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

Macroeconomics, Spring 2008 Exam 3, TTh classes, various versions

Read these Instructions carefully! You must follow them exactly!
I) On your Scantron card you <u>must</u> 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
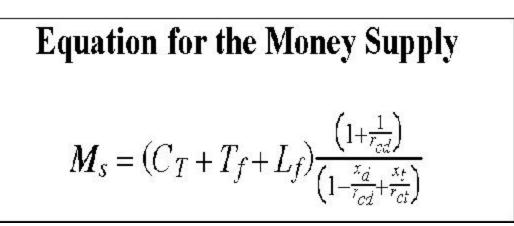   **your score on this exam is "F".**

Questions:

_____ 1. Which of the following best describes what happens during a recession?
   a. The cyclical deficit increases and so does the structural deficit.
   b. The cyclical deficit increases and the structural deficit is unchanged.
   c. The cyclical deficit is unchanged and the structural deficit increases.
   d. The cyclical deficit decreases and the structural deficit increases.
   e. The cyclical deficit is unchanged and so is the structural deficit.

_____ 2. Which of the following are equivalent terms?
   a. the absence of structural unemployment and the absence of cyclical unemployment
   b. normal employment and the absence of structural unemployment
   c. full employment and the absence of cyclical unemployment
   d. normal employment and the absence of frictional unemployment
   e. full employment and the absence of frictional unemployment

_____ 3. Which of the following is an accurate description of the U.S. inflation rate since 1950?
   a. The rate has always been below 4 percent.
   b. Inflation was low in the 1970s.
   c. Episodes of high inflation occurred in the 1970s and early 1980s.
   d. Inflation rates were very high in the 1960s.
   e. Episodes of high inflation occurred in the 1990s.

____   4. **(Repeat your answer on Scantron line 29.)** What is a good historical example of when the Fed created a recession to reduce inflation expectations?
    a.   in the early 1980s
    b.   in the early 1960s
    c.   during the Great Depression
    d.   in the late 1920s
    e.   during World War II

____   5. **(Repeat your answer on Scantron line 30.)** Starting in an unemployment equilibrium of the circular flow model, if the Fed buys 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 will increase
    c.   interest rates will increase
    d.   GDP will increase, at least temporarily
    e.   this open market operation is said to be contractionary

$$Y = \left(\frac{1}{1-a(1-t)+a}\right)(a + I_g + G - cT_\beta + X)$$

____   6. **(Repeat this answer on Scantron line 31.)** Which of the following statements are true about "the multiplier" and "autonomous spending"?
    a.   If the Keynesian model is correct, if the multiplier gets smaller GDP will get smaller.
    b.   If the Keynesian model is correct, increases in autonomous spending cause the multiplier to get larger.
    c.   Government spending is part of autonomous spending in the basic Keynesian model, but exports are not.
    d.   no other answer is true.
    e.   all other answers are true (except "no other answer is true").

____   7. **(Repeat your answer on Scantron lines 32 and 33.)** (You may refer to the equation above.) Choose the **most complete answer**. Assume the Keynesian model gives correct answers. Suppose an economic recovery abroad increases exports by $200 billion per year, but an economic slowdown in the US causes gross investment spending in the U.S. to decline by $250 billion per year, and also an increase in unemployment insurance payments increases autonomous consumption spending ("a" in the equation) by $50 billion, then
    a.   The economy will expand even if government spending is reduced by $200 billion per year.
    b.   The economy will expand.
    c.   The economy will contract.
    d.   The economy will contract even if government spending is increased by $200 billion per year.
    e.   The economy will neither expand nor contract.

____ 8. (**Repeat your answer on Scantron line 34.**) (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

____ 9. (**Repeat your answer on Scantron line 35.**) If people used to expect prices to rise at 5% per year, but expected inflation now has fallen to 2% 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.   nominal interest rates will decline.
   c.   wealth obviously will be redistributed in haphazard ways, since expected inflation always equals actual inflation--lenders will gain and borrowers will lose.
   d.   nominal interest rates will be affected far less than real interest rates, which will increase.
   e.   nominal interest rates are not affected by expected inflation.

Equation for the Money Supply

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

____ 10. (**Repeat your answer on Scantron line 36.**) In the money supply equation just above, assume that $C_T = 50$; $T_f = 130$, $L_f = 20$; $r_d = .4$ and $r_t = .1$, $s_d = .3$ and $s_t = .6$; $r_{cd} = 1$ and $r_{ct} = 1$. Then
   a.   the "money multiplier" is 1.34
   b.   the 'money multiplier" is 1.00
   c.   the "money multiplier" is some other number than given in a) or b) above
   d.   if C_T increases to 75, the money supply will grow by more than 25
   e.   both c) and d) are correct

____ 11. (**Repeat your answer on Scantron lines 37, 38 and 39.**) The institution charged with creating and regulating the U.S. money supply is the
   a.   U.S. Treasury
   b.   Federal Reserve System
   c.   Department of Commerce
   d.   Department of Weights and Measures
   e.   U.S. Mint

_____ 12. **(Repeat your answer on Scantron line 40.)** Government outlays consist of
   a. all governmental purchases resulting from contracts with the private sector and foreign organizations
   b. government purchases, transfer payments, and interest on the national debt
   c. any purchase by an organization that is not trying to earn a profit
   d. government purchases and transfer payments minus the interest on the national debt
   e. total receipts from all organizations doing business with any level of government

_____ 13. **(Repeat your answer on Scantron line 41.)** The two largest sources of revenue for the federal government are
   a. corporate income taxes and personal income taxes
   b. sales taxes and corporate income taxes
   c. Social Security taxes and sales taxes
   d. property taxes and sales taxes
   e. personal income taxes and Social Security taxes

_____ 14. The Consumer Price Index excludes all of the following, except one. Which one *is* included in the CPI?
   a. services purchased directly by consumers
   b. raw materials
   c. services purchased by the government
   d. machinery purchased by firms
   e. intermediate goods purchased by firms

_____ 15. **(Repeat your answer on Scantron line 42.)** If the CPI for 2003 was 112, the typical market basket purchased that year would cost
   a. 12 percent more than the same market basket purchased the previous year
   b. 112 percent more than the same market basket purchased the previous year
   c. 12 percent more than the same market basket purchased in the base year
   d. 112 percent more than the same market basket purchased in the base year
   e. more than the same market basket purchased during any previous year

_____ 16. **(Repeat your answer on Scantron lines 43 and 44.)** In which of the following situations would a worker be happiest?
   a. She receives a pay cut and her nominal wage falls by 5 percent, while the CPI falls by 20 percent.
   b. She receives a pay cut and her nominal wage falls by 5 percent, while the CPI increases by 10 percent.
   c. Her nominal wage remains the same, as does the CPI.
   d. She receives a raise and her nominal wage increases by 5 percent, while the CPI increases by 10 percent.
   e. She receives a raise and her salary increases by 5 percent, while the CPI falls by 5 percent.

_____ 17. 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

_____ 18. What does it mean for the government to "roll over" its debt?
     a. buying bonds from the public to pay off old bonds
     b. continuing to pay interest on old bonds
     c. issuing new bonds to pay off old bonds
     d. running a budget surplus to pay off old bonds
     e. printing money to pay off old bonds

_____ 19. **(Repeat your answer on Scantron lines 45 and 46.)** In the long run, if the Fed lowers the inflation rate by reducing the rate of money growth to a new lower rate, and keeps it growing at that new lower rate,
     a. a zero inflation rate will be reached
     b. a recession will not occur
     c. inflationary expectations will fall
     d. the natural rate of unemployment will rise
     e. structural unemployment will start to decrease

_____ 20. A zero inflation rate is not the Fed's objective because
     a. that would cause prices to rise
     b. that would cause price to fall
     c. it knows that it cannot attain a zero rate
     d. it believes that the true rate of inflation is lower than what is measured by the Consumer Price Index (CPI)
     e. high rates of inflation may help labor markets adjust more easily

_____ 21. **(Repeat your answer on Scantron lines 47 and 48.)** Open market sales of bonds by the Federal Reserve drain reserves from the banking system and shift
     a. the allocation of wealth between bonds and stocks
     b. the economy toward a trough in the business cycle
     c. the money supply curve leftward
     d. reserves to nonmember banks
     e. the demand for money curve leftward

_____ 22. The secondary market for bonds is a market for
     a. bonds that is smaller than the primary market
     b. bonds that are not first-class
     c. previously issued bonds
     d. bonds that are not substitutes for bonds found in the primary market
     e. newly issued bonds

_____ 23. If the Fed increases the money supply, the interest rate
     a. rises and spending increases
     b. rises and spending decreases
     c. falls and spending increases
     d. falls and spending decreases
     e. falls, business spending increases, and consumer spending decreases

____ 24. What major historical event led to the most significant challenge to classical economic thinking?
   a.   the war on poverty
   b.   the American Revolution
   c.   World War II
   d.   the Great Depression
   e.   the oil shocks of the 1970s

____ 25. **(Repeat your answer on Scantron lines 49 and 50.)** According to Keynesian economists,
   a.   the economy will return quickly to full employment in most cases
   b.   if output is below its potential, the economy will soon return to full employment
   c.   production can be stuck below its full-employment level for extended periods of time
   d.   the Great Depression proved that classical economics does a good job of explaining how
         the economy operates
   e.   he economy will achieve full employment in the short run but, in the long run, GDP will
         fluctuate

____ 26. In the long run, if an economy's consumption spending is $5 trillion, its planned investment is $2 trillion,
         government spending is $1 trillion, net tax revenue is $1 trillion, there is no international trade, and household
         savings are $2 trillion, then GDP should be
   a. $3 trillion
   b. $5 trillion
   c. $7 trillion
   d. $8 trillion
   e. $11 trillion

____ 27. Gold, silver and furs, when used as money, are referred to as
   a.   fiat money
   b.   precious money
   c.   paper currency
   d.   commodity money
   e.   exchange money

____ 28. Which of the following best describes the term *deflation*?
   a.   a falling inflation rate
   b.   a negative price level
   c.   a negative inflation rate
   d.   an increasing inflation rate
   e.   a positive inflation rate

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Answer Section

MULTIPLE CHOICE

1. ANS: B
2. ANS: C
3. ANS: C
4. ANS: A
5. ANS: D
6. ANS: A
7. ANS: E
8. ANS: B
9. ANS: B
10. ANS: B
11. ANS: B
12. ANS: B
13. ANS: E
14. ANS: A
15. ANS: C
16. ANS: A
17. ANS: C
18. ANS: C
19. ANS: C
20. ANS: D
21. ANS: C
22. ANS: C
23. ANS: C
24. ANS: D
25. ANS: C
26. ANS: D
27. ANS: D
28. ANS: C