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MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

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

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

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

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

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

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

7) The private ownership of property resources and use of prices to direct and coordinate economic activity is characteristic of:
A) a market system.
B) communism.
C) socialism.
D) a command system.
Answer: A

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

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

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

11) The Canadian economy most closely approximates:
A) market socialism
B) mixed capitalism
C) a command economy
D) authoritarian capitalism
Answer: B

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

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

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14) The market system is an economic system that:
A) gives the government the right to tax individuals and corporations for the production of capital goods.
B) produces more consumer goods than capital goods.
C) produces more capital goods than consumer goods.
D) gives private individuals and institutions the right to own resources used in production.
Answer: D

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

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

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

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

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

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

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

22) How do workers typically express self-interest?
A) by seeking jobs with the best combination of wages and benefits
B) by seeking the highest price when purchasing a consumer product
C) by maximizing the economic profits of other business firms
D) by minimizing the economic losses of other business firms
Answer: A

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

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

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

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26) Competition is more likely to exist when:
A) there is free entry into and exit out of industries.
B) products are produced by a few large firms.
C) the government purchases most goods and services.
D) there is a single supplier of all goods and services.
Answer: A

27) Which condition will encourage competition?
A) the freedom of sellers and buyers to enter or exit an industry
B) the government serving as the only supplier of goods to consumers
C) a small number of buyers and sellers in a market
D) government licensing requirements in order to enter an industry
Answer: A

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

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

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

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

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32) Which statement is correct?
A) In a market system, buyers and sellers must be in face-to-face contact with each other.
B) In a market system, prices serve to ration goods and services to consumers.
C) The operation of a market system has little, if any, effect on the distribution of income in the economy.
D) Prices affect the distribution of goods in a market system but not the allocation of resources.
Answer: B

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

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

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

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

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

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

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

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

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

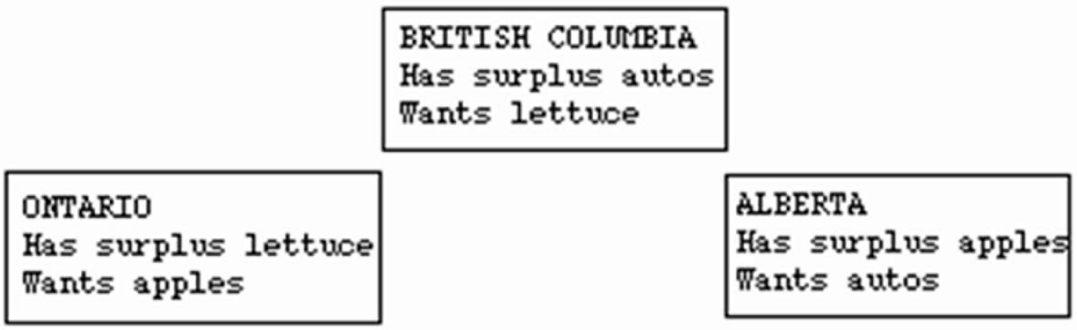
42) The use of money for exchange:
A) encourages more specialization in production.
B) decreases the coincidence of wants.
C) reduces consumer sovereignty.
D) increases the use of barter.
Answer: A

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

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

45) Consider a barter situation where you have pens and you want pencils. To achieve your objective there must be a(n):
A) large number of sellers.
B) coincidence of wants.
C) entry and exit from the market.
D) use of capital goods.
Answer: B



46) On the basis of the information provided it can be said that:
A) a coincidence of wants exists between Ontario and Alberta.
B) a coincidence of wants exists between British Columbia and Ontario.
C) no coincidence of wants exists between any two provinces.
D) a coincidence of wants exists between British Columbia and Alberta.
Answer: C

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

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

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49) Which is assumed to be most limited in scope under a market system?
A) competition
B) government
C) freedom of enterprise
D) freedom of choice
Answer: B

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

80) The idea that the desires of resource suppliers and producers to further their own self-interest will automatically further the public interest is known as:
A) profit maximization.
B) derived demand.
C) the invisible hand.
D) consumer sovereignty.
Answer: C

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

82) While in market economies the profit depends on consumer demand, production production efficiency, and product quality, for command economies profit depends on:
A) quantitative production target.
B) production cost.
C) product mix.
D) product differentiation.
Answer: A

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

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

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

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

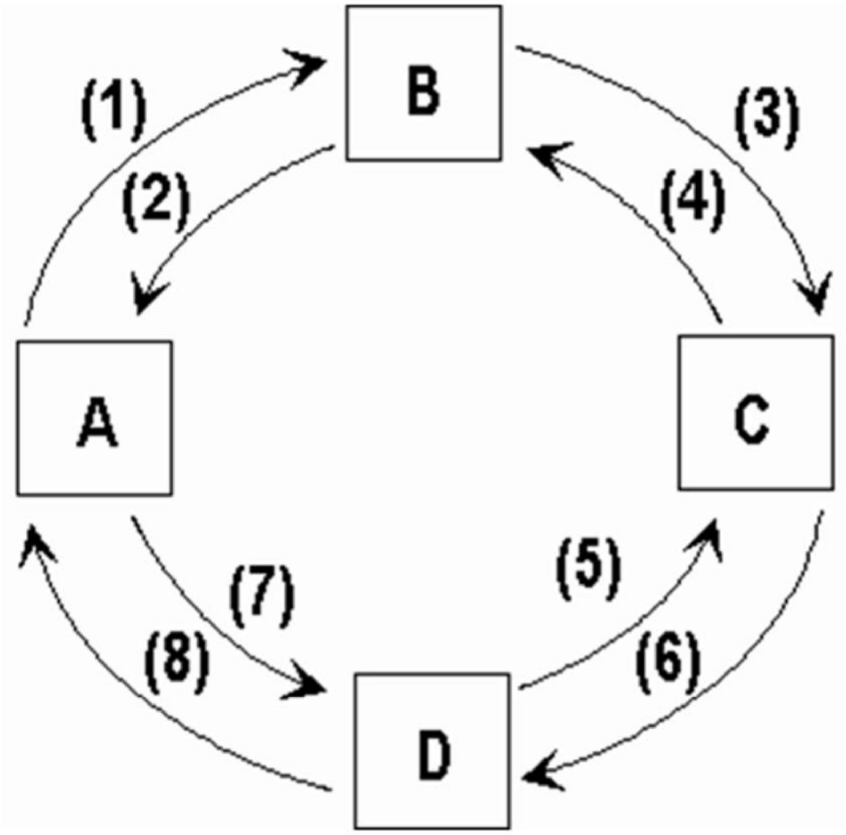
87) The two basic markets shown by the simple circular flow model are:
A) capital goods and consumer goods.
B) household and business.
C) free and controlled.
D) product and factor.
Answer: D

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

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

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



91) Refer to the figure. If box B represents the factor market and flow (3) represents money income, then:
A) box A is the product market and box C is households.
B) box D is the product market and box C is households.
C) box C is the product market and box A is households.
D) box C is the product market and box D is households.
Answer: B

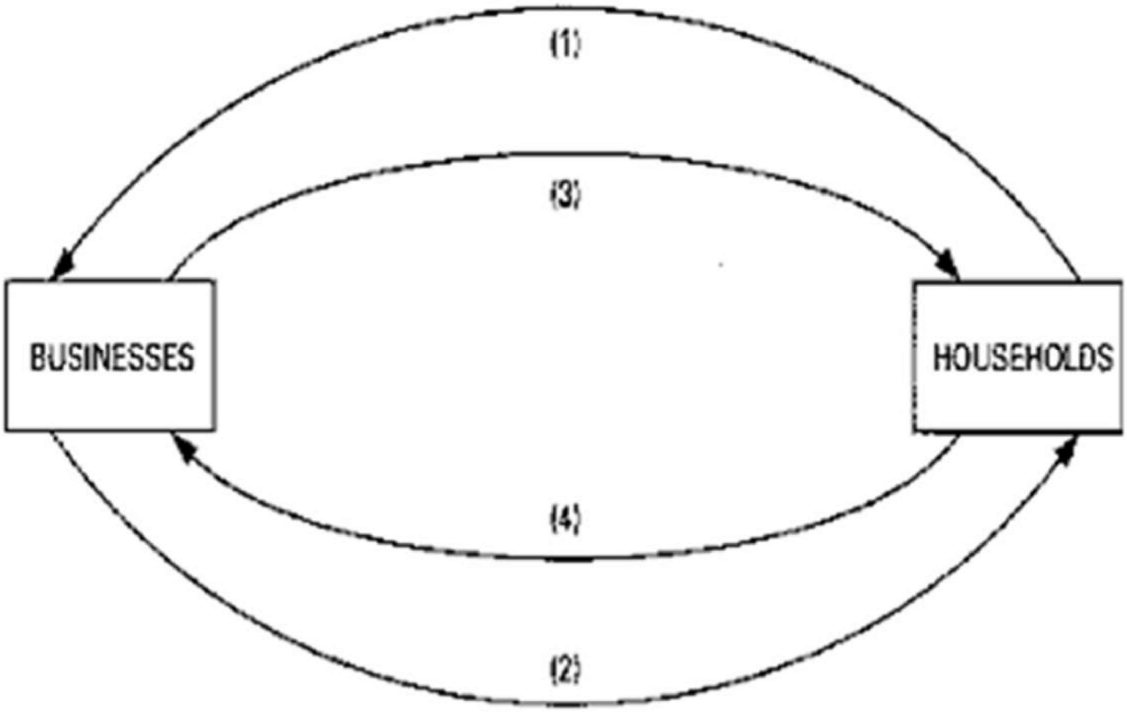
92) Refer to the figure. If box A represents businesses and flow (7) represents goods and services, then:
A) box D is the product market and box B is households.
B) box B is the product market and box C is households.
C) box C is the product market and box B is the factor market.
D) box D is the product market and box B is the factor market.
Answer: D

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93) In terms of the circular flow diagram businesses obtain revenue through the _____ market and make expenditures in the _____ market.

A) capital; product
B) factor; product
C) product; factor
D) product; financial

Answer: C



94) Refer to the diagram. Arrows (1) and (2) represent:

A) money incomes and output respectively.
B) resources and goods respectively.
C) goods and resources respectively.
D) output and money incomes respectively.

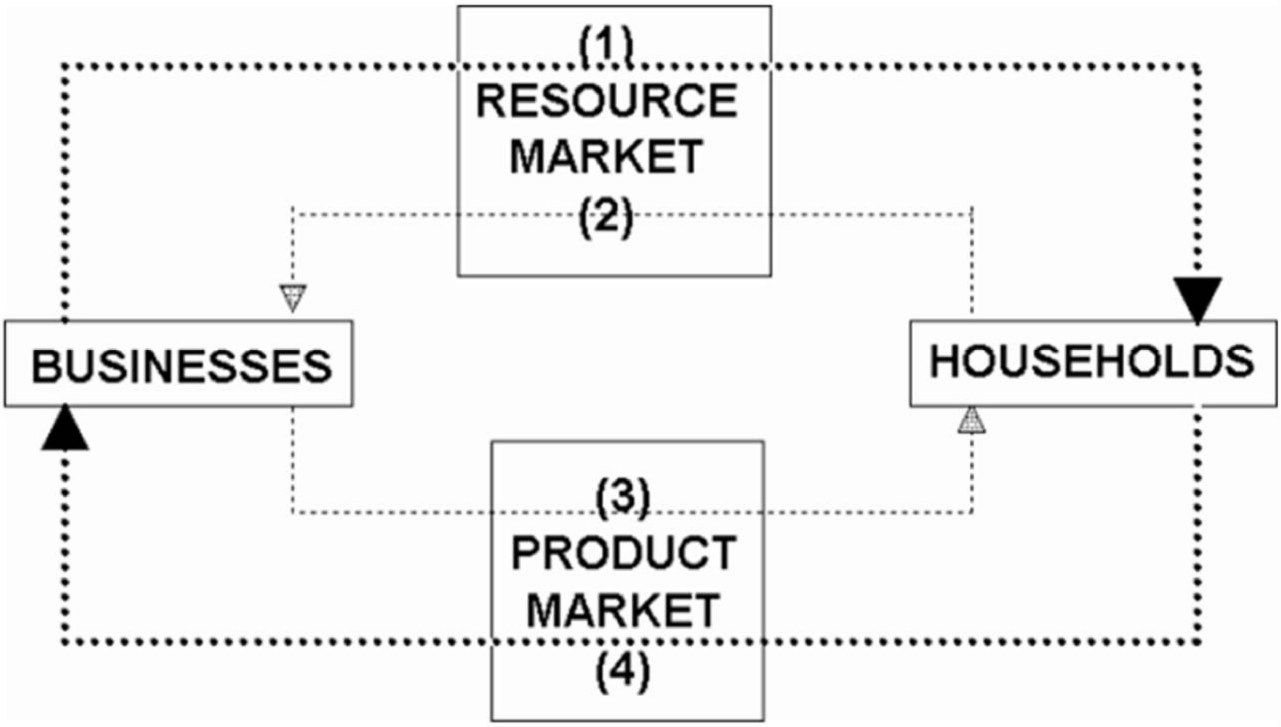
Answer: B

95) Refer to the diagram. Arrows (3) and (4) represent:

A) consumer expenditures and money income respectively.
B) goods and services respectively.
C) money incomes and consumer expenditures respectively.
D) resources and goods respectively.

Answer: C

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

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

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

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

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

TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.

101) Specialization may be conducive to an expansion of total output even though the individuals involved may have identical abilities.
Answer: True False

102) A division of labour enhances society's output by permitting people to take advantage of existing differences in their abilities and skills.
Answer: True False

103) Money functions as a medium of exchange in permitting the ready comparison of the relative worth of heterogeneous products.
Answer: True False

104) Government alters the distribution of income by market intervention, in which case it modifies the prices established by market forces.
Answer: True False

105) Property rights do not encourage people to cooperate.
Answer: True False

106) Consumer sovereignty means that legislation now protects the rights of consumers to dispose of their incomes as they see fit.
Answer: True False

107) The wants of consumers are expressed on the demand side of the product market.
Answer: True False

108) The guiding function of prices indicates that, at equilibrium prices, neither product surpluses nor shortages can occur.
Answer: True False

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

Answer: True ● False

110) In a competitive market economy, firms and resource suppliers will seek to further their own self-interest, but at the same time, as if guided by an "invisible hand," they will promote the public interest.

Answer: ● True False

111) In the simple circular flow model businesses are suppliers of final products.

Answer: ● True False

112) Households and businesses are both suppliers in the product market.

Answer: True ● False

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1) D
2) D
3) D
4) C
5) C
6) B
7) A
8) A
9) A
10) B
11) B
12) D
13) D
14) D
15) B
16) B
17) D
18) A
19) A
20) C
21) C
22) A
23) C
24) B
25) A
26) A
27) A
28) A
29) B
30) A
31) D
32) B
33) D
34) C
35) C
36) D
37) D
38) D
39) D
40) D
41) A
42) A
43) B
44) D
45) B
46) C
47) B
48) B
49) B
50) B

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51) D
52) D
53) B
54) A
55) B
56) B
57) D
58) A
59) C
60) D
61) C
62) C
63) C
64) D
65) C
66) B
67) C
68) C
69) A
70) A
71) B
72) C
73) C
74) A
75) D
76) D
77) A
78) B
79) C
80) C
81) A
82) A
83) A
84) A
85) B
86) C
87) D
88) A
89) D
90) D
91) B
92) D
93) C
94) B
95) C
96) A
97) B
98) A
99) A
100) B

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101) TRUE
102) TRUE
103) TRUE
104) TRUE
105) FALSE
106) FALSE
107) TRUE
108) TRUE
109) FALSE
110) TRUE
111) TRUE
112) FALSE

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ESSAY. Write your answer in the space provided or on a separate sheet of paper.

1) Explain what is meant by a command economy.

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

2) Explain the term "laissez-faire" capitalism.

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

3) List nine characteristics of the market system.

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

4) Why is the right of private property an essential characteristic of a market system?

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

5) Explain the **most** important consequence of legally enforceable property rights?

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

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

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

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

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

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

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

9) What conditions are necessary for economic competition to exist?

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

10) Explain why the market system is an organizing mechanism.

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

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

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

12) Describe two types of specialization in production.

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

13) What are the economic advantages of the division of labour?

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

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

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

15) Describe all the advantages a money economy has over a barter economy?

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

16) How does the use of money differ from the use of barter in the exchange of goods and services?

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

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

Answer: Money is anything that is generally acceptable as a medium of exchange. In Canada, money inc currency, coins, and chequable deposits.

Barter requires a coincidence of wants between the two parties to a transaction. Each has to wa the other has to offer. Money makes this coincidence unnecessary, as the seller is willing to acc money in exchange for goods or services offered and can, in turn, exchange the money earned for other goods and services from another seller. The necessary condition for the use of paper currency is that it must be generally acceptable. Sellers must have faith that the currency will have value when they want to use it to buy goods and services for themselves.

Note that the money does not have to have any intrinsic value; that is, it does not have to be ba material that has some use like gold or silver.

18) Suppose Tom, Dick, and Harry live in a barter economy. Tom produces wine, Dick bakes bread, and Harry makes cheese. Tom wants some bread to go with his wine and is willing to trade 1 litre of wine for two loaves of bread. Dick wants some cheese to go with his bread and is willing to trade one loaf of bread for one-half kilogram of cheese. Harry doesn't want bread, but wants some wine to with his cheese and is willing to trade cheese for one litre of wine. It is not possible for all three of th meet together at one time.

(a) Explain how this situation illustrates the difficulty with a barter economy.
(b) Devise a money system using rubies where four rubies are equivalent in value to one litre of wine other words tell how much bread and cheese would be worth in terms of rubies in this economy. In this system, how much cheese must Harry sell in order to buy one litre of wine?

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

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19) Why does specialization require a convenient means of exchanging goods?

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

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

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

21) What are the so-called Five Fundamental Questions that every economy must answer?

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

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

Product	Market price	Output	Profit
A	$14.00	10	$_____
B	9.00	11	_____
C	.50	300	_____

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

Answer:

Product	Market price	Output	Profit
A	$14.00	10	$40
B	9.00	11	–1
C	.50	300	50

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

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

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

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

Answer:

Product	Market price	Output	Profit
A	$10.00	6	–$40
B	5.00	19	–5
C	1.50	100	50

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

24) How does consumer choice differ from consumer sovereignty in a market system?

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

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

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

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

Answer: The first motive is that because inefficiency drives up costs and lowers profits, any firm wishing to ***maximize its profits*** will make great efforts to minimize production costs. These eff will include using the right mix of labour and capital, given the prices and productivity of those resources. They also mean locating production facilities optimally to minimize production and transportation expenses.

The second motive is due to ***competition***, consumers strongly prefer low prices and will shift their purchases over to the firms that can produce a quality product at the lowest possible price. Any firm foolish enough to use higher-cost production methods will go bankrupt as it is undersold by its more efficient competitors who can still make a profit when selling at a lower price. In other words, ***competition eliminates high-cost producers***, and so firms are motivated to choose the lowest-cost production methods to produce goods and services.

27) What factors determine who will get the output?

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

28) How does the market system accommodate change in consumer's preferences?

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

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29) Assume that a firm finds that its profits will be maximized (or losses minimized) when it produces $3
of product X. Each of these techniques shown in the following table will produce exactly $30 worth o

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

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

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

30) Assume that a firm finds that its profits will be maximized (or losses minimized) when it produces $5
of product X. Each of these techniques shown in the following table will produce exactly $50 worth o

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

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

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

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31) What is meant by the guiding function of prices?

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

32) How can technological advance result in creative destruction?

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

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

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

34) Describe the three major virtues of a market system.

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

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

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

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

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

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

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

38) Describe the basic features of the circular flow model.

Answer: In the simple circular flow model, there are two decision-makers: households and businesses. These two groups are related through the resource and product markets. In the upper half of the circular flow, households sell economic resources (land, labour, capital, and entrepreneurial ability) and businesses buy resources through the resource market. Businesses pay for the cost of these resources, which in turn becomes money income for households. It is t decisions of resources sellers (households) and the buying decisions of businesses that determi and employment in the resource market.

In the lower half of the circular flow, businesses sell goods and services and households buy go and services in the product market. Households pay for these goods and services with the money income they received from providing resources. These consumption expenditures become revenue for businesses. It is the product buying decisions of households and the product selling decisions of businesses that determine prices and output in the product market.

39) What is the relationship between businesses and households in the circular flow model?

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

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40) List and describe the three main categories of businesses?

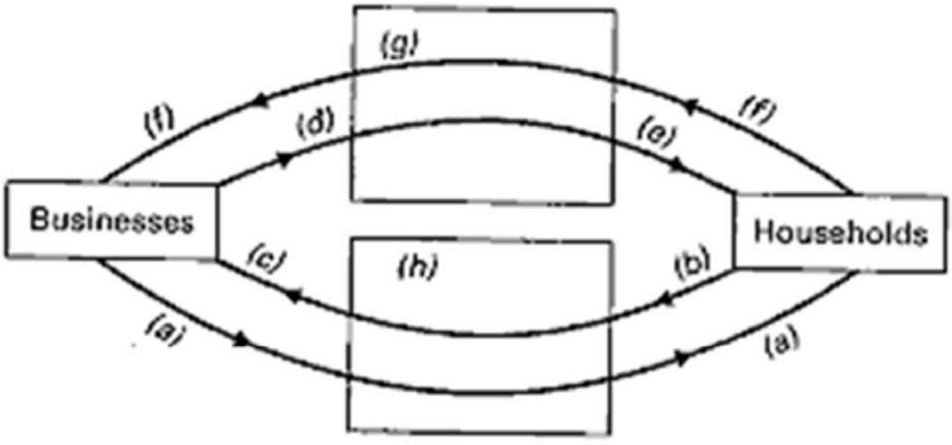
Answer: Businesses fall into three main categories.

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

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

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

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



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

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1) The command economy is the opposite extreme alternative to pure capitalism. It is a system characterized by government ownership of all or nearly all property resources and centrally planned and administered production.
2) Pure capitalism is sometimes called "laissez faire" capitalism which is a French term for "let it be." In pure capitalism the government's role is limited to protecting private property and establishing the legal framework for free enterprise and free markets to function.
3) The nine characteristics discussed in the text are: (1) private property; (2) freedom of enterprise and choice; (3) self-interest as the major motivation for economic activity; (4) competition among buyers and sellers; (5) reliance on the market (price) system; (6) the use of advanced technology and large amounts of capital goods; (7) specialization; (8) the use of money rather than barter; and (9) active but limited role for government
4) The most important consequence of legally enforceable property rights is that they ***encourage people to cooperate*** by helping to ensure that only ***mutually agreeable economic transactions*** take place. Property rights are also important because they give people private ownership of resources. This ownership encourages them to make the best use of those resources because they will benefit if they do. Property rights also encourage people to take the risk of investing in capital goods or to develop new innovation or products because they will receive the benefits from this activity if they are successful. Property rights offer incentives for people to maintain their property to preserve its value and invest in it if they think they can increase its value. Property rights also facilitate exchanges by making clear who owns a resource so that there is no question about the legitimacy of the transaction.
5) The most important consequence of legally enforceable property rights is that they ***encourage people to cooperate*** by helping to ensure that only ***mutually agreeable economic transactions*** take place. Without legally enforceable property rights the strong could simply take whatever they wanted from the weak without giving them any compensation. But in a world of legally enforceable property rights, any person wanting something from you has to get you to agree to give it to them. And you can say no. The result is that if they really want what you have, they must offer you something that you value more highly in return. That is, they must offer you a ***mutually agreeable economic transaction***—one that benefits you as well as them.
6) In capitalism, two essential freedoms are the freedom of enterprise and freedom of choice. Businesses must be free to get economic resources, organize them to produce products, and sell them in the market. Businesses must also be free to enter or leave an industry. Freedom of choice gives business owners, resource owners and consumers the freedom to act to advance their own self-interest. Business owners are free to buy and sell property. Labour resources (workers) can enter or exit any line of work for which they are qualified. Consumers are free to purchase goods and services as they choose based on their budget constraints. Without these freedoms it would be impossible for a market economy to exist.
7) Self-interest is the motivating force behind both the demand and supply sides of the product and resource markets in a capitalist system. Entrepreneurs engage in production with the expectation of making a profit; workers seek the best wage and working conditions they can get; consumers allocate their spending in order to maximize their satisfaction.

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8) Competition is important as the force, which tempers or regulates the self-interest of producers, sellers, workers, and buyers. If producers make too much profit, competitors will arise to take advantage of the opportunity and as production increases, prices and profits will fall. If workers demand too much, employers will seek other workers who are willing to work for less. If buyers are not willing to pay a fair price for the product, producers will sell the product to someone who is. In each case it is competition or the threat of competition that tempers the potential abuse of economic power.
9) Competition requires the presence of large numbers of buyers and sellers. The number must be large enough so that no single buyer or seller can affect the price of the product by their individual actions regarding demand or supply. In addition, competition assumes that it is simple for consumers to leave markets on the basis of their self-interest, and also for producers to enter or leave a particular industry on the basis of their self-interest so that the economy can adjust appropriately to changes in consumer demand, technology, or resource supplies.
10) Markets and price give the economic system its ability to coordinate millions of economics decisions made on a daily basis. The system is an extensive communication network for expressing the wishes of consumers to producers. The price signals given by markets direct resources to the goods and services people want and indicate where profits are to be made for producers. Producers who fail to heed the market signals are punished. Consumers also use the market price to figure out how to make the best use of their limited incomes.
11) The production of capital goods does require time. These capital goods, however, can then be used to increase the production of consumer goods. This roundabout method of production is more efficient over time, but it does not come without a cost. As shown by the production possibilities curve, resources used to make capital goods must be diverted from the production of consumer goods today to produce capital goods that will then be used to increase the consumer goods of tomorrow.
12) Specialization may be of the human form with division of labour where different workers perform different production tasks; or it may be geographic specialization where some goods and services are produced in certain regions and others are produced in other areas.
13) Specialization enables individuals to take advantage of existing differences in their abilities and skills. Other advantages come from increased productivity or output per worker as specialized workers gain skills in performing one task and avoid loss of time in switching from one task to another. Therefore, more is produced with the same amount of resources as before specialization.
14) First, specialization lets people take advantage of differences in skills and abilities so they can be more efficient and productive. Second, specialization fosters learning by doing so people can become good at a particular task. Third, specialization saves time because people do not have to switch from one task to another.
15) Trade is difficult with barter because it requires a coincidence of wants. Money overcomes that problem. A buyer can obtain goods without having to locate a seller who desires what the person has to trade. All products can be priced and traded on a common basis. Also, with money, neither party needs to carry products around with them so they are always available for trade. Money facilitates the exchange of products, which is necessary for specialization. Economic efficiency is improved with a system of money.
16) Barter requires a coincidence of wants. In order for exchange to take place both parties have to want what the other is offering. Money, on the other hand, acts as a medium of exchange in that the appropriate quantity of it is generally acceptable in exchange for any good or service.

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17) Money is anything that is generally acceptable as a medium of exchange. In Canada, money includes curren and chequable deposits.

Barter requires a coincidence of wants between the two parties to a transaction. Each has to want what the c to offer. Money makes this coincidence unnecessary, as the seller is willing to accept money in exchange fo goods or services offered and can, in turn, exchange the money earned for other goods and services from another seller. The necessary condition for the use of paper currency is that it must be generally acceptable. Sellers must have faith that the currency will have value when they want to use it to buy goods and services for themselves.

Note that the money does not have to have any intrinsic value; that is, it does not have to be backed by a ma has some use like gold or silver.

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

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

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

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

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22)

Product	Market price	Output	Profit
A	$14.00	10	$40
B	9.00	11	–1
C	.50	300	50

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

23)

Product	Market price	Output	Profit
A	$10.00	6	–$40
B	5.00	19	–5
C	1.50	100	50

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

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

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

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26) The first motive is that because inefficiency drives up costs and lowers profits, any firm wishing to ***maximize its profits*** will make great efforts to minimize production costs. These efforts will include using t mix of labour and capital, given the prices and productivity of those resources. They also mean locating pro facilities optimally to minimize production and transportation expenses.

The second motive is due to ***competition***, consumers strongly prefer low prices and will shift their purchase over to the firms that can produce a quality product at the lowest possible price. Any firm foolish enough to use higher-cost production methods will go bankrupt as it is undersold by its more efficient competitors who can still make a profit when selling at a lower price. In other words, ***competition eliminates high-cost producers***, and so firms are motivated to choose the lowest-cost production methods to produce goods and services.

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

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

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

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

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

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

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

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

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

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

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

38) In the simple circular flow model, there are two decision-makers: households and businesses. These two groups are related through the resource and product markets. In the upper half of the circular flow, households sell economic resources (land, labour, capital, and entrepreneurial ability) and businesses buy resources through the resource market. Businesses pay for the cost of these resources, which in turn become money income for households. It is the supply decisions of resources sellers (households) and the buying de businesses that determine prices and employment in the resource market.

In the lower half of the circular flow, businesses sell goods and services and households buy goods and serv the product market. Households pay for these goods and services with the money income they received from providing resources. These consumption expenditures become revenue for businesses. It is the product buying decisions of households and the product selling decisions of businesses that determine prices and output in the product market.

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

40) Businesses fall into three main categories.

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

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

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

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