

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,
- The market price of the product will fall in the long run.
 - Producers will increase supply in the long run.
 - Resources will flow away from production of the good, causing supply to decline with the passage of time.
 - The situation will remain unchanged as long as supply and demand remain in balance.

Answer: b

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

Answer: c

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

Answer: a

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

Answer: c

9. High transaction costs will tend to
- Reduce the number of mutually beneficial exchanges that occur.
 - Allow easier specialization according to the law of comparative advantage.
 - Increase the value created by exchanges in an economy.
 - 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
- 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 not have to trade with or cooperate with others.

Answer: a

16. Negative profits and business failures
- Should be avoided at all costs.
 - Serve a productive function in the process of business growth and development.
 - Do not exist in command economies.
 - 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
- The law of comparative advantage.
 - The law of absolute advantage.
 - The law of production possibilities.
 - The invisible hand principle.

Answer: a

18. Adam Smith's invisible hand principle stresses
- That compassion is a powerful motivator that encourages individuals to engage in productive economic activity.
 - The tendency of the competitive market process to direct self-interested individuals into activities that enhance the economic welfare of society.
 - The potential of government regulation as a means of bringing the self interest of individuals into harmony with the economic welfare of society.
 - 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?
- Producers will increase the production of gas guzzling vehicles.
 - Producers will increase the production of fuel-efficient cars.
 - 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