# **Economics, Choice and Scarcity**

**Question 1:** Which of the following is not required for a country to be producing at a point on its production possibility frontier?

1. Full employment of labor.
2. All producers using the latest technology.
3. **Stable prices.**
4. All producers having productive efficiency.

**Feedback:**

Only **c** gives a condition that is **not** required for a country to be on its production possibility frontier. For example, the economy in Figure 2.2 on page 22 could be at point y, producing 35,000 bricks and 70,000 loaves each day. It could be there if prices were stable, or rising at 5% a year, or even 5% a day, or even if prices were falling. But it could not be there unless there was full employment of labor, full productive efficiency, and the use of the latest technology by all producers.

**Question** 2

Which of the following statements is true?

1. **Possibility frontier is straight because some resources are better suited to making some products than others.**
2. The production possibility frontier is steeper at the left end than the right because some resources are better suited to making some products than others.
3. The production possibility passes the point which represents total wants in the economy.

**Feedback**:

Only statement a is true. The frontier is flat at the left end because if a country initially produced only the product on the vertical axis, and then shifted some resources into the product on the horizontal axis, if would initially take resources little suited to the former and well suited to the latter, so output of the former would fall little while output of the latter would rise greatly. Total wants are at a point way outside the frontier.

**Question** 3

Which of the following will not shift a country’s production possibility frontier?

1. **A fall in unemployment.**
2. An increase in the age at which people retire.
3. The introduction of improved technology.
4. Purchases of new capital by firms.

**Feedback**:

Only statement a concerns an event that will not shift the frontier. If there is a fall in unemployment, then a country will move from a point inside the frontier to one closer to it.

**Question** 4

Which of the following types of economy describes the economy of the UK?

1. A command economy.
2. A market economy
3. **A mixed economy.**
4. A planned economy.

**Feedback**:

Only statement c describes the situation in the UK, where the UK government seeks to influence the use of resources rather than leave their use to market forces, as applies in a market economy, or to control their use, as applies in a command or planned economy.

**Question** 5

All the following government policies are likely to increase the quantity of some products that are produced. But with one policy, this effect is a side-effect rather than the aim. Which policy is that?

1. A policy intended to improve efficiency.
2. The introduction of subsidies on some products.
3. A policy intended to reduce unemployment.
4. **The introduction of taxes on the rich and transfers to the poor.**

**Feedback:**

Only policy d does not intend to increase the output of some products, so that any increase is a side-effect. This side-effect is likely to arise, because the products which the poor consume more when the transfers are introduced may differ from the products which the rich consume less when the taxes are introduced.

**Question** 6

Which of the following policies would increase production by taking it to a point closer to the production possibility frontier, but would not shift the frontier?

1. A policy that encouraged firms to buy more industrial plant.
2. A policy that encouraged firms to develop and introduce improved technology.
3. A policy that encouraged firms to buy more machinery.
4. **A policy that encouraged firms to adopt better technologies that are already available.**

**Feedback:**

Only statement d concerns a policy that would not shift the production possibility frontier. That is because if firms are not using the best available technology, then production is inside the frontier, because the economy is producing less than it is currently possible for it to produce. Each other policy would allow the economy in future to produce more than it is possible for it to produce at present.

**Question** 7

Suppose a country is currently producing at a point on its production possibility frontier, and undertakes no trade with other countries. Then trade is opened up. Which of the following would not occur as a direct result?

1. **Its production possibility frontier would shift.**
2. Its production would shift to another point on its production possibility frontier.
3. The pattern of products that the country produced would differ from the pattern that its consumers consumed.
4. Consumers would be able to consume at a point outside the production possibility frontier.

**Feedback**:

Only statement a concerns an effect that would not occur as a direct result of trade. Trade does not of itself shift the frontier because it does not of itself give a country any more resources or allow the country to use its resources more productively. But trade is likely to encourage the country to shift its pattern of production to products which it is relatively good at making. Also, by promoting exports and imports, trade leads to the pattern of products which is consumed differing from the pattern which is produced. Finally, trade does allow consumption to be at a point outside the production possibility frontier. Production, of course, is as always constrained to be at a point on or inside the frontier, which is why the frontier gets its name.

**Question** 8

Which of the following policies is not classed as a stabilization policy?

1. A policy aimed at reducing unemployment.
2. **A policy aimed at reducing the number of people in poverty.**
3. A policy aimed at reducing the rate of inflation.
4. A policy aimed at shifting the production possibility frontier outwards.

**Feedback**:

Only statement b concerns a policy which is not a stabilization policy. Instead, this is a redistribution policy.

**Question** 9

Which of the following statements is a positive statement?

1. Bankers’ bonuses should be taxed.
2. The Eurozone ought to allow member countries in difficulty to stop using the euro and use currencies of their own instead.
3. **One of the largest industries in the UK is the financial services industry.**
4. The UK government ought to split up some of the largest UK banks to promote more competition in the banking industry.

**Feedback**:

Only statement c is a positive statement which concerns a fact; incidentally, the fact is true, but this does not affect whether the statement is a positive one. The other statements are all normative statements about what the person making the statements believes should happen.

**Question** 10

Suppose you buy Economics by David King. What is the opportunity cost of your purchase?

1. The money you paid for the book.
2. **Whatever you would have spent the money on if you had not bought the book.**
3. The cost of producing the book.
4. The time you spend studying the book.

**Feedback**:

Statement b gives the correct answer because it relates to the best alternative you went without in order to buy the book.

# **Elasticity of Demand and Supply**

**Question** 1

A student club wants to raise just enough income to cover its costs. Its income comes partly from membership fees and partly from selling tickets for its nightly discos. Attendance at the discos currently leads to overcrowding of the club’s room. The demand for membership is price inelastic and the demand for discos is price elastic. To reduce the crowding without changing its total income, what should the club do?

1. ***Raise both the disco ticket price and the membership fee***
2. Lower both the disco ticket price and the membership fee.
3. Raise the disco ticket price but lower the membership fee.
4. Lower the disco ticket price but raise the membership fee.

**Feedback**:

To reduce the overcrowding, the club must raise the ticket price for its discos. As disco demand is elastic, its revenue from discos will then fall, so it needs to raise its revenue from membership fees. As membership demand is inelastic, it should raise the fee, and then the revenue from membership fees will rise. So a is the correct answer.

**Question** 2

Suppose the price of a product increases from £12 to £20 and the quantity demanded falls from 55 a week to 45. What is the PED?

1. 0.4
2. -***0.4***
3. 2.5
4. -2.5

**Feedback**:

The correct answer is b. The change in quantity is -10 and the average quantity is 50, so the percentage change is 100(-10/50)100 or -20. The change in price is £8 and the average price is £16, so the percentage change is 100(8/16) or 50. So the PED is -20/50 or -0.4.

**Question** 3

Suppose a demand curve runs from the price axis to the quantity axis in a straight line. Whereabouts will PED=-1.0?

1. Where the curve meets the price axis.
2. Everywhere along the curve.
3. ***At the mid-point of the curve.***
4. Nowhere along the curve.

**Feedback**:

The correct answer is c. PED varies all along any sloping straight line demand curve. Above the mid-point, demand is elastic, so the PED is below -1.0; and below the mid-point demand is inelastic, so the PED is between -1.0 and 0.0. So the PED equals -1.0 at the mid-point.

**Question** 4

A consumer product has a PED of -0.12. Which of the following factors would not help to explain this?

1. There are few substitutes available.
2. Any substitutes there are have higher prices.
3. The product accounts for a small percentage of consumer expenditure.
4. ***The product is a normal good.***

**Feedback**:

Factor d would not help to explain this. A normal good is one where demand decreases if incomes increase, but this says nothing about the PED.

**Question** 5

Which of the following statements is true?

1. When an economy grows, firms would prefer to be making inferior goods rather than making normal goods.
2. If a firm notices that the price of a substitute for its product has fallen, it would prefer the CED between the products to be far from zero rather than close to zero.
3. If a firm notices that the price of a complement for its product has risen, it would prefer the CED between the products to be far from zero rather than close to zero.
4. ***If a firm’s costs increase and it has to increase the price of its output, it would prefer demand to be price inelastic rather than price elastic.***

**Feedback**:

D is true because if demand is inelastic, then the rise in price will lead to only a small fall in the quantity sold and to a higher total revenue, whereas if demand is elastic, then the rise in price will lead to a large fall in the quantity sold and to a fall in revenue. Note that a is false because, when incomes grow, demand for normal goods increases but demand for inferior goods decreases. B and c are false because, if the price of a substitute falls or the price of a complement rises, then firms would like as little effect on the demand for their products a possible.

**Question** 6

Suppose incomes double over a period of years. Which sorts of product will experience the biggest increases in price?

1. ***Those with a PES close to 0.0 and an IED well above 0.0.***
2. Those with a PES close to 0.0 and an IED well below 0.0
3. Those with a PES well above 1.0 and an IED well above 0.0
4. Those with a PES well above 1.0 and an IED well below 0.0

**Feedback**:

The effect on price depends in part on how much demand increases: the further the IED is above 0.0, the more demand will increase. The effect on price also depends on the PES. The more inelastic is the supply, that is the closer the PES is to 0.0, the more the effect will be. So the combination in a is the correct one.

**Question** 7

Suppose the price of a product increases from £50 to £70 and the quantity supplied rises from 40 a day to 80. What is the PES?

1. 0.5
2. -0.5
3. ***2.0***
4. -2.0

**Feedback**:

The change in quantity is 40 and the average quantity is 60, so the percentage change is 100(40/60)100 or 67. The change in price is £20 and the average price is £60, so the percentage change is 100(20/60) or 33. So the PES is 67/33 or 2.0 (answer c).

**Question** 8

Which of the following statements is false?

1. PES is infinity all along any horizontal supply curve.
2. PES is 1.0 all along any supply curve which passes through the origin.
3. PED is zero all along any vertical demand curve.
4. ***PED is -1.0 along any demand curve where spending would be the same at each price.***

**Feedback**:

Statement d is false. For PES to be 1.0 all along a supply curve, the curve must not only pass through the origin: it must also be straight.

**Question** 9

A consumer product has a PES of 0.1. Which of the following factors would not help to explain this?

1. The producers are close to full capacity.
2. One or more of the key intermediate products needed to make the product are themselves items with an inelastic supply.
3. ***Consumers need very little time to respond fully to price changes.***
4. One type of labor used by the producers may be in inelastic supply

**Feedback**:

Only factor c would not help to explain the low PES. This factor concerns the time consumers need to react to price changes, and that affects the PED of a product, not its PES.

**Question** 10

Which of the following statements is false?

1. Price elasticity of demand is negative for most products.
2. Price elasticity of supply is positive for most products.
3. Income elasticity of demand is positive for normal goods.
4. ***Cross elasticity of demand is positive between complements.***

**Feedback**:

Statement d is false. If the price of a product increases, then people will demand a lower quantity of it and, in turn, a lower quantity of any complements they consume with it. So a positive change in the price of one of the complements leads to a negative change in the quantity demanded of the other complements. So a CED between complements is always negative.

# **The Economic Problems**

1 .If a society is at point that is inside the production possibilities frontier, the society is experiencing

* 1. Equity.
  2. Maximizing output.
  3. **Inefficiency**.
  4. Efficiency.

2 .Opportunity cost can be measured as the

1. Decrease in the quantity produced of one good as we move along the production possibilities frontier.
2. Increase in the quantity produced of one good divided by the decrease in the quantity produced of another good as we move along the production possibilities frontier
3. Increase in the quantity produced of one good as we move along the production possibilities frontier.
4. **Decrease in the quantity produced of one good divided by the increase in the quantity produced of another good as we move along the production possibilities frontier.**

3 .The opportunity cost of producing one more unit of a good or service is the

* 1. Production efficiency.
  2. Marginal benefit.
  3. Allocative efficiency.
  4. **Marginal cost.**

4.When we cannot produce more of any one good without giving up some other good that we value more highly, we have achieved

* 1. Inefficiency.
  2. Production efficiency.
  3. **Allocative efficiency.**
  4. Equal opportunity.

5 .An upward or outward shift in the production possibilities frontier is indicative of

* 1. Inefficiency.
  2. Equity.
  3. Efficiency.
  4. **Economic growth.**

6 .Two key factors that generate economic growth are

* 1. **Technological change and capital accumulation.**
  2. Capital accumulation and decreased saving.
  3. Technological change and increased current consumption.
  4. Increased current consumption and decreased saving.

7 .If a person can produce more goods with a given amount of resources than another person, that person has a(n)

* 1. **Absolute advantage**.
  2. Efficiency advantage.
  3. Dynamic comparative advantage.
  4. Comparative advantage.

8 .People can gain from specialization and exchange if

1. Everyone produces the good or service in which they have a higher opportunity cost.
2. **Everyone produces the good or service in which they have a lower opportunity cost.**
3. The marginal cost of producing an additional unit is greater than the marginal benefit.
4. Everyone produces the good or service in which they have an absolute advantage.

9 .Social arrangements that govern the ownership, use, and disposal of resources, goods, and services are

* 1. Efficient.
  2. Preferences.
  3. Markets.
  4. **Property rights**.

10 .In the circular flow of the market economy,

1. **Firms are sellers in resource markets and buyers in goods markets.**
2. Households are buyers in resource markets and sellers in goods markets.
3. Households are sellers in resource markets and buyers in goods markets.