

Chapter 7 Long Run and Short Run Concerns: Growth, Productivity, Unemployment, and Inflation
Principles of Macroeconomics, Case/Fair, 8e

7.1 Long Run Output and Productivity Growth
Multiple Choice

Which of the following is NOT a desirable feature in an economy?

- A. Rapid increase in output per worker
- B. Rapid increase in the general price level
- C. Low unemployment
- D. Low inflation

Answer : B

Which of the following is a desirable characteristic in an economy?

- A. High inflation.
- B. Rapid increase in the general price level
- C. Low unemployment
- D. Low employment.

Answer : C

Which of the following is a desirable characteristic in an economy?

- A. Growing per capita output.
- B. Rapid increase in the general price level
- C. Population growing the same rate as output.
- D. Population growing faster than output.

Answer : A

Which of the following is a desirable characteristic in an economy?

- A. Growing per capita output.
- B. Low inflation.
- C. Low unemployment
- D. All of the above

Answer : D

Output in an economy can be increased by

- A adding more workers.
- B limiting the work week.
- C using fewer machines
- D all of the above.

Answer : A

Output in an economy can be increased by

- A. adding more workers.
- B. increasing the work week of workers.
- C. adding more machines.
- D. all of the above.

Answer : D

Human capital is

- A. the machines people own.
- B. the money people have.
- C. the mental or physical skills people have.
- D. the property people own.

Answer : C

The average growth rate of output in the U.S. economy since 1900 has been

- A. 3.4%.
- B. 2.3%.
- C. 6.3%.
- D. 10.5%.

Answer : A

A prolonged and deep recession is a

- A. hyperinflation.
- B. slowdown.
- C. contraction.
- D. depression.

Answer : D

Which of the following is considered capital?

- A. A factory a company builds to produce other output.
- B. A tractor produced by John Deere.
- C. The knowledge an individual acquires through education.
- D. All of the above

Answer : D

True/False

1) The only source of economic growth is growth in the number of workers in the economy.

Answer: True False

Diff: 2

Skill: C

2) Workers who take a job related training course are enhancing their human capital.

Answer: True False

Diff: 2

Skill: C

3) If the population is growing as fast the economy, then per capita output is growing.

Answer: True False

Diff: 2

Skill: C

4) If more workers have more capital to work with, then production will increase.

Answer: True False

Diff: 2

Skill: C

5) Productivity is output per worker hour.

Answer: True False

Diff: 2

Skill: C

7.2 Recessions, Depressions, and Unemployment Multiple Choice

We can safely say that total output can increase if there is a(n)

- A. increase in the size of the labor force and a decrease in the productivity of workers.
- B. decrease in the size of capital and an increase in the productivity of machines.
- C. increase in the number of machines per worker.
- D. decrease in the number of workers per machine.

Answer : C

The productivity of workers is defined as the

- A. total output produced by the labor force.
- B. output produced by a worker per hour.
- C. number of hours a worker spends at work.
- D. number of hours it takes a worker to produce a unit of output.

Answer : B

The capital per worker ratio is a measure of

- A. how many tools or machines each worker has to work with.
- B. how productive workers are.
- C. how much GDP is growing.
- D. All of the above

Answer : A

Productivity is the ratio of

- A. total output to the total number of worker hours.
- B. total output to the total population.
- C. total output to the total number of unemployed.
- D. total capital to the total number of workers.

Answer : A

For the 1952-2003 period in the United States, output per worker hour

- A. increased at a constant rate.
- B. decreased during the 1960s.
- C. fluctuated in the short run around an upward trend.
- D. showed the largest increase during the 1980s.

Answer C

Which of the following CANNOT explain the growth in output per worker hour during the 20th century?

- A. The quality of labor improved during that period.
- B. The quantity of labor increased during that period.
- C. The quality of capital improved during that period.
- D. The worker capital ratio decreased during that period.

Answer : B

Bob is unemployed if he

- A. is temporarily laid off.
- B. is not looking for a job.
- C. has looked for a job for two months and then quit looking.
- D. A and C are correct.

Answer : A

For you to be considered out of the labor force, you can be

- A. a full-time student.
- B. a full-time retiree.
- C. a full-time volunteer.
- D. any of the above.

Answer : D

Janie graduated from college a month ago and is now without work. She accepted a job that will start next month. Today, Janie is

- A. not in the labor force.
- B. in the labor force.
- C. employed.
- D. a discouraged worker.

Answer : B

The number of people unemployed equals

- A. the number of people employed minus the labor force.
- B. the labor force plus the number of people employed.
- C. the labor force minus the number of people employed.
- D. the number of people employed divided by the labor force.

Answer : C

Bob retired from the police force. He started working an hour or two a day at a paid job in city's courthouse. Bob is

- A. employed.
- B. in the labor force.
- C. unemployed.
- D. not in the labor force.

Answer : A

Carla lost her job and immediately started looking for another job. As a result the

- A. unemployment rate increases.
- B. labor force increases.
- C. labor force decreases.
- D. unemployment rate remains constant.

Answer : A

Refer to the information provided in Table 7.1 below to answer the questions that follow.

Table 7.1

Employed	10,000 people
Unemployed	2,500 people
Not in the Labor Force	3,000 people

Refer to Table 7.1. The labor force equals

- A. 13,000 people.
- B. 12,500 people.
- C. 13,500 people.
- D. 15,500 people.

Answer : B

Refer to Table 7.1. The unemployment rate is

- A. 20%.
- B. 18.5%.
- C. 16.1%.
- D. 35.5%.

Answer : A

Refer to Table 7.1. The labor-force participation rate is

- A. 71.43%.
- B. 81.8%.
- C. 90.91%.
- D. 80.0%.

Answer : D

Refer to Table 7.1. The employment rate is

- A. 81.5%.
- B. 66.7%.
- C. 80%.
- D. 20%.

Answer : C

Refer to the information provided in Table 7.2 below to answer the questions that follow.

Table 7.2

Labor force participation rate	65%
Total population 16 years of age and older	200 million
Unemployment rate	5%

Refer to Table 7.2. The labor force

- A. equals 130 million.
- B. equals 136.5 million.
- C. equals 190 million
- D. cannot be determined from this information.

Answer : A

Refer to Table 7.2. The total number of people unemployed is

- A. 7.58 million.
- B. 10 million.
- C. 6.83 million.
- D. 6.5 million.

Answer : D

Refer to Table 7.2. The total number of people employed is

- A. 129.67 million.
- B. 190 million.
- C. 123.5 million.
- D. 131.83 million.

Answer : C

Refer to Table 7.2. The total population

- A. is 210 million.
- B. is 130.65 million.
- C. is 200 million
- D. cannot be determined from this information.

Answer : D

Which of the following is correct? The unemployment rate is

- A. $\text{unemployed}/\text{population} \times 100$.
- B. $(\text{employed} - \text{unemployed})/\text{labor force} \times 100$.
- C. $(\text{labor force} - \text{employed})/\text{labor force} \times 100$.
- D. $(\text{employed} - \text{labor force})/\text{employed} \times 100$.

Answer : C

The number of people classified as employed is 220,000 and the number of people classified as unemployed is 20,000. The size of the labor force

- A. equals 240,000.
- B. equals 250,000.
- C. equals 200,000.
- D. cannot be determined from this information.

Answer : A

The number of people classified as employed is 575,000 and the number of people in the labor force is 700,000. The total number of people classified as unemployed is

- A. 200,000.
- B. 125,000.
- C. 150,000.
- D. 1.275 million.

Answer : B

If the number of people classified as unemployed is 50,000 and the number of people classified as employed is 300,000, what is the unemployment rate?

- A. 8%
- B. 14.3%
- C. 16.67%
- D. 11.5%

Answer : B

If the number of people classified as unemployed is 20,000 and the number of people classified as employed is 620,000, what is the unemployment rate?

- A. 3.1%
- B. 10.6%
- C. 1.6%
- D. 632%

Answer : A

If the number of people employed is 150,000 and the labor force is 170,000, the unemployment rate is

- A. 6.25%.
- B. 11.76%.
- C. 2.5%.
- D. 6.55%.

Answer : B

If the unemployment rate is 7.4% and the number of people employed is 250,000, total number of people unemployed is around

- A. 15,000 people
- B. 10,000 people.
- C. 20,000 people.
- D. cannot be determined from this information

Answer : C

Refer to the information in the previous question. The labor force is around

- A. 265,000 people.
- B. 260,000 people
- C. 270,000 people.
- D. cannot be determined from this information.

Answer : C

If the labor force is 260,000 and the total population 16 years of age or older is 300,000, the labor-force participation rate is

- A. 79.5%.
- B. 83.3%.
- C. 86.7%.
- D. 80.9%.

Answer : C

If the labor-force participation rate is 87% and the total population 16 years of age or older is 1 million people, the labor force is

- A. 280,000 people.
- B. 870,000 people.
- C. 850,000 people.
- D. 180,000 people.

Answer : B

If the number of unemployed equals 30,000, the number of employed equals 60,000, and the number not in the labor force is 10,000, the labor-force participation rate

- A. is 90%.
- B. is 67%.
- C. is 88.9%.
- D. cannot be determined from this information.

Answer : A

If the number of unemployed equals 100,000 and the number of employed equals 240,000, the labor-force participation rate

- A. is 90%.
- B. is 24.4%.
- C. is 29.4%.
- D. cannot be determined from this information.

Answer : D

In the U.S. the highest unemployment rate is for _____ and the lowest is for _____.

- A. African-American teenagers; white males
- B. men over 55; women below 25
- C. African-American teenagers; white females
- D. African-American women over 25; white males

Answer : A

When an individual quits his/her job and decides to stay at home for a while, the labor-force participation rate

- A. decreases.
- B. increases.
- C. stays the same.
- D. may increase or decrease, depending on the length of time he/she stays at home.

Answer : A

Mike has just graduated from college and is now looking for a job, but has not yet found one. This causes the unemployment rate to _____ and the labor-force participation rate to _____.

- A. increase; decrease
- B. stay the same; stay the same
- C. increase; increase
- D. increase; stay the same

Answer : C

Discouraged workers are

- A. part of the labor force.
- B. part of structural unemployment.
- C. part of frictional unemployment.
- D. None of the above

Answer : D

In June there are 30,000 people classified as unemployed and the size of the labor force is 600,000. The only change between June and July is that 10,000 of the unemployed give up looking for work.

Which of the following is true?

- A. In June the unemployment rate was 6% and in July the unemployment rate was 3.8%.
- B. The unemployment rate in both June and July was 5%.
- C. In June the unemployment rate was 5% and in July the unemployment rate was 3.39%.
- D. In June the unemployment rate was 3.8% and in July the unemployment rate was 6%.

Answer : C

When 100 people who were previously looking for jobs stop looking for jobs, the

- A. unemployment rate increases.
- B. size of the labor force decreases.
- C. labor-force participation rate does not change.
- D. unemployment rate does not change.

Answer : B

Classifying discouraged workers as unemployed would

- A. increase the unemployment rate.
- B. decrease the unemployment rate.
- C. not change the unemployment rate.
- D. have an indeterminate impact on the unemployment rate.

Answer : A

In normal times the number of discouraged workers is approximately _____ of the labor force.

- A. 5%
- B. 4%
- C. 3%
- D. 1%

Answer : D

Which of the following statements is TRUE?

- A. It is possible for the national unemployment rate to be 10% and a state to have an unemployment rate of only 5%.
- B. An unemployment rate of 10% means that the unemployment rate in each sector of the economy is 10%.
- C. An unemployment rate of 10% means that on average people have been unemployed for 10% of the year.
- D. Both A and C

Answer : A

Which of the following groups has the highest unemployment rate among teenagers?

- A. White males
- B. Black males
- C. White females
- D. Black females

Answer : B

Which of the following statements is TRUE?

- A. The unemployment rate does not tell us anything about the duration of unemployment.
- B. The duration of unemployment decreases during recessions.
- C. The duration of unemployment increases during economic expansions.
- D. Both A and B are correct.

Answer : A

The most serious U.S. recession since 1980 was associated with an average unemployment duration of

- A. 13.5 weeks.
- B. 14.6 weeks.
- C. 15.9 weeks.
- D. 20.0 weeks.

Answer : D

During recessions, the number of discouraged workers _____ and this _____ the unemployment rate.

- A. falls; reduces
- B. decreases; increases
- C. increases; reduces
- D. increases; increases

Answer : C

The Humphrey-Hawkins Act formally established a specific unemployment target for the economy of

- A. 2%.
- B. 4%.
- C. 6%.
- D. 8%.

Answer : B

When an economics professor quits his/her job at a university and starts looking for a better job in another university, he/she is

- A. frictionally unemployed.
- B. structurally unemployed.
- C. cyclically unemployed.
- D. naturally unemployed.

Answer : A

Frictional unemployment arises because

- A. there is no job for those who seek employment.
- B. there is a job for those who seek employment, but they haven't found it yet.
- C. those who seek employment are not qualified to perform the jobs they are looking for.
- D. the economy is in a recession.

Answer : B

Increasing the efficiency of various employment agencies to find better matches for those looking for jobs will

- A. reduce the natural rate of unemployment.
- B. reduce structural unemployment.
- C. reduce cyclical unemployment.
- D. not affect frictional unemployment.

Answer : A

A man is fired from his job because he was late for work too many times. While he is searching for another job he would be classified as

- A. not in the labor force because his employer had a legitimate reason for firing him.
- B. structurally unemployed.
- C. cyclically unemployed.
- D. frictionally unemployed.

Answer : D

When the Fed slows the rate of growth of the money supply to slow down the economy, the unemployment type that will be directly affected is the

- A. frictional unemployment.
- B. structural unemployment.
- C. cyclical unemployment.
- D. natural rate of unemployment.

Answer : C

When an individual is not working and is not looking for a job because he/she lacks any marketable job skills, he/she is

- A. structurally unemployed.
- B. frictionally unemployed.
- C. cyclically unemployed.
- D. None of the above.

Answer : D

Structural unemployment is the

- A. portion of unemployment that is due to changes in the structure of the economy that result in a significant loss of jobs in certain industries.
- B. unemployment that occurs during recessions and depressions.
- C. portion of unemployment that is due to the normal working of the labor market.
- D. unemployment that results when people become discouraged about their chances of finding a job so they stop looking for work.

Answer : A

An auto worker in Ohio who loses her job because the company relocated the plant to another country represents an example of

- A. frictional unemployment.
- B. structural unemployment.
- C. cyclical unemployment.
- D. natural unemployment.

Answer : B

A textile firm closes a plant in Massachusetts and transfers production to a plant in South Carolina. The plant supervisor at the Massachusetts plant is given the opportunity to move to South Carolina to become the plant supervisor at that plant. He turns down this opportunity because of family obligations. While he is searching for a new job he would be classified as

- A. structurally unemployed.
- B. cyclically unemployed.
- C. frictionally unemployed.
- D. not in the labor force because he turned down the opportunity to relocate.

Answer : A

An individual who cannot find a job because his or her job skills have become obsolete is an example of

- A. frictional unemployment.
- B. structural unemployment.
- C. cyclical unemployment.
- D. seasonal unemployment.

Answer : B

The natural rate of unemployment is generally thought of as the

- A. ratio of the frictional unemployment rate to the cyclical unemployment rate.
- B. sum of structural unemployment and cyclical unemployment.
- C. sum of frictional unemployment and cyclical unemployment.
- D. sum of frictional unemployment and structural unemployment.

Answer : D

The sum of frictional and structural unemployment is thought of as the

- A. natural rate of unemployment.
- B. normal rate of unemployment.
- C. cyclical rate of unemployment.
- D. seasonal rate of unemployment.

Answer : A

Estimates for the natural rate of unemployment in the United States range from

- A. 4% to 6%.
- B. 4% to 10%.
- C. 4% to 5%.
- D. 4% to 8%.

Answer : A

If the labor market becomes more efficient so that the unemployed are more quickly matched with jobs, then

- A. the natural rate of unemployment will increase.
- B. the natural rate of unemployment will decrease.
- C. the natural rate of unemployment will not change.
- D. the natural rate of unemployment could either increase or decrease.

Answer : B

During the early 1990s, companies started downsizing. One of the results of this downsizing was the permanent reduction in the number of middle management positions. This change in the way businesses operate would have

- A. increased the natural rate of unemployment.
- B. decreased the natural rate of unemployment.
- C. not affected the natural rate of unemployment.
- D. could have either increased or decreased the natural rate of unemployment.

Answer : A

The increase in unemployment that occurs during recessions and depressions is called

- A. frictional unemployment.
- B. structural unemployment.
- C. cyclical unemployment.
- D. normal unemployment.

Answer : C

Cyclical unemployment is the

- A. portion of unemployment that is due to changes in the structure of the economy that result in a significant loss of jobs in certain industries.
- B. unemployment that occurs during recessions and depressions.
- C. portion of unemployment that is due to the normal working of the labor market.
- D. unemployment that results when people become discouraged about their chances of finding a job so they stop looking for work.

Answer : B

The demand for refrigerators falls when the economy enters a downturn. If a refrigerator manufacturer lays off workers during an economic downturn, this would be an example of

- A. frictional unemployment.
- B. natural unemployment.
- C. structural unemployment.
- D. cyclical unemployment.

Answer : D

The economy is in a recession and the housing market is in a slump. As a result of this, a real estate firm lays off half of its real estate agents. This is an example of

- A. frictional unemployment.
- B. structural unemployment.
- C. cyclical unemployment.
- D. natural unemployment.

Answer : C

During the severe recession of the early 1980s, cyclical unemployment increased as the recession continued. This increase in cyclical unemployment would have

- A. increased the natural rate of unemployment.
- B. decreased the natural rate of unemployment.
- C. had no effect on the natural of unemployment.
- D. either increased or decreased the natural rate of unemployment.

Answer : C

During the Great Depression, real output fell by approximately _____ and the unemployment rate rose to about _____.

- A. 15%; 15%
- B. 25%; 30%
- C. 30%; 40%
- D. 30%; 25%

Answer : D

Recessions today may cause lost output in the future because during a recession

- A. consumption tends to fall.
- B. investment tends to fall.
- C. imports tend to fall.
- D. government spending tends to increase.

Answer : B

Which of the following is NOT a cost associated with recessions and unemployment?

- A. Decreased real output
- B. The psychological harm done to the unemployed
- C. Lost output in the future
- D. Worsening of the nation's balance of payments

Answer : D

True/False

- 1) When more people who are not working start looking for jobs, the labor-force participation rate increases.
Answer: True False
Diff: 2
Skill: C
- 2) Labor productivity is total output divided by the total number of worker hours.
Answer: True False
Diff: 1
Skill: D
- 3) An increase in search costs will decrease structural unemployment.
Answer: True False
Diff: 2
Skill: C
- 4) The natural rate of unemployment is the unemployment rate during a period of full employment.
Answer: True False
Diff: 1
Skill: D
- 5) Anyone 16 years of age or older who is not classified as employed is classified as unemployed.
Answer: True False
Diff: 2
Skill: F
- 6) If discouraged workers were counted as unemployed, the measured unemployment rate would increase.
Answer: True False
Diff: 2
Skill: C
- 7) An unemployment rate of 10% means that the average worker has been unemployed for 10% of the year.
Answer: True False
Diff: 1
Skill: C
- 8) If labor markets were perfectly efficient, the unemployment rate would fall to zero.
Answer: True False
Diff: 2
Skill: A
- 9) The natural rate of unemployment in the economy is determined by the Congress and the president of the country.
Answer: True False
Diff: 1
Skill: F

7.3 Inflation

Multiple Choice

In which of the following conditions is the inflation rate likely to fall and the unemployment rate likely to rise?

- A. Hyperinflation
- B. Recession
- C. Boom
- D. Stagflation

Answer : B

Which of the following statements is TRUE?

- A. The costs of recessions are distributed equally among all groups of the population.
- B. Recessions tend to increase the demand for imports and therefore improve the nation's balance of payments.
- C. Recessions may increase efficiency by driving the least efficient firms in the economy out of business.
- D. A recession may lead to an increase in the inflation rate.

Answer : C

An economic boom tends to _____ the demand for imports, which _____ a nation's balance of payments.

- A. reduce; worsens.
- B. reduce; improves.
- C. increase; improves.
- D. increase; worsens.

Answer : D

The floods of 1993 caused the price of corn to increase. This is an example of

- A. inflation.
- B. deflation.
- C. a sustained inflation.
- D. the operations of supply and demand.

Answer : D

The decrease in the demand for mainframe computers caused manufacturers of mainframe computers to reduce prices by 20%. This is an example of

- A. inflation.
- B. deflation.
- C. a sustained inflation.
- D. the operations of supply and demand.

Answer : D

Inflation is an increase in

- A. the price of one item.
- B. the overall price level.
- C. the average income level.
- D. real gross national product.

Answer : B

An increase in the overall price level is

- A. inflation.
- B. deflation.
- C. a price index.
- D. a recession.

Answer : A

Deflation is a decrease in

- A. the price of one item.
- B. the overall price level.
- C. the average income level.
- D. real gross national product.

Answer : B

An increase in the overall price level that continues over a significant period of time is

- A. continuous inflation.
- B. sustained recovery.
- C. sustained inflation.
- D. super inflation.

Answer : C

A price index is

- A. a measurement showing how the average price of a bundle of goods changes over time.
- B. a measurement showing the cost of a bundle of goods at a point in time.
- C. a sustained increase in the overall price level.
- D. a decrease in the overall price level.

Answer : A

Refer to the information provided in Table 7.3 below to answer the questions that follow.

Table 7.3

	Units Purchased	Price per Unit in			
		2000	2001	2002	2003
Apples	10	\$1.50	\$1.80	\$2.00	\$2.10
Oranges	5	\$2.00	\$2.20	\$2.20	\$2.60
Milk	2	\$2.25	\$2.50	\$3.00	\$3.50

Refer to Table 7.3. Suppose 2001 is the base year. The price index in 2001 is

- A. 1,000.
- B. 100.
- C. 1.
- D. 10.

Answer : B

Refer to Table 7.3. If 2001 is the base year, the price index in 2000 is

- A. 84.5.
- B. 96.7.
- C. 113.3.
- D. 86.8.

Answer : D

Refer to Table 7.3. If 2001 is the base year, the price index in 2002 is

- A. 102.4.
- B. 108.8.
- C. 91.9.
- D. 101.4.

Answer : B

Refer to Table 7.3 If 2001 is the base year, the price index in 2003 is

- A. 82.9.
- B. 112.7.
- C. 120.6.
- D. 115.2.

Answer : C

Refer to Table 7.3. If 2001 is the base year, the inflation rate between 2001 and 2002 is

- A. 26.8%.
- B. 24.8%.
- C. 20.0%.
- D. None of the above

Answer : D

Refer to Table 7.3. If 2001 is the base year, the inflation rate between 2001 and 2002 is _____ %, and the inflation rate between 2002 and 2003 is _____ %.

- A. 18.3; 20
- B. 8.8; 20.6
- C. 12.7; 5.9
- D. 24.1; 8.4

Answer : B

Refer to Table 7.3. The lowest inflation rate is between the years

- A. 2002 and 2003.
- B. 2001 and 2002.
- C. 2000 and 2001.
- D. Cannot be determined from the given information.

Answer : B

Refer to the information provided in Table 7.4 below to answer the questions that follow.

Table 7.4

	Units Purchased	Price per Unit in		
		2001	2002	2003
Good A	4	\$1.00	\$1.50	\$1.50
Good B	12	\$2.00	\$2.50	\$3.00
Good C	6	\$4.00	\$4.50	\$5.00

Refer to Table 7.4. The bundle price for the goods in period 2001 is

- A. \$100.
- B. \$53.
- C. \$52.
- D. \$63.

Answer : B

Refer to Table 7.4. If 2001 is the base period, the price index in 2001 is

- A. 1000.
- B. 100.
- C. 10.
- D. 1.

Answer : B

Refer to Table 7.4. If 2001 is the base year, the price index in 2002 is

- A. 121.7.
- B. 121.2
- C. 82.5.
- D. 112.6.

Answer : B

Refer to Table 7.4. If 2001 is the base year, the price index in 2003 is

- A. 114.3.
- B. 138.5.
- C. 138.7.
- D. 71.2.

Answer : B

Refer to Table 7.4. If 2001 is the base year, the inflation rate between 2001 and 2002 is

- A. 38.5%.
- B. 21.7%.
- C. 21.2%.
- D. 8.8%.

Answer : C

Refer to Table 7.4. If 2001 is the base year, the inflation rate between 2001 and 2003 is

- A. 30.8%.
- B. 21.2%.
- C. 38.7%.
- D. 38.5%.

Answer : D

Refer to Table 7.4. If 2002 is the base year, the inflation rate between 2002 and 2003 is

- A. 15.9%.
- B. 8.8%.
- C. 14.3%.
- D. 14.0%.

Answer : C

If period 1 is the base year, the bundle price of goods in period 1 is \$200, and the bundle price of goods in period 2 is \$220, the period 2 price index is

- A. 90.9.
- B. 112.5.
- C. 66.67.
- D. 110.

Answer : D

If 2002 is the base year, the bundle price of goods in 2002 is \$600, and the bundle price of goods in 2003 is \$700, the 2003 price index is

- A. 121.4.
- B. 116.7.
- C. 85.7.
- D. 100.

Answer : B

If the price index in period 2 is 112 and the price index in period 3 is 120, the rate of inflation between period 2 and period 3 is

- A. 8%.
- B. 1.2%.
- C. 7.1%.
- D. 4.3%.

Answer : C

If 2002 is the base year and the inflation rate between 2002 and 2003 is 4%, the price index in 2003 is

- A. 40.
- B. 104.
- C. 140.
- D. Cannot be determined from this information because the index in the base year is not given.

Answer : B

If 2002 is the base year and the inflation rate between 2002 and 2003 is -6, the price index in 2003 is

- A. 106.
- B. -160.
- C. 94.
- D. Cannot be determined from this information because the base year is not known.

Answer : C

If the price index in 2002 is 120 and the price index in 2003 is 110, the rate of inflation between 2002 and 2003

- A. is -10%.
- B. is -8.3%.
- C. is -4.2%.
- D. is -6.6%.

Answer : B

The index used most often to measure inflation is the

- A. producer price index.
- B. consumer price index.
- C. wholesale price index.
- D. GDP deflator.

Answer : B

If the CPI in 2001 was 125.2 and the CPI in 2002 was 130.2, then the rate of inflation between 2001 and 2002 was

- A. 11.1%.
- B. 4%.
- C. 13.9%.
- D. 14.3%.

Answer : B

If the CPI in 2002 was 102 and the CPI in 2003 was 105, then the rate of inflation between 2002 and 2003 was

- A. 2.24%.
- B. 2.94%.
- C. 4.22%.
- D. 1.96%.

Answer : B

If the CPI in period 1 is 150 and the CPI in period 2 is 250, then the rate of inflation between period 1 and period 2 is

- A. 66.7%.
- B. 25%.
- C. 33.33%.
- D. 50%.

Answer : A

The CPI in period 1 is 200 and the CPI in period 2 is 100. The rate of inflation between period 1 and period 2 is

- A. -50%.
- B. -100%.
- C. 33.33%.
- D. -60%.

Answer : A

Which of the following statements is FALSE?

- A. One problem with any fixed-bundle index as a measure of the cost of living is that it does not account for substitutions that consumers might make in response to price changes.
- B. The producer price index is considered to be a leading indicator of future inflation rates.
- C. The best overall indicator of inflationary pressures in the economy is the GDP deflator.
- D. The consumer price index somewhat understates changes in the cost of living.

Answer : D

A price index that tends to be a leading indicator of future inflation rates is the

- A. consumer price index.
- B. producer price index.
- C. GDP price index.
- D. retail price index.

Answer : B

The broadest-based price index available is the

- A. GDP deflator.
- B. producer price index.
- C. consumer price index.
- D. wholesale price index.

Answer : A

Most economists consider the _____ as the best overall indicator of inflationary pressures in the economy.

- A. producer price index
- B. GDP deflator
- C. wholesale price index
- D. consumer price index

Answer : B

Which of the following statements is FALSE?

- A. An individual living on a fixed income is always made worse off as a result of inflation.
- B. Those individuals receiving welfare benefits have been harmed by inflation because increases in welfare payments have not kept pace with inflation.
- C. Inflation will have no effect on an individual whose income is indexed to the inflation rate.
- D. Some people in society benefit from inflation.

Answer : C

The difference between the interest rate on a loan and the inflation rate is the

- A. nominal interest rate.
- B. inflation premium.
- C. real interest rate.
- D. expected interest rate.

Answer : C

Which of the following increases the real interest rate?

- A. A decrease in the nominal interest rate, holding the inflation rate constant
- B. An increase in both the nominal interest rate and the inflation rate by the same percentage points
- C. A decrease in the inflation rate, holding the nominal interest rate constant
- D. A decrease in both the nominal interest rate and the inflation rate by the same percentage points

Answer : C

If A. Jackson is paid an interest rate of 5% on his savings, but the inflation rate is 7%, the real interest rate A. Jackson earns is

- A. 5%.
- B. -2%.
- C. -7%.
- D. 35%.

Answer : B

You want to make a 5% real return on a loan that you are planning to make, and the expected inflation rate during the period of the loan is 4%. You should charge a nominal interest rate of

- A. 1%.
- B. 11%.
- C. -9%.
- D. 9%.

Answer : D

Bridget wants to make an 8% real return on a loan that she is planning to make, and the expected inflation rate during the period of the loan is 8%. She should charge an interest rate of

- A. 8%.
- B. 18%.
- C. 16%.
- D. 0%.

Answer : C

If the inflation rate is smaller than the nominal interest rate, the real interest rate is

- A. positive.
- B. negative.
- C. zero.
- D. either positive or zero.

Answer : A

Jane wants to borrow \$100 from John. John wants to make 6% real return on his money, so they both agree on a 6% interest rate paid next year. Both don't anticipate the -2% inflation next year. In this case,

- A. Jane will pay an 8% real interest rate.
- B. John is better off.
- C. Jane will pay a 6% nominal interest rate.
- D. All of the above

Answer : D

Bill borrows \$100 from Jack. Jack wants to make a 5% real return on his money, so they both agree on a 5% interest rate paid next year. Both don't anticipate the 3% inflation next year. In this case,

- A. Jack is better off.
- B. Bill will pay \$8 a year from now on.
- C. Bill is better off.
- D. Jack will receive more than 5% of real rate of return a year from now.

Answer : C

Which of the following is a cost of anticipated inflation?

- A. Debtors are made worse off.
- B. If people are not fully informed about the price level changes, resources will be misallocated.
- C. The degree of risk associated with investments in the economy increases.
- D. Creditors are made worse off.

Answer : B

Stopping inflation

- A. can only benefit the economy, because the price level will be reduced.
- B. may be costly, if the inflation is stopped by inducing a recession.
- C. may be costly, but the benefits of stopping inflation will always outweigh the costs of such actions.
- D. will have no benefits or costs associated with it.

Answer : B

Which of the following statements is FALSE?

- A. Whether you gain or lose during a period of inflation depends on whether your income rises faster or slower than the prices of the things you buy.
- B. Inflation that is higher than expected benefits debtors, and inflation that is lower than expected benefits creditors.
- C. There are no costs or losses associated with anticipated inflation.
- D. When unanticipated inflation occurs regularly, the degree of risk associated with investments in the economy increases.

Answer : C

When unanticipated inflation occurs regularly, the degree of risk associated with investments in the economy

- A. increases.
- B. decreases.
- C. remains stable.
- D. falls to zero.

Answer : A

Which of the following is TRUE?

- A. A recession will lead to reduced output in the future, but inflation has no effect on future output.
- B. Both recessions and inflations may reduce output in the future.
- C. A recession will lead to reduced output in the future, but inflation will lead to increased output in the future.
- D. A recession will lead to increased output in the future, but inflation will lead to decreased output in the future.

Answer : B

True/False

- 1) The CPI somewhat overstates changes in the cost of living because it does not allow for substitutions that consumers might make in response to price changes.

Answer: True False

Diff: 3

Skill: A

- 2) A 100% increase in the price of salt changes the CPI more than a 10% increase in rent.

Answer: True False

Diff: 2

Skill: F

- 3) An inflation rate that is lower than expected benefits creditors.

Answer: True False

Diff: 3

Skill: F

- 4) There are no costs associated with inflation if the inflation rate is perfectly anticipated.

Answer: True False

Diff: 2

Skill: F

- 5) The actual real rate of interest is the nominal rate less the actual inflation rate.

Answer: True False

Diff: 2

Skill: F

