

Chapter_2

1 ■ ■ An economy is both a social and a financial system.

- True
- False

2 ■ ■ Financial or social systems are not essential to the development of a strong economy.

- True
- False

3 ■ ■ Economics is the study of the choices that people, companies, and governments make in allocating those resources.

- True
- False

4 ■ ■ The study of economics falls into two broad categories called meta-economics and econometrics.

- True
- False

5 ■ ■ An economic system is a structure only for measuring gross domestic product.

- True
- False

6 ■ ■ Macroeconomics issues directly affect one's day-to-day life, influencing key variables such as what jobs will be available, how much cash one will actually take home after taxes, or how much can one buy with that cash in any given month.

- True
- False

- 7 ■ ■ Microeconomics is the study of a country's overall economic dynamics, such as the employment rate, the gross domestic product, and taxation policies.
- True
 - False

- 8 ■ ■ Microeconomics focuses on individual consumers, families, and individual businesses.
- True
 - False

- 9 ■ ■ Luke is taking an economics class that focuses on decisions made by individual business firms and consumers. Luke's class is concerned with microeconomic issues.
- True
 - False

- 10 ■ ■ Starting in the mid-2000s, amidst many regulation and government policies, financial institutions maintained high reserves in case the mortgage-backed funds lost value.
- True
 - False

- 11 ■ ■ In 2011, the foreclosure rate dropped to the lowest level since 2007, when the recession began.
- True
 - False

- 12 ■ ■ The unemployment rate hit 9.6% in 2010, leading to total Great Recession job losses of nearly 8 million. Many of these jobs will never come back as the economy continues to change, and old skills become obsolete.
- True
 - False

- 13 ■ ■ The \$700 billion economic bailout package passed by Congress in 2008 was an example of monetary policy.

- True
- False

14 ■ ■ With a new administration, President Obama proposed, and Congress passed, an \$825 billion economic stimulus package called the American Recovery and Reinvestment Act.

- True
- False

15 ■ ■ Fiscal policy is the government's effort to influence the economy through taxation and spending decisions to encourage growth and boost employment while curbing inflation.

- True
- False

16 ■ ■ In fiscal strategies, most economists agree that higher taxes can boost the economy by leaving more money with the government to spend or invest during economic crisis.

- True
- False

17 ■ ■ The debt ceiling is the maximum amount Congress lets the government borrow.

- True
- False

18 ■ ■ The debt ceiling is the maximum amount Congress lets the government lend to the public.

- True
- False

19 ■ ■ The government experiences a budget surplus when its tax revenue exceeds its expenditures.

- True
- False

20 ■ ■ If revenue is higher than spending, the government incurs a budget deficit and must borrow money to cover the shortfall.

- True
- False

21 ■ ■ The sum of all the money borrowed over the years and not yet repaid is the total fiscal debt.

- True
- False

22 ■ ■ The 12 Federal Reserve Banks are privately owned by the member commercial banks in their individual districts.

- True
- False

23 ■ ■ The federal government does not own the Federal Reserve Banks.

- True
- False

24 ■ ■ The Federal Reserve does not regulate banks. Only state regulatory agencies perform this function.

- True
- False

25 ■ ■ State governments are actually the owners of the Federal Reserve Banks.

- True
- False

26 The Federal Reserve provides banking services to member banks and is the

■ ■ central bank of the United States.

- True
- False

27 ■ ■ The Fed is headed by a 50-member Board of Governors.

- True
- False

28 ■ ■ The Federal Reserve Bank is in charge of both fiscal and monetary policy.

- True
- False

29 ■ ■ Money supply refers specifically to the amount of paper bills and metal coins in the overall economy.

- True
- False

30 ■ ■ When the economy contracts, the Fed typically decreases the money supply.

- True
- False

31 ■ ■ M1 and M2 are commonly used definitions for money supply. If you use the debit card connected to your checking account to make purchases, it would be referred to as M1.

- True
- False

32 ■ ■ Ashley has decided to purchase a dress for the banquet using her credit card. Ashley will be using a form of the money supply most often referred to as M2.

- True

False

33 ■ ■ When the economy is weak, the Fed sells government securities on the open market.

- True
 False

34 ■ ■ When inflation is a concern, the Fed buys securities.

- True
 False

35 ■ ■ The Fed's decision to buy and sell government securities is decided by the Federal Open Market Committee.

- True
 False

36 ■ ■ The discount rate is the interest rate the Fed charges on its loans to commercial banks.

- True
 False

37 ■ ■ The economic system of the United States is called capitalism. Capitalism is based on private ownership, economic freedom, and fair competition.

- True
 False

38 ■ ■ Capitalism places paramount importance on the need for the government to intervene in the economy to ensure a fair and equitable distribution of income.

- True
 False

- 39 ■ ■ The fundamental rights of capitalism guarantee that businesses will be profitable and taxes will be low, thus providing a strong motivation to start a business.
- True
 - False

- 40 ■ ■ Government policies promoting free trade are consistent with the right to free choice, which is fundamental to capitalism.
- True
 - False

- 41 ■ ■ Everlene's Bakery competes against many other bakeries in the same city. However, each bakery uses different recipes and each claims to offer better products than their rivals. For example, Everlene's advertises that it produces the "World's Best" chocolate chip cookies. This suggests that Everlene's Bakery shows an example of pure competition.
- True
 - False

- 42 ■ ■ An entrepreneur, with limited funds, who wants to start a new business would probably be most successful in a monopolistic market because the amount of competition in such markets is very limited.
- True
 - False

- 43 ■ ■ Federal law has made all types of monopolies illegal in the United States.
- True
 - False

- 44 ■ ■ A typical supply curve shows that an increase in the price of a good will cause producers to decrease the quantity they supply.
- True
 - False

- 45 ■ ■ Demand refers to the quantity of products that consumers are willing to buy at different market prices.

- True
- False

46 ■ ■ The price paid for goods and services will rise when the quantity demanded exceeds quantity supplied.

- True
- False

47 ■ ■ Consumers will see prices fall when the quantity demanded exceeds quantity supplied.

- True
- False

48 ■ ■ Brooklyn's Beachfront Bed and Breakfast loses money due to a sharp drop in the number of guests during the winter months. One way to attract more guests would be to offer lower rates during the off-season.

- True
- False

49 ■ ■ Morgan's Moped and Bicycle Store is located on the property of a five-star resort in southern Florida. Rental cost of the mopeds and bikes is based on one-hour increments. Morgan lowers his standard prices to attract patrons during daily rainstorms in June and August. This is an example of decreasing supply.

- True
- False

50 ■ ■ Market equilibrium identifies the price at which quantity supplied is equal to quantity demanded.

- True
- False

51 ■ ■ In capitalist economies, central government planning is paramount.

- True
- False

52 ■ ■ In a planned economy, the government plays only a minor role in the operation of the economy.

- True
- False

53 ■ ■ Socialism is an economic system based on the principle that the government should own and operate key enterprises that directly affect public welfare.

- True
- False

54 ■ ■ Communism is an economic and political system in which a strong central government owns and controls almost all productive enterprises.

- True
- False

55 ■ ■ Karl Marx envisioned communism as a system that would improve the lot of the common worker.

- True
- False

56 ■ ■ The few nations that still rely on a communist economic system have actually seen major improvements in their economic performance over the past decade.

- True
- False

57 ■ ■ One problem that plagued many communist economies was that the absence of free markets resulted in crippling shortages and surpluses of goods and services.

- True
- False

58 ■ ■ By the end of the 1980s, communism began to collapse across the Soviet Union and its satellite nations.

- True
- False

59 ■ ■ The North Korean and Cuban governments still own most of their nations' enterprises and actively control the performance of their nations' economies.

- True
- False

60 ■ ■ In the U.S. economy, various branches of government own major enterprises such as the postal service, schools, parks, libraries, universities, and the military.

- True
- False

61 ■ ■ The U.S. federal government is the nation's largest employer.

- True
- False

62 ■ ■ While the U.S. relies heavily on free markets, it is actually a mixed economy in which the government owns several major enterprises and regulates many aspects of business operations.

- True
- False

63 ■ ■ The federal government creates regulations that prohibit competition and stimulate consumers to work.

- True
- False

64 ■ ■ Competition encourages companies to operate efficiently and responsively. The government does its part to stimulate fair competition by creating regulations to protect consumers and workers.

- True

False

65 ■ ■ Privatization is the conversion of government-owned enterprises to private ownership.

True
 False

66 ■ ■ Privatization is an important element of the movement toward a greater market orientation in many nations.

True
 False

67 ■ ■ The economic restructuring necessary to move toward greater reliance on markets has proven to be relatively easy for most previously planned economies to achieve.

True
 False

68 ■ ■ Many countries that have restructured to become more market-oriented have seen an increase in the standard of living for most of their people.

True
 False

69 ■ ■ Gross Domestic Product (GDP) measures the total value of all final goods and services produced within a nation's physical boundaries over a given period of time.

True
 False

70 ■ ■ Gross Domestic Product (GDP) includes the value of output produced within a nation even if that output is produced by a foreign-owned company.

True
 False

71 ■ ■ The value of a Hyundai Sonata built in Montgomery, Alabama would be included in the U.S. GDP even though Hyundai is actually a South Korean corporation.

- True
- False

72 ■ ■ GDP tends to overstate the amount of output produced by a nation's economy.

- True
- False

73 ■ ■ GDP, as the measurement of the total value of goods and services, includes the output produced within households and output produced by illegal activities.

- True
- False

74 ■ ■ The unemployment rate measures individuals 16 years of age and older without jobs who are actively seeking employment.

- True
- False

75 ■ ■ The unemployment rate includes only individuals over the age of 21 who were involuntarily laid off or fired from their previous jobs.

- True
- False

76 ■ ■ Frictional unemployment may occur even when the economy is healthy and may ultimately result in a better match between workers and jobs.

- True
- False

77 ■ ■ Individuals who quit their jobs experience structural unemployment.

- True
- False

78 ■ ■ Less expensive labor pools overseas might create layoffs at a U.S.-based engine plant. This is an example of structural unemployment.

- True
- False

79 ■ ■ Cyclical unemployment results from layoffs during recessionary periods.

- True
- False

80 ■ ■ The four basic types of unemployment are natural, cyclical, voluntary, and induced.

- True
- False

81 ■ ■ The predictable nature of the business cycle makes it easy to forecast when the next upturn or downturn in business activity will occur.

- True
- False

82 ■ ■ The two key phases of the business cycle are contraction and expansion.

- True
- False

83 ■ ■ An economy is said to be in a recession when GDP decreases for two consecutive quarters.

- True
- False

84 ■ ■ Contraction is a period of economic downturn marked by rising unemployment, business cutbacks, and decreases in consumer spending.

- True
- False

85 ■ ■ Unfortunately, depressions are a common problem in most economies.

- True
- False

86 ■ ■ Recovery is a period of increased employment, business expansion, and increased consumer spending.

- True
- False

87 ■ ■ Inflation occurs as the average prices of goods and services rise.

- True
- False

88 ■ ■ Disinflation is a slowing in the rate of inflation.

- True
- False

89 ■ ■ Productivity growth due to the infusion of technology enables employees to measure quality.

- True
- False

90 ■ ■ To measure productivity, multiply the number of inputs by the cost of each input.

- True
- False

91 ■ ■ It is important that any government examine multiple measures of its own economic health, rather than relying on simply one or two dimensions.

- True
- False

92 ■ ■ A key economic goal is to provide a deep understanding of past choices that can be used to guide future business decisions.

- True
- False

93 ■ ■ An economy, as a system, represents:

- the monitored consumption of material resources in a society.
- the resource flow from production to consumption.
- only the means of production in a social system.
- only a country's overall financial dynamics.


94 ■ ■ In the broadest sense, economics studies the choices that:

- people and communities make in disposing of unnecessary resources.
- federal and state governments make in creating natural resources.
- companies make in producing goods and services for corporate use.
- people, governments, and companies make in allocating resources.


95 The two core categories within the field of economics are:




- production and consumption.
- data collection and forecasting.
- macroeconomics and microeconomics.
- supply economics and demand economics.

96  Macroeconomics focuses on:

- the major issues facing the national economy that do not affect individuals.
- smaller economic units such as individual consumers, families, and individual businesses operating within an economy.
- the major issues facing the national economy that may seem abstract but directly affect an individual's day-to-day life.
- the economics of private companies, while microeconomics focuses on dynamics involving the government.

97  Which of the following is most likely to be studied in a macroeconomics course?

- How a large automobile manufacturer decides how many SUVs to produce in a given model year
- Factors that influence how customers are likely to react when a restaurant increases its prices
- How a firm in an oligopolistic market would respond to a change in the pricing strategy of other firms in its market
- Factors that influence a nation's unemployment rate

98  Microeconomics focuses on:

- the employment rate.

- individual businesses.
- the gross domestic product.
- taxation policies.

99 ■■■ The origin of the global economic crisis is found in the American _____.

- housing market
- commodities market
- insurance market
- healthcare market

100 ■■■ After the collapse of the dotcom bubble and the 9/11 terrorist attacks, the stock market depreciated and unemployment increased-leading many to fear that the country was on the brink of a full-blown recession. In order to stimulate the economy, the Federal Reserve:

- lowered taxes in an effort to increase spending.
- lowered interest rates from 6.5% to 1.25% in an effort to increase spending.
- increased taxes in an effort to increase spending.
- increased interest rates from 1.25% to 6.5% in an effort to increase spending.

101 ■■■ A _____ is targeted to borrowers with low credit scores, high debt-to-income ratios, or other signs of a reduced ability to repay the money they borrow.

- home equity line of credit
- revolving line of credit
- fixed-rate mortgage loan
- subprime mortgage loans

102 ■■■ The Federal Reserve lowering interest rates from mid-2000 to the end of 2002 greatly increased the money supply; however, opportunities to invest yielded paltry returns leading bankers to offer _____ in order to earn a higher return.

- revolving lines of credit
- home equity lines of credit
- fixed-rate mortgage loans
- subprime mortgage loans

- 103 ■ ■ ■ Subprime loans were attractive to lenders because:
- financial institutions maintained high reserves.
 - many rules and regulations governed these loans.
 - they were absolutely risk-free.
 - they offered higher returns than other investments.

- 104 ■ ■ ■ Which of the following was an effect of the 2008 global economic crisis?
- Sharp rises in property values
 - Layoffs numbering the in the millions
 - The stock market gaining in value
 - Home foreclosure rates steeply declining

- 105 ■ ■ ■ Following the global economic crisis, which of the following institutions did NOT intervene in the economy?
- The International Monetary Fund
 - The Federal Reserve
 - U.S. Department of the Treasury
 - Congress

- 106 ■ ■ ■ The \$700 billion economic bailout plan following the subprime mortgage crisis of 2008 was called the:
- American Recovery and Reinvestment Act.
 - Troubled Assets Relief Program.
 - Troubled Assistance Relief Program.
 - Corporate Welfare Program.

- 107 ■ ■ ■ Which of the following corporations was NOT bailed out by the Federal Government or the Federal Reserve during the economic crisis of 2008?
- AIG
 - Ford
 - Bear Stearns
 - Chrysler

108 ■■■ Fiscal policy refers to:

- government efforts to influence the economy through taxation and spending decisions.
- private efforts to increase and encourage economic growth, investment, and entrepreneurship.
- methods that boost the economy by encouraging an increase in the supply of money.
- actions that shape the economy by influencing prevailing rates of interest.

109 ■■■ The debt ceiling is:


- the maximum amount Congress lets the government borrow.
- the sum of all the money that the federal government has lent over the years.
- the total value of all final goods and services produced within a nation's physical boundaries.
- the total amount of money within the national economy.

110 ■■■ In 2011, which of the following resulted in a fiscal cliff?


- Congress reaching a reasonable long-term agreement to lower tax rates
- The government decreasing the debt ceiling
- The government incurring a budget surplus
- Congress finally agreeing to raise the debt ceiling

111 ■■■ The sum of all the money borrowed by the government over the years and not yet repaid is the _____.


- fiscal debt
- subprime loan
- federal debt
- monetary debt

112  When tax revenue is higher than government expenditures, the government incurs a:


- budget deficit.
- positive capital ratio.
- budget surplus.
- national debt.

113  The federal government incurs a budget deficit when its:


- spending is higher than revenue from taxes.
- tax revenue is higher than its expenditures.
- monetary policies reduce the amount of money in circulation.
- gold reserves are inadequate to support the existing money supply.

114  _____ refers to actions that shape the economy by influencing interest rates and the supply of cash.

- Fiscal policy
- Monetary policy
- Revenue policy
- Deficit policy

115  Which of the following is a source of federal government revenue?

- Net interest on debt
- Social security taxes
- National defense
- Income security

116  Why are members of the Board of Governors appointed to serve 14-year terms that are staggered, with one expiring every 2 years?

- To prevent stagnant and outdated decision making and encourage new approaches and fresh ideas from the Board of Governors
- To prevent any single president from appointing all of the members, thereby ensuring that the Fed can act independently of political pressure
- To ensure that there are experienced members during all economic cycles and climates
- To ensure that all members are automatically eligible to run for the Chairmanship of the Federal reserve after serving 14 years

117 ■■= Which of the following is a difference between the M1 money supply and the M2 money supply?

- The M1 money supply takes into account credit cards, whereas the M2 money supply does not take credit cards into account.
- The M1 money supply is liquid, whereas the M2 money supply is illiquid.
- The M1 money supply is illiquid, whereas the M2 money supply is liquid.
- The M1 money supply as of December 2013 was \$10.99 billion, whereas the M2 money supply as of December 2013 was \$2.65 billion.

118 ■■= Which of the following is a security that the Federal Reserve does NOT buy or sell?

- Notes
- Stocks
- Bills
- Bonds

119 ■■= The primary way in which the Fed controls the supply of money is by:

- establishing the amount of currency the U.S. Treasury is allowed to print.
- changing the reserve requirement as per prevailing economic conditions.
- buying and selling government securities in open market operations.
- allowing banks to borrow more money from the U.S. Treasury.

120 ■ ■ ■ — ■ — Credit is tight. Even borrowers with good credit have to shop around for loans, and it seems like banks are reluctant to loan their money. Of the following choices, what could be the reason?

- The Fed is decreasing the discount rate.
- The Federal Open Market Committee has started selling securities.
- The Fed has attempted to increase the money supply as prices begin to rise.
- The Fed has made some changes to the check-clearing processes of the member banks, charging higher fees for the service.

121 ■ ■ ■ — ■ — Which of the following tools used by the Fed helps protect depositors who may want to withdraw their money without notice?

- Discount rate
- Interest rate
- Open market operation
- Reserve requirement

122 ■ ■ ■ — ■ — A federal agency called the _____ was established to protect customer deposits in banks and thrift institutions for up to \$100,000 per customer, per bank.

- Federal Deposit Insurance Corporation
- Federal Reserve System
- Federal Open Market Committee
- Federal Deposit Requirement Program

123 ■ ■ ■ — ■ — Which of the following is a function of the Fed?

- It creates a budget, or a financial plan, for the national economy every year.
- It provides banking services for member banks and the federal government.
- It calculates the expected spending for the federal government every year.
- It outlines expected revenue that is due from the collection of taxes and fees.

124 ■■■ An economic system is a structure for:

- measuring gross domestic products.
- allocating limited resources.
- forecasting trends.
- delivering unsurpassed value to customers.

125 ■■■ A basic characteristic of _____ is that both producers and consumers are free to make their own economic decisions on many basic issues.

- socialism
- capitalism
- communism
- mercantilism

126 ■■■ How do businesses in a capitalist economy contribute toward raising the standard of living of people?

- By offering value to the consumer
- By using available resources
- By regulating available talent
- By forming oligopolistic markets

127 ■■■ Fair competition among businesses:

- is consistent with the goals of socialism.
- is a primary feature of a communist economic system.
- ensures that everyone is a winner.
- drives higher quality and lower prices in

capitalism.

128 ■■■ Pure competition is a market structure:

- with many competitors selling differentiated products.
- with only a handful of competitors selling similar products.
- with just a single producer completely dominating the industry.
- with many competitors selling virtually identical products.

129 ■■■ Monopolistic competition is a market structure:

- with many competitors selling differentiated products.
- with only a handful of competitors selling similar products.
- with many competitors selling virtually identical products.
- with just a single producer completely dominating the industry.

130 ■■■ Firms in oligopolistic markets tend to:

- keep prices as low as possible.
- avoid price competition whenever possible.
- be concerned about the possibility of new entrants.
- have very small market shares.

131 ■■■ _____ is a market structure with just a single producer completely dominating the industry.

- Oligopoly
- Monopoly
- Monopolistic competition

- Pure competition

132 ■■■ Government laws against monopolies are:

- a key way in which the government promotes competition in a capitalist system.
- inconsistent with the role of government in a capitalist system.
- the main reason why the U.S. economy is best classified as a socialist system.
- used to ensure equal distribution of income in the economy.

133 ■■■ Companies that attempt to monopolize a particular market are likely to violate the:

- Fair Competition Standards Act of 1911.
- Taft-Sharpley Free Enterprise Act of 1957.
- Sherman Antitrust Act of 1890.
- Market Competition Enhancement Act of 1978.

134 ■■■ The government often allows only one company to supply electricity in a given geographic area because allowing several companies to do so would result in an inefficient duplication of infrastructure. This suggests that electric utilities are _____.

- victims of monopolies
- oligopolies
- natural monopolies
- unprofitable companies

135 ■■■ Supply is defined as:

- the quantity of products that producers are willing to offer for sale at different market prices.
- the number of consumers in a market that have low debt-to-income ratios.

- the quantity of products that consumers are willing to buy at different prices.
- the number of products produced in a given fiscal year.

136 ■■= The _____ shows the relationship between price and quantity from a producer standpoint.

- supply matrix
- demand curve
- supply curve
- demand matrix

137 ■■= Anne is a manager at a store that sells casual clothing and accessories for both men and women. She notices that the jeans priced at \$120 aren't selling very well. She wants to increase sales of these jeans before the next season. The approach Anne should take to achieve this is to _____.

- keep the prices the same but move the jeans to another section of the store
- lower the price of the jeans so that demand will increase
- raise the price of the jeans to make them seem more exclusive
- put even higher priced jeans next to the \$120 jeans

138 ■■= If low-cost solar power were to become a viable energy source in households across the United States, what would be the economic impact on energy prices?

- Energy costs across the country would increase with adoption of the new energy source.
- Housing prices would decrease as new homes were built with this new energy source.
- Prices would increase due to difficulties with adoption of this new energy source.
- Prices would decrease as competition increases in energy production.

139 ■■= Demand is defined as:

- the number of consumers in a market who have low debt-to-income ratios.
- the quantity of products that consumers are willing to buy at different market prices.
- the amount of products produced in a high-growth, government-owned industry.
- the annual quantity of products sold by retailers as a percentage of the Gross Domestic Product (GDP).

140 ■■■ The demand curve shows the relationship between:

- the price and quantity from a customer demand standpoint.
- the quantity of products produced from a producer demand standpoint.
- macroeconomics and microeconomics.
- suppliers' prices and consumers' prices.

141 ■■■ The _____ is the price associated with the point at which the quantity demanded of a product equals the quantity supplied.

- natural capital
- price ceiling
- equilibrium price
- incentive

142 ■■■ _____ is an economic system based on the principle that the government should own and operate key enterprises that directly affect public welfare.

- Laissez-faire
- Capitalism
- Socialism
- Anarchism

143 ■■■ The primary economic goal of the government in a socialist economy is to:

- keep taxes as low as possible.
- operate key enterprises in the best

interests of the public.

- achieve the highest possible rate of economic growth.
- provide the widest array of economic freedoms to its citizens.

144 ■ ■ ■ Which of the following is a disadvantage of socialist economic systems?

- The migration of an incentivized workforce
- Tax revenues being unable to adequately cover welfare benefits
- Inefficiencies and corruption
- The government running the entire economy

145 ■ ■ ■ Which of the following is a difference between socialist economic systems and free enterprise systems?

- Citizens in socialist economic systems are charged lower taxes, whereas citizens in free enterprise systems are charged higher taxes.
- Citizens in socialist systems are not incentivized workers, whereas citizens in free enterprise systems are highly incentivized workers.
- Citizens in socialist economic systems have to pay for certain services themselves, whereas citizens in free enterprise systems avail these services through taxation.
- Citizens in socialist economic systems avail certain services through taxation, whereas citizens in free enterprise systems have to pay for these services themselves.

146 ■ ■ ■ Which of the following nations developed a powerful socialist economy in the decades after World War II?

- United States

- United Kingdom
- Soviet Union
- China

147 ■ ■ ■ — Socialist economies have experienced a recent slowdown in growth because of:

- high taxes and the elimination of public benefits.
- low taxes and free private education.
- high taxes and lavish social programs.
- low taxes and the elimination of public benefits.

148 ■ ■ ■ — In late 2010, many socialistic economies decided to _____ in order to increase their growth.

- increase government spending
- eliminate some public benefits
- increase some public benefits
- decrease government revenue

149 ■ ■ ■ — Which of the following is a difference between a socialist economic system and a communist economic system?

- A socialist economic system has lower taxes, whereas a communist economic system has higher taxes.
- A socialist economic system mandates that the government run and own virtually all enterprises, whereas a communist economic system mandates that the government run key enterprises that affect public welfare.
- A socialist economic system is politically totalitarian, whereas a communist economic system is not.
- A socialist economic system mandates that the government run key enterprises that affect public welfare, whereas a communist economic system mandates that

the government run and own virtually all enterprises.

150 ■■■ The communist concept was the brainchild of political philosopher ____.

- Karl Marx
- Vladimir Lenin
- Mao Zedong
- Kim Il-Sung

151 ■■■ The ideas of political philosopher Karl Marx are most closely linked to the economic system known as ____.

- communism
- capitalism
- socialism
- mercantilism

152 ■■■ The core principles of communism are outlined in the ____.

- Communist Declaration
- Communist Manifesto
- Communist Handbook
- Communist Platform

153 ■■■ A nation that adopts communist economics is devoid of a free market system and hence develops:

- intense competition among business owners.
- a number of privately-owned businesses.
- adequate production mechanisms.
- crippling shortages and surpluses.

154 ■■■ At the end of which decade was communism replaced with democracy and the free market in the Soviet Union?

- 1970s
- 1990s
- 1980s

○ 2000s

155 ■ ■ ■ — Which of the following communist nations launched free market reforms in the 1990s that stimulated rapid and sustained growth?

- North Korea
- Cuba
- Laos
- Vietnam

156 ■ ■ ■ — Natasha is very upset about conditions in her country. She has very little economic or political freedom. Virtually all productive enterprises are owned by the government, and they seem to be run very inefficiently. The result is a frequent shortage of necessary goods and services. These conditions suggest that Natasha's country relies on a _____ economic system.

- communist
- socialist
- capitalist
- laissez-faire

157 ■ ■ ■ — One reason pure market economies are nonexistent is because they:

- are too expensive to maintain given the sheer number of services provided.
- don't adequately provide for the sick, the young, the elderly, and the environment.
- result in very high tax rates that undermine incentives that lead to labor migrations.
- don't do enough to encourage entrepreneurship on of account of low after-tax profits.

158 ■ ■ ■ — A pure _____ economy would not create enough value to support its people over the long term.

- planned
- market
- laissez-faire
- capitalist

159 ■■■ A pure planned economy is non-existent today because _____.

- it would not create enough value to support its people over the long term
- it would not make sufficient provision for the old, the young, , the sick, and the environment
- authoritarian governments are also non-existent today
- it is unable to regulate the operation of key enterprises that affect public welfare.

160 ■■■ Which of the following is NOT a major enterprise owned by the United States Government?

- Departmental stores
- Libraries
- Parks
- The postal service

161 ■■■ Most business enterprises in the United States are privately owned, but the federal government owns a number of major enterprises-such as the U.S. Postal Service. This suggests that the U.S. economy is best classified as a(n) _____.

- socialist economy
- mixed economy
- differentiated economy
- anarchist economy

162 ■■■ For which of the following reasons has the federal government become part owner of a number of financial institutions?

- Open market operations by the Federal Reserve
- New federal regulations passed by Congress
- Bailouts from the 2008 economic crisis
- A Democratic Presidential administration

163 ■■■ To stimulate competition and protect both consumers and workers, the federal government:

- places heavy taxes on firms in

monopolistic competition.

- places limits on international trade in order to stimulate domestic production.
- creates regulations to intervene in the free market.
- creates business systems to meet the needs of all consumers.

164 ■■■ Government regulations are likely to become stronger in the wake of the ____.

- economic crisis
- dotcom bubble
- budget deficit
- fiscal cliff

165 ■■■ ____ is the process of converting government-owned businesses to independent ownership.

- Privatization
- Globalization
- Competition
- Collusion

166 ■■■ The town of Marion has agreed on a deal to sell their electricity grid management system to the Flow Safe Corporation. The sale of Marion's electricity infrastructure is an example of ____.

- privatization
- nationalization
- public-private partnership
- sequestration

167 ■■■ In moving towards the market side of the spectrum, socialist governments have:

- increased taxes on the middle classes.
- cracked down on economic rights.
- shrunk human services such as free healthcare and education subsidies.
- created new bureaucratic guidelines for businesses newly entering their country.

- 168 ■ ■ ■ Over the past 30 years, tax reforms in formerly planned economies have created new incentives for the:
- creation of a more equal distribution of income throughout society.
 - creation of new incentives for domestic and foreign investment.
 - elimination of the threat of growing prices or hyperinflation.
 - protection of the environment against habitual offenders.


- 169 ■ ■ ■ Countries that have taken strides toward the market end of the spectrum have seen their _____.
- growth rates drop
 - growth rates stagnate
 - standard of living drop
 - standard of living rise

- 170 ■ ■ ■ Which of the following measures the total value of all final goods and services produced within a nation's physical boundaries over a given period of time?
- The consumer price index
 - Gross domestic product
 - Net national production
 - The production function


- 171 ■ ■ ■ Denise is a hard worker, but she has always had differences with her boss, Angela. Angela has recently become more demanding and unwilling to provide clarification on project requirements. After one too many long working days with little or no job satisfaction, Denise walked into Angela's office and submitted her resignation. Denise knows that her résumé is strong and feels confident she will find another job. Denise is now facing _____ unemployment.
- seasonal
 - structural
 - frictional
 - cyclical

- 172 ■ ■ ■ Manufacturing jobs in the United States have migrated overseas due to increased productivity and low wages of workers in other countries. This contributes to _____ unemployment for American workers in the manufacturing sector.
- structural


- frictional
- seasonal
- cyclical

173  _____ unemployment involves layoffs during recessions.

- Frictional
- Structural
- Cyclical
- Seasonal

174  The two key phases of the business cycle are:


- trend and random variation.
- inflation and recession.
- contraction and expansion.
- inflation and deflation.

175  An economy is officially in recession when:


- the GDP increases for at least two consecutive years.
- the GDP decreases for at least two consecutive years.
- the market is in an especially deep and prolonged "trough".
- the GDP decreases for at least two consecutive quarters.

176  In the business cycle, a transition period of rising economic growth and increasing employment is a _____.


- recovery
- peak
- contraction
- disinflation

177  _____ is a period of robust economic growth and high employment.


- Expansion
- Recovery
- Disinflation
- Contraction

178  _____ means that prices, on average, are rising.

- Deflation
- Inflation
- Expansion
- Contraction

179  An economy is experiencing hyperinflation when average prices of goods and services:

- decrease by more than 25% per month.
- increase by more than 100% in a year.
- increase by more than 50% per month.
- decrease by more than 50% per day.

180  _____ is a period of slowing average price increases across the economy.

- A trough
- A depression
- Hyperinflation
- Disinflation


181  For which of the following reasons is a low level of inflation desirable and deflation undesirable?

- It reflects a healthy economy; people have money and are willing to spend it.
- A low level of inflation keeps a currency from edging too near deflation.
- Inflation helps to justify investment and keeps a currency strong.
- Deflation means that the currency is increasing in value, and is actually desirable.


The Consumer Price Index (CPI) measures the:

182 

- change in the prices of gas and energy.
- change in weighted-average price over time in a "market basket" of goods and services bought by the typical consumer.
- change in prices of a set of goods representing the minimum acceptable standard of living for the nation's consumers.
- percentage of their income consumers must use to pay for goods relative to their average incomes in the same time period.

183  Changes in the producer price index (PPI) can predict changes in the consumer price index (CPI) because:

- interaction between supply and demand results in an equilibrium price.
- they are computed using the same market basket.
- producers pass on price increases to consumers within a month or two of the changes.
- consumers and producers often buy the same goods.

184  The amount of goods and services produced by an economy divided by the amount of resources used to make those goods and services equals:

- the consumer price index.
- the budget deficit.
- inflation.
- productivity.

185  Explain how fiscal and monetary policy influences the economy.

Answer:

Macroeconomics is the study of a country's overall economic issues, such

as the employment rate, the gross domestic product, and taxation policies. While macroeconomic issues may seem abstract, they directly impact your day-to-day life, influencing key variables such as what jobs will be available for you, how much cash you'll actually take home after taxes, or how much you can buy with that cash in any given month.

Microeconomics focuses on smaller economic units such as individual consumers, families, and individual businesses. Thus, microeconomics would look at how individual firms decide how much output to produce, what prices to charge, and how much labor to hire.

186



Explain in detail the terms *debt ceiling* and *fiscal cliff* and their effect on the U.S. economy.

Answer:

The debt ceiling is the maximum amount Congress lets the government borrow. In theory, this is meant to limit the amount that the government can borrow, but in practice, voting on the debt ceiling happens separately from voting on taxes and spending, so the debt ceiling ends up being mostly about whether or not the Federal government can pay for debts that it has already incurred. Typically, debt ceiling hikes are fairly routine; in fact, Congress has raised the debt ceiling 74 times since 1962, and 10 times since 2001, all with little or no notice.

Congress finally agreed to raise the debt ceiling, which temporarily averted a shutdown crisis, but the deal they reached to do so created the fiscal cliff. The fiscal cliff was a package of draconian across-the-board spending cuts and sharp tax hikes scheduled to hit at the same time that could dramatically decrease the U.S. budget deficit. Unfortunately, the timing of the spending cuts coincided with the timing of a package of sharp tax hikes that had been negotiated separately.

Going over the fiscal cliff could potentially cripple the U.S. economy, and possibly even cause the U.S. to default on some of its debt, which could send world markets into a tailspin. But once again, Congress could not reach a reasonable long-term agreement, so they simply passed last minute legislation that pushed the really tough tax and spending decisions farther down the road.

187



Identify and explain the three key tools the Federal Reserve uses to expand and contract the money supply.

Answer:

The Fed uses three key tools expand and contract the money supply:

- open market operations
- discount rate changes
- reserve requirement changes

Open Market Operations: This is the Fed's most frequently used tool. Open market operations involve buying and selling government securities, which include treasury bonds, notes, and bills. These securities are the IOUs the government issues to finance its deficit spending.

When the economy is weak, the Fed *buys* government securities on the open market. When the Fed pays the sellers of these securities, money previously held by the Fed is put into circulation. This directly stimulates spending. In addition, any of the additional funds supplied by the Fed that are deposited in banks will allow banks to make more loans, making credit more readily available. This encourages even more spending and further stimulates the economy.

When inflation is a concern, the Fed *sells* securities. Buyers of the securities write checks to the Fed to pay for securities they bought, and the Fed withdraws these funds from banks. With fewer funds, banks must cut back on the loans they make, credit becomes tighter and the money supply shrinks. This reduces spending and cools off the inflationary pressures in the economy.

Discount Rate Changes: The discount rate is the interest rate the Fed charges on its loans to commercial banks. When the Fed reduces the discount rate, banks can obtain funds at a lower cost and use these funds to make more loans to their own customers. With the cost of acquiring funds from the Fed lower, interest rates on bank loans also tend to fall. The result: businesses and individuals are more likely to borrow money and spend it, which stimulates the economy.

Reserve Requirement Changes: The Fed requires that all of its member banks hold funds, called reserves, equal to a stated percentage of the deposits held by their customers. This percentage is called the reserve

requirement. The reserve requirement, currently standing at about 10%, helps protect depositors, who may want to withdraw their money without notice.

If the Fed increases the reserve requirement, banks must hold more funds, meaning they will have fewer funds available to make loans. This makes credit tighter and causes interest rates to rise. If the Fed decreases the reserve requirement, some of the funds that banks were required to hold become available for loans. This increases the availability of credit and causes interest rates to drop.

188



Explain the fundamental rights of capitalism.

Answer:

The right to own a business and keep after-tax profits: Remember that capitalism doesn't guarantee that anyone will actually earn profits. Nor does it promise that there won't be taxes. But if one does earn profits, one gets to keep his or her after-tax income and spend it however he or she sees fit, as long as it's within the limits of the law. This right acts as a powerful motivator for business owners in a capitalist economy; the lower the tax rate, the higher the motivation.

The right to private property: This means that individuals and private businesses can buy, sell, and use property—which includes land, machines, and buildings—in any way that makes sense to them. This right also includes the right to will property to family members.

The right to free choice: Capitalism relies on economic freedom. People and businesses must be free to buy or not buy according to their wishes. They must be free to choose where to work or not work and where to live or not live. Freedom of choice directly feeds competition, creating a compelling incentive for business owners to offer the best goods and services at the lowest prices. U.S. government trade policies boost freedom of choice by encouraging a wide array of both domestic and foreign producers to compete freely for the consumer's dollars.

The right to fair competition: A capitalist system depends on fair competition among businesses to drive higher quality, lower prices, and more choices. Capitalism can not achieve its potential if unfair practices—such as deceptive advertising, predatory pricing, and broken contracts—mar the free competitive environment.



Describe the four degrees of competition with examples.

Answer:

Pure Competition: A market structure with many competitors selling virtually identical products. In today's U.S. economy, examples of pure competition have virtually disappeared. The example of agricultural products probably comes the closest.

Monopolistic Competition: A market structure with many competitors selling differentiated products. Producers have some control over the price of their wares, depending on the value that they offer their customers. And new producers can fairly easily enter categories marked by monopolistic competition. Examples might include the clothing industry and fast food establishments.

Oligopoly: A market structure with only a handful of competitors selling products that are either similar or different. The retail gasoline business and the car manufacturing industry, for example, are both oligopolies. Another example might include the soft drink industry.

Monopoly: A market structure with just a single producer completely dominating the industry, leaving no room for any significant competitors. Monopolies usually are not good for anyone except for the company that has control since without competition there is not any incentive to hold down prices or increase quality and choices. Because these undesirable drawbacks can harm the economy, most attempts to monopolize markets in the United States are illegal. The classic example is a natural monopoly, such as a cable television system, water company, or electric utility. The government also fosters temporary monopolies when it grants patents or copyrights.



Explain the concepts of supply and demand in a free market.

Answer:

The concepts of supply and demand explain how the dynamic interaction between buyers and sellers directly affects the range of products and prices in a free market.

Supply refers to the quantity of products that producers are willing to offer for sale at different market prices. Since businesses seek to make as much profit as possible, they are likely to produce more of a product that commands a higher market price and less of a product that commands a lower price. The relationship between price and

quantity from a supplier standpoint can be shown on a graph called the supply curve. The supply curve maps quantity on the x-axis and price on the y-axis. In most categories, as the price rises, the quantity produced rises correspondingly, yielding a graph that curves up as it moves to the right.

Demand refers to the quantity of products that consumers are willing to buy at different market prices. Since consumers generally seek to get the products they need or want at the lowest possible prices, they tend to buy more products with lower prices and fewer products with higher prices. The relationship between price and quantity from a demand standpoint can be shown on a graph called the demand curve. Like the supply curve, the demand curve maps quantity on the x-axis and price on the y-axis. But different from the supply curve, the demand curve for most goods and services slopes downward as it moves to the right, since the quantity demanded tends to drop as prices rise.

191



Define the two categories of planned economies and illustrate the differences and similarities between them.

Answer:

The two key categories of planned economies are socialism and communism.

Socialism is an economic system based on the principle that the government should own and operate key enterprises that directly affect public welfare, such as utilities, telecommunications, and healthcare. While the official government goal is to run these enterprises in the best interest of the overall public, inefficiencies and corruption often interfere with effectiveness. Socialist economies also tend to have higher taxes, which are designed to distribute wealth more evenly through society.

Communism is an economic and political system that calls for public ownership of virtually all enterprises, under the direction of a strong central government. The communist concept was the brainchild of political philosopher Karl Marx, who outlined its core principles in his 1848 *Communist Manifesto*. The communism that Marx envisioned was supposed to dramatically improve the lot of the worker at the expense of the super-rich.

192



Explain why most of today's nations have mixed economies.

Answer:

In today's world, pure economies-market or planned-are practically nonexistent, since each would fall far short of meeting the needs of its citizens. A pure market economy would make insufficient provision for the old, the young, the sick, and the environment. A pure planned economy would not create enough value to support its people over the long term. Instead, most of today's nations have mixed economies, falling somewhere along a spectrum that ranges from pure planned at one extreme to pure market at the other.

Even the United States-one of the most market-oriented economies in the world-does not have a pure market economy. The various departments of the government own a number of major enterprises, including the postal service, schools, parks, libraries, entire systems of universities, and the military. In fact, the federal government is the nation's largest employer, providing jobs for more than 4 million Americans. And-although the government does not directly operate firms in the financial sector-the federal government has become part owner in a number of financial institutions as part of the recent bailouts. The government also intervenes extensively in the free market by creating regulations that stimulate competition and protect both consumers and workers. Regulations are likely to become stronger in the wake of the economic crisis.

193



Explain gross domestic product. What are the reasons for it to be understated in an economy?

Answer:

Gross domestic product (GDP) is a measure of the total value of all final goods and services produced within a nation in a given time period. Conceptually, all goods produced within a nation's borders should be included in its GDP, even if the firm producing the output is a foreign-owned corporation. Thus, Hondas produced in the United States are included in the U.S. GDP, even though Honda is a Japanese firm. But Mattel toys produced in China are not included in U.S. GDP, even though Mattel is a U.S. corporation.

GDP tends to understate a nation's total production because it does not include output produced illegally, nor does it include the value of output that is not reported because the producer is trying to avoid paying taxes. Another major omission is the work done within households. For example, when households cook their own meals, mow their own lawns, or do their own household repairs, the value of their labor is not included in the GDP. But if they hire others to do these tasks, the value of these goods and services is included in the GDP.

194

Define unemployment rate. Identify and describe the four types of



unemployment in an economy.

Answer:

Most nations track employment levels largely through the **unemployment rate**, which includes everyone age 16 and older who doesn't have a job and is actively seeking one.

Frictional unemployment involves a worker quitting or being terminated and has a short-term impact on the economy because during normal times the worker is able to find new employment relatively quickly. It tends to be ultimately positive since the chances are good that one will find employment that is a better fit for him or her.

Structural unemployment, on the other hand, is usually longer term. This category encompasses people who don't have jobs because the economy no longer needs their skills. In the U.S., growing numbers of workers in the past decade have found themselves victims of structural unemployment as manufacturing jobs have moved overseas. Often their only option is expensive retraining.

Two other categories of unemployment are **cyclical**, which involves layoffs during recessions, and **seasonal**, which involves job loss related to the time of year. An example of seasonal unemployment is the loss of jobs by landscapers during cold winter months.

195




What is a business cycle? Describe the different phases of a business cycle in a changing economy.

Answer:

The business cycle is the periodic expansion and contraction of economic activity that occurs in a nation's economy over a period of years. One key phase of the business cycle is contraction: a period of economic downturn marked by rising unemployment, businesses cutting back on production, and consumers shifting their buying patterns to more basic products and fewer luxuries. The other key phase of the business cycle is expansion: a period of robust, economic growth marked by businesses expanding to capitalize on emerging opportunities; consumers purchase more products, which leads to more production that in turn creates more jobs. The bottom of a contraction in a business cycle is called a trough, while the high point of an expansion is called a peak. If a contraction results in a decline in GDP for at least two


consecutive quarters, the downturn is classified as a recession. A depression is an extremely severe and long-lasting recession. Depressions are rare; the last full-blown depression in the United States occurred in the 1930s.

196  Explain the various changes in the rate of price in an economy.

Answer:

The rate of price changes across the economy is a basic measure of economic well-being. Inflation means that prices, on average, are rising. Similar to unemployment, a low level of inflation is not so bad. It reflects a healthy economy-people have money, and they are willing to spend it. But when the Federal Reserve-the nation's central bank-manages the economy poorly, inflation can spiral out of control, which can lead to hyperinflation, when average prices increase more than 50% per month.

When the rate of price increases slows down, the economy is experiencing disinflation, which was the situation in the United States in the mid-1990s and more recently in the second half of 2008. But when prices actually decrease, the economy is experiencing deflation, typically a sign of economic trouble that goes hand-in-hand with very high unemployment. People do not have money and simply will not spend unless prices drop. During the Great Depression in the 1930s, the U.S. economy experienced deflation, with prices dropping 9% in 1931 and nearly 10% in 1932.

197  Describe the Consumer Price Index (CPI) and Producer Price Index (PPI) as measures of price changes in the economy.

Answer:

The government uses two major price indexes to evaluate inflation: the **Consumer Price Index (CPI)** and the **Producer Price Index (PPI)**.

The CPI measures the change in weighted-average price over time in a consumer "market basket" of goods and services that the average person buys each month. The U.S. Bureau of Labor Statistics creates the basket-which includes hundreds of items such as housing, transportation, haircuts, wine, and pet care-using data from more than 30,000 consumers. While the market basket is meant to represent the average consumer, keep in mind that the "average" includes a lot of variation, so the CPI may not reflect individual personal experience. If one does not have a pet, for example, changes in veterinary costs would not affect him or her, although the changes would (slightly) impact the CPI.

The PPI measures the change over time in weighted-average wholesale prices, or the prices that businesses pay each other for goods and services. Changes in the PPI can sometimes predict changes in the CPI because producers tend to pass on price increases (and sometimes also price decreases) to consumers within a month or two of the changes.

198



Define and describe productivity.

Answer:

Productivity refers to the relationship between the goods and services that an economy produces and the resources needed to produce them. The amount of output-goods and services-divided by the amount of input equals productivity. The goal, of course, is to produce more goods and services, using fewer hours and other inputs. A high level of productivity typically correlates with healthy GDP growth, while low productivity tends to correlate with a more stagnant economy.

Over the past couple of decades, the United States has experienced strong productivity growth, due largely to infusions of technology that help workers produce more output, more quickly. But keep in mind that that productivity does not measure quality. That's why it is so important to examine multiple measures of economic health rather than relying on simply one or two dimensions.