

COURSEBOOK

A. H. STUDENMUND

JAMES D. GWARTNEY

RICHARD L. STROUP

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**PRIVATE AND
PUBLIC CHOICE**

EIGHTH EDITION

COURSEBOOK to accompany

A. H. STUDENMUND

Occidental College

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r

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Florida State University

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Montana State University

e c o n o m i c s

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EIGHTH EDITION



THE DRYDEN PRESS

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P R E F A C E

We are often asked why we call this book a *Coursebook* rather than a “study guide.” We use the title *Coursebook* because we feel that this volume goes well beyond the typical study guide in at least three ways:

1. *Critical Analysis* We stress questions that require in-depth economic reasoning. Most of these more analytical questions force students to come up with their *own* answers rather than passively choosing between a group of prepared alternatives.
2. *Readings and Debates* We include short and interesting readings by a broad spectrum of economists. For example, we have paired opposing viewpoints on given topics into a series of debates. These debates not only provide material for classroom discussion, they also allow students to develop their own opinions on the issues. We also include some interesting crossword puzzles.
3. *Explained Answers* For more than half the questions, we include explanations of why a particular answer is correct. We also provide some references to sections in the text that explain topics in more detail.

In writing this *Coursebook*, we have attempted to strike a balance between economic reasoning and mechanics. Often, a supplementary workbook is little more than a set of mechanical exercises. Such exercises lack substance and meaning for the student who has not yet acquired a firm foundation in the economic way of thinking. Our teaching experience has shown that stressing real-world situations, presenting actual data, providing selected short readings, and explaining why particular answers are correct—as we have done in the *Coursebook*—illuminate the power and utility of economic reasoning.

The *Coursebook* has been structured to maximize the student’s comprehension of the concepts presented in each chapter of *Macroeconomics: Private and Public Choice*, Eighth Edition. Each chapter is divided into several sections that combine the instruction of economic principles, as covered in the text, with mechanical exercises.

The first section of each chapter is composed of approximately 14 true-false questions. Although this section has a realistic flavor, mechanics are emphasized. “Problems and Projects,” the second section, emphasizes both mechanics and economic reasoning. This section contains some case-study-type problems as well as some questions that ask students to review basic concepts. The third section, “Learning the Mechanics—Multiple Choice,” contains multiple-choice questions of the type familiar to most students. Many questions are sufficiently difficult to challenge even knowledgeable students. Questions posed in the fourth section, “The Economic Way of Thinking—Multiple Choice,” often utilize actual data to emphasize economic reasoning. Some items test the student’s ability to distinguish between sound logic and economic nonsense; others ask the student to devise the proper policy for reaching a given set of economic goals. To answer these “complex application”-type questions, the student must be able to apply principles to realistic situations. For students unaccustomed to critical thinking, these questions will be difficult; yet they present a challenge far more stimulating than exercises that test rote learning. Finally, each chapter contains discussion questions that are intended to provoke further speculation on economic issues.

More than merely a workbook, the *Coursebook* serves as a reader, presenting a “Perspectives in Economics” section in almost every chapter. These articles are readable and engaging, will reinforce the classroom presentation of economic lessons, and will expand on important concepts discussed in the text. Some articles offer an historical perspective, clearly stating the views of such renowned economists as Milton Friedman or Walter Heller. Other readings give students the opportunity to read firsthand the ideas of newer voices such as Sam Bowles or Robert Crandall. Following each selection are questions asking the student to evaluate the position

of the author. Is the reasoning sound? Is it opinionated? Does empirical evidence support the author's contention? This feature of the *Coursebook* again highlights the usefulness of economics in our everyday lives.

A popular item for students is a series of "Current Debates in Economics," paired readings that express opposing viewpoints on such topics as "Should We Raise the Minimum Wage?" and "Should We Have a Market Economy?" These debates will force students to come to grips with differences in opinion among economists and to form their own views on the issues. In addition, classes can stage formal "debates," allowing some or all of the students to develop their argumentation and oral presentation skills.

We also include some crossword puzzles in the *Coursebook*. These puzzles, which originally appeared in *The Margin*, provide a relaxing and interesting way for students to review economic definitions and concepts.

Answers to virtually every question are provided in the "Answer Key" at the back of the *Coursebook*. The Answer Key also contains two unique features that will make the questions significantly more useful for student learning. First, all the multiple-choice answers are followed by an explanation of why that particular answer is correct. In addition, we often refer the student to the section where the subject of the question is discussed in *Macroeconomics: Private and Public Choice*. In this way, a student who does not get the correct answer the first time can get an explanation of the correct answer. If that explanation is not convincing, then the student can refer to the corresponding section in the text. Students who take the time to master these questions—and who understand the rationale behind each answer—should do very well in introductory economics classes.

Most of the new questions in the Eighth edition of the *Coursebook* were written by Professor Mary Hirschfeld of Occidental College. Professor Hirschfeld expanded on the excellent work she did for the Seventh edition by adjusting the questions for changes in chapter content, updating aggregate data and other time-related material, and inventing questions on new topics. Throughout this process Mary's work has been superb in terms of its accuracy, timeliness, and concern for student learning. Her contribution to this edition cannot be overstated.

Others to whom we owe a debt of gratitude include Eroica Howard and Professor Jim Halstead of Occidental College, Stacey Sims, Jim Patterson, and Carlyn Hauser of the Dryden Press, Carolyn Summers of the National Education Association, and Jaynie, Scott, and Connell Studenmund. To these folks and everyone else involved in the Eighth edition, we offer our heartfelt thanks.

A. H. Studenmund
Richard L. Stroup
James D. Gwartney

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CHAPTER ONE

THE ECONOMIC APPROACH

TRUE OR FALSE

T F

- ☐ ☐ 1. According to economic theory, if there is an increase in the benefit derived from an activity, individuals will be more likely to choose that activity.
- ☐ ☐ 2. The opportunity cost of going to a movie is the cost of tickets, popcorn, and drinks, *plus* any money spent on transportation or babysitters.
- ☐ ☐ 3. A health care system run by the government would necessitate rationing of health care, unlike a system left to the free market.
- ☐ ☐ 4. Only the actions of selfish people are influenced by economic incentives.
- ☐ ☐ 5. Economic activity often has secondary effects that are not initially observable.
- ☐ ☐ 6. Economic theory cannot be tested because it involves human decision makers.
- ☐ ☐ 7. One's use of time involves economic choice.
- ☐ ☐ 8. Because ascetics don't care about material goods, they do not confront the problem of scarcity.
- ☐ ☐ 9. Positive economic statements involve value judgments about how the world "should be."
- ☐ ☐ 10. Scientific methodology can be used to test normative economic statements.
- ☐ ☐ 11. The following is a positive economic statement: "An increase in the price of butter will lead to a reduction in the quantity of butter purchased by consumers." (All else constant.)
- ☐ ☐ 12. The following is a positive economic statement: "The government should pursue a policy of raising income for the working poor."
- ☐ ☐ 13. If public education is freely provided to the consumer, it is by definition not a scarce or economic good.
- ☐ ☐ 14. Economic analysis applies only to those choices that relate to the production or consumption of physical goods.
- ☐ ☐ 15. A person's well-being is dependent only on the consumption of material goods.

PROBLEMS AND PROJECTS

1. For each question below, use the indicated guidepost from the text to help you answer the question and explain your answer:
 - a. Guidepost 1: Do full scholarships make education free?
 - b. Guidepost 2: According to federal and state laws, Exxon was responsible for a complete cleanup of its 1989 Alaskan oil spill. Should economizing behavior have played a role in the cleanup?
 - c. Guidepost 3: Suppose a sudden increase in the quality of television increased the value of leisure time to the average citizen. Would this be likely to cause a decline in the proportion of citizens who vote?
 - d. Guidepost 4: Halfway through your economics course, you consider dropping the course because of its heavy workload. What should you base your decision on: the total workload of the course or the remaining workload?
 - e. Guidepost 5: Should the Food and Drug Administration require that all new drugs for AIDS be exhaustively tested for safety and effectiveness before approving their use?
 - f. Guidepost 6: What secondary consequences might have followed when the United States signed a deal to sell a large volume of grain to the Soviet Union in 1973?
 - g. Guidepost 7: Many Superbowl ticket holders end up reselling their tickets, sometimes for over \$1,000 each. Who benefits from this scalping: the ticket buyers, the ticket sellers, both, or neither?
 - h. Guidepost 8: Does it make sense to assume that firms try to maximize their profits even though firm owners often deny that profit maximizing is their primary goal?
2. Exhibit 1 shows the relationship between gas consumption of a new Chevrolet and the number of miles traveled.

EXHIBIT 1

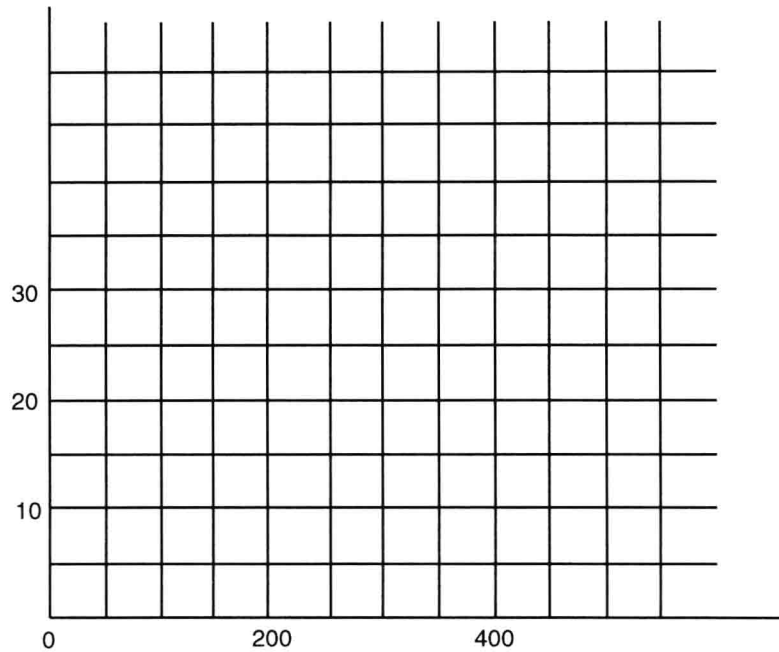
<i>Total distance traveled (miles)</i>	<i>Amount of gasoline consumed (gallons)</i>
0	0
75	5
150	10
225	15
300	20
375	25
450	30

- a. Graph the relationship between miles traveled and gas consumption in the space provided. Measure miles traveled on the horizontal axis (x axis) and gasoline consumption on the vertical axis (y axis).

Label the graph clearly.

- b. Is gasoline consumption related positively or negatively to distance traveled?
- c. How many miles can be traveled on a gallon of gas? What is the slope of the gasoline per mile consumption "curve" (line)?

(graph for question 2)



3. Height and weight are usually related. Exhibit 2 presents data for a sample of men. The average weight for men of differing heights is shown.

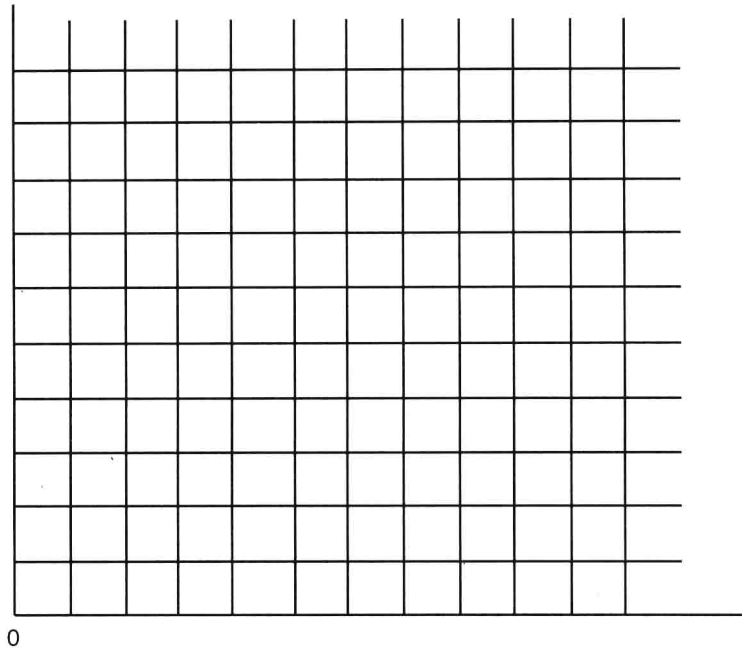
EXHIBIT 2

<i>Number of men in class</i>	<i>Height of individual (inches)</i>	<i>Mean weight (pounds)</i>
20	70	160
23	71	168
17	72	176
18	73	182
14	74	186

- a. Graph the height-weight relationship, plotting height on the horizontal axis and weight on the vertical axis. Be sure to label both axes.

- b. What is the slope of the line (“curve”) between 70 and 71 inches? Between 73 and 74 inches?

(graph for question 3)



4. Exhibit 3 presents data on national income and personal consumption expenditures for the period from 1990 to 1995.

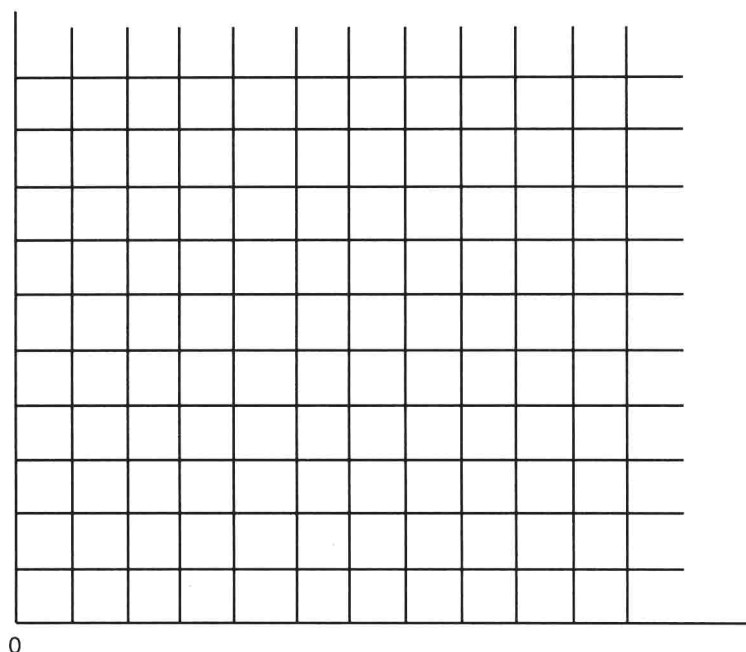
EXHIBIT 3

<i>Year</i>	<i>Disposable personal income (in billions)</i>	<i>Personal consumption expenditures (in billions)</i>
1990	\$4,167	\$3,839
1991	4,344	3,975
1992	4,614	4,220
1993	4,789	4,454
1994	5,019	4,699
1995	5,331	4,965

Source: Economic Report of the President, 1996, p. 310.

- Graph the relationship in the space provided. Plot disposable income on the horizontal axis and consumption expenditures on the vertical axis. Be sure to label both axes.
- Is the relationship between disposable income and consumption expenditures positive or negative?
- How much did income increase between 1990 and 1991? How much did consumption increase? What was the slope of the consumption-income relationship during this time period?
- Calculate the slope of the consumption-income relationship between 1991 and 1992. Is the slope of the relationship constant from year to year?

(graph for question 4)



- Each of the following statements ignores or violates one of the eight guideposts to economic thinking discussed in the text. In each case, identify the guidepost and explain how it has been violated.
 - Before voting in an important election, each voter should learn as much as possible about the issues involved.
 - Reducing the prices of necessities would clearly benefit the poor. Therefore, the government should pass laws (price controls) requiring producers of necessities to sell at low prices.
 - One way to lower the costs associated with the armed services would be to have a military draft with low pay for those who are required to serve.
 - Since I get the same satisfaction from reading a book, seeing a movie, or hearing a concert, it makes no difference to me which one I do.
 - Since criminal activity is associated more with the poor than with the rich, the poor must have lower moral standards than the rich.
 - I recently heard that some people are hiring others to do their shopping for them. It sure is silly to hire someone to do something you can clearly do for yourself.
 - If hamburgers and pizza by the slice cost the same and you like pizza more than you like hamburgers, you would always rather have another slice of pizza than another hamburger.

6. Exhibit 4 shows how the quantity of melons bought by consumers depends on the price of melons and on average consumer income.

EXHIBIT 4

Price (cents per pound)	Quantity bought (thousands of tons per year) for average income of	
	\$10,000/year	\$15,000/year
1.5	1,500	1,690
1.6	1,420	1,600
1.7	1,350	1,510
1.8	1,280	1,430
1.9	1,210	1,370
2.0	1,170	1,310

- On a piece of graph paper (if you do not have a piece of graph paper, draw your own) graph the relationship between price and quantity bought if income is \$10,000. Label this curve D_1 .
 - Graph the relationship between price and quantity bought if income is \$15,000. Label this curve D_2 .
 - Are price and quantity bought positively or negatively related?
 - If price is fixed at 1.7 cents per pound and consumer income rises from \$10,000 to \$15,000 per year, how much will quantity bought change?
7. The text discusses three common pitfalls to avoid in the economic way of thinking:
- (1) Violation of the *ceteris paribus* condition
 - (2) Association is not causation
 - (3) Fallacy of composition

Indicate which pitfall applies to each of the following statements. Briefly explain each case.

- Since everyone who buys a lottery ticket hopes to win the lottery prize, the perfect lottery would make everyone a winner.
- Since low-income families tend to be larger than average, low-income parents must be particularly fond of children compared to average parents.
- In recent years, drug abuse has increased despite increased drug enforcement efforts, so it is pretty clear that drug enforcement efforts have been ineffective.

LEARNING THE MECHANICS—MULTIPLE CHOICE

- In economics, the term scarcity refers to the fact that
 - everything really worthwhile costs money.
 - even in wealthy countries like the United States, some people are poor.
 - no society is able to produce enough to satisfy fully the desires of people for goods and services.
 - the availability of some goods, like oil, will be exhausted someday.

2. Opportunity cost is
 - a. the cost incurred when one fails to take advantage of an opportunity.
 - b. the cost incurred in order to increase the availability of attractive opportunities.
 - c. the cost of the highest valued option forgone as the result of choosing an alternative.
 - d. the drudgery and undesirable aspects of an option.
3. When an economist states that a good is scarce, she means that
 - a. production cannot expand the availability of the good.
 - b. it is rare.
 - c. desire for the good exceeds the amount that is freely available from nature.
 - d. people would want to purchase more of the good at any price.
4. When economists say that an individual displays economizing behavior, they simply mean that the individual is
 - a. making a lot of money.
 - b. purchasing only those products that are cheap and of low quality.
 - c. learning how to run a business more effectively.
 - d. making choices to gain specific benefits at the least possible cost.
5. The national debt is too large. The government must stop spending so much and start thinking about the resources they are depleting. This statement is
 - a. a normative statement about economic policy.
 - b. an objective statement about economic policy.
 - c. a testable hypothesis.
 - d. a conclusion supported by economic theory.
6. Which of the following is a guidepost to clear economic thinking?
 - a. The value of a good to a consumer can objectively be measured by the price he pays for it.
 - b. Individuals should never make a decision without having complete information.
 - c. Incentives matter.
 - d. Goods are scarce for the poor but not for the rich.
7. Competitive behavior
 - a. occurs as a reaction to scarcity.
 - b. occurs only in a market system.
 - c. occurs only when the government allocates goods and services.
 - d. always generates waste.
8. Within the context of economics, the statement “There are no free lunches” refers to which of the following?
 - a. Individuals must always pay for the lunch that they consume.
 - b. Production of a good requires the use of scarce resources regardless of whether it is supplied free to the consumers.
 - c. Restaurant owners act in their own interest.
 - d. Economic maximizers are selfish and will not provide anything free for others.
9. A good economist will
 - a. think much like an ecologist, recognizing the secondary effects of an action as well as the direct effects.
 - b. ignore secondary effects, since in an economy such effects seldom matter.
 - c. recognize that, almost always, secondary effects just reinforce the direct effects of a policy action.
 - d. analyze the secondary effects of an action so long as they occur at about the same time as the direct effects.

10. Which of the following is *not* an example of an economic resource?
- human skills
 - a water buffalo
 - an atomic reactor
 - All of the above *are* (or can be) economic resources.
11. If you were deciding whether to purchase a second car, the economic way of thinking would lead you to compare
- the total benefits expected from two cars with the cost of the two cars.
 - the additional benefits expected from a second car with the total cost of the two cars.
 - the dollar cost of the two cars with the potential income that the two cars will generate.
 - the additional benefits of the second car with its cost.

Questions 12 through 14 refer to the following data:

Function Y		Function Z	
Q	P	Q	P
5	\$10	5	\$120
10	20	10	95
15	30	15	75
20	40	20	60
25	50	25	50
30	60	30	41
35	70	35	35

12. From the data above, we know that
- function Y is linear but function Z is not.
 - function Z is linear but function Y is not.
 - both function Y and function Z are linear.
 - neither function Y nor function Z are linear.
13. From the data above, we know that the slope of function Y between $Q = 20$ and $Q = 25$ is
- 0.5.
 - 2.0.
 - 0.5.
 - 2.0.
14. From the data above, we know that function Y and function Z intersect (cross each other) at
- $Q = 35$.
 - $Q = 25$.
 - an indeterminate point.
 - the two functions do not intersect.

THE ECONOMIC WAY OF THINKING—MULTIPLE CHOICE

1. The basic difference between macroeconomics and microeconomics is that
 - a. macroeconomics looks at how people make choices, and microeconomics looks at why they make those choices.
 - b. macroeconomics is concerned with economic policy, and microeconomics is concerned with economic theory.
 - c. macroeconomics focuses on the aggregate economy, whereas microeconomics focuses on small components of that economy.
 - d. macroeconomics is associated with the fallacy of composition, whereas microeconomics has little to do with the fallacy of composition.
2. Which of the following is the best example of economizing behavior on the part of a student whose only objective in economics is to get an A in the course?
 - a. Taking the optional final exam to improve her grade even though an A in economics is already a certainty
 - b. Spending the economics lecture hour studying for an exam in another class because she is already assured of an A in economics
 - c. Doing outside readings in economics which will not be beneficial for the examination
 - d. Spending time reading the text and attending classes even though the teacher informed the student that her present grade, a B, could not possibly change
3. Which of the following actions is consistent with the basic economic postulate (the guidepost) that incentives matter?
 - a. Consumers buy fewer potatoes because the price of potatoes declines.
 - b. A politician votes against a proposal because most of her constituents are strongly in favor of it.
 - c. Fewer students attend lectures in the introductory economics courses because class participation counts 40 percent of their grade.
 - d. Farmers produce less barley because barley prices have declined.
4. An increase in prison terms for people caught selling drugs might have which of the following secondary effects?
 - a. an increase in the amount of bribery offered by drug sellers to law enforcement agents
 - b. an increase in the price of drugs
 - c. increased efforts to develop new drugs that are not yet covered by anti-drug laws
 - d. all of the above
5. Positive economics differs from normative economics in that
 - a. positive economics deals with how people react to changes in benefits, whereas normative economics deals with how people react to changes in costs.
 - b. positive economic statements are, in principle, empirically testable; normative statements are not.
 - c. positive economic statements tell us what we should be doing; normative economics tells us what we should have done.
 - d. normative economic statements are theoretical, whereas positive statements focus on the application of the theory.

6. The basic postulate that incentives matter concerns human decisions about the allocation of
 - a. leisure and work.
 - b. food and clothing.
 - c. studying and dating time.
 - d. all of the above.
7. The economic way of thinking stresses that
 - a. changes in personal costs and benefits will exert a predictable influence on the choices of human decision makers.
 - b. if one individual gains from an economic activity, then someone else must lose, and in the same proportion.
 - c. if a good is provided free to an individual, its production will not consume valuable scarce resources.
 - d. good intentions lead to sound economic policy.
8. "The price of food usually rises when there is an increase in the general level of prices. High food prices cause inflation." This statement best illustrates fallacious reasoning stemming from
 - a. the fallacy of composition.
 - b. failure to recognize that association is not causation.
 - c. failure to consider the secondary effects of an action.
 - d. wishful thinking on the part of the spokesperson.
9. "Because Jane spent \$10 on a hat from the thrift store, I know that the hat is worth exactly \$10 to her."
 - a. This statement is true.
 - b. This statement overlooks the fallacy of composition.
 - c. This statement overlooks guidepost #7.
 - d. This statement overlooks guidepost #4.
10. If the best test of a theory is its ability to predict, and if economics deals with human beings who can think and respond in a variety of ways, can economic theories really be tested?
 - a. Yes, since, on average, human beings will respond in a predictable way to changes in personal costs and benefits.
 - b. Yes, since all individuals usually respond in the same way.
 - c. No, since individuals will seldom respond in a predictable way.
 - d. No, since the general behavior of a large number of individuals cannot be predicted.
11. Economics assumes that decision makers
 - a. always act rationally and act only when they have full information.
 - b. base their evaluations on psychic factors, leaving out the utility derived from economic goods.
 - c. maximize their utility, insofar as utility indicates the pleasure derived from material goods.
 - d. seek to choose those options that will best advance their objectives.
12. The central message of Adam Smith was that the production and wealth of a nation would be magnified if
 - a. individuals were left free to act in their own interest.
 - b. a central planning agency were established to ensure that labor and capital were allocated efficiently.
 - c. the central government provided free education and training to workers.
 - d. employers were more humanitarian toward workers and employees more concerned about the importance of efficiency in production.