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Chapter 02
The Market System and the Circular Flow

True / False Questions

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

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-12 Specialization

2. Money functions as a medium of exchange in permitting the ready comparison of the relative worth of heterogeneous products.
TRUE

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-13 Division of Labour

3. Government alters the distribution of income by market intervention, in which case it modifies the prices established by market forces.
TRUE

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-14 Geographic Specialization

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4. Property rights do not encourage people to cooperate.
FALSE

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-02 List the main characteristics of the market system.
Topic: 02-05 Characteristics of the Market System

5. Consumer sovereignty means that legislation now protects the rights of consumers to dispose of their incomes as they see fit.
FALSE

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-16 Active but Limited Government

6. The wants of consumers are expressed on the demand side of the product market.
TRUE

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-16 Active but Limited Government

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

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-17 Five Fundamental Questions

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

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-04 Explain the operation of the "invisible hand" and why market economies usually do a better job than command economies at transforming economic resources into desirable output.
Topic: 02-21 How Will the System Accommodate Change?

9. 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

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-04 Explain the operation of the "invisible hand" and why market economies usually do a better job than command economies at transforming economic resources into desirable output.
Topic: 02-21 How Will the System Accommodate Change?

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

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-24 Capital Accumulation

11. Households and businesses are both suppliers in the product market.
FALSE

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-24 Capital Accumulation

Multiple Choice Questions

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12. The command system is also known as:
A. the market system.
B. pure capitalism.
C. market socialism.
D. socialism or communism.

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-01 Differentiate between laissez-faire capitalism; the command system; and the market system.
Topic: 02-03 The Command System

13. The economy of the former Soviet Union was best described as:
A. authoritarian capitalism.
B. mixed capitalism.
C. a command economy.
D. market socialism.

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-01 Economic Systems

14. The economy of North Korea most closely approximates:
A. pure capitalism
B. a command economy
C. market socialism
D. authoritarian capitalism

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-01 Differentiate between laissez-faire capitalism; the command system; and the market system.
Topic: 02-01 Economic Systems

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15. Today, China's economy most closely approximates:
A. pure capitalism
B. a command economy
C. market socialism
D. authoritarian capitalism

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-01 Differentiate between laissez-faire capitalism; the command system; and the market system.
Topic: 02-01 Economic Systems

16. Which would not be characteristic of a capitalist economy?
A. government ownership of the means of production
B. competition and unrestricted markets
C. reliance on the market system
D. free enterprise and choice

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-01 Differentiate between laissez-faire capitalism; the command system; and the market system.
Topic: 02-01 Economic Systems

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

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-01 Differentiate between laissez-faire capitalism; the command system; and the market system.
Topic: 02-01 Economic Systems

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18. 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.

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-06 Private Property

19. In a capitalistic economy:
A. consumers can never be sovereign.
B. markets can never be competitive.
C. there is a reliance on the market system.
D. the government owns the means of production.

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-06 Private Property

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

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-01 Differentiate between laissez-faire capitalism; the command system; and the market system.
Topic: 02-02 Laissez-Faire Capitalism

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

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-01 Differentiate between laissez-faire capitalism; the command system; and the market system.
Topic: 02-01 Economic Systems

22. The Canadian economy most closely approximates:
A. mixed capitalism
B. a command economy
C. market socialism
D. authoritarian capitalism

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-01 Differentiate between laissez-faire capitalism; the command system; and the market system.
Topic: 02-01 Economic Systems

23. Which of the following is unique to a market economy system?
A. the extensive use of capital goods
B. private ownership of property resources
C. specialization
D. the use of money

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-02 List the main characteristics of the market system.
Topic: 02-04 The Market System

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24. Property rights are important because they:
A. encourage investment and growth.
B. are conducive to the writing of books and music.
C. facilitate exchange.
D. do all of the above.

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-06 Private Property

25. 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.

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-02 List the main characteristics of the market system.
Topic: 02-04 The Market System

26. The market system is characterized by:
A. extensive government constraints on individual behaviour.
B. private ownership of the means of production.
C. government control of all production decisions.
D. government rationing of all goods and services.

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-02 List the main characteristics of the market system.
Topic: 02-04 The Market System

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27. In a market system, well-defined property rights are important because they:
A. increase unnecessary investment.
B. limit destructive economic growth.
C. create economic problems.
D. encourage economic activity.

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-02 List the main characteristics of the market system.
Topic: 02-04 The Market System

28. Which is a major feature of the market system?
A. price floors and price ceilings in all markets
B. reallocation of all resources from private to public uses
C. the right to own private property and control resource use
D. central planning by government to provide goods and services

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-02 List the main characteristics of the market system.
Topic: 02-04 The Market System

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

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-01 Differentiate between laissez-faire capitalism; the command system; and the market system.
Topic: 02-02 Laissez-Faire Capitalism

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

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-07 Freedom of Enterprise and Choice

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

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-01 Differentiate between laissez-faire capitalism; the command system; and the market system.
Topic: 02-01 Economic Systems

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

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-01 Differentiate between laissez-faire capitalism; the command system; and the market system.
Topic: 02-01 Economic Systems

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33. 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

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-08 Self-Interest

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

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-08 Self-Interest

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

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-09 Competition

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

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-09 Competition

37. 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.

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-09 Competition

38. 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

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-09 Competition

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39. A purely competitive economy assumes the existence in each industry of a:
A. large number of small firms facing a large number of small buyers.
B. few large firms facing a large number of small buyers.
C. large number of small firms facing a few large buyers.
D. few small firms facing a few small buyers.

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-09 Competition

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

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-09 Competition

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

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-09 Competition

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

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-09 Competition

43. 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.

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-10 Markets and Prices

44. A characteristic of the market system is:
A. extensive use of price controls.
B. extensive use of barter.
C. extensive use of capital goods.
D. low interest rates.

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-10 Markets and Prices

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

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-04 Explain the operation of the "invisible hand" and why market economies usually do a better job than command economies at transforming economic resources into desirable output.
Topic: 02-11 Technology and Capital Goods

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

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-04 Explain the operation of the "invisible hand" and why market economies usually do a better job than command economies at transforming economic resources into desirable output.
Topic: 02-11 Technology and Capital Goods

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

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-12 Specialization

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

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-12 Specialization

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

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-12 Specialization

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

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-12 Specialization

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

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-12 Specialization

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

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-12 Specialization

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

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-13 Division of Labour

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

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-13 Division of Labour

55. _____ helps avoid the problems posed by the lack of double coincidence of wants.
A. Barter
B. Trade
C. Money
D. Freedom of choice

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-13 Division of Labour

56. 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.

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-13 Division of Labour

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57.

	BRITISH COLUMBIA Has surplus autos Wants lettuce	
ONTARIO Has surplus lettuce Wants apples		ALBERTA Has surplus apples Wants autos

On the basis of the information provided and assuming trade occurs between the three provinces we can expect:
A. Alberta to exchange apples with Ontario and receive money in return.
B. Alberta to exchange apples with British Columbia and receive money in return.
C. Ontario to exchange lettuce with British Columbia and receive autos in return.
D. none of the above to occur.

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-13 Division of Labour

58.

	BRITISH COLUMBIA Has surplus autos Wants lettuce	
ONTARIO Has surplus lettuce Wants apples		ALBERTA Has surplus apples Wants autos

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

Accessibility: Keyboard Navigation
Difficulty: Hard
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-13 Division of Labour

59. 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

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-13 Division of Labour

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

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-02 List the main characteristics of the market system.
Topic: 02-05 Characteristics of the Market System

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61. The most important consequence of property rights is that
A. they facilitate exchange.
B. allow for freedom of choice.
C. they encourage people to cooperate by helping to ensure that only mutually agreeable economic transactions take place.
D. they allow for a division of labour.

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-06 Private Property

62. Which is not one of the Five Fundamental Questions?
A. How will the goods and services be produced?
B. How will the system accommodate change?
C. Who will get the goods and services?
D. What goods and services should be produced by government?

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-15 Use of Money

63. What to produce in a market economy is ultimately determined by the:
A. output decisions of business firms.
B. government.
C. spending decisions of households.
D. workers' technical skills.

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-16 Active but Limited Government

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

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-16 Active but Limited Government

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

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-16 Active but Limited Government

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

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-16 Active but Limited Government

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67. "The 'dollar votes' of consumers ultimately determine the composition of output and the allocation of resources in a market economy." This statement best describes the concept of:
A. derived demand.
B. external costs and benefits.
C. consumer sovereignty.
D. the invisible hand.

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-16 Active but Limited Government

68. The term dollar votes means:
A. inflation will occur if consumers don't spend wisely.
B. voters may be offered dollars to help elect certain political candidates.
C. government is responsible for determining what will be considered legal tender.
D. consumers "vote" for certain products to be produced by how they spend their incomes.

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-16 Active but Limited Government

69. Consumer sovereignty and "dollar votes" are most related to which fundamental question about a competitive market system?
A. What will be produced?
B. How is the output to be produced?
C. How can the system accommodate change?
D. Who is to receive the output?

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-16 Active but Limited Government

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

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-17 Five Fundamental Questions

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

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-17 Five Fundamental Questions

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

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-15 Use of Money

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

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-18 What Will Be Produced?

74. For whom is a given mix of goods and services to be produced? How, in other words, is the product to be distributed among people when such commodities and services are available? In a market economy, this problem is resolved primarily in the:
A. public sector through the mechanism of central planning.
B. business sector through the mechanism of advertising.
C. private sector through the earning and spending of income.
D. money market through borrowing and saving by households and businesses.

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-18 What Will Be Produced?

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

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-01 Differentiate between laissez-faire capitalism; the command system; and the market system.
Topic: 02-18 What Will Be Produced?

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

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-01 Differentiate between laissez-faire capitalism; the command system; and the market system.
Topic: 02-15 Use of Money

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

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-01 Differentiate between laissez-faire capitalism; the command system; and the market system.
Topic: 02-19 How Will the Goods and Services Be Produced?

78. An increase in demand for strawberries is most likely to:
A. increase the demand for strawberry pickers.
B. reduce the supply of strawberry pickers.
C. reduce the supply of strawberries.
D. reduce the demand for strawberry pickers.

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-01 Differentiate between laissez-faire capitalism; the command system; and the market system.
Topic: 02-19 How Will the Goods and Services Be Produced?

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

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-01 Differentiate between laissez-faire capitalism; the command system; and the market system.
Topic: 02-19 How Will the Goods and Services Be Produced?

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

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-19 How Will the Goods and Services Be Produced?

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

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-19 How Will the Goods and Services Be Produced?

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

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-19 How Will the Goods and Services Be Produced?

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

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-20 Who Will Get the Output?

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

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-20 Who Will Get the Output?

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85. The development of MP3 players that significantly reduce the market for CDs and DVDs would be an example of:
A. specialization.
B. derived demand.
C. roundabout production.
D. creative destruction.

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-20 Who Will Get the Output?

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

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-04 Explain the operation of the "invisible hand" and why market economies usually do a better job than command economies at transforming economic resources into desirable output.
Topic: 02-21 How Will the System Accommodate Change?

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

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-04 Explain the operation of the "invisible hand" and why market economies usually do a better job than command economies at transforming economic resources into desirable output.
Topic: 02-21 How Will the System Accommodate Change?

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

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-04 Explain the operation of the "invisible hand" and why market economies usually do a better job than command economies at transforming economic resources into desirable output.
Topic: 02-21 How Will the System Accommodate Change?

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

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-04 Explain the operation of the "invisible hand" and why market economies usually do a better job than command economies at transforming economic resources into desirable output.
Topic: 02-21 How Will the System Accommodate Change?

90. 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.

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-04 Explain the operation of the "invisible hand" and why market economies usually do a better job than command economies at transforming economic resources into desirable output.
Topic: 02-21 How Will the System Accommodate Change?

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

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-04 Explain the operation of the "invisible hand" and why market economies usually do a better job than command economies at transforming economic resources into desirable output.
Topic: 02-21 How Will the System Accommodate Change?

92. In market economies, profit primarily depends on consumer demand, production efficiency, and product quality. In contrast, in command economies, profit depends on:
A. production cost.
B. product quality.
C. product mix.
D. quantitative production targets.

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-04 Explain the operation of the "invisible hand" and why market economies usually do a better job than command economies at transforming economic resources into desirable output.
Topic: 02-27 The Coordination Problem

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

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-22 How Will the System Promote Progress?

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

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-01 Differentiate between laissez-faire capitalism; the command system; and the market system.
Topic: 02-22 How Will the System Promote Progress?

95. In the factor market:
A. businesses borrow money capital from households.
B. businesses sell services to households.
C. households sell resources to businesses.
D. firms sell raw materials to households.

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-02 List the main characteristics of the market system.
Topic: 02-24 Capital Accumulation

96. The simple circular flow model shows that:
A. households are on the demand side of both product and factor markets.
B. businesses are on the supply side of both product and factor markets.
C. households are on the supply side of the factor market and on the demand side of the product market.
D. businesses are on the demand side of the product market and on the supply side of the factor market.

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-24 Capital Accumulation

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97. The two basic markets shown by the simple circular flow model are:
A. capital goods and consumer goods.
B. free and controlled.
C. product and factor.
D. household and business.

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-24 Capital Accumulation

98. In the simple circular flow model:
A. households are demanders of factors of production.
B. businesses are suppliers of final products.
C. households are suppliers of final products.
D. there are real flows of goods, services, and factors, but not money flows.

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-24 Capital Accumulation

99. Households and businesses are:
A. both buyers in the factor market.
B. both suppliers in the product market.
C. suppliers in the factor and product markets respectively.
D. suppliers in the product and factor markets respectively.

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-24 Capital Accumulation

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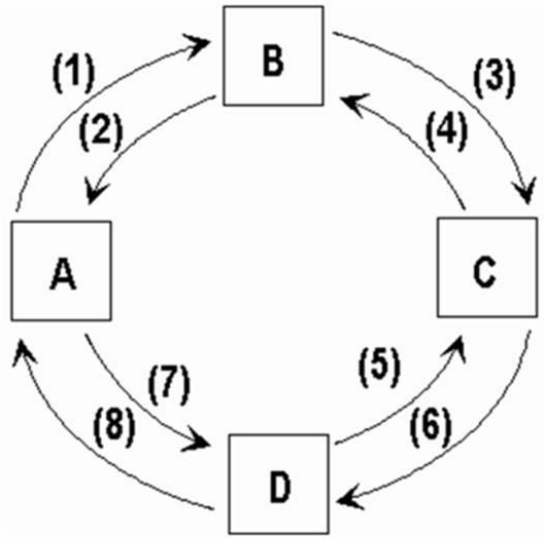
100. In the circular flow model:
A. households supply factors of production to firms.
B. households receive income through the factor market.
C. households spend income in the product market.
D. all of the above hold true.

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-24 Capital Accumulation

101.



Refer to the figure. If box B represents the factor 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.

Difficulty: Medium
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-24 Capital Accumulation

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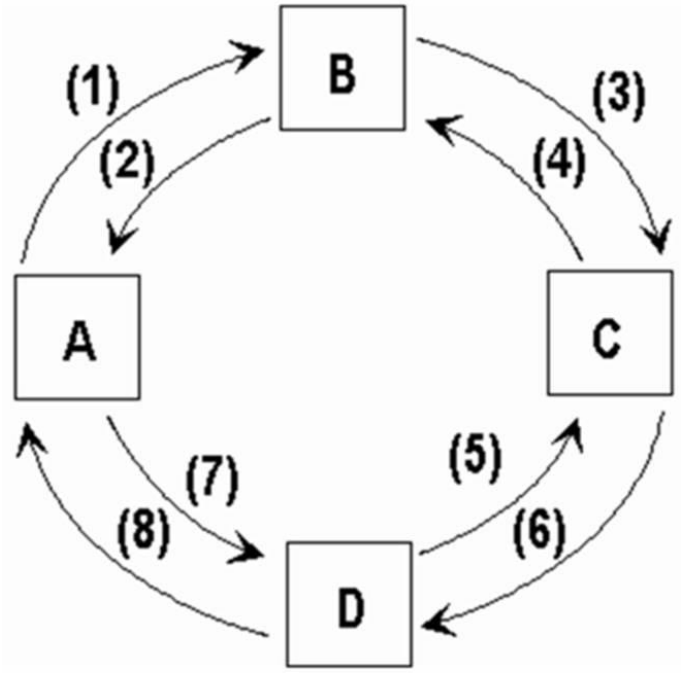
102. 

Refer to the 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 factor market.
B. box D is the product market and box B is households.
C. box B is the product market and box C is households.
D. box C is the product market and box B is the factor market.

Difficulty: Medium
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-24 Capital Accumulation

103. In terms of the circular flow diagram businesses obtain revenue through the _____ market and make expenditures in the _____ market.
A. product; financial
B. factor; product
C. product; factor
D. capital; product

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-24 Capital Accumulation

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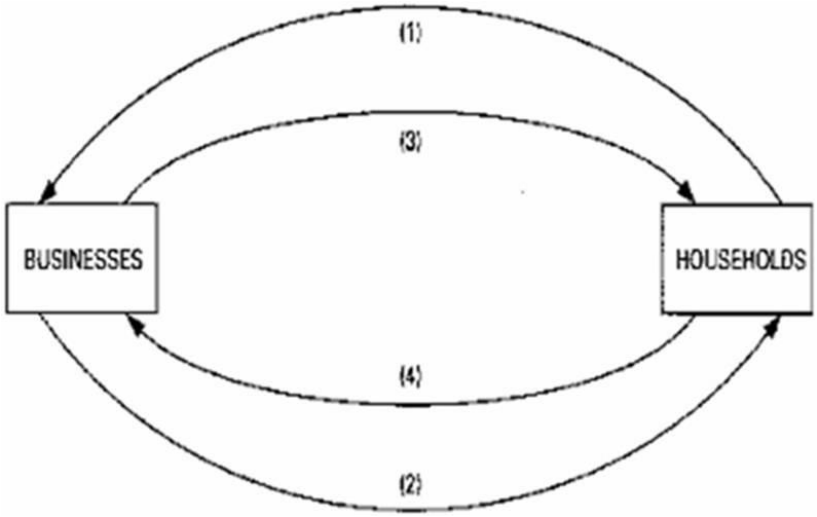

104.

Refer to the diagram. Arrows (1) and (2) represent:
A. goods and resources respectively.
B. money incomes and output respectively.
C. output and money incomes respectively.
D. resources and goods respectively.

Difficulty: Medium
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-24 Capital Accumulation

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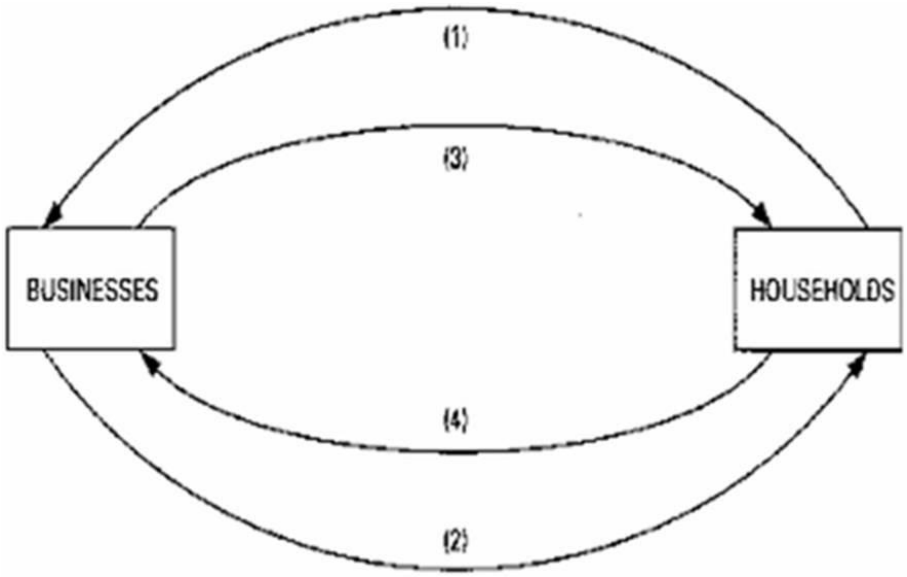

105.

Refer to the diagram. Arrows (3) and (4) represent:
A. goods and services respectively.
B. money incomes and consumer expenditures respectively.
C. resources and goods respectively.
D. consumer expenditures and money income respectively.

Difficulty: Medium
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-24 Capital Accumulation

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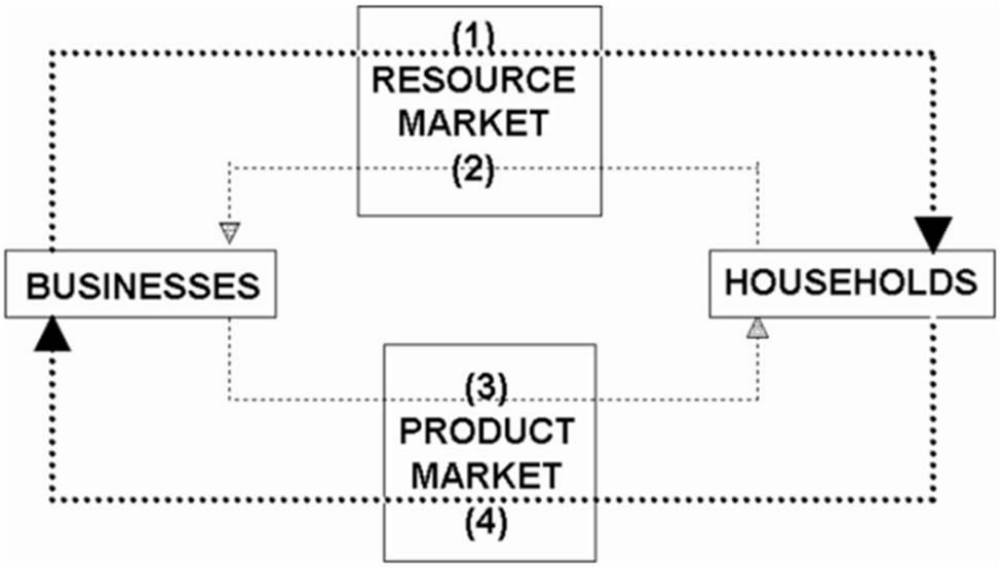
106. 

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

Difficulty: Easy
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-24 Capital Accumulation

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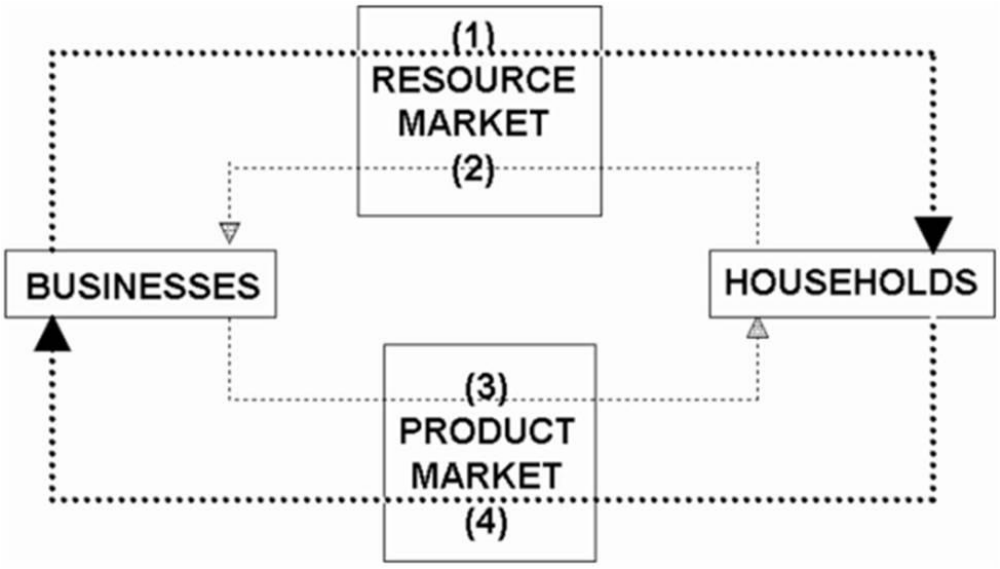
107. 

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

Difficulty: Easy
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-24 Capital Accumulation

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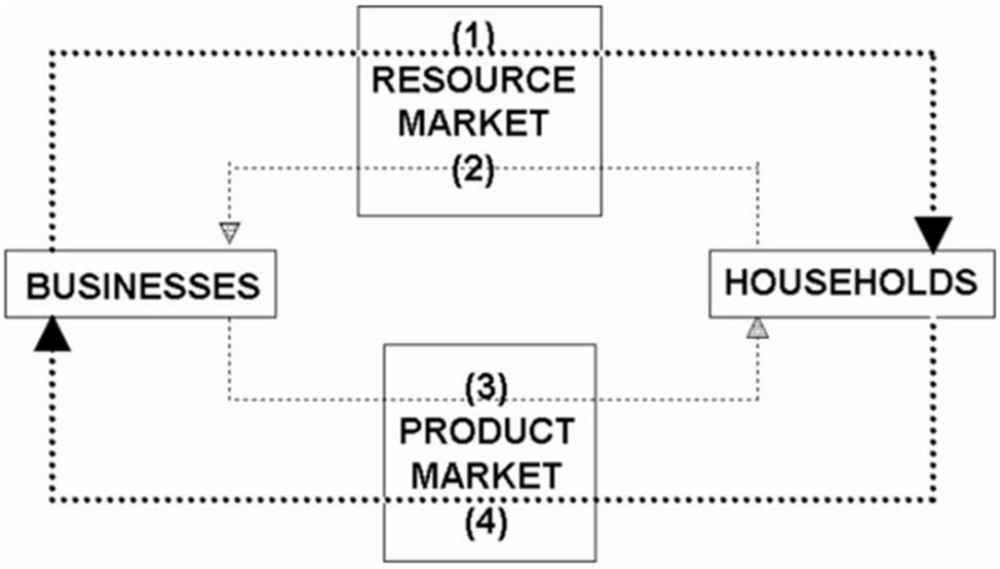
108. 

Refer to the circular flow model of the economy. In the diagram flow (3) represents:
A. wage, rent, interest, and profit income.
B. land, labour, capital, and entrepreneurial ability.
C. goods and services.
D. consumer expenditures.

Difficulty: Easy
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-24 Capital Accumulation

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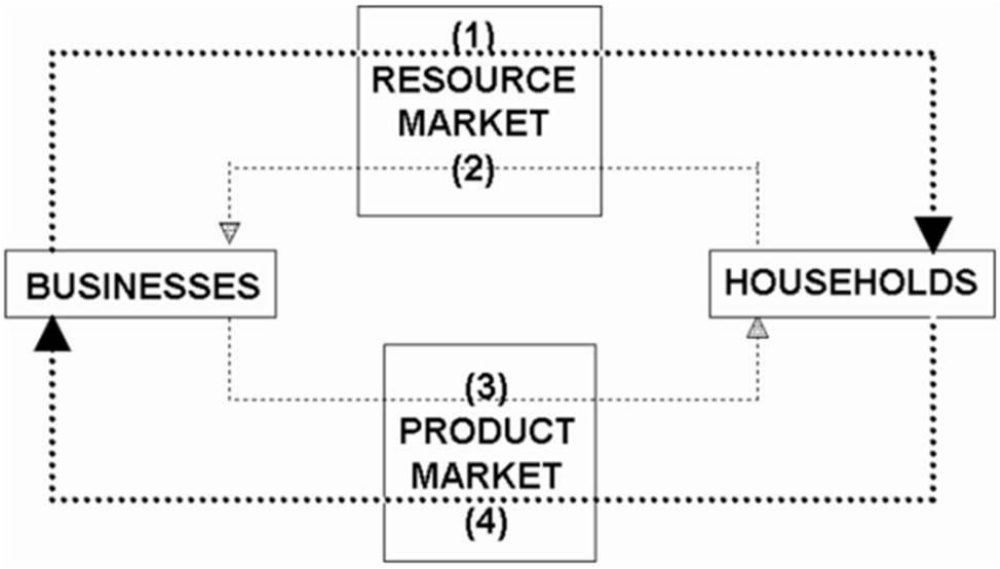

109.

Refer to the circular flow model of the economy. In the diagram flow (4) represents:
A. wage, rent, interest, and profit income.
B. land, labour, capital, and entrepreneurial ability.
C. goods and services.
D. consumer expenditures.

Difficulty: Easy
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-24 Capital Accumulation

110. In terms of the circular flow diagram households make expenditures in the _____ market and receive income through the _____ market.
A. product; financial
B. factor; product
C. product; factor
D. capital; product

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-24 Capital Accumulation

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111. Which of the following economic systems are polar opposites of each other?
A. The market system and laissez-faire capitalism
B. The market system and the command system
C. The command system and laissez-faire capitalism
D. Mixed market and the market system

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-01 Differentiate between laissez-faire capitalism; the command system; and the market system.
Topic: 02-01 Economic Systems

112. Freedom of enterprise is defined as:
A. the freedom of firms to obtain and use resources to produce goods and services.
B. employ and dispose of their property as they see fit.
C. buy property.
D. set up any form of business. entity.

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-02 List the main characteristics of the market system.
Topic: 02-07 Freedom of Enterprise and Choice

113. Freedom of choice enables:
A. entrepreneurs to procure and use resources that are required to produce goods and services at their own will.
B. owners of property to employ and dispose of their properties as they see fit.
C. consumers to maximize their utility by paying the minimum price for goods and services.
D. entrepreneurs to set up any form of business entity as per law.

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-02 List the main characteristics of the market system.
Topic: 02-07 Freedom of Enterprise and Choice

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114. The answer to "Who will get the output?" is based on:
A. ability to pay.
B. willingness to pay.
C. the ability and willingness of consumers to pay for the output.
D. a first-come, first-served basis.

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-20 Who Will Get the Output?

115. In the circular flow diagram, revenues and goods and services flow:
A. in opposite directions but are on the same side of the diagram.
B. in the same direction but are on the same side of the diagram.
C. in either direction as they are not correlated.
D. in opposite directions and are on opposite sides of the diagram.

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-32 Product Market

116. In the circular flow diagram, cost and household income flow:
A. in opposite directions.
B. in the same direction and are on the same side of the diagram.
C. in either direction as they are not correlated.
D. on opposite sides of the circular flow model.

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-33 Factor Market

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117. Labour, land, and capital are examples of:
A. factors of production.
B. revenue for businesses.
C. goods and services for consumers.
D. consumption for consumers.

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-30 Households

118. Producing goods and services is:
A. risky.
B. risk free.
C. always profitable.
D. rarely profitable.

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-06 Explain how the market system deals with risk.
Topic: 02-34 How the Market System Deals with Risk

119. The residual claimant(s) is(are):
A. the employees.
B. the creditors.
C. the owners.
D. the government.

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-06 Explain how the market system deals with risk.
Topic: 02-36 Shielding Employees and Suppliers from Business Risk

102. (Consider This) In 1975, McDonald's introduced its Egg McMuffin breakfast sandwich, which remains popular and profitable today. This longevity illustrates the idea of

A. opportunity cost.
B. upsloping supply.
C. consumer sovereignty.

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D. specialization.

Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: Medium
Learning Objective: US21e

103. (Consider This) In 2013, McDonald's introduced Fish McBites, which failed to catch on with the public and was subsequently dropped from the menu. This failure illustrates the idea of

A. consumer sovereignty.
B. technological change.
C. downsloping demand.
D. specialization.

Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: 02 Medium
Learning Objective: US21e

104. (Consider This) Since World War II,

A. North Korea's command economy has significantly outperformed South Korea's market economy.
B. South Korea's command economy has significantly outperformed North Korea's market economy.
C. North Korea's market economy has significantly outperformed South Korea's command economy.
D. South Korea's market economy has significantly outperformed North Korea's command economy.

Accessibility: Keyboard Navigation
Blooms: Analyze
Difficulty: Hard
Learning Objective: US21e

105. (Consider This) North Korea's command economy

A. is one of the few remaining command economies.
B. has grown much faster than South Korea's economy since the two countries were divided after World War II.
C. produces a per capita GDP of nearly $25,000.
D. has undergone significant market reforms and is now one of the fastest-growing economies.

Accessibility: Keyboard Navigation
Blooms: Analyze

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Difficulty: Hard
Learning Objective: US21e

106. (Consider This) Which of the following statements about insurance and risk is true?

A. Insurance inhibits economic growth and investment by discouraging risk-taking.
B. Insurance transfers risk from those with a high tolerance for risk to those with a low tolerance for risk.
C. Insurance companies always earn profits because insurance premiums always exceed the payout for insured events.
D. Insurance transfers risk from those with a low tolerance for risk to those with a higher tolerance for risk.

Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: Medium
Learning Objective: US21e

107. (Consider This) Martha's Milkshake Company buys earthquake insurance from the Stable Ground Insurance Company. Based on this purchase, economists would conclude that

A. Martha's believes a damaging earthquake is imminent.
B. Stable Ground believes no damaging earthquakes will occur.
C. Martha's has a lower tolerance for earthquake risk than Stable Ground.
D. Martha's has a greater tolerance for earthquake risk than Stable Ground.

Accessibility: Keyboard Navigation
Blooms: Understand
Difficulty: Medium
Learning Objective: US21e

108. (Last Word) According to economist Donald Boudreaux, the world's tens of billions of individual resources get arranged productively

A. because government has become highly effective at central planning.
B. because private property encourages people to consider the alternative uses of their resources and select those that provide the most rewards.
C. because people tend to be creative and orderly.
D. through random trial and error.

Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: Easy
Learning Objective: US21e

109. (Last Word) According to economist Donald Boudreaux,

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A. private property eliminates the possibility that resource arrangements will be random.
B. the market system threatens to do irreparable harm to the world's ecosystem.
C. arranging resources under the market system is much like shuffling a deck of cards.
D. the market system works wondrously for advanced industrial nations but not for developing nations.

Accessibility: Keyboard Navigation
Blooms: Remember
Difficulty: Easy
Learning Objective: US21e

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Short Answer Questions

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120. Explain what is meant by a command economy.

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

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-01 Differentiate between laissez-faire capitalism; the command system; and the market system.
Topic: 02-03 The Command System

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

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

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-01 Differentiate between laissez-faire capitalism; the command system; and the market system.
Topic: 02-02 Laissez-Faire Capitalism

122. List nine characteristics of the market system.

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

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-02 List the main characteristics of the market system.
Topic: 02-04 The Market System

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123. Why is the right of private property an essential characteristic of a market system?

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

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-06 Private Property

124. Explain the **most** important consequence of legally enforceable property rights?

The most important consequence of legally enforceable property rights is that they ***encourage people to cooperate*** by helping to ensure that only ***mutually agreeable economic transactions*** take place. Without legally enforceable property rights the strong could simply take whatever they wanted from the weak without giving them any compensation. But in a world of legally enforceable property rights, any person wanting something from you has to get you to agree to give it to them. And you can say no. The result is that if they really want what you have, they must offer you something that you value more highly in return. That is, they must offer you a ***mutually agreeable economic transaction***—one that benefits you as well as them.

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-06 Private Property

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

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

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-07 Freedom of Enterprise and Choice

126. Explain the importance of self-interest in the operation of a market system.

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

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-08 Self-Interest

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

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

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-08 Self-Interest

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

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

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-09 Competition

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

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

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-09 Competition

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

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

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-10 Markets and Prices

131. Describe two types of specialization in production.

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

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-12 Specialization

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

Specialization enables individuals to take advantage of existing differences in their abilities and skills. Other advantages come from increased productivity or output per worker as specialized workers gain skills in performing one task and avoid loss of time in switching from one task to another. Therefore, more is produced with the same amount of resources as before specialization.

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-12 Specialization

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

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

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-12 Specialization

134. Describe all the advantages a money economy has over a barter economy?

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

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-13 Division of Labour

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

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

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-13 Division of Labour

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

Money is anything that is generally acceptable as a medium of exchange. In Canada, money includes currency, coins, and chequable deposits.
Barter requires a coincidence of wants between the two parties to a transaction. Each has to want what the other has to offer. Money makes this coincidence unnecessary, as the seller is willing to accept money in exchange for goods or services offered and can, in turn, exchange the money earned for other goods and services from another seller. The necessary condition for the use of paper currency is that it must be generally acceptable. Sellers must have faith that the currency will have value when they want to use it to buy goods and services for themselves.
Note that the money does not have to have any intrinsic value; that is, it does not have to be backed by a material that has some use like gold or silver.

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-13 Division of Labour

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137. Suppose Tom, Dick, and Harry live in a barter economy. Tom produces wine, Dick bakes bread, and Harry makes cheese. Tom wants some bread to go with his wine and is willing to trade 1 litre of wine for two loaves of bread. Dick wants some cheese to go with his bread and is willing to trade one loaf of bread for one-half kilogram of cheese. Harry doesn't want bread, but wants some wine to go with his cheese and is willing to trade cheese for one litre of wine. It is not possible for all three of them to meet together at one time.
(a) Explain how this situation illustrates the difficulty with a barter economy.
(b) Devise a money system using rubies where four rubies are equivalent in value to one litre of wine. In other words tell how much bread and cheese would be worth in terms of rubies in this economy. In this system, how much cheese must Harry sell in order to buy one litre of wine?

(a) The lack of coincidence of wants is illustrated in this situation. Tom wants the bread that Dick has, Dick wants Harry's cheese, and Harry wants Tom's wine but for any two of them there is no incentive to trade for something each does not want. In other words, there is no coincidence of wants.
(b) If rubies could be used as a medium of exchange, Tom could receive four rubies for each litre of wine. According to their initial exchange values, he should be willing to pay two rubies for each loaf of bread. Dick would then have four rubies to purchase one kilogram of cheese and Harry could buy wine with the four rubies he earned from selling this cheese. In terms of ruby prices, bread is worth two rubies per loaf and one litre of wine and one kilogram of cheese are each worth four rubies in this economy.

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-13 Division of Labour

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

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

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-12 Specialization

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

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

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-14 Geographic Specialization

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

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

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-15 Use of Money

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

Product	Market price	Output	Profit
A	$14.00	10	$_____
B	9.00	11	$_____
C	0.50	300	$_____

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

(a) Profit for A will be $40; for B will be -$1 (loss); for C will be $50.
(b) Firm will produce product C.
(c) If the price of A rises (assuming the firm can sell all of its output at the new price), it would make a profit of $60 on A and so would produce product A.
(d) If other firms face similar costs, more firms would enter industry A to take advantage of the higher economic profits.

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-16 Active but Limited Government

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

Product	Market price	Output	Profit
A	$10.00	6	$_____
B	5.00	19	$_____
C	1.50	100	$_____

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

(a) Profit for A will be -$40 (loss); for B will be -$5 (loss); for C will be $50.
(b) The firm will produce product C.
(c) The firm would still choose product C.
(d) If all firms are identical with identical costs, there will be no change in the number of firms producing product B because it is still more profitable for each firm to product C. Thus product B is unaffected.

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-16 Active but Limited Government

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

Consumer choice by itself refers only to consumers' freedom to choose what they are willing and able to buy from what is available. Consumer sovereignty that exists in a market system goes one crucial step further. It means that producers respond to the choices that consumers make. If consumer demand declines for a particular product, that decreased demand will be reflected in prices and quantity produced. If consumer demand increases, that also will be reflected in terms of prices and quantities produced. In a centrally planned system changing consumer demand is largely ignored in favour of planners' decisions which focus on the state's goals rather than consumer wishes.

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-16 Active but Limited Government

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144. Why is the consumer the king (or queen) in a market system?

Consumers exert their preferences in a market system through their dollar votes or their purchases. When there is sufficient demand for a product by consumers, businesses that produce those products can make a normal profit. By shifting their purchases, consumers dictate to firms the types and quantities of products they desire. Businesses must respond to the wishes of consumers. When they fail to meet the desires of consumers, they make losses and eventually will cease to exist.

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-02 List the main characteristics of the market system.
Topic: 02-16 Active but Limited Government

145. Explain the two different motives that firms have for choosing the lowest-cost production methods to produce goods and services?

The first motive is that because inefficiency drives up costs and lowers profits, any firm wishing to ***maximize its profits*** will make great efforts to minimize production costs. These efforts will include using the right mix of labour and capital, given the prices and productivity of those resources. They also mean locating production facilities optimally to minimize production and transportation expenses.
The second motive is due to ***competition***, consumers strongly prefer low prices and will shift their purchases over to the firms that can produce a quality product at the lowest possible price. Any firm foolish enough to use higher-cost production methods will go bankrupt as it is undersold by its more efficient competitors who can still make a profit when selling at a lower price. In other words, ***competition eliminates high-cost producers***, and so firms are motivated to choose the lowest-cost production methods to produce goods and services.

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-02 List the main characteristics of the market system.
Topic: 02-15 Use of Money

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146. What factors determine who will get the output?

Individuals are able to choose what they want to buy subject to their income which depends on the property and human resources they possess and the prices of those factors. In a competitive market goods will go to the persons most willing and able to pay.

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-02 List the main characteristics of the market system.
Topic: 02-15 Use of Money

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

As consumers increase their demand for certain products, those product prices will rise and increase profitability. Producers will be induced to increase their production by hiring more workers and other factors of production.

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-02 List the main characteristics of the market system.
Topic: 02-19 How Will the Goods and Services Be Produced?

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

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

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(a) Which method is most efficient? Why?
(b) Given the above prices, will the firm adopt a new method, which involves 10 units of land, 3 of labour, 2 of capital, and 2 of entrepreneurial ability?
(c) Suppose the price of capital falls to $1 without any other prices changing. Which of the methods will the firm now choose? Why?

(a) Method #1 is most efficient because it uses relatively more of the least expensive resources, and relatively less of the more expensive resources.
(b) Yes, it is now the least-cost method.
(c) It will choose #3 because it uses relatively more of capital, which is now much less expensive, and the total cost of each method now makes #3 the least-cost combination.

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-15 Use of Money

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

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

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(a) Which method is most efficient? Why?
(b) Given the above prices, will the firm adopt a new method, which involves 2 units of land, 2 of labour, 4 of capital, and 8 of entrepreneurial ability?
(c) Suppose the price of labour falls to $1 without any other prices changing. Which of the methods will the firm now choose? Why?

(a) Method #2 is most efficient because it uses relatively more of the least expensive resource, and relatively less of the more expensive resources.
(b) Yes, it is now the least-cost method.
(c) It will choose #3 because it uses relatively more of labour, which is now much less expensive, and the total cost of each method now makes #3 the least-cost combination.

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-15 Use of Money

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

The guiding function of prices refers to the response of producers to changes in prices. With a given supply schedule, if demand increases, the market equilibrium price will rise and producers will respond to that by producing an increased quantity of the product. Also, there may be entry of firms into the industry. Conversely, if demand decreases, the market equilibrium price will fall and producers will respond to that change by producing a decreased quantity of the product. There may also be an exodus of firms from the industry. The market system is a communications system and prices are the way information is communicated and incentives are given to take action.

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-19 How Will the Goods and Services Be Produced?

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151. How can technological advance result in creative destruction?

Rival firms must follow the lead of innovative firms that are making economic profits. If the rival firms fail to do so, they can suffer economic losses and eventually fail or be bought by other firms. Sometimes technological advance actually destroys industries because an old product is no longer needed with a new innovation put on the market, a situation referred to as creative destruction. The innovation creates a new product, but in the process of doing so it effectively destroys an industry. One example would be the automobile, which eventually destroyed the market for horse-drawn carriages.

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-03 Explain how the market system answers the five fundamental questions of what to produce; how to produce; who obtains the output; how to adjust to change; and how to promote progress.
Topic: 02-20 Who Will Get the Output?

152. Explain this quote from Adam Smith: "It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner but from their regard to their own interest."

Adam Smith believed that sellers want to make a profit and that is the reason that they are willing to sell to consumers. They are not producing bread, beer, or meat to satisfy the hunger of their customers, but rather to earn the revenues that result from the sale of these products. If they produced due to benevolence, they would give away these products.

Accessibility: Keyboard Navigation
Difficulty: Easy
Learning Objective: 02-04 Explain the operation of the "invisible hand" and why market economies usually do a better job than command economies at transforming economic resources into desirable output.
Topic: 02-28 The Incentive Problem

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

First, the market system promotes efficient use of scarce resources. Products are produced in the least costly way and the products most desired by society get produced. Second, the market system provides incentives for continual improvement and innovation. Rewards are given to entrepreneurs, workers, and consumers who attempt to make the best use of scarce resources. Third, the market system supports individual freedom for producers, consumers, and workers. Each group is able to pursue their own self-interest and thus promote the social interest.

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-02 List the main characteristics of the market system.
Topic: 02-21 How Will the System Accommodate Change?

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

This is true in the absence of government direction of production. Producers are forced to produce at lowest cost by the pressures of competition. If they don't they will not be able to sell their goods and services, because their rivals will attract the buyers at lower prices. Furthermore, producers must produce what consumers want at prices that just cover their economic costs or other producers will attract the buyers away from them. Thus, producers are driven by competition in the most efficient manner in the sense of maximizing output and maximizing society's satisfaction.

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-02 List the main characteristics of the market system.
Topic: 02-21 How Will the System Accommodate Change?

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

Command economies are based on central planning by government planners. In a market system planning occurs primarily at the level of the firm, although government "planning" with regard to fiscal and monetary policy will affect economic performance. Also, government planning takes place in areas of public goods production such as highway construction and national defence. Finally, individuals plan as they make decisions about their economic futures.

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-04 Explain the operation of the "invisible hand" and why market economies usually do a better job than command economies at transforming economic resources into desirable output.
Topic: 02-21 How Will the System Accommodate Change?

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

As a means of organizing national economies, the command system has become noticeably less popular. This is because of the coordination problem and the incentive problem. The coordination problem occurs because there are millions upon millions of individual decisions made by consumers and businesses each day. What to buy, what to sell, how to produce — these things that are all questions answered by individual actions in the market system but require specific government decisions in the command system. The incentive problem occurs because without prices determined independent of planners' decisions there is no simple method to clear up cases of excess supply or excess demand. Without profits serving as a signal there is no independent method to attract resources from one productive activity to another.

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-04 Explain the operation of the "invisible hand" and why market economies usually do a better job than command economies at transforming economic resources into desirable output.
Topic: 02-22 How Will the System Promote Progress?

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

In the simple circular flow model, there are two decision-makers: households and businesses. These two groups are related through the resource and product markets. In the upper half of the circular flow, households sell economic resources (land, labour, capital, and entrepreneurial ability) and businesses buy resources through the resource market. Businesses pay for the cost of these resources, which in turn becomes money income for households. It is the supply decisions of resources sellers (households) and the buying decisions of businesses that determine prices and employment in the resource market.
In the lower half of the circular flow, businesses sell goods and services and households buy goods and services in the product market. Households pay for these goods and services with the money income they received from providing resources. These consumption expenditures become revenue for businesses. It is the product buying decisions of households and the product selling decisions of businesses that determine prices and output in the product market.

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-24 Capital Accumulation

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

Households sell their resources to firms in return for money income. Businesses combine the households' labour with other resources to create products. They offer these products for sale to households and in return receive revenue. These revenues to firms enable them to pay for the cost of resources from households as the cycle begins again.

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-24 Capital Accumulation

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159. List and describe the three main categories of businesses?

Businesses fall into three main categories.

• A **sole proprietorship** is an unincorporated business owned and operated by a single person. The proprietor (the owner) provides all of the labour and produces all of the output. Examples include an arborist who runs her own tree cutting business and an independent accountant who helps his clients with their taxes.
• The **partnership** form of business organization is a natural outgrowth of the sole proprietorship. In a partnership, two or more individuals (the partners) agree to own and operate a business together. They pool their financial resources and business skills to operate the business, and they share any profits or losses that the business may generate. Many law firms and dental practices are organized as partnerships, as are a wide variety of firms in many other industries.
• A Businesses fall into three main categories.
• The **partnership** form of business organization is a natural outgrowth of the sole proprietorship. In a partnership, two or more individuals (the partners) agree to own and operate a business together. They pool their financial resources and business skills to operate the business, and they share any profits or losses that the business may generate. Many law firms and dental practices are organized as partnerships, as are a wide variety of firms in many other industries.
• A **corporation** is an independent legal entity that can—on its own behalf—acquire resources, own assets, produce and sell products, incur debts, extend credit, sue and be sued, and otherwise engage in any legal business activities is an independent legal entity that can—on its own behalf—acquire resources, own assets, produce and sell products, incur debts, extend credit, sue and be sued, and otherwise engage in any legal business activities.

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-26 The Demise of the Command System

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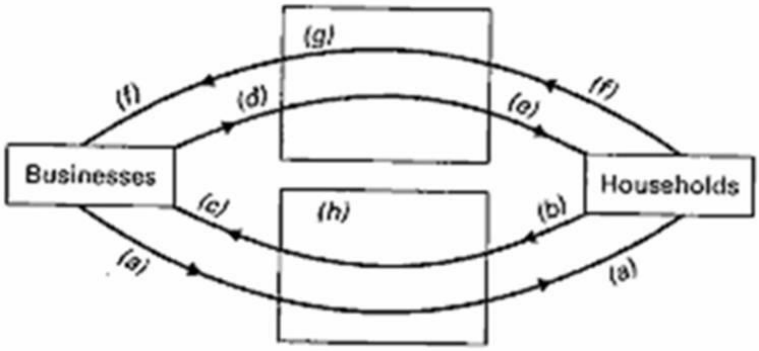
160. Provide examples of prominent Canadian corporations and describe the unique implications that arise due to the fact that such corporations are independent legal entities?

Imperial Oil, Bombardier, and Air Canada are examples of large Canadian corporations, but corporations come in all sizes and operate in every type of industry. The fact that a corporation is an independent legal entity means that its owners bear no personal financial responsibility for the fulfillment of the corporation's debts and obligations. For instance, if a corporation has failed to repay a loan to a bank, the bank can sue the corporation but not its owners.

Accessibility: Keyboard Navigation
Difficulty: Medium
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-26 The Demise of the Command System

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



(a) Goods and services; (b) Consumption expenditures; (c) Revenue; (d) Costs; (e) Money income; (f) Factors land, labour, capital, entrepreneurial ability; (g) Factor markets; (h) Product markets.

Difficulty: Medium
Learning Objective: 02-05 Describe the mechanics of the circular flow model.
Topic: 02-24 Capital Accumulation

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162. Explain the concept of using money to facilitate when wants do not coincide. Provide an example.

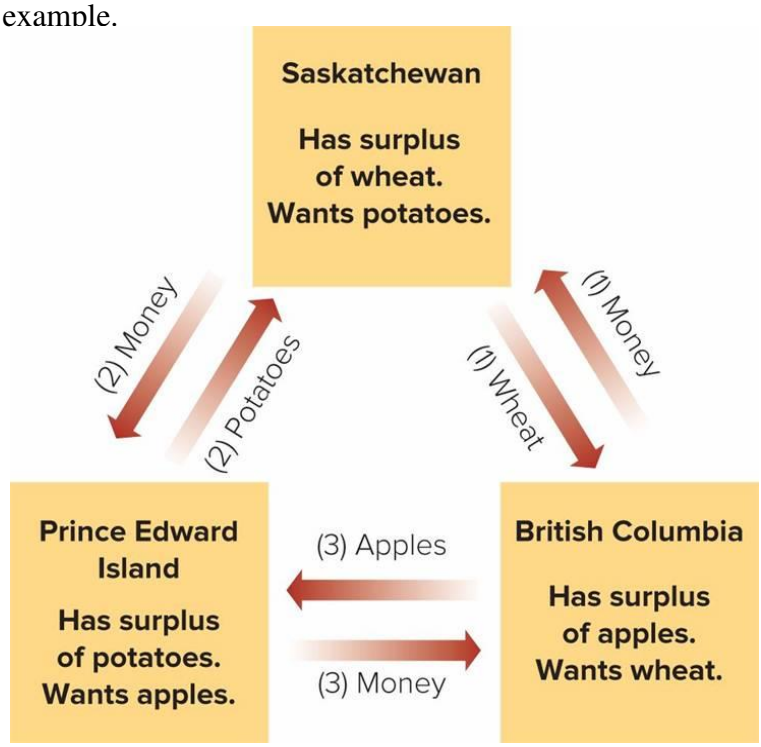

FIGURE 2-1 Money Facilitates Trade When Wants Do Not Coincide
The use of money as a medium of exchange permits trade to be accomplished despite a non-coincidence of wants. (1) Saskatchewan trades the wheat that British Columbia wants for money; (2) Saskatchewan trades the money it receives from British Columbia for the potatoes it wants from Prince Edward Island; (3) Prince Edward Island trades the money it receives from Saskatchewan for the apples it wants from British Columbia.
In none of the cases shown in the figure is there a coincidence of wants. Trade by barter would obviously be difficult. Instead, people in each province use *money*, which is simply a convenient social invention to facilitate exchanges of goods and services. Historically, people have used cattle, cigarettes, shells, stones, pieces of metal, and many other commodities as money with varying degrees of success. To serve as money, an item needs to pass only one test. It must be generally acceptable to sellers in exchange for their goods and services. Money is socially defined: Whatever society accepts as a medium of exchange *is* money.

Difficulty: Medium
Learning Objective: 02-02 List the main characteristics of the market system.
Topic: 02-25 The Invisible Hand

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