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Name:_____ Class:_____ Date:_____

Chapter 02

1. Which of the four resources of production does an economist consider wheat to be?
   a. land
   b. labor
   c. capital
   d. entrepreneurship

ANSWER: a

2. An economist considers a taxi cab owned by a cab company to be which of the four resources of production?
   a. land
   b. labor
   c. capital
   d. entrepreneurship

ANSWER: c

3. Lumen hires three people to work in her photography studio. Which category of the four factors of production do these three workers fall under?
   a. capital
   b. labor
   c. land
   d. entrepreneurship

ANSWER: b

4. Alisa buys a 3D printer for the coworking space that she operates. Which category of the four factors of production does this printer fall under?
   a. capital
   b. labor
   c. land
   d. entrepreneurship

ANSWER: a

5. Taylor decides to create an organic agriculture marketing firm and is working on the business plan for his new business. Which category of the four factors of production does his creation of this business fall under?
   a. capital
   b. labor
   c. land
   d. entrepreneurship

ANSWER: d

6. The initiative to take risks and innovate falls under which category of the four factors of production?
   a. capital
   b. labor

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c. land
d. entrepreneurship

ANSWER: d

7. A professor who teaches a class is contributing which of the four factors of production to the creation of a college education?
a. capital
b. labor
c. land
d. entrepreneurship

ANSWER: b

8. Which of the following does NOT fall under the land category?
a. wood from forests
b. chicken eggs
c. a farmer working on a farm
d. iron ore

ANSWER: c

9. An economist would not consider which of the following to be under the category of capital?
a. a pan used by a chef
b. a camera used by a photographer
c. money used to buy stocks
d. running shoes owned by a professional runner

ANSWER: c

10. The ability to assemble all of the other factors of production into a good falls under the category of:
a. capital.
b. labor.
c. land.
d. entrepreneurship.

ANSWER: d

11. Groups of people who live together and share income are called:
a. firms.
b. households.
c. collectives.
d. individuals.

ANSWER: b

12. What is earned by households in exchange for providing capital?

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a. wages
b. profit
c. rent
d. credit

ANSWER: c

13. Households receive _____ as payment for work effort.
a. wages
b. profit
c. rent
d. credit

ANSWER: a

14. Wages are paid to households in exchange for the supply of:
a. capital.
b. labor.
c. land.
d. entrepreneurship.

ANSWER: b

15. Rents are paid to households in exchange for the supply of:
a. capital only.
b. labor and entrepreneurship.
c. land only.
d. capital and land.

ANSWER: d

16. A business owner receives which of the following types of payment in return for the willingness to accept risk and innovate?
a. wages
b. profit
c. rent
d. credit

ANSWER: b

17. The payment made to the entrepreneurial economic resource is called:
a. wages.
b. rent.
c. profit.
d. credit.

ANSWER: c

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18. Rent is the payment that a household receives in exchange for providing:
    a. capital.
    b. entrepreneurship.
    c. labor.
    d. skills and knowledge.

ANSWER: a

19. In the circular flow model, households:
    a. employ factors from the product markets.
    b. sell factors in the product markets.
    c. collect taxes and pay transfers.
    d. demand goods and services in the product markets.

ANSWER: d

20. In the circular flow model, households:
    a. supply factors in the factor markets.
    b. sell factors in the product markets.
    c. collect taxes and pay transfers.
    d. demand goods and services in the factor markets.

ANSWER: a

21. In the circular flow model, a firm will:
    a. employ factors from the product markets.
    b. sell factors in the product markets.
    c. collect taxes and pay transfers.
    d. sell goods and services in the product markets.

ANSWER: d

22. If an entrepreneur wants the tightest control over the decision making in a firm, what is the best type of firm to operate?
    a. sole proprietorship
    b. limited liability partnership (LLP)
    c. partnership
    d. corporation

ANSWER: a

23. The type of firm that is a distinct legal entity that is separate from the entrepreneur and other owners but cannot sell stock is a:
    a. corporation.
    b. partnership.

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c. limited liability corporation (LLC).
d. nonprofit.

ANSWER: c

24. The type of firm that is a distinct legal entity that is separate from the entrepreneur and other owners and can sell stock is a:
a. corporation.
b. partnership.
c. limited liability corporation (LLC).
d. nonprofit.

ANSWER: a

25. Which of the following is a key distinction between corporations and limited liability corporations (LLCs)?
a. Corporations are distinct legal entities for the purpose of taxes, but LLCs are not.
b. Corporations shield owners from legal liabilities, but LLCs do not.
c. Corporations can borrow money, but LLCs cannot.
d. Corporations can issue stock, but LLCs cannot.

ANSWER: d

26. Which of the following is an advantage that a limited liability corporation has but a corporation does not?
a. Owners are protected from legal liability.
b. A small amount of paperwork is necessary to start them.
c. Owners are protected from tax liability.
d. Owners have the ability to sell stock.

ANSWER: b

27. Pawsabilities is a dog grooming service entirely owned by Clark, Art, and Fred. What type of firm is Pawsabilities?
a. single proprietorship
b. partnership
c. corporation
d. limited liability corporation

ANSWER: b

28. Pawsabilities is a dog grooming service entirely owned by Clark, Art, and Fred. Which of the following statements does NOT describe a downside of this business form?
a. It faces significant paperwork requirements to start.
b. Each owner is personally liable for debts created by the firm.
c. It can use loans only as a way to raise money to expand.
d. Each owner is liable for a legal claim against the firm.

ANSWER: a

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29. Any enterprise that employs the factors of production and sells goods and services is called:
    a. a household.
    b. labor.
    c. capital.
    d. a firm.

ANSWER: d

30. What are the owners of a limited liability corporation (LLC) called?
    a. shareholders
    b. owners
    c. members
    d. bondsmen

ANSWER: c

31. _____ represent(s) ownership in a corporation.
    a. Bonds
    b. Debt
    c. Stocks
    d. Dividends

ANSWER: c

32. A _____ is a payment of a portion of a corporation's profits that is made to a shareholder of the corporation.
    a. bond
    b. debt
    c. stock
    d. dividend

ANSWER: d

33. Firms sell stock to:
    a. generate a profit.
    b. raise funds to begin or expand a business.
    c. pay employees.
    d. create a liability for shareholders.

ANSWER: b

34. To begin her accountancy firm, Cheryl filed articles of incorporation and issued 1,000 shares of stock. Cheryl's accountancy firm is a:
    a. sole proprietorship.
    b. limited liability corporation.
    c. corporation.

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d. partnership.

ANSWER: c

35. Which of the following is a reward that a shareholder receives in payment for holding stock?
    a. rent
    b. dividends
    c. wages
    d. profit

ANSWER: b

36. A firm that is legally distinct from its owners, who are called shareholders, is called a:
    a. limited liability corporation.
    b. sole proprietorship.
    c. partnership.
    d. corporation.

ANSWER: d

37. A firm that is legally distinct from its owners, who are called members, is called a:
    a. limited liability corporation.
    b. sole proprietorship.
    c. partnership.
    d. corporation.

ANSWER: a

38. What is a stock?
    a. a partial ownership in a firm
    b. an article of incorporation
    c. the employees of a firm
    d. the inventory of a firm

ANSWER: a

39. Which of the following is a key distinction between a corporation and a limited liability corporation (LLC)?
    a. A corporation shields its owners from the debts of the firm, but an LLC does not.
    b. A corporation shields its owners from legal claims against the firm, but an LLC does not.
    c. A corporation issues stock, but an LLC does not.
    d. A corporation has many members, but an LLC has one member.

ANSWER: c

40. An organization that has the authority to lead and govern is called a:
    a. corporation.
    b. government.

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c. limited liability corporation (LLC).
d. partnership.

ANSWER: b

41. A _____ is made by a government for something other than the purchase of a good or service.
a. dividend
b. tax
c. share
d. transfer payment

ANSWER: d

42. Which of the following is NOT an example of a transfer payment?
a. An elderly man receives a social security payment.
b. The government buys 200 statues of chickens.
c. The government pays unemployment insurance to unemployed workers.
d. A chicken farmer receives a subsidy.

ANSWER: b

43. A state government collects _____ to pay for necessary services and to employ workers in the state.
a. transfer payments
b. dividends
c. taxes
d. interest

ANSWER: c

44. In order to purchase goods and services and factors of production, a government must:
a. collect taxes.
b. issue stock.
c. pay dividends.
d. provide transfer payments.

ANSWER: a

45. The city council of Moose Jaw in Saskatchewan, Canada, is an example of a:
a. corporation.
b. sole proprietorship.
c. limited liability corporation (LLC).
d. government.

ANSWER: d

46. In the circular flow model, the government:
a. collects taxes and pays transfer payments.

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b. purchases goods and services in the factor markets.
c. purchases resources in the product markets.
d. pays dividends to households.

ANSWER: a

47. In the circular flow model, a firm:
a. sells factors in the product markets.
b. employs factors from the factor markets.
c. collects taxes and pay transfers.
d. sells goods and services in the factor markets.

ANSWER: b

48. In the circular flow diagram, what flows from households to product markets?
a. spending
b. products
c. factor payments
d. income

ANSWER: a

49. In the circular flow diagram, what flows from firms to factor markets?
a. factors of production
b. products
c. factor payments
d. spending

ANSWER: c

50. In the circular flow diagram, what flows from firms to product markets?
a. spending
b. income
c. factors of production
d. services

ANSWER: d

51. In the circular flow diagram, _____ are traded in product markets, and _____ are traded in factor markets.
a. goods and services; resources
b. resources; goods
c. services; goods
d. transfer payments; taxes

ANSWER: a

52. Which of the following statements is correct about the role that is played by the government in the circular

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flow diagram?

a. The government collects taxes only from households.
b. The government both receives factors of production and makes factor payments.
c. The government provides goods and services only to households and collects taxes only from firms.
d. The government does not interact with the product market.

ANSWER: b

53. Which of the following is the role that is played by the government in the circular flow diagram?

a. It provides goods and services to households and firms and pays for these using taxes.
b. It provides resources to product markets in exchange for factor income and provides goods and services to households.
c. It provides goods and services in factor markets and provides goods and services to firms.
d. It provides more goods and services to households and firms than it collects in the form of taxes.

ANSWER: a

54. A situation is considered efficient if:

a. there is no alternative allocation of resources that can make someone better off without making someone else worse off.
b. all resources are allocated in such a way that all participants receive an equal share of what has been produced.
c. production has been allocated in such a way that all people receive the output that they expected to receive.
d. some people receive a higher share of production than others.

ANSWER: a

55. The economist who developed the idea of efficiency in economics is:

a. A. W. Phillips.
b. Adam Smith.
c. David Ricardo.
d. Vilfredo Pareto.

ANSWER: d

56. The central objective that firms, households, and governments have when making economic decisions is:

a. profit.
b. rent.
c. efficiency.
d. equity.

ANSWER: c

57. Economists evaluate an allocation of resources as efficient if:

a. the allocation makes the majority of citizens happy.
b. the allocation distributes the resources equally across all citizens.

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c. the allocation of resources produces goods at the lowest possible prices.
d. no alternative allocation could make some people better off without making other people worse off.

ANSWER: d

58. There are 12 cookies to be distributed between two friends. Which of the following choices would allocate the cookies in the most efficient manner?
a. One person gets 12 cookies, and the other get no cookies.
b. Each person gets an equal share of six cookies.
c. The cookies are distributed by a random lottery.
d. The most cookies are allocated to the friend with the strongest desire for cookies, and the other person gets the rest of the cookies.

ANSWER: d

59. Economists evaluate an allocation of resources as _____ if no alternative allocation could make some people better off without making other people worse off.
a. fair
b. efficient
c. egalitarian
d. unjust

ANSWER: b

60. When Eric is staring into the refrigerator trying to figure out what to make for dinner, which of the three economic questions is he attempting to answer?
a. What should the price be?
b. What should be produced?
c. How should it be produced?
d. For whom should it be produced?

ANSWER: b

61. Cher is a struggling soybean farmer who is frustrated with low soybean prices. In the spring, rather than planting more soybeans, Cher decides to use her economic resources to grow barley instead. Cher's decision is an example of what fundamental economic question?
a. What should be produced?
b. Where shall we produce?
c. How should it be produced?
d. For whom should it be produced?

ANSWER: a

62. If an economy figures out how to allocate land, labor, and capital in such a way that no other allocation makes society better off, then the economy has answered what question?
a. What should the price be?
b. What should be produced?

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c. How should it be produced?
d. For whom should it be produced?

ANSWER: b

63. If resources are allocated in such a way that no more of a good can be produced without producing less of another good, what question has been answered?
a. What should the price be?
b. What should be produced?
c. How should it be produced?
d. For whom should it be produced?

ANSWER: c

64. Sonny owns a grocery store. He realizes that his profits will increase if he can buy more automated check-out machines and then employ fewer workers who check out each shopper. This decision to replace labor with capital is an example of what fundamental economic question?
a. What shall be produced?
b. Where shall we produce?
c. How should it be produced?
d. For whom should it be produced?

ANSWER: c

65. If the goods and services that are produced in a society are allocated in such a way that the ones who receive those goods and services are the ones who value them the most, what economic question has been answered?
a. What should the price be?
b. What should be produced?
c. How should it be produced?
d. For whom should it be produced?

ANSWER: d

66. When a college uses a lottery to determine who is assigned the nicest dorm room on campus, what economic question is being answered?
a. What should the price be?
b. What should be produced?
c. How should it be produced?
d. For whom should it be produced?

ANSWER: d

67. Jane is celebrating her barbershop's fifth anniversary by auctioning a free haircut to the highest bidder. Jane's auction is an example of what fundamental economic question?
a. What shall be produced?
b. What time shall we produce?
c. How should it be produced?

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d. For whom should it be produced?

ANSWER: d

68. Which of the following questions is NOT one of the fundamental economic questions?
a. What shall be produced?
b. When shall we produce?
c. How should it be produced?
d. For whom should it be produced?

ANSWER: b

69. What are the fundamental economic questions?
a. What should be produced, and how much should it be sold for?
b. What should be produced, when should it be produced, and how much should it be sold for?
c. How many units of a good should be produced, when should it be sold, and how should it be priced?
d. What should be produced, how should it be produced, and for whom should it be produced?

ANSWER: d

70. When power plants switch from using coal as a fuel for electricity generation to using less expensive natural gas as a fuel, it demonstrates which of the economic questions?
a. What shall be produced?
b. For whom should it be produced?
c. How should it be produced?
d. Where shall we produce?

ANSWER: c

71. When the state of Colorado uses a lottery to determine which hunters will receive a tag to hunt mountain goats, it demonstrates which of the economic questions?
a. What shall be produced?
b. For whom should it be produced?
c. How should it be produced?
d. Where shall we produce?

ANSWER: b

72. When cell phone producers decided to produce more smartphones and fewer flip-style phones, they demonstrated which of the economic questions?
a. What shall be produced?
b. For whom should it be produced?
c. How should it be produced?
d. Where shall we produce?

ANSWER: a

73. Answers to the fundamental economic questions are determined by the _____ system that is in place.

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a. economic
b. operating
c. voting
d. educational

ANSWER: a

74. An economy in which economic decisions are based on precedent is known as a _____ economy.
a. market-based
b. socialist
c. traditional
d. command

ANSWER: c

75. When a nation adopts aspects of traditional, market, and command economies, it is known as a _____ economy.
a. socialist
b. communist
c. democratic
d. mixed

ANSWER: d

76. Traditional economies make economic decisions based on:
a. markets.
b. elected committees.
c. precedent.
d. supply and demand.

ANSWER: c

77. The nation of Lumen produces goods and services by using techniques that have been around for generations and allocates them based on a complicated social structure. What kind of economic system exists in Lumen?
a. market-based economy
b. socialist economy
c. traditional economy
d. command economy

ANSWER: c

78. What is a characteristic of a purely traditional economic system?
a. There is rapid innovation.
b. Prices determine the allocation of goods.
c. Legislators from a single political party allocate resources.

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d. Economic decisions are based on precedent.

ANSWER: d

79. All goods, services, and resources are allocated based on their price, and those who value them the most pay that price. This best describes what economic system?

a. communism
b. socialism
c. market economy
d. traditional economy

ANSWER: c

80. An economy in which economic decisions are based primarily on the interactions of buyers and sellers is known as a _____ economy.

a. market-based
b. socialist
c. traditional
d. command

ANSWER: a

81. Which of the following would NOT be a feature of pure market economy?

a. Households own the factors of production.
b. Social safety nets exist for the old and sick.
c. Buyers and sellers respond to prices.
d. Firms make decisions in pursuit of profits.

ANSWER: b

82. In the nation of Willowland, all goods are allocated on the basis of price and the value placed on that good. The nation of Willowland most likely has a _____ economy.

a. market
b. socialist
c. communist
d. command

ANSWER: a

83. A potential disadvantage of a market economy is that:

a. efficient methods of production might continue because that is the way things have always been made.
b. the rewards of production are distributed equitably, which might reduce the incentive to produce.
c. a pure market economy may not provide goods that are collectively consumed.
d. general assemblies make most economic decisions.

ANSWER: c

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84. In a _____ economy, households own the factors of production.
a. market
b. socialist
c. communist
d. command
ANSWER: a

85. An advantage of market economies is that:
a. private ownership of resources creates an equal distribution of wealth.
b. private ownership of resources creates incentives to innovate.
c. there is an elimination of social class structures.
d. firms and individuals can develop new products and methods in a risk-free environment.
ANSWER: b

86. In _____ economy, the factors of production are collectively owned.
a. a market
b. a capitalist
c. an emerging
d. a command
ANSWER: d

87. The factors of production are collectively owned in _____ economy.
a. there is no incentive for the government to provide services to the citizens.
b. private ownership of factories and farms creates a risk-free environment for the development of new ideas.
c. there are few incentives for people to take risks and develop new products.
d. private firms and individuals can develop new products and methods and profit from those inventions.
ANSWER: c

88. The economy of Stockbridge has centralized decision making about what is produced and how it is allocated. Stockbridge most likely has a _____ economy.
a. traditional
b. market
c. mixed
d. command
ANSWER: d

89. An economy in which economic decisions are primarily centralized, rather than based on the interactions of buyers and sellers, is known as a _____ economy.
a. market-based
b. capitalistic

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c. traditional
d. command

ANSWER: d

90. Capitalism is also known as a _____ economy.
a. market-based
b. capitalistic
c. traditional
d. command

ANSWER: a

91. Which of the following statements about socialism is true?
a. It is another word for communism.
b. It features state ownership of key industries within a free-market system.
c. It does not have the pitfall of altered incentives to produce.
d. It does not answer the three economic questions.

ANSWER: b

92. Which of the following statements about communism is true?
a. It is another word for socialism.
b. It features state ownership of key industries within a free-market system.
c. It does not have the pitfall of altered incentives to produce.
d. Goods and services are allocated according to needs.

ANSWER: d

93. Most economies in the world are:
a. mixed.
b. command.
c. market.
d. traditional.

ANSWER: a

94. Which of the following is an advantage of communism?
a. Because all firms are owned by the same entity, research and development can be shared by all producers.
b. There is a much greater emphasis on advertising in communism than in other economic systems.
c. Prices send producers and consumers important signals about the value of resources and output.
d. Shared income increases the incentive to produce.

ANSWER: a

95. An economic system under which general assemblies and councils of workers and consumers answer the

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three questions is:

a. a market economy.

b. socialism.

c. communism.

d. a traditional economy.

ANSWER: b

96. Explain the similarities and differences between a sole proprietorship and a partnership.

ANSWER: In both sole proprietorships and partnerships, relatively little paperwork is required, and the owners retain all profits, legal liabilities, and tax liabilities. They differ in that decision making must be shared in a partnership but is controlled by the owner of a sole proprietorship.

97. Pizza is made using ovens, dough, sauce, cheese, electricity, and workers. For each of these, identify the category of the factors of production to which they belong.

ANSWER: Ovens are capital. Dough, sauce, cheese, and electricity are land. Workers are labor.

98. Define the economic resource that is known as capital, and explain how economists think of this word differently than it is used in everyday language.

ANSWER: Capital is the manufactured goods that are used to produce other goods or services. When people say things like a business needs to "raise capital," they really mean that the business needs to raise money in order to purchase capital.

99. List the different types of spending (including to governments) that is done by households in the circular flow diagram.

ANSWER: In the circular flow diagram, households spend on goods and services in product markets and spend on taxes that they pay to the government.

100. List the different types of spending that are done by the government in the circular flow diagram.

ANSWER: In the circular flow diagram, the government spends on goods and services in product markets; spends on transfer payments to households and subsidies to firms; and spends on factors of production in the factor market.

101. Explain why innovation tends to be more common in market economies than in command economies.

ANSWER: In a market system, the risks that are taken in order to invent new things are rewarded when an individual is willing to take risks and successfully create a new product, process, or idea. In a command economy, that return will be shared with others who have not undertaken that risk.

102. Compare and contrast corporations and limited liability companies (LLC).

ANSWER: Corporations and limited liability companies (LLCs) share the features of requiring paperwork to create them, sharing ownership, and protecting owners from legal and tax liabilities that a company might incur. Corporations differ from LLCs in that they require much more extensive paperwork to create, they can issue stock to raise funds to expand or begin, and owners are called shareholders rather than members as in an LLC.

103. What are the three questions that every economic system needs to answer? How are those answered in a

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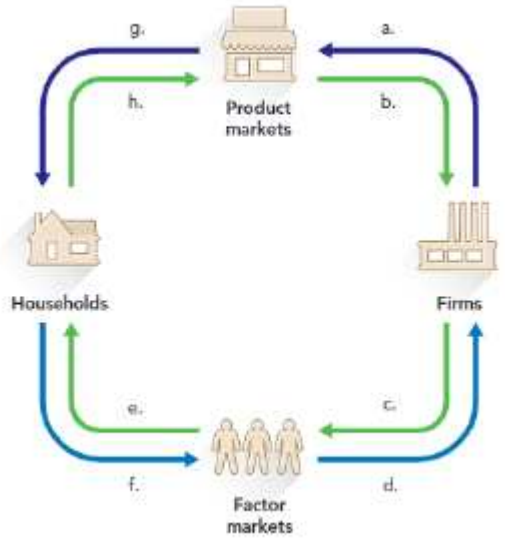
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market system?

ANSWER: Every economic system needs to answer three questions. (1) What to produce: prices signal to producers what buyers value the most. (2) How to produce it: factor prices encourage producers to find the most efficient means of producing an item at the lowest cost. (3) For whom should it be produced: output is allocated in markets so that prices guide goods and services to those who value them the most.

104. The figure below shows an incomplete circular flow diagram. Complete the figure by filling in the missing labels.



ANSWER: (a) Goods and services, (b) spending, (c) factor payments, (d) factors of production, (e) income, (f) factors of production, (g) goods and services, and (h) spending

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