Texas A&M University (TAMU) ECON202 Principles of Economics Practice Exam 1 (Sample)

Study Guide

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Questions

1. Which term describes a one-on-one trade where each participant has something the other wants?
   A. Market
   B. Barter
   C. Exchange
   D. Trade-off

2. Normative economics is primarily concerned with:
   A. Objective descriptions of economic phenomena
   B. What is and what can be statistically proven
   C. What should be or what people ought to do
   D. Trends in historical economic data

3. Under which economic system does the government dictate both what and how goods are produced?
   A. Traditional economy
   B. Market economy
   C. Command economy
   D. Mixed economy

4. In economic terms, the phrase "limited resources" refers to:
   A. A finite amount of inputs available for production
   B. Excess supply in the market
   C. Unregulated consumer demand
   D. Overproduction of goods

5. What is a "change in supply" characterized by?
   A. A movement along the supply curve
   B. A shift of the entire supply curve due to a determinant change
   C. Price elasticity of demand
   D. A fixed quantity supplied irrespective of price

6. What guides markets to positive outcomes according to Adam Smith?

A. Government control

B. Consumer demand

C. An invisible hand

D. Corporate strategy

7. What occurs when the price of a substitute good falls?

A. Demand for the original good increases

B. Demand for the original good decreases

C. Demand remains constant

D. Price of original good will rise

8. What indicates that demand is inelastic according to price elasticity?

A. % change in quantity demanded equals % change in price

B. % change in quantity is greater than % change in price

C. % change in quantity is less than % change in price

D. % change in quantity meets price change

9. According to the law of supply, what happens when the price of a good increases?

A. The quantity supplied decreases

B. The quantity demanded decreases

C. The quantity supplied increases

D. The quantity demanded remains constant

10. Which factor does NOT affect demand?

A. Changes in market size

B. Changes in income

C. Changes in supply

D. Changes in preferences

Answers

1. B
2. C
3. C
4. A
5. B
6. C
7. B
8. C
9. C
10. C

Explanations

1. Which term describes a one-on-one trade where each participant has something the other wants?

   A. Market

   B. Barter

   C. Exchange

   D. Trade-off

The term that best describes a one-on-one trade where each participant has something the other wants is "Barter." Barter refers to the direct exchange of goods or services without the use of money, allowing each participant to satisfy their own needs by trading items they possess for items they desire. This process relies on the idea that both parties have mutually beneficial interests in the transaction. For example, if one person has a surplus of apples and another has extra oranges, they can engage in a barter trade where they exchange apples for oranges, fulfilling their wants without the intermediary of currency. The other terms, while related to economic exchanges, do not specifically convey the nuances of one-on-one trades. A market signifies a broader term where buyers and sellers interact, while exchange generally refers to the act of giving and receiving without the specificity of the relationship between the parties. Trade-off typically involves evaluating alternatives and their costs, rather than focusing on an immediate, mutual exchange of commodities between two individuals.

2. Normative economics is primarily concerned with:

   A. Objective descriptions of economic phenomena

   B. What is and what can be statistically proven

   C. What should be or what people ought to do

   D. Trends in historical economic data

Normative economics is focused on what ought to be and involves value judgments about economic policies and outcomes. It addresses questions about fairness, justice, and what the best course of action should be based on individual or societal values. For instance, normative analysis may involve discussions on whether a government should provide healthcare for all citizens or how resources should be distributed to achieve equity. This aspect of economics is different from positive economics, which strictly deals with objective analysis and descriptions of economic phenomena without the influence of personal beliefs or opinions. In contrast, classifications such as statistical validations or historical trends fall under the domain of positive economics since they rely on empirical evidence rather than subjective judgments about what should occur. By understanding that normative economics entails a prescriptive approach, one can appreciate how it influences policy discussions and debates surrounding economic issues in society.

3. Under which economic system does the government dictate both what and how goods are produced?

A. Traditional economy

B. Market economy

C. Command economy

D. Mixed economy

In a command economy, the government exerts significant control over the production and distribution of goods and services. This system centralizes decision-making, allowing the government to dictate not only what goods are produced but also how they are produced. This control typically aims to achieve specific economic and social objectives, such as equality or direct resource allocation for the benefit of the community as a whole. In contrast, traditional economies rely on customs and practices to determine production, while market economies depend on individual choices and market forces to guide what is produced and how. Mixed economies incorporate elements of both command and market systems, allowing for some degree of government intervention alongside market mechanisms, but they do not feature the same level of government direction in production as a command economy. Thus, the defining characteristic of a command economy is the governmental authority in decision-making regarding the production process and economic outcomes.

4. In economic terms, the phrase "limited resources" refers to:

A. A finite amount of inputs available for production

B. Excess supply in the market

C. Unregulated consumer demand

D. Overproduction of goods

The phrase "limited resources" in economic terms specifically refers to the finite amount of inputs available for production. This concept encompasses various resources such as land, labor, capital, and raw materials that are required to produce goods and services. Since these inputs are not limitless, economies must make choices about how to allocate them effectively among competing uses. This understanding of limited resources is foundational to the study of economics, as it drives the need for trade-offs and prioritization in production and consumption decisions. When resources are scarce, individuals and businesses must weigh their options carefully, leading to the fundamental economic problem of scarcity. This situation prompts concepts such as opportunity cost, where the cost of using a resource for one purpose is the value of what could have been produced with it instead. In contrast, the other options do not accurately represent the concept of limited resources. Excess supply in the market refers to a situation where the quantity supplied exceeds the quantity demanded, which is a separate economic issue related to market equilibrium. Unregulated consumer demand speaks more to preferences and desires rather than the availability of resources. Overproduction of goods deals with scenarios where production exceeds demand but does not directly address the idea of resource availability.

5. What is a "change in supply" characterized by?

A. A movement along the supply curve

B. A shift of the entire supply curve due to a determinant change

C. Price elasticity of demand

D. A fixed quantity supplied irrespective of price

A "change in supply" is accurately characterized by a shift of the entire supply curve due to changes in determinants other than price. This concept signifies that factors such as production costs, technology, taxes, subsidies, and the number of sellers in the market can lead to an overall increase or decrease in supply. When supply changes, it does not merely involve the quantities supplied at various price levels, which is represented by a movement along the existing supply curve. Instead, the entire curve is affected, indicating that at every price level, the quantity supplied has changed. For example, if a new technology reduces production costs, this typically would shift the supply curve to the right, reflecting an increase in supply. Understanding this distinction is crucial, as it highlights the responsiveness of supply to external factors and clarifies how these factors can influence market dynamics.

6. What guides markets to positive outcomes according to Adam Smith?

A. Government control

B. Consumer demand

C. An invisible hand

D. Corporate strategy

The concept that guides markets to positive outcomes according to Adam Smith is the idea of an "invisible hand." This phrase refers to the self-regulating nature of the marketplace, where individual actions motivated by personal self-interest inadvertently contribute to the overall good of society. When individuals seek to maximize their own gain through production, exchange, and consumption, they often allocate resources in a manner that benefits society as a whole. This occurs without any central authority directing these actions, relying instead on the coordination of supply and demand. As consumers make choices based on their preferences and producers respond to those choices by adjusting supply, the market organically reaches equilibrium. The invisible hand illustrates how personal incentives can lead to beneficial outcomes, creating a system where resources are used efficiently and consumers are served effectively. This idea contrasts with the notion of government control or corporate strategy, which may involve more direct guidance of market activities and can lead to inefficiencies or misallocation of resources.

7. What occurs when the price of a substitute good falls?

A. Demand for the original good increases

B. Demand for the original good decreases

C. Demand remains constant

D. Price of original good will rise

When the price of a substitute good falls, consumers are likely to buy more of that substitute instead of the original good. A substitute good is an alternative that can satisfy the same need or want, meaning that when its price decreases, it becomes more attractive to consumers compared to the higher-priced original good. As a result, the demand for the original good will typically decrease because consumers will shift their purchases towards the now cheaper substitute. This shift in consumer behavior directly impacts the demand for the original good, leading to a decrease in its demand as people opt for the more affordable alternative. This concept underlines the relationship between substitute goods in economics.

8. What indicates that demand is inelastic according to price elasticity?

A. % change in quantity demanded equals % change in price

B. % change in quantity is greater than % change in price

C. % change in quantity is less than % change in price

D. % change in quantity meets price change

Demand is considered inelastic when the percentage change in quantity demanded is less than the percentage change in price. This means that consumers do not significantly reduce the quantity they purchase in response to a price increase. Inelastic demand indicates that the good or service is a necessity or lacks sufficient substitutes, leading consumers to continue purchasing it even when the price rises. When analyzing the relationship between quantity demanded and price, if a good has inelastic demand, the total revenue will move in the same direction as price changes. For example, if the price increases, total revenue will also increase, as the loss in quantity demanded is proportionally smaller than the gain from the higher price. The other scenarios presented do not align with the characteristics of inelastic demand. If the percentage change in quantity equals the percentage change in price, we have unit elasticity. If the percentage change in quantity is greater than the percentage change in price, that signifies elastic demand, where consumers significantly react to price changes. Lastly, the phrasing of "meets price change" does not specifically define a measurable relationship, making it less clear in defining elasticity. Thus, the correct understanding of inelastic demand is crucial for analyzing consumer behavior in response to price fluctuations.

9. According to the law of supply, what happens when the price of a good increases?

A. The quantity supplied decreases

B. The quantity demanded decreases

C. The quantity supplied increases

D. The quantity demanded remains constant

The law of supply states that, all else being equal, as the price of a good increases, the quantity supplied of that good also increases. This relationship exists because higher prices provide an incentive for producers to supply more of that good to the market. When prices rise, producers are often willing and able to offer more goods for sale to take advantage of the potential for higher revenue.   This principle reflects the behavior of suppliers in a competitive market. As they anticipate higher profits from increased sales at elevated prices, they are more likely to allocate resources toward producing larger quantities. Thus, when the price of a good increases, it leads to an upward movement along the supply curve, resulting in an increase in the quantity supplied. This concept is foundational in economics and helps to explain various market behaviors in relation to price fluctuations.

10. Which factor does NOT affect demand?

A. Changes in market size

B. Changes in income

C. Changes in supply

D. Changes in preferences

Demand for a good or service is influenced by several factors, including market size, consumer income, and preferences. Each of these elements can lead to shifts in the demand curve. Market size affects demand because an increase in the number of consumers typically raises the overall demand for a product. Changes in consumer income can shift demand as well; for instance, an increase in income generally leads to an increase in demand for normal goods, while a decrease could lower demand. Additionally, changes in consumer preferences or tastes can significantly influence demand, as shifts towards favoring a particular product can lead those consumers to purchase more of it. Supply, however, relates more directly to the ability and willingness of producers to sell a good or service at a given price. While changes in supply can impact market equilibrium and the price of goods, they do not directly alter demand. Therefore, supply does not play a role in shifting the demand curve and is the correct answer as the factor that does not affect demand.