

Chapter 1 Managers and Economics

- 1) Which of the following statements is correct?
- A) Managerial decisions are affected primarily by microeconomic forces.
 - B) Managerial decisions are affected primarily by macroeconomic forces.
 - C) Managerial decisions are affected by both microeconomic and macroeconomic forces.
 - D) By and large, managerial decisions are not affected by either microeconomic or macroeconomic forces.

Answer: C

Diff: 1

Topic: Economic conditions and managerial decision making

- 2) Walmart's decision in 1994 to continue operating stores in specific cities in Mexico when other firms were pulling out would be best classified as:
- A) a macroeconomic decision.
 - B) a microeconomic decision.
 - C) both a microeconomic and a macroeconomic decision.
 - D) neither a microeconomic nor a macroeconomic decision.

Answer: B

Diff: 2

Topic: Microeconomic issues

- 3) Which of the following would be considered an example of a macroeconomic problem?
- A) Should Microsoft reduce the price of its Windows operating system?
 - B) Should the federal government extend the eligibility period for unemployment benefits?
 - C) Should Mitsubishi eliminate one of its production shifts?
 - D) Should JP Morgan Chase increase the interest rate it charges its credit card customers?

Answer: B

Diff: 2

Topic: Macroeconomic issues

- 4) Walmart's entry into the market in Mexico had the effect of:
- A) increasing competition and lowering the prices of many of the goods it sells.
 - B) reducing competition and lowering the prices of many of the goods it sells.
 - C) increasing competition and raising the prices of many of the goods it sells.
 - D) reducing competition and raising the prices of many of the goods it sells.

Answer: A

Diff: 2

Topic: Competition and prices

- 5) Which of the following statements is false?
- A) Price determination is the key element in any market system.
 - B) Input prices influence a firm's costs of production.
 - C) Output prices influence a firm's revenues.
 - D) While managers must understand how output prices are determined, determination of input prices is irrelevant because it is beyond the manager's control.

Answer: D

Diff: 2

Topic: Managerial economics

- 6) All else constant, the choice of whether to use a labor-intensive production process or a capital-intensive one is depends on:
- A) the absolute prices of capital and labor.
 - B) the relative prices of capital labor.
 - C) the type of market in which the firm operates.
 - D) whether the economy is growing or shrinking.

Answer: B

Diff: 1

Topic: Managerial decision making

- 7) Which of the following is *not* a characteristic of a perfectly competitive market?
- A) Large number of firms in the industry.
 - B) Outputs of the firms are perfect substitutes for one another.
 - C) Limited information is available to all market participants.
 - D) Ease of entry into the market.

Answer: C

Diff: 1

Topic: Market structure, perfect competition

- 8) Firms are considered to be price searchers, as opposed to price takers, in all of the following market types except:
- A) perfect competition.
 - B) monopolistic competition.
 - C) oligopoly.
 - D) monopoly.

Answer: A

Diff: 1

Topic: Price-taking firms

- 9) Which of the following conditions ensures that excess profits cannot persist in a perfectly competitive market over the long run?
- A) Large number of firms in the industry.
 - B) Outputs of the firms are perfect substitutes for one another.
 - C) Complete information is available to all market participants.
 - D) Ease of entry into the market.

Answer: D

Diff: 2

Topic: Long-run profits in perfect competition

- 10) Which of the following statements is correct?
- A) So long as a firm is sufficiently large, it will have some amount of market power, regardless of the type of market in which it operates.
 - B) All else constant, a monopoly firm has more market power than a monopolistically competitive firm.
 - C) The amount of market power a firm possesses is unrelated to the type of market in which it operates.
 - D) The fact that the firms in an oligopoly are mutually interdependent means that individual firms do not have any market power.

Answer: B

Diff: 2

Topic: Market power

- 11) The market structure that is characterized by a small number of large firms that have some market power is called:
- A) perfect competition.
 - B) monopolistic competition.
 - C) oligopoly.
 - D) monopoly.

Answer: C

Diff: 1

Topic: Monopolistic competition

- 12) Which of the following market structures is most similar to perfect competition?
- A) Monopsony.
 - B) Monopolistic competition.
 - C) Oligopoly.
 - D) Monopoly.

Answer: B

Diff: 1

Topic: Monopolistic competition versus perfect competition

- 13) The key characteristic of an oligopolistic market is:
- A) production of a homogeneous product.
 - B) mutual interdependence among firms in the market.
 - C) the absence of market power by any one firm.
 - D) ease of entry into, and exit out of, the market.

Answer: B

Diff: 1

Topic: Oligopoly

- 14) Which of the following statements about monopoly is false?
- A) A single firm serves the market.
 - B) There are no close substitutes for the monopolist's output.
 - C) There are usually significant barriers to entry.
 - D) Because there is a single firm serving the entire market, the monopolist can charge whatever price it wants to for its output.

Answer: D

Diff: 2

Topic: Monopoly

- 15) The assumed goal of the firms that operate in each of the four market structures discussed in the text is to maximize:
- A) sales.
 - B) revenue.
 - C) profits.
 - D) price.

Answer: C

Diff: 1

Topic: Profit maximization

- 16) Which of the following statements about the circular flow model is false?
- A) Consumers earn income by selling resources they own to businesses.
 - B) Businesses supply goods and services to the household sector.
 - C) Households supply resources to the business sector.
 - D) Business firms buy goods and services from the household sector.

Answer: D

Diff: 1

Topic: Circular flow model

- 17) Which of the following statements is false? In the circular flow model:
- A) the funds needed to finance investment spending come from the saving of households.
 - B) GDP can be measured either by the income received or by the expenditures made.
 - C) factor payments are made to business firms.
 - D) consumption expenditures are made by households.

Answer: C

Diff: 2

Topic: Circular flow model

- 18) Within the circular flow model, which of the following is *not* represented as a flow of funds into firms?
- A) Foreign purchases of goods and services.
 - B) Income payments.
 - C) Consumption spending.
 - D) Government purchases.

Answer: B

Diff: 2

Topic: Circular flow model

- 19) The major categories of expenditures in the economy are:
- A) consumption, gross investment, and government purchases.
 - B) consumption, net investment, and net exports.
 - C) consumption, fixed investment, government purchases, and net imports.
 - D) consumption, gross investment, government purchases, and net exports.

Answer: D

Diff: 1

Topic: GDP

- 20) Which of the following is *not* included in gross private domestic investment spending?
- A) Household spending on residential construction.
 - B) Spending on business inventories.
 - C) Household spending on durable goods.
 - D) Business spending on plant and equipment.

Answer: C

Diff: 1

Topic: Gross private domestic investment

- 21) Assume that with existing tax and spending laws, government spending exceeds government tax revenues. To cover the resulting shortfall, the government must:
- A) increase consumers' incomes.
 - B) print more money.
 - C) Borrow money in the financial markets.
 - D) lower interest rates.

Answer: C

Diff: 2

Topic: Fiscal policy

- 22) Gross Domestic Product (GDP) is defined as the market value of:
- A) all goods and services sold during the year by domestic and foreign producers.
 - B) all final consumer goods produced during the year by domestic and foreign suppliers.
 - C) all intermediate goods produced during the year by domestic and foreign suppliers.
 - D) all final goods and services produced during the year by domestic and foreign-supplied resources.

Answer: D

Diff: 1

Topic: GDP

- 23) In the equation $GDP = C + I + G + F$, in which F equals net export spending (i.e., total spending on exports minus total spending on imports), imports are subtracted from the other types of expenditures because:
- A) imports reduce national welfare.
 - B) other countries do not import goods from the U.S.
 - C) the value of imports is included in the other components of spending such as consumption spending.
 - D) the value of imports is difficult to determine due to the fact that they are frequently stated in terms of foreign currency.

Answer: C

Diff: 3

Topic: Calculating GDP

- 24) Assuming that $C = \$4,500$, $I = \$1,000$, $G = \$1,200$, Exports = \$450, Imports = \$550, Depreciation = \$600, and Indirect Business Taxes = \$500 (all in billions of dollars), GDP equals:
- A) \$5,500 billion.
 - B) \$6,000 billion.
 - C) \$6,400 billion.
 - D) \$6,600 billion.

Answer: D

Diff: 2

Topic: Calculating GDP

- 25) Which of the following statements is correct?
- A) Because it is subject to change, and frequently does, consumer and business confidence has only a minimal impact on future economic activity.
 - B) Because it has historically remained steady, consumer and business confidence has only a minimal impact on future economic activity.
 - C) Consumer and business confidence is extremely important and can have a great impact on future economic activity.
 - D) Business confidence is extremely important and can have a great impact on future economic activity. The same is not true of consumer confidence.

Answer: C

Diff: 1

Topic: Effects of consumer and business confidence

26) The type of policy that involves interest rates and the availability of loanable funds is known as:

- A) fiscal policy.
- B) monetary policy.
- C) strategic financial policy.
- D) federal policy.

Answer: B

Diff: 1

Topic: Monetary policy

27) The type of policy that involves changes in taxes or spending by the federal government is known as:

- A) fiscal policy.
- B) monetary policy.
- C) strategic financial policy.
- D) federal policy.

Answer: A

Diff: 1

Topic: Fiscal policy

28) If a country's central bank wants to stimulate spending in the economy, it should:

- A) increase the amount of assets banks should keep on reserve at all times.
- B) decrease taxes.
- C) lower interest rates.
- D) increase government spending.

Answer: C

Diff: 2

Topic: Monetary policy

29) If a country's national government wants to stimulate spending in the economy, it should:

- A) decrease taxes and increase government spending.
- B) increase taxes and decrease government spending.
- C) increase taxes and government spending.
- D) decrease taxes and government spending.

Answer: A

Diff: 2

Topic: Fiscal policy

30) Which of the following would have the greatest positive impact on a country's domestic economy?

- A) An increase in spending on imports from other countries.
- B) An increase in spending by foreigners on the country's exports.
- C) A decrease in the confidence of foreign investors in the country's economy.
- D) A decrease in the incomes of consumers in foreign countries.

Answer: B

Diff: 2

Topic: Net exports and GDP

31) Sound business decision making requires a firm understanding of both microeconomic and macroeconomic concepts.

Answer: TRUE

Diff: 1

Topic: Economics and decision making

- 32) The rate of inflation measures the change in the relative prices of the goods and services produced in the macroeconomy over a specified period of time.
Answer: FALSE
Diff: 1
Topic: Inflation
- 33) Macroeconomics is concerned with the behavior of all of the firms in a particular industry, while microeconomics focuses on a single firm in the same industry.
Answer: FALSE
Diff: 1
Topic: Microeconomic versus macroeconomic analysis
- 34) A typical question addressed in microeconomics is, "What determines the price of gasoline in a particular city or town?"
Answer: TRUE
Diff: 1
Topic: Microeconomic topics
- 35) Changes in the macroeconomy, such as an increase in average per person income, can have effects at the microeconomic level, for example, on the profitability of firms in a particular industry.
Answer: TRUE
Diff: 2
Topic: Microeconomic topics
- 36) With respect to prices, at the macroeconomic level attention is focused on relative prices, while at the microeconomic level attention is focused on absolute prices.
Answer: FALSE
Diff: 1
Topic: Microeconomic versus macroeconomic analysis
- 37) Managerial economics refers to the application of microeconomics to business decision making.
Answer: TRUE
Diff: 1
Topic: Managerial economics
- 38) Understanding how individual sectors of the economy will respond to changes in key economic variables gives us a better understanding of how the macroeconomy behaves.
Answer: TRUE
Diff: 1
Topic: Macroeconomic topics
- 39) Assume a bottled water company is trying to decide on a new pricing strategy. Sound decision making would require the firm's managers to consider not only how consumers will respond to the product's own price, but how they will react to the price for the firm's product relative to the prices of similar products offered by the firm's competitors.
Answer: TRUE
Diff: 2
Topic: Microeconomics and decision making

- 40) The term "relative price" is used to refer to how the current price of a good or service compares to the price of the same item in the previous time period.
Answer: FALSE
Diff: 2
Topic: Relative prices
- 41) In deciding which model of a car to buy, microeconomic theory maintains that consumers are concerned about the absolute price of a particular car, rather than its relative price.
Answer: FALSE
Diff: 2
Topic: Relative versus absolute prices
- 42) If we ranked the four market structures on the basis of degree of competition, perfect competition and monopolistic competition would be at opposite ends of the spectrum.
Answer: FALSE
Diff: 2
Topic: Market structures
- 43) Because most gas stations are small relative to the market in which they operate and gasoline is fairly homogeneous, the market for gasoline is considered to be perfectly competitive.
Answer: FALSE
Diff: 1
Topic: Perfect competition
- 44) Assume a monopolistically competitive firm comes up with a new innovation that allows it to earn above-normal economic profits. Given the nature of the market in which it operates, over time those profits will be competed away as new competitors enter the market.
Answer: TRUE
Diff: 2
Topic: Monopolistic competition
- 45) Because it is the only firm operating in a particular market, a monopolist is guaranteed to earn an economic profit.
Answer: FALSE
Diff: 2
Topic: Monopoly
- 46) All else constant, as the barriers to entry into a particular market increase, so will the ability of firms in that market to earn above-average profits.
Answer: TRUE
Diff: 2
Topic: Profits and barriers to entry
- 47) Because it does not face competition from other firms, a monopolist is guaranteed to make excess profits over time.
Answer: FALSE
Diff: 1
Topic: Monopoly

- 48) To develop a competitive advantage and increase their firm's profitability, managers need to understand what affects their revenues, costs, and their ability to set prices.
Answer: TRUE
Diff: 1
Topic: Managerial decision making
- 49) According to the circular flow model, an increase in spending by businesses on productive resources would cause the income and spending of consumers to increase.
Answer: TRUE
Diff: 2
Topic: Circular flow model
- 50) According to the circular flow model, all else constant, an increase in government spending should cause an increase in spending, income, and production in the economy.
Answer: TRUE
Diff: 2
Topic: Circular flow model
- 51) "Gross Investment spending" refers exclusively to purchases of plant and equipment by businesses and net changes in business inventories.
Answer: FALSE
Diff: 1
Topic: Gross private domestic investment
- 52) If government spending exceeds the amount of taxes collected from households and businesses, the government simply finances the difference by printing more money.
Answer: FALSE
Diff: 2
Topic: Fiscal policy
- 53) Consumer income can be used for three things: purchases of goods and services, paying taxes and saving.
Answer: TRUE
Diff: 1
Topic: Income and consumption spending
- 54) Gross Domestic Product (GDP) is defined as the market value of all goods and services purchased in the economy during a particular year.
Answer: FALSE
Diff: 1
Topic: GDP defined
- 55) All else constant, an increase in the amount of borrowing by the federal government would reduce the amount of money available for businesses to borrow to finance investment spending.
Answer: TRUE
Diff: 2
Topic: Circular flow model
- 56) All else constant, an increase in the amount of government spending on roads and bridges would cause GDP in the domestic economy to increase.
Answer: TRUE
Diff: 2
Topic: Government purchases and GDP

- 57) Assuming that $C = \$6,200$, $I = \$1,300$, $G = \$1,100$, Exports = \$630, Imports = \$750, and Depreciation = \$600 (all in billions of dollars), GDP equals \$7,880.
Answer: FALSE
Diff: 2
Topic: Calculating GDP
- 58) Because it has a direct effect on the hiring decisions of firms, a change in business confidence has a much larger impact on the level of economic activity than does a change in consumer confidence.
Answer: FALSE
Diff: 2
Topic: Business and consumer confidence and GDP
- 59) Monetary policy consists of changes in taxes, which in turn affects the amount of money households can spend on consumption.
Answer: FALSE
Diff: 1
Topic: Monetary policy
- 60) All else constant, if the central bank wants to slow the pace at which the economy is expanding, it should increase interest rates.
Answer: TRUE
Diff: 2
Topic: Monetary policy
- 61) The U.S. Treasury is responsible for controlling the money supply and interest rates in the economy.
Answer: FALSE
Diff: 1
Topic: Monetary policy
- 62) One way for the federal government to increase the amount of spending in the domestic economy would be to decrease personal and business taxes.
Answer: TRUE
Diff: 2
Topic: Fiscal policy and taxes
- 63) All else constant, a decrease in the level of economic activity in foreign countries could be expected to have an adverse effect on the domestic economy.
Answer: TRUE
Diff: 2
Topic: Net exports and economic activity
- 64) Explain the basic distinction between microeconomic analysis and macroeconomic analysis. Describe the types of issues that each branch of analysis focuses on.
Answer: Microeconomic analysis focuses on the behavior of individuals, e.g., consumers and firms. It is concerned with such issues as how a firm can produce output most cheaply, how much revenue it can expect to receive from the sale of a good, and how much of a good consumers will purchase at each price. Macroeconomic analysis focuses on the overall level of economic activity. It is concerned with such issues as what factors will cause the rates of inflation and unemployment to change and what types of policies can be used to influence the overall level of economic activity.
Diff: 1
Topic: Microeconomic versus macroeconomic analysis

- 65) Assume the price of product A increases from \$1 to \$1.50, while the price of competing product B increases from \$1.50 to \$2.00. Based on the information, what we can say about the absolute and relative price differences between the two products and the relative attractiveness of the two products to consumers.

Answer: Clearly, the absolute difference in the prices of the two products, \$0.50, has not changed. The relative price difference, however, has changed. Before the price changes, the the price of product A was two thirds of the price of product B. After the price change, the relative price of product A is three fourths of the price of B. Stated differently, before the price change, the price of B was 50 percent higher than the price of A. After the price changes, the price of B is only 33 percent higher than the price of A. Because of the decrease in the difference in relative prices, product B has become more competitive with product A, all else constant.

Diff: 3

Topic: Relative versus absolute prices

- 66) Assume an individual is considering opening a new car dealership in a medium-sized metropolitan area (population = 200,000). Provide a list of economic variables you would recommend that the person consider in making his decision whether to open the business, and explain your rationale for including each variable.

Answer: At a minimum, it would seem that the decision maker should consider 1) the current number of dealerships in the area, 2) the types and quantities of vehicles that consumers in the local economy currently purchase, 3) the income in the local economy, 4) the level of unemployment both locally and nationally, 5) projected trends in unemployment, and 6) possible policy changes that might be undertaken by the central bank or the federal government.

1, 2 and 3 would give the decision maker a sense of how strong the market for his product might be. Information on unemployment in the local economy would provide useful information in this regard as well. 5 and 6 would provide information on what the decision maker could expect in the coming months, especially regarding whether demand for his product is likely to grow or decline.

Diff: 2

Topic: Economic conditions and managerial decision making

- 67) List and describe the sources of spending in the economy by focusing on the four major sectors of the economy.

Answer: The four major sources of spending in the economy include consumption spending, which is spending by households on durable and non-durable goods and services; gross private domestic investment, which includes spending on plant and equipment (by businesses), residential construction (by households), and inventories (by businesses); government consumption expenditures and gross investment; and net exports, i.e., the difference between export spending (by foreigners on domestically produced goods and services) and spending on imports (domestic spending on foreign-made goods and services).

Diff: 2

Topic: Components of GDP

- 68) Many analysts have argued that the federal government should stop spending money on programs such as agricultural price supports and should redirect that spending to such things as improvements in the nation's roads and bridges. Construct an economic argument that supports this proposed change in policy.

Answer: Government spending on agricultural price supports amounts to a transfer of money from one group, taxpayers, to another group, farmers. As such there is no real increase in productive capacity. Furthermore, one could argue that the subsidies further distort market prices and send the wrong signals to farmers. In contrast, spending on roads and bridges (other than the "bridge to nowhere") contributes to an increase in the economy's infrastructure and, as such increases the economy's productive capacity over time.

Diff: 3

Topic: Fiscal policy