

Macroeconomics, 2e, GE (Acemoglu)
Chapter 1 The Principles and Practice of Economics

1.1 The Scope of Economics

1) Which of the following statements is true?

- A) All economic agents are necessarily individuals.
- B) A worker who shirks work is not an economic agent.
- C) A government is an example of an economic agent.
- D) A street gang is not an economic agent.

Answer: C

Difficulty: Easy

AACSB: Analytical Thinking

Topic: Economic Agents and Economic Resources

2) Which of the following best describes scarce resources?

- A) Resources that most people cannot afford to buy
- B) Resources that can only be distributed efficiently by the government
- C) Resources for which the quantity demanded is the same for all economic agents
- D) Resources for which the quantity that people want exceeds the quantity that is freely available

Answer: D

Difficulty: Easy

AACSB: Analytical Thinking

Topic: Economic Agents and Economic Resources

3) Which of the following is NOT a scarce resource?

- A) Gold
- B) Pollution
- C) Petroleum
- D) iPhones

Answer: B

Difficulty: Easy

AACSB: Application of Knowledge

Topic: Economic Agents and Economic Resources

4) In economics, scarcity refers to the situation of _____.

- A) making the best use of limited information
- B) having more wants than the amount of available resources
- C) the government rationing available goods and services
- D) sellers setting the prices of their products too high for people to be able to afford them

Answer: B

Difficulty: Medium

AACSB: Analytical Thinking

Topic: Economic Agents and Economic Resources

5) Which of the following statements is true?

- A) Gold is not a scarce resource.
- B) Both life-saving drugs and ice cream are examples of scarce goods.
- C) If a scarce resource is given away for free, everyone will be able to consume it.
- D) Scarcity means that there is an imbalance between unlimited resources and limited wants.

Answer: B

Difficulty: Easy

AACSB: Analytical Thinking

Topic: Economic Agents and Economic Resources

6) What are scarce resources? Why are economic agents concerned with the allocation of these resources?

Answer: Scarce resources are resources for which the quantity that agents want exceeds the quantity that is freely available. Economic agents need to satisfy their unlimited wants in a world of limited resources. This makes it important for them to understand how these scarce resources are to be used and distributed in order to optimize allocation.

Difficulty: Easy

AACSB: Analytical Thinking

Topic: Economic Agents and Economic Resources

7) Define economics. Who are economic agents?

Answer: Economics is the study of how agents choose to allocate scarce resources and how these choices affect society. An economic agent is an individual or a group that makes choices.

Difficulty: Easy

AACSB: Analytical Thinking

Topic: Economic Agents and Economic Resources

8) Economics is primarily the study of _____.

- A) the mental functions and behavior of individuals and groups
- B) the state, nation, government, and politics and policies of governments
- C) the problems related to the existence and evolution of society
- D) how agents choose to allocate scarce resources and how these choices affect society

Answer: D

Difficulty: Easy

AACSB: Analytical Thinking

Topic: Definition of Economics

9) Economics is primarily the study of _____.

- A) the relationship between matter and its motion
- B) agents' choices and their impact on society
- C) events of the past and how these events affect present human behavior
- D) the different types of governments and the impact of their policies on a nation

Answer: B

Difficulty: Easy

AACSB: Analytical Thinking

Topic: Definition of Economics

10) _____ is analysis that generates objective descriptions or predictions about the world that can be verified with data.

- A) Positive economics
- B) Negative economics
- C) Microeconomics
- D) Normative economics

Answer: A

Difficulty: Easy

AACSB: Analytical Thinking

Topic: Positive Economics and Normative Economics

11) Which of the following is an example of a positive economic statement?

- A) The pricing policies followed in single-producer markets should be strictly supervised.
- B) Unemployment is more harmful than inflation.
- C) Higher interest rates will encourage more savings.
- D) Pollution is one of the most serious economic problems.

Answer: C

Difficulty: Medium

AACSB: Application of Knowledge

Topic: Positive Economics and Normative Economics

12) Which of the following is an example of a positive economic statement?

- A) The government should ideally work as a welfare state.
- B) An increase in income causes an increase in savings.
- C) Economics is the most useful social science.
- D) Eliminating poverty is more important than reducing inflation.

Answer: B

Difficulty: Medium

AACSB: Application of Knowledge

Topic: Positive Economics and Normative Economics

13) _____ economics prescribes what an individual or society ought to do.

- A) Positive
- B) Negative
- C) Behavioral
- D) Normative

Answer: D

Difficulty: Easy

AACSB: Analytical Thinking

Topic: Positive Economics and Normative Economics

14) Which of the following is an example of a normative economic statement?

- A) A cut in the tax rate will lead to an increase in consumption.
- B) Relaxation of import duties will encourage imports.
- C) An increase in subsidies to farmers will boost agricultural production.
- D) An increase in social security benefits will increase the welfare of all economic agents.

Answer: D

Difficulty: Medium

AACSB: Application of Knowledge

Topic: Positive Economics and Normative Economics

15) Which of the following is an example of a normative economic statement?

- A) An increase in government expenditure will lead to an increase in well-being.
- B) An increase in the money supply will lead to an increase in the inflation rate.
- C) An increase in income is accompanied by an increase in savings.
- D) An increase in income is accompanied by an increase in consumption.

Answer: A

Difficulty: Medium

AACSB: Application of Knowledge

Topic: Positive Economics and Normative Economics

16) Which of the following statements is true?

- A) Positive economics deals with issues that are subjective.
- B) Normative statements depend on personal preferences.
- C) Positive economics recommends what people ought to do.
- D) Normative economic statements can be confirmed or disproven.

Answer: B

Difficulty: Easy

AACSB: Analytical Thinking

Topic: Positive Economics and Normative Economics

17) Which of the following statements correctly differentiates between positive and normative economics?

- A) Positive economics is descriptive, whereas normative economics is advisory.
- B) Positive economics describes what people ought to do, whereas normative economics describes what people actually do.
- C) Positive economics is based on judgments, whereas normative economics is not.
- D) Positive economics can only be applied to microeconomics, whereas normative economics can be applied to both microeconomics and macroeconomics.

Answer: A

Difficulty: Easy

AACSB: Analytical Thinking

Topic: Positive Economics and Normative Economics

18) Positive economics is descriptive because _____.

- A) it is based on ethical judgments.
- B) its predictions cannot be verified with data.
- C) it prescribes what an individual or society ought to do.
- D) it explains what has happened or predicts what will happen.

Answer: D

Difficulty: Easy

AACSB: Analytical Thinking

Topic: Positive Economics and Normative Economics

19) Which of the following statements is true?

- A) Positive economics describes what people ought to do.
- B) Normative economics describes what people actually do.
- C) Positive economics generates objective descriptions that can be verified with data.
- D) Normative economics is free from the value judgments, tastes, and preferences of economic agents.

Answer: C

Difficulty: Easy

AACSB: Analytical Thinking

Topic: Positive Economics and Normative Economics

20) Differentiate between positive and normative economics using examples.

Answer: Positive economics is analysis that generates objective descriptions or predictions about the world that can be verified with data. It is analysis that describes what people actually do. "A 5 percent fall in the unemployment rate will lead to a 2 percent increase in the inflation rate" is an example of a positive economic statement. In contrast, normative economics is analysis that prescribes what an individual or society ought to do. It is subjective and depends on personal preferences, tastes, attitudes, feelings, or ethical judgments. "Pollution in developing countries is one of the biggest global environmental problems" is an example of a normative economic statement.

Difficulty: Easy

AACSB: Analytical Thinking

Topic: Positive Economics and Normative Economics

21) Robert and Janet are discussing the unemployment and inflation in their country. Robert, on the basis of a recent newspaper report, claims that a 5 percent reduction in unemployment will lead to a 2 percent rise in inflation. In contrast, Janet insists that inflation is a far bigger problem than unemployment and should be considered as of prime importance. Classify Robert's and Janet's statements as descriptive or advisory. Explain your answer.

Answer: Robert claims that a 5 percent reduction in unemployment will lead to a 2 percent increase in inflation. This statement represents predictions that can be verified with data. Therefore, Robert's approach is positive, which means it is an analysis of things as they are. Positive economics describes what has happened or predicts what will happen. The conclusion of his statement can be verified with data and is not subject to tastes and preferences.

Janet claims that inflation is a far bigger problem than unemployment and should be addressed as an issue of prime importance. Janet's statement is normative. Normative economics is analysis that recommends what people ought to do. Unlike Robert's statement, Janet's belief that inflation is a bigger problem than unemployment is based on her values or ethical judgments. Therefore, while Robert's statement is descriptive in nature, Janet's statement is advisory.

Difficulty: Medium

AACSB: Application of Knowledge

Topic: Positive Economics and Normative Economics

22) Classify the following as positive economics statements or normative economics statements.

- a) An increase in an individual's income increases consumption, but by an amount less than the increase in income.
- b) The government should undertake the responsibility of providing healthcare to all its citizens.
- c) The government should fund infrastructure projects to foster economic development.
- d) An increase in net exports has a positive effect on a country's national income.
- e) The gross domestic product of India is increasing at 5 percent annually.

Answer: a) Positive economic statement

b) Normative economic statement

c) Normative economic statement

d) Positive economic statement

e) Positive economic statement

Difficulty: Medium

AACSB: Application of Knowledge

Topic: Positive Economics and Normative Economics

23) _____ is the study of how individuals, households, governments, and firms make choices and how those choices affect prices, the allocation of resources, and the well-being of other agents.

A) Cost-benefit analysis

B) Microeconomics

C) Macroeconomics

D) Empiricism

Answer: B

Difficulty: Easy

AACSB: Analytical Thinking

Topic: Microeconomics and Macroeconomics

24) Which of the following is a topic studied by microeconomists?

A) National income calculations

B) Price determination by a firm

C) Measures to combat inflation

D) Interest rate determination

Answer: B

Difficulty: Easy

AACSB: Application of Knowledge

Topic: Microeconomics and Macroeconomics

25) Which of the following is a topic studied by microeconomists?

A) Energy consumption by a firm

B) Nationwide inflation rate

C) Economic growth as a means to alleviate poverty

D) Aggregate demand and aggregate supply in an economy

Answer: A

Difficulty: Medium

AACSB: Application of Knowledge

Topic: Microeconomics and Macroeconomics

26) _____ is the study of an economy as a whole.

- A) Microeconomics
- B) Cost-benefit analysis
- C) Behavioral economics
- D) Macroeconomics

Answer: D

Difficulty: Easy

AACSB: Analytical Thinking

Topic: Microeconomics and Macroeconomics

27) Which of the following is a topic studied by macroeconomists?

- A) Aggregate demand in an economy
- B) Price determination by a firm
- C) The consumption choice of a single household
- D) The production decision of a firm

Answer: A

Difficulty: Medium

AACSB: Application of Knowledge

Topic: Microeconomics and Macroeconomics

28) Which of the following is a topic studied by macroeconomists?

- A) The savings of a single household
- B) The productivity of an agricultural farm
- C) The total output of an economy
- D) Price determination in a market

Answer: C

Difficulty: Medium

AACSB: Application of Knowledge

Topic: Microeconomics and Macroeconomics

29) Which of the following statements is true?

- A) Microeconomics is the study of an economy as a whole.
- B) Macroeconomics studies how individuals make choices.
- C) The study of the inflation rate is covered under microeconomics.
- D) The study of the unemployment rate is covered under macroeconomics.

Answer: D

Difficulty: Medium

AACSB: Application of Knowledge

Topic: Microeconomics and Macroeconomics

30) Which of the following statements correctly highlights the difference between microeconomics and macroeconomics?

A) Microeconomics is descriptive, whereas macroeconomics is advisory.

B) Microeconomics primarily deals with positive analysis, whereas macroeconomics primarily deals with normative analysis.

C) Microeconomics deals with a small part of the economy, whereas macroeconomics deals with aggregate economic performance.

D) Microeconomics describes what economic agents actually do, whereas macroeconomics describes what economic agents ought to do.

Answer: C

Difficulty: Easy

AACSB: Analytical Thinking

Topic: Microeconomics and Macroeconomics

31) Why an economy contracts during slowdowns and the analysis of appropriate policies is studied under _____.

A) macroeconomics

B) microeconomics

C) agricultural economics

D) international economics

Answer: A

Difficulty: Easy

AACSB: Application of Knowledge

Topic: Microeconomics and Macroeconomics

32) The impact of carbon taxes on the energy usage of individual households and firms is studied under _____.

A) microeconomics

B) macroeconomics

C) normative economics

D) positive economics

Answer: A

Difficulty: Medium

AACSB: Application of Knowledge

Topic: Microeconomics and Macroeconomics

33) The relationship between the unemployment rate and inflation is studied under _____.

A) microeconomics

B) macroeconomics

C) behavioral economics

D) international economics

Answer: B

Difficulty: Medium

AACSB: Application of Knowledge

Topic: Microeconomics and Macroeconomics

34) The relationship between a firm's advertising expenditure and its profit is studied under _____.

- A) microeconomics
- B) macroeconomics
- C) behavioral economics
- D) international economics

Answer: A

Difficulty: Medium

AACSB: Application of Knowledge

Topic: Microeconomics and Macroeconomics

35) How does microeconomics differ from macroeconomics?

Answer: Microeconomics is the study of how individuals, households, firms, and governments make choices, and how those choices affect prices, the allocation of resources, and the well-being of other agents. In contrast, macroeconomics is the study of the economy as a whole. The scope of macroeconomics extends to the study of economy-wide phenomena, like the growth rate of an economy, the national unemployment rate, or the inflation rate.

Difficulty: Easy

AACSB: Analytical Thinking

Topic: Microeconomics and Macroeconomics

36) A recent news report stated that the unemployment rate in the country of Lithasia had increased from 10.2 percent to 18.2 percent between 2003 and 2013 and that the government has adopted strict fiscal measures to expand employment. Would this report be considered microeconomic or macroeconomic analysis?

Answer: This report pertains to macroeconomics. Macroeconomics refers to the study of an economy as a whole. Macroeconomics covers economy-wide phenomena, like the growth rate of a country's total economic output, the inflation rate, or the unemployment rate.

Difficulty: Medium

AACSB: Application of Knowledge

Topic: Microeconomics and Macroeconomics

37) Students in a class are discussing how a firm that does not face any competition in a market should decide how many units of output to supply in the market. Would this discussion be considered microeconomic or macroeconomic analysis?

Answer: Microeconomics is the study of how individuals, households, firms, and governments make choices. The students are discussing how a firm should make its output decision. This is a discussion about an individual entity and so is considered microeconomic analysis.

Difficulty: Medium

AACSB: Application of Knowledge

Topic: Microeconomics and Macroeconomics

1.2 Three Principles of Economics

1) Which of the following correctly defines the term "equilibrium"?

- A) It refers to a situation in which data are used to arrive at conclusions.
- B) It refers to a situation in which all economic agents are simultaneously optimizing.
- C) It refers to a situation in which an optimizing decision is made by an individual economic agent.
- D) It refers to a situation in which government intervention efficiently allocates scarce resources.

Answer: B

Difficulty: Easy

AACSB: Analytical Thinking

Topic: Three Principles of Economics

2) Which of the following best describes equilibrium?

- A) A situation where the government intervenes to allocate resources
- B) A situation where only one individual or firm makes an optimal decision
- C) A situation where no economic agent would benefit by changing his or her behavior
- D) A situation where economic agents do not optimize as they do not have perfect information

Answer: C

Difficulty: Easy

AACSB: Analytical Thinking

Topic: Three Principles of Economics

3) Empiricism is analysis that uses _____ to test theories.

- A) data
- B) illustrations
- C) philosophy
- D) value judgments

Answer: A

Difficulty: Easy

AACSB: Analytical Thinking

Topic: Three Principles of Economics

4) Which of the following is NOT a key principle of economics?

- A) Optimization
- B) Equilibrium
- C) Empiricism
- D) Substitution

Answer: D

Difficulty: Easy

AACSB: Analytical Thinking

Topic: Three Principles of Economics

5) Define the three key principles of economics.

Answer:

i) Optimization: optimization refers to the process of choosing the best option from a set of alternatives, given the available information.

ii) Equilibrium: equilibrium is a special situation all agents are simultaneously optimizing, so that nobody would benefit personally by changing his or her behavior.

iii) Empiricism: empiricism is analysis that is evidence-based—it uses data to test theories and to determine what is causing things to happen in the world.

Difficulty: Easy

AACSB: Analytical Thinking

Topic: Three Principles of Economics

1.3 The First Principle of Economics: Optimization

1) Which of the following statements is true of optimization?

A) Optimization analysis only relates to the financial budget of an economic agent.

B) Individuals who optimize do not consider costs when choosing the most feasible alternative.

C) Economic agents can optimize only when they are able to perfectly estimate all future costs and benefits.

D) Economic agents who optimize attempt to choose the best feasible option, given the information that they have.

Answer: D

Difficulty: Easy

AACSB: Analytical Thinking

Topic: The First Principle of Economics: Optimization

2) Feasible options are options that are _____.

A) available and affordable

B) available but not affordable

C) affordable but not available

D) optimal for an economic agent

Answer: A

Difficulty: Easy

AACSB: Analytical Thinking

Topic: The First Principle of Economics: Optimization

3) A consumer has \$40 that he wants to spend. He faces four choices: a camera that costs \$60, a cell phone that costs \$150, a book that costs \$10, and a Bluetooth speaker that costs \$45. Which of the following is a feasible option for the consumer?

A) The book

B) The camera

C) The cell phone

D) The Bluetooth speaker

Answer: A

Difficulty: Easy

AACSB: Analytical Thinking

Topic: The First Principle of Economics: Optimization

4) A decision or choice that is made after optimization analysis _____.

- A) has zero opportunity cost
- B) is not necessarily risk free
- C) is the same for all individuals
- D) cannot be justified using normative analysis

Answer: B

Difficulty: Easy

AACSB: Analytical Thinking

Topic: The First Principle of Economics: Optimization

5) Which of the following statements is true?

- A) Optimization requires individuals to foresee the future perfectly.
- B) An optimizing individual need not consider the risks involved in various choices.
- C) An optimizing individual is also likely to exhibit rationality.
- D) The less information that is available, the easier it is to make optimal decisions.

Answer: C

Difficulty: Easy

AACSB: Analytical Thinking

Topic: The First Principle of Economics: Optimization

6) Which of the following statements is true?

- A) Rational economic agents maximize more than just monetary income.
- B) An individual does not require information to make optimal decisions.
- C) The principle of optimization is only accurate when it comes to making monetary decisions.
- D) It is not necessary to consider the risks of alternatives while making an optimal decision.

Answer: A

Difficulty: Easy

AACSB: Analytical Thinking

Topic: The First Principle of Economics: Optimization

7) Which of the following correctly identifies the trade-off that a budget constraint represents?

- A) The amount of income that must be given up to obtain an additional unit of a good
- B) The maximum amount of two goods that a consumer can purchase given his income
- C) The optimum combination of goods that a consumer with a given income should purchase
- D) The amount of one good that has to be given up to purchase an additional unit of the other good

Answer: D

Difficulty: Easy

AACSB: Analytical Thinking

Topic: Trade-offs and Budget Constraints

8) A budget constraint represents the _____.

- A) total money income that an agent earns in different time periods
- B) goods and services an economic agent can choose given her limited income
- C) inequality in the incomes earned by various economic agents
- D) aggregate income earned by all firms in an economy

Answer: B

Difficulty: Easy

AACSB: Analytical Thinking

Topic: Trade-offs and Budget Constraints

9) Which of the following statements is true?

- A) A budget constraint remains the same for a consumer at all levels of income.
- B) A budget constraint quantifies the trade-offs that economic agents face while making decisions.
- C) A budget constraint is a function of the income of the consumer and not of the prices of the goods and services available for consumption.
- D) A budget constraint is based on the minimum amount of money that an economic agent can spend on goods and services.

Answer: B

Difficulty: Easy

AACSB: Analytical Thinking

Topic: Trade-offs and Budget Constraints

10) A consumer has \$20 that he wants to spend on two goods: pens priced at \$2 each and pencils priced at \$1 each. Which of the following correctly represents his budget constraint?

- A) $\$20 = (\$2/\text{Quantity of pens}) + (\$1/\text{Quantity of pencils})$
- B) $\$20 = (\$2 \times \text{Quantity of pens}) + (\$1 \times \text{Quantity of pencils})$
- C) $\$20 = (\$3/\text{Quantity of pens} + \text{Quantity of pencils})$
- D) $\$20 = \$3 \times (\text{Quantity of pens} - \text{Quantity of pencils})$

Answer: B

Difficulty: Medium

AACSB: Application of Knowledge

Topic: Trade-offs and Budget Constraints

11) An individual has 8 hours to spare. She has to divide her time between two activities: reading and writing. Which of the following allocations will completely exhaust the individual's budget?

- A) 3 hours of reading and 4 hours of writing
- B) 4 hours of reading and 6 hours of writing
- C) 2 hours of reading and 2 hours of writing
- D) 5 hours of reading and 3 hours of writing

Answer: D

Difficulty: Easy

AACSB: Application of Knowledge

Topic: Trade-offs and Budget Constraints

12) A consumer has \$50 to spend. He has to decide between buying two goods: magazines priced at \$5 each and DVDs priced at \$10 each. Which of the following combinations of the two goods will entirely exhaust his budget constraint?

- A) 3 magazines and 4 DVDs
- B) 2 magazines and 4 DVDs
- C) 6 magazines and 1 DVD
- D) 2 magazines and 2 DVDs

Answer: B

Difficulty: Medium

AACSB: Application of Knowledge

Topic: Trade-offs and Budget Constraints

13) Which of the following statements is true?

- A) All rational economic agents attempt to maximize their income.
- B) A rational consumer makes his decisions depending on what the majority chooses.
- C) A budget constraint is an economic tool that quantifies the trade-off between the consumption of two goods.
- D) A trade-off refers to the exchange of goods between economic agents through the barter system or mutual exchange.

Answer: C

Difficulty: Easy

AACSB: Analytical Thinking

Topic: Trade-offs and Budget Constraints

14) Why do trade-offs occur? How are budget constraints related to trade-offs?

Answer: Trade-offs occur because of scarcity—economic agents need to satisfy their wants with limited resources. Therefore, in most cases, some benefits have to be given up to gain other benefits. Budget constraints quantify the relevant trade-offs that an economic agent faces. Once trade-offs are quantified, rational decision making becomes easier, allowing the individual to make an optimal decision.

Difficulty: Easy

AACSB: Analytical Thinking

Topic: Trade-offs and Budget Constraints

15) The best alternative use of a resource is referred to as its _____.

- A) optimization cost
- B) market price
- C) social cost
- D) opportunity cost

Answer: D

Difficulty: Easy

AACSB: Analytical Thinking

Topic: Opportunity Cost

16) A student has two options: she can either surf the web or work part-time. Working part-time pays her \$20 per hour. What is the student's opportunity cost of surfing the web for 5 hours?

- A) \$4
- B) \$20
- C) \$50
- D) \$100

Answer: D

Difficulty: Medium

AACSB: Application of Knowledge

Topic: Opportunity Cost

17) John has to choose between two jobs: one that offers him \$50 per hour and one that offers him \$35 per hour. The opportunity cost of choosing the job that offers him \$50 per hour is _____.

- A) \$1.5 per hour
- B) \$15 per hour
- C) \$35 per hour
- D) \$85 per hour

Answer: C

Difficulty: Medium

AACSB: Application of Knowledge

Topic: Opportunity Cost

18) Define opportunity cost. A student who has just graduated from college has three job offers: the first job pays \$35,000 a year, the second job pays \$23,000 a year, and the third one pays \$15,000 a year. What is the student's opportunity cost of taking the first job?

Answer: Opportunity cost is the best alternative use of a resource. It is what an economic agent is giving up when he chooses a particular option. If the individual decides to take the first job, he will earn \$35,000 a year. The opportunity cost of taking this job is the next-best offer that he could have taken. Therefore, the opportunity cost of the first job is \$23,000 a year.

Difficulty: Easy

AACSB: Application of Knowledge

Topic: Opportunity Cost

19) A consumer has a monthly income of \$100 that he wants to spend on two goods: rugs priced at \$10 and chairs priced at \$5. What is the consumer's opportunity cost of buying a rug? What is his opportunity cost of buying a chair? Use a table to represent the consumer's budget constraint.

Answer: Opportunity cost is the best alternative use of a resource. Buying one rug costs \$10, and each chair costs \$5. One rug can be purchased with the same amount of money used to buy two chairs.

Therefore, the opportunity cost of buying a rug is 2 chairs. Similarly, the opportunity cost of buying a chair is half a rug. The consumer's budget constraint is given by:

$$\$100 = 10 \times (\text{Quantity of rugs}) + 5 \times (\text{Quantity of chairs}).$$

The following table shows the various combinations of rugs and chairs that the consumer can buy with \$100:

Budget	Quantity of Rugs	Quantity of Chairs
100	10	0
100	9	2
100	8	4
100	7	6
100	6	8
100	5	10
100	4	12
100	3	14
100	2	16
100	1	18
100	0	20

Difficulty: Medium

AACSB: Application of Knowledge

Topic: Opportunity Cost

20) Sam pays \$600 for 30 days of guitar classes. He attends an hour-long class every day. If, instead of attending class, he works at a part-time job, he would be paid \$5 an hour. Alternatively, he could work at a fast-food outlet and earn \$9 per hour. Once he has already paid a nonrefundable fee of \$600 to enroll in the class, what is his opportunity cost of attending each hour of class?

Answer: Sam's opportunity cost will measure the next best use of an hour of his time plus the hourly cost of guitar classes. Once he pays the nonrefundable \$600, there is no further cost other than the value of his time. For an hour of time, he has two options: work for \$5 per hour or work for \$9 per hour. Therefore, the next best use of an hour that Sam spends on guitar classes is equal to the \$9 he could have earned per hour by working at the fast-food outlet. Sam's opportunity cost of attending his guitar classes is \$9 per hour.

Difficulty: Medium

AACSB: Application of Knowledge

Topic: Opportunity Cost

21) Suppose workers decide to work more and consume less leisure when their hourly wage rate increases. What could explain this behavior?

Answer: With an increase in their hourly wage rates, workers work more and consume less leisure because of a change in their opportunity cost. Assuming that the initial wage of an employee is \$10 per hour, the opportunity cost of one hour of rest or leisure is \$10 per hour. If the wage rate increases from \$10 to \$20 per hour, the opportunity cost of one hour of rest or leisure also increases to \$20 per hour. Therefore, taking an hour of rest becomes more expensive for employees, and so the workers tend to work more than they used to.

Difficulty: Medium

AACSB: Application of Knowledge

Topic: Opportunity Cost

22) _____ is a calculation that adds up the costs and benefits using a common unit of measurement, like dollar values.

- A) Cost-benefit analysis
- B) Revenue-income analysis
- C) Budget constraint analysis
- D) Expenditure-income analysis

Answer: A

Difficulty: Easy

AACSB: Analytical Thinking

Topic: Cost-Benefit Analysis

23) Cost-benefit analysis requires _____.

- A) choosing the alternative with the least net benefit
- B) that all costs and benefits be measured in the same unit
- C) evaluating the budget constraint before making a choice
- D) that the risks associated with different alternatives be ignored

Answer: B

Difficulty: Easy

AACSB: Analytical Thinking

Topic: Cost-Benefit Analysis

24) Suppose that Jinelle, an engineer, has to choose between two jobs. Which of the following statements is true?

- A) When deciding between jobs, she should consider both the wage and the non-wage attributes of each job.
- B) When deciding between jobs, she should focus only on the costs of each job and ignore the benefits.
- C) When deciding between jobs, she should only focus on the benefits of each job and ignore the costs.
- D) When deciding between jobs, she should consider the wage attributes and ignore the non-wage attributes of each job.

Answer: A

Difficulty: Easy

AACSB: Analytical Thinking

Topic: Cost-Benefit Analysis

25) The net benefit of a particular alternative equals _____.

- A) the benefits received from the alternative plus the costs incurred when choosing the alternative
- B) the benefits received from the alternative divided by the costs incurred when choosing the alternative
- C) the costs incurred when choosing the alternative divided by the benefits received from the alternative
- D) the benefits received from the alternative minus the costs incurred when choosing the alternative

Answer: D

Difficulty: Easy

AACSB: Analytical Thinking

Topic: Cost-Benefit Analysis

26) Out of a set of feasible alternatives, an optimizer should choose the alternative with the _____.

- A) highest net benefit
- B) highest opportunity cost
- C) lowest total cost, regardless of benefit
- D) highest total benefit, regardless of cost

Answer: A

Difficulty: Easy

AACSB: Analytical Thinking

Topic: Cost-Benefit Analysis

27) If a particular choice that an individual faces gives him a benefit of \$20 but costs \$30, the net benefit from making this choice equals _____.

- A) \$20
- B) \$10
- C) -\$10
- D) -\$30

Answer: C

Difficulty: Easy

AACSB: Application of Knowledge

Topic: Cost-Benefit Analysis

28) If a job pays a wage of \$50 per hour, but has a non-wage cost valued at \$20 per hour, the net benefit of taking the job equals _____.

- A) \$2.5 per hour
- B) \$20 per hour
- C) \$30 per hour
- D) \$70 per hour

Answer: C

Difficulty: Medium

AACSB: Application of Knowledge

Topic: Cost-Benefit Analysis

Maria has to choose between driving and taking a train to destination A. Traveling by train will cost her \$400 and will take 4 hours. Driving to destination A takes 6 hours, and the required amount of gasoline costs \$250. Her opportunity cost of time is \$15 per hour.

29) Refer to the scenario above. What is the total cost involved if Maria chooses to travel by train?

- A) \$60
- B) \$400
- C) \$420
- D) \$460

Answer: D

Difficulty: Medium

AACSB: Application of Knowledge

Topic: Cost-Benefit Analysis

30) Refer to the scenario above. If Maria borrows her parents' car and pays for only the gasoline, what is her total cost of driving to destination A?

- A) \$90
- B) \$250
- C) \$300
- D) \$340

Answer: D

Difficulty: Medium

AACSB: Application of Knowledge

Topic: Cost-Benefit Analysis

31) Refer to the scenario above. Maria should choose to _____.

- A) drive, as it will save her \$120
- B) travel by train, because it is quicker
- C) drive, as it will give her a real saving of \$150
- D) travel by train, as it will save her \$30 in travel time

Answer: A

Difficulty: Medium

AACSB: Application of Knowledge

Topic: Cost-Benefit Analysis

32) Refer to the scenario above. If Maria's opportunity cost of time increases to \$80 per hour, the cost of taking the train is _____.

- A) \$320
- B) \$720
- C) \$800
- D) \$970

Answer: B

Difficulty: Medium

AACSB: Application of Knowledge

Topic: Cost-Benefit Analysis

33) Refer to the scenario above. If Maria's opportunity cost of time increases to \$80 per hour, the cost of driving to destination A is _____.

- A) \$480
- B) \$730
- C) \$800
- D) \$970

Answer: B

Difficulty: Medium

AACSB: Application of Knowledge

Topic: Cost-Benefit Analysis

34) Refer to the scenario above. If the opportunity cost of time increases to \$80 per hour, which of the following statements is true?

- A) Maria should choose to drive, as it saves her \$10.
- B) Maria should choose to drive, as it saves her \$150.
- C) Maria should choose to travel by train, as it saves her \$10.
- D) Maria should choose to travel by train, as it saves her \$150.

Answer: C

Difficulty: Medium

AACSB: Application of Knowledge

Topic: Cost-Benefit Analysis

35) Which of the following statements is true?

- A) A rational economic agent is not likely to optimize.
- B) Cost-benefit analysis can also be used for normative economic analysis.
- C) Cost-benefit analysis does not yield the same result as optimization analysis.
- D) The net benefit of an option that costs \$50 and provides a benefit of \$100 is equal to \$150.

Answer: B

Difficulty: Medium

AACSB: Analytical Thinking

Topic: Cost-Benefit Analysis

36) Wendy has to decide between taking a flight and driving to California. Air tickets cost \$800 and will get her to California in 2 hours. If she decides to drive, she would need \$300 worth of gasoline and 10 hours to reach her destination. Suppose Wendy's opportunity cost of time is \$20 per hour.

a) Assuming that there are no other costs involved, use cost-benefit analysis to decide whether she should fly or drive to California.

b) If Wendy has an important business meeting to attend and this increases her opportunity cost of time to \$200 per hour, will her optimum decision change? Explain.

Answer:

a) Cost-benefit analysis is a calculation that adds up costs and benefits using a common unit of measurement. It is used to identify the alternative that has the greatest net benefit, which is equivalent to benefits minus costs. If Wendy decides to drive down instead of flying, she saves $(\$800 - \$300) = \$500$. But driving down to California takes an additional 8 hours of travel time. Therefore, the net benefit of driving relative to flying is:

$(\$500 \text{ Cost saving}) - (8 \text{ hours Additional travel time}) \times (\$20/\text{hour}) = \$500 - \$160 = \$340$. Because the net benefit of driving is positive, driving to California is the optimum choice for Wendy when the opportunity cost of time is \$20 per hour.

b) If the opportunity cost of time changes, the net benefit of driving relative to flying will also change: Net benefit of driving relative to flying when the opportunity cost of time is \$200 per hour = $(\$500 \text{ Cost saving}) - (8 \text{ hours Additional travel time}) \times (\$200/\text{hour}) = \$500 - \$1,600 = -\$1,100$.

Because the net benefit of driving relative to flying is negative, flying to California is the optimum choice for Wendy when the opportunity cost of time is \$200 per hour.

Difficulty: Medium

AACSB: Application of Knowledge

Topic: Cost-Benefit Analysis

37) What is cost-benefit analysis? What are the steps involved in using cost-benefit analysis to make the optimal choice?

Answer: Cost-benefit analysis is a calculation that adds up the costs and benefits of a particular choice using a common unit of measurement. It involves the conversion of all costs and benefits to a common unit of measurement so that they can be compared. The difference between the benefits and costs of choosing an alternative is referred to as the net benefit of the alternative. The alternative with the highest net benefit is the optimal choice.

Difficulty: Easy

AACSB: Analytical Thinking

Topic: Cost-Benefit Analysis

38) Kevin has a lot of free time, and he decides to pick up a new hobby. He has two options—he can take art classes or sign up for cooking classes. He estimates that the art classes would cost him \$70 and would provide him with a benefit of \$100. In contrast, the cooking classes would cost him \$120 but provide him benefits worth \$160. Use cost-benefit analysis to arrive at the optimum choice for Kevin.

Answer: Kevin's optimal choice depends on the net benefits of both options:

Net benefit of taking art classes = $\$100 - \$70 = \$30$;

Net benefit of taking cooking classes = $\$160 - \$120 = \$40$.

Therefore, given the costs and benefits involved, Kevin should sign up for the cooking classes rather than the art classes.

Difficulty: Medium

AACSB: Application of Knowledge

Topic: Cost-Benefit Analysis

39) Which of the following statements is true of economic reasoning?

- A) Economic reasoning hampers optimal decision making.
- B) Economic reasoning can only be used with normative choices.
- C) Economic reasoning implies that leisure time is free and costless.
- D) Economic reasoning helps people make the best use of scarce resources.

Answer: D

Difficulty: Easy

AACSB: Analytical Thinking

Topic: Evidence-Based Economics: Is Facebook Free?

40) If Tom spends 4 hours a day on Facebook, and the minimum wage in his country is \$7 per hour.

- a) What is his opportunity cost of spending time on Facebook?
- b) Given that spending time on Facebook has an opportunity cost, does this analysis suggest that Tom should work rather than spend his time on social networking?

Answer: a) Opportunity cost refers to the best alternative use of a resource. In this case, the resource is time. So, if Tom decided to work instead of spending time on Facebook, he would earn \$7 every hour. Therefore, Tom's opportunity cost of spending time on Facebook is equal to $\$7 \times 4 = \28 .

b) No, economic analysis does not dictate choices. Economics would not tell Tom what to do; it would only help him identify the trade-offs that he is making in his decisions. Whether Tom chooses to work or spend time on Facebook is a normative choice that Tom should make based on costs and benefits.

Difficulty: Medium

AACSB: Application of Knowledge

Topic: Evidence-Based Economics: Is Facebook Free?

1.4 The Second Principle of Economics: Equilibrium

1) Which of the following statements is true of equilibrium?

- A) Economic agents have an incentive to divert from equilibrium.
- B) Each economic agent can reach equilibrium irrespective of the actions of others.
- C) In equilibrium, the opportunity cost of the choices made by each economic agent is zero.
- D) In equilibrium, all economic agents are choosing the best feasible option simultaneously.

Answer: D

Difficulty: Easy

AACSB: Analytical Thinking

Topic: The Second Principle of Economics: Equilibrium

2) Which of the following will hold true if the market for cameras is in equilibrium at a price of \$40?

- A) Sellers of cameras will have an incentive to charge a price higher than \$40.
- B) The quantity of cameras produced will equal the quantity of cameras bought in the market.
- C) Buyers of cameras will want to buy fewer cameras than they are purchasing at equilibrium.
- D) If the cost of producing cameras falls below \$40 per camera, all sellers will stop supplying cameras.

Answer: B

Difficulty: Medium

AACSB: Application of Knowledge

Topic: The Second Principle of Economics: Equilibrium

3) When the market for a commodity is in equilibrium, _____.

- A) no economic agent will want to change his or her behavior
- B) there will still be some unsold stock of the commodity
- C) all buyers of the commodity will want to change their behavior
- D) all sellers of the commodity will want to change their behavior

Answer: A

Difficulty: Easy

AACSB: Analytical Thinking

Topic: The Second Principle of Economics: Equilibrium

4) Which of the following is true of equilibrium?

- A) Equilibrium refers to a situation where the government allocates resources among economic agents.
- B) Equilibrium refers to a situation where all economic agents simultaneously optimize after considering one another's actions.
- C) Equilibrium refers to a situation where all economic agents are making suboptimal choices and have an incentive to change their behavior.
- D) Equilibrium refers to a situation where an economic agent can be made better off without making anyone else worse off.

Answer: B

Difficulty: Easy

AACSB: Analytical Thinking

Topic: The Second Principle of Economics: Equilibrium

5) Suppose the market for pizza slices is in equilibrium at a price of \$1 per slice. What conditions are likely to be satisfied in the pizza slice market?

Answer: The conditions that will be satisfied when the market for pizza slices is in equilibrium are the following:

- i) The number of pizza slices made by sellers will be equal to the number of pizza slices purchased by buyers.
- ii) Pizza sellers will produce pizzas at the point where the cost of production is less than or equal to the market price of \$1.
- iii) Buyers will consume pizza as long as the benefit that they derive from consumption is at least equal to the market price of \$1.

Difficulty: Medium

AACSB: Application of Knowledge

Topic: The Second Principle of Economics: Equilibrium

6) When a market is in equilibrium, both buyers and sellers do not perceive a benefit from changing their behavior. Why?

Answer: In most economic situations, an economic agent is not optimizing individually. His decision is influenced by the decisions taken by other economic agents. In equilibrium, each and every economic agent is doing the best that they can do, given the information they have and given the actions of other economic agents. Therefore, nobody perceives a benefit from changing his or her behavior.

Difficulty: Easy

AACSB: Analytical Thinking

Topic: The Second Principle of Economics: Equilibrium

- 7) The term "free riders" refers to people who _____.
- A) don't contribute but still benefit from others' actions
 - B) make economic decisions randomly and are not rational
 - C) selflessly pay for others' consumption of goods and services
 - D) haggle over the prices of the goods and services that they buy

Answer: A

Difficulty: Easy

AACSB: Analytical Thinking

Topic: The Free-Rider Problem

- 8) Who among the following is an example of a free rider?
- A) An individual who sneaks into a music concert
 - B) A consumer who buys her groceries from a nearby store
 - C) A taxpayer who exercises in the public park near his house
 - D) A club member who makes voluntary contributions to the club

Answer: A

Difficulty: Medium

AACSB: Application of Knowledge

Topic: The Free-Rider Problem

- 9) Who among the following is an example of a free rider?
- A) A housekeeper cleaning a house
 - B) A tax evader enjoying national security
 - C) A consumer paying for pollution control
 - D) An individual who buys a ticket for a baseball game

Answer: B

Difficulty: Medium

AACSB: Application of Knowledge

Topic: The Free-Rider Problem

- 10) Each member in a group might do what's best for himself or herself instead of behaving in a way that optimizes the well-being of the entire group. This gives rise to the problem of _____.

- A) Pareto inefficiency
- B) free riding
- C) irrational behavior
- D) disequilibrium

Answer: B

Difficulty: Easy

AACSB: Analytical Thinking

Topic: The Free-Rider Problem

- 11) Which of the following statements is true of free riding?
- A) Free riding is easy to detect and punish.
 - B) Free riding is reduced with social pressure.
 - C) Free riding is not affected by incentives.
 - D) Free riding does not impose a cost on society.

Answer: B

Difficulty: Easy

AACSB: Analytical Thinking

Topic: The Free-Rider Problem

12) Assume that a house is rented by four students. When it comes to keeping the house clean, each of the four roommates has an incentive to leave the cleaning to the others. As a result, the house is never clean. Which of the following is the best solution to this problem of free riding?

- A) Asking every roommate to clean the house if they dirty it
- B) Requiring every roommate to contribute to a cleaning service
- C) Requiring each roommate to pay more toward the house rent and groceries
- D) Assigning one roommate the responsibility of watching over the other students

Answer: B

Difficulty: Medium

AACSB: Application of Knowledge

Topic: The Free-Rider Problem

13) Explain the term "free riders."

Answer: Free riders are people who do not contribute but still benefit from the actions that others undertake. When people pursue their own private interests and do not contribute voluntarily to the public interest, the problem of free riding arises. For example, a free rider may avoid paying taxes but enjoy the same benefits enjoyed by tax payers.

Difficulty: Easy

AACSB: Analytical Thinking

Topic: The Free-Rider Problem

1.5 The Third Principle of Economics: Empiricism

1) Empiricism refers to the process of _____.

- A) measuring variables
- B) testing ideas using data
- C) collecting and organizing data
- D) making choices using values and beliefs

Answer: B

Difficulty: Medium

AACSB: Analytical Thinking

Topic: The Third Principle of Economics: Empiricism

2) Which of the following statements is true?

- A) Data help establish whether theories match reality.
- B) Data are not an integral part of optimization analysis.
- C) Empiricism is not an integral part of optimization analysis.
- D) Empiricism refers to the testing of ideas without using data.

Answer: A

Difficulty: Easy

AACSB: Analytical Thinking

Topic: The Third Principle of Economics: Empiricism

3) Which of the following statements is true of data?

- A) Data help verify causal relationships.
- B) Data are not important for evaluating theories.
- C) Anecdotes are good substitutes for data.
- D) The fewer data that are available, the better the empirical analysis will be.

Answer: A

Difficulty: Easy

AACSB: Analytical Thinking

Topic: The Third Principle of Economics: Empiricism

4) Which of the following statements is true?

- A) Testing with data is essential to developing a good theory.
- B) The knowledge of economics complicates decision making.
- C) Cost-benefit analysis can be applied only to limited economic decisions.
- D) Economics is more of a theoretical subject with limited applications in the real world.

Answer: A

Difficulty: Easy

AACSB: Analytical Thinking

Topic: The Third Principle of Economics: Empiricism

5) Which of the following is a feature of a good theory?

- A) A good theory does not rely on data.
- B) A good theory cannot be tested with data.
- C) A good theory is free from approximations.
- D) A good theory closely predicts actual behavior.

Answer: D

Difficulty: Easy

AACSB: Analytical Thinking

Topic: The Third Principle of Economics: Empiricism

6) What is the rationale behind empiricism in economic analysis?

Answer: Empiricism refers to the use of data to test theoretical ideas or concepts. Empiricism is important, because it enables economists to determine whether economic theories are consistent with actual human behavior. This allows economists to refute faulty theories or modify them so that they are a better fit to the real world. Empiricism also enables researchers to identify causal relationships between different sets of variables.

Difficulty: Easy

AACSB: Analytical Thinking

Topic: The Third Principle of Economics: Empiricism

1.6 Is Economics Good for You?

1) Which of the following statements is true?

- A) Economics is concerned with money, not choices.
- B) Economics can be used to predict people's actions.
- C) Economics does not provide insights into human behavior.
- D) Economic reasoning tends to reduce the quality of decision making.

Answer: B

Difficulty: Easy

AACSB: Analytical Thinking

Topic: Is Economics Good for You?

2) Economic reasoning allows economic agents to make decisions _____.

- A) by random selection
- B) by comparing the costs and benefits of various options
- C) by replicating the choices made by other economic agents
- D) solely on the basis of tastes and preferences for various options

Answer: B

Difficulty: Easy

AACSB: Analytical Thinking

Topic: Is Economics Good for You?