Answers to End-of-Chapter Review Questions

1. The four essential economic activities are resource maintenance, production, distribution, and consumption.

2. The three basic economic questions are:
   a. What should be produced, and what should be maintained?
   b. How should production and maintenance be accomplished?
   c. For whom should economic activity be undertaken?

3. A positive question concerns issues of fact while a normative questions concern goals and values.

4. Intermediate goals are not ends in themselves but are expected to serve as a means to further ends. Final goals are sought for their own sake.

5. Wealth is whatever confers the ability to produce and procure valued goods and services while efficiency aims to use the minimum amount of resources to achieve a desired result. Efficiency is often considered synonymous with maximizing wealth, measured in dollar terms. However, both are generally only intermediate goals in pursuit of broader goals and should not be construed as final goals.

6. An economic actor is an individual, group, or organization that is engaged in resource maintenance or the production, distribution or consumption of goods and services.

7. A negative externality is a harmful side effect, or unintended consequence, of economic activity that affects persons, or entities such as the environment, that are not among the economic actors directly responsible for the activity. An example would be the air pollution created by a factory. A positive externality is a beneficial effect of economic activity that rebounds largely on persons or entities that are not among the economic actors directly involved in the activity. An example would be the positive impacts a private garden has on passersby.

8. Transactions costs are the costs of arranging economic activities.

9. Abundance means that resources exist for meeting many of our goals. Scarcity implies that insufficient resources are available to meet all goals at the same time. Economic decision making allows us to assess the tradeoffs between alternative goals.

10. Figure 1.1 presents a production possibilities frontier (for guns and butter). The frontier defines the necessary tradeoff between the two goods—more of one can only be obtained by giving up some of the other good. In other words, the opportunity cost of more guns is less butter. All points within and along the PPF are attainable, including points A, B, and D. All points beyond the PPF are currently unattainable,
such as point C. We are efficiently allocating resources when we are operating along a PPF (such as points A and B) because no resources are idle.

11. A PPF will expand over time through technological progress and improvements in capital (including human, natural, and social capital). A PPF may shrink over time if resources are depleted or degraded.

12. The core sphere includes households and small-scale community organizations that organize production, distribution, consumption, and resource maintenance primarily without monetary exchanges. In the core sphere, production tends to be rewarded directly with the output rather than with money. The core sphere also responds to immediately perceived needs rather than the ability to pay.

13. The public purpose sphere, which includes government, NGOs, and international institutions, exists for the purpose of the public good at some level. Organizations in the public purpose sphere tend to be formally structured and primarily obtain their money through monetary contributions rather than direct payment for goods or services. The public purpose sphere often provides public goods, which are not exchanged in markets.

14. Individuals can generally not be prevented from benefiting from public goods. Thus, a business could not exclude those who haven’t paid from enjoying a public good. Once the good is provided, commonly anyone can benefit with or without paying. This tends to create free riders, people who benefit but do not pay. As everyone has an incentive to be a free rider, business generally cannot make a profit through the provisioning of public goods.

15. The business sphere is made up of firms and proprietors that produce goods and services for profitable sale. While the primary goal of businesses is to make profits, firms may still have other goals such as community service or environmental protection. Businesses are formally structured and commonly involve the complex interaction of many actors. The drive for profits encourage firms to behave efficiently, respond to market influences, and innovate to remain competitive.