

Macroeconomics Example Final Exam, Spring 2002

Multiple Choice

Identify the letter of the choice that best completes the statement or answers the question.

1. Gross Domestic Product
 - a. is the money value of all final goods and services produced in a country during a year's period of time.
 - b. is the money value of the stock of all goods present in a country at a given period of time.
 - c. is the money value of all transactions that occur in a country during a year's period of time.
 - d. is the money value of all exports from a country during a year's period of time.

2. Which of the following is NOT included in GDP?
 - a. income and output for the year.
 - b. the value of childcare services rendered to their own children by housewives.
 - c. consumer spending on durables.
 - d. different types of investment.

3. Which of the following is an example of Monetary Policy?
 - a. The federal government cuts taxes.
 - b. The U.S. Treasury Department issues bonds to finance debt.
 - c. The Federal Reserve buys bonds in the open market.
 - d. Defense spending is cut to balance the budget.

4. What would be the appropriate Monetary Policy to fight inflation?
 - a. The Federal Reserve could sell bonds.
 - b. The Federal Reserve could decrease the discount rate.
 - c. The Federal Reserve could lower the reserve ratio.
 - d. The Federal Reserve could increase taxes.

5. In 2000, the nominal GDP of the United States was approximately
 - a. \$8.5 billion
 - b. \$10 trillion
 - c. \$4.5 billion
 - d. \$6 million
 - e. \$7.5 trillion

6. REPEAT THIS ANSWER 3 TIMES BY GIVING SAME ANSWER IN QUESTIONS 26, 27 AND 28:

Assume an economy has a natural rate of unemployment of about 5%, which means that unemployment cannot be lower than 5% without creating inflation. Assume the economy is in macroeconomic equilibrium with 10% unemployment. If the Federal Reserve increases the money

supply by 10% then roughly the following will happen:

- a. the economy will grow to full employment and prices will rise by 10%.
- b.
- c. employment will rise by 10% and prices will not rise.
- d. prices will decline and the economy will grow by 10%.
- e. the economy will grow to full employment and prices will rise by 5%.

7. REPEAT THIS ANSWER 2 TIMES BY GIVING SAME ANSWER IN QUESTIONS 29 AND 30:

- a. an increase in non-wage income is likely to reduce hours worked.
- b. almost any person who has at least some non-wage income will stop working if the wage rate drops low enough.
- c. almost any person who has at least some non-wage income will continue working even if the wage rate drops very low.
- d. a. and b. are both true.
- e. a. and c. are both true.

8. In the "circular flow model" of a macroeconomy a "macroeconomic equilibrium" exists

- a. if the population is neither growing nor shrinking.
- b. if savings are large enough that the financial sector can lend money.
- c. if the money supply is stable.
- d. if each major group in the economy (for example households and firms) receive the same amounts each time period and also spend the same amounts each time period.
- e. none of the other answers.

9. REPEAT THIS ANSWER 2 TIMES BY GIVING SAME ANSWER IN QUESTIONS 31 AND 32:

Which of the following statements are true about "the multiplier" and "autonomous spending"?

- a. If the Keynesian model is correct, if the multiplier gets larger GDP will get smaller.
- b. If the Keynesian model is correct, if the multiplier gets larger autonomous spending will get smaller.
- c. Government spending is part of autonomous spending in a simple Keynesian model, but exports are not.
- d. none of the above are true.
- e. all of the above are true.

10. REPEAT THIS ANSWER 2 TIMES BY GIVING SAME ANSWER IN QUESTIONS 33 AND 34: If people used to expect prices to rise at 2% per year, but expected inflation recently has risen to 7% per year,

- a. nominal interest rates will increase by exactly 3 percentage points, but real interest rates will not be affected very much in the long run.

- b. interest rates will decline, since purchasing power now is eroding much faster than before.
- c. there is no way to know whether wealth will be redistributed in haphazard ways, since wealth is only redistributed if actual inflation is different from expected inflation.
- d. nominal interest rates will be affected far less than real interest rates, which will increase.
- e. no other answer is correct.

11. REPEAT THIS ANSWER 2 TIMES BY GIVING SAME ANSWER IN QUESTIONS 35 AND 36: It is difficult to know exactly how much inflation there is in a modern economy because

- a. if the base year market basket becomes out of date, and the prices of the new goods are rising more slowly than the prices of those in the base year basket, calculated inflation will be lower than actual inflation.
- b. no other answer is correct.
- c. because people tend to buy fewer units of goods whose prices are rising, inflation hits them harder and actual inflation is higher than the calculations show.
- d. when the reliability of many goods are rising, and also their prices, calculated inflation tends to be lower than actual inflation.
- e. more than one answer is correct.

12. REPEAT THIS ANSWER 2 TIMES BY GIVING SAME ANSWER IN QUESTIONS 37 AND 38: Using the equation of exchange, $P_y = MV$, as the framework for your analysis, if the Fed sharply increases the money supply the following sequence is likely if the economy is already at full employment:

- a. Economic activity will increase within 18-24 months followed by an increase in prices within 2-3 years.
- b. Real interest rates will fall while the money supply is rising and the actual velocity of money is declining. Then households and firms will attempt to reduce individual quantities of money held, resulting in spending in excess of income. This will lead to increases in wages and prices without much of an increase in real economic activity. As wages and prices rise, the demand for money will increase until eventually the demand for money is equal to the increased supply. As this happens, the real interest rate will go back to its original level and the economy will still be at full employment, with prices now higher.
- c. Real interest rates will rise while the money supply is rising and the actual velocity of money is declining. Then households and firms will attempt to increase individual quantities of money held, resulting in spending in excess of income. This will lead to increases in wages and prices without much of an increase in real economic activity. As wages and prices rise, the demand for money will increase until eventually the demand for money is equal to the increased supply. As this happens, the real interest rate will go back to its original level and the economy will still be at full employment, with prices now higher.
- d. expected inflation will rise, so nominal interest rates will rise also.
- e. none of the other answers.

13. During which year in the period 1960-1999 did the U.S. unemployment rate reach its highest level?

- a. 1965
- b. 1975
- c. 1982
- d. 1988
- e. 1990

14. Which of the following shocks have caused most of the recessions since 1950?

- a. both c and e
- b. all of the following
- c. oil price increases
- d. the beginning of a war
- e. financial crises

15. REPEAT THIS ANSWER 2 TIMES BY GIVING SAME ANSWER IN QUESTIONS 39 AND 40: Considering "unemployment",

- a. none of the other statements are true.
- b. an individual is defined to be "unemployed" if the person is not currently employed and also looked for work during the past four weeks, and if they give up searching because they become discouraged they are no longer counted as unemployed.
- c. cyclical unemployment is the only type which macroeconomics can help to explain.
- d. "full employment" occurs when cyclical unemployment is zero, even if structural and seasonal unemployment are substantial.
- e. all of these statements are true, except a.

16. REPEAT THIS ANSWER 2 TIMES BY GIVING SAME ANSWER IN QUESTIONS 41 AND 42: "The accelerator effect"

- a. all of these other statements are correct.
- b. occurs because just as the economy reaches full capacity and needs to decelerate, there may be a large increase in demand for net investment expenditures.
- c. has very little effect on an economy which is at the lowpoint of a recession, with lots of idle capacity.
- d. makes it kind of silly to assume that investment expenditures are autonomous, as in the simple Keynesian model.
- e. is difficult to manage because a small change in the expected growth rate can have a large effect on the demand for investment goods.

17. Following a shock,

- a. the labor market adjusts instantaneously
- b. the labor market does not adjust as rapidly as the classical model suggests

- c. the wage rate changes rapidly to equate the quantity of labor supplied with the quantity demanded
- d. the labor market often fails to adjust at all
- e. disequilibrium is eliminated in a matter of days

18. REPEAT THIS ANSWER 2 TIMES BY GIVING SAME ANSWER IN QUESTIONS 43 AND 44: Consider the following statements about inflation, expected inflation and interest rates.

- a. Since the average loan has a term of several years (the average of the short term loans, the 5 year auto loans and the 30 year mortgages for example), expected inflation over the next few months, or the next 30 years, are not relevant, but
- b. if expected inflation rises from 3 percent to 6 percent, and the Federal Reserve increases the Federal Funds rate from 2% up to 4%, then the real interest rate has
- c. if the real interest rate is 10% for a 4 year auto loan, and expected inflation for the next four years is 5% per year, then auto loans will have an interest rate of 15%.
- d. the real interest rate plus the nominal interest rate equals the expected rate of inflation.
- e. none of the other answers is correct.

19. The text defines a shock to the economy as a change in

- a. production that only affects a few sectors
- b. production that initially affects the whole economy and then one or more sectors
- c. spending or production that initially affects one or more sectors and then the whole economy
- d. spending that only affects a few sectors
- e. spending that initially affects the whole economy and then one or more sectors

20.

45:

When the Fed conducts open market sales, we should expect to see the money supply

- a. decrease, the interest rate increase, autonomous consumption decrease, business investment decrease, and real GDP decrease
- b. increase, the interest rate decrease, autonomous consumption decrease, business investment decrease, and real GDP decrease
- c. increase, the interest rate decrease, autonomous consumption increase, business investment increase, and real GDP increase
- d. decrease, the interest rate decrease, autonomous consumption increase, business investment increase, and real GDP decrease
- e. decrease, the interest rate increase, autonomous consumption increase, business investment increase, and real GDP increase

21.

- a. the national debt

- b. significantly more than 50 percent of all tax revenue
- c. approximately 50 percent of all tax revenue
- d. the fastest growing sources of revenue for the federal government
- e. a relatively small fraction of the federal government's revenue

22. A progressive tax

- a. is one where people reach a point such that additional work gains them nothing
- b. is one that incorporates the newest and most innovative principles of taxation
- c. taxes those with more income at higher rates
- d. progresses in efficiency as incomes rise
- e. is one that encourages the greater work effort

23.

- a. it may take months for the policy to be enacted
- b. the policy may take effect too quickly
- c. the money supply cannot be changed until several months have passed
- d. tax cuts must be matched with spending changes
- e. it has no effect on consumption spending

24. Open market purchases of bonds by the Federal Reserve eventually

- a. reduce the pressures on bond markets
- b. increase real GDP
- c. lead to open market sales of bonds
- d. increase the interest rate
- e. encourage tax increases

25. Increases in government purchases, investment spending, and autonomous consumption all tend to

- a. increase real GDP and raise the interest rate
- b. increase real GDP and lower the interest rate
- c. increase real GDP but leave the interest rate unchanged
- d. decrease real GDP and lower the interest rate
- e. decrease real GDP and raise the interest rate

Macroeconomics Final Exam, MWF 9:00 am
Answer Section

MULTIPLE CHOICE

1. ANS: A TOP: ACC Assessment Question
2. ANS: B TOP: ACC Assessment Questions
3. ANS: C TOP: ACC Assessment Questions
4. ANS: A TOP: ACC Assessment Question
5. ANS: B DIF: 1 TOP: GDP: A Definition
6. ANS: E
7. ANS: D
8. ANS: D
9. ANS: D
10. ANS: C
11. ANS: B
12. ANS: B
13. ANS: C DIF: 2 TOP: Can the Classical Model Explain Economic Fluctuations?
14. ANS: A DIF: 2 TOP: Shocks That Push the Economy Away from Equilibrium
15. ANS: E
16. ANS: A
17. ANS: B DIF: 2 TOP: The Speed of Adjustment
18. ANS: C
19. ANS: C DIF: 1 TOP: Shocks That Push the Economy Away from Equilibrium

20. ANS: A DIF: 2 TOP: How do Interest Rate Changes Affect the
Economy?
21. ANS: E DIF: 3 TOP: Federal Tax Revenues
22. ANS: C DIF: 2 TOP: Federal Tax Revenues
23. ANS: A DIF: 2 TOP: Countercyclical Fiscal Policy?
24. ANS: B DIF: 2 TOP: How do Interest Rate Changes Affect the
Economy?
25. ANS: A DIF: 2 TOP: Fiscal Policy (and Other Spending Changes)
Revisited