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Chapter 2 Economics The Framework for Business

TRUEFALSE

1. An economy is one that includes a financial system and excludes a social system.

(A) True

(B) False

Answer : (B)

2. In the context of fiscal strategies, most economists agree that higher taxes can boost the economy by leaving more money with the government to spend during an economic crisis.

(A) True

(B) False

Answer : (B)

3. If spending is lower than revenue, the government incurs a budget deficit and must borrow money to cover the shortfall.

(A) True

(B) False

Answer : (B)

4. The discount rate is the interest rate the Fed charges on its loans to commercial banks.

(A) True

(B) False

Answer : (A)

5. When the Fed reduces the discount rate, banks can obtain funds at a lower cost and use these funds to make more loans to their own customers.

(A) True

(B) False

Answer : (A)

6. The Fed requires that all of its member banks hold funds called "reserves," equal to a stated

percentage of the deposits held by their customers. This percentage is called the reserve requirement.

(A) True

(B) False

Answer : (A)

7. Countries that adopted communism in the 1900s-most notably the former Soviet Union, China, Cuba, North Korea, and Vietnam-thrived and prospered more than all the other countries in the world.

(A) True

(B) False

Answer : (B)

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

(A) True

(B) False

Answer : (A)

9. The amount of input divided by the amount of output equals productivity.

(A) True

(B) False

Answer : (B)

10. Gross Domestic Product (GDP) tends to overstate the amount of output produced by a nation's economy.

(A) True

(B) False

Answer : (B)

11. In most nations, the unemployment rate includes only individuals over the age of 21 who were involuntarily laid off or terminated from their previous jobs.

(A) True

(B) False

Answer : (B)

MULTICHOICE

12. Macroeconomics is primarily engaged in the study of:

(A) smaller business units in a locality.

(B) employment rates in a country.

(C) individual consumers.

(D) households and families in a region.

Answer : (B)

13. Identify a true statement about macroeconomics.

(A) It focusses primarily on monitoring the activities of individual businesses.

(B) It hardly affects the day-to-day lives of people.

(C) It is the study of a country's overall economic dynamics.

(D) It has little or no influence on variables such as jobs and taxes.

Answer : (C)

14. Macroeconomics focuses on:

(A) the major issues facing the national economy that do not affect individuals.

(B) the smaller economic units such as individual consumers and individual businesses operating within an economy.

(C) the major issues facing the national economy that may seem abstract but directly affect an individual's day-to-day life.

(D) the economics of private companies.

Answer : (C)

15. Microeconomics focuses on:

(A) the employment rate in a country.

(B) individual businesses.

(C) the gross domestic product of a country.

(D) taxation policies.

Answer : (B)

16. Which of the following statements is true of microeconomics?

(A) It includes the monitoring of national, regional, and global economies.

(B) It primarily focuses on smaller economic units.

(C) It is the study of a country's overall economic dynamics.

(D) It excludes the study of families.

Answer : (B)

17. Identify a true statement about subprime mortgage loans.

(A) They are given to people with a high credit score.

(B) They are less attractive to lenders because they provide a lower return than any other form of investment.

(C) They are usually issued to people who have a high ability to repay the money they borrow.

(D) They are lent to borrowers with high debt-to-income ratios.

Answer : (D)

18. The $700 billion economic bailout plan following the subprime mortgage crisis of 2008 was called the _____.

(A) American Recovery and Reinvestment Act

(B) Troubled Assets Relief Program

(C) Clayton Antitrust Act

(D) NCUA Corporate Stabilization Program

Answer : (B)

19. The debt ceiling is:

(A) the maximum amount Congress lets the government borrow.

(B) the shortfall that occurs when expenses are higher than revenue over a given period of time.

(C) the overage that occurs when revenue is higher than expenses over a given period of time.

(D) the total amount of money within the national economy.

Answer : (A)

20. The sum of all the money borrowed by the government over the years and not yet repaid is the _____.

(A) trade gap

(B) subprime loan

(C) federal debt

(D) monetary devaluation

Answer : (C)

21. When tax revenue is higher than government expenditures, the government incurs a _____.

(A) private debt

(B) trade gap

(C) budget surplus

(D) fiscal deficit

Answer : (C)

22. Which of the following is a function of the Fed?

(A) It creates a budget, or a financial plan, for the national economy every year.

(B) It performs banking services for commercial banks in districts in which it operates.

(C) It calculates the expected spending for the federal government every year.

(D) It outlines expected revenue that is due from the collection of taxes and fees.

Answer : (B)

23. Identify a true statement about the Fed.

(A) The Fed is headed by a fifteen-member Board of Governors.

(B) The Fed manages the monetary policy of the United States.

(C) The Federal Reserve Banks are owned by the federal government.

(D) The Fed drastically increases the money supply when prices begin to rise.

Answer : (B)

24. Identify a true statement about types of money supply.

(A) The M1 money supply includes market accounts and certificates of deposit.

(B) The M1 money supply includes all currency plus checking accounts and traveler's checks.

(C) The M2 money supply excludes all of M1 supply except certificates of deposit, which last typically less than one year.

(D) The M2 money supply excludes paper bills and metal coins.

Answer : (B)

25. Identify the tool that the Fed most frequently uses to expand and contract the money supply in the economy.

(A) Open market operations

(B) Discount rate changes

(C) Reserve requirement changes

(D) Interest rate charges

Answer : (A)

26. In a particular state, many commercial banks struggle to lend money to the borrowers due to lack of money supply. The Fed buys securities from these banks and this creates a smooth flow of money for the banks to conduct their transactions. In this case, which of the following tools has the Fed most likely used to control the money supply?

(A) Open market operations

(B) Discount rate changes

(C) Reserve requirement changes

(D) Interest rate charges

Answer : (A)

27. Which of the following tools does the Fed use to help protect depositors who may want to withdraw their money without notice?

(A) Discount rate

(B) Interest rate

(C) Open market operation

(D) Reserve requirement

Answer : (D)

28. The economic system of the United States is called _____.

(A) capitalism

(B) communism

(C) socialism

(D) mercantilism

Answer : (A)

29. Which of the following is a true feature of capitalist economies?

(A) Individuals and businesses are restricted from buying and selling machines and buildings.

(B) Businesses have the right to keep after-tax profit and spend it however they see fit.

(C) Government has absolute power in controlling the economy.

(D) All enterprises are owned by the public, under the direction of a strong central government.

Answer : (B)

30. A capitalist system depends on fair competition among businesses to:

(A) be consistent with the goals of socialism.

(B) buy and sell government securities.

(C) guarantee that every individual business earns profits.

(D) drive higher quality and lower prices.

Answer : (D)

31. Monopolistic competition is a market structure:

(A) with many competitors selling differentiated products.

(B) with only a handful of competitors selling similar products.

(C) with many competitors selling virtually identical products.

(D) with just a single producer completely dominating the industry.

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Answer : (A)

32. Identify a true statement about oligopoly.

(A) It is a market structure that has many competitors selling virtually identical products.

(B) Firms in an oligopoly market structure typically avoid price competition.

(C) Agriculture exemplifies an oligopoly market structure.

(D) It has a single producer completely dominating the industry, leaving no room for competitors.

Answer : (B)

33. _____ refers to the quantity of products that producers are willing to offer for sale at different market prices.

(A) Supply

(B) Demand

(C) Ration

(D) Rebate

Answer : (A)

34. Anne is a manager at a store that sells clothes and accessories for both men and women. She notices that the jeans priced at $120 aren't selling very well. She wants to increase the sales of these jeans before the onset of the next season. She learns that there is direct relationship between the price and the sales of the clothes at her store. The approach Anne should take to achieve this is to _____.

(A) keep the prices the same but move the jeans to another section of the store

(B) lower the price of the jeans so that demand will increase

(C) raise the price of the jeans to make them seem more exclusive

(D) put jeans that are priced even higher next to the $120 jeans

Answer : (B)

35. Which of the following is a negative feature of socialist economic systems?

(A) Excessive private ownership of healthcare and utilities

(B) Absence of any tax structure

(C) Inefficiencies and corruption

(D) Lack of government ownership of key enterprises

Answer : (C)

36. Countries that adopted communist economics most likely developed:

(A) individualism and narcissistic values among people.

(B) an excessive number of privately-owned businesses.

(C) a free market system for services.

(D) crippling shortages and surpluses.

Answer : (D)

37. Identify a true statement about the economy of the United States.

(A) The economy of the United States is one of the most market-oriented economies in the world.

(B) The economy of the United States is one of the most market-oriented economies in the world.

(C) The economy of the United States is an extreme form of planned economy.

(D) In the U.S. economy, the government is prevented from creating any regulations that intervene in the free market.

Answer : (A)

38. Denise is a hard worker, but she has always had differences with her boss, Angela. Angela has recently become more demanding and is often unwilling to provide clarification on project requirements. After too many long working days with little or no job satisfaction, Denise walked into Angela's office and submitted her resignation. Denise knows that her résumé is strong and feels confident she will find another job. Denise is now facing _____ unemployment.

(A) seasonal

(B) structural

(C) frictional

(D) cyclical

Answer : (C)

39. The two key phases of a business cycle are:

(A) stagflation and hyperinflation.

(B) depression and contraction.

(C) contraction and expansion.

(D) recession and deflation.

Answer : (C)

40. The economy of Suielevia is under severe financial distress. Over the last few months, the economy has gradually picked up and the employment levels are slowly rising back to the normal levels. The consumers are also beginning to engage in regular buying activities. In this case, the economy of Suielevia is currently in the _____ phase of its business cycle.

(A) recovery

(B) deflation

(C) inflation

(D) hyperinflation

Answer : (A)

41. _____ measures the change over time in weighted-average wholesale prices, or the prices that businesses pay each other for goods and services.

(A) Consumer price index (CPI)

(B) House price index

(C) Producer price index (PPI)

(D) Gross domestic product index

Answer : (C)

SHORTANSWER

42. The sum of all the money borrowed by the government over the years and not yet repaid is the _____. A. fiscal debt
B. subprime loan
C. federal debt
D. monetary debt

Answer : federal debt

43. _____ refers to Federal Reserve decisions that shape the economy by influencing interest rates and the supply of money.
A. Fiscal policy
B. Monetary policy
C. Revenue policy

D. Deficit policy
Answer : Monetary policy

44. _____ is a market structure with just a single producer completely dominating the industry.
A. Oligopoly
B. Monopoly
C. Monopolistic competition
D. Pure competition
Answer : Monopoly

45. _____ is a period of robust economic growth and high employment.
A. Expansion
B. Recovery
C. Disinflation
D. Contraction
Answer : Expansion

46. _____ refers to a period of falling average prices across the economy. A. Recovery
B. Inflation
C. Expansion
D. Deflation

Answer : Deflation

ESSAY

47. Describe the four degrees of competition with examples.

Graders Info :

The four degrees of competition are pure competition, monopolistic competition, oligopoly, and monopoly. Pure Competition: A market structure with many competitors selling virtually identical products. In today's U.S. economy, examples of pure competition have virtually disappeared. The example of agricultural products probably comes the closest.
Monopolistic Competition: A market structure with many competitors selling differentiated products. Producers have some control over the price of their wares, depending on the value that they offer their customers. And new producers can fairly easily enter categories marked by monopolistic competition. Examples might include the clothing industry and fast food establishments.
Oligopoly: A market structure with only a handful of competitors selling products that are either similar or different. The retail gasoline business and the car manufacturing industry, for example, are both oligopolies. Another example might be the soft drink industry.
Monopoly: A market structure with just a single producer completely dominating the industry, leaving no room for any significant competitors. Monopolies usually are not good for anyone except for the company that has control since without competition there is not any incentive to hold down prices or increase quality and choices. Because these undesirable drawbacks can harm the economy, most attempts to monopolize markets in the United States are illegal. The classic example is a natural monopoly, such as a cable television system, water company, or electric utility. The government also fosters temporary monopolies when it grants patents or copyrights.

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48. Define the two categories of planned economies and illustrate the differences and similarities between them.

Graders Info :

The two key categories of planned economies are socialism and communism.
Socialism is an economic system based on the principle that the government should own and operate key enterprises that directly affect public welfare, such as utilities, telecommunications, and healthcare. While the official government goal is to run these enterprises in the best interest of the overall public, inefficiencies and corruption often interfere with effectiveness. Socialist economies also tend to have higher taxes, which are designed to distribute wealth more evenly through society. Communism is an economic and political system that calls for public ownership of virtually all enterprises, under the direction of a strong central government. The communist concept was the brainchild of political philosopher Karl Marx, who outlined its core principles in his 1848 Communist Manifesto. The communism that Marx envisioned was supposed to dramatically improve the lot of the worker at the expense of the super-rich.

49. What is a business cycle? Describe the different phases of a business cycle in a changing economy.

Graders Info :

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

50. Explain the various changes in the rate of price in an economy.

Graders Info :

The rate of price changes across the economy is a basic measure of economic well-being. Inflation means that prices, on average, are rising. Similar to unemployment, a low level of inflation is not so bad. It reflects a healthy economy-people have money, and they are willing to spend it. But when the Federal Reserve-the nation's central bank-manages the economy poorly, inflation can spiral out of control, which can lead to hyperinflation, when average prices increase more than 50% per month. When the rate of price increases slows down, the economy is experiencing disinflation, which was the situation in the United States in the mid-1990s and more recently in the second half of 2008. But

when prices actually decrease, the economy is experiencing deflation, typically a sign of economic trouble that goes hand-in-hand with very high unemployment. People do not have money and simply will not spend unless prices drop. During the Great Depression in the 1930s, the U.S. economy experienced deflation, with prices dropping 9% in 1931 and nearly 10% in 1932.

51. Define and describe productivity.

Graders Info :

Productivity refers to the relationship between the goods and services that an economy produces and the resources needed to produce them. The amount of output-goods and services-divided by the amount of input equals productivity. The goal, of course, is to produce more goods and services, using fewer hours and other inputs. A high level of productivity typically correlates with healthy GDP growth, while low productivity tends to correlate with a more stagnant economy.
Over the past couple of decades, the United States has experienced strong productivity growth, due largely to infusions of technology that help workers produce more output, more quickly. But keep in mind that that productivity does not measure quality. That's why it is so important to examine multiple measures of economic health rather than relying on simply one or two dimensions.