

Macroeconomics, Spring 2011, 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 line 31.)** 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 15% then roughly the following will happen:
- the economy will grow to full employment and prices will rise by 15%.
 - employment will remain stagnant and prices will rise by 15%
 - employment will rise by 15% and prices will not rise.
 - prices will decline and the economy will grow by 10%.
 - the economy will grow to full employment and prices will rise by 10%.
- _____ 2. **(Repeat your answer on Scantron lines 32 and 33.)** Consider the following statements about inflation, expected inflation and interest rates.
- If actual inflation turns out lower than was expected at the time the loan was made, the lender loses and the borrower benefits.
 - if the expected inflation rate for the coming year rises from 3 percent to 6 percent, but the Fed prevents nominal interest rates from rising, then the real interest rate must have risen.
 - 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%.
 - the real interest rate plus the nominal interest rate equals the expected rate of inflation.
 - none of the other answers is correct.
- _____ 3. **(Repeat your answer on Scantron line 34.)** The precise definition of *GDP* is the total value of all
- goods and services produced by a nation, minus household labor
 - goods and services produced by a nation, minus depreciation
 - goods and services produced for the marketplace during a given period
 - final goods and services produced for the marketplace during a given period, within a nation's borders
 - final goods and services produced within a nation's borders and by this nation's citizens abroad during a given period
- _____ 4. Based on the circular flow model as presented in recent lectures, and beginning in an unemployment equilibrium, a tax cut probably will:

- a. increase disposable income and therefore stimulate the economy.
- b. increase interest rates, but only stimulate the economy if the demand for money is strongly affected by interest rates.
- c. as a practical matter not stimulate the economy much, if at all.
- d. not stimulate the economy, but look as if it is stimulating the economy because the economy was going to grow anyway or the money supply increased at the same time.
- e. B, C and D are correct.

5. **(Repeat your answer on Scantron line 35.)** 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 stimulate the economy to grow.
- 2) If the government increases government spending, this will stimulate 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.

6. **(Repeat your answer on Scantron line 36.)** Based on the circular flow model as presented in lecture, if the economy is in full employment equilibrium and the money supply increases by 14%

- a. then the economy will grow by 14% as more people find jobs.
- b. then the economy will go into a recession.
- c. then prices will increase by 14%.
- d. then prices will increase by 9% (since the normal rate of employment is about 5% for the U.S.
- e. none of the other answers is correct.

7. 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.

Recall:

$$FR = IR * (FN/IN)*(II/FI)$$

8. **(Repeat your answer on Scantron line 37.)** Between 1960 and 1983 the price index rises from 80 to 120. Over the same period your nominal wage rises from \$10/hour to \$12/ hour. Assume your real wage was \$20 in 1960. Then in 1983 your real wage becomes:

- a. \$16
- b. \$11.11
- c. \$36
- d. \$20
- e. \$24

9. Considering "unemployment",

- a. all of these statements are true, except the one beginning with “none”.
- b. an individual is defined as "unemployed" if the person is not currently employed, not on temporary layoff, and searched for work during the past four weeks.

- 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, seasonal and frictional unemployment are substantial.
- e. none of the other statements are true.

- _____ 10. Choose the best answer. According to the text, deflation
- a. creates difficulties for monetary policy because people would rather hold money, which yields a positive rate of return, than invest in projects, which may drop in value because of the deflation.
 - b. was very substantial during the first four years of the Great Depression, prices falling 10 percent per year or more.
 - c. probably created difficulties in Japan during the late 1990s and early 2000s.
 - d. creates a problem for the Fed, because nominal interest rates cannot be lower than zero and this prevents real interest rates from falling low enough to encourage investment.
 - e. all the other answers are correct.
- _____ 11. Since 1960, the two worst years of inflation have seen prices rise
- a. less than 3% both years.
 - b. between 3 and 5% both years.
 - c. between 5 and 7% both years.
 - d. between 7 and 10% both years.
 - e. more than 10% in both years.
- _____ 12. **(Repeat your answer on Scantron line 38.)** Which of the following statements about measuring prices are true?
- 1) If my "base year basket" costs \$1,000 to purchase this year, and one year from now it costs \$1,200 to purchase the same base year basket, then the price index based on this basket tells you that prices have risen by 10%.
 - 2) If dingbats are one of the goods in the base year basket, and 30% of the base year budget was spent on dingbats, and in some future year all prices are unchanged except the price of dingbats has increased by 20%, then the price index will have risen by 6%.
 - 3) Suppose people are now purchasing more computers and fewer typewriters than in the base year, however we are still using the base year basket to calculate inflation. Suppose also that typewriter prices have been rising and computer prices have been falling. Then the computed price index will show less inflation than actually exists.
- a. All the above statements are correct.
 - b. Only statement 1 is correct.
 - c. Only statement 2 is correct.
 - d. Only statement 3 is correct.
 - e. Only statements 2 and 3 are correct.
- _____ 13. Improvements in the quality of goods and services over time
- a. cause GDP statistics to understate true output growth from year to year
 - b. cause GDP statistics to overstate true output growth from year to year
 - c. are fully accounted for in the Bureau of Economic Analysis' measurement of GDP
 - d. are reflected in higher prices and therefore do not affect the measurement of real GDP
 - e. are offset by declining productivity over time
- _____ 14. **(Repeat your answer on Scantron line 39.)** If the price of oil rises 9% while the cost of living (the price index) falls 7% then real oil prices have
- a. fallen about 2%.
 - b. fallen considerably more than 2%.
 - c. risen by about 9%.
 - d. risen by about 2%.
 - e. risen by about 16%.

Recall:

$$FR = IR * (FN/IN)*(II/FI)$$

- _____ 15. Suppose the nominal price of oil in 1984 was \$30 per barrel when the consumer price index was 100. What is the real price of oil today, assuming it was \$30 per barrel in 1984? (You can assume that today's price of oil is \$100 per barrel and today's price index is 200.)
- \$50 per barrel.
 - \$40 per barrel.
 - \$35 per barrel.
 - \$30 per barrel.
 - \$25 per barrel.
- _____ 16. **(Repeat your answer on Scantron lines 40 and 41.)** Evaluate the following statements, then choose the best answer.
- The 1981-82 recession was triggered by a change in Federal Reserve policy leading to a decline in spending on new homes, auto and net investment.
 - The 2001 recession was triggered by large increases in oil prices leading to reduced spending on energy using products.
 - The 1974 recession was triggered by a sharp increase in oil prices leading to a decline in spending on cars and energy-using products.
- All three statements are correct.
 - None of the three statements are correct.
 - Only statements 1 and 3 are correct.
 - Only statements 1 and 2 are correct.
 - Only statements 2 and 3 are correct.
- _____ 17. **(Repeat your answer on Scantron line 42.)** Evaluate the following statements about the historical record since 1960 of Real GDP growth rates:
- In the majority of years, Real GDP grew more than 2%
 - There are several years when Real GDP grew by 7% or more.
 - Real GDP has declined in at least 15 of those 47 years, always during the recessions.
- Only statement 1 is true.
 - Only statement 2 is true.
 - Only statements 2 and 3 are true.
 - Only statements 1 and 3 are true.
 - Only statements 1 and 2 are true.
- _____ 18. 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
- the economy will grow by 6% and prices by 2%.
 - the economy will grow by 8% but prices may not increase very much because the excess money growth is quite small--only 2%.
 - the economy will grow by 8% and prices will rise by 2% within a year or two.
 - the economy will not grow but prices will increase by 10%.
 - none of the other answers is correct.
- _____ 19. If you had to pick an unemployment rate from those mentioned below, which one would most accurately describe average US unemployment from 1950 through 2006:
- 2.5%
 - 5%
 - 6.5%
 - 10%
 - 12%

- _____ 20. If you borrow \$1000 for 30 days from a bank, and the bank tells you the interest rate is 5%,
- when you pay back the loan you will owe \$1,000 plus \$50 interest.
 - this interest rate is roughly equivalent to 60% per year.
 - this interest rate is equal to 5% per year, so you will owe much less than \$50 when you repay the loan.
 - two of the other answers are correct.
 - none of the other answers is correct.
- _____ 21. **(Repeat your answer on Scantron line 43.)** 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%,
- prices will rise about 3% within a year.
 - economic activity will increase by 3% within a year.
 - prices will rise by 3% within two years.
 - prices may take a very long time to rise, and will not rise more than about 3%
 - the smaller the inflation rate, the more immediate the response, so prices will rise quickly.
- _____ 22. Based on the circular flow model as presented in recent lectures, a large **reduction** in government spending will:
- push the economy into a big recession, since government spending is so important in the economy.
 - cause an increase in interest rates but not affect the economy much.
 - cause a decrease in interest rates but not affect the economy much because, in reality, the decrease in interest rates will increase the demand for money only slightly.
 - cause a decrease in interest rates but not affect the economy much because, in reality, a decrease in interest rates is likely to sharply increase the demand for money.
 - no other answer is correct.
- _____ 23. Even though households do not actually purchase certain items, the government estimates and adds to the consumption component what the household would pay for these items in the marketplace. An example of this type of item is
- a car that an individual builds from parts of old cars
 - food that a farm family grows for themselves
 - a pond that a household member digs by hand
 - police and fire protection
 - a barn that a household builds on their own property
- _____ 24. In 2008, the Ace Card Company produced \$10 million worth of playing cards. Because of strong consumer demand for their product in 2008, Ace sold \$12 million worth of cards, reducing their inventories by \$2 million. How much value did Ace add to GDP in 2008?
- \$2 million
 - \$8 million
 - \$10 million
 - \$12 million
 - \$14 million
- _____ 25. Transfer payments are important for society because
- the government needs to perform acts of goodwill to maintain citizens' support
 - we could not count GDP without them
 - they serve to redistribute money from one group of citizens to another
 - government investment is an important component of GDP
 - they result in lower taxes for citizens
- _____ 26. **(Repeat your answer on Scantron line 44.)** What is the difference between nominal and real GDP?
- 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.

27. **(Repeat your answer on Scantron lines 45 and 46.)** 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

28. Suppose that population grows by 2 percent annually. For the standard of living to rise, which of the following must occur?

- a. Nominal GDP must grow by more than 2 percent.
- b. Real GDP must grow by more than 2 percent.
- c. Real GDP per capita must grow by more than 2 percent.
- d. Consumption spending must grow by more than 2 percent.
- e. Private investment spending must grow by more than 2 percent.

29. **(Repeat your answer on Scantron lines 47 and 48.)** Question on economic growth. Evaluate the following statements, then select the best answer.

1. The US 200-year growth rate (of income per capita) has averaged only somewhere between one and two percent per year.
 2. Today's poorer countries grow faster than the US in their good years, but decline much farther in their bad years.
 3. Today's poorer countries tend to have shorter periods of decline than today's advanced countries, but they don't grow fast enough in the good years to make up for it.
- a. statements 1 and 3 are correct.
 - b. all three statements are incorrect.
 - c. only statement 2 is correct.
 - d. only statement 3 is correct.
 - e. only statements 1 and 2 are correct.

30. **(Repeat your answer on Scantron lines 49 and 50.)** Question on economic growth and development. Evaluate the following statements, then select the best answer.

1. As discussed in both the text and lecture, investment leading to increases in capital per worker, by giving workers more tools and equipment to work with, is a central engine of economic growth, especially of the advanced countries.
2. The invention of new and better methods of production, never used anywhere before, has been crucial to the economic growth of the fastest growing countries such as China, India and Japan over the past 30 years.

- a. Only statement 1 is correct.
- b. Only statement 2 is correct.
- c. Both statements are correct.
- d. Both statements are wrong.

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Answer Section

MULTIPLE CHOICE

1. ANS: E PTS: 1
2. ANS: C PTS: 1
3. ANS: D PTS: 1 NAT: Financial theories, analysis, reporting, and markets
LOC: Unemployment and inflation
4. ANS: E PTS: 1
5. ANS: C PTS: 1
6. ANS: C PTS: 1
7. ANS: B PTS: 1
8. ANS: A PTS: 1
9. ANS: A PTS: 1
10. ANS: E PTS: 1
11. ANS: E PTS: 1
12. ANS: C PTS: 1
13. ANS: A PTS: 1 NAT: Financial theories, analysis, reporting, and markets
LOC: Unemployment and inflation
14. ANS: E PTS: 1
15. ANS: A PTS: 1
16. ANS: C PTS: 1
17. ANS: A PTS: 1
18. ANS: B PTS: 1
19. ANS: C PTS: 1 REF: Unemployment chart Ch4 p93
20. ANS: C
Difficulty: Medium

PTS: 1
21. ANS: D PTS: 1
22. ANS: C PTS: 1
23. ANS: B PTS: 1 NAT: Financial theories, analysis, reporting, and markets
LOC: Unemployment and inflation
24. ANS: C PTS: 1 NAT: Financial theories, analysis, reporting, and markets
LOC: Unemployment and inflation
25. ANS: C PTS: 1 NAT: Financial theories, analysis, reporting, and markets
LOC: Unemployment and inflation
26. ANS: C PTS: 1 NAT: Financial theories, analysis, reporting, and markets
LOC: Unemployment and inflation
27. ANS: A PTS: 1 NAT: Financial theories, analysis, reporting, and markets
LOC: Unemployment and inflation
28. ANS: B PTS: 1 NAT: Financial theories, analysis, reporting, and markets
LOC: Unemployment and inflation
29. ANS: E PTS: 1
30. ANS: D PTS: 1