay the benefits they received.
  - establishing income limits for those who apply for safety net social programs.

ANS: A            DIF: Moderate    REF: Incentives    OBJ: 1.2  
MSC: Remembering

46. What is the indirect incentive in the unemployment insurance program?
- Workers get paid when they are laid off.
  - Workers face an incentive to find a new job as quickly as possible.
  - Workers have a reduced incentive to find a new job until the insurance runs out.
  - Workers are paid all of their wages by the unemployment insurance program.
  - Workers on unemployment insurance are given training opportunities.

ANS: C            DIF: Moderate    REF: Incentives    OBJ: 1.2  
MSC: Understanding

47. The U.S. federal government offers homeowners a tax deduction for their home loan interest payments. This reduction in taxes may have encouraged too many people to own homes. If the tax deduction caused people who otherwise would have rented to own, the tax deduction serves as a(n) \_\_\_\_\_ incentive.
- direct
  - indirect
  - neutral
  - complementary
  - unintended

ANS: B            DIF: Moderate    REF: Incentives    OBJ: 1.2  
MSC: Applying

48. Although generous disability insurance can help those who have been permanently injured, it can also increase the likelihood that individuals will falsely claim to be disabled. This likelihood is a(n)
- a. direct incentive.
  - b. indirect incentive.
  - c. positive incentive.
  - d. innovation.
  - e. marginal cost.

ANS: B                      DIF: Moderate                      REF: Incentives                      OBJ: 1.2  
MSC: Applying

49. The government has been trying to encourage the use of fuel-efficient cars. One way it has been doing this has been by allowing fuel-efficient cars to use a separate highway lane. This encourages people to use fuel-efficient cars because
- a. those who place a high value on their scarce time may be encouraged to buy a fuel-efficient car to take advantage of the separate highway lane.
  - b. those who place a low value on their scarce time may be encouraged to buy a fuel-efficient car to take advantage of the separate highway lane.
  - c. those who are more concerned about the environment are also those who happen to place a high value on their time.
  - d. those who purchase a fuel-efficient car are forced to pay more for a new car, and the use of the separate highway lane compensates them for this.
  - e. those who purchase a fuel-efficient car are likely to be unhappy because it is less powerful or more cramped inside; use of the separate highway lane compensates them for this.

ANS: A                      DIF: Difficult                      REF: Trade-offs                      OBJ: 1.2  
MSC: Applying

50. In the area of many college campuses, parking spaces are often scarce. If these parking spaces have parking meters, which population described below would pay for parking?
- a. those that are willing to take risks and believe that they will not be caught if they don't place change in the meter
  - b. those that place a high opportunity cost on making sure they have change and placing change in the meter
  - c. those that are willing to take risks, believe that they will not be caught if they don't place change in the meter, and disregard any possible \$5 ticket for parking illegally
  - d. those that are unwilling to take risks and believe there is a high chance that they will not be caught if they don't pay for parking
  - e. those that are unwilling to take risks, believe there is a high chance that they will be caught if they don't pay for parking, and place a high value on doing the "right" thing

ANS: E                      DIF: Difficult                      REF: Opportunity Cost  
OBJ: 1.2                      MSC: Applying

51. Some public transit systems use an “honor system” whereby patrons have to show that they have paid their fare only when asked for it by an enforcement officer. With what population would such a system be successful?
- a population that is willing to take risks and whose people believe that they will not be caught if they don't pay their fare
  - a population that places a high opportunity cost on taking time to purchase a ticket
  - a population whose people are willing to take risks, believe that they will not be caught if they don't pay their fare, and treat fines for not paying a fare as a nuisance
  - a population that is unwilling to take risks and whose people believe there is a high chance that they will be caught if they don't pay their fare
  - a population whose people are unwilling to take risks, believe there is a high chance that they will not be caught if they don't pay their fare, and place a low value on doing the right thing

ANS: D                    DIF: Difficult            REF: Opportunity Cost  
 OBJ: 1.2                    MSC: Applying

52. Rational decision making under conditions of scarcity requires individuals to
- place a monetary value on everything.
  - know the prices of all goods they might buy.
  - be alert to price reductions on desired products.
  - understand that trade-offs are necessary.
  - earn as much income as possible.

ANS: D                    DIF: Moderate            REF: Trade-offs            OBJ: 1.2  
 MSC: Understanding

53. Economics is concerned with the trade-offs that emerge because of scarcity. The term “trade-offs” refers to
- the decision about whether households or businesses should bear the entire burden of the scarcity problem.
  - the buying and selling that occur as unwanted goods are exchanged for goods that are desired.
  - the alternatives given up when making choices.
  - recycling and transforming old goods into new goods to reduce scarcity problems.
  - forcing businesses to produce some goods and services and not others.

ANS: C                    DIF: Moderate            REF: Trade-offs            OBJ: 1.2  
 MSC: Understanding

54. What is the opportunity cost of taking an exam?
- all of the things that someone could have done by not studying
  - each of the questions that someone misses on the exam
  - the highest valued alternative that someone gave up to prepare for and attend the exam
  - the money someone spent purchasing the textbook and the other materials with which he or she studies
  - the money someone spent on tuition

ANS: C                    DIF: Moderate            REF: Opportunity Cost  
 OBJ: 1.2                    MSC: Applying

55. Kelly is an architect, and she is trying to decide whether to hire Lawrence, a draftsman, to assist with her work. Kelly could hire Lawrence at \$20 per hour, but it would take him three times as long to complete a task as it takes Kelly. Kelly is able to earn \$90 per hour and has more architectural jobs than she is able to handle. Which of the following is true?
- Kelly should not hire Lawrence because it would be faster for her to do the work herself.
  - Kelly should do the drafting work herself because she has the lower opportunity cost.
  - Lawrence should be hired at the \$20 per hour wage rate.
  - Lawrence should be hired, but only if he is paid more than \$30 per hour.
  - Kelly should hire someone who earns minimum wage instead of Lawrence.

ANS: C                      DIF: Difficult                      REF: Opportunity Cost  
 OBJ: 1.2                      MSC: Analyzing

56. The cost of a trade-off is known as the \_\_\_\_\_ cost of that decision.
- marginal
  - net
  - opportunity
  - comparative
  - explicit

ANS: C                      DIF: Easy                      REF: Opportunity Cost  
 OBJ: 1.2                      MSC: Understanding

57. Opportunity cost is the \_\_\_\_\_ alternative forfeited when a choice is made.
- least-valued
  - highest-valued
  - most recently considered
  - most convenient
  - first

ANS: B                      DIF: Easy                      REF: Opportunity Cost  
 OBJ: 1.2                      MSC: Remembering

58. An opportunity cost is the
- lowest possible cost.
  - highest possible cost.
  - monetary price paid for a good or service.
  - cost of a purchase or decision as measured by what is given up.
  - cost of finding the lowest price for a product.

ANS: D                      DIF: Easy                      REF: Opportunity Cost  
 OBJ: 1.2                      MSC: Understanding

59. The opportunity cost of a purchase is
- zero if the item is what someone wants most.
  - always equal to the selling price of what someone purchased.
  - always greater for people who are out of work than for people who are working.
  - the alternative good or service that one sacrifices because a different good was purchased.
  - the lowest possible price.

ANS: D                      DIF: Easy                      REF: Opportunity Cost  
 OBJ: 1.2                      MSC: Understanding

60. An opportunity cost
- can be measured only when the decision involves expenditures of money.
  - can be measured only when the decision involves spending time on one thing and not on another.
  - is impossible to measure.
  - is equal to the value of what is given up to make a purchase or take an action.
  - exists for every decision made by individuals and businesses, but not by the government.

ANS: D                    DIF: Easy                    REF: Opportunity Cost  
OBJ: 1.2                    MSC: Understanding

61. The trade-offs that are made because of scarcity
- are important in developing economies, but they do not apply to developed economies.
  - are important in developed economies, but they do not apply to developing economies.
  - are different when they involve the wants of people, but they are similar when they involve the needs of people.
  - can be accurately made to the extent that they can be quantified.
  - depend on the decision maker's value judgments about the relative importance of the alternatives.

ANS: E                    DIF: Moderate                    REF: Trade-offs                    OBJ: 1.2  
MSC: Understanding

62. How are changes in opportunity cost related to decision-making behavior?
- The lower the opportunity cost of doing activity X, the more likely activity X will be done.
  - The higher the opportunity cost of doing activity X, the more likely activity X will be done.
  - Changes in the opportunity cost play no role in decision making.
  - The lower the opportunity cost of doing activity Y, the more likely activity X will be done.
  - The higher the opportunity cost of doing activity Y, the less likely activity X will be done.

ANS: A                    DIF: Difficult                    REF: Opportunity Cost  
OBJ: 1.2                    MSC: Understanding

63. Nicole asked her neighbor to rake the leaves on his lawn because they were blowing into her yard. It takes an hour to rake the yard, regardless of who performs the task. He responded that it wouldn't be rational for him to do so, but he would be willing to hire someone else to rake. Why would this be the case?
- Her neighbor lacks the equipment to rake leaves and thinks it would take too long to do the job.
  - Her neighbor is a busy person and doesn't have time to rake leaves.
  - Her neighbor is getting revenge on her because Nicole didn't rake the leaves on her lawn last year.
  - Her neighbor is a lawyer who values his time at \$200 an hour and knows that he can hire a high school kid to rake leaves for \$20 an hour.
  - Her neighbor is a high school teacher and values his time at \$15 an hour, and he knows that he can hire one of his students to rake leaves for \$20 an hour.

ANS: D                    DIF: Moderate        REF: Opportunity Cost  
 OBJ: 1.2                MSC: Applying

64. Instead of taking an economics course, Adam could have taken a history course that meets at the exact same time. The total cost of taking the economics course would be
- the tuition cost for the economics course.
  - the fact that Adam could not take the history course at the same time.
  - the tuition cost for the economics course plus the price of the textbook and a notebook for the economics course.
  - the tuition cost, the cost of the textbook and notebook, and the fact that Adam could not take the history course at the same time.
  - the price of the textbook and a notebook for the economics course.

ANS: D                    DIF: Difficult        REF: Opportunity Cost  
 OBJ: 1.2                MSC: Applying

65. The opportunity cost for Jeremiah of going to a water park is
- the price of the admission pass.
  - zero, if he can go with his parents who will pay.
  - zero, if it is raining that day and the water park is closed.
  - the price of the admission pass plus the highest valued alternative activity Jeremiah could have done instead.
  - the highest valued alternative activity Jeremiah could have done instead.

ANS: E                    DIF: Difficult        REF: Opportunity Cost  
 OBJ: 1.2                MSC: Applying

66. Why would economists find it surprising if the CEO of a large company does his or her own housework?
- The opportunity cost of a CEO's time is quite high because they have an abundance of time to spend on housework.
  - The opportunity cost of a CEO's time is quite low because they have a scarcity of time to spend on housework.
  - The opportunity cost of a CEO's time is quite low because they have an abundance of time to spend on housework.
  - The opportunity cost of a CEO's time is quite high because they have a scarcity of time to spend on housework.
  - The opportunity cost of a CEO's time is equal to that of everyone else that works at the same company.

ANS: B                      DIF: Moderate              REF: Opportunity Cost  
 OBJ: 1.2                    MSC: Applying

67. The opportunity cost of going to school rather than working is the cost of
- food.
  - housing.
  - clothing.
  - health care.
  - potential wages.

ANS: E                      DIF: Moderate              REF: Opportunity Cost  
 OBJ: 1.2                    MSC: Applying

68. The opportunity cost of working rather than going to school is
- the cost of food and housing.
  - the cost of clothing and transportation.
  - zero because the person is earning an income by working.
  - the higher wages that come with additional education.
  - the annual wages earned by working.

ANS: D                      DIF: Moderate              REF: Opportunity Cost  
 OBJ: 1.2                    MSC: Applying

69. When Lucy chose a major, she likely thought about her skills. Let's say Lucy doesn't enjoy dealing with numbers. How could she explain to her parents, using logic from economics, why she chose to major in English instead of mathematics?
- The opportunity cost of learning mathematics is too high.
  - The opportunity cost of learning to appreciate literature is too high.
  - The expected value of a major in English after graduation is low.
  - The expected value of a major in mathematics after graduation is high.
  - The opportunity cost of going to college is too low.

ANS: A                      DIF: Moderate              REF: Opportunity Cost  
 OBJ: 1.2                    MSC: Applying

70. Restaurants, bars, and convenience stores are often located near college campuses. These businesses frequently charge higher than normal prices. They are taking advantage of the fact that students
- are able to pay higher prices than the rest of the population, so the businesses can charge higher prices than they otherwise would have been able to charge.
  - are unable to pay higher prices than the rest of the population, but they are able to succeed because they can sell to a large number of people.
  - place a high value on their scarce time and are willing to pay higher prices than they would at locations farther from campus.
  - place a low value on their scarce time and are willing to pay higher prices than they would at locations farther from campus.
  - place a high value on their scarce time and are unwilling to pay higher prices.

ANS: C                    DIF: Moderate        REF: Opportunity Cost  
 OBJ: 1.2                MSC: Applying

71. The government has been considering doing away with minting pennies because they are rarely used for purchases (with most people collecting them or throwing them away). How would an economist best explain this consumer behavior?
- More people are using credit and debit cards, so they are not in the habit of using monetary change.
  - Prices have increased over time, and it would take far too many pennies to buy anything of value.
  - Prices have increased over time, and the opportunity cost of carrying around large quantities of pennies has become too large.
  - Prices have increased over time, and the opportunity cost of carrying around pennies has fallen.
  - People who use pennies probably aren't spending enough money; removing the penny will force people to spend more.

ANS: C                    DIF: Moderate        REF: Opportunity Cost  
 OBJ: 1.2                MSC: Applying

72. The government has been trying to mint dollar coins instead of printing paper dollar bills, but people have been reluctant to use coins instead of paper bills. How would an economist explain this reluctance?
- More people are using credit and debit cards, so people are not accustomed to using change.
  - Retailers find it too expensive to deal with coins and would have to raise their prices if consumers used coins more.
  - The opportunity cost of carrying around large quantities of coins is too large.
  - Prices have increased over time, and the opportunity cost of carrying around a large number of coins would be low.
  - People who receive a dollar coin are more likely to collect than spend the money, and the economy won't grow as quickly because less is being spent.

ANS: C                    DIF: Moderate        REF: Opportunity Cost  
 OBJ: 1.2                MSC: Applying



73. According to economists, one reason few professional athletes have PhD's is that the
- opportunity cost of going to graduate school is too high.
  - marginal benefit of going to graduate school is too high.
  - marginal cost of going to graduate school is too high.
  - comparative cost of going to graduate school is too high.
  - explicit cost of going to graduate school would be too high.

ANS: A                    DIF: Moderate        REF: Opportunity Cost  
 OBJ: 1.2                MSC: Applying

74. Economists believe that individuals compare the benefits and costs of various options when making decisions and in so doing act
- fairly.
  - selfishly.
  - collectively.
  - unpredictably.
  - rationally.

ANS: E                    DIF: Moderate        REF: Marginal Thinking  
 OBJ: 1.2                MSC: Understanding

75. The term \_\_\_\_\_ means "additional."
- marginal*
  - comparative*
  - incentive*
  - opportunity cost*
  - trade-off*

ANS: A                    DIF: Easy              REF: Marginal Thinking  
 OBJ: 1.2                MSC: Understanding

76. Economists believe that optimal decisions are made up to the point where
- marginal benefit is zero.
  - marginal cost is zero.
  - marginal benefits are greater than marginal costs.
  - marginal costs are greater than marginal benefits.
  - marginal benefits are equal to marginal costs.

ANS: E                    DIF: Difficult        REF: Marginal Thinking  
 OBJ: 1.2                MSC: Analyzing

77. An activity's marginal benefit is \_\_\_\_\_ at the optimal quantity.
- zero
  - greater than zero
  - less than zero
  - equal to the marginal cost
  - greater than the marginal cost

ANS: D                    DIF: Difficult        REF: Marginal Thinking  
 OBJ: 1.2                MSC: Analyzing

78. When most economists wake up in the morning, their first decision is whether to hit the snooze bar on the alarm clock. What statement best represents their thought process as rational decision makers?
- Sal had a really late night grading exams, and he deserves 10 more minutes of sleep.
  - The total amount of work Sal has to do today is rather small, so the total benefit to going to work for a full eight hours is also small.
  - The total amount of work Sal has to do today is rather small, so the marginal cost of going to work 10 minutes late is small.
  - The total amount of work Sal has to do today is rather small, so the marginal benefit of sleeping 10 more minutes is rather large.
  - The marginal benefit of sleeping 10 more minutes is greater than the marginal benefit of 10 more minutes of work.

ANS: E                    DIF: Moderate        REF: Marginal Thinking  
 OBJ: 1.2                MSC: Applying

79. One way to promote a new business is to offer free items. If Jayleen were to open a restaurant and offer free food, she likely would have a line out the door. How would an economist understand the behavior of those standing in line?
- Those waiting in line place a high value on the use of their time.
  - Those waiting in line believe that the marginal cost of waiting in line exceeds the marginal benefit of waiting in line.
  - Those waiting in line place a low value on the use of their time.
  - Those waiting in line believe that the marginal cost of waiting in line is zero.
  - Those waiting in line believe that the marginal benefit of waiting in line is zero.

ANS: C                    DIF: Moderate        REF: Marginal Thinking  
 OBJ: 1.2                MSC: Applying

80. Instead of deciding to finish high school, Cecily could have decided to work full-time. How would an economist explain her decision to receive her high school degree?
- The cost of going to high school was greater than the benefit of working full-time.
  - The benefit of working full-time was greater than the benefit of going to high school.
  - The benefit of going to high school was greater than the benefit of working full-time.
  - The cost of working full-time was greater than the benefit of going to high school.
  - The benefit of working full-time was greater than the cost of going to high school.

ANS: C                    DIF: Moderate        REF: Marginal Thinking  
 OBJ: 1.2                MSC: Applying

81. Many stores are open 24 hours a day. When store managers make the decision to stay open 24 hours, it must be the case that
- the marginal benefit of staying open all day and the marginal cost to remaining open all day are at least equal.
  - the marginal benefit of staying open all day must always be greater than the marginal cost to remaining open all day.
  - the marginal cost of staying open all day must always be greater than the marginal benefit to remaining open all day.
  - the calculation of marginal benefits or marginal costs of remaining open all day plays no role.
  - the marginal benefit of remaining open all day is zero.

ANS: A                    DIF: Moderate        REF: Marginal Thinking  
 OBJ: 1.2                MSC: Applying

82. In 2009, the federal government created a program called Cash for Clunkers whereby consumers could trade in a less efficient car for a more efficient car and receive a higher value than they would have otherwise. How would an economist understand the decision that consumers faced?
- Consumers would compare the marginal benefits to the marginal costs of replacing their cars, and this program made sure that marginal benefits would exceed marginal costs.
  - Consumers would compare the marginal benefits to the marginal costs of replacing their cars, and this program made sure that marginal costs would exceed marginal benefits.
  - The Cash for Clunkers program increased the opportunity cost of replacing a car.
  - The Cash for Clunkers program served as a negative incentive to replacing a fuel-inefficient car.
  - The Cash for Clunkers program served as an indirect incentive to replacing a fuel-inefficient car.

ANS: A                    DIF: Moderate        REF: Marginal Thinking  
 OBJ: 1.2                MSC: Applying

83. Who benefits from voluntary trade?
- buyers
  - sellers
  - the government
  - buyers and sellers
  - buyers and the government

ANS: D                    DIF: Easy              REF: Trade            OBJ: 1.2  
 MSC: Remembering

84. What creates comparative advantage?
- lower costs
  - higher opportunity costs
  - specialization
  - scarcity
  - population growth

ANS: C                    DIF: Easy              REF: Trade            OBJ: 1.2  
 MSC: Remembering

85. Comparative advantage emerges because of the presence of
- trade.
  - differing opportunity costs.
  - marginal benefits that equal marginal costs.
  - scarcity.
  - incentives.

ANS: B            DIF: Easy            REF: Trade            OBJ: 1.2  
 MSC: Remembering

86. The opportunity cost to free trade is
- economic growth.
  - government involvement.
  - domestic jobs.
  - lower prices.
  - greater efficiency.

ANS: C            DIF: Moderate            REF: Trade            OBJ: 1.2  
 MSC: Remembering

87. A person has a comparative advantage in the production of a good when she or he can produce the product at a(n) \_\_\_\_\_ opportunity cost compared to another person.
- higher
  - lower
  - equal
  - diminishing
  - increasing

ANS: B            DIF: Easy            REF: Trade            OBJ: 1.2  
 MSC: Remembering

88. When trade is voluntary, who benefits?
- the seller
  - the buyer
  - No one benefits.
  - both the buyer and the seller
  - Trade is never voluntary.

ANS: D            DIF: Easy            REF: Trade            OBJ: 1.2  
 MSC: Remembering

89. More oranges are grown in Florida than North Dakota because Florida's warm climate gives it a \_\_\_\_\_ advantage in growing oranges.
- comparative
  - public
  - revenue
  - producer
  - planning

ANS: A            DIF: Moderate            REF: Trade            OBJ: 1.2  
 MSC: Applying

90. The United States is able to experience economic growth to the extent that
- specialization and trade are encouraged.
  - the government involves itself in the economy.
  - trade is restricted.
  - jobs are protected from outsourcing.
  - consumers are encouraged to buy domestically produced goods.

ANS: A            DIF: Moderate            REF: Trade            OBJ: 1.2  
 MSC: Understanding

91. Saudi Arabia has a comparative advantage in producing oil because it
- has specialized in the production of oil given its natural resources.
  - has forced other countries not to sell their oil.
  - has specialized in the production of all goods.
  - forces the use of oil for the production of all electricity.
  - benefits from the heavy use of oil for transportation.

ANS: A                    DIF: Moderate        REF: Trade            OBJ: 1.2  
MSC: Applying

92. According to economic thinking, the presence of scarcity requires
- incentives.
  - choices.
  - intelligence.
  - a dismal outlook.
  - unintended consequences.

ANS: B                    DIF: Easy                REF: What Is Economics?  
OBJ: 1.1                    MSC: Understanding

93. The allocation of limited resources within an environment of almost unlimited wants is the focus of
- capitalism.
  - fiscal policy.
  - economics.
  - scarcity.
  - altruism.

ANS: C                    DIF: Easy                REF: What Is Economics?  
OBJ: 1.1                    MSC: Understanding

94. An economist is most capable of determining
- how worker productivity affects the output of an economy.
  - psychological factors that contribute to worker productivity.
  - interior paint colors that boost business revenue.
  - which individuals are allowed to make decisions.
  - why some consumers prefer emeralds over diamonds.

ANS: A                    DIF: Moderate        REF: What Is Economics?  
OBJ: 1.1                    MSC: Understanding

95. Without scarcity, the study of \_\_\_\_\_ would be unnecessary.
- positive incentives
  - negative incentives
  - resource allocation
  - economics
  - productivity

ANS: D                    DIF: Easy                REF: What Is Economics?  
OBJ: 1.1                    MSC: Understanding

96. Low prices for water in the developed world may lead individuals to believe it is NOT a \_\_\_\_\_ resource.
- desired
  - scarce
  - plentiful
  - controlled
  - economic

ANS: B                    DIF: Easy                REF: What Is Economics?  
OBJ: 1.1                    MSC: Applying

97. A recession has crippled the national economy, producing a high rate of unemployment. Which of the following would be a microeconomic decision?
- a. Congress decides to institute a tax cut and encourage consumer spending.
  - b. The United States negotiates a new trade agreement with Japan, hoping to bolster exports.
  - c. The federal government extends the duration of unemployment benefits.
  - d. A Congresswoman decides to delay the purchase of a new car.
  - e. The Federal Reserve lowers interest rates in an effort to stimulate business activity.

ANS: D                      DIF: Easy                      REF: Microeconomics and Macroeconomics  
OBJ: 1.1                      MSC: Applying

98. Which is NOT one of the five foundations of economics?
- a. innovation
  - b. incentives
  - c. trade-offs
  - d. opportunity cost
  - e. marginal thinking

ANS: A                      DIF: Easy                      REF: Microeconomics and Macroeconomics  
OBJ: 1.1                      MSC: Remembering

99. Macroeconomics would be concerned with
- a. a family's decision to finance the purchase of a home.
  - b. the consequence of a massive layoff by a major corporation.
  - c. a local government issuing bonds to build a new sporting arena.
  - d. a single national government choosing to implement trade tariffs.
  - e. the opening of an auto plant in a county with high unemployment.

ANS: D                      DIF: Moderate                      REF: Microeconomics and Macroeconomics  
OBJ: 1.1                      MSC: Applying

100. Decisions by individuals and firms are the domain of
- a. microeconomics.
  - b. macroeconomics.
  - c. consumption economics.
  - d. median economics.
  - e. choice economics.

ANS: A                      DIF: Easy                      REF: Microeconomics and Macroeconomics  
OBJ: 1.1                      MSC: Applying

101. Why do incentives matter to economists?
- a. People make poor decisions when they're given money they didn't earn.
  - b. Governments are the source of all incentives and there is value in studying the actions of government.
  - c. Incentives are often the guiding principle behind greed and exploitation.
  - d. Incentives explain how people make decisions, and are the key to understanding economics.
  - e. Without incentives, the distinction between microeconomics and macroeconomics would be unclear.

ANS: D                      DIF: Easy                      REF: Incentives                      OBJ: 1.2  
MSC: Understanding

102. When an individual chooses to act, he or she is said to be motivated by
- scarcity.
  - incentives.
  - disincentives.
  - indifference.
  - ambivalence.

ANS: B            DIF: Easy            REF: Incentives    OBJ: 1.2  
MSC: Remembering

103. A mother takes her daughter on an outing and promises her ice cream if she behaves. In addition, she warns her that if she misbehaves, she won't be allowed to play with her toys at home. The latter is an example of a(n) \_\_\_\_\_ incentive and reinforces the efficacy of the ice cream, a(n) \_\_\_\_\_ incentive.
- direct; indirect
  - indirect; direct
  - negative; positive
  - positive; negative
  - negative; direct

ANS: C            DIF: Moderate        REF: Incentives    OBJ: 1.2  
MSC: Applying

104. Hassan enjoys lifting weights in his spare time, but his gain in strength has come to a plateau. He is considering giving up weight lifting altogether, unless he experiences significant gains in the near future. Hassan is seeking a \_\_\_\_\_ incentive.
- power
  - reasonable
  - negative
  - positive
  - neutral

ANS: D            DIF: Moderate        REF: Incentives    OBJ: 1.2  
MSC: Applying

105. Clarice must choose between reading the next chapter in her economics textbook or streaming the next episode of her favorite show. In her experience, she does well on exams, but even better when she reads the textbook. If she chooses to watch the show, what can be said of incentives?
- Adding a negative incentive (e.g., her parents block access to streaming services) would more likely result in Clarice choosing to read the textbook.
  - Positive incentives are always more effective than negative incentives.
  - Negative incentives are always more effective than positive incentives.
  - Only marginal incentives play a role in this example.
  - Clarice is motivated by the stronger of two negative incentives.

ANS: A            DIF: Moderate        REF: Incentives    OBJ: 1.2  
MSC: Applying

106. A new tax on gasoline causes a reduction in the purchase of new vehicles with poor fuel economy. This is an example of what type of incentive?
- negative direct
  - positive direct
  - negative indirect
  - positive indirect
  - The tax does not provide an incentive.

ANS: C            DIF: Difficult        REF: Incentives    OBJ: 1.2  
MSC: Analyzing

107. Which of the following is an example of an unintended consequence?
- Competition between two businesses causes each to lower prices.
  - A tax rebate on electric cars results in increased household electricity consumption.
  - A tax cut leads to a spike in consumer spending.
  - Low interest rates encourage businesses to borrow money from banks.
  - A welfare program causes individuals to purchase necessities and seek employment.

ANS: B                      DIF: Moderate              REF: Incentives              OBJ: 1.2  
 MSC: Applying

108. The \_\_\_\_\_ system encourages innovation by creating a powerful financial reward for creativity.
- direct incentive
  - indirect incentive
  - patent
  - trade-off
  - tax credit

ANS: C                      DIF: Easy                      REF: Incentives              OBJ: 1.2  
 MSC: Remembering

109. Corporate leadership sometimes waits until after presidential elections in order to make major business decisions. An economist would maintain that this is in anticipation of future
- forecasting.
  - fear.
  - scarcity.
  - incentives.
  - taxes.

ANS: D                      DIF: Moderate              REF: Incentives              OBJ: 1.2  
 MSC: Applying

110. The proliferation of BitTorrent and other file sharing media have threatened the copyright system. Based on an understanding of incentives and opportunity cost, how are the decisions of musicians likely impacted?
- They will spend more time in court, reducing the amount of music they produce.
  - They will illegally download the music of other artists to balance the impact across the industry.
  - Since music theft cannot be stopped, musicians will stop trying to sell their music.
  - Most musicians will be forced to take a second job in order to support themselves.
  - If more money can be made in alternative professions, individuals will choose not to pursue music.

ANS: E                      DIF: Moderate              REF: Opportunity Cost  
 OBJ: 1.2                      MSC: Analyzing

111. The concept of \_\_\_\_\_ explains that making one choice means an individual will not have the time, resources, or energy to do something else.
- scarcity
  - negative incentives
  - trade-offs
  - opportunity cost
  - marginal benefit

ANS: C                      DIF: Easy                      REF: Trade-offs              OBJ: 1.2  
 MSC: Remembering



112. Trade-offs occur in all of the following scenarios EXCEPT
- a student has two exams on the following day and must divide study time between the classes.
  - a couple chooses between two equally appealing vacation destinations for the following weekend.
  - a shopper wants to buy two equally appealing shirts totaling \$50, and has \$35 to spend on each.
  - a caterer selects from two potential jobs, both paying \$2,500 on a Saturday night.
  - consumers are often forced to make a compromise between quality and price.

ANS: C                    DIF: Moderate        REF: Trade-offs    OBJ: 1.2  
MSC: Applying

113. During a job search, individuals will sometimes accept the lower of two competing salary offers. What would best explain this decision?
- Individuals never accept a salary that exceeds their personal values.
  - A person may accept a lower starting salary in order to receive greater future pay increases.
  - The total benefits of the higher paying job are greater than the total benefits of the lower paying job.
  - The total benefits of the lower paying job are greater than the total benefits of the higher paying job.
  - The lower salary is still better than the salary earned at the previous job.

ANS: D                    DIF: Moderate        REF: Trade-offs    OBJ: 1.2  
MSC: Analyzing

114. The presence of scarcity means that no choices come without
- shortages.
  - trade-offs.
  - regret.
  - incentives.
  - consumption.

ANS: B                    DIF: Moderate        REF: Trade-offs    OBJ: 1.2  
MSC: Analyzing

115. Laura leaves her job as an accountant, where she earns \$80,000 per year, to start her own business. After the first year, her business earns a profit of \$60,000. How would an economist describe the profitability of Laura's career change?
- Laura had a profit of \$140,000.
  - Laura had a loss of \$20,000.
  - Laura had a profit of \$20,000.
  - Laura had a profit of \$60,000.
  - Laura had a loss of \$80,000.

ANS: B                    DIF: Difficult        REF: Opportunity Cost  
OBJ: 1.2                    MSC: Applying

116. Dexter decides to buy a new smartphone and offset the cost by selling his old phone to one of his friends. His friend has no money and wants to barter for the old phone. Dexter's preference for the items offered is in this order: laser printer, television, headphones, and bicycle. If Dexter accepts the laser printer as payment, what is his opportunity cost of this exchange?
- the total value of the television, headphones, and bicycle
  - the difference between the value of the old phone and that of the new smartphone
  - There is no opportunity cost in a consensual trade.
  - the value of the laser printer
  - the value of the television

ANS: E                      DIF: Difficult              REF: Opportunity Cost  
 OBJ: 1.2                    MSC: Applying

117. Isaac has four potential jobs to consider, each with different salary offers. From highest to lowest, the salaries are: \$47,500, \$46,000, \$45,000, and \$42,000. Based on the information provided, if Isaac accepts the highest-paying position, what is his opportunity cost of this position?
- \$46,000
  - \$42,000
  - \$47,500
  - \$133,000
  - \$1,500

ANS: A                      DIF: Moderate              REF: Opportunity Cost  
 OBJ: 1.2                    MSC: Applying

118. Which statement represents a rational application of opportunity cost?
- The value of the choice must be greater than or equal to the cost of the next-best alternative.
  - The value of the next-best alternative must be greater than or equal to the cost of the choice.
  - Opportunity cost is useful for evaluating a decision after the fact, but not during the decision-making process.
  - The value of the choice must be greater than the sum of all available alternatives.
  - The value of the next-best alternative is irrelevant since the alternative was not selected.

ANS: A                      DIF: Moderate              REF: Opportunity Cost  
 OBJ: 1.2                    MSC: Applying

119. What is NOT a possible opportunity cost of attending a four-year college following high school graduation?
- the experience of traveling throughout Europe and staying in hostels
  - the income earned at a full-time job
  - the cost of tuition at a four-year college
  - job training learned at a vocational school
  - the cost savings from attending a community college

ANS: C                      DIF: Moderate              REF: Opportunity Cost  
 OBJ: 1.2                    MSC: Applying

120. What is the opportunity cost of purchasing a college textbook?
- the price paid at the university bookstore
  - the cost savings from not purchasing a book
  - the prospect of failing homework assignments and quizzes
  - the trade-in value at the end of the semester
  - the cost of the course minus the cost of the textbook

ANS: B                    DIF: Moderate        REF: Opportunity Cost  
 OBJ: 1.2                MSC: Applying

121. An economist would argue that the true cost of a college education exceeds the cost of tuition, housing, and books because of
- opportunity cost.
  - invisible costs.
  - inflation.
  - tax credits.
  - scholarships.

ANS: A                    DIF: Easy                REF: Opportunity Cost  
 OBJ: 1.2                MSC: Remembering

122. Marginal decisions are said to be made on the \_\_\_\_\_ unit(s) under consideration.
- total
  - additional
  - average of
  - sum of
  - previous

ANS: B                    DIF: Easy                REF: Marginal Thinking  
 OBJ: 1.2                MSC: Remembering

123. \_\_\_\_\_ is the process of breaking down decisions into smaller parts.
- Economics
  - Marginal analysis
  - Divisional analysis
  - Segmentation
  - Reduction

ANS: B                    DIF: Moderate        REF: Marginal Thinking  
 OBJ: 1.2                MSC: Remembering

124. According to marginal thinking, an individual will continue to consume until after the benefit of additional consumption \_\_\_\_\_ its cost.
- is equal to
  - totals
  - is greater than
  - is less than
  - marginalizes

ANS: D                    DIF: Moderate        REF: Marginal Thinking  
 OBJ: 1.2                MSC: Understanding

125. \_\_\_\_\_ is value added by making additional effort.
- Income
  - Money
  - Marginal benefit
  - Optimization
  - Opportunity benefit

ANS: C                    DIF: Easy                REF: Marginal Thinking  
 OBJ: 1.2                MSC: Understanding

126. Shoppers at supermarkets often abandon their empty shopping carts at various locations in the parking lot, despite the risk of damage to vehicles or the additional labor cost of retrieving those carts. How might an economist explain this behavior?
- People go to the supermarket when they have the energy to shop only, without considering the cost of returning their carts.
  - The perceived potential benefit of going to a cart return location is less than the time and energy cost to the shopper.
  - People are generally lazy and gravitate toward any decision with the lowest cost.
  - Once a shopper leaves the parking lot, the abandoned cart becomes someone else's problem.
  - Because food prices are always subsidized by the government, shoppers are ignorant of additional costs.

ANS: B                      DIF: Moderate      REF: Marginal Thinking  
 OBJ: 1.2                    MSC: Understanding

127. Rodrigo operates a dry-cleaning service and charges customers \$5 per article of clothing. Based on his knowledge of operations, the 1,000th piece of clothing costs him \$4.95 to dry-clean. If he takes additional business, however, the 1,001st piece will cost \$5 for the service. Does he take the additional business?
- No, he has hidden costs that far exceed his estimate of \$5, so he loses money.
  - No, taking on additional business doesn't earn him any money.
  - Yes, if he turns away business, his service will be forced to close.
  - Maybe. If a competitor is accepting that many customers, he must at least equal that amount.
  - Yes. At a \$5 cost, he breaks even and is indifferent. He necessarily turns away business when the cost of the additional unit exceeds the income.

ANS: E                      DIF: Difficult      REF: Marginal Thinking  
 OBJ: 1.2                    MSC: Analyzing

128. People often clean cabinet doors, but do not regularly clean inside the cabinet. The insides of cabinets aren't visible and require the removal of contents in order to clean. This is an example of \_\_\_\_\_ thinking.
- conscientious
  - deferential
  - dismal
  - incentive
  - marginal

ANS: E                      DIF: Easy            REF: Marginal Thinking  
 OBJ: 1.2                    MSC: Understanding

129. At any quantity, when the marginal benefit equals the marginal cost, that quantity is said to be
- excessive.
  - inadequate.
  - optimal.
  - equivalent.
  - allocated.

ANS: C                      DIF: Moderate      REF: Marginal Thinking  
 OBJ: 1.2                    MSC: Analyzing

130. It is crucial to recognize that \_\_\_\_\_ and \_\_\_\_\_ are separate evaluations made at the margin.
- costs; benefits
  - buying; selling
  - incentives; trade-offs
  - economics; accounting
  - trade-offs; opportunity costs

ANS: A                    DIF: Moderate        REF: Marginal Thinking  
 OBJ: 1.2                MSC: Remembering

131. The U.S. federal government imposes a tariff on cheaper steel arriving from other countries. When producers make the decision to purchase domestic steel, what must first occur?
- Producers always purchase domestic steel because the quality is superior to foreign products.
  - The price of domestic steel must be at least equal to or greater than that of foreign steel.
  - Producers never purchase domestic steel because it can't be produced as efficiently as foreign products.
  - The government must subsidize the manufacturing costs of domestic steel.
  - The price of foreign steel must be at least equal to or greater than that of domestic steel.

ANS: E                    DIF: Moderate        REF: Marginal Thinking  
 OBJ: 1.2                MSC: Applying

132. Decision makers engage in marginal thinking by
- comparing the average cost and benefit of all units produced.
  - comparing the sum of the cost and benefit of all units produced.
  - ignoring benefits, which are a subjective determination.
  - comparing the benefit of one additional unit with its cost to produce.
  - focusing on mass production, which often keeps costs down.

ANS: D                    DIF: Easy              REF: Marginal Thinking  
 OBJ: 1.2                MSC: Understanding

133. \_\_\_\_\_ show(s) how resources and final goods and services flow through the economy.
- Money
  - Government
  - Allocation
  - Trade-offs
  - Circular flow

ANS: E                    DIF: Easy              REF: Trade            OBJ: 1.2  
 MSC: Remembering

134. A double coincidence of wants means that
- each party in an exchange transaction has what the other party desires.
  - one party in an exchange transaction wants twice what the other party is offering.
  - both parties desire the same good or service, making exchange impossible.
  - desires in the marketplace are always unpredictable, so it takes at least two exchanges for every market participant to be satisfied.
  - both parties in an exchange have a desire, but no means by which to pay for it.

ANS: A                    DIF: Easy              REF: Trade            OBJ: 1.2  
 MSC: Remembering

135. \_\_\_\_\_ avoids the double coincidence of wants.
- a. Bartering
  - b. Mandated trade
  - c. Government ownership
  - d. Money
  - e. Demand

ANS: D            DIF: Easy            REF: Trade            OBJ: 1.2  
MSC: Remembering

136. \_\_\_\_\_ involves individuals trading goods they already have or providing services in exchange for something they want.
- a. Circular flow model
  - b. Circular flow model with money
  - c. Optimization
  - d. Barter
  - e. Cash exchange

ANS: D            DIF: Easy            REF: Trade            OBJ: 1.2  
MSC: Remembering

137. Which is NOT a benefit of trade?
- a. reaping the rewards of specialization
  - b. creation of value for all parties involved
  - c. equivalent gains for all parties involved
  - d. improved allocation of resources
  - e. More wants are satisfied.

ANS: C            DIF: Moderate            REF: Trade            OBJ: 1.2  
MSC: Understanding

138. If specialization and outsourcing can harm domestic workers, why do countries still engage in trade?
- a. Most workers have little influence on politicians and are ignored.
  - b. The gains from trade far outweigh the costs, and the economy benefits overall.
  - c. Domestic workers can move to a country with a greater need for their skills.
  - d. Welfare programs can support unemployed workers.
  - e. Shipping companies have a powerful lobby in Congress.

ANS: B            DIF: Moderate            REF: Trade            OBJ: 1.2  
MSC: Applying

139. Disparities in opportunity cost among competitors are the cause of
- a. optimization.
  - b. comparative advantage.
  - c. trade-offs.
  - d. command economies.
  - e. marginal benefits.

ANS: B            DIF: Easy            REF: Trade            OBJ: 1.2  
MSC: Remembering

140. A possible opportunity cost of NOT engaging in free trade is
- a loss of domestic jobs.
  - a smaller variety of goods and services.
  - higher prices.
  - economic growth.
  - import tariffs.

ANS: D                    DIF: Moderate      REF: Trade            OBJ: 1.2  
MSC: Understanding

141. A nation will engage in voluntary trade if
- the terms are mutually beneficial for both parties.
  - the trade is approved by the World Trade Center.
  - there are no domestic costs associated with trade.
  - it allows a trade partner to specialize.
  - it lacks a comparative advantage in the production of every good.

ANS: A                    DIF: Moderate      REF: Trade            OBJ: 1.2  
MSC: Understanding

142. Coastal regions have stronger commercial fishing economies because they have a \_\_\_\_\_ in the production of seafood.
- comparative advantage
  - proximity advantage
  - rational advantage
  - higher opportunity cost
  - government subsidy

ANS: A                    DIF: Moderate      REF: Trade            OBJ: 1.2  
MSC: Understanding

143. William can create 30 meals in one hour, or wash 90 dishes in the same time. Jeremy can create 25 meals in one hour, or wash 50 dishes in one hour. Using opportunity cost, who should specialize in what task?
- William is more productive and therefore should make meals and wash dishes.
  - Since creating meals is harder, William should create meals and wash dishes.
  - Since washing dishes is easier, Jeremy should wash dishes and create meals.
  - Jeremy can wash twice as many dishes per meal, so Jeremy should wash dishes.
  - Jeremy gives up fewer dish washings per meal creation, so Jeremy should create meals.

ANS: E                    DIF: Moderate      REF: Trade            OBJ: 1.2  
MSC: Evaluating

144. If the United States creates a trade agreement with Vietnam, we know that
- Vietnam will benefit, but trade with a less developed, Third World country will not help the United States.
  - Vietnam can get no benefit, since its workers are not as productive as the United States'.
  - Vietnam can get no benefit, since its businesses have less capital than the United States'.
  - Vietnam and the United States can both benefit.
  - physical and cultural differences between the two countries are too great to benefit from trade.

ANS: D                    DIF: Moderate      REF: Trade            OBJ: 1.2  
MSC: Understanding

145. Bea bakes pastries well, and Lucian raises great herbs. If Lucian trades parsley with Bea in exchange for cupcakes, then
- both Bea and Lucian are made better off by trade.
  - neither Bea nor Lucian are made better off by trade.
  - only Bea is made better off by trade.
  - only Lucian is made better off by trade.
  - either Bea or Lucian is made better off by trade, but not both.

ANS: A            DIF: Moderate    REF: Trade            OBJ: 1.2  
MSC: Understanding

146. Trade makes costs of goods and services
- lower and raises the variety of goods and services in markets.
  - lower but reduces the variety of goods and services in markets.
  - higher but reduces the variety of goods and services in markets.
  - higher but raises the variety of goods and services in markets.
  - Neither lower nor higher, since so many other variables need to be considered.

ANS: A            DIF: Easy            REF: Trade            OBJ: 1.2  
MSC: Remembering

147. Choosing to trade \_\_\_\_\_ specialization, \_\_\_\_\_ opportunity costs.
- reduces; reducing
  - reduces; increasing
  - increases; decreasing
  - increases; increasing
  - increases; but doesn't change

ANS: C            DIF: Moderate    REF: Trade            OBJ: 1.2  
MSC: Remembering

148. Wages are higher in Country X than in Country Y. If the countries decide to trade, then who will benefit?
- Neither country can benefit unless one knows the product that is traded.
  - Both countries can benefit regardless of the products traded.
  - Only the country that can produce the product more efficiently will benefit.
  - Only the country that can produce the product at a lower opportunity cost will benefit.
  - Both countries will benefit, but only if a trade agreement for specific products is made by their respective governments.

ANS: D            DIF: Moderate    REF: Trade            OBJ: 1.2  
MSC: Understanding

149. Benefits from trade would NOT include
- lower prices.
  - less competition.
  - more variety of goods and services in the market.
  - the ability of producers to specialize.
  - more employment for the country.

ANS: B            DIF: Easy            REF: Trade            OBJ: 1.2  
MSC: Remembering



150. The two highest paid midcareer jobs with only a bachelor's degree are
- business management and accounting.
  - criminal justice and psychology.
  - civil engineering and math.
  - economics and computer engineering.
  - economics and business management.

ANS: D                      DIF: Easy  
 REF: Economics for Life: Midcareer Earnings by Selected Majors  
 OBJ: 1.2                    MSC: Remembering

## SHORT ANSWER

1. List and briefly explain each of the five foundations of economic thought.

ANS:

The five foundations of economic thought are incentives, trade-offs, opportunity cost, marginal thinking, and the idea that trade creates value. Incentives encourage or discourage individuals or firms to do certain things and influence their decision-making process. Thinking about trade-offs forces us to think about the costs and benefits to each activity. Once we make a choice about an activity, we have to remember that every activity has an opportunity cost (an alternative activity that we could have done). The comparison of the trade-offs between activities and the opportunity costs associated with them is called marginal thinking. As individuals specialize in the production of goods in which they have a comparative advantage (i.e., face the lowest opportunity costs), there are gains to be had from trade.

DIF: Easy                    REF: What Are the Five Foundations of Economics?  
 OBJ: 1.1                    MSC: Understanding

2. Using any of the five foundations of economic thought, explain why farms are not located in major metropolitan areas.

ANS:

In terms of incentives, major metropolitan areas often restrict the types of activities one can do, and farmers would face a negative incentive to locate in a congested area because their neighbors would heavily scrutinize the smells, runoff, and machinery. In a congested area, space is scarce and city planners would likely prefer to have retail and housing rather than farming. City planners would know that there is a trade-off between these activities but would realize that the opportunity cost to farming in the city is too high. Thus, for each acre of land in the city, city planners consider the marginal benefit to having food grown closer to where it is consumed versus the marginal cost to having less housing and fewer retail establishments. In almost all cases, the marginal benefit to having farms closer to the population is less than the marginal cost of having less housing.

DIF: Moderate            REF: What Are the Five Foundations of Economics?  
 OBJ: 1.1                    MSC: Applying

3. Health insurance companies have the goal of reducing payments to doctors and hospitals. One way they have done this is by requiring individuals to pay a deductible. For example, a \$1,000 deductible means that individuals are responsible for the first \$1,000 in health care expenses over the course of a year. In terms of incentives, explain how the presence of a deductible reduces expenses for the health insurance company.

ANS:

Deductibles act as a positive and direct incentive to encourage individuals either to refrain from going to the doctor for a minor ailment or to be responsible in the choices made for the care they receive.

DIF: Moderate      REF: Incentives      OBJ: 1.2      MSC: Applying

4. Economic growth in developed countries has been altered by the increased popularity of the Internet. How has the Internet, in terms of both negative and positive incentives, promoted but also discouraged economic growth?

ANS:

The Internet has certainly done a great deal to encourage economic growth: those who are creative and those who invent things now have a way to sell their products to a larger set of individuals and thus face a positive incentive to sell their work and products over the Internet. The Internet has also made it more convenient to buy things and has provided a positive incentive to consumers to consume more. There has been some discouragement of economic growth through negative incentives provided by the Internet. With the use of the Internet, there has been more theft of digital music, movies, and ideas. These thefts provide a negative incentive for creative and innovative individuals.

DIF: Moderate      REF: Incentives      OBJ: 1.2      MSC: Applying

5. The discipline of economics is largely based on encouraging individuals to engage in certain activities and discouraging them from engaging in others. Why is encouraging or discouraging individuals through incentives so important?

ANS:

Economics as a discipline focuses on how people allocate their scarce resources to satisfy their wants and needs. Due to the fact that individuals are generally free to do what they want, when they want, the only way to get individuals to do what you want is to reward them (either monetarily or nonmonetarily) through a positive incentive or punish them (either monetarily or nonmonetarily) through a negative incentive.

DIF: Easy      REF: Incentives      OBJ: 1.2      MSC: Evaluating

6. A dangerous habit among those who own cell phones is driving while talking or texting. Although a great deal has been done to inform drivers of the risks of doing multiple tasks while driving, this informational campaign has been ineffective in the face of increased ownership of cell phones. If you were a policymaker, what types of negative incentives would you suggest to discourage individuals from driving, talking, and texting at the same time?

ANS:

Some possible answers would include making it illegal to drive and do other things at the same time, and the negative incentive would be avoiding a traffic ticket and fine. Another negative incentive might be setting up cameras to take pictures of people driving and talking on the phone at the same time and making the pictures public. Another negative incentive might be making mandatory the installation in cars of equipment that interferes with a cell phone signal, so that using the phone in the car becomes inconvenient.

DIF: Moderate    REF: Incentives    OBJ: 1.2    MSC: Applying

7. Due to the fact that firms concern themselves primarily with earning profits, a common complaint is that they often damage the environment in the process. More recently, markets have been set up so that firms can actually reduce their costs and profit more by damaging the environment less and selling their “right to pollute” to other companies. Discuss how this serves as a positive incentive for a firm to act in an environmentally responsible manner. What would be a way to discourage firms from polluting through the use of negative incentives?

ANS:

Market environmentalism is a way by which firms can profit by polluting less. As they create less pollution, they can sell their right to pollute to others and thereby capture additional revenue (and perhaps reduce their costs as well because they employ more efficient technology). Firms don’t care directly about preserving the environment. Rather, they are given a positive incentive not to pollute by increasing their profit. The alternative would be to provide a negative incentive not to pollute through the use of fines and government regulations (through an organization like the Environmental Protection Agency).

DIF: Difficult    REF: Incentives    OBJ: 1.2    MSC: Applying

8. What are opportunity costs, and why do economists spend so much time talking about them?

ANS:

The opportunity cost is the highest-valued alternative that one gives up when making a decision to do something else. Economists tend to spend so much time talking about opportunity costs because of scarcity—doing an activity or buying something always means not doing something else or not being able to buy something else.

DIF: Easy    REF: Opportunity Cost    OBJ: 1.2  
MSC: Understanding

9. One of the first major decisions that one faces after graduation is getting an apartment. Describe how someone might employ the concepts of trade-offs, opportunity costs, and making decisions at the margin in deciding which apartment to rent.

ANS:

Apartments have varying sizes, prices, and amenities. Someone who wants a pet, a balcony, hardwood floors, and an elevator may have to pay more rent, get an apartment in a less than desirable location, or get a smaller apartment. Among the variables of size, price, location, and amenities, apartments can then be compared to one another (and trade-offs among these variables identified); the opportunity cost to having a pet, a balcony, hardwood floors, or an elevator can be understood, and the marginal benefits and marginal costs of these variables can be appreciated.

DIF: Moderate      REF: Marginal Thinking      OBJ: 1.2  
MSC: Applying

10. What is meant when one says that decisions are made at the margin? Provide an example of making a decision at the margin.

ANS:

When decisions are made at the margin, one is saying that he or she compares the benefit and the cost to doing something or buying something one more time. All of our decisions involve this marginal analysis. Examples might include how much to study for a course, how much sleep to get, where one lives, and what one eats.

DIF: Easy      REF: Marginal Thinking      OBJ: 1.2  
MSC: Understanding

11. Explain why economics is not such a “dismal science.”

ANS:

The study of economics isn't concerned primarily with overpopulation and mass starvation, as were the predictions of Thomas Malthus. Economists focus on the proper allocation of scarce resources, even in the face of population changes (or other factors). So, in reality, economics is a study that seeks to improve the overall well-being of people through efficiency and optimization.

DIF: Moderate      REF: What Is Economics?      OBJ: 1.1  
MSC: Understanding

12. Explain how abundant resources such as water can be considered “scarce.”

ANS:

Scarcity refers to the limited nature of a resource. Even resources that are plentiful, like water, are not unlimited. In addition, some areas of the world do not have access to vast supplies of water, or must deal with temporary shortages due to drought. In all cases, scarcity is a real concern that must be answered by economics.

DIF: Easy      REF: What Is Economics?      OBJ: 1.1  
MSC: Understanding

13. Economics is divided into two subfields: microeconomics and macroeconomics. Why is this separation necessary?

ANS:

In general, the field of economics is so broad that it requires specialization, much like any other academic discipline. Specifically, the two subfields deal with entirely different aspects of study. Microeconomics is a zoomed-in look at how individual persons and firms make decisions and the consequences of those decisions. Macroeconomics is a zoomed-out look of how entire economies operate. While the same principles govern both studies, it is impractical to analyze the movement of mass phenomena like unemployment, interest rates, or economic growth through the lens of individual decision makers.

DIF: Moderate    REF: What Is Economics?    OBJ: 1.1  
MSC: Understanding

14. If opportunity cost is the value of the best alternative not chosen, why is a rejected option important?

ANS:

Alternatives are still valuable measuring sticks. It is impossible to determine which choice is best without knowing the value of all possible alternatives—especially the highest valued alternative. Opportunity cost also gives a clearer picture of the total cost of a decision. Most people only view cost in explicit terms, for example, the amount of money spent to obtain an item or service. In reality, the true cost goes beyond that. With scarcity, we live in a world of trade-offs, and making one decision means earning those benefits but sacrificing those of the rejected options.

DIF: Moderate    REF: Opportunity Cost    OBJ: 1.2  
MSC: Analyzing

15. Explain how a market might develop naturally without planning by government.

ANS:

When individuals attempt to produce multiple goods or provide multiple services, they quickly develop a sense of which is the most efficient activity. This recognition gives them intuition that they would be better off if they were to specialize in the activity for which they have a comparative advantage. For other goods and services that the individuals desire, they should trade with other producers that have a comparative advantage in those activities. So, markets naturally emerge out of a desire to improve individual well-being.

DIF: Moderate    REF: Trade    OBJ: 1.2    MSC: Understanding

16. When the Federal Reserve, the entity that manages money and banking in the United States, announces changes in the supply of money it makes available to banks, it often causes a significant response in financial markets. Based on an understanding of incentives, why is this not surprising?

ANS:

Financial markets are comprised of decision makers that have an interest in the direction of the economy. Since incentives are simply a motivation to act, any major policy shift that dramatically affects the economy will produce a response in financial markets. Changes in Federal Reserve policy or interest rates are a signal of economic health and a clue into the decisions an individual or firm must make in order to benefit.

DIF: Moderate      REF: Incentives      OBJ: 1.2      MSC: Applying

17. Many car insurance companies offer discounts for safe drivers. The promise is lower premiums or a reduction in deductibles for customers that remain accident-free for a specified period of time. The discounts are not without a cost, however. Policyholders must pay an additional premium (periodic fee paid for insurance coverage) in order to participate in the program. Understanding opportunity cost, explain how safe-driver programs might be beneficial for some customers but not others.

ANS:

For poor drivers, a safe-driver program is never a wise option. The insured would sacrifice additional money for no perceivable benefit. For a mediocre driver, it is still probably a bad option. The likelihood of an accident over a period is probably as great as having none. An individual risks sacrificing lots of money in premiums for no benefit. At least with the alternative, you get nothing, but you also sacrifice nothing. For the good driver, it is still a difficult decision. Clearly, a discount on premiums would be a preferable reward for safe driving, because utilizing a lower deductible still requires spending personal funds. An individual is forced to compare the additional premium sacrificed against the risk of things like damaged windshields, theft, or vandalism.

DIF: Moderate      REF: Opportunity Cost      OBJ: 1.2  
MSC: Applying

18. It can be said that voluntary trade will not occur unless all parties involved believe that they will be better off after trading than they were before. Considering that the supply of goods and services does not change in trade and only changes hands, how is it possible that each party improves? Shouldn't one party benefit at the expense of another?

ANS:

Not at all. Each party in a trade transaction values goods and services differently. Someone may produce beans, but wants rice to go along with them. If he or she produces more beans than can be consumed personally, the marginal benefit declines sharply for each unit of beans beyond the need for consumption. Someone who produces rice but is seeking beans has the opposite problem. He or she places little value on each unit of rice beyond the need for consumption. So, both parties have what the other wants. Not only are the demands of the two traders met but the desire for beans and rice add value to the excess supplies.

DIF: Easy      REF: Trade      OBJ: 1.2      MSC: Understanding