

Name: _____ Days/Times Class Meets: _____ Today's
Date: _____

Macroeconomics, Spring 2006 Exam 3, TTh classes, several versions

Read these Instructions carefully! You must follow them exactly!

I) 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) Print the number I have written in ink on the upper right corner of your copy 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.)

II) 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!

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

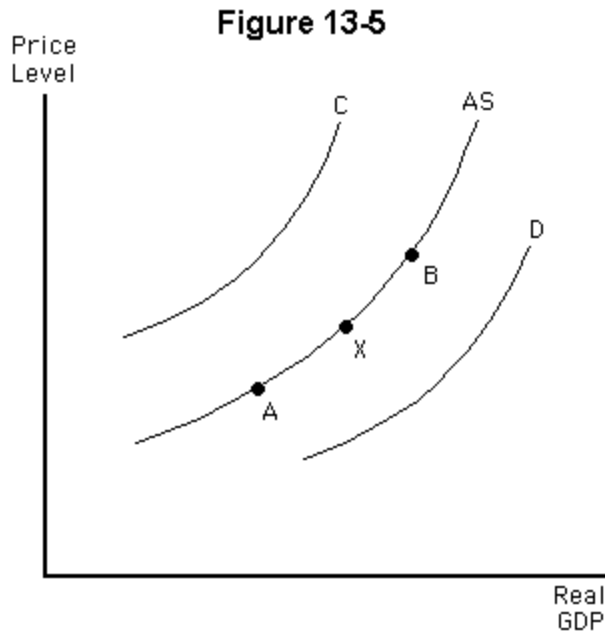
Questions:

- _____ 1. **(Repeat your answer on Scantron line 29.)** Approximately what fraction of U.S. GDP does government purchases now represent?
- a. one-half
 - b. three-quarters
 - c. none; it is not included in GDP
 - d. two-thirds
 - e. one-sixth
- _____ 2. **(Repeat this answer on Scantron line 30.)** If expected inflation used to be 2% per year, but 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.
- _____ 3. **(Repeat this answer on Scantron lines 31 and 32.)** If the Fed sells bonds in an open market operation, which of the following is most likely to occur?
- a. GDP will decrease, at least temporarily
 - b. the money supply increases
 - c. the interest rate falls
 - d. the aggregate demand curve shifts to the right
 - e. the open market operation is said to be expansionary

Equation for the Money Supply

$$M_s = (C_T + T_f + L_f) \frac{\left(1 + \frac{1}{r_{cd}}\right)}{\left(1 - \frac{x_d}{r_{cd}} + \frac{x_t}{r_{ct}}\right)}$$

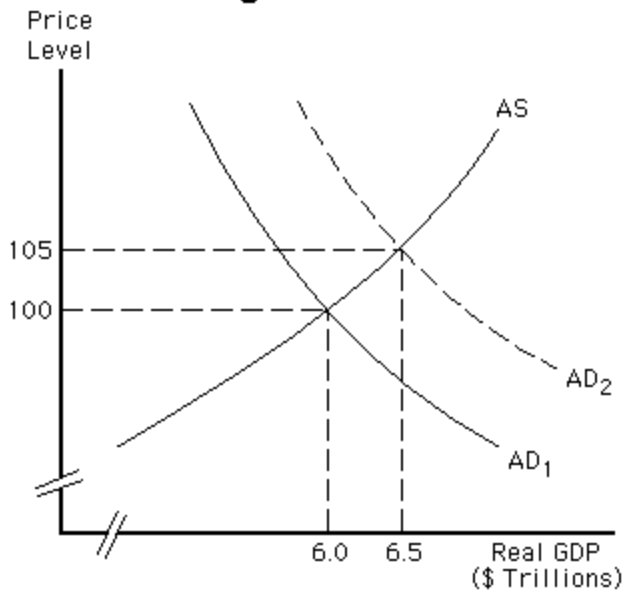
- _____ 4. **(Repeat this answer on Scantron lines 33 and 34.)** Suppose that just as the U.S. economy is heading into a recession, two major U.S. banks fail. Many citizens lose access to their checking accounts for several weeks. Also assume the Fed stupidly does nothing. Evaluate each of the following statements and select the best answer. (Refer to the money supply equation just above if this helps you.)
- 1) Reserve requirements on demand deposits and time deposits will increase.
 - 2) x_d or x_t in the Money Supply Equation will probably increase since bankers now will fear bank runs.
 - 3) the public's desired ratios of currency to demand deposits, and currency to time deposits, will increase
 - 4) the money supply will definitely increase.
- a. all four statements are correct
 - b. statements 2, 3 and 4 are correct, but not statement 1
 - c. only statements 2 and 3 are correct
 - d. only statement 3 is correct
 - e. only statement 4 is correct
- _____ 5. **(Repeat this answer on Scantron line 35.)** If the Fed buys Treasury bills,
- a. no answer is any good except this one.
 - b. either c. or d. is likely to be true, but we don't have enough information to choose between them.
 - c. the impact on the real economy is likely to be very small, neither inflation nor an economic expansion, since the classical assumptions are fairly realistic.
 - d. interest rates will tend to decline, the supply of money will tend to rise on balance, and the resulting excess supply of money will cause inventories to drop, therefore increasing either economic activity and/or prices.
 - e. the money supply will actually decline along with the supply of money, leading to a reduction either in economic activity or prices.



- _____ 6. Refer to **Figure 13-5**. Assuming that the economy starts at point X, a decrease in world oil prices would
- move the economy to point A
 - move the economy to point B
 - shift the aggregate supply curve upward to curve C
 - shift the aggregate supply curve downward to curve D
 - have no impact since the model only shows the relationship between the overall price level and real GDP
- _____ 7. **(Repeat this answer on Scantron line 36.)** If Congress voted to eliminate the minimum wage, which of the following would most likely occur?
- decrease in unit costs and an upward shift of the aggregate supply curve
 - decrease in unit costs and an upward movement along the aggregate supply curve
 - decrease in unit costs and a downward shift of the aggregate supply curve
 - increase in unit costs and an upward shift of the aggregate supply curve
 - increase in unit costs and an upward movement along the aggregate supply curve
- _____ 8. The historical record of the Fed's success in controlling inflation has been
- consistently strong
 - inconsistent
 - consistently disappointing
 - shaped primarily by supply shocks
 - incapable of measurement

- _____ 9. Which of the following is an accurate description of the U.S. inflation rate since 1950?
- The rate has always been below 4 percent.
 - Inflation was low in the 1970s.
 - Episodes of high inflation occurred in the 1970s and early 1980s.
 - Inflation rates were very high in the 1960s.
 - Episodes of high inflation occurred in the 1990s.

Figure 13-8



- _____ 10. **(Repeat this answer on Scantron line 37.)** Refer to **Figure 13-8**. Suppose that the economy is at the full-employment level of output of \$6 trillion. Then a demand shock shifts aggregate demand from AD_1 to AD_2 , which initially increases real GDP to \$6.5 trillion. In the long run, we would expect the
- economy to remain at the new level of output of \$6.5 trillion
 - aggregate demand curve to shift leftward until the economy returns to full employment at the original price level
 - aggregate supply curve to shift upward until the economy returns to full employment, but at a higher price level
 - aggregate supply curve to shift downward until the price level returns to its original level
 - aggregate demand curve to shift further to right as the multiplier effect occurs

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

- _____ 11. **(Repeat this answer on Scantron lines 38 and 39.)** In our Keynesian model, if the marginal propensity to consume is 0.8, the marginal tax rate is .3, the marginal propensity to import is .06, what is the value of the multiplier?
- 0.2
 - 0.8
 - 1.25
 - 2.0
 - 5.0
- _____ 12. **(Repeat this answer on Scantron line 40.)** Which of the following statements are true about "the multiplier" and "autonomous spending"?
- If the Keynesian model is correct, if the multiplier gets larger GDP will get smaller.
 - If the Keynesian model is correct, if the multiplier gets larger autonomous spending will get smaller.
 - Government spending is part of autonomous spending in the basic Keynesian model, but exports are not.
 - no other answer is true.
 - all other answers are true (except "no other answer is true").
- _____ 13. According to the text, the approximate value for the marginal propensity to consume in the U.S. is
- 1.25
 - 0.50
 - 0.90
 - 0.60
 - 0.25
- _____ 14. **(Repeat this answer on Scantron line 41.)** Using the AD/AS model, if there is an increase in the price of oil and the Fed wishes to maintain price stability, the Fed should
- do nothing because the economy must go into a recession to create a deflationary gap to reduce other costs of production
 - do nothing because the price level seldom changes when the price of oil increases
 - sell bonds in the open market
 - encourage firms to not adjust the wages they pay
 - buy bonds in the open market
- _____ 15. **(Repeat this answer on Scantron line 42.)** If there is a large increase in the price of oil and the Fed wishes to maintain stable output, which of the following should it do?
- do nothing, because the self-correcting mechanism will adjust the economy
 - sell bonds in the open market
 - wait, because output seldom changes when there is an increase in the price of oil
 - encourage firms to not adjust the wages they pay
 - buy bonds in the open market

- _____ 16. **(Repeat this answer on Scantron lines 43 and 44.)** To eliminate built-in inflation from the economy, the Fed must
- announce its intention to have a single policy objective
 - create a recession
 - maintain a constant rate of inflation
 - resist the temptation to change its interest rate targets
 - work closely with Congress and the President
- _____ 17. The standard measure of the money stock, M1, refers to
- checking account balances, travelers' checks, and cash in the hands of the public
 - cash in the hands of the public, demand deposits, and small time deposits
 - cash in the hands of the public, savings-type account balances, and travelers' checks
 - savings-type account balances, small time deposits, and checking account deposits
 - the sum of the cash in the hands of the public
- _____ 18. M1 and M2 are
- usually equal
 - aggregates that, when added together, encompass all methods of payment
 - nonofficial measures of the U.S. money supply
 - both measures of the U.S. money supply
 - the best way to measure the U.S. money supply
- _____ 19. **(Repeat this answer on Scantron line 45.)** The group within the Federal Reserve System that determines the general course for the nation's money supply is the
- Federal Monetary Oversight Committee
 - Federal Advisory Council
 - Board of Governors
 - Department of Commerce
 - Federal Open Market Committee
- _____ 20. Which of the following is *not* a responsibility of the Federal Reserve?
- controlling the money supply
 - printing paper currency
 - supervising banks
 - acting as a bank for banks (e.g., lender of last resort)
 - clearing checks
- _____ 21. Which of the following is an "open market purchase"?
- when private individuals sell government bonds
 - when the Fed sells government bonds
 - when private individuals purchase government bonds
 - when bond dealers buy government bonds from the fed
 - when the Fed buys government bonds

- _____ 22. If the required reserve ratio is 0.25 and the First National Bank holds \$10 million in demand deposits and \$2.5 million in reserves, how much more money is the bank capable of creating?
- \$0
 - \$0.625 million
 - \$1.875 million
 - \$2.5 million
 - \$10 million
- _____ 23. **(Repeat this answer on Scantron line 46.)** Which statement best describes economic fluctuations?
- Expansions and contractions typically have about the same lengths.
 - Expansions typically last 7 years, while recessions typically last 3 years.
 - Expansions tend to be shorter than contractions.
 - The percent change in output is larger during recessions than during expansions.
 - Expansions and contractions vary in duration and magnitude, with expansions tending to last longer than contractions.
- _____ 24. **(Repeat this answer on Scantron line 47.)** A *shock* to the economy is a change in
- production that only affects a few sectors
 - production that initially affects the whole economy and then one or more sectors
 - spending or production that initially affects one or more sectors and then spreads throughout the whole economy
 - spending that only affects a few sectors
 - spending that initially affects the whole economy and then one or more sectors
- _____ 25. **(Repeat this answer on Scantron line 48.)** Assume the economy is at full employment. Which of the following would you expect if oil prices suddenly decreased?
- a recession
 - a decrease in employment below its full-employment level
 - an economic contraction
 - a technological breakthrough
 - an increase in employment above its full-employment level
- _____ 26. If we knew that the price of goods rose, on average, by 5 percent last year and by 4 percent this year, we would know
- nothing about the rate of inflation
 - that the inflation rate is rising
 - that the inflation rate is falling
 - that we are in a depression
 - that we are in a recession
- _____ 27. **(Repeat this answer on Scantron line 49.)** Suppose that Colleen's nominal wage rate was \$20 per hour in 1998, the base year for the CPI. If the CPI in 2003 was 120.0 and her nominal wage had risen to \$22 per hour, what was her real wage in 2003?
- \$16.67
 - \$18.33
 - \$22.00
 - \$26.40
 - her real wage for 2003 cannot be determined with the information given

Name: _____

ID: A

- _____ 28. **(Repeat this answer on Scantron line 50.)** In which of the following situations would a person be best off in real terms?
- a. receiving a 10 percent increase in a nominal wage, with an 8 percent rate of inflation in the economy
 - b. receiving a 3 percent increase in a nominal wage, with a 0 percent rate of inflation in the economy
 - c. receiving a 4 percent increase in a nominal wage, with a 5 percent rate of inflation in the economy
 - d. receiving no increase in a nominal wage, with a 5 percent rate of deflation in the economy
 - e. receiving a 2 percent decrease in a nominal wage, with a 6 percent rate of deflation in the economy