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CLEP Principles of Microeconomics Exam



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Question: 1

Economics is best defined as the study of what?

- A. Scarcity
- B. Business
- C. Trade
- D. Supply and demand
- E. Efficiency

Answer: A

Explanation:

Economics is defined as the study of scarcity, the situation in which resources are limited and wants are unlimited.

Question: 2

Which of the following statements concerning choice theory are correct?

1. Scarcity forces people, including producers, to make choices II. Producers make choices and, as a result, face trade-offs III. Opportunity cost is one way to measure the cost of a choice

- A. I only
- B. I and II only
- C. II and III only
- D. I, II, and III
- E. III only

Answer: D

Explanation:

It is true that scarcity causes producers (and other people) to make choices. Producers must choose what to produce with limited resources. It is also true that the choices a producer makes when faced with scarcity come with trade-offs. There are advantages and disadvantages to different production decisions. And, finally, calculating the opportunity cost of a choice provides a manner with which to measure the consequence of a choice and compare that against the consequence of other choices.

Question: 3

What measures the impact of choosing one option over another?

- A. Supply
- B. Elasticity
- C. Comparative advantage
- D. The Law of Diminishing Marginal Returns
- E. Opportunity cost

Answer: E

Explanation:

The opportunity cost of a producer's choice to produce one good is the loss of the ability to use the same resources to produce another good.

Question: 4

Miguel and Huan both work at a software company. In one hour, Miguel can create one computer graphic or write ten pages of text. In the same hour, Huan can create three computer graphics or write 20 pages of text. Based on this information, it can be said that:

- A. Miguel has an absolute advantage in creating computer graphics.
- B. Miguel has an absolute advantage in writing pages of text.
- C. Miguel has a comparative advantage in creating computer graphics.
- D. Miguel has a comparative advantage in writing text.
- E. None of the above

Answer: D

Explanation:

Miguel has a comparative advantage in writing text because he can create 10 pages of text for an opportunity cost of only 1 graphic for a ratio of 10-1, whereas Huan creates 20 pages of text at an opportunity cost of 3 graphics for a ratio of 20-3 or 10-1.5. Miguel's opportunity cost of 1 graphic per 10 pages of text is less than Huan's opportunity cost of 1.5 graphics per 10 pages of text.

Question: 5

Which of the following statements about the production possibilities frontier are correct?

- I. Points on the frontier are efficient
 - II. Points inside the line are efficient
 - III. Points outside the line are unattainable
 - IV. The frontier represents all possible production combinations of all goods
-
- a. I and IV
 - A. b. II and III
 - B. c. I and III
 - C. d. II and IV
 - D. e. II, III, and IV

Answer: C

Explanation:

The production possibilities frontier, or PPF, represents all the possible production combinations of two goods, not all goods. Points inside the frontier are inefficient because they do not fully utilize all available resources. Points on the frontier are efficient because they maximize the usage of all available resources. Points beyond the frontier are unattainable because they offer combinations of goods that are unavailable due to resource and production limitations.

Question: 6

Which basic questions do all economic systems need to answer?

- 1. Supply and demand
- II. What goods and services will be produced?
- III. How goods and services will be produced
- IV. To which people will goods be distributed?

- A. I only
- B. I, II, and III
- C. II and IV
- D. II, III, and IV
- E. IV only

Answer: D

Explanation:

An economic system must decide what goods and services are produced, how they are produced, and who gets them. The economic system will not set supply or demand.

Question: 7

What does the distinctive, outwardly bowed shape of the PPF signify?

- A. The law of supply and demand
- B. The efficiency of the free market system
- C. That the two goods do not have constant opportunity costs when producing in different quantities along the PPF.
- D. The unequal distribution of wealth within a society
- E. The shift in demand to match a corresponding shift in supply

Answer: C

Explanation:

Because the PPF shows all the combinations of goods that can be produced with a given set of resources, it is bowed, signifying that some combinations of the two goods have different opportunity costs.

Question: 8

According to Adam Smith, what brings about the maximum levels of production of goods and services when faced with limited resources?

- A. Opportunity cost
- B. Specialization
- C. Inelastic demand
- D. Monopolistic competition
- E. Public subsidies

Answer: B

Explanation:

A basic element of Adam Smith's thought is that, since economies have access to limited resources with which to produce services, they should specialize in producing those goods and services they can produce most efficiently.

Question: 9

John is considering using \$100 dollars to download \$100 worth of music, buy \$100 worth of video games, or contribute \$100 to charity. Which of the following statements correctly defines the opportunity cost of his decision?

- A. If John buys music, the opportunity cost is the lost opportunity to buy video games and contribute to charity.
- B. If John contributes to charity, there is no opportunity cost.
- C. If John contributes to charity, the opportunity cost is the lost opportunity to buy music and video games.
- D. If John buys video games, the opportunity cost can be defined as the lost opportunity to buy music or donate to charity.
- E. All of the above are correct

Answer: D

Explanation:

When making an economic decision, the opportunity cost is the lost opportunity to do the next best alternative. Therefore, options a. and c. are incorrect because they define the opportunity cost as the lost option to do two other things. Option b. is incorrect because giving money to charity has an opportunity cost just like spending money does. Option d. is correct because it says the opportunity cost is either purchasing music or donating to charity --- whichever is preferred would be correct but from the question we do not know which is preferred so "or" is appropriate.

Question: 10

Thrifty Buy More sells blue baseball hats at \$10 a hat in May. The equilibrium price for blue baseball hats increases to \$12 in June. Which of the following is a potential explanation for the change?

- A. An increase in supply of blue baseball hats
- B. A decrease in demand for blue baseball hats
- C. Both supply and demand stay the same
- D. Government subsidies make it less costly to produce blue hats
- E. Substitute goods decrease in supply

Answer: E

Explanation:

An increase in the supply of the hats and a decrease in demand would both cause the equilibrium price to decrease, not increase. If both supply and demand stayed the same, the equilibrium price would also stay the same. If government subsidies made it cheaper to produce the hats, the price would go down. If the supply of a substitute good went down, more consumers might be driven to buy the blue hats, causing demand to increase and the equilibrium price to increase with it.

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