

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

1) A *business* provides goods or services in order to earn profits.

Answer:  True  False

2) Non-profit businesses operate in many of the same ways as businesses that seek profits.

Answer:  True  False

3) The external environment consists of everything inside an organization's boundaries that might affect it.

Answer:  True  False

4) Businesses seek to be close to customers, establish strong relationships with suppliers and distinguish themselves from competitors.

Answer:  True  False

5) Global business environment refers to the international forces that affect a business.

Answer:  True  False

6) Technology only includes electronics and telecommunications used to perform business activities.

Answer:  True  False

7) Political-legal environment includes the customs, mores, values and demographic characteristics of the society in which an organization functions.

Answer:  True  False

8) An example of economic environment is when most people have jobs and therefore a growing company may find it necessary to pay higher wages and offer more benefits in order to attract workers from other companies.

Answer:  True  False

9) A factor of production is a nation's system for allocating resources among its citizens.

Answer:  True  False

10) An entrepreneur is a business that accepts the risks and opportunities to create and operate.

Answer:  True  False

11) Physical resources are the data and other information used by businesses.

Answer:  True  False

12) A planned economy relies on a centralized government to control all or most of the factors of production and to make all or most production and allocation decisions.

Answer:  True  False

13) Capitalism allows for the private ownership of the factors of production.

Answer:  True  False

14) In a socialist economy, the government owns and operates selected major industries.

Answer:  True  False

15) Economic systems allocate the factors of production differently.

Answer:  True  False

- 16) The law of demand states that buyers will purchase more of a product as its price drops and less of a product as its price increases.  
Answer:  True  False
- 17) The point at which the supply curve and the demand curve intersect is the market price.  
Answer:  True  False
- 18) There are many sellers in an oligopoly.  
Answer:  True  False
- 19) A differentiating strategy used in monopolistic competition is to use brand names such as Tide and Cheer.  
Answer:  True  False
- 20) Standard of living refers to the quantity and quality of goods and services that people can purchase with the currency used in their economic system.  
Answer:  True  False
- 21) Aggregate output refers to the pattern of short-term ups and downs in the economy.  
Answer:  True  False
- 22) The Gross National Product (GNP) is the total value of all goods and services produced by a national economy within a given period regardless of where the factors of production are located.  
Answer:  True  False
- 23) Purchasing power parity is a principle that states that exchange rates are set so that the prices of similar products in different countries are about the same.  
Answer:  True  False
- 24) A positive balance of trade results when a country imports more than it exports.  
Answer:  True  False
- 25) Inflation refers to widespread price increases in an economic system.  
Answer:  True  False
- 26) The consumer price index measures the prices of typical products purchased by consumers living in urban areas.  
Answer:  True  False
- 27) The United States government manages the collection and spending of its revenues through monetary policy.  
Answer:  True  False
- 28) The pursuit of profits distinguishes a business from organizations such as most universities, hospitals, and government agencies.  
Answer:  True  False
- 29) Physical resources, labor, capital, and entrepreneurs are four traditional factors of production.  
Answer:  True  False

- 30) Communism and capitalism are the two basic forms of planned economies.  
Answer: True  False
- 31) One of the four elements that must be present in private enterprise is reasonable prices.  
Answer: True  False
- 32) As a rule, in perfect competition there will be very few sellers.  
Answer: True  False
- 33) Similar products are differentiated in monopolistic competition.  
Answer:  True  False
- 34) The market for clothing is best characterized as monopolistic competition.  
Answer:  True  False
- 35) In an oligopoly, the entry of new competitors is hard because large capital investment is needed.  
Answer:  True  False
- 36) Electric companies are good examples of natural monopolies.  
Answer:  True  False
- 37) Nearly every economic system has two broad goals: economic growth and economic stability.  
Answer:  True  False
- 38) The primary measure of growth in the business cycle is inflation.  
Answer: True  False
- 39) Standard of living tends to decrease with growth in the economy.  
Answer: True  False
- 40) Gross domestic product (GDP) refers to the total value of goods and services produced by a national economy within a given period regardless of where the factors of production are located.  
Answer: True  False
- 41) GDP per capita is computed by dividing a nation's GDP by its total population.  
Answer:  True  False
- 42) Inflation results in increased purchasing power for the consumer.  
Answer: True  False
- 43) Tax increases and decreases are a form of fiscal policy.  
Answer:  True  False
- 44) When the Fed restricts the money supply, it is practicing a tight monetary policy.  
Answer:  True  False
- 45) The purpose of monetary and fiscal policy is to smooth out fluctuations in output and unemployment and to stabilize prices.  
Answer:  True  False

- 46) Product differentiation exists in a market characterized by monopolistic competition.  
Answer:  True  False
- 47) Price decreases by one company in an oligopoly are likely to be matched by other companies.  
Answer:  True  False
- 48) Monopolistically competitive businesses may be large or small and may enter or exit the market easily.  
Answer:  True  False
- 49) Electric companies are good examples of natural monopolies because their price is government-regulated and they can supply all the power needed in a local area.  
Answer:  True  False
- 50) The main measure of growth in the business cycle is aggregate output.  
Answer:  True  False
- 51) An increase in aggregate output, offset by an increase in inflation, will typically result in a recession.  
Answer:  True  False
- 52) The real growth rate of the U.S. economic system, as well as the standard of living, has decreased in recent years.  
Answer:  True  False
- 53) Profits from an American-owned automobile factory in Brazil are included in the GDP of Brazil.  
Answer:  True  False
- 54) If productivity increases, prices charged to consumers will tend to increase as well.  
Answer:  True  False
- 55) Inflation increases the purchasing power of your money.  
Answer:  True  False
- 56) With a price index change of 2.5 and an initial price index of 160.5, the inflation rate would be 1.6 percent.  
Answer:  True  False
- 57) With a 1998 CPI of 148.2 and a 1999 CPI of 152.4, the inflation rate would be 1.5%.  
Answer:  True  False
- 58) Taken together, fiscal policy and monetary policy make up growth policy during inflationary times.  
Answer:  True  False

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

- 59) After considering the textbook's definition of *business*, how are universities and hospitals different from the organizations described?
- A) They typically are not profit-seeking.
  - B) They do not produce goods or services.
  - C) They are not affected by the global environment.
  - D) Their organizational boundaries are narrower than normal.

Answer: A

- 60) Which of the following is an important element of an organization's external environment?
- A) sociocultural environment
  - B) technological environment
  - C) political-legal environment
  - D) all of the above

Answer: D

- 61) The political-legal environment reflects the relationship between \_\_\_\_\_.
- A) business and labor unions
  - B) business and industry
  - C) business and government
  - D) business and foreign trade

Answer: C

- 62) A(n) \_\_\_\_\_ is a nation's basis for allocating its resources among its citizens.
- A) economic system
  - B) capital structure
  - C) distribution network
  - D) ownership system

Answer: A

- 63) The funds needed to create and operate a business enterprise are \_\_\_\_\_.
- A) capital
  - B) liabilities
  - C) the money supply
  - D) physical resources

Answer: A

- 64) A(n) \_\_\_\_\_ is an individual who accepts the risks and opportunities entailed by creating and operating a new business.
- A) entrepreneur
  - B) partner
  - C) officer
  - D) proprietor

Answer: A

- 65) Tangible goods that organizations use in conducting their businesses are referred to as \_\_\_\_\_.
- A) information resources
  - B) physical resources
  - C) capital
  - D) the money supply

Answer: B

- 66) A \_\_\_\_\_ economy has characteristics of both planned and market economies.
- A) privatized
  - B) hybrid
  - C) capitalist
  - D) mixed market

Answer: D

- 67) The process of converting government enterprises into privately owned firms is called \_\_\_\_\_.
- A) privatization
  - B) entrepreneurship
  - C) demand
  - D) socialism

Answer: A

- 68) A \_\_\_\_\_ shows how many of a given product will be bought at different prices.
- A) price list
  - B) price control
  - C) supply curve
  - D) demand curve

Answer: D

- 69) The point at which the supply curve and the demand curve intersect on a graph is referred to as the \_\_\_\_\_.  
 A) perfect price                      B) decision point                      C) equilibrium price                      D) surplus price  
 Answer: C
- 70) The price at which the quantity of goods demanded and the quantity of goods supplied are equal is referred to as \_\_\_\_\_.  
 A) the fixed point price                      B) consumer equality price  
 C) the deal-maker price                      D) the equilibrium price  
 Answer: D
- 71) The price at which the quantity of goods demanded and the quantity of goods supplied are equal is referred to as \_\_\_\_\_.  
 A) the market price                      B) the going rate at the auction  
 C) the point-of-no-return price                      D) the better price  
 Answer: A
- 72) A \_\_\_\_\_ occurs when the quantity supplied exceeds the quantity demanded.  
 A) surplus                      B) demand deficit                      C) overage                      D) shortage  
 Answer: A
- 73) In the city of Westminster, Christmas trees are being sold for \$25. At this price, buyers are able to satisfy their demand, though some trees remain unsold. This is the market condition known as \_\_\_\_\_.  
 A) shortage                      B) stoppage                      C) demand deficit                      D) surplus  
 Answer: D
- 74) When the quantity demanded exceeds the quantity supplied, a \_\_\_\_\_ will result.  
 A) demand deficit                      B) equilibrium point                      C) shortage                      D) surplus  
 Answer: C
- 75) \_\_\_\_\_ occurs when two or more businesses vie for the same resources or customers.  
 A) Socialism                      B) Differentiation                      C) Conflict                      D) Competition  
 Answer: D
- 76) \_\_\_\_\_ exists when an industry has only a handful of sellers, most of which are large.  
 A) A monopoly                      B) Perfect competition  
 C) An oligopoly                      D) Monopolistic competition  
 Answer: C
- 77) Which of the following exists when an industry or market has only one producer?  
 A) monopoly                      B) perfect competition  
 C) communism                      D) oligopoly  
 Answer: A
- 78) The term \_\_\_\_\_ refers to the total quantity and quality of goods and services that people living in an economic system can purchase.  
 A) consumer price index                      B) aggregate output  
 C) business cycle                      D) standard of living  
 Answer: D

- 79) The \_\_\_\_\_ refers to the total value of all goods and services produced within a given period by a national economy through domestic factors of production.
- A) aggregate output  
B) gross national produce  
C) gross domestic product  
D) standard of living
- Answer: C
- 80) The \_\_\_\_\_ is the pattern of short-term ups and downs in an economy.
- A) standard of living  
B) aggregate output  
C) business cycle  
D) balance of payments
- Answer: C
- 81) The \_\_\_\_\_ is the growth rate of the GDP adjusted for inflation and changes in the value of the country's currency.
- A) GDP per capita  
B) adjusted growth rate  
C) real GDP  
D) real growth rate
- Answer: D
- 82) The principle of \_\_\_\_\_ states that exchange rates are set so that the prices of similar products in different countries are about the same.
- A) nominal GDP  
B) purchasing power parity  
C) gross national product  
D) consumer price index
- Answer: B
- 83) \_\_\_\_\_ is a measure of economic growth that compares how much a system produces with the resources needed to produce it.
- A) Stability  
B) Inflation  
C) Purchasing power parity  
D) Productivity
- Answer: D
- 84) The \_\_\_\_\_ is the amount of money that the government owes to its creditors.
- A) national debt  
B) business cycle  
C) standard of living  
D) aggregate output
- Answer: A
- 85) \_\_\_\_\_ is the condition in an economic system in which the amount of money available and the number of goods and services produced are growing at about the same rate.
- A) Unemployment  
B) Deflation  
C) Stability  
D) Expansion
- Answer: C
- 86) \_\_\_\_\_ is the economic condition characterized by widespread increased prices without increased purchasing power.
- A) Deflation  
B) Unemployment  
C) Expansion  
D) Inflation
- Answer: D
- 87) The \_\_\_\_\_ is a measure of the prices of typical products purchased by consumers living in urban areas.
- A) Gross domestic product  
B) Consumer price index  
C) Gross national product  
D) National debt
- Answer: B





- 97) In a market economy, the factors of production are allocated by \_\_\_\_\_.  
A) the federal government  
B) state commerce department  
C) producers and consumers  
D) all of the above

Answer: C

- 98) The two most basic forms of planned economies are \_\_\_\_\_.  
A) communism and socialism  
B) socialism and free-enterprise  
C) capitalism and socialism  
D) socialism and the welfare state

Answer: A

- 99) Which economic system provides for the private ownership of the factors of production and encourages entrepreneurship by offering profits as an incentive?  
A) marxism  
B) capitalism  
C) socialism  
D) communism

Answer: B

- 100) In which economic system does the government own and operate select major industries?  
A) socialism  
B) communism  
C) free enterprise  
D) capitalism

Answer: A

- 101) The term *supply* is best defined as \_\_\_\_\_.  
A) the willingness and ability of producers to offer a good or service for sale  
B) giving something to someone who needs it  
C) the area in which a firm keeps its wholesale stock for future use  
D) the willingness and ability of buyers to buy a good or service

Answer: A

- 102) "Buyers will purchase more of a product as its price drops and less of a product as its price increases." The situation being described is referred to as \_\_\_\_\_.  
A) purchase dissonance  
B) buyer's remorse  
C) the law of supply  
D) the law of demand

Answer: D

- 103) The law of demand maintains that buyers will purchase more of a product as its price \_\_\_\_\_.  
A) fits a person's personal budget  
B) rises  
C) drops  
D) stays the same

Answer: C

- 104) "Producers will offer more of a product for sale as its price rises and less as its price drops." The situation being described refers to \_\_\_\_\_.  
A) the law of demand  
B) the law of supply  
C) the evoked set  
D) the push strategy

Answer: B

- 105) A \_\_\_\_\_ shows how many of a given product will be supplied at different prices.  
A) equilibrium price  
B) demand curve  
C) quantity demanded  
D) supply curve

Answer: D

106) Which of the following statements best captures the notion of private enterprise?

- A) Certain business activities remain "private."
- B) Small businesses will do better than big business in the long run.
- C) Individuals pursue their own interests with minimal government restriction.
- D) Business can do anything they want, free of legal restraints.

Answer: C

107) Which of the following is one of the elements required in private enterprise?

- A) the right to market leadership
- B) adequate representation in the government
- C) freedom from foreign competition
- D) freedom of choice

Answer: D

108) Which of the following is NOT one of the elements required in private enterprise?

- A) private property rights
- B) stability of cash flow
- C) profits
- D) freedom of choice

Answer: B

109) In perfect competition, which of the following conditions must prevail?

- A) The number of firms in the industry must be large.
- B) No single firm is powerful enough to influence the price of its product.
- C) All firms in a given industry must be small.
- D) All of the above

Answer: D

110) Which of the following is NOT a characteristic of perfect competition?

- A) It is very difficult for a firm to enter or leave the market.
- B) Firms are small.
- C) There are many firms in the industry.
- D) There is great similarity among products offered by different firms.

Answer: A

111) U.S. agriculture is a good example of \_\_\_\_\_.

- A) an oligopoly
- B) a monopoly
- C) monopolistic competition
- D) perfect competition

Answer: D

112) How does monopolistic competition differ from perfect competition?

- A) There are more sellers in a market characterized by monopolistic competition.
- B) In a market characterized by monopolistic competition, individual firms have some control over price.
- C) In a perfectly competitive market, products are more dissimilar.
- D) It is easier for sellers to enter a market/industry characterized by monopolistic competition.

Answer: B

113) In the market for breakfast cereals, only a few large producers dominate the market. This situation best describes which of the following?

- A) oligopoly
- B) monopolistic competition
- C) monopoly
- D) pure competition

Answer: A

114) Which of the following is characterized by having few sellers, similar prices among sellers, and difficult market entry?

- A) monopoly
- B) oligopoly
- C) monopolistic competition
- D) pure competition

Answer: B

115) Which of the following might be considered an oligopoly?

- A) clothing
- B) backpacks
- C) cell phones
- D) airlines

Answer: D

116) In an oligopoly, when one firm reduces its prices, how do other sellers react?

- A) Other firms are not usually aware that price has changed.
- B) Other firms may reduce their prices, but usually gradually.
- C) Other firms reduce their prices also, usually quite quickly.
- D) There is no reaction.

Answer: C

117) Which of the following seems the most likely pricing approach for a monopoly?

- A) Charge a price that will not cause consumer demand to drop.
- B) Undercut the prices of the competition.
- C) Charge customers whatever you please.
- D) Give customers a real bargain on price.

Answer: A

118) Which of the following is an example of a natural monopoly?

- A) automobiles
- B) motion pictures
- C) sporting goods
- D) electric companies

Answer: D

119) Economists refer to the pattern of short-term expansions and contractions in the economy as the \_\_\_\_\_.

- A) aggregate output
- B) consumer price index
- C) business cycle
- D) standard of living

Answer: C

120) \_\_\_\_\_ refers to the total quantity of goods and services produced by an economic system during a given period.

- A) Gross domestic product
- B) The consumer price index
- C) Aggregate output
- D) The business cycle

Answer: C

121) Which of the following best defines the term *business cycle*?

- A) the conditions of the economic system in which an organization operates
- B) the pattern of short-term ups and downs in an economy
- C) the measure of economic growth that compares how much a system produces with the resources needed to produce it
- D) the total quantity and quality of goods and services that a country's citizens can purchase with the currency used in their economic system

Answer: B

122) The main measure of growth in the business cycle is \_\_\_\_\_.

- A) the average number of hours worked by employees
- B) unemployment
- C) aggregate output
- D) the prices of products

Answer: C

123) Which of the following best defines the term *aggregate output*?

- A) the conditions of the economic system in which an organization operates
- B) the total quantity of goods and services produced by an economic system during a given period
- C) the pattern of short-term ups and downs in an economy
- D) the total quantity and quality of goods and services that country's citizens can purchase with the currency used in their economic system

Answer: B

124) An increase in \_\_\_\_\_ will result in growth.

- A) the national debt
- B) aggregate output
- C) the business cycle
- D) the standard of living

Answer: B

125) Which of the following best describes the term *gross domestic product*?

- A) total value of all goods and services produced within a given period by a national economy through domestic factors of production
- B) total quantity of goods and services produced by an economic system
- C) conditions of the economic system in which an organization operates
- D) total quantity of goods that a country's citizens can purchase with the currency used in their economic system

Answer: A

126) Which of the following best describes the term *gross national product*?

- A) total value of all goods and services produced within a given period regardless of where the factors of production are located
- B) total value of all goods and services produced within a given period by a national economy through domestic factors of production
- C) total quantity of goods and services produced within a given period by a national economy, not including foreign production
- D) total quantity of goods and services produced by an economic system

Answer: A

127) Which of the following best describes *nominal GDP*?

- A) total value of all goods and services produced within a given period by a national economy regardless of where the factors of production are located
- B) total value of all goods and services produced within a given period by a national economy through domestic factors of production adjusted to account for changes in currency values and price changes
- C) total quantity of goods and services produced by an economic system
- D) total value of all goods and services produced within a given period by a national economy through domestic factors of production measured in current dollars, or with all components valued at current prices

Answer: D

- 128) Which of the following best describes *purchasing power parity*?
- A) total quantity of goods and services that could have been purchased if one's pay rose in the same proportion as inflation
  - B) total quantity of goods and services that can be purchased with one paycheck
  - C) the principle that exchange rates are set so that prices of similar products in different countries are about the same
  - D) total quantity of goods and services produced by an economic system

Answer: C

- 129) Increases in an economic system's standard of living result primarily from increases in \_\_\_\_\_.
- A) real GNP
  - B) productivity
  - C) balance of trade
  - D) nominal GDP

Answer: B

- 130) The chief goal of an economic system is \_\_\_\_\_.
- A) equality
  - B) stability
  - C) productivity
  - D) growth

Answer: B

- 131) Which of the following statements about inflation is true?
- A) Productivity decreases the purchasing power of consumer dollars.
  - B) Inflation increases the purchasing power of consumer dollars.
  - C) The consumer price index (CPI) is a good way of measuring inflation.
  - D) None of the above

Answer: C

- 132) Which of the following best describes *economic stability*?
- A) the economic condition where a country's exports exceed its imports
  - B) the amount of money that the government owes its creditors
  - C) the measure of economic growth that compares how much a system produces with the resources needed to produce it
  - D) condition in an economic system in which the amount of money available and the number of goods and services produced are growing at about the same rate

Answer: D

- 133) What are the two major factors that threaten stability?
- A) unemployment and a negative trade balance
  - B) inflation and unemployment
  - C) purchasing power parity and productivity
  - D) purchasing power parity and inflation

Answer: B

- 134) The \_\_\_\_\_ rate is the percentage change in a price index.
- A) price
  - B) inflation
  - C) economic
  - D) index

Answer: B

- 135) Increased prices for products, decreased purchasing power, and decreased profit margins are likely to result from \_\_\_\_\_.
- A) low inflation
  - B) low unemployment
  - C) high unemployment
  - D) none of the above

Answer: B

136) \_\_\_\_\_ unemployment results from recession or depression.  
A) Frictional                      B) Structural                      C) Seasonal                      D) Cyclical  
Answer: D

137) A \_\_\_\_\_ is a period during which aggregate output declines.  
A) favorable balance of trade                      B) recession  
C) depression                      D) decade  
Answer: B

138) A(n) \_\_\_\_\_ is a prolonged and deep recession.  
A) contraction                      B) expansion  
C) negative trade balance                      D) depression  
Answer: D

139) Taken together, fiscal policy and monetary policy make up \_\_\_\_\_ policy.  
A) stabilization                      B) trade                      C) economic                      D) financial  
Answer: A

140) Which of the following is identified as a communist nation by the textbook?  
A) Malaysia                      B) Vietnam                      C) Indonesia                      D) Iraq  
Answer: B

141) Which of the following statements best describes the law of demand?  
A) As the price goes up, I like the product better.  
B) As the price goes down, I like the product better.  
C) Well over 90 percent of all shoppers pay no attention to price.  
D) When I want a product, price makes no difference to me.  
Answer: B

142) Under the law of demand, which of the following situations will likely result in increases in product purchases?  
A) lowering the price of the product  
B) the consumer's need for the product  
C) raising the price of the product as an indication that it is of high quality  
D) the knowledge that possessing such a product can add to a person's positive image  
Answer: A

143) When plotted on a graph, the supply curve and the demand curve will normally \_\_\_\_\_.  
A) cross one another at some point  
B) get closer together as demand increases, but never intersect  
C) run parallel to one another  
D) be far apart due to the differences between supply and demand in an economy  
Answer: A

144) In the city of Westminster, market analysts have observed that all Christmas trees offered for sale will be purchased at a price of \$20 and all demand will be satisfied. In this market, \$20 is the \_\_\_\_\_.  
A) margin price                      B) equilibrium price                      C) supply price                      D) demand price  
Answer: B







164) Describe the law of demand.

Answer: The law of demand states that buyers will purchase more of a product as its price drops and less of a product as its price increases.

165) Explain what happens when the demand curve intersects with the supply curve.

Answer: At this intersection, we have the equilibrium or market price. At this price, there will be neither a shortage nor surplus. Over time, markets tend to price products at the equilibrium price.

166) What are the four required elements for a private enterprise system?

Answer: Private enterprise systems require the presence of private property rights, freedom of choice, profits, and competition.

167) What are the two broad goals of nearly every economic system?

Answer: The two broad goals of nearly every economic system are economic growth and economic stability.

168) What is the main measure of growth in the business cycle?

Answer: The main measure of growth in the business cycle is aggregate output.

169) What are the two primary factors that threaten economic stability?

Answer: Inflation and unemployment are the two primary factors that threaten economic stability.

170) What is measured by the consumer price index (CPI)?

Answer: The consumer price index measures the prices of typical products purchased by consumers living in urban areas.

171) What is cyclical unemployment?

Answer: Cyclical unemployment is unemployment that results from a downturn in the business cycle.

172) List and describe the five factors of production.

Answer: The factors of production are labor, capital, entrepreneurs, physical resources, and information resources. Labor refers to the physical and mental capabilities of people as they contribute to the economic system. Capital refers to the funds needed to create and operate a business enterprise. Entrepreneurs are individuals who embrace the opportunities and accept the risks of setting up and operating businesses. Physical resources are tangible things organizations use in the conduct of their business. Information resources include data and other information used by businesses.

173) How does a planned economy differ from a market economy?

Answer: A planned economy relies on a centralized government to control all or most factors of production and to make all or most production and allocation decision. In a market economy, individuals control production and allocation decisions through supply and demand.

174) What is socialism?

Answer: Socialism is a partially planned system in which the government owns and operates selected major industries. In such mixed market economies, the government may control banking, transportation or manufacturing industries, for example. Smaller businesses, such as clothing stores and restaurants, are privately owned.

175) Describe perfect competition.

Answer: In perfect competition, firms are small and there are many firms. Products are extremely similar and consumers cannot tell them apart. Entering and leaving the market is easy and prices are set exclusively by supply and demand.

176) Describe monopolistic competition.

Answer: In a market characterized by monopolistic competition, there are fewer sellers than in perfect competition. Sellers will attempt to differentiate their product from those of their competitors. Product differentiation gives sellers some control over prices. Monopolistically competitive businesses can be large or small and can enter and exit the market easily.

177) Describe oligopoly.

Answer: When an industry has only a few sellers, an oligopoly exists. While there are only a few sellers, they tend to be large. The entry of new competitors is difficult because of the large capital investment needed. As with monopolistic competition, sellers will attempt to differentiate their product from those of their competitors, and each seller will have some control over price. However, when one firm cuts prices, others will tend to do the same. Therefore, the prices of comparable products are usually similar.

178) Describe monopoly.

Answer: A monopoly exists when an industry or market has only one producer. The sole supplier enjoys complete control over the prices of its products. Its only constraint is a decrease in consumer demand due to increased prices. In the United States, the Sherman Antitrust Act and the Clayton Act forbid many monopolies and regulate prices charged by natural monopolies.

179) Explain how monopolies harm consumers and hurt the economy.

Answer: If a company has a monopoly, it can harm consumers by raising prices, cutting output, or stifling innovation. Furthermore, because most monopolies have total control over certain products and prices and the market share for those products, competitors are likely to find it extremely difficult to enter markets where monopolies exist. Consequently, a number of laws and regulations have been established by the federal government to help prevent individual companies or groups of companies from gaining control of markets in ways that restrain competition or harm consumers.

180) Explain the relationship between productivity and the standard of living.

Answer: Standard of living refers to the total quantity and quality of goods and services that people can purchase with the currency used by their economic system. Productivity is a measure of economic growth that compares how much a system produces with the resources needed to produce it. Standard of living improves only through increases in productivity.

181) How does inflation affect purchasing power?

Answer: Inflation is the occurrence of widespread price increases throughout an economic system. Purchasing power declines as a result of the increased prices associated with inflation.

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

182) Explain the role of both profit-seeking businesses and non-profit organizations in the overall "meaning of business."

Answer: Businesses are organizations that provide goods and services that are then sold to earn profits. Indeed, the prospect of earning profits—the difference between a business's revenue and its expenses—is what encourages people to open and expand businesses. After all, profits are the reward owners get for risking their money and time. The right to pursue profits distinguishes a business from non-profit organizations, such as universities, hospitals, and government agencies, that run in much the same way but that generally do not seek profits. Whereas profits may be considered the final reward in profit-seeking businesses, the final reward for non-profit organizations might be operational efficiency, for example.

183) "A nation's economic system is its system for allocating its resources among its citizens, both individuals and organizations." Comment.

Answer: A nation's resources, often referred to as the *factors of production*, include four traditional factors: labor, capital, entrepreneurs and physical resources. Recently, information resources were added to the list. An economic system is defined by how it manages and allocates these factors of production. In a planned economy, for example, the factors of production are government-owned and controlled. In a market economy, such as that of the United States, individual producers and consumers control production and allocation by creating combinations of supply and demand. In a mixed-market economy, which features characteristics of both a planned and a market economy, there is some government control of some factors of production—often through the nation's major industries, such as transportation, communication, and information—alongside some private ownership.

184) Explain the roles of demand and supply in a market economy.

Answer: On all economic levels of a market economy, decisions about what to buy and what to sell are determined primarily by the forces of demand and supply. Demand is the willingness and ability of buyers to purchase a product; supply is the willingness and ability of producers to offer a good or service for sale. The law of demand states that buyers will purchase more of a product as its price drops and less as its price increases. The law of supply states that producers will offer more of a product for sale as its price rises and less as its price drops.

185) Explain the role of private enterprise in a market economy. Include an explanation of the elements that comprise free enterprise.

Answer: Market economies rely on a private enterprise system—one that allows individuals to pursue their own interests with minimal government restriction. Private enterprise requires four elements: private property rights, freedom of choice, profits, and competition. Private property rights allow the ownership of resources used to create wealth to be in the hands of individuals. Freedom of choice allows a number of freedoms in the market, including the freedom for a worker to sell his or her labor to any employer he or she chooses, the freedom to choose which products and brands to buy, and the freedom for producers to choose whom they hire and what they will produce. Profits are the incentives for entrepreneurs to assume the risks of business ownership. Competition occurs when businesses vie for the same resources and customers; competition is a driver of goods and services quality and price levels. All four of these elements are welcomed in a market economy.

186) Compare and contrast the four degrees of competition in a private enterprise system.

Answer: The four degrees of competition include perfect competition, monopolistic competition, oligopoly, and monopoly. In perfect competition, all firms in an industry are small but the number of firms in the industry is large. No single firm is powerful enough to influence price; therefore, price is determined by such market forces as supply and demand. The products in a perfectly competitive market are so similar that buyers view them as identical to those of other firms. In monopolistic competition, there are many buyers and sellers. Often, sellers attempt to differentiate their products and services from others through design, styling, advertising, or the use of brand names; this often gives sellers some control over prices. Monopolistically competitive businesses face few market entry/exit barriers. In an oligopoly, an industry has only a handful of sellers, who are generally quite large. Market entry is difficult because large capital outlays are needed for new start-ups. In an oligopoly, the actions of one firm tend to affect the actions of all firms; for example, when one firm changes price, all firms tend to change price rather quickly. A monopoly exists when an industry or market has only one producer that dominates the entire market. Though monopolies are illegal in the U.S., natural monopolies—such as utilities companies—are government-regulated; they are allowed to exist since one such company can often efficiently supply all needed goods or services.

SHORT ANSWER. Write the word or phrase that best completes each statement or answers the question.

187) How is risk a welcomed ingredient in a free-enterprise system?

Answer: Entrepreneurship is a factor of production, which in itself is a welcomed ingredient in a free-enterprise system. New business start-ups or revitalizations are built on an entrepreneurial spirit of risk-taking.

188) Assess the degrees of risk in perfect competition versus monopolistic competition. Are the risks similar? Different?

Answer: In perfect competition, no single firm is powerful enough to influence the price of its product. Further, products of each firm in perfect competition are so similar that buyers view them as identical to those of other firms. These are two major factors that are completely out of the hands of the individual business owner. However, in monopolistic competition, there are many sellers who are attempting to differentiate their products from all others. For those sellers who succeed, they have overcome some of the greatest risk. In addition, sellers in monopolistic competition do have some control over price. Both types of competition present numerous risks.

189) If the amount of money in an economic system exceeds the system's output during times of inflation, people will have more money to spend. How can inflation present increased risk to consumers?

Answer: Inflation occurs when widespread price increases occur throughout an economic system; in addition, the amount of money injected into the economy outstrips the increase in actual output. When this happens, people will have more money to spend but there will still be the same quantity of products available for them to buy. As a result, prices increase as consumers compete with one another to buy the available products. Eventually, high prices will erase the increase in the amount of money injected into the economy. Purchasing power ultimately declines.

190) What risks does the U.S. government face when determining the nation's monetary policy?

Answer: Monetary policies, controlled by the Fed, focus on controlling the size of the nation's money supply. Higher interest rates make money more expensive to borrow and thereby reduce spending by those who produce goods and services. In addition, lower interest rates make money less expensive to borrow and thereby increase spending by those who produce goods and services. The risk faced by the U.S. government lay in arriving at a proper balance.

191) What type of competition prevails for McDonald's?

Answer: McDonald's operates in an environment of monopolistic competition. There are many buyers and many similar competitors who are all trying to differentiate their product offerings.

192) In Year 3, a hamburger cost twice as much as in Year 1 but you had twice as much income to pay for it. In effect, the price was actually the same. In Year 4, however, your income increased 250 percent while the price of the hamburger increased by 275 percent. How can this be explained?

Answer: You got hit by inflation; inflation decreases the purchasing power of your money.

193) Will the value of goods produced by McDonald's in Stockholm, Sweden, be included in Sweden's GDP? Explain.

Answer: Yes. Sweden's GDP will include the value of all goods and services produced with a given period by Swedish factors of production.

194) Will the factors of production required for the operation of a McDonald's store in France, a mixed market economy, be similar to the factors of production required for the operations of a McDonald's in the United States?

Answer: Absolutely. In both locations, human resources will be needed in the same way. Capital will be needed for the daily operation of both stores. Entrepreneurship is essential, especially since the stores in France have determined the need for a "face lift," unlike what American McDonald's owners have decided; however, entrepreneurship will be needed in the United States in different capacities, such as determining whether to build two drive-thru lanes. Physical resources and informational resources are needed for the continued operation of every McDonald's store around the world.

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

#### Short Case Scenario 1-1

Expert Electronics is a manufacturer of computers on the large, but isolated, island nation of New Vermont. Although imports extremely limited because of difficult navigation to and from New Vermont, there are a handful of computer manufacturers in addition to Expert Electronics. While the government provides some services, such as public education and a well-maintained system, almost all businesses are privately owned. Home ownership is unusually high, with 80 percent of all families owning their own home. Expert Electronics is selling a state-of-the-art desktop computer system for 1,299 veros (the local currency). At this price, Expert Electronics is able to fill all orders, but they have no waiting list.

195) If New Vermont is operating under a capitalistic, market-based economy, what four elements must be present in the economic system to make it work?

Answer: Such systems require private property rights, freedom of choice, profits, and competition.

196) A Danish company has built a production facility on the island of New Vermont. Will the value of the goods produced by the Danish company be included in New Vermont's GNP? Explain.

Answer: The value of the goods won't be included in New Vermont's GNP but will be included in its GDP because they are produced domestically—that is, in New Vermont.

197) New Vermont's CPI for 2003 was 152.4; its CPI for 2004 was 156.9. What was New Vermont's inflation rate for 2004?

Answer: Inflation Rate =  $(4.5/152.4) \times 100 = 2.95\%$ .

198) What type of economic system exists in New Vermont? Support your conclusions.

Answer: It appears that New Vermont operates under a market-based, capitalist economy. In a market economy, there is private ownership of the factors of production. As mentioned in the case, almost all businesses are privately owned and people are able to own their own homes. The political basis for a market economy is capitalism, which sanctions the private ownership of the factors of production and encourages entrepreneurship by offering profits as an incentive.

199) Based on the concepts of demand and supply, how is Expert Electronics pricing its computer systems?

Answer: It appears that Expert Electronics is pricing its computers at the equilibrium price, the intersection of the demand and supply curves. At the equilibrium price, the quantity of goods demanded and the quantity of goods supplied is equal.

200) How would you characterize the level of competition for computers in New Vermont? How are prices set in this type of competitive environment?

Answer: Because there are only a few sellers, the market for computers in New Vermont is best described as an oligopoly. In an oligopoly, the prices of comparable products are usually very similar.

201) If Expert Electronics cuts the prices for its computer system, how will competitors respond?

Answer: In an oligopoly, when one firm cuts prices or offers incentives to increase sales, the others usually protect sales by doing the same.

202) New Vermont underwent a recession two years ago. How might New Vermont's aggregate output have been affected?

Answer: A recession is defined as a period during which aggregate output, as measured by GDP, declines. Therefore, New Vermont's aggregate output would have declined.

203) In the past year, interest rates have risen by 3 percent. How has this led to New Vermont's tight monetary policy?

Answer: High interest rates make money more expensive to borrow and thereby reduce spending by those who produce goods and services; when the government restricts money supply, a tight monetary policy is being implemented.

204) Name one factor that may be detrimental to Expert Electronics' productivity.

Answer: Productivity is the measure of economic growth that compares how much a system produces with the resources needed to produce it. Because New Vermont's location prevents the efficient import and export of products, manufacturers are depending more on local materials, which may not provide the highest levels of productivity.

205) Even with a handful of computer manufacturers on the island, the industry runs the risk of market saturation in the long run. How might this affect equilibrium price?

Answer: If the market becomes saturated with too much supply, the surplus will cause the equilibrium price to fall. In turn, manufacturers will supply less. Over time, buyers will eventually buy if price remains low.

206) How will consumers react to a decrease in price?

Answer: According to the law of demand, a decrease in price will result in an increase in the demand for the product. However, since 1,299 veros appears to be the equilibrium price, it is likely that shortages may result unless production increases. At a lower price, more buyers will be willing to purchase a computer and Expert Electronics will be unable to meet the needs of all consumers.