

TEST OF ECONOMIC THINKING *Student Version*

Introduction

The Test of Economic Thinking is intended to measure how students are able to apply a problem solving approach called the “economic way of thinking.” This is a system of logical thinking that is based on key assumptions based on traditional economic problem analysis. The economic way of thinking involves the application of one or more well established principles which include but are not limited to the following: choices and scarcity, costs, incentives, economic systems, voluntary trade, and primary and secondary effects.

Directions

What follows are 13 situations for your consideration. Please read each situation and then circle the letter of the answer that best reflects the principles of economic thinking. Then, please indicate the top two economic principles that you think are the most appropriate to apply to the situation.

A. Scarcity and Choices

Situation 1

Fred and Wilma are a young married couple who are financially well off. Fred runs a finance company and Wilma is a physician. They are discussing how to celebrate their wedding anniversary. Fred wants to spend a week on a Caribbean cruise. Wilma wishes to spend a week in Orlando, Florida visiting the theme parks and shopping. From an economic perspective, what is the problem Fred and Wilma are facing?

- A. Time is an unlimited resource and no choice is necessary
- B. Time is a limited resource and thus they have to make a choice.
- C. Financial success encourages excessive spending and indulgence.
- D. Financial success means people can have all that they want with no sacrifice.

From the following list of economic principles, please choose two which you think are the most important reasons for your answer to Situation 1. Write the letters in the spaces below.

_____ Most Important

_____ Next most important

- A. People make choices because they face scarcity.
- B. People's choices involve costs.
- C. People respond to incentives in predictable ways.
- D. People create economic systems that influence individual decision.
- E. People gain when they trade voluntarily.
- F. People's choices sometimes create unintended consequences.

Situation 2

Once or twice a week, Robyn arrives at work a few minutes late. Most often she is late because traffic is heavier than expected. Noticing the pattern of tardiness, Robyn's employer explained that a condition of Robyn's continued employment means arriving to work on time. Using economic thinking, what is the source of Robyn's tardiness?

- A. Robyn's elected officials are at fault because they fail to fund adequate roads that can handle peak hour traffic.
- B. Robyn's employer is at fault because she should offer flexible start times to take account of changing traffic conditions.
- C. Robyn is at fault because to her the benefits of being late to work outweigh the costs.
- D. Robyn's parents and teachers are at fault because they failed to teach Robyn the importance of being punctual.

From the following list of economic principles, please choose two which you think are the most important reasons for your answer to Situation 2. Write the letters in the spaces below.

_____ Most Important

_____ Next most important

- A. People make choices because they face scarcity.
- B. People's choices involve costs.
- C. People respond to incentives in predictable ways.
- D. People create economic systems that influence individual decision.
- E. People gain when they trade voluntarily.
- F. People's choices sometimes create unintended consequences.

B. Costs

Situation 3

Luke decides to play his favorite video game instead of studying for tomorrow's math exam. Which of the following best describes the cost of his decision?

- A. Luke's cost for playing his favorite video game were the benefits he would have gained on the math exam if he had used the time to study for the exam.
- B. Luke's decision did not involve money and thus no meaningful cost was involved.
- C. Luke's decision reflected his individual preferences so no real cost was incurred.
- D. Luke's cost for playing his favorite video game was the time he could have spent being with friends after school.

From the following list of economic principles, please choose two which you think are the most important reasons for your answer to Situation 3. Write the letters in the spaces below.

_____ Most Important

_____ Next most important

- A. People make choices because they face scarcity.
- B. People's choices involve costs.
- C. People respond to incentives in predictable ways.
- D. People create economic systems that influence individual decision.
- E. People gain when they trade voluntarily.
- F. People's choices sometimes create unintended consequences

Situation 4

Ricky and Lucy want to enroll their 5-year-old daughter Angela in the local public schools. They are pleased that the local school board and the state provide a free education for children like Angela. From an economic perspective, are they correct in thinking that public school education is free?

- A. Yes. Ricky and Lucy do not have to pay tuition for Angela's schooling.
- B. No. The benefits of public schools outweigh the costs.
- C. Yes. Tax payers support public education at no direct cost to parents.
- D. No. Resources used to pay teachers and buy books are not free.

From the following list of economic principles, please choose two which you think are the most important reasons for your answer to Situation 4. Write the letters in the spaces below.

_____ Most Important

_____ Next most important

- A. People make choices because they face scarcity.
- B. People's choices involve costs.
- C. People respond to incentives in predictable ways.
- D. People create economic systems that influence individual decision.
- E. People gain when they trade voluntarily.
- F. People's choices sometimes create unintended consequences.

Situation 5

Elaine lives in an apartment building where all the units are occupied. A new person approaches George, the owner of the building, and offers to pay twice as much rent for an apartment. George is not certain what to do. Finally, he approaches Elaine with the following deal: George will turn down the new applicant's offer but Elaine must pay a higher rent because George's costs have increased. Elaine disagrees and points out that George's costs have not increased – the taxes, utilities, and maintenance – everything has stayed the same. Using the economic way of thinking, decide whether Elaine or George is correct in his/her analysis?

- A. George is correct because the offer from the new applicant changed his implicit costs.
- B. George is correct because charging Elaine a higher rent recognizes what George would give up if he does not accept the new applicant's offer.
- C. Elaine is correct because George's monetary costs have not changed.
- C. Elaine is correct because George should only raise rents when incomes of renters like Elaine are keeping pace with inflation.

From the following list of economic principles, please choose two which you think are the most important reasons for your answer to Situation 5. Write the letters in the spaces below.

_____ Most Important

_____ Next most important

- A. People make choices because they face scarcity.
- B. People's choices involve costs.
- C. People respond to incentives in predictable ways.
- D. People create economic systems that influence individual decision.
- E. People gain when they trade voluntarily.
- F. People's choices sometimes create unintended consequences.

C. Incentives

Situation 6

Martin and Max started a business that produces popular new apps for smartphones. After all of the business bills were paid, Martin and Max split evenly the income that was left – the profit. From an economic perspective, what is the role of profits for Max and Martin?

- A. Martin and Max are earning a profit which should now be passed along to employees and consumers.
- B. Martin and Max are learning that earning a profit is almost certain in the app business.
- C. Martin and Max are earning a profit that should now be taxed as a normal cost of doing business.
- D. Martin and Max are responding to profit as the reward for providing consumers what they want.

From the following list of economic principles, please choose two which you think are the most important reasons for your answer to Situation 6. Write the letters in the spaces below.

_____ Most Important

_____ Next most important

- A. People make choices because they face scarcity.
- B. People's choices involve costs.
- C. People respond to incentives in predictable ways.
- D. People create economic systems that influence individual decision.
- E. People gain when they trade voluntarily.
- F. People's choices sometimes create unintended consequences.

Situation 7

In 1970, proven oil reserves were 531 billion barrels. Today, there are over 1 trillion barrels of proven oil reserves despite that fact that the world oil consumption has increased several times over. From an economic perspective, how is the increase in oil reserves best explained?

- A. Government investments in research have resulted in new discoveries for producing oil.
- B. Oil companies can earn increased profits if they are able to discover new sources of oil.
- C. Government regulations require maximum levels of oil production while protecting worker safety.
- D. Oil companies with low profits are well positioned to increase levels of production.

From the following list of economic principles, please choose two which you think are the most important reasons for your answer to Situation 7. Write the letters in the spaces below.

_____ Most Important

_____ Next most important

- A. People make choices because they face scarcity.
- B. People's choices involve costs.
- C. People respond to incentives in predictable ways.
- D. People create economic systems that influence individual decision.
- E. People gain when they trade voluntarily.
- F. People's choices sometimes create unintended consequences.

D. Economic Systems/Rules of the Game

Situation 8

Lois, a member of the City Council of Big Falls, wants to help low-income families to find less expensive housing. She has proposed that the City of Big Falls approve rent controls on landlords who rent apartments. That is, by law, the price of rent for an apartment will be set at new low rates. What do you predict will be the outcome of this policy if the City Council approves?

- A. More low-income families will have access to affordable apartments.
- B. Fewer low-income families will have access to affordable apartments.
- C. Access to apartments for low-income families will remain unchanged.
- D. Landlords will take steps to improve their apartments to attract new tenants.

From the following list of economic principles, please choose two which you think are the most important reasons for your answer to Situation 8. Write the letters in the spaces below.

_____ Most Important

_____ Next most important

- A. People make choices because they face scarcity.
- B. People's choices involve costs.
- C. People respond to incentives in predictable ways.
- D. People create economic systems that influence individual decision.
- E. People gain when they trade voluntarily.
- F. People's choices sometimes create unintended consequences.

Situation 9

Amsterdam is a European city famous for its very narrow, tall, long buildings with narrow, steep stairways built from 1500 to 1600. What is the most likely economic explanation of this unusual architecture?

- A. Narrow and tall homes were found to have less risk of flooding from Amsterdam's many canals. This reduced the cost of home insurance.
- B. Amsterdam's property taxes were assessed according to the width of the front of homes. Wider homes were subject to higher taxes.
- C. Narrow and tall homes were the result of limited skills of architects during this time period. This caused home builders to select a simple and low-cost design.
- D. Amsterdam's property taxes were assessed according to the height of homes. Taller homes were subject to higher taxes.

From the following list of economic principles, please choose two which you think are the most important reasons for your answer to Situation 9. Write the letters in the spaces below.

_____ Most Important

_____ Next most important

- A. People make choices because they face scarcity.
- B. People's choices involve costs.
- C. People respond to incentives in predictable ways.
- D. People create economic systems that influence individual decision.
- E. People gain when they trade voluntarily.
- F. People's choices sometimes create unintended consequences.

E. Voluntary Trade

Situation 10

Goods and services in the United States today can be easily sold across state lines. What would be the likely outcome of granting each of the 50 states the right to tax all incoming goods and services from other states?

A. State tax revenues would increase, reducing state governments' budget problems while increasing each state's prosperity.

B. All states would tax each other's incoming goods and services but there would be no other economic effects.

C. The United States would become less prosperous because of reduced specialization and trade among the 50 states.

D. U.S. trade with foreign countries would be reduced because people would have the opportunity to support their own state governments by buying U.S.-made goods from other states.

From the following list of economic principles, please choose two which you think are the most important reasons for your answer to Situation 10. Write the letters in the spaces below.

_____ Most Important

_____ Next most important

A. People make choices because they face scarcity.

B. People's choices involve costs.

C. People respond to incentives in predictable ways.

D. People create economic systems that influence individual decision.

E. People gain when they trade voluntarily.

F. People's choices sometimes create unintended consequences.

Situation 11

In 2011, the U.S. approved a free trade agreement with South Korea that would eliminate most trade barriers between the two countries. Which country, if either, stands to benefit from this agreement?

A. South Korea will benefit but not the United States.

B. The United States will benefit but not South Korea.

C. Both South Korea and the United States will benefit.

D. Neither South Korea nor the United States will benefit.

From the following list of economic principles, please choose two which you think are the most important reasons for your answer to Situation 11. Write the letters in the spaces below.

_____ Most Important

_____ Next most important

A. People make choices because they face scarcity.

B. People's choices involve costs.

C. People respond to incentives in predictable ways.

D. People create economic systems that influence individual decision.

E. People gain when they trade voluntarily.

F. People's choices sometimes create unintended consequences.

F. Primary and Secondary Effects

Situation 12

In 1990, members of the U.S. Congress approved a 10 percent excise tax on yachts sold in the U.S. at a price of higher than \$100,000. The goal of the tax was to increase government revenues in a time when the federal government faced high deficits. What result do you think was unexpected by members of Congress?

- A. Yacht sales increased as wealthy buyers stepped up spending to help the government reduce the deficit.*
- B. Yacht sales decreased and thousands of skilled workers lost their jobs.*
- C. Tax revenues from yacht sales increased at a level that was higher than expected and helped to reduce the deficit.*
- D. Yacht sales remained unchanged because manufacturers passed the increased cost along to yacht buyers.*

From the following list of economic principles, please choose two which you think are the most important reasons for your answer to Situation 12. Write the letters in the spaces below.

_____ *Most Important*

_____ *Next most important*

- A. People make choices because they face scarcity.*
- B. People's choices involve costs.*
- C. People respond to incentives in predictable ways.*
- D. People create economic systems that influence individual decision.*
- E. People gain when they trade voluntarily.*
- F. People's choices sometimes create unintended consequences.*

Situation 13

Beginning in the 1990s, government regulators eased the rules for low and moderate income families to obtain home loans. They did not have to make down payments nor did they have to prove they could make the monthly mortgage payments. One goal of the regulators was to increase levels of homeownership. What result do you think was unexpected by the regulators?

- A. Home owners often could not afford the payments and lost their homes.*
- B. Home ownership decreased among low and moderate income families.*
- C. Home sales increased while home buying decreased.*
- D. Home shortages became widespread as home builders were unable to meet the new demand.*

From the following list of economic principles, please choose two which you think are the most important reasons for your answer to Situation 13. Write the letters in the spaces below.

_____ *Most Important*

_____ *Next most important*

- A. People make choices because they face scarcity.*
- B. People's choices involve costs.*
- C. People respond to incentives in predictable ways.*
- D. People create economic systems that influence individual decision.*
- E. People gain when they trade voluntarily.*
- F. People's choices sometimes create unintended consequences.*