THE PRAXIS SERIES

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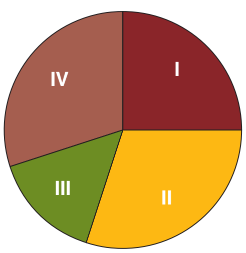
Economics (0910)

Test at a Glance

Test Name	Economics		
Test Code	0910		
Time	2 hours		
Number of Questions	100		
Format	Multiple-choice questions		
	Content Categories	Approximate Number of Questions	Approximate Percentage of Examination
	I. Microeconomics I: Scarcity, Choice and Opportunity Costs, Economic Systems, Comparative Advantage and Trade, Supply and Demand, Elasticity, Market Efficiency, Market Failures and Public Policy	25	20%–30%
	II. Microeconomics II: Production and Cost, Product Markets and Behavior of Firms, Factor Markets, and Income Distribution	30	25%–35%
	III. Macroeconomics I: Measures of Economic Performance, National Income Accounting, Unemployment, Inflation, and Business Cycle	15	10%–20%
	IV. Macroeconomics II: National Income Determination, Fiscal Policy, Money and Banking, Monetary Policy, International Finance and Investment, and Economic Growth	30	25%–30%

About This Test

The Economics test is designed for prospective teachers of economics in secondary schools. The 100 multiple-choice questions assess knowledge of the major concepts, principles, and theories of economics across the content areas of microeconomics and macroeconomics. Microeconomics topics include Scarcity, Choice and Opportunity Costs, Economic Systems, Comparative Advantage and Trade, Supply and Demand, Elasticity, Market Efficiency, Market Failures and Public Policy, Production and Cost, Product Markets and Behavior of Firms, Factor Markets, and Income Distribution. Macroeconomics topics include Circular Flow Model, Business Cycle, National Income Accounting, Unemployment and Inflation, National Income Determination, Fiscal Policy, Money and Banking, Monetary Policy, International Finance and Investment, and Economic Growth.

This test may contain some questions that do not count toward your score.

Topics Covered

Representative descriptions of topics covered in each category are provided below.

I. Microeconomics I: Scarcity, Choice, and Opportunity Costs, Economic Systems, Comparative Advantage and Trade, Supply and Demand, Elasticity, Market Efficiency

- Scarcity, Choice, and Opportunity Costs: factors of production, production possibilities curve, and efficiency
- Economic Systems: free markets, mixed models of capitalism and socialism, property rights and incentives
- Comparative Advantage and Trade: comparative advantage, absolute advantage, specialization and trade, international trade, terms of trade, gains from trade, free trade vs. protection, impacts of tariffs and quotas
- Supply and Demand:
  - The law of demand, determinants of demand and the demand curve, changes in demand vs. changes in quantity demanded
  - The law of supply, determinants of supply and the supply curve, changes in supply vs. changes in the quantity supplied
  - Market equilibrium, equilibrium price, equilibrium quantity, shortage, and surplus; price ceilings, price floors, and taxes
- Elasticity: Price elasticity of demand; elasticity of demand and total revenue; cross price elasticity, income elasticity, price elasticity of supply; elasticity and tax incidence
- Efficiency of Markets and the Role of Government: consumer surplus, producer surplus, market efficiency; market failures, externalities, public goods; public policies, taxes and subsidies

II. Microeconomics II: Production and Cost, Product Markets and Behavior of Firms, Factor Markets and the Distribution of Income

- Production and Cost: short-run production function; total product and marginal product; the law of diminishing marginal returns; average variable, average total, and marginal costs; long-run costs, economies of scale; and diseconomies of scale; cost and profit, profit-maximization rule, forms of business organizations
- Product Markets and Behavior of Firms: perfect competition, monopoly, oligopoly and monopolistic competition; public policies toward imperfect competition, antitrust policy and regulation of businesses
- Factor Markets and Income Distributions: pricing the factors of production (wage, interest, rent, profits), labor market, labor demand and labor supply, and wage determination; income distribution and poverty

III. Macroeconomics I: Measures of Economic Performance, National Income Accounting, Unemployment, Inflation, and Business Cycle

- National Income Accounting: gross domestic product (GDP), nominal GDP and real GDP, alternative measures of income such as gross national product (GNP) and disposable personal income
- Unemployment: measures of unemployment, the unemployment rate, the labor force; types of unemployment; full employment and the concept of the natural rate of unemployment
- Inflation: measures of inflation, the consumer price index (CPI); types, causes, and impact of inflation; problems associated with the CPI measure; comparing dollar values across time; nominal interest rate and real interest rate

IV. Macroeconomics II: National Income Determination, Fiscal Policy, Money and Banking, Monetary Policy, International Finance and Investment, and Economic Growth.

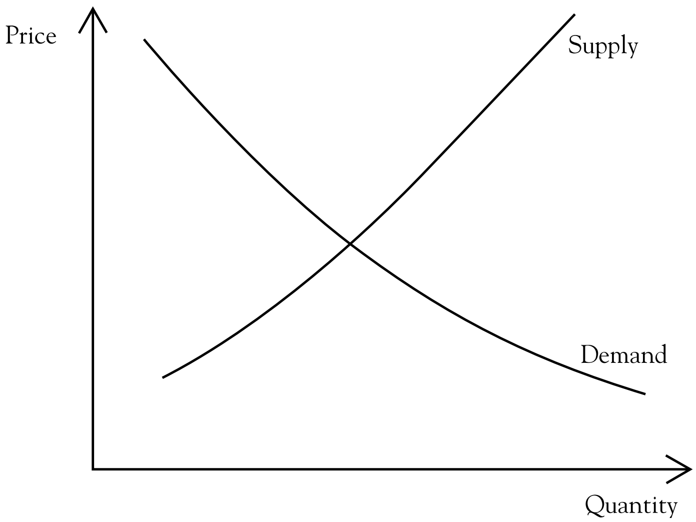
- National Income Determination: business cycle and economic fluctuations, recession and expansion; aggregate demand, aggregate supply, equilibrium output and price level, short-run vs. long-run equilibria
- Fiscal Policy: policy instruments; taxes and government spending; types of policy: expansionary and contractionary; budget deficits, budget surpluses, and the national debt; automatic stabilizers, pros and cons of fiscal policy
- Money and Banking: kinds and functions of money, measures of the money supply, history of banking, fractional reserve banking, money creation process by banks; the Federal Reserve System, structure, function ownership and control
- Monetary Policy: monetary policy instruments, the discount rate, reserve ratios, and open-market operations; types of policy and impacts on employment, price level and economic growth; pros and cons of monetary policy
- International Finance and Investment: balance of payments accounts, foreign exchange markets and exchange rate determination; currency appreciation or depreciation and capital flows; foreign direct investment and portfolio investment
- Long-run Economic Growth: saving and investment; technological change

Sample Test Questions

The sample questions that follow illustrate the types of questions in the test. They are not, however, representative of the entire scope of the test in either content or difficulty. Answers with explanations follow the questions.

Directions: Each of the questions or statements below is followed by four suggested answers or completions. Select the one that is best in each case.

Questions 1 and 2 are based on the diagram below that shows the demand and supply curves for leather garments.



1. An increase in the price of leather and a simultaneous increase in consumers' incomes will most likely have which of the following effects on the equilibrium price and quantity of leather garments?

	Price	Quantity
(A)	Increase	Increase
(B)	Increase	Indeterminate
(C)	Indeterminate	Decrease
(D)	Decrease	Decrease

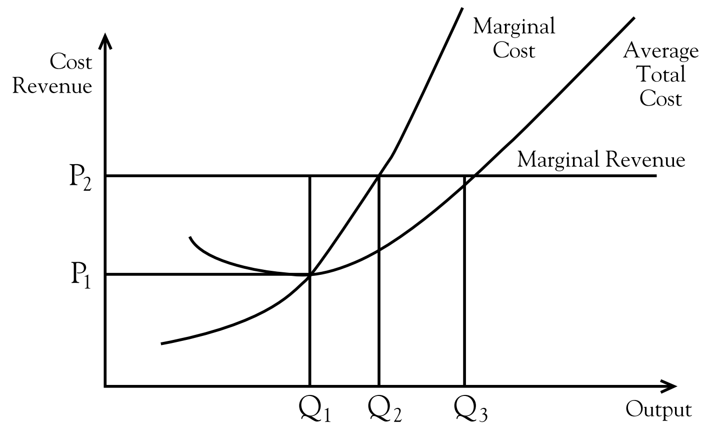
2. If the government places a price ceiling on leather garments that is below the equilibrium price, which of the following will occur in the market for leather garments?

   (A) There will be a shortage.

   (B) There will be a surplus.

   (C) The demand curve for leather garments will shift leftward.

   (D) The supply curve for leather garments will shift rightward.



3. The profit-maximizing price and quantity for the firm whose cost and revenue curves are shown above will be which of the following?

	Price	Quantity
(A)	P1	Q2
(B)	P2	Q1
(C)	P2	Q2
(D)	P2	Q3

4. The average propensity to consume is the ratio of

   (A) total consumption to total disposable income

   (B) a change in consumption to the change in income

   (C) a change in equilibrium income to the change in investment spending

   (D) equilibrium income to total consumption

5. In a socialist economic system, resource allocation is managed primarily by

   (A) large corporations

   (B) workers' committees

   (C) markets

   (D) central planning

6. When the opportunity cost ratios for two countries differ, a basis for mutually beneficial international trade exists. This situation describes the principle of

   (A) comparative advantage

   (B) absolute advantage

   (C) economic growth

   (D) equilibrium

7. Which of the following types of inflation would result if the price level rose because of an increase in the price of raw materials?

   (A) Deflation

   (B) Hyperinflation

   (C) Demand-pull inflation

   (D) Cost-push inflation

8. Gross domestic product minus depreciation equals which of the following?

   (A) Disposable income

   (B) Personal income

   (C) Net domestic product

   (D) Consumption

9. The Federal Reserve's primary policy tools include all of the following EXCEPT

   (A) operating in the open market

   (B) borrowing from foreign governments

   (C) changing the discount rate

   (D) setting reserve requirements

10. Which of the following expresses a relationship proposed by Keynesian consumption theory?

    (A) If disposable income increases, saving will increase.

    (B) If interest rates rise, saving will increase.

    (C) If government expenditures increase, national income will decline.

    (D) If personal consumption increases, disposable income will decline.

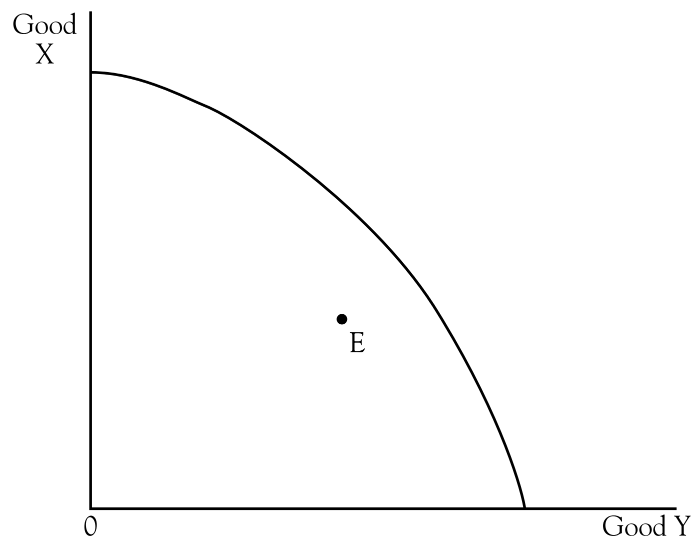
11. During a recession, an appropriate fiscal policy would be

    (A) an increase in taxes

    (B) an increase in government spending

    (C) a decrease in the reserve requirement

    (D) a decrease in the discount rate



12. The diagram above shows the production possibilities frontier for an economy. If the economy is producing at point E, which of the following must be true?

    I. The economy is not fully employing all its resources.

    II. The economy can increase the production of good x only if it decreases the production of good y.

    III. The economy can move to the frontier without changing current techniques of production.

    (A) I only

    (B) II only

    (C) I and III only

    (D) II and III only

13. If consumers in the United States favor imports over domestically produced goods, the international value of the United States dollar and United States exports will most likely change in which of the following ways?

	International Value of the Dollar	Exports
(A)	Appreciate	Increase
(B)	Appreciate	Decrease
(C)	Depreciate	Increase
(D)	Depreciate	Decrease

14. Carmen consumes only two goods: X and Y. She spends her entire weekly income on goods X and Y. At her current consumption level of the two goods, the marginal utility of the last dollar she spent on good X is 5 and the marginal utility of the last dollar she spent on good Y is 10. To maximize her utility, Carmen should

(A) maintain her current consumption level of the two goods
(B) buy fewer units of X and more units of Y
(C) buy fewer units of Y and more units of X
(D) buy fewer units of both X and Y

Questions 15-16 are based on the following information.

Assume that the required reserve ratio is 20 percent and that a bank is currently fully loaned up, but it receives a cash deposit of $500 from a new customer.

15. The bank is legally required to

(A) keep 20 percent of the $500 as reserves
(B) keep 80 percent of the $500 as reserves
(C) lend 20 percent of the $500 and keep the rest as reserves
(D) send 80 percent of the $500 to the Federal Reserve Bank

16. The maximum increase in the money supply that can be generated from this deposit is

(A) $400
(B) $500
(C) $2,000
(D) $2,500

Answers

1. B is the correct answer, because an increase in the price of leather decreases the supply of leather garments and an increase in incomes will increase the demand for leather garments, assuming leather garments are normal goods. These simultaneous shifts in the curves will result in an increase in price, but the effect on quantity is indeterminate and will depend on the extent of the shift of each curve.

2. The result of an effective price ceiling below the equilibrium price will be an excess of quantity demanded over quantity supplied, which will result in a shortage. Thus, A is the correct answer.

3. The diagram shows demand and cost curves for a firm in perfect competition. Such a firm maximizes profit when it produces that quantity at which marginal revenue equals marginal costs; since it is a price-taker, the price will always be equal to marginal revenue, which is P2 corresponding to Quantity Q2. The correct answer is C.

4. The correct answer is A. Average propensity to consume is the percentage of disposable income that is spent on consumption. Thus, it is the ratio of total consumption to total disposable income. The concept of the propensity to consume deals with the relationship between disposable income and expenditures on consumption.

5. The correct answer is D. Socialist systems utilize a central planning process to determine the most efficient use of resources and then manage the resources accordingly.

6. The correct answer is A. Each country would have an advantage in the specialization of its resources in a specific good (comparative advantage). Each country would then gain by trading with the other country.

7. The correct answer is D. Cost-push inflation comes about because the increased costs of production are passed on to the consumer. The prices of raw materials are a cost, and as they rise, the increased prices are pushed on to the consumer.

8. The correct answer is C. Net domestic product is the remainder after depreciation.

9. The correct answer is B. The three other choices are the primary policy tools that the Federal Reserve utilizes to conduct monetary policy.

10. A is the correct answer because Keynesians hold that consumption and savings depend on disposable income. Thus, as disposable income rises, both savings and consumption rise.

11. The best answer is B, since choices C and D are monetary policy measures and, although choice A is a fiscal policy measure, it will only aggravate the recession.

12. If the economy is producing at point E, it is by definition not fully employing all its resources and can move toward the frontier without changing current techniques of production. Thus, C is the correct answer.

13. The correct answer is C. Favoring imports over domestically produced goods results in an increase in the amount of imports to the United States. This increase in imports increases the supply of United States dollars on the foreign exchange markets, resulting in a depreciation of the dollar. The depreciating dollar will make goods produced in the United States relatively less expensive in the world market, causing United States exports to increase.

14. The correct answer is B. To maximize utility, Carmen should equalize the marginal utilities per dollar spent on the last unit of each good. Since the marginal utility of the last dollar spent on good X, 5, is less than the marginal utility of the last dollar spent on good Y, 10, Carmen is not maximizing her utility at her current consumption level. To maximize her utility, she should reallocate her income so that she buys fewer units of X and more units of Y. As she buys fewer X and more Y, the marginal utility of good X rises and the marginal utility of good Y falls. The process will continue until the marginal utilities per dollar spent on each good are equal.

15. The correct answer is A. The required reserve ratio refers to the fraction of deposits a bank is legally required to keep as reserves to meet its liabilities.

16. The correct answer is C. Assuming there are no cash leakages and the bank does not keep more than the minimum required in reserves, the maximum increase in the money supply that can be obtained from the $500 deposit is $2,000—that is, the money multiplier times the amount of excess reserves. From the $500 deposit, the bank will have excess reserves equal to $400, which is $500 minus 0.2($500). Thus, the maximum increase in the money supply will be equal to $2,000, which is 5 times $400.

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