Common Sense Economics
Part I. Ten Key Elements of Economics
Practice Test
Multiple Choice Questions

1. Incentives matter
   a. Only when people are greedy and selfish.
   b. Only in a free market system.
   c. Only in the private sector.
   d. To all human beings regardless of environment.

Answer: d

2. Which of the following is often referred to as the basic postulate of economics?
   a. Individuals act only out of selfish motives.
   b. Incentives matter—individuals respond in predictable ways to changes in personal costs and benefits.
   c. The accuracy of the assumptions is the best test of an economic theory.
   d. The value of a good is objective; it is equal to the cost of producing the good.

Answer: b

3. The expression, "There's no such thing as a free lunch," implies that
   a. Everyone has to pay for his own lunch.
   b. The person consuming a good must always pay for it.
   c. Opportunity costs are incurred when resources are used to produce goods and services.
   d. No one has time for a good lunch anymore.

Answer: c

4. Maria wishes to buy gasoline and have her car washed. She finds that if she buys 9 gallons of gasoline at $2.50 per gallon, the car wash costs $2, but if she buys 10 gallons of gasoline, the car wash is free. For Maria, the marginal cost of the tenth gallon of gasoline and car wash is
   a. zero.
   b. 50 cents.
   c. $2.00.
   d. $2.50.

Answer: b
5. If the market price of a good is more than the opportunity cost of producing it,
   a. The market price of the product will fall in the long run.
   b. Producers will increase supply in the long run.
   c. Resources will flow away from production of the good, causing supply to
decline with the passage of time.
   d. The situation will remain unchanged as long as supply and demand remain
   in balance.

Answer: b

6. Who gains in a voluntary trade?
   a. The buyer only.
   b. The seller only.
   c. Both the buyer and the seller.
   d. Both the buyer and the seller, but the seller usually gains more.

Answer: c

7. Economic progress
   a. Reflects that people are achieving higher income levels and living
      standards.
   b. Requires that individuals work longer hours.
   c. Implies scarcity is no longer a problem.
   d. Indicates income levels are higher even though environmental and health
      conditions have worsened.

Answer: a

8. Voluntary trade promotes economic progress because
   a. It moves goods, services and resources from people who value them more
to individuals who value them less.
   b. It makes individuals self-sufficient.
   c. It encourages businesses to seek lower per-unit costs by adopting mass
      production methods.
   d. It discourages trade on the basis of comparative advantages.

Answer: c

9. High transaction costs will tend to
   a. Reduce the number of mutually beneficial exchanges that occur.
   b. Allow easier specialization according to the law of comparative
      advantage.
   c. Increase the value created by exchanges in an economy.
   d. Increase the number of mutually beneficial exchanges that occur.

Answer: a
10. Middlemen
   a. Increase transaction costs.
   b. Increase the price of goods, services and resources without providing any benefits.
   c. Impede trade and hinder economic growth.
   d. Reduce transactions costs.

Answer: d

11. If the Internet allows buyers and sellers to find each other quickly and helps buyers learn easily about the products available for sale, we would expect that
   a. The volume of trade will decline.
   b. Transaction costs will rise.
   c. The gains from trade will increase.
   d. Buyers and sellers will be worse off.

Answer: c

12. When individuals increase their personal wealth through production and exchange, they
   a. Reduce the wealth of others.
   b. Must rely heavily on government intervention and regulation.
   c. Increase the wealth of others.
   d. Must be selfish and greedy.

Answer: c

13. The pursuit of profit will
   a. Encourage firms to produce efficiently and keep their costs low.
   b. Encourage firms to produce goods and services that consumers value highly relative to costs.
   c. Discover and develop better products and lower-cost production methods.
   d. All of the above are correct.

Answer: d

14. Economic progress comes primarily through
   a. Central planning.
   b. Trade barriers.
   c. Government investment in heavy industry.
   d. Entrepreneurial action guided by competitive markets.

Answer: d
15. If you want to earn a high income you should figure out what others value because
   a. Others will be willing to pay you for what they value.
   b. You will be able to gain at the expense of others.
   c. You will not have to compete in the job market.
   d. You will not have to trade with or cooperate with others.

   Answer: a

16. Negative profits and business failures
   a. Should be avoided at all costs.
   b. Serve a productive function in the process of business growth and development.
   c. Do not exist in command economies.
   d. Retard economic progress.

   Answer: b

17. Specialization in goods and services one can produce at a low cost makes it possible for trading partners to produce a larger joint output. This is called
   a. The law of comparative advantage.
   b. The law of absolute advantage.
   c. The law of production possibilities.
   d. The invisible hand principle.

   Answer: a

18. Adam Smith's invisible hand principle stresses
   a. That compassion is a powerful motivator that encourages individuals to engage in productive economic activity.
   b. The tendency of the competitive market process to direct self-interested individuals into activities that enhance the economic welfare of society.
   c. The potential of government regulation as a means of bringing the self interest of individuals into harmony with the economic welfare of society.
   d. The tendency of self-interested individuals to pursue activities that benefit themselves, but harm the overall economic welfare of society.

   Answer: b

19. Which of the following is a predictable, secondary effect of a sharp increase in gasoline prices?
   a. Producers will increase the production of gas guzzling vehicles.
   b. Producers will increase the production of fuel-efficient cars.
   c. Research on the cost-effective production of cars using alternative energies will stop.
d. The federal government will place a quota on the number of fuel efficient cars for sale thus “forcing” consumers to purchase the gas guzzling vehicles.

Answer: b

20. In a free market economy, consumption and investment decisions
a. Are controlled largely by the government.
b. Shape the future course of the national economy.
c. Are necessarily controlled by big businesses.
d. Require protection from foreign forces if individuals desire wealth accumulation.

Answer: b