

Chapter 02

The Market System and the Circular Flow

Multiple Choice Questions

1. Economic systems differ according to what two main characteristics?
 - A. Ownership of resources and methods of coordinating economic activity
 - B. Quantity of output produced and who receives the output
 - C. Who produces the output and what technology is used to produce it
 - D. The system of government and the quantity of natural resources available

2. 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.

3. In a capitalistic economy:

- A. consumers are not sovereign.
- B. markets are not competitive.
- C. there is a reliance on the market system.
- D. the government owns the means of production.

4. Which statement best describes a capitalist economy?

- A. The production of goods and services is determined primarily by markets, but the allocation of goods and services is determined primarily by government.
- B. The production of goods and services is determined primarily by government, but the allocation of goods and services is determined primarily by markets.
- C. The production and allocation of goods and services is determined primarily through markets.
- D. The production and allocation of goods and services is determined primarily through government.

5. Which statement best describes a command economy?

- A. The production of goods and services is determined primarily by markets, but the allocation of goods and services is determined primarily by government.
- B. The production of goods and services is determined primarily by government, but the allocation of goods and services is determined primarily by markets.
- C. The production and allocation of goods and services is determined primarily through markets.
- D. The production and allocation of goods and services is determined primarily through government.

6. Which would *not* be characteristic of a capitalist economy?

- A. Government ownership of the factors of production
- B. Competition and unrestricted markets
- C. Reliance on the market system
- D. Free enterprise and choice

7. A basic characteristic of a command system is that:

- A. wages paid to labor are higher.
- B. government owns most economic resources.
- C. markets function mostly free from government intervention.
- D. government planners play a limited role in deciding what goods will be produced.

8. 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.

9. Another term for capitalism is the:

- A. command system.
- B. socialist economy.
- C. market system.
- D. system of inputs and outputs.

10. Capitalism is an economic system that:

- A. produces more capital goods than consumer goods.
- B. produces more consumer goods than capital goods.
- C. is characterized by government control of markets.
- D. gives private individuals and corporations the right to own productive resources.

11. The Soviet Union economy of the 1980s would best be classified as:

- A. a market system.
- B. pure capitalism.
- C. laissez-faire capitalism.
- D. a command system.

12. The economy of Australia would best be classified as:

- A. a command system.
- B. socialism.
- C. pure capitalism.
- D. a market system.

13. The economy of North Korea would best be classified as:

- A. a laissez-faire economy.
- B. a command system.
- C. a capitalist economy.
- D. a market system.

14. The economy of Cuba most closely approximates:

- A. laissez-faire capitalism.
- B. a command economy.
- C. pure capitalism.
- D. a market economy.

15. As of 2012, the economy of Hong Kong most closely approximates:

- A. socialism.
- B. a command economy.
- C. pure capitalism.
- D. a market economy.

16. The market system is characterized by:

- A. extensive government constraints on individual behavior.
- B. private ownership of the means of production.
- C. government control of all production decisions.
- D. government rationing of all goods and services.

17. 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.

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

- A. Government-established prices in all markets
- B. Reallocation of all resources from private to public uses
- C. The right to own private property and control resource uses
- D. Central planning by government to provide goods and services

19. Legal and social rules that affect the ownership of property are:

- A. property rights.
- B. the coincidence of wants.
- C. the division of labor.
- D. the freedom of enterprise.

20. The institution of private property encourages:

- A. lack of maintenance because people are not forced by law to do it.
- B. lack of easy exchange because ownership is sometimes hard to prove.
- C. easy exchange of some property because a formal title or deed exists.
- D. lack of incentives because the owner is responsible for maintenance costs.

21. Which is characteristic of the market system?

- A. Unselfish individuals
- B. Centralized decision making
- C. Free enterprise and choice
- D. Government ownership of the means of production

22. By free enterprise, we mean that:

- A. products are provided free to those who cannot 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.

23. 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 in getting consumer goods to their most valued uses.
- D. Freedom of choice and enterprise are essential elements of the market system.

24. The maximization of profit and the minimization of losses is the primary factor affecting the economic decision making of:

- A. workers.
- B. consumers.
- C. public officials.
- D. entrepreneurs.

25. 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

26. In a market economy, entrepreneurs are most concerned with:

- A. maximizing utility or satisfaction from limited incomes.
- B. increasing the wages and salaries of workers.
- C. maximizing profits or minimizing losses.
- D. the selfish pursuit of money.

27. 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.

28. 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

29. A competitive economy assumes each industry consists 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.

30. 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.

31. A market system is best characterized by:

- A. extensive government intervention in economic activity.
- B. the private production of most capital goods.
- C. government regulation of all private markets.
- D. central planning and control.

32. A characteristic of the market system is:

- A. frequent use of price controls.
- B. frequent use of barter.
- C. extensive use of capital goods.
- D. low interest rates.

33. Which is assumed to be most limited in scope under a market system?

- A. Freedom of enterprise
- B. Freedom of choice
- C. Competition
- D. Government

34. All of the following accurately describe a market economy *except*.

- A. government establishes maximum and minimum prices for most goods and services.
- B. prices serve as a signaling mechanism to buyers and sellers.
- C. the allocation of resources is determined by their prices.
- D. the actions of buyers and sellers establish a product's price.

35. Which statement best describes a capitalist economy?

- A. Society determines production and the allocation of goods and services only through markets.
- B. Government policies determine the production and the allocation of goods and services.
- C. Government policies determine the production, but not the allocation, of goods and services.
- D. The role of individual self-interest is relatively unimportant because government makes most economic decisions.

36. The process in which workers do 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 labor.

37. How does human specialization contribute to an economy's output?

- A. It makes use of differences in abilities.
- B. It is a process of creative destruction.
- C. It works like an "invisible hand."
- D. It decreases derived demand.

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 labor lowers prices for products.
- D. all of the above are correct.

39. Advantages of specialization *do not* include:

- A. increased production of economic goods with no increase in resources.
- B. the more efficient use of scarce resources.
- C. increased ability to utilize the division of labor.
- D. less interdependence.

40. Which of the following *does not* explain why specialization increases output?

- A. Specialization capitalizes on differences in ability.
- B. Specialization promotes self-sufficiency and independence.
- C. Specialization fosters learning by doing.
- D. Specialization saves time by eliminating shifting between tasks.

41. A prerequisite of specialization is:

- A. a capitalistic economic system.
- B. a medium of exchange or money system.
- C. free enterprise.
- D. competition.

42. Which is an example of barter?

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

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

- A. planned economy.
- B. market economy.
- C. mixed economy.
- D. barter economy.

44. Which is necessary to make a trade in a barter economy?

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

45. Consider a barter situation where you have pens and you want pencils. To achieve your objective there must be a(n):

- A. use of capital goods.
- B. entry and exit from the market.
- C. large number of sellers.
- D. coincidence of wants.

46. The use of money for exchange:

- A. increases the use of barter.
- B. reduces consumer sovereignty.
- C. increases the importance of a coincidence of wants.
- D. encourages more specialization in production.

47. Which is the main problem with the barter system of exchange? Barter:

- A. encourages self-interest and selfishness.
- B. fosters specialization and division of labor.
- C. requires a coincidence of wants.
- D. undermines the right to leave property to one's heirs.

48. The direct exchange of goods for goods is:

- A. barter.
- B. the circular flow.
- C. the invisible hand.
- D. roundabout production.

49. Why might a company use barter rather than money to make a transaction?

- A. Barter is generally more efficient than money exchanges.
- B. Barter can enable two firms to trade when their cash flows are limited.
- C. Money requires a coincidence of wants but barter is more direct.
- D. Money is economically efficient for large transactions, but barter is preferred for smaller transactions.

50. Consumer sovereignty and "dollar votes" are most related to which fundamental question about a competitive market system?

- A. What goods and services will be produced?
- B. How will the goods and services be produced?
- C. How will the system promote progress?
- D. Who will get the goods and services?

51. Economic efficiency would be primarily discussed with respect to which of the fundamental questions about a competitive market economy?

- A. What goods and services will be produced?
- B. How will the goods and services be produced?
- C. How will the system promote progress?
- D. Who will get the goods and services?

52. Issues of the distribution of goods and services and incomes in a competitive market system are the primary topic of which fundamental question?

- A. What goods and services will be produced?
- B. How will the goods and services be produced?
- C. How will the system promote progress?
- D. Who will get the goods and services?

53. Which fundamental question about a competitive market system primarily focuses on technological progress and capital accumulation?

- A. What goods and services will be produced?
- B. How will the goods and services be produced?
- C. How will the system promote progress?
- D. Who will get the goods and services?

54. All economic systems must answer certain fundamental economic questions. Which is *not* one of these questions?

- A. Which actions should government take to reduce inflation?
- B. How will the goods and services be produced?
- C. What goods and services will be produced?
- D. Who is to receive the output?

55. Which is not one of the Four Fundamental Questions?

- A. How will goods and services be produced?
- B. How should the system promote progress?
- C. Who is to receive the output of the system?
- D. What goods and services should be produced by government?

56. In 1999, McDonald's introduced the "Big Xtra" and it turned out to be a successful product. In the marketplace for fast-food products, this success would be an example of:

- A. derived demand.
- B. medium of exchange.
- C. consumer sovereignty.
- D. roundabout production.

57. In 1997, McDonald's introduced the "55-cent special." It turned out to be an unsuccessful product. In the marketplace for fast-food products, this lack of success is an example of:
- A. normal profit.
 - B. economic costs.
 - C. consumer sovereignty.
 - D. medium of exchange.
58. The introduction in 1996 of "Arch Deluxe" was a hit product for McDonald's. This example shows that in the market for such fast-food products:
- A. normal profits are greater than economic profits.
 - B. the medium of exchange is more important than the message.
 - C. consumer sovereignty is less important than specialization.
 - D. the dollar votes of consumers determined which products succeed.
59. The process by which new products and technologies drive out existing products and techniques is known as:
- A. Destructive creation.
 - B. Creative destruction.
 - C. Consumer sovereignty.
 - D. Capital accumulation.

60. What to produce in a market economy is ultimately determined by the:

- A. output decisions of business firms.
- B. income plans of households.
- C. spending decisions of households.
- D. workers' technical skills.

61. 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 purchase.
- C. there are no limits on what consumers may buy under capitalism.
- D. businesses produce with tax minimization as their primary goal.

62. Within a market economy, some industries may be declining while other industries may be expanding. This indicates that:

- A. incomes are declining.
- B. productive resources are being reallocated.
- C. factors of production are scarce.
- D. producers are not maximizing profits.

63. By consumer sovereignty we mean that:

- A. government is responsible for protecting consumer interests.
- B. consumers determine what goods and services are produced.
- C. businesses decide what the consumer will buy.
- D. all goods and services are produced by consumers.

64. 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 major role of consumers in determining what goods are produced.

65. A major feature of a market system is that:

- A. there is economic equality.
- B. there is consumer sovereignty.
- C. there is full employment.
- D. all producers make profits.

66. The failure of the McDonald's McLean burger was an example of:

- A. an increase in demand.
- B. consumer sovereignty.
- C. technological advances.
- D. economic profit.

67. The term "dollar votes" means:

- A. inflation will occur if consumers do not 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 money.
- D. consumers "vote" for certain products to be produced by how they spend their incomes.

68. From society's point of view, the economic function of profits is to:

- A. equalize incomes.
- B. ensure that the rich get richer.
- C. provide revenues to pay high wages.
- D. direct resources in response to changes in the economy.

69. In a market economy, the money incomes of individuals depend primarily upon:

- A. government policies in setting wages and interest rates.
- B. the value and amounts of the productive resources the individuals possess.
- C. the amount of college education the individuals have.
- D. who you know and how well you know them.

70. 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.

71. Which best describes the "invisible hand" concept?

- A. Highly detailed central direction of an economy will maximize the public's best interests.
- B. The market system works best when resources are highly substitutable.
- C. The problem of scarcity can best be overcome in a system of mixed capitalism.
- D. The desires of producers and resource suppliers to further their own self-interest will tend to promote the social interest.

72. The idea that firms and resource suppliers, while seeking to further their own self-interests in a market economy, also promote the public interest describes:

- A. the guiding function of prices.
- B. capital accumulation.
- C. the "invisible hand."
- D. "dollar votes."

73. The influential book written by Adam Smith was:

- A. *Capitalism and Freedom*.
- B. *The Affluent Society*.
- C. *The Age of the Economist*.
- D. *The Wealth of Nations*.

74. The "invisible hand" concept to describe the guiding function of prices was developed by:

- A. Jeremy Bentham.
- B. Adam Smith.
- C. Milton Friedman.
- D. David Ricardo.

75. The development of the Internet and e-mail to often replace regular mail services is an example of:

- A. roundabout production.
- B. derived demand.
- C. creative destruction.
- D. specialization.

76. The development of CDs and DVDs, which significantly reduced the market for cassette tapes, is an example of:

- A. specialization.
- B. derived demand.
- C. roundabout production.
- D. creative destruction.

77. The basic economic argument for the market system is that it promotes:

- A. an efficient allocation of resources.
- B. equality in the distribution of income.
- C. personal freedom.
- D. the use of money.

78. Command systems in the Soviet Union and pre-reform China failed primarily because of:

- A. coordination and incentive problems.
- B. greater resource scarcity than in market systems.
- C. the failure to accumulate and use capital.
- D. the failure to specialize in production.

79. Which of the following *does not* explain why the command systems of the Soviet Union and Eastern Europe failed?

- A. Coordination problems.
- B. Prices and profits did not fluctuate to reflect wants for a different allocation of resources.
- C. Incentive problems.
- D. The failure to use money for most exchanges.

80. In the circular flow model, households:

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

81. The circular flow model:

- A. assumes that central planning is taking place.
- B. illustrates how natural resources are created.
- C. illustrates how money is created by the banking system.
- D. illustrates the interdependence of businesses and consumers.

82. The simple circular flow model shows that workers, entrepreneurs, and the owners of land and capital offer their services through:

- A. product markets.
- B. resource markets.
- C. employment agencies.
- D. business firms.

83. Markets in which firms sell their output of goods and services are called:

- A. resource markets.
- B. product markets.
- C. command markets.
- D. mixed markets.

84. The circular flow model shows that the goods and services produced by business firms are sold through:

- A. product markets.
- B. stock markets.
- C. money markets.
- D. resource markets.

85. In a circular flow model consisting of the household sector, the business sector, product markets, and resource markets:

- A. households are sellers of products.
- B. businesses are sellers of products.
- C. households are buyers of productive resources.
- D. resource markets are sellers of products.

86. In the simple circular flow model:

- A. households are sellers of resources and demanders of products.
- B. households are sellers of products and demanders of resources.
- C. businesses are sellers of resources and demanders of products.
- D. businesses are sellers of both resources and products.

87. In product markets:

- A. households sell products to business firms.
- B. households sell resources to business firms.
- C. businesses sell resources to households.
- D. businesses sell goods and services to households.

88. The money income of households consists of the sum of:

- A. wages plus salaries plus benefits.
- B. consumption expenditures plus profits.
- C. wages plus rents plus interest plus profits.
- D. consumption expenditures plus costs of resources.

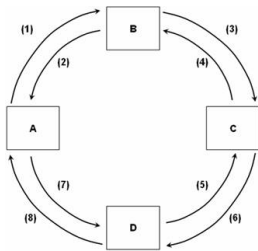
89. Which of the following would be primarily determined in the resource market?

- A. The price of compact discs
- B. The wage rates for electricians
- C. The number of automobiles produced
- D. The amount of money in circulation

90. The fact that expenditures on products and payments to owners of resources used to produce those products flow in opposite directions is known as:

- A. roundabout production.
- B. a barter economy.
- C. a pure economy.
- D. the circular flow of income.

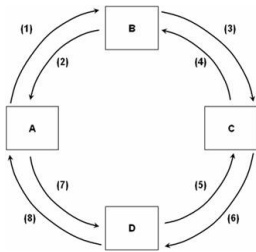
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Refer to the above figure. If box B represents the resource market and flow (3) represents money income, then:

- 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.

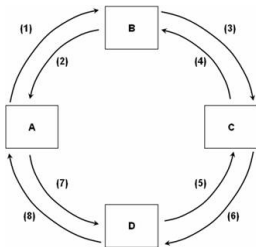
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Refer to the above figure. If box A represents businesses and flow (7) represents goods and services, then:

- A. box D is the product market and box B is the resource 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 resource market.

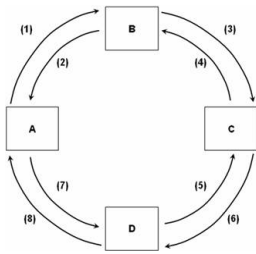
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Refer to the above figure. If flow (1) is the cost businesses pay to the resource market, then:

- A. (2) is the flow of productive resources.
- B. (4) is the flow of goods and services.
- C. (6) is the flow of money income.
- D. (7) is the flow of revenue.

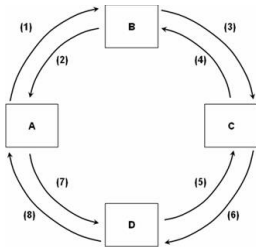
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Refer to the above figure. If box D represents the product market and flow (6) represents consumption expenditures, then box C is:

- A. households, flow (7) is revenue, and flow (8) is goods and services.
- B. businesses, flow (7) is revenue, and flow (8) is goods and services.
- C. households, flow (7) is goods and services, and flow (8) is revenue.
- D. businesses, flow (7) is goods and services, and flow (8) is revenue.

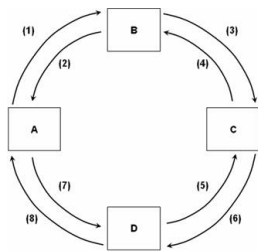
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Refer to the above figure. If box A represents businesses and box B represents the resource market in this circular flow model, then the real flow of goods, services, and economic resources would be represented by flows:

- A. (1), (3), (6), and (8).
- B. (7), (5), (4), and (2).
- C. (1), (2), (3), and (4).
- D. (5), (6), (7), and (8).

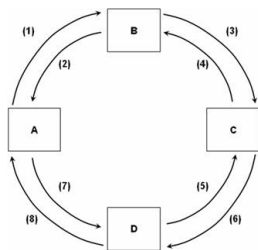
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Refer to the above figure. If box A represents businesses and box D represents the product market in this circular flow model, then money flow in the model would be represented by:

- A. (1), (2), (3), and (4).
- B. (5), (6), (7), and (8).
- C. (1), (3), (6), and (8).
- D. (7), (5), (4), and (2).

97.



Refer to the above figure. If you know that flow (8) is revenues and flow (4) is economic resources (land, labor, capital, and entrepreneurial ability), then box:

- A. A is the resource market and box B is the product market.
- B. B is the resource market and box A is the product market.
- C. C is the product market and box B is the resource market.
- D. D is the product market and box B is the resource market.

98. Assume that rents flow clockwise in a circular economic flow diagram. This implies that land flows:

- A. clockwise and capital flows counterclockwise.
- B. clockwise and profits flow counterclockwise.
- C. counterclockwise and capital flows clockwise.
- D. counterclockwise and profits flow clockwise.

99. If goods and services flow clockwise in a circular economic flow diagram, then consumption expenditures flow:

- A. clockwise and firm revenues flow clockwise.
- B. clockwise and firm revenues flow counterclockwise.
- C. counterclockwise and firm revenues flow clockwise.
- D. counterclockwise and firm revenues flow counterclockwise.

100. In the circular economic flow diagram, households:

- A. make consumption expenditures and pay for land, labor, and capital.
- B. make consumption expenditures and receive goods and services.
- C. buy resources and receive goods and services.
- D. receive money income and supply resources.

101.As of 2012, approximately what percentage of U.S. firms are sole proprietorships?

- A. 18 percent
- B. 50 percent
- C. 72 percent
- D. 84 percent

102.According to the text, U.S. corporations generate approximately what percentage of total sales revenue?

- A. 11 percent
- B. 20 percent
- C. 72 percent
- D. 82 percent

103.According to the text, what is the largest source of earned income for U.S. households?

- A. Wages and salaries
- B. Interest
- C. Proprietors' income
- D. Corporate profits

104. Over half of U.S. consumer expenditures are for what?

- A. Housing
- B. Services
- C. Nondurable goods
- D. Durable goods

105. A durable consumer good is expected to last for at least how long?

- A. 6 months
- B. 1 year
- C. 3 years
- D. 10 years

106. As of 2012, approximately how many households are in the United States?

- A. 60 million
- B. 115 million
- C. 200 million
- D. 290 million

107. Which of the following is *not* considered a consumption expenditure?

- A. Purchases of services
- B. Purchases of houses
- C. Purchases of nondurable goods
- D. Purchases of durable goods

True / False Questions

108. Property rights have a positive effect in a market economy because they encourage owners to maintain their property.

True False

109. The institution of private property is supported by clear claims to ownership.

True False

110. Individual property rights are the right of the government to own, use, and dispose of resources in an economy.

True False

111. An important part of the market system is that producers and consumers consider the public interest in making production and consumption decisions.

True False

112. More specialization in a market economy generally leads to the more efficient use of its resources.

True False

113. Specialization in production can occur based on geographic advantages.

True False

114. A division of labor enhances society's output by permitting people to take advantage of existing differences in their abilities and skills.

True False

115. Exchange by barter requires a coincidence of wants.

True False

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

True False

117. The concept of consumer sovereignty refers to situations in which consumers are represented on the board of directors of large corporations.

True False

118.Economic efficiency entails getting the smallest amount of output from a given level of input of scarce resources.

True False

119.In the market system, prices tend to guide resources from less important to more important uses.

True False

120.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

121.It is generally agreed that a major advantage of the competitive price system is the achievement of greater efficiency.

True False

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

True False

123.Command systems in the Soviet Union and Eastern Europe failed primarily because of a lack of resources.

True False

124. Command systems in the Soviet Union and Eastern Europe failed primarily because of coordination and incentive problems.

True False

125. In the circular flow model, households function on the selling side of the resource market and the buying side of product markets.

True False

126. In the circular flow model, there is a money flow of economic resources and finished goods and services and a real flow of income and consumption expenditures.

True False

127. The economy of the United States can best be described as pure capitalism.

True False

128. In the U.S. economy, corporations account for about 20 percent of the firms and about 84 percent of the total sales revenue.

True False

129. In the U.S. economy, sole proprietorships account for over half the firms and over half of total sales revenue.

True False

130. In the U.S. economy, rents are the smallest source of household income.

True False

131. In the U.S. economy, services account for over half of all consumer expenditures.

True False

132. In the U.S. economy, housing accounts for over half of all consumer expenditures.

True False

133. Durable goods are expected to last for at least 10 years.

True False

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

Multiple Choice Questions

1. Economic systems differ according to what two main characteristics?
- A. Ownership of resources and methods of coordinating economic activity
 - B. Quantity of output produced and who receives the output
 - C. Who produces the output and what technology is used to produce it
 - D. The system of government and the quantity of natural resources available

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-01 Differentiate between a command system and a market system.

Topic: Economic systems

2. 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.

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-01 Differentiate between a command system and a market system.

3. In a capitalistic economy:
- A. consumers are not sovereign.
 - B. markets are not competitive.
 - C. there is a reliance on the market system.
 - D. the government owns the means of production.

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-01 Differentiate between a command system and a market system.

Topic: Economic systems

4. Which statement best describes a capitalist economy?
- A. The production of goods and services is determined primarily by markets, but the allocation of goods and services is determined primarily by government.
 - B. The production of goods and services is determined primarily by government, but the allocation of goods and services is determined primarily by markets.
 - C. The production and allocation of goods and services is determined primarily through markets.
 - D. The production and allocation of goods and services is determined primarily through government.

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-01 Differentiate between a command system and a market system.

Topic: Economic systems

5. Which statement best describes a command economy?

- A. The production of goods and services is determined primarily by markets, but the allocation of goods and services is determined primarily by government.
- B. The production of goods and services is determined primarily by government, but the allocation of goods and services is determined primarily by markets.
- C. The production and allocation of goods and services is determined primarily through markets.
- D. The production and allocation of goods and services is determined primarily through government.

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-01 Differentiate between a command system and a market system.

Topic: Economic systems

6. Which would *not* be characteristic of a capitalist economy?

- A. Government ownership of the factors of production
- B. Competition and unrestricted markets
- C. Reliance on the market system
- D. Free enterprise and choice

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-01 Differentiate between a command system and a market system.

Topic: Economic systems

7. A basic characteristic of a command system is that:

- A. wages paid to labor are higher.
- B. government owns most economic resources.
- C. markets function mostly free from government intervention.
- D. government planners play a limited role in deciding what goods will be produced.

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-01 Differentiate between a command system and a market system.

Topic: Economic systems

8. 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.

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-01 Differentiate between a command system and a market system.

Topic: Economic systems

9. Another term for capitalism is the:

- A. command system.
- B. socialist economy.
- C. market system.
- D. system of inputs and outputs.

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-01 Differentiate between a command system and a market system.

Topic: Economic systems

10. Capitalism is an economic system that:

- A. produces more capital goods than consumer goods.
- B. produces more consumer goods than capital goods.
- C. is characterized by government control of markets.
- D. gives private individuals and corporations the right to own productive resources.

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-01 Differentiate between a command system and a market system.

Topic: Economic systems

11. The Soviet Union economy of the 1980s would best be classified as:

- A. a market system.
- B. pure capitalism.
- C. laissez-faire capitalism.
- D. a command system.

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-01 Differentiate between a command system and a market system.

Topic: Economic systems

12. The economy of Australia would best be classified as:

- A. a command system.
- B. socialism.
- C. pure capitalism.
- D. a market system.

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-01 Differentiate between a command system and a market system.

Topic: Economic systems

13. The economy of North Korea would best be classified as:

- A. a laissez-faire economy.
- B. a command system.**
- C. a capitalist economy.
- D. a market system.

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-01 Differentiate between a command system and a market system.

Topic: Economic systems

14. The economy of Cuba most closely approximates:

- A. laissez-faire capitalism.
- B. a command economy.**
- C. pure capitalism.
- D. a market economy.

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-01 Differentiate between a command system and a market system.

Topic: Economic systems

15. As of 2012, the economy of Hong Kong most closely approximates:

- A. socialism.
- B. a command economy.
- C. pure capitalism.
- D. a market economy.

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-01 Differentiate between a command system and a market system.

Topic: Economic systems

16. The market system is characterized by:

- A. extensive government constraints on individual behavior.
- B. private ownership of the means of production.
- C. government control of all production decisions.
- D. government rationing of all goods and services.

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

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

Topic: Characteristics of the market system

17. 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.

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

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

Topic: Characteristics of the market system

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

- A. Government-established prices in all markets
- B. Reallocation of all resources from private to public uses
- C. The right to own private property and control resource uses
- D. Central planning by government to provide goods and services

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

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

Topic: Characteristics of the market system

19. Legal and social rules that affect the ownership of property are:

- A. property rights.
- B. the coincidence of wants.
- C. the division of labor.
- D. the freedom of enterprise.

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

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

Topic: Characteristics of the market system

20. The institution of private property encourages:

- A. lack of maintenance because people are not forced by law to do it.
- B. lack of easy exchange because ownership is sometimes hard to prove.
- C. easy exchange of some property because a formal title or deed exists.
- D. lack of incentives because the owner is responsible for maintenance costs.

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

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

Topic: Characteristics of the market system

21. Which is characteristic of the market system?

- A. Unselfish individuals
- B. Centralized decision making
- C. Free enterprise and choice
- D. Government ownership of the means of production

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

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

Topic: Characteristics of the market system

22. By free enterprise, we mean that:

- A. products are provided free to those who cannot 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.

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

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

Topic: Characteristics of the market system

23. 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 in getting consumer goods to their most valued uses.
- D. Freedom of choice and enterprise are essential elements of the market system.

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

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

Topic: Characteristics of the market system

24. The maximization of profit and the minimization of losses is the primary factor affecting the economic decision making of:

- A. workers.
- B. consumers.
- C. public officials.
- D. entrepreneurs.

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

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

Topic: Characteristics of the market system

25. 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

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

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

Topic: Characteristics of the market system

26. In a market economy, entrepreneurs are most concerned with:

- A. maximizing utility or satisfaction from limited incomes.
- B. increasing the wages and salaries of workers.
- C. maximizing profits or minimizing losses.
- D. the selfish pursuit of money.

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

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

Topic: Characteristics of the market system

27. 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.

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

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

Topic: Characteristics of the market system

28. 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

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

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

Topic: Characteristics of the market system

29. A competitive economy assumes each industry consists 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.

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

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

Topic: Characteristics of the market system

30. 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.

AACSB: Analytic

Blooms: Remember

Difficulty: 3 Hard

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

Topic: Characteristics of the market system

31. A market system is best characterized by:

- A. extensive government intervention in economic activity.
- B. the private production of most capital goods.
- C. government regulation of all private markets.
- D. central planning and control.

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

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

Topic: Characteristics of the market system

32. A characteristic of the market system is:

- A. frequent use of price controls.
- B. frequent use of barter.
- C. extensive use of capital goods.
- D. low interest rates.

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

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

Topic: Characteristics of the market system

33. Which is assumed to be most limited in scope under a market system?

- A. Freedom of enterprise
- B. Freedom of choice
- C. Competition
- D. Government

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

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

Topic: Characteristics of the market system

34. All of the following accurately describe a market economy *except*.

- A. government establishes maximum and minimum prices for most goods and services.
- B. prices serve as a signaling mechanism to buyers and sellers.
- C. the allocation of resources is determined by their prices.
- D. the actions of buyers and sellers establish a product's price.

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

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

Topic: Characteristics of the market system

35. Which statement best describes a capitalist economy?

- A. Society determines production and the allocation of goods and services only through markets.
- B. Government policies determine the production and the allocation of goods and services.
- C. Government policies determine the production, but not the allocation, of goods and services.
- D. The role of individual self-interest is relatively unimportant because government makes most economic decisions.

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

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

Topic: Characteristics of the market system

36. The process in which workers do 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 labor.

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

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

Topic: Characteristics of the market system

37. How does human specialization contribute to an economy's output?

- A. It makes use of differences in abilities.
- B. It is a process of creative destruction.
- C. It works like an "invisible hand."
- D. It decreases derived demand.

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

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

Topic: Characteristics of the market system

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 labor lowers prices for products.
- D. all of the above are correct.

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

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

Topic: Characteristics of the market system

39. Advantages of specialization *do not* include:

- A. increased production of economic goods with no increase in resources.
- B. the more efficient use of scarce resources.
- C. increased ability to utilize the division of labor.
- D. less interdependence.

AACSB: Analytic

Blooms: Remember

Difficulty: 3 Hard

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

Topic: Characteristics of the market system

40. Which of the following *does not* explain why specialization increases output?

- A. Specialization capitalizes on differences in ability.
- B. Specialization promotes self-sufficiency and independence.
- C. Specialization fosters learning by doing.
- D. Specialization saves time by eliminating shifting between tasks.

AACSB: Analytic

Blooms: Remember

Difficulty: 3 Hard

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

Topic: Characteristics of the market system

41. A prerequisite of specialization is:

- A. a capitalistic economic system.
- B. a medium of exchange or money system.
- C. free enterprise.
- D. competition.

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

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

Topic: Characteristics of the market system

42. Which is an example of barter?

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

AACSB: Analytic

Blooms: Understand

Difficulty: 1 Easy

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

Topic: Characteristics of the market system

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

- A. planned economy.
- B. market economy.
- C. mixed economy.
- D. barter economy.

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

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

Topic: Characteristics of the market system

44. Which is necessary to make a trade in a barter economy?

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

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

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

Topic: Characteristics of the market system

45. Consider a barter situation where you have pens and you want pencils. To achieve your objective there must be a(n):

- A. use of capital goods.
- B. entry and exit from the market.
- C. large number of sellers.
- D. coincidence of wants.

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

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

Topic: Characteristics of the market system

46. The use of money for exchange:

- A. increases the use of barter.
- B. reduces consumer sovereignty.
- C. increases the importance of a coincidence of wants.
- D. encourages more specialization in production.

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

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

Topic: Characteristics of the market system

47. Which is the main problem with the barter system of exchange? Barter:

- A. encourages self-interest and selfishness.
- B. fosters specialization and division of labor.
- C. requires a coincidence of wants.
- D. undermines the right to leave property to one's heirs.

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

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

Topic: Characteristics of the market system

48. The direct exchange of goods for goods is:

- A. barter.
- B. the circular flow.
- C. the invisible hand.
- D. roundabout production.

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

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

Topic: Characteristics of the market system

49. Why might a company use barter rather than money to make a transaction?

- A. Barter is generally more efficient than money exchanges.
- B. Barter can enable two firms to trade when their cash flows are limited.
- C. Money requires a coincidence of wants but barter is more direct.
- D. Money is economically efficient for large transactions, but barter is preferred for smaller transactions.

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

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

Topic: Characteristics of the market system

50. Consumer sovereignty and "dollar votes" are most related to which fundamental question about a competitive market system?

- A. What goods and services will be produced?
- B. How will the goods and services be produced?
- C. How will the system promote progress?
- D. Who will get the goods and services?

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-03 Explain how the market system answers the four fundamental questions.

Topic: Four fundamental questions

51. Economic efficiency would be primarily discussed with respect to which of the fundamental questions about a competitive market economy?

- A. What goods and services will be produced?
- B. How will the goods and services be produced?
- C. How will the system promote progress?
- D. Who will get the goods and services?

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-03 Explain how the market system answers the four fundamental questions.

Topic: Four fundamental questions

52. Issues of the distribution of goods and services and incomes in a competitive market system are the primary topic of which fundamental question?

- A. What goods and services will be produced?
- B. How will the goods and services be produced?
- C. How will the system promote progress?
- D. Who will get the goods and services?

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-03 Explain how the market system answers the four fundamental questions.

Topic: Four fundamental questions

53. Which fundamental question about a competitive market system primarily focuses on technological progress and capital accumulation?

- A. What goods and services will be produced?
- B. How will the goods and services be produced?
- C. How will the system promote progress?
- D. Who will get the goods and services?

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-04 Discuss how the market system adjusts to change and promotes progress.

Topic: Four fundamental questions

54. All economic systems must answer certain fundamental economic questions. Which is *not* one of these questions?

- A. Which actions should government take to reduce inflation?
- B. How will the goods and services be produced?
- C. What goods and services will be produced?
- D. Who is to receive the output?

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-03 Explain how the market system answers the four fundamental questions.

Topic: Four fundamental questions

55. Which is not one of the Four Fundamental Questions?

- A. How will goods and services be produced?
- B. How should the system promote progress?
- C. Who is to receive the output of the system?
- D. What goods and services should be produced by government?

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-03 Explain how the market system answers the four fundamental questions.

Topic: Four fundamental questions

56. In 1999, McDonald's introduced the "Big Xtra" and it turned out to be a successful product. In the marketplace for fast-food products, this success would be an example of:

- A. derived demand.
- B. medium of exchange.
- C. consumer sovereignty.
- D. roundabout production.

AACSB: Analytic

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 02-03 Explain how the market system answers the four fundamental questions.

Topic: Four fundamental questions

57. In 1997, McDonald's introduced the "55-cent special." It turned out to be an unsuccessful product. In the marketplace for fast-food products, this lack of success is an example of:

- A. normal profit.
- B. economic costs.
- C. consumer sovereignty.
- D. medium of exchange.

AACSB: Analytic

Blooms: Understand

Difficulty: 1 Easy

Learning Objective: 02-03 Explain how the market system answers the four fundamental questions.

Topic: Four fundamental questions

58. The introduction in 1996 of "Arch Deluxe" was a hit product for McDonald's. This example shows that in the market for such fast-food products:

- A. normal profits are greater than economic profits.
- B. the medium of exchange is more important than the message.
- C. consumer sovereignty is less important than specialization.
- D. the dollar votes of consumers determined which products succeed.

AACSB: Analytic

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 02-03 Explain how the market system answers the four fundamental questions.

Topic: Four fundamental questions

59. The process by which new products and technologies drive out existing products and techniques is known as:

- A. Destructive creation.
- B. Creative destruction.
- C. Consumer sovereignty.
- D. Capital accumulation.

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-04 Discuss how the market system adjusts to change and promotes progress.

Topic: Four fundamental questions

60. What to produce in a market economy is ultimately determined by the:

- A. output decisions of business firms.
- B. income plans of households.
- C. spending decisions of households.
- D. workers' technical skills.

AACSB: Analytic

Blooms: Remember

Difficulty: 3 Hard

Learning Objective: 02-03 Explain how the market system answers the four fundamental questions.

Topic: Four fundamental questions

61. 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 purchase.**
- C. there are no limits on what consumers may buy under capitalism.
- D. businesses produce with tax minimization as their primary goal.

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-03 Explain how the market system answers the four fundamental questions.

Topic: Four fundamental questions

62. Within a market economy, some industries may be declining while other industries may be expanding. This indicates that:

- A. incomes are declining.
- B. productive resources are being reallocated.**
- C. factors of production are scarce.
- D. producers are not maximizing profits.

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-04 Discuss how the market system adjusts to change and promotes progress.

Topic: Four fundamental questions

63. By consumer sovereignty we mean that:

- A. government is responsible for protecting consumer interests.
- B. consumers determine what goods and services are produced.
- C. businesses decide what the consumer will buy.
- D. all goods and services are produced by consumers.

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-03 Explain how the market system answers the four fundamental questions.

Topic: Four fundamental questions

64. 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 major role of consumers in determining what goods are produced.

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-03 Explain how the market system answers the four fundamental questions.

Topic: Four fundamental questions

65. A major feature of a market system is that:

- A. there is economic equality.
- B.** there is consumer sovereignty.
- C. there is full employment.
- D. all producers make profits.

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-03 Explain how the market system answers the four fundamental questions.

Topic: Four fundamental questions

66. The failure of the McDonald's McLean burger was an example of:

- A. an increase in demand.
- B.** consumer sovereignty.
- C. technological advances.
- D. economic profit.

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-03 Explain how the market system answers the four fundamental questions.

Topic: Four fundamental questions

67. The term "dollar votes" means:

- A. inflation will occur if consumers do not 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 money.
- D. consumers "vote" for certain products to be produced by how they spend their incomes.

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-03 Explain how the market system answers the four fundamental questions.

Topic: Four fundamental questions

68. From society's point of view, the economic function of profits is to:

- A. equalize incomes.
- B. ensure that the rich get richer.
- C. provide revenues to pay high wages.
- D. direct resources in response to changes in the economy.

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-04 Discuss how the market system adjusts to change and promotes progress.

Topic: Four fundamental questions

69. In a market economy, the money incomes of individuals depend primarily upon:

- A. government policies in setting wages and interest rates.
- B. the value and amounts of the productive resources the individuals possess.**
- C. the amount of college education the individuals have.
- D. who you know and how well you know them.

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-03 Explain how the market system answers the four fundamental questions.

Topic: Four fundamental questions

70. 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.

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-03 Explain how the market system answers the four fundamental questions.

Topic: Four fundamental questions

71. Which best describes the "invisible hand" concept?

- A. Highly detailed central direction of an economy will maximize the public's best interests.
- B. The market system works best when resources are highly substitutable.
- C. The problem of scarcity can best be overcome in a system of mixed capitalism.
- D. The desires of producers and resource suppliers to further their own self-interest will tend to promote the social interest.

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-03 Explain how the market system answers the four fundamental questions.

Topic: Four fundamental questions

72. The idea that firms and resource suppliers, while seeking to further their own self-interests in a market economy, also promote the public interest describes:

- A. the guiding function of prices.
- B. capital accumulation.
- C. the "invisible hand."
- D. "dollar votes."

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-03 Explain how the market system answers the four fundamental questions.

Topic: Four fundamental questions

73. The influential book written by Adam Smith was:

- A. *Capitalism and Freedom*.
- B. *The Affluent Society*.
- C. *The Age of the Economist*.
- D. *The Wealth of Nations*.

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-03 Explain how the market system answers the four fundamental questions.

Topic: Four fundamental questions

74. The "invisible hand" concept to describe the guiding function of prices was developed by:

- A. Jeremy Bentham.
- B. Adam Smith.
- C. Milton Friedman.
- D. David Ricardo.

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-03 Explain how the market system answers the four fundamental questions.

Topic: Four fundamental questions

75. The development of the Internet and e-mail to often replace regular mail services is an example of:

- A. roundabout production.
- B. derived demand.
- C. creative destruction.
- D. specialization.

AACSB: Analytic

Blooms: Apply

Difficulty: 2 Medium

Learning Objective: 02-03 Explain how the market system answers the four fundamental questions.

Topic: Four fundamental questions

76. The development of CDs and DVDs, which significantly reduced the market for cassette tapes, is an example of:

- A. specialization.
- B. derived demand.
- C. roundabout production.
- D. creative destruction.

AACSB: Analytic

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 02-03 Explain how the market system answers the four fundamental questions.

Topic: Four fundamental questions

77. The basic economic argument for the market system is that it promotes:

- A. an efficient allocation of resources.
- B. equality in the distribution of income.
- C. personal freedom.
- D. the use of money.

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-03 Explain how the market system answers the four fundamental questions.

Topic: Four fundamental questions

78. Command systems in the Soviet Union and pre-reform China failed primarily because of:

- A. coordination and incentive problems.
- B. greater resource scarcity than in market systems.
- C. the failure to accumulate and use capital.
- D. the failure to specialize in production.

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-03 Explain how the market system answers the four fundamental questions.

Topic: Four fundamental questions

79. Which of the following *does not* explain why the command systems of the Soviet Union and Eastern Europe failed?

- A. Coordination problems.
- B. Prices and profits did not fluctuate to reflect wants for a different allocation of resources.
- C. Incentive problems.
- D. The failure to use money for most exchanges.

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-03 Explain how the market system answers the four fundamental questions.

Topic: Four fundamental questions

80. In the circular flow model, households:

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

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

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

Topic: Circular flow model

81. The circular flow model:

- A. assumes that central planning is taking place.
- B. illustrates how natural resources are created.
- C. illustrates how money is created by the banking system.
- D. illustrates the interdependence of businesses and consumers.

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

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

Topic: Circular flow model

82. The simple circular flow model shows that workers, entrepreneurs, and the owners of land and capital offer their services through:

- A. product markets.
- B. resource markets.
- C. employment agencies.
- D. business firms.

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

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

Topic: Circular flow model

83. Markets in which firms sell their output of goods and services are called:

- A. resource markets.
- B. product markets.
- C. command markets.
- D. mixed markets.

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

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

Topic: Circular flow model

84. The circular flow model shows that the goods and services produced by business firms are sold through:

- A. product markets.
- B. stock markets.
- C. money markets.
- D. resource markets.

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

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

Topic: Circular flow model

85. In a circular flow model consisting of the household sector, the business sector, product markets, and resource markets:

- A. households are sellers of products.
- B. businesses are sellers of products.
- C. households are buyers of productive resources.
- D. resource markets are sellers of products.

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

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

Topic: Circular flow model

86. In the simple circular flow model:

- A. households are sellers of resources and demanders of products.
- B. households are sellers of products and demanders of resources.
- C. businesses are sellers of resources and demanders of products.
- D. businesses are sellers of both resources and products.

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

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

Topic: Circular flow model

87. In product markets:

- A. households sell products to business firms.
- B. households sell resources to business firms.
- C. businesses sell resources to households.
- D. businesses sell goods and services to households.

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

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

Topic: Circular flow model

88. The money income of households consists of the sum of:

- A. wages plus salaries plus benefits.
- B. consumption expenditures plus profits.
- C. wages plus rents plus interest plus profits.
- D. consumption expenditures plus costs of resources.

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

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

Topic: Circular flow model

89. Which of the following would be primarily determined in the resource market?

- A. The price of compact discs
- B. The wage rates for electricians
- C. The number of automobiles produced
- D. The amount of money in circulation

AACSB: Analytic

Blooms: Understand

Difficulty: 2 Medium

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

Topic: Circular flow model

90. The fact that expenditures on products and payments to owners of resources used to produce those products flow in opposite directions is known as:

- A. roundabout production.
- B. a barter economy.
- C. a pure economy.
- D. the circular flow of income.

AACSB: Analytic

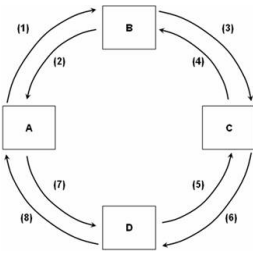
Blooms: Remember

Difficulty: 2 Medium

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

Topic: Circular flow model

91.



Refer to the above figure. If box B represents the resource market and flow (3) represents money income, then:

- 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.

AACSB: Analytic

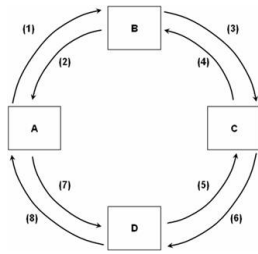
Blooms: Understand

Difficulty: 2 Medium

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

Topic: Circular flow model

92.



Refer to the above figure. If box A represents businesses and flow (7) represents goods and services, then:

- A. box D is the product market and box B is the resource 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 resource market.

AACSB: Analytic

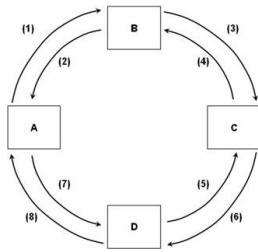
Blooms: Understand

Difficulty: 3 Hard

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

Topic: Circular flow model

93.



Refer to the above figure. If flow (1) is the cost businesses pay to the resource market, then:

- A. (2) is the flow of productive resources.
- B. (4) is the flow of goods and services.
- C. (6) is the flow of money income.
- D. (7) is the flow of revenue.

AACSB: Analytic

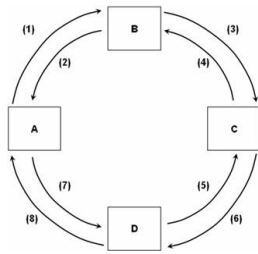
Blooms: Understand

Difficulty: 3 Hard

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

Topic: Circular flow model

94.



Refer to the above figure. If box D represents the product market and flow (6) represents consumption expenditures, then box C is:

- A. households, flow (7) is revenue, and flow (8) is goods and services.
- B. businesses, flow (7) is revenue, and flow (8) is goods and services.
- C. households, flow (7) is goods and services, and flow (8) is revenue.
- D. businesses, flow (7) is goods and services, and flow (8) is revenue.

AACSB: Analytic

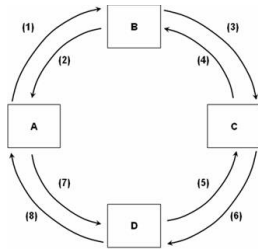
Blooms: Understand

Difficulty: 3 Hard

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

Topic: Circular flow model

95.



Refer to the above figure. If box A represents businesses and box B represents the resource market in this circular flow model, then the real flow of goods, services, and economic resources would be represented by flows:

- A. (1), (3), (6), and (8).
- B. (7), (5), (4), and (2).**
- C. (1), (2), (3), and (4).
- D. (5), (6), (7), and (8).

AACSB: Analytic

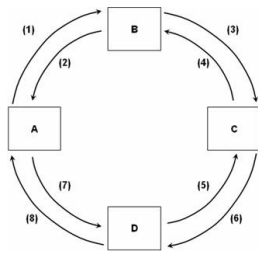
Blooms: Understand

Difficulty: 2 Medium

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

Topic: Circular flow model

96.



Refer to the above figure. If box A represents businesses and box D represents the product market in this circular flow model, then money flow in the model would be represented by:

- A. (1), (2), (3), and (4).
- B. (5), (6), (7), and (8).
- C. (1), (3), (6), and (8).
- D. (7), (5), (4), and (2).

AACSB: Analytic

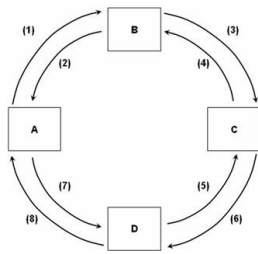
Blooms: Understand

Difficulty: 2 Medium

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

Topic: Circular flow model

97.



Refer to the above figure. If you know that flow (8) is revenues and flow (4) is economic resources (land, labor, capital, and entrepreneurial ability), then box:

- A. A is the resource market and box B is the product market.
- B. B is the resource market and box A is the product market.
- C. C is the product market and box B is the resource market.
- D. D is the product market and box B is the resource market.

AACSB: Analytic

Blooms: Understand

Difficulty: 2 Medium

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

Topic: Circular flow model

98. Assume that rents flow clockwise in a circular economic flow diagram. This implies that land flows:

- A. clockwise and capital flows counterclockwise.
- B. clockwise and profits flow counterclockwise.
- C. counterclockwise and capital flows clockwise.
- D. counterclockwise and profits flow clockwise.

AACSB: Analytic

Blooms: Understand

Difficulty: 3 Hard

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

Topic: Circular flow model

99. If goods and services flow clockwise in a circular economic flow diagram, then consumption expenditures flow:

- A. clockwise and firm revenues flow clockwise.
- B. clockwise and firm revenues flow counterclockwise.
- C. counterclockwise and firm revenues flow clockwise.
- D. counterclockwise and firm revenues flow counterclockwise.

AACSB: Analytic

Blooms: Understand

Difficulty: 3 Hard

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

Topic: Circular flow model

100. In the circular economic flow diagram, households:

- A. make consumption expenditures and pay for land, labor, and capital.
- B. make consumption expenditures and receive goods and services.
- C. buy resources and receive goods and services.
- D. receive money income and supply resources.

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

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

Topic: Circular flow model

101. As of 2012, approximately what percentage of U.S. firms are sole proprietorships?

- A. 18 percent
- B. 50 percent
- C. 72 percent
- D. 84 percent

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

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

Topic: Circular flow model

102. According to the text, U.S. corporations generate approximately what percentage of total sales revenue?

- A. 11 percent
- B. 20 percent
- C. 72 percent
- D. 82 percent

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

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

Topic: Circular flow model

103. According to the text, what is the largest source of earned income for U.S. households?

- A. Wages and salaries
- B. Interest
- C. Proprietors' income
- D. Corporate profits

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

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

Topic: Circular flow model

104. Over half of U.S. consumer expenditures are for what?

- A. Housing
- B. Services
- C. Nondurable goods
- D. Durable goods

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

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

Topic: Circular flow model

105. A durable consumer good is expected to last for at least how long?

- A. 6 months
- B. 1 year
- C. 3 years
- D. 10 years

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

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

Topic: Circular flow model

106. As of 2012, approximately how many households are in the United States?

- A. 60 million
- B. 115 million
- C. 200 million
- D. 290 million

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

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

Topic: Circular flow model

107. Which of the following is *not* considered a consumption expenditure?

- A. Purchases of services
- B. Purchases of houses
- C. Purchases of nondurable goods
- D. Purchases of durable goods

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

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

Topic: Circular flow model

True / False Questions

108. Property rights have a positive effect in a market economy because they encourage owners to maintain their property.

TRUE

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-01 Differentiate between a command system and a market system.

Topic: Characteristics of the market system

109. The institution of private property is supported by clear claims to ownership.

TRUE

AACSB: Analytic

Blooms: Remember

110. Individual property rights are the right of the government to own, use, and dispose of resources in an economy.

FALSE

111. An important part of the market system is that producers and consumers consider the public interest in making production and consumption decisions.

FALSE

112. More specialization in a market economy generally leads to the more efficient use of its resources.

TRUE

113. Specialization in production can occur based on geographic advantages.

TRUE

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-01 Differentiate between a command system and a market system.

Topic: Characteristics of the market system

114. A division of labor enhances society's output by permitting people to take advantage of existing differences in their abilities and skills.

TRUE

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-01 Differentiate between a command system and a market system.

Topic: Characteristics of the market system

115. Exchange by barter requires a coincidence of wants.

TRUE

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-01 Differentiate between a command system and a market system.

Topic: Characteristics of the market system

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

FALSE

AACSB: Analytic

Blooms: Remember

117. The concept of consumer sovereignty refers to situations in which consumers are represented on the board of directors of large corporations.

FALSE

118. Economic efficiency entails getting the smallest amount of output from a given level of input of scarce resources.

FALSE

119. In the market system, prices tend to guide resources from less important to more important uses.

TRUE

120. 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

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-01 Differentiate between a command system and a market system.

Topic: Characteristics of the market system

121. It is generally agreed that a major advantage of the competitive price system is the achievement of greater efficiency.

TRUE

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-01 Differentiate between a command system and a market system.

Topic: Characteristics of the market system

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

TRUE

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-01 Differentiate between a command system and a market system.

Topic: Characteristics of the market system

123. Command systems in the Soviet Union and Eastern Europe failed primarily because of a lack of resources.

FALSE

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-03 Explain how the market system answers the four fundamental questions.

Topic: Four fundamental questions

124. Command systems in the Soviet Union and Eastern Europe failed primarily because of coordination and incentive problems.

TRUE

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-03 Explain how the market system answers the four fundamental questions.

Topic: Four fundamental questions

125. In the circular flow model, households function on the selling side of the resource market and the buying side of product markets.

TRUE

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

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

Topic: Circular flow model

126. In the circular flow model, there is a money flow of economic resources and finished goods and services and a real flow of income and consumption expenditures.

FALSE

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

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

Topic: Circular flow model

127. The economy of the United States can best be described as pure capitalism.

FALSE

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-01 Differentiate between a command system and a market system.

Topic: Economic systems

128. In the U.S. economy, corporations account for about 20 percent of the firms and about 84 percent of the total sales revenue.

TRUE

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

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

Topic: Circular flow model

129. In the U.S. economy, sole proprietorships account for over half the firms and over half of total sales revenue.

FALSE

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

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

Topic: Circular flow model

130. In the U.S. economy, rents are the smallest source of household income.

TRUE

AACSB: Analytic

Blooms: Remember

Difficulty: 1 Easy

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

Topic: Circular flow model

131. In the U.S. economy, services account for over half of all consumer expenditures.

TRUE

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

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

Topic: Circular flow model

132. In the U.S. economy, housing accounts for over half of all consumer expenditures.

FALSE

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

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

Topic: Circular flow model

133. Durable goods are expected to last for at least 10 years.

FALSE

AACSB: Analytic

Blooms: Remember

Difficulty: 2 Medium

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

Topic: Circular flow model