Macroeconomics, Fall 2009, Exam 2, several versions

Read these Instructions carefully! You must follow them exactly!

I) Answer on your Scantron card, using a #2 pencil.

Warning: SOME QUESTIONS MUST BE ANSWERED SEVERAL TIMES! Such questions will begin with a phrase such as this:

(**Repeat answer on Scantron lines 37, 38 and 39)**

---Remember to do it!

II) On your Scantron card you must print three things:

1) Print your full name clearly;

2) Print the day and time of your section (for example TTh 7 AM);

3) Near your name, print your test number from the upper right corner of this test.

(This number tells me which version of the test you have. Without it your test cannot be graded properly and you get no credit for your answers.)

III) You must turn in this printed exam along with your Scantron card, otherwise your score on this exam is "F".

Questions:

____ 1. **(Repeat your answer on Scantron lines 27 and 28.)** Which of the following occurs during a recession?

a. Output falls, employment rises, and unemployment rises.
b. Output rises, employment falls, and unemployment falls.
c. Output falls, employment falls, and unemployment rises.
d. Output rises, employment rises, and unemployment falls.
e. Output falls, employment falls, and unemployment falls.

____ 2. **(Repeat your answer on Scantron line 29.)** Using the table below, calculate GDP for a particular year.

Consumption spending	$1,000
Wages and salaries	$ 800
Rent	$ 100
Government purchases	$ 200
Profit	$ 300
Exports	$ 400
Interest	$ 250
Private investment spending	$ 400
Imports	$ 550

Based on the above information, GDP in this year was

a. $1,450
b. $2,000
c. $2,550
d. $2,900
e. $4,000

____ 3. What is the difference between nominal and real GDP?

a. Nominal GDP is adjusted for changes in the price level; real GDP is not.
b. Real GDP is adjusted for taxes and transfer payments; nominal GDP is not.
c. Real GDP is adjusted for changes in the price level; nominal GDP is not.
d. Nominal GDP is adjusted for depreciation; real GDP is not.

e. Real GDP is adjusted for depreciation; nominal GDP is not.

____ 4. **(Repeat your answer on Scantron lines 30 and 31.)** Suppose an economy has 90,000 employed persons and 10,000 unemployed persons, the unemployment rate is
   a. 11.1%
   b. 10%
   c. 5%
   d. 20%
   e. 90%

____ 5. In the Full Employment and Balanced Growth Act of 1978, Congress set a target for the unemployment rate, namely:
   a. 5%, which is seldom achieved.
   b. 4%, which is seldom achieved.
   c. 2%, which is seldom achieved.
   d. 2% which is often achieved.
   e. 5%, which is often achieved.

____ 6. **(Repeat your answer on Scantron line 32.)** If the price of your house rises 7% while your cost of living (the price of your "base year basket") rises 10%, then the real value of your house has
   a. fallen about 3%.
   b. fallen considerably more than 3%.
   c. risen by about 7%.
   d. risen by about 3%.
   e. risen by about 17%.

____ 7. **(Repeat your answer on Scantron line 33.)** If the economy is in full employment equilibrium, and the money supply is increased 12%, then we expect:
   a. the economy to grow.
   b. prices to rise by more than 12%
   c. prices to rise 12%
   d. prices to rise by less than 12%
   e. nothing will happen

____ 8. **(Repeat your answer on Scantron line 34.)** Choose the best answer. Based on what your professor has said in lecture, if the economy is in a full employment equilibrium and the money supply increases by a small amount, like 3%,
   a. prices will rise about 3% within a year.
   b. economic activity will increase by 3% within a year.
   c. prices will rise by 3% within less than two years.
   d. prices may take a very long time to rise, and will not rise more than about 3%
   e. the smaller the inflation rate, the more immediate the response, so prices will rise quickly.

Recall:
FR = IR * (FN/IN)*(PI/PF)

____ 9. **(Repeat your answer on Scantron line 35.)** Suppose nominal GDP was $4,200 billion two years ago and is $2,100 now. And also the GDP price index has fallen from 120 two years ago to 40 today. If real GDP was $4,200 two years ago, what is it today?
   a. higher than $6,300
   b. $6,300
   c. less than $4,200 and more than $2,100
   d. $4.200
   e. $2,100 or less

____ 10. **(Repeat your answer on Scantron line 36.)** Choose the best answer. Based on the circular flow model as presented in lecture, if the economy is in an unemployment equilibrium with 8% extra unemployment, and then the money supply is increased by 10%, then
   a. the economy will grow by 6% and prices by 2%.
   b. the economy will grow by 8% but prices may not increase very much because the excess money growth is quite small--only 2%.
   c. the economy will grow by 8% and prices will rise by 2% within a year or two.
   d. the economy will not grow but prices wil increase by 10%.
   e. none of the other answers is correct.

____ 11. **(Repeat your answer on Scantron line 37.)** In the language of economists, "full employment" means
   a. the situation in which seasonal plus frictional plus structural unemployment equal zero.
   b. none of the other answers is correct.
   c. the situation in which cyclical unemployement is zero.
   d. everyone has a job who wants a jog.
   e. an unemployment rate of zero percent unemployed.

____ 12. When explaining expansions and recessions, the classical model is
   a. reliable
   b. seriously flawed
   c. the favorite explanatory tool of economists
   d. overly focused on the labor market
   e. sometimes accurate and sometimes not

____ 13. Which of the following is a common reaction to an increase in the interest rate?
   a. a decline in oil prices
   b. a war
   c. a decrease in spending on new homes
   d. an expansion
   e. an increase in military spending

____ 14. **(Repeat your answer on Scantron line 38.)** The recession of 1982 was largely caused
   a. on purpose by the Federal Reserve's decision to raise interest rates to combat inflation.
   b. on purpose by the Federal Reserve's decision to cut interest rates to combat inflation.
   c. by accident, by Reagan era tax cuts.
   d. by dramatically rising oil prices.

____ 15. **(Repeat your answer on Scantron line 39.)** Based on the circular flow model as presented in recent lectures, and beginning in a unemployment equilibrium with 4% cyclical unemployment, if the money supply is increased by 10%:
   a. no other answer is correct.
   b. it may take a year or two, but employment will increase by about 4% and prices will increase by about 6%.
   c. the classical model applies in this situation, so employment is not likely to be affected.
   d. it may take a year or two, but prices will increase by 10%.
   e. both C and D are correct.

____ 16. **(Repeat your answer on Scantron lines 40 and 41.)** Based on the circular flow model as presented in recent lectures, and starting from an "unemployment equilibrium", decide whether each of the following statements is True or False, then choose the best answer from among a. through e. below.
   1) If the government cuts taxes, this will cause the economy to grow.
   2) If the government increases government spending, this will cause the economy to grow.

3) If the government increases the money supply, this will stimulate the economy to grow.

a. All three of the statements 1), 2) and 3) are true.
b. Statements 1) and 2) are true but 3) is false.
c. Statements 1) and 2) are false but 3) is true.
d. All three of the statements 1), 2) and 3) are false
e. Statements 2) and 3) are true, but tax cuts cannot stimulate the economy so 1) is false.

Keynesian Model:

$$Y = \left(\frac{1}{1-c(1-t)+w}\right)(a + I_g + G - cT_p + X)$$

____ 17. **(Repeat your answer on Scantron line 42.)** Here is a Keynesian model question: Assume governement tax revenues come entirely from taxes similar to "property taxes" (not at all from revenue sources which vary with income); also assume the **MPC = .9**; also assume the **"marginal propensity to import" = .1**. If local governments **cut property taxes by $10 billion dollars**, and no other variables change, then:

a. economic activity will decrease by $9 billion
b. economic activity will increase by $9 billion
c. economic activity will be unchanged, or will change, but not by an amount listed in the other answers.
d. economic activity will decrease by $45 billion
e. economic activity will increase by $45 billion

____ 18. **(Repeat your answer on Scantron lines 43 and 44.)** Using the Keynesian model as developed in recent lectures, if "the multiplier" = 2, gross investment, I_g, increases by $15 billion, exports, X, increase by $5 billion, and government spending, G, drops by $10 billion, then economic activity, Y, will

a. remain unchanged.
b. decrease by $20 billion.
c. decrease by $10 billion.
d. increase by $20 billion.
e. no other answer is correct.

____ 19. **(Repeat your answer on Scantron line 45.)** (You may refer to the equation above.) In the Keynesian multiplier model, if the marginal propensity to consume falls, the economy will

a. expand
b. contract
c. not change
d. may either expand or contract

____ 20. **(Repeat your answer on Scantron line 46.)** Which of the following statements about measuring prices are true?

1) If my "base year basket" costs $30,000 to purchase this year, and three years from now it costs $33,000 to purchase the same base year basket, then the price index based on this basket will tell you that prices have risen by 10%.

2) If the cost of my base year basket has risen by 10%, then the cost of your base year basket has also risen by 10%.

3) A new base year basket must be calculated every few years, otherwise inflation starts looking lower than it really is.
4) If a good rises in price and also in quality, calculated inflation will be lower than actual inflation.

a. All the above statements are correct.
b. Only statements 1 and 2 are correct.
c. None of these statements are correct.
d. Only statement 1 is correct.
e. Only statements 1 and 3 are correct.

____ 21. In the opinion of your instructor, recessions and depressions are caused by "economic shocks" which take the form of unexpected changes in supply and/or demand for goods (leading people to delay purchases of discretionary goods) or are caused by declines in the rate of growth of the money supply. Choose the most complete answer:

a. The part about economic shocks is, but the part about declines in the rate of growth of the money supply is not, a good summary of what your instructor believes.
b. The above statement is incomplete because your instructor also believes that fiscal policy shocks such as tax increases or cuts in government spending also have caused several recessions or depressions.
c. The complete statement is a good summary of what your instructor believes.
d. Neither part of the statement is a good summary of what your instructor believes.

____ 22. **(Repeat your answer on Scantron line 47.)** Choose the most complete answer. The equation $i_N = r + e_i$ (which tells us about the relationship between nominal and real interest rates) tells us:

a. If the expected rate of inflation goes down and nominal interest rates are unchanged then real interest rates must have gone up.
b. If the expected rate of inflation goes down and real interest rates are unchanged then nominal interest rates must have gone up.
c. If the expected rate of inflation goes down and real interest rates are unchanged then nominal interest rates must have gone down.
d. Both A and B are true.
e. Both A and C are true.

____ 23. **(Repeat your answer on Scantron lines 48 and 49.)** If "the multiplier" is 2, and "autonomous expenditures" decline by $100 billion, and assumptions of the Keynesian multiplier model are valid, then economic activity (GDP) will:

a. increase by $50 billion.
b. increase by $200 billion.
c. decrease by $50 billion.
d. decrease by $200 billion.
e. no other answer is correct.

____ 24. If firms increase their investment spending, the resulting change in equilibrium GDP is equal to the change in investment spending

a. multiplied by 2.5
b. alone
c. multiplied by the Keynesian multiplier
d. divided by the marginal propensity to consume
e. plus the change in consumption spending

____ 25. Automatic stabilizers reduce fluctuations in GDP by

a. eliminating spending shocks

b. increasing the amount of spending each year
c. reducing the additional spending that occurs in each round of the multiplier
d. increasing saving
e. reducing the need for government involvement in the economy

____ 26. **(Repeat your answer on Scantron line 50.)** Which of the following is considered the major cause of the recession of 2001?
a. decrease in consumption spending
b. decrease in investment spending
c. decrease in government spending
d. none of the above

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Answer Section

MULTIPLE CHOICE

1. ANS: C PTS: 1 NAT: financial theories, analysis, reporting, and markets
   LOC: Understanding and applying economic models
2. ANS: A PTS: 1 NAT: financial theories, analysis, reporting, and markets
   LOC: Unemployment and inflation
3. ANS: C PTS: 1 NAT: financial theories, analysis, reporting, and markets
   LOC: Unemployment and inflation
4. ANS: B PTS: 1 NAT: financial theories, analysis, reporting, and markets
   LOC: Unemployment and inflation
5. ANS: B PTS: 1
6. ANS: A PTS: 1
7. ANS: C PTS: 1
8. ANS: D PTS: 1
9. ANS: B PTS: 1
10. ANS: B PTS: 1
11. ANS: C PTS: 1
12. ANS: B PTS: 1 NAT: financial theories, analysis, reporting, and markets
    LOC: Understanding and applying economic models
13. ANS: C PTS: 1 NAT: financial theories, analysis, reporting, and markets
    LOC: Understanding and applying economic models
14. ANS: A PTS: 1 NAT: financial theories, analysis, reporting, and markets
    LOC: Understanding and applying economic models
15. ANS: B PTS: 1
16. ANS: C PTS: 1
17. ANS: E PTS: 1
18. ANS: D PTS: 1
19. ANS: B
    Refer To: Keynesian Multiplier Equation

    PTS: 1
20. ANS: D PTS: 1
21. ANS: B PTS: 1
22. ANS: E PTS: 1
23. ANS: D PTS: 1
24. ANS: C PTS: 1 NAT: financial theories, analysis, reporting, and markets
    LOC: Aggregate demand and aggregate supply
25. ANS: C PTS: 1 NAT: financial theories, analysis, reporting, and markets
    LOC: Aggregate demand and aggregate supply
26. ANS: B PTS: 1 NAT: financial theories, analysis, reporting, and markets
    LOC: Understanding and applying economic models