# Chapter 2

*Multiple Choice Solutions:*

1. An individual’s value for a good or service is
   1. The amount of money he or she used to pay for a good. [Past payments do not necessarily indicate the current value of a good or service to an individual]
   2. **The amount of money he or she is willing to pay for it. [correct;** to “value” a good means that you want it and can pay for it**]**
   3. The amount of money he or she has to spend on goods. [Total individual wealth does not reflect the value of a particular good or service]
   4. None of the above [To “value” a good means that you want it and can pay for it]
2. The biggest advantage of capitalism is that
   1. it allows the market to self-regulate [Competition in the market results in self-regulation]
   2. it allows a person to follow his self-interest [Transactions will not be consummated unless both sides’ interests are met]
   3. it allows voluntary transactions which creates wealth [Wealth-creating transactions only occur when both buyer and seller see a surplus]
   4. **All of the above [correct]**
3. Wealth creating transactions are more likely to occur
   1. with private property rights [private property rights facilitate voluntary transactions]
   2. with strong contract enforcement [contract enforcement helps facilitate voluntary transactions]
   3. with black markets [black markets are often created from a wealth-generating arbitrage opportunity]
   4. **All of the above [correct;** By making sure that buyers and sellers can keep the gains of trade, legal mechanisms such as private property and contract rights that facilitate voluntary transactions will help generate wealth; black markets also create wealth from seizing arbitrage opportunities that exist from inefficiencies in the market]
4. Which of these actions creates value?
   1. Buying a struggling firm and selling off its assets for more than the purchase price. [Other firms value the sum of the individual assets more than they did when the firm was a collection of individual assets.]
   2. A baseball slugger drawing paying fans into the ballpark. [The baseball player increases the value of attending the game for ticket holders and potential ticket holders, thereby increasing ticket sales.]
   3. A student increasing his decision-making ability with an MBA. [The student is more valuable to firms with an MBA than without]
   4. **All of the above [correct]**
5. Which of the following are examples of a price floor?
   1. **Minimum wages [correct;** by outlawing wages below a certain price, minimum wages are an example of a price floor]
   2. Rent controls in New York [this is an example of a price ceiling, in which the price of rent cannot go above a specified value]
   3. Both a and b [Of the two options, one is indeed an example of a price floor, while the other is a price ceiling]
   4. None of the above. [At least one of the answers above is an example of a price floor, which is defined as a regulation that outlaws trade at prices below the specified “floor” value]
6. A price ceiling
   1. Is a government-set maximum price. [A price ceiling is a regulation that outlaws trade above a specified price; it does not have to be above market equilibrium]
   2. **Is an implicit tax on producers and an implicit subsidy to consumers**. **[correct;** Price ceilings prevent producers from selling at a higher price to consumers who would be willing to pay more, while consumers have the opportunity to purchase something they may not have been able to otherwise]
   3. Will create a surplus. [Likely, both the consumer (buyer) and producer (seller) will value the good at or above the specified ceiling. If the producer is forced to sell, any surplus for the consumer is a loss for the producer, so no net surplus is created from the transaction]
   4. Causes an increase in consumer and producer surplus. [Both the consumer (buyer) and producer [seller] likely value the item at or above the specified ceiling, resulting in a benefit for the consumer but a loss of potential wealth for the producers]
7. Taxes
   1. impede the movement of assets to higher valued uses. [This is the result of anything that deters a wealth creating transaction]
   2. reduce incentives to work. [By not allowing people to capture the full value of their labor and production, taxes reduce the incentive to work]
   3. decrease the number of wealth-creating transactions. [If a tax is larger than the total surplus created by a transaction, the transaction will not take place]
   4. **All of the above. [correct;** when taxes are larger than the surplus of a transaction, that transaction will not take place, thus deterring a wealth creating transaction. Likewise, by not allowing people to keep the gains from their own trade, taxes can diminish the incentive to work**].**
8. A consumer values a car at $20,000 and it costs a producer $15,000 to make the same car. If the transaction is completed at $18,000, the transaction will generate
   1. no surplus [A surplus is created from this transaction]
   2. $5,000 worth of seller surplus and unknown amount of buyer surplus [Seller surplus is $3,000, (Final price less seller value); Similarly, buyer surplus can be calculated by looking at the difference between the buyer value and the final price.
   3. **$2,000 worth of buyer surplus and $3,000 of seller surplus [correct;** Buyer surplus is calculated by looking at the difference between the buyer value and the final price ($20,000-$18,000=$2,000), while the seller surplus is calculated by looking at the difference between the final price and the seller’s value ($18,000-$15,000=$3,000)]
   4. $3,000 worth of buyer surplus and unknown amount of seller surplus. [Buyer surplus is $2,000, (Buyer value less final price); similarly, seller surplus can be calculated by looking at the difference between the final price and the seller value]
9. A consumer values a car at $525,000 and a seller values the same car at $485,000. If sales tax is 8% and is levied on the seller, then the seller’s bottom line price is (rounded to the nearest thousand)
   1. **$527,000 (correct;** At a price of $527,000, the seller will receive $485,760 ($528,000\*0.92) which is above his bottom line (For the exact value, look at $485,000/0.92 = $527,173.93. As the seller requires a number at or above this value, $528,000 is the best response)**]**
   2. $524,000 [at a price of $524,000, the seller will only receive $482,080 ($524,000\*0.92) which is below his bottom line]
   3. $525,000 [at a price of $525,000, the seller will only receive $483,000 ($525,000\*0.92) which is below his bottom line]
   4. $500,000 [at a price of $500,000, the seller will only receive $460,000 ($500,000\*0.92) which is below his bottom line]
10. Voluntary transactions
    1. **Always produce gains for both parties [Correct;** To be voluntary, both sides must see gains from consummating the transaction]
    2. Produce gains for at least one party [If one side does not see value in the transaction, they will choose to not consummate the deal. Both sides must see value.]
    3. Always increase wealth for everyone [Voluntary transactions only create wealth for the parties involved.]
    4. Are inefficient [Voluntary transactions move assets to their higher-value uses, a feature of an efficient market]