

**Test Bank for BUSN 6 6th Edition by Kelly McGowen Williams  
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**TEST PLANNING TABLE FOR CHAPTER 2**

<b>Learning Objective</b>	<b>Easy: Knows Basic Terms and Facts</b>	<b>Moderate: Understands Concepts and Principles</b>	<b>Challenging: <u>Applies Principles</u></b>
<b>2-1:</b> Define economics and discuss global economic crisis	1, 2, 3, 4, 5, 6, 7, 8, 9, 10, 15, <b>93, 94, 95, 96, 97, 98, 99, 107, 109</b>	11, 12, 13, 16, 17, 18, 19, <b>100, 101, 102, 103, 108</b>	14, <b>104, 105, 106, 110, 186, 187, 188</b>
<b>2-2:</b> Analyze the impact of fiscal and monetary policy on the economy	20, 21, 22, 23, 24, 25, 26, 27, 28, 29, 30, <b>112, 113, 114, 115, 116, 117, 118</b>	31, 32, 33, <b>119, 120, 121, 122, 123, 124, 125, 126</b>	34, <b>111, 127, 128, 129, 189, 190, 191</b>
<b>2-3:</b> Explain and evaluate the free market system and supply and demand	41, <b>130, 131, 142, 145</b>	35, 36, 37, 39, 40, 42, 43, 44, <b>132, 134, 135, 136, 139, 140, 141, 143, 146, 147, 149, 150, 153</b>	38, 45, 46, 47, 48, <b>133, 137, 138, 144, 148, 151, 152, 192, 193, 194</b>
<b>2-4:</b> Explain and evaluate planned market systems	49, 51, <b>154, 156</b>	50, 52, 53, 54, 55, 56, 57, <b>157, 158, 159</b>	<b>155, 195</b>
<b>2-5:</b> Describe the trend toward mixed market systems	58, 59, 60, 61, 65, 66, <b>160, 161, 162, 163, 165, 167</b>	62, 63, 64	<b>164, 166, 168, 196</b>
<b>2-6:</b> Discuss key terms and tools to evaluate economic performance	67, 68, 69, 70, 71, 72, 75, 76, 77, 78, 79, 80, 81, 82, 83, 86, 87, 88, <b>169, 170, 173, 175, 176, 177, 178, 179, 180, 181, 182</b>	73, 89, 90, 91, 92, <b>171, 183</b>	74, 84, 85, <b>172, 174, 184, 185, 197, 198, 199, 200</b>

True/False questions are in plain text.  
Multiple choice questions are in **bold text**.  
Essay questions are in **bold underlined text**.

*The answers are displayed:*

**ANS:** B   **DIF:** Easy   **REF:** Page 7   **OBJ:** 2-1   **NAT:** BUSPROG: Communication  
**TOP:** The Economic Environment   **KEY:** Bloom's Comprehension

**ANS:** Answer is B

**DIF:** Difficulty Level - Easy

**REF:** Page number of the book where the answer can be found

**OBJ:** Learning Objective 1 in chapter 2

**NAT:** Tier 1 Standards (Interdisciplinary Learning Outcomes)

**TOP:** Topic – A Head/B Head of where the answer can be found

**KEY:** Bloom's Taxonomy Tags

## Chapter 2: Economics: The Framework for Business

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### TRUE/FALSE

1. An economy is both a social and a financial system.

ANS: T      DIF: Easy      REF: Page 19      OBJ: 2-1  
NAT: BUSPROG: Communication      TOP: Economics: Navigating a Crisis  
KEY: Bloom's Knowledge

2. Financial or social systems are not essential to the development of a strong economy.

ANS: F      DIF: Easy      REF: Page 19      OBJ: 2-1  
NAT: BUSPROG: Analytic      TOP: Economics: Navigating a Crisis  
KEY: Bloom's Comprehension

3. The study of economics focuses on how people, businesses, and governments choose to allocate resources.

ANS: T      DIF: Easy      REF: Page 19      OBJ: 2-1  
NAT: BUSPROG: Communication      TOP: Economics: Navigating a Crisis  
KEY: Bloom's Knowledge

4. A key economic goal is to provide a deep understanding of past choices that can be used to guide future business decisions.

ANS: T      DIF: Easy      REF: Page 19      OBJ: 2-1  
NAT: BUSPROG: Analytic      TOP: Economics: Navigating a Crisis  
KEY: Bloom's Comprehension

5. An economic system is a structure for measuring gross domestic product.

ANS: F      DIF: Easy      REF: Page 19      OBJ: 2-1  
NAT: BUSPROG: Communication      TOP: Economics: Navigating a Crisis  
KEY: Bloom's Knowledge

6. Economists forecast business needs based on a deep understanding of past choices.

ANS: T      DIF: Easy      REF: Page 19      OBJ: 2-1  
NAT: BUSPROG: Communication      TOP: Economics: Navigating a Crisis  
KEY: Bloom's Comprehension

7. A surprisingly small number of key variables have a significant impact on the performance of the economy.

ANS: F      DIF: Easy      REF: Page 19      OBJ: 2-1  
NAT: BUSPROG: Communication      TOP: Economics: Navigating a Crisis  
KEY: Bloom's Comprehension

8. In the early 2000s, the Federal Reserve decreased the interest rate in order to decrease spending and discourage investment.

ANS: F      DIF: Easy      REF: Page 19      OBJ: 2-1  
NAT: BUSPROG: Communication      TOP: Global Economic Crisis: How Did This Happen?  
KEY: Bloom's Knowledge

9. The complexity of the economy makes economic forecasting an inexact process.

ANS: T      DIF: Easy      REF: Page 19      OBJ: 2-1  
NAT: BUSPROG: Communication      TOP: Global Economic Crisis: How Did This Happen?  
KEY: Bloom's Comprehension

10. Constant change is the most predictable economic force in the last few decades.

ANS: T      DIF: Easy      REF: Page 19      OBJ: 2-1  
NAT: BUSPROG: Communication      TOP: Global Economic Crisis: How Did This Happen?  
KEY: Bloom's Application

11. Microeconomics is the study of broad, economy-wide issues such as the unemployment rate, gross domestic product, and inflation.

ANS: F      DIF: Moderate      REF: Page 19      OBJ: 2-1  
NAT: BUSPROG: Communication      TOP: Economics: Navigating a Crisis  
KEY: Bloom's Knowledge

12. Macroeconomic conditions impact day-to-day life by influencing variables such as the availability of jobs, the amount of take home pay households have available after paying taxes, and the buying power of those incomes.

ANS: T      DIF: Moderate      REF: Page 19      OBJ: 2-1  
NAT: BUSPROG: Communication      TOP: Economics: Navigating a Crisis  
KEY: Bloom's Knowledge

13. The study of economics falls into two broad categories called meta-economics and econometrics.

ANS: F      DIF: Moderate      REF: Page 19      OBJ: 2-1  
NAT: BUSPROG: Communication      TOP: Economics: Navigating a Crisis  
KEY: Bloom's Knowledge

14. Luke is taking an economics class that focuses on decisions made by individual business firms and consumers. Luke's class is concerned with microeconomic issues.

ANS: T      DIF: Challenging      REF: Page 19      OBJ: 2-1  
NAT: BUSPROG: Analytic      TOP: Economics: Navigating a Crisis  
KEY: Bloom's Application

15. RealtyTrac believes we will see a decrease in the 2011 foreclosure rates.

ANS: F      DIF: Easy      REF: Page 21      OBJ: 2-1  
NAT: BUSPROG: Communication      TOP: Global Economic Crisis: How Did This Happen?  
KEY: Bloom's Knowledge

16. TARP, the \$700 billion economic bailout plan passed by Congress, was developed to increase economic stability.

ANS: T      DIF: Moderate      REF: Page 21      OBJ: 2-1  
NAT: BUSPROG: Analytic      TOP: Moving in a Better Direction  
KEY: Bloom's Analysis

17. The unemployment rate hit 9.6% in 2010, leading to total Great Recession job losses of nearly 8 million. Many of these jobs will never come back as the economy continues to change, and old skills become obsolete.

ANS: T      DIF: Moderate      REF: Page 21      OBJ: 2-1  
NAT: BUSPROG: Analytic      TOP: Global Economic Crisis: How Did This Happen?  
KEY: Bloom's Analysis

18. The \$700 billion economic bailout package passed by Congress in 2008 was an example of monetary policy.

ANS: F      DIF: Moderate      REF: Page 21      OBJ: 2-1  
NAT: BUSPROG: Communication      TOP: Moving in a Better Direction  
KEY: Bloom's Comprehension

19. Broad economic trends in employment, inflation, and economic growth provide a context that has an important impact on businesses throughout the economy.

ANS: T      DIF: Moderate      REF: Page 21      OBJ: 2-1  
NAT: BUSPROG: Communication      TOP: Moving in a Better Direction  
KEY: Bloom's Analysis

20. Fiscal policy is the government's effort to influence the economy through taxation and spending decisions to encourage growth and boost employment while curbing inflation.

ANS: T      DIF: Easy      REF: Page 22      OBJ: 2-2  
NAT: BUSPROG: Communication      TOP: Fiscal Policy  
KEY: Bloom's Knowledge

21. The federal government experiences a budget deficit when its revenue from taxes is higher than its expenditures.

ANS: F      DIF: Easy      REF: Page 22      OBJ: 2-2  
NAT: BUSPROG: Communication      TOP: Fiscal Policy  
KEY: Bloom's Knowledge

22. The government experiences a budget surplus when its tax revenue exceeds its expenditures.

ANS: T      DIF: Easy      REF: Page 22      OBJ: 2-2  
NAT: BUSPROG: Communication      TOP: Fiscal Policy  
KEY: Bloom's Knowledge

23. The U.S federal debt in 2011 is more than \$45,000 per person.
- ANS: T      DIF: Easy      REF: Pages 22-23      OBJ: 2-2  
NAT: BUSPROG: Communication      TOP: Fiscal Policy  
KEY: Bloom's Knowledge
24. The 12 Federal Reserve Banks are regional banks, privately owned by the member commercial banks in their individual districts.
- ANS: T      DIF: Easy      REF: Page 24      OBJ: 2-2  
NAT: BUSPROG: Communication      TOP: Monetary Policy  
KEY: Bloom's Knowledge
25. Ben Bernanke is the current chairman of the Federal Reserve.
- ANS: T      DIF: Easy      REF: Page 24      OBJ: 2-2  
NAT: BUSPROG: Communication      TOP: Monetary Policy  
KEY: Bloom's Knowledge
26. The Federal Reserve does not regulate banks; only state regulatory agencies perform this function.
- ANS: F      DIF: Easy      REF: Page 24      OBJ: 2-2  
NAT: BUSPROG: Communication      TOP: Monetary Policy  
KEY: Bloom's Comprehension
27. The Federal Reserve provides banking services to member banks and is the central bank of the United States.
- ANS: T      DIF: Easy      REF: Page 24      OBJ: 2-2  
NAT: BUSPROG: Communication      TOP: Monetary Policy  
KEY: Bloom's Knowledge
28. The Fed is headed by a 10-member Board of Governors.
- ANS: F      DIF: Easy      REF: Page 24      OBJ: 2-2  
NAT: BUSPROG: Communication      TOP: Monetary Policy  
KEY: Bloom's Knowledge
29. The Federal Reserve Bank is in charge of both fiscal and monetary policy.
- ANS: F      DIF: Easy      REF: Page 24      OBJ: 2-2  
NAT: BUSPROG: Analytic      TOP: Monetary Policy  
KEY: Bloom's Analysis
30. Money supply refers specifically to the amount of paper bills and metal coins in our overall economy.
- ANS: F      DIF: Easy      REF: Page 24      OBJ: 2-2  
NAT: BUSPROG: Communication      TOP: Monetary Policy  
KEY: Bloom's Knowledge

31. M1 & M2 are commonly used definitions for money supplies. If you use the debit card connected to your checking account to make purchases it would be referred to as an M1.

ANS: T      DIF: Moderate      REF: Page 24      OBJ: 2-2  
NAT: BUSPROG: Communication      TOP: Monetary Policy  
KEY: Bloom's Comprehension

32. Ashley has decided to purchase a dress for the banquet using her credit card. Ashley will be using a form of the money supply most often referred to as M2.

ANS: F      DIF: Moderate      REF: Page 24      OBJ: 2-2  
NAT: BUSPROG: Communication      TOP: Monetary Policy  
KEY: Bloom's Comprehension

33. The Fed's decision to buy and sell government securities is decided by the Federal Open Market Committee.

ANS: T      DIF: Moderate      REF: Page 25      OBJ: 2-2  
NAT: BUSPROG: Analytic      TOP: Monetary Policy  
KEY: Bloom's Analysis

34. Monetary Policy is made by the Federal Open Market Committee.

ANS: T      DIF: Challenging      REF: Page 25      OBJ: 2-2  
NAT: BUSPROG: Reflective Thinking      TOP: Monetary Policy  
KEY: Bloom's Synthesis

35. Capitalism is based on private ownership, economic freedom, and fair competition.

ANS: T      DIF: Moderate      REF: Pages 26-27      OBJ: 2-3  
NAT: BUSPROG: Communication      TOP: Capitalism: The Free Market System  
KEY: Bloom's Knowledge

36. Capitalism places paramount importance on the need for the government to intervene in the economy to ensure a fair and equitable distribution of income.

ANS: F      DIF: Moderate      REF: Page 27      OBJ: 2-3  
NAT: BUSPROG: Analytic      TOP: Capitalism: The Free Market System  
KEY: Bloom's Comprehension

37. The fundamental rights of capitalism guarantee that businesses will be profitable and taxes will be low, thus providing a strong motivation to start a business.

ANS: F      DIF: Moderate      REF: Page 27      OBJ: 2-3  
NAT: BUSPROG: Communication      TOP: The Fundamental Rights of Capitalism  
KEY: Bloom's Comprehension

38. Everlene's Bakery competes against many other bakeries in the same city. However, each bakery uses different recipes and each claims to offer better products than their rivals. For example, Everlene's advertises that it produces the "World's Best" chocolate chip cookies. This suggests that Everlene's Bakery is an example of pure competition.

ANS: F      DIF: Challenging      REF: Page 27      OBJ: 2-3  
NAT: BUSPROG: Reflective Thinking      TOP: Four Degrees of Competition  
KEY: Bloom's Evaluation

39. Government policies promoting free trade are consistent with the right to free choice, which is fundamental to capitalism.

ANS: T      DIF: Moderate      REF: Page 27      OBJ: 2-3  
NAT: BUSPROG: Communication      TOP: The Fundamental Rights of Capitalism  
KEY: Bloom's Comprehension

40. An entrepreneur with limited funds who wants to start a new business would probably be most successful in an oligopolistic market, because the amount of competition in such markets is very limited.

ANS: F      DIF: Moderate      REF: Page 28      OBJ: 2-3  
NAT: BUSPROG: Analytic      TOP: Four Degrees of Competition  
KEY: Bloom's Analysis

41. A typical supply curve shows that an increase in the price of a good will cause producers to decrease the quantity they supply.

ANS: F      DIF: Easy      REF: Page 29      OBJ: 2-3  
NAT: BUSPROG: Communication  
TOP: Supply and Demand: Fundamental Principles of a Free Market System  
KEY: Bloom's Knowledge

42. Federal law has made all types of monopolies illegal in the United States.

ANS: F      DIF: Moderate      REF: Page 29      OBJ: 2-3  
NAT: BUSPROG: Ethics      TOP: Four Degrees of Competition  
KEY: Bloom's Analysis

43. Consumers will see prices fall when the quantity demanded exceeds quantity supplied.

ANS: F      DIF: Moderate      REF: Page 29      OBJ: 2-3  
NAT: BUSPROG: Analytic  
TOP: Supply and Demand: Fundamental Principles of a Free Market System  
KEY: Bloom's Analysis

44. The price paid for goods and services will rise when the quantity demanded exceeds quantity supplied.

ANS: T      DIF: Moderate      REF: Page 29      OBJ: 2-3  
NAT: BUSPROG: Analytic  
TOP: Supply and Demand: Fundamental Principles of a Free Market System  
KEY: Bloom's Analysis



45. Brooklyn's Beachfront Bed and Breakfast loses money due to a sharp drop in the number of guests during the winter months. If Brooklyn's demand curve is like most demand curves, one way to attract more guests would be to offer lower rates during the off-season.
- ANS: T      DIF: Challenging      REF: Pages 29-30      OBJ: 2-3  
NAT: BUSPROG: Reflective Thinking  
TOP: Supply and Demand: Fundamental Principles of a Free Market System  
KEY: Bloom's Evaluation
46. Morgan's Moped and Bicycle Store is located on the property of a five-star resort in southern Florida. Rental cost of the mopeds and bikes is based on one-hour increments. Morgan lowers her standard prices to attract patrons during daily rainstorms in June and August. This is an example of decreasing supply.
- ANS: F      DIF: Challenging      REF: Pages 29-30      OBJ: 2-3  
NAT: BUSPROG: Reflective Thinking  
TOP: Supply and Demand: Fundamental Principles of a Free Market System  
KEY: Bloom's Evaluation
47. Market equilibrium is the point at which the supply curve intersects the demand curve.
- ANS: T      DIF: Moderate      REF: Page 30      OBJ: 2-3  
NAT: BUSPROG: Communication  
TOP: Supply and Demand: Fundamental Principles of a Free Market System  
KEY: Bloom's Comprehension
48. Market equilibrium identifies the price at which quantity supplied is equal to quantity demanded.
- ANS: T      DIF: Moderate      REF: Page 30      OBJ: 2-3  
NAT: BUSPROG: Communication  
TOP: Supply and Demand: Fundamental Principles of a Free Market System  
KEY: Bloom's Comprehension
49. In a planned economy, the government plays only a minor role in the operation of the economy.
- ANS: F      DIF: Easy      REF: Page 30      OBJ: 2-4  
NAT: BUSPROG: Communication      TOP: Planned Economies: Socialism and Communism  
KEY: Bloom's Knowledge
50. In capitalism, what gets produced is largely determined by central government planning.
- ANS: F      DIF: Moderate      REF: Page 30      OBJ: 2-4  
NAT: BUSPROG: Communication      TOP: Planned Economies: Socialism and Communism  
KEY: Bloom's Comprehension
51. Many socialist economies were able to impose measures to control government spending without eliminating public benefits.
- ANS: F      DIF: Easy      REF: Page 31      OBJ: 2-4  
NAT: BUSPROG: Communication      TOP: Socialism      KEY: Bloom's Knowledge

52. The North Korean and Cuban governments still own most of their nations' enterprises and actively control the performance of their nations' economies.

ANS: T      DIF: Moderate      REF: Page 31      OBJ: 2-4  
 NAT: BUSPROG: Analytic      TOP: Communism      KEY: Bloom's Analysis

53. Communism is an economic and political system in which a strong central government owns and controls almost all productive enterprises.

ANS: T      DIF: Moderate      REF: Page 31      OBJ: 2-4  
 NAT: BUSPROG: Communication      TOP: Communism      KEY: Bloom's  
 Comprehension

54. By the end of the 1980s, communism began to collapse across the Soviet Union and its satellite nations.

ANS: T      DIF: Moderate      REF: Page 31      OBJ: 2-4  
 NAT: BUSPROG: Communication      TOP: Communism      KEY: Bloom's Knowledge

55. The few nations that still rely on a communist economic system have actually seen major improvements in their economic performance over the past decade.

ANS: F      DIF: Moderate      REF: Page 31      OBJ: 2-4  
 NAT: BUSPROG: Analytic      TOP: Communism      KEY: Bloom's Analysis

56. Karl Marx envisioned communism as a system that would improve the lot of the common worker.

ANS: T      DIF: Moderate      REF: Page 31      OBJ: 2-4  
 NAT: BUSPROG: Communication      TOP: Communism      KEY: Bloom's Knowledge

57. One problem that plagued many communist economies was that the absence of free markets resulted in crippling shortages and surpluses of goods and services.

ANS: T      DIF: Moderate      REF: Page 31      OBJ: 2-4  
 NAT: BUSPROG: Communication      TOP: Communism      KEY: Bloom's Knowledge

58. In the U.S. economy, various branches of government own major enterprises such as the postal service, schools, parks, libraries, universities, and the military.

ANS: T      DIF: Easy      REF: Page 31      OBJ: 2-5  
 NAT: BUSPROG: Communication      TOP: Mixed Economies: The Story of the Future  
 KEY: Bloom's Knowledge

59. The U.S. federal government is the nation's largest employer.

ANS: T      DIF: Easy      REF: Page 31      OBJ: 2-5  
 NAT: BUSPROG: Communication      TOP: Mixed Economies: The Story of the Future  
 KEY: Bloom's Knowledge

60. The federal government creates regulations that prohibit competition and stimulate consumers to work.

ANS: F      DIF: Easy      REF: Page 31      OBJ: 2-5  
NAT: BUSPROG: Communication      TOP: Mixed Economies: The Story of the Future  
KEY: Bloom's Knowledge

61. Privatization is the conversion of government-owned enterprises to private ownership.

ANS: T      DIF: Easy      REF: Page 31      OBJ: 2-5  
NAT: BUSPROG: Communication      TOP: Mixed Economies: The Story of the Future  
KEY: Bloom's Comprehension

62. While the U.S. relies heavily on free markets, it is actually a mixed economy in which the government owns several major enterprises and regulates many aspects of business operations.

ANS: T      DIF: Moderate      REF: Page 31      OBJ: 2-5  
NAT: BUSPROG: Analytic      TOP: Mixed Economies: The Story of the Future  
KEY: Bloom's Analysis

63. Competition encourages companies to operate efficiently and responsively. The government does its part to stimulate fair competition by creating regulations to protect consumers and workers.

ANS: T      DIF: Moderate      REF: Page 31      OBJ: 2-5  
NAT: BUSPROG: Analytic      TOP: Mixed Economies: The Story of the Future  
KEY: Bloom's Analysis

64. Privatization is an important element of the movement toward a greater market orientation in many nations.

ANS: T      DIF: Moderate      REF: Pages 31-32      OBJ: 2-5  
NAT: BUSPROG: Analytic      TOP: Mixed Economies: The Story of the Future  
KEY: Bloom's Analysis

65. The economic restructuring necessary to move toward greater reliance on markets has proven to be relatively easy for most previously planned economies to achieve.

ANS: F      DIF: Easy      REF: Page 32      OBJ: 2-5  
NAT: BUSPROG: Communication      TOP: Mixed Economies: The Story of the Future  
KEY: Bloom's Comprehension

66. Many countries that have restructured to become more market-oriented have seen dramatic increases in the standard of living for most of their people.

ANS: T      DIF: Easy      REF: Page 32      OBJ: 2-5  
NAT: BUSPROG: Communication      TOP: Mixed Economies: The Story of the Future  
KEY: Bloom's Comprehension

67. Gross Domestic Product (GDP) measures the total value of all final goods and services produced within a nation's physical boundaries over a given period of time.

ANS: T      DIF: Easy      REF: Page 32      OBJ: 2-6  
NAT: BUSPROG: Communication      TOP: Gross Domestic Product  
KEY: Bloom's Knowledge

68. GDP tends to overstate the amount of output produced by a nation's economy.

ANS: F      DIF: Easy      REF: Page 32      OBJ: 2-6  
NAT: BUSPROG: Communication      TOP: Gross Domestic Product  
KEY: Bloom's Knowledge

69. GDP, as the measurement of the total value of goods and services, includes the output produced within households and output produced by illegal activities.

ANS: F      DIF: Easy      REF: Page 32      OBJ: 2-6  
NAT: BUSPROG: Communication      TOP: Gross Domestic Product  
KEY: Bloom's Comprehension

70. Resulting from a 2.7% growth rate increase since 2009, the 2010 GDP of the United States is close to \$15 trillion.

ANS: T      DIF: Easy      REF: Page 32      OBJ: 2-6  
NAT: BUSPROG: Communication      TOP: Gross Domestic Product  
KEY: Bloom's Comprehension

71. The unemployment rate includes only individuals over the age of 21 who were involuntarily laid off or fired from their previous jobs.

ANS: F      DIF: Easy      REF: Page 32      OBJ: 2-6  
NAT: BUSPROG: Communication      TOP: Employment Level  
KEY: Bloom's Knowledge

72. The unemployment rate measures individuals 16 years of age and older without jobs who are actively seeking employment.

ANS: T      DIF: Easy      REF: Page 32      OBJ: 2-6  
NAT: BUSPROG: Communication      TOP: Employment Level  
KEY: Bloom's Knowledge

73. Gross Domestic Product (GDP) includes the value of output produced within a nation even if that output is produced by a foreign-owned company.

ANS: T      DIF: Moderate      REF: Page 32      OBJ: 2-6  
NAT: BUSPROG: Communication      TOP: Gross Domestic Product  
KEY: Bloom's Comprehension

74. The value of a Hyundai Sonata built in Montgomery, Alabama would be included in U.S. GDP even though Hyundai is actually a South Korean corporation.

ANS: T      DIF: Challenging      REF: Page 32      OBJ: 2-6  
NAT: BUSPROG: Reflective Thinking      TOP: Gross Domestic Product  
KEY: Bloom's Synthesis

75. Individuals who quit their jobs experience structural unemployment.

ANS: F      DIF: Easy      REF: Page 33      OBJ: 2-6  
NAT: BUSPROG: Communication      TOP: Employment Level  
KEY: Bloom's Comprehension

76. Cyclical unemployment results from layoffs during recessionary periods.

ANS: T      DIF: Easy      REF: Page 33      OBJ: 2-6  
NAT: BUSPROG: Communication      TOP: Employment Level  
KEY: Bloom's Knowledge

77. Frictional unemployment may occur even when the economy is healthy, and may ultimately result in a better match between workers and jobs.

ANS: T      DIF: Easy      REF: Page 33      OBJ: 2-6  
NAT: BUSPROG: Communication      TOP: Employment Level  
KEY: Bloom's Analysis

78. The predictable nature of the business cycle makes it easy to forecast when the next upturn or downturn in business activity will occur.

ANS: F      DIF: Easy      REF: Page 33      OBJ: 2-6  
NAT: BUSPROG: Communication      TOP: The Business Cycle  
KEY: Bloom's Knowledge

79. An economy is said to be in a recession when GDP decreases for two consecutive quarters.

ANS: T      DIF: Easy      REF: Page 33      OBJ: 2-6  
NAT: BUSPROG: Communication      TOP: The Business Cycle  
KEY: Bloom's Knowledge

80. The two key phases of the business cycle are contraction and expansion.

ANS: T      DIF: Easy      REF: Page 33      OBJ: 2-6  
NAT: BUSPROG: Communication      TOP: The Business Cycle  
KEY: Bloom's Knowledge

81. Contraction is a period of economic downturn marked by rising unemployment, business cutbacks, and decreases in consumer spending.

ANS: T      DIF: Easy      REF: Page 33      OBJ: 2-6  
NAT: BUSPROG: Communication      TOP: The Business Cycle  
KEY: Bloom's Comprehension

82. The four basic types of unemployment are natural, cyclical, voluntary, and induced.
- ANS: F      DIF: Easy      REF: Page 33      OBJ: 2-6  
NAT: BUSPROG: Communication      TOP: Employment Level  
KEY: Bloom's Comprehension
83. Unfortunately, depressions are a common problem in most free-market economies.
- ANS: F      DIF: Easy      REF: Page 33      OBJ: 2-6  
NAT: BUSPROG: Communication      TOP: The Business Cycle  
KEY: Bloom's Comprehension
84. Less expensive labor pools overseas might create layoffs at a U.S.-based engine plant. This is an example of structural unemployment.
- ANS: T      DIF: Challenging      REF: Page 33      OBJ: 2-6  
NAT: BUSPROG: Reflective Thinking      TOP: Employment Level  
KEY: Bloom's Evaluation
85. During the peak holiday season, retail workers are hired in great numbers to meet the demands of holiday shoppers. At the end of the holiday season many of those workers are released from their jobs, thus creating seasonal unemployment.
- ANS: T      DIF: Challenging      REF: Page 33      OBJ: 2-6  
NAT: BUSPROG: Reflective Thinking      TOP: Employment Level  
KEY: Bloom's Evaluation
86. Recovery is a period of increased employment, business expansion, and increased consumer spending.
- ANS: T      DIF: Easy      REF: Page 34      OBJ: 2-6  
NAT: BUSPROG: Communication      TOP: The Business Cycle  
KEY: Bloom's Knowledge
87. Inflation occurs as the average prices of goods and services rise.
- ANS: T      DIF: Easy      REF: Page 34      OBJ: 2-6  
NAT: BUSPROG: Communication      TOP: Price Levels  
KEY: Bloom's Comprehension
88. Productivity growth due to the infusion of technology enables employees to increase output and measure quality.
- ANS: F      DIF: Easy      REF: Page 34      OBJ: 2-6  
NAT: BUSPROG: Communication      TOP: Productivity  
KEY: Bloom's Comprehension
89. Disinflation is a slowing in the rate of inflation.
- ANS: T      DIF: Moderate      REF: Page 34      OBJ: 2-6  
NAT: BUSPROG: Analytic      TOP: Price Levels  
KEY: Bloom's Analysis

90. It is important that any government examine multiple measures of its own economic health, rather than relying on simply one or two dimensions.

ANS: T      DIF: Moderate      REF: Page 34      OBJ: 2-6  
 NAT: BUSPROG: Communication      TOP: Productivity      KEY: Bloom's Knowledge

91. To measure productivity, multiply the number of inputs by the cost of each input.

ANS: F      DIF: Moderate      REF: Page 34      OBJ: 2-6  
 NAT: BUSPROG: Communication      TOP: Productivity  
 KEY: Bloom's Comprehension

92. Changes in the producer price index (PPI) can sometimes predict changes in the consumer price index (CPI).

ANS: T      DIF: Moderate      REF: Page 34      OBJ: 2-6  
 NAT: BUSPROG: Analytic      TOP: Price Levels      KEY: Bloom's Analysis

## MULTIPLE CHOICE

93. The economy, as a system, represents the
- non-efficient use of material resources.
  - flow of resources from production through consumption.
  - means of production only.
  - means of capitalistic systems.

ANS: B      DIF: Easy      REF: Page 19      OBJ: 2-1  
 NAT: BUSPROG: Communication      TOP: Economics: Navigating a Crisis  
 KEY: Bloom's Knowledge

94. In the broadest sense, *economics* studies the choices that
- people make in disposing of unnecessary resources.
  - governments make in creating natural resources.
  - companies make in producing goods and services for corporate use.
  - people, governments, and companies make in allocating resources.

ANS: D      DIF: Easy      REF: Page 19      OBJ: 2-1  
 NAT: BUSPROG: Communication      TOP: Economics: Navigating a Crisis  
 KEY: Bloom's Knowledge

95. From the business perspective, a key reason to study economics is to
- gain a better understanding of past business choices in order to make better future decisions.
  - avoid the temptation to focus on past events.
  - ensure that demand exceeds supply.
  - learn how to achieve a monopoly position in markets with the potential to generate high profits.

ANS: A      DIF: Easy      REF: Page 19      OBJ: 2-1  
 NAT: BUSPROG: Analytic      TOP: Economics: Navigating a Crisis  
 KEY: Bloom's Analysis

96. A \_\_\_\_\_ is targeted to borrowers with low credit scores, high debt-to-income ratios or signs of a reduced ability to repay the money they borrow.
- home equity line of credit
  - revolving line of credit
  - fixed rate mortgage loan
  - subprime mortgage loan

ANS: D      DIF: Easy      REF: Page 19      OBJ: 2-1  
NAT: BUSPROG: Communication      TOP: Global Economic Crisis: How Did This Happen?  
KEY: Bloom's Knowledge

97. Economics is divided into two core areas of study known as
- production and consumption.
  - data collection and forecasting.
  - macroeconomics and microeconomics.
  - supply economics and demand economics.

ANS: C      DIF: Easy      REF: Page 19      OBJ: 2-1  
NAT: BUSPROG: Communication      TOP: Economics: Navigating a Crisis  
KEY: Bloom's Knowledge

98. An economic system is a structure for
- measuring gross domestic products.
  - allocating limited resources.
  - forecasting trends.
  - none of the above.

ANS: B      DIF: Easy      REF: Page 19      OBJ: 2-1  
NAT: BUSPROG: Communication      TOP: Economics: Navigating a Crisis  
KEY: Bloom's Comprehension

99. \_\_\_\_\_ is a structure for allocating scarce resources.
- An economic system
  - An econometric plan
  - A factor distributor
  - The gross domestic product

ANS: A      DIF: Easy      REF: Page 19      OBJ: 2-1  
NAT: BUSPROG: Communication      TOP: Economics: Navigating a Crisis  
KEY: Bloom's Comprehension

100. Macroeconomics focuses on
- the major issues facing the national economy, but has little or no relevance to individuals.
  - smaller economic units such as individual consumers, families, and individual businesses operating within the economy.
  - the major issues facing the national economy that may seem abstract, but directly affect an individual's day-to-day life.
  - the role of government, while microeconomics focuses on the private sector.

ANS: C      DIF: Moderate      REF: Page 19      OBJ: 2-1  
NAT: BUSPROG: Analytic      TOP: Economics: Navigating a Crisis  
KEY: Bloom's Analysis



101. Which of the following would be studied in the greatest detail in a macroeconomics course?
- How a large automobile manufacturer decides how many SUVs to produce in a given model year.
  - How consumers would respond if a restaurant raised its prices.
  - How a firm in an oligopolistic market would respond to a change in the pricing strategy of other firms in its market.
  - Factors that influence the nation's unemployment rate.

ANS: D      DIF: Moderate      REF: Page 19      OBJ: 2-1  
 NAT: BUSPROG: Communication      TOP: Economics: Navigating a Crisis  
 KEY: Bloom's Analysis

102. Some argue that the Federal Reserve lowering interest rates from mid-2000 to the end of 2002 greatly increased the money supply; however, opportunities to invest yielded paltry returns leading bankers to offer \_\_\_\_\_ in order to earn a higher return.
- revolving lines of credit
  - home equity lines of credit
  - fixed rate mortgage loans
  - subprime mortgage loans

ANS: D      DIF: Moderate      REF: Page 19      OBJ: 2-1  
 NAT: BUSPROG: Communication  
 TOP: Global Economic Crisis: How Did This Happen?  
 KEY: Bloom's Comprehension

103. After the collapse of the dot com bubble and the 9/11 terrorist attacks, the stock market depreciated and unemployment increased leading many to fear that the country was on the brink of a full-blown recession. In order to stimulate the economy the Federal Reserve Bank
- lowered taxes in an effort to increase spending.
  - lowered interest rates from 6.5% to 1.25% in an effort to increase spending.
  - increased taxes in an effort to increase spending.
  - increased interest rates from 1.25% to 6.5% in an effort to increase spending.

ANS: B      DIF: Moderate      REF: Page 19      OBJ: 2-1  
 NAT: BUSPROG: Communication  
 TOP: Global Economic Crisis: How Did This Happen?  
 KEY: Bloom's Comprehension

104. GeeGee's is a neighborhood bakery known for its scrumptious tea cakes. GeeGee's recipes call for expensive spices imported from Asia. Recently the cost of these spices has risen dramatically, leading GeeGee's to consider increasing its prices. In order to analyze how this change would affect consumer choices, GeeGee's management could perform a
- microeconomic analysis.
  - macroeconomic analysis.
  - transformational economic analysis.
  - structural analysis.

ANS: A      DIF: Challenging      REF: Page 19      OBJ: 2-1  
 NAT: BUSPROG: Reflective Thinking      TOP: Economics: Navigating a Crisis  
 KEY: Bloom's Evaluation

105. Define economics.
- a financial and social system
  - the study of a country's overall economic issues
  - the integration between consumers, families, and businesses
  - the study of the choices that different entities make in allocating resources
- ANS: D      DIF: Challenging      REF: Page 19      OBJ: 2-1  
NAT: BUSPROG: Reflective Thinking      TOP: Economics: Navigating a Crisis  
KEY: Bloom's Evaluation
106. What was the cause of the financial crisis of 2008?
- Consumers had taken on far too much debt.
  - The country had taken on far too much debt.
  - Monetary policy was very lax, and this policy led to a bubble in the housing market that burst.
  - Bear Stearns.
- ANS: C      DIF: Challenging      REF: Pages 19-20      OBJ: 2-1  
NAT: BUSPROG: Analytic  
TOP: Global Economic Crisis: How Did This Happen?  
KEY: Bloom's Synthesis
107. RealtyTrac reported that foreclosure rates were 33% higher in 2010 than they were in 2009. RealtyTrac expects foreclosure rates to
- decrease in 2011.
  - increase in 2011.
  - remain the same.
  - increase the first half of 2011 then steadily decrease the second half of the year.
- ANS: B      DIF: Easy      REF: Page 21      OBJ: 2-1  
NAT: BUSPROG: Communication  
TOP: Global Economic Crisis: How Did This Happen?  
KEY: Bloom's Comprehension
108. The Great Recession resulted in nearly 8 million jobs lost in a 3-year period. Many of these lost jobs will
- come back as the economy continues to change.
  - come back because the old skills are needed.
  - never come back.
  - never come back because people don't want to do them.
- ANS: C      DIF: Moderate      REF: Page 21      OBJ: 2-1  
NAT: BUSPROG: Analytic  
TOP: Global Economic Crisis: How Did This Happen?  
KEY: Bloom's Analysis
109. The \$700 billion economic bailout plan is called the
- American Recovery and Reinvestment Act
  - Troubled Assets Relief Program
  - Troubled Assistance Relief Program
  - Big Business Assistance Program

ANS: B      DIF: Easy      REF: Page 21      OBJ: 2-1  
 NAT: BUSPROG: Communication      TOP: Moving in a Better Direction  
 KEY: Bloom's Knowledge

110. Early in your first term as President of the United States you faced an economy in the beginnings of a recession. Which of the following would represent an example of a fiscal policy you might suggest to deal with this situation?
- Ask Congress to cut total spending on social programs to avoid running a budget deficit.
  - Ask Congress to cut taxes in order to give consumers and businesses more income to spend and invest.
  - Order the Fed to raise the required reserve ratio.
  - Urge Congress to give the U.S. Treasury the authority to print more money.

ANS: B      DIF: Challenging      REF: Page 21      OBJ: 2-1  
 NAT: BUSPROG: Reflective Thinking      TOP: Moving in a Better Direction  
 KEY: Bloom's Synthesis

111. Which choice refers to fiscal policy?
- The Fed's policy was announced today that the Federal Funds Rate will increase by 1.25%, thereby helping to curb inflation.
  - The President signed an executive order that mandated a tax rate increase of 10% on durable goods.
  - President Franklin Delano Roosevelt signed an executive order that required private citizens to surrender all gold and silver currency to the federal government in 1935, or face fines or imprisonment.
  - For fiscal year 2008, the federal government's expenditures exceeded its revenues by nearly five hundred billion dollars.

ANS: B      DIF: Challenging      REF: Page 22      OBJ: 2-2  
 NAT: BUSPROG: Reflective Thinking      TOP: Fiscal Policy  
 KEY: Bloom's Synthesis

112. \_\_\_\_\_ refers to government efforts to influence the economy through taxation and spending decisions designed to encourage growth, boost employment, and curb inflation.
- Monetary policy
  - Fiscal policy
  - Pricing policy
  - Production policy

ANS: B      DIF: Easy      REF: Page 22      OBJ: 2-2  
 NAT: BUSPROG: Communication      TOP: Fiscal Policy  
 KEY: Bloom's Knowledge

113. When tax revenue is higher than government expenditures, the government incurs a
- budget deficit.
  - windfall.
  - budget surplus.
  - national debt.

ANS: C      DIF: Easy      REF: Page 22      OBJ: 2-2  
 NAT: BUSPROG: Communication      TOP: Fiscal Policy  
 KEY: Bloom's Knowledge

114. The federal government runs a budget deficit when its
- spending outpaces revenue from taxes.
  - tax revenue outpaces its expenditures.
  - monetary policies reduce the amount of money in circulation.
  - gold reserves are inadequate to support the existing money supply.
- ANS: A      DIF: Easy      REF: Page 22      OBJ: 2-2  
NAT: BUSPROG: Communication      TOP: Fiscal Policy  
KEY: Bloom's Comprehension
115. \_\_\_\_\_ refers to actions that shape the economy by influencing interest rates and the supply of money.
- Fiscal policy
  - Monetary policy
  - Revenue policy
  - Deficit policy
- ANS: B      DIF: Easy      REF: Page 24      OBJ: 2-2  
NAT: BUSPROG: Communication      TOP: Monetary Policy  
KEY: Bloom's Knowledge
116. The M2 money supply includes
- all currency, credit cards, and most savings accounts.
  - all currency, most savings accounts, money market accounts, and certificates of deposit.
  - only currency and short-term money market accounts.
  - all currency.
- ANS: B      DIF: Easy      REF: Page 24      OBJ: 2-2  
NAT: BUSPROG: Communication      TOP: Monetary Policy  
KEY: Bloom's Knowledge
117. \_\_\_\_\_ is the current chairman of the Federal Reserve.
- Alan Greenspan
  - William Gates
  - George Bush
  - Ben Bernanke
- ANS: D      DIF: Easy      REF: Page 24      OBJ: 2-2  
NAT: BUSPROG: Communication      TOP: Monetary Policy  
KEY: Bloom's Knowledge
118. In the U.S., the control of the money supply is the responsibility of the
- U.S. Department of the Treasury.
  - Federal Reserve.
  - U.S. Department of State.
  - U.S. Congress.
- ANS: B      DIF: Easy      REF: Page 24      OBJ: 2-2  
NAT: BUSPROG: Communication      TOP: Monetary Policy  
KEY: Bloom's Comprehension

119. Why are the members of the Fed Board of Governors appointed to 14-year terms that are staggered, with one expiring every 2 years?
- to encourage new approaches and fresh ideas from the Board of Governors
  - so that no single president can appoint all of the members, thereby ensuring that the Fed can act independently of political pressure
  - to ensure that there are experienced members during all economic cycles
  - because after 14 years they are automatically eligible to run for Fed Chair

ANS: B      DIF: Moderate      REF: Page 24      OBJ: 2-2  
NAT: BUSPROG: Communication      TOP: Monetary Policy  
KEY: Bloom's Comprehension

120. The Federal Reserve is the \_\_\_\_\_ of the United States.
- financial market
  - central bank
  - state business regulator
  - foreign exchange controller

ANS: B      DIF: Moderate      REF: Page 24      OBJ: 2-2  
NAT: BUSPROG: Communication      TOP: Monetary Policy  
KEY: Bloom's Knowledge

121. In setting monetary policy, the Federal Reserve oversees the operation of \_\_\_\_\_ Federal Reserve Banks, which carry out Fed policies and perform banking services for commercial banks in their districts. These Federal Reserve Banks are owned by \_\_\_\_\_.
- 12; the member commercial banks in their district
  - 15; the federal government
  - 12; the state government where they are located
  - 15; the Treasury Department

ANS: A      DIF: Moderate      REF: Page 24      OBJ: 2-2  
NAT: BUSPROG: Communication      TOP: Monetary Policy  
KEY: Bloom's Comprehension

122. Banks help increase the money supply by
- printing more money.
  - extending more loans to credit-worthy consumers.
  - holding more money in their accounts with the Federal Reserve.
  - sending more money to the Treasury Department.

ANS: B      DIF: Moderate      REF: Page 25      OBJ: 2-2  
NAT: BUSPROG: Analytic      TOP: Monetary Policy  
KEY: Bloom's Analysis

123. The primary way the Fed controls the supply of money is by
- establishing the amount of currency the U.S. Treasury is allowed to print each month.
  - changing the reserve requirement.
  - buying and selling government securities on the open market.
  - allowing banks to borrow more money from the U.S. Treasury.

ANS: C      DIF: Moderate      REF: Page 25      OBJ: 2-2  
NAT: BUSPROG: Communication      TOP: Monetary Policy  
KEY: Bloom's Comprehension

124. If the Fed wants to increase the money supply it should:

- a) raise the reserve requirement.
- b) raise the discount rate.
- c) cut taxes.
- d) buy government securities.

ANS: D      DIF: Moderate  
NAT: BUSPROG: Analytic  
KEY: Bloom's Comprehension

REF: Page 25      OBJ: 2-2  
TOP: Monetary Polic /

125. A federal agency called the \_\_\_\_\_ was established to protect customer deposits in banks and thrift institutions for up to \$250,000 per customer, per bank.

- a) Federal Deposit Insurance Corporation (FDIC)
- b) Federal Reserve System
- c) Federal Open Market Committee
- d) Federal Deposit Requirement Program

ANS: A      DIF: Moderate  
NAT: BUSPROG: Analytic  
KEY: Bloom's Comprehension

REF: Page 25      OBJ: 2-2  
TOP: Monetary Polic /

126. Open Market operations are set by the Federal Open Market Committee. These operations help the government finance its deficit spending. To help guide them in decision making, who would benefit from closely watching the rate setting and outlook statements produced by the Open Market Committee?

- a) businesses
- b) markets
- c) businesses and markets
- d) individuals

ANS: C      DIF: Moderate  
NAT: BUSPROG: Analytic  
KEY: Bloom's Analysis

REF: Page 25      OBJ: 2-2  
TOP: Monetary Polic /

127. Recently, I.B. Rheele read in the newspaper that the Federal Reserve chairman had expressed concern about inflation and indicated the Federal Reserve would be taking some action in order to prevent inflation from spiraling out of control. The Federal Reserve could use all of the following tools EXCEPT

- a) selling government bonds in the open market.
- b) increasing the discount rate.
- c) increasing banks reserve requirements.
- d) increasing government spending on roads and bridges.

ANS: D      DIF: Challenging  
NAT: BUSPROG: Reflective Thinking  
KEY: Bloom's Evaluation

REF: Page 25      OBJ: 2-2  
TOP: Monetary Polic /

128. Michael has inherited \$500,000 from the sale of a family business. His banker is advising him to find multiple banks to deposit his money. Why?
- The Open Market Operations of the Federal Reserve would invest his money in other securities and might lose it without needing to justify the expenditure.
  - The Federal Reserve does not keep that much money in any one bank due to federal regulations prohibiting the buying and selling of securities.
  - The Federal Deposit Insurance Corporation will only insure up to \$250,000 in each account per customer, per bank. He would need more than one bank to ensure his money is federally protected in the event of an economic collapse of the banking system.
  - He needs to diversify his holdings in more than one bank to protect himself against fraudulent lending practices of banks.

ANS: C      DIF: Challenging      REF: Page 25      OBJ: 2-2  
 NAT: BUSPROG: Reflective Thinking      TOP: Monetary Polic '   
 KEY: Bloom's Synthesis

129. Credit is tight. Even borrowers with good credit have to shop around for loans, and it seems like banks are reluctant to loan their money. Of the following choices, what could be the reason?
- The Fed has raised the discount rate, thereby making it impossible for consumers to get a decent interest rate on their loans.
  - The Federal Open Market Committee has started selling securities.
  - The Federal Open Market Committee has started selling securities, and the Fed has just issued new reserve requirements, changing the policy from 10% to 12%.
  - The Fed has made some changes to the check-clearing processes of the member banks, charging higher fees for the service.

ANS: C      DIF: Challenging      REF: Page 26      OBJ: 2-2  
 NAT: BUSPROG: Reflective Thinking      TOP: Monetary Polic '   
 KEY: Bloom's Evaluation

130. A basic characteristic of \_\_\_\_\_ is that both producers and consumers are free to make their own economic decisions on many basic issues.
- socialism
  - capitalism
  - communism
  - mercantilism

ANS: B      DIF: Easy      REF: Page 27      OBJ: 2-3  
 NAT: BUSPROG: Communication      TOP: Capitalism: The Free Market System   
 KEY: Bloom's Knowledge

131. In \_\_\_\_\_, many firms compete by selling differentiated products.
- a monopoly
  - monopolistic competition
  - an oligopoly
  - a natural monopoly

ANS: B      DIF: Easy      REF: Page 27      OBJ: 2-3  
 NAT: BUSPROG: Communication      TOP: Four Degrees of Competition   
 KEY: Bloom's Knowledge

132. In capitalism, people strive to raise their standard of living. Businesses contribute to this goal by
- offering value to the consumer.
  - using available resources.
  - regulating available talent.
  - forming oligopolistic markets.

ANS: A      DIF: Moderate      REF: Page 27      OBJ: 2-3  
NAT: BUSPROG: Communication      TOP: Capitalism: The Free Market System  
KEY: Bloom's Comprehension

133. A market structure with pure competition has all of the following characteristics EXCEPT
- the firms use product differentiation allowing consumers to easily identify their favorite brands.
  - there are many firms competing in the market.
  - firms can easily enter and leave the market.
  - no individual firm has any control over the price of the product.

ANS: A      DIF: Challenging      REF: Page 27      OBJ: 2-3  
NAT: BUSPROG: Analytic      TOP: Four Degrees of Competition  
KEY: Bloom's Analysis

134. Which of the following is not a fundamental right of capitalism?
- right to own property
  - right to compete
  - right to keep profits and not pay taxes
  - right to run a business

ANS: C      DIF: Moderate      REF: Page 27      OBJ: 2-3  
NAT: BUSPROG: Communication      TOP: The Fundamental Rights of Capitalism  
KEY: Bloom's Comprehension

135. Competition among businesses
- is consistent with the goals of socialism.
  - is a primary feature of a communist economic system.
  - ensures that everyone is a winner.
  - drives higher quality and lower prices in capitalism.

ANS: D      DIF: Moderate      REF: Page 27      OBJ: 2-3  
NAT: BUSPROG: Communication      TOP: The Fundamental Rights of Capitalism  
KEY: Bloom's Knowledge

136. Which of the following is not a degree of competition?
- oligopolistic competition
  - monopolistic competition
  - natural competition
  - pure competition

ANS: C      DIF: Moderate      REF: Pages 27-28      OBJ: 2-3  
NAT: BUSPROG: Communication      TOP: Four Degrees of Competition  
KEY: Bloom's Knowledge



137. Which of the following industries operates under a market structure of monopolistic competition?
- clothing industry
  - agricultural industry
  - soft drink industry
  - utility industry

ANS: A      DIF: Challenging      REF: Page 28      OBJ: 2-3  
NAT: BUSPROG: Reflective Thinking      TOP: Four Degrees of Competition  
KEY: Bloom's Evaluation

138. A competitor decided to drop its prices by 15% across the board, in an effort to increase market share. In response, its primary competitor dropped its prices by 20%. In which of the Four Degrees of Competition would this be undesirable, even disastrous?
- pure competition
  - natural monopoly
  - monopoly
  - oligopoly

ANS: D      DIF: Challenging      REF: Page 28      OBJ: 2-3  
NAT: BUSPROG: Reflective Thinking      TOP: Four Degrees of Competition  
KEY: Bloom's Evaluation

139. Firms in oligopolistic markets tend to
- keep prices as low as possible.
  - avoid price competition whenever possible.
  - be very concerned about the possibility of new firms entering their market.
  - have very small market shares.

ANS: B      DIF: Moderate      REF: Page 28      OBJ: 2-3  
NAT: BUSPROG: Communication      TOP: Four Degrees of Competition  
KEY: Bloom's Knowledge

140. Government laws against monopolies are
- a key way the government promotes competition in a capitalist system.
  - inconsistent with the role of government in a capitalist system.
  - the main reason the U.S. economy is best classified as a socialist system.
  - the main way the government ensures an equal distribution of income in the U.S. economy.

ANS: A      DIF: Moderate      REF: Pages 28-29      OBJ: 2-3  
NAT: BUSPROG: Analytic      TOP: Four Degrees of Competition  
KEY: Bloom's Analysis

141. Which of the following directly impacts the range of products and prices in the free market system?
- government pricing policies
  - new product development plans
  - the constant interaction between buyers and sellers
  - corporate marketing programs

ANS: C      DIF: Moderate      REF: Page 29      OBJ: 2-3  
NAT: BUSPROG: Communication      TOP: Supply and Demand: Fundamental Principles of a Free Market System  
KEY: Bloom's Comprehension

142. The \_\_\_\_\_ shows the quantity of products that producers will offer at various market prices.
- supply matrix
  - demand curve
  - supply curve
  - demand analysis

ANS: C      DIF: Easy      REF: Page 29      OBJ: 2-3  
NAT: BUSPROG: Communication  
TOP: Supply and Demand: Fundamental Principles of a Free Market System  
KEY: Bloom's Comprehension

143. Companies that attempt to monopolize a particular market are likely to violate the
- Fair Competition Standards Act of 1911.
  - Taft-Sharpley Free Enterprise Act of 1957.
  - Sherman Antitrust Act of 1890.
  - Market Competition Enhancement Act of 1978.

ANS: C      DIF: Moderate      REF: Page 29      OBJ: 2-3  
NAT: BUSPROG: Communication      TOP: Four Degrees of Competition  
KEY: Bloom's Comprehension

144. If low-cost solar power were to become a viable energy source in households across the U.S., what would be the economic impact on energy prices?
- Energy costs across the country would increase with adoption of the new energy source.
  - Housing prices would decrease as new homes are built with this new energy source.
  - Prices would increase as this is a new energy source.
  - Prices would decrease as competition increases in energy production.

ANS: D      DIF: Challenging      REF: Page 29      OBJ: 2-1  
NAT: BUSPROG: Reflective Thinking  
TOP: Supply and Demand: Fundamental Principles of a Free Market System  
KEY: Bloom's Synthesis

145. Demand is defined as
- the number of consumers in a market.
  - the quantity of products that consumers are willing to buy at different prices.
  - the amount of products produced.
  - the annual quantity of products sold by retailers.

ANS: B      DIF: Easy      REF: Page 29      OBJ: 2-3  
NAT: BUSPROG: Communication  
TOP: Supply and Demand: Fundamental Principles of a Free Market System  
KEY: Bloom's Knowledge

146. A supply curve shows that as prices rise the
- quantity of products produced declines.
  - equilibrium point shifts upward.
  - number of products demanded stays the same.
  - quantity of products produced rises.

ANS: D      DIF: Moderate      REF: Page 29      OBJ: 2-3  
NAT: BUSPROG: Communication  
TOP: Supply and Demand: Fundamental Principles of a Free Market System  
KEY: Bloom's Comprehension

147. Supply refers to the quantity of products that producers are willing to offer for sale
- at different market prices.
  - in different competitive markets.
  - during an economic downturn.
  - when demand increases.

ANS: A      DIF: Moderate      REF: Page 29      OBJ: 2-3  
NAT: BUSPROG: Communication  
TOP: Supply and Demand: Fundamental Principles of a Free Market System  
KEY: Bloom's Knowledge

148. The government often allows only one company to provide electricity in a given geographic area, because allowing several companies to do so would result in an inefficient duplication of infrastructure. This suggests that electric utilities are
- trust busters.
  - oligopolies.
  - natural monopolies.
  - pure players.

ANS: C      DIF: Challenging      REF: Page 29      OBJ: 2-3  
NAT: BUSPROG: Reflective Thinking      TOP: Four Degrees of Competition  
KEY: Bloom's Synthesis

149. If the cost of an iced-tea is more expensive during the summer months, consumers will
- not buy at all.
  - buy no more or less due to the increase in price.
  - buy more due to the increase in price.
  - buy less due to the increase in price.

ANS: D      DIF: Moderate      REF: Pages 29-30      OBJ: 2-3  
NAT: BUSPROG: Communication  
TOP: Supply and Demand: Fundamental Principles of a Free Market System  
KEY: Bloom's Application

150. The demand curve shows the relationship between the
- price and quantity from a customer demand standpoint..
  - quantity of products produced and sold.
  - macroeconomics and microeconomics.
  - suppliers' prices and consumers' prices.

ANS: A      DIF: Moderate      REF: Page 30      OBJ: 2-3  
NAT: BUSPROG: Communication  
TOP: Supply and Demand: Fundamental Principles of a Free Market System  
KEY: Bloom's Comprehension

151. Anne notices that her clothing store isn't selling many of the jeans priced at \$120. She wants to quickly increase sales of these jeans before next season's fashions come in. What would be her best approach?
- Keep the prices the same but move the jeans to another section of the store.
  - Drop the price of the jeans so that demand will increase.
  - Raise the price of the jeans to make them seem more exclusive.
  - Put even higher priced jeans next to the \$120 jeans.

ANS: B      DIF: Challenging      REF: Page 30      OBJ: 2-3  
 NAT: BUSPROG: Analytic  
 TOP: Supply and Demand: Fundamental Principles of a Free Market System  
 KEY: Bloom's Evaluation

152. Which best describes the equilibrium price in the relationship between supply and demand?
- Hank said, "We can charge whatever the market will bear."
  - Andre told us, "Demand is highest when there are more widgets to sell; if you don't have widgets, how can people buy them?"
  - Shauna told her employees, "The company is only sending one fuel truck per week now, so the price is going up. It's like they're rationing us."
  - Dave said, "Man, there are so many laptops out there they don't know what to do with them! They're a dime a dozen now."

ANS: A      DIF: Challenging      REF: Page 30      OBJ: 2-3  
 NAT: BUSPROG: Reflective Thinking  
 TOP: Supply and Demand: Fundamental Principles of a Free Market System  
 KEY: Bloom's Synthesis

153. In 2006, the price of a gallon of gasoline rose from \$2.00 per gallon to over \$4.00 per gallon. If the demand curve for gasoline is like most demand curves, the increase in the price of gasoline
- resulted in more demand for gasoline than at the lower price.
  - resulted in less demand for gasoline than at the lower price.
  - resulted in an increase in the number of miles driven by consumers.
  - had no effect on the amount of gasoline consumers would buy.

ANS: B      DIF: Moderate      REF: Page 30      OBJ: 2-3  
 NAT: BUSPROG: Analytic  
 TOP: Supply and Demand: Fundamental Principles of a Free Market System  
 KEY: Bloom's Analysis

154. What cause is attributable to the failure of socialism and communism wherever they have been attempted throughout the world?
- Lack of opportunity. Clearly communism could have worked if it had been better executed, especially with today's technology.
  - The corruption of powerful central governments has been their downfall. If a stronger mandate for police power were present in these countries, they would have survived, strong and intact.
  - The social burden of entitlement programs, at some point, outstrips the ability of the people to produce. If these programs were better funded through higher taxes, they would have been sustainable.
  - Capitalism, with its agility and potential for a country's economic growth, has been largely responsible for the failure of both communism and socialism.

ANS: D      DIF: Challenging      REF: Page 31      OBJ: 2-4  
 NAT: BUSPROG: Reflective Thinking  
 TOP: Planned Economies: Socialism and Communism  
 KEY: Bloom's Evaluation

155. The main economic goal of the government in a socialist economy is to
- keep taxes as low as possible.
  - operate key economic enterprises in the best interests of the general public.
  - achieve the highest possible rate of economic growth.
  - provide the widest array of economic freedoms to its citizens.
- ANS: B      DIF: Easy      REF: Pages 30-31      OBJ: 2-4  
NAT: BUSPROG: Communication      TOP: Socialism      KEY: Bloom's Knowledge
156. In late 2010, in order to increase their growth, many socialistic economies have decided to
- increase government spending.
  - eliminate some public benefits.
  - increase some public benefits.
  - increase government spending by eliminating public benefits.
- ANS: B      DIF: Easy      REF: Page 31      OBJ: 2-4  
NAT: BUSPROG: Communication      TOP: Socialism      KEY: Bloom's Comprehension
157. The ideas of political philosopher Karl Marx are most closely linked to the economic system known as
- communism.
  - capitalism.
  - socialism.
  - mercantilism.
- ANS: A      DIF: Moderate      REF: Page 31      OBJ: 2-4  
NAT: BUSPROG: Communication      TOP: Communism  
KEY: Bloom's Comprehension
158. Socialist economies have experienced a recent slow down in growth because of
- high taxes and the elimination of public benefits.
  - low taxes and lavish social programs.
  - high taxes and lavish social programs.
  - low taxes and the elimination of public benefits..
- ANS: C      DIF: Moderate      REF: Page 31      OBJ: 2-4  
NAT: BUSPROG: Analytic      TOP: Socialism      KEY: Bloom's Analysis
159. Communist economies have faced a number of issues that have interfered with their effectiveness. The issues include all of the following EXCEPT
- crippling shortages and surpluses.
  - abundant natural resources.
  - corruption.
  - suspension of individual rights and choices.
- ANS: B      DIF: Moderate      REF: Page 31      OBJ: 2-4  
NAT: BUSPROG: Communication      TOP: Communism  
KEY: Bloom's Comprehension
160. Today the economies of virtually all nations would be classified as
- pure socialism.
  - mixed economies.
  - pure capitalism.
  - combined economies.

ANS: B      DIF: Easy      REF: Page 31      OBJ: 2-5  
NAT: BUSPROG: Communication  
TOP: Mixed Economies: The Story of the Future  
KEY: Bloom's Knowledge

161. One reason pure market economies are nonexistent is because they
- are too expensive to maintain.
  - don't adequately provide for the sick, the young, the elderly, and the environment.
  - result in very high tax rates that undermine incentives.
  - don't do enough to encourage entrepreneurship.

ANS: B      DIF: Easy      REF: Page 31      OBJ: 2-5  
NAT: BUSPROG: Communication  
TOP: Mixed Economies: The Story of the Future  
KEY: Bloom's Comprehension

162. Most business enterprises in the United States are privately owned, but the federal government owns a number of major enterprises, e.g., the U.S. Postal Service. This suggests that the U.S. economy is best classified as a
- pure market economy.
  - mixed economy.
  - true command economy.
  - pure planned economy.

ANS: B      DIF: Easy      REF: Page 31      OBJ: 2-5  
NAT: BUSPROG: Communication  
TOP: Mixed Economies: The Story of the Future  
KEY: Bloom's Comprehension

163. To stimulate competition and protect both consumers and workers, the federal government
- places heavy taxes on firms in monopolistic competition.
  - places limits on international trade in order to stimulate domestic production.
  - creates regulations to intervene in the free market.
  - creates business systems to meet the needs of all consumers.

ANS: C      DIF: Easy      REF: Page 31      OBJ: 2-5  
NAT: BUSPROG: Communication  
TOP: Mixed Economies: The Story of the Future  
KEY: Bloom's Comprehension

164. Natasha is very unhappy with conditions in her country. She has very little economic or political freedom. Virtually all productive enterprises are owned by the government, and they seem to be run very inefficiently. The result is frequent shortages and surpluses of goods and services. These conditions suggest that Natasha's country relies on a \_\_\_\_\_ economic system.
- communist
  - socialist
  - capitalist
  - monopolistic

ANS: A      DIF: Challenging      REF: Page 31      OBJ: 2-4  
NAT: BUSPROG: Reflective Thinking  
TOP: Communism      KEY: Bloom's Synthesis

165. \_\_\_\_\_ is the process of converting government-owned businesses to private ownership.
- a) Privatization
  - b) Globalization
  - c) Competition
  - d) Collusion

ANS: A      DIF: Easy      REF: Page 31      OBJ: 2-5  
NAT: BUSPROG: Communication  
TOP: Mixed Economies: The Story of the Future  
KEY: Bloom's Knowledge

166. The government of Puritania has begun a program to restructure the economy, with a goal of moving toward a more market-oriented system. Which of the following is LEAST likely to occur as the result of this restructuring?
- a) A rise in social unrest as citizens try to adjust to the economic reforms.
  - b) Privatization of formerly government-owned enterprises.
  - c) Cuts in social programs such as free healthcare and unemployment benefits.
  - d) Slower rates of economic growth and lower standards of living for the majority of citizens.

ANS: D      DIF: Challenging      REF: Pages 31-32      OBJ: 2-5  
NAT: BUSPROG: Reflective Thinking  
TOP: Mixed Economies: The Story of the Future  
KEY: Bloom's Analysis

167. In recent years, the most common reason for tax reforms in formerly planned economies has been to
- a) create a more equal distribution of income.
  - b) create new incentives for domestic and foreign investment.
  - c) eliminate the threat of hyperinflation.
  - d) protect the environment.

ANS: B      DIF: Easy      REF: Page 32      OBJ: 2-5  
NAT: BUSPROG: Communication  
TOP: Mixed Economies: The Story of the Future  
KEY: Bloom's Knowledge

168. What best describes the trend in mixed economies?
- a) Most socialized economies at the leading edge of economic sensibility are being restructured toward free market principles in the interest of sustainability.
  - b) Most economies are abandoning capitalist principles and economic rights in favor of a more socialized approach.
  - c) The trend in first world societies is toward social justice issues like free healthcare and green technology, both proven sustainable approaches to economics.
  - d) The trend is toward the Keynesian approach to centrally planned, demand-side models of the economy, because these have historically proven themselves to work best.

ANS: A      DIF: Challenging      REF: Page 32      OBJ: 2-5  
NAT: BUSPROG: Reflective Thinking  
TOP: Mixed Economies: The Story of the Future  
KEY: Bloom's Synthesis

169. \_\_\_\_\_ measures the total value of all final goods and services produced within a nation's borders over a given period of time.
- a) The consumer price index
  - b) Gross domestic product
  - c) Net national production
  - d) The production function

ANS: B      DIF: Easy      REF: Page 32      OBJ: 2-6  
NAT: BUSPROG: Communication      TOP: Gross Domestic Product  
KEY: Bloom's Knowledge

170. Two key phases of the business cycle are
- a) trend and random variation.
  - b) inflation and recession.
  - c) contraction and expansion.
  - d) inflation and deflation.

ANS: C      DIF: Easy      REF: Page 33      OBJ: 2-6  
NAT: BUSPROG: Communication      TOP: The Business Cycle  
KEY: Bloom's Knowledge

171. Manufacturing jobs have migrated overseas due to increased productivity and low wages of workers in other countries. This contributes to \_\_\_\_\_ unemployment for American workers in the manufacturing sector.
- a) structural
  - b) frictional
  - c) seasonal
  - d) cyclical

ANS: A      DIF: Moderate      REF: Page 33      OBJ: 2-6  
NAT: BUSPROG: Analytic      TOP: Employment Level  
KEY: Bloom's Analysis

172. In the business cycle, when is an economy in recession?
- a) when the economic "feel good factor" disappears
  - b) when the GDP decreases for two consecutive years
  - c) an especially deep and prolonged "trough" in the market
  - d) when the GDP decreases for two consecutive quarters

ANS: D      DIF: Challenging      REF: Page 33      OBJ: 2-6  
NAT: BUSPROG: Communication      TOP: The Business Cycle  
KEY: Bloom's Knowledge

173. In the business cycle, a period in which GDP declines for at least two consecutive quarters is known as a(n)
- a) expansion.
  - b) depression.
  - c) trough.
  - d) recession.

ANS: D      DIF: Easy      REF: Page 33      OBJ: 2-6  
NAT: BUSPROG: Communication      TOP: The Business Cycle  
KEY: Bloom's Knowledge



174. Denise is a hard worker, but within the last year she and her boss, Angela, have not seen eye to eye. Angela has become more demanding and harder to reach to get clarification on projects. After one too many long working days with little or no job satisfaction, Denise walks into Angela's office and submits her resignation. Denise knows that her resumé is strong and feels confident she will find work. Denise is now facing \_\_\_\_\_ unemployment.
- a) seasonal
  - b) structural
  - c) frictional
  - d) cyclical

ANS: C      DIF: Challenging      REF: Page 33      OBJ: 2-6  
NAT: BUSPROG: Reflective Thinking      TOP: Employment Level  
KEY: Bloom's Evaluation

175. The economic measure that provides the most information about what is happening to prices of consumer goods is the
- a) GDP.
  - b) PPI.
  - c) GNP.
  - d) CPI.

ANS: D      DIF: Easy      REF: Page 34      OBJ: 2-6  
NAT: BUSPROG: Analytic      TOP: Price Levels  
KEY: Bloom's Analysis

176. In the business cycle, a transition period of rising economic growth and increasing employment is a
- a) recovery.
  - b) peak.
  - c) contraction.
  - d) disinflation.

ANS: A      DIF: Easy      REF: Page 34      OBJ: 2-6  
NAT: BUSPROG: Communication      TOP: The Business Cycle  
KEY: Bloom's Knowledge

177. \_\_\_\_\_ is a period of robust economic growth and high employment indicating that businesses are capitalizing on new market opportunities.
- a) Expansion
  - b) Recovery
  - c) Depression
  - d) Contraction

ANS: A      DIF: Easy      REF: Page 34      OBJ: 2-6  
NAT: BUSPROG: Communication      TOP: The Business Cycle  
KEY: Bloom's Knowledge

178. \_\_\_\_\_ means that prices on average are rising.
- a) Deflation
  - b) Inflation
  - c) Disinflation
  - d) Hyperinflation

ANS: B      DIF: Easy      REF: Page 34      OBJ: 2-6  
NAT: BUSPROG: Communication      TOP: Price Levels      KEY: Bloom's Knowledge

179. To evaluate inflation, the government uses
- inflation and disinflation.
  - the consumer price index (CPI) and producer price index (PPI).
  - productivity and unemployment.
  - monetary policy and fiscal policy.

ANS: B      DIF: Easy      REF: Page 34      OBJ: 2-6  
NAT: BUSPROG: Communication      TOP: Price Levels  
KEY: Bloom's Comprehension

180. The Consumer Price Index (CPI) measures the
- change in the prices of gas and energy.
  - change in weighted-average price over time in a "market basket" of goods and services bought by the typical consumer.
  - change in prices of a set of goods representing the minimum acceptable standard of living for the nation's consumers.
  - percentage of their income consumers must use to pay for goods relative to their average incomes in the same time period.

ANS: B      DIF: Easy      REF: Page 34      OBJ: 2-6  
NAT: BUSPROG: Communication      TOP: Price Levels      KEY: Bloom's Knowledge

181. Changes in the PPI can predict changes in the Consumer Price Index (CPI) because
- consumers pay what retailers charge.
  - they are computed using the same market basket.
  - producers often pass along price increases to consumers.
  - consumers and producers often buy the same goods.

ANS: C      DIF: Easy      REF: Page 34      OBJ: 2-6  
NAT: BUSPROG: Communication      TOP: Price Levels      KEY: Bloom's Knowledge

182. The amount of goods and services produced by an economy divided by the amount of resources used to make those goods and services, measures economic
- consumer price index.
  - deflation.
  - inflation.
  - productivity.

ANS: D      DIF: Easy      REF: Page 34      OBJ: 2-6  
NAT: BUSPROG: Communication      TOP: Productivity      KEY: Bloom's Knowledge

183. An economy is experiencing hyperinflation when average prices of goods and services
- rise faster than productivity.
  - increase by more than 100% in a year.
  - increase more than 50% per month.
  - decrease more than 50% per day.

ANS: C      DIF: Moderate      REF: Page 34      OBJ: 2-6  
NAT: BUSPROG: Communication      TOP: Price Levels      KEY: Bloom's Knowledge

184. Pampered Pooch is a dog groomer in the area looking to increase productivity for the business. Currently, in an eight-hour day, Pampered Pooch can wash and groom 12 large dogs. To calculate productivity, the management of Pampered Pooch would
- divide the number of dogs groomed per day (12) by the amount of labor per day (8 hours).
  - divide the total weight of the dogs by 12, then multiply the results by the number of hours of labor per day (8 hours).
  - divide 8 hours by 12 dogs per day.
  - divide 12 dogs by a 7-day work week and multiply the result by 8.

ANS: A      DIF: Challenging      REF: Page 34      OBJ: 2-6  
 NAT: BUSPROG: Analytic      TOP: Productivity  
 KEY: Bloom's Application

185. Why is a low level of inflation desirable in an economy, and why is deflation not desirable?
- It reflects a healthy economy; people have money and are willing to spend it.
  - Because a low level of inflation keeps a currency from edging too near deflation.
  - Inflation helps to justify investment and keeps a currency strong.
  - Deflation means that the currency is increasing in value, and is actually desirable.

ANS: A      DIF: Challenging      REF: Page 34      OBJ: 2-6  
 NAT: BUSPROG: Reflective Thinking      TOP: Price Levels  
 KEY: Bloom's Synthesis

## ESSAY

186. Explain how macroeconomics differs from microeconomics. Illustrate these differences by identifying some specific topics these two branches of economics would examine.

ANS:

**Macroeconomics** is the study of a country's overall economic issues, such as the employment rate, the gross domestic product, and taxation policies. While macroeconomic issues may seem abstract, they directly impact your day-to-day life, influencing key variables such as what jobs will be available for you, how much cash you'll actually take home after taxes, or how much you can buy with that cash in any given month.

**Microeconomics** focuses on smaller economic units such as individual consumers, families, and individual businesses. Thus, microeconomics would look at how individual firms decide how much output to produce, what prices to charge, and how much labor to hire. It would also look at how consumers decide which products to buy, and why the wage rates of some workers are higher than the wages earned by other workers.

On a broader scale, the constant, changing interplay between micro and macroeconomic factors—individual behavior and broad trends—determines the shape of the entire economy.

NOTE: The examples of micro and macro topics in this answer are by no means exhaustive. Students may come with other equally satisfactory illustrations.

DIF: Challenging      REF: Page 19      OBJ: 2-1  
 NAT: BUSPROG: Reflective Thinking      TOP: Economics: Navigating a Crisis  
 KEY: Bloom's Evaluation

187. Describe the events that led up to the 2008-2009 global economic crisis.

ANS:

The events that lead up to the global economic crisis began almost a decade earlier. Even though the United States economy experienced unprecedented growth during the last half of the 1990s the situation began to change with the collapse of the dot com bubble and the 9/11 terrorist attacks. In response to these events, the Federal Reserve dramatically increased the money supply with a sharp reduction in the interest rates. As a result, the economy was awash with money, but opportunities to invest yielded paltry returns. At this time, subprime mortgage loans came into play. Subprime mortgage loans are targeted to borrowers with low credit scores, high debt-to-income ratios, or other signs of a reduced ability to repay the money they borrow. These mortgage loans allowed hundreds of thousands of people who previously could not purchase homes to borrow money to purchase one. As demand for homes increased, home prices continued to rise creating even greater demand. Banks and investment houses invented a range of stunningly complex financial instruments to slice up and resell the mortgages as specialized securities. Hedge funds swapped the new securities, convinced that they were risk-free. With a lack of government regulation, financial institutions did not maintain sufficient reserves in case those mortgage-backed funds lost value.

Like all good times, the meteoric rise in housing prices came to an end peaking in 2006, at which time they began to fall precipitously. As housing prices depreciated, many subprime borrowers found themselves owing their lenders more than the value of their home. This led to an increase in foreclosure rates. As mortgage values dropped, financial institutions such as Bear Stearns and Washington Mutual began to collapse, creating a wave of fear that spread throughout the entire banking industry. As fear spread throughout the industry, banks became unwilling to lend money, so funds were not available for businesses to finance their day-to-day operations or invest for the long term. As credit dried up, large and small companies alike began to announce layoffs.

DIF: Challenging REF: Pages 19-20 OBJ: 2-1

NAT: BUSPROG: Reflective Thinking

TOP: Global Economic Crisis: How Did This Happen?

KEY: Bloom's Synthesis

188. How did the use of subprime mortgage loans contribute to the economic crisis?

ANS:

Subprime mortgages are loans to borrowers with low credit scores, high debt-to-income ratios, or other signs of a reduced ability to repay the money they borrow. These subprime mortgage loans were attractive to borrowers and lenders offering many subprime borrowers the opportunity to purchase a home for the first time. Lenders were willing to loan these subprime borrowers money, often with little or no documentation of income, since the fees charged for these loans were so attractive and provided a higher return compared to many other investments. As demand for these loans skyrocketed, home prices continued to rise creating even more demand for these risky loans. When housing prices peaking in 2006 and then began to drop precipitously, many of these subprime borrowers found they owed their lenders more than the value of their homes. Once this happened, they were not able to refinance to achieve lower monthly payments. Foreclosure rates climbed at an increasing pace. As the rate of foreclosures increased, financial institutions such as Bear Stearns and Washington Mutual began to feel pressure and ultimately collapsed setting off a wave of fear that washed over the entire banking industry.

DIF: Challenging REF: Pages 19-20 OBJ: 2-1  
 NAT: BUSPROG: Reflective Thinking  
 TOP: Global Economic Crisis: How Did This Happen?  
 KEY: Bloom's Synthesis

189. Explain the difference between monetary and fiscal policy and explain how they are formulated and by whom.

ANS:

**Fiscal policy** refers to government efforts to influence the economy through taxation and spending decisions that are designed to encourage growth, boost employment, and curb inflation. This type of policy is enacted by Congress through the budget process.

**Monetary policy** refers to actions that shape the economy by influencing interest rates and the supply of money. The Federal Reserve System, better known as the Fed, manages U.S. monetary policy. It does so by controlling the amount of reserves banks have available for making loans. The most frequently used tool for this purpose is open market operations, which consist of the Fed's purchase and sale of government securities.

DIF: Challenging REF: Page 22|Pages 24-26 OBJ: 2-2  
 NAT: BUSPROG: Analytic  
 TOP: Managing the Economy Through Fiscal and Monetary Policy  
 KEY: Bloom's Analysis

190. Identify and explain the three key tools the Federal Reserve uses to expand and contract the money supply.

ANS:

The Fed uses three key tools expand and contract the money supply:

- open market operations
- discount rate changes
- reserve requirement changes

**Open Market Operations:** This is the Fed's most frequently used tool. Open market operations involve buying and selling government securities, which include treasury bonds, notes, and bills. These securities are the IOUs the government issues to finance its deficit spending.

When the economy is weak, the Fed *buys* government securities on the open market. When the Fed pays the sellers of these securities, money previously held by the Fed is put into circulation, increasing the money supply. This directly stimulates spending. In addition, any of the additional funds supplied by the Fed that are deposited in banks will allow banks to make more loans, making credit more readily available. This encourages even more spending and further stimulates the economy.

When inflation is a concern, the Fed *sells* securities. Buyers of the securities write checks to the Fed to pay for securities they bought, and the Fed withdraws these funds from banks. With fewer funds, banks must cut back on the loans they make, credit becomes tighter and the money supply shrinks. This reduces spending and cools off the inflationary pressures in the economy.

**Discount Rate Changes:** The discount rate is the interest rate the Fed charges on its loans to commercial banks. When the Fed reduces the discount rate, banks can obtain funds at a lower cost and use these funds to make more loans to their own customers. With the cost of acquiring funds from the Fed lower, interest rates on bank loans also tend to fall. The result: businesses and individuals are more likely to borrow money and spend it, which stimulates the economy.

**Reserve Requirement Changes:** The Fed requires that all of its member banks hold funds, called reserves, equal to a stated percentage of the deposits held by their customers. This percentage is called the reserve requirement (or required reserve ratio). The reserve requirement, currently standing at about 10%, helps protect depositors, who may want to withdraw their money without notice.

If the Fed increases the reserve requirement, banks must hold more funds, meaning they will have fewer funds available to make loans. This decreases the money supply, makes credit tighter, and causes interest rates to rise. If the Fed decreases the reserve requirement, some of the funds that banks were required to hold become available for loans. This increases the availability of credit and causes interest rates to drop.

DIF: Challenging REF:Pages 25-26 OBJ: 2-2  
 NAT: BUSPROG: Reflective Thinking TOP: Monetary Policy  
 KEY: Bloom's Evaluation

191. Explain how the Fed can use the reserve requirement to influence interest rates and the availability of loans. Why is the Fed reluctant to make frequent changes in the reserve requirement?

ANS:

The Fed requires that all of its member banks hold funds, called reserves, equal to a stated percentage of the deposits held by their customers. This percentage is called the reserve requirement (or required reserve ratio). The reserve requirement helps protect depositors, who may want to withdraw their money without notice.

Currently, the reserve requirement stands at about 10%, depending on the size and type of a bank's deposits. If the Fed increases the reserve requirement, banks must hold more funds, meaning they will have fewer funds available to make loans. This makes credit tighter and causes interest rates to rise. It decreases the money supply.

If the Fed decreases the reserve requirement, some of the funds that banks were required to hold become available for loans. This increases the availability of credit and causes interest rates to drop. It also increases the money supply. Since changes in the reserve requirement can have a dramatic impact on both the economy and the financial health of individual banks, the Fed uses this tool quite infrequently.

DIF: Challenging REF:Page 26 OBJ: 2-2  
 NAT: BUSPROG: Reflective Thinking TOP: Monetary Policy  
 KEY: Bloom's Synthesis

192. What are the fundamental rights of capitalism? Include an example of each to support your answer.

ANS:

The right to own a business and keep after-tax profits: Remember that capitalism doesn't guarantee that anyone will actually earn profits. Nor does it promise that there won't be taxes. But if you do earn profits, you get to keep your after-tax income and spend it however you see fit (within the limits of the law, of course). This right acts as a powerful motivator for business owners in a capitalist economy; the lower the tax rate, the higher the motivation.

The right to private property: This means that individuals and private businesses can buy, sell, and use property—which includes land, machines, and buildings—in any way that makes sense to them. This right also includes the right to will property to family members.

The right to free choice: Capitalism relies on economic freedom. People and businesses must be free to buy (or not buy) according to their wishes. They must be free to choose where to work (or not work) and where to live (or not live). Freedom of choice directly feeds competition, creating a compelling incentive for business owners to offer the best goods and services at the lowest prices. U.S. government trade policies boost freedom of choice by encouraging a wide array of both domestic and foreign producers to compete freely for the consumer's dollars.

The right to fair competition: A capitalist system depends on fair competition among businesses to drive higher quality, lower prices, and more choices. Capitalism can't achieve its potential if unfair practices—such as deceptive advertising, predatory pricing, and broken contracts—mar the free competitive environment.

DIF: Challenging REF:Page 27

OBJ: 2-3

NAT: BUSPROG: Reflective Thinking

TOP: The Fundamental Rights of Capitalism

KEY: Bloom's Evaluation

193. Define the four degrees of competition. Include at least one example for each.

ANS:

**Pure Competition:** A market structure with many competitors selling virtually identical products. In today's U.S. economy, examples of pure competition have virtually disappeared. The example of agricultural products probably comes the closest.

**Monopolistic Competition:** A market structure with many competitors selling differentiated products. Producers have some control over the price of their wares, depending on the value that they offer their customers. And new producers can fairly easily enter categories marked by monopolistic competition. Examples might include the clothing industry and fast food establishments.

**Oligopoly:** A market structure with only a handful of competitors selling products that are either similar or different. The retail gasoline business and the car manufacturing industry, for example, are both oligopolies. Another example might include the soft drink industry.

**Monopoly:** A market structure with just a single producer completely dominating the industry, leaving no room for any significant competitors. Monopolies usually aren't good for anyone except for the company that has control, since without competition there isn't any incentive to hold down prices or increase quality and choices. Because these undesirable drawbacks can harm the economy, most attempts to monopolize markets in the United States are illegal. However, the

government does allow monopolies to operate in certain special cases. The classic example is a natural monopoly, such as a cable television system, water company, or electric utility. (The pricing and output decisions of such natural monopolies are often regulated by the government to protect the public interest.) The government also fosters temporary monopolies when it grants patents or copyrights.

NOTE: Student answers should include a specific definition; however, the examples will vary based on the text and classroom discussions.

DIF: Challenging REF:Pages 27-29

OBJ: 2-3

NAT: BUSPROG: Reflective Thinking

TOP: Four Degrees of Competition

KEY: Bloom's Evaluation

194. Assume that the price of gasoline is currently falling. What will happen to the quantity of gasoline supplied at your local gas station? Under this circumstance, what else might the local gas station focus on selling to keep profits growing? When the price of gasoline was rising rapidly, how did that impact the demand for transportation and the selection of cars available to consumers? Explain your answers in terms of the principles underlying demand and supply curves.

ANS:

Students' answers may vary, but should show an understanding of the forces of supply and demand

According to the principles of the supply curve, as the price of gasoline falls the amount that your local gas station will be willing to sell will decrease, since the gas station has much less incentive to focus on selling gasoline. The station's management may put more effort into selling items where more profit can be made, such as the food and beverages in the station's convenience store, repair services, or other car-related products.

According to the demand curve, quantity demanded drops as prices rise. When gasoline prices were rising, lower demand was evident as consumers chose lower-cost alternatives to cars, such as public transportation and bicycles. Demand decreased for "gas guzzling" cars such as SUVs and demand increased for cars with more fuel efficiency. The interaction between buyers and sellers of gasoline and cars resulted in the accelerated production of fuel-efficient cars, such as the Toyota Prius and other hybrids. Today, there is an increasing selection of fuel-efficient cars from both domestic and foreign automakers.

DIF: Challenging REF: Pages 29-30

OBJ: 2-3

NAT: BUSPROG: Reflective Thinking

TOP: Supply and Demand: Fundamental Principles of a Free Market System

KEY: Bloom's Synthesis

195. Define the differences and similarities between the command economies of socialism and communism.

ANS:

**Socialism** is an economic system based on the principle that the government should own and operate key enterprises that directly affect public welfare, such as utilities, telecommunications, and healthcare. While the official government goal is to run these enterprises in the best interest of the overall public, inefficiencies and corruption often interfere with effectiveness. Socialist economies also tend to have higher taxes, which are designed to distribute wealth more evenly through society.



**Communism** is an economic and political system that calls for public ownership of virtually all enterprises, under the direction of a strong central government. The communist concept was the brainchild of political philosopher Karl Marx, who outlined its core principles in his 1848 *Communist Manifesto*. Marx's approach was idealistic. He aimed to create a fair society in which each individual would contribute according to his or her ability and consume according to his or her needs. The communism that Marx envisioned was supposed to dramatically improve the lot of the worker at the expense of the extremely wealthy "capitalists" who owned the factories and other means of production.

DIF: Challenging REF: Pages 30-31 OBJ: 2-4  
 NAT: BUSPROG: Reflective Thinking  
 TOP: Planned Economies: Socialism and Communism  
 KEY: Bloom's Evaluation

196. Explain the reason for the current trend toward a mixed market system. Include examples of this trend in your answer.

ANS:

Virtually all nations have mixed economies, falling somewhere along a spectrum that ranges from pure planned at one extreme to pure market at the other. Over the past 30 years, most major economies around the world have moved toward the market end of the spectrum.

Government-owned businesses have converted to private ownership. Socialist governments have reduced red tape, cracked down on corruption, and established new laws to protect economic rights. Lavish human services have shrunk. And tax reform has created new incentives for both domestic and foreign investment.

Examples will vary among students. Students should mention the social aspect of market economies with the government running the postal service, road maintenance, and education. The government stimulates economic growth with regulations that protect consumers and workers as well (Federal Product Safety Commission standards, Food & Drug Administration guidelines). In addition, countries like China, moving toward the market end of the spectrum, have seen the payoff in rejuvenated growth rates that have raised the standard of living for millions of people., etc.)

DIF: Challenging REF: Pages 31-32 OBJ: 2-5  
 NAT: BUSPROG: Reflective Thinking  
 TOP: Mixed Economies: The Story of the Future  
 KEY: Bloom's Synthesis

197. What is gross domestic product? How well does it measure what it is intended to measure?

ANS:

Gross domestic product (GDP) is a measure of the total value of all final goods and services produced within a nation in a given time period. Conceptually, all goods produced within a nation's borders should be included in its GDP, even if the firm producing the output is a foreign-owned corporation. Thus, Hondas produced in the United States are included in the U.S. GDP, even though Honda is a Japanese firm. But Mattel toys produced in China are not included in U.S. GDP, even though Mattel is a U.S. corporation.

GDP tends to understate a nation's total production because it does not include output produced illegally, nor does it include the value of output that is not reported because the producer is trying to avoid paying taxes. Another major omission is the work done within households. For example, when households cook their own meals, mow their own lawns, or do their own household repairs, the value of their labor is not included in the GDP. But if they hire others to do these tasks, the value of these goods and services is included in the GDP (assuming of course that the people performing these services report their incomes).

DIF: Challenging REF:Page 32 OBJ: 2-6  
 NAT: BUSPROG: Reflective Thinking TOP: Gross Domestic Product  
 KEY: Bloom's Evaluation

198. What is unemployment? Identify and describe the four types and each one's effect on the economy.

ANS:

The United States Department of Labor tracks employment levels largely through the **unemployment rate**, which includes everyone age 16 and older who doesn't have a job and is actively seeking one.

**Frictional unemployment** involves a worker quitting or being terminated and has a short-term impact on the economy because during normal times the worker is able to find new employment relatively quickly. It tends to be ultimately positive since the chances are good that you will find employment that is a better fit for you.

**Structural unemployment**, on the other hand, is usually longer term. This category encompasses people who don't have jobs because the economy no longer needs their skills. In the U.S., growing numbers of workers in the past decade have found themselves victims of structural unemployment as manufacturing jobs have moved overseas. Often their only option is expensive retraining.

Two other categories of unemployment are **cyclical**, which involves layoffs during recessions, and **seasonal**, which involves job loss related to the time of year. An example of seasonal unemployment is the loss of jobs by landscapers during cold winter months.

DIF: Challenging REF:Pages 32-33 OBJ: 2-6  
 NAT: BUSPROG: Reflective Thinking TOP: Employment Level  
 KEY: Bloom's Evaluation

199. What is a business cycle? Describe the basic phases of a typical business cycle.

ANS:

The business cycle is the periodic expansion and contraction of economic activity that occurs in a nation's economy over a period of years. One key phase of the business cycle is contraction: a period of economic downturn marked by rising unemployment, businesses cutting back on production, and consumers shifting their buying patterns to more basic products and fewer luxuries. The other key phase of the business cycle is expansion: a period of robust, economic growth marked by businesses expanding to capitalize on emerging opportunities; consumers purchase more products, which leads to more production that in turn creates more jobs. The bottom of a contraction is called a trough, while the high point of an expansion is called a peak. If a contraction results in a decline in GDP for at least two consecutive quarters, the downturn is classified as a recession. A depression is an extremely severe and long-lasting recession. Depressions are rare; the last full-blown depression in the United States occurred in the 1930s.

DIF: Challenging REF:Pages 33-34 OBJ: 2-6  
NAT: BUSPROG: Reflective Thinking TOP: The Business Cycle  
KEY: Bloom's Evaluation

200. Compare and contrast the Consumer Price Index (CPI) and Producer Price Index (PPI) as measures of price changes in the economy.

ANS:

The government uses two major price indexes to evaluate inflation: the **Consumer Price Index (CPI)**, and the **Producer Price Index (PPI)**.

The CPI measures the change in weighted-average price over time in a consumer “market basket” of goods and services that the average person buys each month. The U.S. Bureau of Labor Statistics creates the basket—which includes hundreds of items such as housing, transportation, haircuts, wine, and pet care—using data from more than 30,000 consumers. While the market basket is meant to represent the average consumer, keep in mind that the “average” includes a lot of variation, so the CPI may not reflect individual personal experience. If you don't have a pet, for example, changes in veterinary costs wouldn't affect you, although they would (slightly) impact the CPI.

The PPI measures the change over time in weighted-average wholesale prices, or the prices that businesses pay each other for goods and services. Changes in the PPI can sometimes predict changes in the CPI, because producers tend to pass on price increases (and sometimes also price decreases) to consumers within a month or two of the changes.

DIF: Challenging REF: Page 34 OBJ: 2-6 NAT: BUSPROG: Analytic  
TOP: Price Levels KEY: Bloom's Evaluation