Better Business 4th edition Solomon Test Bank

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Better Business, 4e **(Solomon)**
Chapter 2 Economics and Banking

1) The main function of economics is to study _____.
A) the exchange of goods and services between individuals, businesses, and nations
B) the exchange of cultural information in a diverse society
C) the stock exchange
D) the exchange of diplomatic relations between nations
E) the exchange of ideas about motivation and behavior in the workplace
Answer: A
Explanation: A) Economics is the study of how individuals and businesses make decisions to best satisfy wants, needs, and desires with limited resources. It is about businesses making goods or supplying services that we want or need to buy.
Diff: 1
AACSB: Reflective thinking
LO: 2.1: What is economics, and what are the different types of economic systems?
Classification: Concept

2) Celeste is interested in studying the effects that natural disasters have on the value of goods and services in the affected areas. Her area of study should be _____.
A) marketing
B) microeconomics
C) macroeconomics
D) sociology
E) sustainability
Answer: B
Explanation: B) Microeconomics is the study of how individuals, businesses, households, and consumers allocate their resources in exchange for goods and services. Marketing is the process or technique of selling goods to consumers. Macroeconomics is the study of the behavior of the economy as a whole. Sociology is the study of social relations and change. Sustainability is the use of resources without permanently depleting or damaging the resource.
Diff: 2
AACSB: Reflective thinking
LO: 2.1: What is economics, and what are the different types of economic systems?
Classification: Application

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3) Joseph took a class in macroeconomics, which means that he was studying the behavior of _____.
A) individual businesses
B) people with limited resources
C) the overall economy
D) corporate executives
E) Fortune 500 companies
Answer: C
Explanation: C) Macroeconomics is the study of the behavior of the economy as a whole. The study of behavior of individual businesses, people with limited resources, and corporate executives would fall under the area of microeconomics.
Diff: 1
AACSB: Reflective thinking
LO: 2.1: What is economics, and what are the different types of economic systems?
Classification: Concept

4) A free market economy is one in which _____.
A) the government or other centralized group determines what to produce
B) individuals determine what to produce with some level of government involvement
C) the government controls healthcare while privately owned businesses operate in other market sectors
D) individuals and private firms make decisions based on consumer needs and wants
E) privately owned, profit-seeking enterprises are converted to government-owned production and services
Answer: D
Explanation: D) A market economy is run entirely by individuals and businesses with no government involvement. The other responses refer to planned and mixed economies.
Diff: 1
AACSB: Reflective thinking
LO: 2.1: What is economics, and what are the different types of economic systems?
Classification: Concept
Learning Outcome: Compare and contrast different economic systems

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5) A mixed economy is one in which _____.
A) both resources and means of production are extremely limited and generally confined to agricultural produce
B) the government or other centralized group determines and controls all resources and means of production
C) both individuals and government control resources and determine production methods
D) either individuals or private firms, but not both, control resources and determine production methods
E) there is no government intervention whatsoever in industry
Answer: C
Explanation: C) A mixed economy is one in which individuals, businesses, and government share responsibility for determining allocation of resources and methods of production. The other responses refer to planned economies or market economies.
Diff: 1
AACSB: Reflective thinking
LO: 2.1: What is economics, and what are the different types of economic systems?
Classification: Concept
Learning Outcome: Compare and contrast different economic systems

6) A planned economy is one in which _____.
A) the government or other centralized group determines wages, sets prices, and distributes resources and products to the common group
B) individuals and businesses determine the production methods, with a focus on efficiency and productivity
C) individual income ultimately controls purchasing decisions
D) government distributes some goods and services through selected social programs, and individual income determines purchasing decisions for other goods and services
E) the production and pricing of goods and services is determined through the operation of a market
Answer: A
Explanation: A) A planned economy is one in which the government controls the distribution of goods and resources. The other responses refer to market economies and mixed economies.
Diff: 1
AACSB: Reflective thinking
LO: 2.1: What is economics, and what are the different types of economic systems?
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7) John is an employee at a car manufacturer. Today he has come into work to find that production has stopped because the government has determined that the steel used in the cars will be better used in the manufacture of a new railway line. John doesn't mind, because although his wages are low, he gets paid whether there is any work for him to do or not. John MOST likely lives in a _____.
A) blended economy
B) planned economy
C) market economy
D) mixed economy
E) capitalist economy
Answer: B
Explanation: B) In a planned economy, government determines what to produce, controls the resources and means of production, and determines wages. Resources and products are distributed to the common group.
Diff: 2
AACSB: Analytical thinking
LO: 2.1: What is economics, and what are the different types of economic systems?
Classification: Application
Learning Outcome: Compare and contrast different economic systems

8) Socialism is similar to communism in that _____.
A) the government provides all of the social services
B) the government fails under economic stress
C) the government distributes goods and services
D) the government does not charge taxes
E) the government does not intervene in industry
Answer: C
Explanation: C) In both socialist and communist states, the government is responsible for distributing both goods and services. However, in a communist state, the entire responsibility for the distribution is in the hands of the government, whereas in a socialist state, the government traditionally runs some of the social services and utilities but also allows for some private enterprise.
Diff: 1
AACSB: Analytical thinking
LO: 2.1: What is economics, and what are the different types of economic systems?
Classification: Application
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9) Which of the following statements is NOT true of a market economy?
A) The pricing of goods is determined by what sellers wish to charge and buyers wish to pay.
B) The system encourages private ownership of resources.
C) The individual makes his or her own economic decisions.
D) The government may supply some goods or services.
E) The economy is defined by a freedom of choice for both buyers and sellers.
Answer: D
Explanation: D) In a free market economy, the government does not intervene in the production of goods or services. Most modern economies, including that of the United States, are mixed economies of privately owned businesses and some government control of social services.
Diff: 2
AACSB: Reflective thinking
LO: 2.1: What is economics, and what are the different types of economic systems?
Classification: Concept
Learning Outcome: Compare and contrast different economic systems

10) _____ is one of the countries closest to having a planned economy, and _____ is one of the countries closest to having a market economy.
A) Russia; Italy
B) India; Norway
C) Russia; Norway
D) Cuba; Singapore
E) Canada; China
Answer: D
Explanation: D) According to Figure 2.1: Cuba is at the end of the spectrum closest to a planned economy, and Singapore is at the end of the spectrum closest to a market economy.
Diff: 1
AACSB: Reflective thinking
LO: 2.1: What is economics, and what are the different types of economic systems?
Classification: Concept
Learning Outcome: Compare and contrast different economic systems

11) Microeconomics is the study of the behavior of the overall economies of small countries.
Answer: FALSE
Explanation: Microeconomics is the study of how individual businesses, households, and consumers make decisions to allocate their resources in the exchange of goods and services. Macroeconomics is the study of the behavior of the overall economy.
Diff: 1
AACSB: Analytical thinking
LO: 2.1: What is economics, and what are the different types of economic systems?
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12) Macroeconomics is the study of how certain occurrences affect the economy as a whole.
Answer: TRUE
Explanation: Macroeconomics is the study of the behavior of the overall economy.
Diff: 1
AACSB: Analytical thinking
LO: 2.1: What is economics, and what are the different types of economic systems?
Classification: Concept

13) The supply of services is not part of the study of economics because it does not involve the exchange of goods.
Answer: FALSE
Explanation: The supply of services is part of the study of economics because services are exchanged for resources the same way goods are.
Diff: 1
AACSB: Analytical thinking
LO: 2.1: What is economics, and what are the different types of economic systems?
Classification: Concept

14) Economics is the study of how goods and services are exchanged between individuals, businesses, and governments.
Answer: TRUE
Explanation: Economics is the study of how individuals and businesses make decisions to best satisfy wants, needs, and desires.
Diff: 1
AACSB: Analytical thinking
LO: 2.1: What is economics, and what are the different types of economic systems?
Classification: Concept

15) Communism and socialism are examples of market economies.
Answer: FALSE
Explanation: These are examples of planned economic systems, in which the government plays a significant role in determining the goods and services produced and distributed.
Diff: 1
AACSB: Analytical thinking
LO: 2.1: What is economics, and what are the different types of economic systems?
Classification: Concept
Learning Outcome: Compare and contrast different economic systems

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16) In a planned economy, an individual's personal income dictates his or her spending choices.
Answer: FALSE
Explanation: In a planned economy, the government determines wages and sets prices, and resources are distributed throughout the group. In a market economy, the individual's personal income and preferences control their purchasing decisions.
Diff: 1
AACSB: Analytical thinking
LO: 2.1: What is economics, and what are the different types of economic systems?
Classification: Concept
Learning Outcome: Compare and contrast different economic systems

17) Although the United States comes close to being a capitalist economy, it is considered a mixed economy because there is some government intervention.
Answer: TRUE
Explanation: Capitalism is an economic system that allows freedom of choice for both buyers and sellers and encourages private ownership of resources. However, the United States is a mixed economy because its government does collect and distribute some resources under certain circumstances.
Diff: 1
AACSB: Reflective thinking
LO: 2.1: What is economics, and what are the different types of economic systems?
Classification: Concept
Learning Outcome: Compare and contrast different economic systems

18) Business managers do not need to be aware of the decisions of collective businesses outside their own industry.
Answer: FALSE
Explanation: Business managers need to be aware of any decisions by the government (e.g., a change in interest rates) or by collective businesses (e.g., the level of unemployment) that may impact the economy as a whole.
Diff: 1
AACSB: Reflective thinking
LO: 2.1: What is economics, and what are the different types of economic systems?
Classification: Concept

19) Define economics and explain the difference between microeconomics and macroeconomics.
Answer: Economics is the study of how governments, businesses, and individuals make decisions to best satisfy their wants and needs with limited resources. Microeconomics focuses on how individual businesses and consumers make decisions to allocate their resources. Macroeconomics focuses on the behavior of the overall economy.
Diff: 1
AACSB: Reflective thinking
LO: 2.1: What is economics, and what are the different types of economic systems?
Classification: Concept

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20) Explain the differences between how a market economy and a mixed economy decide what to produce, how to produce it, and for whom to produce it.
Answer: In a market economy, individuals and private firms make decisions about what to produce based on consumer needs and wants with no government involvement. Individuals and private firms determine production methods based on calculations of efficiency and profitability. Individual income ultimately controls purchasing decisions. In a mixed economy, individuals and private firms make decisions about what to produce, but the government is involved in providing services and regulating some aspects of conducting business. Individuals and private firms determine production methods, but may be influenced or regulated by the government. Government distributes some goods and services through social programs, but individual income informs most purchasing decisions.
Diff: 2
AACSB: Reflective thinking
LO: 2.1: What is economics, and what are the different types of economic systems?
Classification: Concept
Learning Outcome: Compare and contrast different economic systems

21) Which transaction best describes bartering?
A) an exchange of goods for currency, in which the price of something is determined by establishing its value against an underlying commodity
B) a transfer of goods without an exchange of currency, in which the price of something is determined by the seller, and the buyer agrees to pay at a later time
C) an exchange of goods without an exchange of currency, in which the price of something is determined by the needs and resources of each person involved in the exchange
D) an exchange of goods for currency, in which the price of something is determined by what buyers are willing to pay
E) an exchange of currency without an exchange of goods, in which the price of something is determined by what sellers demand
Answer: C
Explanation: C) The barter system involved a trading of goods without an exchange of money where the price was determined by the needs and resources of each person taking part in the exchange. Response A) refers to the use of currency in a transaction in which the price of an item depends on its value relative to a consistent standard; Response B) to a transaction involving credit; and Response D) to a transaction in which the price is set by the law of demand. Response E) mixes up aspects of several of the other responses.
Diff: 2
AACSB: Analytical thinking
LO: 2.2: What are the principles of supply and demand and the factors that affect each principle?
Classification: Concept

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22) Mae's Country Kitchen sells out of her cinnamon rolls every morning before 8:30 a.m., and her later customers ask her to make more. The next day, Mae makes an additional two dozen cinnamon rolls and raises the price of an individual cinnamon roll by 50¢. She sells all but one of them. Mae has found the _____ price of her cinnamon rolls.
A) market
B) supply
C) demand
D) determinant
E) surplus
Answer: A
Explanation: A) The market price is the price at which everyone who wants the item can get it without surplus or further demand.
Diff: 2
AACSB: Analytical thinking
LO: 2.2: What are the principles of supply and demand and the factors that affect each principle?
Classification: Application
Learning Outcome: Discuss strategies for setting and adjusting prices

23) The amount of a product or service that is available for purchase at any given time is called _____.
A) commodity
B) surplus
C) supply
D) demand
E) shortage
Answer: C
Explanation: C) Supply is the amount of a product or service available; commodities are particular economic goods; a surplus is the amount of supply over the demand; demand is the need for an item; shortage is not having enough of an item.
Diff: 1
AACSB: Reflective thinking
LO: 2.2: What are the principles of supply and demand and the factors that affect each principle?
Classification: Concept

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24) Prices become higher when a unique and highly desirable item is auctioned _____.
A) because the supply and demand are equal
B) because the demand is higher than the supply
C) because the supply is higher than the demand
D) because the supply and demand are kept unknown
E) because the demand is lower than the supply
Answer: B
Explanation: B) Prices increase depending on demand, therefore, the greater the demand the higher the price. If similar or identical items are offered for auction, there is less demand; therefore, the selling price is likely to be lower than for the unique and highly desirable item.
Diff: 1
AACSB: Reflective thinking
LO: 2.2: What are the principles of supply and demand and the factors that affect each principle?
Classification: Concept

25) According to the law of supply, the amount of a good or service supplied will increase as the price increases, and decrease as the price decreases. This direct relationship exists because _____.
A) supply is not dependent on the resources required to produce the product
B) supply is derived from a producer's desire to maximize profit
C) supply is affected by the number of suppliers
D) supply is not affected by the quantity of similar or substitute products
E) supply is affected by changes in technology
Answer: B
Explanation: B) All else held constant, supply is derived from a producer's desire to maximize profits. The more money a business can get for its good or service, the more of its product it is willing to supply.
Diff: 2
AACSB: Analytical thinking
LO: 2.2: What are the principles of supply and demand and the factors that affect each principle?
Classification: Application

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26) A supply curve illustrates _____.
A) that as supply decreases, demand decreases
B) the effects of price on quantity supplied
C) the effects of price on quantity demanded
D) that as supply increases, the price stays the same
E) the effects of changes in resource prices on supply
Answer: B
Explanation: B) Supply curves illustrate that supply increases as the prices increases. The more a supplier can charge for a product, the more of that product he will want to supply.
Diff: 2
AACSB: Reflective thinking
LO: 2.2: What are the principles of supply and demand and the factors that affect each principle?
Classification: Concept

27) _____ refers to how much of a product or service people want to buy at any given time.
A) Commodity
B) Surplus
C) Supply
D) Demand
E) Equilibrium
Answer: D
Explanation: D) Demand refers to how much of a product or service people want to buy at any given time. Commodities are particular economic goods. A surplus is the amount of supply that exceeds market demand; supply is the amount of the item available; equilibrium is the point at which supply meets with demand.
Diff: 1
AACSB: Reflective thinking
LO: 2.2: What are the principles of supply and demand and the factors that affect each principle?
Classification: Concept

28) A demand curve illustrates _____.
A) the effects of price on quantity demanded
B) that as price increases, demand stays the same
C) the effects of supply on quantity demanded
D) that demand decreases as price decreases
E) the effects on population changes on demand
Answer: A
Explanation: A) Demand curves illustrate that demand increases as prices decrease by showing the relationship between price and quantity demanded.
Diff: 1
AACSB: Reflective thinking
LO: 2.2: What are the principles of supply and demand and the factors that affect each principle?
Classification: Concept

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29) When the supply curve and the demand curve for a single product or service are shown on the same graph, the point at which the curves intersect identifies the _____.
A) total profit earned by the producers
B) market price of the good
C) quality of the good or service being purchased
D) amount of the surplus to be anticipated
E) number of substitute goods available
Answer: B
Explanation: B) The market price of an item is the price at which supply equals demand. Therefore, the market price is the point at which the supply curve and the demand curve intersect.
Diff: 1
AACSB: Reflective thinking
LO: 2.2: What are the principles of supply and demand and the factors that affect each principle?
Classification: Concept

30) Taken together, the iPod and iTunes are _____.
A) substitute goods
B) complementary goods
C) competitive goods
D) monopolistic goods
E) intangible goods
Answer: B
Explanation: B) Products or services that go with each other and are consumed together, such as the iPod and iTunes, are considered complementary goods. The demand for iTunes is great as long as consumers are buying and using iPods and other portable media devices. These two products do not substitute for or compete with one another. Apple, their manufacturer, is successful in the market, but is not a monopoly, since there are substitute products that consumers may choose to purchase. An iPod is a physical item that can be touched, so it is not an intangible good.
Diff: 1
AACSB: Reflective thinking
LO: 2.2: What are the principles of supply and demand and the factors that affect each principle?
Classification: Application

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31) Pilar's daughter wants a Betty the Builder doll for Christmas. When Pilar gets to the toy store they are sold out, so she goes to another store. There she is told that they have a limited quantity, which will go on special sale at 6 a.m. the next morning–and that she'd better get in line early. This is an example of which of the following determinants of demand?
A) complementary goods
B) population changes
C) substitute goods
D) consumer preference
E) changes in income levels
Answer: D
Explanation: D) Consumer preference drives demand by increasing popularity of the item.
Diff: 1
AACSB: Reflective thinking
LO: 2.2: What are the principles of supply and demand and the factors that affect each principle?
Classification: Application

32) One example of complementary goods is _____.
A) cheese and crackers
B) cable television and Internet service
C) dog food and a dog bowl
D) a cell phone and wireless phone service
E) magazines and newspapers
Answer: D
Explanation: D) Complementary goods go with each other and are consumed together, and if new technology renders one obsolete, the demand for the other goes down. Although cable TV and Internet may be consumed at the same time and are often bundled together by service providers, neither is necessary to the operation of the other. The other choices are inaccurate because, though they describe items that go with each other and are consumed together, the obsolescence of one does not lead to less demand of the other.
Diff: 2
AACSB: Reflective thinking
LO: 2.2: What are the principles of supply and demand and the factors that affect each principle?
Classification: Application

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33) What are substitute goods?
A) goods that can be used in place of others
B) goods that can be modified to replace others
C) goods that complement others
D) goods that can be used to repair others
E) goods that experience seasonal changes in demand
Answer: A
Explanation: A) Substitute goods can be used in place of others, such as cola-type soft drinks Coke or Pepsi.
Diff: 1
AACSB: Reflective thinking
LO: 2.2: What are the principles of supply and demand and the factors that affect each principle?
Classification: Concept

34) Currency is a unit of exchange for the transfer of goods and services, and provides a consistent standard.
Answer: TRUE
Explanation: Initially the value of the standard was based on an underlying commodity, such as gold. Today, the U.S. currency isn't based on gold, but rather on a perceived value of its worth.
Diff: 1
AACSB: Reflective thinking
LO: 2.2: What are the principles of supply and demand and the factors that affect each principle?
Classification: Concept

35) The price of a product or service is based entirely on its actual value.
Answer: FALSE
Explanation: The price of a product or service is based ultimately on supply and demand, or how much of that product or service is available against the degree to which individuals or businesses need or want it.
Diff: 1
AACSB: Reflective thinking
LO: 2.2: What are the principles of supply and demand and the factors that affect each principle?
Classification: Concept

36) Supply refers to how much of a product or service is available for purchase at a given time.
Answer: TRUE
Explanation: Supply is the availability of a given item or service. It is dependent on a number of factors, including the resources required to produce or offer it.
Diff: 1
AACSB: Reflective thinking
LO: 2.2: What are the principles of supply and demand and the factors that affect each principle?
Classification: Concept

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37) The law of demand states that as the price for an item or service increases, so will the supply and that if the price is lower, the supply will also be less.
Answer: FALSE
Explanation: This statement does not reflect the law of demand but rather the law of supply. The more money a business can get for its good or service, the more of its product it is willing to supply. In economic terms, the amount supplied will increase as the price increases; also, if the price is lower, less of the product is supplied.
Diff: 1
AACSB: Reflective thinking
LO: 2.2: What are the principles of supply and demand and the factors that affect each principle?
Classification: Concept

38) Mae bakes 100 cinnamon rolls each day to sell at her café, and each day she sells out before breakfast is over. Many of her customers ask for, but don't get one. Her customers ask that she bake more cinnamon rolls each day. This is an example of a shortage.
Answer: TRUE
Explanation: The need for an item is *demand,* and the availability of that item is *supply*. Because the number of people who want the cinnamon rolls is greater than the number of cinnamon rolls available, the supply does not meet the demand, and there is a shortage.
Diff: 1
AACSB: Analytical thinking
LO: 2.2: What are the principles of supply and demand and the factors that affect each principle?
Classification: Application

39) Holding all other factors constant, prices are set slightly above the point where supply equals demand.
Answer: FALSE
Explanation: Holding all other factors constant, prices are set at a point where supply exactly equals demand. This is known as the market price.
Diff: 1
AACSB: Reflective thinking
LO: 2.2: What are the principles of supply and demand and the factors that affect each principle?
Classification: Concept
Learning Outcome: Discuss strategies for setting and adjusting prices

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40) The price at which supply of an item or service equals the demand for that item is known as the market price.
Answer: TRUE
Explanation: Holding all other factors constant, prices are set at a point where supply equals demand.
Diff: 1
AACSB: Reflective thinking
LO: 2.2: What are the principles of supply and demand and the factors that affect each principle?
Classification: Concept
Learning Outcome: Discuss strategies for setting and adjusting prices

41) Changes in the prices of resources do not help determine supply because those resources can be replaced by substitute goods.
Answer: FALSE
Explanation: Changes in resource prices help determine supply by altering the price of production. An increase in resource prices increases the cost of production and reduces profits, thus lowering the incentive to supply a product.
Diff: 1
AACSB: Reflective thinking
LO: 2.2: What are the principles of supply and demand and the factors that affect each principle?
Classification: Concept
Learning Outcome: Discuss strategies for setting and adjusting prices

42) Population changes are a key determinant of demand for goods and services.
Answer: TRUE
Explanation: Population changes help determine demand by increasing or reducing the amount of goods and services a given location can supply and still maintain economic equilibrium.
Diff: 1
AACSB: Reflective thinking
LO: 2.2: What are the principles of supply and demand and the factors that affect each principle?
Classification: Concept

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43) Mae is considering raising the price of her cinnamon rolls in order to maximize her profits. Describe the factors that will help her determine the best price for her cinnamon rolls.
Answer: Mae should take into consideration the basic conflict of price-setting, which is that the higher the price of an item, the more likely she is to supply the product, but that the lower the price, the more likely the product is to be purchased. Mae must consider whether the demand for her cinnamon rolls is high enough that customers will still want to buy them at a higher price. Holding all other factors constant, prices are set at a point where supply equals demand.
Diff: 2
AACSB: Analytical thinking
LO: 2.2: What are the principles of supply and demand and the factors that affect each principle?
Classification: Application
Learning Outcome: Discuss strategies for setting and adjusting prices

44) How might a decrease in income levels lead to population changes?
Answer: A decrease in income levels might lead to population changes if it becomes necessary for people to sell their homes and/or move to another community in search of employment. Income losses also affect discretionary spending. For instance, people who have had a decrease in income are less likely to go on vacation and take part in seasonal rentals or activities. This might then negatively impact the economy in seasonal towns, leading to additional decreases of income in regions that rely on tourism.
Diff: 3
AACSB: Analytical thinking
LO: 2.2: What are the principles of supply and demand and the factors that affect each principle?
Classification: Synthesis

45) How do consumer preferences for popular goods affect the demand curve? Give an example using a specific product.
Answer: When consumers show a high rate of preference for a particular product or service, the quantity of demand for that item increases and the demand curve shifts to the right (toward more demand). Examples will vary, but students should identify a product with high initial demand, or a demand that grew noticeably stronger over time such as Nintendo Wii, Apple iPad, and Tickle Me Elmo dolls.
Diff: 1
AACSB: Reflective thinking
LO: 2.2: What are the principles of supply and demand and the factors that affect each principle?
Classification: Application

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46) What best determines the level of competition?
A) the degree of population change
B) the number of substitutes for a certain good or service
C) the degree of change in income levels
D) the number of complementary products or service
E) the existence of complementary goods
Answer: B
Explanation: B) Competition is driven by substitute goods and services, one of the factors of demand. The greater the number of substitute products, the more competition a product faces.
Diff: 2
AACSB: Reflective thinking
LO: 2.3: What are the various degrees of competition?
Classification: Concept

47) _____ occurs when there is only one provider of a service or product and no substitutes for the service or product exist.
A) A duopoly
B) A monopoly
C) An oligopoly
D) Perfect competition
E) Monopolistic competition
Answer: B
Explanation: B) True monopolies are rare and the FTC regulates business mergers carefully to prevent the formation of monopolies.
Diff: 1
AACSB: Reflective thinking
LO: 2.3: What are the various degrees of competition?
Classification: Concept

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48) The _____ and the Department of Justice must review mergers between large competitors to determine whether the combined firm would be a monopolistic corporation.
A) Federal Trade Commission
B) Internal Revenue Service
C) Federal Reserve Bank
D) Federal Appeals Court
E) Securities and Exchange Commission
Answer: A
Explanation: A) The Federal Trade Commission and the Department of Justice review proposed mergers to ensure that such a merger would not be disadvantageous to consumers. The IRS, Federal Reserve Bank, the Federal Appeals Court, and the Securities and Exchange Commission are not charged with evaluating proposed mergers to determine the potential impact on consumers.
Diff: 1
AACSB: Reflective thinking
LO: 2.3: What are the various degrees of competition?
Classification: Concept
Learning Outcome: Discuss the functions of different types of financial institutions in the monetary system

49) The government allows some _____ companies to operate as regulated monopolies.
A) airline
B) mining
C) utility
D) timber
E) telecommunications
Answer: C
Explanation: C) Utility companies are often permitted to operate as regulated monopolies because they deal with limited supplies of resources like water. However, although they are allowed to run as monopolies, the government will regulate their prices to ensure that they do not inflate prices.
Diff: 1
AACSB: Reflective thinking
LO: 2.3: What are the various degrees of competition?
Classification: Concept

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50) What is the MOST likely scenario in a monopoly, where only one seller supplies a product or service?
A) Demand may be low.
B) Demand may vary.
C) Supply may be abundant.
D) Supply may be limited.
E) Prices will be low.
Answer: D
Explanation: D) Supply may be limited, potentially increasing cost of products to consumers.
Diff: 1
AACSB: Reflective thinking
LO: 2.3: What are the various degrees of competition?
Classification: Concept

51) _____ occurs when there are a few sellers in a given market and each seller has a fairly large share of that market.
A) Monopolistic competition
B) A monopoly
C) An oligopoly
D) Perfect competition
E) A duopoly
Answer: C
Explanation: C) An oligopoly is a competition in which only a few sellers exist.
Diff: 1
AACSB: Reflective thinking
LO: 2.3: What are the various degrees of competition?
Classification: Concept

52) Which of the following industries is LEAST likely to form an oligopoly?
A) airline
B) automobile
C) tobacco
D) consulting
E) pharmaceutical
Answer: D
Explanation: D) Typically, oligopolies occur in industries in which there is a high investment to enter, so oligopolies are often major corporations in certain areas such as the airline, automobile, high-tech, pharmaceutical, and tobacco industries. Because consulting is knowledge intensive rather than resource intensive, it is least likely to become part of an oligopoly.
Diff: 2
AACSB: Reflective thinking
LO: 2.3: What are the various degrees of competition?
Classification: Application

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53) _____ occurs when there are many buyers and sellers and little differentiation between products, but perceived differences between products among consumers.
A) Monopolistic competition
B) A monopoly
C) An oligopoly
D) Perfect competition
E) A duopoly
Answer: A
Explanation: A) Monopolistic competition occurs when there are many buyers and sellers and little differentiation between the products themselves (e.g., coffee versus coffee), but there is a perceived difference among consumers, who thereby favor one product offering over another.
Diff: 1
AACSB: Reflective thinking
LO: 2.3: What are the various degrees of competition?
Classification: Concept

54) In what way does monopolistic competition favor consumers?
A) A limited number of sellers differentiate their products or services by offering better quality items and/or greater incentives to purchase them.
B) A large number of sellers providing virtually identical products means that no single seller can set the price.
C) A large number of sellers and products increases supply of similar, but not identical, products and services, so to increase demand sellers are likely to reduce prices.
D) A single seller or provider ensures consistency of product quality and regulated pricing.
E) A small number of sellers compete by differentiating their products from one another.
Answer: C
Explanation: C) Monopolistic competition is characterized by a market in which there are a large number of sellers providing similar goods to consumers whose purchasing choices are based on perceived differences between them. Price is often the distinction.
Diff: 2
AACSB: Analytical thinking
LO: 2.3: What are the various degrees of competition?
Classification: Concept

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55) _____ occurs when there are many buyers and sellers of products that are virtually identical and any seller can easily enter and exit the market.
A) Monopolistic competition
B) A monopoly
C) An oligopoly
D) A duopoly
E) Perfect competition
Answer: E
Explanation: E) Perfect competition occurs when there are many buyers and sellers of products that are virtually identical and any seller can easily enter and exit the market. When these conditions exist, no single supplier can influence the price.
Diff: 1
AACSB: Reflective thinking
LO: 2.3: What are the various degrees of competition?
Classification: Concept

56) What is the purpose of the U.S. government's regulation of monopolies?
A) to ensure that there are as many opportunities for perfect competition as possible
B) to ensure that no single seller can drastically increase the price of a given product or service
C) to ensure that no one industry has control of the entire national economy
D) to ensure that local businesses are always the preferred provider of products consumers want
E) to ensure that companies have equal access to natural resources like water and natural gas
Answer: B
Explanation: B) Formation of monopolies is regulated so that a potential monopolistic supplier cannot charge an excessive price or be unresponsive to consumer needs. In the United States, as well as in other countries, large monopolies are rarely allowed. Natural monopolies are an exception. Utility companies, such as those that sell natural gas or water to consumers, may be permitted to hold monopolies in an effort to conserve natural resources.
Diff: 1
AACSB: Reflective thinking
LO: 2.3: What are the various degrees of competition?
Classification: Concept

57) Mae's Restaurant is the only establishment in town that sells cinnamon rolls. Mae therefore has a monopoly on the cinnamon roll business in town.
Answer: TRUE
Explanation: A monopoly occurs when there is only one provider of a good or service and no substitutes for that good or service exist.
Diff: 1
AACSB: Reflective thinking
LO: 2.3: What are the various degrees of competition?
Classification: Application

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58) Competition in an oligopoly is centered more on making one product stand out from another than it is on price.
Answer: TRUE
Explanation: Because there is little differentiation between products, competition in an oligopoly is strong and prices differ only slightly.
Diff: 2
AACSB: Reflective thinking
LO: 2.3: What are the various degrees of competition?
Classification: Concept

59) Describe how each of the four degrees of competition affect supply and demand.
Answer: (1) In a monopoly, there is only one supplier of a good or service. Supply is not as high as it would be in a different form of competition, but demand for that good or service will be very high. (2) In an oligopoly, there is more supply than in a monopoly and more competition. Prices tend to be very similar between products because the products themselves are similar. Competition is centered on product differentiation in order to capture a larger share of the market rather than on price. (3) In a monopolistic competition, there are many buyers and sellers and both supply and demand are high. Monopolistic competition is driven by the differences consumers perceive between similar products. This perceived distinction between products is often driven by differences in price. (4) In perfect competition, there are many buyers and sellers of virtually identical products. Supply and demand are both high, but because consumers do not differentiate between products and there are so many products available, no single seller can set the price.
Diff: 3
AACSB: Analytical thinking
LO: 2.3: What are the various degrees of competition?
Classification: Concept

60) Explain the relationship between monopoly as a form of economic competition and the failures of communism as an economic system.
Answer: A monopoly occurs when there is only one provider of a good or service and no substitutes for the good or service exist. Because there is only one supplier, there is less abundant supply in general and the supplier is more susceptible to changes in resource prices. In the communist system, the government is the sole supplier of all goods and services across the economic spectrum and is responsible as well for controlling prices and distributing those goods and services. The entire economy (rather than just a single product or service) is therefore in some sense a monopoly, and because competition is limited to nonexistent, motivation to produce goods can be limited and severe shortages of goods and services may result.
Diff: 3
AACSB: Analytical thinking
LO: 2.3: What are the various degrees of competition?
Classification: Synthesis
Learning Outcome: Compare and contrast different economic systems

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61) What is an economic indicator?
A) a business expert who understands the economy and can advise managers how best to handle their companies
B) a formula used by accountants to determine their company's net profit
C) an aspect of the economy that can be measured in order to determine a country's overall economic health
D) a way of identifying whether a given market is an oligopoly or monopolistic competition
E) an action taken by the government to influence swings in the business cycle
Answer: C
Explanation: C) Economic indicators–particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity–are used to determine how well businesses are performing overall.
Diff: 1
AACSB: Reflective thinking
LO: 2.4: How do economic indicators—particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity—reflect economic health?
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

62) ArmiLiza, a popular United States-based brand of handbags, has built a second factory in Mexico. The majority of the new factory's employees are Mexican citizens or Honduran immigrants. On which country's gross domestic product will the second factory's goods be counted?
A) the United States
B) Mexico
C) Honduras
D) They will be split between the United States and Mexico.
E) They will be split among all three countries.
Answer: B
Explanation: B) GDP measures market value of all goods and services produced in a country, including goods and services produced by foreign-owned companies.
Diff: 2
AACSB: Reflective thinking
LO: 2.4: How do economic indicators—particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity—reflect economic health?
Classification: Application
Learning Outcome: Explain how economic performance is monitored

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63) The _____ is the most widely used indicator of economic growth in the world today.
A) gross national product
B) consumer price index
C) producer price index
D) gross domestic product
E) unemployment rate
Answer: D
Explanation: D) Most countries use the GDP to measure their economic health.
Diff: 1
AACSB: Reflective thinking
LO: 2.4: How do economic indicators—particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity—reflect economic health?
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

64) A downward-moving GDP indicates that _____.
A) more goods and services are being produced and sold
B) fewer goods and services are being produced and sold
C) businesses are doing well
D) the number of unemployed people is decreasing
E) the number of products created in a country by non-domestic companies is increasing
Answer: B
Explanation: B) A rising GDP indicates that more goods and services are being produced and that businesses are doing well. A downward-moving GDP indicates that fewer goods are being produced, fewer services are being sold, and businesses are not doing as well.
Diff: 1
AACSB: Reflective thinking
LO: 2.4: How do economic indicators—particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity—reflect economic health?
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

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65) A rise in the general level of prices over time is called _____.
A) deflation
B) inflation
C) disinflation
D) deflection
E) equilibrium
Answer: B
Explanation: B) Inflation is a rise in the general level of prices over time. Deflation is a decrease in general level of prices over time. Disinflation is a decrease in the rate of inflation over time. Deflection is not an economic term. Equilibrium is when need and availability for an item are in balance.
Diff: 1
AACSB: Reflective thinking
LO: 2.4: How do economic indicators—particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity—reflect economic health?
Classification: Concept

66) _____ is a decrease in the rate of inflation.
A) Deflation
B) Inflation
C) Disinflation
D) Deflection
E) Depression
Answer: C
Explanation: C) By definition, disinflation is a decrease in the rate of inflation over time.
Diff: 1
AACSB: Reflective thinking
LO: 2.4: How do economic indicators—particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity—reflect economic health?
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

67) A continuous decrease in the level of prices over time is called _____.
A) deflation
B) inflation
C) disinflation
D) deflection
E) depression
Answer: A
Explanation: A) By definition, deflation is a decrease in the general level of prices over time.
Diff: 1
AACSB: Reflective thinking
LO: 2.4: How do economic indicators—particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity—reflect economic health?
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

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68) What does the monthly consumer price index (CPI) measure?
A) the changes in prices of goods and services as determined by the sellers
B) the amount of products and services manufactured domestically
C) the number of new products purchased by consumers
D) the changes in prices of goods and services purchased by households
E) the changes in prices of the resources used to create consumer goods
Answer: D
Explanation: D) CPI is a benchmark used to track changes over a period of time in the price of goods and services that consumers purchase. The CPI measures price changes by creating a "market basket" of a specified set of goods and services that represent the average buying pattern of urban households. The value of this market basket is determined by the combined prices of these goods and services and is compared to its value in a prior period (generally a month), and the change is noted.
Diff: 1
AACSB: Reflective thinking
LO: 2.4: How do economic indicators—particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity—reflect economic health?
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

69) The value of the CPI's "market basket" is determined by _____.
A) the combined prices of a specified set of goods and services
B) the net profit earned by businesses selling a specified set of goods and services
C) the price of all goods and services purchased in a particular period
D) the cost of production for a specified set of goods and services in a given market
E) the difference between the prices of the raw materials used to create goods and the prices the consumer actually pays for these finished goods
Answer: A
Explanation: A) The value of the market basket is determined by the prices of a certain set of goods and services. The value of the market basket in a given period (e.g., a month) is then compared to its value in a prior period.
Diff: 1
AACSB: Reflective thinking
LO: 2.4: How do economic indicators—particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity—reflect economic health?
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

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70) Why does the U.S. Bureau of Labor Statistics evaluate the CPI's "market basket"?
A) to ensure that it reflects current trends in the production of goods and services
B) to ensure that it reflects current consumer spending habits
C) to ensure that it reflects current wholesale spending habits
D) to ensure that it reflects current consumer demand
E) to ensure that it reflects current wholesale resource costs
Answer: B
Explanation: B) The Bureau of Labor Statistics evaluates the market basket as a way to track spending habits of many different families and thus get a better idea of what people are spending money on. This helps determine how the economy is doing and how inflation rates are affecting spending habits in specific areas of the economy.
Diff: 2
AACSB: Reflective thinking
LO: 2.4: How do economic indicators—particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity—reflect economic health?
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

71) The average total of goods and services required to maintain a particular standard of living is called _____.
A) the cost of living
B) total household expenditure
C) the cost of fundamental human needs
D) the cost/price index
E) quality of life
Answer: A
Explanation: A) The cost of living is the average monetary costs of the goods and services required to maintain a particular standard of living. It is closely related to the CPI. In fact, to keep up with inflation, the Social Security Administration calculates automatic cost of living adjustments to Social Security benefits based on annual percentage increases in the CPI. As you can imagine, the cost of living varies greatly by state and city. For example, the cost of living in New York City or San Francisco is much higher than in Topeka, Kansas, or Little Rock, Arkansas.
Diff: 1
AACSB: Reflective thinking
LO: 2.4: How do economic indicators—particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity—reflect economic health?
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

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72) The producer price index tracks the average change in prices from the _____ perspective.
A) government's
B) buyer's
C) seller's
D) economist's
E) marketer's
Answer: C
Explanation: C) The PPI tracks the prices of goods sellers use to create their products, such as raw materials, product components that require further processing, and finished goods sold to retailers. The PPI excludes energy prices and prices for services.
Diff: 1
AACSB: Reflective thinking
LO: 2.4: How do economic indicators—particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity—reflect economic health?
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

73) Goods tracked by the PPI include _____ and _____.
A) education; medical care
B) recreation; apparel
C) transportation; communication
D) raw materials; finished goods sold to retailers
E) energy prices; prices for services
Answer: D
Explanation: D) PPI does not track consumer goods or services, but rather the cost of the resources, such as raw materials used to produce consumer goods. The PPI excludes energy prices and prices for services.
Diff: 2
AACSB: Reflective thinking
LO: 2.4: How do economic indicators—particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity—reflect economic health?
Classification: Application
Learning Outcome: Explain how economic performance is monitored

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74) _____ unemployment measures unemployment caused by lack of demand for those who want to work; it generally follows the economy.
A) Seasonal
B) Frictional
C) Structural
D) Cyclical
E) Temporary
Answer: D
Explanation: D) Cyclical unemployment measures unemployment caused by a lack of demand for those who want to work. This generally follows the economy. Companies must cut back their workforce when there is a downturn in the business cycle. Once the demand for goods and services increases, companies begin to hire again.
Diff: 1
AACSB: Reflective thinking
LO: 2.4: How do economic indicators—particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity—reflect economic health?
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

75) _____ unemployment measures those out of work during the off-season, such as those employed in snow- or beach-related industries, agriculture, and/or holiday activities.
A) Seasonal
B) Frictional
C) Structural
D) Cyclical
E) Temporary
Answer: A
Explanation: A) Seasonal unemployment occurs when workers get laid off during the off-season.
Diff: 1
AACSB: Reflective thinking
LO: 2.4: How do economic indicators—particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity—reflect economic health?
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

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76) _____ unemployment refers to a temporary state of unemployment in which workers move between jobs, careers, and locations.
A) Seasonal
B) Frictional
C) Structural
D) Cyclical
E) Circumstantial
Answer: B
Explanation: B) Frictional unemployment occurs because it simply takes a certain amount of time for workers to find the right jobs and employers to find the right workers.
Diff: 1
AACSB: Reflective thinking
LO: 2.4: How do economic indicators—particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity—reflect economic health?
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

77) _____ unemployment measures permanent unemployment associated with massive industry-wide changes that lead to complete elimination of the positions formerly held.
A) Seasonal
B) Frictional
C) Structural
D) Cyclical
E) Circumstantial
Answer: C
Explanation: C) Structural unemployment measures permanent unemployment associated when an industry changes in such a way that jobs are terminated completely. For instance, many steel workers and miners lost their jobs when there was a decline in those industries. Likewise, robots have replaced many automobile workers, and computers have replaced many newspaper typesetters.
Diff: 1
AACSB: Reflective thinking
LO: 2.4: How do economic indicators—particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity—reflect economic health?
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

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78) Mae's oven bakes 50 cinnamon rolls an hour. She bakes 200 cinnamon rolls a day. The cost of power for running her oven each day is $30. Mae has decided that she would like to bake the same amount of cinnamon rolls in less time in order to save on energy costs. What should she do?
A) Increase productivity by baking more cinnamon rolls per hour.
B) Increase efficiency by beginning her baking operations earlier in the day.
C) Increase profitability by charging more money per cinnamon roll.
D) Manage competition by baking muffins as well as cinnamon rolls.
E) Increase her customer base by advertising on popular local food blogs.
Answer: A
Explanation: A) Although all responses represent potential ways to improve Mae's profitability, by definition, the only way to make more cinnamon rolls in less time is to bake more cinnamon rolls per hour.
Diff: 1
AACSB: Reflective thinking
LO: 2.4: How do economic indicators—particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity—reflect economic health?
Classification: Application
Learning Outcome: Explain how economic performance is monitored

79) Products manufactured in foreign countries by U.S. companies are included in the U.S.'s gross domestic product (GDP).
Answer: FALSE
Explanation: The GDP is based on products manufactured domestically, that is, within the country. All goods manufactured in a country are included in that country's GDP, no matter the nationality of the parent company.
Diff: 1
AACSB: Reflective thinking
LO: 2.4: How do economic indicators—particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity—reflect economic health?
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

80) The consumer price index (CPI) tracks changes in prices at the wholesale level.
Answer: FALSE
Explanation: The consumer price index (CPI) tracks changes in price at the consumer level. The producer price index (PPI) tracks changes in price at the wholesale level.
Diff: 1
AACSB: Reflective thinking
LO: 2.4: How do economic indicators—particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity—reflect economic health?
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

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81) Change in prices is an important economic indicator because it is a measurement of consumers' purchasing power.
Answer: TRUE
Explanation: When prices increase, the purchasing power of the dollar decreases. This eventually leads to an increase in wages in order to compensate. Businesses must then increase the prices of their goods and services in order to cover the higher cost of labor.
Diff: 2
AACSB: Reflective thinking
LO: 2.4: How do economic indicators—particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity—reflect economic health?
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

82) Cyclical unemployment measures those out of work during the off-season, such as those employed in agriculture and snow-, beach-, or holiday-related industries.
Answer: FALSE
Explanation: Cyclical unemployment measures unemployment caused by lack of demand for those who want to work. It generally follows the economy. Seasonal unemployment measures those out of work due to their being employed in seasonal industries like landscaping or agricultural harvesting.
Diff: 1
AACSB: Reflective thinking
LO: 2.4: How do economic indicators—particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity—reflect economic health?
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

83) Higher productivity results in higher costs and higher prices, resulting in lower income and lower profitability.
Answer: FALSE
Explanation: Higher productivity results in lower costs and lower prices because higher productivity indicates that workers are producing more goods and services in a certain amount of time than previously. Higher productivity thus generates more business income and profitability.
Diff: 1
AACSB: Reflective thinking
LO: 2.4: How do economic indicators—particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity—reflect economic health?
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

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84) Divya owns a small boutique in a busy neighborhood. She has been thinking of expanding her business hours and hiring a sales associate to work evenings and weekends. She sees on the news that the GDP is down and decides to hold off on expanding her business for the time being. Why?
Answer: A downward-moving GDP indicates problems with the economy. The GDP moves down because fewer goods are being produced and fewer services being sold. This means that the businesses that produce these goods and services will have less profit and may need to lay off workers. The change in income for these workers means that they will spend less money overall, which means she may not have enough customers to make the expansion worthwhile.
Diff: 2
AACSB: Analytical thinking
LO: 2.4: How do economic indicators—particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity—reflect economic health?
Classification: Application
Learning Outcome: Explain how economic performance is monitored

85) Describe how the consumer price index (CPI) uses the "market basket" to measure price changes.
Answer: The CPI measures price changes by creating a "market basket" of a specified set of goods and services that represent the average buying pattern of urban households. The value of this market basket, as determined by the combined prices of these goods and services, is compared to its value in a prior period (generally a month) and the change is noted.
Diff: 2
AACSB: Reflective thinking
LO: 2.4: How do economic indicators—particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity—reflect economic health?
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

86) What does the consumer price index (CPI) tell us about the purchasing power of the dollar? How does it function as an economic indicator?
Answer: During periods of increasing prices as reflected by the CPI, the purchasing power of the dollar decreases, meaning that less can be bought with a dollar today than yesterday. This functions as an economic indicator by showing that inflation is on the rise and that businesses should prepare for increases in the cost of labor and production.
Diff: 3
AACSB: Reflective thinking
LO: 2.4: How do economic indicators—particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity—reflect economic health?
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

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87) What are some consequences of a high unemployment rate? What are some consequences of a low unemployment rate?
Answer: High unemployment results in an increase in government spending on unemployment benefits and social services. It can also bring about increases in stress, mental illness, and crime throughout a population. Also, it is costly for businesses to lay off workers and then, as the economy improves eventually, hire and train new employees. Low unemployment means that workers have increased buying power and spend more, which can lead to a higher inflation rate. The challenge is to try to keep both inflation and unemployment low.
Diff: 1
AACSB: Reflective thinking
LO: 2.4: How do economic indicators—particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity—reflect economic health?
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

88) The gross domestic product (GDP) measures _____.
A) the overall market value of final goods and services produced in a country in a given year
B) the overall gross profit a country earns in a given year
C) a country's overall income resulting from production in a year
D) a country's overall expenditures in a given year
E) a country's overall increase in profitability from one year to the next
Answer: A
Explanation: A) GDP measures market value of all goods and services produced in a country, including goods and services produced by foreign-owned companies that operate in the country.
Diff: 1
AACSB: Reflective thinking
LO: 2.4: How do economic indicators—particularly the gross domestic product (GDP), price indices, the unemployment rate, and productivity—reflect economic health?
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

89) The term "business cycle" refers to _____.
A) the periodic increases and decreases of the economy
B) the periodic purchases of goods and services by the government
C) the increases and decreases in the rate of inflation
D) the periodic growth of the Federal Reserve system
E) the periodic increases and decreases in the GDP due to seasonal factors
Answer: A
Explanation: A) Over time, the economy naturally goes through periodic increases and decreases in what is known as the business cycle.
Diff: 1
AACSB: Reflective thinking
LO: 2.5: What are the four stages of the business cycle?
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

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90) A recession is an increase in the unemployment rate over two or more consecutive quarters of a year.
Answer: FALSE
Explanation: A recession is a decline in the gross domestic product (GDP) over two or more consecutive quarters of a year.
Diff: 1
AACSB: Reflective thinking
LO: 2.5: What are the four stages of the business cycle?
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

91) Name the four parts of the business cycle and describe how they relate to each other.
Answer: The *peak* of a business cycle occurs when the economy is at its strongest. The peak occurs when expansion ends and recession begins. A *recession* is a decline in GDP for two or more consecutive quarters and is characterized by a decline in corporate profits and a rise in unemployment. The *trough* is the point in the cycle at which the economy is at its weakest. The trough occurs when recession ends and recovery begins. *Recovery*, or expansion, is a growth in GDP and is characterized by rising profits and reduced unemployment.
Diff: 2
AACSB: Reflective thinking
LO: 2.5: What are the four stages of the business cycle?
Classification: Concept
Learning Outcome: Explain how economic performance is monitored

92) The government determines the appropriate level of taxes and spending through its _____.
A) monetary policy
B) domestic policy
C) foreign policy
D) fiscal policy
E) currency policy
Answer: D
Explanation: D) Fiscal policy involves raising and spending money; monetary policy involves managing the supply of money.
Diff: 1
AACSB: Reflective thinking
LO: 2.6: How does the government use both fiscal policy and monetary policy to control swings in the business cycle?
Classification: Concept
Learning Outcome: Discuss the functions of different types of financial institutions in the monetary system

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93) Decreasing taxes can stimulate the economy by _____.
A) allowing consumers more money to spend
B) decreasing the amount of money the government is able to spend
C) directly influencing the consumer price index
D) controlling the money supply
E) helping to contain an economy that is growing too quickly
Answer: A
Explanation: A) Decreasing taxes means that consumers have more money to spend. However, consumers may save money that accrues as a result of tax decreases. This would not stimulate the economy, which relies on consumer spending.
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94) What is the money supply?
A) the total amount of money held in the Federal Reserve Bank
B) the combined amount of money available in privately owned accounts
C) the combined amount of money available within the economy
D) the amount of money the government is allowed to spend to stimulate economic growth
E) all the coins and bills held by people, businesses, and banks
Answer: C
Explanation: C) The money supply is defined as all available money within the economy. It includes not only currency, but also personal savings and checking accounts as well as the deposit accounts from large institutions.
Diff: 2
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95) The government manages the supply of money through its _____.
A) monetary policy
B) domestic policy
C) foreign policy
D) fiscal policy
E) stimulus policy
Answer: A
Explanation: A) Monetary policy involves managing the supply of money; fiscal policy involves raising and spending money.
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96) The Federal Reserve System (the Fed) manages the country's money supply through its monetary policy to control inflation by doing all of the following EXCEPT _____.
A) buying and selling government securities
B) trading in foreign exchange markets
C) changing certain interest rates
D) increasing taxes
E) manipulating reserve requirements
Answer: D
Explanation: D) Increasing taxes is not within the power of the Federal Reserve System, nor does it fall under monetary policy. It is a fiscal decision, not a monetary one.
Diff: 2
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97) All of the following statements about open market operations are true EXCEPT _____.
A) they are used by the Federal Reserve to change the Federal Funds Rate
B) they are used by the Federal Reserve to change the discount rate
C) they are used by the Federal Reserve to buy and sell mutual funds
D) they are used by the Federal Reserve to transact with securities dealers
E) they are probably the most influential tool the Federal Reserve has to alter money supply
Answer: B
Explanation: B) The primary tool the Fed uses in its monetary policy is open market operations–buying and selling U.S. Treasury and federal agency bonds on the "open market." When the Fed buys securities, it adds reserves to the system, money is said to be "easy," and interest rates drop. Lower interest rates help stimulate the economy by decreasing the desire to save and increasing the demand for loans such as home mortgages. Open market operations would not change the discount rate, the interest rate charged by the Fed to banks in order to maintain their reserve funds.
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98) In which part of the business cycle would the Federal Reserve be most likely to increase the discount rate to discourage banks from borrowing?
A) trough
B) expansion
C) peak
D) recession
E) depression
Answer: B
Explanation: B) During expansion, banks are discouraged from seeking loans from the Federal Reserve at higher discount rates, thereby slowing the addition of funds into the economy, which keeps the economy from expanding too rapidly. If the money supply were allowed to continually expand, eventually there might not be enough goods and services to satisfy demand, and when demand is high, prices will rise. Inflation results from an increase in overall prices.
Diff: 3
AACSB: Analytical thinking
LO: 2.6: How does the government use both fiscal policy and monetary policy to control swings in the business cycle?
Classification: Synthesis
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99) The reserve requirement is defined as _____.
A) the maximum amount of money banks can borrow from the Federal Reserve
B) the maximum amount of money banks can borrow from one another
C) the minimum amount of money banks hold in reserve to cover deposits
D) the minimum amount of money that can be deposited by banks in the Federal Reserve
E) the maximum amount of money that is insured by the Federal Deposit Insurance Corporation
Answer: C
Explanation: C) By definition, the reserve requirement is the minimum amount of money banks must hold in reserve to cover deposits. The Federal Reserve can raise or lower the reserve requirement to ensure that banks have enough money to cover deposits.
Diff: 1
AACSB: Reflective thinking
LO: 2.6: How does the government use both fiscal policy and monetary policy to control swings in the business cycle?
Classification: Concept
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100) The government can influence the economy through its fiscal policy by making changes in the money supply.
Answer: FALSE
Explanation: A government's fiscal policy determines the appropriate level of taxes and spending but does not directly influence changes in the money supply. A government's monetary policy, on the other hand, is the medium through which it may make changes in the money supply.
Diff: 2
AACSB: Reflective thinking
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101) When the Federal Reserve Bank buys or sells U.S. securities, it changes the level of reserves in the banking system which has an effect on interest rates.
Answer: TRUE
Explanation: When the Fed buys securities, it adds reserves to the system, making it easier to obtain money through loans, etc., and interest rates drop. When the Fed sells securities, it removes money from the system, money becomes harder to obtain, and interest rates rise.
Diff: 2
AACSB: Analytical thinking
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102) The discount rate is the interest rate banks are charged when they borrow money from the Fed.
Answer: TRUE
Explanation: By definition, the discount rate is the interest rate banks are charged when they borrow money from the Federal Reserve Bank. The discount rate may be confused with the Federal Funds rate, which is the interest rate that banks charge other banks when they borrow funds overnight from each other in order to maintain their reserves.
Diff: 1
AACSB: Reflective thinking
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103) The Fed relies primarily on changes in the reserve requirement (the minimum amount of money banks must hold in reserve to cover deposits) to ease or tighten the money supply.
Answer: FALSE
Explanation: The Fed only rarely makes changes in the reserve requirement as a means of monetary policy, as these actions would be very disruptive to the banking industry. When they do, they lower the reserve requirement to increase the money supply and increase it to decrease the money supply.
Diff: 1
AACSB: Reflective thinking
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104) Define open market operations and describe how the Federal Reserve Bank uses them to control the money supply.
Answer: Open market operations are the buying and selling by the Federal Reserve Bank of U.S. Treasury and federal agency bonds on the open market. Securities dealers compete in these transactions to get the best deal. When the Fed buys or sells U.S. securities, it is changing the level of monetary reserves in the banking system. When it buys securities, it adds reserves to the banking system, thereby increasing the money supply and lowering interest rates. When it sells securities, it decreases the amount of reserves in the system, thereby reducing the money supply and causing interest rates to rise.
Diff: 2
AACSB: Reflective thinking
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105) What are the possible consequences of a continual expansion in the money supply?
Answer: If the money supply continues to expand, eventually there may not be enough goods and services to satisfy demand. When demand is high, prices will rise. An overall rise in price results in inflation, which leads to a decrease in the purchasing power of the dollar. To compensate, businesses increase wages to compensate for the price increases and eventually increase prices to compensate for the expanded costs of production.
Diff: 3
AACSB: Analytical thinking
LO: 2.6: How does the government use both fiscal policy and monetary policy to control swings in the business cycle?
Classification: Application
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106) How does lowering the discount rate enable the Fed to stimulate the economy? How does raising the discount rate enable the Fed to control an economy that is too robust?
Answer: The Fed lowers the discount rate on loans to banks to stimulate the economy by making it easier for banks to obtain additional reserves. The banks can then lend this money out to businesses, thereby stimulating the economy by adding funds into the economy. When the economy is too robust, the Fed can increase the discount rate, making it harder for banks to get loans. Businesses are then discouraged from taking out loans at the higher interest rate, thereby slowing the addition of funds to the economy.
Diff: 2
AACSB: Analytical thinking
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