

Common Sense Economics
Part I: Twelve Key Elements of Economics
Practice Test

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.

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.

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.

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 is
 - a. zero.
 - b. 50 cents.
 - c. \$2.00.
 - d. \$2.50.

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 increase 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.

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

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

8. Voluntary trade promotes economic progress because it
 - a. moves goods, services and resources from people who value them more to individuals who value them less.
 - b. encourages individuals to become self-sufficient.
 - c. makes larger outputs possible as a result of specialization.
 - d. benefits buyers at the expense of sellers.

9. High transaction costs will tend to
 - a. reduce the number of mutually beneficial exchanges.
 - b. lead to more specialization in accordance with the law of comparative advantage.
 - c. increase the total gains from trade.
 - d. increase the number of mutually beneficial exchanges.

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.

11. If the Internet helps buyers learn about the availability of products and find potential sellers more quickly,
 - a. the volume of trade will decline.
 - b. transaction costs will rise.
 - c. the gains from trade will increase.
 - d. buyers will be better off, but sellers will be worse off.

12. The curve that shows the relationship between the price of a good and the quantity that consumers are willing to purchase at each price is the
- supply curve.
 - demand curve.
 - production possibilities curve.
 - consumption curve.
13. If equilibrium is present in a market,
- the price of the product will tend to rise.
 - quantity demanded equals quantity supplied.
 - quantity demanded exceeds quantity supplied.
 - quantity supplied exceeds quantity demanded.
14. When individuals increase their personal wealth through production and exchange, they
- reduce the wealth of others.
 - must rely heavily on government intervention and regulation.
 - increase the wealth of others.
 - must be selfish and greedy.
15. The pursuit of profit will
- encourage firms to produce efficiently and keep their costs low.
 - encourage firms to produce goods and services that consumers value highly relative to costs.
 - discover and develop better products and lower-cost production methods.
 - All of the above are correct.
16. Economic progress comes primarily through
- central planning.
 - imposition of trade barriers.
 - government investment in heavy industry.
 - entrepreneurial action directed by competitive markets.
17. If you want to earn a high income you should figure out what others value because
- others will be willing to pay you for what they value.
 - you will be able to gain at the expense of others.
 - you will not have to compete in the job market.
 - you will then be able to charge higher prices than alternative suppliers.

18. Losses and business failures
- illustrate why government subsidies are necessary if resources are going to be allocated efficiently.
 - will help redirect resources away from unproductive projects.
 - reflect that buyers value the product highly relative to costs.
 - indicate that sellers are producing the commodity at the lowest possible cost.
19. 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
- the law of comparative advantage.
 - the law of absolute advantage.
 - the law of production possibilities.
 - the law of demand.
20. The income and living standards of a nation will increase when
- jobs are protected and total employment expands.
 - the prices of goods and services increase.
 - the imports of goods and services fall.
 - the availability of goods and services that people value increases.
21. When the government funds a project that will create jobs, the funds for the project
- are essentially free, because the project originated in the government sector.
 - will leave private sector output and employment unchanged.
 - will generate additional tax revenues that will pay for the project.
 - will have to be either taxed or borrowed from the private sector.
22. Adam Smith's invisible hand principle stresses the tendency of
- compassion to encourage productive economic activity.
 - the competitive market process to direct self-interested individuals into activities that enhance the economic welfare of society.
 - government regulation to bring the self interest of individuals into harmony with the economic welfare of society.
 - self-interested individuals to pursue activities that benefit themselves, but harm the overall economic welfare of society.

23. 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. the termination of research on the cost-effectiveness of alternative fuels to power automobiles.
 - 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.
24. 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.
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ANSWER KEY 1 THROUGH 24

1. (d), 2. (b), 3. (c), 4. (b), 5. (b), 6. (c), 7. (a), 8. (c), 9. (a), 10. (d), 11. (c), 12. (b)
13. (b), 14. (c), 15. (d), 16. (d), 17. (a), 18. (b), 19. (a), 20. (d), 21. (d), 22. (b)
23. (b), 24. (b)