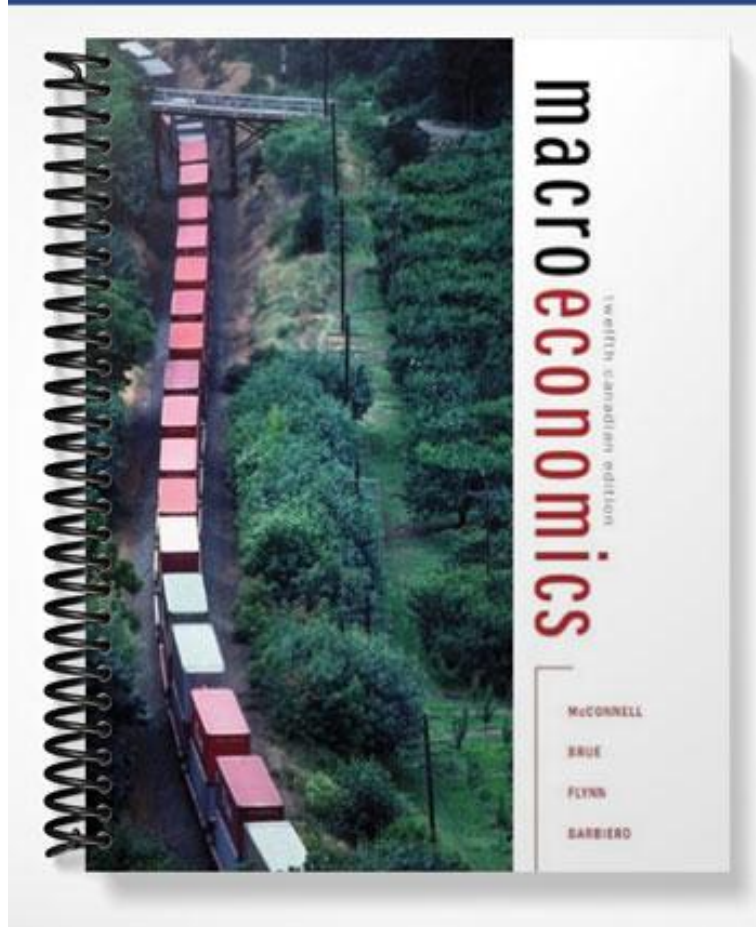


TEST BANK



Student: _____

1. The command system is also known as:
 - A. market system.
 - B. pure capitalism.
 - C. market socialism.
 - D. socialism or communism.
2. The economy of the former Soviet Union was best described as:
 - A. authoritarian capitalism.
 - B. mixed capitalism.
 - C. a command economy.
 - D. market socialism.
3. The economy of North Korea most closely approximates:
 - A. pure capitalism
 - B. a command economy
 - C. market socialism
 - D. authoritarian capitalism
4. The recent China's economy most closely approximates:
 - A. pure capitalism
 - B. a command economy
 - C. market socialism
 - D. authoritarian capitalism
5. Which would not be characteristic of a capitalist economy?
 - A. government ownership of the means of production
 - B. competition and unrestricted markets
 - C. reliance on the market system
 - D. free enterprise and choice
6. Which of the following statements best describes a mixed economy?
 - A. In a mixed economy, society determines production and the allocation of goods and services only through the market system.
 - B. In a mixed economy, government policies determine the production and the allocation of goods and services, but each individual is free to pursue his or her own self-interest.
 - C. In a mixed economy, the government and private sectors interact in determining production and allocation of goods and services.
 - D. In a mixed economy, the role of individual self-interest is relatively unimportant because government makes most of the economic decisions.
7. The private ownership of property resources and use of prices to direct and coordinate economic activity is characteristic of:
 - A. a command system.
 - B. a market system.
 - C. communism.
 - D. socialism.
8. In a capitalistic economy:
 - A. consumers can never be sovereign.
 - B. markets can never be competitive.
 - C. there is a reliance on the market system.
 - D. the government owns the means of production.

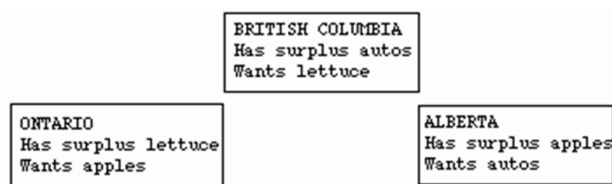
9. The term "laissez faire" suggests that:
- A. land and other natural resources should be privately owned, but capital should be publicly owned.
 - B. land and other natural resources should be publicly owned, but capital equipment should be privately owned.
 - C. government should not interfere with the operation of the economy.
 - D. government action is necessary if the economy is to achieve full employment and full production.
10. The term "mixed economy" refers to an economy:
- A. comprised of both product and resource markets.
 - B. which engages in both domestic and international trade.
 - C. comprised of both extensive private markets and government involvement in the economy.
 - D. which functions primarily on the basis of custom and tradition.
11. The Canadian economy most closely approximates:
- A. mixed capitalism
 - B. a command economy
 - C. market socialism
 - D. authoritarian capitalism
12. Which of the following is unique to a market economy system?
- A. the extensive use of capital goods
 - B. private ownership of property resources
 - C. specialization
 - D. the use of money
13. Well-property rights are important because they:
- A. encourage investment and growth.
 - B. are conducive to the writing of books and music.
 - C. facilitate exchange.
 - D. do all of these.
14. 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 and institutions the right to own resources used in production.
 - D. gives the government the right to tax individuals and corporations for the production of capital goods.
15. The market system is characterized by:
- A. extensive government constraints on individual behaviour.
 - B. private ownership of the means of production.
 - C. government control of all production decisions.
 - D. government rationing of all goods and services.
16. In a market system, well-defined property rights are important because they:
- A. reduce unnecessary investment.
 - B. limit destructive economic growth.
 - C. create economic problems.
 - D. encourage economic activity.
17. Which is a major feature of the market system?
- A. price floors and price ceilings in all markets
 - B. reallocation of all resources from private to public uses
 - C. the right to own private property and control resource use
 - D. central planning by government to provide goods and services

18. Which is a major feature of pure capitalism?
- A. price floors and price ceilings in markets
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 - C. the right to own private property and control resource use
 - D. central planning by government to provide goods and services
19. By free enterprise, we mean that:
- A. products are provided free to those who can't afford to buy them.
 - B. individual producers determine how to produce, but government agencies determine what will be produced.
 - C. individuals may obtain resources, organize production, and sell the resulting output in any legal way they choose.
 - D. individuals are free to produce those products that government agencies determine can be produced profitably.
20. Which statement is correct?
- A. The operation of a market system eventually results in an equal distribution of income.
 - B. Producers are "kings" in a market economy because they determine what is produced.
 - C. The market system is efficient at allocation of resources, but not consumer goods to their most valued uses.
 - D. Freedom of choice and enterprise are essential elements of the market system.
21. Which is characteristic of the capitalistic ideology?
- A. unselfish individuals
 - B. centralized decision-making
 - C. free enterprise and choice
 - D. government ownership of the means of production
22. How do workers typically express self-interest?
- A. by minimizing the economic losses of other business firms
 - B. by maximizing the economic profits of other business firms
 - C. by seeking the highest price when purchasing a consumer product
 - D. by seeking jobs with the best combination of wages and benefits
23. Consumers express self-interest when they:
- A. reduce business losses.
 - B. collect economic profits.
 - C. seek the lowest price for the product.
 - D. search for jobs with the highest wage
24. Competition means that:
- A. sellers can cause artificial product scarcities and thereby manipulate market price.
 - B. there are large numbers of independently acting buyers and sellers in each market.
 - C. a given product can be purchased at a number of different prices.
 - D. there is more than one seller in a market.
25. The competitive market system:
- A encourages innovation because government provides tax breaks and subsidies to those who develop . new products or new productive techniques.
 - B. discourages innovation because it is difficult to acquire additional capital in the form of new machinery and equipment.
 - C. discourages innovation because firms want to get all the profits possible from existing machinery and equipment.
 - D. encourages innovation because successful innovators are rewarded with economic profits.

26. Competition is more likely to exist when:
- A. there is free entry into and exit out of industries.
 - B. there is a single supplier of all goods and services.
 - C. the government purchases most goods and services.
 - D. products are produced by a few large firms.
27. Which condition will encourage competition?
- A. government licensing requirements in order to enter an industry
 - B. a small number of buyers and sellers in a market
 - C. the freedom of sellers and buyers to enter or exit an industry
 - D. the government serving as the only supplier of goods to consumers
28. A purely competitive economy assumes the existence in each industry of a:
- A. large number of small firms facing a large number of small buyers.
 - B. few large firms facing a large number of small buyers.
 - C. large number of small firms facing a few large buyers.
 - D. few small firms facing a few small buyers.
29. Competition denotes a condition where:
- A. there is more than one seller in a market.
 - B. a given product can be purchased at a range of prices.
 - C. there are many independent buyers and sellers in a market.
 - D. a few sellers attempt to garner a larger share of the market by cutting prices.
30. If competitive industry Y is incurring substantial losses, we can expect that output will:
- A. expand, product price will rise, and losses will tend to disappear.
 - B. contract, product price will fall, and losses will increase.
 - C. contract, product price will rise, and losses will tend to disappear.
 - D. expand, product price will fall, and losses will tend to disappear.
31. Suppose industry A is realizing substantial economic profits. Which of the following best describes the adjustment process which would bring about a new equilibrium?
- A. Firms will leave the industry, output will fall, and product price will rise.
 - B. Firms will enter the industry, output will rise, and product price will rise.
 - C. Firms will leave the industry, output will rise, and product price will fall.
 - D. Firms will enter the industry, output will rise, and product price will fall.
32. Which statement 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.
33. A characteristic of the market system is:
- A. extensive use of price controls.
 - B. extensive use of barter.
 - C. extensive use of capital goods.
 - D. low interest rates.
34. The development of new technology and capital goods are essential elements for the market system. This is because:
- A. using more efficient production process means more output for the economy.
 - B. more capital goods means less future consumption goods.
 - C. the standard of living and development of new technology are inversely related.
 - D. the most direct methods of production are more efficient.

35. The basic reason for the production of capital goods is to:
- A. promote the concentration of economic power in the business sector.
 - B. facilitate exchange where a coincidence of wants does not exist.
 - C. better synchronize the operation of resource and product markets.
 - D. enhance future productive efficiency.
36. The process in which workers select specialized tasks to make a product is referred to as:
- A. a coincidence of wants.
 - B. roundabout production.
 - C. freedom of choice.
 - D. division of labour.
37. The division of labour means that:
- A. labour markets are geographically segmented.
 - B. unskilled workers outnumber skilled workers.
 - C. workers specialize in various production tasks.
 - D. each worker performs a large number of tasks.
38. Specialization and trade are beneficial to society because:
- A. the output of economic goods may be increased with no increase in resources.
 - B. scarce resources are utilized more efficiently.
 - C. a division of labour lowers prices for products.
 - D. all of these are correct.
39. Specialization in production is important primarily because it:
- A. results in greater total output.
 - B. allows society to avoid the coincidence-of-problem.
 - C. allows society to trade by barter.
 - D. allows society to have fewer capital goods.
40. The division of labour enhances productivity and efficiency by:
- A. allowing workers to take advantage of existing differences in their abilities and skills.
 - B. avoiding the time loss involved in shifting from one production task to another.
 - C. allowing workers to develop skills by working on one, or a limited number, of tasks.
 - D. all of these means.
41. Specialization in production is economically beneficial primarily because it:
- A. allows everyone to have a job which they like.
 - B. permits the production of a larger output with fixed amounts of resources.
 - C. facilitates trade by bartering.
 - D. guarantees full employment.
42. The use of money for exchange:
- A. increases the use of barter.
 - B. reduces consumer sovereignty.
 - C. decreases the coincidence of wants.
 - D. encourages more specialization in production.
43. Anything that is generally acceptable in exchange for goods and services is:
- A. a medium of exchange.
 - B. a measure of value.
 - C. a store of value.
 - D. token money.
44. Which is the main problem with the barter system of exchange? Barter:
- A. encourages self-interest and selfishness.
 - B. fosters specialization and division of labour.
 - C. requires a coincidence of wants.
 - D. undermines the right to bequeath.

45. Consider a barter situation where you have pens and you want pencils. To achieve your objective there must be a(n):
- use of capital goods.
 - entry and exit from the market.
 - large number of sellers.
 - coincidence of wants.



46. On the basis of the information provided it can be said that:
- no coincidence of wants exists between any two provinces.
 - a coincidence of wants exists between British Columbia and Ontario.
 - a coincidence of wants exists between Ontario and Alberta.
 - a coincidence of wants exists between British Columbia and Alberta.
47. On the basis of the information provided and assuming trade occurs between the three provinces we can expect:
- Alberta to exchange apples with Ontario and receive money in return.
 - Alberta to exchange apples with British Columbia and receive money in return.
 - Ontario to exchange lettuce with British Columbia and receive autos in return.
 - None of these to occur.
48. Given the information provided and assuming trade does occur between the provinces, we can expect:
- that there is no means by which British Columbia can obtain lettuce while specializing in the production of autos.
 - that money will not be needed to accomplish the desired exchanges.
 - money to flow counterclockwise from British Columbia to Ontario to Alberta.
 - money to flow clockwise from British Columbia to Alberta to Ontario.
49. Which is assumed to be most limited in scope under a market system?
- freedom of enterprise
 - freedom of choice
 - competition
 - government
50. Which of the following is not a part of a market system?
- private property
 - freedom of enterprise and choice
 - competition in product and resource markets
 - government determination of basic economic goals
51. Which is not one of the Five Fundamental Questions?
- How will the goods and services be produced?
 - How will the system accommodate change?
 - Who will get the goods and services?
 - What goods and services should be produced by government?
52. What to produce in a market economy is ultimately determined by the:
- output decisions of business firms.
 - income plans of households.
 - spending decisions of households.
 - workers' technical skills.

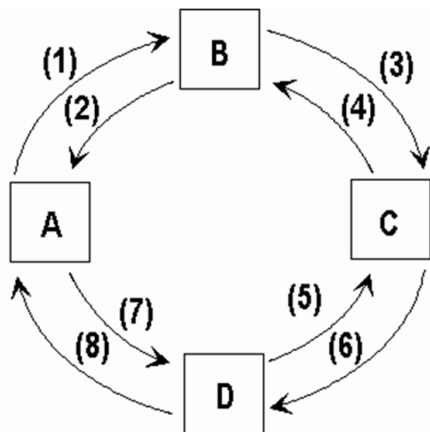
53. "Consumer sovereignty" refers to the:
- A. fact that resource prices tend to be high relative to product prices in capitalistic economies.
 - B. idea that the pursuit of self-interest will prove ultimately to be in the public interest.
 - C. notion that the decisions of producers and resource suppliers with respect to the kinds and amounts of goods produced must be appropriate to consumer demands.
 - D. fact that a federal agency exists to protect consumers from harmful and defective products.
54. The term consumer sovereignty means that:
- A. consumers are controlled by the actions of the marketplace.
 - B. what is produced is ultimately determined by what consumers buy.
 - C. there are no limits on what consumers may buy under capitalism.
 - D. businesses produce with consumer satisfaction as their primary goal.
55. The market system is said to be characterized by "consumer sovereignty." This is because:
- A. a large number of consumer goods are produced.
 - B. the prices of consumer goods are regulated by government.
 - C. consumer goods are more profitable than investment goods.
 - D. of the role of consumers in determining what goods are produced.
56. The introduction of "new" Coca-Cola and the reintroduction of the old "Classic Coke" was an example of:
- A. an increase in demand.
 - B. consumer sovereignty.
 - C. technological advances.
 - D. economic profit.
57. "The 'dollar votes' of consumers ultimately determine the composition of output and the allocation of resources in a market economy." This statement best describes the concept of:
- A. derived demand.
 - B. external costs and benefits.
 - C. consumer sovereignty.
 - D. the invisible hand.
 - E. market failure.
58. The term dollar votes 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.
59. Consumer sovereignty and "dollar votes" are most related to which fundamental question about a competitive market system?
- 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?
60. Economic efficiency would be primarily discussed in response to which of the fundamental questions about a competitive market economy?
- A. What will be produced?
 - B. How will the goods and services be produced?
 - C. How will the system accommodate change?
 - D. Who is to receive the output?

61. Which fundamental question about a competitive market system primarily focuses on the cost of producing the good and services?
- A. What will be produced?
 - B. How will the goods and services be produced?
 - C. How will the system accommodate change?
 - D. Who is to receive the output?
62. The issues of distribution of goods and services and incomes in a competitive market system are the primary topic of which fundamental question?
- A. What will be produced?
 - B. How will the goods and services be produced?
 - C. How will the system accommodate change?
 - D. Who is to receive the output?
63. In the market system, the statement of "Wages, interest, rent, and profit are crucial determinants of the size of each person's income", is an indication of:
- A. What will be produced?
 - B. How will the goods and services be produced?
 - C. Who will get the output?
 - D. How will the system accommodate change?
64. "For whom is a given mix of goods and services to be produced? How, in other words, is the product to be distributed among people when such commodities and services are available?" In a market economy, this problem 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. In a market economy the distribution of income would be determined primarily by
- A. consumer needs and preferences.
 - B. the quantities and prices of the resources which households supply.
 - C. government regulations which provide a minimum income for all.
 - D. a social consensus as to what distribution of income is most equitable.
66. Which fundamental question about a competitive market system primarily focuses on technological progress and capital accumulation?
- A. What will be produced?
 - B. How will the goods and services be produced?
 - C. How will the system accommodate change?
 - D. Who is to receive the output?
67. If an increase occurs in the demand for product X, we would expect all of the following to occur except:
- A. an increase in the profits of industry X.
 - B. an increase in the demand for resources employed by industry X.
 - C. an increase in the output of industry X.
 - D. a decrease in the prices of resources employed in industry X.
68. An increase in demand for strawberries is most likely to:
- A. increase the demand for strawberry pickers.
 - B. reduce the supply of strawberry pickers.
 - C. reduce the supply of strawberries.
 - D. reduce the demand for strawberry pickers.
 - E. decrease the demand for raspberries.

69. The market system communicates changes in supply and demand and elicits appropriate responses from businesses and resource suppliers. This is known as the:
- A. rationing function of prices.
 - B. guiding function of prices.
 - C. monetary function of prices.
 - D. circular flow of income.
70. Which of the following best describes the "guiding function" of competitive prices?
- A. Profitable industries tend to contract and unprofitable industries tend to expand.
 - B. The market system will always generate economic profits for firms which use the least costly production technology.
 - C. The market system can negotiate reallocations of resources which are appropriate to changes in . consumer tastes, technology, and resource supplies.
 - D. When prices are in equilibrium, product shortages or surpluses cannot occur.
71. Assume the demand for product Y increases and the subsequent market system responses result in the production of more Y. This illustrates:
- A. that the concept of derived demand is inapplicable.
 - B. that consumer sovereignty is inoperative in this economy.
 - C. the scarcity function of prices.
 - D. the directing or guiding function of prices.
72. Which statement accurately summarizes the relationship between the prices of goods and their relative scarcity?
- A. The price of a good is a direct function of the relative scarcity of the good.
 - B. The price of a good is an inverse function of the relative scarcity of the good.
 - C. The price of a good is independent of the relative scarcity of the good.
 - D. High prices lead to greater relative scarcity.
73. The most efficient combination of resources in producing any output is that combination which:
- A. comes closest to using the same quantities of land, labour, capital, and entrepreneurial ability.
 - B. can be obtained for the smallest money outlay.
 - C. uses the smallest total quantity of all resources.
 - D. conserves most on the use of labour.
74. The development of the Internet and e-mail to replace regular mail services in many cases would be an example of:
- A. roundabout production.
 - B. derived demand.
 - C. creative destruction.
 - D. specialization.
75. The development of CDs and DVD that significantly reduced the market for cassette tapes would be an example of:
- A. specialization.
 - B. derived demand.
 - C. roundabout production.
 - D. creative destruction.
76. Which of the following best describes the "invisible hand" concept?
- A. The desires of resource suppliers and producers to further their own self-interest will automatically further the public interest.
 - B. The nonsubstitutability of resources gives rise to a conflict between private and public interests and the . need for government intervention.
 - C. Mixed capitalism is the best system for overcoming the scarce resources-unlimited wants problem.
 - D. Central direction by the government will improve resource allocation in a capitalistic economy.

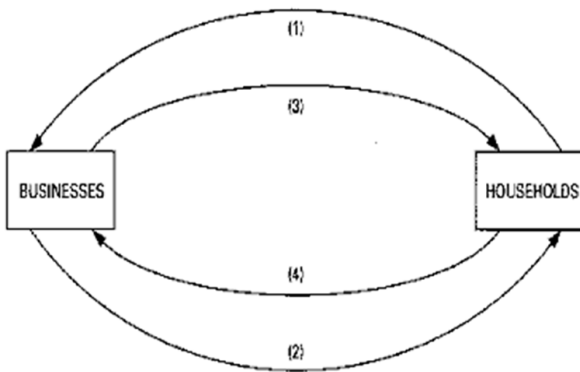
77. The "invisible hand" concept suggests that:
- A. changes in product demands are only randomly reflected in changes in the demands for resources.
 - B. profit maximization is inconsistent with an efficient allocation of resources.
 - C. government action is necessary to correct for market failures.
 - D. when firms maximize their profits, society's domestic output will also be maximized.
78. The "invisible hand" concept suggests that:
- A. market failures imply the need for a national economic plan.
 - B. big businesses are inherently more efficient than small businesses.
 - C. the competitiveness of a capitalistic market economy invariably diminishes over time.
 - D. given competition, private and public interests will tend to coincide.
79. The "invisible hand" refers to the:
- A. fact that our tax system redistributes income from rich to poor.
 - B. notion that, under competition, decisions motivated by self-interest promote the social interest.
 - C. tendency of monopolistic sellers to raise prices above competitive levels.
 - D. fact that government controls the functioning of the market system.
80. The idea that the desires of resource suppliers and producers 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. profit maximization.
81. The idea that firms and resource suppliers in seeking to further their own self-interests in a competitive market economy also simultaneously promotes the public or social interest is a description of:
- A. the guiding function of prices.
 - B. capital accumulation.
 - C. the "invisible hand."
 - D. "dollar votes."
82. While in market economies the profit depends on consumer demand, production efficiency, and product quality, for command economies profit depends on:
- A. production cost.
 - B. product differentiation.
 - C. product mix.
 - D. quantitative production target.
83. The coordination problem in command economies became more difficult as:
- A. the number of industries expanded.
 - B. less quantitative targets were assigned to each industry.
 - C. planning techniques improved.
 - D. production cost decreased.
84. As opposed to the market system, in command economies:
- A. the reward for innovation is extensive.
 - B. the reward for innovation does not exist.
 - C. meeting the production targets are extremely important.
 - D. the profit motives are extremely high.
85. In the factor market:
- A. businesses borrow money capital from households.
 - B. businesses sell services to households.
 - C. households sell resources to businesses.
 - D. firms sell raw materials to households.

86. The simple circular flow model shows that:
- households are on the demand side of both product and factor markets.
 - businesses are on the supply side of both product and factor markets.
 - households are on the supply side of the factor market and on the demand side of the product market.
 - businesses are on the demand side of the product market and on the supply side of the factor market.
87. The two basic markets shown by the simple circular flow model are:
- capital goods and consumer goods.
 - free and controlled.
 - product and factor.
 - household and business.
88. In the simple circular flow model:
- households are demanders of factors of production.
 - businesses are suppliers of final products.
 - households are suppliers of final products.
 - there are real flows of goods, services, and factors, but not money flows.
89. Households and businesses are:
- both buyers in the factor market.
 - both suppliers in the product market.
 - suppliers in the factor and product markets respectively.
 - suppliers in the product and factor markets respectively.
90. In the circular flow model:
- households supply factors of production to firms.
 - households receive income through the factor market.
 - households spend income in the product market.
 - all of these hold true.

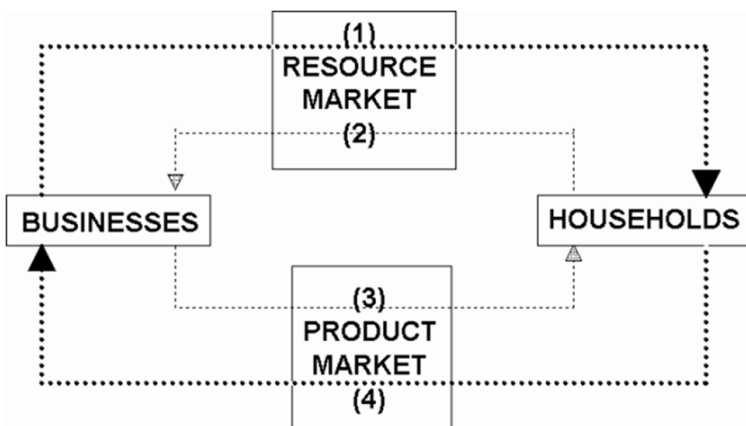


91. Refer to the figure. If box B represents the factor market and flow (3) represents money income, then:
- box A is the product market and box C is households.
 - box C is the product market and box A is households.
 - box D is the product market and box C is households.
 - box C is the product market and box D is households.
92. Refer to the figure. If box A represents businesses and flow (7) represents goods and services, then:
- box D is the product market and box B is the factor market.
 - box D is the product market and box B is households.
 - box B is the product market and box C is households.
 - box C is the product market and box B is the factor market.

93. In terms of the circular flow diagram businesses obtain revenue through the _____ market and make expenditures in the _____ market.
- product; financial
 - factor; product
 - product; factor
 - capital; product



94. Refer to the diagram. Arrows (1) and (2) represent:
- goods and resources respectively.
 - money incomes and output respectively.
 - output and money incomes respectively.
 - resources and goods respectively.
95. Refer to the diagram. Arrows (3) and (4) represent:
- goods and services respectively.
 - money incomes and consumer expenditures respectively.
 - resources and goods respectively.
 - consumer expenditures and money income respectively.



96. Refer to the circular flow model of the economy. In the diagram flow (1) represents:
- wage, rent, interest, and profit income.
 - land, labour, capital, and entrepreneurial ability.
 - goods and services.
 - consumer expenditures.
97. Refer to the circular flow model of the economy. In the diagram flow (2) represents:
- wage, rent, interest, and profit income.
 - land, labour, capital, and entrepreneurial ability.
 - goods and services.
 - consumer expenditures.

98. Refer to the circular flow model of the economy. In the diagram flow (3) represents:
- A. wage, rent, interest, and profit income.
 - B. land, labour, capital, and entrepreneurial ability.
 - C. goods and services.
 - D. consumer expenditures.
99. Refer to the circular flow model of the economy. In the diagram flow (4) represents:
- A. wage, rent, interest, and profit income.
 - B. land, labour, capital, and entrepreneurial ability.
 - C. goods and services.
 - D. consumer expenditures.
100. In terms of the circular flow diagram households make expenditures in the _____ market and receive income through the _____ market.
- A. product; financial
 - B. factor; product
 - C. product; factor
 - D. capital; product
101. Private property rights are important because they:
- A. discourage investment and growth.
 - B. eliminate the possibility of randomness in resource arrangements.
 - C. facilitate the production of public goods.
 - D. create a random distribution of the economic resources.
102. The knowledge of how each and every economic resource might be combined productively with each other is important because:
- A. it will allow the production of more consumer goods than capital goods.
 - B. it produces more capital goods than consumer goods.
 - C. it gives the government the right to own resources used in production.
 - D. it will eliminate the randomness in allocating the resources.
103. Markets fail to allocate resources efficiently when
- A. private property rights are not established.
 - B. there is a well established private property right.
 - C. the randomness does not exist in allocation of resources.
 - D. the government produces the public goods.
104. Specialization may be conducive to an expansion of total output even though the individuals involved may have identical abilities.
True False
105. A division of labour enhances society's output by permitting people to take advantage of existing differences in their abilities and skills.
True False
106. Money functions as a medium of exchange in permitting the ready comparison of the relative worth of heterogeneous products.
True False
107. Government alters the distribution of income by market intervention, in which case it modifies the prices established by market forces.
True False
108. Consumer sovereignty means that legislation now protects the rights of consumers to dispose of their incomes as they see fit.
True False
109. The wants of consumers are expressed on the demand side of the product market.
True False

110. The guiding function of prices indicates that, at equilibrium prices, neither product surpluses nor shortages can occur.
True False
111. The "invisible hand" refers to the many indirect controls which the federal government imposes in a system of mixed capitalism.
True False
112. In a competitive market economy, firms and resource suppliers will seek to further their own self-interest, but at the same time, as if guided by an "invisible hand," they will promote the public interest.
True False
113. In the simple circular flow model businesses are suppliers of final products.
True False
114. Households and businesses are both suppliers in the product market.
True False
115. Explain what is meant by a command economy.
116. Explain the term "laissez-faire capitalism."
117. List nine characteristics of the market system.
118. Why is the right of private property an essential characteristic of a market system?

119. What roles do freedom of enterprise and freedom of choice play in capitalism? How important are they to the operation of a competitive market economy?
120. Explain the importance of self-interest in the operation of a market system.
121. What is the importance of competition in relation to self-interest in a market system?
122. What conditions are necessary for economic competition to exist?
123. Explain why the market system is an organizing mechanism.
124. Respond to the following question: "Producing capital goods takes time, so how can that be a more efficient form of production of consumer goods?"

125. Describe two types of specialization in production.

126. What are the economic advantages of the division of labour?

127. Describe three ways that the division of labour contributes to society's output.

128. What advantage does a money economy have over a barter economy?

129. How does the use of money differ from the use of barter in the exchange of goods and services?

130. What is money and what important function does it perform? Explain how it overcomes the disadvantages associated with barter. What conditions are necessary for people to accept paper currency in exchange for the goods and services, which they sell?

131. Suppose Tom, Dick, and Harry live in a barter economy. Tom produces wine, Dick bakes bread, and Harry makes cheese. Tom wants some bread to go with his wine and is willing to trade 1 litre of wine for two loaves of bread. Dick wants some cheese to go with his bread and is willing to trade one loaf of bread for one-half kilogram of cheese. Harry doesn't want bread, but wants some wine to go with his cheese and is willing to trade cheese for one litre of wine. It is not possible for all three of them to meet together at one time.

(a) Explain how this situation illustrates the difficulty with a barter economy.

(b) Devise a money system using rubies where four rubies are equivalent in value to one litre of wine. In other words tell how much bread and cheese would be worth in terms of rubies in this economy. In this system, how much cheese must Harry sell in order to buy one litre of wine?

132. Why does specialization require a convenient means of exchanging goods?

133. One of the characteristics of a modern market economy is an "active, but limited, government." How can the government "help" the economy?

134. What are the so-called Five Fundamental Questions that every economy must answer?

135. Assume that a firm can produce product A, product B, or product C with the resources it currently employs. These resources cost the firm a total of \$100 per week. Assume, for the purposes of this problem, that the firm's costs cannot be changed. The market prices and the quantities of A, B, and C these resources can produce are given as follows.

<u>Product</u>	<u>Market price</u>	<u>Output</u>	<u>Profit</u>
A	\$14.00	10	\$ _____
B	9.00	11	_____
C	.50	300	_____

- Compute the firm's profit when it produces A, B, or C and enter these data in the table.
- Which product will the firm produce?
- If the price of A rose to \$16, which product will the firm produce?
- If the firm produces A at a price of \$16, what would tend to happen to the number of firms producing product A?

136. Assume that a firm can produce product A, product B, or product C with the resources it currently employs. These resources cost the firm a total of \$100 per week. Assume, for the purposes of this problem, that the firm's costs cannot be changed. The market prices and the quantities of A, B, and C these resources can produce are given below.

<u>Product</u>	<u>Market price</u>	<u>Output</u>	<u>Profit</u>
A	\$10.00	6	\$ _____
B	5.00	19	_____
C	1.50	100	_____

- Compute the firm's profit when it produces A, B, or C and enter these data in the table.
- Which product will the firm produce?
- Suppose the quantity of product B the firm was able to produce with the same amount of inputs now rose to 25. Which product will the firm now produce?
- As a result of the rise in quantity of product B to 25 that each firm can produce, what will happen to the number of firms producing product B?

137. How does consumer choice differ from consumer sovereignty in a market system?

138. Why is the consumer the king in a market system?

139. What factors determine who will get the output?

140. How is the demand for a factor of production different from the demand for a product?

141. How does the market system accommodate change in consumer's preferences?

142. Assume that a firm finds that its profits will be maximized (or losses minimized) when it produces \$30 worth of product X. Each of these techniques shown in the following table will produce exactly \$30 worth of X.

	Unit resource Prices	Method #1	Method #2	Method #3
Land	\$1	6	3	4
Labour	2	4	3	3
Capital	3	3	4	6
Entrepreneurship	4	2	4	1

(a) Which method is most efficient? Why?

(b) Given the above prices, will the firm adopt a new method, which involves 10 units of land, 3 of labour, 2 of capital, and 2 of entrepreneurial ability?

(c) Suppose the price of capital falls to \$1 without any other prices changing. Which of the methods will the firm now choose? Why?

143. Assume that a firm finds that its profits will be maximized (or losses minimized) when it produces \$50 worth of product X. Each of these techniques shown in the following table will produce exactly \$50 worth of X.

	Unit resource Prices	Method #1	Method #2	Method #3
Land	\$4	4	2	1
Labour	3	4	3	6
Capital	2	3	4	3
Entrepreneurship	1	3	6	4

(a) Which method is most efficient? Why?

(b) Given the above prices, will the firm adopt a new method, which involves 2 units of land, 2 of labour, 4 of capital, and 8 of entrepreneurial ability?

(c) Suppose the price of labour falls to \$1 without any other prices changing. Which of the methods will the firm now choose? Why?

144. What is meant by the guiding function of prices?

145. How can technological advance result in creative destruction?

146. Explain this quote from Adam Smith: "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."

147. Describe the three major virtues of a market system.

148. "Competition is the mechanism that brings order out of potential chaos in a price-directed economy." Explain.

149. "Every economy is based on 'planning' of one sort or another." Interpret and explain.

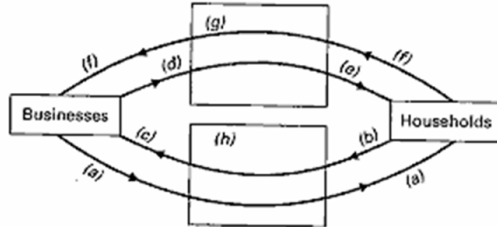
150. List two problems that have contributed to the decline of command systems on a national scale.

151. Explain what is meant by the free-rider problem and how a government can help solve the problem.

152. Describe the basic features of the circular flow model.

153. What is the relationship between businesses and households in the circular flow model?

154. In the below circular flow diagram, the household and business sectors are labelled with arrows representing the flows of income and output labelled (a) through (f) and the two appropriate markets labelled (g) and (h). Supply the correct descriptive titles for each of these labels (a) through (h).



155. Explain why the market system's ability to bring organization to the economy is so very remarkable.

02 Key

1. The command system is also known as:
(p. 31)
A. market system.
B. pure capitalism.
C. market socialism.
D. socialism or communism.
2. The economy of the former Soviet Union was best described as:
(p. 32)
A. authoritarian capitalism.
B. mixed capitalism.
C. a command economy.
D. market socialism.
3. The economy of North Korea most closely approximates:
(p. 32)
A. pure capitalism
B. a command economy
C. market socialism
D. authoritarian capitalism
4. The recent China's economy most closely approximates:
(p. 32)
A. pure capitalism
B. a command economy
C. market socialism
D. authoritarian capitalism
5. Which would not be characteristic of a capitalist economy?
(p. 32)
A. government ownership of the means of production
B. competition and unrestricted markets
C. reliance on the market system
D. free enterprise and choice

Learning Objective: 2.1 Economic systems
Level: Easy
McConnell - Chapter 002 #1
Type: Application

Learning Objective: 2.1 Economic systems
Level: Easy
McConnell - Chapter 002 #2
Type: Application

Learning Objective: 2.1 Economic systems
Level: Easy
McConnell - Chapter 002 #3
Type: Application

Learning Objective: 2.1 Economic systems
Level: Easy
McConnell - Chapter 002 #4
Type: Application

Learning Objective: 2.1 Economic systems
Level: Easy
McConnell - Chapter 002 #5
Type: Application

6. Which of the following statements best describes a mixed economy?
(p. 32)
- A. In a mixed economy, society determines production and the allocation of goods and services only through the market system.
 - B. In a mixed economy, government policies determine the production and the allocation of goods and services, but each individual is free to pursue his or her own self-interest.
 - C.** In a mixed economy, the government and private sectors interact in determining production and allocation of goods and services.
 - D. In a mixed economy, the role of individual self-interest is relatively unimportant because government makes most of the economic decisions.

*Learning Objective: 2.1 Economic systems
Level: Moderate
McConnell - Chapter 002 #6
Type: Definition*

7. The private ownership of property resources and use of prices to direct and coordinate economic activity is characteristic of:
(p. 32)
- A. a command system.
 - B.** a market system.
 - C. communism.
 - D. socialism.

*Learning Objective: 2.1 Economic systems
Level: Easy
McConnell - Chapter 002 #7
Type: Definition*

8. In a capitalistic economy:
(p. 32)
- A. consumers can never be sovereign.
 - B. markets can never be competitive.
 - C.** there is a reliance on the market system.
 - D. the government owns the means of production.

*Learning Objective: 2.1 Economic systems
Level: Easy
McConnell - Chapter 002 #8
Type: Application*

9. The term "laissez faire" suggests that:
(p. 32)
- A. land and other natural resources should be privately owned, but capital should be publicly owned.
 - B. land and other natural resources should be publicly owned, but capital equipment should be privately owned.
 - C.** government should not interfere with the operation of the economy.
 - D. government action is necessary if the economy is to achieve full employment and full production.

*Learning Objective: 2.1 Economic systems
Level: Easy
McConnell - Chapter 002 #9
Type: Definition*

10. The term "mixed economy" refers to an economy:
(p. 32)
- A. comprised of both product and resource markets.
 - B. which engages in both domestic and international trade.
 - C.** comprised of both extensive private markets and government involvement in the economy.
 - D. which functions primarily on the basis of custom and tradition.

*Learning Objective: 2.1 Economic systems
Level: Easy
McConnell - Chapter 002 #10
Type: Definition*

11. The Canadian economy most closely approximates:
(p. 32)
- A.** mixed capitalism
 - B. a command economy
 - C. market socialism
 - D. authoritarian capitalism

*Learning Objective: 2.1 Economic systems
Level: Easy
McConnell - Chapter 002 #11
Type: Application*

12. Which of the following is unique to a market economy system?

- (p. 32-33) A. the extensive use of capital goods
B. private ownership of property resources
C. specialization
D. the use of money

Learning Objective: 2.2 Characteristics of the market system

Level: Easy

McConnell - Chapter 002 #12

Type: Definition

13. Well-property rights are important because they:

- (p. 32-33) A. encourage investment and growth.
B. are conducive to the writing of books and music.
C. facilitate exchange.
D. do all of these.

Learning Objective: 2.2 Characteristics of the market system

Level: Easy

McConnell - Chapter 002 #13

Type: Application

14. The market system is an economic system that:

- (p. 32-33) A. produces more consumer goods than capital goods.
B. produces more capital goods than consumer goods.
C. gives private individuals and institutions the right to own resources used in production.
D. gives the government the right to tax individuals and corporations for the production of capital goods.

Learning Objective: 2.2 Characteristics of the market system

Level: Easy

McConnell - Chapter 002 #14

Type: Definition

15. The market system is characterized by:

- (p. 32-33) A. extensive government constraints on individual behaviour.
B. private ownership of the means of production.
C. government control of all production decisions.
D. government rationing of all goods and services.

Learning Objective: 2.2 Characteristics of the market system

Level: Easy

McConnell - Chapter 002 #15

Type: Application

16. In a market system, well-defined property rights are important because they:

- (p. 32-33) A. reduce unnecessary investment.
B. limit destructive economic growth.
C. create economic problems.
D. encourage economic activity.

Learning Objective: 2.2 Characteristics of the market system

Level: Easy

McConnell - Chapter 002 #16

Type: Application

17. Which is a major feature of the market system?

- (p. 32-33) A. price floors and price ceilings in all markets
B. reallocation of all resources from private to public uses
C. the right to own private property and control resource use
D. central planning by government to provide goods and services

Learning Objective: 2.2 Characteristics of the market system

Level: Easy

McConnell - Chapter 002 #17

Type: Application

18. Which is a major feature of pure capitalism?
(p. 32-33) A. price floors and price ceilings in markets
B. reallocation of resources from private to public uses
C. the right to own private property and control resource use
D. central planning by government to provide goods and services

Learning Objective: 2.2 Characteristics of the market system

Level: Easy

McConnell - Chapter 002 #18

Type: Definition

19. By free enterprise, we mean that:
(p. 33) A. products are provided free to those who can't afford to buy them.
B. individual producers determine how to produce, but government agencies determine what will be produced.
C. individuals may obtain resources, organize production, and sell the resulting output in any legal way they choose.
D. individuals are free to produce those products that government agencies determine can be produced profitably.

Learning Objective: 2.2 Characteristics of the market system

Level: Easy

McConnell - Chapter 002 #19

Type: Definition

20. Which statement is correct?
(p. 33) A. The operation of a market system eventually results in an equal distribution of income.
B. Producers are "kings" in a market economy because they determine what is produced.
C. The market system is efficient at allocation of resources, but not consumer goods to their most valued uses.
D. Freedom of choice and enterprise are essential elements of the market system.

Learning Objective: 2.2 Characteristics of the market system

Level: Moderate

McConnell - Chapter 002 #20

Type: Application

21. Which is characteristic of the capitalistic ideology?
(p. 33) A. unselfish individuals
B. centralized decision-making
C. free enterprise and choice
D. government ownership of the means of production

Learning Objective: 2.2 Characteristics of the market system

Level: Easy

McConnell - Chapter 002 #21

Type: Definition

22. How do workers typically express self-interest?
(p. 33) A. by minimizing the economic losses of other business firms
B. by maximizing the economic profits of other business firms
C. by seeking the highest price when purchasing a consumer product
D. by seeking jobs with the best combination of wages and benefits

Learning Objective: 2.2 Characteristics of the market system

Level: Easy

McConnell - Chapter 002 #22

Type: Definition

23. Consumers express self-interest when they:
(p. 33) A. reduce business losses.
B. collect economic profits.
C. seek the lowest price for the product.
D. search for jobs with the highest wage

Learning Objective: 2.2 Characteristics of the market system

Level: Easy

McConnell - Chapter 002 #23

Type: Application

24. Competition means that:
(p. 33) A. sellers can cause artificial product scarcities and thereby manipulate market price.
B. there are large numbers of independently acting buyers and sellers in each market.
C. a given product can be purchased at a number of different prices.
D. there is more than one seller in a market.

Learning Objective: 2.2 Characteristics of the market system
Level: Easy
McConnell - Chapter 002 #24
Type: Definition

25. The competitive market system:
(p. 33) A encourages innovation because government provides tax breaks and subsidies to those who develop
. new products or new productive techniques.
B. discourages innovation because it is difficult to acquire additional capital in the form of new
machinery and equipment.
C. discourages innovation because firms want to get all the profits possible from existing machinery
and equipment.
D. encourages innovation because successful innovators are rewarded with economic profits.

Learning Objective: 2.2 Characteristics of the market system
Level: Moderate
McConnell - Chapter 002 #25
Type: Application

26. Competition is more likely to exist when:
(p. 33) **A.** there is free entry into and exit out of industries.
B. there is a single supplier of all goods and services.
C. the government purchases most goods and services.
D. products are produced by a few large firms.

Learning Objective: 2.2 Characteristics of the market system
Level: Easy
McConnell - Chapter 002 #26
Type: Application

27. Which condition will encourage competition?
(p. 33) A. government licensing requirements in order to enter an industry
B. a small number of buyers and sellers in a market
C. the freedom of sellers and buyers to enter or exit an industry
D. the government serving as the only supplier of goods to consumers

Learning Objective: 2.2 Characteristics of the market system
Level: Moderate
McConnell - Chapter 002 #27
Type: Application

28. A purely competitive economy assumes the existence in each industry of a:
(p. 33) **A.** large number of small firms facing a large number of small buyers.
B. few large firms facing a large number of small buyers.
C. large number of small firms facing a few large buyers.
D. few small firms facing a few small buyers.

Learning Objective: 2.2 Characteristics of the market system
Level: Easy
McConnell - Chapter 002 #28
Type: Definition

29. Competition denotes a condition where:
(p. 33) A. there is more than one seller in a market.
B. a given product can be purchased at a range of prices.
C. there are many independent buyers and sellers in a market.
D. a few sellers attempt to garner a larger share of the market by cutting prices.

Learning Objective: 2.2 Characteristics of the market system
Level: Easy
McConnell - Chapter 002 #29
Type: Definition

30. If competitive industry Y is incurring substantial losses, we can expect that output will:
- (p. 34)
- A. expand, product price will rise, and losses will tend to disappear.
 - B. contract, product price will fall, and losses will increase.
 - C.** contract, product price will rise, and losses will tend to disappear.
 - D. expand, product price will fall, and losses will tend to disappear.

Learning Objective: 2.2 Characteristics of the market system

Level: Moderate

McConnell - Chapter 002 #30

Type: Application

31. Suppose industry A is realizing substantial economic profits. Which of the following best describes the adjustment process which would bring about a new equilibrium?
- (p. 34)
- A. Firms will leave the industry, output will fall, and product price will rise.
 - B. Firms will enter the industry, output will rise, and product price will rise.
 - C. Firms will leave the industry, output will rise, and product price will fall.
 - D.** Firms will enter the industry, output will rise, and product price will fall.

Learning Objective: 2.2 Characteristics of the market system

Level: Moderate

McConnell - Chapter 002 #31

Type: Application

32. Which statement is correct?
- (p. 34)
- 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.

Learning Objective: 2.2 Characteristics of the market system

Level: Easy

McConnell - Chapter 002 #32

Type: Application

33. A characteristic of the market system is:
- (p. 35)
- A. extensive use of price controls.
 - B. extensive use of barter.
 - C.** extensive use of capital goods.
 - D. low interest rates.

Learning Objective: 2.2 Characteristics of the market system

Level: Easy

McConnell - Chapter 002 #33

Type: Definition

34. The development of new technology and capital goods are essential elements for the market system. This is because:
- (p. 35)
- A.** using more efficient production process means more output for the economy.
 - B. more capital goods means less future consumption goods.
 - C. the standard of living and development of new technology are inversely related.
 - D. the most direct methods of production are more efficient.

Learning Objective: 2.2 Characteristics of the market system

Level: Easy

McConnell - Chapter 002 #34

Type: Definition

35. The basic reason for the production of capital goods is to:
- (p. 35)
- A. promote the concentration of economic power in the business sector.
 - B. facilitate exchange where a coincidence of wants does not exist.
 - C. better synchronize the operation of resource and product markets.
 - D.** enhance future productive efficiency.

Learning Objective: 2.2 Characteristics of the market system

Level: Moderate

McConnell - Chapter 002 #35

Type: Application

36. The process in which workers select specialized tasks to make a product is referred to as:
(p. 35) A. a coincidence of wants.
B. roundabout production.
C. freedom of choice.
D. division of labour.

Learning Objective: 2.2 Characteristics of the market system

Level: Easy

McConnell - Chapter 002 #36

Type: Definition

37. The division of labour means that:
(p. 35) A. labour markets are geographically segmented.
B. unskilled workers outnumber skilled workers.
C. workers specialize in various production tasks.
D. each worker performs a large number of tasks.

Learning Objective: 2.2 Characteristics of the market system

Level: Easy

McConnell - Chapter 002 #37

Type: Definition

38. Specialization and trade are beneficial to society because:
(p. 35) A. the output of economic goods may be increased with no increase in resources.
B. scarce resources are utilized more efficiently.
C. a division of labour lowers prices for products.
D. all of these are correct.

Learning Objective: 2.2 Characteristics of the market system

Level: Moderate

McConnell - Chapter 002 #38

Type: Application

39. Specialization in production is important primarily because it:
(p. 35) **A.** results in greater total output.
B. allows society to avoid the coincidence-of-problem.
C. allows society to trade by barter.
D. allows society to have fewer capital goods.

Learning Objective: 2.2 Characteristics of the market system

Level: Easy

McConnell - Chapter 002 #39

Type: Application

40. The division of labour enhances productivity and efficiency by:
(p. 35-36) A. allowing workers to take advantage of existing differences in their abilities and skills.
B. avoiding the time loss involved in shifting from one production task to another.
C. allowing workers to develop skills by working on one, or a limited number, of tasks.
D. all of these means.

Learning Objective: 2.2 Characteristics of the market system

Level: Moderate

McConnell - Chapter 002 #40

Type: Definition

41. Specialization in production is economically beneficial primarily because it:
(p. 36) A. allows everyone to have a job which they like.
B. permits the production of a larger output with fixed amounts of resources.
C. facilitates trade by bartering.
D. guarantees full employment.

Learning Objective: 2.2 Characteristics of the market system

Level: Easy

McConnell - Chapter 002 #41

Type: Application

42. The use of money for exchange:
(p. 36) A. increases the use of barter.
B. reduces consumer sovereignty.
C. decreases the coincidence of wants.
D. encourages more specialization in production.

Learning Objective: 2.2 Characteristics of the market system

Level: Easy

McConnell - Chapter 002 #42

Type: Application

43. Anything that is generally acceptable in exchange for goods and services is:
(p. 36) **A. a medium of exchange.**
B. a measure of value.
C. a store of value.
D. token money.

Learning Objective: 2.2 Characteristics of the market system

Level: Easy

McConnell - Chapter 002 #43

Type: Definition

44. Which is the main problem with the barter system of exchange? Barter:
(p. 36) A. encourages self-interest and selfishness.
B. fosters specialization and division of labour.
C. requires a coincidence of wants.
D. undermines the right to bequeath.

Learning Objective: 2.2 Characteristics of the market system

Level: Easy

McConnell - Chapter 002 #44

Type: Application

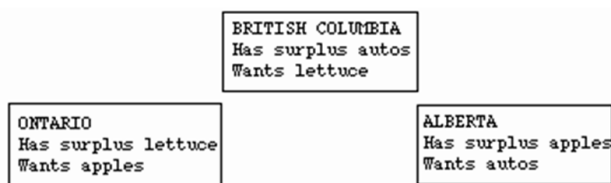
45. Consider a barter situation where you have pens and you want pencils. To achieve your objective there must be a(n):
(p. 36) A. use of capital goods.
B. entry and exit from the market.
C. large number of sellers.
D. coincidence of wants.

Learning Objective: 2.2 Characteristics of the market system

Level: Easy

McConnell - Chapter 002 #45

Type: Application



46. On the basis of the information provided it can be said that:
(p. 36-37) **A. no coincidence of wants exists between any two provinces.**
B. a coincidence of wants exists between British Columbia and Ontario.
C. a coincidence of wants exists between Ontario and Alberta.
D. a coincidence of wants exists between British Columbia and Alberta.

McConnell - Chapter 002

Learning Objective: 2.2 Characteristics of the market system

Level: Easy

McConnell - Chapter 002 #46

Type: Application

47. On the basis of the information provided and assuming trade occurs between the three provinces we can expect:
(p. 36-37)
- A.** Alberta to exchange apples with Ontario and receive money in return.
 - B. Alberta to exchange apples with British Columbia and receive money in return.
 - C. Ontario to exchange lettuce with British Columbia and receive autos in return.
 - D. None of these to occur.

Learning Objective: 2.2 Characteristics of the market system

Level: Moderate

McConnell - Chapter 002 #47

Type: Application

48. Given the information provided and assuming trade does occur between the provinces, we can expect:
(p. 36-37)
- A. that there is no means by which British Columbia can obtain lettuce while specializing in the production of autos.
 - B. that money will not be needed to accomplish the desired exchanges.
 - C.** money to flow counterclockwise from British Columbia to Ontario to Alberta.
 - D. money to flow clockwise from British Columbia to Alberta to Ontario.

Learning Objective: 2.2 Characteristics of the market system

Level: Difficult

McConnell - Chapter 002 #48

Type: Application

49. Which is assumed to be most limited in scope under a market system?
(p. 37)
- A. freedom of enterprise
 - B. freedom of choice
 - C. competition
 - D.** government

Learning Objective: 2.2 Characteristics of the market system

Level: Easy

McConnell - Chapter 002 #49

Type: Definition

50. Which of the following is not a part of a market system?
(p. 37)
- A. private property
 - B. freedom of enterprise and choice
 - C. competition in product and resource markets
 - D.** government determination of basic economic goals

Learning Objective: 2.2 Characteristics of the market system

Level: Easy

McConnell - Chapter 002 #50

Type: Definition

51. Which is not one of the Five Fundamental Questions?
(p. 38)
- A. How will the goods and services be produced?
 - B. How will the system accommodate change?
 - C. Who will get the goods and services?
 - D.** What goods and services should be produced by government?

Learning Objective: 2.3 Five fundamental questions

Level: Easy

McConnell - Chapter 002 #51

Type: Definition

52. What to produce in a market economy is ultimately determined by the:
(p. 38)
- A. output decisions of business firms.
 - B. income plans of households.
 - C.** spending decisions of households.
 - D. workers' technical skills.

Learning Objective: 2.3 Five fundamental questions

Level: Easy

McConnell - Chapter 002 #52

Type: Application

53. "Consumer sovereignty" refers to the:
- (p. 38)
- A. fact that resource prices tend to be high relative to product prices in capitalistic economies.
 - B. idea that the pursuit of self-interest will prove ultimately to be in the public interest.
 - C.** notion that the decisions of producers and resource suppliers with respect to the kinds and amounts of goods produced must be appropriate to consumer demands.
 - D. fact that a federal agency exists to protect consumers from harmful and defective products.

Learning Objective: 2.3 Five fundamental questions

Level: Easy

McConnell - Chapter 002 #53

Type: Definition

54. The term consumer sovereignty means that:
- (p. 38)
- A. consumers are controlled by the actions of the marketplace.
 - B.** what is produced is ultimately determined by what consumers buy.
 - C. there are no limits on what consumers may buy under capitalism.
 - D. businesses produce with consumer satisfaction as their primary goal.

Learning Objective: 2.3 Five fundamental questions

Level: Easy

McConnell - Chapter 002 #54

Type: Definition

55. The market system is said to be characterized by "consumer sovereignty." This is because:
- (p. 38)
- A. a large number of consumer goods are produced.
 - B. the prices of consumer goods are regulated by government.
 - C. consumer goods are more profitable than investment goods.
 - D.** of the role of consumers in determining what goods are produced.

Learning Objective: 2.3 Five fundamental questions

Level: Easy

McConnell - Chapter 002 #55

Type: Application

56. The introduction of "new" Coca-Cola and the reintroduction of the old "Classic Coke" was an example of:
- (p. 38)
- A. an increase in demand.
 - B.** consumer sovereignty.
 - C. technological advances.
 - D. economic profit.

Learning Objective: 2.3 Five fundamental questions

Level: Easy

McConnell - Chapter 002 #56

Type: Application

57. "The 'dollar votes' of consumers ultimately determine the composition of output and the allocation of resources in a market economy." This statement best describes the concept of:
- (p. 38)
- A. derived demand.
 - B. external costs and benefits.
 - C.** consumer sovereignty.
 - D. the invisible hand.
 - E. market failure.

Learning Objective: 2.3 Five fundamental questions

Level: Easy

McConnell - Chapter 002 #57

Type: Definition

58. The term dollar votes means:
- (p. 38)
- 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.

Learning Objective: 2.3 Five fundamental questions

Level: Easy

McConnell - Chapter 002 #58

Type: Definition

59. Consumer sovereignty and "dollar votes" are most related to which fundamental question about a competitive market system?
(p. 38)
- 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?

Learning Objective: 2.3 Five fundamental questions
Level: Easy
McConnell - Chapter 002 #59
Type: Application

60. Economic efficiency would be primarily discussed in response to which of the fundamental questions about a competitive market economy?
(p. 39)
- A. What will be produced?
 - B.** How will the goods and services be produced?
 - C. How will the system accommodate change?
 - D. Who is to receive the output?

Learning Objective: 2.3 Five fundamental questions
Level: Moderate
McConnell - Chapter 002 #60
Type: Application

61. Which fundamental question about a competitive market system primarily focuses on the cost of producing the good and services?
(p. 39)
- A. What will be produced?
 - B.** How will the goods and services be produced?
 - C. How will the system accommodate change?
 - D. Who is to receive the output?

Learning Objective: 2.3 Five fundamental questions
Level: Easy
McConnell - Chapter 002 #61
Type: Application

62. The issues of distribution of goods and services and incomes in a competitive market system are the primary topic of which fundamental question?
(p. 39)
- A. What will be produced?
 - B. How will the goods and services be produced?
 - C. How will the system accommodate change?
 - D.** Who is to receive the output?

Learning Objective: 2.3 Five fundamental questions
Level: Easy
McConnell - Chapter 002 #62
Type: Application

63. In the market system, the statement of "Wages, interest, rent, and profit are crucial determinants of the size of each person's income", is an indication of:
(p. 39)
- A. What will be produced?
 - B. How will the goods and services be produced?
 - C.** Who will get the output?
 - D. How will the system accommodate change?

Learning Objective: 2.3 Five fundamental questions
Level: Easy
McConnell - Chapter 002 #63
Type: Application

64. "For whom is a given mix of goods and services to be produced? How, in other words, is the product to be distributed among people when such commodities and services are available?" In a market economy, this problem is resolved primarily in the:
(p. 39)
- 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.

Learning Objective: 2.3 Five fundamental questions
Level: Moderate
McConnell - Chapter 002 #64
Type: Application

65. In a market economy the distribution of income would be determined primarily by
(p. 39) A. consumer needs and preferences.
B. the quantities and prices of the resources which households supply.
C. government regulations which provide a minimum income for all.
D. a social consensus as to what distribution of income is most equitable.

Learning Objective: 2.3 Five fundamental questions
Level: Moderate
McConnell - Chapter 002 #65
Type: Application

66. Which fundamental question about a competitive market system primarily focuses on technological
(p. 39) progress and capital accumulation?
A. What will be produced?
B. How will the goods and services be produced?
C. How will the system accommodate change?
D. Who is to receive the output?

Learning Objective: 2.3 Five fundamental questions
Level: Easy
McConnell - Chapter 002 #66
Type: Application

67. If an increase occurs in the demand for product X, we would expect all of the following to occur
(p. 39) except:
A. an increase in the profits of industry X.
B. an increase in the demand for resources employed by industry X.
C. an increase in the output of industry X.
D. a decrease in the prices of resources employed in industry X.

Learning Objective: 2.3 Five fundamental questions
Level: Moderate
McConnell - Chapter 002 #67
Type: Application

68. An increase in demand for strawberries is most likely to:
(p. 39) **A.** increase the demand for strawberry pickers.
B. reduce the supply of strawberry pickers.
C. reduce the supply of strawberries.
D. reduce the demand for strawberry pickers.
E. decrease the demand for raspberries.

Learning Objective: 2.3 Five fundamental questions
Level: Moderate
McConnell - Chapter 002 #68
Type: Application

69. The market system communicates changes in supply and demand and elicits appropriate responses
(p. 40) from businesses and resource suppliers. This is known as the:
A. rationing function of prices.
B. guiding function of prices.
C. monetary function of prices.
D. circular flow of income.

Learning Objective: 2.3 Five fundamental questions
Level: Easy
McConnell - Chapter 002 #69
Type: Definition

70. Which of the following best describes the "guiding function" of competitive prices?
(p. 40) A. Profitable industries tend to contract and unprofitable industries tend to expand.
B. The market system will always generate economic profits for firms which use the least costly production technology.
C. The market system can negotiate reallocations of resources which are appropriate to changes in consumer tastes, technology, and resource supplies.
D. When prices are in equilibrium, product shortages or surpluses cannot occur.

Learning Objective: 2.3 Five fundamental questions
Level: Moderate
McConnell - Chapter 002 #70
Type: Definition

71. Assume the demand for product Y increases and the subsequent market system responses result in the production of more Y. This illustrates:
(p. 40)
A. that the concept of derived demand is inapplicable.
B. that consumer sovereignty is inoperative in this economy.
C. the scarcity function of prices.
D. the directing or guiding function of prices.

Learning Objective: 2.3 Five fundamental questions
Level: Moderate
McConnell - Chapter 002 #71
Type: Application

72. Which statement accurately summarizes the relationship between the prices of goods and their relative scarcity?
(p. 40)
A. The price of a good is a direct function of the relative scarcity of the good.
B. The price of a good is an inverse function of the relative scarcity of the good.
C. The price of a good is independent of the relative scarcity of the good.
D. High prices lead to greater relative scarcity.

Learning Objective: 2.3 Five fundamental questions
Level: Moderate
McConnell - Chapter 002 #72
Type: Application

73. The most efficient combination of resources in producing any output is that combination which:
(p. 40)
A. comes closest to using the same quantities of land, labour, capital, and entrepreneurial ability.
B. can be obtained for the smallest money outlay.
C. uses the smallest total quantity of all resources.
D. conserves most on the use of labour.

Learning Objective: 2.3 Five fundamental questions
Level: Moderate
McConnell - Chapter 002 #73
Type: Definition

74. The development of the Internet and e-mail to replace regular mail services in many cases would be an example of:
(p. 40)
A. roundabout production.
B. derived demand.
C. creative destruction.
D. specialization.

Learning Objective: 2.3 Five fundamental questions
Level: Easy
McConnell - Chapter 002 #74
Type: Application

75. The development of CDs and DVD that significantly reduced the market for cassette tapes would be an example of:
(p. 40)
A. specialization.
B. derived demand.
C. roundabout production.
D. creative destruction.

Learning Objective: 2.3 Five fundamental questions
Level: Easy
McConnell - Chapter 002 #75
Type: Application

76. Which of the following best describes the "invisible hand" concept?
(p. 41)
A. The desires of resource suppliers and producers to further their own self-interest will automatically further the public interest.
B. The nonsubstitutability of resources gives rise to a conflict between private and public interests and the need for government intervention.
C. Mixed capitalism is the best system for overcoming the scarce resources-unlimited wants problem.
D. Central direction by the government will improve resource allocation in a capitalistic economy.

Learning Objective: 2.3 Five fundamental questions
Level: Moderate
McConnell - Chapter 002 #76
Type: Definition

77. The "invisible hand" concept suggests that:
(p. 41) A. changes in product demands are only randomly reflected in changes in the demands for resources.
B. profit maximization is inconsistent with an efficient allocation of resources.
C. government action is necessary to correct for market failures.
D. when firms maximize their profits, society's domestic output will also be maximized.

Learning Objective: 2.3 Five fundamental questions

Level: Easy

McConnell - Chapter 002 #77

Type: Application

78. The "invisible hand" concept suggests that:
(p. 41) A. market failures imply the need for a national economic plan.
B. big businesses are inherently more efficient than small businesses.
C. the competitiveness of a capitalistic market economy invariably diminishes over time.
D. given competition, private and public interests will tend to coincide.

Learning Objective: 2.3 Five fundamental questions

Level: Moderate

McConnell - Chapter 002 #78

Type: Application

79. The "invisible hand" refers to the:
(p. 41) A. fact that our tax system redistributes income from rich to poor.
B. notion that, under competition, decisions motivated by self-interest promote the social interest.
C. tendency of monopolistic sellers to raise prices above competitive levels.
D. fact that government controls the functioning of the market system.

Learning Objective: 2.3 Five fundamental questions

Level: Easy

McConnell - Chapter 002 #79

Type: Definition

80. The idea that the desires of resource suppliers and producers to further their own self-interest will automatically further the public interest is known as:
(p. 41) A. consumer sovereignty.
B. the invisible hand.
C. derived demand.
D. profit maximization.

Learning Objective: 2.3 Five fundamental questions

Level: Easy

McConnell - Chapter 002 #80

Type: Definition

81. The idea that firms and resource suppliers in seeking to further their own self-interests in a competitive market economy also simultaneously promotes the public or social interest is a description of:
(p. 41) A. the guiding function of prices.
B. capital accumulation.
C. the "invisible hand."
D. "dollar votes."

Learning Objective: 2.3 Five fundamental questions

Level: Easy

McConnell - Chapter 002 #81

Type: Definition

82. While in market economies the profit depends on consumer demand, production efficiency, and product quality, for command economies profit depends on:
(p. 42) A. production cost.
B. product differentiation.
C. product mix.
D. quantitative production target.

Learning Objective: 2.4 The demise of the command system

Level: Easy

McConnell - Chapter 002 #82

Type: Application

83. The coordination problem in command economies became more difficult as:
(p. 42) **A.** the number of industries expanded.
B. less quantitative targets were assigned to each industry.
C. planning techniques improved.
D. production cost decreased.

Learning Objective: 2.4 The demise of the command system

Level: Easy

McConnell - Chapter 002 #83

Type: Application

84. As opposed to the market system, in command economies:
(p. 43) **B.** the reward for innovation does not exist.
A. the reward for innovation is extensive.
C. meeting the production targets are extremely important.
D. the profit motives are extremely high.

Learning Objective: 2.4 The demise of the command system

Level: Easy

McConnell - Chapter 002 #84

Type: Application

85. In the factor market:
(p. 44) **C.** households sell resources to businesses.
A. businesses borrow money capital from households.
B. businesses sell services to households.
D. firms sell raw materials to households.

Learning Objective: 2.5 The circular flow model

Level: Easy

McConnell - Chapter 002 #85

Type: Application

86. The simple circular flow model shows that:
(p. 44-45) **C.** households are on the supply side of the factor market and on the demand side of the product market.
A. households are on the demand side of both product and factor markets.
B. businesses are on the supply side of both product and factor markets.
D. businesses are on the demand side of the product market and on the supply side of the factor market.

Learning Objective: 2.5 The circular flow model

Level: Moderate

McConnell - Chapter 002 #86

Type: Definition

87. The two basic markets shown by the simple circular flow model are:
(p. 44-45) **C.** product and factor.
A. capital goods and consumer goods.
B. free and controlled.
D. household and business.

Learning Objective: 2.5 The circular flow model

Level: Easy

McConnell - Chapter 002 #87

Type: Definition

88. In the simple circular flow model:
(p. 44-45) **B.** businesses are suppliers of final products.
A. households are demanders of factors of production.
C. households are suppliers of final products.
D. there are real flows of goods, services, and factors, but not money flows.

Learning Objective: 2.5 The circular flow model

Level: Easy

McConnell - Chapter 002 #88

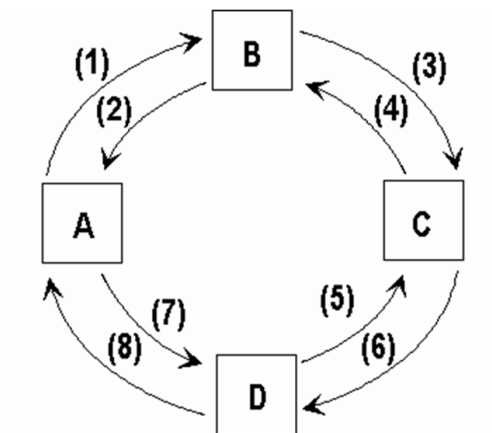
Type: Definition

89. Households and businesses are:
 (p. 44-45) A. both buyers in the factor market.
 B. both suppliers in the product market.
C. suppliers in the factor and product markets respectively.
 D. suppliers in the product and factor markets respectively.

Learning Objective: 2.5 The circular flow model
 Level: Easy
 McConnell - Chapter 002 #89
 Type: Definition

90. In the circular flow model:
 (p. 44-45) A. households supply factors of production to firms.
 B. households receive income through the factor market.
 C. households spend income in the product market.
D. all of these hold true.

Learning Objective: 2.5 The circular flow model
 Level: Easy
 McConnell - Chapter 002 #90
 Type: Definition



91. Refer to the figure. If box B represents the factor market and flow (3) represents money income, then:
 (p. 44-45) A. box A is the product market and box C is households.
 B. box C is the product market and box A is households.
C. box D is the product market and box C is households.
 D. box C is the product market and box D is households.

McConnell - Chapter 002

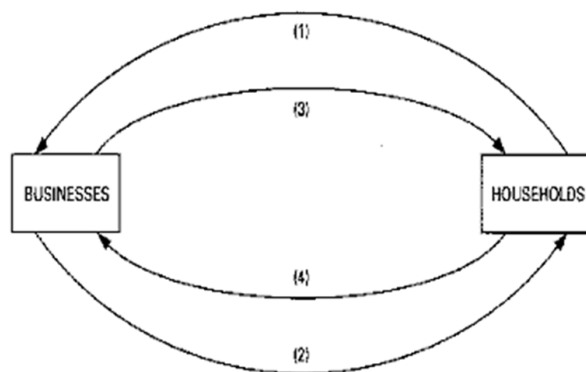
Learning Objective: 2.5 The circular flow model
 Level: Moderate
 McConnell - Chapter 002 #91
 Type: Application

92. Refer to the figure. If box A represents businesses and flow (7) represents goods and services, then:
 (p. 44-45) A. box D is the product market and box B is the factor market.
 B. box D is the product market and box B is households.
 C. box B is the product market and box C is households.
 D. box C is the product market and box B is the factor market.

Learning Objective: 2.5 The circular flow model
 Level: Moderate
 McConnell - Chapter 002 #92
 Type: Application

93. In terms of the circular flow diagram businesses obtain revenue through the _____ market and make expenditures in the _____ market.
(p. 44-45)
- product; financial
 - factor; product
 - C. product; factor**
 - capital; product

Learning Objective: 2.5 The circular flow model
Level: Easy
McConnell - Chapter 002 #93
Type: Definition

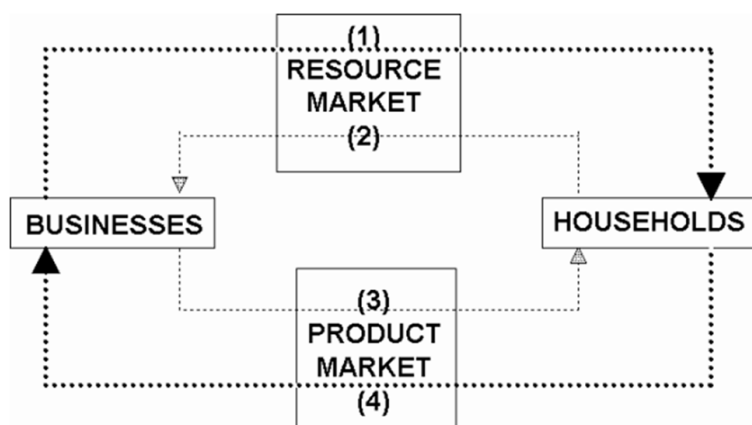


94. Refer to the diagram. Arrows (1) and (2) represent:
(p. 44-45)
- goods and resources respectively.
 - money incomes and output respectively.
 - output and money incomes respectively.
 - D. resources and goods respectively.**

McConnell - Chapter 002

95. Refer to the diagram. Arrows (3) and (4) represent:
(p. 44-45)
- goods and services respectively.
 - B. money incomes and consumer expenditures respectively.**
 - resources and goods respectively.
 - consumer expenditures and money income respectively.

Learning Objective: 2.5 The circular flow model
Level: Moderate
McConnell - Chapter 002 #94
Type: Application



Learning Objective: 2.5 The circular flow model
Level: Moderate
McConnell - Chapter 002 #95
Type: Application

McConnell - Chapter 002

96. Refer to the circular flow model of the economy. In the diagram flow (1) represents:

- (p. 44-45) **A.** wage, rent, interest, and profit income.
B. land, labour, capital, and entrepreneurial ability.
C. goods and services.
D. consumer expenditures.

Learning Objective: 2.5 The circular flow model

Level: Easy

McConnell - Chapter 002 #96

Type: Application

97. Refer to the circular flow model of the economy. In the diagram flow (2) represents:

- (p. 44-45) A. wage, rent, interest, and profit income.
B. land, labour, capital, and entrepreneurial ability.
C. goods and services.
D. consumer expenditures.

Learning Objective: 2.5 The circular flow model

Level: Easy

McConnell - Chapter 002 #97

Type: Application

98. Refer to the circular flow model of the economy. In the diagram flow (3) represents:

- (p. 44-45) A. wage, rent, interest, and profit income.
B. land, labour, capital, and entrepreneurial ability.
C. goods and services.
D. consumer expenditures.

Learning Objective: 2.5 The circular flow model

Level: Easy

McConnell - Chapter 002 #98

Type: Application

99. Refer to the circular flow model of the economy. In the diagram flow (4) represents:

- (p. 44-45) A. wage, rent, interest, and profit income.
B. land, labour, capital, and entrepreneurial ability.
C. goods and services.
D. consumer expenditures.

Learning Objective: 2.5 The circular flow model

Level: Easy

McConnell - Chapter 002 #99

Type: Application

100. In terms of the circular flow diagram households make expenditures in the _____ market and receive income through the _____ market.

- (p. 44-45) A. product; financial
B. factor; product
C. product; factor
D. capital; product

Learning Objective: 2.5 The circular flow model

Level: Easy

McConnell - Chapter 002 #100

Type: Application

101. Private property rights are important because they:

- (p. 46) A. discourage investment and growth.
B. eliminate the possibility of randomness in resource arrangements.
C. facilitate the production of public goods.
D. create a random distribution of the economic resources.

Learning Objective: Last Word

Level: Easy

McConnell - Chapter 002 #101

Type: Application

102. The knowledge of how each and every economic resource might be combined productively with each other is important because:
(p. 46)
A. it will allow the production of more consumer goods than capital goods.
B. it produces more capital goods than consumer goods.
C. it gives the government the right to own resources used in production.
D. it will eliminate the randomness in allocating the resources.

Learning Objective: Last Word
Level: Easy
McConnell - Chapter 002 #102
Type: Application

103. Markets fail to allocate resources efficiently when
(p. 46)
A. private property rights are not established.
B. there is a well established private property right.
C. the randomness does not exist in allocation of resources.
D. the government produces the public goods.

Learning Objective: Last Word
Level: Easy
McConnell - Chapter 002 #103
Type: Application

104. Specialization may be conducive to an expansion of total output even though the individuals involved may have identical abilities.
(p. 32)
TRUE

Learning Objective: 2.2 Characteristics of the market system
Level: Moderate
McConnell - Chapter 002 #104
Type: Application

105. A division of labour enhances society's output by permitting people to take advantage of existing differences in their abilities and skills.
(p. 32)
TRUE

Learning Objective: 2.2 Characteristics of the market system
Level: Easy
McConnell - Chapter 002 #105
Type: Application

106. Money functions as a medium of exchange in permitting the ready comparison of the relative worth of heterogeneous products.
(p. 36)
FALSE

Learning Objective: 2.2 Characteristics of the market system
Level: Moderate
McConnell - Chapter 002 #106
Type: Application

107. Government alters the distribution of income by market intervention, in which case it modifies the prices established by market forces.
(p. 37)
TRUE

Learning Objective: 2.2 Characteristics of the market system
Level: Moderate
McConnell - Chapter 002 #107
Type: Application

108. Consumer sovereignty means that legislation now protects the rights of consumers to dispose of their incomes as they see fit.
(p. 38)
FALSE

Learning Objective: 2.3 Five fundamental questions
Level: Easy
McConnell - Chapter 002 #108
Type: Definition

109. The wants of consumers are expressed on the demand side of the product market.
(p. 38)
TRUE

Learning Objective: 2.3 Five fundamental questions
Level: Easy
McConnell - Chapter 002 #109
Type: Application

110. The guiding function of prices indicates that, at equilibrium prices, neither product surpluses nor shortages can occur.

(p. 40)

FALSE

Learning Objective: 2.3 Five fundamental questions

Level: Easy

McConnell - Chapter 002 #110

Type: Application

111. The "invisible hand" refers to the many indirect controls which the federal government imposes in a system of mixed capitalism.

(p. 41)

FALSE

Learning Objective: 2.3 Five fundamental questions

Level: Easy

McConnell - Chapter 002 #111

Type: Definition

112. In a competitive market economy, firms and resource suppliers will seek to further their own self-interest, but at the same time, as if guided by an "invisible hand," they will promote the public interest.

(p. 41)

TRUE

Learning Objective: 2.3 Five fundamental questions

Level: Easy

McConnell - Chapter 002 #112

Type: Application

113. In the simple circular flow model businesses are suppliers of final products.

(p. 44)

TRUE

Learning Objective: 2.5 The circular flow model

Level: Easy

McConnell - Chapter 002 #113

Type: Application

114. Households and businesses are both suppliers in the product market.

(p. 44)

FALSE

Learning Objective: 2.5 The circular flow model

Level: Easy

McConnell - Chapter 002 #114

Type: Application

115. Explain what is meant by a command economy.

(p. 31)

The command economy is the opposite extreme alternative to pure capitalism. It is a system characterized by government ownership of all or nearly all property resources and centrally planned and administered production.

Learning Objective: 2.1 Economic systems

McConnell - Chapter 002 #115

116. Explain the term "laissez-faire capitalism."

(p. 32)

Pure capitalism is sometimes called "laissez faire" capitalism which is a French term for "let it be." In pure capitalism the government's role is limited to protecting private property and establishing the legal framework for free enterprise and free markets to function.

Learning Objective: 2.1 Economic systems

McConnell - Chapter 002 #116

117. List nine characteristics of the market system.
(p. 32-37)

The nine characteristics discussed in the text are: (1) private property; (2) freedom of enterprise and choice; (3) self-interest as the major motivation for economic activity; (4) competition among buyers and sellers; (5) reliance on the market (price) system; (6) the use of advanced technology and large amounts of capital goods; (7) specialization; (8) the use of money rather than barter; and (9) active but limited role for government

*Learning Objective: 2.2 Characteristics of the market system
McConnell - Chapter 002 #117*

118. Why is the right of private property an essential characteristic of a market system?
(p. 32-33)

Property rights are important because they give people private ownership of resources. This ownership encourages them to make the best use of those resources because they will benefit if they do. Property rights also encourage people to take the risk of investing in capital goods or to develop new innovation or products because they will receive the benefits from this activity if they are successful. Property rights offer incentives for people to maintain their property to preserve its value and invest in it if they think they can increase its value. Property rights also facilitate exchanges by making clear who owns a resource so that there is no question about the legitimacy of the transaction.

*Learning Objective: 2.2 Characteristics of the market system
McConnell - Chapter 002 #118*

119. What roles do freedom of enterprise and freedom of choice play in capitalism? How important are they to the operation of a competitive market economy?
(p. 33)

In capitalism, two essential freedoms are the freedom of enterprise and freedom of choice. Business must be free to get economic resources, organize them to produce products, and sell them in the market. Businesses must also be free to enter or leave an industry. Freedom of choice gives business owners, resource owners, and consumers freedom to act to advance their own self-interest. Business owners are free to buy and sell property. Labour resources (workers) can enter or exit any line of work for which they are qualified. Consumers are free to purchase goods and services as they choose based on their budget constraints. Without these freedoms it would be impossible for a market economy to exist.

*Learning Objective: 2.2 Characteristics of the market system
McConnell - Chapter 002 #119*

120. Explain the importance of self-interest in the operation of a market system.
(p. 33)

Self-interest is the motivating force behind both the demand and supply sides of the product and resource markets in a capitalist system. Entrepreneurs engage in production with the expectation of making a profit; workers seek the best wage and working conditions they can get; consumers allocate their spending in order to maximize their satisfaction.

*Learning Objective: 2.2 Characteristics of the market system
McConnell - Chapter 002 #120*

121. What is the importance of competition in relation to self-interest in a market system?

(p. 33-34)

Competition is important as the force, which tempers or regulates the self-interest of producers, sellers, workers, and buyers. If producers make too much profit, competitors will arise to take advantage of the opportunity and as production increases, prices and profits will fall. If workers demand too much, employers will seek other workers who are willing to work for less. If buyers are not willing to pay a fair price for the product, producers will sell the product to someone who is. In each case it is competition or the threat of competition that tempers the potential abuse of economic power.

*Learning Objective: 2.2 Characteristics of the market system
McConnell - Chapter 002 #121*

122. What conditions are necessary for economic competition to exist?

(p. 33-34)

Competition requires the presence of large numbers of buyers and sellers. The number must be large enough so that no single buyer or seller can affect the price of the product by their individual actions regarding demand or supply. In addition, competition assumes that it is simple for producers to enter or leave a particular industry so that the economy can adjust appropriately to changes in consumer demand, technology, or resource supplies.

*Learning Objective: 2.2 Characteristics of the market system
McConnell - Chapter 002 #122*

123. Explain why the market system is an organizing mechanism.

(p. 35)

Markets and price give the economic system its ability to coordinate millions of economics decisions made on a daily basis. The system is an extensive communication network for expressing the wishes of consumers to producers. The price signals given by markets direct resources to the goods and services people want and indicate where profits are to be made for producers. Producers who fail to heed the market signals are punished. Consumers also use the market price to figure out how to make the best use of their limited incomes.

*Learning Objective: 2.2 Characteristics of the market system
McConnell - Chapter 002 #123*

124. Respond to the following question: "Producing capital goods takes time, so how can that be a more efficient form of production of consumer goods?"

(p. 35 (and 18-19))

The production of capital goods does require time. These capital goods, however, can then be used to increase the production of consumer goods. This roundabout method of production is more efficient over time, but it does not come without a cost. As shown by the production possibilities curve, resources used to make capital goods must be diverted from the production of consumer goods today to produce capital goods that will then be used to increase the consumer goods of tomorrow.

*Learning Objective: 2.2 Characteristics of the market system
McConnell - Chapter 002 #124*

125. Describe two types of specialization in production.

(p. 35-36)

Specialization may be of the human form with division of labour where different workers perform different production tasks; or it may be geographic specialization where some goods and services are produced in certain regions and others are produced in other areas.

*Learning Objective: 2.2 Characteristics of the market system
McConnell - Chapter 002 #125*

126. What are the economic advantages of the division of labour?

(p. 35-36)

The advantages come from increased productivity or output per worker as specialized workers gain skills in performing one task and avoid loss of time in switching from one task to another. Therefore, more is produced with the same amount of resources as before specialization.

*Learning Objective: 2.2 Characteristics of the market system
McConnell - Chapter 002 #126*

127. Describe three ways that the division of labour contributes to society's output.

(p. 35-36)

First, specialization lets people take advantage of differences in skills and abilities so they can be more efficient and productive. Second, specialization fosters learning by doing so people can become good at a particular task. Third, specialization saves time because people do not have to switch from one task to another.

*Learning Objective: 2.2 Characteristics of the market system
McConnell - Chapter 002 #127*

128. What advantage does a money economy have over a barter economy?

(p. 36-37)

Trade is difficult with barter because it requires a coincidence of wants. Money overcomes that problem. A buyer can obtain goods without having to locate a seller who desires what the person has to trade. All products can be priced and traded on a common basis. Also, with money, neither party needs to carry products around with them so they are always available for trade. Money facilitates the exchange of products, which is necessary for specialization. Economic efficiency is improved with a system of money.

*Learning Objective: 2.2 Characteristics of the market system
McConnell - Chapter 002 #128*

129. How does the use of money differ from the use of barter in the exchange of goods and services?

(p. 36-37)

Barter requires a coincidence of wants. In order for exchange to take place both parties have to want what the other is offering. Money, on the other hand, acts as a medium of exchange in that the appropriate quantity of it is generally acceptable in exchange for any good or service.

*Learning Objective: 2.2 Characteristics of the market system
McConnell - Chapter 002 #129*

130. What is money and what important function does it perform? Explain how it overcomes the disadvantages associated with barter. What conditions are necessary for people to accept paper currency in exchange for the goods and services, which they sell?

(p. 36-37)

Money is anything that is generally acceptable as a medium of exchange. In Canada, money includes currency, coins, and chequable deposits.

Barter requires a coincidence of wants between the two parties to a transaction. Each has to want what the other has to offer. Money makes this coincidence unnecessary, as the seller is willing to accept money in exchange for goods or services offered and can, in turn, exchange the money earned for other goods and services from another seller. The necessary condition for the use of paper currency is that it must be generally acceptable. Sellers must have faith that the currency will have value when they want to use it to buy goods and services for themselves.

Note that the money does not have to have any intrinsic value; that is, it does not have to be backed by a material that has some use like gold or silver.

*Learning Objective: 2.2 Characteristics of the market system
McConnell - Chapter 002 #130*

131. Suppose Tom, Dick, and Harry live in a barter economy. Tom produces wine, Dick bakes bread, and Harry makes cheese. Tom wants some bread to go with his wine and is willing to trade 1 litre of wine for two loaves of bread. Dick wants some cheese to go with his bread and is willing to trade one loaf of bread for one-half kilogram of cheese. Harry doesn't want bread, but wants some wine to go with his cheese and is willing to trade cheese for one litre of wine. It is not possible for all three of them to meet together at one time.

(a) Explain how this situation illustrates the difficulty with a barter economy.

(b) Devise a money system using rubies where four rubies are equivalent in value to one litre of wine. In other words tell how much bread and cheese would be worth in terms of rubies in this economy. In this system, how much cheese must Harry sell in order to buy one litre of wine?

(a) The lack of coincidence of wants is illustrated in this situation. Tom wants the bread that Dick has, Dick wants Harry's cheese, and Harry wants Tom's wine but for any two of them there is no incentive to trade for something each does not want. In other words, there is no coincidence of wants.

(b) If rubies could be used as a medium of exchange, Tom could receive four rubies for each litre of wine. According to their initial exchange values, he should be willing to pay two rubies for each loaf of bread. Dick would then have four rubies to purchase one kilogram of cheese and Harry could buy wine with the four rubies he earned from selling this cheese. In terms of ruby prices, bread is worth two rubies per loaf and one litre of wine and one kilogram of cheese are each worth four rubies in this economy.

*Learning Objective: 2.2 Characteristics of the market system
McConnell - Chapter 002 #131*

132. Why does specialization require a convenient means of exchanging goods?
(p. 36-37)

As consumers, individuals prefer to have a wide range of products to satisfy their desires. However, when individuals specialize in production, they focus their efforts on producing one or a few goods. This limited range of production does not match their preferences in consumption. Therefore, individuals must be able to exchange the goods that they specialize in for other goods that they desire to consume. Without a convenient means of exchanging goods, individuals could only consume what they produce. Instead, individuals would be jacks-of-all-trades producing a wide variety of products for their own consumption. There would be little incentive to specialize and to take advantage of the resulting increase in productivity.

*Learning Objective: 2.2 Characteristics of the market system
McConnell - Chapter 002 #132*

133. One of the characteristics of a modern market economy is an "active, but limited, government." How can the government "help" the economy?
(p. 37, 43)

The market is not always perfect. In some cases it directs the economy to an undesirable outcome. We call these instances market failures. When market failures exist, the governments can direct the economy to a more efficient outcome.

*Learning Objective: 2.2 Characteristics of the market system
Learning Objective: 2.4 The demise of the command system
McConnell - Chapter 002 #133*

134. What are the so-called Five Fundamental Questions that every economy must answer?
(p. 38)

Every economy must respond to five fundamental economic questions. What goods and services will be produced? How will the goods and services be produced? Who will get the goods and services? How will the system accommodate change? How will the system promote progress?

*Learning Objective: 2.3 Five fundamental questions
McConnell - Chapter 002 #134*