

Chapter 2 Trade-offs, Comparative Advantage, and the Market System

2.3 The Market System

1) Which of the following is a factor of production?

- A) a sofa produced by a furniture manufacturer
- B) 20 shares of Microsoft stock
- C) the janitor at the local elementary school
- D) \$500 in cash

Answer: C

Diff: 2 Page Ref: 51/51

Topic: Factors of Production

*: Recurring

Learning Outcome: Micro 3: Discuss different types of market systems and the gains that can be made from trade

AACSB: Reflective Thinking

Special Feature: None

- 2) An example of a factor of production is
- A) a car produced by an auto manufacturer.
 - B) a worker hired by an auto manufacturer.
 - C) a loan granted to an auto manufacturer.
 - D) the automobiles exported by an auto manufacturer.

Answer: B

Diff: 2 Page Ref: 51/51

Topic: Factors of Production

*: Recurring

Learning Outcome: Micro 3: Discuss different types of market systems and the gains that can be made from trade

AACSB: Reflective Thinking

Special Feature: None

- 3) If a vineyard wants to raise funds to purchase a new bottling machine, it does so in the
- A) factor market.
 - B) output market.
 - C) product market.
 - D) alcoholic beverages market.

Answer: A

Diff: 1 Page Ref: 51/51

Topic: Markets

*: Recurring

Learning Outcome: Micro 3: Discuss different types of market systems and the gains that can be made from trade

AACSB: Reflective Thinking

Special Feature: None

- 4) A worker is hired in a
- A) goods and services market.
 - B) product market.
 - C) government market.
 - D) factor market.

Answer: D

Diff: 1 Page Ref: 51/51

Topic: Markets

*: Recurring

Learning Outcome: Micro 3: Discuss different types of market systems and the gains that can be made from trade

AACSB: Reflective Thinking

Special Feature: None

5) When you purchase a new surfboard you do so in the

- A) resource market.
- B) product market
- C) input market
- D) factor market

Answer: B

Diff: 1 Page Ref: 51/51

Topic: Markets

*: Recurring

Learning Outcome: Micro 3: Discuss different types of market systems and the gains that can be made from trade

AACSB: Reflective Thinking

Special Feature: None

6) The resource income earned by those who supply labor services is called

- A) wages and salaries.
- B) stock options.
- C) profit.
- D) bonus.

Answer: A

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Topic: Factors of Production

*: Recurring

Learning Outcome: Micro 3: Discuss different types of market systems and the gains that can be made from trade

AACSB: Reflective Thinking

Special Feature: None

7) Which of the following statements about an entrepreneur is true?

- A) purchases other factors of production in the output market
- B) develops the vision for the firm and funds the producing unit
- C) sells his entrepreneurial services in the output market
- D) does not face personal risk

Answer: B

Diff: 2 Page Ref: 52/52

Topic: Factors of Production

*: Recurring

Learning Outcome: Micro 3: Discuss different types of market systems and the gains that can be made from trade

AACSB: Reflective Thinking

Special Feature: None

- 8) The circular flow model demonstrates
- A) the role of the government in overseeing the market system.
 - B) the roles played by households and firms in the market system.
 - C) how shortages and surpluses are eliminated in a market.
 - D) how demand and supply for goods and services are brought into equilibrium.

Answer: B

Diff: 2 Page Ref: 52/52

Topic: The Circular Flow of Income

*: Recurring

Learning Outcome: Micro 3: Discuss different types of market systems and the gains that can be made from trade

AACSB: Reflective Thinking

Special Feature: None

9) Firms

- A) have no influence on the circular flow in a market economy.
- B) purchase resources in the product market.
- C) sell goods in the product market.
- D) sell resources in the factor market.

Answer: C

Diff: 1 Page Ref: 52/52

Topic: The Circular Flow of Income

*: Recurring

Learning Outcome: Micro 3: Discuss different types of market systems and the gains that can be made from trade

AACSB: Reflective Thinking

Special Feature: None

10) Households

- A) purchase final goods and services in the factor market.
- B) purchase final goods and services in the product market.
- C) purchase resources in the product market.
- D) purchase resources in the factor market.

Answer: B

Diff: 1 Page Ref: 52/52

Topic: The Circular Flow of Income

*: Recurring

Learning Outcome: Micro 3: Discuss different types of market systems and the gains that can be made from trade

AACSB: Reflective Thinking

Special Feature: None

- 11) In the circular flow model, households
- A) sell goods and services in the input market.
 - B) and firms spend earnings from resource sales on goods and services in the factor market.
 - C) hire resources sold by firms in the factor market.
 - D) spend earnings from resource sales on goods and services in the product market.

Answer: D

Diff: 1 Page Ref: 52/52

Topic: The Circular Flow of Income

*: Recurring

Learning Outcome: Micro 20: Apply the concepts of opportunity cost, marginal analysis, and present value to make decisions

AACSB: Reflective Thinking

Special Feature: None

- 12) Which of the following is *not* a flow in the circular flow model?
- A) the flow of goods and services and the flow of resources to produce goods and services
 - B) the flow of profit and the flow of revenue
 - C) the flow of income earned by households and the flow of expenditures incurred by households
 - D) the flow of revenue received by producers and the flow of payments to resource owners

Answer: B

Diff: 2 Page Ref: 52/52

Topic: The Circular Flow of Income

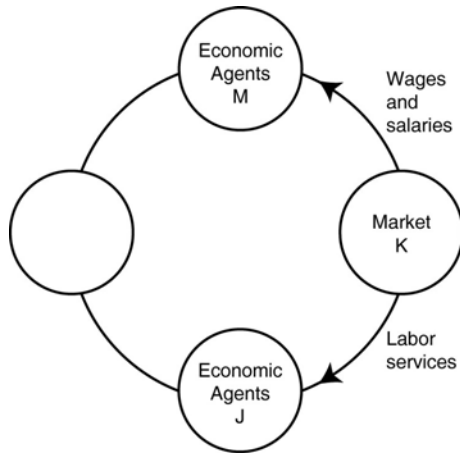
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Learning Outcome: Micro 3: Discuss different types of market systems and the gains that can be made from trade

AACSB: Reflective Thinking

Special Feature: None

Figure 2-8



13) **Refer to Figure 2-8.** In the circular flow diagram, market *K* represents

- A) households.
- B) product markets.
- C) firms.
- D) factor markets.

Answer: D

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Topic: The Circular Flow of Income

*: Recurring

Learning Outcome: Micro 2: Interpret and analyze information presented in different types of graphs

AACSB: Reflective Thinking

Special Feature: None

14) **Refer to Figure 2-8.** In the circular flow diagram, economic agents *M* represent

- A) households.
- B) product markets.
- C) firms.
- D) factor markets.

Answer: A

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Topic: The Circular Flow of Income

*: Recurring

Learning Outcome: Micro 2: Interpret and analyze information presented in different types of graphs

AACSB: Reflective Thinking

Special Feature: None

- 15) Which of the following are represented by the same flow in the circular flow model?
- A) the flow of goods and the flow of factors of production
 - B) the flow of costs and the flow of revenue
 - C) the flow of income earned from the sale of resources and the flow of expenditures on goods and services.
 - D) the flow of income received by households and the flow of tax revenues paid by firms

Answer: B

Diff: 2 Page Ref: 52-53/52-53

Topic: The Circular Flow of Income

*: Recurring

Learning Outcome: Micro 3: Discuss different types of market systems and the gains that can be made from trade

AACSB: Reflective Thinking

Special Feature: None

- 16) Which of the following statements is true about a simple circular flow model?
- A) Producers are neither buyers nor sellers in the product market.
 - B) Households are neither buyers nor sellers in the input market.
 - C) Producers are buyers in the factors market.
 - D) Households are sellers in the product market.

Answer: C

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Topic: The Circular Flow of Income

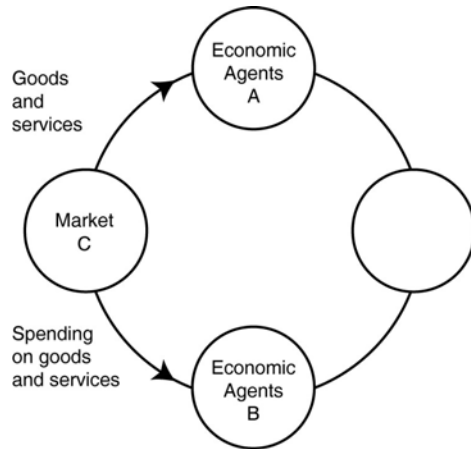
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Learning Outcome: Micro 3: Discuss different types of market systems and the gains that can be made from trade

AACSB: Reflective Thinking

Special Feature: None

Figure 2-9



17) **Refer to Figure 2-9.** In the circular flow diagram, who are economic agents *A* and who are economic agents *B*?

- A) *A* = firms; *B* = households
- B) *A* = households; *B* = firms
- C) *A* = households; *B* = factor markets
- D) *A* = firms; *B* = product markets

Answer: B

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Topic: The Circular Flow of Income

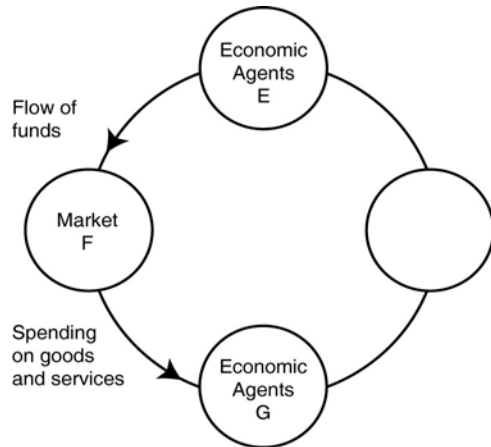
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Learning Outcome: Micro 2: Interpret and analyze information presented in different types of graphs

AACSB: Reflective Thinking

Special Feature: None

Figure 2-10



18) **Refer to Figure 2-10.** One segment of the circular flow diagram in the Figure shows the flow of funds from market *F* to economic agents *G*. The funds represent spending on goods and services. What is market *F* and who are economic agents *G*?

- A) *F* = factor markets; *G* = households
- B) *F* = product markets; *G* = households
- C) *F* = factor markets; *G* = firms
- D) *F* = product markets; *G* = firms

Answer: D

Diff: 2 Page Ref: 52-53/52-53

Topic: The Circular Flow of Income

*: Recurring

Learning Outcome: Micro 3: Discuss different types of market systems and the gains that can be made from trade

AACSB: Reflective Thinking

Special Feature: None

19) Which of the following is an examples of spending on factors of production in the circular flow model?

- A) Tuan purchases a cappuccino at the student union.
- B) Laurence rents a car to drive to a wedding in San Diego.
- C) Yvette pays \$50 to join a softball league.
- D) The "Lucky Ducky" casino buys a new craps table for the casino floor.

Answer: D

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Topic: The Circular Flow of Income

*: Recurring

Learning Outcome: Micro 3: Discuss different types of market systems and the gains that can be made from trade

AACSB: Reflective Thinking

Special Feature: None

20) All of the following are examples of spending on goods and services in the circular flow model *except*

- A) Amanda purchases a new electric guitar to pursue her hobby seriously.
- B) Chaitanya buys a new spa pedicure chair for her expanding nail salon business.
- C) Hernan buys a pizza at Papa C's.
- D) Lenny buys a new digital camera to take pictures at his son's graduation.

Answer: B

Diff: 2 Page Ref: 52-53/52-53

Topic: The Circular Flow of Income

*: Recurring

Learning Outcome: Micro 3: Discuss different types of market systems and the gains that can be made from trade

AACSB: Reflective Thinking

Special Feature: None

21) Published in 1776, _____ was written by Adam Smith.

- A) "The General Theory of Employment, Interest, and Money"
- B) "The Communist Manifesto"
- C) "The Declaration of Economics"
- D) "An Inquiry into the Nature and Causes of the Wealth of Nations"

Answer: D

Diff: 1 Page Ref: 53/53

Topic: Markets

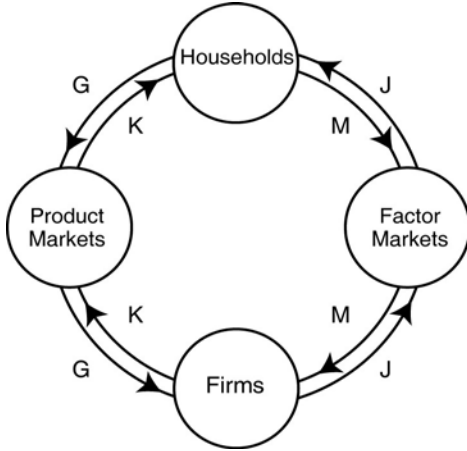
*: Recurring

Learning Outcome: Micro 1: Identify the basic principles of economics and explain how to think like an economist

AACSB: Reflective Thinking

Special Feature: None

Figure 2-11



22) **Refer to Figure 2-11.** Which two arrows in the diagram depict the following transaction: Stanley purchases the novel, "Night of Sorrows" for his summer reading pleasure.

- A) *J* and *M*
- B) *J* and *G*
- C) *K* and *M*
- D) *K* and *G*

Answer: D

Diff: 2 Page Ref: 52-53/52-53

Topic: The Circular Flow of Income

*: Recurring

Learning Outcome: Micro 2: Interpret and analyze information presented in different types of graphs

AACSB: Reflective Thinking

Special Feature: None

23) **Refer to Figure 2-11.** Which two arrows in the diagram depict the following transaction: Lizzie Haxem hires "The Paint Pros," a professional painting company, to paint her home.

- A) *J* and *M*
- B) *K* and *G*
- C) *K* and *M*
- D) *J* and *G*

Answer: B

Diff: 2 Page Ref: 52-53/52-53

Topic: The Circular Flow of Income

*: Recurring

Learning Outcome: Micro 2: Interpret and analyze information presented in different types of graphs

AACSB: Reflective Thinking

Special Feature: None

24) **Refer to Figure 2-11.** Which two arrows in the diagram depict the following transaction: Carter earns a \$400 commission for selling men's designer shoes at Brooks Brothers.

- A) *J* and *M*
- B) *K* and *G*
- C) *K* and *M*
- D) *J* and *G*

Answer: A

Diff: 2 Page Ref: 52-53/52-53

Topic: The Circular Flow of Income

*: Recurring

Learning Outcome: Micro 2: Interpret and analyze information presented in different types of graphs

AACSB: Reflective Thinking

Special Feature: None

25) _____ behavioral assumption about humans was that people usually act in a rational, self-interested way.

- A) Thomas Malthus's
- B) Adam Smith's
- C) Karl Marx's
- D) Ben Bernanke's

Answer: B

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Topic: Markets

*: Recurring

Learning Outcome: Micro 1: Identify the basic principles of economics and explain how to think like an economist

AACSB: Reflective Thinking

Special Feature: None

26) Which of the following countries does not come close to the free market benchmark?

- A) the United States
- B) Japan
- C) Cuba
- D) France

Answer: C

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Topic: Markets

*: Recurring

Learning Outcome: Micro 3: Discuss different types of market systems and the gains that can be made from trade

AACSB: Reflective Thinking

Special Feature: None

27) Adam Smith's _____ refers to the process by which individuals acting in their own self-interest bring about a market outcome that benefits society as a whole.

- A) Utopian society
- B) comparative advantage model
- C) invisible hand
- D) survival of the fittest theory

Answer: C

Diff: 2 Page Ref: 54/54

Topic: Markets

*: Recurring

Learning Outcome: Micro 1: Identify the basic principles of economics and explain how to think like an economist

AACSB: Reflective Thinking

Special Feature: None

28) A critical function of the government in facilitating the operation of a market economy is

- A) producing goods and services for low income households.
- B) setting up and enforcing private property rights.
- C) ensuring an equal distribution of income to all citizens.
- D) controlling the market prices of food items.

Answer: B

Diff: 2 Page Ref: 57/57

Topic: Markets

*: Recurring

Learning Outcome: Micro 3: Discuss different types of market systems and the gains that can be made from trade

AACSB: Reflective Thinking

Special Feature: None

29) The ability to exercise control over one's own resources within the confines of the law refers to

- A) the free market.
- B) one's property rights.
- C) entrepreneurship.
- D) having an absolute advantage.

Answer: B

Diff: 1 Page Ref: 57/57

Topic: Property Rights

*: Recurring

Learning Outcome: Micro 3: Discuss different types of market systems and the gains that can be made from trade

AACSB: Reflective Thinking

Special Feature: None

- 30) The primary purpose of patents and copyrights is to
- A) provide owners with large profit forever.
 - B) protect firms from being taken advantage of by competing firms.
 - C) protect domestic firms from foreign competition.
 - D) encourage the expenditure of funds on research and development to create new products.

Answer: D

Diff: 1 Page Ref: 57/57

Topic: Property Rights

*: Recurring

Learning Outcome: Micro 3: Discuss different types of market systems and the gains that can be made from trade

AACSB: Reflective Thinking

Special Feature: None

- 31) If property rights are not well enforced, all of the following are likely to occur *except*
- A) fewer goods and services will be produced.
 - B) economic efficiency will be reduced.
 - C) an economy will produce inside its production possibilities frontier.
 - D) a significant number of people will be willing to risk their funds by investing them in local businesses.

Answer: D

Diff: 2 Page Ref: 58/58

Topic: Property Rights

*: Recurring

Learning Outcome: Micro 3: Discuss different types of market systems and the gains that can be made from trade

AACSB: Reflective Thinking

Special Feature: None

- 32) A successful market economy requires well defined property rights and
- A) balanced supplies of all factors of production.
 - B) an independent court system to adjudicate disputes based on the law.
 - C) detailed government regulations.
 - D) a safety net to ensure that those who cannot participate in the market economy can earn an income.

Answer: B

Diff: 2 Page Ref: 58/58

Topic: Property Rights

*: Recurring

Learning Outcome: Micro 3: Discuss different types of market systems and the gains that can be made from trade

AACSB: Reflective Thinking

Special Feature: None

33) All of the following are considered intellectual property *except*

- A) books.
- B) films.
- C) software.
- D) shares of stock.

Answer: D

Diff: 2 Page Ref: 57/57

Topic: Property Rights

*: Recurring

Learning Outcome: Micro 3: Discuss different types of market systems and the gains that can be made from trade

AACSB: Reflective Thinking

Special Feature: None

34) A guild is

- A) a group of independent producers competing with each other.
- B) an organization of producers that limits the amount of a good produced.
- C) a group of nations who agree not to compete with each other.
- D) a nation that is a free market benchmark.

Answer: B

Diff: 1 Page Ref: 53/53

Topic: Markets

*: Recurring

Learning Outcome: Micro 3: Discuss different types of market systems and the gains that can be made from trade

AACSB: Reflective Thinking

Special Feature: None

35) In 18th century Europe, governments gave guilds legal authority to limit production of goods. This authority obstructed the market mechanism because the guild's actions prevented the forces of _____ from coordinating the self-interested decisions of producers and consumers.

- A) absolute advantage
- B) demand and supply
- C) opportunity cost
- D) nature

Answer: B

Diff: 2 Page Ref: 53/53

Topic: Markets

*: Recurring

Learning Outcome: Micro 3: Discuss different types of market systems and the gains that can be made from trade

AACSB: Reflective Thinking

Special Feature: None

36) When a celebrity has the desire to have his image protected following his death, this is best described as an example of the protection of

- A) an invention.
- B) a patent.
- C) a trademark.
- D) intellectual property.

Answer: D

Diff: 2 Page Ref: 57/57

Topic: Property Rights

*: Recurring

Learning Outcome: Micro 5: List ways in which governments intervene in markets and explain the consequences of such intervention

AACSB: Reflective Thinking

Special Feature: None

37) In the desire to have a celebrity's image protected to prevent it from being used in ways he would not approve, a celebrity's estate

- A) will probably not be successful, since there are no laws regulating this kind of use in the United States.
- B) will have to be granted a patent declaring the celebrity's image a new product, and this will give the estate protection for 7 years.
- C) can rely on U.S. laws that protect intellectual property rights to prevent the unauthorized use of his image.
- D) will most likely be more successful in developing countries than in high-income countries, since property regulations are better enforced in developing countries.

Answer: C

Diff: 2 Page Ref: 57/57

Topic: Property Rights

*: Recurring

Learning Outcome: Micro 5: List ways in which governments intervene in markets and explain the consequences of such intervention

AACSB: Reflective Thinking

Special Feature: None

38) The payment received by suppliers of entrepreneurial skills is called profit.

Answer: TRUE

Diff: 1 Page Ref: 52/52

Topic: Factors of Production

*: Recurring

Learning Outcome: Micro 3: Discuss different types of market systems and the gains that can be made from trade

AACSB: Reflective Thinking

Special Feature: None

39) In the circular flow model, households demand resources such as labor services in the product market.

Answer: FALSE

Diff: 1 Page Ref: 52/52

Topic: The Circular Flow of Income

*: Recurring

Learning Outcome: Micro 3: Discuss different types of market systems and the gains that can be made from trade

AACSB: Reflective Thinking

Special Feature: None

40) In economics, the term "free market" refers to a market where no sales tax is imposed on products sold.

Answer: FALSE

Diff: 1 Page Ref: 52/52

Topic: Markets

*: Recurring

Learning Outcome: Micro 3: Discuss different types of market systems and the gains that can be made from trade

AACSB: Reflective Thinking

Special Feature: None

41) In a free market there are virtually no restrictions, or at best few restrictions, on how a good or service can be produced or sold.

Answer: TRUE

Diff: 1 Page Ref: 53/53

Topic: Markets

*: Recurring

Learning Outcome: Micro 3: Discuss different types of market systems and the gains that can be made from trade

AACSB: Reflective Thinking

Special Feature: None

42) A stand of redwood trees is not an example of a factor of production but the harvested and processed redwood is a factor of production.

Answer: FALSE

Diff: 2 Page Ref: 52/52

Topic: Factors of Production

*: Recurring

Learning Outcome: Micro 3: Discuss different types of market systems and the gains that can be made from trade

AACSB: Reflective Thinking

Special Feature: None

43) The idea underlying Adam Smith's "invisible hand" is that people tend to behave in ways that go unnoticed in society.

Answer: FALSE

Diff: 2 Page Ref: 54/54

Topic: Markets

*: Recurring

Learning Outcome: Micro 3: Discuss different types of market systems and the gains that can be made from trade

AACSB: Reflective Thinking

Special Feature: None

44) In a simple circular flow diagram, who supplies factors of production in markets and who buys these factors of production? Who supplies goods and services in markets and who buys these goods and services?

Answer: Households supply factors of production and buy goods and services in markets. Firms buy factors of production and supply goods and services in markets.

Diff: 2 Page Ref: 52-53/52-53

Topic: The Circular Flow of Income

*: Recurring

Learning Outcome: Micro 3: Discuss different types of market systems and the gains that can be made from trade

AACSB: Reflective Thinking

Special Feature: None

45) List the four broad categories of factors of production.

Answer: labor, capital, natural resources, and entrepreneurship

Diff: 2 Page Ref: 51-52/51-52

Topic: Factors of Production

*: Recurring

Learning Outcome: Micro 3: Discuss different types of market systems and the gains that can be made from trade

AACSB: Reflective Thinking

Special Feature: None

46) Define the term "property rights." Explain why the lack of well defined and enforceable property rights is detrimental to the smooth functioning of a market system.

Answer: The term "property rights" refers to the rights that individuals or firms have to the exclusive use of their resources, within the confines of the law. Well defined and enforceable property rights provide the incentive for people and firms to invest resources and undertake risks. This encourages the production of a wide range of goods and services. Without property rights and the means to enforce these rights, no person would want to undertake such a risk.

Diff: 2 Page Ref: 57/57

Topic: Property Rights

*: Recurring

Learning Outcome: Micro 3: Discuss different types of market systems and the gains that can be made from trade

AACSB: Reflective Thinking

Special Feature: None

47) Why are music, television, and movie companies concerned about their products being posted to Internet websites such as YouTube?

Answer: These companies believe that their intellectual property rights are being violated when the unauthorized use of their material appears on these websites, and this reduces their ability to sell CDs and DVDs of this material.

Diff: 3 Page Ref: 57/57

Topic: Property Rights

*: Recurring

Learning Outcome: Micro 3: Discuss different types of market systems and the gains that can be made from trade

AACSB: Reflective Thinking

Special Feature: None

48) Adam Smith, the father of modern economics wrote in his book, *An Inquiry into the Nature and Causes of the Wealth of Nations*, "It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner but from their regard to their own interest." Explain what he meant by that statement and how such behavior promotes the wealth of a nation.

Answer: The statements refer to the fact that people act in their own self interest. For example, the butcher who sells meat and the baker who bakes bread carry out these activities because these tasks contributed to their livelihood, not because they were concerned about the diner.

Nevertheless, their actions benefited the diner. This is precisely one of the virtues of a market: people do not have to act virtuously to produce worthwhile outcomes. Producing goods and services that consumers value increases the wealth of a nation.

Diff: 3 Page Ref: 55/55

Topic: Markets

Learning Outcome: Micro 1: Identify the basic principles of economics and explain how to think like an economist

AACSB: Reflective Thinking

Special Feature: Making the Connection: A Story of the Marketing System in Action: How Do You Make an iPad?