

CHAPTER 2 The Market System and the Circular Flow

CHAPTER 2

The Market System and the Circular Flow

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1. The command system is also known as:

- A) market system.
- B) pure capitalism.
- C) market socialism.
- D) socialism or communism.

Ans: D Level: Easy Main Topic: 2.1 Economic systems
Page: 31 Subtopic: The command system Type: Application

2. The economy of the former Soviet Union was best described as:

- A) authoritarian capitalism.
- B) mixed capitalism.
- C) a command economy.
- D) market socialism.

Ans: C Level: Easy Main Topic: 2.1 Economic systems
Page: 32 Subtopic: The command system Type: Application

3. The economy of North Korea most closely approximates:

- A) pure capitalism
- B) a command economy
- C) market socialism
- D) authoritarian capitalism

Ans: B Level: Easy Main Topic: 2.1 Economic systems
Page: 32 Subtopic: The command system Type: Application

4. The recent China's economy most closely approximates:

- A) pure capitalism
- B) a command economy
- C) market socialism
- D) authoritarian capitalism

Ans: C Level: Easy Main Topic: 2.1 Economic systems
Page: 32 Subtopic: The command system Type: Application

5. Which would not be characteristic of a capitalist economy?

- A) government ownership of the means of production
- B) competition and unrestricted markets
- C) reliance on the market system
- D) free enterprise and choice

Ans: A Level: Easy Main Topic: 2.1 Economic systems
Page: 32 Subtopic: The market system Type: Application

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

Ans: C Level: Moderate Main Topic: 2.1 Economic systems
Page: 32 Subtopic: The market system Type: Definition

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

Ans: B Level: Easy Main Topic: 2.1 Economic systems
Page: 32 Subtopic: The market system Type: Definition

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

Ans: C Level: Easy Main Topic: 2.1 Economic systems
Page: 32 Subtopic: The market system Type: Application

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

Ans: C Level: Easy Main Topic: 2.1 Economic systems Page: 32
Subtopic: The market system Type: Definition

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

Ans: C Level: Easy Main Topic: 2.1 Economic systems Page: 32
Subtopic: The market system Type: Definition

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

Ans: A Level: Easy Main Topic: 2.1 Economic systems Page: 32
Subtopic: The market system Type: Application

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

Ans: B Level: Easy Main Topic: 2.2 Characteristics of the market system
Page: 32-33 Subtopic: Private property Type: Definition

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

Ans: D Level: Easy Main Topic: 2.2 Characteristics of the market system
Page: 32-33 Subtopic: Private property Type: Application

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

Ans: C Level: Easy Main Topic: 2.2 Characteristics of the market system
Page: 32-33 Subtopic: Private property Type: Definition

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

Ans: B Level: Easy Main Topic: 2.2 Characteristics of the market system
Page: 32-33 Subtopic: Private property Type: Application

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

Ans: D Level: Easy Main Topic: 2.2 Characteristics of the market system
Page: 32-33 Subtopic: Private property Type: Application

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

Ans: C Level: Easy Main Topic: 2.2 Characteristics of the market system
Page: 32-33 Subtopic: Private property Type: Application

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18. Which is a major feature of pure capitalism?

- A) price floors and price ceilings in markets
- B) reallocation of resources from private to public uses
- C) the right to own private property and control resource use
- D) central planning by government to provide goods and services

Ans: C Level: Easy Main Topic: 2.2 Characteristics of the market system
Page: 32-33 Subtopic: Private property Type: Definition

19. By free enterprise, we mean that:

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

Ans: C Level: Easy Main Topic: 2.2 Characteristics of the market system
Page: 33 Subtopic: Freedom of enterprise and choice Type: Definition

20. Which statement is correct?

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

Ans: D Level: Moderate Main Topic: 2.2 Characteristics of the market system
Page: 33 Subtopic: Freedom of enterprise and choice Type: Application

21. Which is characteristic of the capitalistic ideology?

- A) unselfish individuals
- B) centralized decision-making
- C) free enterprise and choice
- D) government ownership of the means of production

Ans: C Level: Easy Main Topic: 2.2 Characteristics of the market system
Page: 33 Subtopic: Freedom of enterprise and choice Type: Definition

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22. How do workers typically express self-interest?

- A) by minimizing the economic losses of other business firms
- B) by maximizing the economic profits of other business firms
- C) by seeking the highest price when purchasing a consumer product
- D) by seeking jobs with the best combination of wages and benefits

Ans: D Level: Easy Main Topic: 2.2 Characteristics of the market system

Page: 33 Subtopic: Self interest Type: Definition

23. Consumers express self-interest when they:

- A) reduce business losses.
- B) collect economic profits.
- C) seek the lowest price for the product.
- D) search for jobs with the highest wage

Ans: C Level: Easy Main Topic: 2.2 Characteristics of the market system

Page: 33 Subtopic: Self interest Type: Application

24. Competition means that:

- A) sellers can cause artificial product scarcities and thereby manipulate market price.
- B) there are large numbers of independently acting buyers and sellers in each market.
- C) a given product can be purchased at a number of different prices.
- D) there is more than one seller in a market.

Ans: B Level: Easy Main Topic: 2.2 Characteristics of the market system

Page: 33 Subtopic: Competition Type: Definition

25. The competitive market system:

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

Ans: D Level: Moderate Main Topic: 2.2 Characteristics of the market system

Page: 33 Subtopic: Competition Type: Application

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

Ans: A Level: Easy Main Topic: 2.2 Characteristics of the market system
Page: 33 Subtopic: Competition Type: Application

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

Ans: C Level: Moderate Main Topic: 2.2 Characteristics of the market system
Page: 33 Subtopic: Competition Type: Application

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

Ans: A Level: Easy Main Topic: 2.2 Characteristics of the market system
Page: 33 Subtopic: Competition Type: Definition

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

Ans: C Level: Easy Main Topic: 2.2 Characteristics of the market system
Page: 33 Subtopic: Competition Type: Definition

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

Ans: C Level: Moderate Main Topic: 2.2 Characteristics of the market system
Page: 34 Subtopic: Markets and prices Type: Application

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

Ans: D Level: Moderate Main Topic: 2.2 Characteristics of the market system
Page: 34 Subtopic: Markets and prices Type: Application

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

Ans: C Level: Easy Main Topic: 2.2 Characteristics of the market system
Page: 34 Subtopic: Markets and prices Type: Application

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

Ans: C Level: Easy Main Topic: 2.2 Characteristics of the market system
Page: 35 Subtopic: Technology and capital goods Type: Definition

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

Ans: A Level: Easy Main Topic: 2.2 Characteristics of the market system
Page: 35 Subtopic: Technology and capital goods Type: Definition

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

Ans: D Level: Moderate Main Topic: 2.2 Characteristics of the market system
Page: 35 Subtopic: Technology and capital goods Type: Application

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

Ans: D Level: Easy Main Topic: 2.2 Characteristics of the market system
Page: 35 Subtopic: Specialization Type: Definition

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

Ans: C Level: Easy Main Topic: 2.2 Characteristics of the market system
Page: 35 Subtopic: Specialization Type: Definition

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

Ans: D Level: Moderate Main Topic: 2.2 Characteristics of the market system
Page: 35 Subtopic: Specialization Type: Application

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

Ans: A Level: Easy Main Topic: 2.2 Characteristics of the market system
Page: 35 Subtopic: Specialization Type: Application

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

Ans: D Level: Moderate Main Topic: 2.2 Characteristics of the market system
Page: 35-36 Subtopic: Specialization Type: Definition

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

Ans: B Level: Easy Main Topic: 2.2 Characteristics of the market system
Page: 36 Subtopic: Specialization Type: Application

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

Ans: D Level: Easy Main Topic: 2.2 Characteristics of the market system
Page: 36 Subtopic: Use of Money Type: Application

43. Anything that is generally acceptable in exchange for goods and services is:
- A) a medium of exchange.
 - B) a measure of value.
 - C) a store of value.
 - D) token money.

Ans: A Level: Easy Main Topic: 2.2 Characteristics of the market system
Page: 36 Subtopic: Use of Money Type: Definition

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44. Which is the main problem with the barter system of exchange? Barter:

- A) encourages self-interest and selfishness.
- B) fosters specialization and division of labour.
- C) requires a coincidence of wants.
- D) undermines the right to bequeath.

Ans: C Level: Easy Main Topic: 2.2 Characteristics of the market system

Page: 36 Subtopic: Use of Money Type: Application

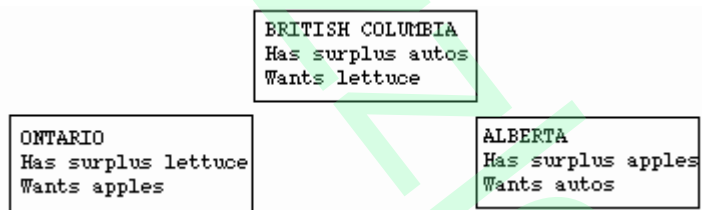
45. Consider a barter situation where you have pens and you want pencils. To achieve your objective there must be a(n):

- A) use of capital goods.
- B) entry and exit from the market.
- C) large number of sellers.
- D) coincidence of wants.

Ans: D Level: Easy Main Topic: 2.2 Characteristics of the market system

Page: 36 Subtopic: Use of Money Type: Application

Use the following to answer questions 46-48:



46. On the basis of the information provided it can be said that:

- A) no coincidence of wants exists between any two provinces.
- B) a coincidence of wants exists between British Columbia and Ontario.
- C) a coincidence of wants exists between Ontario and Alberta.
- D) a coincidence of wants exists between British Columbia and Alberta.

Ans: A Level: Easy Main Topic: 2.2 Characteristics of the market system

Page: 36-37 Subtopic: Use of Money Type: Application

47. On the basis of the information provided and assuming trade occurs between the three provinces we can expect:

- A) Alberta to exchange apples with Ontario and receive money in return.
- B) Alberta to exchange apples with British Columbia and receive money in return.
- C) Ontario to exchange lettuce with British Columbia and receive autos in return.
- D) none of the above to occur.

Ans: A Level: Moderate Main Topic: 2.2 Characteristics of the market system

Page: 36-37 Subtopic: Use of Money Type: Application

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48. Given the information provided and assuming trade does occur between the provinces, we can expect:

- A) that there is no means by which British Columbia can obtain lettuce while specializing in the production of autos.
- B) that money will not be needed to accomplish the desired exchanges.
- C) money to flow counterclockwise from British Columbia to Ontario to Alberta.
- D) money to flow clockwise from British Columbia to Alberta to Ontario.

Ans: C Level: Difficult Main Topic: 2.2 Characteristics of the market system
Page: 36-37 Subtopic: Use of Money Type: Application

49. Which is assumed to be most limited in scope under a market system?

- A) freedom of enterprise
- B) freedom of choice
- C) competition
- D) government

Ans: D Level: Easy Main Topic: 2.2 Characteristics of the market system
Page: 37 Subtopic: Active, but limited, government Type: Definition

50. Which of the following is not a part of a market system?

- A) private property
- B) freedom of enterprise and choice
- C) competition in product and resource markets
- D) government determination of basic economic goals

Ans: D Level: Easy Main Topic: 2.2 Characteristics of the market system
Page: 37 Subtopic: Active, but limited, government Type: Definition

51. Which is not one of the Five Fundamental Questions?

- A) How will the goods and services be produced?
- B) How will the system accommodate change?
- C) Who will get the goods and services?
- D) What goods and services should be produced by government?

Ans: D Level: Easy Main Topic: 2.3 Five fundamental questions Page: 38
Subtopic: What will be produced Type: Definition

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52. What to produce in a market economy is ultimately determined by the:

- A) output decisions of business firms.
- B) income plans of households.
- C) spending decisions of households.
- D) workers' technical skills.

Ans: C Level: Easy Main Topic: 2.3 Five fundamental questions Page: 38
Subtopic: What will be produced Type: Application

53. "Consumer sovereignty" refers to the:

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

Ans: C Level: Easy Main Topic: 2.3 Five fundamental questions Page: 38
Subtopic: What will be produced Type: Definition

54. The term consumer sovereignty means that:

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

Ans: B Level: Easy Main Topic: 2.3 Five fundamental questions Page: 38
Subtopic: What will be produced Type: Definition

55. The market system is said to be characterized by "consumer sovereignty." This is because:

- A) a large number of consumer goods are produced.
- B) the prices of consumer goods are regulated by government.
- C) consumer goods are more profitable than investment goods.
- D) of the role of consumers in determining what goods are produced.

Ans: D Level: Easy Main Topic: 2.3 Five fundamental questions Page: 38
Subtopic: What will be produced Type: Application

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56. The introduction of "new" Coca-Cola and the reintroduction of the old "Classic Coke" was an example of:
- A) an increase in demand.
 - B) consumer sovereignty.
 - C) technological advances.
 - D) economic profit.

Ans: B Level: Easy Main Topic: 2.3 Five fundamental questions Page: 38
Subtopic: What will be produced Type: Application

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

Ans: C Level: Easy Main Topic: 2.3 Five fundamental questions Page: 38
Subtopic: What will be produced Type: Definition

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

Ans: D Level: Easy Main Topic: 2.3 Five fundamental questions Page: 38
Subtopic: What will be produced Type: Definition

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

Ans: A Level: Easy Main Topic: 2.3 Five fundamental questions Page: 38
Subtopic: What will be produced Type: Application

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60. Economic efficiency would be primarily discussed in response to which of the fundamental questions about a competitive market economy?

- A) What will be produced?
- B) How will the goods and services be produced?
- C) How will the system accommodate change?
- D) Who is to receive the output?

Ans: B Level: Moderate Main Topic: 2.3 Five fundamental questions Page: 39
Subtopic: How will the goods and services be produced Type: Application

61. Which fundamental question about a competitive market system primarily focuses on the cost of producing the good and services?

- A) What will be produced?
- B) How will the goods and services be produced?
- C) How will the system accommodate change?
- D) Who is to receive the output?

Ans: B Level: Easy Main Topic: 2.3 Five fundamental questions Page: 39
Subtopic: How will the goods and services be produced Type: Application

62. The issues of distribution of goods and services and incomes in a competitive market system are the primary topic of which fundamental question?

- A) What will be produced?
- B) How will the goods and services be produced?
- C) How will the system accommodate change?
- D) Who is to receive the output?

Ans: D Level: Easy Main Topic: 2.3 Five fundamental questions Page: 39
Subtopic: Who will get the output Type: Application

63. In the market system, the statement of “Wages, interest, rent, and profit are crucial determinants of the size of each person's income”, is an indication of:

- A) What will be produced?
- B) How will the goods and services be produced?
- C) Who will get the output?
- D) How will the system accommodate change?

Ans: C Level: Easy Main Topic: 2.3 Five fundamental questions Page: 39
Subtopic: Who will get the output Type: Application

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

Ans: C Level: Moderate Main Topic: 2.3 Five fundamental questions Page: 39
Subtopic: Who will get the output Type: Application

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

Ans: B Level: Moderate Main Topic: 2.3 Five fundamental questions Page: 39
Subtopic: Who will get the output Type: Application

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

Ans: C Level: Easy Main Topic: 2.3 Five fundamental questions Page: 39
Subtopic: How will the system accommodate change Type: Application

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

Ans: D Level: Moderate Main Topic: 2.3 Five fundamental questions Page: 39
Subtopic: How will the system accommodate change Type: Application

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68. An increase in demand for strawberries is most likely to:

- A) increase the demand for strawberry pickers.
- B) reduce the supply of strawberry pickers.
- C) reduce the supply of strawberries.
- D) reduce the demand for strawberry pickers.
- E) decrease the demand for raspberries.

Ans: A Level: Moderate Main Topic: 2.3 Five fundamental questions Page: 39
Subtopic: How will the system accommodate change Type: Application

69. The market system communicates changes in supply and demand and elicits appropriate responses from businesses and resource suppliers. This is known as the:

- A) rationing function of prices.
- B) guiding function of prices.
- C) monetary function of prices.
- D) circular flow of income.

Ans: B Level: Easy Main Topic: 2.3 Five fundamental questions Page: 40
Subtopic: How will the system accommodate change Type: Definition

70. Which of the following best describes the "guiding function" of competitive prices?

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

Ans: C Level: Moderate Main Topic: 2.3 Five fundamental questions Page: 40
Subtopic: How will the system accommodate change Type: Definition

71. Assume the demand for product Y increases and the subsequent market system responses result in the production of more Y. This illustrates:

- A) that the concept of derived demand is inapplicable.
- B) that consumer sovereignty is inoperative in this economy.
- C) the scarcity function of prices.
- D) the directing or guiding function of prices.

Ans: D Level: Moderate Main Topic: 2.3 Five fundamental questions Page: 40
Subtopic: How will the system accommodate change Type: Application

CHAPTER 2 The Market System and the Circular Flow

72. Which statement accurately summarizes the relationship between the prices of goods and their relative scarcity?

- A) The price of a good is a direct function of the relative scarcity of the good.
- B) The price of a good is an inverse function of the relative scarcity of the good.
- C) The price of a good is independent of the relative scarcity of the good.
- D) High prices lead to greater relative scarcity.

Ans: A Level: Moderate Main Topic: 2.3 Five fundamental questions Page: 40
Subtopic: How will the system accommodate change Type: Application

73. The most efficient combination of resources in producing any output is that combination which:

- A) comes closest to using the same quantities of land, labour, capital, and entrepreneurial ability.
- B) can be obtained for the smallest money outlay.
- C) uses the smallest total quantity of all resources.
- D) conserves most on the use of labour.

Ans: B Level: Moderate Main Topic: 2.3 Five fundamental questions Page: 40
Subtopic: How will the system accommodate change Type: Definition

74. The development of the Internet and e-mail to replace regular mail services in many cases would be an example of:

- A) roundabout production.
- B) derived demand.
- C) creative destruction.
- D) specialization.

Ans: C Level: Easy Main Topic: 2.3 Five fundamental questions Page: 40
Subtopic: How will the system promote progress Type: Application

75. The development of CDs and DVD that significantly reduced the market for cassette tapes would be an example of:

- A) specialization.
- B) derived demand.
- C) roundabout production.
- D) creative destruction.

Ans: D Level: Easy Main Topic: 2.3 Five fundamental questions Page: 40
Subtopic: How will the system promote progress Type: Application

CHAPTER 2 The Market System and the Circular Flow

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

Ans: A Level: Moderate Main Topic: 2.3 Five fundamental questions Page: 41
Subtopic: The "invisible hand" Type: Definition

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

Ans: D Level: Easy Main Topic: 2.3 Five fundamental questions Page: 41
Subtopic: The "invisible hand" Type: Application

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

Ans: D Level: Moderate Main Topic: 2.3 Five fundamental questions Page: 41
Subtopic: The "invisible hand" Type: Application

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

Ans: B Level: Easy Main Topic: 2.3 Five fundamental questions Page: 41
Subtopic: The "invisible hand" Type: Definition

CHAPTER 2 The Market System and the Circular Flow

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

Ans: B Level: Easy Main Topic: 2.3 Five fundamental questions Page: 41
Subtopic: The "invisible hand" Type: Definition

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

Ans: C Level: Easy Main Topic: 2.3 Five fundamental questions Page: 41
Subtopic: The "invisible hand" Type: Definition

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

Ans: D Level: Easy Main Topic: 2.4 The demise of the command system
Page: 42 Subtopic: The coordination problem Type: Application

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

Ans: A Level: Easy Main Topic: 2.4 The demise of the command system
Page: 42 Subtopic: The coordination problem Type: Application

CHAPTER 2 The Market System and the Circular Flow

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

Ans: B Level: Easy Main Topic: 2.4 The demise of the command system
Page: 43 Subtopic: The incentive problem Type: Application

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

Ans: C Level: Easy Main Topic: 2.5 The circular flow model Page: 44
Subtopic: Factor market and Product market Type: Application

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

Ans: C Level: Moderate Main Topic: 2.5 The circular flow model Page: 44-45
Subtopic: Factor market and Product market Type: Definition

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

Ans: C Level: Easy Main Topic: 2.5 The circular flow model Page: 44-45
Subtopic: Factor market and Product market Type: Definition

CHAPTER 2 The Market System and the Circular Flow

88. In the simple circular flow model:

- A) households are demanders of factors of production.
- B) businesses are suppliers of final products.
- C) households are suppliers of final products.
- D) there are real flows of goods, services, and factors, but not money flows.

Ans: B Level: Easy Main Topic: 2.5 The circular flow model Page: 44-45
Subtopic: Factor market and Product market Type: Definition

89. Households and businesses are:

- A) both buyers in the factor market.
- B) both suppliers in the product market.
- C) suppliers in the factor and product markets respectively.
- D) suppliers in the product and factor markets respectively.

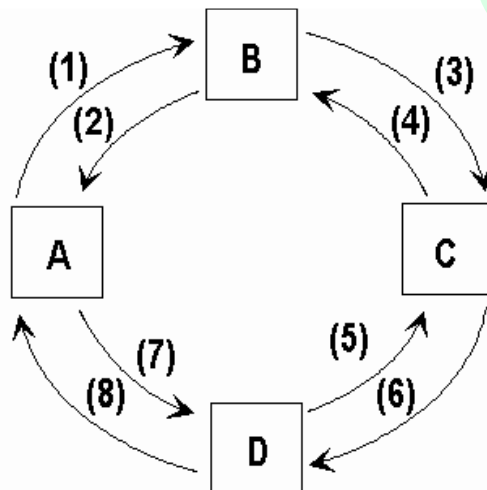
Ans: C Level: Easy Main Topic: 2.5 The circular flow model Page: 44-45
Subtopic: Factor market and Product market Type: Definition

90. In the circular flow model:

- A) households supply factors of production to firms.
- B) households receive income through the factor market.
- C) households spend income in the product market.
- D) all of the above hold true.

Ans: D Level: Easy Main Topic: 2.5 The circular flow model Page: 44-45
Subtopic: Factor market and Product market Type: Definition

Use the following to answer questions 91-92:



CHAPTER 2 The Market System and the Circular Flow

91. Refer to the figure. If box B represents the factor market and flow (3) represents money income, then:

- A) box A is the product market and box C is households.
- B) box C is the product market and box A is households.
- C) box D is the product market and box C is households.
- D) box C is the product market and box D is households.

Ans: C Level: Moderate Main Topic: 2.5 The circular flow model Page: 44-45
Subtopic: Factor market and Product market Type: Application

92. Refer to the figure. If box A represents businesses and flow (7) represents goods and services, then:

- A) box D is the product market and box B is the factor market.
- B) box D is the product market and box B is households.
- C) box B is the product market and box C is households.
- D) box C is the product market and box B is the factor market.

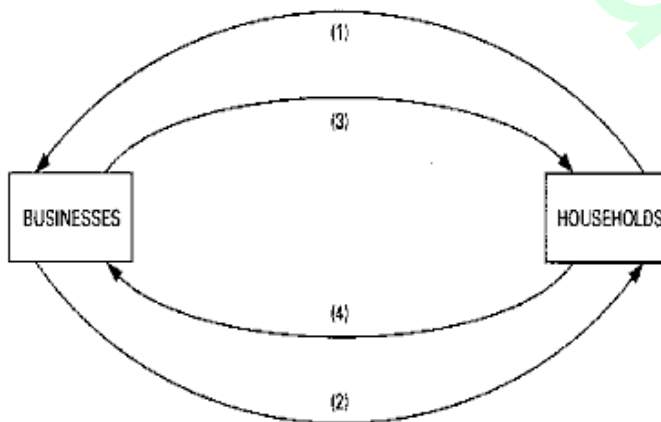
Ans: A Level: Moderate Main Topic: 2.5 The circular flow model Page: 44-45
Subtopic: Factor market and Product market Type: Application

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

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

Ans: C Level: Easy Main Topic: 2.5 The circular flow model Page: 44-45
Subtopic: Factor market and Product market Type: Definition

Use the following to answer questions 94-95:



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

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

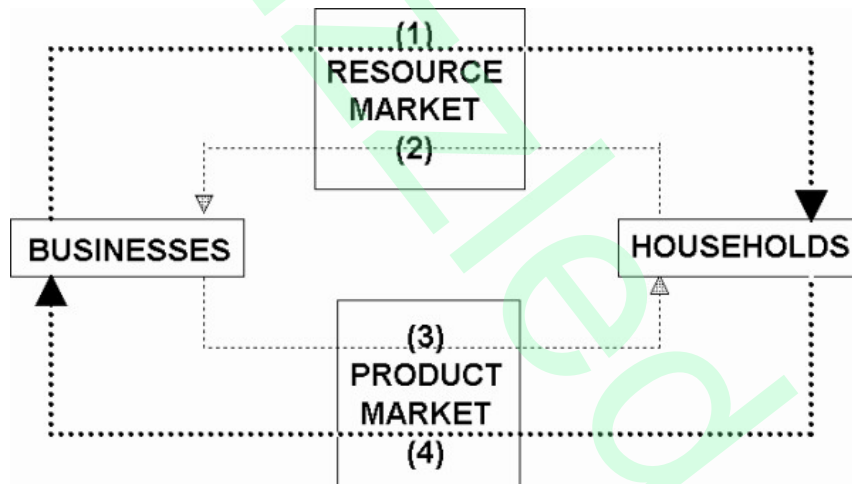
Ans: D Level: Moderate Main Topic: 2.5 The circular flow model Page: 44-45
Subtopic: Factor market and Product market Type: Application

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

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

Ans: B Level: Moderate Main Topic: 2.5 The circular flow model Page: 44-45
Subtopic: Factor market and Product market Type: Application

Use the following to answer questions 96-99:



96. Refer to the circular flow model of the economy. In the diagram flow (1) represents:

- A) wage, rent, interest, and profit income.
- B) land, labour, capital, and entrepreneurial ability.
- C) goods and services.
- D) consumer expenditures.

Ans: A Level: Easy Main Topic: 2.5 The circular flow model Page: 44-45
Subtopic: Factor market and Product market Type: Application

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

Ans: B Level: Easy Main Topic: 2.5 The circular flow model Page: 44-45
Subtopic: Factor market and Product market Type: Application

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

Ans: C Level: Easy Main Topic: 2.5 The circular flow model Page: 44-45
Subtopic: Factor market and Product market Type: Application

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

Ans: D Level: Easy Main Topic: 2.5 The circular flow model Page: 44-45
Subtopic: Factor market and Product market Type: Application

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

Ans: C Level: Easy Main Topic: 2.5 The circular flow model Page: 44-45
Subtopic: Factor market and Product market Type: Application

101. Private property rights are important because they:
- A) discourage investment and growth.
 - B) eliminate the possibility of randomness in resource arrangements.
 - C) facilitate the production of public goods.
 - D) create a random distribution of the economic resources.

Ans: B Level: Easy Main Topic: Last Word Page: 46 Type: Application

CHAPTER 2 The Market System and the Circular Flow

102. The knowledge of how each and every economic resource might be combined productively with each other is important because:

- A) it will allow the production of more consumer goods than capital goods.
- B) it produces more capital goods than consumer goods.
- C) it gives the government the right to own resources used in production.
- D) it will eliminate the randomness in allocating the resources.

Ans: D Level: Easy Main Topic: Last Word Page: 46 Type: Application

103. Markets fail to allocate resources efficiently when

- A) private property rights are not established.
- B) there is a well established private property right.
- C) the randomness does not exist in allocation of resources.
- D) the government produces the public goods.

Ans: A Level: Easy Main Topic: Last Word Page: 46 Type: Application

104. Specialization may be conducive to an expansion of total output even though the individuals involved may have identical abilities.

Ans: True Level: Moderate Main Topic: 2.2 Characteristics of the market system
Page: 32 Type: Application

105. A division of labour enhances society's output by permitting people to take advantage of existing differences in their abilities and skills.

Ans: True Level: Easy Main Topic: 2.2 Characteristics of the market system
Page: 32 Type: Application

106. Money functions as a medium of exchange in permitting the ready comparison of the relative worth of heterogeneous products.

Ans: False Level: Moderate Main Topic: 2.2 Characteristics of the market system
Page: 36 Type: Application

107. Government alters the distribution of income by market intervention, in which case it modifies the prices established by market forces.

Ans: True Level: Moderate Main Topic: 2.2 Characteristics of the market system
Page: 37 Type: Application

CHAPTER 2 The Market System and the Circular Flow

108. Consumer sovereignty means that legislation now protects the rights of consumers to dispose of their incomes as they see fit.

Ans: False Level: Easy Main Topic: 2.3 Five fundamental questions Page: 38
Type: Definition

109. The wants of consumers are expressed on the demand side of the product market.

Ans: True Level: Easy Main Topic: 2.3 Five fundamental questions Page: 38
Type: Application

110. The guiding function of prices indicates that, at equilibrium prices, neither product surpluses nor shortages can occur.

Ans: False Level: Easy Main Topic: 2.3 Five fundamental questions Page: 40
Type: Application

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

Ans: False Level: Easy Main Topic: 2.3 Five fundamental questions Page: 41
Type: Definition

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

Ans: True Level: Easy Main Topic: 2.3 Five fundamental questions Page: 41
Type: Application

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

Ans: True Level: Easy Main Topic: 2.5 The circular flow model Page: 44
Type: Application

114. Households and businesses are both suppliers in the product market.

Ans: False Level: Easy Main Topic: 2.5 The circular flow model Page: 44
Type: Application