

Chapter 1—Ten Principles of Economics

MULTIPLE CHOICE

1. Which word comes from the Greek word for “one who manages a household”?
- market
 - consumer
 - producer
 - economy

ANS: D PTS: 1 DIF: Easy REF: 3-4
BLM: Remember NOT: Micro TB_1-1

2. From which Greek word(s) is the word economy derived?
- environment
 - one who manages a household
 - one who participates in a market
 - conservation

ANS: B PTS: 1 DIF: Easy REF: 3-4
BLM: Remember NOT: Micro TB_1-2

3. What do households and economies have in common?
- They both must allocate scarce resources.
 - They both face many decisions.
 - They both must allocate the goods and services they produce.
 - They both must have a central decision maker.

ANS: D PTS: 1 DIF: Average REF: 3-4
BLM: Remember NOT: Micro TB_1-3

4. What concept does economics primarily deal with?
- scarcity
 - poverty
 - change
 - power

ANS: A PTS: 1 DIF: Easy REF: 4
BLM: Remember NOT: Micro TB_1-4

5. Which of the following is NOT included in the decisions that every society must make?
- what goods will be produced
 - who will produce the goods
 - what determines consumer preferences
 - who will consume the goods

ANS: C PTS: 1 DIF: Average REF: 4
BLM: Remember NOT: Micro TB_1-5

6. Why do both households and societies face many decisions?
- because resources are scarce
 - because populations may increase or decrease over time
 - because wages for households and therefore society fluctuate with business cycles
 - because people, by nature, tend to disagree

ANS: A PTS: 1 DIF: Average REF: 4
BLM: Remember NOT: Micro TB_1-6

7. When is a good considered scarce in a society?
- when more output of the good is possible
 - when everyone in that society cannot have all they want of the good
 - when the government restricts production of the good
 - when only the richest people in the economy can buy all they want of the good

ANS: B PTS: 1 DIF: Average REF: 4
BLM: Remember NOT: Micro TB_1-7

8. When does scarcity exist?
- when there is less than an infinite amount of a resource or good
 - when society can meet the wants of every individual
 - when there is less of a good or resource available than people wish to have
 - when the government fails to produce goods

ANS: C PTS: 1 DIF: Average REF: 4
BLM: Remember NOT: Micro TB_1-8

9. How are goods and services allocated in a market economy?
- by government decisions
 - by giving each individual just enough for a decent standard of living
 - by the actions of all firms and consumers
 - by inherited rights and properties

ANS: C PTS: 1 DIF: Average REF: 4
BLM: Higher Order NOT: Micro TB_1-9

10. Approximately what percentage of the world's economies experience scarcity?
- 25%
 - 50%
 - 75%
 - 100%

ANS: D PTS: 1 DIF: Easy REF: 4
BLM: Remember NOT: Micro TB_1-10

11. What is the economy experiencing when a society cannot produce all the goods and services people wish to have?
- scarcity
 - communism
 - externalities
 - market failure

ANS: A PTS: 1 DIF: Easy REF: 4
BLM: Higher Order NOT: Micro TB_1-11

12. For society, when is a good NOT scarce?
- a. if at least one individual in society can obtain all he or she wants of the good
 - b. if firms are producing at full capacity
 - c. if all members of society can have all they want of the good
 - d. if those who have enough income can buy all they want of the good

ANS: C PTS: 1 DIF: Average REF: 4
BLM: Higher Order NOT: Micro TB_1-12

13. Which of the following goods best meets the definition of scarcity?
- a. air
 - b. water in the ocean
 - c. water in a city
 - d. wood in a forest

ANS: C PTS: 1 DIF: Average REF: 4
BLM: Remember NOT: Micro TB_1-13

14. What does economics study?
- a. business
 - b. how society manages its scarce resources
 - c. central planning
 - d. government regulation

ANS: B PTS: 1 DIF: Easy REF: 4
BLM: Remember NOT: Micro TB_1-14

15. What does economics study?
- a. how society manages its scarce resources
 - b. the government's role in society
 - c. how to increase production
 - d. how firms make profits

ANS: A PTS: 1 DIF: Easy REF: 4
BLM: Remember NOT: Micro TB_1-15

16. In most societies, who allocates resources?
- a. a single central planner
 - b. those who own the resources
 - c. those firms that use resources to provide goods and services
 - d. the combined actions of millions of households and firms

ANS: D PTS: 1 DIF: Average REF: 4
BLM: Remember NOT: Micro TB_1-16

17. What do economists study?
- a. how people make decisions
 - b. how governments interact with one another
 - c. the forces and trends that affect only the economy as a whole
 - d. how societies change over time

ANS: D PTS: 1 DIF: Average REF: 4
BLM: Remember NOT: Micro TB_1-17

18. Which of the following is NOT a major area of study for economists?
- a. how people make decisions
 - b. how countries choose national leaders
 - c. how people interact with each other
 - d. how forces and trends affect the overall economy

ANS: B PTS: 1 DIF: Average REF: 4
BLM: Remember NOT: Micro TB_1-18

19. What concept is illustrated by the adage, "There is no such thing as a free lunch"?
- a. tradeoffs
 - b. scarcity
 - c. productivity
 - d. efficiency

ANS: A PTS: 1 DIF: Average REF: 4
BLM: Remember NOT: Micro TB_1-19

20. What does the adage "There is no such thing as a free lunch" mean?
- a. Even people on welfare have to pay for food.
 - b. The cost of living is always increasing.
 - c. To get something we like, we usually have to give up another thing we like.
 - d. All costs are included in the price of a product.

ANS: C PTS: 1 DIF: Average REF: 4
BLM: Remember NOT: Micro TB_1-20

21. What do economists illustrate when they use the phrase "There is no such thing as a free lunch"?
- a. how inflation increases prices
 - b. that to get one thing, we must give up something else
 - c. that nothing is free in a market economy
 - d. that if something looks too good to be true, it probably is

ANS: B PTS: 1 DIF: Average REF: 4
BLM: Remember NOT: Micro TB_1-21

22. Which best represents the concept represented by the adage "There is no such thing as a free lunch"?
- a. Melissa can only attend the concert if she takes her sister with her.
 - b. Greg is hungry and homeless.
 - c. Brian must repair the tire on his bike before he can ride it to class.
 - d. Kendra must decide between going to Miami or Cancun for spring break.

ANS: D PTS: 1 DIF: Challenging REF: 4
BLM: Remember NOT: Micro TB_1-22

23. Guns and butter represent the classic societal tradeoff between spending on which two items?
- a. durable and nondurable goods
 - b. imports and exports
 - c. national defence and consumer goods
 - d. law enforcement and agriculture

ANS: C PTS: 1 DIF: Average REF: 4-5
BLM: Remember NOT: Micro TB_1-23

24. Henry decides to spend two hours playing golf rather than working at his job, which pays \$8 per hour. What is Henry's tradeoff?
- a. the \$16 he could have earned working for two hours
 - b. nothing, because he enjoys playing golf more than working
 - c. the increase in skill he obtains from playing golf for those two hours
 - d. nothing, because he spent \$16 for green fees to play golf

ANS: A PTS: 1 DIF: Average REF: 4-5
BLM: Higher Order NOT: Micro TB_1-24

25. When society requires that firms reduce pollution, what happens?
- a. There is a tradeoff because of reduced incomes to the firms' owners, workers, and customers.
 - b. There is no tradeoff, since everyone benefits from reduced pollution.
 - c. There is no tradeoff for society as a whole, since the cost of reducing pollution falls only on the firms affected by the requirements.
 - d. There is a tradeoff only if some firms are forced to close.

ANS: A PTS: 1 DIF: Challenging REF: 4-5
BLM: Higher Order NOT: Micro TB_1-25

26. Daniel decides to spend the last two hours of the night before his economics exam studying instead of sleeping. For Daniel, what would his tradeoff be?
- a. nothing, since no dollar value can be put on sleep
 - b. nothing, since studying would be more beneficial than sleep
 - c. the six hours of sleep he could have had if he had gone to bed before midnight
 - d. the two hours of rest he would have gotten

ANS: D PTS: 1 DIF: Average REF: 4-5
BLM: Higher Order NOT: Micro TB_1-26

27. How does a tradeoff exist between a clean environment and a higher level of income?
- a. Studies show that individuals with higher levels of income actually pollute less than low-income individuals.
 - b. To pay for pollution cleanup, the government must increase taxes, which lowers income.
 - c. Laws that reduce pollution raise costs of production and reduce incomes.
 - d. By employing individuals to clean up pollution, employment and income both rise.

ANS: C PTS: 1 DIF: Challenging REF: 4-5
BLM: Higher Order NOT: Micro TB_1-27

28. Which of the following would NOT be a result of laws that require firms to reduce pollution?
- a. lower spending by government
 - b. higher prices to consumers
 - c. lower wages to workers
 - d. smaller profit to firms

ANS: A PTS: 1 DIF: Average REF: 4-5
BLM: Remember NOT: Micro TB_1-28

29. What will pollution regulations do?
- a. increase profit to firms
 - b. impose a tradeoff on society
 - c. allow firms to raise workers' wages
 - d. lower prices for consumers

ANS: B PTS: 1 DIF: Average REF: 4-5
BLM: Remember NOT: Micro TB_1-29

30. Which of the following best defines efficiency?
- a. absolute fairness
 - b. equal distribution
 - c. minimum waste
 - d. consumer sovereignty

ANS: C PTS: 1 DIF: Easy REF: 5
BLM: Remember NOT: Micro TB_1-30

31. What does efficiency mean?
- a. Society is conserving resources in order to save them for the future.
 - b. Society's goods and services are distributed fairly among society's members.
 - c. Society has lessened its dependence on foreign energy sources.
 - d. Society is getting the most it can from its scarce resources.

ANS: D PTS: 1 DIF: Average REF: 5
BLM: Remember NOT: Micro TB_1-31

32. In which of the following situations would economists use the word equity?
- a. Each member of society has the same income.
 - b. Society is getting the most it can from its scarce resources.
 - c. Those in society who have the least will receive the most.
 - d. The benefits of society's resources are distributed fairly among society's members.

ANS: D PTS: 1 DIF: Average REF: 5
BLM: Remember NOT: Micro TB_1-32

33. What is one definition of equity?
- a. equality
 - b. efficiency
 - c. fairness
 - d. similarity

ANS: C PTS: 1 DIF: Easy REF: 5
BLM: Remember NOT: Micro TB_1-33

34. What happens when government policies are being designed?
- a. There is usually a tradeoff between equity and efficiency.
 - b. Equity and efficiency goals are usually independent of each other.
 - c. Equity can usually be achieved without an efficiency loss.
 - d. Increasing efficiency usually results in more equity.

ANS: A PTS: 1 DIF: Average REF: 5
BLM: Remember NOT: Micro TB_1-34

35. When government policies such as the welfare system try to help the neediest members of society, what happens?
- a. It increases equity and reduces efficiency.
 - b. It reduces charitable contributions in an economy.
 - c. It increases the productivity of the needy in society.
 - d. It causes market failure to occur.

ANS: A PTS: 1 DIF: Average REF: 5
BLM: Higher Order NOT: Micro TB_1-35

36. When the government implements programs such as progressive income tax rates, which of the following is likely to occur?
- a. Equity and efficiency is increased.
 - b. Equity and efficiency is decreased.
 - c. Equity is decreased, and efficiency is increased.
 - d. Equity is decreased, and efficiency is decreased.

ANS: B PTS: 1 DIF: Average REF: 5
BLM: Higher Order NOT: Micro TB_1-36

37. When the government attempts to cut the economic pie into more equal slices, what happens?
- a. It is easier to cut the pie, and therefore the economy can produce a larger pie.
 - b. The government can more easily allocate the pie to those most in need.
 - c. The pie gets smaller, and there will be less pie for everyone.
 - d. The economy will spend too much time cutting the pie and lose the ability to produce enough pie for everyone.

ANS: C PTS: 1 DIF: Challenging REF: 5
BLM: Remember NOT: Micro TB_1-37

38. When the government attempts to improve equity in an economy, what is often the result?
- a. an increase in overall output in the economy
 - b. additional government revenue since overall income will increase
 - c. an actual reduction in equity
 - d. reduced efficiency in the economy

ANS: D PTS: 1 DIF: Average REF: 5
BLM: Remember NOT: Micro TB_1-38

39. When the government redistributes income from the rich to the poor, what is the result?
- a. Efficiency is improved, but equity is not.
 - b. Both rich people and poor people benefit directly.
 - c. People work less and produce fewer goods and services.
 - d. Rich people consume fewer goods, but poor people consume more goods, resulting in no real change.

ANS: C PTS: 1 DIF: Average REF: 5
BLM: Remember NOT: Micro TB_1-39

40. In economics, what is the cost of something?
- the dollar amount of obtaining it
 - what it takes to produce it
 - what you give up to obtain it
 - the amount of labour to produce it

ANS: C PTS: 1 DIF: Easy REF: 5
BLM: Remember NOT: Micro TB_1-40

41. What is the term for what you give up to obtain an item?
- opportunity cost
 - explicit cost
 - true cost
 - direct cost

ANS: A PTS: 1 DIF: Easy REF: 6
BLM: Remember NOT: Micro TB_1-41

42. Paul receives \$300 as a birthday gift. In deciding how to spend the money, he narrows his options down to four: A, B, C, and D. The price of each option is \$200, but Paul prefers B to A, A to C, and C to D. What is the opportunity cost of option B?
- It is Paul's valuation of A.
 - It is Paul's valuation of A, C, and D together.
 - It is \$300.
 - It is \$200.

ANS: A PTS: 1 DIF: Average REF: 6
BLM: Higher Order NOT: Micro TB_1-42

43. What is the opportunity cost of going to university?
- the total spent on food, clothing, books, transportation, tuition, lodging, and other expenses
 - the value of the best opportunity a student gives up to attend university
 - zero for students who are fortunate enough to have all of their college expenses paid by someone else
 - zero, since a college education will allow a student to earn a larger income after graduation

ANS: B PTS: 1 DIF: Average REF: 6
BLM: Higher Order NOT: Micro TB_1-43

44. For most students, what is the largest single cost of a university education?
- the wages given up to attend school
 - tuition, fees, and books
 - room and board
 - transportation, parking, and entertainment

ANS: A PTS: 1 DIF: Average REF: 6
BLM: Higher Order NOT: Micro TB_1-44

45. What is the largest single cost of going to university?

- a. books
- b. room and board
- c. tuition
- d. lost wages

ANS: D

PTS: 1

DIF: Easy

REF: 6

BLM: Higher Order

NOT: Micro TB_1-45

46. What is the opportunity cost of an item?

- a. the number of hours needed to earn money to buy it
- b. what you give up to get that item
- c. usually more than the dollar value of the item
- d. usually less than the dollar value of the item

ANS: B

PTS: 1

DIF: Easy

REF: 6

BLM: Remember NOT: Micro TB_1-46

47. Maurice receives \$100 as a birthday gift. In deciding how to spend the money, he narrows his options down to four choices: A, B, C, and D. Each option costs \$100, but Maurice values each option differently. Finally, he decides on B. What is the opportunity cost of B?

- a. the value to him of the option he would have chosen if B was not available
- b. the value to him of options A, C, and D combined
- c. \$300
- d. \$100

ANS: A

PTS: 1

DIF: Average

REF: 6

BLM: Higher Order

NOT: Micro TB_1-47

48. Mallory decides to spend three hours working overtime rather than watching a video with her friends. She earns \$8 an hour. What is her opportunity cost of working?

- a. the \$24 she earns working
- b. the \$24 minus the enjoyment she would have received from watching the video
- c. the enjoyment she would have received had she watched the video
- d. nothing, since she would have received less than \$24 of enjoyment from the video

ANS: C

PTS: 1

DIF: Challenging

REF: 6

BLM: Higher Order

NOT: Micro TB_1-48

49. Russell spends an hour studying instead of playing tennis. What is the opportunity cost to him of studying?

- a. the improvement in his grades from studying for the hour
- b. the difference between the improvement in his grades from studying minus the enjoyment of playing tennis
- c. the enjoyment and exercise he would have received had he played tennis
- d. nothing, since Russell chose to study rather than to play tennis, the value of studying must have been greater than the value of playing tennis

ANS: C

PTS: 1

DIF: Average

REF: 6

BLM: Higher Order

NOT: Micro TB_1-49

50. What do we know about college-age athletes who drop out of college to play professional sports?
- a. They are not rational decision makers.
 - b. They are well aware that their opportunity cost of attending college is very high.
 - c. They are concerned more about present circumstances than their future.
 - d. They underestimate the value of a college education.

ANS: B PTS: 1 DIF: Average REF: 6
BLM: Remember NOT: Micro TB_1-50

51. How do people make decisions at the margin?
- a. by following tradition
 - b. by experience
 - c. by calculating dollar costs
 - d. by comparing costs and benefits

ANS: D PTS: 1 DIF: Easy REF: 6
BLM: Remember NOT: Micro TB_1-51

52. What does the word “margin” mean?
- a. edge
 - b. distance
 - c. space
 - d. measure

ANS: A PTS: 1 DIF: Easy REF: 6
BLM: Remember NOT: Micro TB_1-52

53. What does making decisions “at the margin” mean?
- a. that people make those decisions that do not impose a marginal cost
 - b. that people evaluate how easily a decision can be reversed if problems arise
 - c. that people compare the marginal costs and marginal benefits of each decision
 - d. that people always calculate the marginal dollar costs for each decision

ANS: C PTS: 1 DIF: Average REF: 6
BLM: Remember NOT: Micro TB_1-53

54. What is a marginal change?
- a. a long-term trend
 - b. a large, significant adjustment
 - c. a change for the worse, and so is usually short term
 - d. a small incremental adjustment

ANS: D PTS: 1 DIF: Easy REF: 6
BLM: Remember NOT: Micro TB_1-54

55. Which of the following is the best example of a marginal change?
- a. After graduating from university, Audrey's income increases from \$500 per month to \$3000 per month.
 - b. Morgan gets a raise at her part-time job and is now paid \$10.25 per hour instead of \$10.00.
 - c. Housing prices in an area increase by 40% when a new highway is built in a small town.
 - d. A hard freeze wipes out half of the tobacco crop in Ontario and the price of cigarettes doubles.

ANS: B

PTS: 1

DIF: Challenging REF: 6-7

BLM: Higher Order

NOT: Micro TB_1-55

56. Which of the following is the best example of a marginal change?
- a. After graduating from university, Neville's income increases from \$1000 per month to \$1,100 per month.
 - b. Marliss is granted a raise at her part-time job and is now paid \$11.25 per hour instead of \$11.00.
 - c. Housing prices in an area increase by 50% when a new freeway is built in a small town.
 - d. A hard freeze wipes out half of the potato crop in Prince Edward Island and the price of potatoes doubles.

ANS: B

PTS: 1

DIF: Challenging REF: 6-7

BLM: Higher Order

NOT: Micro TB_1-56

57. Which of the following is the best example of a marginal change?
- a. The price of water rose in Calgary by 2% last year.
 - b. Kim gets a big promotion at work. She also gets a raise from \$25 000 per year to \$40 000 per year.
 - c. Mark graduates from university and takes a job. His income increases from \$10 000 per year to \$50 000 per year.
 - d. A drought hits Saskatchewan and the price of wheat increases from \$4.00 per bushel to \$8.00 per bushel.

ANS: A

PTS: 1

DIF: Challenging REF: 6

BLM: Higher Order

NOT: Micro TB_1-57

58. Which of the following illustrates a marginal change?
- a. Nancy retires and takes a part-time job. She was working 40 hours per week, but now works 10 hours per week.
 - b. Provincial University has announced that due to provincial budget deficits, tuition must rise by 25% next year.
 - c. Ryan moved to a new apartment and now pays 40% more for rent than before.
 - d. Vancouver, which usually receives 250 mm of rain per year, received 275 mm last year.

ANS: D

PTS: 1

DIF: Challenging REF: 6

BLM: Higher Order

NOT: Micro TB_1-58

59. After much consideration, you have chosen Cancun over Fort Lauderdale for your spring break trip this year. For this decision to change, which of the following must occur?
- The marginal benefit of Cancun must increase.
 - The marginal cost of Cancun must decrease.
 - The marginal benefit of Fort Lauderdale must increase.
 - The marginal cost of Fort Lauderdale must increase.

ANS: C PTS: 1 DIF: Challenging REF: 6-7
BLM: Higher Order NOT: Micro TB_1-59

60. The average cost per seat on a bus trip from Montreal to Toronto is \$140. Suppose no refreshments are served and three seats are empty. How could the bus company increase its profit?
- if it charged no less than \$140 for the three remaining seats
 - if it charged more than \$140 for the three remaining seats
 - if it charged any ticket price above \$0 for the remaining seats
 - if it left the seats empty

ANS: C PTS: 1 DIF: Average REF: 6-7
BLM: Higher Order NOT: Micro TB_1-60

61. The average cost per seat on an airplane trip from Calgary to Edmonton is \$105. Suppose no refreshments are served and seven seats are empty. How could the airline company increase its profit?
- if it charged no less than \$105 for the seven remaining seats
 - if it charged more than \$105 for the seven remaining seats
 - if it charged any ticket price above \$0 for the remaining seats
 - if it left the seats empty

ANS: C PTS: 1 DIF: Average REF: 6-7
BLM: Higher Order NOT: Micro TB_1-61

62. When does a rational decision maker take an action?
- only if the marginal benefit is less than the marginal cost
 - only if the marginal benefit is greater than the marginal cost
 - only if the average benefit is greater than the average cost
 - only if the marginal benefit is greater than both the average cost and the marginal cost

ANS: B PTS: 1 DIF: Average REF: 6-7
BLM: Remember NOT: Micro TB_1-62

63. Mike has spent \$500 purchasing and repairing an old fishing boat, which he expects to sell for \$800. He discovers that he needs an additional repair, which will cost \$400. He can sell the boat as it is now for \$300. What should he do?
- He should take the \$300.
 - He should never sell something for less than its cost.
 - He should complete the repairs and sell the boat.
 - It doesn't matter which action he takes; the outcome is the same either way.

ANS: C PTS: 1 DIF: Challenging REF: 6-7
BLM: Higher Order NOT: Micro TB_1-63

64. Mike has spent \$800 purchasing and repairing an old motorcycle, which he expects to sell for \$1,200. He discovers that he needs an additional repair, which will cost \$200. He can sell the motorcycle as it is now for \$400. What should he do?
- a. He should take the \$400.
 - b. He should never sell something for less than it cost.
 - c. He should complete the repairs and sell the motorcycle.
 - d. It doesn't matter which action he takes; the outcome is the same either way.

ANS: C

PTS: 1

DIF: Challenging REF: 6-7

BLM: Higher Order

NOT: Micro TB_1-64

65. Carol has spent \$2000 purchasing and repairing an old car, which she expects to sell for \$2400. She discovers that she needs an additional repair, which will cost \$400. She can sell the car as it is now for \$2000. What should she do?
- a. She should sell the car now for \$2000.
 - b. She should never sell something for less than it cost.
 - c. She should complete the repairs and sell the car.
 - d. It doesn't matter which action she takes; the outcome is the same either way.

ANS: D

PTS: 1

DIF: Challenging REF: 6-7

BLM: Higher Order

NOT: Micro TB_1-65

66. Tim has spent \$2500 purchasing and repairing a Hummer, which he expects to sell for \$3500. He discovers that he needs an additional repair, which will cost \$1100. He can sell the Hummer as it is now for \$900. What should he do?
- a. He should take the \$900.
 - b. He should never sell something for less than it cost.
 - c. He should complete the repairs and sell the Hummer.
 - d. It doesn't matter which action he takes; the outcome is the same either way.

ANS: C

PTS: 1

DIF: Challenging REF: 6-7

BLM: Higher Order

NOT: Micro TB_1-66

67. Monica has spent \$30 000 purchasing and repairing an old cabin, which she expects to sell for \$40 000. She discovers that she needs an additional repair, which will cost \$20 000. She can sell the cabin as it is now for \$25 000. What should she do?
- a. She should take the \$25 000.
 - b. She should never sell something for less than its cost.
 - c. She should complete the repairs and sell the cabin.
 - d. It doesn't matter which action she takes; the outcome is the same either way.

ANS: A

PTS: 1

DIF: Challenging REF: 6-7

BLM: Higher Order

NOT: Micro TB_1-67

68. Stan buys a 1966 Mustang, which he plans to restore and sell. He anticipates that the cost of the car and the repairs will be \$10 000 and that he can sell it for \$13 000. When he has spent \$10 000, he discovers he needs to replace the engine, which will cost \$4000. He can sell the car without the new engine for \$9000. What should Stan do?
- a. He should complete the repairs and sell the car for \$13 000.
 - b. He should sell the car now for \$9000.
 - c. He should never try such an expensive project again.
 - d. He should be totally indifferent between finishing the project and selling the car now.

ANS: D

PTS: 1

DIF: Challenging REF: 6-7

BLM: Higher Order

NOT: Micro TB_1-68

69. Stan buys a 1966 Mustang, which he plans to restore and sell. He anticipates that the cost of the car and the repairs will be \$8000 and that he can sell it for \$10 000. When he has spent \$7000, he discovers he needs to replace the engine, which will cost \$4000. He can sell the car without the new engine for \$9000. What should Stan do?
- a. He should complete the repairs and sell the car for \$10 000.
 - b. He should sell the car now for \$9000.
 - c. He should keep the car for his own use because selling it would be a loss.
 - d. He should be totally indifferent between finishing the project and selling the car now.

ANS: B

PTS: 1

DIF: Challenging REF: 6-7

BLM: Higher Order

NOT: Micro TB_1-69

70. Lisa buys a 1982 BMW, which she plans to restore and sell. She anticipates that the cost of the car and the repairs will be \$11 000 and that she can sell it for \$20 000. After she has spent \$11 000, she discovers she needs to replace the engine, which will cost \$5000. She can sell the car without the new engine for \$14 000. What should Lisa do?
- a. She should complete the repairs for \$5000 and sell the car for \$20 000.
 - b. She should sell the car now for \$14 000.
 - c. She should keep the car for her own use because selling it would be a loss.
 - d. She should be totally indifferent between finishing the project and selling the car now.

ANS: A

PTS: 1

DIF: Challenging REF: 6-7

BLM: Higher Order

NOT: Micro TB_1-70

71. Lisa buys a 1982 BMW, which she plans to restore and sell. She anticipates that the cost of the car and the repairs will be \$10 000 and that she can sell it for \$15 000. After she has spent \$10 000, she discovers she needs to replace the engine, which will cost \$4000. She can sell the car without the new engine for \$11 000. What should Lisa do?
- a. She should complete the repairs for \$4000 and sell the car for \$15 000.
 - b. She should sell the car now for \$11 000.
 - c. She should keep the car because selling it would be a loss.
 - d. She should be totally indifferent between finishing the project and selling the car now.

ANS: D

PTS: 1

DIF: Challenging REF: 6-7

BLM: Higher Order

NOT: Micro TB_1-71

72. A donut shop sells fresh baked donuts from 5 a.m. until 3 p.m. every day but Sunday. The cost of making and selling a dozen glazed donuts is \$1.00. Since this shop does not sell day-old donuts the next day, what should the manager do if he still has ten dozen left at 2:30 p.m.?
- a. lower the price of the remaining donuts even if the price falls below \$1.00
 - b. lower the price of the remaining donuts as long as it's more than \$1.00
 - c. lower the price on all donuts so they will all be sold earlier in the day
 - d. throw them away and produce ten fewer dozen tomorrow

ANS: A

PTS: 1

DIF: Challenging REF: 6-7

BLM: Higher Order

NOT: Micro TB_1-72

73. A donut shop sells fresh baked donuts from 5 a.m. until 3 p.m. every day but Sunday. The cost of making and selling a dozen glazed donuts is \$2.00. Since this shop does not sell day-old donuts the next day, what should the manager do if she still has ten dozen left at 2:30 p.m.?
- a. lower the price of the remaining donuts even if the price falls below \$2.00
 - b. lower the price of the remaining donuts as long as it's more than \$2.00
 - c. lower the price on all donuts so they will all be sold earlier in the day
 - d. throw them away and produce ten fewer dozen tomorrow

ANS: A

PTS: 1

DIF: Challenging REF: 6-7

BLM: Higher Order

NOT: Micro TB_1-73

74. A furniture maker currently produces 100 tables per week and sells them for a profit. She is considering expanding her operation in order to make more tables. Should she expand?
- a. Yes, because making tables is profitable.
 - b. No, because she may not be able to sell the additional tables.
 - c. It depends on the marginal cost of producing more tables and the marginal revenue she will earn from selling more tables.
 - d. It depends on the average cost of producing more tables and the average revenue she will earn from selling more tables.

ANS: C

PTS: 1

DIF: Average REF: 7

BLM: Higher Order

NOT: Micro TB_1-74

75. In the nation of Dictatorland, farmers traditionally feed grain to their livestock. Central planners, however, decided to increase the price of grain to make grain farmers happy and to reduce the price of bread made from that grain to make city dwellers happy. Now the price of bread is lower than the price of grain. What might we now expect?
- a. farmers to continue to feed grain to their livestock
 - b. farmers to start feeding bread to their livestock
 - c. city dwellers to start buying grain to make bread to eat
 - d. city dwellers to start buying grain to make bread to sell

ANS: B

PTS: 1

DIF: Average REF: 7

BLM: Higher Order

NOT: Micro TB_1-75

76. Your professor loves her work, teaching economics. She has been offered other positions in the corporate world making 25 percent more, but has decided to stay in teaching. What might change her decision?
- a. if the marginal cost of teaching increased
 - b. if the marginal benefit of teaching increased
 - c. if the marginal cost of teaching decreased
 - d. if the marginal cost of a corporate job increased

ANS: A PTS: 1 DIF: Challenging REF: 6-7
BLM: Higher Order NOT: Micro TB_1-76

77. Suppose your management professor has been offered a corporate job with a 30 percent pay increase. Why has he decided to take the job?
- a. The marginal cost of leaving was greater than the marginal benefit.
 - b. The marginal benefit of leaving was greater than the marginal cost.
 - c. The marginal benefit of teaching was greater than the marginal cost.
 - d. The marginal cost of teaching was greater than the marginal benefit.

ANS: B PTS: 1 DIF: Challenging REF: 6-7
BLM: Higher Order NOT: Micro TB_1-77

78. Suppose your management professor has been offered a corporate job with a 30 percent pay increase. Why has he decided NOT to take the job?
- a. The marginal cost of leaving was greater than the marginal benefit.
 - b. The marginal benefit of leaving was greater than the marginal cost.
 - c. The marginal benefit of leaving was less than the marginal cost.
 - d. The marginal benefit of teaching was greater than the marginal cost.

ANS: C PTS: 1 DIF: Challenging REF: 6-7
BLM: Higher Order NOT: Micro TB_1-78

79. When policymakers make policies that change the costs and benefits that people face, what can the policymakers do?
- a. alter behaviours
 - b. make people ignore incentives
 - c. create inflation
 - d. reduce government revenue

ANS: A PTS: 1 DIF: Average REF: 8-9
BLM: Remember NOT: Micro TB_1-79

80. According to economists, what do people respond to?
- a. laws
 - b. incentives
 - c. threats more than rewards
 - d. positives, but not negatives

ANS: B PTS: 1 DIF: Easy REF: 8-9
BLM: Remember NOT: Micro TB_1-80

81. What did Ralph Nader's book *Unsafe at Any Speed* cause the U.S. government to require?
- a. safety glass in all new cars
 - b. seat belts in all new cars
 - c. air bags in all new cars
 - d. stricter drunk driving laws

ANS: B PTS: 1 DIF: Easy REF: 8-9
BLM: Remember NOT: Micro TB_1-81

82. What has been the result of laws requiring that drivers wear seat belts?
- a. a reduction in both driver deaths and pedestrian deaths
 - b. fewer accidents and fewer deaths per accident
 - c. fewer driver deaths, fewer accidents, and fewer pedestrian deaths
 - d. little change in the number of driver deaths, but more accidents and more pedestrian deaths

ANS: D PTS: 1 DIF: Average REF: 8-9
BLM: Remember NOT: Micro TB_1-82

83. What has been one effect of a government-imposed seat belt law?
- a. fewer pedestrian deaths
 - b. safer driving
 - c. an increase in the number of accidents
 - d. everyone now wears seat belts

ANS: C PTS: 1 DIF: Easy REF: 8-9
BLM: Remember NOT: Micro TB_1-83

84. Which of the following does NOT result when seat belt laws alter a driver's cost-benefit calculation?
- a. fewer drivers are killed
 - b. more pedestrians are killed
 - c. drivers drive faster
 - d. more accidents occur

ANS: A PTS: 1 DIF: Average REF: 8-9
BLM: Remember NOT: Micro TB_1-84

85. In the former Soviet Union, producers were paid for meeting output targets, not for selling products. Under those circumstances, what were the economic incentives for producers?
- a. to produce good quality products so that society benefits from the resources used
 - b. to conserve on costs, so as to maintain efficiency in the economy
 - c. to produce enough to meet the output target, without regard for quality or cost
 - d. to produce those products that society desires most

ANS: C PTS: 1 DIF: Average REF: 8-9
BLM: Remember NOT: Micro TB_1-85

86. How can trade benefit a family?
- a. A family benefits by allowing the family to buy a greater variety of goods and services at a lower cost.
 - b. A family benefits by allowing each person to buy only the goods and services they want most.
 - c. A family can benefit only if the family is not in economic competition with other families.
 - d. Trade can only benefit entire nations, not individuals.

ANS: A PTS: 1 DIF: Average REF: 8-9
BLM: Remember NOT: Micro TB_1-86

87. How does trade affect the well-being of the nations involved?
- a. Trade makes every nation better off.
 - b. Trade makes exporting nations better off and importing nations worse off.
 - c. Trade makes a nation better off only if the nation cannot produce that good itself.
 - d. Trade makes rich nations better off and poor nations worse off.

ANS: A PTS: 1 DIF: Average REF: 8-9
BLM: Remember NOT: Micro TB_1-87

88. What does trade NOT achieve?
- a. increased competition
 - b. equal gains for both countries involved
 - c. some gains for both countries involved
 - d. greater production efficiency

ANS: B PTS: 1 DIF: Average REF: 8-9
BLM: Remember NOT: Micro TB_1-88

89. What is NOT a benefit from trade?
- a. the ability to specialize
 - b. a greater variety of goods and services becoming available
 - c. less competition
 - d. lower prices

ANS: C PTS: 1 DIF: Average REF: 8-9
BLM: Remember NOT: Micro TB_1-89

90. What is the effect of a trade between Canada and India?
- a. benefits for both Canada and India
 - b. a losing proposition for Canada because India has cheaper labour
 - c. like a sports contest, one side wins and the other side loses
 - d. a losing proposition for India because Canadian workers are more productive

ANS: A PTS: 1 DIF: Average REF: 8-9
BLM: Remember NOT: Micro TB_1-90

91. With which nations does Canada benefit from trade?
- a. only nations that can produce goods Canada cannot produce
 - b. with any nation
 - c. with any nation not in economic competition with Canada
 - d. only with less developed nations

ANS: B PTS: 1 DIF: Average REF: 8-9
BLM: Remember NOT: Micro TB_1-91

92. What happens if Japan chooses to engage in trade?
- a. It will only benefit if it trades with countries that produce goods it cannot produce.
 - b. It cannot benefit if it trades with less developed countries.
 - c. It should first attempt to produce the good itself.
 - d. It can benefit by trading with any other country.

ANS: D PTS: 1 DIF: Average REF: 8-9
BLM: Remember NOT: Micro TB_1-92

93. If Canada decides to trade with Mexico, what do we know?
- a. Mexico will be better off, but trade with a less developed country will not help Canada.
 - b. It will not benefit Mexico because workers in Canada are more productive.
 - c. It will benefit Mexico because workers in Canada are more productive.
 - d. Mexico and Canada can both be better off.

ANS: D PTS: 1 DIF: Average REF: 8-9
BLM: Remember NOT: Micro TB_1-93

94. If France is better than Belarus at producing wine, but Belarus is better than France at producing crystal, what should happen?
- a. Belarus should sell crystal to France, and should buy French wine.
 - b. Belarus should impose a tariff on French wine in order to protect jobs in the Belarusian crystal industry.
 - c. Belarus should subsidize its wine industry so that it can compete with French wine.
 - d. Belarus should put a quota on the amount of French wine imported.

ANS: A PTS: 1 DIF: Challenging REF: 8-9
BLM: Remember NOT: Micro TB_1-94

95. How good are markets at organizing economic activity?
- a. Markets are usually a good way to organize economic activity.
 - b. Markets are usually inferior to central planning as a way to organize economic activity.
 - c. Markets fail and are therefore not a good way to organize economic activity.
 - d. Markets are a good way to organize economic activity in developed nations, but not in less developed nations.

ANS: A PTS: 1 DIF: Average REF: 9
BLM: Higher Order NOT: Micro TB_1-96

96. Which of the following is NOT a characteristic of markets?
- a. Firms decide whom to hire and what to produce.
 - b. Government policies do not affect the decisions of firms and households.
 - c. Households decide which firms to work for and what to buy with their incomes.
 - d. Firms and households guide the decisions based on profit and self-interest.

ANS: B PTS: 1 DIF: Average REF: 9
BLM: Remember NOT: Micro TB_1-96

97. In what economy are the decisions of firms and households guided by profit and self-interest?
- a. a command economy
 - b. a traditional economy
 - c. a market economy
 - d. in every economy

ANS: C PTS: 1 DIF: Easy REF: 9
BLM: Remember NOT: Micro TB_1-97

98. A friend of yours asks you why market prices are better than government-determined prices. What do you say?
- a. because they generally reflect the value of a good to society, but not the cost of making it
 - b. because they generally reflect the cost to society of making a good, but not its value
 - c. because they generally reflect both the value of a good to society and the cost of making it
 - d. because they generally reflect neither the value of a good to society nor the cost of making it

ANS: C PTS: 1 DIF: Easy REF: 9
BLM: Remember NOT: Micro TB_1-98

99. In a market economy, what guides economic activity?
- a. the government
 - b. corporations
 - c. central planners
 - d. prices

ANS: D PTS: 1 DIF: Average REF: 9-11
BLM: Remember NOT: Micro TB_1-99

100. In a market economy, decisions are guided by individual self-interest. What impact does this have?
- a. There is still the ability to achieve desirable economic well-being for society as a whole.
 - b. There is a strong need for government intervention in the market.
 - c. There is less efficiency in market economies than in command economies.
 - d. There is more need for a strong legal system to control individual greed.

ANS: A PTS: 1 DIF: Challenging REF: 9
BLM: Remember NOT: Micro TB_1-100

101. How do prices direct economic activity in a market economy?
- a. by influencing the actions of buyers and sellers
 - b. by reducing scarcity of the goods and services produced
 - c. by eliminating the need for government intervention
 - d. by allocating goods and services produced in the most equitable way

ANS: A PTS: 1 DIF: Average REF: 10
BLM: Remember NOT: Micro TB_1-101

102. In a market economy, what do prices reflect?
- a. the popularity of a good in society
 - b. the cost to society of making the good
 - c. the quantity society will ultimately choose to produce
 - d. the level of wealth in society

ANS: B PTS: 1 DIF: Average REF: 10
BLM: Remember NOT: Micro TB_1-102

103. What is one advantage that market economies have over central planning?
- a. Market economies provide an equal distribution of goods and services to consumers.
 - b. Market economies establish government economic control.
 - c. Market economies solve the problem of scarcity.
 - d. Market economies are more efficient.

ANS: D PTS: 1 DIF: Average REF: 9-10
BLM: Remember NOT: Micro TB_1-103

104. To what extent does the invisible hand model of a market ensure equity and efficiency?
- a. The invisible hand always ensures both equity and efficiency.
 - b. The invisible hand cannot ensure either equity or efficiency.
 - c. The invisible hand is more effective at ensuring efficiency than it is at ensuring equity.
 - d. The invisible hand is more effective at ensuring equity than it is at ensuring efficiency.

ANS: C PTS: 1 DIF: Challenging REF: 9-10
BLM: Higher Order NOT: Micro TB_1-104

105. According to Adam Smith, what is the success of decentralized market economies primarily due to?
- a. the basic benevolence of society
 - b. society's justice (legal) system
 - c. individuals' self-interest
 - d. basic human survival instincts

ANS: C PTS: 1 DIF: Average REF: 9-10
BLM: Remember NOT: Micro TB_1-105

106. How is the self-interest of the participants in an economy guided into promoting general economic self-interest?
- a. by the invisible hand
 - b. by market power
 - c. by government intervention
 - d. by property rights

ANS: A PTS: 1 DIF: Easy REF: 9-10
BLM: Remember NOT: Micro TB_1-106

107. Which of the following observations was made famous by Adam Smith in his book *The Wealth of Nations*?
- a. There is no such thing as a free lunch.
 - b. People buy more when prices are low than when prices are high.
 - c. People tend to spend more than they earn.
 - d. Markets are guided by an invisible hand that leads to desirable outcomes.

ANS: D PTS: 1 DIF: Average REF: 9-10
BLM: Remember NOT: Micro TB_1-107

108. Who coined the term “invisible hand”?
- a. Adam Smith
 - b. David Ricardo
 - c. John Maynard Keynes
 - d. Milton Friedman

ANS: A PTS: 1 DIF: Easy REF: 9-10
BLM: Remember NOT: Micro TB_1-108

109. How does the invisible hand direct economic activity?
- a. through advertising
 - b. through prices
 - c. through central planning
 - d. through government regulations

ANS: B PTS: 1 DIF: Average REF: 9-10
BLM: Remember NOT: Micro TB_1-109

110. How does a market economy reward people?
- a. according to their need for goods and services
 - b. according to how willing they are to work
 - c. according to their ability to produce things that other people are willing to pay for
 - d. according to their ability to produce things of cultural importance

ANS: C PTS: 1 DIF: Average REF: 9-10
BLM: Remember NOT: Micro TB_1-110

111. What can hinder the invisible hand’s ability to coordinate the decisions of the firms and households in the economy?
- a. government actions that distort prices
 - b. increased competition in the market
 - c. extended periods of unemployment
 - d. a dramatic reduction in consumer spending

ANS: A PTS: 1 DIF: Challenging REF: 9-10
BLM: Remember NOT: Micro TB_1-111

112. When was Adam Smith's book *The Wealth of Nations* published?

- a. 1692
- b. 1776
- c. 1816
- d. 1936

ANS: B PTS: 1 DIF: Easy REF: 10
BLM: Remember NOT: Micro TB_1-112

113. When people act in their self-interest, what typically happens in a market system, according to Adam Smith?

- a. They help only themselves.
- b. They harm others.
- c. They help others, but not as much as they would have if they were not self-interested.
- d. They help others even more than when they seek to help others.

ANS: D PTS: 1 DIF: Average REF: 10
BLM: Remember NOT: Micro TB_1-113

114. How does the invisible hand primarily work to promote general well-being in the economy?

- a. through government intervention
- b. through the political process
- c. through self-interest
- d. through altruism

ANS: C PTS: 1 DIF: Easy REF: 9
BLM: Remember NOT: Micro TB_1-114

115. Why do taxes adversely affect the allocation of resources in society?

- a. because they do not always fall more heavily on the rich
- b. because the taxes collected are not enough to finance government spending
- c. because not everyone pays taxes
- d. because they distort prices and thus the decisions of households and firms

ANS: D PTS: 1 DIF: Average REF: 10
BLM: Remember NOT: Micro TB_1-115

116. What is a primary function of prices in a market economy?

- a. to provide participants with economic information
- b. to provide participants with spending limits
- c. to provide participants with accounting capabilities
- d. to provide participants with an equitable distribution of goods

ANS: A PTS: 1 DIF: Average REF: 10
BLM: Remember NOT: Micro TB_1-116

117. What happens when the government prevents prices from adjusting naturally to supply and demand?

- a. It stabilizes the economy by reducing market uncertainties.
- b. It adversely affects the allocation of resources.
- c. There is an improvement in equity that justifies the reduction in efficiency.
- d. There is an improvement in efficiency that justifies the reduction in equity.

ANS: B PTS: 1 DIF: Challenging REF: 10
BLM: Remember NOT: Micro TB_1-117

118. What is one component necessary for markets to work?

- a. government intervention
- b. a benevolent society
- c. property rights
- d. abundant resources

ANS: C PTS: 1 DIF: Average REF: 12
BLM: Remember NOT: Micro TB_1-118

119. What is one necessary role of government in a market economy?

- a. to tax goods and services that are most desired by consumers
- b. to maintain welfare programs for the poor
- c. to provide services such as pensions
- d. to enforce property rights

ANS: D PTS: 1 DIF: Average REF: 12
BLM: Remember NOT: Micro TB_1-119

120. How does the government enforce property rights?

- a. by requiring property owners to pay property taxes
- b. by providing police and courts
- c. by allowing people to decide whether or not they wish to own property
- d. by providing a system of recording property deeds

ANS: B PTS: 1 DIF: Easy REF: 12
BLM: Remember NOT: Micro TB_1-120

121. What would happen without the government's protection of property rights?

- a. Businesses would have less incentive to provide goods and services.
- b. There would be less government regulation of businesses and prices would be lower for consumers.
- c. Taxes would be lower, causing less market inefficiencies.
- d. Businesses would have more freedom with production processes.

ANS: A PTS: 1 DIF: Challenging REF: 12
BLM: Remember NOT: Micro TB_1-121

122. What does the term "market failure" refer to?

- a. a situation in which the market on its own fails to allocate resources efficiently
- b. an unsuccessful advertising campaign that reduces buyer demand
- c. a situation in which competition among firms becomes ruthless
- d. a firm that is forced out of business because of losses

ANS: A PTS: 1 DIF: Average REF: 12
BLM: Remember NOT: Micro TB_1-122

123. Which of the following is NOT a reason for the government to intervene in the market?
- a. to promote efficiency
 - b. to enforce property rights
 - c. to promote equity
 - d. to protect an industry

ANS: D PTS: 1 DIF: Average REF: 12
BLM: Remember NOT: Micro TB_1-123

124. What are two most likely reasons for a government to intervene in a market?
- a. to raise revenues and to promote stability
 - b. to promote equity and to promote efficiency
 - c. to promote equity and to promote stability
 - d. to promote efficiency and to raise revenues

ANS: B PTS: 1 DIF: Average REF: 12
BLM: Remember NOT: Micro TB_1-124

125. What are two causes of market failure?
- a. externalities and market power
 - b. market power and incorrect forecasts of consumer demand
 - c. externalities and foreign competition
 - d. incorrect forecasts of consumer demand and foreign competition

ANS: A PTS: 1 DIF: Average REF: 12
BLM: Remember NOT: Micro TB_1-125

126. What is the term used to describe a situation in which markets fail to allocate resources efficiently?
- a. economic meltdown
 - b. market failure
 - c. corporate bankruptcy
 - d. disequilibrium

ANS: B PTS: 1 DIF: Easy REF: 13
BLM: Remember NOT: Micro TB_1-126

127. What is an example of market power?
- a. a fast food restaurant in a university town
 - b. a wheat farmer in Saskatchewan
 - c. the last gas station in Manitoba for 200 kilometres
 - d. a shoe store in Ontario

ANS: C PTS: 1 DIF: Average REF: 13
BLM: Higher Order NOT: Micro TB_1-127

128. What is an example of a firm with market power?
- a. a deli in Winnipeg
 - b. a cable TV provider in Victoria
 - c. a clothing store in Vancouver
 - d. a farmer in Quebec

ANS: B PTS: 1 DIF: Average REF: 13
BLM: Higher Order NOT: Micro TB_1-128

129. What can cause market failure?

- a. low consumer demand
- b. government intervention and price controls
- c. externalities and market power
- d. high prices and foreign competition

ANS: C PTS: 1 DIF: Average REF: 13
BLM: Remember NOT: Micro TB_1-129

130. What is an externality?

- a. the impact of one person's actions on the well-being of a bystander
- b. the impact of a person's actions on that person's well-being
- c. the impact of society's decisions on the well-being of society
- d. the impact of society's decisions on the well-being of one person in the society

ANS: A PTS: 1 DIF: Easy REF: 13
BLM: Remember NOT: Micro TB_1-130

131. What is an example of an externality?

- a. the impact of bad weather on the income of farmers
- b. the impact of the personal income tax on a person's ability to purchase goods and services
- c. the impact of pollution from a factory on the health of people in the vicinity of the factory
- d. the impact of increases in health care costs on the health of individuals in society

ANS: C PTS: 1 DIF: Average REF: 13
BLM: Higher Order NOT: Micro TB_1-131

132. Which of the following is most likely to generate an externality?

- a. Teachers at a local high school have pizza delivered every Friday for lunch.
- b. A young man from a small town attends medical school to become a doctor.
- c. A newlywed couple buys a TV for their family room.
- d. John buys a tractor to mow his newly purchased five-hectare lot.

ANS: B PTS: 1 DIF: Challenging REF: 13
BLM: Higher Order NOT: Micro TB_1-132

133. If an externality is present in a market, what may enhance economic efficiency?

- a. government intervention
- b. increased competition
- c. better informed market participants
- d. more defined property rights

ANS: A PTS: 1 DIF: Average REF: 13
BLM: Remember NOT: Micro TB_1-133

134. If a copper refinery does NOT bear the entire cost of the smoke it emits, what will happen?

- a. It will not emit any smoke so as to avoid the entire cost of the smoke.
- b. It will emit lower levels of smoke.
- c. It will emit an acceptable level of smoke.
- d. It will emit too much smoke.

ANS: D PTS: 1 DIF: Average REF: 13
BLM: Higher Order NOT: Micro TB_1-134

135. Which of these consumption activities will most likely impose an external cost?
- a. An executive plays a vigorous game of golf.
 - b. A student in a dorm plays her CDs at 120 decibels late at night.
 - c. A young mother exercises to an aerobics video.
 - d. A construction worker eats a sandwich during his lunch break.

ANS: B PTS: 1 DIF: Average REF: 13
BLM: Higher Order NOT: Micro TB_1-135

136. Which of these activities will most likely result in an external benefit?
- a. A university student buys a deck of cards to play solitaire in her dorm room.
 - b. An elderly woman plants a flower garden on the vacant lot next to her house.
 - c. An executive purchases a book to read on a business trip.
 - d. A ten year old buys new Nikes with his allowance money he has saved.

ANS: B PTS: 1 DIF: Average REF: 13
BLM: Higher Order NOT: Micro TB_1-136

137. If education produces external benefits for society, which of the following might NOT be an appropriate policy for society to establish regarding education?
- a. tax incentives for schooling
 - b. mandatory minimum levels of education
 - c. programs that promote the hiring of high school dropouts
 - d. public subsidies of education

ANS: C PTS: 1 DIF: Average REF: 13
BLM: Higher Order NOT: Micro TB_1-137

138. According to an economic principle, what is the effect of government intervention in the presence of a market failure?
- a. Government action does not improve on the market outcome because sometimes public policies simply reward the politically powerful.
 - b. Government action does not improve on the market outcome because some leaders are not fully informed.
 - c. Government action can sometimes improve on the market outcome.
 - d. Government action will always improve on the market outcome.

ANS: D PTS: 1 DIF: Easy REF: 13
BLM: Higher Order NOT: Micro TB_1-138

139. What happens if a sawmill creates too much air pollution?
- a. Interference by the government will surely make the matter worse.
 - b. A sense of social responsibility will cause the owners of the mill to reduce pollution.
 - c. The government can raise economic well-being by providing health care to those affected by the pollution.
 - d. The government can raise economic well-being through environmental regulation.

ANS: D PTS: 1 DIF: Average REF: 13
BLM: Higher Order NOT: Micro TB_1-139

140. What is the term for when a single entity has the ability to influence market prices?
- a. competition
 - b. market power
 - c. efficiency
 - d. productivity

ANS: B PTS: 1 DIF: Easy REF: 13
BLM: Remember NOT: Micro TB_1-140

141. What is market power?
- a. the power of a single person or group to influence market prices
 - b. the ability of a person or group of people to successfully market new products
 - c. the power of the government to regulate a market
 - d. the relative importance of a market to the overall economy

ANS: A PTS: 1 DIF: Easy REF: 13
BLM: Remember NOT: Micro TB_1-141

142. What is an example of a monopoly?
- a. a jewellery store in Burnaby, British Columbia
 - b. a souvenir shop in Cancun, Mexico
 - c. an electric company in Outlook, Saskatchewan
 - d. a doctor in St. John's, New Brunswick

ANS: C PTS: 1 DIF: Average REF: 13
BLM: Higher Order NOT: Micro TB_1-142

143. Which of the following businesses most likely has market power?
- a. a furniture store in Kingston
 - b. a vineyard in the Okanagan Valley
 - c. a maple sugar candy store in Sherbrooke, Quebec
 - d. a hospital in Nelson, British Columbia

ANS: D PTS: 1 DIF: Average REF: 13
BLM: Higher Order NOT: Micro TB_1-143

144. How could you justify higher income tax rates on rich people in Canada?
- a. on the basis of market efficiency
 - b. on the basis of the lack of other sources of government revenue
 - c. on the basis of equity for society
 - d. on the basis of government bias against the wealthy

ANS: C PTS: 1 DIF: Average REF: 13
BLM: Higher Order NOT: Micro TB_1-144

145. What is the primary determinant of a country's standard of living?
- a. the ability to reduce foreign competition
 - b. the ability to produce goods and services
 - c. the total supply of money in the economy
 - d. the average age of the country's labour force

ANS: B PTS: 1 DIF: Average REF: 13
BLM: Remember NOT: Micro TB_1-145

146. In 2010, what was the average Canadian income?

- a. \$25 368
- b. \$29 000
- c. \$36 800
- d. \$43 000

ANS: D PTS: 1 DIF: Easy REF: 13
BLM: Remember NOT: Micro TB_1-146

147. In Canada, incomes have historically grown about 2% per year. At this rate, how long will it take for incomes to double?

- a. 10 years
- b. 25 years
- c. 35 years
- d. 50 years

ANS: C PTS: 1 DIF: Average REF: 14
BLM: Remember NOT: Micro TB_1-147

148. The income of a typical worker in a country is most closely linked to which of the following?

- a. population
- b. productivity
- c. the number of labour unions
- d. government policies

ANS: B PTS: 1 DIF: Average REF: 13-14
BLM: Remember NOT: Micro TB_1-148

149. If the average income of an Australian is higher than the average income of a Russian, what is the most likely reason?

- a. Productivity is higher in Australia than in Russia.
- b. Australia has a more industrial economy than Russia.
- c. There is more competition in Australia than in Russia.
- d. Labour unions are more aggressive in Australia than in Russia.

ANS: A PTS: 1 DIF: Challenging REF: 13-14
BLM: Remember NOT: Micro TB_1-149

150. Suppose that the average income of a Kenyan is higher than the average income of a South African. What might you conclude?

- a. South African firms are faced with stricter government regulations than Kenyan firms.
- b. Total income is divided among fewer workers in Kenya since it has a smaller labour force than South Africa.
- c. Kenya's climate allows for longer growing seasons and therefore Kenya can produce large quantities of grain.
- d. Productivity in Kenya is higher than in South Africa.

ANS: D PTS: 1 DIF: Challenging REF: 13-14
BLM: Higher Order NOT: Micro TB_1-150

151. A typical worker in Italy can produce 24 units of product in an eight-hour day, where a typical worker in Poland produces 25 units of product in a ten-hour day. What can we conclude?
- a. Worker productivity in Poland is higher than in Italy.
 - b. The standard of living will be higher in Italy than in Poland.
 - c. Productivity for the Polish worker is 3 units per hour and 2.5 units per hour for the Italian worker.
 - d. There will be no difference between the standard of living in Italy and Poland.

ANS: B PTS: 1 DIF: Challenging REF: 13-14
BLM: Higher Order NOT: Micro TB_1-151

152. A worker in Bangladesh can earn \$1 per day making cotton cloth on a handloom. A worker in Canada can earn \$100 per day making cotton cloth with a mechanical loom. What accounts for the difference in wages?
- a. Canadian textile workers belong to a union.
 - b. There is little demand for cotton cloth in Bangladesh and great demand in Canada.
 - c. Labour is more productive making cotton cloth with a mechanical loom than with a handloom.
 - d. Bangladesh has a low-wage policy to make its textile industry more competitive in world markets.

ANS: C PTS: 1 DIF: Challenging REF: 13-14
BLM: Higher Order NOT: Micro TB_1-152

153. Over the past century, how much has the average income in Canada risen by?
- a. twofold
 - b. fivefold
 - c. eightfold
 - d. tenfold

ANS: C PTS: 1 DIF: Easy REF: 14
BLM: Remember NOT: Micro TB_1-153

154. What causes almost all variation in living standards in different countries?
- a. population growth rates
 - b. endowments of natural resources
 - c. national government budgets
 - d. productivity

ANS: D PTS: 1 DIF: Average REF: 13-14
BLM: Remember NOT: Micro TB_1-154

155. What is the definition of productivity?
- a. the amount of goods and services produced from each hour of a worker's time
 - b. the amount of labour that can be saved by replacing workers with machines
 - c. the actual amount of effort workers put into an hour of working time
 - d. the estimated amount of effort workers put into an hour of working time

ANS: A PTS: 1 DIF: Easy REF: 13-14
BLM: Remember NOT: Micro TB_1-155

156. What is the amount of goods and services produced from each hour of a worker's time called?
- a. total output
 - b. productivity
 - c. marginal product
 - d. efficiency

ANS: B PTS: 1 DIF: Easy REF: 13-14
BLM: Remember NOT: Micro TB_1-156

157. Which of the following display a direct or positive relationship?
- a. a country's productivity and its standard of living
 - b. a country's government spending and its tax rates
 - c. a country's total population and its per-capita income
 - d. a country's prices for its goods and services and its exports

ANS: A PTS: 1 DIF: Average REF: 13-14
BLM: Higher Order NOT: Micro TB_1-157

158. If the government wanted to enact a policy to increase living standards, what might it do?
- a. allow corporate tax write-offs for money spent on worker safety
 - b. make it more difficult to receive unemployment benefits
 - c. increase educational opportunities for workers
 - d. prohibit unions from organizing

ANS: C PTS: 1 DIF: Average REF: 13-14
BLM: Higher Order NOT: Micro TB_1-158

159. To improve living standards, what should policymakers do?
- a. impose restriction on foreign competition
 - b. formulate policies designed to increase productivity
 - c. impose tougher immigration policies
 - d. provide tax breaks for the middle class

ANS: B PTS: 1 DIF: Average REF: 13-14
BLM: Remember NOT: Micro TB_1-159

160. To increase living standards, what should public policy do?
- a. ensure that workers are well educated and have the necessary tools and technology
 - b. make unemployment benefits more liberal
 - c. move workers into jobs directly from high school
 - d. ensure that workers have access to union membership and benefits

ANS: A PTS: 1 DIF: Average REF: 13-14
BLM: Higher Order NOT: Micro TB_1-160

161. To raise productivity, what could policymakers do?
- a. increase spending on education
 - b. lower tax credits to firms for capital improvements
 - c. reduce the number of imports allowed into the economy
 - d. eliminate minimum wage laws

ANS: A PTS: 1 DIF: Average REF: 13-14
BLM: Higher Order NOT: Micro TB_1-161

162. What is an increase in the overall level of prices in an economy called?
- a. economic growth
 - b. inflation
 - c. monetary policy
 - d. supply stocks

ANS: B PTS: 1 DIF: Easy REF: 14
BLM: Remember NOT: Micro TB_1-162

163. What is the definition of inflation?
- a. a period of rising productivity in the economy
 - b. a period of rising income in the economy
 - c. an increase in the overall level of output in the economy
 - d. an increase in the overall level of prices in the economy

ANS: D PTS: 1 DIF: Easy REF: 14
BLM: Remember NOT: Micro TB_1-163

164. What happened when the German government increased the quantity of money in the German economy in the 1920s?
- a. Germany experienced hyperinflation.
 - b. Many people in Germany became rich.
 - c. Unemployment increased.
 - d. Germany was able to repay all its foreign debts.

ANS: A PTS: 1 DIF: Easy REF: 14
BLM: Remember NOT: Micro TB_1-164

165. What happened to prices in Germany during the early 1920s?
- a. They doubled annually.
 - b. They doubled monthly.
 - c. They tripled monthly.
 - d. They tripled annually.

ANS: C PTS: 1 DIF: Average REF: 14
BLM: Remember NOT: Micro TB_1-165

166. When and where did one of the worst episodes of inflation occur?
- a. in the United States in the 1960s
 - b. in Argentina in the 1950s
 - c. in Russia in the 1930s
 - d. in Germany in the 1920s

ANS: D PTS: 1 DIF: Average REF: 14
BLM: Remember NOT: Micro TB_1-166

167. What is almost always the cause of large or persistent inflation?
- a. an increase in demand for domestic production
 - b. growth in the quantity of money
 - c. foreign competition
 - d. higher worker productivity

ANS: B PTS: 1 DIF: Average REF: 14
BLM: Remember NOT: Micro TB_1-167

168. What was inflation in Canada in the 1990s?
- a. It was almost zero.
 - b. It was about 2 percent per year.
 - c. It was approaching double digits.
 - d. It was about 10 percent per year.

ANS: B PTS: 1 DIF: Average REF: 14
BLM: Remember NOT: Micro TB_1-168

169. During the 1990s, the United Kingdom experienced low levels of inflation while Turkey experienced high levels of inflation. What best explains the difference?
- a. The United Kingdom is more industrialized than Turkey.
 - b. The United Kingdom printed money at a slower rate than Turkey.
 - c. Workers in the United Kingdom are more productive than workers in Turkey.
 - d. There were more cases of market failure in Turkey than in the United Kingdom.

ANS: B PTS: 1 DIF: Easy REF: 14
BLM: Remember NOT: Micro TB_1-169

170. What does inflation cause?
- a. incomes to fall
 - b. productivity to increase
 - c. the government to lower taxes
 - d. the value of money to fall

ANS: D PTS: 1 DIF: Average REF: 14
BLM: Remember NOT: Micro TB_1-170

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

ANS: B PTS: 1 DIF: Challenging REF: 15
BLM: Remember NOT: Micro TB_1-171

172. What is the effect of an increase in the money supply in the economy?
- a. It increases unemployment in the short run.
 - b. It increases inflation in the long run.
 - c. It increases inflation in the short run.
 - d. It increases unemployment in the long run.

ANS: B PTS: 1 DIF: Easy REF: 15
BLM: Remember NOT: Micro TB_1-172

173. In the short run, what does the tenth principle of economics illustrate?
- a. the tradeoff between inflation and unemployment
 - b. the tradeoff between equity and efficiency
 - c. labour productivity in an economy
 - d. the level of government intervention in a market economy

ANS: A PTS: 1 DIF: Average REF: 15
BLM: Remember NOT: Micro TB_1-173

174. Although the tenth principle of economics is controversial, what do most economists believe?
- a. that society faces a tradeoff between unemployment and inflation in the short run only
 - b. that society faces a tradeoff between unemployment and inflation in the long run only
 - c. that no tradeoff exists between unemployment and inflation
 - d. that society faces a continuous tradeoff between unemployment and inflation

ANS: A PTS: 1 DIF: Challenging REF: 15
BLM: Remember NOT: Micro TB_1-174

175. Which of the following policy targets will NOT affect the combination of inflation and unemployment the economy experiences?
- a. taxes
 - b. government spending
 - c. the money supply
 - d. market prices

ANS: D PTS: 1 DIF: Average REF: 15
BLM: Remember NOT: Micro TB_1-175

176. What does the tenth principle of economics help explain?
- a. the business cycle
 - b. supply and demand
 - c. government spending
 - d. money supply changes

ANS: A PTS: 1 DIF: Easy REF: 15
BLM: Remember NOT: Micro TB_1-176

177. What is the business cycle?
- a. the relationship between unemployment and inflation
 - b. the irregular fluctuations in economic activity
 - c. the positive relationship between the quantity of money in an economy and inflation
 - d. the predictable changes in economic activity due to changes in government spending and taxes

ANS: B PTS: 1 DIF: Easy REF: 15
BLM: Remember NOT: Micro TB_1-177

178. Which of the following is consistent with the tenth principle of economics?
- If we increase the rate of inflation from 3 percent to 6 percent, then the rate of unemployment will temporarily fall.
 - If we increase the rate of inflation from 3 percent to 6 percent, then the rate of unemployment will temporarily rise.
 - If we increase the rate of inflation from 3 percent to 6 percent, then the rate of unemployment will permanently fall.
 - If we increase the rate of inflation from 3 percent to 6 percent, then the rate of unemployment will permanently rise.

ANS: A PTS: 1 DIF: Average REF: 15
BLM: Higher Order NOT: Micro TB_1-178

TRUE/FALSE

1. Scarcity means that there is less of a good or resource available than people wish to have.

ANS: T PTS: 1 DIF: Easy REF: 4
BLM: Remember NOT: Micro TB_1-179

2. Economics is the study of how fairly goods and services are distributed within society.

ANS: F PTS: 1 DIF: Easy REF: 4
BLM: Remember NOT: Micro TB_1-180

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

ANS: F PTS: 1 DIF: Average REF: 4-5
BLM: Remember NOT: Micro TB_1-181

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

ANS: F PTS: 1 DIF: Average REF: 5
BLM: Remember NOT: Micro TB_1-182

5. Equity refers to how the pie is divided, and efficiency refers to the size of the economic pie.

ANS: T PTS: 1 DIF: Average REF: 5
BLM: Remember NOT: Micro TB_1-183

6. Tuition is the single-largest cost of attending college for most students.

ANS: F PTS: 1 DIF: Average REF: 6
BLM: Remember NOT: Micro TB_1-184

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

ANS: T PTS: 1 DIF: Average REF: 6
BLM: Remember NOT: Micro TB_1-185

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

ANS: T PTS: 1 DIF: Average REF: 6
BLM: Remember NOT: Micro TB_1-186

9. If the average cost of transporting a passenger on the train from Brockville to Toronto is \$75, it would be irrational for the railroad to allow any passenger to ride for less than \$75.

ANS: F PTS: 1 DIF: Average REF: 6-7
BLM: Higher Order NOT: Micro TB_1-187

10. A rational decision maker takes an action if and only if the marginal cost exceeds the marginal benefit.

ANS: F PTS: 1 DIF: Average REF: 7
BLM: Remember NOT: Micro TB_1-188

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

ANS: T PTS: 1 DIF: Average REF: 9
BLM: Remember NOT: Micro TB_1-189

12. Trade with any nation can be mutually beneficial.

ANS: T PTS: 1 DIF: Easy REF: 9
BLM: Remember NOT: Micro TB_1-190

13. A market economy cannot produce a socially desirable outcome because individuals are motivated by their own selfish interests.

ANS: F PTS: 1 DIF: Average REF: 9-10
BLM: Remember NOT: Micro TB_1-191

14. Since taxes affect only the price paid by the buyer, they cannot have an adverse impact on the allocation of society's resources.

ANS: F PTS: 1 DIF: Average REF: 10
BLM: Remember NOT: Micro TB_1-192

15. The government can potentially improve market outcomes if market inequalities or market failure exist.

ANS: T PTS: 1 DIF: Average REF: 13
BLM: Remember NOT: Micro TB_1-193

16. Market failure refers to a situation in which the market does not allocate resources efficiently.

ANS: T PTS: 1 DIF: Average REF: 13
BLM: Remember NOT: Micro TB_1-194

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

ANS: T PTS: 1 DIF: Average REF: 14
BLM: Remember NOT: Micro TB_1-195

18. Productivity is the primary determinant of a country's living standards.

ANS: T PTS: 1 DIF: Average REF: 14
BLM: Remember NOT: Micro TB_1-196

19. Inflation increases the value of money.

ANS: F PTS: 1 DIF: Average REF: 14
BLM: Remember NOT: Micro TB_1-197

20. Government spending is the ultimate source of inflation.

ANS: F PTS: 1 DIF: Average REF: 15
BLM: Remember NOT: Micro TB_1-198

21. The tenth principle of economics shows the short-run tradeoff between inflation and economic growth.

ANS: F PTS: 1 DIF: Average REF: 15
BLM: Remember NOT: Micro TB_1-199

SHORT ANSWER

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

ANS:

Since economics is the study of how society allocates its scarce resources, if there were no scarcity, there would be no need for economics. Everyone could have all the goods and services they wanted. No one would have to make decisions based on tradeoffs, because there would be no opportunity cost associated with the decision. (It is difficult to conceive of a situation where time is not scarce, however.)

PTS: 1 DIF: Average REF: 4 BLM: Higher Order
NOT: Micro TB_1-200

2. One tradeoff society faces is between efficiency and equity. Define each term. If the Canadian government redistributes income from the rich to the poor, explain how this action affects equity as well as efficiency in the economy.

ANS:

Efficiency is the property of society getting the most it can from its scarce resources. Equity is defined as the property of distributing economic prosperity fairly among the members of society. Often, these two goals conflict. When the government redistributes income from the rich to the poor, it reduces the reward for working hard. Fewer goods and services are produced and the economic pie gets smaller. When the government tries to cut the economic pie into more equal slices, the pie gets smaller. Policies aimed at achieving a more equal distribution of economic well-being, such as the welfare system, try to help those members of society who are most in need. The individual income tax asks the financially successful to contribute more than others to support the government.

PTS: 1

DIF: Average

REF: 5

BLM: Higher Order

NOT: Micro TB_1-201

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

ANS:

Whatever must be given up to obtain some item is its opportunity cost. Basically, this would be a person's second choice. The opportunity cost of a person attending college is the value of the best alternative use of that person's time. For most students this would be the income the student gives up by not working. A student's opportunity cost of coming to class was the value of the best opportunity the student gave up.

PTS: 1

DIF: Average

REF: 5-6

BLM: Higher Order

NOT: Micro TB_1-202

4. With the understanding that people respond to incentives, outline the possible outcome for teachers if the K–12 school year is extended to 11 months per year instead of the existing 10 months per year.

ANS:

The concept of working longer per year would be perceived by many teachers as a definite increase in the cost of teaching. Even with additional compensation, many teachers look at summers off as a major benefit of the education profession. If this benefit were eliminated or even diminished, some teachers may perceive that the marginal cost of teaching would now be greater than the marginal benefit and would choose to leave teaching.

PTS: 1

DIF: Average

REF: 7

BLM: Higher Order

NOT: Micro TB_1-203

5. Under what conditions might government intervention in an economy improve the market outcome?

ANS:

If there is a market failure, such as an externality or monopoly, government regulation might improve the well-being of society by promoting efficiency. If the distribution of income or wealth is considered to be unfair by society, government intervention might achieve a more equitable distribution of economic well-being.

PTS: 1

DIF: Average

REF: 12

BLM: Higher Order

NOT: Micro TB_1-204

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

ANS:

To lower inflation, the government may choose to reduce the money supply in the economy. When the money supply is reduced, prices do not adjust immediately. Lower spending, combined with prices that are too high, reduces sales and causes workers to be laid off. Hence, the lower price level is associated with higher unemployment.

PTS: 1

DIF: Challenging

REF: 14-15

BLM: Higher Order

NOT: Micro TB_1-205

PROBLEM

1. In each of the following decision situations, show what tradeoffs are involved.
- You are driving and need to decide how fast to drive.
 - You meet a young lady at a party and you are considering whether to ask her out.
 - You like a co-worker whom you have known for a couple of years, and you need to decide whether to go on a date with him.
 - You ponder moving back with your parents.
 - You need to decide whether to buy a used or a new car.
 - You are thinking about opening a computer services business in your basement.
 - You are a consultant for the City of Toronto. The city council asks you to analyze the implications of a new high-rise office building in downtown.

ANS:

- Driving faster gets you earlier to your destination. However, driving faster is less safe, takes more gas, and may get you a ticket.
- If you ask her out you might enjoy her company and form a long-term relationship. However, you may not enjoy her company, wasting some time and money. Moreover, if you ask her and she refuses, you will feel humiliated, wishing you had not done so.
- If you ask her and she accepts, you will enjoy her company and you may have a long-term relationship. However, you may get to know a side of her personality that you may not like, or she may not like you, and you will both be embarrassed and try to avoid each other at work.
- If you move back with your parents, you will have to comply with the rules of the house. You will enjoy less freedom, but more money and, perhaps, a more comfortable life.
- A used car may be substantially cheaper, it requires lower insurance costs, and you do not need to pay interest on the loan that you might need for the new car. However, it may break down more often and it may be less fun to own and drive.

- f) There are many positive sides of having your own business, starting from learning how to run it to the profits you might make. The costs of running it are, however, substantial: you could rent your basement for a monthly rental fee, you could use your time in a more lucrative employment, or you could use more of your time for travelling.
- g) A new office building will contribute to the economic and social development of the city. There are, however, costs such as an increase in traffic congestion or higher prices because of the increased demand for adjacent services and utilities.

PTS: 1 NOT: Micro TB_1-206

2. An economic principle is that people respond to incentives. Identify the incentives and discuss the possible outcomes in each of the following situations.
- a) A Liberal government decides to increase the level of required health benefits that firms pay on behalf of their employees.
 - b) The City of Winnipeg decides to set a rather high regulated parking fee in downtown in order to reduce traffic congestion.
 - c) A very popular hip-hop singer asks his managers to set concert prices very low such that everybody can afford them.
 - d) The government of Canada subsidizes the purchases of new electric cars.
 - e) A provincial government subsidizes tuition fees for all students who get admitted to college for the whole period of studies.
 - f) A father gives his daughter \$50 when she gets a grade of D at school, \$100 for a C, \$500 for a B, and \$1000 for an A.

ANS:

- a) People will increase their demand for health services beyond the system's capacity when health care becomes more affordable. Firms, on the other hand, will hire fewer workers as the cost of labour increases due to the new health benefits provisions.
- b) When parking fees are high, traffic congestion may not decrease as desired. Why? Because high parking fees makes building more parking lots by private entrepreneurs more profitable. With more parking lots available, people who were previously deterred by the difficulty of finding a parking spot will prefer now to drive to work.
- c) If tickets to a concert are cheap, some entrepreneurs will buy a large number of them to re-sell them for profit. Thus, those who were supposed to benefit from the lower prices will actually have to pay even more. The benefit from low prices goes to the entrepreneurs.
- d) Subsidizing a certain industry always diverts resources from other production sectors. Besides, the subsidized sector does not face the true market costs of their activity, and are not well prepared to survive when the subsidies are terminated.
- e) When tuition is fully subsidized, more students will want to go to college, but many have little incentive to devote great effort to their studies.
- f) After a few good grades and a sufficient amount of money, the daughter might find working hard for an A not worth the effort.

PTS: 1 NOT: Micro TB_1-207

3. Suppose you have your own pizza delivery business and receive a call to deliver to a remote client. You need to decide whether to take the call. If you don't, there are no consequences, since someone else will. Based on the distance to the client, you calculate that it would cost you \$5 to deliver, and expect to receive \$6 for the service. You also pay monthly rent for the car, which on average, based on past experience, comes down to about \$2 per trip. Your time doesn't matter, as you have nothing more enjoyable or useful to do for the time being. How do you make this decision? What economic principle is at work in your decision process?

ANS:

The benefit from the trip is \$6 and the overall cost is $\$5 + \$2 = \$7$. Apparently, the cost exceeds the benefit, so you should not take the job. However, this conclusion is wrong, because you pay the rent no matter how many calls you take. Therefore, the \$2 rent is irrelevant in deciding whether to take a new call. The correct way of thinking is to compare the additional benefit of \$6 to the additional cost of \$5 and take the call. The main principle involved in this problem is that people think at the margin: an action should be undertaken only if the additional costs are less than the additional benefits. Costs that are not directly related to the action and have to be paid anyway are irrelevant.

PTS: 1

NOT: Micro TB_1-208

4. In each of the following situations, identify the relevant economic principle and explain how it applies.
- a) Peter has lived in his own apartment for many years. However, rents have recently increased so much that Peter considers moving into a smaller apartment and renting out his own.
 - b) Alfonso is a talented singer and he strongly wants to pursue an artist's career. However, he is two years short of graduating from law school. He is certain he will never be a lawyer because he does not like it and has no gift to be a lawyer. However, his family insists he finish his studies, since he has already spent so much time and money on law studies. What should he do?
 - c) There are a few industrial sites in town, producing essential goods and services for the residents and providing the citizens with vital jobs. However, the businesses, including an airport in the very downtown, also produce pollution, congestion, and noise. People understand the blessings of economic and civil freedoms and are pleased and proud to have productive activities in their town. They started, though, to crave for a more pleasant place to live in. What economic principle can give these people some guidance about what to do?

ANS:

- a) Though Peter does not pay rent for living in his apartment, he misses the opportunity of making a good profit. This missed opportunity is, in fact, Peter's cost of living in his home. The economic principle guiding Peter's decision is Principle #2, which defines opportunity cost.
- b) Since Alfonso is certain he will never be a lawyer, there is no point in continuing his studies. (The only reason for doing so would be if there was a reasonable chance that he would be forced in the future to make a living using his law studies.) The economic principle at work here is that sunk (past) costs are irrelevant when making decisions.
- c) Under some conditions such as pollution, the existence of a government can improve the outcome of a free market economy. Thus, the people in the small town should get together and draft regulations that limit companies' appetite for pollution.

PTS: 1

NOT: Micro TB_1-209

5. For your birthday, your friends have joined forces and offer you a choice among the following options (they will pay all expenses of your choice): A) A two-week trip to an exotic destination; B) A new, high-tech mountain bike, C) An annual pass to your preferred sports team games, and D) A dinner with your preferred movie star. Suppose your subjective valuations of these options are as follows: A)\$800, B)\$700, C)\$1500, and D)\$1000. If you are a rational individual, you will obviously choose C, the annual pass, because it is the option of your highest valuation.
- a) What is your opportunity cost of choosing option C? Explain.
 - b) Now, suppose your friends announce at the last minute a fifth option, E, a cheque of \$1100. What is now your opportunity cost of choosing option C?
 - c) As you can see, the theory of opportunity cost implies that the cost of an action depends on other, seemingly unrelated facts. Why does this make sense?

ANS:

- a) The opportunity cost of an action is your valuation of the next desired alternative. In this case, the next-desired alternative is the dinner, which you value at \$1000. In other words, you “pay” (i.e., give up) \$1000 for your annual pass.
- b) When the new alternative becomes available, your (opportunity) cost of choosing the pass raises to \$1100.
- c) Although you do not actually pay anything for any of these choices, there is a cost for choosing one over another. To see why this makes sense, think of the following scenario: Suppose that, after making and announcing your choice, you find out that there was yet another choice available which you were not aware of. That sixth alternative would have been a flight to the International Space Station, which would have given you an immense pleasure. Would you regret just a little bit that you chose the annual pass instead of the outer space trip that was simply lost in your mailbox? Do you feel you have just lost something? If yes, it proves that the opportunity cost theory does make some sense.

PTS: 1

NOT: Micro TB_1-210