Introductory Economics

Use this key to check answers and read the explanations.

1. A community garden has more applicants than plots. Which basic economic idea explains why it must decide how to allocate the plots?

A. Scarcity
B. Inflation
C. A budget surplus
D. Comparative advantage

Correct answer: A. Scarcity

Plots are limited relative to the number people want. Scarcity creates the need to allocate available resources.

2. Jo has one free hour. Her only options are practicing guitar and attending a free workshop. What activity is her opportunity cost if she chooses the workshop?

A. Buying a guitar
B. Attending the workshop
C. Practicing guitar
D. Finding out when the workshop starts

Correct answer: C. Practicing guitar

Opportunity cost is the value of the next-best alternative given up. Here the alternative activity is guitar practice.

3. A bakery lowers its price for muffins. Under the law of demand, what happens to the quantity demanded if everything else relevant stays the same?

A. It decreases
B. It increases
C. It stays fixed
D. It becomes equal to the old quantity supplied

Correct answer: B. It increases

A lower price increases the quantity buyers want at that price, other things equal. This is a movement along the demand curve.

4. Which condition describes the equilibrium price in a basic supply-and-demand model?

A. All potential buyers purchase the same number of goods
B. Every buyer pays the highest price they would accept
C. Sellers have no production costs
D. Quantity demanded equals quantity supplied

Correct answer: D. Quantity demanded equals quantity supplied

At equilibrium, the amount buyers plan to buy equals the amount sellers plan to sell at that price.

5. Which transaction reflects new production counted in this year's U.S. gross domestic product?

A. A used blender passed from one household to another
B. A kitchen blender made in the U.S. this year and sold this year
C. A blender made and purchased abroad
D. A payment received for selling an existing stock holding

Correct answer: B. A kitchen blender made in the U.S. this year and sold this year
GDP measures the value of final goods and services produced inside a country during the period. A resale does not create another new blender.

6. Household incomes rise. Assume board games are a normal good. What happens to the demand for board games, all else equal?

A. It rises at each price
B. It falls at each price
C. Only supply increases
D. Demand can rise only if the market price falls

Correct answer: A. It rises at each price
When income rises, buyers typically want more of a normal good at each price. That shifts the demand curve to the right.

7. A cheaper ingredient lowers the cost of baking bread. What happens to bread supply, all else equal?

A. The supply curve stays fixed and sellers move up it
B. Sellers offer less at a given price
C. Buyers want more at every price because their income rose
D. Sellers offer more at a given price

Correct answer: D. Sellers offer more at a given price
Lower production costs make larger quantities profitable at a given sale price. Supply shifts to the right.

8. At $4, buyers want 90 notebooks and sellers offer 60. At $5, both want to trade 75. At $6, buyers want 60 and sellers offer 90. Which listed price clears the market?

A. $6
B. $4
C. $5
D. None of the listed prices

Correct answer: C. $5
At $5, both quantities are 75. The $4 price produces excess demand and the $6 price produces excess supply.

9. A workshop's noise keeps nearby residents awake. The residents do not buy its products or receive compensation. What describes the cost imposed on them?

A. A negative externality
B. A price ceiling
C. A production subsidy
D. A decrease in private production costs

Correct answer: A. A negative externality
The noise imposes a cost on people outside the transaction. Such a spillover is a negative externality.

10. A stall can make one more batch of rolls. It would bring in $9 of additional revenue and add $7 of cost, with no other effects. What is the batch's effect on profit?

A. Profit rises by $16
B. Profit rises by $9
C. Profit falls by $7
D. Profit rises by $2

Correct answer: D. Profit rises by $2
The incremental revenue is $9 and the incremental cost is $7. Their difference is a $2 increase in profit.

11. A binding price ceiling is set at $4. At that price, buyers want 120 units and sellers offer 90. What imbalance does the model predict?

A. A shortage of 90 units
B. A surplus of 30 units
C. A shortage of 30 units
D. A surplus of 120 units

Correct answer: C. A shortage of 30 units
At the ceiling, quantity demanded is higher than quantity supplied. The shortage is 120 − 90, or 30 units.

12. A consumer price index rises from 120 to 132 over one year. What is the percentage increase?

A. 12%
B. 10%
C. 9.1%
D. 32%

Correct answer: B. 10%
The index is up 12 points. Divide those 12 points by the starting index of 120 to get 0.10, or 10%.

13. In one shift, Ari can make 8 mugs or 4 plates. Bo can make 6 mugs or 6 plates. Assuming constant trade-offs, who gives up fewer mugs to make one plate?

A. Neither, because both can make mugs and plates
B. Ari, who gives up half a mug per plate
C. Ari, because Ari can make more mugs per shift
D. Bo, who gives up one mug per plate

Correct answer: D. Bo, who gives up one mug per plate
Bo gives up 6 ÷ 6, or one mug, per plate. Ari gives up 8 ÷ 4, or two mugs. Bo has the comparative advantage in plates.

14. An economy produces only 100 chairs each year. The price rises from $40 to $50. Using the first year's price as the base, what happens in the second year?

A. Nominal GDP rises to $5,000, and real GDP stays at $4,000.
B. Nominal and real GDP both rise to $5,000.
C. Nominal GDP stays at $4,000, and real GDP rises to $5,000.
D. Nominal and real GDP both stay at $4,000.

Correct answer: A. Nominal GDP rises to $5,000, and real GDP stays at $4,000.
Nominal GDP uses the new price, so it is 100 × $50. Real GDP uses the base price, so it remains 100 × $40.

15. One more unit brings $22 in benefit to its buyer. It costs the producer $18 in resources and imposes $7 of pollution damage on others. With no other effects, what does a social cost-benefit test say about producing the unit?

A. Produce it. Total social benefit is $29, above the $18 cost.
B. Produce it. Total social cost is $18, below the $22 benefit.
C. Skip it. Total social cost is $25, above the $22 benefit.
D. Skip it. Only the $7 pollution damage counts as a social cost.

Correct answer: C. Skip it. Total social cost is $25, above the $22 benefit.
Add the $7 external cost to the $18 private cost. At $25, the full cost exceeds the $22 benefit by $3.