

Chapter 02

The Market System and the Circular Flow

Multiple Choice Questions

1. Economic systems differ from one another based on who own the factors of production and:
 - A. How much resources are available in the economy and where they are located
 - B. Who make decisions regarding what to produce and how it is produced
 - C. What kinds of products are produced in the economy and how plentiful they are
 - D. How big the population is, and the makeup of the population

2. The market system is an economic system that:
 - A. Produces more consumer goods than capital goods
 - B. Produces more capital goods than consumer goods
 - C. Gives private individuals the right to own resources used in production
 - D. Emphasizes the government's power to control markets and direct economic activity

3. The market system is also known as:
 - A. Capitalism
 - B. Socialism
 - C. Central planning
 - D. Production system

4. Laissez-faire capitalism limits the government's economic functions to the following, *except*.
 - A. Protecting private property rights
 - B. Establishing a legal environment to enforce contracts among individuals
 - C. Preventing individuals and firms from coercing others
 - D. Setting prices of individual goods and services

5. One major element of the command system is:
 - A. An emphasis on private ownership of resources
 - B. Individual decentralized decision-making
 - C. Reliance on supply-and-demand forces to guide economic activity
 - D. Central planning conducted by the government

6. The government may impose industrial safety regulations and occupational licensing requirements in which of the following economic systems?
 - A. Laissez-faire economy
 - B. Pure capitalism
 - C. Mixed market economy
 - D. Macroeconomic system

7. In a command system:
 - A. Self-interest motivates and commands each business firm's decisions and actions
 - B. The head of each family decides what to do with the family's resources
 - C. The government makes production and allocation decisions
 - D. Market traders command what outputs are produced and how they are allocated

8. Which of the following would *not* be emphasized in a capitalist economy?
- A. Private ownership of capital and other resources
 - B. Competition and decentralized decisions
 - C. Reliance on market forces to coordinate economic activity
 - D. Prevention of owners of capital from exposing this resource to risk
9. The government may not implement policies intended to redistribute income in which of the following economic systems?
- A. Laissez-faire capitalism
 - B. Command system
 - C. Mixed economy
 - D. Market system
10. The economies of North Korea and Cuba are:
- A. Similar in that they are both basically command systems
 - B. Similar in that they are both basically market systems
 - C. Different in that North Korea has a command system while Cuba has a market system
 - D. Different in that Cuba has a command system while North Korea has a market system
11. *Laissez-faire* capitalism is characterized by:
- A. Very limited government role in the economy
 - B. Active government intervention in the economy
 - C. Individuals and firms abiding by a government economic plan
 - D. A very fair distribution of income and wealth

12. By freedom of enterprise, we mean that individual:
- A. Workers are free to look for jobs and work in whichever firm will hire them
 - B. Firms are free to employ resources, to produce their output, and to sell their products
 - C. Producers are free to produce whatever the government decides are needed by the society
 - D. Consumers are free to buy whatever products will satisfy their needs the most
13. Capitalism gets its name from the fact that capital resources are mostly:
- A. Owned by the state or government
 - B. Given the highest priority in the economy's income distribution
 - C. Treated as private property
 - D. In the form of money and financial resources
14. Which of the following statements is correct?
- A. The operation of a market system eventually results in an equal distribution of income
 - B. Producers are "sovereign" in a market economy because they determine what is produced
 - C. The market system is efficient at allocating resources, but not at allocating products
 - D. Freedom of choice and enterprise are essential elements of the market system
15. In a market system, self-interest is the motivating force that:
- A. Makes individuals unwilling to deliver anything of value to others
 - B. Makes owners of resources always want to use their resources themselves
 - C. Leads the economy to chaos and confusion, especially the larger economies
 - D. Coordinates and creates consistency in the operations of various parts of the economy

16. Which of the following statements about self-interest in a market system is false?
- A. Self-interest usually motivates an individual to deliver something of value to others
 - B. Self-interest of entrepreneurs implies seeking maximum profits or minimum losses
 - C. Self-interest applies only to capitalists and entrepreneurs, not to workers employed by others
 - D. In a market system, consumers are just like firms: self-interest is what motivates them
17. Consumers express self-interest when they:
- A. Seek the lowest price for a product
 - B. Reduce business losses
 - C. Collect economic profits
 - D. Exclude others in their thinking
18. Private ownership and property rights in a market system have the following implications, *except*:
- A. Individuals are free to take on the financial risks involved in a business
 - B. Trades that take place in the economy are mutually-agreeable transactions among individuals
 - C. Economic agents are allowed to act in their own self-interest
 - D. Large firms are allowed to coerce other firms and individuals
19. Which of the following statements about the right to private ownership is false?
- A. It enables individuals to obtain, use, and dispose of land and capital resources as they see fit
 - B. It encourages investment and innovation, and thus fosters economic growth
 - C. It extends to intangibles such as pieces of music and computer programs
 - D. It weakens the incentive to maintain the property that one already owns

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

24. All of the following statements describe a market economy *except*.
- A. Government prescribes the market prices for goods and services
 - B. Prices provide important signals to buyers and sellers
 - C. The allocation of resources is determined by their prices
 - D. The actions of buyers and sellers establish a product's price
25. A characteristic of the market system is:
- A. Extensive use of direct methods of production
 - B. A focus on labor, as opposed to capital resources
 - C. Reliance on the use of capital goods to expand total output
 - D. Avoidance of producing goods that do not satisfy consumer wants directly
26. Which of the following does not foster innovation and technological advance?
- A. Competition in markets
 - B. Freedom of choice and enterprise
 - C. Self-interest and personal rewards
 - D. Fear and avoidance of risk
27. The Heritage Foundation in 2012 ranked which of the following economies to have among the highest economic freedom?
- A. The United States
 - B. Germany
 - C. Argentina
 - D. Hong Kong

28. A production system where various workers concentrate on different specialized tasks to contribute towards a whole product is referred to as:
- A. A coincidence of wants
 - B. Roundabout production
 - C. Freedom of enterprise
 - D. Division of labor
29. How does human specialization contribute towards increasing an economy's output?
- A. It exploits the differences in abilities
 - B. It is a process of creative destruction
 - C. It pushes each worker to master the whole product
 - D. It encourages people to be "jacks-of-all-trades"
30. With specialization in a market economy, individual:
- A. Firms produce a wide range of products
 - B. Producers consume little or none of the products they produce
 - C. Producers consume most of the output that they produce
 - D. Consumers have to produce most of what they consume
31. Which of the following is not a reason why specialization and trade are beneficial to society?
- A. The total output of economic goods may be increased even without any increase in resources
 - B. Scarce resources are utilized more efficiently by exploiting differences among them
 - C. Specialization fosters learning by doing, thus lowering the unit-costs of products
 - D. Firms and workers become less dependent on others for producing goods and services

32. A required element for specialization to lead to an increase in the satisfaction of society's wants is:

- A. A capitalist economy
- B. Exchange and trade
- C. The use of money
- D. A central plan

33. Specialization is beneficial:

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

34. Which is an example of barter?

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

35. An economic system in which money is *not* used is a:

- A. Planned economy
- B. Market economy
- C. Mixed economy
- D. Barter economy

36. Which of the following is necessary to make a trade in a barter economy?

- A. Money
- B. Unlimited wants
- C. A medium of exchange
- D. A coincidence of wants

37. The use of money for exchange and trade:

- A. Increases the importance of barter
- B. Fosters more specialization in production
- C. Reduces consumer sovereignty
- D. Raises the need for a coincidence of wants

38. Anything that is generally acceptable in trading for goods and services is a:

- A. Medium of exchange
- B. Capital good
- C. Store of value
- D. Token money

39. Which of the following is the main problem with the barter system of exchange?

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

40. International specialization and trade:
- A. Has to be done on a barter system
 - B. Often requires the exchange of currencies
 - C. Does not illustrate the division of labor
 - D. Requires active government regulation
41. Why might a company use barter rather than money to make a trade?
- A. Barter trade is generally more efficient than money-based trade
 - B. Barter can enable two firms to trade when their cash flows are limited
 - C. Money requires a coincidence of wants, barter is more direct
 - D. Money is efficient only for large transactions, so barter is preferred for smaller transactions
42. Which of the following is assumed to be most limited in scope under a market system?
- A. Entrepreneurship
 - B. Self-interest
 - C. Competition
 - D. Government
43. If a nation restricts trade with other nations, then the most likely effect is:
- A. Lower prices of goods and services in the nation
 - B. Increased specialization of production
 - C. Expanded economic wealth of the nation
 - D. Make consumers in the nation worse off

44. Which is one of the five fundamental questions that need to be dealt with in any economic system?
- A. What makes the rate of unemployment low?
 - B. Who will be the richest group in the economy?
 - C. How will goods and services be produced?
 - D. How high should the prices of goods and services be?
45. Which of the following is *not* one of the five fundamental questions that an economy must deal with?
- A. How will the goods and services be produced?
 - B. Why should the goods and services be produced?
 - C. Who is to receive the goods and services produced in the economy?
 - D. In what ways will progress be promoted?
46. Consumer sovereignty and "dollar votes" guide the market system in dealing with which fundamental economic question?
- A. Which output will be produced?
 - B. How is the output to be produced?
 - C. How can the system accommodate change?
 - D. Who is to receive the output?
47. The term *consumer sovereignty* means that:
- A. Government is responsible for protecting consumers' interests
 - B. What is produced is ultimately determined by what consumers buy
 - C. There are no limits on what consumers may buy in a market system
 - D. Producers have strong control over what consumers buy

48. The market system is said to be characterized by "consumer sovereignty." This is because:
- A. A sovereign government determines which consumer goods will be produced
 - B. The prices of consumer goods are regulated by a sovereign government
 - C. Firms must match their production decisions to the consumers' choices
 - D. Consumer goods are considered to be more important than capital goods
49. The term *dollar votes* in a market system means:
- A. Inflation will occur if consumers don't spend wisely
 - B. Voters may be offered dollars to help elect certain political candidates
 - C. Government is responsible for determining what will be considered legal tender
 - D. Consumers "vote" for certain products to be produced by how they spend their incomes
50. Payments that a firm makes to obtain needed resources comprise its:
- A. Costs
 - B. Profits
 - C. Capital
 - D. Revenues
51. In a market system, which of the following will eliminate high-cost producers, and allow only the low-cost producers to survive?
- A. Competition
 - B. Money
 - C. A sovereign government
 - D. Specialization

52. If the total costs of producing 1,500 units of output is \$15,000 and this output sold to consumers for a total of \$16,500, then the firm would earn profits of:
- A. \$1,000
 - B. \$16,500
 - C. \$1,500
 - D. \$15,000
53. The production technique that is most efficient is the one that produces a given amount of output:
- A. using the least amount of labor resources
 - B. at the highest price per unit
 - C. at the lowest cost per unit
 - D. that yields the highest revenues
54. McDonald's introduced the "Big Mac" in 1968 and it turned out to be a hit, but the "Arch Deluxe" introduced in 1996 was not. The success or failure of a product in the market system is determined by:
- A. Capitalism and entrepreneurship
 - B. Specialization and exchange
 - C. Consumer sovereignty and dollar votes
 - D. Capital goods and roundabout production
55. Economic efficiency is the primary guide in answering which of the fundamental questions in a market economy?
- A. What will be produced?
 - B. How is the output to be produced?
 - C. How can the system accommodate change?
 - D. Who is to receive the output?

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Refer to the above table. Using the technique cited in the previous question will result in an:

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

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

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

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

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

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

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

Refer to the above table. At the \$3 price for labor the most efficient technique will result in an:

- A. Economic loss of \$2
 - B. Economic profit of \$1
 - C. Economic profit of \$2
 - D. Economic profit of \$3
63. In a market system, the distribution of goods and services among consumers is largely determined by:
- A. The willingness and ability of consumers to pay the prices
 - B. Whoever needs the goods and services the most
 - C. Whoever has the closest connection to firms and the government
 - D. A random factor that is almost impossible to predict
64. "For whom is a given mix of goods and services to be produced? How, in other words, are the society's outputs to be distributed among its members?" In a market economy, this question is resolved primarily in the:
- A. Public sector through the mechanism of central planning
 - B. Business sector through the mechanism of advertising
 - C. Private sector through the earning and spending of income
 - D. Money market through borrowing and saving by households and businesses

65. The distribution of income in a market system is a primary factor that resolves which of the following fundamental economic questions?
- A. What will be produced?
 - B. How will the output to be produced?
 - C. How will the system accommodate change?
 - D. Who will get the output?
66. In a market economy, the incomes of consumers depend primarily upon:
- A. Government policies in setting wages and interest rates
 - B. The quantity and prices of resources that they possess
 - C. The amount of savings that they have accumulated
 - D. How closely connected they are to government and business leaders
67. If economic profits in a particular industry increase, then we would expect:
- A. Resources to be diverted away from that industry
 - B. Firms in that industry to produce less output
 - C. Firms to enter that industry thus expanding it
 - D. Consumers to buy less from that industry
68. In a market system, resources will move away from an industry when:
- A. Profits of firms in the industry are rising
 - B. Demand for the industry's product is decreasing
 - C. The production of output in the industry is rising
 - D. Profits of firms in other industries are falling

69. "Creative destruction" in a market system is brought about by:
- A. Entrepreneurship
 - B. Striking workers
 - C. Regulation by the government
 - D. Money-based trade
70. An increase in the demand for a product and a reduction in its costs of production would:
- A. Decrease the profits of producers
 - B. Encourage firms to leave an industry
 - C. Encourage firms to enter an industry
 - D. Cause a shortage of the product
71. In a market system, as one industry expands while another contracts, resources will flow:
- A. Away from the expanding industry towards the contracting one
 - B. From one industry due to the changes in resource prices paid by firms
 - C. Towards the industry where the product demand is declining
 - D. Because resource allocation will have to equalize between the two industries
72. The market system communicates changes in market conditions and elicits appropriate responses from businesses and resource suppliers through changes in prices. This is known as the:
- A. Guiding function of prices
 - B. Monetary function of prices
 - C. Circular flow of income
 - D. Market determination of prices

73. The development of the digital video and camera which replaced film cameras is an example of:

- A. Roundabout production
- B. Derived demand
- C. Creative destruction
- D. Specialization

74. Which of the following does not illustrate the idea of *creative destruction*?

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

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

- A. Consumer sovereignty
- B. The invisible hand
- C. Derived demand
- D. Creative destruction

76. Which of the following best describes the "invisible hand" concept?

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

77. The highly influential book by Adam Smith, who brought up the "invisible hand" notion, is titled:

- A. *The Worldly Philosophers*
- B. *The Affluent Society*
- C. *The Age of the Economist*
- D. *The Wealth of Nations*

78. The "invisible hand" concept refers to the:

- A. Guiding function of prices in a market system
- B. Implicit influence that the government has on the actions of firms
- C. Regulatory structure that markets must operate in
- D. Underlying money flows that promote the trading of goods and services

79. Capital accumulation in a market system results from:

- A. Increased purchases of consumers or households
- B. The "invisible hand" that guides the market
- C. Dollar votes by entrepreneurs and business owners
- D. Consumer sovereignty that prevails in the market

80. The major virtues of the market system include all of the following, *except*:

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

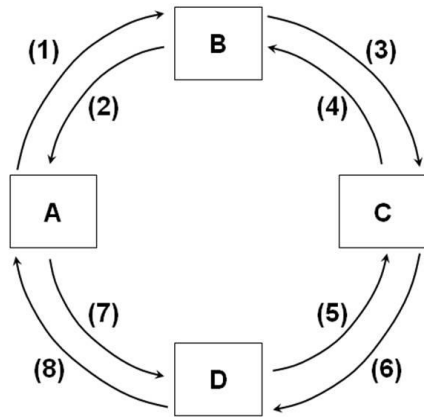
81. The market economy is regarded as "efficient" in that:
- A. It achieves the lowest rate of unemployment
 - B. It leads to the lowest level of poverty in the society
 - C. It directs resources towards products that the society wants most
 - D. It puts the best people in government positions
82. One basic problem faced by central planners, but hardly present in a market system, has to do with:
- A. Determining the production goals or targets in a factory
 - B. Having limited resources and trying to match them with unlimited wants
 - C. Coordinating production in various industries so that bottlenecks do not develop
 - D. Providing financial resources for increasing the real flows of products in the economy
83. The major "success indicator" for business managers in command economies like the Soviet Union and China *in the past* was:
- A. The quantity of output
 - B. Product quality
 - C. The amount of profits
 - D. Worker morale
84. A characteristic of centrally planned economies is that:
- A. The price is relatively unimportant in allocating resources
 - B. Output reflects the pattern of consumer spending
 - C. Entrepreneurship is quite prevalent and highly rewarded
 - D. There are many incentives for innovation and hard work

85. Which is true of an economy which operates entirely through central planning?
- A. Individual economic incentive is reduced by the absence of the profit motive
 - B. There is relative ease in matching resource allocation to consumer demand
 - C. Central planners receive market information through the price mechanism
 - D. The system adapts easily to technological change
86. In a command economy like the old Soviet Union, one is able to improve one's lot and get ahead in society largely through:
- A. Entrepreneurship and risk-taking
 - B. Innovation and profits
 - C. Participating in the political hierarchy
 - D. Getting high prices for one's products and resources
87. What, according to economist Donald Boudreaux in the "Last Word" section of the chapter, best explains why the market system is *not* a random, chaotic mess?
- A. There is active cooperation among private property owners and government officials to correct the excesses of a market economy
 - B. The roundabout methods of production allocate resources from consumers to producers in an orderly fashion
 - C. Government planning limits the chaos, and the government regulates economic activity to create stability in the market
 - D. Private property rights encourage mutual accommodation that leads to an arrangement of resources that is productive

88. In the circular flow model of the market system, households:
- A. Buy products and resources
 - B. Sell products and resources
 - C. Buy products and sell resources
 - D. Sell products and buy resources
89. In the circular flow model of the market system, business firms:
- A. Buy products and resources
 - B. Sell products and resources
 - C. Buy products and sell resources
 - D. Sell products and buy resources
90. The circular flow model illustrates:
- A. The importance of having a central plan for the economy
 - B. How natural and other resources are created
 - C. How money is created by the banking system
 - D. The interdependence of businesses and consumers
91. The simple circular flow model shows that workers and capital-owners offer their services to firms through the:
- A. Product markets
 - B. Resource markets
 - C. Employment agencies
 - D. Government agencies

92. In the circular flow model, households earn their incomes in the:
- A. Resource markets
 - B. Product markets
 - C. Capitalist markets
 - D. Money markets
93. According to the circular flow model, product markets are where:
- A. Households earn their money incomes
 - B. Businesses incur their consumption expenditures to households
 - C. Businesses acquire their inputs from households
 - D. Businesses earn their revenues from households
94. The money income of households consists of all the following, *except*:
- A. Wages
 - B. Profits
 - C. Interest
 - D. Revenues
95. Which of the following would be primarily determined in the resource markets?
- A. The airfares charged by airlines for family vacations
 - B. The wage rates for computer programmers and engineers
 - C. The number of home-internet connections installed
 - D. The amount of money in circulation issued by the government

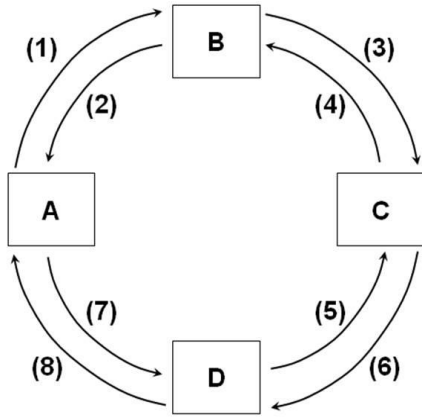
96.



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

- A. Costs
- B. Money income
- C. Consumption expenditures
- D. Resources

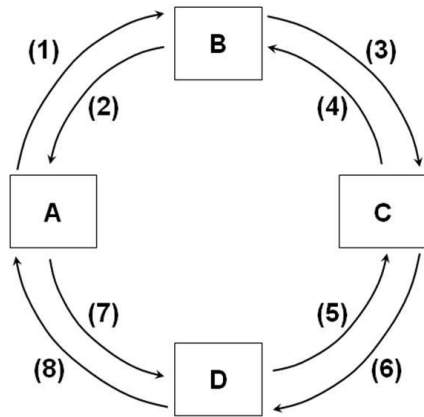
97.



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

- A. Goods and services; consumption expenditures
- B. Consumption expenditures; goods and services
- C. Resources; money income
- D. Money income; resources

98.



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

- A. Resources
- B. Goods and services
- C. Revenues
- D. Money incomes

99. Which of the following is not a major category of business structure?

- A. Sole proprietorship
- B. Partnership
- C. Public agency
- D. Corporation

100. In the circular flow diagram, households get their ability to pay for their consumption expenditures from the:

- A. Revenues they receive for their products
- B. Costs they incur for resources
- C. Incomes they earn for their resources
- D. Goods and services they get in the product markets

101. In the circular flow diagram, firms get their ability to pay for the costs of production from the:

- A. Revenues they receive for their products
- B. Resources they acquire in the resource markets
- C. Incomes they earn for their resources
- D. Goods and services they get in the product markets

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

- A. Labor
- B. Capital suppliers
- C. Entrepreneurs
- D. Customers

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

- A. The profit and loss system
- B. The "invisible hand"
- C. Taxes and subsidies
- D. Consumer sovereignty

104. In a market system, a firm's employees are typically shielded from business risk by:

- A. Profit-sharing agreements
- B. Wage contracts
- C. The Social Security program
- D. Paid vacation leaves

105. One essential trade-off involving business risk which the market system provides is reflected in which of the following?

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

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

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

107. Insurance companies facilitate the transfer of risk from:

- A. Those who have a low-risk tolerance to those with high risk-tolerance
- B. Those who have a high-risk tolerance to those with low risk-tolerance
- C. The insurance companies' owners to the insurance-policy holders
- D. Insurance policyholders to the bankers who lend money to the companies

True / False Questions

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

True False

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

True False

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

True False

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

True False

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

True False

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

True False

114. Selfishness and self-interest are identical concepts.

True False

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

True False

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

True False

117. Being a "jack-of-all-trades" implies reducing the reliance on the division of labor.

True False

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

True False

119. One of the most important economic resources is money.

True False

120. Maximum profits are what motivate consumers to decide who will get the goods and services in a market system.

True False

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

True False

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

True False

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

True False

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

True False

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

True False

126. In a market system, a consumer's willingness to pay—but *not* his ability to pay—is based on his income.

True False

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

True False

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

True False

129. The problems of central planning become less complex as an economy grows in size over time.

True False

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

True False

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

True False

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

True False

133. In a market system, entrepreneurs start up businesses in order to earn a high salary.

True False

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

True False

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

True False

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

True False

137. According to the circular flow model of the market system, when resource-owners' money income is rising, then the costs to business firms must be falling.

True False

138. Have a high fixed salary is what motivates entrepreneurs to make prudent decisions is dealing with business risk.

True False

139. Government bailouts of failing businesses, like banks during the recent economic crisis, will tend to reduce the motivation among entrepreneurs to make prudent decisions is dealing with business risk.

True False

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

True False

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

True False

Chapter 02 The Market System and the Circular Flow **Answer Key**

Multiple Choice Questions

1. Economic systems differ from one another based on who own the factors of production and:
- A. How much resources are available in the economy and where they are located
 - B.** Who make decisions regarding what to produce and how it is produced
 - C. What kinds of products are produced in the economy and how plentiful they are
 - D. How big the population is, and the makeup of the population

AACSB: Communication

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-01 Differentiate between laissez-faire capitalism; the command system; and the market system.

Topic: Economic Systems

2. The market system is an economic system that:
- A. Produces more consumer goods than capital goods
 - B. Produces more capital goods than consumer goods
 - C.** Gives private individuals the right to own resources used in production
 - D. Emphasizes the government's power to control markets and direct economic activity

AACSB: Communication

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-01 Differentiate between laissez-faire capitalism; the command system; and the market system.

Topic: Economic Systems

3. The market system is also known as:

- A. Capitalism
- B. Socialism
- C. Central planning
- D. Production system

AACSB: Communication

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-01 Differentiate between laissez-faire capitalism; the command system; and the market system.

Topic: Economic Systems

4. Laissez-faire capitalism limits the government's economic functions to the following, *except*:

- A. Protecting private property rights
- B. Establishing a legal environment to enforce contracts among individuals
- C. Preventing individuals and firms from coercing others
- D. Setting prices of individual goods and services

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-01 Differentiate between laissez-faire capitalism; the command system; and the market system.

Topic: Economic Systems

5. One major element of the command system is:

- A. An emphasis on private ownership of resources
- B. Individual decentralized decision-making
- C. Reliance on supply-and-demand forces to guide economic activity
- D. Central planning conducted by the government

AACSB: Communication

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-01 Differentiate between laissez-faire capitalism; the command system; and the market system.

Topic: Economic Systems

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

- A. Laissez-faire economy
- B. Pure capitalism
- C. Mixed market economy
- D. Macroeconomic system

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-01 Differentiate between laissez-faire capitalism; the command system; and the market system.

Topic: Economic Systems

7. In a command system:

- A. Self-interest motivates and commands each business firm's decisions and actions
- B. The head of each family decides what to do with the family's resources
- C. The government makes production and allocation decisions
- D. Market traders command what outputs are produced and how they are allocated

AACSB: Communication

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-01 Differentiate between laissez-faire capitalism; the command system; and the market system.

Topic: Economic Systems

8. Which of the following would *not* be emphasized in a capitalist economy?
- A. Private ownership of capital and other resources
 - B. Competition and decentralized decisions
 - C. Reliance on market forces to coordinate economic activity
 - D. Prevention of owners of capital from exposing this resource to risk

AACSB: Communication

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-01 Differentiate between laissez-faire capitalism; the command system; and the market system.

Topic: Economic Systems

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

- A. Laissez-faire capitalism
- B. Command system
- C. Mixed economy
- D. Market system

AACSB: Communication

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-01 Differentiate between laissez-faire capitalism; the command system; and the market system.

Topic: Economic Systems

10. The economies of North Korea and Cuba are:

- A. Similar in that they are both basically command systems
- B. Similar in that they are both basically market systems
- C. Different in that North Korea has a command system while Cuba has a market system
- D. Different in that Cuba has a command system while North Korea has a market system

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-01 Differentiate between laissez-faire capitalism; the command system; and the market system.

Topic: Economic Systems

11. *Laissez-faire* capitalism is characterized by:

- A. Very limited government role in the economy
- B. Active government intervention in the economy
- C. Individuals and firms abiding by a government economic plan
- D. A very fair distribution of income and wealth

AACSB: Communication

Accessibility: Keyboard Navigation

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 02-01 Differentiate between laissez-faire capitalism; the command system; and the market system.

Topic: Economic Systems

12. By freedom of enterprise, we mean that individual:

- A. Workers are free to look for jobs and work in whichever firm will hire them
- B. Firms are free to employ resources, to produce their output, and to sell their products
- C. Producers are free to produce whatever the government decides are needed by the society
- D. Consumers are free to buy whatever products will satisfy their needs the most

AACSB: Communication

Accessibility: Keyboard Navigation

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 02-02 List the main characteristics of the market system.

Topic: Characteristics of the Market System

13. Capitalism gets its name from the fact that capital resources are mostly:

- A. Owned by the state or government
- B. Given the highest priority in the economy's income distribution
- C. Treated as private property
- D. In the form of money and financial resources

AACSB: Communication

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-02 List the main characteristics of the market system.

Topic: Characteristics of the Market System

14. Which of the following statements is correct?

- A. The operation of a market system eventually results in an equal distribution of income
- B. Producers are "sovereign" in a market economy because they determine what is produced
- C. The market system is efficient at allocating resources, but not at allocating products
- D. Freedom of choice and enterprise are essential elements of the market system

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-02 List the main characteristics of the market system.

Topic: Characteristics of the Market System

15. In a market system, self-interest is the motivating force that:

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

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-02 List the main characteristics of the market system.

Topic: Characteristics of the Market System

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

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 02-02 List the main characteristics of the market system.

Topic: Characteristics of the Market System

17. Consumers express self-interest when they:
- A. Seek the lowest price for a product
 - B. Reduce business losses
 - C. Collect economic profits
 - D. Exclude others in their thinking

AACSB: Communication

Accessibility: Keyboard Navigation

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 02-02 List the main characteristics of the market system.

Topic: Characteristics of the Market System

18. Private ownership and property rights in a market system have the following implications, *except*.

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

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 02-02 List the main characteristics of the market system.

Topic: Characteristics of the Market System

19. Which of the following statements about the right to private ownership is false?

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

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-02 List the main characteristics of the market system.

Topic: Characteristics of the Market System

20. Competition is more likely to exist when:

- A. There is easy entry into and exit out of industries
- B. A government-issued license is required to set up a firm in an industry
- C. The government purchases most goods and services
- D. Economic power is concentrated among a few large firms

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 02-02 List the main characteristics of the market system.

Topic: Characteristics of the Market System

21. Competition in a market system denotes a condition where:

- A. The diffusion of economic power limits its potential abuse
- B. Any given product can be purchased at a wide range of prices
- C. Contractual agreements among individual firms are restricted and avoided
- D. A few large sellers are constantly jostling for market share

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 02-02 List the main characteristics of the market system.

Topic: Characteristics of the Market System

22. Which of the following statements about markets and prices is correct?

- A. In a market system, buyers and sellers must be in face-to-face contact with each other
- B. Prices affect the distribution of goods in a market system but not the allocation of resources
- C. In a market system, prices serve to ration goods and services to consumers
- D. The operation of a market system has little, if any, effect on the distribution of income in the economy

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-02 List the main characteristics of the market system.

Topic: Characteristics of the Market System

23. In a capitalist system, the decisions and actions of millions of consumers and firms are highly coordinated by:

- A. The state and government
- B.** Markets and prices
- C. A central planning agency
- D. An international organization

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-02 List the main characteristics of the market system.

Topic: Characteristics of the Market System

24. All of the following statements describe a market economy *except*.

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

AACSB: Communication

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-02 List the main characteristics of the market system.

Topic: Characteristics of the Market System

25. A characteristic of the market system is:
- A. Extensive use of direct methods of production
 - B. A focus on labor, as opposed to capital resources
 - C. Reliance on the use of capital goods to expand total output
 - D. Avoidance of producing goods that do not satisfy consumer wants directly

AACSB: Communication

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-02 List the main characteristics of the market system.

Topic: Characteristics of the Market System

26. Which of the following does not foster innovation and technological advance?

- A. Competition in markets
- B. Freedom of choice and enterprise
- C. Self-interest and personal rewards
- D. Fear and avoidance of risk

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-02 List the main characteristics of the market system.

Topic: Characteristics of the Market System

27. The Heritage Foundation in 2012 ranked which of the following economies to have among the highest economic freedom?

- A. The United States
- B. Germany
- C. Argentina
- D. Hong Kong

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-02 List the main characteristics of the market system.

Topic: Characteristics of the Market System

28. A production system where various workers concentrate on different specialized tasks to contribute towards a whole product is referred to as:

- A. A coincidence of wants
- B. Roundabout production
- C. Freedom of enterprise
- D. Division of labor

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-02 List the main characteristics of the market system.

Topic: Characteristics of the Market System

29. How does human specialization contribute towards increasing an economy's output?

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

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 02-02 List the main characteristics of the market system.

Topic: Characteristics of the Market System

30. With specialization in a market economy, individual:

- A. Firms produce a wide range of products
- B.** Producers consume little or none of the products they produce
- C. Producers consume most of the output that they produce
- D. Consumers have to produce most of what they consume

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 02-02 List the main characteristics of the market system.

Topic: Characteristics of the Market System

31. Which of the following is not a reason why specialization and trade are beneficial to society?

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

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 02-02 List the main characteristics of the market system.

Topic: Characteristics of the Market System

32. A required element for specialization to lead to an increase in the satisfaction of society's wants is:

- A. A capitalist economy
- B.** Exchange and trade
- C. The use of money
- D. A central plan

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-02 List the main characteristics of the market system.

Topic: Characteristics of the Market System

33. Specialization is beneficial:

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

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Apply

Difficulty: 1 Easy

Learning Objective: 02-02 List the main characteristics of the market system.

Topic: Characteristics of the Market System

34. Which is an example of barter?

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

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Apply

Difficulty: 1 Easy

Learning Objective: 02-02 List the main characteristics of the market system.

Topic: Characteristics of the Market System

35. An economic system in which money is *not* used is a:

- A. Planned economy
- B. Market economy
- C. Mixed economy
- D.** Barter economy

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-02 List the main characteristics of the market system.

Topic: Characteristics of the Market System

36. Which of the following is necessary to make a trade in a barter economy?

- A. Money
- B. Unlimited wants
- C. A medium of exchange
- D.** A coincidence of wants

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-02 List the main characteristics of the market system.

Topic: Characteristics of the Market System

37. The use of money for exchange and trade:
- A. Increases the importance of barter
 - B.** Fosters more specialization in production
 - C. Reduces consumer sovereignty
 - D. Raises the need for a coincidence of wants

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 02-02 List the main characteristics of the market system.

Topic: Characteristics of the Market System

38. Anything that is generally acceptable in trading for goods and services is a:

- A.** Medium of exchange
- B. Capital good
- C. Store of value
- D. Token money

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-02 List the main characteristics of the market system.

Topic: Characteristics of the Market System

39. Which of the following is the main problem with the barter system of exchange?

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

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 02-02 List the main characteristics of the market system.

Topic: Characteristics of the Market System

40. International specialization and trade:
- A. Has to be done on a barter system
 - B.** Often requires the exchange of currencies
 - C. Does not illustrate the division of labor
 - D. Requires active government regulation

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Apply

Difficulty: 2 Medium

Learning Objective: 02-02 List the main characteristics of the market system.

Topic: Characteristics of the Market System

41. Why might a company use barter rather than money to make a trade?
- A. Barter trade is generally more efficient than money-based trade
 - B.** Barter can enable two firms to trade when their cash flows are limited
 - C. Money requires a coincidence of wants, barter is more direct
 - D. Money is efficient only for large transactions, so barter is preferred for smaller transactions

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 02-02 List the main characteristics of the market system.

Topic: Characteristics of the Market System

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

- A. Entrepreneurship
- B. Self-interest
- C. Competition
- D. Government

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-02 List the main characteristics of the market system.

Topic: Characteristics of the Market System

43. If a nation restricts trade with other nations, then the most likely effect is:

- A. Lower prices of goods and services in the nation
- B. Increased specialization of production
- C. Expanded economic wealth of the nation
- D. Make consumers in the nation worse off

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

Blooms: Apply

Difficulty: 3 Hard

Learning Objective: 02-02 List the main characteristics of the market system.

Topic: Characteristics of the Market System

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

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

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.

Topic: Five Fundamental Questions

45. Which of the following is *not* one of the five fundamental questions that an economy must deal with?
- A. How will the goods and services be produced?
 - B.** Why should the goods and services be produced?
 - C. Who is to receive the goods and services produced in the economy?
 - D. In what ways will progress be promoted?

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.

Topic: Five Fundamental Questions

46. Consumer sovereignty and "dollar votes" guide the market system in dealing with which fundamental economic question?
- A.** Which output will be produced?
 - B. How is the output to be produced?
 - C. How can the system accommodate change?
 - D. Who is to receive the output?

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.

Topic: Five Fundamental Questions

47. The term *consumer sovereignty* means that:
- A. Government is responsible for protecting consumers' interests
 - B.** What is produced is ultimately determined by what consumers buy
 - C. There are no limits on what consumers may buy in a market system
 - D. Producers have strong control over what consumers buy

AACSB: Communication

Accessibility: Keyboard Navigation

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.

Topic: Five Fundamental Questions

48. The market system is said to be characterized by "consumer sovereignty." This is because:
- A. A sovereign government determines which consumer goods will be produced
 - B. The prices of consumer goods are regulated by a sovereign government
 - C.** Firms must match their production decisions to the consumers' choices
 - D. Consumer goods are considered to be more important than capital goods

AACSB: Communication

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.

Topic: Five Fundamental Questions

49. The term *dollar votes* in a market system means:

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

AACSB: Communication

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.

Topic: Five Fundamental Questions

50. Payments that a firm makes to obtain needed resources comprise its:

- A. Costs
- B. Profits
- C. Capital
- D. Revenues

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.

Topic: Five Fundamental Questions

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

- A. Competition
- B. Money
- C. A sovereign government
- D. Specialization

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.

Topic: Five Fundamental Questions

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

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

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.

Topic: Five Fundamental Questions

53. The production technique that is most efficient is the one that produces a given amount of output:

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

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.

Topic: Five Fundamental Questions

54. McDonald's introduced the "Big Mac" in 1968 and it turned out to be a hit, but the "Arch Deluxe" introduced in 1996 was not. The success or failure of a product in the market system is determined by:

- A. Capitalism and entrepreneurship
- B. Specialization and exchange
- C. Consumer sovereignty and dollar votes
- D. Capital goods and roundabout production

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.

Topic: Five Fundamental Questions

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

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

*AACSB: Analytic
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Easy*

*Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: Five Fundamental Questions*

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

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

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

- A. A
- B. B
- C. C
- D.** D

*AACSB: Analytic
Blooms: Apply
Difficulty: 2 Medium*

Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.

Topic: Five Fundamental Questions

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

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

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

- A. \$70
- B. \$57
- C.** \$13
- D. \$83

AACSB: Analytic

Blooms: Apply

Difficulty: 3 Hard

Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.

Topic: Five Fundamental Questions

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

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

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

- A. A
- B. B**
- C. C
- D. D

AACSB: Analytic

Blooms: Apply

Difficulty: 3 Hard

Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.

Topic: Five Fundamental Questions

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

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

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

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

AACSB: Analytic

Blooms: Apply

Difficulty: 2 Medium

Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.

Topic: Five Fundamental Questions

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

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

Refer to the above table. Using the technique cited in the previous question will result in an:

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

AACSB: Analytic

Blooms: Apply

Difficulty: 2 Medium

Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.

Topic: Five Fundamental Questions

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

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

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

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

AACSB: Analytic

Blooms: Apply

Difficulty: 3 Hard

Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.

Topic: Five Fundamental Questions

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

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

Refer to the above table. At the \$3 price for labor the most efficient technique will result in an:

- A. Economic loss of \$2
- B.** Economic profit of \$1
- C. Economic profit of \$2
- D. Economic profit of \$3

AACSB: Analytic

Blooms: Apply

Difficulty: 3 Hard

Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.

Topic: Five Fundamental Questions

63. In a market system, the distribution of goods and services among consumers is largely determined by:

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

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.

Topic: Five Fundamental Questions

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

- A. Public sector through the mechanism of central planning
- B. Business sector through the mechanism of advertising
- C. Private sector through the earning and spending of income
- D. Money market through borrowing and saving by households and businesses

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.

Topic: Five Fundamental Questions

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

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

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.

Topic: Five Fundamental Questions

66. In a market economy, the incomes of consumers depend primarily upon:

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

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.

Topic: Five Fundamental Questions

67. If economic profits in a particular industry increase, then we would expect:

- A. Resources to be diverted away from that industry
- B. Firms in that industry to produce less output
- C.** Firms to enter that industry thus expanding it
- D. Consumers to buy less from that industry

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-04 Explain the operation of the "invisible hand" and why market economies usually do a better job than command economies at efficiently transforming economic resources into desirable output.

Topic: Five Fundamental Questions

68. In a market system, resources will move away from an industry when:

- A. Profits of firms in the industry are rising
- B.** Demand for the industry's product is decreasing
- C. The production of output in the industry is rising
- D. Profits of firms in other industries are falling

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 02-04 Explain the operation of the "invisible hand" and why market economies usually do a better job than command economies at efficiently transforming economic resources into desirable output.

Topic: Five Fundamental Questions

69. "Creative destruction" in a market system is brought about by:

- A.** Entrepreneurship
- B. Striking workers
- C. Regulation by the government
- D. Money-based trade

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 02-04 Explain the operation of the "invisible hand" and why market economies usually do a better job than command economies at efficiently transforming economic resources into desirable output.

Topic: Five Fundamental Questions

70. An increase in the demand for a product and a reduction in its costs of production would:

- A. Decrease the profits of producers
- B. Encourage firms to leave an industry
- C.** Encourage firms to enter an industry
- D. Cause a shortage of the product

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 02-04 Explain the operation of the "invisible hand" and why market economies usually do a better job than command economies at efficiently transforming economic resources into desirable output.

Topic: Five Fundamental Questions

71. In a market system, as one industry expands while another contracts, resources will flow:

- A. Away from the expanding industry towards the contracting one
- B.** From one industry due to the changes in resource prices paid by firms
- C. Towards the industry where the product demand is declining
- D. Because resource allocation will have to equalize between the two industries

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 02-04 Explain the operation of the "invisible hand" and why market economies usually do a better job than command economies at efficiently transforming economic resources into desirable output.

Topic: Five Fundamental Questions

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

- A. Guiding function of prices
- B. Monetary function of prices
- C. Circular flow of income
- D. Market determination of prices

AACSB: Communication

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-04 Explain the operation of the "invisible hand" and why market economies usually do a better job than command economies at efficiently transforming economic resources into desirable output.

Topic: Five Fundamental Questions

73. The development of the digital video and camera which replaced film cameras is an example of:

- A. Roundabout production
- B. Derived demand
- C. Creative destruction
- D. Specialization

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 02-04 Explain the operation of the "invisible hand" and why market economies usually do a better job than command economies at efficiently transforming economic resources into desirable output.

Topic: Five Fundamental Questions

74. Which of the following does not illustrate the idea of *creative destruction*?

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

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

Blooms: Apply

Difficulty: 2 Medium

Learning Objective: 02-04 Explain the operation of the "invisible hand" and why market economies usually do a better job than command economies at efficiently transforming economic resources into desirable output.

Topic: Five Fundamental Questions

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

- A. Consumer sovereignty
- B.** The invisible hand
- C. Derived demand
- D. Creative destruction

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-04 Explain the operation of the "invisible hand" and why market economies usually do a better job than command economies at efficiently transforming economic resources into desirable output.

Topic: The "Invisible Hand"

76. Which of the following best describes the "invisible hand" concept?

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

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-04 Explain the operation of the "invisible hand" and why market economies usually do a better job than command economies at efficiently transforming economic resources into desirable output.

Topic: The "Invisible Hand"

77. The highly influential book by Adam Smith, who brought up the "invisible hand" notion, is titled:

- A. *The Worldly Philosophers*
- B. *The Affluent Society*
- C. *The Age of the Economist*
- D. *The Wealth of Nations*

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-04 Explain the operation of the "invisible hand" and why market economies usually do a better job than command economies at efficiently transforming economic resources into desirable output.

Topic: The "Invisible Hand"

78. The "invisible hand" concept refers to the:

- A. Guiding function of prices in a market system
- B. Implicit influence that the government has on the actions of firms
- C. Regulatory structure that markets must operate in
- D. Underlying money flows that promote the trading of goods and services

AACSB: Communication

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-04 Explain the operation of the "invisible hand" and why market economies usually do a better job than command economies at efficiently transforming economic resources into desirable output.

Topic: The "Invisible Hand"

79. Capital accumulation in a market system results from:

- A. Increased purchases of consumers or households
- B. The "invisible hand" that guides the market
- C. Dollar votes by entrepreneurs and business owners
- D. Consumer sovereignty that prevails in the market

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-04 Explain the operation of the "invisible hand" and why market economies usually do a better job than command economies at efficiently transforming economic resources into desirable output.

Topic: The "Invisible Hand"

80. The major virtues of the market system include all of the following, *except*.

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

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-04 Explain the operation of the "invisible hand" and why market economies usually do a better job than command economies at efficiently transforming economic resources into desirable output.

Topic: The "Invisible Hand"

81. The market economy is regarded as "efficient" in that:

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

AACSB: Communication

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-04 Explain the operation of the "invisible hand" and why market economies usually do a better job than command economies at efficiently transforming economic resources into desirable output.

Topic: The "Invisible Hand"

82. One basic problem faced by central planners, but hardly present in a market system, has to do with:

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

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-04 Explain the operation of the "invisible hand" and why market economies usually do a better job than command economies at efficiently transforming economic resources into desirable output.

Topic: The Demise of the Command Systems

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

- A. The quantity of output
- B. Product quality
- C. The amount of profits
- D. Worker morale

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-04 Explain the operation of the "invisible hand" and why market economies usually do a better job than command economies at efficiently transforming economic resources into desirable output.

Topic: The Demise of the Command Systems

84. A characteristic of centrally planned economies is that:

- A. The price is relatively unimportant in allocating resources
- B. Output reflects the pattern of consumer spending
- C. Entrepreneurship is quite prevalent and highly rewarded
- D. There are many incentives for innovation and hard work

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-04 Explain the operation of the "invisible hand" and why market economies usually do a better job than command economies at efficiently transforming economic resources into desirable output.

Topic: The Demise of the Command Systems

85. Which is true of an economy which operates entirely through central planning?

- A. Individual economic incentive is reduced by the absence of the profit motive
- B. There is relative ease in matching resource allocation to consumer demand
- C. Central planners receive market information through the price mechanism
- D. The system adapts easily to technological change

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-04 Explain the operation of the "invisible hand" and why market economies usually do a better job than command economies at efficiently transforming economic resources into desirable output.

Topic: The Demise of the Command Systems

86. In a command economy like the old Soviet Union, one is able to improve one's lot and get ahead in society largely through:
- A. Entrepreneurship and risk-taking
 - B. Innovation and profits
 - C. Participating in the political hierarchy
 - D. Getting high prices for one's products and resources

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 02-04 Explain the operation of the "invisible hand" and why market economies usually do a better job than command economies at efficiently transforming economic resources into desirable output.

Topic: The Demise of the Command Systems

87. What, according to economist Donald Boudreaux in the "Last Word" section of the chapter, best explains why the market system is *not* a random, chaotic mess?
- A. There is active cooperation among private property owners and government officials to correct the excesses of a market economy
 - B. The roundabout methods of production allocate resources from consumers to producers in an orderly fashion
 - C. Government planning limits the chaos, and the government regulates economic activity to create stability in the market
 - D. Private property rights encourage mutual accommodation that leads to an arrangement of resources that is productive

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 02-04 Explain the operation of the "invisible hand" and why market economies usually do a better job than command economies at efficiently transforming economic resources into desirable output.

Topic: Five Fundamental Questions

88. In the circular flow model of the market system, households:

- A. Buy products and resources
- B. Sell products and resources
- C. Buy products and sell resources
- D. Sell products and buy resources

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-05 Describe the mechanics of the circular flow model.

Topic: The Circular Flow Model

89. In the circular flow model of the market system, business firms:

- A. Buy products and resources
- B. Sell products and resources
- C. Buy products and sell resources
- D. Sell products and buy resources

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-05 Describe the mechanics of the circular flow model.

Topic: The Circular Flow Model

90. The circular flow model illustrates:

- A. The importance of having a central plan for the economy
- B. How natural and other resources are created
- C. How money is created by the banking system
- D. The interdependence of businesses and consumers

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-05 Describe the mechanics of the circular flow model.

Topic: The Circular Flow Model

91. The simple circular flow model shows that workers and capital-owners offer their services to firms through the:

- A. Product markets
- B.** Resource markets
- C. Employment agencies
- D. Government agencies

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-05 Describe the mechanics of the circular flow model.

Topic: The Circular Flow Model

92. In the circular flow model, households earn their incomes in the:

- A.** Resource markets
- B. Product markets
- C. Capitalist markets
- D. Money markets

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-05 Describe the mechanics of the circular flow model.

Topic: The Circular Flow Model

93. According to the circular flow model, product markets are where:

- A. Households earn their money incomes
- B. Businesses incur their consumption expenditures to households
- C. Businesses acquire their inputs from households
- D. Businesses earn their revenues from households

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-05 Describe the mechanics of the circular flow model.

Topic: The Circular Flow Model

94. The money income of households consists of all the following, *except*:

- A. Wages
- B. Profits
- C. Interest
- D. Revenues

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-05 Describe the mechanics of the circular flow model.

Topic: The Circular Flow Model

95. Which of the following would be primarily determined in the resource markets?

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

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

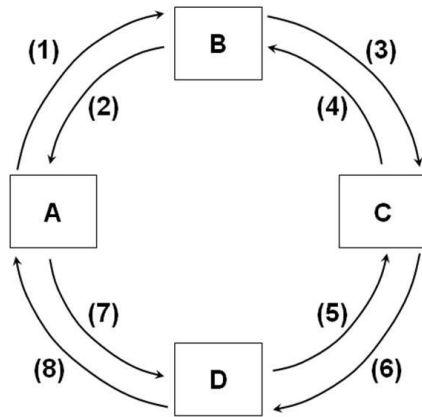
Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 02-05 Describe the mechanics of the circular flow model.

Topic: The Circular Flow Model

96.



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

- A. Costs
- B. Money income
- C. Consumption expenditures
- D. Resources

AACSB: Analytic

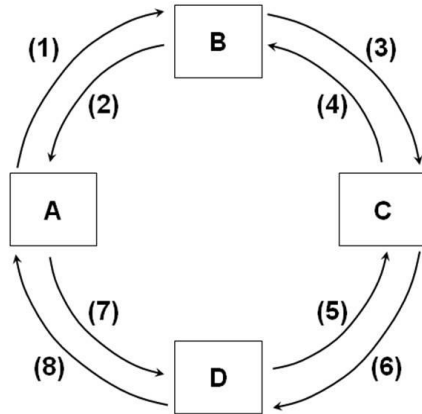
Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 02-05 Describe the mechanics of the circular flow model.

Topic: The Circular Flow Model

97.



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

- A. Goods and services; consumption expenditures
- B. Consumption expenditures; goods and services
- C. Resources; money income
- D. Money income; resources

AACSB: Analytic

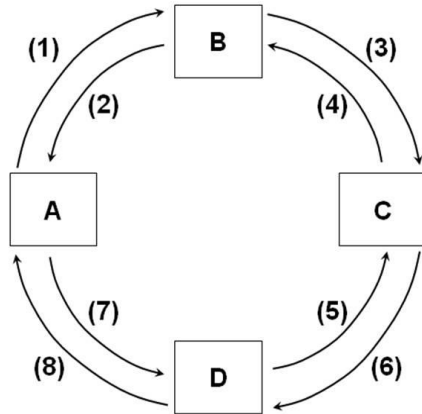
Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 02-05 Describe the mechanics of the circular flow model.

Topic: The Circular Flow Model

98.



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

- A. Resources
- B. Goods and services**
- C. Revenues
- D. Money incomes

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-05 Describe the mechanics of the circular flow model.

Topic: The Circular Flow Model

99. Which of the following is not a major category of business structure?

- A. Sole proprietorship
- B. Partnership
- C. Public agency**
- D. Corporation

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-05 Describe the mechanics of the circular flow model.

Topic: The Circular Flow Model

100. In the circular flow diagram, households get their ability to pay for their consumption expenditures from the:

- A. Revenues they receive for their products
- B. Costs they incur for resources
- C. Incomes they earn for their resources
- D. Goods and services they get in the product markets

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

Blooms: Apply

Difficulty: 2 Medium

Learning Objective: 02-05 Describe the mechanics of the circular flow model.

Topic: The Circular Flow Model

101. In the circular flow diagram, firms get their ability to pay for the costs of production from the:

- A. Revenues they receive for their products
- B. Resources they acquire in the resource markets
- C. Incomes they earn for their resources
- D. Goods and services they get in the product markets

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

Blooms: Apply

Difficulty: 2 Medium

Learning Objective: 02-05 Describe the mechanics of the circular flow model.

Topic: The Circular Flow Model

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

- A. Labor
- B. Capital suppliers
- C. Entrepreneurs
- D. Customers

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-06 Explain how the market system deals with risk.

Topic: How the Market System Deals with Risk

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

- A. The profit and loss system
- B. The "invisible hand"
- C. Taxes and subsidies
- D. Consumer sovereignty

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-06 Explain how the market system deals with risk.

Topic: How the Market System Deals with Risk

104. In a market system, a firm's employees are typically shielded from business risk by:

- A. Profit-sharing agreements
- B. Wage contracts**
- C. The Social Security program
- D. Paid vacation leaves

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 02-06 Explain how the market system deals with risk.

Topic: How the Market System Deals with Risk

105. One essential trade-off involving business risk which the market system provides is reflected in which of the following?

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

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 02-06 Explain how the market system deals with risk.

Topic: How the Market System Deals with Risk

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

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

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 02-06 Explain how the market system deals with risk.

Topic: How the Market System Deals with Risk

107. Insurance companies facilitate the transfer of risk from:

- A.** Those who have a low-risk tolerance to those with high risk-tolerance
- B. Those who have a high-risk tolerance to those with low risk-tolerance
- C. The insurance companies' owners to the insurance-policy holders
- D. Insurance policyholders to the bankers who lend money to the companies

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 02-06 Explain how the market system deals with risk.

Topic: How the Market System Deals with Risk

True / False Questions

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

TRUE

*AACSB: Analytic
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Easy*

*Learning Objective: 02-01 Differentiate between laissez-faire capitalism; the command system; and the market system.
Topic: Economic Systems*

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

TRUE

*AACSB: Analytic
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Easy*

*Learning Objective: 02-01 Differentiate between laissez-faire capitalism; the command system; and the market system.
Topic: Economic Systems*

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

FALSE

*AACSB: Analytic
Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: 1 Easy*

*Learning Objective: 02-01 Differentiate between laissez-faire capitalism; the command system; and the market system.
Topic: Economic Systems*

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

FALSE

*AACSB: Analytic
Accessibility: Keyboard Navigation*

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-01 Differentiate between laissez-faire capitalism; the command system; and the market system.

Topic: Economic Systems

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

FALSE

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 02-02 List the main characteristics of the market system.

Topic: Characteristics of the Market System

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

FALSE

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-02 List the main characteristics of the market system.

Topic: Characteristics of the Market System

114. Selfishness and self-interest are identical concepts.

FALSE

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-02 List the main characteristics of the market system.

Topic: Characteristics of the Market System

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

FALSE

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Understand

Difficulty: 3 Hard

Learning Objective: 02-02 List the main characteristics of the market system.

Topic: Characteristics of the Market System

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

FALSE

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 02-02 List the main characteristics of the market system.

Topic: Characteristics of the Market System

117. Being a "jack-of-all-trades" implies reducing the reliance on the division of labor.

TRUE

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 02-02 List the main characteristics of the market system.

Topic: Characteristics of the Market System

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

FALSE

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-02 List the main characteristics of the market system.

Topic: Characteristics of the Market System

119. One of the most important economic resources is money.

FALSE

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-02 List the main characteristics of the market system.

Topic: Characteristics of the Market System

120. Maximum profits are what motivate consumers to decide who will get the goods and services in a market system.

FALSE

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.

Topic: Five Fundamental Questions

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

FALSE

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.

Topic: Five Fundamental Questions

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

FALSE

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.

Topic: Five Fundamental Questions

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

FALSE

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.

Topic: Five Fundamental Questions

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

FALSE

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.

Topic: Five Fundamental Questions

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

TRUE

AACSB: Reflective Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 3 Hard

Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: Five Fundamental Questions

126. In a market system, a consumer's willingness to pay—but *not* his ability to pay—is based on his income.

FALSE

AACSB: Reflective Thinking
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: Five Fundamental Questions

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

FALSE

AACSB: Analytic
Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 02-04 Explain the operation of the "invisible hand" and why market economies usually do a better job than command economies at efficiently transforming economic resources into desirable output.
Topic: The "Invisible Hand"

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

TRUE

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-04 Explain the operation of the "invisible hand" and why market economies usually do a better job than command economies at efficiently transforming economic resources into desirable output.

Topic: The "Invisible Hand"

129. The problems of central planning become less complex as an economy grows in size over time.

FALSE

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-04 Explain the operation of the "invisible hand" and why market economies usually do a better job than command economies at efficiently transforming economic resources into desirable output.

Topic: The Demise of the Command Systems

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

FALSE

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-04 Explain the operation of the "invisible hand" and why market economies usually do a better job than command economies at efficiently transforming economic resources into desirable output.

Topic: The Demise of the Command Systems

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

FALSE

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 02-04 Explain the operation of the "invisible hand" and why market economies usually do a better job than command economies at efficiently transforming economic resources into desirable output.

Topic: The Demise of the Command Systems

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

FALSE

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-05 Describe the mechanics of the circular flow model.

Topic: The Circular Flow Model

133. In a market system, entrepreneurs start up businesses in order to earn a high salary.

FALSE

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-05 Describe the mechanics of the circular flow model.

Topic: The Circular Flow Model

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

FALSE

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-05 Describe the mechanics of the circular flow model.

Topic: The Circular Flow Model

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

FALSE

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-05 Describe the mechanics of the circular flow model.

Topic: The Circular Flow Model

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

TRUE

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 02-05 Describe the mechanics of the circular flow model.

Topic: The Circular Flow Model

137. According to the circular flow model of the market system, when resource-owners' money income is rising, then the costs to business firms must be falling.

FALSE

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

Blooms: Understand

Difficulty: 3 Hard

Learning Objective: 02-05 Describe the mechanics of the circular flow model.

Topic: The Circular Flow Model

138. Have a high fixed salary is what motivates entrepreneurs to make prudent decisions is dealing with business risk.

FALSE

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-06 Explain how the market system deals with risk.

Topic: How the Market System Deals with Risk

139. Government bailouts of failing businesses, like banks during the recent economic crisis, will tend to reduce the motivation among entrepreneurs to make prudent decisions is dealing with business risk.

TRUE

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

Blooms: Apply

Difficulty: 3 Hard

Learning Objective: 02-06 Explain how the market system deals with risk.

Topic: How the Market System Deals with Risk

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

TRUE

AACSB: Reflective Thinking

Accessibility: Keyboard Navigation

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 02-06 Explain how the market system deals with risk.

Topic: How the Market System Deals with Risk

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

TRUE

AACSB: Analytic

Accessibility: Keyboard Navigation

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-06 Explain how the market system deals with risk.

Topic: How the Market System Deals with Risk