

Test Item File to Accompany

**Principles of
Macroeconomics - Test
Item File 1**
Ninth Edition

by

Case / Fair / Oster

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Chapter 1 The Scope and Method of Economics

1.1 Why Study Economics?

1 Multiple Choice

- 1) Which of the following is NOT listed in the book as a reason to study economics?
- A) to learn a way of thinking
 - B) to understand society and global affairs
 - C) to be an informed voter
 - D) to learn how to make lots of money

Answer: D

Diff: 1

Topic: *Why Study Economics?*

Skill: *Fact*

- 2) Among the fundamental concepts in economics are
- A) opportunity cost.
 - B) marginalism.
 - C) efficient markets.
 - D) all of the above

Answer: D

Diff: 1

Topic: *Why Study Economics?*

Skill: *Fact*

- 3) Which of the following is the best definition of economics?
- A) the study of how individuals and societies choose to use the scarce resources that nature and previous generations have provided
 - B) the study of how consumers spend their income
 - C) the study of how business firms decide what inputs to hire and what outputs to produce
 - D) the study of how the federal government allocates tax dollars

Answer: A

Diff: 2

Topic: *Why Study Economics?*

Skill: *Definition*

- 4) The rise of the modern factory system in England during the late eighteenth and early nineteenth centuries is known as the
- A) Great Migration.
 - B) Industrial Revolution.
 - C) Wealth of Nations.
 - D) Dark Ages.

Answer: B

Diff: 1

Topic: *Why Study Economics?*

Skill: *Fact*

- 5) Which of the following statements is NOT correct?
- A) Economics is a behavioral science.
 - B) In large measure, economics is the study of how people make choices.
 - C) If poverty was eliminated there would be no reason to study economics.
 - D) Economic analysis can be used to explain how both individuals and societies make decisions.

Answer: C

Diff: 1

Topic: *Why Study Economics?*

Skill: *Fact*

- 6) The study of economics
- A) is a very narrow endeavor.
 - B) is a way of analyzing decision-making processes caused by scarcity.
 - C) is concerned with proving that capitalism is better than socialism.
 - D) focuses on how a business should function.

Answer: B

Diff: 2

Topic: *Why Study Economics?*

Skill: *Definition*

- 7) Sunk costs are
- A) costs that cannot be avoided, because they have already been incurred.
 - B) the costs of what we give up when we make a choice or a decision.
 - C) the additional costs of producing an additional unit of a product.
 - D) the additional costs of consuming an additional unit of a product.

Answer: A

Diff: 2

Topic: *Why Study Economics?*

Skill: *Definition*

- 8) Suppose that you purchased a ticket to a jazz festival for \$100 a month ago. Last week someone invited you to a hockey game on the same night as the jazz festival. You would much rather go to the hockey game than the jazz festival. You have tried unsuccessfully to sell the jazz festival ticket. Which of the following statements regarding this situation is correct?
- A) The \$100 you paid for the jazz festival ticket is relevant to the decision, as this represents the opportunity cost of attending the hockey game.
 - B) You should base your decision on whether or not the hockey game will provide you with more than \$100 in satisfaction.
 - C) The \$100 you paid for the jazz festival ticket should be irrelevant in your decision making, because it is a sunk cost.
 - D) The \$100 jazz festival ticket should be irrelevant in your decision making, because it represents the marginal cost of attending the hockey game.

Answer: C

Diff: 2

Topic: *Why Study Economics?*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

9) You have decided that you want to attend a costume party as Ironman. You estimate that it will cost \$40 to assemble your costume. After spending \$40 on the costume, you realize that the additional pieces you need will cost you \$25 more. The marginal cost of completing the costume is

- A) \$15. B) \$25. C) \$40. D) \$65.

Answer: B

Diff: 2

Topic: *Why Study Economics?*

Skill: *Analytic*

AACSB: *Analytic Skills*

10) The concept of opportunity cost

- A) is relevant only to economics.
B) can be applied to the analysis of any decision-making process.
C) applies to consumers but not to firms.
D) refers only to actual payments and incomes.

Answer: B

Diff: 2

Topic: *Why Study Economics?*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

11) Opportunity cost is

- A) that which we forgo, or give up, when we make a choice or a decision.
B) a cost that cannot be avoided, regardless of what is done in the future.
C) the additional cost of producing an additional unit of output.
D) the additional cost of buying an additional unit of a product.

Answer: A

Diff: 2

Topic: *Why Study Economics?*

Skill: *Definition*

12) The reason that opportunity costs arise is that

- A) an economy relies on money to facilitate exchange of goods and services.
B) resources are scarce.
C) there are no alternative decisions that could be made.
D) people have limited wants.

Answer: B

Diff: 1

Topic: *Why Study Economics?*

Skill: *Fact*

13) Which of the following is NOT an opportunity cost of attending college?

- A) the tuition you pay
B) the income you could have earned if you didn't attend college
C) the alternative uses of the time you spend studying
D) the cost of the food that you consume while you are attending college

Answer: D

Diff: 3

Topic: *Why Study Economics?*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

14) If your tuition is \$5,000 this semester, your books cost \$600, you can only work 20 rather than 40 hours per week during the 15 weeks you are taking classes and you make \$15 per hour, and your room and board is \$3000 this semester, then your opportunity cost of attending college this semester is

- A) \$5,600. B) \$5,900. C) \$10,100. D) \$11,600.

Answer: C

Diff: 3

Topic: *Why Study Economics?*

Skill: *Analytic*

AACSB: *Analytic Skills*

15) If your tuition is \$25,000 this semester, your books cost \$1,500, you can only work 20 rather than 40 hours per week during the 15 weeks you are taking classes and you make \$15 per hour, and your room and board is \$7,500 this semester, then your opportunity cost of attending college this semester is

- A) \$26,500. B) \$26,800. C) \$31,000. D) \$38,500.

Answer: C

Diff: 3

Topic: *Why Study Economics?*

Skill: *Analytic*

AACSB: *Analytic Skills*

16) If you own a building and you decide to use that building to open a book store,

- A) there is no opportunity cost of using this building for a book store because you own it.
B) there is an opportunity cost of using this building for a book store because it could have been used in other ways.
C) there are no sunk costs involved in this decision.
D) the only cost relevant to this decision is the price you paid for the building.

Answer: B

Diff: 2

Topic: *Why Study Economics?*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

17) You own the *Star Wars* six DVD set. The opportunity cost of watching these DVDs for the second time

- A) is zero.
B) is one-half the cost of the DVDs, as this is the second time you have watched it.
C) is the value of the alternative use of the time you spend watching the DVDs.
D) cannot be calculated.

Answer: C

Diff: 2

Topic: *Why Study Economics?*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 18) That which we forgo, or give up, when we make a choice or decision is called
- A) sunk cost.
 - B) marginal cost.
 - C) real cost.
 - D) opportunity cost.

Answer: D

Diff: 1

Topic: Why Study Economics?

Skill: Definition

- 19) Costs that cannot be avoided, regardless of what is done in the future, because they have already been incurred are
- A) total costs.
 - B) sunk costs.
 - C) marginal costs.
 - D) allocative costs.

Answer: B

Diff: 1

Topic: Why Study Economics?

Skill: Definition

- 20) If you can buy 9 DVDs for \$126 or you could buy 10 DVDs for \$130, then the marginal cost of the tenth DVD is:
- A) \$4.
 - B) \$13.
 - C) \$14.
 - D) \$130.

Answer: A

Diff: 2

Topic: Why Study Economics?

Skill: Analytic

- 21) If you eat at a sushi restaurant that charges \$20 for its all you can eat sushi special, then the marginal cost of your 10th piece of sushi is
- A) zero.
 - B) \$2.
 - C) \$200.
 - D) \$2,000.

Answer: A

Diff: 2

Topic: Why Study Economics?

Skill: Analytic

AACSB: Analytic Skills

- 22) A market in which profit opportunities are eliminated almost instantaneously is
- A) a laissez-faire market.
 - B) a capitalist market.
 - C) a socialist market.
 - D) an efficient market.

Answer: D

Diff: 2

Topic: Why Study Economics?

Skill: Definition

- 23) If information is less costly and more easily available, then usually this
- A) makes markets more efficient.
 - B) makes markets less efficient.
 - C) increases profit opportunities.
 - D) increases the opportunity cost of acquiring more information.

Answer: A

Diff: 3

Topic: Why Study Economics?

Skill: Conceptual

AACSB: Reflective Thinking

- 24) An efficient market is a market
- A) in which everyone always gets what they want.
 - B) in which profit opportunities are eliminated almost instantaneously.
 - C) in which profits are always very high and persistent.
 - D) in which opportunity costs are zero.

Answer: B

Diff: 2

Topic: *Why Study Economics?*

Skill: *Definition*

- 25) Related to the *Economics in Practice* on p. 6: Which one of the following best supports the argument that most of the value of Apple's iPod is in its conception and design?
- A) Apple's history of innovative product design includes the earliest use of a Graphic User Interface (GUI) in the home computer market.
 - B) The iPod would not have been as successful without the development of Web sites that allow users to purchase and download music.
 - C) Companies that assemble the iPod and those that manufacture iPod components together capture only a small fraction of the iPod's retail value.
 - D) Increases in the costs of components will reduce the profitability of the iPod, although price increases can be passed on to consumers.

Answer: C

Diff: 3

Topic: *Why Study Economics?: Economics in Practice*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 26) Related to the *Economics in Practice* on p. 6: Which one of the following best explains why Apple's iPod is neither a pure import nor a pure export?
- A) The iPod has earned a large share of the market for portable music players in both the United States and other industrialized nations.
 - B) Intellectual property laws protect the iPod in both domestic and international markets, although enforcement of those laws varies widely between countries.
 - C) Apple stock is publicly traded, and so citizens of any country can own Apple stock.
 - D) The iPod was designed and is sold by a U.S. company, but it is assembled in China from parts made in the United States and other countries.

Answer: D

Diff: 3

Topic: *Why Study Economics?: Economics in Practice*

Skill: *Analytic*

AACSB: *Analytic Skills*

2 True/False

- 1) Resources are unlimited in a wealthy society.

Answer: FALSE

Diff: 1

Topic: *Why Study Economics?*

Skill: *Fact*

2) The value of the best alternative foregone is the opportunity cost of making a decision.

Answer: TRUE

Diff: 1

Topic: *Why Study Economics?*

Skill: *Definition*

3) Opportunity costs arise due to scarce resources.

Answer: TRUE

Diff: 1

Topic: *Why Study Economics?*

Skill: *Fact*

4) Sunk costs do not affect marginal decision making.

Answer: TRUE

Diff: 2

Topic: *Why Study Economics?*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

5) Marginal costs are those that can not be recaptured.

Answer: FALSE

Diff: 1

Topic: *Why Study Economics?*

Skill: *Fact*

1.2 The Scope of Economics

1 Multiple Choice

1) The branch of economics that examines the functioning of individual industries and the behavior of individual decision-making units is

A) positive economics.

B) normative economics.

C) macroeconomics.

D) microeconomics.

Answer: D

Diff: 2

Topic: *The Scope of Economics*

Skill: *Definition*

2) Studying how the management of Hewlett Packard decides how many computers to produce and the price to charge for its computers would be considered

A) descriptive economics.

B) empirical economics.

C) microeconomics.

D) macroeconomics.

Answer: C

Diff: 2

Topic: *The Scope of Economics*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 3) Studying how Joshua allocates his time between school and video games is an example of
- A) macroeconomics.
 - B) microeconomics.
 - C) industrial organization.
 - D) descriptive economics.

Answer: B

Diff: 1

Topic: *The Scope of Economics*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 4) The study of how benefits are determined for city employees would be considered
- A) microeconomics.
 - B) macroeconomics.
 - C) descriptive economics.
 - D) institutional economics.

Answer: A

Diff: 1

Topic: *The Scope of Economics*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 5) Inflation and unemployment
- A) are the focus of normative economics.
 - B) are a focus of microeconomics.
 - C) are a focus of positive economics.
 - D) are a focus of macroeconomics.

Answer: D

Diff: 1

Topic: *The Scope of Economics*

Skill: *Fact*

2 True/False

- 1) The rate of economic growth is a topic of microeconomics.

Answer: FALSE

Diff: 1

Topic: *The Scope of Economics*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 2) The aggregate price level is a topic of macroeconomics.

Answer: TRUE

Diff: 2

Topic: *The Scope of Economics*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

1.3 The Method of Economics

1 Multiple Choice

1) Better insurance benefits increase the incentive of some individuals to work. This statement is best described as a

- A) positive statement.
- B) Marxist ideology.
- C) normative statement.
- D) descriptive economics statement.

Answer: A

Diff: 2

Topic: *The Method of Economics*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

2) The Bureau of Labor Statistics announced that the unemployment rate fell by one percentage point. This is best described as

- A) an economic model.
- B) Marxist ideology.
- C) a normative statement.
- D) descriptive economics.

Answer: D

Diff: 2

Topic: *The Method of Economics*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

3) The amount of education that one has is an important factor in the determination of his or her wage rate. This is best described as

- A) a positive statement.
- B) Marxist ideology.
- C) a normative statement.
- D) descriptive economics.

Answer: A

Diff: 2

Topic: *The Method of Economics*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

4) The cost involved when choosing between alternatives is known as the

- A) marginal cost.
- B) sunk cost.
- C) opportunity cost.
- D) normative cost.

Answer: C

Diff: 2

Topic: *The Method of Economics*

Skill: *Definition*

- 5) Positive economics is an approach to economics that
- A) seeks to understand behavior and the operation of systems while making judgments about their usefulness to society.
 - B) analyzes outcomes of economic behavior, evaluates them as good or bad, and may prescribe preferred courses of action.
 - C) applies statistical techniques and data to economic problems.
 - D) examines the role of government in the economy.

Answer: C

Diff: 1

Topic: *The Method of Economics*

Skill: *Fact*

- 6) Normative economics is an approach to economics that
- A) seeks to understand behavior and the operation of systems without making judgments.
 - B) analyzes outcomes of economic behavior, evaluates them as good or bad, and may prescribe preferred courses of action.
 - C) applies statistical techniques and data to economic problems.
 - D) examines the role of government in the economy.

Answer: B

Diff: 1

Topic: *The Method of Economics*

Skill: *Fact*

- 7) Which of the following is a normative question?
- A) Why do gasoline prices increase between Memorial Day and Labor Day?
 - B) What will happen to gasoline consumption if the federal tax on gasoline is eliminated?
 - C) To reduce the regressive nature of the gasoline excise tax, should the portion of the gasoline excise tax paid by high-income individuals be increased?
 - D) How will oil exploration be affected if the government subsidizes oil producers?

Answer: C

Diff: 2

Topic: *The Method of Economics*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 8) Which of the following is a positive question?
- A) Will the level of teenage unemployment increase if the minimum wage is increased?
 - B) Should the minimum wage be set at one-half the average manufacturing wage to guarantee individuals a decent standard of living?
 - C) Wouldn't it be more equitable if the minimum wage increased automatically with the cost of living?
 - D) Wouldn't it be better to try to increase people's wages through job-training programs rather than by requiring employers to pay minimum wages?

Answer: A

Diff: 2

Topic: *The Method of Economics*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 9) Health insurance should be provided to every citizen in a wealthy nation such as the United States. This statement is best described as
- A) a positive statement.
 - B) a normative statement.
 - C) a descriptive economics statement.
 - D) an implication of an efficient market.

Answer: B

Diff: 2

Topic: The Method of Economics

Skill: Conceptual

AACSB: Reflective Thinking

- 10) There is great concern over the fact that millions of Americans do not have health insurance. A study of the costs and benefits of implementing a national health-insurance program is an example of
- A) laissez-faire economics.
 - B) positive economics.
 - C) labor economics.
 - D) normative economics.

Answer: B

Diff: 2

Topic: The Method of Economics

Skill: Conceptual

AACSB: Reflective Thinking

- 11) Descriptive economics
- A) identifies actions and reactions.
 - B) requires model building.
 - C) looks at the outcomes of economic behavior and asks if they are good or bad.
 - D) mainly involves the compilation of data that describe phenomena and facts.

Answer: D

Diff: 2

Topic: The Method of Economics

Skill: Definition

- 12) An example of descriptive economics is when an economist
- A) collects data on the wage rates and employment levels in the farming industry.
 - B) tries to develop a model to explain the changes in employment and wages in the farming industry.
 - C) tries to understand the relationship between the price of imported agricultural products and the level of employment in the U.S. farming industry.
 - D) tries to determine if there are any regular patterns in the employment levels in the farming industry and then makes generalizations from these patterns.

Answer: A

Diff: 2

Topic: The Method of Economics

Skill: Conceptual

AACSB: Reflective Thinking

Refer to Scenario 1.1 below to answer the questions that follow.

SCENARIO 1.1: An economist wants to understand the relationship between minimum wages and the level of teenage unemployment. The economist collects data on the values of the minimum wage and the levels of teenage unemployment over time. The economist concludes that a 1% increase in minimum wage causes a 0.2% increase in teenage unemployment. From this information he concludes that the minimum wage is harmful to teenagers and should be reduced or eliminated to increase employment among teenagers.

13) Refer to Scenario 1.1. The statement that a 1% increase in the minimum wage causes a 0.2% increase in teenage unemployment is an example of

- A) descriptive economics.
- B) normative economics.
- C) positive economics.
- D) Marxist economics.

Answer: C

Diff: 2

Topic: The Method of Economics

Skill: Conceptual

AACSB: Reflective Thinking

14) Refer to Scenario 1.1. The statement, "the minimum wage is harmful to teenagers and should be reduced or eliminated to increase employment among teenagers," is an example of

- A) descriptive economics.
- B) normative economics.
- C) positive economics.
- D) Marxist economics.

Answer: B

Diff: 2

Topic: The Method of Economics

Skill: Conceptual

AACSB: Reflective Thinking

15) Refer to Scenario 1.1. The process of collecting data on minimum wage and teenage unemployment levels is an example of

- A) law and economics.
- B) economic history.
- C) econometrics.
- D) descriptive economics.

Answer: D

Diff: 2

Topic: The Method of Economics

Skill: Conceptual

AACSB: Reflective Thinking

16) Refer to Scenario 1.1. The statement that an increase in the minimum wage causes an increase in teenage unemployment is an example of

- A) descriptive reasoning.
- B) an economic theory.
- C) normative economics.
- D) deductive reasoning.

Answer: B

Diff: 2

Topic: The Method of Economics

Skill: Conceptual

AACSB: Reflective Thinking

17) Refer to Scenario 1.1. A graph of the value of the minimum wage on one axis and the level of teenage unemployment on the other axis is an example of

- A) an economic theory.
- B) an economic model.
- C) inductive reasoning.
- D) a variable theory.

Answer: B

Diff: 2

Topic: *The Method of Economics*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

18) To isolate the impact of one single factor, economists invoke the assumption of

- A) inductive reasoning.
- B) Ockham's razor.
- C) ceteris paribus.
- D) post hoc, ergo prompter hoc.

Answer: C

Diff: 2

Topic: *The Method of Economics*

Skill: *Definition*

19) The principle that irrelevant detail should not be included in a model is known as

- A) Say's Identity.
- B) ceteris paribus.
- C) Ockham's razor.
- D) Hobson's choice.

Answer: C

Diff: 2

Topic: *The Method of Economics*

Skill: *Definition*

20) Economists use the phrase "ceteris paribus" to express the assumption

- A) "all else equal."
- B) "everything affects everything else."
- C) "scarcity is a fact of life."
- D) "there is no such thing as a free lunch."

Answer: A

Diff: 2

Topic: *The Method of Economics*

Skill: *Definition*

21) The Latin phrase economists use that means all else equal is:

- A) "ceteris paribus."
- B) "cogito ergo sum."
- C) "carpe diem."
- D) "caveat emptor."

Answer: A

Diff: 2

Topic: *The Method of Economics*

Skill: *Definition*

- 22) Stanley Jevons, an economist in the nineteenth century, noted a high correlation between economic prosperity and sunspots. Based on this observation he developed a "sunspot theory" of how the economy operated. We now know that Jevons
- A) committed the fallacy of composition.
 - B) committed the ceteris paribus error.
 - C) was too quick to conclude that correlation implies causation.
 - D) showed good reasoning for the nineteenth but not the twentieth century.

Answer: C

Diff: 3

Topic: *The Method of Economics*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 23) Whenever the Democrats gain control of the Congress, spending on social programs increases; whenever Republicans gain control of the Congress, spending on defense increases. Hence, we know what the next party in control will do. This statement is an example of
- A) fallacy of inductive reasoning.
 - B) post hoc, ergo prompter hoc fallacy.
 - C) fallacy of composition.
 - D) ceteris paribus fallacy.

Answer: B

Diff: 2

Topic: *The Method of Economics*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 24) I have lived in a house on the Mississippi River for many years and have never seen a flood. Therefore, there is no reason for anyone to buy flood insurance. This statement is an example of
- A) fallacy of composition.
 - B) post hoc, ergo prompter hoc fallacy.
 - C) fallacy of inductive reasoning.
 - D) ceteris paribus fallacy.

Answer: A

Diff: 2

Topic: *The Method of Economics*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 25) The economy was expanding during all of the years that I was a student, but as soon as I graduated, the economy contracted. Therefore, the labor market was waiting until I started looking for a job to contract. This statement is an example of
- A) ceteris paribus fallacy.
 - B) post hoc, ergo prompter hoc fallacy.
 - C) fallacy of composition.
 - D) fallacy of inductive reasoning.

Answer: B

Diff: 2

Topic: *The Method of Economics*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 26) Experimental research in small cities suggests that mandating work for welfare recipients increases their income. Therefore, we should mandate work requirements for all welfare recipients. This statement is an example of
- A) fallacy of inductive reasoning.
 - B) ceteris paribus fallacy.
 - C) fallacy of composition.
 - D) post hoc, ergo prompter hoc fallacy.

Answer: C

Diff: 2

Topic: *The Method of Economics*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 27) Rent control laws are imposed when city officials believe landlords have been exploiting tenants. Which of the following criteria are they using to guide their actions?
- A) efficiency
 - B) equity
 - C) growth
 - D) stability

Answer: B

Diff: 3

Topic: *The Method of Economics*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 28) A government policy that tries to minimize inflation and unemployment can best be described as trying to achieve economic
- A) efficiency.
 - B) equity.
 - C) profitability.
 - D) stability.

Answer: D

Diff: 3

Topic: *The Method of Economics*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 29) Redistribution of income from the rich to the poor is achieved from a tax system that requires taxes to rise with income. Which of the following criteria best explains the goal of this tax system?
- A) efficiency
 - B) equity
 - C) growth
 - D) stability

Answer: B

Diff: 3

Topic: *The Method of Economics*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 30) You know that the computer lab at school gets very crowded at about 3:00 p.m. To avoid the crowds, you start going to the computer lab one hour earlier every day. However many students make the same decision, and now the computer lab becomes very crowded at 2:00 p.m. This is an example of the
- A) post hoc, ergo prompter hoc fallacy.
 - B) ceteris paribus fallacy.
 - C) fallacy of division.
 - D) fallacy of composition.

Answer: D

Diff: 3

Topic: *The Method of Economics*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 31) It always rains about an hour after you finish washing your car. Concluding that washing your car caused it to rain is an example of the
- A) fallacy of composition.
 - B) post hoc, ergo prompter hoc fallacy.
 - C) fallacy of inductive reasoning.
 - D) ceteris paribus conditions.

Answer: B

Diff: 2

Topic: The Method of Economics

Skill: Conceptual

AACSB: Reflective Thinking

- 32) At a political rally, you stand up to see better. Everyone else stands up, as well. This is an example of
- A) ceteris paribus.
 - B) the post hoc, ergo prompter hoc fallacy.
 - C) the fallacy of composition.
 - D) Ockham's razor.

Answer: C

Diff: 2

Topic: The Method of Economics

Skill: Conceptual

AACSB: Reflective Thinking

- 33) You have observed that every time you do 30 minutes of cardio exercise before taking an exam you get an A. You therefore conclude that to get an A on an exam, all you have to do is 30 minutes of cardio exercise before you take an exam. You have committed the
- A) fallacy of composition.
 - B) fallacy of inductive reasoning.
 - C) post hoc, ergo prompter hoc fallacy.
 - D) fallacy of division.

Answer: C

Diff: 2

Topic: The Method of Economics

Skill: Conceptual

AACSB: Reflective Thinking

- 34) If you observe that Event A happens before Event B happens, and you conclude that Event A caused Event B, you would be guilty of an error called the
- A) fallacy of composition.
 - B) fallacy of inductive reasoning.
 - C) fallacy of ceteris paribus.
 - D) post hoc, ergo prompter hoc fallacy.

Answer: D

Diff: 2

Topic: The Method of Economics

Skill: Definition

- 35) Two variables are said to be _____ if one variable changes when the other variable changes.
- A) causally related
 - B) correlated
 - C) statistically related
 - D) dependent

Answer: B

Diff: 2

Topic: The Method of Economics

Skill: Definition

- 36) The fallacy of composition is
- A) the belief that if Event A happens before Event B happens, then Event A causes Event B to occur.
 - B) the belief that what is true for the whole is necessarily true of the parts.
 - C) the belief that what is true for a part is necessarily true for the whole.
 - D) the belief that it is impossible to draw generalizations about cause and effect.

Answer: C

Diff: 2

Topic: *The Method of Economics*

Skill: *Definition*

- 37) The collection and use of data to test economic theories is
- A) empirical economics.
 - B) descriptive economics.
 - C) normative economics.
 - D) positive economics.

Answer: A

Diff: 2

Topic: *The Method of Economics*

Skill: *Definition*

- 38) A change in economic output is potentially efficient
- A) if the value of the resulting gains exceeds the value of the resulting losses.
 - B) if the value of the resulting gains exactly equals the value of the resulting losses.
 - C) only if no one is made worse off.
 - D) if the value of the resulting gains is less than the value of the resulting losses.

Answer: A

Diff: 3

Topic: *The Method of Economics*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 39) An efficient economy is an economy
- A) in which output is steady or growing and there is low inflation.
 - B) that produces what consumers demand and does so at the least possible cost.
 - C) that distributes output equally among all consumers.
 - D) in which there is a fair distribution of wealth.

Answer: B

Diff: 2

Topic: *The Method of Economics*

Skill: *Definition*

- 40) An efficient market is characterized by the fact that
- A) output is steady or growing and there is low inflation.
 - B) profit opportunities are eliminated almost instantaneously.
 - C) there are no opportunity costs.
 - D) wealth is distributed fairly.

Answer: B

Diff: 1

Topic: *The Method of Economics*

Skill: *Fact*

- 41) The four criteria that are frequently used in judging the outcome of economic policy are
- A) efficiency, equity, stability, and economic growth.
 - B) efficiency, equality, stability, and economic growth.
 - C) efficiency, equality, profitability, and stability.
 - D) efficiency, equity, profitability, and stability.

Answer: A

Diff: 1

Topic: *The Method of Economics*

Skill: *Fact*

- 42) You have noticed that there is an increase in the number of homeless people in your city. At the same time you observe that there are also a number of vacant apartments. You believe that the government could reduce the number of homeless people if landlords were required to rent their apartments for less than they are currently charging. This policy recommendation would be motivated by concerns over
- A) efficiency.
 - B) equity.
 - C) economic growth.
 - D) stability.

Answer: B

Diff: 3

Topic: *The Method of Economics*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 43) There is a possibility that a national sales tax will be implemented. Many economists argue that items such as food and clothing should be exempt from such a tax because low-income people spend a greater percentage of their income on these goods than do high-income individuals. This argument is motivated by concerns over
- A) economic growth.
 - B) economic stability.
 - C) efficiency.
 - D) equity.

Answer: D

Diff: 3

Topic: *The Method of Economics*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 44) Which of the following is an example of a normative statement?
- A) The unemployment rate is six percent.
 - B) There should be no unemployment in an advanced industrial society.
 - C) Higher prices cause consumers to buy less.
 - D) Equilibrium price implies that quantity demanded equals quantity supplied.

Answer: B

Diff: 2

Topic: *The Method of Economics*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 45) Which of the following is an example of a positive statement?
- A) There should be no unemployment in an advanced industrial society.
 - B) Higher prices cause consumers to purchase less.
 - C) Consumption should be distributed fairly in society.
 - D) People should pollute as little as possible.

Answer: B

Diff: 2

Topic: *The Method of Economics*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

2 True/False

- 1) Normative economics looks at outcomes of economic behavior and evaluates them as good or bad.

Answer: TRUE

Diff: 2

Topic: *The Method of Economics*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 2) Positive economics looks at outcomes of economic behavior and evaluates them as good or bad.

Answer: FALSE

Diff: 2

Topic: *The Method of Economics*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 3) An efficient economy is one that produces what consumers demand and does so at the least possible cost.

Answer: TRUE

Diff: 2

Topic: *The Method of Economics*

Skill: *Definition*

- 4) "Ceteris paribus" literally translated means, "buyer beware."

Answer: FALSE

Diff: 2

Topic: *The Method of Economics*

Skill: *Definition*

- 5) Positive economics seeks to understand behavior, but not make judgments.

Answer: TRUE

Diff: 2

Topic: *The Method of Economics*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

6) Stability implies a steady rate of economic growth and low inflation.

Answer: TRUE

Diff: 2

Topic: *The Method of Economics*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

7) The compilation of data to describe phenomena and facts is known as descriptive economics.

Answer: TRUE

Diff: 2

Topic: *The Method of Economics*

Skill: *Definition*

1.4 Appendix: How to Read and Understand Graphs

1 Multiple Choice

Refer to the information provided in Figure 1.1 below to answer the questions that follow.

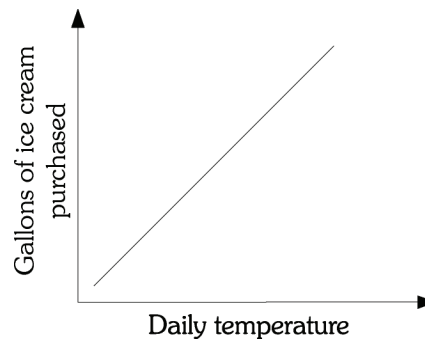


Figure 1.1

1) Refer to Figure 1.1. There is _____ relationship between the daily temperature and the number of gallons of ice cream purchased.

A) a negative

B) a positive

C) either a negative or a positive

D) an inverse

Answer: B

Diff: 2

Topic: *Appendix: How to Read and Understand Graphs*

Skill: *Analytic*

AACSB: *Analytic Skills*

Refer to the information provided in Figure 1.2 below to answer the questions that follow.

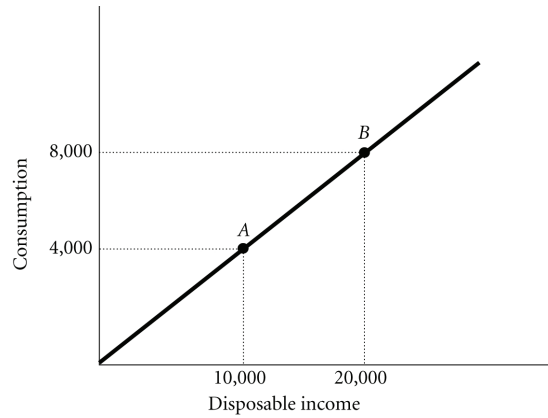


Figure 1.2

- 2) Refer to Figure 1.2. The slope of the line between Points *A* and *B* is
- A) 0.4.
 - B) 1.2.
 - C) 2.5.
 - D) indeterminate from this information.

Answer: A

Diff: 2

Topic: Appendix: How to Read and Understand Graphs

Skill: Analytic

AACSB: Analytic Skills

- 3) If the slope of a straight line is -3 . and if Y (the variable on the vertical axis) decreases by 6, then X (the variable on the horizontal axis) will
- A) increase by 2.
 - B) decrease by 2.
 - C) increase by 18.
 - D) decrease by 18.

Answer: A

Diff: 2

Topic: Appendix: How to Read and Understand Graphs

Skill: Analytic

AACSB: Analytic Skills

Refer to the information provided in Figure 1.3 below to answer the questions that follow.

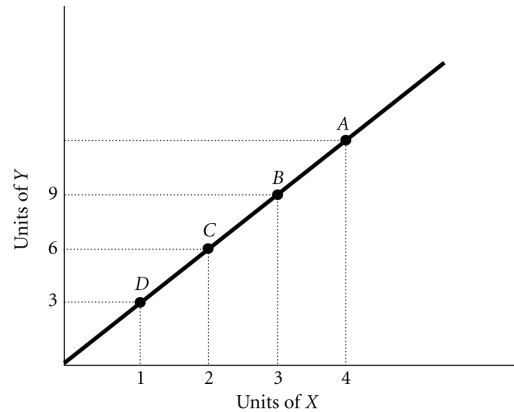


Figure 1.3

- 4) Refer to Figure 1.3. The slope of the line is
- A) positive.
 - B) negative.
 - C) increasing at an increasing rate.
 - D) decreasing at an increasing rate.

Answer: A

Diff: 2

Topic: Appendix: How to Read and Understand Graphs

Skill: Analytic

AACSB: Analytic Skills

- 5) Refer to Figure 1.3. The slope of the line between Points B and D is
- A) -0.33.
 - B) -3.
 - C) 0.33.
 - D) 3.

Answer: D

Diff: 2

Topic: Appendix: How to Read and Understand Graphs

Skill: Analytic

AACSB: Analytic Skills

- 6) Refer to Figure 1.3. The slope of the line between Points D and C is
- A) -0.33.
 - B) -3.
 - C) 0.33.
 - D) 3.

Answer: D

Diff: 2

Topic: Appendix: How to Read and Understand Graphs

Skill: Analytic

AACSB: Analytic Skills

- 7) Refer to Figure 1.3. If a 45 degree line were also graphed, the existing line shown on the graph would _____ it.
- A) lie above
 - B) lie below
 - C) cross
 - D) indeterminant from this information

Answer: A

Diff: 3

Topic: Appendix: How to Read and Understand Graphs

Skill: Analytic

AACSB: Analytic Skills

- 8) Refer to Figure 1.3. At Point *A*, what is the value of *Y*?
A) 10. B) 12.
C) 15. D) indeterminate from this information

Answer: B

Diff: 2

Topic: Appendix: How to Read and Understand Graphs

Skill: Analytic

AACSB: Analytic Skills

- 9) Refer to Figure 1.3. At Point *A* the slope of the line is 3, so at Point *D* the slope would be
A) greater than 3. B) less than 3.
C) equal to 3. D) indeterminate from this information.

Answer: C

Diff: 2

Topic: Appendix: How to Read and Understand Graphs

Skill: Analytic

AACSB: Analytic Skills

Refer to the information provided in Figure 1.4 below to answer the questions that follow.

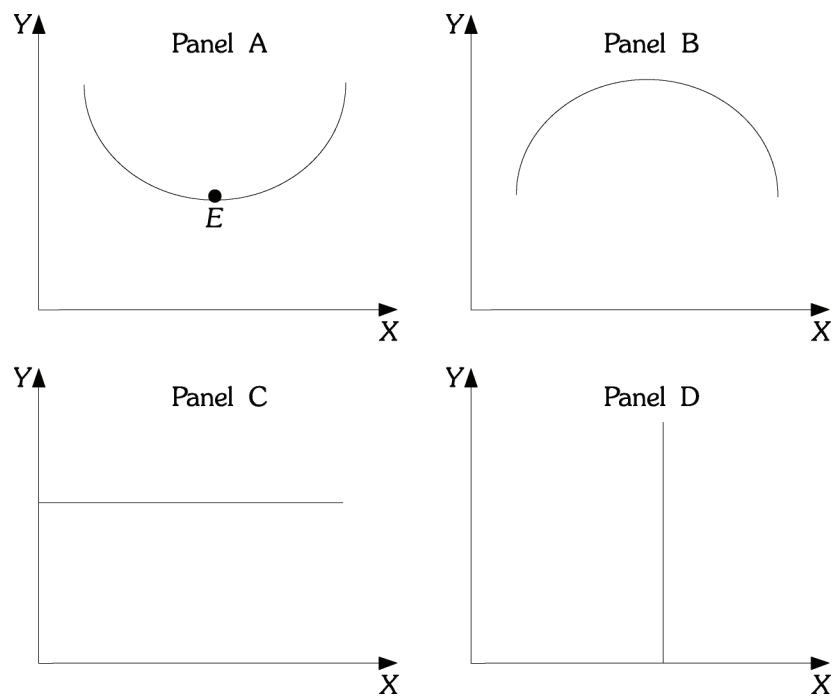


Figure 1.4

- 10) Refer to Figure 1.4. Which of the curves or lines has a slope that is first positive and then negative?
A) A B) B C) C D) D

Answer: B

Diff: 2

Topic: Appendix: How to Read and Understand Graphs

Skill: Analytic

AACSB: Analytic Skills

11) Refer to Figure 1.4. Which of the curves or lines has a slope that is negative and then positive?

- A) A B) B C) C D) D

Answer: A

Diff: 2

Topic: Appendix: How to Read and Understand Graphs

Skill: Analytic

AACSB: Analytic Skills

12) Refer to Figure 1.4. Which of the following curves or lines has a zero slope throughout?

- A) A B) B C) C D) D

Answer: C

Diff: 2

Topic: Appendix: How to Read and Understand Graphs

Skill: Analytic

AACSB: Analytic Skills

13) Refer to Figure 1.4. Which of the curves or lines has an infinite slope throughout?

- A) A B) B C) C D) D

Answer: D

Diff: 2

Topic: Appendix: How to Read and Understand Graphs

Skill: Analytic

AACSB: Analytic Skills

14) Refer to Figure 1.4. At Point E in panel A, the slope is

- A) zero. B) infinite.
C) negative. D) indeterminate from this information.

Answer: A

Diff: 2

Topic: Appendix: How to Read and Understand Graphs

Skill: Analytic

AACSB: Analytic Skills

15) The slope of a non-linear curve

- A) is always positive. B) must first increase then decrease.
C) is not constant. D) is constant.

Answer: C

Diff: 1

Topic: Appendix: How to Read and Understand Graphs

Skill: Fact

16) The slope of a horizontal line is

- A) negative. B) zero.
C) continually changing. D) infinite.

Answer: B

Diff: 1

Topic: Appendix: How to Read and Understand Graphs

Skill: Fact

- 17) If the slope of a straight line is 4 and if X (the variable on the horizontal axis) increases by 12, then Y (the variable on the vertical axis) will
- A) decrease by 3.
 - B) decrease by 0.33.
 - C) increase by 3.
 - D) increase by 48.

Answer: D

Diff: 2

Topic: Appendix: How to Read and Understand Graphs

Skill: Analytic

AACSB: Analytic Skills

- 18) If the slope of a straight line is 4 and if Y (the variable on the vertical axis) decreases by 20, then X (the variable on the horizontal axis)
- A) increases by 5.
 - B) decreases by 5.
 - C) increases by 80.
 - D) decreases by 80.

Answer: B

Diff: 2

Topic: Appendix: How to Read and Understand Graphs

Skill: Analytic

AACSB: Analytic Skills

- 19) The slope of a vertical line is
- A) zero.
 - B) infinite.
 - C) continually changing.
 - D) negative.

Answer: B

Diff: 1

Topic: Appendix: How to Read and Understand Graphs

Skill: Fact

Refer to the information provided in Figure 1.5 below to answer the questions that follow.

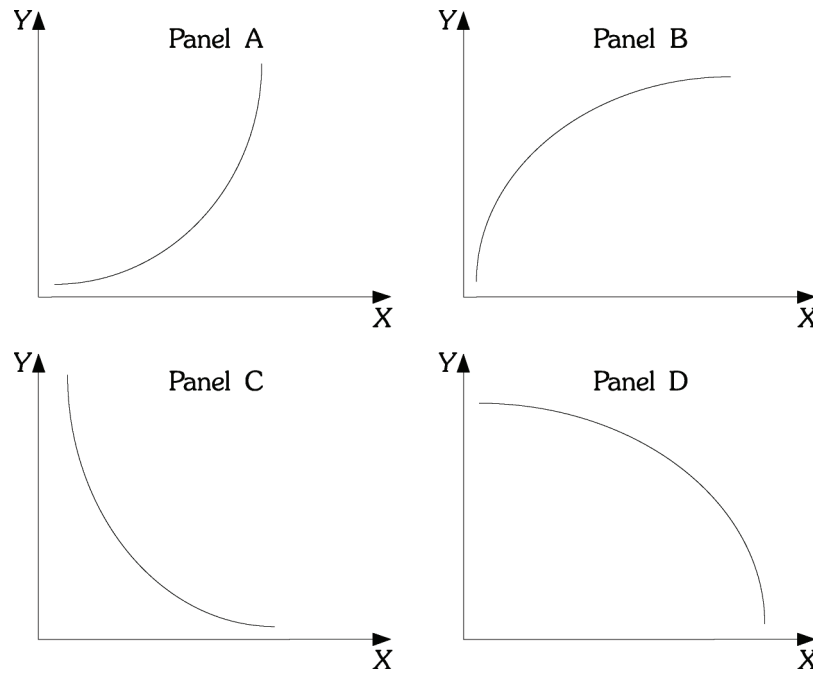


Figure 1.5

20) Refer to Figure 1.5. Which of the curves has a slope that is positive and decreasing?

- A) A B) B C) C D) D

Answer: B

Diff: 2

Topic: Appendix: How to Read and Understand Graphs

Skill: Analytic

AACSB: Analytic Skills

21) Refer to Figure 1.5. Which of the curves has a slope that is positive and increasing?

- A) A B) B C) C D) D

Answer: A

Diff: 2

Topic: Appendix: How to Read and Understand Graphs

Skill: Analytic

AACSB: Analytic Skills

22) Refer to Figure 1.5. As income increases, consumption increases, but for each additional increase in income, consumption increases by a larger and larger amount. If consumption is graphed on the vertical axis and income is graphed on the horizontal axis, the relationship between consumption and income would look like which of the following panels?

- A) A B) B C) C D) D

Answer: A

Diff: 2

Topic: Appendix: How to Read and Understand Graphs

Skill: Analytic

AACSB: Analytic Skills

- 23) Refer to Figure 1.5. In many industries, as firms produce additional units, average costs of production decline as the firm produces an additional unit, but average costs declines by a smaller and smaller amount as production continues to increase. If output is graphed on the horizontal axis and average costs are graphed on the vertical axis, the relationship between average costs and output would be like which of the following panels?
- A) A B) B C) C D) D

Answer: C

Diff: 2

Topic: Appendix: How to Read and Understand Graphs

Skill: Analytic

AACSB: Analytic Skills

2 True/False

- 1) Dividing the change in quantity on the Y axis by the change in quantity on the X axis calculates the slope of a line.

Answer: TRUE

Diff: 1

Topic: Appendix: How to Read and Understand Graphs

Skill: Definition

- 2) A graph illustrating how one variable changes over time is a Cartesian coordinate system.

Answer: FALSE

Diff: 2

Topic: Appendix: How to Read and Understand Graphs

Skill: Definition

- 3) If as the variable on the Y-axis rises the variable on the X-axis rises, the relationship between X and Y is said to be direct.

Answer: TRUE

Diff: 2

Topic: Appendix: How to Read and Understand Graphs

Skill: Definition

- 4) If as the variable on the Y-axis falls the variable on the X-axis rises, the relationship between X and Y is said to be inverse.

Answer: TRUE

Diff: 1

Topic: Appendix: How to Read and Understand Graphs

Skill: Definition

- 5) The slope of a straight line is not constant unless the line is vertical or horizontal.

Answer: FALSE

Diff: 1

Topic: Appendix: How to Read and Understand Graphs

Skill: Definition

Chapter 2 The Economic Problem: Scarcity and Choice

2.1 Scarcity, Choice, and Opportunity Cost

1 Multiple Choice

- 1) The process by which resources are transformed into useful forms is
A) capitalization. B) consumption. C) production. D) allocation.

Answer: C

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Definition

- 2) Outputs in the production process are
A) pollution.
B) money.
C) good and services of value to households.
D) resources.

Answer: C

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Definition

- 3) Which of the following is NOT a resource as the term is used by economists?
A) land B) labor C) buildings D) money

Answer: D

Diff: 1

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Fact

- 4) Which of the following would an economist classify as capital?
A) a \$50 bill B) a corporate bond
C) a post office employee D) a guitar used by a musician

Answer: D

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Conceptual

AACSB: Reflective Thinking

- 5) Capital, as economists use the term,
A) is the money the firm spends to hire resources.
B) is money the firm raises from selling stock.
C) refers to the process by which resources are transformed into useful forms.
D) refers to things that have already been produced that are in turn used to produce other goods and services.

Answer: D

Diff: 3

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Conceptual

AACSB: Reflective Thinking

- 6) The concept of opportunity cost is based on the principle of
A) need. B) consumption. C) scarcity. D) profit.

Answer: C

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Conceptual

- 7) The concept of trade-offs would become irrelevant if
A) we were dealing with a very simple, one-person economy.
B) poverty was eliminated.
C) scarcity was eliminated.
D) capital was eliminated.

Answer: C

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Conceptual

AACSB: Reflective Thinking

- 8) Suppose you are deciding whether to spend your tax rebate check on a new iPod player or a new digital camera. You are dealing with the concept of
A) diminishing marginal returns. B) comparative advantage.
C) opportunity costs. D) the fallacy of composition.

Answer: C

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Conceptual

AACSB: Reflective Thinking

- 9) According to the theory of comparative advantage, specialization and free trade will benefit
A) only that trading party that has both an absolute advantage and a comparative advantage in the production of all goods.
B) all trading parties, even when some are absolutely more efficient producers than others.
C) only that trading party that has an absolute advantage in the production of all goods.
D) only that trading party that has a comparative advantage in the production of all goods.

Answer: B

Diff: 3

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Conceptual

AACSB: Reflective Thinking

Refer to the information provided in Table 2.1 below to answer the following questions.

Table 2.1

	Krystal	Mark
Writing Poems	8	12
Writing TV Commercials	2	4

- 10) Refer to Table 2.1. For Krystal, the opportunity cost of writing one TV commercial is
A) 1/4 of a poem. B) 2 poems. C) 4 poems. D) 6 poems.

Answer: C

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Analytic

AACSB: Analytic Skills

- 11) Refer to Table 2.1. For Mark, the opportunity cost of writing one TV commercial is
A) 1/3 of a poem. B) 2 poems. C) 3 poems. D) 8 poems.

Answer: C

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Analytic

AACSB: Analytic Skills

- 12) Refer to Table 2.1. Which of the following statements is TRUE?
A) Krystal has a comparative advantage in both writing TV commercials and writing poems.
B) Mark has a comparative advantage in both writing TV commercials and writing poems.
C) Krystal has a comparative advantage in writing TV commercials and Mark has a comparative advantage in writing poems.
D) Mark has a comparative advantage in writing TV commercials and Krystal has a comparative advantage in writing poems.

Answer: D

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Analytic

AACSB: Analytic Skills

- 13) Refer to Table 2.1. To maximize total production,
A) Krystal should specialize in writing TV commercials and Mark should specialize in writing poems.
B) Mark should specialize in writing TV commercials and Krystal should specialize in writing poems.
C) Krystal and Mark should both split their time between writing poems and writing TV commercials.
D) Krystal should write poems and write TV commercials, but Mark should only write poems.

Answer: B

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Analytic

AACSB: Analytic Skills

14) Refer to Table 2.1. For Mark, the opportunity cost of writing six TV commercials is _____ poems made.

A) 2

B) 18

C) 24

D) an indeterminate number of

Answer: B

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Analytic

AACSB: Analytic Skills

15) Refer to Table 2.1. For Krystal, the opportunity cost of writing four TV commercials is _____ poems.

A) 2

B) 8

C) 16

D) 32

Answer: C

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Analytic

AACSB: Analytic Skills

16) According to the theory of comparative advantage, _____ raise(s) productivity by lowering opportunity costs.

A) trade and specialization

B) investment in capital goods

C) economic growth

D) exchange and consumption

Answer: A

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Conceptual

AACSB: Reflective Thinking

17) When two people trade

A) both of them expect to be made worse off by the exchange.

B) they are trying to help out each other.

C) they know one of them will get the better of the other.

D) they both expect to be made better off by the exchange.

Answer: D

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Conceptual

AACSB: Reflective Thinking

18) Someone has a comparative advantage in producing a good if they can produce that good

A) in greater quantities.

B) at a lower opportunity cost.

C) using more capital and less labor.

D) without sunk costs.

Answer: B

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Conceptual

AACSB: Reflective Thinking

- 19) If someone has a comparative advantage in growing pineapples,
- A) they can grow pineapples at a lower opportunity cost than other pineapple growers.
 - B) they also have an absolute advantage in growing pineapples.
 - C) they can grow more pineapples using the same resources than other pineapple growers.
 - D) pineapples are the only product they can grow.

Answer: A

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Conceptual

AACSB: Reflective Thinking

- 20) Which of the following does NOT constitute an act of "investment" as economists use the term?
- A) The city council authorizes the construction of a new fire station.
 - B) A retiree buys 50 shares of stock at \$10 a share and then sells the stock at a profit for \$20 a share.
 - C) An accountant attends a seminar on changes in the federal tax code.
 - D) A department store increases its inventory of football jerseys before the Super Bowl.

Answer: B

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Conceptual

AACSB: Reflective Thinking

- 21) In economics, investment always refers to
- A) the act of buying stocks or bonds.
 - B) the creation of capital.
 - C) increasing the quantity of labor.
 - D) an increase in per capita output.

Answer: B

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Definition

- 22) The process of using resources to produce new capital is
- A) research and development.
 - B) investment.
 - C) consumption.
 - D) economic growth.

Answer: B

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Definition

- 23) An example of forgoing present benefits in order to receive future benefits is
- A) production.
 - B) saving.
 - C) consumption.
 - D) growth.

Answer: B

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Definition

- 24) Because resources are scarce, the opportunity cost of investment in capital is
- A) zero.
 - B) forgone future consumption.
 - C) forgone present consumption.
 - D) infinite.

Answer: C

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Conceptual

AACSB: Reflective Thinking

- 25) An example of an investment is
- A) the purchase of a share of Google stock.
 - B) the purchase of an Exxon Mobil bond.
 - C) the purchase of a Hewlett Packard laser printer for use by a business.
 - D) all of the above.

Answer: C

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Conceptual

AACSB: Reflective Thinking

- 26) The opportunity cost of investment in capital is forgone present consumption because
- A) capital takes a long time to produce.
 - B) capital increases the productivity of labor.
 - C) resources are scarce.
 - D) capital is an intangible good.

Answer: C

Diff: 3

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Conceptual

AACSB: Reflective Thinking

- 27) If the unemployment rate increases from 10% to 14%, the economy will
- A) move closer to a point on the ppf.
 - B) move away from the ppf toward the origin.
 - C) remain on the ppf.
 - D) remain on the origin.

Answer: B

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Conceptual

AACSB: Reflective Thinking

- 28) Periods of less than full employment correspond to
- A) points outside the ppf.
 - B) points underneath the ppf.
 - C) points on the ppf.
 - D) either points inside or outside the ppf.

Answer: B

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Conceptual

AACSB: Reflective Thinking

Refer to the information provided in Figure 2.1 below to answer the questions that follow.

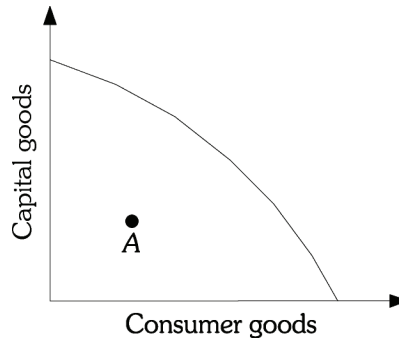


Figure 2.1

- 29) Refer to Figure 2.1. Macroland is currently operating at Point A. The best explanation for this is that
- A) the economy has very poor technology.
 - B) the economy's resources are being used inefficiently.
 - C) the economy has very few resources.
 - D) the economy operates as an efficient market.

Answer: B

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Conceptual

AACSB: Reflective Thinking

- 30) Refer to Figure 21. Macroland's production possibility frontier is bowed out from the origin due to
- A) decreasing opportunity costs.
 - B) trade.
 - C) unemployment.
 - D) specialized resources.

Answer: D

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Conceptual

AACSB: Reflective Thinking

- 31) Refer to Figure 2.1. The shape of Macroland's production possibility frontier shows
- A) increasing opportunity costs.
 - B) constant opportunity costs.
 - C) decreasing opportunity costs.
 - D) random opportunity costs.

Answer: A

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Conceptual

AACSB: Reflective Thinking

- 32) The production possibility frontier is used to illustrate the concept of
- A) the laissez-faire economy.
 - B) opportunity costs.
 - C) equilibrium.
 - D) aggregate demand.

Answer: B

Diff: 1

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Fact

Refer to the information provided in Figure 2.2 below to answer the questions that follow.

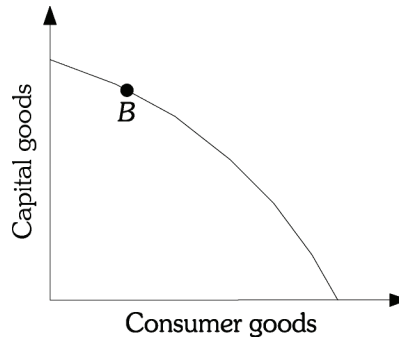


Figure 2.2

- 33) Refer to Figure 2.2. Point B represents a situation of
- A) full employment but production inefficiency.
 - B) less than full employment but production efficiency.
 - C) both full resource employment and production efficiency.
 - D) less than full employment and production inefficiency.

Answer: C

Diff: 1

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Conceptual

AACSB: Reflective Thinking

- 34) Refer to Figure 2.2. Microland is currently operating at Point B. You correctly deduce that
- A) in Microland all resources are fully employed and there are no production inefficiencies.
 - B) Microland has achieved a position of inefficiency.
 - C) Microland has recently experienced some type of technological breakthrough.
 - D) Microland has overcome the problem of scarcity.

Answer: A

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Analytic

AACSB: Analytic Skills

- 35) The production possibility frontier is a graph that shows
- A) all the combinations of goods and services that are consumed over time if all of society's resources are used efficiently.
 - B) the amount of goods and services consumed at various average price levels.
 - C) the rate at which an economy's output will grow over time if all resources are used efficiently.
 - D) all the combinations of goods and services that can be produced if all of society's resources are used efficiently.

Answer: D

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Definition

- 36) Production inefficiency occurs
- A) only when an economy produces underneath its production possibility frontier.
 - B) only when an economy produces at the wrong point on the production possibility frontier.
 - C) either when an economy produces underneath the production possibility frontier or when the economy is producing the wrong combination of goods on the production possibility frontier.
 - D) only when the economy produces outside the production possibility frontier.

Answer: A

Diff: 3

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Conceptual

AACSB: Reflective Thinking

- 37) An economy that is producing on the production possibility frontier at some point other than the output of efficient allocation is
- A) efficient, as it is on the production possibility frontier.
 - B) inefficient, as the combination of goods and services produced is not what people want.
 - C) efficient, as the economy is producing goods at the lowest possible cost.
 - D) inefficient, as that combination of goods could be produced at a lower cost if more efficient technology were employed.

Answer: B

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Conceptual

AACSB: Reflective Thinking

- 38) If resources are combined efficiently in production, then the society
- A) is producing at the most-desirable point on the production possibility frontier.
 - B) is producing at a point on the production possibility frontier but not necessarily at the most-desirable point.
 - C) is producing at a point outside the production possibility frontier.
 - D) is experiencing economic growth.

Answer: B

Diff: 1

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Conceptual

AACSB: Reflective Thinking

- 39) Suppose an economy produces hybrid engines and solar panels in perfectly competitive industries. The economy is currently operating at a point on its ppf. If a single firm gains control over the production of solar panels, which of the following is most likely to happen?
- A) The economy will move to a less-desirable point on the ppf.
 - B) The economy's ppf will shift inward.
 - C) The economy will now be able to produce at a point outside its ppf.
 - D) The economy's ppf will shift outward, but the maximum number of solar panels will remain the same.

Answer: A

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Analytic

AACSB: Analytic Skills

- 40) The value of the slope of a society's production possibility frontier is called its
- A) marginal rate of substitution.
 - B) inflation rate.
 - C) unemployment rate.
 - D) marginal rate of transformation.

Answer: D

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Definition

- 41) The marginal rate of transformation is the
- A) slope of the production possibility frontier.
 - B) dollar value of the best forgone alternative.
 - C) process of using resources to produce new capital.
 - D) transformation of resources into a form that is useful to people.

Answer: A

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Definition

Refer to the information provided in Figure 2.3 below to answer the questions that follow.

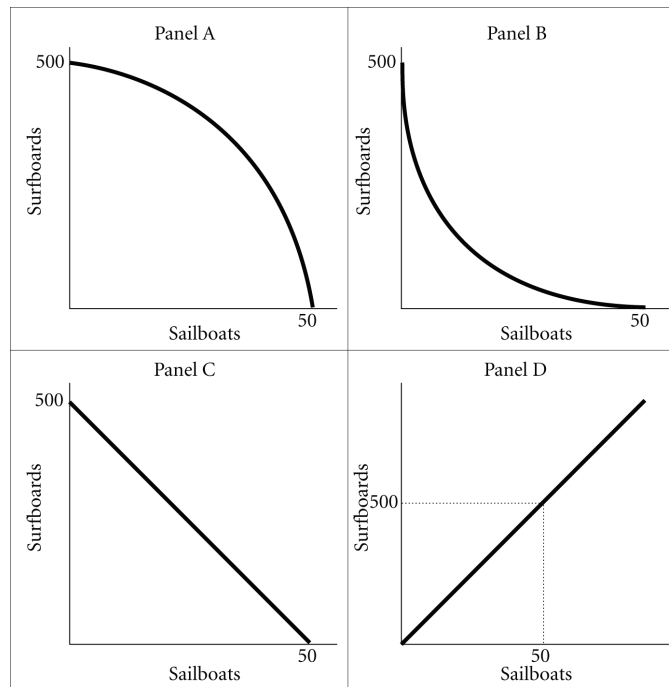


Figure 2.3

- 42) Refer to Figure 2.3. Assume that in this society the marginal rate of transformation of sailboats for surfboards is constant and equal to -10 . A graph of this society's production possibility frontier will be represented by

A) A. B) B. C) C. D) D.

Answer: C

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Conceptual

AACSB: Reflective Thinking

- 43) Refer to Figure 2.3. Assume that in this society the opportunity cost of sailboats in terms of surfboards is increasing. A graph of this society's production possibility frontier will be represented by

A) A. B) B. C) C. D) D.

Answer: A

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Conceptual

AACSB: Reflective Thinking

44) Refer to Figure 2.3. The law of _____ opportunity costs is best depicted by the production possibilities frontier in panel A.

- A) increasing B) constant C) decreasing D) zero

Answer: A

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Conceptual

AACSB: Reflective Thinking

45) A society can produce two goods: donuts and beer. The society's production possibility frontier is negatively sloped and "bowed outward" from the origin. As this society moves down its production possibility frontier, producing more and more units of donuts, the opportunity cost of producing beer

- A) decreases.
B) remains constant.
C) increases.
D) could decrease or increase depending on the technology.

Answer: C

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Conceptual

AACSB: Reflective Thinking

Refer to the information provided in Figure 2.4 below to answer the questions that follow.

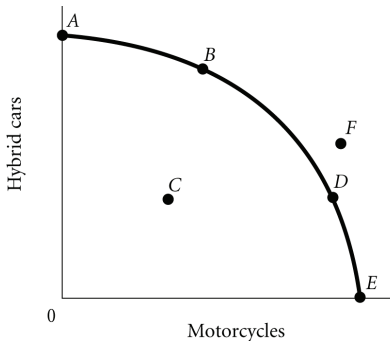


Figure 2.4

46) According to Figure 2.4, the point where only motorcycles are produced is

- A) A. B) B. C) C. D) E.

Answer: D

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Analytic

AACSB: Analytic Skills

47) According to Figure 2.4, the optimal point for the economy is

- A) A.
- B) B.
- C) F.
- D) indeterminate from the information given.

Answer: D

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Analytic

AACSB: Analytic Skills

48) According to Figure 2.4, which point cannot be produced with the current state of technology?

- A) A
- B) B
- C) C
- D) F

Answer: D

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Analytic

AACSB: Analytic Skills

49) According to Figure 2.4, the point where only hybrid cars are produced is

- A) A.
- B) B.
- C) C.
- D) D.

Answer: A

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Analytic

AACSB: Analytic Skills

50) According to Figure 2.4, a decrease in unemployment may be represented by the movement from

- A) B to A.
- B) B to D.
- C) C to D.
- D) A to C.

Answer: C

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Analytic

AACSB: Analytic Skills

51) According to Figure 2.4, as the economy moves from Point A to Point E, the opportunity cost of motorcycles, measured in terms of hybrid cars,

- A) decreases.
- B) increases.
- C) remains constant.
- D) initially increases, then decreases.

Answer: B

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Analytic

AACSB: Analytic Skills

- 52) According to Figure 2.4, as the economy moves from Point *E* to Point *A*, the opportunity cost of hybrid cars, measured in terms of motorcycles,
- A) increases.
 - B) decreases.
 - C) remains constant.
 - D) initially increases, then decreases.

Answer: A

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Analytic

AACSB: Analytic Skills

- 53) Refer to Figure 2.4. The economy moves from Point *A* to Point *D*. This could be explained by
- A) a reduction in unemployment.
 - B) an improvement in technology.
 - C) an increase in economic growth.
 - D) a change in society's preferences for motorcycles versus hybrid cars.

Answer: D

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Analytic

AACSB: Analytic Skills

Refer to the information provided in Figure 2.5 below to answer the questions that follow.

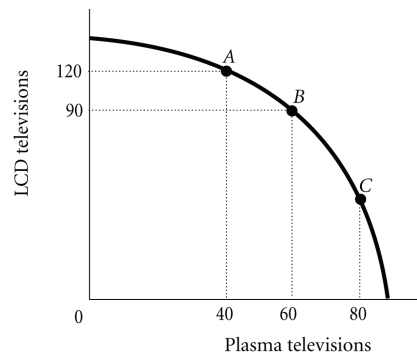


Figure 2.5

- 54) Refer to Figure 2.5. The economy is currently at Point *A*. The opportunity cost of moving from Point *A* to Point *B* is the
- A) 90 LCD televisions that must be forgone to produce 20 additional plasma televisions.
 - B) 30 LCD televisions that must be forgone to produce 60 additional plasma televisions.
 - C) 120 LCD televisions that must be forgone to produce 40 additional plasma televisions.
 - D) 30 LCD televisions that must be forgone to produce 20 additional plasma televisions.

Answer: D

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Analytic

AACSB: Analytic Skills

- 55) Refer to Figure 2.5. The marginal rate of transformation in moving from Point *A* to Point *B* is
A) $-2/3$. B) -1.5 . C) -3 . D) -30 .

Answer: B

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Analytic

AACSB: Analytic Skills

- 56) Refer to Figure 2.5. For this economy to move from Point *B* to Point *C* so that an additional 20 plasma televisions could be produced, production of LCD televisions would have to be reduced by

- A) exactly 30. B) fewer than 30. C) more than 30. D) exactly 60.

Answer: C

Diff: 3

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Analytic

AACSB: Analytic Skills

- 57) Refer to Figure 2.5. The best point for society would be

- A) Point *C*, as at this point there are approximately equal amounts of LCD and plasma televisions being produced.
B) either Point *B* or Point *C*, as the total amount being produced at either of these points is approximately the same.
C) at any of the labeled points, as all of the points represent an efficient allocation of resources.
D) indeterminate from this information, as we don't have any information about the society's desires.

Answer: D

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Analytic

AACSB: Analytic Skills

- 58) If the opportunity costs of producing a good increase as more of that good is produced, the economy's production possibility frontier will be

- A) negatively sloped and "bowed inward" toward the origin.
B) negatively sloped and "bowed outward" from the origin.
C) a negatively sloped straight line.
D) a positively sloped straight line.

Answer: B

Diff: 3

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Conceptual

AACSB: Reflective Thinking

- 59) As you move down the production possibility frontier, the absolute value of the marginal rate of transformation
- A) increases.
 - B) decreases.
 - C) initially increases, then decreases.
 - D) initially decreases, then increases.

Answer: A

Diff: 3

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Conceptual

AACSB: Reflective Thinking

- 60) As more of a good, such as television sets, is produced, the opportunity costs of producing it increases. This most likely occurs because
- A) as more of a good is produced the inputs used to produce that good will increase in price.
 - B) consumers would be willing to pay higher prices for the good as more of the good is produced.
 - C) resources are not equally well suited to producing all goods and as more of a good is produced it is necessary to use resources less well suited to the production of that good.
 - D) as more of a good is produced the quality of that good declines and therefore the costs of production increase.

Answer: C

Diff: 3

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Conceptual

AACSB: Reflective Thinking

- 61) Economic growth may occur when
- A) a society acquires new resources.
 - B) a society learns to produce more using existing resources.
 - C) the society begins to produce the combination of goods society wants most.
 - D) both A and B

Answer: D

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Conceptual

AACSB: Reflective Thinking

Refer to the information provided in Figure 2.6 below to answer the questions that follow.

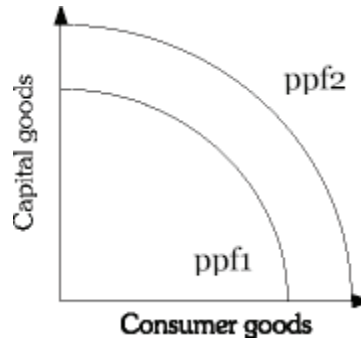


Figure 2.6

- 62) Refer to Figure 2.6. Economic growth is represented by a
- A) shift from ppf^2 to ppf^1 .
 - B) shift from ppf^1 to ppf^2 .
 - C) movement along ppf^1 .
 - D) movement along ppf^2 .

Answer: B

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Analytic

AACSB: Analytic Skills

- 63) Refer to Figure 2.6. An improvement in technology may be represented by a
- A) shift from ppf^2 to ppf^1 .
 - B) shift from ppf^1 to ppf^2 .
 - C) movement along ppf^2 .
 - D) movement along ppf^1 .

Answer: B

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Analytic

AACSB: Analytic Skills

- 64) Refer to Figure 2.6. Which of the following will shift an economy's production possibility frontier from ppf^1 to ppf^2 ?
- A) a decrease in unemployment
 - B) an increase in production efficiency
 - C) a change in consumer's tastes
 - D) an increase in the economy's capital stock

Answer: D

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Analytic

AACSB: Analytic Skills

65) Refer to Figure 2.6. Which of the following will NOT cause the production possibility frontier to shift from ppf^1 to ppf^2 ?

- A) the discovery of previously unknown oil fields
- B) an improvement in technology
- C) an increase in the stock of capital
- D) a decrease in the unemployment rate

Answer: D

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Analytic

AACSB: Analytic Skills

66) Refer to Figure 2.6. Which of the following is most likely to shift the production possibility frontier from ppf^1 to ppf^2 ?

- A) a change in consumer tastes
- B) the purchase of stocks on the New York Stock Exchange
- C) moving resources from capital to consumer goods
- D) an increase in the general educational level of the population

Answer: D

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Analytic

AACSB: Analytic Skills

67) Refer to Figure 2.6. If the economy is at ppf^1 , a change in consumer preferences would be shown by a

- A) shift from ppf^2 to ppf^1 .
- B) movement along ppf^1 .
- C) movement along ppf^2 .
- D) shift from ppf^1 to ppf^2 .

Answer: B

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Analytic

AACSB: Analytic Skills

68) During the Iraq War many of Iraq's oil refineries were destroyed. This would best be represented by a

- A) movement down Iraq's production possibility frontier.
- B) movement off Iraq's production possibility frontier to some point inside the frontier.
- C) shift of Iraq's production possibility frontier toward the origin.
- D) movement up Iraq's production possibility frontier.

Answer: C

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Analytic

AACSB: Analytic Skills

- 69) For an economy to produce at a point beyond its current ppf, the economy must
- A) waste less.
 - B) be more efficient.
 - C) reduce inputs.
 - D) increase its resource base.

Answer: D

Diff: 3

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Conceptual

AACSB: Reflective Thinking

- 70) In terms of the production possibility frontier, an increase in productivity attributable to new technology would best be shown by
- A) a movement along the frontier.
 - B) the production possibility frontier shifting outward, away from the origin.
 - C) a movement from a point inside the frontier to a point on it.
 - D) a movement toward the origin.

Answer: B

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Conceptual

AACSB: Reflective Thinking

- 71) An improvement in technology will cause the
- A) production possibility frontier to shift outward.
 - B) production possibility frontier to shift inward.
 - C) economy to move down the production possibility frontier.
 - D) economy to move closer to its production possibility frontier.

Answer: A

Diff: 1

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Conceptual

AACSB: Reflective Thinking

- 72) Consider two countries, Japan and Malaysia. Japan devotes a smaller portion of its production to capital. All other things equal which of the following statements is most likely true?
- A) Japan is a poorer country than Malaysia.
 - B) Japan will move up its production possibility curve faster than Malaysia.
 - C) Malaysia is producing inside its production possibility frontier, whereas Japan is producing at a point on its production possibility frontier.
 - D) Malaysia's production possibility frontier will shift up and out farther and faster than Japan's.

Answer: D

Diff: 3

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Conceptual

AACSB: Reflective Thinking

- 73) The gap between rich and poor countries
- A) has decreased over time because poor countries can more easily devote resources to capital production.
 - B) has increased over time because poor countries find it difficult to devote resources to capital production.
 - C) has remained constant over time because technological advances can be easily shared among nations.
 - D) has remained constant over time because the rate of capital production has remained constant in rich and poor nations.

Answer: B

Diff: 1

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Fact

- 74) An economy produces capital goods and consumer goods. This economy is operating at a point on its production possibility frontier associated with a small amount of capital goods and a large amount of consumer goods. This is most likely to be a
- A) "poor" country because such a nation has difficulty devoting many resources to the production of capital goods.
 - B) "rich" country because such a nation can afford to sacrifice.
 - C) country with a free market.
 - D) country with a command economy.

Answer: A

Diff: 3

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Conceptual

AACSB: Reflective Thinking

- 75) The economic problem can best be stated as
- A) How can the economy improve technology so as to shift the production possibility frontier up and to the right?
 - B) Given scarce resources, how exactly do societies go about deciding what to produce, how to produce it, and for whom to produce?
 - C) Given the fact that the economy is inefficient, how much and what type of government intervention should be used to improve the efficiency of the economy?
 - D) What is the best rate of economic growth for a society?

Answer: B

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Definition

- 76) Related to the *Economics in Practice* on p. 28: Which one of the following occurs when an individual enters the paid work force?
- A) The opportunity cost of time for housework increases, because time spent on housework could be spent on money-earning activities.
 - B) The opportunity cost of time for housework increases, because money earned at a job can allow individuals to pay someone to do household chores that the individuals used to do themselves.
 - C) The opportunity cost of time for housework decreases, because increased earning power makes individuals less likely to do their own housework.
 - D) The opportunity cost of time for housework decreases, because as more people enter the work force, businesses have greater incentives to develop innovations that make housework more efficient.

Answer: A

Diff: 3

Topic: Scarcity, Choice, and Opportunity Cost: *Economics in Practice*

Skill: Analytic

AACSB: Analytic Skills

- 77) Related to the *Economics in Practice* on p. 28: How did the introduction of the microwave in 1960 affect the market for frozen food?
- A) It encouraged people to leave the work force by making cooking easier and less time-consuming.
 - B) It reduced the opportunity cost of eating frozen food by decreasing the amount of time required to prepare frozen meals.
 - C) It increased the financial cost of alternative methods of food preparation, such as conventional ovens.
 - D) It made frozen foods more appealing by increasing the variety of meals that could be frozen and reheated.

Answer: B

Diff: 3

Topic: Scarcity, Choice, and Opportunity Cost: *Economics in Practice*

Skill: Analytic

AACSB: Analytic Skills

2 True/False

- 1) In economics, the term *capital* refers only to some form of money.

Answer: FALSE

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Definition

- 2) Among the resources used in production are labor and capital.

Answer: TRUE

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Definition

3) Things that have already been produced that are in turn used to produce other goods and services over time are called "capital."

Answer: TRUE

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Definition

4) When two people trade, one must lose.

Answer: FALSE

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Conceptual

AACSB: Reflective Thinking

5) Economic growth shifts a society's production possibility frontier away from the origin.

Answer: TRUE

Diff: 1

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Conceptual

AACSB: Reflective Thinking

6) A society's production possibility frontier is bowed in from the origin due to specialized resources.

Answer: FALSE

Diff: 1

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Fact

7) The "economic problem" is that given scarce resources, how do large societies go about answering the basic economic questions of what will be produced, how it will be produced, and who will get it.

Answer: TRUE

Diff: 1

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Definition

8) Comparative advantage refers to the ability to produce better quality goods than a competitor.

Answer: FALSE

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Definition

9) Comparative advantage refers to the ability to produce at a lower opportunity cost than a competitor.

Answer: TRUE

Diff: 2

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Definition

10) The government produces only what the market is willing to pay for.

Answer: FALSE

Diff: 1

Topic: Scarcity, Choice, and Opportunity Cost

Skill: Conceptual

AACSB: Reflective Thinking

2.2 Economic Systems

1 Multiple Choice

1) An economy in which a central authority draws up a plan that establishes what will be produced and when, sets production goals, and makes rules for distribution is a

A) free market economy.

B) laissez-faire economy.

C) public goods economy.

D) command economy.

Answer: D

Diff: 2

Topic: Economic Systems

Skill: Definition

2) An economy in which individual people and firms pursue their own self-interest without any central direction or regulation is a(n)

A) command economy.

B) laissez-faire economy.

C) invisible-hand economy.

D) private-sector economy.

Answer: B

Diff: 2

Topic: Economic Systems

Skill: Definition

3) Which of the following statements is FALSE?

A) Many planned economies have not fared very well in recent years; many of these economies have almost completely collapsed.

B) Command economies operate the most efficiently because the government makes all the production decisions.

C) In command economies consumers still exercise choice.

D) In a command economy the government answers the questions of what to produce, how to produce it, and how to distribute it.

Answer: B

Diff: 2

Topic: Economic Systems

Skill: Conceptual

AACSB: Reflective Thinking

4) Which of the following is an element of a command economy?

A) The market decides distribution.

B) The means of production are privately owned.

C) Production decisions are centralized.

D) The market decides what will be produced.

Answer: C

Diff: 1

Topic: Economic Systems

Skill: Fact

- 5) Which of the following statements is NOT true for a command economy?
- A) Consumers have some choices concerning what they buy.
 - B) The government decides what is produced.
 - C) The amount of a good supplied always equals the amount of the good demanded.
 - D) The state decides how to distribute what is produced.

Answer: C

Diff: 1

Topic: Economic Systems

Skill: Fact

- 6) In a laissez-faire economy _____ what gets produced, how it is produced, and who gets it.
- A) the behavior of buyers and sellers determines
 - B) the central government authority determines
 - C) firms but not consumers determine
 - D) consumers but not firms determine

Answer: A

Diff: 1

Topic: Economic Systems

Skill: Fact

- 7) An institution through which buyers and sellers interact and engage in exchange is
- A) a central authority.
 - B) "laissez-faire."
 - C) a market.
 - D) a production frontier.

Answer: C

Diff: 2

Topic: Economic Systems

Skill: Definition

- 8) Which of the following is NOT true of a market economy?
- A) In its pure form, it is also known as a laissez-faire economy.
 - B) Decisions are regulated by a central agency.
 - C) The interaction between buyers and sellers answers the basic economic questions of what gets produced, how it gets produced, and who gets it.
 - D) It relies on millions of individual economic decisions to determine economic outcomes.

Answer: B

Diff: 2

Topic: Economic Systems

Skill: Fact

- 9) Consumer sovereignty
- A) is dependent on profits.
 - B) is the idea that consumers can buy whatever they want to.
 - C) is the idea that consumers determine what is produced in the economy through their demands.
 - D) is only possible in a monarchy.

Answer: C

Diff: 2

Topic: Economic Systems

Skill: Definition

10) The idea that consumers ultimately dictate what will be produced by choosing what to purchase is known as

- A) laissez-faire.
- B) the economic problem.
- C) centralized decision making.
- D) consumer sovereignty.

Answer: D

Diff: 2

Topic: Economic Systems

Skill: Definition

11) The amount that households have accumulated out of past income through saving and inheritance is

- A) future income.
- B) wealth.
- C) consumption.
- D) past income.

Answer: B

Diff: 2

Topic: Economic Systems

Skill: Definition

12) In a free market system, the amount of output that any one household gets depends on its

- A) income.
- B) wealth.
- C) wage and interest income.
- D) income and wealth.

Answer: D

Diff: 1

Topic: Economic Systems

Skill: Conceptual

AACSB: Reflective Thinking

13) Advocates of an unregulated market system argue that

- A) competition promotes efficiency.
- B) competition leads to innovation.
- C) competition leads to product variety and quality.
- D) all of the above

Answer: D

Diff: 3

Topic: Economic Systems

Skill: Conceptual

AACSB: Reflective Thinking

14) The basic coordinating mechanism in a free market system is

- A) quantity.
- B) price.
- C) a central government authority.
- D) the corporation.

Answer: B

Diff: 1

Topic: Economic Systems

Skill: Fact

15) Which of the following statements is FALSE?

- A) In a free market system, the basic economic questions are answered without the help of a central government plan or directive.
- B) Individuals guided by their own-self interest will produce products and services that other people want.
- C) The basic coordinating mechanism in a free market system is quantity adjustments toward equilibrium.
- D) In a free market system, competition forces firms to adopt efficient production techniques.

Answer: C

Diff: 2

Topic: Economic Systems

Skill: Conceptual

AACSB: Reflective Thinking

16) Some economists advocate government intervention in a market economy

- A) to produce collective goods and services.
- B) when resource costs for a private producer do not reflect the full cost to society.
- C) to stabilize the economy.
- D) all of the above

Answer: D

Diff: 1

Topic: Economic Systems

Skill: Fact

2 True/False

1) A laissez-faire economy is one in which individual people and firms pursue their own self-interest without any central direction or regulation.

Answer: TRUE

Diff: 1

Topic: Economic Systems

Skill: Definition

2) A command economy is one in which a central government sets output targets, incomes and prices.

Answer: TRUE

Diff: 1

Topic: Economic Systems

Skill: Definition

3) A command economy eliminates markets.

Answer: FALSE

Diff: 2

Topic: Economic Systems

Skill: Conceptual

AACSB: Reflective Thinking

4) Price is the coordinating mechanism in a planned economy.

Answer: FALSE

Diff: 1

Topic: Economic Systems

Skill: Definition

5) The notion that buyers determine what will be produced by choosing what they purchase is called consumer sovereignty.

Answer: TRUE

Diff: 1

Topic: Economic Systems

Skill: Definition

Chapter 3 Demand, Supply, and Market Equilibrium

3.1 Firms and Households: The Basic Decision Making Units

1 Multiple Choice

- 1) Michael Dell was the first individual who sold computers by mail order. The company founded by Dell is now one of the largest and most successful computer companies in the United States. Michael Dell would be classified as a(n)
- A) entrepreneur. B) opportunist. C) monopolist. D) socialist.

Answer: A

Diff: 1

Topic: Firms and Households

Skill: Conceptual

- 2) Firms are organizations that
- A) take advantage of the public. B) transform resources into products.
C) transform outputs into inputs. D) consumer outputs.

Answer: B

Diff: 1

Topic: Firms and Households

Skill: Definition

- 3) An entrepreneur is a person who does all of the following EXCEPT
- A) assumes the risk of a firm.
B) organizes and manages a firm.
C) turns a new idea or product into a business.
D) always makes a profit.

Answer: D

Diff: 1

Topic: Firms and Households

Skill: Definition

- 4) Why do firms engage in the activity of production?
- A) to help society advance technologically B) to participate in the circular flow
C) to acquire profits D) to develop a supply schedule

Answer: C

Diff: 1

Topic: Market Equilibrium

Skill: Conceptual

AACSB: Reflective Thinking

2 True/False

- 1) Economists would classify the Boston Symphony Orchestra as a firm.

Answer: TRUE

Diff: 2

Topic: Firms and Households

Skill: Conceptual

AACSB: Reflective Thinking

2) Households are the consuming units of the economy.

Answer: TRUE

Diff: 1

Topic: Firms and Households

Skill: Definition

3) Entrepreneurs are unnecessary in a market economy and their profit is unearned.

Answer: FALSE

Diff: 1

Topic: Firms and Households

Skill: Conceptual

3.2 Input Markets and Output Markets: The Circular Flow

1 Multiple Choice

1) In input or factor markets

A) consumers purchase products.

C) households supply resources

B) firms supply goods.

D) households demand goods.

Answer: C

Diff: 1

Topic: Input Markets and Output Markets

Skill: Conceptual

2) A factor market is

A) where goods are exchanged.

C) where goods are made.

B) where resources are exchanged.

D) organized by government.

Answer: B

Diff: 1

Topic: Input Markets and Output Markets

Skill: Definition

3) In an output market

A) consumers purchase products.

B) firms purchase resources.

C) households earn income.

D) land, labor and capital may be exchanged.

Answer: A

Diff: 2

Topic: Input Markets and Output Markets

Skill: Conceptual

4) Among the factors of production are

A) capital.

C) income.

B) wages.

D) all of the above

Answer: A

Diff: 2

Topic: Input Markets and Output Markets

Skill: Fact

2 True/False

- 1) Factors of production are traded in the product market.

Answer: FALSE

Diff: 1

Topic: *Input Markets and Output Markets*

Skill: *Conceptual*

- 2) Households are paid income for the resources they supply in an input market.

Answer: TRUE

Diff: 1

Topic: *Input Markets and Output Markets*

Skill: *Conceptual*

- 3) Labor is demanded by firms in an output market.

Answer: FALSE

Diff: 1

Topic: *Input Markets and Output Markets*

Skill: *Conceptual*

3.3 Demand in Product / Output Markets

1 Multiple Choice

- 1) Which of the following is held constant along the demand curve?

A) price of the good

B) quantity

C) income

D) both A and B

Answer: C

Diff: 1

Topic: *Demand in Product / Output Markets*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 2) Which of the following will NOT cause a shift in the demand curve for compact discs?

A) a change in income

B) a change in wealth

C) a change in the price of downloadable online music

D) a change in the price of compact discs

Answer: D

Diff: 1

Topic: *Demand in Product / Output Markets*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 3) The "law of demand" implies that

A) as prices fall, demand increases.

B) as prices rise, demand increases.

C) as prices fall, quantity demanded increases.

D) as prices rise, quantity demanded increases.

Answer: C

Diff: 2

Topic: *Demand in Product / Output Markets*

Skill: *Definition*

- 4) According to the law of demand, as prices rise, *ceteris paribus*
- A) demand increases.
 - B) demand decreases.
 - C) quantity demanded decreases.
 - D) quantity demanded increases.

Answer: C

Diff: 2

Topic: Demand in Product / Output Markets

Skill: Definition

- 5) According to the law of demand there is _____ relationship between price and quantity demanded.
- A) a positive
 - B) a negative
 - C) either a positive or negative
 - D) a constantly changing

Answer: B

Diff: 1

Topic: Demand in Product / Output Markets

Skill: Conceptual

- 6) As an individual consumes more of a product within a given period of time, it is likely that each additional unit consumed will yield
- A) successively less satisfaction.
 - B) successively more satisfaction.
 - C) the same amount of satisfaction.
 - D) less satisfaction for a while and then start to add more satisfaction.

Answer: A

Diff: 2

Topic: Demand in Product / Output Markets

Skill: Conceptual

AACSB: Reflective Thinking

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

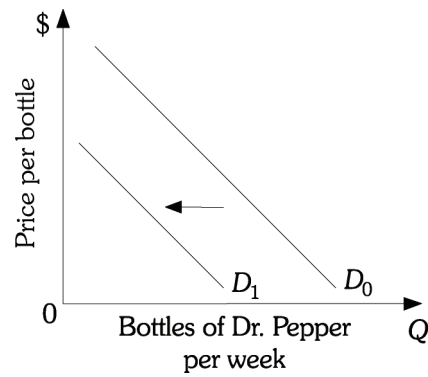


Figure 3.1

- 7) Refer to Figure 3.1. Which of the following would be most likely to cause the demand for Dr. Pepper to shift from D_0 to D_1 ?
- A) a decrease in income, assuming that Dr. Pepper is a normal good
 - B) an increase in the price of 7-UP, assuming 7-UP is a substitute for Dr. Pepper
 - C) a decrease in the price of Dr. Pepper
 - D) a reduction in the price of sugar used to make Dr. Pepper

Answer: A

Diff: 2

Topic: Demand in Product / Output Markets

Skill: Analytic

AACSB: Analytic Skills

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

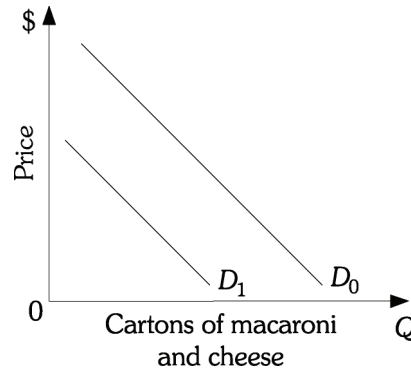


Figure 3.2

- 8) Refer to Figure 3.2. Which of the following would be most likely to cause the demand for macaroni and cheese to shift from D_1 to D_0 ?
- A) an increase in the price of macaroni and cheese
 - B) an increase in the price of flour used to make macaroni and cheese
 - C) an increase in income, assuming macaroni and cheese is a normal good
 - D) an increase in the quantity demanded for macaroni and cheese

Answer: C

Diff: 2

Topic: Demand in Product / Output Markets

Skill: Analytic

AACSB: Analytic Skills

- 9) If the demand for coffee decreases as income decreases, coffee is a(n)
- A) normal good.
 - B) inferior good.
 - C) substitute good.
 - D) complementary good.

Answer: A

Diff: 2

Topic: Demand in Product / Output Markets

Skill: Conceptual

AACSB: Reflective Thinking

- 10) If the demand for sardines increases as income decreases, sardines are a(n)
- A) normal good.
 - B) inferior good.
 - C) substitute good.
 - D) complementary good.

Answer: B

Diff: 2

Topic: Demand in Product / Output Markets

Skill: Conceptual

AACSB: Reflective Thinking

Refer to the information provided in Figure 3.3 below to answer the questions that follow.

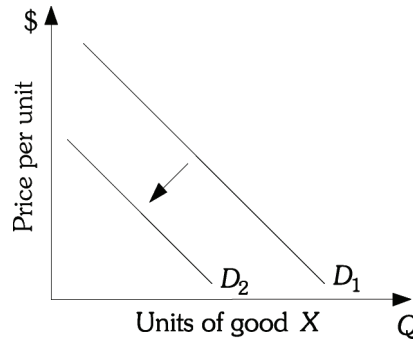


Figure 3.3

11) Refer to Figure 3.3. As your income increased, the demand for X shifted from D_1 to D_2 . Good X is

- A) an inferior good.
- B) a normal good.
- C) a luxury good.
- D) an income-neutral good.

Answer: A

Diff: 2

Topic: Demand in Product / Output Markets

Skill: Analytic

AACSB: Analytic Skills

Refer to the information provided in Figure 3.4 below to answer the questions that follow.

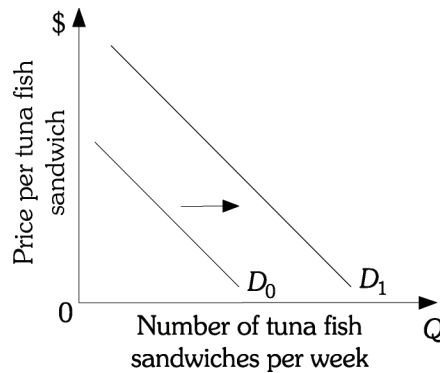


Figure 3.4

12) Refer to Figure 3.4. If consumer income falls, the demand for tuna fish sandwiches shifts from D_0 to D_1 . This implies that tuna fish sandwiches are a(n)

- A) normal good.
- B) inferior good.
- C) substitute good.
- D) complementary good.

Answer: B

Diff: 2

Topic: Demand in Product / Output Markets

Skill: Analytic

AACSB: Analytic Skills

Refer to the information provided in Figure 3.5 below to answer the questions that follow.

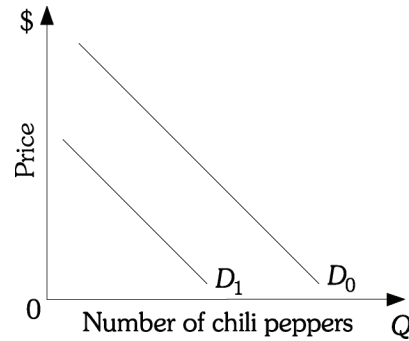


Figure 3.5

13) Refer to Figure 3.5. If consumer income increases, the demand for chili peppers shifts from D_0 to D_1 . This implies that chili peppers are a(n)

- A) normal good. B) inferior good.
C) substitute good. D) complementary good.

Answer: B

Diff: 2

Topic: Demand in Product / Output Markets

Skill: Analytic

AACSB: Analytic Skills

14) Suppose the demand for books goes down when the price of video games goes down. We can say that these two goods are

- A) complements. B) substitutes.
C) unrelated goods. D) perfect substitutes.

Answer: B

Diff: 2

Topic: Demand in Product / Output Markets

Skill: Conceptual

AACSB: Reflective Thinking

15) During an economic downturn when consumer income falls, the demand for tacos increases and the demand for sushi decreases. This implies that tacos

- A) and sushi are complements.
B) are a normal good and sushi is an inferior good.
C) are an inferior good and sushi is a normal good.
D) are an economic bad and sushi is an economic good.

Answer: C

Diff: 2

Topic: Demand in Product / Output Markets

Skill: Conceptual

AACSB: Reflective Thinking

- 16) A good whose demand is inversely related to income is a(n)
A) normal good. B) inferior good. C) regular good. D) new good.

Answer: B

Diff: 2

Topic: Demand in Product / Output Markets

Skill: Definition

- 17) In college you practically existed on instant noodles, but now you earn \$95,000 a year. You never want to see instant noodles again. We can safely conclude that you consider instant noodles to be a(n)

- A) normal good. B) complementary good.
C) luxury. D) inferior good.

Answer: D

Diff: 2

Topic: Demand in Product / Output Markets

Skill: Conceptual

AACSB: Reflective Thinking

- 18) For inferior goods, an increase in income will cause the

- A) quantity demanded to fall. B) demand to increase.
C) demand to fall. D) quantity demanded to increase.

Answer: C

Diff: 1

Topic: Demand in Product / Output Markets

Skill: Definition

- 19) A decrease in demand for cameras would likely be caused by

- A) an increase in the price of a substitute good.
B) an increase in the price of cameras.
C) an increase in the price of a complementary good.
D) a decrease in the price of cameras.

Answer: C

Diff: 2

Topic: Demand in Product / Output Markets

Skill: Conceptual

AACSB: Reflective Thinking

- 20) When the decrease in the price of one good causes the demand for another good to decrease, the goods are

- A) normal. B) inferior. C) substitutes. D) complements.

Answer: C

Diff: 2

Topic: Demand in Product / Output Markets

Skill: Definition

- 21) Demand for one item goes down when the price of another item goes up. These items must be

- A) substitutes. B) complements. C) normal goods. D) inferior goods.

Answer: B

Diff: 2

Topic: Demand in Product / Output Markets

Skill: Definition

- 22) In response to news reports that taking aspirin daily can reduce an individual's risk of a heart attack, there will most likely be a(n)
- A) increase in the supply of aspirin.
 - B) decrease in the supply of aspirin.
 - C) increase in the demand for aspirin.
 - D) increase in the quantity demanded of aspirin.

Answer: C

Diff: 2

Topic: Demand in Product / Output Markets

Skill: Conceptual

AACSB: Reflective Thinking

- 23) Demand curves are derived while holding constant
- A) income, tastes, and the price of the good.
 - B) only income and tastes.
 - C) income, tastes, and the prices of other goods.
 - D) only tastes and the price of other goods.

Answer: C

Diff: 2

Topic: Demand in Product / Output Markets

Skill: Conceptual

- 24) The quantity demanded of Pepsi has decreased. The best explanation for this is that
- A) the price of Coca-Cola has increased.
 - B) Pepsi's advertising is not as effective as in the past.
 - C) the price of Pepsi has increased.
 - D) Pepsi consumers had an increase in income.

Answer: C

Diff: 2

Topic: Demand in Product / Output Markets

Skill: Conceptual

AACSB: Reflective Thinking

Refer to the information provided in Figure 3.6 below to answer the questions that follow.

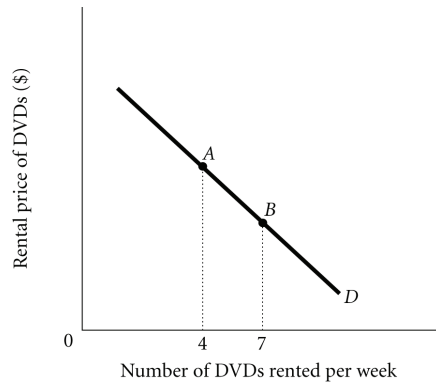


Figure 3.6

- 25) Refer to Figure 3.6. The number of DVDs Isabel rents per week increases from 4 to 7. This is caused by
- A) an increase in income if DVDs are a normal good.
 - B) a decrease in the price of popcorn which is a complement to DVDs.
 - C) a decrease in the rental price of DVDs.
 - D) either A or B

Answer: C

Diff: 2

Topic: Demand in Product / Output Markets

Skill: Analytic

AACSB: Analytic Skills

- 26) A change in the price of a good or service leads to a _____ that leads to a _____.
- A) change in demand; movement along the demand curve
 - B) change in quantity demanded; movement along the demand curve
 - C) change in demand; shift in the demand curve
 - D) change in quantity demanded; shift of the demand curve

Answer: B

Diff: 2

Topic: Demand in Product / Output Markets

Skill: Conceptual

AACSB: Reflective Thinking

- 27) A change in income, preferences, or prices of other goods or services leads to a _____ that causes a _____.
- A) change in demand; movement along the demand curve
 - B) change in quantity demanded; movement along the demand curve
 - C) change in demand; shift of the demand curve
 - D) change in quantity demanded; shift of the demand curve

Answer: C

Diff: 2

Topic: Demand in Product / Output Markets

Skill: Conceptual

AACSB: Reflective Thinking

Refer to the information provided in Figure 3.7 below to answer the following questions.

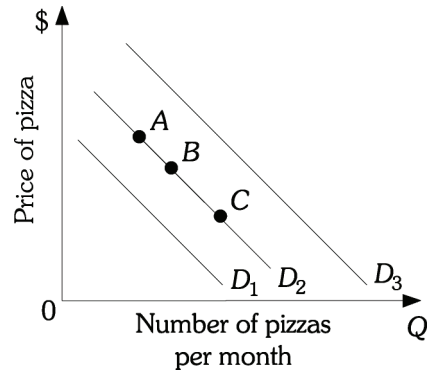


Figure 3.7

- 28) Refer to Figure 3.7. Assume the market is initially at Point B and that pizza is a normal good. A decrease in income would cause the market to move from Point B on demand curve D_2 to
- A) demand curve D_1 .
 - B) demand curve D_3 .
 - C) Point A on demand curve D_2 .
 - D) Point C on demand curve D_2 .

Answer: A

Diff: 2

Topic: Demand in Product / Output Markets

Skill: Analytic

AACSB: Analytic Skills

- 29) Refer to Figure 3.7. If pizza and beer are complementary goods, a decrease in the price of beer will cause a movement from Point B on demand curve D_2 to
- A) demand curve D_1 .
 - B) demand curve D_3 .
 - C) Point A on demand curve D_2 .
 - D) Point C on demand curve D_2 .

Answer: B

Diff: 2

Topic: Demand in Product / Output Markets

Skill: Analytic

AACSB: Analytic Skills

- 30) Refer to Figure 3.7. If pizza and hamburgers are substitutes, an increase in the price of hamburgers will cause a movement from Point B on demand curve D_2 to
- A) demand curve D_1 .
 - B) demand curve D_3 .
 - C) Point A on demand curve D_2 .
 - D) Point C on demand curve D_2 .

Answer: B

Diff: 2

Topic: Demand in Product / Output Markets

Skill: Analytic

AACSB: Analytic Skills

- 31) Refer to Figure 3.7. A movement from Point C to Point B on demand curve D_2 would be caused by a(n)
- A) decrease in income, assuming pizza is a normal good.
 - B) decrease in the price of hamburgers, assuming that pizza and hamburgers are substitutes.
 - C) decrease in the price of pizza.
 - D) increase in the price of pizza.

Answer: D

Diff: 2

Topic: Demand in Product / Output Markets

Skill: Conceptual

AACSB: Reflective Thinking

- 32) Refer to Figure 3.7. A decrease in demand is represented by the movement
- A) from D_2 to D_1 .
 - B) from D_2 to D_3 .
 - C) along D_2 from Point B to Point A.
 - D) along D_2 from Point B to Point C.

Answer: A

Diff: 2

Topic: Demand in Product / Output Markets

Skill: Conceptual

AACSB: Reflective Thinking

- 33) Refer to Figure 3.7. An increase in quantity demanded is represented by movement
- A) from D_2 to D_1 .
 - B) from D_2 to D_3 .
 - C) along D_2 from Point B to point A.
 - D) along D_2 from Point B to point C.

Answer: D

Diff: 2

Topic: Demand in Product / Output Markets

Skill: Conceptual

AACSB: Reflective Thinking

Refer to the information provided in Figure 3.8 below to answer the following questions.

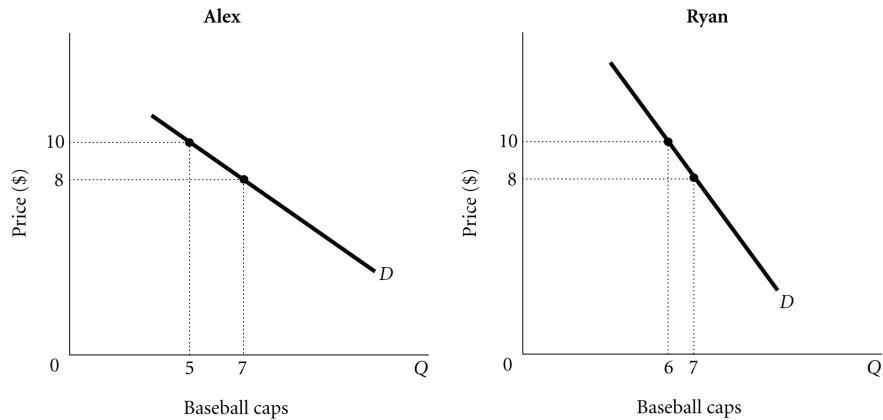


Figure 3.8

- 34) Refer to Figure 3.8. Assume that there are only two people in the market for baseball caps: Alex and Ryan. Along the market demand curve for baseball caps, at a price of _____, quantity demanded would be _____.
- A) \$10; 7 B) \$10; 11 C) \$8; 12 D) \$8; 13

Answer: B

Diff: 2

Topic: Demand in Product / Output Markets

Skill: Analytic

AACSB: Analytic Skills

- 35) Refer to Figure 3.8. Assume there are only two people in the market for baseball caps: Alex and Ryan. Along the market demand curve for baseball caps, at a price of _____, quantity demanded would be _____.
- A) \$10; 6 B) \$10; 12 C) \$8; 14 D) \$8; 25

Answer: C

Diff: 2

Topic: Demand in Product / Output Markets

Skill: Analytic

AACSB: Analytic Skills

Refer to the information provided in Figure 3.9 below to answer the following questions.

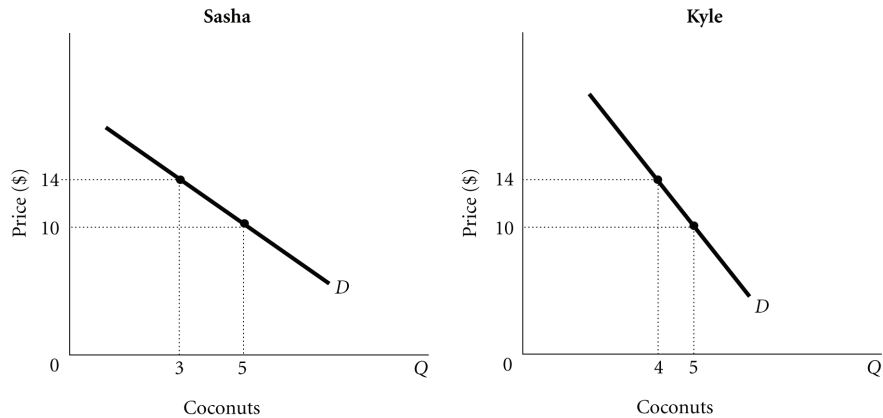


Figure 3.9

- 36) Refer to Figure 3.9. Assume that there are only two people in the market for coconuts: Sasha and Kyle. Along the market demand curve for coconuts, at a price of _____, quantity demanded would be _____.
- A) \$14; 7 B) \$14; 9 C) \$10; 9 D) \$10; 8

Answer: A

Diff: 2

Topic: Demand in Product / Output Markets

Skill: Analytic

AACSB: Analytic Skills

- 37) Refer to Figure 3.9. Assume there are only two people in the market for coconuts: Sasha and Kyle. Along the market demand curve for coconuts, at a price of _____, quantity demanded would be _____.
- A) \$10; 9 B) \$10; 10 C) \$14; 9 D) \$14; 8

Answer: B

Diff: 2

Topic: Demand in Product / Output Markets

Skill: Analytic

AACSB: Analytic Skills

Refer to the information provided in Scenario 3.1 below to answer the following questions.

SCENARIO 3.1: Rented DVDs and movies shown in theaters are substitutes. Rented DVDs and plasma TVs are complements. Plasma TVs and movies shown in theaters are normal goods. People watch rented DVDs more often in the winter than in the summer.

- 38) Refer to Scenario 3.1. Most plasma TVs sold in the United States are imported from Japan. If the United States government reduces the number of plasma TVs that can be imported into the United States, *ceteris paribus*, what would happen?
- A) The price of plasma TVs and the rental price of DVDs would decrease.
 - B) The price of plasma TVs would decrease and the rental price of DVDs would increase.
 - C) The price of plasma TVs would increase and the rental price of DVDs would decrease.
 - D) The price of plasma TVs and the rental price of DVDs would increase.

Answer: C

Diff: 3

Topic: Demand in Product / Output Markets

Skill: Conceptual

AACSB: Reflective Thinking

- 39) Refer to Scenario 3.1. To raise additional revenues, the government imposes an entertainment tax on movie tickets, but there are no new additional taxes levied on rented DVDs. This would lead to
- A) an increase in the price of movie tickets, but no change in the rental price of DVDs.
 - B) an increase in the price of movie tickets and the rental price of DVDs.
 - C) an increase in the price of a movie ticket and a decrease in the rental price of DVDs.
 - D) no change in the price of a movie ticket and an increase in the rental price of DVDs.

Answer: B

Diff: 3

Topic: Demand in Product / Output Markets

Skill: Conceptual

AACSB: Reflective Thinking

- 40) Refer to Scenario 3.1. You observe that the rental price for DVDs is higher in the winter than in the summer. This would be explained by the fact that
- A) demand for rented DVDs is higher in the winter than in the summer.
 - B) the quantity demanded of rented DVDs is higher in the winter than in the summer.
 - C) there are more DVDs released into the rental market in the winter than in the summer.
 - D) consumer income tends to fall in the winter and increase in the summer.

Answer: A

Diff: 3

Topic: Demand in Product / Output Markets

Skill: Conceptual

AACSB: Reflective Thinking

- 41) Refer to Scenario 3.1. The number of stores renting DVDs is reduced by 25%, reducing the number of DVDs available. Which of the following would occur?
- A) The rental price of DVDs would increase, and the price of plasma TVs and movie tickets would decrease.
 - B) The rental price of DVDs would increase, but the price of plasma TVs and movie tickets would be unaffected.
 - C) The rental price of DVDs and movie tickets would decrease, but the price of plasma TVs would increase.
 - D) The rental price of DVDs and the price of movie tickets would increase, but the price of plasma TVs would decrease.

Answer: D

Diff: 3

Topic: Demand in Product / Output Markets

Skill: Conceptual

AACSB: Reflective Thinking

2 True/False

- 1) Wealth is a flow measure.

Answer: FALSE

Diff: 1

Topic: Demand in Product / Output Markets

Skill: Fact

- 2) A change in the price of a good or service leads to a change in quantity demanded of the good.

Answer: TRUE

Diff: 1

Topic: Demand in Product / Output Markets

Skill: Conceptual

AACSB: Reflective Thinking

- 3) Quantity demanded of a product is determined only by how much of that product consumers desire.

Answer: FALSE

Diff: 1

Topic: Demand in Product / Output Markets

Skill: Conceptual

- 4) Inferior goods are always substandard.

Answer: FALSE

Diff: 1

Topic: Demand in Product / Output Markets

Skill: Conceptual

- 5) If iPods and iTunes are complements, then a decrease in the price of iPods will result in a decrease in the demand for iTunes.

Answer: FALSE

Diff: 1

Topic: Demand in Product / Output Markets

Skill: Conceptual

AACSB: Reflective Thinking

3.4 Supply in Product / Output Markets

1 Multiple Choice

- 1) According to the law of supply, there is a
- A) negative relationship between price and the quantity of a good supplied.
 - B) positive relationship between price and the quantity of a good supplied.
 - C) negative relationship between price and the change in supply.
 - D) positive relationship between price and the change in supply.

Answer: B

Diff: 2

Topic: Supply in Product / Output Markets

Skill: Definition

- 2) The price of hard drives used in the manufacturing of laptop computers has risen. This will lead to _____ laptop computers.
- A) an increase in the supply of
 - B) a decrease in the supply of
 - C) an increase in the quantity supplied of
 - D) a decrease in the quantity supplied of

Answer: B

Diff: 3

Topic: Supply in Product / Output Markets

Skill: Conceptual

AACSB: Reflective Thinking

- 3) If the price of chili increases, there will be _____ of chili cheese fries.
- A) an increase in the supply
 - B) a decrease in the supply
 - C) an increase in the quantity supplied
 - D) a decrease in the quantity supplied

Answer: B

Diff: 3

Topic: Supply in Product / Output Markets

Skill: Conceptual

AACSB: Reflective Thinking

- 4) A frozen food manufacturer can produce either pizzas or calzones. As the result of an increase in the price of calzones, the firm produces more calzones and fewer pizzas. An economist would explain this by saying
- A) the supply of calzones increased and the supply of pizzas decreased.
 - B) there has been an increase in the quantity supplied of calzones and a decrease in the quantity supplied of pizzas.
 - C) there has been an increase in the quantity supplied of calzones and a decrease in the supply of pizza.
 - D) the supply of calzones increased and the quantity supplied of pizza decreased.

Answer: C

Diff: 3

Topic: Supply in Product / Output Markets

Skill: Conceptual

AACSB: Reflective Thinking

Refer to the information provided in Figure 3.14 below to answer the following questions.

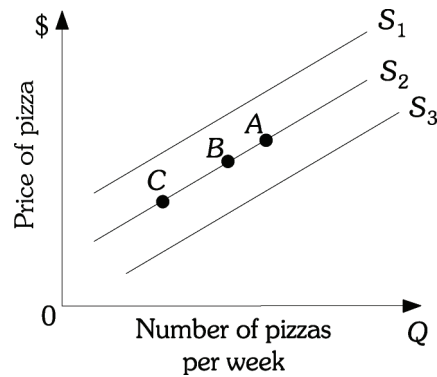


Figure 3.14

- 5) Refer to Figure 3.14. A decrease in the wage rate of pizza makers will cause a movement from Point B on supply curve S₂ to
- A) Point A on supply curve S₂.
 - B) Point B on supply curve S₂.
 - C) supply curve S₃.
 - D) supply curve S₁.

Answer: C

Diff: 2

Topic: Supply in Product / Output Markets

Skill: Analytic

AACSB: Analytic Skills

- 6) Refer to Figure 3.14. An increase in supply is represented by the movement from
- A) S₂ to S₃.
 - B) S₂ to S₁.
 - C) Point B to Point A along supply curve S₂.
 - D) Point B to Point C along supply curve S₂.

Answer: A

Diff: 2

Topic: Supply in Product / Output Markets

Skill: Analytic

AACSB: Analytic Skills

- 7) Refer to Figure 3.14. A decrease in quantity supplied is represented by a movement from
- A) S₂ to S₃.
 - B) S₂ to S₁.
 - C) Point B to Point A along supply curve S₂.
 - D) Point B to Point C along supply curve S₂.

Answer: D

Diff: 2

Topic: Supply in Product / Output Markets

Skill: Analytic

AACSB: Analytic Skills

- 8) Refer to Figure 3.14. An increase in the price of pizza sauce will cause a movement from Point B on supply curve S_2 to
- A) supply curve S_3 .
 - B) supply curve S_1 .
 - C) Point A on supply curve S_2 .
 - D) Point C on supply curve S_2 .

Answer: B

Diff: 2

Topic: Supply in Product / Output Markets

Skill: Analytic

AACSB: Analytic Skills

- 9) Refer to Figure 3.14. A movement from Point A to Point B on supply curve S_2 would be caused by a(n)
- A) increase in the price of pizza.
 - B) decrease in the demand for pizza.
 - C) increase in the price of pizza dough.
 - D) increase in the price of hamburgers, assuming hamburgers are a substitute for pizza.

Answer: B

Diff: 3

Topic: Supply in Product / Output Markets

Skill: Analytic

AACSB: Analytic Skills

Refer to the information provided in Figure 3.15 below to answer the following questions.

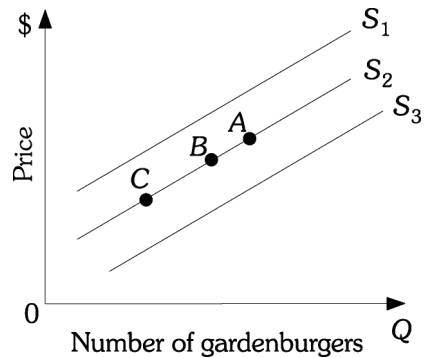


Figure 3.15

- 10) Refer to Figure 3.15. An increase in the wage rate of gardenburger makers will cause a movement from Point B on supply curve S_2 to
- A) Point A on supply curve S_2 .
 - B) Point B on supply curve S_2 .
 - C) supply curve S_3 .
 - D) supply curve S_1 .

Answer: D

Diff: 2

Topic: Supply in Product / Output Markets

Skill: Analytic

AACSB: Analytic Skills

11) Refer to Figure 3.15. A decrease in supply is represented by the movement from

- A) S_2 to S_3 .
- B) S_2 to S_1 .
- C) Point B to Point A along supply curve S_2 .
- D) Point B to Point C along supply curve S_2 .

Answer: B

Diff: 2

Topic: Supply in Product / Output Markets

Skill: Analytic

AACSB: Analytic Skills

12) Refer to Figure 3.15. An increase in quantity supplied is represented by a movement from

- A) S_2 to S_1 .
- B) S_2 to S_3 .
- C) Point B to Point A along supply curve S_2 .
- D) Point B to Point C along supply curve S_2 .

Answer: C

Diff: 2

Topic: Supply in Product / Output Markets

Skill: Analytic

AACSB: Analytic Skills

13) Refer to Figure 3.15. A decrease in the price of mushrooms (an input for gardenburgers) will cause a movement from Point B on supply curve S_2 to

- A) supply curve S_3 .
- B) supply curve S_1 .
- C) Point A on supply curve S_2 .
- D) Point C on supply curve S_2 .

Answer: A

Diff: 2

Topic: Supply in Product / Output Markets

Skill: Analytic

AACSB: Analytic Skills

14) Refer to Figure 3.15. A movement from Point C to Point B on supply curve S_2 would be caused by a(n)

- A) decrease in the price of gardenburgers.
- B) increase in the demand for gardenburgers.
- C) decrease in the price of mushrooms.
- D) decrease in the price of hamburgers, assuming hamburgers are a substitute for pizza.

Answer: B

Diff: 3

Topic: Supply in Product / Output Markets

Skill: Analytic

AACSB: Analytic Skills

- 15) The change in the price of a good leads to a change in _____, which leads to a _____.
- A) quantity supplied; movement along a supply curve
 - B) quantity supplied; shift of the supply curve
 - C) supply; movement along a supply curve
 - D) supply; shift of the supply curve

Answer: A

Diff: 2

Topic: Supply in Product / Output Markets

Skill: Conceptual

AACSB: Reflective Thinking

Refer to the information provided in Figure 3.16 below to answer the questions that follow.

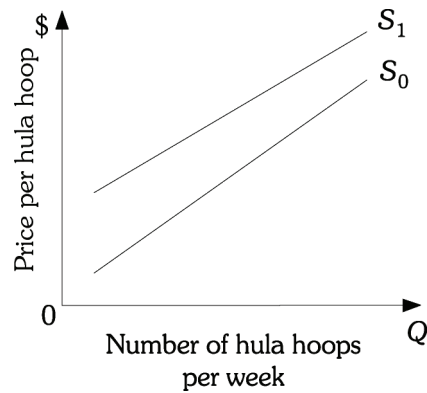


Figure 3.16

- 16) Refer to Figure 3.16. The supply curve for hula hoops shifts from S_0 to S_1 . This could be caused by
- A) an decrease in the price of hula hoops.
 - B) a decrease in the number of firms selling hula hoops.
 - C) a decrease in the demand for hula hoops.
 - D) either B or C

Answer: B

Diff: 2

Topic: Supply in Product / Output Markets

Skill: Conceptual

AACSB: Reflective Thinking

Refer to the information provided in Figure 3.11 below to answer the questions that follow.

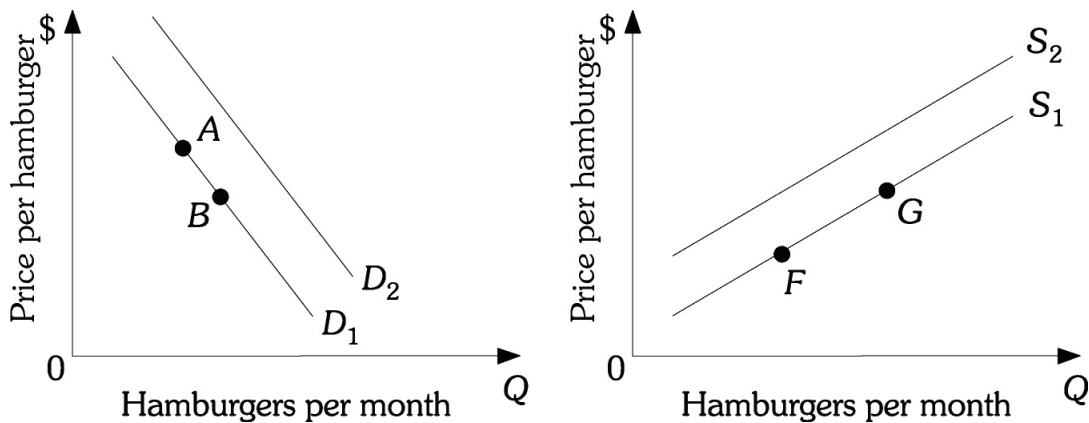


Figure 3.11

- 17) Refer to Figure 3.11. Assume hamburgers are a normal good. An increase in income will cause a movement from:
- A) Point A to Point B.
 - B) Point G to Point F.
 - C) D_1 to D_2 .
 - D) S_1 to S_2 .

Answer: C

Diff: 2

Topic: Supply in Product / Output Markets

Skill: Analytic

AACSB: Analytic Skills

- 18) Refer to Figure 3.11. Assume hamburgers and hot dogs are substitutes. A decrease in the price of hot dogs will cause a movement from:
- A) Point A to Point B.
 - B) Point F to Point G.
 - C) D_2 to D_1 .
 - D) D_1 to D_2 .

Answer: C

Diff: 2

Topic: Supply in Product / Output Markets

Skill: Analytic

AACSB: Analytic Skills

- 19) Refer to Figure 3.11. Assume hamburgers and french fries are complements. A decrease in the price of french fries will cause a movement from:
- A) Point A to Point B.
 - B) Point G to Point F.
 - C) D_1 to D_2 .
 - D) S_2 to S_1 .

Answer: C

Diff: 2

Topic: Supply in Product / Output Markets

Skill: Analytic

AACSB: Analytic Skills

- 20) Refer to Figure 3.11. An increase in the number of cattle ranchers will cause a movement from:
- A) Point B to Point A.
 - B) Point G to Point F.
 - C) D_2 to D_1 .
 - D) S_2 to S_1 .

Answer: D

Diff: 2

Topic: Supply in Product / Output Markets

Skill: Analytic

AACSB: Analytic Skills

2 True/False

- 1) A shift of the supply curve is caused by a change in a good's own price.

Answer: FALSE

Diff: 1

Topic: Supply in Product / Output Markets

Skill: Conceptual

- 2) A technological advance in the production of MP3 players will cause the equilibrium selling price to increase.

Answer: FALSE

Diff: 1

Topic: Supply in Product / Output Markets

Skill: Conceptual

AACSB: Reflective Thinking

- 3) An increase in the wage rate of steel workers will reduce the supply of steel.

Answer: TRUE

Diff: 1

Topic: Supply in Product / Output Markets

Skill: Conceptual

AACSB: Reflective Thinking

- 4) Quantity supplied is determined by how much producers are willing and able to produce.

Answer: TRUE

Diff: 1

Topic: Supply in Product / Output Markets

Skill: Conceptual

3.5 Market Equilibrium

1 Multiple Choice

- 1) Equilibrium is the condition that exists
- A) whenever there is no government intervention in the market.
 - B) when the demand curve intersects the price axis.
 - C) when quantity demanded equals quantity supplied.
 - D) when the demand curve intersects the quantity axis.

Answer: C

Diff: 2

Topic: Market Equilibrium

Skill: Definition

Refer to the information provided in Table 3.1 below to answer the questions that follow.

Table 3.1

Price per Pizza	Quantity Demanded (Pizzas per Month)	Quantity Supplied (Pizzas per Month)
\$3	1,200	600
6	1,000	700
9	800	800
12	600	900
15	400	1,000

- 2) Refer to Table 3.1. This market will be in equilibrium if the price per pizza is
A) \$6. B) \$9. C) \$12. D) \$15.

Answer: B

Diff: 1

Topic: Market Equilibrium

Skill: Analytic

AACSB: Analytic Skills

- 3) Refer to Table 3.1. If the price per pizza is \$12, the price will
A) remain constant because the market is in equilibrium.
B) increase because there is an excess demand in the market.
C) decrease because there is an excess demand in the market.
D) decrease because there is an excess supply in the market.

Answer: D

Diff: 2

Topic: Market Equilibrium

Skill: Analytic

AACSB: Analytic Skills

- 4) Refer to Table 3.1. If the price per pizza is \$15, there is a(n)
A) market equilibrium. B) excess demand of 400 units.
C) excess demand of 900 units. D) excess supply of 600 units.

Answer: D

Diff: 2

Topic: Market Equilibrium

Skill: Analytic

AACSB: Analytic Skills

- 5) Refer to Table 3.1. If the price per pizza is \$6, there is an excess
A) demand of 300 pizzas. B) demand of 600 pizzas.
C) supply of 700 pizzas. D) supply of 1,000 pizzas.

Answer: A

Diff: 2

Topic: Market Equilibrium

Skill: Analytic

AACSB: Analytic Skills

- 6) Refer to Table 3.1. In this market there will be an excess demand of 300 pizzas at a price of
 A) \$6. B) \$9. C) \$12. D) \$15.

Answer: A

Diff: 2

Topic: Market Equilibrium

Skill: Analytic

AACSB: Analytic Skills

- 7) Refer to Table 3.1. In this market there will be an excess supply of 300 pizzas at a price of
 A) \$6. B) \$9. C) \$12. D) \$15.

Answer: C

Diff: 2

Topic: Market Equilibrium

Skill: Analytic

AACSB: Analytic Skills

- 8) Refer to Table 3.1. If the price per pizza is \$3, the price will
 A) remain constant because the market is in equilibrium.
 B) increase because there is an excess demand in the market.
 C) increase because there is an excess supply in the market.
 D) decrease because there is an excess supply in the market.

Answer: B

Diff: 2

Topic: Market Equilibrium

Skill: Analytic

AACSB: Analytic Skills

Refer to the information provided in Table 3.2 below to answer the questions that follow.

Table 3.2

Price per Cheeseburger	Quantity Demanded (Cheeseburgers per Month)	Quantity Supplied (Cheeseburgers per Month)
\$5	1,500	500
6	1,200	700
7	900	900
8	600	1,100
9	300	1,300

- 9) Refer to Table 3.2. This market will be in equilibrium if the price per cheeseburger is
 A) \$5. B) \$6. C) \$7. D) \$8.

Answer: C

Diff: 2

Topic: Market Equilibrium

Skill: Analytic

AACSB: Analytic Skills

- 10) Refer to Table 3.2. If the price per cheeseburger is \$6, the price will
- A) remain constant because the market is in equilibrium.
 - B) decrease because there is an excess demand in the market.
 - C) increase because there is an excess demand in the market.
 - D) decrease because there is an excess supply in the market.

Answer: C

Diff: 2

Topic: Market Equilibrium

Skill: Analytic

AACSB: Analytic Skills

- 11) Refer to Table 3.2. If the price per cheeseburger is \$9, there is a(n)
- A) market equilibrium.
 - B) excess demand of 500 units.
 - C) excess demand of 300 units.
 - D) excess supply of 1,000 units.

Answer: D

Diff: 2

Topic: Market Equilibrium

Skill: Analytic

AACSB: Analytic Skills

- 12) Refer to Table 3.2. If the price per cheeseburger is \$5, there is an excess
- A) demand of 300 cheeseburgers.
 - B) supply of 500 cheeseburgers.
 - C) demand of 1,000 cheeseburgers.
 - D) supply of 2,000 cheeseburgers.

Answer: C

Diff: 2

Topic: Market Equilibrium

Skill: Analytic

AACSB: Analytic Skills

- 13) Refer to Table 3.2. In this market there will be an excess demand of 500 cheeseburgers at a price of
- A) \$5.
 - B) \$6.
 - C) \$7.
 - D) \$8.

Answer: B

Diff: 2

Topic: Market Equilibrium

Skill: Analytic

AACSB: Analytic Skills

- 14) Refer to Table 3.2. In this market there will be an excess supply of 500 cheeseburgers at a price of
- A) \$5.
 - B) \$6.
 - C) \$8.
 - D) \$9.

Answer: C

Diff: 2

Topic: Market Equilibrium

Skill: Analytic

AACSB: Analytic Skills

- 15) Refer to Table 3.2. If the price per cheeseburger is \$7, the price will
- A) remain constant because the market is in equilibrium.
 - B) increase because there is an excess demand in the market.
 - C) increase because there is an excess supply in the market.
 - D) decrease because there is an excess supply in the market.

Answer: A

Diff: 2

Topic: Market Equilibrium

Skill: Analytic

AACSB: Analytic Skills

- 16) When there is an excess supply of a product in an unregulated market, the tendency is for
- A) price to rise.
 - B) price to decrease.
 - C) quantity supplied to increase.
 - D) quantity demanded to decrease.

Answer: B

Diff: 2

Topic: Market Equilibrium

Skill: Conceptual

AACSB: Reflective Thinking

Refer to the information provided in Figure 3.17 below to answer the questions that follow.

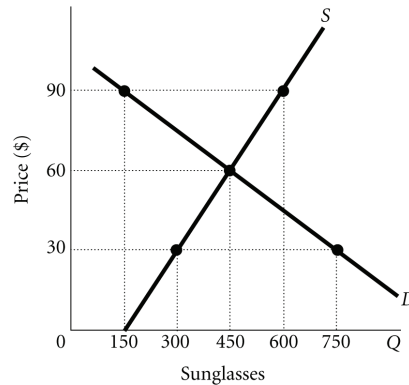


Figure 3.17

- 17) Refer to Figure 3.17. The market for sunglasses is in equilibrium at a price of _____ and a quantity of _____ sunglasses.
- A) \$30; 300
 - B) \$30; 600
 - C) \$60; 450
 - D) \$90; 300

Answer: C

Diff: 1

Topic: Market Equilibrium

Skill: Analytic

AACSB: Analytic Skills

- 18) Refer to Figure 3.17. At a price of \$30, there is an excess
- A) demand of 450 sunglasses.
 - B) demand of 750 sunglasses.
 - C) demand of 300 sunglasses.
 - D) supply of 300 sunglasses.

Answer: A

Diff: 2

Topic: Market Equilibrium

Skill: Analytic

AACSB: Analytic Skills

- 19) Refer to Figure 3.17. If this market is unregulated and the price is currently \$90, you would expect that the price
- A) of sunglasses would remain at \$90, because firms would not want to reduce the price.
 - B) of sunglasses would fall to \$30, so the firm could sell its excess supply.
 - C) of sunglasses would fall to \$60, where quantity demanded equals quantity supplied.
 - D) of sunglasses would fall, but the new price is indeterminate from the information provided.

Answer: C

Diff: 2

Topic: Market Equilibrium

Skill: Analytic

AACSB: Analytic Skills

- 20) Refer to Figure 3.17. At a price of \$90, there is an excess
- A) demand of 150 sunglasses.
 - B) supply of 450 sunglasses.
 - C) demand of 600 sunglasses.
 - D) supply of 600 sunglasses.

Answer: B

Diff: 2

Topic: Market Equilibrium

Skill: Analytic

AACSB: Analytic Skills

- 21) When there is a shortage of a product in an unregulated market, there is a tendency for
- A) price to rise.
 - B) price to fall.
 - C) quantity demanded to increase.
 - D) quantity supplied to decrease.

Answer: A

Diff: 2

Topic: Market Equilibrium

Skill: Conceptual

AACSB: Reflective Thinking

- 22) If the market for tires is unregulated and is presently characterized by excess supply, you can accurately predict that price will
- A) increase, the quantity demanded will fall, and the quantity supplied will rise.
 - B) increase, the quantity demanded will rise, and the quantity supplied will fall.
 - C) decrease, the quantity demanded will rise, and the quantity supplied will fall.
 - D) decrease, the quantity demanded will fall, and the quantity supplied will rise.

Answer: C

Diff: 3

Topic: Market Equilibrium

Skill: Conceptual

AACSB: Reflective Thinking

- 23) DVDs and DVD players are complements. An increase in the price of DVD players would cause which of the following in the market for DVDs?
- A) The equilibrium price and quantity of DVDs would increase.
 - B) The equilibrium price and quantity of DVDs would decrease.
 - C) The equilibrium price of DVDs would increase and the equilibrium quantity would decrease.
 - D) The equilibrium price of DVDs would decrease and the equilibrium quantity would increase.

Answer: B

Diff: 3

Topic: Market Equilibrium

Skill: Conceptual

AACSB: Reflective Thinking

- 24) Suppose that video game discs are a normal good. If the income of video game players increases, you predict that in the market for video games
- A) both equilibrium price and quantity will fall.
 - B) both equilibrium price and quantity will increase.
 - C) equilibrium price will increase and quantity will decrease.
 - D) equilibrium price will fall but quantity will increase.

Answer: B

Diff: 3

Topic: Market Equilibrium

Skill: Conceptual

AACSB: Reflective Thinking

Refer to the information provided in Figure 3.18 below to answer the questions that follow.

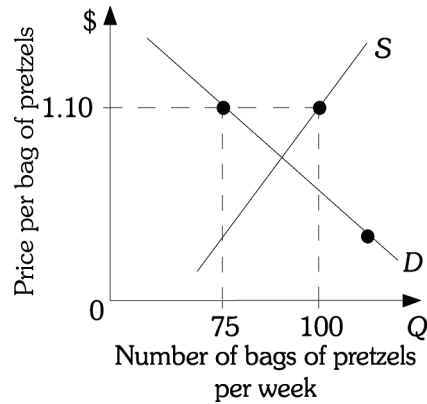


Figure 3.18

- 25) Refer to Figure 3.18. The current price of a bag of pretzels is \$1.10. You accurately predict that in this market
- A) price tends to remain constant and quantity supplied increases.
 - B) price, quantity demanded, and quantity supplied decrease.
 - C) price and quantity demanded increase and quantity supplied decreases.
 - D) price and quantity supplied decrease and quantity demanded increases.

Answer: D

Diff: 3

Topic: Market Equilibrium

Skill: Conceptual

AACSB: Reflective Thinking

- 26) When Hurricane Andrew passed through Louisiana in the summer of 1992, approximately a quarter of the sugar cane crop was destroyed. *Ceteris paribus*,
- A) the supply of sugar decreased and the price of sugar increased.
 - B) the supply of sugar decreased and the price of sugar decreased.
 - C) the demand for sugar increased and the price of sugar increased.
 - D) the demand for sugar decreased and the price of sugar decreased.

Answer: A

Diff: 2

Topic: Market Equilibrium

Skill: Conceptual

AACSB: Reflective Thinking

- 27) The price of mozzarella cheese, which is used in making pizza, increases. In the market for pizza you would expect that
- A) the demand for pizza would increase and the price of pizza would increase.
 - B) the demand for pizza would decrease and the price of pizza would fall.
 - C) the supply of pizza would decrease and the price of pizza would increase.
 - D) the supply of pizza would increase and the price of pizza would decrease.

Answer: C

Diff: 3

Topic: Market Equilibrium

Skill: Conceptual

AACSB: Reflective Thinking

- 28) If improvements in technology have reduced the cost of producing personal computers, you accurately predict that in the market for personal computers, there will be a(n)
- A) increase in the quantity supplied of personal computers, a reduction in the price, and an increase in the quantity demanded.
 - B) increase in the supply of personal computers, a decrease in the price, and an increase in the quantity demanded.
 - C) increase in the supply of personal computers, a reduction in the price, and an increase in the demand.
 - D) decrease in the supply of personal computers, an increase in the price, and a decrease in the demand.

Answer: B

Diff: 3

Topic: Market Equilibrium

Skill: Conceptual

AACSB: Reflective Thinking

- 29) Which of the following will definitely occur when there is a simultaneous decrease in demand and a decrease in supply?
- A) an increase in equilibrium price
 - B) a decrease in equilibrium price
 - C) an increase in equilibrium quantity
 - D) a decrease in equilibrium quantity

Answer: D

Diff: 3

Topic: Market Equilibrium

Skill: Conceptual

AACSB: Reflective Thinking

- 30) A movement along the demand curve to the left may be caused by a
- A) rise in income.
 - B) decrease in supply.
 - C) fall in the number of substitute goods.
 - D) fall in the price of inputs.

Answer: B

Diff: 3

Topic: Market Equilibrium

Skill: Conceptual

AACSB: Reflective Thinking

- 31) Which of the following will definitely occur when there is an increase in the supply of and decrease in demand for MP3 players?
- A) an increase in equilibrium price
 - B) a decrease in equilibrium price
 - C) an increase in equilibrium quantity
 - D) a decrease in equilibrium quantity

Answer: B

Diff: 3

Topic: Market Equilibrium

Skill: Conceptual

AACSB: Reflective Thinking

32) Which of the following will definitely occur when there is an increase in demand for and a decrease in supply of milk?

- A) an increase in equilibrium price
- B) a decrease in equilibrium price
- C) an increase in equilibrium quantity
- D) a decrease in equilibrium quantity

Answer: A

Diff: 3

Topic: Market Equilibrium

Skill: Conceptual

AACSB: Reflective Thinking

33) An insect that is resistant to currently used pesticides has infested the cotton crop, and this year's crop is only half of what was produced last year. You accurately predict that this

- A) will shift the supply curve of cotton to the right, the equilibrium price of cotton will increase, and the demand for cotton will fall.
- B) will shift the supply curve of cotton to the right, the equilibrium price of cotton will increase, and the quantity demanded of cotton will decrease.
- C) will shift the supply curve of cotton to the left, the equilibrium price of cotton will increase, and the quantity demanded of cotton will decrease.
- D) will shift the supply curve of cotton to the left, the equilibrium price of cotton will increase, and the demand for cotton will fall.

Answer: C

Diff: 3

Topic: Market Equilibrium

Skill: Conceptual

AACSB: Reflective Thinking

34) Papayas and grapefruit are substitute goods. A drought in California destroyed a good portion of the grapefruit crop. *Ceteris paribus*,

- A) the price of both papayas and grapefruit will increase.
- B) the price of both papayas and grapefruit will fall.
- C) the price of grapefruit will increase and the price of papayas will fall.
- D) the price of grapefruit will fall and the price of papayas will increase.

Answer: A

Diff: 3

Topic: Market Equilibrium

Skill: Conceptual

AACSB: Reflective Thinking

Refer to the information provided in Figure 3.19 below to answer the questions that follow.

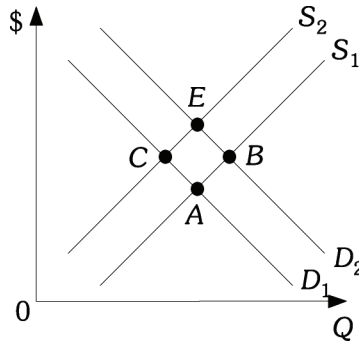


Figure 3.19

- 35) Refer to Figure 3.19. When the economy moves from Point A to Point B, there has been
- A) an increase in demand and an increase in supply.
 - B) an increase in demand and an increase in quantity supplied.
 - C) an increase in quantity demanded and an increase in quantity supplied.
 - D) an increase in quantity demanded and an increase in supply.

Answer: B

Diff: 2

Topic: Market Equilibrium

Skill: Analytic

AACSB: Analytic Skills

- 36) Refer to Figure 3.19. When the economy moves from Point A to Point C, there has been
- A) a decrease in supply and a decrease in quantity demanded.
 - B) a decrease in quantity supplied and a decrease in demand.
 - C) a decrease in supply and an increase in quantity demanded.
 - D) an increase in supply and a decrease in quantity demanded.

Answer: A

Diff: 2

Topic: Market Equilibrium

Skill: Analytic

AACSB: Analytic Skills

- 37) Refer to Figure 3.19. When the economy moves from Point A to Point E, there has been
- A) an increase in demand and an increase in supply.
 - B) a decrease in demand and a decrease in supply.
 - C) an increase in demand and a decrease in supply.
 - D) an increase in quantity demanded and an increase in quantity supplied.

Answer: C

Diff: 2

Topic: Market Equilibrium

Skill: Analytic

AACSB: Analytic Skills

- 38) Refer to Figure 3.19. When the economy moves from Point *E* to Point *B*, there has been
- A) an increase in supply and an increase in quantity demanded.
 - B) an increase in both supply and demand.
 - C) a decrease in supply and an increase in demand.
 - D) a decrease in supply and an increase in quantity demanded.

Answer: A

Diff: 2

Topic: Market Equilibrium

Skill: Analytic

AACSB: Analytic Skills

Refer to Scenario 3.2 below to answer the questions that follow.

SCENARIO 3.2: Lettuce and spinach are substitutes. Lettuce and tomatoes are complements. Lettuce is a normal good. During the winter, about 20% of the lettuce crop was destroyed by flooding.

- 39) Refer to Scenario 3.2. As a result of the flooding during the winter, you would expect that
- A) the price of lettuce would increase, the supply of lettuce would increase, and the quantity demanded of lettuce would decrease.
 - B) the supply of lettuce would decrease, the price of lettuce would increase, and the quantity demanded of lettuce would decrease.
 - C) the price of lettuce would increase and both the quantity of lettuce supplied and the quantity of lettuce demanded would increase.
 - D) the supply of lettuce would decrease, the price of lettuce would increase, and the demand for lettuce would decrease.

Answer: B

Diff: 3

Topic: Market Equilibrium

Skill: Conceptual

AACSB: Reflective Thinking

- 40) Refer to Scenario 3.2. The floods that destroyed part of the lettuce crop would have caused the equilibrium price of spinach to _____ and the equilibrium quantity of spinach to _____.
- A) decrease; decrease
 - B) decrease; increase
 - C) increase; increase
 - D) increase; decrease

Answer: C

Diff: 3

Topic: Market Equilibrium

Skill: Conceptual

AACSB: Reflective Thinking

- 41) Refer to Scenario 3.2. The floods that destroyed part of the lettuce crop would have caused
- A) an increase in the demand for tomatoes.
 - B) a decrease in the demand for tomatoes.
 - C) an increase in the quantity demanded of tomatoes.
 - D) a decrease in the quantity demanded of tomatoes.

Answer: B

Diff: 3

Topic: Market Equilibrium

Skill: Conceptual

AACSB: Reflective Thinking

- 42) Refer to Scenario 3.2. If at the same time that part of the lettuce crop was destroyed, consumer income also decreased. Then, *ceteris paribus*, in the market for lettuce this would have caused
- A) both the equilibrium price and quantity to decrease.
 - B) the equilibrium price to increase and the equilibrium quantity to decrease.
 - C) the equilibrium price to decrease. The equilibrium quantity could have increased, decreased, or remained the same.
 - D) the equilibrium price to either increase, decrease, or remain the same and the equilibrium quantity to decrease.

Answer: D

Diff: 3

Topic: Market Equilibrium

Skill: Conceptual

AACSB: Reflective Thinking

- 43) Refer to Scenario 3.2. The government wants to protect consumers from rising food prices. Therefore, price restrictions are imposed on lettuce growers prohibiting them from raising the price of lettuce. This will cause

- A) an excess supply of lettuce.
- B) an excess demand for lettuce.
- C) an increase in the demand for lettuce.
- D) a decrease in the supply of lettuce.

Answer: B

Diff: 3

Topic: Market Equilibrium

Skill: Conceptual

AACSB: Reflective Thinking

Refer to the information provided in Figure 3.10 below to answer the questions that follow.

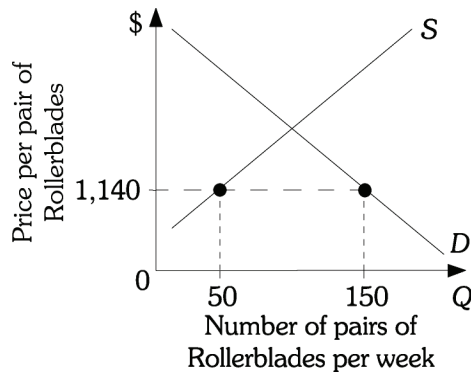


Figure 3.10

- 44) Refer to Figure 3.10. In the Rollerblade market, which is *not* government controlled, you accurately predict that price will
- A) increase, the quantity demanded will fall, and the quantity supplied will rise.
 - B) increase, the quantity demanded will rise, and the quantity supplied will fall.
 - C) decrease, the quantity demanded will fall, and the quantity supplied will fall.
 - D) decrease, the quantity demanded will rise, and the quantity supplied will fall.

Answer: A

Diff: 3

Topic: Market Equilibrium

Skill: Analytic

AACSB: Analytic Skills

Refer to the information provided in Figure 3.12 below to answer the questions that follow.

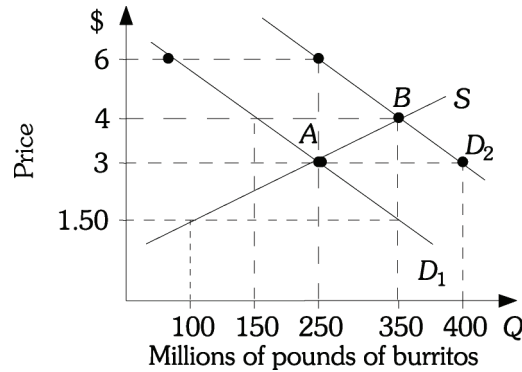


Figure 3.12

- 45) Refer to Figure 3.12. The market is initially in equilibrium at Point A. If demand shifts from D_1 to D_2 and the price of burritos remains constant at \$3.00, there will be
- A) an excess supply of 150 million pounds of burritos.
 - B) an excess demand of 150 million pounds of burritos.
 - C) an excess supply of 50 million pounds of burritos.
 - D) an excess demand of 100 million pounds of burritos.

Answer: B

Diff: 2

Topic: Market Equilibrium

Skill: Analytic

AACSB: Analytic Skills

- 46) Refer to Figure 3.12 The market is initially in equilibrium at Point B. If demand shifts from D_2 to D_1 and the price of burritos remains constant at \$4.00, there will be
- A) an excess supply of 200 million pounds of burritos.
 - B) an excess demand of 200 million pounds of burritos.
 - C) an excess supply of 100 million pounds of burritos.
 - D) an excess demand of 100 million pounds of burritos.

Answer: A

Diff: 2

Topic: Market Equilibrium

Skill: Analytic

AACSB: Analytic Skills

- 47) Refer to Figure 3.12 The market is initially in equilibrium at Point A. If demand shifts from D_1 to D_2 , the new equilibrium price will be _____ and the new equilibrium quantity will be _____.

- A) \$3.00; 250 B) \$6.00; 250 C) \$4.00; 350 D) \$4.00; 150

Answer: C

Diff: 2

Topic: Market Equilibrium

Skill: Analytic

AACSB: Analytic Skills

48) Refer to Figure 3.12. The market is initially in equilibrium at Point B. If demand shifts from D_2 to D_1 , the new equilibrium price will be _____ and the new equilibrium quantity will be _____.

- A) \$4.00; 350 B) \$3.00; 250 C) \$3.00; 400 D) \$4.00; 150

Answer: B

Diff: 2

Topic: Market Equilibrium

Skill: Analytic

AACSB: Analytic Skills

Refer to the information provided in Figure 3.13 below to answer the questions that follow.

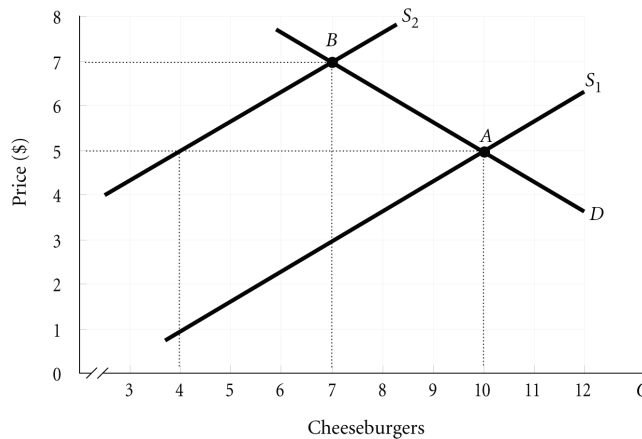


Figure 3.13

49) Refer to Figure 3.13. The market is initially in equilibrium at Point A. If supply shifts from S_1 to S_2 and the price of cheeseburgers remains constant at \$5.00, there will be

- A) an excess supply of 6 cheeseburgers. B) an excess demand of 6 cheeseburgers.
 C) an excess supply of 3 cheeseburgers. D) an excess demand of 4 cheeseburgers.

Answer: B

Diff: 2

Topic: Market Equilibrium

Skill: Analytic

AACSB: Analytic Skills

50) Refer to Figure 3.13. The market is initially in equilibrium at Point A. If supply shifts from S_1 to S_2 , the new equilibrium price will be _____ and the new equilibrium quantity will be _____.

- A) \$5.00; 4 B) \$5.00; 10 C) \$7.00; 6 D) \$7.00; 7

Answer: D

Diff: 2

Topic: Market Equilibrium

Skill: Analytic

AACSB: Analytic Skills

51) Refer to Figure 3.13. The market is initially in equilibrium at Point B. If supply shifts from S_2 to S_1 , the new equilibrium price will be _____ and the new equilibrium quantity will be _____.

- A) \$5.00; 4 B) \$5.00; 10 C) \$7.00; 6 D) \$7.00; 7

Answer: B

Diff: 1

Topic: Market Equilibrium

Skill: Analytic

AACSB: Analytic Skills

52) Related to the *Economics in Practice* on p. 67: Bad weather that reduces the supply of oranges would most likely shift the supply curve for oranges to the _____ and lead to a(n) _____ in the price of producing orange juice.

- A) left; increase B) left; decrease C) right; increase D) right; decrease

Answer: A

Diff: 3

Topic: Market Equilibrium: Economics in Practice

Skill: Conceptual

AACSB: Reflective Thinking

53) Related to the *Economics in Practice* on p. 67: The freezing weather in California decreased the supply of oranges. This would increase the demand for apple juice, assuming apple juice is considered

- A) a substitute for orange juice. B) a complement to orange juice.
C) a normal good. D) an inferior good.

Answer: A

Diff: 3

Topic: Market Equilibrium: Economics in Practice

Skill: Conceptual

AACSB: Reflective Thinking

54) Related to the *Economics in Practice* on p. 69: One explanation for the increase in the price of the Baltimore newspaper is the increase in the cost of newsprint. This would cause the _____ of Baltimore newspapers to _____.

- A) supply; increase B) quantity supplied; increase
C) supply; decrease D) quantity supplied; decrease

Answer: C

Diff: 3

Topic: Market Equilibrium: Economics in Practice

Skill: Analytic

AACSB: Analytic Skills

55) Related to the *Economics in Practice* on p. 69: Assuming the demand for Baltimore newspapers _____ while the supply of Baltimore newspapers _____, the equilibrium price will definitely increase.

- A) increases; increases B) decreases; increases
C) increases; decreases D) decreases; decreases

Answer: C

Diff: 3

Topic: Market Equilibrium: Economics in Practice

Skill: Conceptual

AACSB: Reflective Thinking

2 True/False

- 1) A decrease in demand for a product will cause the price of the product to fall and supply of the product to decrease.

Answer: FALSE

Diff: 1

Topic: Market Equilibrium

Skill: Conceptual

AACSB: Reflective Thinking

- 2) A simultaneous decrease in both the supply of and the demand for silk boxer shorts would cause a decrease in the equilibrium quantity of silk boxer shorts.

Answer: TRUE

Diff: 3

Topic: Market Equilibrium

Skill: Conceptual

AACSB: Reflective Thinking

- 3) If price is above the equilibrium, then quantity supplied will be greater than quantity demanded putting downward pressure on price.

Answer: TRUE

Diff: 1

Topic: Market Equilibrium

Skill: Conceptual

AACSB: Reflective Thinking

Chapter 4 Demand and Supply Applications

4.1 The Price System: Rationing and Allocating Resources

1 Multiple Choice

- 1) In the short run, it is necessary to non-price ration a good whenever _____ exists.
- A) excess demand
 - B) excess supply
 - C) a surplus
 - D) market equilibrium

Answer: A

Diff: 2

Topic: *The Price System: Rationing and Allocating Resources*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 2) Among the methods of nonprice rationing are
- A) coupons.
 - B) favored customers.
 - C) waiting in line.
 - D) all of the above

Answer: D

Diff: 2

Topic: *The Price System: Rationing and Allocating Resources*

Skill: *Conceptual*

- 3) The price system
- A) automatically distributes scarce goods.
 - B) is inefficient.
 - C) requires government help to allocate goods.
 - D) is the only way to allocate goods.

Answer: A

Diff: 2

Topic: *The Price System: Rationing and Allocating Resources*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 4) Attempts to bypass price rationing in the market
- A) are efficient.
 - B) are easily administered.
 - C) are costly.
 - D) always fail.

Answer: C

Diff: 2

Topic: *The Price System: Rationing and Allocating Resources*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 5) Favored customers are customers who receive special treatment from dealers during periods of
- A) excess demand.
 - B) excess supply.
 - C) price above equilibrium.
 - D) equilibrium.

Answer: A

Diff: 2

Topic: *The Price System: Rationing and Allocating Resources*

Skill: *Definition*

- 6) In a "black market"
- A) suppliers take advantage of buyers.
 - B) price is illegally below market price.
 - C) illegal trading at market prices takes place.
 - D) only illegal goods and services are traded.

Answer: C

Diff: 2

Topic: *The Price System: Rationing and Allocating Resources*

Skill: *Definition*

- 7) When supply is fixed or the product is unique, then price is
- A) supply determined.
 - B) demand determined.
 - C) government determined.
 - D) indeterminate.

Answer: B

Diff: 2

Topic: *The Price System: Rationing and Allocating Resources*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 8) If the government imposes a maximum price that is above the equilibrium price,
- A) this maximum price will have no economic impact.
 - B) quantity demanded will be less than quantity supplied.
 - C) demand will be greater than supply.
 - D) the available supply will have to be rationed with a nonprice rationing mechanism.

Answer: A

Diff: 1

Topic: *The Price System: Rationing and Allocating Resources*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 9) People scalping tickets for a jazz festival will be successful at selling the tickets for a profit
- A) any time the jazz festival is popular.
 - B) when the price set by the festival organizers is less than the market equilibrium price.
 - C) when prices are too high.
 - D) only when there is excess supply.

Answer: B

Diff: 1

Topic: *The Price System: Rationing and Allocating Resources*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 10) People scalping tickets for the Super Bowl will be successful at selling the tickets for a profit
- A) any time the Super Bowl is popular.
 - B) when prices are too high.
 - C) when the price set by the National Football League is less than the market equilibrium price.
 - D) only when there is excess supply.

Answer: C

Diff: 1

Topic: *The Price System: Rationing and Allocating Resources*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

Refer to the information provided in Figure 4.1 below to answer the questions that follow.

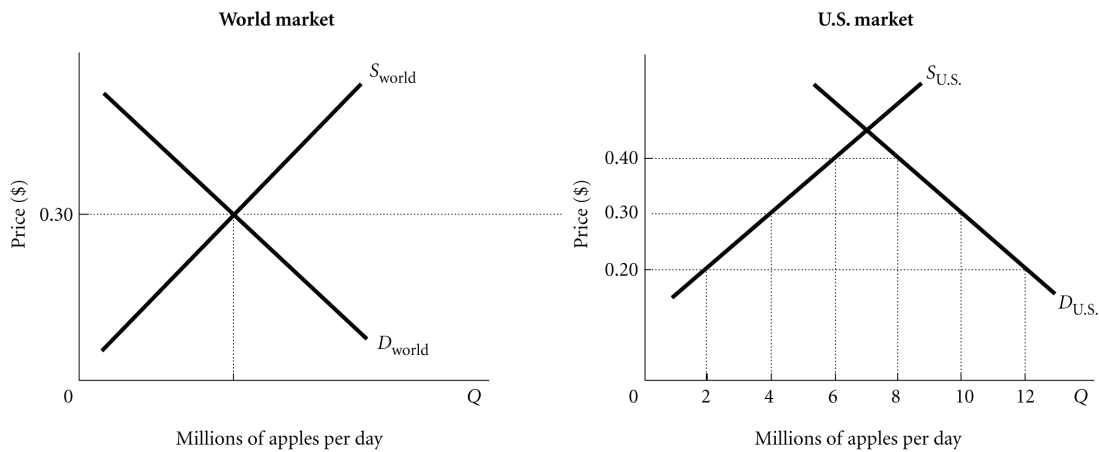


Figure 4.1

- 11) Refer to Figure 4.1. At the world price of 30 cents per apple the United States imports _____ million apples per day.
- A) 2
 - B) 4
 - C) 6
 - D) 10

Answer: C

Diff: 2

Topic: *The Price System: Rationing and Allocating Resources*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 12) Refer to Figure 4.1. If a 10-cent-per-apple tax is levied on imported apples, the United States will
- A) import 2 million apples per day.
 - B) import 4 million apples per day.
 - C) import 6 million apples per day.
 - D) import 8 million apples per day.

Answer: A

Diff: 2

Topic: *The Price System: Rationing and Allocating Resources*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 13) Refer to Figure 4.1. If the United States levies no taxes on apples, the price of apples in the United States would fall to _____, and the United States would import _____.
- A) 20 cents per apple; 10 million apples per day
 - B) 30 cents per apple; 6 million apples per day
 - C) 40 cents per apple; 2 million apples per day
 - D) The price of apples in the United States after the U.S. government eliminated all taxes on imported apples cannot be determined from this information.

Answer: B

Diff: 2

Topic: *The Price System: Rationing and Allocating Resources*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 14) Refer to Figure 4.1. Assume that initially there is free trade. If the United States then imposes a 10-cent tax per apple,
- A) the quantity demanded of apples will be reduced by 4 million apples per day.
 - B) the quantity of apples supplied by U.S. firms will increase by 6 million apples per day.
 - C) the price of apples in the United States will increase to 40 cents per apple.
 - D) U.S. imports of apples will increase by 6 million per day.

Answer: C

Diff: 2

Topic: *The Price System: Rationing and Allocating Resources*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 15) Refer to Figure 4.1. Assume that initially there is free trade. If the United States then imposes a 10-cent tax per apple,
- A) the quantity demanded of apples will be reduced by 2 million apples per day.
 - B) the quantity of apples supplied by U.S. firms will increase by 2 million apples per day.
 - C) the price of apples in the United States will increase to 40 cents per apple.
 - D) all of the above

Answer: D

Diff: 2

Topic: *The Price System: Rationing and Allocating Resources*

Skill: *Analytic*

AACSB: *Analytic Skills*

Refer to the information provided in Figure 4.2 below to answer the questions that follow.

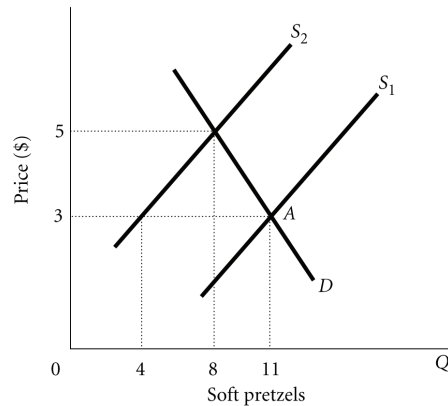


Figure 4.2

- 16) Refer to Figure 4.2. The market is initially in equilibrium at Point A and supply shifts from S_1 to S_2 . Which of the following statements is TRUE?
- A) Price will still serve as a rationing device causing quantity supplied to rise from 8 to 15 soft pretzels.
 - B) There is no need for price to serve as a rationing device in this case because the new equilibrium quantity is higher than the original equilibrium quantity.
 - C) Price will still serve as a rationing device causing quantity demanded to fall from 11 to 8 soft pretzels.
 - D) The market cannot move to a new equilibrium until there is also a change in supply.

Answer: C

Diff: 1

Topic: The Price System: Rationing and Allocating Resources

Skill: Analytic

AACSB: Analytic Skills

- 17) An example of an ineffective price ceiling would be the government setting the price of wheat at _____ per bushel when the market price is at \$5.00 per bushel.
- A) \$2.25
 - B) \$3.00
 - C) \$4.75
 - D) \$6.00

Answer: D

Diff: 2

Topic: The Price System: Rationing and Allocating Resources

Skill: Conceptual

AACSB: Reflective Thinking

- 18) If the equilibrium price of gasoline is \$4.00 per gallon and the government will not allow oil companies to charge more than \$3.00 per gallon of gasoline, which of the following will happen?
- A) Demand must eventually decrease so that the market will come into equilibrium at a price of \$3.00.
 - B) Supply must eventually increase so that the market will come into equilibrium at a price of \$3.00.
 - C) A nonprice rationing system such as ration coupons must be used to ration the available supply of gasoline.
 - D) The market will be in equilibrium at a price of \$3.00.

Answer: C

Diff: 1

Topic: *The Price System: Rationing and Allocating Resources*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 19) An example of a price ceiling would be the government setting the price of sugar
- A) above the equilibrium market price.
 - B) at the equilibrium market price.
 - C) below the equilibrium market price.
 - D) none of the above

Answer: C

Diff: 2

Topic: *The Price System: Rationing and Allocating Resources*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 20) If the market price of coffee is \$3.00 per pound but the government will not allow coffee growers to charge more than \$2.00 per pound of coffee, which of the following will happen?
- A) Demand must eventually decrease so that the market will come into equilibrium at a price of \$2.50.
 - B) There will be a shortage of coffee.
 - C) Supply must eventually increase so that the market will come into equilibrium at a price of \$2.50.
 - D) The market will be in equilibrium at a price of \$2.00.

Answer: B

Diff: 3

Topic: *The Price System: Rationing and Allocating Resources*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 21) It is necessary to ration a good whenever _____ exists.
- A) excess demand
 - B) excess supply
 - C) a surplus
 - D) market equilibrium

Answer: A

Diff: 2

Topic: *The Price System: Rationing and Allocating Resources*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 22) The adjustment of _____ is the rationing mechanism in market economies.
- A) quantity B) price C) supply D) demand

Answer: B

Diff: 2

Topic: *The Price System: Rationing and Allocating Resources*

Skill: *Definition*

- 23) A price ceiling is
- A) a minimum price set by government that sellers must charge for a good.
B) a maximum price set by government that sellers may charge for a good.
C) the difference between the initial equilibrium price and the equilibrium price after a decrease in supply.
D) the minimum price that consumers are willing to pay for a good.

Answer: B

Diff: 2

Topic: *The Price System: Rationing and Allocating Resources*

Skill: *Definition*

- 24) A price floor is
- A) a minimum price set by government that sellers must charge for a good.
B) a maximum price set by government that sellers may charge for a good.
C) the difference between the initial equilibrium price and the equilibrium price after a decrease in supply.
D) the minimum price that consumers are willing to pay for a good.

Answer: A

Diff: 2

Topic: *The Price System: Rationing and Allocating Resources*

Skill: *Definition*

- 25) A maximum price, set by the government, that sellers may charge for a good is known as
- A) a price floor. B) a price rationing mechanism.
C) a price ceiling. D) a subsidy.

Answer: C

Diff: 2

Topic: *The Price System: Rationing and Allocating Resources*

Skill: *Definition*

- 26) A minimum price, set by the government, that sellers may charge for a good is known as
- A) a price floor. B) a price rationing mechanism.
C) a price ceiling. D) a subsidy.

Answer: A

Diff: 2

Topic: *The Price System: Rationing and Allocating Resources*

Skill: *Definition*

Refer to the information provided in Figure 4.3 below to answer the questions that follow.

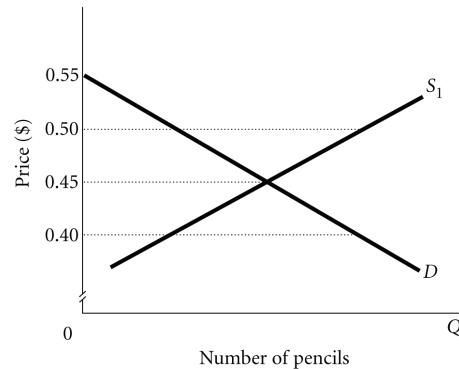


Figure 4.3

27) Refer to Figure 4.3. An example of an effective price ceiling would be government setting the price of pencils at

- A) \$0.40. B) \$0.45. C) \$0.50. D) \$0.55.

Answer: A

Diff: 1

Topic: The Price System: Rationing and Allocating Resources

Skill: Analytic

AACSB: Analytic Skills

28) Refer to Figure 4.3. An example of an effective price floor would be the government setting the price of pencils at

- A) \$0.00. B) \$0.40. C) \$0.45. D) \$0.50.

Answer: D

Diff: 1

Topic: The Price System: Rationing and Allocating Resources

Skill: Analytic

AACSB: Analytic Skills

29) Refer to Figure 4.3. At an effective price ceiling for pencils,

- A) quantity demanded is greater than quantity supplied.
B) quantity demanded is less than quantity supplied.
C) quantity demanded is equal to quantity supplied.
D) price is above equilibrium.

Answer: A

Diff: 1

Topic: The Price System: Rationing and Allocating Resources

Skill: Conceptual

AACSB: Reflective Thinking

- 30) Refer to Figure 4.3. If the government will not allow the retailers to charge more than \$0.40 for a pencil, which of the following will happen?
- A) Demand must eventually decrease so that the market will come into equilibrium at a price of \$0.40.
 - B) Supply must eventually increase so that the market will come into equilibrium at a price of \$0.40.
 - C) A nonprice rationing system such as queuing must be used to ration the available supply of pencils.
 - D) The market will be in equilibrium at a price of \$0.40.

Answer: C

Diff: 2

Topic: *The Price System: Rationing and Allocating Resources*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 31) Refer to Figure 4.3. If the government will not allow retailers to charge less than \$0.50 for a pencil, which of the following will happen?
- A) Demand must eventually increase so that the market will come into equilibrium at a price of \$0.50.
 - B) Supply must eventually decrease so that the market will come into equilibrium at a price of \$0.50.
 - C) Retailers will have an excess supply of pencils.
 - D) The market will be in equilibrium at a price of \$0.50.

Answer: C

Diff: 1

Topic: *The Price System: Rationing and Allocating Resources*

Skill: *Analytic*

AACSB: *Reflective Thinking*

- 32) If the price ceiling is set below the equilibrium price,
- A) quantity demanded will equal quantity supplied.
 - B) there will be a surplus.
 - C) there will be a shortage.
 - D) demand will be less than supply.

Answer: C

Diff: 1

Topic: *The Price System: Rationing and Allocating Resources*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 33) If the price floor is set below the equilibrium price,
- A) quantity demanded will be less than quantity supplied.
 - B) there will be a surplus.
 - C) there will be a shortage.
 - D) the floor will be ineffective.

Answer: D

Diff: 2

Topic: *The Price System: Rationing and Allocating Resources*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 34) If the price ceiling is set above the equilibrium price,
A) quantity demanded will equal quantity supplied.
B) there will be a surplus.
C) there will be a shortage.
D) demand will be less than supply.

Answer: A

Diff: 3

Topic: *The Price System: Rationing and Allocating Resources*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 35) If the price floor is set above the equilibrium price,
A) quantity demanded will equal quantity supplied.
B) there will be a surplus.
C) there will be a shortage.
D) the floor will be ineffective.

Answer: B

Diff: 1

Topic: *The Price System: Rationing and Allocating Resources*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 36) The government imposes a maximum price on apartments that is ABOVE the equilibrium price. You accurately predict that
A) the law will have no economic impact.
B) the law will create a surplus of apartments.
C) renters will find that landlords start offering to furnish the apartments.
D) landlords are less likely to do routine maintenance work in the apartments.

Answer: A

Diff: 3

Topic: *The Price System: Rationing and Allocating Resources*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 37) The type of non-price rationing that most closely approaches the market outcome is
A) coupon rationing with coupons that can be resold.
B) coupon rationing with coupons that cannot be resold.
C) first-come, first-served basis or queuing.
D) favored customer rationing.

Answer: A

Diff: 3

Topic: *The Price System: Rationing and Allocating Resources*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 38) The government imposes a price ceiling on gasoline that is below the market price. You are asked to suggest a rationing scheme that will minimize the misallocation of resources. You suggest
- A) using rationing coupons that can be resold.
 - B) using rationing coupons that cannot be resold.
 - C) using rationing on a first-come, first-served basis.
 - D) using rationing only on weekdays.

Answer: A

Diff: 3

Topic: *The Price System: Rationing and Allocating Resources*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 39) The government imposes a price ceiling on sugar that is above the market price. You are asked to suggest a rationing scheme that will minimize the misallocation of resources. You suggest
- A) using rationing coupons that cannot be resold.
 - B) using rationing on a first-come, first-served basis.
 - C) using rationing coupons that can be resold.
 - D) that no rationing system will be necessary.

Answer: D

Diff: 3

Topic: *The Price System: Rationing and Allocating Resources*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 40) People scalping tickets for a rock concert can sell their tickets for at least a normal profit
- A) any time the rock group is popular.
 - B) when the price set by the concert hall is less than the market equilibrium price.
 - C) when prices are too high.
 - D) only when there is excess supply.

Answer: B

Diff: 3

Topic: *The Price System: Rationing and Allocating Resources*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 41) Related to the *Economics in Practice* on p. 79: When acquiring a ticket for a play takes a significant amount of time, the true economic cost of that ticket would include all of the following factors EXCEPT:
- A) the amount of time spent acquiring the ticket
 - B) the utility provided by seeing the play
 - C) the earning power of the person acquiring the ticket
 - D) the purchase price of the ticket

Answer: B

Diff: 3

Topic: *The Price System: Economics in Practice*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 42) Related to the *Economics in Practice* on p. 79: Which of the following best explains why the people who wait for hours to acquire tickets to free performances earn less on average than the people who actually see those performances?
- A) The value of time spent waiting in line is less for people who earn less money.
 - B) People who earn more money are less likely to be aware of the opportunity to acquire free tickets.
 - C) High-wage individuals are more likely to have schedule conflicts that prevent them from using their tickets.
 - D) People interested in live performances are likely to have access to other forms of entertainment, such as television and radio.

Answer: A

Diff: 3

Topic: *The Price System: Economics in Practice*

Skill: *Analytic*

AACSB: *Analytic Skills*

2 True/False

- 1) Goods are allocated in a market system by price rationing.

Answer: TRUE

Diff: 2

Topic: *The Price System: Rationing and Allocating Resources*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 2) Nonprice rationing will happen whenever there is excess supply in a market.

Answer: FALSE

Diff: 2

Topic: *The Price System: Rationing and Allocating Resources*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 3) When supply is fixed, price is supply determined.

Answer: FALSE

Diff: 2

Topic: *The Price System: Rationing and Allocating Resources*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 4) With price rationing those who are both able and willing to pay for a product get it.

Answer: TRUE

Diff: 2

Topic: *The Price System: Rationing and Allocating Resources*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 5) Queuing or waiting in line is an alternative rationing mechanism to price rationing.

Answer: TRUE

Diff: 2

Topic: *The Price System: Rationing and Allocating Resources*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

6) A shortage is when there is an excess supply in a market.

Answer: FALSE

Diff: 1

Topic: *The Price System: Rationing and Allocating Resources*

Skill: *Definition*

7) In a "black market" goods are traded at market determined prices.

Answer: TRUE

Diff: 2

Topic: *The Price System: Rationing and Allocating Resources*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

8) Favored customers receive special treatment from dealers during periods of excess demand.

Answer: TRUE

Diff: 2

Topic: *The Price System: Rationing and Allocating Resources*

Skill: *Definition*

9) Ration coupons are tickets or coupons that give someone a right to purchase a certain amount of a product each time period such as a month.

Answer: TRUE

Diff: 2

Topic: *The Price System: Rationing and Allocating Resources*

Skill: *Definition*

4.2 Supply and Demand Analysis

1 Multiple Choice

Refer to the information provided in Figure 4.4 below to answer the questions that follow.

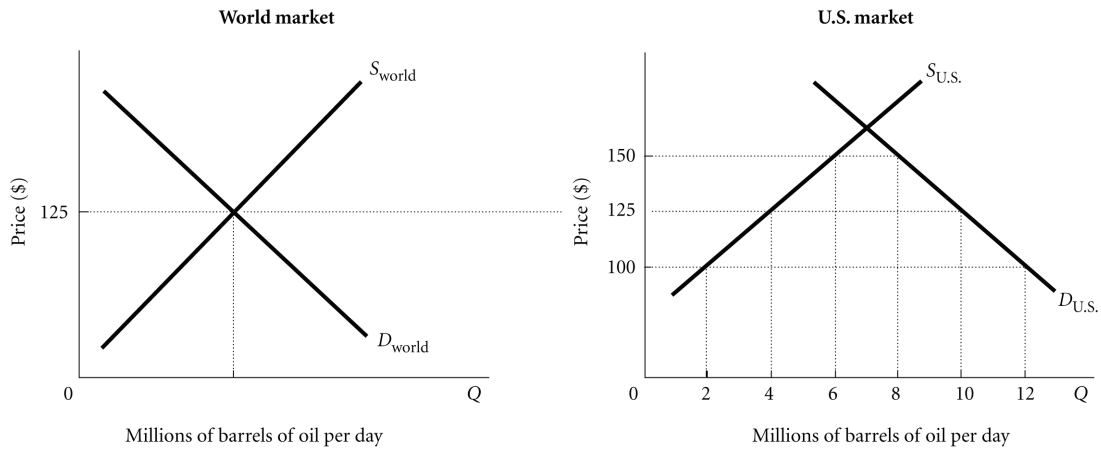


Figure 4.4

- 1) Refer to Figure 4.4. At the world price of \$125 per barrel of oil, the United States imports _____ million barrels of oil per day.

A) 4 B) 6 C) 8 D) 10

Answer: B

Diff: 2

Topic: Supply and Demand Analysis

Skill: Analytic

AACSB: Analytic Skills

- 2) Refer to Figure 4.4. If a \$25 per barrel tax is levied on imported oil, the United States will
- A) import 2 million barrels of oil per day. B) import 6 million barrels of oil per day.
C) import 10 million barrels of oil per day. D) export 10 million barrels of oil per day.

Answer: A

Diff: 2

Topic: Supply and Demand Analysis

Skill: Analytic

AACSB: Analytic Skills

- 3) Refer to Figure 4.4. If the United States levies no taxes on imported oil, which of the following would occur?
- A) The price of oil in the United States would fall to \$100 per barrel, and the United States would import 10 million barrels of oil per day.
 - B) The price of oil in the United States would be \$125 per barrel, and the United States would import 6 million barrels of oil per day.
 - C) The price of oil in the United States would be \$150 per barrel, and the United States would import 2 million barrels of oil per day.
 - D) The price of oil in the United States after the U.S. government eliminated all taxes on imported oil cannot be determined from this information.

Answer: B

Diff: 2

Topic: Supply and Demand Analysis

Skill: Analytic

AACSB: Analytic Skills

- 4) Refer to Figure 4.4. Assume that initially there is free trade. If the United States then imposes a \$25 tax per barrel of imported oil,
- A) the quantity demanded of oil will be reduced by 4 million barrels per day.
 - B) the quantity of oil supplied by U.S. firms will increase by 8 million barrels per day.
 - C) U.S. imports of oil will increase by 4 million barrels per day.
 - D) the price of oil in the U.S. will increase to \$150 per barrel.

Answer: D

Diff: 2

Topic: Supply and Demand Analysis

Skill: Analytic

AACSB: Analytic Skills

- 5) Refer to Figure 4.4. Assume that initially there is free trade. If the United States then imposes a \$25 tax per barrel of imported oil, the tax revenue generated will equal
- A) \$25 million per day.
 - B) \$50 million per day.
 - C) \$100 million per day.
 - D) \$125 million per day.

Answer: B

Diff: 2

Topic: Supply and Demand Analysis

Skill: Analytic

AACSB: Analytic Skills

- 6) Refer to Figure 4.4. Assume that initially there is free trade. To reduce U.S. imports without a tax the U.S. could
- A) increase pollution control regulations.
 - B) allow drilling for oil in the Alaska National Wildlife Refuge.
 - C) increase safety regulations for oil refineries.
 - D) all of the above

Answer: B

Diff: 2

Topic: Supply and Demand Analysis

Skill: Conceptual

AACSB: Reflective Thinking

Refer to the information provided in Figure 4.5 below to answer the questions that follow.

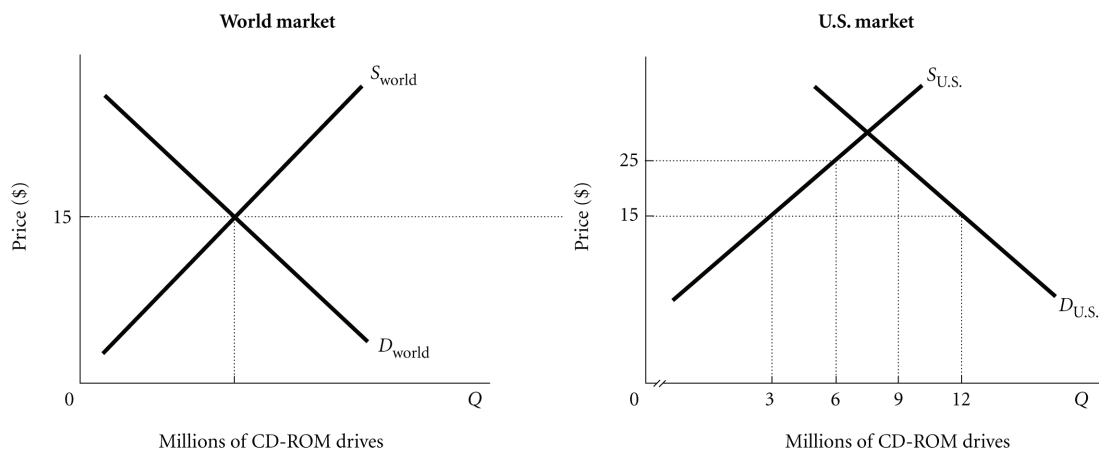


Figure 4.5

- 7) Refer to Figure 4.5. At the world price of \$15 per CD-Rom drive, the United States imports _____ million CD-Rom drives.

A) 3 B) 6 C) 9 D) 12

Answer: C

Diff: 2

Topic: Supply and Demand Analysis

Skill: Analytic

AACSB: Analytic Skills

- 8) Refer to Figure 4.5. If a \$10.00 per CD-Rom drive tax is levied on imported CD-Rom drives, the United States will

A) import 3 million CD-Rom drives. B) import 6 million CD-Rom drives.
C) import 9 million CD-Rom drives. D) import 12 million CD-Rom drives.

Answer: A

Diff: 2

Topic: Supply and Demand Analysis

Skill: Analytic

AACSB: Analytic Skills

- 9) Refer to Figure 4.5. If the United States eliminates all taxes on CD-Rom drives, which of the following would occur?

A) The price of CD-Rom drives in the United States would be \$15 per CD-Rom drive, and the United States would import 3 million CD-Rom drives.
B) The price of CD-Rom drives in the United States would be \$25 per CD-Rom drive, and the United States would import 3 million CD-Rom drives.
C) The price of CD-Rom drives in the United States would be \$15 per CD-Rom drive, and the United States would import 9 million CD-Rom drives.
D) The price of CD-Rom drives in the United States after the U.S. government eliminated all taxes on imported CD-Rom drives cannot be determined from this information.

Answer: C

Diff: 1

Topic: Supply and Demand Analysis

Skill: Analytic

AACSB: Analytic Skills

- 10) Refer to Figure 4.5. Assume that initially there is free trade. If the United States then imposes a \$10.00 tax per CD-Rom drive on imported CD-Rom drives,
- A) the quantity demanded of CD-Rom drives will be reduced by 3 million CD-Rom drives.
 - B) the quantity of CD-Rom drives supplied by U.S. firms will increase by 3 million CD-Rom drives.
 - C) the price of CD-Rom drives in the United States will increase to \$25.
 - D) all of the above

Answer: D

Diff: 2

Topic: Supply and Demand Analysis

Skill: Analytic

AACSB: Analytic Skills

- 11) Refer to Figure 4.5. Assume that initially there is free trade. If the United States then imposes a \$10.00 tax per CD-Rom drive on imported CD-Rom drives,
- A) the quantity demanded of CD-Rom drives will be reduced by 6 million CD-Rom drives.
 - B) the quantity of CD-Rom drives supplied by U.S. firms will increase by 3 million CD-Rom drives.
 - C) the price of CD-Rom drives in the United States will decrease to \$5.
 - D) U.S. imports of CD-Rom drives will increase by 3 million CD-Rom drives.

Answer: B

Diff: 2

Topic: Supply and Demand Analysis

Skill: Analytic

AACSB: Analytic Skills

2 True/False

- 1) A U.S. import fee on oil would reduce imports and raise the price of U.S. oil products.

Answer: TRUE

Diff: 2

Topic: Supply and Demand Analysis

Skill: Conceptual

AACSB: Reflective Thinking

- 2) A U.S. import fee on oil would reduce the domestic quantity demanded of oil.

Answer: TRUE

Diff: 2

Topic: Supply and Demand Analysis

Skill: Conceptual

AACSB: Reflective Thinking

- 3) A U.S. import fee on oil would reduce the domestic quantity supplied of oil.

Answer: FALSE

Diff: 2

Topic: Supply and Demand Analysis

Skill: Conceptual

AACSB: Reflective Thinking

4.3 Supply and Demand and Market Efficiency

1 Multiple Choice

1) Producer surplus is

- A) the difference between the maximum a person is willing to pay and current market price.
- B) the difference between current market price and full costs of production for the firm.
- C) the difference between willingness to sell and full costs of productions for the firm.
- D) current market price.

Answer: B

Diff: 2

Topic: *Supply and Demand and Market Efficiency*

Skill: *Definition*

2) Consumer surplus is

- A) the difference between the maximum a person is willing to pay and current market price.
- B) the difference between current market price and full costs of production for the firm.
- C) the difference between the maximum a person is willing to pay and full costs of productions for the firm.
- D) current market price.

Answer: A

Diff: 2

Topic: *Supply and Demand and Market Efficiency*

Skill: *Definition*

3) If the most someone is willing to pay for ticket to see their favorite team is \$100 and the market price of the ticket is \$35, then this buyer will get consumer surplus of

- A) 1 ticket.
- B) \$35.
- C) \$65.
- D) \$100.

Answer: C

Diff: 2

Topic: *Supply and Demand and Market Efficiency*

Skill: *Analytic*

AACSB: *Analytic Skills*

4) The market price of a basketball is \$35 and the full cost of producing it is \$20, then a basketball producing firm gets producer surplus of

- A) 1 basketball.
- B) \$35.
- C) \$20.
- D) \$15.

Answer: D

Diff: 2

Topic: *Supply and Demand and Market Efficiency*

Skill: *Analytic*

AACSB: *Analytic Skills*

Refer to the information provided in Figure 4.6 below to answer the questions that follow.
Equilibrium in this market occurs at the intersection of curves S and D.

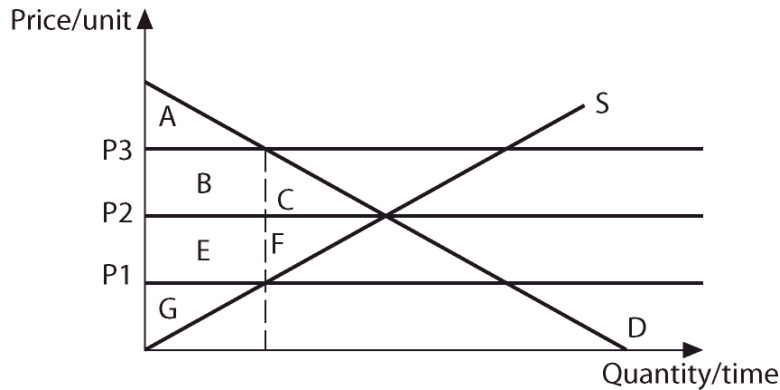


Figure 4.6

- 5) In figure 4.6 at equilibrium consumer surplus is area
 A) A. B) A+B+C. C) G. D) E+F+G.
 Answer: B
 Diff: 2
 Topic: Supply and Demand and Market Efficiency
 Skill: Analytic
 AACSB: Analytic Skills
- 6) In figure 4.6 at equilibrium producer surplus is area
 A) A. B) A+B+C. C) G. D) E+F+G.
 Answer: D
 Diff: 2
 Topic: Supply and Demand and Market Efficiency
 Skill: Analytic
 AACSB: Analytic Skills
- 7) In figure 4.6 if price is P1, consumer surplus is area
 A) A. B) A+B+E. C) G. D) B+C+E+F+G.
 Answer: B
 Diff: 2
 Topic: Supply and Demand and Market Efficiency
 Skill: Analytic
 AACSB: Analytic Skills
- 8) In figure 4.6 if price is P1, producer surplus is area
 A) A. B) A+B+E. C) G. D) B++E+G.
 Answer: C
 Diff: 2
 Topic: Supply and Demand and Market Efficiency
 Skill: Analytic
 AACSB: Analytic Skills

- 9) In figure 4.6 if price is P_1 , the deadweight loss due to under production is area
A) A+C. B) C+F C) E+G. D) F+G.

Answer: B

Diff: 2

Topic: Supply and Demand and Market Efficiency

Skill: Analytic

AACSB: Analytic Skills

- 10) In figure 4.6 if price goes from equilibrium to P_1 , producer surplus changes by the area
A) E-C. B) C+E C) E+F. D) B-F.

Answer: C

Diff: 3

Topic: Supply and Demand and Market Efficiency

Skill: Analytic

AACSB: Analytic Skills

- 11) In figure 4.6 if price goes from equilibrium to P_1 , consumer surplus changes by the area
A) E-C. B) C+E C) E+F. D) B-F.

Answer: A

Diff: 3

Topic: Supply and Demand and Market Efficiency

Skill: Analytic

AACSB: Analytic Skills

- 12) The total of consumer plus producer surplus is greatest
A) when consumer surplus is maximized. B) when producer surplus is maximized.
C) at the the market equilibrium. D) all of the above

Answer: C

Diff: 2

Topic: Supply and Demand and Market Efficiency

Skill: Conceptual

AACSB: Reflective Thinking

- 13) When there is over production in a market,
A) market price is too low.
B) there is excess quantity demanded.
C) the total of consumer and producer surplus is maximized.
D) there is a deadweight loss.

Answer: D

Diff: 2

Topic: Supply and Demand and Market Efficiency

Skill: Conceptual

AACSB: Reflective Thinking

2 True/False

- 1) Consumer surplus is the difference between the most a person is willing to pay and market price.

Answer: TRUE

Diff: 2

Topic: Supply and Demand and Market Efficiency

Skill: Definition

2) Consumer surplus describes a situation in which there is excess quantity supplied.

Answer: FALSE

Diff: 2

Topic: *Supply and Demand and Market Efficiency*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

3) If someone is willing to pay \$500 to go to the Super Bowl but can buy a ticket for \$300, they will get \$200 in consumer surplus.

Answer: TRUE

Diff: 2

Topic: *Supply and Demand and Market Efficiency*

Skill: *Analytic*

AACSB: *Analytic Skills*

4) A firm that sells a car for \$30,000 gets producer surplus of \$30,000.

Answer: FALSE

Diff: 2

Topic: *Supply and Demand and Market Efficiency*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

5) The total of consumer plus producer surplus is largest at the market equilibrium.

Answer: TRUE

Diff: 2

Topic: *Supply and Demand and Market Efficiency*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

6) The total of producer and consumer surplus is maximized when there is underproduction.

Answer: FALSE

Diff: 2

Topic: *Supply and Demand and Market Efficiency*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

Chapter 5 Introduction to Macroeconomics

5.1 Macroeconomic Concerns

1 Multiple Choice

1) Which of the following is NOT a topic studied in Macroeconomics?

- A) gross domestic product
- B) the unemployment rate
- C) the price of IBM computers
- D) the inflation rate

Answer: C

Diff: 1

Topic: Macroeconomic Concerns

Skill: Conceptual

AACSB: Reflective Thinking

2) Which of the following is a topic studied in Macroeconomics?

- A) gross domestic product
- B) the wage of auto workers
- C) the price of IBM computers
- D) the amount of pizza produced

Answer: A

Diff: 1

Topic: Macroeconomic Concerns

Skill: Conceptual

AACSB: Reflective Thinking

3) Which of the following is a topic studied in Macroeconomics?

- A) the functioning of individual industries
- B) aggregate behavior of households and industries
- C) the behavior of individual households
- D) the decision-making behavior of individual business firms

Answer: B

Diff: 1

Topic: Macroeconomic Concerns

Skill: Conceptual

AACSB: Reflective Thinking

4) Prices that do not always adjust rapidly to maintain equality between quantity supplied and quantity demanded are

- A) administered prices.
- B) sticky prices.
- C) regulatory prices.
- D) market prices.

Answer: B

Diff: 1

Topic: Macroeconomic Concerns

Skill: Definition

- 5) The demand for corn has increased in May without any change in supply. Eight months later there still has been no change in corn prices. This is an example of a
- A) price floor.
 - B) price control.
 - C) sticky price.
 - D) macroeconomic price.

Answer: C

Diff: 2

Topic: Macroeconomic Concerns

Skill: Conceptual

AACSB: Reflective Thinking

- 6) The demand for massage therapists declined in the spring of 2007, but the starting wages paid to massage therapists was still the same at the end of 2007. This is an example of a
- A) sticky price.
 - B) flexible price.
 - C) highly regulated market.
 - D) price control.

Answer: A

Diff: 2

Topic: Macroeconomic Concerns

Skill: Conceptual

AACSB: Reflective Thinking

- 7) An increase in the overall price level is known as
- A) deflation.
 - B) recession.
 - C) inflation.
 - D) stagflation.

Answer: C

Diff: 1

Topic: Macroeconomic Concerns

Skill: Definition

- 8) Aggregate behavior is
- A) the behavior of each household and firm.
 - B) the behavior of each individual.
 - C) the behavior of all households and firms together.
 - D) none of the above.

Answer: C

Diff: 2

Topic: Macroeconomic Concerns

Skill: Definition

- 9) Inflation is a(n)
- A) decrease in the overall price level.
 - B) decrease in the overall level of economic activity.
 - C) increase in the overall price level.
 - D) increase in the overall level of economic activity.

Answer: C

Diff: 1

Topic: Macroeconomic Concerns

Skill: Definition

- 10) Deflation occurs when
- A) the average price level declines.
 - B) economic activity declines.
 - C) the economic growth rate declines.
 - D) the unemployment rate declines.

Answer: A

Diff: 2

Topic: Macroeconomic Concerns

Skill: Definition

- 11) A period of very rapid increase in the overall price level is known as
- A) stagnation.
 - B) hyperinflation.
 - C) stagflation.
 - D) depression.

Answer: B

Diff: 1

Topic: Macroeconomic Concerns

Skill: Definition

- 12) The trend of the economy is
- A) the long run growth path of the economy.
 - B) the long run inflation rate.
 - C) the long run unemployment rate.
 - D) the short run production capacity of an economy.

Answer: A

Diff: 1

Topic: Macroeconomic Concerns

Skill: Definition

- 13) The term *business cycle* refers to the
- A) short-term ups and downs in the price level.
 - B) long-term trends in the price level.
 - C) short-term ups and downs in the level of economic activity.
 - D) long-term trends in the level of economic activity.

Answer: C

Diff: 1

Topic: Macroeconomic Concerns

Skill: Definition

- 14) A period during which aggregate output rises is known as a(n)
- A) recession.
 - B) inflation.
 - C) hyperinflation.
 - D) expansion.

Answer: D

Diff: 1

Topic: Macroeconomic Concerns

Skill: Definition

- 15) A period when the economy shrinks is known as
- A) a recession.
 - B) a contraction.
 - C) a slump.
 - D) all of the above.

Answer: D

Diff: 1

Topic: Macroeconomic Concerns

Skill: Definition

16) In a business cycle, a peak represents the end of _____ and a trough represents the end of _____.

- A) an expansion; a recession
B) a depression; an expansion
C) a trough; a peak
D) a recession; an expansion

Answer: A

Diff: 1

Topic: Macroeconomic Concerns

Skill: Conceptual

AACSB: Reflective Thinking

17) In a business cycle, a peak represents the end of

- A) an expansion. B) a depression. C) trough. D) a recession

Answer: A

Diff: 1

Topic: Macroeconomic Concerns

Skill: Conceptual

AACSB: Reflective Thinking

18) In a business cycle, a trough represents the end of

- A) an expansion. B) an inflation. C) a peak D) a recession.

Answer: D

Diff: 1

Topic: Macroeconomic Concerns

Skill: Conceptual

AACSB: Reflective Thinking

19) It has become conventional to classify an economic downturn as a recession when aggregate output declines for

- A) three consecutive quarters. B) two consecutive quarters.
C) a year. D) six consecutive quarters.

Answer: B

Diff: 1

Topic: Macroeconomic Concerns

Skill: Fact

20) If the labor force is 500 and employment is 450, then the unemployment rate is

- A) 100%. B) 90%. C) 10%. D) 0%.

Answer: C

Diff: 2

Topic: Macroeconomic Concerns

Skill: Analytic

21) A prolonged and deep recession is called

- A) a business cycle. B) a depression.
C) a stagflation. D) hyperinflation.

Answer: B

Diff: 1

Topic: Macroeconomic Concerns

Skill: Definition

- 22) Between a trough and a peak, the economy goes through a(n)
A) recession. B) bust.
C) expansion. D) hyperinflation.

Answer: C

Diff: 1

Topic: Macroeconomic Concerns

Skill: Conceptual

AACSB: Reflective Thinking

- 23) Between a peak and a trough, the economy goes through a(n)
A) expansion. B) inflation. C) recession. D) boom.

Answer: C

Diff: 1

Topic: Macroeconomic Concerns

Skill: Conceptual

AACSB: Reflective Thinking

- 24) Unemployment means that
A) at the going wage rate, there are people who want to work but cannot find work.
B) people are not willing to work at the going wage rate.
C) there are some people who will not work at the going wage rate.
D) there is excess demand in the labor market.

Answer: A

Diff: 1

Topic: Macroeconomic Concerns

Skill: Definition

- 25) Unemployment implies that in the labor market
A) there is an excess supply of labor.
B) there is an excess demand for labor.
C) there are too few workers for the jobs available.
D) quantity demanded of labor exceeds quantity supplied.

Answer: A

Diff: 1

Topic: Macroeconomic Concerns

Skill: Conceptual

AACSB: Reflective Thinking

- 26) The unemployment rate equals
A) labor force/population. B) unemployed/employed.
C) (employed - unemployed)/labor force. D) (labor force - employed)/labor force.

Answer: D

Diff: 2

Topic: Macroeconomic Concerns

Skill: Definition

- 27) The unemployment rate equals
 A) labor force/population. B) unemployed/employed.
 C) (employed – unemployed)/labor force. D) unemployed/labor force.
- Answer: D
 Diff: 2
 Topic: Macroeconomic Concerns
 Skill: Definition
- 28) If the labor force is 50 million and 48 million are employed then the unemployment rate is:
 A) 2%. B) 4%. C) 5%. D) 52%.
- Answer: B
 Diff: 2
 Topic: Macroeconomic Concerns
 Skill: Analytic
 AACSB: Analytic Skills
- 29) If 20 million workers are unemployed and 180 million workers are employed, then the unemployment rate is
 A) 10%. B) 11.1%. C) 18%. D) 80%.
- Answer: A
 Diff: 2
 Topic: Macroeconomic Concerns
 Skill: Analytic
 AACSB: Analytic Skills
- 30) The period in the business cycle from a trough to peak is called a(n)
 A) recession. B) expansion. C) slump. D) depression.
- Answer: B
 Diff: 1
 Topic: Macroeconomic Concerns
 Skill: Conceptual
- 31) If output is rising and unemployment is falling, the economy MUST be in a(n)
 A) contraction. B) expansion.
 C) depression. D) hyperinflationary period.
- Answer: B
 Diff: 1
 Topic: Macroeconomic Concerns
 Skill: Conceptual
 AACSB: Reflective Thinking
- 32) The period in the business cycle from a peak to a trough is a(n)
 A) recession. B) boom. C) expansion. D) inflation.
- Answer: A
 Diff: 1
 Topic: Macroeconomic Concerns
 Skill: Conceptual

- 33) Unemployment generally _____ during recessions and _____ during expansions.
A) falls; rises. B) falls; falls. C) rises; falls. D) rises; rises.

Answer: C

Diff: 1

Topic: Macroeconomic Concerns

Skill: Conceptual

AACSB: Reflective Thinking

- 34) Which of the following statements is FALSE?
- A) The rate of change in economic activity is used to assess whether an economy is expanding or contracting.
 - B) Short-term ups and downs in the economy are known as business cycles.
 - C) During a recession, output and employment are falling.
 - D) Business cycles are always symmetric—the length of an expansion is the same as the length of a contraction.

Answer: D

Diff: 2

Topic: Macroeconomic Concerns

Skill: Conceptual

AACSB: Reflective Thinking

2 True/False

- 1) Macroeconomics is concerned with inflation or deflation, output growth and unemployment.

Answer: TRUE

Diff: 1

Topic: Macroeconomic Concerns

Skill: Conceptual

AACSB: Reflective Thinking

- 2) Macroeconomics is concerned with the market price and equilibrium quantity of each good or service.

Answer: FALSE

Diff: 1

Topic: Macroeconomic Concerns

Skill: Conceptual

AACSB: Reflective Thinking

- 3) The employment rate is the number of people employed divided by number of people in the labor force.

Answer: TRUE

Diff: 1

Topic: Macroeconomic Concerns

Skill: Definition

- 4) Hyperinflation and stagflation are two different names which refer to identical economic conditions.

Answer: FALSE

Diff: 1

Topic: Macroeconomic Concerns

Skill: Definition

5) Macroeconomic behavior is the sum of all the microeconomic decisions made by individual households and firms.

Answer: TRUE

Diff: 1

Topic: Macroeconomic Concerns

Skill: Conceptual

AACSB: Reflective Thinking

6) All business cycles are symmetric—the length of an expansion is the same as the length of a recession.

Answer: FALSE

Diff: 1

Topic: Macroeconomic Concerns

Skill: Conceptual

7) The following is a correct order in a business cycle: recession, trough, peak, expansion.

Answer: FALSE

Diff: 1

Topic: Macroeconomic Concerns

Skill: Conceptual

8) A recession is usually associated with increasing unemployment.

Answer: TRUE

Diff: 1

Topic: Macroeconomic Concerns

Skill: Conceptual

AACSB: Reflective Thinking

9) An expansion is usually associated with rising price levels.

Answer: TRUE

Diff: 1

Topic: Macroeconomic Concerns

Skill: Conceptual

AACSB: Reflective Thinking

10) A recession is associated with a negative rate of growth of the economy.

Answer: TRUE

Diff: 1

Topic: Macroeconomic Concerns

Skill: Conceptual

AACSB: Reflective Thinking

5.2 The Components of the Macroeconomy

1 Multiple Choice

- 1) If the central bank decreases the money supply, it is conducting
- A) monetary policy.
 - B) supply-side policy.
 - C) fiscal policy.
 - D) incomes policy.

Answer: A

Diff: 1

Topic: The Components of the Macroeconomy

Skill: Conceptual

AACSB: Reflective Thinking

- 2) If Congress increases government spending, it is using
- A) monetary policy.
 - B) supply-side policy.
 - C) fiscal policy.
 - D) incomes policy.

Answer: C

Diff: 1

Topic: The Components of the Macroeconomy

Skill: Conceptual

AACSB: Reflective Thinking

- 3) Government policies regarding taxes and expenditures are called
- A) fiscal policy.
 - B) income policies.
 - C) supply-side policy.
 - D) monetary policy.

Answer: A

Diff: 1

Topic: The Components of the Macroeconomy

Skill: Definition

- 4) The government implements fiscal policy when it changes
- A) spending and/or interest rate.
 - B) money supply and/or taxes.
 - C) taxes and/or spending.
 - D) taxes and/or interest rate.

Answer: C

Diff: 1

Topic: The Components of the Macroeconomy

Skill: Conceptual

AACSB: Reflective Thinking

- 5) The government wants to encourage consumer spending through cutting income taxes. This is an example of
- A) an incomes policy.
 - B) a fiscal policy.
 - C) a supply-side policy.
 - D) a monetary policy.

Answer: B

Diff: 1

Topic: The Components of the Macroeconomy

Skill: Conceptual

AACSB: Reflective Thinking

6) The _____ can change the quantity of money in the economy.

- A) Treasury Department
- B) Federal Reserve
- C) Congress
- D) Office of the Comptroller of the Currency

Answer: B

Diff: 1

Topic: The Components of the Macroeconomy

Skill: Fact

7) The Federal Reserve affecting the supply of money is known as

- A) fiscal policy.
- B) monetary policy.
- C) growth policy.
- D) supply side policy.

Answer: B

Diff: 1

Topic: The Components of the Macroeconomy

Skill: Definition

8) Policies designed to affect the quantity of money are

- A) fiscal policies.
- B) supply side or growth policies.
- C) government spending policies.
- D) monetary policies.

Answer: D

Diff: 1

Topic: The Components of the Macroeconomy

Skill: Definition

9) The diagram that shows the income received and payments made by each sector of the economy is the

- A) aggregate demand–aggregate supply diagram.
- B) circular flow diagram.
- C) income flow diagram.
- D) income–production diagram.

Answer: B

Diff: 1

Topic: The Components of the Macroeconomy

Skill: Definition

10) In the circular flow diagram, the different payments made by firms to households include

- A) wages and profits.
- B) interest and taxes.
- C) transfer payments and dividends.
- D) taxes and transfer payments.

Answer: A

Diff: 1

Topic: The Components of the Macroeconomy

Skill: Conceptual

- 11) An example of a transfer payment is
- A) an interest payment on a General Motors' bond.
 - B) the added value of stock from the time it was bought to the time it was sold.
 - C) a Social Security retirement benefit.
 - D) the salary paid to a member of the armed forces.

Answer: C

Diff: 2

Topic: The Components of the Macroeconomy

Skill: Conceptual

AACSB: Reflective Thinking

- 12) A transfer payment is
- A) a bonus to get a worker to accept a transfer.
 - B) a cash payment made by the government to people who do not supply goods, services or labor in exchange for the payment.
 - C) a cash payment for transferring a good from one person to another.
 - D) an in kind payment for working "off the books."

Answer: B

Diff: 2

Topic: The Components of the Macroeconomy

Skill: Definition

- 13) A household that spends less than it receives in income during a given period is
- A) saving.
 - B) dissaving.
 - C) running a deficit.
 - D) receiving transfer payments.

Answer: A

Diff: 1

Topic: The Components of the Macroeconomy

Skill: Conceptual

AACSB: Reflective Thinking

- 14) The major lesson of the circular flow diagram is that
- A) saving must always be less than investment.
 - B) taxes must always be greater than government expenditures.
 - C) total income in the economy must always equal total spending.
 - D) tax receipts must be equal to transfer payments

Answer: C

Diff: 2

Topic: The Components of the Macroeconomy

Skill: Conceptual

AACSB: Reflective Thinking

- 15) In which of the following markets are funds demanded and supplied?
- A) the labor market
 - B) the goods and services market
 - C) the money market
 - D) the factor market

Answer: C

Diff: 1

Topic: The Components of the Macroeconomy

Skill: Definition

- 16) In the goods-and-services market, households
- A) only supply.
 - B) only demand.
 - C) both supply and demand.
 - D) neither supply nor demand.

Answer: B

Diff: 2

Topic: *The Components of the Macroeconomy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 17) The demanders in the goods-and-services market are
- A) households and business firms.
 - B) households, the government, and the rest of the world.
 - C) the government and business firms.
 - D) households, the government, business firms, and the rest of the world.

Answer: D

Diff: 2

Topic: *The Components of the Macroeconomy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 18) In which basic market would DVDs be traded?
- A) the goods and services market
 - B) the money market
 - C) the labor market
 - D) the factor market

Answer: A

Diff: 1

Topic: *The Components of the Macroeconomy*

Skill: *Conceptual*

- 19) In the circular flow diagram, firms _____ labor and households _____ goods and services.
- A) demand; supply.
 - B) demand; demand.
 - C) supply; demand.
 - D) supply; supply.

Answer: B

Diff: 2

Topic: *The Components of the Macroeconomy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 20) In the circular flow diagram, households demand _____ and supply _____.
- A) labor; labor.
 - B) goods; services.
 - C) goods and services; labor.
 - D) labor; goods and services.

Answer: C

Diff: 2

Topic: *The Components of the Macroeconomy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 21) Promissory notes issued by the federal government when it borrows money are known as
- A) Treasury shares.
 - B) Treasury stocks.
 - C) Treasury bonds.
 - D) none of the above

Answer: C

Diff: 2

Topic: *The Components of the Macroeconomy*

Skill: *Definition*

- 22) A promissory note issued by a corporation when it borrows money is a
- A) share.
 - B) corporate bond.
 - C) corporate dividend.
 - D) stock.

Answer: B

Diff: 1

Topic: *The Components of the Macroeconomy*

Skill: *Definition*

- 23) Dividends are
- A) government profits distributed among bondholders.
 - B) corporate profits distributed among shareholders.
 - C) capital gains realized by stockholders.
 - D) promissory notes issued by corporations.

Answer: B

Diff: 1

Topic: *The Components of the Macroeconomy*

Skill: *Definition*

- 24) Which of the following is a CORRECT statement?
- A) Companies issue shares but don't issue bonds.
 - B) The government issues both bonds and shares.
 - C) Bondholders earn dividends but shareholders don't.
 - D) Shareholders earn dividends but bondholders don't.

Answer: D

Diff: 2

Topic: *The Components of the Macroeconomy*

Skill: *Conceptual*

- 25) A capital gain is
- A) a financial instrument that gives the holder a share in the ownership of a firm and therefore the right to share in the profits of the firm.
 - B) the portion of a corporation's profits that the firm pays out each period to its shareholders.
 - C) an increase in the value of an asset over the price initially paid for it.
 - D) the difference between an individual's economic income and money income.

Answer: C

Diff: 2

Topic: *The Components of the Macroeconomy*

Skill: *Definition*

- 26) An increase in the value of an asset over the price initially paid for it is a
- A) dividend.
 - B) share of stock.
 - C) promissory note.
 - D) capital gain.

Answer: D

Diff: 2

Topic: *The Components of the Macroeconomy*

Skill: *Definition*

- 27) If Tomas purchases a share of stock for \$150 and one year later sells it for \$225, he will realize a
- A) dividend of \$75.
 - B) capital gain of \$75.
 - C) dividend of \$225.
 - D) a capital gain of \$225

Answer: B

Diff: 2

Topic: *The Components of the Macroeconomy*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 28) If Juanita purchases a share of stock for \$20 and three years later sells it for \$120, she will realize a
- A) dividend of \$100.
 - B) capital gain of \$100.
 - C) dividend of \$120.
 - D) capital gain of \$140.

Answer: B

Diff: 2

Topic: *The Components of the Macroeconomy*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 29) Wayne purchased 10 autographed Eli Manning football cards when he was 15 years old for a total cost of \$50 and then sold those football cards 4 years later for \$800. Due to these transactions
- A) Wayne earned a capital gain of \$800.
 - B) Wayne earned a capital gain of \$750.
 - C) Wayne earned a dividend of \$800.
 - D) Wayne earned a dividend of \$750.

Answer: B

Diff: 2

Topic: *The Components of the Macroeconomy*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 30) Mike purchased a 1968 Chevy Corvette in 2006 for \$30,000 and a year later he sold it for \$36,000. Due to these transactions
- A) Mike earned a capital loss of \$6,000.
 - B) Mike earned a dividend of \$36,000.
 - C) Mike earned a dividend of \$600.
 - D) Mike earned a capital gain of \$6,000.

Answer: D

Diff: 2

Topic: *The Components of the Macroeconomy*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 31) Ami purchased 100 shares of stock for \$10,000. A year later the stock is valued at \$18,000. Instead of selling the stock, Ami held onto it for another year. Which of the following is TRUE?
- A) The \$8,000 increase in the value of the stock represents an unrealized capital gain.
 - B) The \$8,000 increase in the value of the stock represents a dividend.
 - C) To determine the capital gain, it is first necessary to know the normal rate of return on capital.
 - D) none of the above

Answer: A

Diff: 2

Topic: *The Components of the Macroeconomy*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 32) A dividend is
- A) a promissory note issued by corporations when they borrow money.
 - B) an increase in the value of an asset over the purchase price initially paid for it.
 - C) the difference between the interest rate a bank pays on deposits and the interest rate it charges for loans.
 - D) the portion of a corporation's profits that the firm pays out each period to its shareholders.

Answer: D

Diff: 1

Topic: *The Components of the Macroeconomy*

Skill: *Definition*

- 33) The portion of a corporation's profits that a firm pays out each period to its shareholders is a
- A) dividend.
 - B) promissory note.
 - C) capital gain.
 - D) corporate bond.

Answer: A

Diff: 1

Topic: *The Components of the Macroeconomy*

Skill: *Definition*

2 True/False

- 1) Fiscal policy generally takes the form of regulations specifying the maximum amount by which the money supply can be changed.

Answer: FALSE

Diff: 1

Topic: *The Components of the Macroeconomy*

Skill: *Conceptual*

- 2) Contractionary fiscal policy includes raising taxes.

Answer: TRUE

Diff: 1

Topic: *The Components of the Macroeconomy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 3) Monetary policy includes changing the level of household taxes.
Answer: FALSE
Diff: 2
Topic: *The Components of the Macroeconomy*
Skill: *Conceptual*
AACSB: *Reflective Thinking*
- 4) A corporate bond is a promissory note issued by a firm when it borrows money.
Answer: TRUE
Diff: 1
Topic: *The Components of the Macroeconomy*
Skill: *Definition*
- 5) In the circular flow diagram everyone's expenditure is someone else's receipt.
Answer: TRUE
Diff: 1
Topic: *The Components of the Macroeconomy*
Skill: *Conceptual*
AACSB: *Reflective Thinking*
- 6) A dividend is is paid by shareholders to firms.
Answer: FALSE
Diff: 1
Topic: *The Components of the Macroeconomy*
Skill: *Definition*
- 7) A transfer payment is the tax one pays when transferring real estate.
Answer: FALSE
Diff: 1
Topic: *The Components of the Macroeconomy*
Skill: *Definition*
- 8) A capital gain is the increase in value of an asset above its initial cost.
Answer: TRUE
Diff: 1
Topic: *The Components of the Macroeconomy*
Skill: *Definition*

5.3 A Brief History of Macroeconomics

1 Multiple Choice

- 1) To get the economy out of a slump, Keynes believed that the government should
- A) cut both taxes and government spending.
 - B) increase both taxes and government spending.
 - C) increase taxes and/or decrease government spending.
 - D) decrease taxes and/or increase government spending.
- Answer: D
Diff: 2
Topic: *A Brief History of Macroeconomics*
Skill: *Fact*
AACSB: *Reflective Thinking*

- 2) To bring the economy out of an inflationary period, Keynes argued that the government should
- A) cut both taxes and government spending.
 - B) increase both taxes and government spending.
 - C) increase taxes and/or decrease government spending.
 - D) decrease taxes and/or increase government spending.

Answer: C

Diff: 2

Topic: *A Brief History of Macroeconomics*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 3) Which of the following is an assumption used by Classical economists?
- A) Wages adjust downward but not upward.
 - B) Wages adjust upward but not downward.
 - C) Wages are inflexible.
 - D) Wages adjust both upward and downward.

Answer: D

Diff: 1

Topic: *A Brief History of Macroeconomics*

Skill: *Fact*

- 4) According to the Classical model, unemployment
- A) could not persist because wages would rise to eliminate the excess supply of labor.
 - B) could not persist because wages would fall to eliminate the excess supply of labor.
 - C) could be eliminated through fiscal and monetary policies.
 - D) could be eliminated only through government intervention.

Answer: B

Diff: 2

Topic: *A Brief History of Macroeconomics*

Skill: *Fact*

- 5) According to Classical economists, if the quantity of labor demanded exceeds the quantity supplied, there is a
- A) surplus of labor and wages will rise.
 - B) shortage of labor and wages will fall.
 - C) shortage of labor and wages will rise.
 - D) surplus of labor and wages will fall.

Answer: C

Diff: 2

Topic: *A Brief History of Macroeconomics*

Skill: *Fact*

- 6) According to the Classical economists, the economy
- A) requires fine-tuning to reach full employment.
 - B) has sticky prices in many industries.
 - C) is self-correcting.
 - D) will never be at full employment.

Answer: C

Diff: 2

Topic: *A Brief History of Macroeconomics*

Skill: *Fact*

- 7) Macroeconomic policies became more influenced by Keynes' theories starting with,
- A) the period of high unemployment and high inflation in the 1970s.
 - B) the Great Depression.
 - C) the period of high inflation in the early 1980s.
 - D) the OPEC recession.

Answer: B

Diff: 1

Topic: A Brief History of Macroeconomics

Skill: Fact

- 8) According to Classical models, the level of employment is determined primarily by
- A) the level of aggregate demand for goods and services.
 - B) prices and wages.
 - C) government taxation.
 - D) government spending.

Answer: B

Diff: 2

Topic: A Brief History of Macroeconomics

Skill: Fact

- 9) According to Keynes, the level of employment is determined by
- A) flexible wages and prices.
 - B) interest rates.
 - C) price and wages.
 - D) the level of aggregate demand for goods and services.

Answer: D

Diff: 2

Topic: A Brief History of Macroeconomics

Skill: Fact

- 10) The concept of "market clearing" is adopted and defended by
- A) Keynesian economists.
 - B) Classical economists.
 - C) fine-tuning economists.
 - D) demand-side economists.

Answer: B

Diff: 1

Topic: A Brief History of Macroeconomics

Skill: Fact

- 11) Suppose the economy suffers a high rate of unemployment. According to Keynesian economists, the government should increase employment by
- A) decreasing money supply.
 - B) balancing the budget.
 - C) not doing anything.
 - D) increasing government spending.

Answer: D

Diff: 1

Topic: A Brief History of Macroeconomics

Skill: Conceptual

AACSB: Reflective Thinking

- 12) Which of the following would be an example of fine tuning?
- A) Firms increase wages to attract high-quality workers.
 - B) Firms increase employment benefits to increase workers' productivity.
 - C) The federal government enacts legislation to increase spending to try to stimulate the economy.
 - D) The federal government passes legislation that would require that the government's budget always be balanced.

Answer: C

Diff: 2

Topic: *A Brief History of Macroeconomics*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 13) Rapid increases in the price level during periods of recession or high unemployment are known as
- A) stagflation.
 - B) stagnation.
 - C) depression.
 - D) inflation.

Answer: A

Diff: 1

Topic: *A Brief History of Macroeconomics*

Skill: *Definition*

- 14) Stagflation occurs when the economy's inflation rate is high and
- A) employment is high.
 - B) the unemployment rate is high.
 - C) the unemployment rate is low.
 - D) the rate of change in economic activities is positive.

Answer: B

Diff: 1

Topic: *A Brief History of Macroeconomics*

Skill: *Definition*

- 15) Related to the *Economics in Practice* on p. 97 [409]: F. Scott Fitzgerald's *The Great Gatsby* is set in the "Roaring '20s". This decade in U.S. history was characterized by
- A) economic expansion and high unemployment.
 - B) recession and high unemployment.
 - C) economic expansion and low unemployment.
 - D) the Great Depression and stagflation.

Answer: C

Diff: 2

Topic: *A Brief History of Macroeconomics: Economics in Practice*

Skill: *Fact*

- 16) Related to the *Economics in Practice* on p. 97 [409]: John Steinbeck's *The Grapes of Wrath* is set in the early 1930s. During this time, the U.S. economy was primarily in the _____ phase of the business cycle, culminating in the Great Depression.
- A) peak
 - B) recession
 - C) trough
 - D) expansion

Answer: B

Diff: 2

Topic: *A Brief History of Macroeconomics: Economics in Practice*

Skill: *Fact*

17) Related to the *Economics in Practice* on p. 99 [411]: John Maynard Keynes' most notable published work is entitled

- A) *Capitalism Doomed.*
- B) *The General Theory of Employment, Interest, and Money.*
- C) *The Communist Manifesto.*
- D) *Freakonomics.*

Answer: B

Diff: 2

Topic: *A Brief History of Macroeconomics: Economics in Practice*

Skill: *Fact*

18) Related to the *Economics in Practice* on p. 99 [411]: John Maynard Keynes sought to solve the economic paradox of the Great Depression, which was the coexistence of

- A) low production and low unemployment.
- B) high production and low inflation.
- C) high production and high inflation.
- D) low production and high unemployment.

Answer: D

Diff: 2

Topic: *A Brief History of Macroeconomics: Economics in Practice*

Skill: *Fact*

2 True/False

1) Keynes believed that expansionary fiscal policy could help get an economy out of an inflation.

Answer: FALSE

Diff: 1

Topic: *A Brief History of Macroeconomics*

Skill: *Fact*

2) According to the Classical model, an excess supply of labor would drive up wages to a new equilibrium level and therefore unemployment would not persist.

Answer: FALSE

Diff: 2

Topic: *A Brief History of Macroeconomics*

Skill: *Fact*

3) According to Keynes, aggregate supply determines the level of economic activities in the economy.

Answer: FALSE

Diff: 1

Topic: *A Brief History of Macroeconomics*

Skill: *Fact*

4) According to Keynes, the government's role during periods when private demand is low is to stimulate aggregate demand and, by so doing, lift the economy out of recession.

Answer: TRUE

Diff: 1

Topic: *A Brief History of Macroeconomics*

Skill: *Fact*

5) In the Classical model, the level of employment is determined by the level of aggregate demand.

Answer: FALSE

Diff: 1

Topic: *A Brief History of Macroeconomics*

Skill: *Fact*

6) "Fine tuning" is any government attempt to regulate inflation or unemployment.

Answer: TRUE

Diff: 1

Topic: *A Brief History of Macroeconomics*

Skill: *Definition*

7) Classical economists believed that economic slowdowns are self-correcting.

Answer: TRUE

Diff: 1

Topic: *A Brief History of Macroeconomics*

Skill: *Fact*

5.4 The U.S. Economy Since 1970

1 Multiple Choice

1) Since 1970, the U.S. economy has experienced four

A) periods of high inflation.

B) recessions.

C) deflations.

D) periods of stagflation.

Answer: B

Diff: 1

Topic: *The U.S. Economy Since 1970*

Skill: *Fact*

2) Since 1970, the U.S. economy has experienced two

A) periods of high inflation.

B) recessions.

C) deflations.

D) all of the above

Answer: A

Diff: 1

Topic: *The U.S. Economy Since 1970*

Skill: *Fact*

3) During the U.S. recession of 1980–1982, the unemployment rate reached a high of _____ percent.

A) 7.6

B) 8.8

C) 10.7

D) 22.4

Answer: C

Diff: 1

Topic: *The U.S. Economy Since 1970*

Skill: *Fact*

- 4) In the U.S. economy, the inflation rate in 1975 peaked at _____ percent.
 A) 10.1 B) 11.0 C) 14.2 D) 22.4

Answer: B

Diff: 1

Topic: The U.S. Economy Since 1970

Skill: Fact

Refer to the information for this hypothetical economy provided in Table 5.1 below to answer the questions that follow.

Table 5.1

	2006				2007				2008			
Quarter	I	II	III	IV	I	II	III	IV	I	II	III	IV
Output	90	94	98	102	96	91	88	84	87	94	90	87

- 5) Refer to Table 5.1. In this economy, a trough existed around the
 A) fourth quarter of the year 2007 B) fourth quarter of the year 2006.
 C) second quarter of the year 2007. D) third quarter of the year 2008.

Answer: A

Diff: 2

Topic: The U.S. Economy Since 1970

Skill: Analytic

AACSB: Analytic Skills

- 6) Refer to Table 5.1. In this economy, a peak existed around the
 A) third quarter of the year 2008. B) third quarter of the year 2006.
 C) fourth quarter of the year 2007. D) fourth quarter of the year 2006.

Answer: D

Diff: 2

Topic: The U.S. Economy Since 1970

Skill: Analytic

AACSB: Analytic Skills

- 7) Refer to Table 5.1. The period from after the fourth quarter of 2006 until before the first quarter of 2008 can be categorized as a period of
 A) high inflation. B) low unemployment.
 C) high production. D) high unemployment.

Answer: D

Diff: 2

Topic: The U.S. Economy Since 1970

Skill: Analytic

AACSB: Analytic Skills

- 8) Refer to Table 5.1. Which of the following quarters can be associated with inflation?
 A) the second quarter of the year 2006 B) the first quarter of the year 2008
 C) the second quarter of the year 2008 D) all of the above

Answer: D

Diff: 2

Topic: The U.S. Economy Since 1970

Skill: Analytic

AACSB: Analytic Skills

2 True/False

- 1) Since 1970, the U.S. economy has experienced 2 recessions.

Answer: FALSE

Diff: 1

Topic: *The U.S. Economy Since 1970*

Skill: *Fact*

- 2) Since 1970, the U.S. economy has experienced 2 periods of high inflation.

Answer: TRUE

Diff: 1

Topic: *The U.S. Economy Since 1970*

Skill: *Fact*

- 3) Since 1970, the annual inflation rate in the U.S. has been about 9.7 percent or more.

Answer: FALSE

Diff: 1

Topic: *The U.S. Economy Since 1970*

Skill: *Fact*

Chapter 6 Measuring National Output and National Income

6.1 Gross Domestic Product

1 Multiple Choice

- 1) The total market value of all final goods and services produced within a given period by factors of production located within a country is
- A) gross domestic product.
 - B) gross national product.
 - C) net national product.
 - D) net national income.

Answer: A

Diff: 1

Topic: Gross Domestic Product

Skill: Definition

- 2) Gross domestic product measures
- A) the total spending of everyone in the economy.
 - B) the value of all output in the economy.
 - C) the total income of everyone in the economy.
 - D) all of the above

Answer: D

Diff: 2

Topic: Gross Domestic Product

Skill: Definition

- 3) Which of the following is an example of a final good or service?
- A) wheat a bakery purchases to make bread
 - B) coffee beans Starbucks purchases to make coffee
 - C) lumber purchased by a construction company to used in building houses
 - D) a computer purchased by Federal Express to track shipments

Answer: D

Diff: 2

Topic: Gross Domestic Product

Skill: Conceptual

AACSB: Reflective Thinking

- 4) Which of the following is a good or service counted in GDP?
- A) tires Ford buys to put on a car
 - B) a used tire you buy for your personal car
 - C) a new tire you buy for your personal car
 - D) used tires bought by a used car dealer to put on a car on his lot

Answer: C

Diff: 2

Topic: Gross Domestic Product

Skill: Conceptual

AACSB: Reflective Thinking

- 5) Which of the following is an example of an intermediate good?
- A) the dough you buy to fix yourself a pizza for dinner
 - B) the chocolate you buy to make yourself some cookies
 - C) the pizza sauce you purchase to make pizzas to sell for a fund-raiser for an organization you belong to
 - D) lumber you buy to build a house for your dog

Answer: C

Diff: 2

Topic: Gross Domestic Product

Skill: Conceptual

AACSB: Reflective Thinking

- 6) Double counting can be avoided by
- A) including the value of intermediate goods in the current year.
 - B) not counting the value of intermediate goods in GDP.
 - C) including the value of intermediate goods in the GNP but not in the GDP.
 - D) including the value of intermediate goods in the production year but not in the selling year of those goods.

Answer: B

Diff: 2

Topic: Gross Domestic Product

Skill: Conceptual

AACSB: Reflective Thinking

- 7) Which of the following would NOT be counted in 2007's GDP?
- A) the value of a 2005 boat you purchase from a boat dealer in 2007
 - B) the 2007 salary of a used motorcycle salesperson
 - C) the commissions earned by a real estate agent in selling condominiums built prior to 2007
 - D) the value of a refrigerator manufactured in 2007 but not sold in 2007

Answer: A

Diff: 2

Topic: Gross Domestic Product

Skill: Conceptual

AACSB: Reflective Thinking

- 8) Which of the following would be counted in 2003's GDP?
- A) the value of a loan you take in 2003
 - B) the value of a TV that was produced in 2002 but not sold until 2003
 - C) the bonus check a stockbroker gets from his/her company in 2003
 - D) the value of a bond sold by the federal government

Answer: C

Diff: 2

Topic: Gross Domestic Product

Skill: Conceptual

AACSB: Reflective Thinking

- 9) Which of the following is NOT included in 2008's GDP?
- A) the value of a motorcycle produced in the United States and exported to Japan
 - B) the profit earned in 2008 from selling a stock that you purchased in 2005
 - C) the value of a motor that is used in the production of a lawn mower
 - D) the commission earned by a headhunter when she locates a job for a client

Answer: B

Diff: 2

Topic: Gross Domestic Product

Skill: Conceptual

AACSB: Reflective Thinking

- 10) Gross national product is the total market value of
- A) all final and intermediate goods and service produced by resources owned by a country in a given year.
 - B) all final and intermediate goods and services produced in a country, regardless of who owns the resources.
 - C) all final goods and services produced in a country in a given year, regardless of who owns the resources.
 - D) all final goods and services produced by resources owned by a country, regardless of where production takes place.

Answer: D

Diff: 1

Topic: Gross Domestic Product

Skill: Definition

- 11) If no foreign companies produce in a country, but many of the country's companies produce abroad, then
- A) the country's GNP will tend to exceed its GDP.
 - B) the country's GDP will tend to exceed its GNP.
 - C) the country's GNP and GDP will tend to be equal.
 - D) the country's GDP will tend to be equal to its domestic income.

Answer: A

Diff: 2

Topic: Gross Domestic Product

Skill: Conceptual

AACSB: Reflective Thinking

- 12) Which of the following is included in both the U.S. GDP and GNP?
- A) The value of all cars produced by Ford in Mexico.
 - B) The value of all cars produced by General Motors in the U.S.
 - C) The value of all cars produced by Toyota in the U.S.
 - D) The value of cars produced by Nissan in Japan and the U.S.

Answer: B

Diff: 2

Topic: Gross Domestic Product

Skill: Conceptual

AACSB: Reflective Thinking

- 13) Which of the following is NOT counted in the GNP of the United States?
- A) The wage of a U.S. citizen who works in a foreign country for a foreign firm.
 - B) The interest earned by a U.S. bank on loans to a business firm located in Brazil.
 - C) The profit earned by a restaurant located in the United States but owned by a Mexican company.
 - D) The value of services that are produced by state and local governments in the United States.

Answer: C

Diff: 2

Topic: Gross Domestic Product

Skill: Conceptual

AACSB: Reflective Thinking

- 14) The value of what KFC produces in Japan is included in the U.S. _____ and in the Japanese _____.
- A) GDP; GDP
 - B) GNP; GNP
 - C) GNP; GDP
 - D) GDP; GNP

Answer: C

Diff: 2

Topic: Gross Domestic Product

Skill: Conceptual

AACSB: Reflective Thinking

- 15) Profits earned in the United States by foreign-owned companies are included in
- A) the U.S. GDP but not GNP.
 - B) neither the U.S. GDP nor GNP.
 - C) the U.S. GNP but not GDP.
 - D) both the U.S. GDP and GNP.

Answer: A

Diff: 1

Topic: Gross Domestic Product

Skill: Conceptual

AACSB: Reflective Thinking

- 16) The GDP of the U.S. in 2002 was around \$10 trillion. This means
- A) that the value of output in the U.S. in 2002 was around \$10 trillion.
 - B) that total income in the U.S. in 2002 was around \$10 trillion.
 - C) that total spending on final goods and services in the U.S. in 2002 was around \$10 trillion.
 - D) all of the above

Answer: D

Diff: 2

Topic: Gross Domestic Product

Skill: Conceptual

AACSB: Reflective Thinking

- 17) The GDP includes
- A) the value of all intermediate goods and services.
 - B) the value of all final goods and services.
 - C) the value of both intermediate and final goods and services.
 - D) the value of all transactions.

Answer: B

Diff: 2

Topic: Gross Domestic Product

Skill: Conceptual

AACSB: Reflective Thinking

- 18) Income Mexican citizens earn in the U.S. counts in
- A) U.S. GNP.
 - B) Mexican GNP.
 - C) Mexican GDP.
 - D) both U.S. and Mexican GDP.

Answer: B

Diff: 2

Topic: Gross Domestic Product

Skill: Conceptual

AACSB: Reflective Thinking

2 True/False

- 1) GDP measures the total income of everyone and the total spending by everyone in the economy.

Answer: FALSE

Diff: 1

Topic: Gross Domestic Product

Skill: Conceptual

AACSB: Reflective Thinking

- 2) Total income in the economy can sometimes be greater than total spending.

Answer: FALSE

Diff: 2

Topic: Gross Domestic Product

Skill: Conceptual

AACSB: Reflective Thinking

- 3) The income of U.S. citizens working abroad counts in U.S. GDP.

Answer: FALSE

Diff: 2

Topic: Gross Domestic Product

Skill: Conceptual

AACSB: Reflective Thinking

- 4) Stock market transactions are part of GNP.

Answer: FALSE

Diff: 2

Topic: Gross Domestic Product

Skill: Conceptual

AACSB: Reflective Thinking

- 5) Value added is the difference between the value of good as they leave a stage of production and cost of the goods as they entered that stage of production.

Answer: TRUE

Diff: 2

Topic: Gross Domestic Product

Skill: Definition

6.2 Calculating GDP

1 Multiple Choice

- 1) The equation for GDP using the expenditure approach is

A) $GDP = C + I + G + EX - IM$.

B) $GDP = C + I + G + (IM - EX)$.

C) $GDP = C + I + G + EX + IM$.

D) $GDP = C + I + G - EX - IM$.

Answer: A

Diff: 1

Topic: Calculating GDP

Skill: Definition

- 2) The single largest expenditure component in GDP is

A) government spending.

B) investment.

C) consumption.

D) net exports.

Answer: C

Diff: 1

Topic: Calculating GDP

Skill: Fact

Refer to the information provided in Table 6.1 below to answer the questions that follow.

Table 6.1

	\$Billions
Durable goods	800
Nonresidential investment	400
Federal purchases of goods	300
Exports	400
State and local purchases of goods	200
Residential investment	50
Services	500
Imports	250
Change in business inventories	-25
Nondurable goods	700

- 3) Refer to Table 6.1. Personal consumption expenditures in billions of dollars are

A) 1,000.

B) 1,300.

C) 1,500.

D) 2,000.

Answer: D

Diff: 2

Topic: Calculating GDP

Skill: Analytic

AACSB: Analytic Skills

- 4) Refer to Table 6.1. The value for gross private domestic investment in billions of dollars is
A) 300. B) 375. C) 425. D) 450.

Answer: C

Diff: 2

Topic: Calculating GDP

Skill: Analytic

AACSB: Analytic Skills

- 5) Refer to Table 6.1. The value for net exports in billions of dollars is
A) 150. B) 250. C) 650. D) 800.

Answer: A

Diff: 1

Topic: Calculating GDP

Skill: Analytic

AACSB: Analytic Skills

- 6) Refer to Table 6.1. The value of gross domestic product in billions of dollars is
A) 3,000. B) 3,075. C) 3,125. D) 3,750.

Answer: B

Diff: 2

Topic: Calculating GDP

Skill: Analytic

AACSB: Analytic Skills

- 7) Refer to Table 6.1. The value of government spending in billions of dollars is
A) 100. B) 200. C) 300. D) 500.

Answer: D

Diff: 2

Topic: Calculating GDP

Skill: Analytic

AACSB: Analytic Skills

Refer to the information provided in Table 6.2 below to answer the questions that follow.

	\$Billions
Federal purchases of goods	800
Services	500
Imports	200
Change in business inventories	40
Durable goods	300
Nondurable goods	600
Exports	50
Residential investment	200
State and local purchases	200
Nonresidential investment	650

- 8) Refer to Table 6.2. Personal consumption expenditures in billions of dollars are
A) 900. B) 1,100. C) 1,400. D) 1,600.

Answer: C

Diff: 2

Topic: Calculating GDP

Skill: Analytic

AACSB: Analytic Skills

- 9) Refer to Table 6.2. The value for gross private domestic investment in billions of dollars is
A) 740. B) 810. C) 850. D) 890.

Answer: D

Diff: 2

Topic: Calculating GDP

Skill: Analytic

AACSB: Analytic Skills

- 10) Refer to Table 6.2. The value for net exports in billions of dollars is
A) -200. B) -150. C) 50. D) 250.

Answer: B

Diff: 1

Topic: Calculating GDP

Skill: Analytic

AACSB: Analytic Skills

- 11) Refer to Table 6.2. The value for gross domestic product in billions of dollars is
A) 2,900. B) 3,140. C) 3,440. D) 3,650.

Answer: B

Diff: 2

Topic: Calculating GDP

Skill: Analytic

AACSB: Analytic Skills

- 12) Refer to Table 6.2. The value of government spending in billions of dollars is
A) 200. B) 600. C) 800. D) 1,000.

Answer: D

Diff: 2

Topic: Calculating GDP

Skill: Analytic

AACSB: Analytic Skills

- 13) A company produced 8 dishwasher machines in 2005. The company sold 6 in 2005 and added 2 to its inventories. The market value of the dishwasher machines in 2005 was \$200 per unit. What is the value of this company's output that will be included in the 2005 GDP?
A) \$400. B) \$1,400. C) \$1,600. D) \$2,000.

Answer: C

Diff: 2

Topic: Calculating GDP

Skill: Analytic

AACSB: Analytic Skills

- 14) A farmer buys a new tractor from John Deere to use on her cotton farm. This tractor is included in GDP as
A) part of gross private domestic investment.
B) a durable consumption good.
C) a service.
D) a nondurable consumption good.

Answer: A

Diff: 2

Topic: Calculating GDP

Skill: Conceptual

AACSB: Reflective Thinking

- 15) The change in business inventories is measured as
A) final sales minus GDP. B) final sales plus GDP.
C) GDP minus final sales. D) the ratio of final sales to GDP.

Answer: C

Diff: 2

Topic: Calculating GDP

Skill: Conceptual

AACSB: Reflective Thinking

- 16) In 2007 final sales equal \$200 billion, and the change in business inventories is \$50 billion. GDP in 2007
A) is \$250 billion. B) is \$200 billion. C) is \$150 billion. D) is \$40 billion.

Answer: A

Diff: 2

Topic: Calculating GDP

Skill: Analytic

AACSB: Analytic Skills

- 17) In 2006 final sales equal \$350 billion and the change in business inventories is -\$60 billion. GDP in 2006
- A) is \$290 billion.
 - B) is \$295 billion.
 - C) is \$410 billion.
 - D) cannot be determined from this information.

Answer: A

Diff: 2

Topic: Calculating GDP

Skill: Analytic

AACSB: Analytic Skills

- 18) In 2008 the change in business inventories is -\$70 billion and GDP is \$200 billion. Final sales in 2008
- A) are \$130 billion.
 - B) are \$200 billion.
 - C) are \$270 billion.
 - D) are \$340 billion.

Answer: C

Diff: 2

Topic: Calculating GDP

Skill: Analytic

AACSB: Analytic Skills

- 19) In 2007, GDP was exactly equal to final sales. This implies that
- A) there was accumulation of inventories that year.
 - B) there was a decline in inventories that year.
 - C) there was no change in inventories that year.
 - D) GDP did not grow that year compared to the year before.

Answer: C

Diff: 2

Topic: Calculating GDP

Skill: Analytic

AACSB: Analytic Skills

- 20) If the change in business inventories is zero, then final sales are
- A) zero.
 - B) less than GDP.
 - C) greater than GDP.
 - D) equal to GDP.

Answer: D

Diff: 2

Topic: Calculating GDP

Skill: Analytic

AACSB: Analytic Skills

- 21) If in a year there is a positive inventory investment, then final sales
- A) exceed GDP.
 - B) are less than GDP.
 - C) equal GDP.
 - D) are zero.

Answer: B

Diff: 1

Topic: Calculating GDP

Skill: Analytic

AACSB: Analytic Skills

- 22) Net investment equals
- A) GDP minus final sales.
 - B) gross investment minus final sales.
 - C) gross investment minus depreciation.
 - D) depreciation plus GDP.

Answer: C

Diff: 1

Topic: Calculating GDP

Skill: Definition

- 23) If net investment is zero, then
- A) gross investment is greater than depreciation.
 - B) gross investment is less than depreciation.
 - C) gross investment equals depreciation.
 - D) depreciation is zero.

Answer: C

Diff: 1

Topic: Calculating GDP

Skill: Analytic

AACSB: Analytic Skills

- 24) Suppose that net investment in 2008 was \$20 billion and depreciation was \$4 billion. Gross investment in 2008 was
- A) \$16 billion.
 - B) \$20 billion.
 - C) \$24 billion.
 - D) \$28 billion.

Answer: C

Diff: 1

Topic: Calculating GDP

Skill: Analytic

AACSB: Analytic Skills

- 25) The total value of all capital goods newly produced in a given period is
- A) the change in business inventories.
 - B) depreciation.
 - C) net investment.
 - D) gross investment.

Answer: D

Diff: 1

Topic: Calculating GDP

Skill: Definition

- 26) The change in capital stock in a period is equal to
- A) the ratio of the amount of the capital at the beginning of the period to the amount of depreciation.
 - B) the amount of the capital stock at the beginning of the period plus gross investment minus depreciation.
 - C) the amount of the capital at the beginning of the period plus gross investment.
 - D) the amount of the capital at the beginning of the period minus net investment.

Answer: B

Diff: 2

Topic: Calculating GDP

Skill: Definition

- 27) Net investment is
- A) gross investment minus depreciation.
 - B) gross investment plus depreciation.
 - C) depreciation minus gross investment.
 - D) GNP minus final sales.

Answer: A

Diff: 1

Topic: Calculating GDP

Skill: Definition

- 28) Depreciation is
- A) the decrease in the overall price level.
 - B) the additional capital stock in a year.
 - C) the amount of used up machinery in a year.
 - D) the amount of decline in business inventories.

Answer: C

Diff: 1

Topic: Calculating GDP

Skill: Definition

- 29) If net investment in 2007 is \$350 billion and gross investment in 2007 is \$500 billion, depreciation in 2007 is
- A) \$0.7 billion.
 - B) \$150 billion.
 - C) \$175 billion.
 - D) \$250 billion.

Answer: B

Diff: 1

Topic: Calculating GDP

Skill: Analytic

AACSB: Analytic Skills

- 30) If net investment in 2008 is \$500 billion and gross investment in 2008 is \$900 billion, depreciation in 2008 is
- A) -\$500 billion.
 - B) \$0.
 - C) \$400 billion.
 - D) \$1,400 billion.

Answer: C

Diff: 1

Topic: Calculating GDP

Skill: Analytic

AACSB: Analytic Skills

- 31) If gross investment in 2008 is \$750 billion and depreciation in 2008 is \$850 billion, net investment in 2008 is
- A) -\$50 billion.
 - B) -\$100 billion.
 - C) -\$800 billion.
 - D) -\$1,600 billion.

Answer: B

Diff: 1

Topic: Calculating GDP

Skill: Analytic

AACSB: Analytic Skills

- 32) If gross investment in 2008 is \$200 billion and depreciation in 2008 is \$1,000 billion, net investment in 2008 is
A) -\$900 billion. B) -\$800 billion. C) \$1,000 billion. D) \$1,200 billion.

Answer: B

Diff: 1

Topic: Calculating GDP

Skill: Analytic

AACSB: Analytic Skills

- 33) Exports equal
A) imports - net exports. B) net exports + imports.
C) net exports - imports. D) imports + (exports + imports).

Answer: B

Diff: 1

Topic: Calculating GDP

Skill: Definition

- 34) When calculating GDP, exports are _____ and imports are _____.
A) added; added B) added; subtracted
C) subtracted; added D) subtracted; subtracted

Answer: B

Diff: 1

Topic: Calculating GDP

Skill: Conceptual

AACSB: Reflective Thinking

- 35) If the value of net exports is negative, then
A) exports exceed imports. B) imports exceed exports.
C) exports equal imports. D) imports are zero.

Answer: B

Diff: 1

Topic: Calculating GDP

Skill: Conceptual

AACSB: Reflective Thinking

- 36) The largest income component of GDP is
A) proprietors' income. B) rental income.
C) compensation of employees. D) corporate profit.

Answer: C

Diff: 2

Topic: Calculating GDP

Skill: Fact

37) What should be subtracted from GDP to calculate national income?

- A) depreciation
- B) indirect taxes
- C) personal income taxes.
- D) net factor payments to the rest of the world

Answer: A

Diff: 2

Topic: Calculating GDP

Skill: Conceptual

AACSB: Reflective Thinking

38) Proprietors' income is

- A) the income of unincorporated businesses.
- B) the income of all businesses—incorporated and unincorporated.
- C) the income of sole proprietorships.
- D) the income of partnerships.

Answer: A

Diff: 2

Topic: Calculating GDP

Skill: Definition

39) Net interest is the interest on loans paid by

- A) businesses, households, and the government.
- B) businesses and households.
- C) businesses and the government.
- D) businesses.

Answer: D

Diff: 3

Topic: Calculating GDP

Skill: Definition

40) Interest paid by households and by the government is

- A) counted in national income, but not in GDP.
- B) not counted in GDP because it is not assumed to flow from the production of goods and services.
- C) not counted in GDP but is counted in GNP because it is paid by U.S. citizens to people living in the United States.
- D) included in both GDP and GNP because it represents an expenditure by one group and a receipt of income by another group.

Answer: B

Diff: 3

Topic: Calculating GDP

Skill: Conceptual

AACSB: Reflective Thinking

41) What type of tax affects the amount of money you pay for a product?

- A) direct tax
- B) income tax
- C) indirect tax
- D) all of the above

Answer: C

Diff: 2

Topic: Calculating GDP

Skill: Conceptual

- 42) Depreciation is
- A) subtracted from national income to get GDP.
 - B) added to national income to get GDP.
 - C) subtracted from GNP to get NNP.
 - D) added to GNP to get NNP.

Answer: C

Diff: 2

Topic: Calculating GDP

Skill: Conceptual

AACSB: Reflective Thinking

Refer to the information provided in Table 6.3 below to answer the questions that follow.

Table 6.3

	\$Billions
Compensation of employees	475
Proprietors' income	60
Corporate profit	40
Net interest	25
Rental income	10
Deprecation	70
Indirect taxes	40
Direct taxes	80
Subsidies	15
Payments of factor income to the rest of the world	20
Receipts of factor income from the rest of the world	15

- 43) Refer to Table 6.3. The value for national income in billions of dollars is
- A) 585.
 - B) 600.
 - C) 635.
 - D) 850.

Answer: C

Diff: 2

Topic: Calculating GDP

Skill: Analytic

AACSB: Analytic Skills

- 44) Refer to Table 6.3. The value for gross domestic product in billions of dollars is
- A) 485.
 - B) 680.
 - C) 685.
 - D) 710.

Answer: D

Diff: 2

Topic: Calculating GDP

Skill: Analytic

AACSB: Analytic Skills

- 45) Refer to Table 6.3. The value of net factor payments to the rest of the world is
- A) 5.
 - B) 15.
 - C) 25.
 - D) 35.

Answer: A

Diff: 2

Topic: Calculating GDP

Skill: Analytic

AACSB: Analytic Skills

- 46) Refer to Table 6.3. The value of disposable income
- A) is 505.
 - B) is 560.
 - C) is 605.
 - D) cannot be calculated given the information in Table 6.3.

Answer: D

Diff: 2

Topic: Calculating GDP

Skill: Analytic

AACSB: Analytic Skills

- 47) If receipts of factor income from the rest of the world exceed payments of factor income to the rest of the world, then
- A) GDP is greater than GNP.
 - B) GDP equals GNP.
 - C) GNP equals NNP.
 - D) GNP is greater than GDP.

Answer: D

Diff: 2

Topic: Calculating GDP

Skill: Analytic

AACSB: Analytic Skills

Refer to the information provided in Table 6.4 below to answer the questions that follow.

Table 6.4

	\$Billions
Depreciation	40
Receipts of factor income from the rest of the world	30
Government purchases	100
Imports	50
Payments of factor income to the rest of the world	50
Net private domestic investment	200
Personal income taxes	120
Personal consumption expenditures	600
Dividends	20
Exports	60
Amount of national income not going to households	20

- 48) Refer to Table 6.4. The value for GDP in billions of dollars is
- A) 910.
 - B) 920.
 - C) 950.
 - D) 1,050.

Answer: C

Diff: 2

Topic: Calculating GDP

Skill: Analytic

AACSB: Analytic Skills

- 49) Refer to Table 6.4. The value for GNP in billions of dollars is
- A) 900.
 - B) 930.
 - C) 980.
 - D) 1,010.

Answer: B

Diff: 2

Topic: Calculating GDP

Skill: Analytic

AACSB: Analytic Skills

- 50) Refer to Table 6.4. The value for NNP in billions of dollars is
A) 890. B) 910. C) 940. D) 970.

Answer: A

Diff: 2

Topic: Calculating GDP

Skill: Analytic

AACSB: Analytic Skills

- 51) Refer to Table 6.4. The value for national income in billions of dollars is
A) 890. B) 910. C) 940. D) 970.

Answer: A

Diff: 2

Topic: Calculating GDP

Skill: Analytic

AACSB: Analytic Skills

- 52) Refer to Table 6.4. The value for personal income in billions of dollars is
A) 870. B) 890. C) 950. D) 960.

Answer: A

Diff: 2

Topic: Calculating GDP

Skill: Analytic

AACSB: Analytic Skills

- 53) Refer to Table 6.4. The value for disposable personal income in billions of dollars is
A) 750. B) 770. C) 820. D) 990.

Answer: A

Diff: 2

Topic: Calculating GDP

Skill: Analytic

AACSB: Analytic Skills

- 54) If GNP is \$600 billion, receipts of factor income from the rest of the world are \$50 billion, and payments of factor income to the rest of the world are \$30 billion, then GDP is
A) \$520 billion. B) \$580 billion. C) \$620 billion. D) \$680 billion.

Answer: B

Diff: 3

Topic: Calculating GDP

Skill: Analytic

AACSB: Analytic Skills

- 55) If GNP is \$200 billion, receipts of factor income from the rest of the world are \$10 billion, and payments of factor income to the rest of the world are \$30 billion, then GDP is
A) \$160 billion. B) \$210 billion. C) \$220 billion. D) \$240 billion.

Answer: C

Diff: 3

Topic: Calculating GDP

Skill: Analytic

AACSB: Analytic Skills

56) If GDP is \$500 billion and depreciation is \$40 billion, then net national product

- A) is \$460 billion.
- B) is \$500 billion.
- C) is \$540 billion.
- D) cannot be determined from this information.

Answer: D

Diff: 2

Topic: Calculating GDP

Skill: Analytic

AACSB: Analytic Skills

57) If GDP is \$300 billion, depreciation is \$30 billion, and net factor income from the rest of the world is -\$40 billion, then net national product is

- A) \$230 billion.
- B) \$270 billion.
- C) \$290 billion.
- D) \$310 billion.

Answer: D

Diff: 3

Topic: Calculating GDP

Skill: Analytic

AACSB: Analytic Skills

58) If GNP is \$800 billion and depreciation is \$90 billion, then net national product is

- A) \$710 billion.
- B) \$845 billion.
- C) \$890 billion.
- D) \$980 billion.

Answer: A

Diff: 1

Topic: Calculating GDP

Skill: Analytic

AACSB: Analytic Skills

59) If GNP is \$200 billion and depreciation is \$20 billion, then net national product is

- A) \$100 billion.
- B) \$180 billion.
- C) \$210 billion.
- D) \$220 billion.

Answer: B

Diff: 1

Topic: Calculating GDP

Skill: Analytic

AACSB: Analytic Skills

60) If depreciation equals zero and retained earnings equal \$5 billion, then

- A) GNP is less than net national product by \$5 billion.
- B) GNP equals net national product.
- C) Net national product is less than GNP by \$5 billion.
- D) GNP is greater than GDP by \$5 billion.

Answer: B

Diff: 1

Topic: Calculating GDP

Skill: Analytic

AACSB: Analytic Skills

- 61) Net national product is
- A) GDP plus depreciation.
 - B) GDP minus depreciation.
 - C) GNP minus depreciation.
 - D) GNP plus depreciation.

Answer: C

Diff: 1

Topic: Calculating GDP

Skill: Definition

- 62) The total income of households is
- A) net national product.
 - B) personal income.
 - C) national income.
 - D) production income.

Answer: B

Diff: 1

Topic: Calculating GDP

Skill: Definition

- 63) Personal income is national income minus
- A) depreciation.
 - B) net factor income to the rest of the world.
 - C) the amount of national income not going to households.
 - D) imports.

Answer: C

Diff: 2

Topic: Calculating GDP

Skill: Fact

- 64) If national income is \$600 billion, personal income is \$400 billion, personal taxes are \$120 billion, then disposable income equals
- A) \$480 billion.
 - B) \$320 billion.
 - C) \$280 billion.
 - D) \$80 billion.

Answer: C

Diff: 2

Topic: Calculating GDP

Skill: Analytic

AACSB: Analytic Skills

- 65) Which of the following is subtracted from national income to get to personal income?
- A) retained earnings
 - B) personal interest income
 - C) depreciation
 - D) personal Taxes

Answer: A

Diff: 2

Topic: Calculating GDP

Skill: Conceptual

AACSB: Reflective Thinking

- 66) Personal income
- A) is always less than national income.
 - B) is always greater than national income.
 - C) may be greater than or less than national income.
 - D) will always equal national income.

Answer: C

Diff: 2

Topic: Calculating GDP

Skill: Conceptual

AACSB: Reflective Thinking

- 67) If personal income is \$925 billion and personal income taxes are \$70 billion, the value of disposable personal income is
- A) \$835 billion.
 - B) \$855 billion.
 - C) \$890 billion.
 - D) \$995 billion.

Answer: B

Diff: 1

Topic: Calculating GDP

Skill: Analytic

AACSB: Analytic Skills

- 68) If personal saving is -\$10 billion and disposable personal income is \$370 billion, then personal consumption spending
- A) is \$360 billion.
 - B) is \$380 billion.
 - C) is \$390 billion.
 - D) cannot be determined from this information.

Answer: B

Diff: 2

Topic: Calculating GDP

Skill: Analytic

AACSB: Analytic Skills

- 69) The personal saving rate is
- A) the difference between total personal spending and personal saving.
 - B) the difference between personal income and disposable personal income.
 - C) the ratio of personal income to personal saving.
 - D) the percentage of disposable personal income that is saved.

Answer: D

Diff: 2

Topic: Calculating GDP

Skill: Definition

- 70) If disposable personal income is \$400 billion and personal saving is \$8 billion, the personal saving rate is
- A) 1.5%.
 - B) 2%.
 - C) 5%.
 - D) 12%.

Answer: B

Diff: 1

Topic: Calculating GDP

Skill: Analytic

AACSB: Analytic Skills

- 71) If the personal saving rate is 5% and personal saving is \$10 billion, the value of personal disposable income
- A) is \$100 billion.
 - B) is \$200 billion.
 - C) is \$500 billion.
 - D) cannot be determined from this information.

Answer: B

Diff: 1

Topic: Calculating GDP

Skill: Analytic

AACSB: Analytic Skills

- 72) Saving rates tend to _____ during boom times and _____ during recession periods.
- A) rise; rise
 - B) rise; fall
 - C) fall; rise
 - D) fall; fall

Answer: C

Diff: 2

Topic: Calculating GDP

Skill: Conceptual

AACSB: Reflective Thinking

- 73) Related to the *Economics in Practice* on p. 109 [421]: The value of the used goods sold on eBay from a U.S. seller to a U.S. buyer is
- A) counted in U.S. GDP but not GNP.
 - B) counted in U.S. GNP but not GDP.
 - C) counted in both U.S. GDP and GNP.
 - D) not counted in either U.S. GDP or GNP.

Answer: D

Diff: 2

Topic: Calculating GDP: Economics in Practice

Skill: Conceptual

AACSB: Reflective Thinking

- 74) Related to the *Economics in Practice* on p. 109 [421]: If a Swiss dealer sells a newly produced Swiss watch on eBay to a U.S. customer, the value of the watch is
- A) counted in U.S. GDP.
 - B) counted in U.S. GDP and Swiss GDP.
 - C) counted in Swiss GDP.
 - D) not counted in either U.S. or Swiss GDP.

Answer: C

Diff: 2

Topic: Calculating GDP: Economics in Practice

Skill: Conceptual

AACSB: Reflective Thinking

- 75) Related to the *Economics in Practice* on p. 113 [425]: The National Income and Product Accounts (NIPAs) allow policymakers and economists to analyze the impact of
- A) spending and tax plans.
 - B) price shocks.
 - C) monetary policy.
 - D) all of the above

Answer: D

Diff: 1

Topic: Calculating GDP: Economics in Practice

Skill: Conceptual

AACSB: Reflective Thinking

- 76) Related to the *Economics in Practice* on p. 113 [425]: _____ is responsible for producing and maintaining the National Income and Product Accounts (NIPAs).

- A) The Department of the Treasury
- B) The Federal Reserve Bank
- C) Congress
- D) The Department of Commerce

Answer: D

Diff: 1

Topic: Calculating GDP: Economics in Practice

Skill: Fact

2 True/False

- 1) Transfer payments are subtracted from national income to get to personal income.

Answer: FALSE

Diff: 1

Topic: Calculating GDP

Skill: Conceptual

AACSB: Reflective Thinking

- 2) If investment is larger than depreciation, the capital stock decreases.

Answer: FALSE

Diff: 1

Topic: Calculating GDP

Skill: Analytic

AACSB: Analytic Skills

- 3) Depreciation is included in GDP, but excluded from NNP.

Answer: TRUE

Diff: 2

Topic: Calculating GDP

Skill: Conceptual

AACSB: Reflective Thinking

- 4) Final sales plus changes in inventories equals GDP.

Answer: TRUE

Diff: 2

Topic: Calculating GDP

Skill: Conceptual

AACSB: Reflective Thinking

5) New houses count as consumer durables.

Answer: FALSE

Diff: 2

Topic: Calculating GDP

Skill: Conceptual

AACSB: Reflective Thinking

6) Dairy Queen opens a branch in Estonia. The sales of the restaurant enter the U.S. GDP and the Estonian GNP.

Answer: FALSE

Diff: 2

Topic: Calculating GDP

Skill: Conceptual

AACSB: Reflective Thinking

7) Consumers can spend their entire personal income.

Answer: FALSE

Diff: 2

Topic: Calculating GDP

Skill: Conceptual

AACSB: Reflective Thinking

8) The difference between GNP and GDP is depreciation.

Answer: FALSE

Diff: 2

Topic: Calculating GDP

Skill: Conceptual

AACSB: Reflective Thinking

9) Disposable personal income is personal income minus personal taxes.

Answer: TRUE

Diff: 2

Topic: Calculating GDP

Skill: Definition

6.3 Nominal versus Real GDP

1 Multiple Choice

1) Nominal GDP measures the value of all goods and services

A) in constant dollars.

B) in current dollars.

C) in fixed dollars.

D) without inflation.

Answer: B

Diff: 1

Topic: Nominal versus Real GDP

Skill: Definition

2) Gross domestic product measured in terms of the prices of a fixed, or base, year is

A) current GDP.

B) base GDP.

C) real GDP.

D) nominal GDP.

Answer: C

Diff: 1

Topic: Nominal versus Real GDP

Skill: Definition

- 3) Nominal GDP is gross domestic product measured
- A) in the prices of a base year.
 - B) in current dollars.
 - C) at a constant output level but at the base-year prices.
 - D) as the difference between the current year's GDP and last year's GDP.

Answer: B

Diff: 1

Topic: Nominal versus Real GDP

Skill: Definition

- 4) Real GDP is gross domestic product measured
- A) at a constant output level but at current prices.
 - B) in current dollars.
 - C) in the prices of a base year.
 - D) as the difference between the current year's GDP and last year's GDP.

Answer: C

Diff: 1

Topic: Nominal versus Real GDP

Skill: Definition

- 5) If real GDP in 2007 using 2006 prices is lower than nominal GDP of 2007, then
- A) prices in 2007 are lower than prices in 2006.
 - B) nominal GDP in 2007 equals nominal GDP in 2006.
 - C) prices in 2007 are higher than prices in 2006.
 - D) real GDP in 2007 is larger than real GDP in 2006.

Answer: C

Diff: 3

Topic: Nominal versus Real GDP

Skill: Analytic

AACSB: Analytic Skills

- 6) If real GDP in 2008 using 2007 prices is higher than nominal GDP of 2008, then
- A) prices in 2008 are lower than prices in the base year.
 - B) nominal GDP in 2008 equals nominal GDP in 2007.
 - C) prices in 2008 are higher than prices in the base year.
 - D) real GDP in 2008 is larger than real GDP in 2007.

Answer: A

Diff: 3

Topic: Nominal versus Real GDP

Skill: Analytic

AACSB: Analytic Skills

Refer to the information provided in Table 6.5 below to answer the questions that follow.

Table 6.5

	Production			Prices		
	Year 1	Year 2	Year 3	Year 1	Year 2	Year 3
Good X	60	80	100	\$1.00	\$1.00	\$1.40
Good Y	100	110	130	\$0.80	\$0.90	\$1.00

- 7) Refer to Table 6.5. Assume that this economy produces only two goods Good X and Good Y. The value for this economy's nominal GDP in year 1
- A) is \$140. B) is \$160. C) is \$180. D) is \$200.

Answer: A

Diff: 1

Topic: Nominal versus Real GDP

Skill: Analytic

AACSB: Analytic Skills

- 8) Refer to Table 6.5. Assume that this economy produces only two goods Good X and Good Y. The value for this economy's nominal GDP in year 3 is
- A) \$204. B) \$222. C) \$250. D) \$270.

Answer: D

Diff: 1

Topic: Nominal versus Real GDP

Skill: Analytic

AACSB: Analytic Skills

- 9) Refer to Table 6.5. Assume that this economy produces only two goods Good X and Good Y. The value for this economy's nominal GDP in year 2 is
- A) \$168. B) \$179. C) \$202. D) \$214.

Answer: B

Diff: 1

Topic: Nominal versus Real GDP

Skill: Analytic

AACSB: Analytic Skills

- 10) Refer to Table 6.5. Assume that this economy produces only two goods Good X and Good Y. If year 1 is the base year, the value for this economy's real GDP in year 2 is
- A) \$168. B) \$179. C) \$202. D) \$214.

Answer: A

Diff: 2

Topic: Nominal versus Real GDP

Skill: Analytic

AACSB: Analytic Skills

- 11) Refer to Table 6.5. Assume that this economy produces only two goods Good X and Good Y. If year 1 is the base year, the value for this economy's GDP deflator in year 1 is
- A) 1. B) 100. C) 110. D) 111.

Answer: B

Diff: 2

Topic: Nominal versus Real GDP

Skill: Analytic

AACSB: Analytic Skills

- 12) Refer to Table 6.5. Assume that this economy produces only two goods Good X and Good Y. If year 1 is the base year, the value for this economy's GDP deflator in year 2 is
- A) 93.9. B) 100. C) 106.5. D) 179.

Answer: C

Diff: 2

Topic: Nominal versus Real GDP

Skill: Analytic

AACSB: Analytic Skills

- 13) Refer to Table 6.5. Assume that this economy produces only two goods Good X and Good Y. If year 1 is the base year, the value for this economy's inflation rate between year 1 and year 2 is
- A) -6.1%. B) -5.5%. C) 6.5%. D) 79%.

Answer: C

Diff: 3

Topic: Nominal versus Real GDP

Skill: Analytic

AACSB: Analytic Skills

- 14) The GDP deflator is the
- A) difference between real GDP and nominal GDP multiplied by 100.
B) difference between nominal GDP and real GDP multiplied by 100.
C) ratio of nominal GDP to real GDP multiplied by 100.
D) ratio of real GDP to nominal GDP multiplied by 100.

Answer: C

Diff: 1

Topic: Nominal versus Real GDP

Skill: Definition

- 15) If nominal GDP is \$8 trillion and real GDP is \$6 trillion, the GDP deflator is
- A) 48. B) 75. C) 133.33. D) 480.

Answer: C

Diff: 1

Topic: Nominal versus Real GDP

Skill: Analytic

AACSB: Analytic Skills

- 16) If the GDP deflator is greater than 100, then
- A) nominal GDP is greater than real GDP.
B) nominal GDP is lower than real GDP.
C) nominal GDP equals real GDP.
D) prices decreased by more than half between the current and the base years.

Answer: A

Diff: 1

Topic: Nominal versus Real GDP

Skill: Analytic

AACSB: Analytic Skills

17) The GDP deflator in year 2 is 110 and the GDP deflator in year 3 is 118. The rate of inflation between years 2 and 3 is

- A) 4.55%. B) 7.27%. C) 8%. D) 18%.

Answer: B

Diff: 2

Topic: Nominal versus Real GDP

Skill: Analytic

AACSB: Analytic Skills

18) The GDP deflator in year 2 is 110 using year 1 as a base year. This means that, on average, the price of goods and services is

- A) 110% higher in year 2 than in year 1. B) 10% higher in year 2 than in year 1.
C) 5% higher in year 1 than in year 2. D) 110% higher in year 1 than in year 2.

Answer: B

Diff: 2

Topic: Nominal versus Real GDP

Skill: Analytic

AACSB: Analytic Skills

19) The GDP deflator in year 2 is 95 using year 1 as a base year. This means that, on average, the price of goods and services is

- A) 105% higher in year 2 than in year 1. B) 5% higher in year 2 than in year 1.
C) 5% higher in year 1 than in year 2. D) 105% higher in year 1 than in year 2.

Answer: C

Diff: 2

Topic: Nominal versus Real GDP

Skill: Analytic

AACSB: Analytic Skills

2 True/False

1) If in the same period output doubles and the price level remains the same, nominal GDP doubles.

Answer: TRUE

Diff: 2

Topic: Nominal versus Real GDP

Skill: Analytic

AACSB: Analytic Skills

2) A GDP deflator is real GDP divided by nominal GDP times 100.

Answer: FALSE

Diff: 2

Topic: Nominal versus Real GDP

Skill: Definition

3) If the GDP deflator next year is less than the GDP deflator this year, then the price level has fallen.

Answer: TRUE

Diff: 2

Topic: Nominal versus Real GDP

Skill: Analytic

AACSB: Analytic Skills

4) GDP measured in base year prices is real GDP.

Answer: TRUE

Diff: 2

Topic: Nominal versus Real GDP

Skill: Definition

5) If nominal GDP rises, then so must real GDP.

Answer: FALSE

Diff: 2

Topic: Nominal versus Real GDP

Skill: Conceptual

AACSB: Reflective Thinking

6) If real GDP rises, then so must nominal GDP.

Answer: FALSE

Diff: 2

Topic: Nominal versus Real GDP

Skill: Conceptual

AACSB: Reflective Thinking

7) If real GDP increased during a year, then output must have increased.

Answer: TRUE

Diff: 2

Topic: Nominal versus Real GDP

Skill: Conceptual

AACSB: Reflective Thinking

6.4 Limitations of the GDP Concept

1 Multiple Choice

1) GDP is not a perfect measure of social welfare and the society's economic well-being because

- A) it does not say anything about the distribution of income.
- B) GDP accounting rules do not adjust for production that causes negative externalities.
- C) it does not include all economic activities in the economy.
- D) all of the above

Answer: D

Diff: 2

Topic: Limitations of the GDP Concept

Skill: Conceptual

AACSB: Reflective Thinking

2) Legalizing all forms of illegal activities would

- A) reduce measured GDP.
- B) reduce the size of the underground economy and increase measured GDP.
- C) reduce both the underground economy and measured GDP.
- D) increase the size of the underground economy and reduce measured GDP.

Answer: B

Diff: 2

Topic: Limitations of the GDP Concept

Skill: Conceptual

AACSB: Reflective Thinking

- 3) Per capita gross national income (GNI) decreases when
- A) GNI and the population increase at the same rate.
 - B) GNI does not change and the population increases.
 - C) GNI and the population decrease at the same rate.
 - D) GNI increases and the population does not change.

Answer: B

Diff: 2

Topic: Limitations of the GDP Concept

Skill: Conceptual

AACSB: Reflective Thinking

- 4) Gross national income is
- A) GNP converted into dollars using an average exchange rate over several years adjusted for rates of inflation.
 - B) GDP converted into dollars using an average exchange rate over several years adjusted for rates of inflation.
 - C) GNP measured using an incomes approach.
 - D) GNP divided by population.

Answer: A

Diff: 2

Topic: Limitations of the GDP Concept

Skill: Conceptual

AACSB: Reflective Thinking

- 5) The base year of an index is
- A) the year chosen for the weights in a fixed weight procedure.
 - B) the year currently being calculated.
 - C) the last year of the index.
 - D) the first year of the index.

Answer: A

Diff: 2

Topic: Limitations of the GDP Concept

Skill: Fact

- 6) Fixed weight indexes
- A) account for responses to supply shifts.
 - B) account for response to demand shifts.
 - C) generally become less accurate the farther in time they are from the base year.
 - D) generally become less accurate the closer in time they are to the base year.

Answer: C

Diff: 2

Topic: Limitations of the GDP Concept

Skill: Conceptual

AACSB: Reflective Thinking

2 True/False

- 1) All economic activities in the economy are included in the GDP.

Answer: FALSE

Diff: 1

Topic: *Limitations of the GDP Concept*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 2) The costs of pollution are subtracted from the value of final sales before calculating GDP.

Answer: FALSE

Diff: 1

Topic: *Limitations of the GDP Concept*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 3) A weakness in the concept of GDP is that it ignores income distribution.

Answer: TRUE

Diff: 1

Topic: *Limitations of the GDP Concept*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 4) Production in the illegal or underground economy is not reflected in GDP.

Answer: TRUE

Diff: 1

Topic: *Limitations of the GDP Concept*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 5) Fixed weight indexes can not account for new goods.

Answer: TRUE

Diff: 1

Topic: *Limitations of the GDP Concept*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

Chapter 7 Unemployment, Inflation, and Long-Run Growth

7.1 Unemployment

1 Multiple Choice

- 1) 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

Diff: 2

Topic: Unemployment

Skill: Conceptual

AACSB: Reflective Thinking

- 2) 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 workers needed to produce one day's volume of output.

Answer: B

Diff: 2

Topic: Unemployment

Skill: Definition

- 3) 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) how much borrowed money is needed per worker.

Answer: A

Diff: 2

Topic: Unemployment

Skill: Definition

- 4) 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

Diff: 1

Topic: Unemployment

Skill: Definition

- 5) 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 around an upward trend.
 - D) showed the largest increase during the 1980s.

Answer: C

Diff: 1

Topic: Unemployment

Skill: Fact

- 6) All of the following explain the growth in output per worker hour during the 20th century EXCEPT
- 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

Diff: 2

Topic: Unemployment

Skill: Conceptual

AACSB: Reflective Thinking

- 7) 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

Diff: 1

Topic: Unemployment

Skill: Conceptual

AACSB: Reflective Thinking

- 8) 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

Diff: 1

Topic: Unemployment

Skill: Conceptual

AACSB: Reflective Thinking

- 9) Cheryl graduated from college a month ago and is now without work. She accepted a job that will start next month. Today, Cheryl is
- A) not in the labor force.
 - B) in the labor force.
 - C) employed.
 - D) a discouraged worker.

Answer: B

Diff: 2

Topic: Unemployment

Skill: Conceptual

AACSB: Reflective Thinking

- 10) 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

Diff: 1

Topic: Unemployment

Skill: Definition

- 11) Jake retired from the police force. He started working an hour or two a day at a paid job in city's courthouse. Jake is
- A) employed.
 - B) in the labor force.
 - C) unemployed.
 - D) not in the labor force.

Answer: A

Diff: 2

Topic: Unemployment

Skill: Conceptual

AACSB: Reflective Thinking

- 12) Diane 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

Diff: 2

Topic: Unemployment

Skill: Conceptual

AACSB: Reflective Thinking

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

Table 7.1

Employed	14,000 people
Unemployed	3,000 people
Not in the Labor Force	4,000 people

- 13) Refer to Table 7.1. The labor force equals
- A) 14,000 people.
 - B) 17,000 people.
 - C) 18,000 people.
 - D) 21,000 people.

Answer: B

Diff: 2

Topic: Unemployment

Skill: Analytic

AACSB: Analytic Skills

- 14) Refer to Table 7.1. The unemployment rate is
- A) 17.6%.
 - B) 16.7%.
 - C) 14.3%.
 - D) 25.0%.

Answer: A

Diff: 2

Topic: Unemployment

Skill: Analytic

AACSB: Analytic Skills

- 15) Refer to Table 7.1. The labor-force participation rate is
A) 75.0%. B) 66.7%. C) 77.8%. D) 80.9%.

Answer: D

Diff: 2

Topic: Unemployment

Skill: Analytic

AACSB: Analytic Skills

- 16) Refer to Table 7.1. The employment rate is
A) 85.7%. B) 83.3%. C) 82.4%. D) 75.0%.

Answer: C

Diff: 2

Topic: Unemployment

Skill: Analytic

AACSB: Analytic Skills

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

Table 7.2

Labor force participation rate	75%
Total population 16 years of age and older	200 million
Unemployment rate	10%

- 17) Refer to Table 7.2. The labor force
A) equals 150 million.
B) equals 130 million.
C) equals 170 million
D) cannot be determined from this information.

Answer: A

Diff: 3

Topic: Unemployment

Skill: Analytic

AACSB: Analytic Skills

- 18) Refer to Table 7.2. The total number of people unemployed is
A) 20 million. B) 13 million. C) 17 million. D) 15 million.

Answer: D

Diff: 3

Topic: Unemployment

Skill: Analytic

AACSB: Analytic Skills

- 19) Refer to Table 7.2. The total number of people employed is
A) 153 million. B) 117 million. C) 135 million. D) 180 million.

Answer: C

Diff: 3

Topic: Unemployment

Skill: Analytic

AACSB: Analytic Skills

- 20) The unemployment rate is
- A) unemployed/population \times 100.
 - B) (employed – unemployed)/labor force \times 100.
 - C) (labor force – employed)/labor force \times 100.
 - D) (employed – labor force)/employed \times 100.

Answer: C

Diff: 3

Topic: Unemployment

Skill: Definition

- 21) The number of people classified as employed is 260,000 and the number of people classified as unemployed is 30,000. The size of the labor force
- A) equals 290,000.
 - B) equals 230,000.
 - C) equals 260,000.
 - D) equals 320,000.

Answer: A

Diff: 1

Topic: Unemployment

Skill: Analytic

AACSB: Analytic Skills

- 22) The number of people classified as employed is 350,000 and the number of people in the labor force is 500,000. The total number of people classified as unemployed is
- A) 350,000.
 - B) 150,000.
 - C) 425,000.
 - D) 500,000.

Answer: B

Diff: 1

Topic: Unemployment

Skill: Analytic

AACSB: Analytic Skills

- 23) If the number of people classified as unemployed is 20,000 and the number of people classified as employed is 400,000, what is the unemployment rate?
- A) 2.0%
 - B) 4.8%
 - C) 5.0%
 - D) 9.2%

Answer: B

Diff: 2

Topic: Unemployment

Skill: Analytic

AACSB: Analytic Skills

- 24) 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

Diff: 2

Topic: Unemployment

Skill: Analytic

AACSB: Analytic Skills

25) 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

Diff: 2

Topic: Unemployment

Skill: Analytic

AACSB: Analytic Skills

26) If the unemployment rate is 6.2% and the number of people employed is 200,000, the total number of people unemployed is approximately

- A) 12,400 people
B) 10,970 people.
C) 13,220 people.
D) cannot be determined from this information

Answer: C

Diff: 3

Topic: Unemployment

Skill: Analytic

AACSB: Analytic Skills

27) If the unemployment rate is 6.2% and the number of people employed is 200,000, the labor force is approximately

- A) 212,400 people.
B) 210,970 people
C) 213,220 people.
D) cannot be determined from this information

Answer: C

Diff: 3

Topic: Unemployment

Skill: Analytic

AACSB: Analytic Skills

28) If the labor force is 320,000 and the total population 16 years of age or older is 400,000, the labor-force participation rate is

- A) 72%. B) 76%. C) 80%. D) 88%.

Answer: C

Diff: 2

Topic: Unemployment

Skill: Analytic

AACSB: Analytic Skills

29) If the labor-force participation rate is 82% and the total population 16 years of age or older is 1 million people, the labor force is

- A) 910,000 people. B) 820,000 people.
C) 740,000 people. D) 180,000 people.

Answer: B

Diff: 2

Topic: Unemployment

Skill: Analytic

AACSB: Analytic Skills

- 30) 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

Diff: 3

Topic: Unemployment

Skill: Analytic

AACSB: Analytic Skills

- 31) If the number of unemployed equals 240,000 and the number of employed equals 300,000, the labor-force participation rate
- A) is 80%.
 - B) is 24%.
 - C) is 55.6%.
 - D) cannot be determined from this information.

Answer: D

Diff: 2

Topic: Unemployment

Skill: Analytic

AACSB: Analytic Skills

- 32) 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

Diff: 1

Topic: Unemployment

Skill: Fact

- 33) 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

Diff: 1

Topic: Unemployment

Skill: Conceptual

AACSB: Reflective Thinking

34) 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

Diff: 2

Topic: Unemployment

Skill: Conceptual

AACSB: Reflective Thinking

35) Discouraged workers are

A) considered cyclically unemployed.

B) considered structurally unemployed.

C) considered frictionally unemployed.

D) not considered as part of the labor force.

Answer: D

Diff: 2

Topic: Unemployment

Skill: Conceptual

AACSB: Reflective Thinking

36) 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

Diff: 3

Topic: Unemployment

Skill: Analytic

AACSB: Analytic Skills

37) 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

Diff: 2

Topic: Unemployment

Skill: Conceptual

AACSB: Reflective Thinking

- 38) 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

Diff: 2

Topic: Unemployment

Skill: Conceptual

AACSB: Reflective Thinking

- 39) In normal times the number of discouraged workers is approximately _____ of the labor force.
- A) .5%
 - B) 4%
 - C) 3%
 - D) 1%

Answer: D

Diff: 1

Topic: Unemployment

Skill: Fact

- 40) Which of the following groups has the highest unemployment rate among teenagers?
- A) white males
 - B) African American males
 - C) white females
 - D) African American females

Answer: B

Diff: 1

Topic: Unemployment

Skill: Fact

- 41) 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) The median duration of unemployment is usually greater than the average duration.

Answer: A

Diff: 2

Topic: Unemployment

Skill: Analytic

AACSB: Analytic Skills

- 42) The labor force participation rate is the
- A) total number of people who are participating in the labor force.
 - B) ratio of the number of employed people to the number of unemployed people.
 - C) ratio of the labor force to the total population 16 years old or older.
 - D) the number of people in the labor force minus the number of people who are unemployed.

Answer: C

Diff: 1

Topic: Unemployment

Skill: Fact

43) 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

Diff: 2

Topic: Unemployment

Skill: Conceptual

AACSB: Reflective Thinking

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

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

Answer: B

Diff: 1

Topic: Unemployment

Skill: Fact

45) 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

Diff: 1

Topic: Unemployment

Skill: Conceptual

AACSB: Reflective Thinking

46) 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

Diff: 2

Topic: Unemployment

Skill: Conceptual

AACSB: Reflective Thinking

47) 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

Diff: 2

Topic: Unemployment

Skill: Conceptual

AACSB: Reflective Thinking

- 48) 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

Diff: 2

Topic: Unemployment

Skill: Conceptual

AACSB: Reflective Thinking

- 49) 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

Diff: 1

Topic: Unemployment

Skill: Conceptual

AACSB: Reflective Thinking

- 50) 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

Diff: 2

Topic: Unemployment

Skill: Definition

- 51) 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

Diff: 2

Topic: Unemployment

Skill: Conceptual

AACSB: Reflective Thinking

- 52) A textile firm closes a plant in Massachusetts and transfers production to a plant in South Carolina, where the firm can take advantage of cheaper labor. 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

Diff: 2

Topic: Unemployment

Skill: Conceptual

AACSB: Reflective Thinking

- 53) 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

Diff: 1

Topic: Unemployment

Skill: Conceptual

AACSB: Reflective Thinking

- 54) 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

Diff: 1

Topic: Unemployment

Skill: Definition

- 55) 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

Diff: 1

Topic: Unemployment

Skill: Definition

- 56) 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

Diff: 1

Topic: Unemployment

Skill: Fact

- 57) 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

Diff: 1

Topic: Unemployment

Skill: Conceptual

AACSB: Reflective Thinking

- 58) 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

Diff: 2

Topic: Unemployment

Skill: Conceptual

AACSB: Reflective Thinking

- 59) 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

Diff: 1

Topic: Unemployment

Skill: Definition

- 60) 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

Diff: 1

Topic: Unemployment

Skill: Definition

- 61) 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

Diff: 1

Topic: Unemployment

Skill: Conceptual

AACSB: Reflective Thinking

- 62) 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

Diff: 1

Topic: Unemployment

Skill: Conceptual

AACSB: Reflective Thinking

- 63) 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 rate of unemployment.
 - D) caused structural unemployment to decrease.

Answer: C

Diff: 2

Topic: Unemployment

Skill: Conceptual

AACSB: Reflective Thinking

- 64) 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

Diff: 1

Topic: Unemployment

Skill: Fact

- 65) 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

Diff: 3

Topic: Unemployment

Skill: Conceptual

AACSB: Reflective Thinking

- 66) Related to the *Economics in Practice* on p. 127 [439]: In the U.S. from 1955 to 1996, the labor force participation rate _____ for men and _____ for women.
- A) increased; increased
 - B) increased; decreased
 - C) decreased; increased
 - D) decreased; decreased

Answer: C

Diff: 1

Topic: Unemployment: Economics in Practice

Skill: Fact

- 67) Related to the *Economics in Practice* on p. 127 [439]: If more women enter the labor force and the number of available jobs remains unchanged, the unemployment rate will, *ceteris paribus*,
- A) increase.
 - B) decrease.
 - C) remain unchanged.
 - D) equal the natural rate of unemployment.

Answer: A

Diff: 2

Topic: Unemployment: Economics in Practice

Skill: Conceptual

AACSB: Reflective Thinking

2 True/False

- 1) When more people who are not working start looking for jobs, the labor-force participation rate increases.

Answer: TRUE

Diff: 2

Topic: Unemployment

Skill: Conceptual

AACSB: Reflective Thinking

- 2) Labor productivity is total output divided by the total number of worker hours.

Answer: TRUE

Diff: 1

Topic: Unemployment

Skill: Definition

- 3) An increase in search costs will decrease structural unemployment.

Answer: FALSE

Diff: 2

Topic: Unemployment

Skill: Conceptual

AACSB: Reflective Thinking

- 4) The natural rate of unemployment is the unemployment rate during a period of full employment.

Answer: TRUE

Diff: 1

Topic: Unemployment

Skill: Definition

5) Anyone 16 years of age or older who is not classified as employed is classified as unemployed.

Answer: FALSE

Diff: 2

Topic: Unemployment

Skill: Conceptual

AACSB: Reflective Thinking

6) If discouraged workers were counted as unemployed, the measured unemployment rate would increase.

Answer: TRUE

Diff: 2

Topic: Unemployment

Skill: Conceptual

AACSB: Reflective Thinking

7) An unemployment rate of 10% means that the average worker has been unemployed for 10% of the year.

Answer: FALSE

Diff: 1

Topic: Unemployment

Skill: Conceptual

AACSB: Reflective Thinking

8) If labor markets were perfectly efficient, the unemployment rate would fall to zero.

Answer: FALSE

Diff: 2

Topic: Unemployment

Skill: Conceptual

AACSB: Reflective Thinking

9) The natural rate of unemployment in the economy is determined by the Congress and the president of the country.

Answer: FALSE

Diff: 1

Topic: Unemployment

Skill: Fact

7.2 Inflation

1 Multiple Choice

1) 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

Diff: 2

Topic: Inflation

Skill: Analytic

AACSB: Analytic Skills

- 2) 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

Diff: 3

Topic: Inflation

Skill: Analytic

AACSB: Analytic Skills

- 3) 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

Diff: 2

Topic: Inflation

Skill: Analytic

AACSB: Analytic Skills

- 4) 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

Diff: 2

Topic: Inflation

Skill: Conceptual

AACSB: Reflective Thinking

- 5) 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

Diff: 2

Topic: Inflation

Skill: Conceptual

- 6) 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

Diff: 1

Topic: Inflation

Skill: Definition

- 7) An increase in the overall price level is
 A) inflation. B) deflation. C) a price index. D) a recession.

Answer: A
 Diff: 1
 Topic: Inflation
 Skill: Definition

- 8) 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
 Diff: 1
 Topic: Inflation
 Skill: Definition

- 9) An increase in the overall price level that continues over a significant period of time is
 A) high inflation. B) sustained recovery.
 C) sustained inflation. D) super inflation.

Answer: C
 Diff: 1
 Topic: Inflation
 Skill: Definition

- 10) 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
 Diff: 1
 Topic: Inflation
 Skill: Definition

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

Table 7.3

		Price per Unit in			
	Units Purchased	2005	2006	2007	2008
Blueberries	8	\$2.00	\$2.00	\$2.10	\$2.40
Pineapples	5	\$2.00	\$2.50	\$2.50	\$3.00
Cheese	3	\$2.50	\$3.00	\$3.50	\$4.00

- 11) Refer to Table 7.3. Suppose 2006 is the base year. The price index in 2006 is
 A) 1,000. B) 100. C) 1. D) 10.

Answer: B
 Diff: 2
 Topic: Inflation
 Skill: Analytic
 AACSB: Analytic Skills

- 12) Refer to Table 7.3. If 2006 is the base year, the price index in 2005 is
 A) 96.0. B) 104.0. C) 111.9. D) 89.3.
- Answer: D
 Diff: 2
 Topic: Inflation
 Skill: Analytic
 AACSB: Analytic Skills
- 13) Refer to Table 7.3. If 2006 is the base year, the price index in 2007 is
 A) 93.9. B) 106.1. C) 94.2. D) 105.8.
- Answer: B
 Diff: 2
 Topic: Inflation
 Skill: Analytic
 AACSB: Analytic Skills
- 14) Refer to Table 7.3 If 2006 is the base year, the price index in 2008 is
 A) 81.2. B) 118.8. C) 123.2. D) 86.8.
- Answer: C
 Diff: 2
 Topic: Inflation
 Skill: Analytic
 AACSB: Analytic Skills
- 15) Refer to Table 7.3. If 2006 is the base year, the inflation rate between 2006 and 2007 is
 A) 3.9%. B) 10.2%. C) 7.4%. D) 6.1%.
- Answer: D
 Diff: 3
 Topic: Inflation
 Skill: Analytic
 AACSB: Analytic Skills
- 16) Refer to Table 7.3. If 2006 is the base year, the inflation rate between 2006 and 2007 is _____
 %, and the inflation rate between 2007 and 2008 is _____ %.
- A) 7.4; 13.9 B) 6.1; 16.1 C) 3.9; 17.1 D) 10.2; 10.4
- Answer: B
 Diff: 3
 Topic: Inflation
 Skill: Analytic
 AACSB: Analytic Skills
- 17) Refer to Table 7.3. The lowest inflation rate is between the years
 A) 2007 and 2008.
 B) 2006 and 2007.
 C) 2005 and 2006.
 D) cannot be determined from the given information
- Answer: B
 Diff: 3
 Topic: Inflation
 Skill: Analytic
 AACSB: Analytic Skills

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

	Units Purchased	Price per Unit in		
		2006	2007	2008
Good A	5	\$1.00	\$1.50	\$1.50
Good B	10	\$2.00	\$2.50	\$3.00
Good C	4	\$4.00	\$4.50	\$5.00

- 18) Refer to Table 7.4. The bundle price for the goods in period 2006 is
 A) \$100. B) \$41. C) \$50.50. D) \$57.50.

Answer: B

Diff: 2

Topic: Inflation

Skill: Analytic

AACSB: Analytic Skills

- 19) Refer to Table 7.4. If 2006 is the base period, the price index in 2006 is
 A) 1000. B) 100. C) 10. D) 1.

Answer: B

Diff: 2

Topic: Inflation

Skill: Analytic

AACSB: Analytic Skills

- 20) Refer to Table 7.4. If 2006 is the base year, the price index in 2007 is
 A) 81.9. B) 123.2. C) 119.1. D) 76.8.

Answer: B

Diff: 2

Topic: Inflation

Skill: Analytic

AACSB: Analytic Skills

- 21) Refer to Table 7.4. If 2006 is the base year, the price index in 2008 is
 A) 71.3. B) 140.2. C) 59.8. D) 128.7.

Answer: B

Diff: 2

Topic: Inflation

Skill: Analytic

AACSB: Analytic Skills

- 22) Refer to Table 7.4. If 2006 is the base year, the inflation rate between 2006 and 2007 is
 A) 12.4%. B) 19.1%. C) 23.2%. D) 17.6%.

Answer: C

Diff: 3

Topic: Inflation

Skill: Analytic

AACSB: Analytic Skills

- 23) Refer to Table 7.4. If 2006 is the base year, the inflation rate between 2006 and 2008 is
A) 28.7%. B) 17.4%. C) 25.1%. D) 40.2%.

Answer: D

Diff: 3

Topic: Inflation

Skill: Analytic

AACSB: Analytic Skills

- 24) Refer to Table 7.4. If 2007 is the base year, the inflation rate between 2007 and 2008 is
A) 12.2%. B) 7.0%. C) 13.9%. D) 9.4%.

Answer: C

Diff: 3

Topic: Inflation

Skill: Analytic

AACSB: Analytic Skills

- 25) If period 1 is the base year, the bundle price of goods in period 1 is \$300, and the bundle price of goods in period 2 is \$320, the period 2 price index is
A) 93.8. B) 106.2. C) 93.3. D) 106.7.

Answer: D

Diff: 2

Topic: Inflation

Skill: Analytic

AACSB: Analytic Skills

- 26) If 2007 is the base year, the bundle price of goods in 2007 is \$500, and the bundle price of goods in 2008 is \$700, the 2008 price index is
A) 128.6. B) 140.0. C) 71.4. D) 60.0.

Answer: B

Diff: 2

Topic: Inflation

Skill: Analytic

AACSB: Analytic Skills

- 27) If the price index in period 2 is 109 and the price index in period 3 is 125, the rate of inflation between period 2 and period 3 is
A) 16%. B) 9%. C) 14.7%. D) 8.7%.

Answer: C

Diff: 2

Topic: Inflation

Skill: Analytic

AACSB: Analytic Skills

- 28) If 2007 is the base year and the inflation rate between 2007 and 2008 is 6.4%, the price index in 2008 is
- A) 16.4.
 - B) 106.4.
 - C) 64.
 - D) cannot be determined from this information because the index in the base year is not given

Answer: B

Diff: 3

Topic: Inflation

Skill: Analytic

AACSB: Analytic Skills

- 29) If 2007 is the base year and the inflation rate between 2007 and 2008 is -4.5, the price index in 2008 is
- A) 104.5.
 - B) -145.
 - C) 95.5.
 - D) cannot be determined from this information because the base year is not known

Answer: C

Diff: 3

Topic: Inflation

Skill: Analytic

AACSB: Analytic Skills

- 30) If the price index in 2007 is 115 and the price index in 2008 is 102, the rate of inflation between 2007 and 2008 is
- A) 12.7%.
 - B) -11.3%.
 - C) -13.0%.
 - D) 13.0%.

Answer: B

Diff: 2

Topic: Inflation

Skill: Analytic

AACSB: Analytic Skills

- 31) 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

Diff: 1

Topic: Inflation

Skill: Fact

- 32) If the CPI in 2007 was 114.7 and the CPI in 2008 was 124.5, then the rate of inflation between 2007 and 2008 was
- A) 9.8%.
 - B) 8.5%.
 - C) 7.9%.
 - D) 14.7%.

Answer: B

Diff: 2

Topic: Inflation

Skill: Analytic

AACSB: Analytic Skills

33) If the CPI in 2007 was 104 and the CPI in 2008 was 106, then the rate of inflation between 2007 and 2008 was

- A) 2.0%. B) 1.92%. C) 1.89%. D) 2.2%.

Answer: B

Diff: 2

Topic: Inflation

Skill: Analytic

AACSB: Analytic Skills

34) If the CPI in period 1 is 180 and the CPI in period 2 is 240, then the rate of inflation between period 1 and period 2 is

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

Answer: C

Diff: 2

Topic: Inflation

Skill: Analytic

AACSB: Analytic Skills

35) The CPI in period 1 is 300 and the CPI in period 2 is 150. The rate of inflation between period 1 and period 2 is

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

Answer: A

Diff: 2

Topic: Inflation

Skill: Analytic

AACSB: Analytic Skills

36) 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

Diff: 3

Topic: Inflation

Skill: Fact

37) 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

Diff: 3

Topic: Inflation

Skill: Fact

- 38) 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

Diff: 2

Topic: Inflation

Skill: Fact

- 39) 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

Diff: 1

Topic: Inflation

Skill: Fact

- 40) 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

Diff: 2

Topic: Inflation

Skill: Analytic

AACSB: Analytic Skills

- 41) 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

Diff: 2

Topic: Inflation

Skill: Definition

- 42) 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

Diff: 2

Topic: Inflation

Skill: Analytic

AACSB: Analytic Skills

- 43) If Mr. Garrison is paid an interest rate of 4% on his savings, but the inflation rate is 7%, the real interest rate Mr. Garrison earns is
- A) 4%. B) -3%. C) -7%. D) 28%.

Answer: B

Diff: 1

Topic: Inflation

Skill: Analytic

AACSB: Analytic Skills

- 44) You want to make a 10% 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) 6%. B) -6%. C) 10%. D) 14%.

Answer: D

Diff: 2

Topic: Inflation

Skill: Analytic

AACSB: Analytic Skills

- 45) Lola wants to make an 6% real return on a loan that she is planning to make, and the expected inflation rate during the period of the loan is 5%. She should charge an interest rate of
- A) 6%. B) 16%. C) 11%. D) 1%.

Answer: C

Diff: 2

Topic: Inflation

Skill: Analytic

AACSB: Analytic Skills

- 46) 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

Diff: 2

Topic: Inflation

Skill: Analytic

AACSB: Analytic Skills

- 47) Eliza wants to borrow \$100 from Sandy. Sandy wants to make 4% real return on his money, so they both agree on a 4% interest rate paid next year. Eliza and Sandy did not anticipate any inflation, yet the actual inflation turned out to be -5% next year. In this case,
- A) Eliza will pay an 9% real interest rate.
B) Sandy is better off.
C) Eliza will pay a 4% nominal interest rate.
D) all of the above

Answer: D

Diff: 2

Topic: Inflation

Skill: Analytic

AACSB: Analytic Skills

- 48) Dean borrows \$400 from Tim. Tim wants to make a 10% real return on his money, so they both agree on a 10% interest rate paid next year. Dean and Tim did not anticipate any inflation, yet the actual inflation turned out to be 4% next year. In this case,
- A) Tim is better off.
 - B) Dean will pay \$56 a year from now on.
 - C) Dean is better off.
 - D) Tim will receive more than 10% of real rate of return a year from now.

Answer: C

Diff: 2

Topic: Inflation

Skill: Analytic

AACSB: Analytic Skills

- 49) 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

Diff: 2

Topic: Inflation

Skill: Conceptual

AACSB: Reflective Thinking

- 50) 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

Diff: 2

Topic: Inflation

Skill: Conceptual

AACSB: Reflective Thinking

- 51) 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

Diff: 3

Topic: Inflation

Skill: Analytic

AACSB: Analytic Skills

- 52) 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

Diff: 3

Topic: Inflation

Skill: Conceptual

AACSB: Reflective Thinking

- 53) 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

Diff: 2

Topic: Inflation

Skill: Conceptual

AACSB: Reflective Thinking

2 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

Diff: 3

Topic: Inflation

Skill: Analytic

AACSB: Analytic Skills

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

Answer: FALSE

Diff: 2

Topic: Inflation

Skill: Fact

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

Answer: TRUE

Diff: 3

Topic: Inflation

Skill: Conceptual

AACSB: Reflective Thinking

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

Answer: FALSE

Diff: 2

Topic: Inflation

Skill: Conceptual

AACSB: Reflective Thinking

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

Answer: TRUE

Diff: 2

Topic: Inflation

Skill: Definition

7.3 Long-Run Growth

1 Multiple Choice

1) 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

Diff: 1

Topic: Long-Run Growth

Skill: Conceptual

AACSB: Reflective Thinking

2) 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

Diff: 1

Topic: Long-Run Growth

Skill: Conceptual

AACSB: Reflective Thinking

3) 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

Diff: 1

Topic: Long-Run Growth

Skill: Conceptual

AACSB: Reflective Thinking

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

A) growing per capita output

B) high inflation

C) cyclical unemployment

D) sustained deflation

Answer: A

Diff: 1

Topic: Long-Run Growth

Skill: Conceptual

AACSB: Reflective Thinking

- 5) Output in an economy can be increased by
- A) adding more workers.
 - B) limiting the work week.
 - C) using fewer machines.
 - D) decreasing inflation.

Answer: A

Diff: 1

Topic: Long-Run Growth

Skill: Conceptual

AACSB: Reflective Thinking

- 6) 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

Diff: 2

Topic: Long-Run Growth

Skill: Definition

- 7) 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

Diff: 1

Topic: Long-Run Growth

Skill: Fact

- 8) A prolonged and deep recession is a
- A) hyperinflation.
 - B) slowdown.
 - C) contraction.
 - D) depression.

Answer: D

Diff: 1

Topic: Long-Run Growth

Skill: Definition

- 9) Which of the following is *not* 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) 10,000 U.S. dollars

Answer: D

Diff: 2

Topic: Long-Run Growth

Skill: Conceptual

AACSB: Reflective Thinking

2 True/False

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

Answer: FALSE

Diff: 2

Topic: Long-Run Growth

Skill: Conceptual

AACSB: Reflective Thinking

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

Answer: TRUE

Diff: 2

Topic: Long-Run Growth

Skill: Conceptual

AACSB: Reflective Thinking

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

Answer: FALSE

Diff: 2

Topic: Long-Run Growth

Skill: Conceptual

AACSB: Reflective Thinking

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

Answer: TRUE

Diff: 2

Topic: Long-Run Growth

Skill: Conceptual

AACSB: Reflective Thinking

- 5) Productivity is output per worker hour.

Answer: TRUE

Diff: 2

Topic: Long-Run Growth

Skill: Definition

Chapter 8 Aggregate Expenditure and Equilibrium Output

8.1 The Keynesian Theory of Consumption

1 Multiple Choice

- 1) The MPC is
- A) the change in consumption divided by the change in income.
 - B) consumption divided by income.
 - C) the change in consumption divided by the change in saving.
 - D) the change in saving divided by the change in income.

Answer: A

Diff: 1

Topic: The Keynesian Theory of Consumption

Skill: Definition

- 2) The MPS is
- A) the change in saving divided by the change in income.
 - B) $1 + \text{MPC}$
 - C) income divided by saving.
 - D) total saving divided by total income.

Answer: A

Diff: 1

Topic: The Keynesian Theory of Consumption

Skill: Definition

- 3) Saving equals
- A) $Y - C$.
 - B) $Y - \text{planned } I$.
 - C) $Y - \text{actual } I$.
 - D) Inventory changes.

Answer: A

Diff: 1

Topic: The Keynesian Theory of Consumption

Skill: Definition

- 4) If the MPS is .60, MPC
- A) is 1.60.
 - B) is .30.
 - C) is .40.
 - D) cannot be determined by the given information.

Answer: C

Diff: 1

Topic: The Keynesian Theory of Consumption

Skill: Conceptual

AACSB: Reflective Thinking

- 5) If you earn additional \$500 in disposable income one week for painting your neighbors house,
A) the total of your consumption and saving will increase by more than \$500.
B) the total of your consumption and saving will increase by \$500.
C) the total of your consumption and saving will increase by less than \$500.
D) your consumption will increase by more than \$500, even if your *MPS* is 0.1.

Answer: B

Diff: 2

Topic: *The Keynesian Theory of Consumption*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 6) If Logan received a \$2,500 bonus and his *MPS* is 0.20, his consumption rises by \$_____ and his saving rises by \$_____.
A) 500; 100 B) 2,500; 200 C) 2,000; 500 D) 2,500; 20

Answer: C

Diff: 2

Topic: *The Keynesian Theory of Consumption*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 7) Saving is a _____ variable and savings is a _____ variable.
A) flow; flow B) stock; stock C) flow; stock D) stock; flow

Answer: C

Diff: 1

Topic: *The Keynesian Theory of Consumption*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 8) Uncertainty about the future is likely to
A) increase current spending.
B) have no impact on current spending.
C) decrease current spending.
D) either increase or decrease current spending.

Answer: C

Diff: 2

Topic: *The Keynesian Theory of Consumption*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 9) Higher interest rates are likely to
A) have no effect on consumer spending or saving.
B) decrease consumer spending and increase consumer saving.
C) decrease both consumer spending and consumer saving.
D) increase consumer spending and decrease consumer saving.

Answer: B

Diff: 2

Topic: *The Keynesian Theory of Consumption*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 10) Consumption is
- A) positively related to household income and wealth and households' expectations about the future, but negatively related to interest rates.
 - B) negatively related to household income and wealth, interest rates, and households' expectations about the future.
 - C) determined only by income.
 - D) positively related to household income and wealth, interest rates, and households' expectations about the future.

Answer: A

Diff: 3

Topic: *The Keynesian Theory of Consumption*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 11) In a closed economy with no government, aggregate expenditure is
- A) consumption plus investment.
 - B) saving plus investment.
 - C) consumption plus the MPC.
 - D) MPC + MPS.

Answer: A

Diff: 3

Topic: *The Keynesian Theory of Consumption*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 12) If Wanda's income is reduced to zero after she loses her job, her consumption will be _____ and her saving will be _____.
- A) less than zero; less than zero
 - B) greater than zero; greater than zero
 - C) less than zero; greater than zero
 - D) greater than zero; less than zero

Answer: D

Diff: 2

Topic: *The Keynesian Theory of Consumption*

Skill: *Analytic*

AACSB: *Analytic Skills*

Refer to the information provided in Figure 8.1 below to answer the questions that follow.

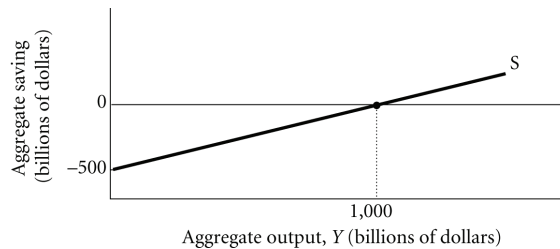


Figure 8.1

- 13) Refer to Figure 8.1. The *MPS* for this household is _____ and the *MPC* is _____.
- A) 0.4; 0.6
 - B) 0.5; 0.5
 - C) 0.2; 0.8
 - D) 0.3; 0.7

Answer: B

Diff: 2

Topic: *The Keynesian Theory of Consumption*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 14) Refer to Figure 8.1. The equation for this household's saving function is
- A) $S = -200 + .8Y$.
C) $S = -500 + .5Y$.
- B) $S = -300 + 0.25Y$.
D) $S = -1,000 + 0.8Y$.

Answer: C

Diff: 3

Topic: The Keynesian Theory of Consumption

Skill: Analytic

AACSB: Analytic Skills

- 15) Refer to Figure 8.1. At income level \$1,500, this household's saving is _____ than (to) zero and this household's consumption is _____ zero.
- A) less than; greater than
C) greater than; less than
- B) equal to ; equal to
D) greater than; greater than

Answer: D

Diff: 2

Topic: The Keynesian Theory of Consumption

Skill: Analytic

AACSB: Analytic Skills

- 16) Refer to Figure 8.1. This household's consumption function is
- A) $C = 200 + 0.2Y$.
C) $C = 500 + 0.5Y$.
- B) $C = 300 + 0.75Y$.
D) $C = 1,000 + 0.2Y$.

Answer: C

Diff: 3

Topic: The Keynesian Theory of Consumption

Skill: Analytic

AACSB: Analytic Skills

- 17) Refer to Figure 8.1. This household saves -\$300 at an income level of
- A) \$400.
B) \$300
C) \$250.
D) \$125.

Answer: A

Diff: 3

Topic: The Keynesian Theory of Consumption

Skill: Analytic

AACSB: Analytic Skills

- 18) Refer to Figure 8.1. This household consumes \$2,000 at an income level of
- A) \$3,000.
B) \$2,000.
C) \$2,275.
D) \$1,840.

Answer: A

Diff: 3

Topic: The Keynesian Theory of Consumption

Skill: Analytic

AACSB: Analytic Skills

- 19) Refer to Figure 8.1. An increase in the amount of consumption this household makes when this household's income is zero
- A) makes the consumption function steeper.
 - B) makes the saving function flatter.
 - C) shifts the consumption function downward.
 - D) shifts the saving function downward.

Answer: D

Diff: 3

Topic: The Keynesian Theory of Consumption

Skill: Analytic

AACSB: Analytic Skills

- 20) Refer to Figure 8.1. An increase in the MPC
- A) makes the consumption function flatter.
 - B) makes the saving function flatter.
 - C) shifts the consumption function upward.
 - D) shifts the saving function downward.

Answer: B

Diff: 2

Topic: The Keynesian Theory of Consumption

Skill: Analytic

AACSB: Analytic Skills

Refer to the information provided in Figure 8.2 below to answer the questions that follow.

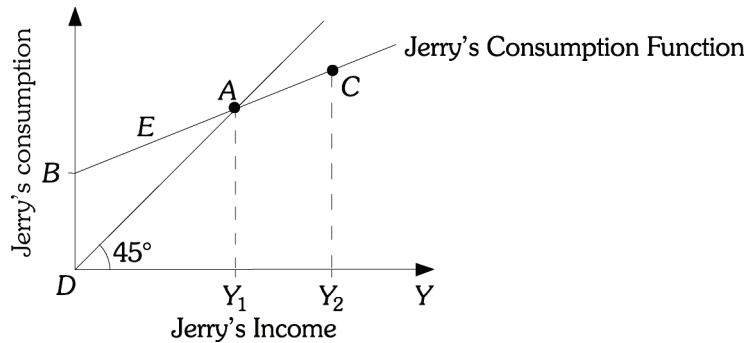


Figure 8.2

- 21) Refer to Figure 8.2. The line segment BD represents Jerry's
- A) consumption when income equals Y_1 .
 - B) saving when income equals zero.
 - C) saving when income is Y_1 .
 - D) consumption when income equals zero.

Answer: D

Diff: 2

Topic: The Keynesian Theory of Consumption

Skill: Analytic

AACSB: Analytic Skills

22) Refer to Figure 8.2. Jerry's consumption equals his income at Point

- A) B. B) A. C) D. D) C.

Answer: B

Diff: 2

Topic: *The Keynesian Theory of Consumption*

Skill: *Analytic*

AACSB: *Analytic Skills*

23) Refer to Figure 8.2. Jerry's saving equals zero at income level

- A) zero. B) Y_1 . C) Y_2 . D) $Y_2 - Y_1$.

Answer: B

Diff: 2

Topic: *The Keynesian Theory of Consumption*

Skill: *Analytic*

AACSB: *Analytic Skills*

24) Refer to Figure 8.2. Along the line segment AC, Jerry's

- A) consumption equals his income.
B) consumption is greater than his income.
C) saving is zero.
D) saving is positive.

Answer: D

Diff: 2

Topic: *The Keynesian Theory of Consumption*

Skill: *Analytic*

AACSB: *Analytic Skills*

25) Refer to Figure 8.2. Along the segment AB, Jerry's

- A) consumption is less than his income. B) saving is positive.
C) consumption equals his income. D) saving is negative.

Answer: D

Diff: 2

Topic: *The Keynesian Theory of Consumption*

Skill: *Analytic*

AACSB: *Analytic Skills*

26) Refer to Figure 8.2. Positive saving occurs along the line segment

- A) BC. B) DC. C) AC. D) BA.

Answer: C

Diff: 2

Topic: *The Keynesian Theory of Consumption*

Skill: *Analytic*

AACSB: *Analytic Skills*

27) Refer to Figure 8.2. An increase in Jerry's income is represented by

- A) an upward shift in Jerry's consumption function.
- B) an increase in the slope of Jerry's consumption function.
- C) a movement from Point B to A.
- D) none of the above

Answer: C

Diff: 2

Topic: *The Keynesian Theory of Consumption*

Skill: *Analytic*

AACSB: *Analytic Skills*

28) Refer to Figure 8.2. Suppose Jerry's MPC increases. At income Y_1 , Jerry's

- A) consumption will be greater than his income.
- B) consumption will be less than his income.
- C) saving will be zero.
- D) all of the above

Answer: A

Diff: 3

Topic: *The Keynesian Theory of Consumption*

Skill: *Analytic*

AACSB: *Analytic Skills*

29) The fraction of a change in income that is consumed or spent is called

- A) the marginal propensity of income.
- B) the marginal propensity to save.
- C) the marginal propensity to consume.
- D) average consumption.

Answer: C

Diff: 2

Topic: *The Keynesian Theory of Consumption*

Skill: *Definition*

30) If you save \$80 when you experience a \$400 rise in your income,

- A) your MPS is 0.25.
- B) your MPC is 0.80.
- C) your MPC is 0.85.
- D) your MPS is 0.40.

Answer: B

Diff: 1

Topic: *The Keynesian Theory of Consumption*

Skill: *Analytic*

AACSB: *Analytic Skills*

31) If consumption is \$30,000 when income is \$35,000, and consumption increases to \$36,000 when income increases to \$43,000, the MPC is

- A) 0.65.
- B) 0.80.
- C) 0.75.
- D) 0.95.

Answer: C

Diff: 2

Topic: *The Keynesian Theory of Consumption*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 32) If consumption is \$10,000 when income is \$10,000, and consumption increases to \$11,000 when income increases to \$12,000, the *MPS* is
A) 0.10. B) 0.25. C) 0.50. D) 0.90.

Answer: C

Diff: 2

Topic: *The Keynesian Theory of Consumption*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 33) Suppose consumption is \$5,000 when income is \$8,000 and the *MPC* equals 0.9. When income increases to \$10,000, consumption is
A) \$4,500. B) \$2,700. C) \$6,800. D) \$7,200.

Answer: C

Diff: 2

Topic: *The Keynesian Theory of Consumption*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 34) Suppose saving is \$1,400 when income is \$10,000 and the *MPC* equals 0.8. When income increases to \$12,000, saving is
A) \$1,680. B) \$1,800. C) \$2,200. D) \$3,000.

Answer: B

Diff: 2

Topic: *The Keynesian Theory of Consumption*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 35) Suppose consumption is \$60,000 when income is \$90,000 and the *MPS* equals 0.25. When income increases to \$100,000, consumption is
A) \$70,000. B) \$85,000. C) \$67,500. D) \$90,250.

Answer: C

Diff: 3

Topic: *The Keynesian Theory of Consumption*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 36) If the *MPS* is .22, the *MPC* is
A) -0.22. B) 0.78. C) 1.22. D) 0.66.

Answer: B

Diff: 1

Topic: *The Keynesian Theory of Consumption*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 37) If the *MPS* is .05, the *MPC* is
A) -0.05. B) 2.25. C) 0.95. D) 1.05.

Answer: C

Diff: 1

Topic: *The Keynesian Theory of Consumption*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 38) If the consumption function is of the form $C = 80 + 0.4Y$, the *MPS* equals
A) -0.4. B) 0.4. C) 0.6. D) -0.6.

Answer: C

Diff: 2

Topic: *The Keynesian Theory of Consumption*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 39) If the saving function is of the form $S = -20 + 0.3Y$, consumption at an income level of 200 is
A) 80. B) 120. C) 160. D) 180.

Answer: C

Diff: 3

Topic: *The Keynesian Theory of Consumption*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 40) If Lily's consumption function is of the form $C = 100 + 0.8Y$, her saving equals zero at an income level of
A) 180.
B) 500.
C) 800.
D) cannot be determined from the given information

Answer: B

Diff: 3

Topic: *The Keynesian Theory of Consumption*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 41) If Zander's saving function is of the form $S = -150 + 0.5Y$, his consumption equals his income at an income level of
A) 150. B) 225. C) 1,500. D) 300.

Answer: D

Diff: 3

Topic: *The Keynesian Theory of Consumption*

Skill: *Analytic*

AACSB: *Analytic Skills*

Refer to the information provided in Table 8.1 below to answer the questions that follow.

Aggregate Income (\$ billion)	Aggregate Consumption (\$billion)
0	80
50	125
100	170
150	215
200	260

- 42) Refer to Table 8.1. The equation for the aggregate consumption function is
 A) $C = 80 + .95Y$. B) $C = 80 + .9Y$. C) $C = 80 + .75Y$. D) $C = -80 + .45Y$.

Answer: B

Diff: 3

Topic: The Keynesian Theory of Consumption

Skill: Analytic

AACSB: Analytic Skills

- 43) Refer to Table 8.1. Society's MPC is
 A) 0.90. B) 0.95. C) 0.80. D) 0.05.

Answer: A

Diff: 2

Topic: The Keynesian Theory of Consumption

Skill: Analytic

AACSB: Analytic Skills

- 44) Refer to Table 8.1. Society's MPS is
 A) 0.05. B) 0.10. C) 0.20. D) 0.95.

Answer: B

Diff: 2

Topic: The Keynesian Theory of Consumption

Skill: Analytic

AACSB: Analytic Skills

- 45) Refer to Table 8.1. At an aggregate income level of \$100, aggregate saving would be
 A) -\$30. B) \$30. C) -\$70. D) \$50.

Answer: C

Diff: 3

Topic: The Keynesian Theory of Consumption

Skill: Analytic

AACSB: Analytic Skills

- 46) Refer to Table 8.1. Assuming society's MPC is constant at an aggregate of income of \$300, aggregate consumption would be _____.
 A) \$325. B) \$350. C) \$305. D) \$425.

Answer: B

Diff: 3

Topic: The Keynesian Theory of Consumption

Skill: Analytic

AACSB: Analytic Skills

Refer to the information provided in Table 8.2 below to answer the questions that follow.

Aggregate Income (\$ billions)	Aggregate Saving (\$ billion)
0	-100
150	-85
300	-70
450	-55
600	-40

47) Refer to Table 8.2. The equation for the aggregate saving function is

A) $S = -100 + .15Y$.

B) $S = -100 + .1Y$.

C) $S = -150 + .2Y$.

D) $S = -150 + .85Y$.

Answer: B

Diff: 3

Topic: The Keynesian Theory of Consumption

Skill: Analytic

AACSB: Analytic Skills

48) Refer to Table 8.2. Society's MPC is

A) 0.1.

B) 0.2.

C) 0.8.

D) 0.9.

Answer: D

Diff: 2

Topic: The Keynesian Theory of Consumption

Skill: Analytic

AACSB: Analytic Skills

49) Refer to Table 8.2. Society's MPS is

A) 0.2.

B) 0.3.

C) 0.1.

D) 0.9.

Answer: C

Diff: 2

Topic: The Keynesian Theory of Consumption

Skill: Analytic

AACSB: Analytic Skills

50) Refer to Table 8.2. Assuming society's MPC is constant, at an aggregate income level of \$900, aggregate consumption would be

A) \$665.

B) \$910.

C) \$1,200.

D) \$1,750.

Answer: B

Diff: 3

Topic: The Keynesian Theory of Consumption

Skill: Analytic

AACSB: Analytic Skills

51) Refer to Table 8.2. Assuming society's MPC is constant, at an aggregate income of \$1,200 aggregate saving would be _____.

A) \$0

B) \$20

C) \$55

D) \$150

Answer: B

Diff: 3

Topic: The Keynesian Theory of Consumption

Skill: Analytic

AACSB: Analytic Skills

Refer to the information provided in Figure 8.3 below to answer the questions that follow.

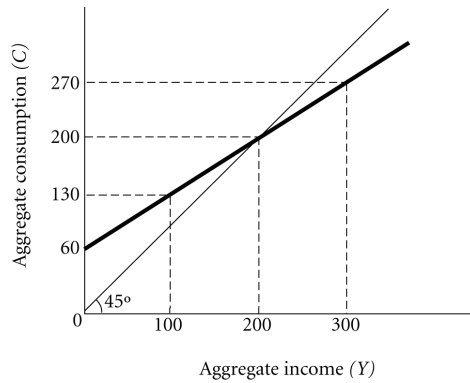


Figure 8.3

- 52) Refer to Figure 8.3. The equation for the aggregate consumption function is
 A) $C = 140 + .5Y$. B) $C = 60 + .7Y$. C) $C = 80 + .6Y$. D) $C = 60 + .4Y$.

Answer: B

Diff: 3

Topic: The Keynesian Theory of Consumption

Skill: Analytic

AACSB: Analytic Skills

- 53) Refer to Figure 8.3. The equation for the aggregate saving function is
 A) $S = -60 + .3Y$. B) $S = -200 + .6Y$. C) $S = -140 + .5Y$. D) $S = -80 + .4Y$

Answer: A

Diff: 3

Topic: The Keynesian Theory of Consumption

Skill: Analytic

AACSB: Analytic Skills

- 54) Refer to Figure 8.3. In this economy, aggregate saving will be zero if income is
 A) \$100 billion. B) \$200 billion. C) \$300 billion. D) \$400 billion.

Answer: B

Diff: 2

Topic: The Keynesian Theory of Consumption

Skill: Analytic

AACSB: Analytic Skills

- 55) Refer to Figure 8.3. For this society, aggregate saving is positive if aggregate income is
 A) above zero. B) between \$0 and \$150 billion.
 C) equal to \$200 billion. D) above \$200 billion.

Answer: D

Diff: 2

Topic: The Keynesian Theory of Consumption

Skill: Analytic

AACSB: Analytic Skills

56) Refer to Figure 8.3. If aggregate income is \$1,000 billion, then in this society aggregate saving is _____ billion.

- A) \$300 B) \$320 C) \$240 D) \$550

Answer: C

Diff: 3

Topic: The Keynesian Theory of Consumption

Skill: Analytic

AACSB: Analytic Skills

57) Refer to Figure 8.3. Which of the following statements is FALSE?

- A) Aggregate saving is negative for all income levels below \$400 billion.
 B) For all aggregate income levels above \$200 billion, aggregate consumption is less than aggregate income.
 C) If consumption is the only expenditure, this economy would be in equilibrium at an aggregate income level of \$200 billion.
 D) Saving is negative at all income levels below \$200 billion.

Answer: A

Diff: 3

Topic: The Keynesian Theory of Consumption

Skill: Analytic

AACSB: Analytic Skills

Refer to the information provided in Figure 8.4 below to answer the questions that follow.

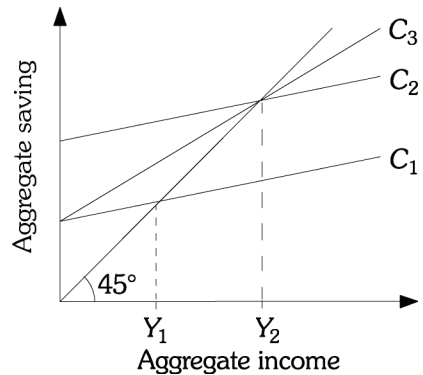


Figure 8.4

58) Refer to Figure 8.4. The aggregate consumption functions C_1 and C_2

- A) have the same MPC values.
 B) imply a different MPS values.
 C) have the same autonomous consumption values.
 D) have the same break-even values.

Answer: A

Diff: 2

Topic: The Keynesian Theory of Consumption

Skill: Analytic

AACSB: Analytic Skills

- 59) Refer to Figure 8.4. Which consumption function has the largest MPC ?
- A) C_1 .
 - B) C_2 .
 - C) C_3 .
 - D) cannot be determined from the figure

Answer: C

Diff: 2

Topic: *The Keynesian Theory of Consumption*

Skill: Analytic

AACSB: Analytic Skills

- 60) Refer to Figure 8.4. Suppose the consumption function for $C_1 = 10 + 0.8Y$, the consumption function that best fits C_2 is
- A) $C_2 = 20 + 0.8Y$.
 - B) $C_2 = 10 + 0.4Y$.
 - C) $C_2 = 40 + 0.5Y$.
 - D) $C_2 = 20 + 0.1Y$.

Answer: A

Diff: 3

Topic: *The Keynesian Theory of Consumption*

Skill: Analytic

AACSB: Analytic Skills

- 61) Refer to Figure 8.4. Suppose the consumption function for $C_1 = 20 + 0.5Y$, the consumption function that best fits C_3 is
- A) $C_3 = 20 + 0.8Y$.
 - B) $C_3 = 20 + 0.4Y$.
 - C) $C_3 = 40 + 0.5Y$.
 - D) $C_3 = 40 + 0.4Y$.

Answer: A

Diff: 3

Topic: *The Keynesian Theory of Consumption*

Skill: Analytic

AACSB: Analytic Skills

- 62) Refer to Figure 8.4. If income is Y_1 , aggregate consumption is the greatest when the aggregate consumption function is
- A) C_3 .
 - B) C_2 .
 - C) C_1 .
 - D) cannot be determined from the figure

Answer: B

Diff: 3

Topic: *The Keynesian Theory of Consumption*

Skill: Analytic

AACSB: Analytic Skills

- 63) Refer to Figure 8.4. If income is Y_2
- A) the society's saving is negative along C_1 , C_2 , and C_3 .
 - B) the society's consumption is equal along C_2 and C_3 .
 - C) the society's saving is positive along C_2 and C_3 .
 - D) the society's savings is negative along C_1 .

Answer: B

Diff: 3

Topic: *The Keynesian Theory of Consumption*

Skill: Analytic

AACSB: Analytic Skills

- 64) If the consumption function is below the 45-degree line,
 A) consumption is less than income and saving is positive.
 B) consumption is less than income and saving is negative.
 C) consumption exceeds income and saving is positive.
 D) consumption exceeds income and saving is negative.

Answer: A

Diff: 2

Topic: The Keynesian Theory of Consumption

Skill: Analytic

AACSB: Analytic Skills

Refer to the information provided in Figure 8.5 below to answer the questions that follow.

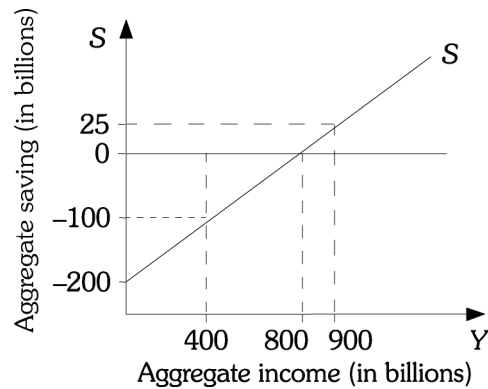


Figure 8.5

- 65) Refer to Figure 8.5. The *MPS* for this saving function is
 A) 5. B) 0.25. C) 0.5. D) 4.

Answer: B

Diff: 2

Topic: The Keynesian Theory of Consumption

Skill: Analytic

AACSB: Analytic Skills

- 66) Refer to Figure 8.5. If aggregate income is \$400 billion, aggregate saving is _____ billion.
 A) -\$300 B) -\$100 C) \$0 D) \$500

Answer: B

Diff: 2

Topic: The Keynesian Theory of Consumption

Skill: Analytic

AACSB: Analytic Skills

67) Refer to Figure 8.5. If aggregate income is \$900 billion, aggregate consumption

- A) is \$25 billion.
- B) is \$800 billion.
- C) is \$875 billion.
- D) cannot be determined from this information.

Answer: C

Diff: 2

Topic: The Keynesian Theory of Consumption

Skill: Analytic

AACSB: Analytic Skills

Refer to the information provided in Figure 8.6 below to answer the questions that follow.

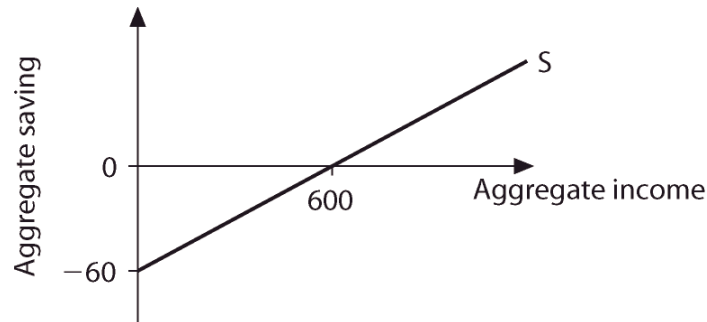


Figure 8.6

68) Refer to Figure 8.6. The *MPS* for this saving function is

- A) .4.
- B) .2.
- C) .25.
- D) .1.

Answer: D

Diff: 2

Topic: The Keynesian Theory of Consumption

Skill: Analytic

AACSB: Analytic Skills

69) Refer to Figure 8.6. If aggregate income is \$800, aggregate saving is _____.

- A) -\$100
- B) -\$20
- C) \$40
- D) \$20

Answer: D

Diff: 2

Topic: The Keynesian Theory of Consumption

Skill: Analytic

AACSB: Analytic Skills

70) Refer to Figure 8.6. If aggregate income is \$1,000, aggregate consumption is

- A) \$850.
- B) \$960.
- C) \$910.
- D) \$920.

Answer: B

Diff: 3

Topic: The Keynesian Theory of Consumption

Skill: Analytic

AACSB: Analytic Skills

2 True/False

- 1) As interest rates fall, spending decreases.

Answer: FALSE

Diff: 1

Topic: *The Keynesian Theory of Consumption*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 2) Uncertainty about the future is likely to increase current spending.

Answer: FALSE

Diff: 1

Topic: *The Keynesian Theory of Consumption*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 3) The marginal propensity to consume is the change in consumption per change in income.

Answer: TRUE

Diff: 1

Topic: *The Keynesian Theory of Consumption*

Skill: *Definition*

- 4) If the marginal propensity to consume is .8, the marginal propensity to save is 8.

Answer: FALSE

Diff: 1

Topic: *The Keynesian Theory of Consumption*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

8.2 Planned Investment

1 Multiple Choice

- 1) The Tiny Tots Toy Company manufactures only sleds. In 2007 Tiny Tots manufactured 10,000 sleds, but sold only 8,000 sleds. In 2007 Tiny Tots' change in inventory was

A) -2,000 sleds. B) 1,000 sleds. C) 2,000 sleds. D) 3,000 sleds.

Answer: C

Diff: 2

Topic: *Planned Investment*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 2) The Jackson Tool Company manufactures only tools. In 2008 Jackson Tools manufactured 20,000 tools, but sold 21,000 tools. In 2008 Jackson Tools' change in inventory was

A) -2,000 tools. B) 1,000 tools. C) -1,000 tools. D) 3,000 tools.

Answer: C

Diff: 2

Topic: *Planned Investment*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 3) Which of the following is NOT considered investment?
- A) The acquisition of capital goods
 - B) The purchase of government bonds
 - C) The increase in planned inventories
 - D) The construction of a new factory

Answer: B

Diff: 1

Topic: *Planned Investment*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 4) Which of the following is an investment?
- A) the purchase of a new printing press by a business
 - B) the purchase of a corporate bond by a household
 - C) the purchase of a share of stock by a household
 - D) a leveraged buyout of one corporation by another

Answer: A

Diff: 1

Topic: *Planned Investment*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 5) Over which component of investment do firms have the least amount of control?
- A) purchases of new equipment
 - B) construction of new factories
 - C) changes in inventories
 - D) building new machines

Answer: C

Diff: 1

Topic: *Planned Investment*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 6) Assume that in Scandia, planned investment is \$80 billion but actual investment is \$60 billion. Unplanned inventory investment is
- A) -\$10 billion.
 - B) \$140 billion.
 - C) -\$20 billion.
 - D) \$70 billion.

Answer: C

Diff: 1

Topic: *Planned Investment*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 7) Assume that in Jabara, planned investment is \$30 billion, but actual investment is \$45 billion. Unplanned inventory investment is
- A) \$75 billion.
 - B) -\$15 billion.
 - C) \$15 billion.
 - D) -\$75 billion.

Answer: C

Diff: 1

Topic: *Planned Investment*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 8) If unplanned business investment is \$20 million and planned investment is \$20 million, then actual investment is
A) \$20 million. B) \$40 million. C) -\$20 million. D) \$200 million.

Answer: B

Diff: 1

Topic: *Planned Investment*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 9) In 2006 Happyland's planned investment was \$90 billion and its actual investment was \$140 billion. In 2006 Happyland's unplanned inventory change was
A) -\$50 billion. B) -\$115 billion. C) \$50 billion. D) \$230 billion.

Answer: C

Diff: 1

Topic: *Planned Investment*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 10) If planned investment exceeds actual investment,
A) there will be an accumulation of inventories.
B) there will be no change in inventories.
C) there will be a decline in inventories.
D) none of the above

Answer: C

Diff: 1

Topic: *Planned Investment*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 11) If Inventory investment is higher than firms planned,
A) actual and planned investment are equal.
B) actual investment is less than planned investment.
C) actual investment is greater than planned investment.
D) actual investment must be negative.

Answer: C

Diff: 1

Topic: *Planned Investment*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

Refer to the information provided in Figure 8.7 below to answer the questions that follow.

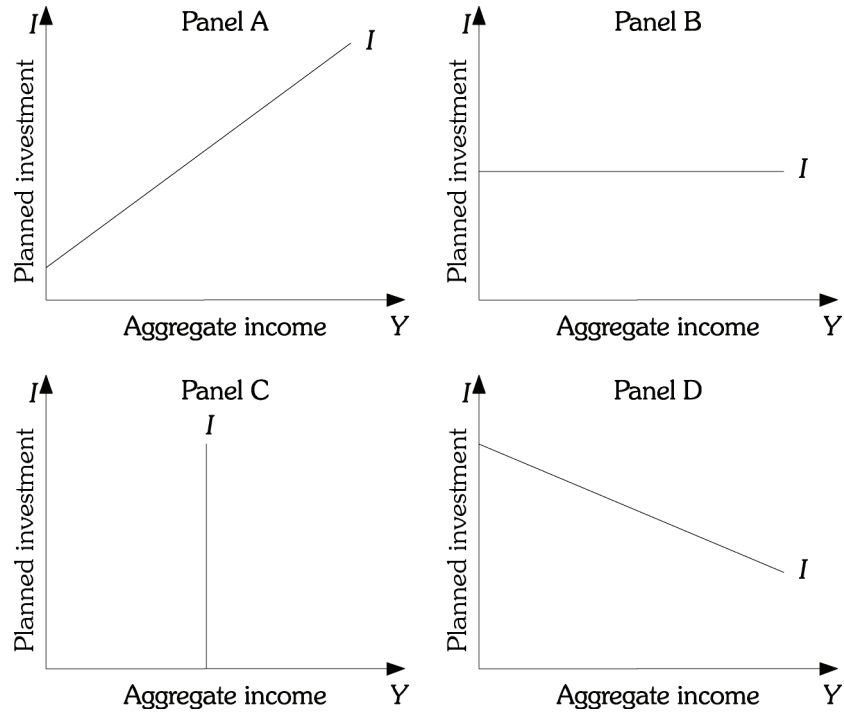


Figure 8.7

- 12) Refer to Figure 8.7. In Azora, planned investment does not vary with income. Azora's planned investment function is represented by
- A) Panel A. B) Panel B. C) Panel C. D) Panel D.

Answer: B

Diff: 2

Topic: Planned Investment

Skill: Analytic

AACSB: Analytic Skills

- 13) Refer to Figure 8.7. In Farley, planned investment varies inversely with income. Farley's planned investment function is represented by
- A) Panel A. B) Panel B. C) Panel C. D) Panel D.

Answer: D

Diff: 2

Topic: Planned Investment

Skill: Analytic

AACSB: Analytic Skills

- 14) Without the government or the foreign sector in the income-expenditure model, planned aggregate expenditure equals
- A) consumption plus actual investment.
 - B) consumption plus inventory adjustment.
 - C) consumption minus planned investment.
 - D) consumption plus planned investment.

Answer: D

Diff: 1

Topic: *Planned Investment*

Skill: *Conceptual*

- 15) Related to the *Economics in Practice* on p. 147 [459]: A recent study by economists at Yale University and the University of Chicago suggests that changing retirement plan enrollment options from "opt-in" systems to "opt-out" systems increased pension plan enrollment after three months of work from _____ percent of workers to _____ percent of workers.
- A) 80; 22
 - B) 10; 100
 - C) 65; 98
 - D) 77; 42

Answer: C

Diff: 1

Topic: *Planned Investment: Economics in Practice*

Skill: *Fact*

- 16) Related to the *Economics in Practice* on p. 147 [459]: Early results from the Save More Tomorrow retirement plans have shown _____ in the savings rates of the enrolled.
- A) very little change
 - B) mixed results
 - C) significant decreases
 - D) dramatic increases

Answer: D

Diff: 1

Topic: *Planned Investment: Economics in Practice*

Skill: *Fact*

2 True/False

- 1) If actual investment is greater than planned investment, unplanned inventories decline.

Answer: FALSE

Diff: 2

Topic: *Planned Investment*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 2) Firms react to an unplanned inventory investment by increasing output.

Answer: FALSE

Diff: 2

Topic: *Planned Investment*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 3) Firms react to negative inventory investment by increasing output.

Answer: TRUE

Diff: 2

Topic: *Planned Investment*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

4) If planned saving exceeds planned investment, injections are greater than leakages.

Answer: FALSE

Diff: 2

Topic: *Planned Investment*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

5) If planned investment increases, equilibrium will be restored only when saving has increased by exactly the amount of the initial increase in planned investment, assuming there is no government or foreign sector.

Answer: TRUE

Diff: 2

Topic: *Planned Investment*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

8.3 The Determination of Equilibrium Output (Income)

1 Multiple Choice

1) In macroeconomics, equilibrium is defined as that point at which

- A) saving equals consumption.
- B) planned aggregate expenditure equals aggregate output.
- C) planned aggregate expenditure equals consumption.
- D) aggregate output equals consumption minus investment.

Answer: B

Diff: 1

Topic: *The Determination of Equilibrium Output (Income)*

Skill: *Definition*

2) The economy can be in equilibrium if, and only if,

- A) planned investment is zero.
- B) actual investment is zero.
- C) planned investment is greater than actual investment.
- D) planned investment equals actual investment.

Answer: D

Diff: 2

Topic: *The Determination of Equilibrium Output (Income)*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

3) If aggregate output is greater than planned spending, then

- A) unplanned inventory investment is zero.
- B) unplanned inventory investment is negative.
- C) unplanned inventory investment is positive.
- D) actual investment equals planned investment.

Answer: C

Diff: 2

Topic: *The Determination of Equilibrium Output (Income)*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 4) If unplanned inventory investment is positive, then
- A) planned investment must be zero.
 - B) planned aggregate spending must be greater than aggregate output.
 - C) planned aggregate spending must be less than aggregate output.
 - D) planned aggregate spending must equal aggregate output.

Answer: C

Diff: 2

Topic: The Determination of Equilibrium Output (Income)

Skill: Conceptual

AACSB: Reflective Thinking

- 5) If aggregate output equals planned aggregate expenditure, then
- A) unplanned inventory investment is zero.
 - B) unplanned inventory adjustment is negative.
 - C) unplanned inventory adjustment is positive.
 - D) actual investment is greater than planned investment.

Answer: A

Diff: 2

Topic: The Determination of Equilibrium Output (Income)

Skill: Conceptual

AACSB: Reflective Thinking

Refer to the information provided in Table 8.3 below to answer the questions that follow.

All Figures in Billions of Dollars		
Aggregate Output	Aggregate Consumption	Planned Investment
200	300	100
400	450	100
600	600	100
800	750	100
1,000	900	100

- 6) Refer to Table 8.3. At an aggregate output level of \$400 billion, planned expenditure equals
- A) \$550 billion.
 - B) \$450 billion.
 - C) \$500 billion.
 - D) \$850 billion.

Answer: A

Diff: 2

Topic: The Determination of Equilibrium Output (Income)

Skill: Analytic

AACSB: Analytic Skills

- 7) Refer to Table 8.3. At an aggregate output level of \$800 billion, aggregate saving
- A) equals -\$50 billion.
 - B) equals \$0.
 - C) equals \$50 billion.
 - D) cannot be determined from this information.

Answer: C

Diff: 2

Topic: The Determination of Equilibrium Output (Income)

Skill: Analytic

AACSB: Analytic Skills

8) Refer to Table 8.3. At an aggregate output level of \$200 billion, the unplanned inventory change is

- A) -\$150 billion. B) -\$200 billion. C) -\$50 billion. D) \$100 billion.

Answer: B

Diff: 2

Topic: The Determination of Equilibrium Output (Income)

Skill: Analytic

AACSB: Analytic Skills

9) Refer to Table 8.3. At an aggregate output level of \$600 billion, the unplanned inventory change is

- A) -\$100 billion. B) -\$50 billion. C) \$0. D) \$50 billion.

Answer: A

Diff: 2

Topic: The Determination of Equilibrium Output (Income)

Skill: Analytic

AACSB: Analytic Skills

10) Refer to Table 8.3. If aggregate output equals _____, there will be a \$100 billion unplanned decrease in inventories.

- A) \$200 billion B) \$400 billion C) \$600 billion D) \$800 billion

Answer: C

Diff: 2

Topic: The Determination of Equilibrium Output (Income)

Skill: Analytic

AACSB: Analytic Skills

11) Refer to Table 8.3. The equilibrium level of aggregate output equals

- A) \$400 billion. B) \$600 billion. C) \$800 billion. D) \$1,000 billion.

Answer: D

Diff: 1

Topic: The Determination of Equilibrium Output (Income)

Skill: Analytic

AACSB: Analytic Skills

12) Refer to Table 8.3. Which of the following statements is FALSE?

- A) At output levels greater than \$800 billion, there is a positive unplanned inventory change.
B) If aggregate output equals \$1000 billion, then aggregate saving equals \$100.
C) The MPC for this economy is .75.
D) At an output level of \$400 billion, there is a \$150 billion unplanned inventory decrease.

Answer: A

Diff: 3

Topic: The Determination of Equilibrium Output (Income)

Skill: Analytic

AACSB: Analytic Skills

- 13) Refer to Table 8.3. Planned saving equals planned investment at an aggregate output level
- A) of \$1000 billion.
 - B) of \$600 billion.
 - C) of \$800 billion.
 - D) that cannot be determined from this information.

Answer: A

Diff: 2

Topic: The Determination of Equilibrium Output (Income)

Skill: Analytic

AACSB: Analytic Skills

- 14) Refer to Table 8.3. Planned investment equals actual investment at
- A) all income levels.
 - B) all income levels above \$600 billion.
 - C) all income levels below \$600 billion.
 - D) \$1000 billion.

Answer: D

Diff: 2

Topic: The Determination of Equilibrium Output (Income)

Skill: Analytic

AACSB: Analytic Skills

Refer to the information provided in Table 8.4 below to answer the questions that follow.

Table 8.4

Aggregate Output (\$ million)	Aggregate Consumption (\$ million)	Planned Investment (\$ million)
3,000	2,000	1,600
4,000	2,800	1,600
5,000	3,600	1,600
6,000	4,400	1,600
7,000	5,000	1,600

- 15) Refer to Table 8.4. At an aggregate output level of \$3,000 million, planned expenditure equals
- A) \$3,000.
 - B) \$3,600.
 - C) \$2,800.
 - D) \$4,400.

Answer: B

Diff: 2

Topic: The Determination of Equilibrium Output (Income)

Skill: Analytic

AACSB: Analytic Skills

- 16) Refer to Table 8.4. The MPC in this economy is
- A) 0.5.
 - B) 0.6.
 - C) 0.7.
 - D) 0.8.

Answer: D

Diff: 2

Topic: The Determination of Equilibrium Output (Income)

Skill: Analytic

AACSB: Analytic Skills

17) Refer to Table 8.4. At an aggregate output level of \$4,000 million, the unplanned inventory change is

- A) \$1,200 million. B) 0. C) \$400 million. D) -\$400 million.

Answer: D

Diff: 2

Topic: The Determination of Equilibrium Output (Income)

Skill: Analytic

AACSB: Analytic Skills

18) Refer to Table 8.4. At an aggregate output level of \$7,000 million, the unplanned inventory change is

- A) 0. B) \$400 million.
C) -\$400 million. D) -\$1,200 million.

Answer: B

Diff: 2

Topic: The Determination of Equilibrium Output (Income)

Skill: Analytic

AACSB: Analytic Skills

19) Refer to Table 8.4. If aggregate output equals _____, there will be a \$200 million unplanned decrease in inventories.

- A) \$3,000 million B) \$4,000 million C) \$5,000 million D) \$6,000 million

Answer: C

Diff: 2

Topic: The Determination of Equilibrium Output (Income)

Skill: Analytic

AACSB: Analytic Skills

20) Refer to Table 8.4. The equilibrium level of aggregate output equals

- A) \$3,000 million. B) \$4,000 million. C) \$5,000 million. D) \$6,000 million.

Answer: D

Diff: 1

Topic: The Determination of Equilibrium Output (Income)

Skill: Analytic

AACSB: Analytic Skills

21) Refer to Table 8.4. Which of the following statements is FALSE?

- A) At an output level \$4,000, there is a \$400 million unplanned inventory decrease.
B) If aggregate output equals \$4,000 million, then aggregate saving equals \$1000 million.
C) The MPC for this economy is 0.8.
D) At an output level of \$3,000 million, there is a \$600 million unplanned inventory decrease.

Answer: B

Diff: 3

Topic: The Determination of Equilibrium Output (Income)

Skill: Analytic

AACSB: Analytic Skills

- 22) Refer to Table 8.4. Planned saving equals planned investment at an aggregate output level of
A) \$4,000 million. B) \$5,000 million. C) \$6,000 million. D) \$7,000 million.

Answer: C

Diff: 2

Topic: *The Determination of Equilibrium Output (Income)*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 23) Refer to Table 8.4. Planned investment equals actual investment at
A) all income levels. B) all income levels above \$6,000 million.
C) all income levels below \$6,000 million D) an income level of \$6,000 million.

Answer: D

Diff: 2

Topic: *The Determination of Equilibrium Output (Income)*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 24) If $C = 100 + .8Y$ and $I = 50$, then the equilibrium level of income is
A) 600. B) 375. C) 187.5. D) 750.

Answer: D

Diff: 3

Topic: *The Determination of Equilibrium Output (Income)*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 25) If $C = 500 + .9Y$ and $I = 400$, then the equilibrium level of income is
A) 900. B) 1,800. C) 1,000. D) 9,000.

Answer: D

Diff: 3

Topic: *The Determination of Equilibrium Output (Income)*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 26) If $S = -200 + 0.2Y$ and $I = 100$, then the equilibrium level of income is
A) 3,000. B) 1,500. C) 4,000. D) 1,200.

Answer: B

Diff: 3

Topic: *The Determination of Equilibrium Output (Income)*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 27) If $C = 1,500 + .75Y$ and $I = 500$, then planned saving equals planned investment at aggregate output level of
A) 8,000. B) 20,000. C) 2,666.67. D) 10,000.

Answer: A

Diff: 3

Topic: *The Determination of Equilibrium Output (Income)*

Skill: *Analytic*

AACSB: *Analytic Skills*

Refer to the information provided in Figure 8.8 below to answer the questions that follow.

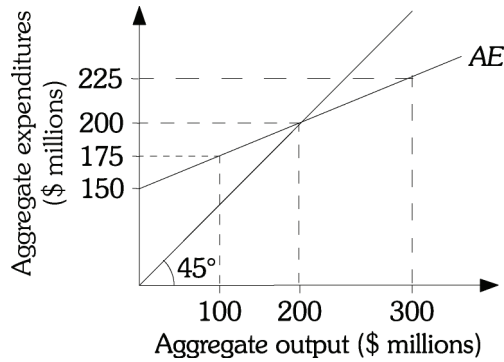


Figure 8.8

28) Refer to Figure 8.8. What is the equation for the aggregate expenditure function (AE)?

- A) $AE = 200 + .5Y.$
- B) $AE = 150 + .25Y.$
- C) $AE = 200 + .8Y.$
- D) $AE = 350 + .6Y.$

Answer: B

Diff: 2

Topic: The Determination of Equilibrium Output (Income)

Skill: Analytic

AACSB: Analytic Skills

29) Refer to Figure 8.8. Equilibrium output equals

- A) 100.
- B) 200.
- C) 150.
- D) 300.

Answer: B

Diff: 1

Topic: The Determination of Equilibrium Output (Income)

Skill: Analytic

AACSB: Analytic Skills

30) Refer to Figure 8.8. At aggregate output level \$300 million, there is a

- A) \$75 million unplanned increase in inventories.
- B) \$75 million unplanned decrease in inventories.
- C) \$100 million decrease in inventories.
- D) \$100 million increase in inventories.

Answer: A

Diff: 2

Topic: The Determination of Equilibrium Output (Income)

Skill: Analytic

AACSB: Analytic Skills

31) Refer to Figure 8.8. At aggregate output level \$100 million, there is a

- A) \$75 million unplanned increase in inventories.
- B) \$75 million unplanned decrease in inventories.
- C) \$100 million decrease in inventories.
- D) \$100 million increase in inventories.

Answer: B

Diff: 2

Topic: *The Determination of Equilibrium Output (Income)*

Skill: *Analytic*

AACSB: *Analytic Skills*

32) Refer to Figure 8.8. How will equilibrium aggregate expenditure and equilibrium aggregate output change as a result of a decrease in investment by \$20 million?

- A) AE line shifts down, increasing equilibrium output and equilibrium expenditure.
- B) AE line shifts up, increasing equilibrium output and equilibrium expenditure.
- C) AE line shifts down, decreasing equilibrium output and equilibrium expenditure.
- D) AE line shifts down, increasing equilibrium output and decreasing equilibrium expenditure.

Answer: C

Diff: 3

Topic: *The Determination of Equilibrium Output (Income)*

Skill: *Analytic*

AACSB: *Analytic Skills*

33) Refer to Figure 8.8. Leakages are greater than injections at an aggregate output level of

- A) \$300 million.
- B) \$100 million.
- C) \$200 million.
- D) cannot be determined from the figure

Answer: A

Diff: 3

Topic: *The Determination of Equilibrium Output (Income)*

Skill: *Analytic*

AACSB: *Analytic Skills*

Refer to the information provided in Figure 8.9 below to answer the questions that follow.

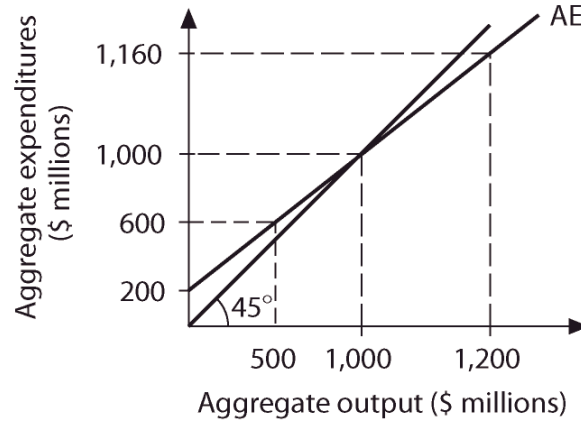


Figure 8.9

- 34) Refer to Figure 8.9. What is the equation for the aggregate expenditure function (AE)?
- A) $AE = 600 + .1Y$.
 - B) $AE = 200 + .8Y$.
 - C) $AE = 550 + .8Y$.
 - D) $AE = 100 + .9Y$.

Answer: B

Diff: 2

Topic: The Determination of Equilibrium Output (Income)

Skill: Analytic

AACSB: Analytic Skills

- 35) Refer to Figure 8.9. At an aggregate output level of \$500 million, there is a
- A) \$100 million unplanned increase in inventories.
 - B) \$175 million unplanned decrease in inventories.
 - C) \$0 change in unplanned inventories.
 - D) \$100 million unplanned decrease in inventories.

Answer: D

Diff: 2

Topic: The Determination of Equilibrium Output (Income)

Skill: Analytic

AACSB: Analytic Skills

- 36) Refer to Figure 8.9. At aggregate output levels above \$1,000 million, there are
- A) unplanned increases in inventories and output increases.
 - B) unplanned decreases in inventories and output increases.
 - C) unplanned decreases in inventories and output decreases.
 - D) unplanned increases in inventories and output decreases.

Answer: D

Diff: 2

Topic: The Determination of Equilibrium Output (Income)

Skill: Analytic

AACSB: Analytic Skills

- 37) Refer to Figure 8.9. At aggregate output levels below \$1,000 million, there are
- A) unplanned decreases in inventories and output increases.
 - B) unplanned increases in inventories and output increases.
 - C) unplanned increases in inventories and output decreases.
 - D) unplanned decreases in inventories and output decreases.

Answer: A

Diff: 2

Topic: The Determination of Equilibrium Output (Income)

Skill: Analytic

AACSB: Analytic Skills

- 38) Refer to Figure 8.9. At aggregate output levels above \$1,000 million,
- A) leakages equal injections.
 - B) leakages are more than injections.
 - C) leakages are zero, but injections are positive.
 - D) leakages are less than injections.

Answer: B

Diff: 3

Topic: The Determination of Equilibrium Output (Income)

Skill: Analytic

AACSB: Analytic Skills

- 39) Refer to Figure 8.9. At aggregate output levels below \$1,000 million,
- A) leakages equal injections.
 - B) leakages are greater than injections.
 - C) leakages are less than injections.
 - D) leakages are positive, but injections are negative.

Answer: C

Diff: 3

Topic: The Determination of Equilibrium Output (Income)

Skill: Analytic

AACSB: Analytic Skills

- 40) Using the saving/investment approach to equilibrium, the equilibrium condition can be written as

A) $C + I = C + S$.

B) $C = S + I$.

C) $C - S = I$.

D) $C + S = I$.

Answer: A

Diff: 1

Topic: The Determination of Equilibrium Output (Income)

Skill: Conceptual

AACSB: Reflective Thinking

- 41) Firms react to unplanned inventory reductions by
- A) reducing output.
 - B) increasing output.
 - C) reducing planned investment.
 - D) increasing consumption.

Answer: B

Diff: 2

Topic: The Determination of Equilibrium Output (Income)

Skill: Conceptual

AACSB: Reflective Thinking

- 42) Firms react to unplanned increases in inventories by
- A) reducing output.
 - B) increasing output.
 - C) increasing planned investment.
 - D) increasing consumption.

Answer: A

Diff: 2

Topic: *The Determination of Equilibrium Output (Income)*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 43) Aggregate output will increase if there is a(n)
- A) increase in saving.
 - B) unplanned rise in inventories.
 - C) unplanned fall in inventories.
 - D) decrease in consumption.

Answer: C

Diff: 2

Topic: *The Determination of Equilibrium Output (Income)*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 44) A decrease in planned investment causes
- A) output to increase.
 - B) output to decrease, but by a smaller amount than the decrease in investment.
 - C) output to decrease, but by a larger amount than the decrease in investment.
 - D) output to decrease by an amount equal to the decrease in investment.

Answer: C

Diff: 2

Topic: *The Determination of Equilibrium Output (Income)*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

2 True/False

- 1) When aggregate expenditure is greater than aggregate output, there will be an unplanned build up of inventories.

Answer: FALSE

Diff: 2

Topic: *The Determination of Equilibrium Output (Income)*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 2) When there is an unplanned draw down of inventories, firms will increase production.

Answer: TRUE

Diff: 2

Topic: *The Determination of Equilibrium Output (Income)*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 3) Actual investment equals planned investment plus unplanned changes in inventories.

Answer: TRUE

Diff: 2

Topic: *The Determination of Equilibrium Output (Income)*

Skill: *Definition*

4) When the economy is in equilibrium, savings equals planned investment.

Answer: TRUE

Diff: 2

Topic: *The Determination of Equilibrium Output (Income)*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

5) If aggregate expenditure decreases, then equilibrium output increases.

Answer: FALSE

Diff: 2

Topic: *The Determination of Equilibrium Output (Income)*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

6) Assuming there is no government or foreign sector, the economy will be in equilibrium if, and only if, planned investment equals actual investment.

Answer: TRUE

Diff: 2

Topic: *The Determination of Equilibrium Output (Income)*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

8.4 The Multiplier

1 Multiple Choice

1) The ratio of the change in the equilibrium level of output to a change in some autonomous variable is the

A) elasticity coefficient.

B) multiplier.

C) automatic stabilizer.

D) marginal propensity of the autonomous variable.

Answer: B

Diff: 2

Topic: *The Multiplier*

Skill: *Definition*

Refer to the information provided in Figure 8.10 below to answer the questions that follow.

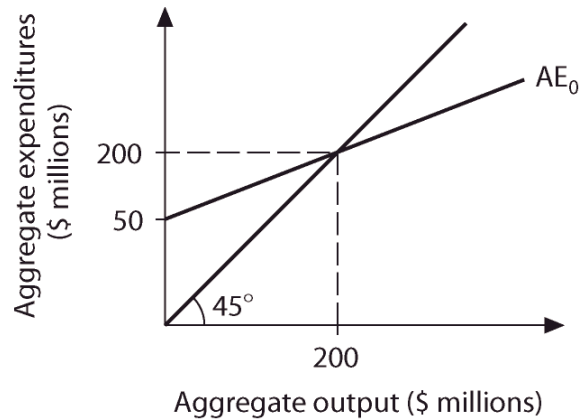


Figure 8.10

2) Refer to Figure 8.10. The equation for the aggregate expenditure function AE_0 is

A) $AE_0 = 50 + .6Y$.

B) $AE_0 = 80 + .6Y$.

C) $AE_0 = 50 + .75Y$.

D) $AE_0 = 50 + .4Y$.

Answer: C

Diff: 2

Topic: The Multiplier

Skill: Analytic

AACSB: Analytic Skills

3) Refer to Figure 8.10. The value of the multiplier is

A) 2.

B) 2.5.

C) 3.

D) 4.

Answer: D

Diff: 2

Topic: The Multiplier

Skill: Analytic

AACSB: Analytic Skills

4) Refer to Figure 8.10. A \$10 million increase in investment changes equilibrium output to

A) \$240 million.

B) \$90 million.

C) \$225 million.

D) \$175 million.

Answer: A

Diff: 2

Topic: The Multiplier

Skill: Analytic

AACSB: Analytic Skills

- 5) Refer to Figure 8.10. A \$20 million decrease in autonomous consumption
- A) changes equilibrium expenditure to \$120 million.
 - B) changes equilibrium output to \$180 million.
 - C) will change the *MPC*.
 - D) will change the *MPS*.

Answer: A

Diff: 3

Topic: *The Multiplier*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 6) Refer to Figure 8.10. If *MPC* increases to 0.8, equilibrium aggregate output
- A) increases to \$250 million.
 - B) remains at \$200 million.
 - C) increases to \$400 million.
 - D) cannot be determined from the given information.

Answer: A

Diff: 3

Topic: *The Multiplier*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 7) Assuming no government or foreign sector, if the *MPC* is 0.9, the multiplier is
- A) 0.1.
 - B) 5.
 - C) 9.
 - D) 10.

Answer: D

Diff: 1

Topic: *The Multiplier*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 8) Assuming no government or foreign sector, the formula for the multiplier is
- A) $1/MPC$.
 - B) $1/MPS$.
 - C) $1/(1 + MPC)$.
 - D) $1 - MPC$.

Answer: B

Diff: 1

Topic: *The Multiplier*

Skill: *Definition*

- 9) Assuming there is no government or foreign sector, the formula for the multiplier is
- A) $1/(1 - MPC)$.
 - B) $1/MPC$.
 - C) $1/(1 + MPC)$.
 - D) $1 - MPC$.

Answer: A

Diff: 1

Topic: *The Multiplier*

Skill: *Definition*

- 10) Assuming there is no government or foreign sector, if the multiplier is 10, the *MPC* is
- A) 0.9.
 - B) 0.8.
 - C) 0.5.
 - D) 0.1.

Answer: A

Diff: 1

Topic: *The Multiplier*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 11) Assume there is no government or foreign sector. If the *MPS* is .05, the multiplier is
A) 0.95. B) 20. C) 10. D) 50.

Answer: B

Diff: 1

Topic: The Multiplier

Skill: Analytic

AACSB: Analytic Skills

- 12) Assume there is no government or foreign sector. If the multiplier is 10, a \$10 billion increase in planned investment will cause aggregate output to increase by
A) \$1 billion. B) \$5 billion. C) \$10 billion. D) \$100 billion.

Answer: D

Diff: 1

Topic: The Multiplier

Skill: Analytic

AACSB: Analytic Skills

- 13) Assume there is no government or foreign sector. If the *MPS* is 0.2, a \$40 billion decrease in planned investment will cause aggregate output to decrease by
A) \$20 billion. B) \$50 billion. C) \$80 billion. D) \$200 billion.

Answer: D

Diff: 1

Topic: The Multiplier

Skill: Analytic

AACSB: Analytic Skills

- 14) Assume there is no government or foreign sector. If the multiplier is 4, a \$20 billion increase in investment will cause aggregate output to increase by
A) \$5 billion. B) \$20 billion. C) \$40 billion. D) \$80 billion.

Answer: D

Diff: 1

Topic: The Multiplier

Skill: Analytic

AACSB: Analytic Skills

Refer to the information provided in Figure 8.11 below to answer the questions that follow.

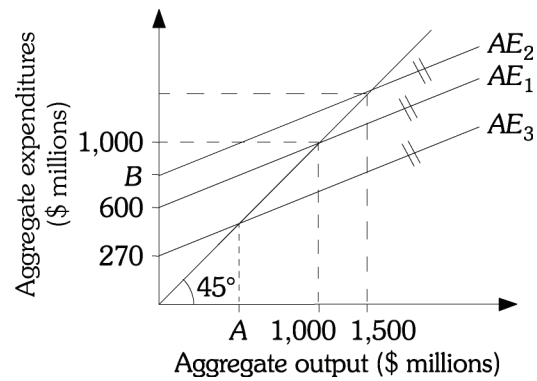


Figure 8.11

15) Refer to Figure 8.11. What is the equation for aggregate expenditure AE_1 ?

- A) $AE_1 = 1,000 + .5Y$.
B) $AE_1 = 600 + .4Y$.
C) $AE_1 = 1,000 + .6Y$.
D) $AE_1 = 400 + .4Y$.

Answer: B

Diff: 2

Topic: The Multiplier

Skill: Analytic

AACSB: Analytic Skills

16) Refer to Figure 8.11. Suppose AE_1 , AE_2 and AE_3 are parallel. What is the value of Point B ?

- A) \$750 million
B) \$800 million
C) \$900 million
D) cannot be determined from the given information

Answer: C

Diff: 3

Topic: The Multiplier

Skill: Analytic

AACSB: Analytic Skills

17) Refer to Figure 8.11. Suppose AE_1 , AE_2 and AE_3 are parallel. What is the value of Point A ?

- A) \$450 million
B) \$540 million
C) \$510 million
D) cannot be determined from the given information

Answer: A

Diff: 3

Topic: The Multiplier

Skill: Analytic

AACSB: Analytic Skills

- 18) Refer to Figure 8.11. Suppose the economy's aggregate expenditure line is AE_1 . A \$10 million increase in planned investment causes aggregate equilibrium output to increase to
- A) \$1,016.7 million.
 - B) \$1,010 million.
 - C) \$1,125.5 million.
 - D) \$1,215.6 million.

Answer: A

Diff: 2

Topic: *The Multiplier*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 19) As the MPS decreases, the multiplier will
- A) increase.
 - B) decrease.
 - C) remain constant.
 - D) either increase or decrease depending on the size of the change in investment.

Answer: A

Diff: 2

Topic: *The Multiplier*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 20) Midwest State University in Nebraska is trying to convince Nebraska taxpayers that the tax dollars spent at Midwest State University are well spent. One of the university's arguments is that for every \$1 spent by Midwest State University an additional \$5 of expenditures are generated within Nebraska. Midwest State University is arguing that the multiplier for their expenditures is
- A) 0.2.
 - B) 1.
 - C) 4.
 - D) 5.

Answer: D

Diff: 2

Topic: *The Multiplier*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 21) If autonomous consumption increases, the size of the multiplier would
- A) increase.
 - B) decrease.
 - C) remain constant.
 - D) either increase or decrease depending on the size of the change in autonomous consumption.

Answer: C

Diff: 2

Topic: *The Multiplier*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 22) In practice, the actual size of the multiplier is about
- A) 1.
 - B) 1.4.
 - C) 2.
 - D) 4.

Answer: B

Diff: 1

Topic: *The Multiplier*

Skill: *Fact*

- 23) Related to the *Economics in Practice* on p. 154 [466]: According to the "paradox of thrift," as individuals increase their saving,
- A) income in the economy increases because there is more money available for firms to invest.
 - B) income in the economy increases because interest rates will fall and the economy will expand.
 - C) income in the economy will remain constant because the change in consumption equals the change in saving.
 - D) income in the economy will fall because the decreased consumption that results from increased saving causes the economy to contract.

Answer: D

Diff: 1

Topic: *The Multiplier: Economics in Practice*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 24) Related to the *Economics in Practice* on p. 154 [466]: According to the "paradox of thrift," increased efforts to save will cause a(n)
- A) increase in income and an increase in overall saving.
 - B) increase in income but no overall change in saving.
 - C) decrease in income and an overall decrease in saving.
 - D) decrease in income but an increase in saving.

Answer: C

Diff: 1

Topic: *The Multiplier: Economics in Practice*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

2 True/False

- 1) The larger the *MPC*, the smaller the multiplier.

Answer: FALSE

Diff: 2

Topic: *The Multiplier*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 2) The smaller the *MPS*, the larger the multiplier.

Answer: TRUE

Diff: 2

Topic: *The Multiplier*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 3) If the *MPC* is .75, then the multiplier is 4.

Answer: TRUE

Diff: 2

Topic: *The Multiplier*

Skill: *Analytic*

AACSB: *Analytic Skills*

4) If the MPS is .1, then the multiplier is 10.

Answer: TRUE

Diff: 1

Topic: *The Multiplier*

Skill: *Analytic*

AACSB: *Analytic Skills*

5) An increase in the MPC, reduces the multiplier.

Answer: FALSE

Diff: 2

Topic: *The Multiplier*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

6) Related to the *Economics in Practice* on p. 154 [466]: The paradox of thrift is that all people deciding to save more could lead to them saving less.

Answer: TRUE

Diff: 2

Topic: *The Multiplier: Economics in Practice*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

Chapter 9 The Government and Fiscal Policy

9.1 Government in the Economy

1 Multiple Choice

- 1) Fiscal policy refers to
- A) the techniques used by a business firm to reduce its tax liability.
 - B) the behavior of the nation's central bank, the Federal Reserve, regarding the nation's money supply.
 - C) the spending and taxing policies used by the government to influence the economy.
 - D) the government's ability to regulate a firm's behavior in the financial markets.

Answer: C

Diff: 1

Topic: Government in the Economy

Skill: Definition

- 2) Which of the following is NOT a category of fiscal policy?
- A) government policies regarding the purchase of goods and services
 - B) government policies regarding taxation
 - C) government policies regarding money supply in the economy
 - D) government policies regarding transfer payments and welfare benefits

Answer: C

Diff: 1

Topic: Government in the Economy

Skill: Conceptual

AACSB: Reflective Thinking

- 3) What determines tax revenues?
- A) the income tax rate
 - B) the rate of interest
 - C) the money supply in the economy
 - D) the rate of inflation

Answer: A

Diff: 2

Topic: Government in the Economy

Skill: Conceptual

AACSB: Reflective Thinking

- 4) Which of the following is INCORRECT regarding tax revenues?
- A) they increase during recessions
 - B) they change with changes in the tax rate
 - C) they are a revenue source in the government's budget
 - D) they increase the rate of interest

Answer: A

Diff: 2

Topic: Government in the Economy

Skill: Conceptual

AACSB: Reflective Thinking

- 5) During recessions, government spending usually
- A) decreases because unemployment payments decrease.
 - B) increases because unemployment payments increase.
 - C) decrease because unemployment payments increase.
 - D) increases because unemployment payments decrease.

Answer: B

Diff: 1

Topic: Government in the Economy

Skill: Conceptual

AACSB: Reflective Thinking

- 6) Disposable income
- A) increases when net taxes increase.
 - B) increases when income increases.
 - C) decreases when saving increases.
 - D) increases when saving decreases.

Answer: B

Diff: 1

Topic: Government in the Economy

Skill: Conceptual

AACSB: Reflective Thinking

- 7) Bill's income is \$1,000 and his net taxes are \$350. His disposable income is
- A) \$1,350.
 - B) \$650.
 - C) -\$350.
 - D) \$750.

Answer: B

Diff: 1

Topic: Government in the Economy

Skill: Analytic

AACSB: Analytic Skills

- 8) When the government sector is included in the income–expenditure model, the equation for aggregate income is
- A) $Y = C + S - T$.
 - B) $Y = C + I$.
 - C) $Y = C + I + G$.
 - D) $Y = C + S + I$.

Answer: C

Diff: 1

Topic: Government in the Economy

Skill: Definition

- 9) The difference between what a government spends and what it collects in taxes in a year is
- A) net revenue.
 - B) net taxes.
 - C) the government budget deficit or surplus.
 - D) the government debt.

Answer: C

Diff: 1

Topic: Government in the Economy

Skill: Definition

- 10) In 2007, the city of Canfield collected \$500,000 in taxes and spent \$450,000. In 2007, the city of Canfield had a
- A) budget surplus of \$450,000.
 - B) budget surplus of \$50,000.
 - C) budget deficit of \$50,000.
 - D) budget surplus of \$5,000.

Answer: B

Diff: 1

Topic: Government in the Economy

Skill: Analytic

AACSB: Analytic Skills

- 11) In 2007, the city of Miketown collected \$250,000 in taxes and spent \$350,000. In 2007, the city of Miketown had a
- A) budget surplus of \$100,000.
 - B) budget surplus of 57%.
 - C) budget deficit of \$100,000.
 - D) budget deficit of \$200,000.

Answer: C

Diff: 1

Topic: Government in the Economy

Skill: Analytic

AACSB: Analytic Skills

- 12) After government is added to the income-expenditure model, the formula for the aggregate consumption function is
- A) $C = a - b(Y - T)$.
 - B) $C = a - b(T - Y)$.
 - C) $C = a + b(Y + T)$.
 - D) $C = a + b(Y - T)$.

Answer: D

Diff: 2

Topic: Government in the Economy

Skill: Definition

- 13) The aggregate consumption function is $C = 100 + .6Yd$. If income is \$1,000 and net taxes are \$300, consumption equals
- A) 800.
 - B) 520.
 - C) 580.
 - D) 700.

Answer: B

Diff: 2

Topic: Government in the Economy

Skill: Analytic

AACSB: Analytic Skills

- 14) The aggregate consumption function is $C = 800 + .8Yd$. If income is \$2,000 and net taxes are \$500, consumption equals
- A) 2,000.
 - B) 1,500.
 - C) 2,150.
 - D) 2,050.

Answer: A

Diff: 2

Topic: Government in the Economy

Skill: Analytic

AACSB: Analytic Skills

15) The aggregate consumption function is $C = 100 + .8Yd$. If income is \$600 and net taxes are zero, consumption equals

- A) zero. B) 460. C) 580. D) 360.

Answer: C

Diff: 2

Topic: Government in the Economy

Skill: Analytic

AACSB: Analytic Skills

16) The aggregate consumption function is $C = 1,000 + .9Yd$. If income is \$3,600 and net taxes are \$600, consumption equals

- A) 3,400. B) 3,700. C) 2,400. D) 4,000.

Answer: B

Diff: 2

Topic: Government in the Economy

Skill: Analytic

AACSB: Analytic Skills

17) If output is less than planned aggregate expenditure, there will be

- A) an unplanned increase in inventories. B) an unplanned decrease in inventories.
C) no change in inventories. D) a planned increase in inventories.

Answer: B

Diff: 2

Topic: Government in the Economy

Skill: Conceptual

AACSB: Reflective Thinking

Refer to the information provided in Table 9.1 below to answer the questions that follow.

Table 9.1

All Numbers are in \$ Billion				
Output (Income)	Consumption Spending	Net Taxes	Investment Spending	Government Spending
400	400	100	200	100
800	700	100	200	100
1,200	1,000	100	200	100
1,600	1,300	100	200	100
2,000	1,600	100	200	100

18) Refer to Table 9.1. At an output level of \$1,200 billion, the level of aggregate expenditure is

- A) \$1,000 billion. B) \$1,200 billion. C) \$1,300 billion. D) \$1,400 billion.

Answer: C

Diff: 1

Topic: Government in the Economy

Skill: Analytic

AACSB: Analytic Skills

19) Refer to Table 9.1. At an output level of \$1,200 billion, there is an unplanned inventory change of

- A) positive \$10 billion. B) zero.
C) negative \$100 billion. D) positive \$100 billion.

Answer: C

Diff: 2

Topic: Government in the Economy

Skill: Analytic

AACSB: Analytic Skills

20) Refer to Table 9.1. At an output level of \$2,000 billion, the level of aggregate expenditure is

- A) \$1,500 billion. B) \$1,800 billion. C) \$1,900 billion. D) \$2,000 billion.

Answer: C

Diff: 1

Topic: Government in the Economy

Skill: Analytic

AACSB: Analytic Skills

21) Refer to Table 9.1. At an output level of \$2,000 billion, there is an unplanned inventory change of

- A) positive \$100 billion. B) positive \$10 billion.
C) negative \$100 billion. D) zero.

Answer: A

Diff: 2

Topic: Government in the Economy

Skill: Analytic

AACSB: Analytic Skills

22) Refer to Table 9.1. The equilibrium level of output is _____ billion.

- A) \$800 B) \$1,200 C) \$1,600 D) \$2,000

Answer: C

Diff: 1

Topic: Government in the Economy

Skill: Analytic

AACSB: Analytic Skills

23) Refer to Table 9.1. At an output level of \$800 billion, disposable income equals _____ billion.

- A) \$800 B) \$700 C) \$600 D) \$500

Answer: B

Diff: 1

Topic: Government in the Economy

Skill: Analytic

AACSB: Analytic Skills

- 24) Refer to Table 9.1. At an output level of \$2,000 billion, the value of saving
- A) cannot be determined from the given information.
 - B) is \$300 billion.
 - C) is \$200 billion.
 - D) is \$100 billion.

Answer: B

Diff: 2

Topic: Government in the Economy

Skill: Analytic

AACSB: Analytic Skills

- 25) Refer to Table 9.1. At the equilibrium level of income, leakages equal _____ billion.
- A) \$0
 - B) \$100
 - C) \$200
 - D) \$300

Answer: D

Diff: 3

Topic: Government in the Economy

Skill: Analytic

AACSB: Analytic Skills

- 26) Refer to Table 9.1 At an output level of \$1,200 billion, there is a tendency for output
- A) to fall.
 - B) to increase.
 - C) to remain constant.
 - D) to either increase or decrease.

Answer: B

Diff: 3

Topic: Government in the Economy

Skill: Analytic

AACSB: Analytic Skills

Refer to the information provided in Table 9.2 below to answer the questions that follow.

Table 9.2

Output (Income)	Net Taxes	Consumption Spending	Planned	
			Investment Spending	Government Purchases
Y	T	C	I	G
500	100	400	150	50
1,000	100	800	150	50
1,500	100	1,200	150	50
2,000	100	1,600	150	50
2,500	100	2,000	150	50

- 27) Refer to Table 9.2. At an output level of \$1,500 billion, the level of aggregate expenditure is _____ billion.
- A) \$1,300
 - B) \$1,400
 - C) \$1,500
 - D) \$1,600

Answer: B

Diff: 1

Topic: Government in the Economy

Skill: Analytic

AACSB: Analytic Skills

- 28) Refer to Table 9.2. At an output level of \$1,500 billion, there is an unplanned inventory
- A) decrease of \$200 billion.
 - B) change of \$0.
 - C) increase of \$100 billion.
 - D) increase of \$150 billion.

Answer: C

Diff: 2

Topic: Government in the Economy

Skill: Analytic

AACSB: Analytic Skills

- 29) Refer to Table 9.2. At an output level of \$2,500, the level of aggregate expenditure is _____ billion.
- A) \$1,500
 - B) \$2,000
 - C) \$2,300
 - D) \$2,200

Answer: D

Diff: 1

Topic: Government in the Economy

Skill: Analytic

AACSB: Analytic Skills

- 30) Refer to Table 9.2. At an output level of \$2,500, there is an unplanned inventory
- A) increase of \$300 billion.
 - B) decrease of \$200 billion.
 - C) change of \$0.
 - D) increase of \$200 billion.

Answer: A

Diff: 2

Topic: Government in the Economy

Skill: Analytic

AACSB: Analytic Skills

- 31) Refer to Table 9.2. The equilibrium level of output is _____ billion.
- A) \$1000
 - B) \$1,500
 - C) \$2,000
 - D) \$2,500

Answer: A

Diff: 1

Topic: Government in the Economy

Skill: Analytic

AACSB: Analytic Skills

- 32) Refer to Table 9.2. At an output level of \$1,500, disposable income
- A) is \$1,000.
 - B) is \$1,200.
 - C) is \$1,400.
 - D) cannot be determined from this information.

Answer: C

Diff: 1

Topic: Government in the Economy

Skill: Analytic

AACSB: Analytic Skills

33) Refer to Table 9.2. At an output level of \$2,500, the level for saving

- A) is \$300.
- B) is \$400.
- C) is \$500.
- D) cannot be determined from this information.

Answer: B

Diff: 2

Topic: Government in the Economy

Skill: Analytic

AACSB: Analytic Skills

34) Refer to Table 9.2 At the equilibrium level of income, leakages equal _____ billion.

- A) \$0
- B) \$300
- C) \$500
- D) \$200

Answer: D

Diff: 3

Topic: Government in the Economy

Skill: Analytic

AACSB: Analytic Skills

35) Refer to Table 9.2. At an output level of \$2,500, there is a tendency for output

- A) to increase.
- B) to remain constant.
- C) to either increase or decrease.
- D) to fall.

Answer: D

Diff: 2

Topic: Government in the Economy

Skill: Analytic

AACSB: Analytic Skills

The Italian economy can be characterized by Equation 9.1.

EQUATION 9.1:

$$C = 300 + .8Yd$$

$$G = 400$$

$$T = 200$$

$$I = 200$$

36) Refer to Equation 9.1. The equilibrium level of output for the Italian economy is

- A) \$2,850.
- B) \$3,700.
- C) \$3,145.
- D) \$3,800.

Answer: B

Diff: 2

Topic: Government in the Economy

Skill: Analytic

AACSB: Analytic Skills

37) Refer to Equation 9.1. At the equilibrium level of output in Italy, consumption equals

- A) \$3,100.
- B) \$3,250.
- C) \$3,400.
- D) \$3,625.

Answer: A

Diff: 2

Topic: Government in the Economy

Skill: Analytic

AACSB: Analytic Skills

- 38) Refer to Equation 9.1. At the equilibrium level of output in Italy, saving equals
A) \$450. B) \$400. C) \$550. D) \$500.

Answer: B

Diff: 3

Topic: Government in the Economy

Skill: Analytic

AACSB: Analytic Skills

- 39) Refer to Equation 9.1. At the equilibrium level of output in Italy, leakages equal
A) \$650. B) \$600. C) \$750. D) \$700.

Answer: B

Diff: 3

Topic: Government in the Economy

Skill: Analytic

AACSB: Analytic Skills

The Canadian economy can be characterized by Equation 9.2.

EQUATION 9.2:

$$C = 500 + .5Yd$$

$$\text{Taxes} = 600$$

$$\text{Equilibrium Output} = \$4,000$$

- 40) Refer to Equation 9.2. At equilibrium, the sum of investment and government purchases in Canada is
A) \$1,800.
B) \$1,500.
C) \$1,750.
D) cannot be determined from the given information

Answer: A

Diff: 3

Topic: Government in the Economy

Skill: Analytic

AACSB: Analytic Skills

- 41) Refer to Equation 9.2. At equilibrium, government purchases in Canada is
A) \$1,500.
B) \$1,000.
C) \$1,250.
D) cannot be determined from the given information

Answer: D

Diff: 3

Topic: Government in the Economy

Skill: Analytic

AACSB: Analytic Skills

- 42) Refer to Equation 9.2. At equilibrium, saving in Canada equals
A) \$1,200. B) \$1,600. C) \$1,350. D) \$1,250.

Answer: A

Diff: 3

Topic: Government in the Economy

Skill: Analytic

AACSB: Analytic Skills

- 43) Refer to Equation 9.2. At equilibrium leakages in Canada equal
A) \$1,750. B) \$1,800. C) \$2,100. D) \$1,700.

Answer: B

Diff: 3

Topic: Government in the Economy

Skill: Analytic

AACSB: Analytic Skills

- 44) Assuming there is no foreign trade in the economy, the economy is in equilibrium when
A) $S + T = C + I$. B) $I + G = S + T$. C) $IT = S + G$. D) $G + T = S + I$.

Answer: B

Diff: 1

Topic: Government in the Economy

Skill: Conceptual

AACSB: Reflective Thinking

- 45) Assuming there is no foreign trade in the economy, equilibrium is achieved when government purchases equal
A) saving minus net taxes minus consumption.
B) saving plus net taxes minus investment.
C) net taxes plus investment minus saving.
D) net taxes minus investment minus saving.

Answer: B

Diff: 1

Topic: Government in the Economy

Skill: Conceptual

AACSB: Reflective Thinking

Refer to the information provided in Figure 9.1 below to answer the questions that follow.

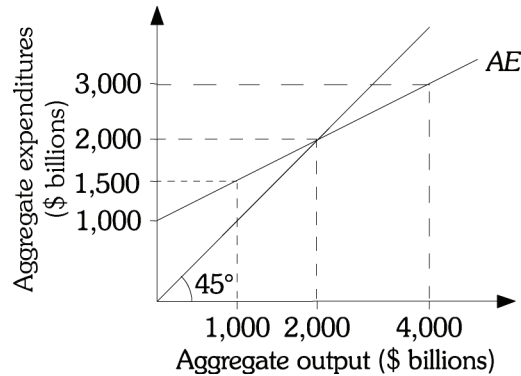


Figure 9.1

- 46) Refer to Figure 9.1. The equilibrium level of aggregate expenditure is \$_____ billion.
 A) 3,000 B) 2,000 C) 4,000 D) 1,500

Answer: B

Diff: 1

Topic: Government in the Economy

Skill: Analytic

AACSB: Analytic Skills

- 47) Refer to Figure 9.1. The MPC in this economy is
 A) 0.4.
 B) 0.6.
 C) 0.5.
 D) cannot be determined from the given information

Answer: C

Diff: 2

Topic: Government in the Economy

Skill: Analytic

AACSB: Analytic Skills

- 48) Refer to Figure 9.1. At equilibrium, injections
 A) can be greater than \$1,000 billion. B) equal \$1,500 billion.
 C) equal leakages. D) equal \$2,000 billion.

Answer: C

Diff: 3

Topic: Government in the Economy

Skill: Analytic

AACSB: Analytic Skills

- 49) Refer to Figure 9.1. At equilibrium, the part of consumption that is dependent on income equals \$_____ billion.
- A) \$1,500
 - B) \$1,000
 - C) \$2,000
 - D) cannot be determined from the given information

Answer: B

Diff: 2

Topic: Government in the Economy

Skill: Analytic

AACSB: Analytic Skills

- 50) Refer to Figure 9.1. Suppose that the consumption function is $C = 400 + 0.5Yd$ and taxes are \$200 billion, at equilibrium the value of injections are
- A) \$700 billion.
 - B) \$500 billion.
 - C) \$650 billion.
 - D) \$350 billion.

Answer: A

Diff: 3

Topic: Government in the Economy

Skill: Analytic

AACSB: Analytic Skills

- 51) Refer to Figure 9.1. Suppose that the consumption function is $C = 400 + 0.5Yd$ and taxes are \$200 billion, at equilibrium the value of autonomous consumption is
- A) \$400 billion.
 - B) \$300 billion.
 - C) \$100 billion.
 - D) \$200 billion.

Answer: A

Diff: 2

Topic: Government in the Economy

Skill: Analytic

AACSB: Analytic Skills

- 52) Refer to Figure 9.1. Suppose that the consumption function is $C = 400 + 0.5Yd$ and taxes are \$200 billion, at equilibrium, what is the value of consumption?
- A) \$1,350
 - B) \$2,000
 - C) \$1,300
 - D) \$1,150

Answer: C

Diff: 2

Topic: Government in the Economy

Skill: Analytic

AACSB: Analytic Skills

- 53) If planned injections exceed leakages, output will
- A) decrease.
 - B) increase.
 - C) remain constant.
 - D) either increase or decrease.

Answer: B

Diff: 2

Topic: Government in the Economy

Skill: Conceptual

AACSB: Reflective Thinking

- 54) For the economy to be in equilibrium,
- A) government purchases must equal tax revenue and saving must equal investment.
 - B) government purchases must equal the sum of tax revenue, saving and investment.
 - C) government purchases plus investment must equal saving plus tax revenue.
 - D) investment plus tax revenue must equal government purchases plus saving.

Answer: C

Diff: 1

Topic: Government in the Economy

Skill: Conceptual

AACSB: Reflective Thinking

2 True/False

- 1) The economy is in equilibrium when aggregate output equals consumption spending.

Answer: FALSE

Diff: 1

Topic: Government in the Economy

Skill: Conceptual

AACSB: Reflective Thinking

- 2) For the economy to be in equilibrium, the following condition must be satisfied: $G + I = S + T$.

Answer: TRUE

Diff: 1

Topic: Government in the Economy

Skill: Definition

- 3) When investment is greater than planned investment, output grows.

Answer: FALSE

Diff: 2

Topic: Government in the Economy

Skill: Conceptual

AACSB: Reflective Thinking

- 4) Disposable income is income less net taxes.

Answer: TRUE

Diff: 1

Topic: Government in the Economy

Skill: Definition

9.2 Fiscal Policy at Work: Multiplier Effects

1 Multiple Choice

- 1) If the government wants to reduce unemployment, government purchases should be _____ and/or taxes should be _____.

A) increased; increased

B) decreased; decreased

C) decreased; increased

D) increased; decreased

Answer: D

Diff: 1

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Conceptual

AACSB: Reflective Thinking

- 2) The President of Vulcan hires you as an economic consultant. He is concerned that the output level in Vulcan is too high and that this will cause prices to rise. He feels that it is necessary to reduce output by \$10 billion. He tells you that the *MPC* in Vulcan is 0.6. Which of the following would be the best advice to give to the Vulcan president?
- A) reduce government purchases by \$4 billion
 - B) increase taxes by \$10 billion
 - C) reduce government purchases by \$10 billion
 - D) increase taxes by \$2.5 billion

Answer: A

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

- 3) The leader of Atlantis hires you as an economic consultant. He is concerned that the output level in Atlantis is too low and that this will cause prices to fall. He feels that it is necessary to increase output by \$200 billion. He tells you that the *MPC* in Atlantis is 0.8. Which of the following would be the best advice to give to the Atlantis president?
- A) reduce government spending by \$100 billion
 - B) decrease taxes by \$50 billion
 - C) increase government spending by \$200 billion
 - D) increase government spending by \$100 billion

Answer: B

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

Refer to the information provided in Table 9.3 below to answer the questions that follow.

Table 9.3
All Numbers are in \$ Million

Output (Income)	Net Taxes	Consumption	Savings	Planned Investment	Planned Government Spending
1,000	200	—	120	200	200
1,100	200	760	140	200	200
1,200	200	840	—	200	200
1,300	200	—	180	200	200
1,400	200	1,000	200	200	200
1,500	200	1,080	220	200	200
1,600	200	1,160	—	200	200

- 4) Refer to Table 9.3. Assuming constant *MPC*, at income of \$1,000 million, consumption is \$_____ million, and at income of \$1,300 million, consumption is \$_____ million.
- A) 600; 860
 - B) 640; 900
 - C) 680; 920
 - D) 720; 960

Answer: C

Diff: 1

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

- 5) Refer to Table 9.3. Assuming constant MPC , at income of \$1,200 million, saving is \$_____ million, at income of \$1,600 million, saving is \$_____ million.
A) 150; 230 B) 160; 240 C) 170; 250 D) 180; 260

Answer: B

Diff: 1

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

- 6) Refer to Table 9.3. The MPC in this economy is _____ and the MPS is _____.
A) 0.5; 0.5 B) 0.7; 0.5 C) 0.9; 0.1 D) 0.8; 0.2

Answer: D

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

- 7) Refer to Table 9.3. The equilibrium level of aggregate output is \$_____ million.
A) 1,200 B) 1,300 C) 1,400 D) 1,500

Answer: C

Diff: 1

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

- 8) Refer to Table 9.3. Which of the following variables is NOT considered autonomous?
A) Saving B) Planned investment
C) Planned government spending D) none of the above

Answer: A

Diff: 1

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

- 9) Refer to Table 9.3. Suppose the economy is in equilibrium and the government increases spending by \$50 million, the new equilibrium output is \$_____ million
A) 1,650 B) 1,450 C) 1,750 D) 1,350

Answer: A

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

- 10) Refer to Table 9.3. Suppose the economy is in equilibrium and the government raises taxes from \$200 million to \$220 million, equilibrium output will _____ by \$_____ million.
A) decrease; 20 B) increase; 20 C) decrease; 80 D) increase; 80

Answer: C

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

Refer to the information provided in Table 9.4 below to answer the questions that follow.

Table 9.4
All Figures in Billions of Dollars

Output (Income)	Consumption		Planned		
	Net Taxes	Spending ($C = 100 + .9Y_d$)	Savings	Investment Purchases	Government Spending
2,400	100	2,170	150	130	200
2,800	100	2,530	170	130	200
3,000	100	2,710	190	130	200
3,200	100	2,890	210	130	200
3,400	100	3,070	230	130	200
3,600	100	3,250	250	130	200
3,800	100	3,300	270	130	200

- 11) Refer to Table 9.4. The equilibrium level of income is
 A) \$3,400 billion. B) \$3,800 billion. C) \$2,000 billion. D) \$3,600 billion.

Answer: A

Diff: 1

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

- 12) Refer to Table 9.4. The *MPS*
 A) is .8.
 B) is .1.
 C) is .2
 D) cannot be determined from the available information.

Answer: B

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

- 13) Refer to Table 9.4. The value of the government spending multiplier
 A) is 10.
 B) is .9.
 C) is 5.
 D) cannot be determined from the available information.

Answer: A

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

- 14) Refer to Table 9.4. The economy is at the equilibrium level of output. If government spending increases to a level of \$400 billion, the new equilibrium level of output is
A) \$5,400 billion. B) \$2,100 billion. C) \$6,040 billion. D) \$6,600 billion.

Answer: A

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

- 15) Refer to Table 9.4. The economy is at the equilibrium level of output. If government spending decreases by \$100 billion, the new equilibrium level of output is
A) \$3,100 billion. B) \$2,400 billion. C) \$1,450 billion. D) \$1,550 billion.

Answer: B

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

- 16) Refer to Table 9.4. If taxes are reduced from \$100 billion to \$50 billion, the new equilibrium level of output is
A) \$4,050 billion. B) \$1,600 billion. C) \$3,850 billion. D) \$2,100 billion.

Answer: C

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

- 17) Refer to Table 9.4. If taxes are reduced from \$100 billion to \$50 billion and government spending is reduced from \$200 billion to \$150 billion, the new equilibrium level of income
A) is \$3,350 billion.
B) is \$3,550 billion.
C) is \$1,600 billion.
D) cannot be determined from this information.

Answer: A

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

- 18) The government purchases multiplier is
A) the difference between the old equilibrium level of output and the new equilibrium level of output.
B) the ratio of the change in government purchases to the change in the equilibrium level of output.
C) the ratio of the change in the equilibrium level of output to a change in government purchases.
D) the difference between the new and old levels of government purchases.

Answer: C

Diff: 1

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Definition

- 19) If the MPC is .75, the government spending multiplier is
 A) 2.5. B) 4. C) 3. D) 1.75.
 Answer: B
 Diff: 1
 Topic: Fiscal Policy at Work: Multiplier Effects
 Skill: Analytic
 AACSB: Analytic Skills
- 20) If the MPC is .5, the tax multiplier is
 A) -2.5. B) -2. C) -1. D) -1.666.
 Answer: C
 Diff: 1
 Topic: Fiscal Policy at Work: Multiplier Effects
 Skill: Analytic
 AACSB: Analytic Skills
- 21) If the government spending multiplier is 2 and government purchases increase by \$200 billion, output will increase by
 A) \$100 billion. B) \$400 billion. C) \$1,600 billion. D) \$500 billion.
 Answer: B
 Diff: 2
 Topic: Fiscal Policy at Work: Multiplier Effects
 Skill: Analytic
 AACSB: Analytic Skills
- 22) If the government spending multiplier is 5 and government spending decreases by \$200 billion, output will _____ by \$_____ billion.
 A) increase; 200 B) decrease; 1,000
 C) decrease; 40 D) decrease; 200
 Answer: B
 Diff: 2
 Topic: Fiscal Policy at Work: Multiplier Effects
 Skill: Analytic
 AACSB: Analytic Skills

The economy of Bananaland can be characterized by Equation 9.3.

EQUATION 9.3:

$$C = 2,000 + .75Yd$$

$$T = 200$$

$$G = 400$$

$$I = 500$$

- 23) Refer to Equation 9.3. The equilibrium level of income in Bananaland is
 A) 4,800. B) 11,000. C) 10,000. D) 5,600.
 Answer: B
 Diff: 2
 Topic: Fiscal Policy at Work: Multiplier Effects
 Skill: Analytic
 AACSB: Analytic Skills

- 24) Refer to Equation 9.3. If government spending in Bananaland increases by \$50, equilibrium output increases by
- A) \$100. B) \$200. C) \$400. D) \$800.

Answer: B

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

Refer to the information provided in Figure 9.3 below to answer the questions that follow.

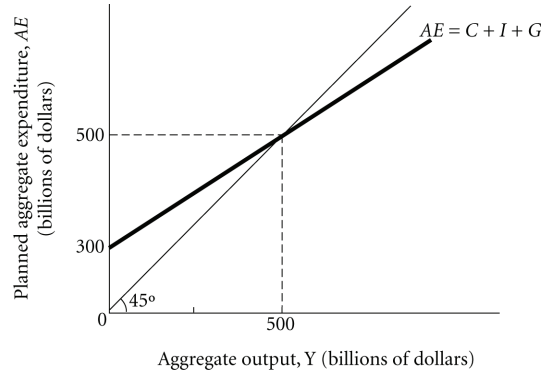


Figure 9.3

- 25) Refer to Figure 9.3. At equilibrium, autonomous planned expenditures equal \$_____ billion.
- A) 200 B) 100 C) 500 D) 300

Answer: D

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

- 26) Refer to Figure 9.3. The expenditure multiplier is
- A) 4. B) 5. C) 2.5. D) 2.

Answer: C

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

- 27) Refer to Figure 9.3. If autonomous planned expenditure increases by \$20 billion, equilibrium aggregate output _____ to \$_____ billion.
- A) decreases; 360 B) increases; 550 C) increases; 600 D) increases; 640

Answer: B

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

Refer to the information provided in Figure 9.4 below to answer the questions that follow.

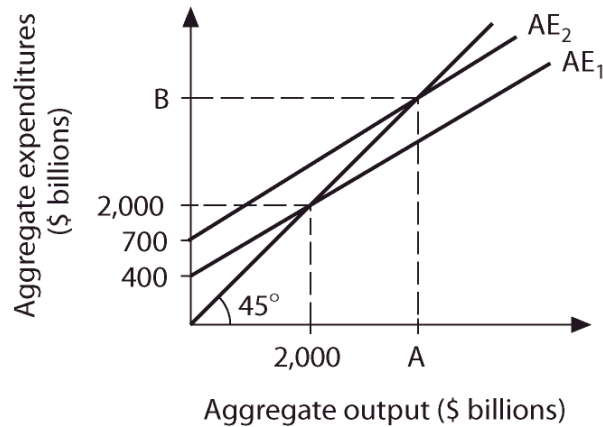


Figure 9.4

- 28) Refer to Figure 9.4. Along aggregate expenditure AE_1 , the MPC is
- A) .6. B) .7. C) .8. D) .9.

Answer: C

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

- 29) Refer to Figure 9.4. What is the value of Point A?
- A) \$3,500 billion.
 B) \$6,000 billion.
 C) \$7,000 billion.
 D) cannot be determined from the given information

Answer: A

Diff: 3

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

- 30) Refer to Figure 9.4. What is the value of Point B?
- A) \$7,000 billion
 B) \$3,500 billion
 C) \$6,000 billion
 D) cannot be determined from the given information

Answer: B

Diff: 3

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

31) Refer to Figure 9.4. What is the value of the expenditure multiplier?

- A) 8 B) 10 C) 5 D) 20

Answer: C

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

32) Refer to Figure 9.4. Along AE_1 , injections equal leakages when aggregate output equals \$_____ billion.

- A) 1,500 B) 3,000 C) 2,500 D) 2,000

Answer: D

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

33) Refer to Figure 9.4. If aggregate expenditures are represented by AE_2 and government spending increases by \$20 billion, equilibrium aggregate output increases by \$_____ billion.

- A) 100 B) 200 C) 400 D) 800

Answer: A

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

34) Government spending increases by \$40 billion and the equilibrium level of output increases by \$200 billion. The government spending multiplier

- A) is 5.
B) is 4.
C) is 6.
D) cannot be determined from this information, because the MPC is not given.

Answer: A

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

35) Assume an economy is in equilibrium at an output level of \$1,500 billion. If government spending increases by \$200 billion, then at the output level of \$1,500 billion, there is

- A) an unplanned rise in inventories.
B) an unplanned fall in inventories.
C) an unplanned inventory change of zero.
D) either an unplanned increase or decrease in inventories depending on the value of the MPC .

Answer: B

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

- 36) Assume an economy is in equilibrium at an output level of \$600 billion. If government purchases decrease by \$75 billion, then at the output level of \$600 billion, there is
- A) an unplanned increase in inventories.
 - B) an unplanned inventory change of zero.
 - C) either an unplanned increase or decrease in inventories depending on the value of the MPC.
 - D) an unplanned decrease in inventories.

Answer: A

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

- 37) A decrease in lump-sum taxes will
- A) make the consumption function flatter.
 - B) make the consumption function steeper.
 - C) shift the consumption function downward.
 - D) shift the consumption function upward.

Answer: D

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Conceptual

AACSB: Reflective Thinking

- 38) The tax multiplier is
- A) the ratio of the change in taxes to the change in the equilibrium level of output.
 - B) the MPC multiplied by the MPS.
 - C) the difference in taxes multiplied by the change in the equilibrium level of output.
 - D) the ratio of the change in the equilibrium level of output to the change in taxes.

Answer: D

Diff: 1

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Definition

- 39) If the MPC is 0.7, the tax multiplier is
- A) -2.22.
 - B) -1.22.
 - C) -2.33.
 - D) -3.33.

Answer: C

Diff: 1

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

- 40) If the MPS is 0.4, the tax multiplier is
- A) -2.5.
 - B) -1.67.
 - C) -1.5.
 - D) -2.33.

Answer: C

Diff: 1

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

41) If the MPS is 0.5, the tax multiplier is

- A) -5. B) -2. C) -1. D) -0.5.

Answer: C

Diff: 1

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

42) Taxes are reduced by \$70 billion and income increases by \$280 billion. The value of the tax multiplier is

- A) -4. B) -20. C) -10. D) -5.

Answer: A

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

43) Taxes are reduced by \$15 billion and income increases by \$75 billion. The value of the tax multiplier is

- A) -4. B) 9. C) -10. D) -5.

Answer: D

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

44) If the tax multiplier is -9 and taxes are reduced by \$100 billion, output

- A) falls by \$100 billion. B) falls by \$900 billion.
C) increases by \$900 billion. D) increases by \$100 billion.

Answer: C

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

45) If the tax multiplier is -12 and taxes are increased by \$6 billion, output

- A) falls by \$2 billion. B) falls by \$72 billion.
C) increases by \$2 billion. D) increases by \$72 billion.

Answer: B

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

Refer to the information provided in Figure 9.5 below to answer the questions that follow.

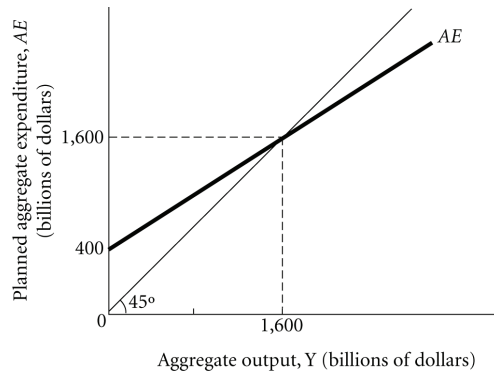


Figure 9.5

46) Refer to Figure 9.5. Which of the following equations best represents the aggregate expenditure function?

A) $AE = 1,600 + .4Y$.

B) $AE = 400 + .75Y$.

C) $AE = 1,200 + .8Y$.

D) $AE = 1,000 + .5Y$.

Answer: B

Diff: 3

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

47) Refer to Figure 9.5. At aggregate output of \$2,400 billion, unplanned inventories equal \$ _____ billion.

A) 200

B) 800

C) -800

D) -400

Answer: A

Diff: 3

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

48) Refer to Figure 9.5. The government spending multiplier equals _____ and the tax multiplier equals _____.

A) 2.5; -1.5

B) 4; -3

C) 5; -4

D) 9; -8

Answer: B

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

49) Refer to Figure 9.5. If the economy is in equilibrium and the government increases spending by \$100 billion, equilibrium aggregate expenditures increase to \$ _____ billion.

A) 1,700

B) 1,800

C) 2,000

D) 2,400

Answer: C

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

- 50) Refer to Figure 9.5. If the economy is in equilibrium and the government decreases spending by \$200 billion, equilibrium aggregate output decreases to \$_____ billion.
A) 1,400 B) 1,200 C) 1,000 D) 800

Answer: D

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

- 51) Refer to Figure 9.5. If the economy is in equilibrium and the government increases taxes by \$50 billion, equilibrium aggregate output _____ to \$_____ billion.
A) increases; 2,000 B) decreases; 1,550
C) decreases; 1,450 D) decreases; 1,400

Answer: C

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

- 52) Refer to Figure 9.5. If the economy is in equilibrium and the government increases spending by \$100 billion and increases taxes by \$100 billion, equilibrium aggregate output
A) does not change. B) increases by \$100 billion.
C) increases by less than \$100 billion. D) increases by more than \$100 billion.

Answer: B

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

- 53) If the government spending multiplier is 10, then the tax multiplier
A) is -5.
B) is -4.
C) is -9.
D) cannot be determined because the *MPS* is not given.

Answer: C

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Conceptual

AACSB: Reflective Thinking

- 54) If the tax multiplier is -8.42, then the government purchases multiplier
A) is 8.42.
B) is 9.42.
C) is 1.58.
D) cannot be determined because the *MPS* is not given.

Answer: B

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Conceptual

AACSB: Reflective Thinking

- 55) If government spending is increased by \$300, taxes are reduced by \$300, and the MPS is .5, equilibrium output will change by
- A) \$300.
 - B) \$0.
 - C) \$900.
 - D) an amount that cannot be determined from this information.

Answer: C

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

- 56) If government purchases are increased by \$100, taxes are reduced by \$100, and the MPC is .8, equilibrium output will change by
- A) -\$400.
 - B) \$1,800.
 - C) \$900.
 - D) an amount that cannot be determined from this information.

Answer: C

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

- 57) If government spending is increased by \$550 and taxes are increased by \$550, the equilibrium level of income will
- A) decrease by \$550.
 - B) not change.
 - C) increase by \$550.
 - D) increase by \$1,100.

Answer: C

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

- 58) If government purchases are decreased by \$800 and taxes are decreased by \$800, the equilibrium level of income will
- A) decrease by \$800.
 - B) increase by \$800.
 - C) not change.
 - D) decrease by \$1600.

Answer: A

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

- 59) Assume that the MPC is $.75$. If government spending increases by \$400, equilibrium output _____; and if taxes increase by \$400, equilibrium output _____.
- A) increases by \$1,600; decreases by \$1,600 B) increases by \$1,600; decreases by \$1,200
C) increases by \$1,200; decreases by \$1,600 D) increases by \$400; decreases by \$400

Answer: B

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

- 60) Assume that the MPC is $.9$. If government purchases increase by \$100, equilibrium output _____; and if taxes increase by \$100, equilibrium output _____.
- A) increases by \$1,000; decreases by \$1,000 B) increases by \$900; decreases by \$1,000
C) increases by \$1,000; decreases by \$900 D) increases by \$400; decreases by \$400

Answer: C

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

- 61) You are hired by the Council of Economic Advisors (CEA) as an economic consultant. The Chairperson of the CEA tells you that she believes the current unemployment rate is too high. The unemployment rate can be reduced if aggregate output increases. She wants to know what policy to pursue to increase aggregate output by \$300 billion. The best estimate she has for the MPC is $.8$. Which of the following policies should you recommend?
- A) Increase government purchases by \$60 billion.
B) Increase government purchases by \$150 billion.
C) Cut taxes by \$60 billion.
D) Cut taxes by \$60 billion and to increase government purchases by \$60 billion.

Answer: A

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

- 62) You are hired by the Bureau of Economic Analogies (BEA) as an economic consultant. The Chairperson of the BEA tells you that he believes the current unemployment rate is too low. The unemployment rate can be increased if aggregate output decreases. He wants to know what policy to pursue to decrease aggregate output by \$100 billion. The best estimate he has for the MPC is $.9$. Which of the following policies should you recommend?
- A) Decrease government spending by \$10 billion.
B) Decrease government spending by \$100 billion.
C) Increase taxes by \$100 billion.
D) Cut taxes by \$60 billion and to increase government spending by \$60 billion.

Answer: A

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

- 63) You are hired by the Council of Economic Advisors (CEA) as an economic consultant. The chairperson of the CEA tells you that she believes the current unemployment rate is too high. The unemployment rate can be reduced if aggregate output increases. She wants to know what policy to pursue to increase aggregate output by \$300 billion. The best estimate she has for the MPC is .8. Which of the following policies should you recommend?
- A) Increase government purchases by \$75 billion.
 - B) Reduce taxes by \$75 billion.
 - C) Reduce taxes by \$75 billion and to increase government purchases by \$75 billion.
 - D) Reduce the budget deficit by \$300 billion.

Answer: B

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

- 64) You are hired by the Bureau of Economic Analogies (BEA) as an economic consultant. The chairperson of the BEA tells you that he believes the current unemployment rate is too high. The unemployment rate can be reduced if aggregate output increases. He wants to know what policy to pursue to increase aggregate output by \$500 billion. The best estimate he has for the MPC is .7. Which of the following policies should you recommend?
- A) Decrease government spending by \$75 billion.
 - B) Reduce taxes by \$214.3 billion.
 - C) Reduce taxes by \$314.3 billion and to decrease government spending by \$500 billion.
 - D) Reduce the budget deficit by \$300 billion.

Answer: B

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

- 65) You are hired by the Council of Economic Advisors (CEA) as an economic consultant. The chairperson of the CEA tells you that she believes the current unemployment rate is too high. The unemployment rate can be reduced if aggregate output increases. She wants to know what policy to pursue to increase aggregate output by \$300 billion. The best estimate she has for the MPC is .8. Which of the following policies should you recommend?
- A) Increase government spending by \$300 billion and reduce taxes by \$300 billion.
 - B) Reduce government spending by \$300 billion and increase taxes by \$300 billion.
 - C) Increase both government spending and taxes by \$300 billion.
 - D) Decrease both government spending and taxes by \$300 billion.

Answer: C

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

- 66) You are hired by the Bureau of Economic Analogies (BEA) as an economic consultant. The chairperson of the BEA tells you that he believes the current unemployment rate is too high. The unemployment rate can be reduced if aggregate output increases. He wants to know what policy to pursue to increase aggregate output by \$500 billion. The best estimate he has for the MPC is .75. Which of the following policies should you recommend?
- A) Reduce government spending by \$500 billion and reduce taxes by \$500 billion.
 - B) Increase both government spending and taxes by \$500 billion.
 - C) Increase government spending by \$500 billion and reduce taxes by \$500 billion.
 - D) none of the above

Answer: B

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Analytic

AACSB: Analytic Skills

- 67) As the size of the MPC increases, the value of the balanced-budget multiplier
- A) increases.
 - B) decreases.
 - C) remains constant.
 - D) could either increase or decrease.

Answer: C

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Conceptual

AACSB: Reflective Thinking

- 68) Suppose that in the beginning of 2007 the federal debt was \$9 trillion. During 2007, the government balanced its budget. At the end of 2007, the federal debt
- A) increased.
 - B) stayed the same.
 - C) decreased.
 - D) was eliminated.

Answer: B

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Conceptual

AACSB: Reflective Thinking

2 True/False

- 1) If autonomous spending increases, the aggregate expenditure function becomes steeper.

Answer: FALSE

Diff: 1

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Conceptual

AACSB: Reflective Thinking

- 2) If the government increases taxes by \$4 billion and increases spending by \$4 billion, equilibrium output increases by \$4 billion.

Answer: TRUE

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Conceptual

AACSB: Reflective Thinking

- 3) A tax cut of \$12 billion will have less effect on the economy than an increase in government purchases of \$12 billion.

Answer: TRUE

Diff: 2

Topic: Fiscal Policy at Work: Multiplier Effects

Skill: Conceptual

AACSB: Reflective Thinking

9.3 The Federal Budget

1 Multiple Choice

- 1) The total amount owed by the federal government to the public is the
- A) federal budget deficit.
 - B) federal debt.
 - C) net tax revenue.
 - D) fiscal drag.

Answer: B

Diff: 1

Topic: The Federal Budget

Skill: Definition

- 2) What is the largest expenditure source in the government's budget?
- A) consumption
 - B) transfer payments
 - C) net interest payments
 - D) net subsidies

Answer: B

Diff: 1

Topic: The Federal Budget

Skill: Fact

- 3) What is the largest source of revenue in the government's budget?
- A) social insurance
 - B) indirect business taxes
 - C) corporate taxes
 - D) personal taxes

Answer: D

Diff: 1

Topic: The Federal Budget

Skill: Fact

- 4) A government's debt is reduced when it
- A) balances its budget.
 - B) sells more bonds.
 - C) runs a deficit.
 - D) runs a surplus.

Answer: D

Diff: 2

Topic: The Federal Budget

Skill: Conceptual

AACSB: Reflective Thinking

5) When a government runs a deficit

- A) its debt increases.
- C) its debt decreases.

- B) it must raise taxes
- D) it must cut spending.

Answer: A

Diff: 1

Topic: *The Federal Budget*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

2 True/False

1) The amount the government owes to the public is the deficit.

Answer: FALSE

Diff: 1

Topic: *The Federal Budget*

Skill: *Definition*

2) If tax receipts are less than government expenditures the government is running a deficit.

Answer: TRUE

Diff: 1

Topic: *The Federal Budget*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

3) If the government runs a deficit, then the government debt increases.

Answer: TRUE

Diff: 2

Topic: *The Federal Budget*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

4) Defense spending is the largest part of the U.S. government spending.

Answer: FALSE

Diff: 2

Topic: *The Federal Budget*

Skill: *Fact*

5) The government budget is balanced when tax receipts equal government spending.

Answer: TRUE

Diff: 1

Topic: *The Federal Budget*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

9.4 The Economy's Influence on the Government Budget

1 Multiple Choice

- 1) Which of the following is a CORRECT sequence of events during a recession?
- A) unemployment falls, income falls, tax revenue falls, unemployment benefits rise, and the budget deficit rises
 - B) unemployment rises, income falls, tax revenue falls, unemployment benefits rise, and the budget deficit rises
 - C) unemployment rises, income falls, tax revenue rises, unemployment benefits fall, and the budget deficit falls
 - D) unemployment rises, income rises, tax revenue rises, unemployment benefits rise, and the budget deficit rises

Answer: B

Diff: 2

Topic: *The Economy's Influence on the Government Budget*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 2) Which of the following is a CORRECT sequence of events during an expansion?
- A) unemployment falls, income falls, tax revenue falls, unemployment benefits rise, and the budget deficit falls
 - B) unemployment rises, income falls, tax revenue falls, unemployment benefits rise, and the budget deficit rises
 - C) unemployment rises, income falls, tax revenue rises, unemployment benefits fall, and the budget deficit falls
 - D) unemployment falls, income rises, tax revenue rises, unemployment benefits fall, and the budget deficit falls

Answer: D

Diff: 2

Topic: *The Economy's Influence on the Government Budget*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 3) The presence of automatic stabilizers means that the federal deficit is _____ than it otherwise would be in a recession and _____ than it otherwise would be in an expansion.
- A) larger; smaller
 - B) smaller; larger
 - C) smaller; smaller
 - D) larger; larger

Answer: A

Diff: 2

Topic: *The Economy's Influence on the Government Budget*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 4) During a recession, automatic stabilizers cause the federal deficit to
- A) decrease.
 - B) either increase or decrease.
 - C) remain unchanged.
 - D) increase.

Answer: D

Diff: 2

Topic: *The Economy's Influence on the Government Budget*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 5) An example of an automatic stabilizer is
- A) the food stamp program.
 - B) changing the tax laws to increase the marginal tax rates.
 - C) the indexation of social security benefits to the consumer price index.
 - D) the interest the government pays on loans.

Answer: A

Diff: 2

Topic: *The Economy's Influence on the Government Budget*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 6) If the economy is in a recession, the full-employment deficit is _____ the actual deficit.
- A) larger than
 - B) equal to
 - C) smaller than
 - D) equal to or larger than

Answer: C

Diff: 1

Topic: *The Economy's Influence on the Government Budget*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 7) If the economy's full-employment output is \$6 trillion, actual output is \$3.5 trillion, and the budget deficit is \$20 billion, the deficit in this case is known as a
- A) natural employment deficit.
 - B) cyclical deficit.
 - C) structural deficit.
 - D) debt deficit.

Answer: B

Diff: 1

Topic: *The Economy's Influence on the Government Budget*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 8) If the economy's full-employment output is \$9 trillion, actual output is \$9 trillion, and the budget deficit is \$20 billion, the deficit in this case is known as a
- A) natural employment deficit.
 - B) cyclical deficit.
 - C) structural deficit.
 - D) fiscal deficit.

Answer: C

Diff: 1

Topic: *The Economy's Influence on the Government Budget*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 9) Assume that in the United States the actual deficit is \$300 billion. If the United States were at full employment, the deficit would be \$100 billion. The structural deficit in the United States is
- A) \$100 billion.
 - B) \$200 billion.
 - C) \$300 billion.
 - D) \$400 billion.

Answer: A

Diff: 1

Topic: *The Economy's Influence on the Government Budget*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 10) Assume that in the Atlantis the actual deficit is \$200 billion. If the Atlantis were at full employment, the deficit would be \$50 billion. The structural deficit in the Atlantis is
- A) \$100 billion. B) \$200 billion. C) \$50 billion. D) \$150 billion.

Answer: C

Diff: 1

Topic: *The Economy's Influence on the Government Budget*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 11) In which case will the government collect more tax revenue?
- A) 40% tax rate and \$40,000 average income
B) 90% tax rate and \$10,000 average income
C) 20% tax rate and \$90,000 average income
D) 4% tax rate and \$80,000 average income

Answer: C

Diff: 1

Topic: *The Economy's Influence on the Government Budget*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 12) If taxes are a function of income, then the *AE* function is
- A) flatter than if taxes are a lump-sum amount.
B) steeper than if taxes are a lump-sum amount.
C) vertical.
D) downward sloping.

Answer: A

Diff: 2

Topic: *The Economy's Influence on the Government Budget*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 13) Related to the *Economics in Practice* on p. 174 [486]: The value of the rebate checks issued by the government in 2008 will impact the economy and be affected by the
- A) government spending multiplier. B) tax multiplier.
C) money multiplier. D) balanced-budget multiplier.

Answer: B

Diff: 1

Topic: *The Economy's Influence on the Government Budget: Economics in Practice*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 14) Related to the *Economics in Practice* on p. 174 [486]: As a direct stimulus for the economy, tax rebates will generally have _____ increasing government spending.
- A) a greater impact than B) a smaller impact than
C) an equal impact to D) no impact, as opposed to

Answer: B

Diff: 2

Topic: *The Economy's Influence on the Government Budget: Economics in Practice*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

2 True/False

- 1) During recessions, automatic stabilizers work to reduce government expenditures and increase government revenues.

Answer: FALSE

Diff: 2

Topic: *The Economy's Influence on the Government Budget*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 2) The structural deficit is the deficit at full employment.

Answer: TRUE

Diff: 1

Topic: *The Economy's Influence on the Government Budget*

Skill: *Definition*

- 3) In an expansion the U.S. federal government deficit automatically grows.

Answer: FALSE

Diff: 1

Topic: *The Economy's Influence on the Government Budget*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 4) Automatic stabilizers include those elements of government spending that automatically grow during a recession.

Answer: TRUE

Diff: 1

Topic: *The Economy's Influence on the Government Budget*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

9.5 Appendix A: Deriving the Fiscal Policy Multipliers

1 Multiple Choice

- 1) The formula for the government spending multiplier is

A) $1/(1 + MPC)$.

B) $1/MPS$.

C) $1/MPC$.

D) $1/(1 + MPS)$.

Answer: B

Diff: 1

Topic: *Appendix A: Deriving the Fiscal Policy Multipliers*

Skill: *Definition*

- 2) If the MPS is 0.2, the tax multiplier is

A) -4.

B) -1.11.

C) -9.

D) -5.

Answer: A

Diff: 1

Topic: *Appendix A: Deriving the Fiscal Policy Multipliers*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 3) If the MPS is 0.1, the government spending multiplier is
A) 10. B) 1.11. C) 5. D) 2.

Answer: A

Diff: 1

Topic: Appendix A: Deriving the Fiscal Policy Multipliers

Skill: Analytic

AACSB: Analytic Skills

- 4) The formula for the tax multiplier is
A) $-(MPS/MPC)$. B) MPS/MPC . C) $-(MPC/MPS)$. D) $-1/MPS$.

Answer: C

Diff: 1

Topic: Appendix A: Deriving the Fiscal Policy Multipliers

Skill: Definition

- 5) If the MPC is 0.9, the tax multiplier is
A) -9. B) -10. C) -1.10. D) 10.

Answer: A

Diff: 1

Topic: Appendix A: Deriving the Fiscal Policy Multipliers

Skill: Analytic

AACSB: Analytic Skills

- 6) The balanced-budget multiplier
A) equals 0. B) is greater than 0 but less than 1.
C) is greater than 1. D) equals 1.

Answer: D

Diff: 1

Topic: Appendix A: Deriving the Fiscal Policy Multipliers

Skill: Definition

2 True/False

- 1) As the MPC decreases, the government spending multiplier increases.

Answer: FALSE

Diff: 1

Topic: Appendix A: Deriving the Fiscal Policy Multipliers

Skill: Conceptual

AACSB: Reflective Thinking

- 2) The balanced-budget multiplier works whenever the government increases spending and increases taxes by the same amount.

Answer: TRUE

Diff: 1

Topic: Appendix A: Deriving the Fiscal Policy Multipliers

Skill: Conceptual

AACSB: Reflective Thinking

9.6 Appendix B: The Case in Which Tax Revenues Depend on Income

1 Multiple Choice

- 1) Assume that taxes depend on income. The MPC is 0.8 and t is 0.25. The government spending multiplier is

A) 1.67. B) 2.5. C) 5. D) 10.

Answer: B

Diff: 2

Topic: Appendix B: The Case in Which Tax Revenues Depend on Income

Skill: Analytic

AACSB: Analytic Skills

- 2) Assume that taxes depend on income. The MPC is 0.9 and t is 0.3. The government spending multiplier is

A) 10. B) 2.7. C) 1.17. D) 1.42.

Answer: B

Diff: 2

Topic: Appendix B: The Case in Which Tax Revenues Depend on Income

Skill: Analytic

AACSB: Analytic Skills

- 3) Assume that taxes depend on income. The MPC is 0.5 and t is 0.2. If government spending increases by \$10 billion, the equilibrium level of output will increase by

A) \$16.7 billion. B) \$25 billion. C) \$50 billion. D) \$100 billion.

Answer: A

Diff: 2

Topic: Appendix B: The Case in Which Tax Revenues Depend on Income

Skill: Analytic

AACSB: Analytic Skills

- 4) Assume that taxes depend on income. The MPC is 0.8 and t is 0.4. If government purchases increase by \$100 billion, the equilibrium level of output will increase by

A) \$16.7 billion. B) \$215.9 billion.
C) \$57.5 billion. D) \$192.31 billion.

Answer: D

Diff: 2

Topic: Appendix B: The Case in Which Tax Revenues Depend on Income

Skill: Analytic

AACSB: Analytic Skills

- 5) If taxes depend on income and the MPC is 0.6 and t is 0.3, the tax multiplier is

A) -1.72. B) -1.03. C) -2.0. D) -2.24.

Answer: B

Diff: 1

Topic: Appendix B: The Case in Which Tax Revenues Depend on Income

Skill: Analytic

AACSB: Analytic Skills

- 6) Assume that taxes depend on income and the MPC is 0.6 and t is 0.3. An increase in taxes of \$10 billion will decrease equilibrium income by
- A) \$17.2 billion. B) \$10.3 billion. C) \$20.0 billion. D) \$22.4 billion.

Answer: B

Diff: 2

Topic: Appendix B: The Case in Which Tax Revenues Depend on Income

Skill: Analytic

AACSB: Analytic Skills

- 7) If taxes depend on income, then the magnitude of the government spending multiplier _____ it would be if taxes were a lump-sum amount.
- A) could be either larger than or smaller than
B) is larger than
C) is equal to what
D) is smaller than

Answer: D

Diff: 2

Topic: Appendix B: The Case in Which Tax Revenues Depend on Income

Skill: Conceptual

AACSB: Reflective Thinking

- 8) If taxes depend on income, then the absolute value of the tax multiplier _____ it would be if taxes were a lump-sum amount.
- A) could be either larger than or smaller than
B) is larger than
C) is equal to what
D) is smaller than

Answer: D

Diff: 2

Topic: Appendix B: The Case in Which Tax Revenues Depend on Income

Skill: Conceptual

AACSB: Reflective Thinking

- 9) As the tax rate increases, the government spending multiplier
- A) increases.
B) decreases.
C) does not change.
D) could either increase or decrease depending on the value of the MPC .

Answer: B

Diff: 1

Topic: Appendix B: The Case in Which Tax Revenues Depend on Income

Skill: Conceptual

AACSB: Reflective Thinking

- 10) As the tax rate increases, the absolute value of the tax multiplier
- A) increases.
 - B) decreases.
 - C) does not change.
 - D) could either increase or decrease depending on the value of the MPC.

Answer: B

Diff: 2

Topic: Appendix B: The Case in Which Tax Revenues Depend on Income

Skill: Conceptual

AACSB: Reflective Thinking

2 True/False

- 1) When taxes depend on income, a higher tax rate implies a higher government spending multiplier.

Answer: FALSE

Diff: 1

Topic: Appendix B: The Case in Which Tax Revenues Depend on Income

Skill: Conceptual

AACSB: Reflective Thinking

- 2) When the MPC is 0.8 and t is 0.4, then the government spending multiplier is about -1.54 .

Answer: FALSE

Diff: 2

Topic: Appendix B: The Case in Which Tax Revenues Depend on Income

Skill: Analytic

AACSB: Analytic Skills

- 3) If the MPS is 0.25 and t is 0.4, then the tax multiplier is about -2.96 .

Answer: FALSE

Diff: 3

Topic: Appendix B: The Case in Which Tax Revenues Depend on Income

Skill: Analytic

AACSB: Analytic Skills

- 4) If the MPS is 0.4 and t is 0.3, then the tax multiplier is about -1.03 .

Answer: TRUE

Diff: 3

Topic: Appendix B: The Case in Which Tax Revenues Depend on Income

Skill: Analytic

AACSB: Analytic Skills

- 5) When the tax rate increases, the absolute value of the tax multiplier falls.

Answer: TRUE

Diff: 1

Topic: Appendix B: The Case in Which Tax Revenues Depend on Income

Skill: Conceptual

AACSB: Reflective Thinking

Chapter 10 The Money Supply and the Federal Reserve System

10.1 An Overview of Money

1 Multiple Choice

- 1) Money is
- A) the same as income.
 - B) anything that is generally accepted as a medium of exchange.
 - C) the value of all coins and currency in circulation at any time.
 - D) backed by gold in Fort Knox.

Answer: B

Diff: 1

Topic: An Overview of Money

Skill: Definition

- 2) Any transaction that involves exchanging one good for another without using money is considered a
- A) liquidity transaction.
 - B) barter transaction.
 - C) deferred payment.
 - D) black market exchange.

Answer: B

Diff: 1

Topic: An Overview of Money

Skill: Definition

- 3) Jacob makes excellent tamales and Amanda is very good at mowing lawns. Amanda agrees to mow Jacob's lawn, if he makes her a dozen tamales. This is an example of
- A) legal tender.
 - B) barter.
 - C) commodity money.
 - D) fiat money.

Answer: B

Diff: 2

Topic: An Overview of Money

Skill: Conceptual

AACSB: Reflective Thinking

- 4) Which of the following factors causes the barter system to be inefficient?
- A) Its cost of transaction is too low.
 - B) The cost associated with information search is too low.
 - C) It requires a double coincidence of wants.
 - D) It requires high liquidity.

Answer: C

Diff: 2

Topic: An Overview of Money

Skill: Conceptual

AACSB: Reflective Thinking

- 5) Josie wants to trade swimming lessons for cooking lessons. Maria wants to trade cooking lessons for swimming lessons. Josie and Maria have
- A) the basis for a liquidity exchange.
 - B) a double incidence of demand.
 - C) the basis for a double fiat exchange.
 - D) a double coincidence of wants.

Answer: D

Diff: 2

Topic: An Overview of Money

Skill: Conceptual

AACSB: Reflective Thinking

- 6) The development of money as a medium of exchange has facilitated the expansion of trade because
- A) holding money increases people's wealth.
 - B) holding money increases people's income.
 - C) money eliminates the "double coincidence of wants" problem.
 - D) no other mediums of exchange are available.

Answer: C

Diff: 2

Topic: An Overview of Money

Skill: Conceptual

AACSB: Reflective Thinking

- 7) When money is used as a medium of exchange
- A) the need for a barter system diminishes.
 - B) the cost of transactions increases.
 - C) the need for a banking system in the economy decreases.
 - D) it reduces the number of transactions in the economy.

Answer: A

Diff: 2

Topic: An Overview of Money

Skill: Conceptual

AACSB: Reflective Thinking

- 8) Betty won \$500 in a poker tournament. She deposits her \$500 winnings into a money market fund so that she can use the money next year to help her pay for a trip to Las Vegas. This is an example of money serving as a(n)
- A) unit of account.
 - B) medium of exchange.
 - C) store of value.
 - D) investment good.

Answer: C

Diff: 1

Topic: An Overview of Money

Skill: Conceptual

AACSB: Reflective Thinking

- 9) When you pay \$8 for salad you ordered for lunch, you are using money as a(n)
- A) store of value.
 - B) investment good.
 - C) medium of exchange.
 - D) unit of account.

Answer: C

Diff: 1

Topic: An Overview of Money

Skill: Conceptual

AACSB: Reflective Thinking

10) Veronica received a federal income tax rebate check of \$600 in May 2008. Veronica put this money in a saving account so that she could spend it when she went on vacation in July 2008. This is an example of money serving as a(n)

- A) store of value.
- B) medium of exchange.
- C) unit of account.
- D) investment good.

Answer: A

Diff: 1

Topic: An Overview of Money

Skill: Conceptual

AACSB: Reflective Thinking

11) When you keep your savings in a saving account, you are using money as a(n)

- A) investment good.
- B) store of value.
- C) medium of exchange.
- D) unit of account.

Answer: B

Diff: 1

Topic: An Overview of Money

Skill: Conceptual

AACSB: Reflective Thinking

12) The main disadvantage of using money as a store of value is that

- A) money is not portable.
- B) it requires a double coincidence of wants.
- C) currency is intrinsically worthless.
- D) the value of money actually falls when the prices of goods and services rise.

Answer: D

Diff: 1

Topic: An Overview of Money

Skill: Conceptual

AACSB: Reflective Thinking

13) The liquidity property of money is the property that makes money

- A) a good medium of exchange and a good unit of account.
- B) a good store of value and a good unit of account.
- C) a good medium of exchange and a good store of value.
- D) a good store of value and a good standard of deferred payment.

Answer: C

Diff: 1

Topic: An Overview of Money

Skill: Conceptual

AACSB: Reflective Thinking

14) When the manager of a department store attaches price tags to his/her products, he/she is using money as a

- A) medium of exchange.
- B) store of value.
- C) unit of transfer.
- D) unit of account.

Answer: D

Diff: 1

Topic: An Overview of Money

Skill: Conceptual

AACSB: Reflective Thinking

- 15) Circuit City, a retailer of electronics, has 2,000 different products in inventory. Circuit City reports its inventory is worth \$12 million. This is an example of using money as a
- A) medium of exchange.
 - B) unit of account.
 - C) standard of deferred payment.
 - D) store of value.

Answer: B

Diff: 1

Topic: An Overview of Money

Skill: Conceptual

AACSB: Reflective Thinking

- 16) Denny's lists the price of a Grand Slam Breakfast at \$4.99 a plate. Listing the price on the menu is an example of money serving as a(n)
- A) store of value.
 - B) unit of account.
 - C) medium of exchange.
 - D) investment good.

Answer: B

Diff: 1

Topic: An Overview of Money

Skill: Conceptual

AACSB: Reflective Thinking

- 17) When Mexico experiences a period of high inflation and Mexicans lose confidence in their peso as a store of value, which of the following would be most likely to occur?
- A) The demand for pesos would increase.
 - B) The buying power of the peso would increase.
 - C) The value of foreign currencies would depreciate relative to the peso.
 - D) Mexicans would use a different currency as a medium of exchange.

Answer: D

Diff: 2

Topic: An Overview of Money

Skill: Analytic

AACSB: Analytic Skills

- 18) A currency that is not backed by gold, silver, or any other precious commodity equal to the face value of the money is known as
- A) fake money.
 - B) weak money.
 - C) token money.
 - D) commodity money.

Answer: C

Diff: 1

Topic: An Overview of Money

Skill: Definition

- 19) After World War II, cigarettes were used as money in Germany. This is an example of
- A) fiat money.
 - B) legal money.
 - C) token money.
 - D) commodity money.

Answer: D

Diff: 1

Topic: An Overview of Money

Skill: Conceptual

AACSB: Reflective Thinking

- 20) The U.S. dollar is an example of fiat money because
- A) it is the strongest currency in the world.
 - B) it is the most widely used currency in international trade.
 - C) it is backed by a large reserve of gold and silver.
 - D) by law, it is decreed as money.

Answer: D

Diff: 1

Topic: An Overview of Money

Skill: Conceptual

AACSB: Reflective Thinking

- 21) Which of the following is an example of fiat money?
- A) cigarettes
 - B) an ounce of gold
 - C) a U.S. one-hundred dollar bill
 - D) a government bond

Answer: C

Diff: 1

Topic: An Overview of Money

Skill: Conceptual

AACSB: Reflective Thinking

- 22) Money that a government has required to be accepted in settlement of debts is
- A) fiat money.
 - B) commodity money.
 - C) barter money.
 - D) legal tender.

Answer: D

Diff: 1

Topic: An Overview of Money

Skill: Definition

- 23) To ensure that paper money will be accepted, the U.S. government implicitly promises the public that
- A) it will not print money so fast that it loses its value.
 - B) it will not change the rate at which the dollar is exchanged for other currencies.
 - C) it will always remain the strongest currency of all industrialized nations.
 - D) the U.S. monetary system will always be backed by a precious metal.

Answer: A

Diff: 2

Topic: An Overview of Money

Skill: Conceptual

AACSB: Reflective Thinking

- 24) Currency debasement occurs when
- A) the value of money falls as a result of a rapid increase in its supply.
 - B) the government requires that a certain form of money must be accepted in settlement of debts.
 - C) items are designated as money that are intrinsically worthless.
 - D) items are used as money that also have intrinsic value in some other use.

Answer: A

Diff: 2

Topic: An Overview of Money

Skill: Definition

25) Assume that in the country of Salmon, the government tripled the money supply overnight. As a result of this action, the price of a loaf of bread increased from 1 bill to 100 bills. This is an example of

- A) a change in the legal tender.
- B) a change from commodity money to fiat money.
- C) currency debasement.
- D) deflation.

Answer: C

Diff: 2

Topic: An Overview of Money

Skill: Conceptual

AACSB: Reflective Thinking

26) Currency held outside banks + demand deposits + travelers checks + other checkable deposits =

- A) M_3 .
- B) $M_2 - M_1$.
- C) $M_3 - M_1$.
- D) M_1 .

Answer: D

Diff: 2

Topic: An Overview of Money

Skill: Definition

27) Transaction money is

- A) M_1 .
- B) M_2 .
- C) M_3 .
- D) M_4 .

Answer: A

Diff: 1

Topic: An Overview of Money

Skill: Conceptual

AACSB: Reflective Thinking

28) Traveler's checks are

- A) not money.
- B) included in M_1 and M_2 .
- C) not included in M_2 .
- D) not included in M_1 .

Answer: B

Diff: 1

Topic: An Overview of Money

Skill: Conceptual

AACSB: Reflective Thinking

29) Which of the following is included in M_2 , but not included in M_1 ?

- A) currency held outside banks
- B) travelers checks
- C) demand deposits
- D) savings accounts

Answer: D

Diff: 1

Topic: An Overview of Money

Skill: Conceptual

AACSB: Reflective Thinking

- 30) Jaime transfers \$2,500 from his checking account to his savings account. This transaction will
- A) decrease both M_1 and M_2 .
 - B) not change M_1 and decrease M_2 .
 - C) decrease M_1 and not change M_2 .
 - D) increase both M_1 and M_2 .

Answer: C

Diff: 2

Topic: An Overview of Money

Skill: Analytic

AACSB: Analytic Skills

- 31) Ruby transfers \$700 from her saving account to her checking account. This transaction will
- A) increase M_1 and not change M_2 .
 - B) not change M_1 and decrease M_2 .
 - C) increase both M_1 and M_2 .
 - D) decrease both M_1 and M_2 .

Answer: A

Diff: 2

Topic: An Overview of Money

Skill: Analytic

AACSB: Analytic Skills

- 32) Teddy transfers \$175 from his money market fund to his checking account. This transaction will
- A) decrease M_2 and increase M_1 .
 - B) increase M_1 , but leave M_2 unchanged.
 - C) decrease M_1 and increase M_2 .
 - D) decrease both M_1 and M_2 .

Answer: B

Diff: 2

Topic: An Overview of Money

Skill: Analytic

AACSB: Analytic Skills

- 33) Which of the following would NOT be counted as part of M_1 ?
- A) demand deposits
 - B) traveler's check
 - C) money market accounts
 - D) currency

Answer: C

Diff: 1

Topic: An Overview of Money

Skill: Conceptual

AACSB: Reflective Thinking

- 34) Saving account balances are included in
- A) M_1 .
 - B) M_2 .
 - C) neither M_1 nor M_2 .
 - D) both M_1 and M_2 .

Answer: B

Diff: 1

Topic: An Overview of Money

Skill: Conceptual

AACSB: Reflective Thinking

35) Which of the following would NOT be included in M_2 ?

- A) demand deposits
- B) money market accounts
- C) checking accounts
- D) Treasury bonds

Answer: D

Diff: 1

Topic: An Overview of Money

Skill: Conceptual

AACSB: Reflective Thinking

36) Included in M_2 are

- A) bank loans.
- B) credit cards.
- C) bank capital.
- D) demand deposits.

Answer: D

Diff: 1

Topic: An Overview of Money

Skill: Conceptual

AACSB: Reflective Thinking

37) Which of the following would NOT be included in M_1 ?

- A) demand deposits
- B) money market accounts
- C) checking accounts
- D) traveler's checks

Answer: B

Diff: 1

Topic: An Overview of Money

Skill: Conceptual

AACSB: Reflective Thinking

38) Currency held outside banks is included in

- A) both M_1 and M_2 .
- B) M_2 only.
- C) M_1 only.
- D) neither M_1 nor M_2 .

Answer: A

Diff: 1

Topic: An Overview of Money

Skill: Conceptual

AACSB: Reflective Thinking

39) Close substitutes for transactions money are known as

- A) fiat monies.
- B) near monies.
- C) commodity monies.
- D) token monies.

Answer: B

Diff: 1

Topic: An Overview of Money

Skill: Definition

40) Which of the following is the best example of a near money?

- A) a valuable painting
- B) a dollar bill
- C) a Treasury bond
- D) a money market account

Answer: D

Diff: 1

Topic: An Overview of Money

Skill: Conceptual

AACSB: Reflective Thinking

- 41) An equation for M_1 is
- A) $M_2 + \text{Savings Accounts} - \text{Currency Held Outside Banks} + \text{Other Near Monies}$.
 - B) $M_2 - \text{Savings Accounts} - \text{Money Market Accounts} - \text{Other Near Monies}$.
 - C) $\text{Money Market Accounts} + \text{Automatic-transfer Savings Accounts}$.
 - D) $M_2 + \text{Near Monies}$.

Answer: B

Diff: 2

Topic: An Overview of Money

Skill: Definition

- 42) The main advantage of using M_2 instead of M_1 as the measure for money is that
- A) M_2 can be measured more accurately.
 - B) M_2 includes only instantly accessible assets.
 - C) M_2 is sometimes more stable.
 - D) M_2 varies as the interest rate varies.

Answer: C

Diff: 2

Topic: An Overview of Money

Skill: Conceptual

AACSB: Reflective Thinking

- 43) Commercial banks
- A) implement monetary policy.
 - B) are nonprofit organizations that lend and borrow funds.
 - C) are financial intermediaries that lend funds and accept deposits.
 - D) hold reserves against bank capital.

Answer: C

Diff: 1

Topic: An Overview of Money

Skill: Definition

- 44) Among the assets of a commercial bank are
- A) loans.
 - B) demand deposits.
 - C) savings deposits.
 - D) time deposits.

Answer: A

Diff: 1

Topic: An Overview of Money

Skill: Conceptual

AACSB: Reflective Thinking

- 45) Among the liabilities of commercial banks are
- A) loans.
 - B) demand deposits.
 - C) reserves.
 - D) government securities.

Answer: B

Diff: 1

Topic: An Overview of Money

Skill: Conceptual

AACSB: Reflective Thinking

- 46) Net worth is
- | | |
|--------------------------|--------------------------|
| A) assets – liabilities. | B) assets + capital. |
| C) assets – capital. | D) assets + liabilities. |

Answer: A

Diff: 1

Topic: *An Overview of Money*

Skill: *Definition*

- 47) Related to the *Economics in Practice* on p. 183 [495]: In the Solomon Islands, dolphin teeth are used as currency. In this instance, dolphin teeth would be considered
- | | |
|---------------------|------------------|
| A) fiat money. | B) token money. |
| C) commodity money. | D) legal tender. |

Answer: C

Diff: 1

Topic: *An Overview of Money: Economics in Practice*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 48) Related to the *Economics in Practice* on p. 183 [495]: In the Solomon Islands, dolphin teeth are used as currency. Using dolphin teeth to make a purchase would be using the teeth as a(n)
- | | |
|------------------------|--------------------|
| A) medium of exchange. | B) store of value. |
| C) unit of account. | D) legal tender. |

Answer: A

Diff: 1

Topic: *An Overview of Money: Economics in Practice*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

2 True/False

- 1) When you use money to fill your car with gas every week, you are using money as a unit of account.

Answer: FALSE

Diff: 1

Topic: *An Overview of Money*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 2) Money is anything that generally is accepted as a medium of exchange.

Answer: TRUE

Diff: 1

Topic: *An Overview of Money*

Skill: *Definition*

- 3) In an economy that uses fiat money, there is no need for double coincidence of wants.

Answer: TRUE

Diff: 1

Topic: *An Overview of Money*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

4) When you take \$100 from your saving account and deposit it in your checking account, M_2 decreases.

Answer: FALSE

Diff: 2

Topic: *An Overview of Money*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

5) If all banks are loaned up and so will not make further loans, a \$1,000 deposit creates \$1,000 in new money.

Answer: FALSE

Diff: 2

Topic: *An Overview of Money*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

6) Fiat money is money the government says is money.

Answer: TRUE

Diff: 2

Topic: *An Overview of Money*

Skill: *Definition*

7) The M1 definition of money includes money market accounts.

Answer: FALSE

Diff: 2

Topic: *An Overview of Money*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

8) The M2 definition of money includes demand deposits.

Answer: TRUE

Diff: 2

Topic: *An Overview of Money*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

10.2 How Banks Create Money

1 Multiple Choice

1) Napoli National Bank has liabilities of \$3 million and net worth of \$200,000. Napoli National Bank's assets are

A) \$200,000.

B) \$3 million

C) \$3.2 million.

D) \$2.8 million.

Answer: C

Diff: 2

Topic: *How Banks Create Money*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 2) Saturn County Savings and Loan has liabilities of \$400,000 and net worth of \$125,000. Saturn County Savings and Loan's assets are
- A) \$525,000. B) \$275,000. C) \$400,000. D) \$125,000.

Answer: A

Diff: 2

Topic: How Banks Create Money

Skill: Analytic

AACSB: Analytic Skills

- 3) Thompson National Trust has assets of \$500,000 and liabilities of \$400,000. Thompson National Trust's net worth is
- A) \$900,000. B) \$400,000. C) \$100,000. D) \$500,000.

Answer: C

Diff: 2

Topic: How Banks Create Money

Skill: Analytic

AACSB: Analytic Skills

- 4) A commercial bank lists
- A) loans as liabilities. B) deposits as liabilities.
C) required reserves as liabilities. D) excess reserves as liabilities.

Answer: B

Diff: 1

Topic: How Banks Create Money

Skill: Conceptual

AACSB: Reflective Thinking

- 5) Things that a firm owns that are worth something are classified as
- A) liabilities. B) assets. C) deposits. D) net worth.

Answer: B

Diff: 1

Topic: How Banks Create Money

Skill: Conceptual

AACSB: Reflective Thinking

- 6) Which of the following is considered a liability to a bank?
- A) time deposits B) reserves
C) the bank's loans D) the bank's buildings and equipment

Answer: A

Diff: 2

Topic: How Banks Create Money

Skill: Conceptual

AACSB: Reflective Thinking

- 7) The central bank of the United States is known as the
 A) Federal Reserve System.
 B) Federal Deposit Insurance Corporation.
 C) Department of the Treasury.
 D) Federal Savings and Loan Insurance Corporation.

Answer: A

Diff: 1

Topic: How Banks Create Money

Skill: Fact

- 8) A loan made by a bank is considered _____ of that bank.
 A) a liability B) capital C) net worth D) an asset

Answer: D

Diff: 1

Topic: How Banks Create Money

Skill: Conceptual

AACSB: Reflective Thinking

- 9) A checking deposit in a bank is considered _____ of that bank.
 A) an asset B) a liability C) net worth D) capital

Answer: B

Diff: 1

Topic: How Banks Create Money

Skill: Conceptual

AACSB: Reflective Thinking

Refer to the information provided in Table 10.1 below to answer the questions that follow.

First Charter Bank			
Assets		Liabilities	
Reserves	—	\$800	Deposits
Loans	—	\$400	Net Worth
Total	—	\$1,200	Total

- 10) Refer to Table 10.1. The required reserve ratio is 25%. If the First Charter Bank is meeting its reserve requirement and has no excess reserves, its reserves equal
 A) \$100. B) \$200. C) \$600. D) \$300.

Answer: B

Diff: 2

Topic: How Banks Create Money

Skill: Analytic

AACSB: Analytic Skills

- 11) Refer to Table 10.1. The required reserve ratio is 25%. If the First Charter Bank is meeting its reserve requirement and has no excess reserves, its loans equal
- A) \$900. B) \$1,000. C) \$600. D) \$1,800.

Answer: B

Diff: 2

Topic: How Banks Create Money

Skill: Analytic

AACSB: Analytic Skills

- 12) Refer to Table 10.1. First Charter Bank's total assets are
- A) \$1,200. B) \$400. C) \$800. D) \$2,400

Answer: A

Diff: 2

Topic: How Banks Create Money

Skill: Analytic

AACSB: Analytic Skills

Refer to the information provided in Table 10.2 below to answer the questions that follow.

First Commercial Bank			
	Assets	Liabilities + Net Worth	
Reserves:	\$800,000	\$2 million	Deposits
Required	\$200,000	\$500,000	Net Worth
Excess	—		
Loans	—		
Total	\$2.5 million	\$2.5 million	Total

- 13) Refer to Table 10.2. First Commercial Bank's excess reserves equal \$_____.
- A) 600,000 B) 1,000,000 C) 200,000 D) 1,500,000

Answer: A

Diff: 2

Topic: How Banks Create Money

Skill: Analytic

AACSB: Analytic Skills

- 14) Refer to Table 10.2. The required reserve ratio
- A) is 5%.
 B) is 10%.
 C) is 20%.
 D) cannot be determined from the given information.

Answer: B

Diff: 2

Topic: How Banks Create Money

Skill: Analytic

AACSB: Analytic Skills

- 15) Refer to Table 10.2. First Commercial Bank's total loans equal \$_____.
- A) 1,000,000 B) 5,000,000 C) 2,500,000 D) 1,700,000.

Answer: D

Diff: 2

Topic: How Banks Create Money

Skill: Analytic

AACSB: Analytic Skills

Refer to the information provided in Table 10.3 below to answer the questions that follow.

Table 10.3			
People's Bank			
	Assets	Liabilities + Net Worth	
Reserves:	\$300,000	\$500,000	Deposits
Required	\$100,000	—	Net Worth
Excess	—		
Loans	—		
Total	\$800,000	\$800,000	Total

- 16) Refer to Table 10.3. The net worth of People's Bank is \$_____.
- A) 1,000,000 B) 200,000 C) 800,000 D) 300,000

Answer: D

Diff: 2

Topic: How Banks Create Money

Skill: Analytic

AACSB: Analytic Skills

- 17) Refer to Table 10.3. The required reserve ratio is
- A) 25%. B) 20%. C) 50%. D) 10%.

Answer: B

Diff: 2

Topic: How Banks Create Money

Skill: Analytic

AACSB: Analytic Skills

- 18) Refer to Table 10.3. People's Bank excess reserves are \$_____.
- A) 200,000 B) 100,000 C) 300,000 D) 400,000

Answer: A

Diff: 2

Topic: How Banks Create Money

Skill: Analytic

AACSB: Analytic Skills

- 19) Refer to Table 10.3. Total loans of People's Bank equal \$_____.
- A) 100,000 B) 400,000 C) 500,000 D) 800,000

Answer: C

Diff: 2

Topic: How Banks Create Money

Skill: Analytic

AACSB: Analytic Skills

20) Crescent City Bank has \$200 million in deposits. Crescent City Bank is meeting its reserve requirement and has no excess reserves. It has \$40 million in reserves. Crescent City Bank faces a required reserve ratio of

- A) 5%. B) 4%. C) 20%. D) 25%.

Answer: C

Diff: 2

Topic: How Banks Create Money

Skill: Analytic

AACSB: Analytic Skills

21) Narnia National Bank has \$750 million in deposits. The required reserve ratio is 30%. Narnia National Bank must keep _____ in reserves.

- A) \$125 million B) \$150 million C) \$225 million D) \$250 million

Answer: C

Diff: 2

Topic: How Banks Create Money

Skill: Analytic

AACSB: Analytic Skills

22) Neon Bank has \$300 million in deposits. The required reserve ratio is 25%. Neon Bank must keep _____ in reserves.

- A) \$275 million B) \$145 million C) \$75 million D) \$120 million

Answer: C

Diff: 2

Topic: How Banks Create Money

Skill: Analytic

AACSB: Analytic Skills

23) The Intracoastal Bank has \$5 million in deposits and \$500,000 in reserves. If the required reserve ratio is 5%, excess reserves are equal to

- A) \$125,000. B) \$500,000. C) zero. D) \$250,000.

Answer: D

Diff: 2

Topic: How Banks Create Money

Skill: Analytic

AACSB: Analytic Skills

24) The Bank of Arugula has \$9 million in deposits and \$900,000 in reserves. If the required reserve ratio is 10%, excess reserves are equal to

- A) \$90,000. B) \$180,000. C) \$81,000. D) zero.

Answer: D

Diff: 2

Topic: How Banks Create Money

Skill: Analytic

AACSB: Analytic Skills

- 25) The Bank of Red Oak has \$2 million in deposits and \$400,000 in reserves. If excess reserves are equal to \$100,000, the required reserve ratio is
- A) 15%. B) 10%. C) 20%. D) 5%.

Answer: A

Diff: 2

Topic: How Banks Create Money

Skill: Analytic

AACSB: Analytic Skills

Refer to the information provided in Table 10.4 below to answer the questions that follow .

Table 10.4

First Charter Bank			
	Assets	Liabilities	
Reserves	\$1.2 million	\$8 million	Deposits
Loans	\$6.8 million		
Total	\$8 million	\$8 million	Total

- 26) Refer to Table 10.4. If the required reserve ratio is 15%, First Charter Bank
- A) is loaned up.
 B) has too few reserves on hand.
 C) is meeting its required reserve ratio and has \$200,000 in excess reserves.
 D) has excess reserves of \$100,000.

Answer: A

Diff: 2

Topic: How Banks Create Money

Skill: Analytic

AACSB: Analytic Skills

- 27) Refer to Table 10.4. First Charter Bank could make additional, first round loans of \$400,000 if the required reserve ratio were
- A) 10%. B) 8%. C) 7.5%. D) 12%.

Answer: A

Diff: 3

Topic: How Banks Create Money

Skill: Analytic

AACSB: Analytic Skills

- 28) Refer to Table 10.4. If the required reserve ratio were changed to 5% and First Charter Bank continues to hold \$1,200,000 in reserves, its excess reserves will be
- A) \$600,000. B) \$1,000,000. C) \$800,000. D) \$400,000.

Answer: C

Diff: 2

Topic: How Banks Create Money

Skill: Analytic

AACSB: Analytic Skills

- 29) Dollar Bank is currently loaned up. If the required reserve ratio is lowered,
- A) Dollar Bank's net worth will increase.
 - B) Dollar Bank will have excess reserves that it can lend out.
 - C) Dollar Bank will still be loaned up because it did not receive any additional deposits.
 - D) Dollar Bank's actual reserves will increase, but it will still be loaned up.

Answer: B

Diff: 2

Topic: How Banks Create Money

Skill: Analytic

AACSB: Analytic Skills

- 30) When a bank has no excess reserves, and thus can make no more loans, it is said to be
- A) bankrupt.
 - B) ripe for a takeover.
 - C) in receivership.
 - D) loaned up.

Answer: D

Diff: 1

Topic: How Banks Create Money

Skill: Conceptual

- 31) Commercial banks create money through
- A) printing treasury notes.
 - B) making loans.
 - C) facilitating borrowing from the Federal Reserve to the public.
 - D) reducing risk in the economy.

Answer: B

Diff: 1

Topic: How Banks Create Money

Skill: Conceptual

AACSB: Reflective Thinking

- 32) The multiple by which total deposits can increase for every dollar increase in reserves is the
- A) required reserve ratio.
 - B) bank's line of credit.
 - C) deposit insurance limit.
 - D) money multiplier.

Answer: D

Diff: 1

Topic: How Banks Create Money

Skill: Definition

- 33) Suppose the required reserve ratio is 20%. A \$40 million cash deposit will, at most, allow an expansion of the money supply to
- A) \$20 million.
 - B) \$80 million.
 - C) \$200 million.
 - D) \$800 million.

Answer: C

Diff: 2

Topic: How Banks Create Money

Skill: Analytic

AACSB: Analytic Skills

- 34) Suppose the required reserve ratio is 15%. A \$10 million deposit will, at most, allow an expansion of the money supply to
A) \$147.5 million. B) \$250 million. C) \$150 million. D) \$66.7 million.

Answer: D

Diff: 2

Topic: How Banks Create Money

Skill: Analytic

AACSB: Analytic Skills

- 35) The required reserve ratio is 5%. The money multiplier is
A) 0.5. B) 5. C) 15. D) 20.

Answer: D

Diff: 1

Topic: How Banks Create Money

Skill: Analytic

AACSB: Analytic Skills

- 36) The required reserve ratio is 50%. The money multiplier is
A) 2.5. B) 10. C) 5. D) 2.

Answer: D

Diff: 1

Topic: How Banks Create Money

Skill: Analytic

AACSB: Analytic Skills

- 37) If the money multiplier is 8, the required reserve ratio is
A) 8%. B) 16%. C) 12.5%. D) 20%.

Answer: C

Diff: 1

Topic: How Banks Create Money

Skill: Analytic

AACSB: Analytic Skills

- 38) Assume that banks become more conservative in their lending policies and start holding some excess reserves. Compared to a situation in which banks are not holding excess reserves, the size of the money supply will be
A) zero. B) larger. C) the same. D) smaller.

Answer: D

Diff: 2

Topic: How Banks Create Money

Skill: Conceptual

AACSB: Reflective Thinking

- 39) As commercial banks keep more excess reserves, money creation
A) increases. B) decreases.
C) remains the same. D) could either increase or decrease.

Answer: B

Diff: 2

Topic: How Banks Create Money

Skill: Conceptual

AACSB: Reflective Thinking

Refer to the information provided in Scenario 10.1 below to answer the questions that follow.

SCENARIO 10.1: The following table shows the changes in deposits, reserves, and loans of 4 banks as a result of a \$100,000 initial deposit in Bank No. 1. Assume all banks are loaned up.

	New Deposit	Required Reserve	Loans
Bank No. 1	\$100,000.00	\$5,000.00	\$95,000.00
Bank No. 2	\$95,000.00	\$4,750.00	\$90,250.00
Bank No. 3	\$90,250.00	\$4,512.50	\$85,737.00
Bank No. 4	\$85,737.50	\$4,286.90	\$81,450.63

40) Refer to Scenario 10.1. What is the required reserve ratio?

- A) 4% B) 5% C) 8% D) 10%

Answer: B

Diff: 2

Topic: How Banks Create Money

Skill: Analytic

AACSB: Analytic Skills

41) Refer to Scenario 10.1. What is the money multiplier in this economy?

- A) 20 B) 10 C) 50 D) 16.67

Answer: A

Diff: 2

Topic: How Banks Create Money

Skill: Analytic

AACSB: Analytic Skills

42) Refer to Scenario 10.1. Based on the initial \$100,000 deposit, the money supply will, at most, expand to

- A) \$1 million. B) \$2 million. C) \$50 million. D) \$16.67 million.

Answer: B

Diff: 2

Topic: How Banks Create Money

Skill: Analytic

AACSB: Analytic Skills

43) Refer to Scenario 10.1. If the required reserve ratio were changed to 10%, total loans of Bank No. 2 will change to

- A) 81,000. B) 90,000. C) 85,000. D) 77,440.

Answer: A

Diff: 3

Topic: How Banks Create Money

Skill: Analytic

AACSB: Analytic Skills

2 True/False

- 1) Only the required reserve ratio determines how much money the Federal Reserve can create.

Answer: FALSE

Diff: 2

Topic: *How Banks Create Money*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 2) Excess reserves in a bank are the difference between required reserves and the bank's total net worth.

Answer: FALSE

Diff: 1

Topic: *How Banks Create Money*

Skill: *Definition*

- 3) Among the assets of commercial banks are demand deposits.

Answer: FALSE

Diff: 1

Topic: *How Banks Create Money*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 4) The amount of money banks can loan out is determined by the discount rate.

Answer: FALSE

Diff: 2

Topic: *How Banks Create Money*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 5) Among the liabilities of commercial banks are deposits.

Answer: TRUE

Diff: 2

Topic: *How Banks Create Money*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 6) Since they must lend money to make money, all banks are necessarily insolvent.

Answer: FALSE

Diff: 2

Topic: *How Banks Create Money*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

10.3 The Federal Reserve System

1 Multiple Choice

- 1) The Federal Reserve System consists of _____ Federal Reserve Banks.
A) 8 B) 10 C) 12 D) 14

Answer: C

Diff: 1

Topic: The Federal Reserve System

Skill: Fact

- 2) Which of the following activities is one of the responsibilities of the Federal Reserve?
A) issuing new bonds to finance the federal budget deficit
B) loaning money to other countries that are friendly to the United States
C) assisting banks that are in a difficult financial position
D) auditing the various agencies and departments of the federal government

Answer: C

Diff: 2

Topic: The Federal Reserve System

Skill: Fact

- 3) Among the members of the Federal Open Market Committee
A) is the Secretary of the Treasury.
B) is the Comptroller of the Currency.
C) are the seven members of the Board of Governors of the Fed.
D) is the Chair of the Senate Banking Committee.

Answer: C

Diff: 2

Topic: The Federal Reserve System

Skill: Fact

- 4) The Board of governors of the Fed
A) are appointed by the House of Representatives.
B) has 12 members.
C) have a 7-year term.
D) is headquartered in Washington, D.C.

Answer: D

Diff: 2

Topic: The Federal Reserve System

Skill: Fact

- 5) The Fed
A) issues deposits to the public. B) lends money to foreign governments.
C) clears inter-bank payments. D) lends money to the public.

Answer: C

Diff: 2

Topic: The Federal Reserve System

Skill: Fact

2 True/False

- 1) The President of the NY Federal Reserve Bank is always a member of the Federal Open Market committee.

Answer: TRUE

Diff: 1

Topic: *The Federal Reserve System*

Skill: *Fact*

- 2) The Chair of the Fed also serves as one of the Reserve Bank Presidents.

Answer: FALSE

Diff: 1

Topic: *The Federal Reserve System*

Skill: *Fact*

- 3) The Fed acts as a lender of last resort for the banking system.

Answer: TRUE

Diff: 2

Topic: *The Federal Reserve System*

Skill: *Fact*

- 4) The members of the Board of Governors of the Fed make up a majority of the Federal Open Market Committee.

Answer: TRUE

Diff: 2

Topic: *The Federal Reserve System*

Skill: *Fact*

- 5) The Fed is a division of the Department of the Treasury.

Answer: FALSE

Diff: 2

Topic: *The Federal Reserve System*

Skill: *Fact*

10.4 How the Federal Reserve Controls the Money Supply

1 Multiple Choice

- 1) Which of the following instruments is NOT used by the Federal Reserve to change the money supply?

A) the discount rate

B) the required reserve ratio

C) the federal tax code

D) open market operations

Answer: C

Diff: 1

Topic: *How the Federal Reserve Controls the Money Supply*

Skill: *Fact*

- 2) The Federal Open Market Committee (FOMC) directs the Open Market Desk to
- A) determine the required reserve ratio.
 - B) determine the discount rate.
 - C) buy or sell government securities.
 - D) determine the federal funds rate.

Answer: C

Diff: 1

Topic: How the Federal Reserve Controls the Money Supply

Skill: Fact

- 3) Which of the following is NOT a tool available to the Fed to change the supply of money?
- A) open market operations
 - B) the required reserve ratio
 - C) the money multiplier
 - D) the discount rate

Answer: C

Diff: 1

Topic: How the Federal Reserve Controls the Money Supply

Skill: Fact

- 4) The discount rate is
- A) the interest rate commercial banks charge each other for borrowing funds.
 - B) the interest rate commercial banks charge their new customers.
 - C) the interest rate the Fed charges commercial banks for borrowing funds.
 - D) the interest rate commercial banks charge their most creditworthy customers.

Answer: C

Diff: 1

Topic: How the Federal Reserve Controls the Money Supply

Skill: Definition

- 5) A decrease in the required reserve ratio
- A) will increase the money supply.
 - B) will decrease the money supply.
 - C) will not change the money supply.
 - D) will decrease the discount rate.

Answer: A

Diff: 1

Topic: How the Federal Reserve Controls the Money Supply

Skill: Conceptual

AACSB: Reflective Thinking

- 6) Assume that all commercial banks are loaned up. Total deposits in the banking system are \$200 million. The required reserve ratio is increased. The money supply will
- A) decrease.
 - B) increase.
 - C) not change because there was no change in deposits.
 - D) not change because the required reserve ratio has no impact on money supply.

Answer: A

Diff: 2

Topic: How the Federal Reserve Controls the Money Supply

Skill: Analytic

AACSB: Analytic Skills

- 7) The Fed has tended not to use changes in the reserve requirement as a means of controlling the money supply because
- A) only banks that are members of the Fed are subject to reserve requirements, and most banks do not belong to the Fed.
 - B) a change in the reserve requirement has only a very small impact on the money supply.
 - C) it is a crude monetary policy tool because a change in the requirement does not affect banks until about two weeks after the change is implemented.
 - D) it takes a long time for the Congress to approve a change in the reserve requirement.

Answer: C

Diff: 3

Topic: How the Federal Reserve Controls the Money Supply

Skill: Conceptual

AACSB: Reflective Thinking

- 8) The interest rate banks pay to borrow money from the Fed is the
- A) federal funds rate.
 - B) discount rate.
 - C) prime lending rate.
 - D) reserve rate.

Answer: B

Diff: 1

Topic: How the Federal Reserve Controls the Money Supply

Skill: Definition

- 9) Which of the following represents an action by the Federal Reserve that is designed to increase the money supply?
- A) a decrease in the required reserve ratio
 - B) an increase in the discount rate
 - C) a decrease in federal tax rates
 - D) selling government securities in the open market

Answer: A

Diff: 2

Topic: How the Federal Reserve Controls the Money Supply

Skill: Conceptual

AACSB: Reflective Thinking

- 10) Which of the following represents an action by the Federal Reserve that is designed to increase the money supply?
- A) buying government securities in the open market
 - B) an increase in the required reserve ratio
 - C) a decrease in federal spending
 - D) an increase in the discount rate

Answer: A

Diff: 2

Topic: How the Federal Reserve Controls the Money Supply

Skill: Conceptual

AACSB: Reflective Thinking

- 11) Of the tools available to the Fed to regulate the money supply, which is the least used?
- A) the federal funds rate
 - B) the reserve ratio
 - C) tax cutting
 - D) the open-market operations

Answer: B

Diff: 1

Topic: How the Federal Reserve Controls the Money Supply

Skill: Conceptual

AACSB: Reflective Thinking

- 12) If the Fed sells government securities, then there is
- A) an increase in the supply of money.
 - B) a decrease in the supply of money.
 - C) a decrease in the discount rate.
 - D) an increase in the required reserve ratio.

Answer: B

Diff: 2

Topic: How the Federal Reserve Controls the Money Supply

Skill: Conceptual

AACSB: Reflective Thinking

- 13) Which of the following represents an action by the Federal Reserve that is designed to decrease the money supply?
- A) a decrease in the discount rate
 - B) a decrease in federal spending
 - C) selling government securities in the open market
 - D) a decrease in the required reserve ratio

Answer: C

Diff: 2

Topic: How the Federal Reserve Controls the Money Supply

Skill: Conceptual

AACSB: Reflective Thinking

- 14) When the Fed raises the required reserve ratio, the banks' excess reserves will initially _____ and the money supply _____.
- A) remains constant; decreases
 - B) decrease; decreases
 - C) increase; remain constant
 - D) increase; increases

Answer: B

Diff: 2

Topic: How the Federal Reserve Controls the Money Supply

Skill: Conceptual

AACSB: Reflective Thinking

- 15) The best instrument for controlling week-to-week changes in the money supply is
- A) the required reserve ratio.
 - B) moral suasion.
 - C) open-market operations.
 - D) the discount rate.

Answer: C

Diff: 2

Topic: How the Federal Reserve Controls the Money Supply

Skill: Conceptual

AACSB: Reflective Thinking

- 16) Which of the following statements is FALSE?
- A) Open-market operations can be used by the Federal Reserve with some precision.
 - B) Open-market operations are extremely flexible.
 - C) The Federal Reserve undertakes open-market operations on an infrequent basis.
 - D) Open-market operations have a fairly predictable effect on the supply of money.

Answer: C

Diff: 2

Topic: How the Federal Reserve Controls the Money Supply

Skill: Conceptual

AACSB: Reflective Thinking

- 17) An open-market purchase of securities by the Fed results in _____ in reserves and _____ in the supply of money.
- A) an increase; a decrease
 - B) a decrease; a decrease
 - C) an increase; an increase
 - D) a decrease; an increase

Answer: C

Diff: 2

Topic: How the Federal Reserve Controls the Money Supply

Skill: Conceptual

AACSB: Reflective Thinking

- 18) An open-market sale of securities by the Fed results in _____ in reserves and _____ in the supply of money.
- A) an increase; a decrease
 - B) an increase; an increase
 - C) a decrease; an increase
 - D) a decrease; a decrease

Answer: D

Diff: 2

Topic: How the Federal Reserve Controls the Money Supply

Skill: Conceptual

AACSB: Reflective Thinking

- 19) Assume there is no leakage from the banking system and that all commercial banks are loaned up. The required reserve ratio is 16%. If the Fed sells \$5 million worth of government securities to the public, the change in the money supply will be
- A) -\$16 million.
 - B) -\$31.25 million.
 - C) -\$21 million.
 - D) -\$11.75 million.

Answer: B

Diff: 3

Topic: How the Federal Reserve Controls the Money Supply

Skill: Analytic

AACSB: Analytic Skills

- 20) Assume there is no leakage from the banking system and that all commercial banks are loaned up. The required reserve ratio is 10%. If the Fed buys \$10 million worth of government securities from the public, the change in the money supply will be
- A) \$1 million.
 - B) \$110 million.
 - C) \$100 million.
 - D) \$10 million.

Answer: C

Diff: 3

Topic: How the Federal Reserve Controls the Money Supply

Skill: Analytic

AACSB: Analytic Skills

- 21) The money supply has increased from \$1.4 trillion to \$1.45 trillion. Which of the following could have caused this increase?
- A) The Fed sold government securities to the public.
 - B) Consumers who were holding money outside the banking system deposit this money.
 - C) The Fed increased the discount rate.
 - D) Commercial banks began to hold excess reserves.

Answer: B

Diff: 2

Topic: *How the Federal Reserve Controls the Money Supply*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 22) If the Fed sets the money supply independent of the interest rate, then the money supply curve is
- A) upward sloping.
 - B) downward sloping.
 - C) vertical.
 - D) horizontal.

Answer: C

Diff: 2

Topic: *How the Federal Reserve Controls the Money Supply*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

2 True/False

- 1) A decrease in the required reserve ratio increases the money supply.

Answer: TRUE

Diff: 1

Topic: *How the Federal Reserve Controls the Money Supply*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 2) A sale of government securities to the public by the Federal Reserve will increase the money supply.

Answer: FALSE

Diff: 1

Topic: *How the Federal Reserve Controls the Money Supply*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 3) The discount rate cannot be used to control the money supply with great precision because its effects on banks' demand for reserves are uncertain.

Answer: TRUE

Diff: 2

Topic: *How the Federal Reserve Controls the Money Supply*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 4) The tool most frequently used by the Fed to change the money supply is changing the required reserve ratio.

Answer: FALSE

Diff: 2

Topic: *How the Federal Reserve Controls the Money Supply*

Skill: *Fact*

5) If the Fed buys securities on the open market, it will increase the money supply .

Answer: TRUE

Diff: 2

Topic: *How the Federal Reserve Controls the Money Supply*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

Chapter 11 Money Demand and the Equilibrium Interest Rate

11.1 The Demand for Money

1 Multiple Choice

- 1) When you deposit \$100 in a bank, the bank
- A) pays you an interest rate and the deposit is a liability to you.
 - B) charges you an interest rate and the deposit is a liability to you.
 - C) pays you an interest rate and the deposit is a liability to the bank.
 - D) pays you an interest rate and the deposit is an asset to the bank.

Answer: C

Diff: 1

Topic: The Demand for Money

Skill: Conceptual

AACSB: Reflective Thinking

- 2) When you borrow \$2,000 from a bank, you _____ an interest rate and the loan is _____.
- A) pay; a liability to you
 - B) pay; an asset to you
 - C) receive; a liability to you
 - D) pay; a liability to the bank

Answer: A

Diff: 1

Topic: The Demand for Money

Skill: Conceptual

AACSB: Reflective Thinking

- 3) Your M1 money demand is the amount of money you wish to
- A) earn.
 - B) accumulate before you retire.
 - C) earn per hour.
 - D) leave outside any interest-bearing account.

Answer: D

Diff: 2

Topic: The Demand for Money

Skill: Conceptual

AACSB: Reflective Thinking

- 4) Veronica's income is \$4,000 a month. She deposits \$800 in a saving account, buys \$300 worth of government securities, and leaves the rest for daily transactions. Veronica's transaction money demand is
- A) \$5,100.
 - B) \$2,900.
 - C) \$3,200.
 - D) \$3,700.

Answer: B

Diff: 2

Topic: The Demand for Money

Skill: Analytic

- 5) Mary is paid on the 1st of every month and her rent is due on the 15th of every month. This is an example of the
- A) cash flow problem.
 - B) financial float.
 - C) money management problem.
 - D) nonsynchronization of income and spending.

Answer: D

Diff: 2

Topic: *The Demand for Money*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 6) The average monthly balance in Tony's bank account is \$650. Tony spends the same amount of money each day during the month and at the end of the month his account balance is \$0. Tony's monthly starting balance is
- A) \$650.
 - B) \$1,300.
 - C) \$975.
 - D) \$21.67.

Answer: B

Diff: 2

Topic: *The Demand for Money*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 7) The average monthly balance in Aaron's bank account is \$2,000. Aaron spends the same amount of money each day during the month, and at the end of the month his account balance is \$0. Aaron's monthly starting balance is
- A) \$6,000.
 - B) \$2,000.
 - C) \$4,000.
 - D) \$3,500.

Answer: C

Diff: 2

Topic: *The Demand for Money*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 8) The average monthly balance in Yolanda's bank account is \$1,800. Yolanda spends the same amount of money each day during a 30-day month, and at the end of the month her account balance is \$0. Yolanda spends her money at a constant rate of _____ per day.
- A) \$120
 - B) \$60
 - C) \$180
 - D) \$360

Answer: A

Diff: 2

Topic: *The Demand for Money*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 9) The average monthly balance in Bobby's bank account is \$3,000. Bobby spends the same amount of money each day during a 30-day month, and at the end of the month his account balance is \$0. Bobby spends his money at a constant rate of _____ per day.
- A) \$75
 - B) \$100
 - C) \$200
 - D) \$300

Answer: C

Diff: 2

Topic: *The Demand for Money*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 10) Ed's monthly starting balance is \$3,000. Ed spends \$100 per day. Initially, Ed keeps all of his income in a non interest-bearing checking account. Ed decided to change his strategy and at the beginning of each month he deposits one-third of his income into his checking account and buys two bonds with the remainder of his income. After 10 days he cashes in one bond and 10 days after that he cashes in the other bond. Which of the following statements is TRUE?
- A) If Ed uses either strategy, his average monthly balance is \$1,500.
 - B) The second strategy involves lower money management costs because Ed now earns interest on the bonds he has purchased.
 - C) Ed's optimal money balance is \$100.
 - D) If the interest rate paid on bonds decreases, the opportunity cost of Ed's original strategy is reduced.

Answer: D

Diff: 2

Topic: *The Demand for Money*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 11) An increase in the interest rate will
- A) have no impact on the optimal money balance.
 - B) increase the optimal money balance.
 - C) lower the optimal money balance.
 - D) either increase or decrease the optimal money balance depending on the level of current household wealth.

Answer: C

Diff: 2

Topic: *The Demand for Money*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 12) John's optimal money balance has increased. This could have been caused by
- A) a reduction in the costs paid for switching from bonds to money.
 - B) a decrease in the price of bonds.
 - C) a decrease in the amount of transactions spending.
 - D) a decrease in the interest rate.

Answer: D

Diff: 2

Topic: *The Demand for Money*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 13) Lisa's optimal monetary balance has decreased. This could have been caused by
- A) an increase in the amount of transactions spending.
 - B) a decrease in the interest rate.
 - C) a reduction in the costs paid for switching from bonds to money.
 - D) an increase in the price of bonds.

Answer: C

Diff: 2

Topic: *The Demand for Money*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 14) The interest rate paid on bonds increases from 4% to 7%. This will cause
- A) no change in the optimal balance of money because checking deposits don't earn interest.
 - B) the optimal balance of money to increase because it raises the opportunity costs of holding money.
 - C) the optimal balance of money to decrease because it raises the opportunity cost of holding money.
 - D) the optimal balance of money to increase because it reduces the opportunity cost of holding money.

Answer: C

Diff: 2

Topic: *The Demand for Money*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 15) The price of bonds and the interest rate are
- A) positively related.
 - B) negatively related.
 - C) sometimes positively related and other times negatively related, depending on the bond payments.
 - D) not related.

Answer: B

Diff: 1

Topic: *The Demand for Money*

Skill: *Fact*

- 16) Ernesto bought a 10% bond a year ago for \$15,000. The market interest rate has increased to 20%. Ernesto wants to sell the bond. To be able to sell the bond Ernesto must charge a price of no more than
- A) \$13,500. B) \$12,000. C) \$7,500. D) \$3,750.

Answer: C

Diff: 2

Topic: *The Demand for Money*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 17) Jay bought a 10% bond a year ago for \$20,000. The market interest rate has decreased to 5%. Jay wants to sell the bond. To be able to sell the bond Jay must charge a price of no more than
- A) \$40,000. B) \$30,000. C) \$20,000. D) \$10,000.

Answer: A

Diff: 2

Topic: *The Demand for Money*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 18) Which one or more of the following is a motive for holding money?
- A) the transaction motive
 - B) the asset motive
 - C) the speculative motive
 - D) all of the above

Answer: B

Diff: 1

Topic: *The Demand for Money*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 19) The speculative demand for money is
- A) positively related to income.
 - B) positively related to interest rate.
 - C) negatively related to interest rate.
 - D) negatively related to income.

Answer: C

Diff: 1

Topic: *The Demand for Money*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 20) The transactions demand for money is
- A) positively related to aggregate income.
 - B) positively related to the interest rate.
 - C) negatively related to the price level.
 - D) negatively related to the interest rate.

Answer: A

Diff: 1

Topic: *The Demand for Money*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 21) As the interest rate falls, people hold _____ money instead of bonds because the opportunity cost of holding money has _____.
- A) more; fallen
 - B) less; fallen
 - C) less; risen
 - D) more; risen

Answer: A

Diff: 1

Topic: *The Demand for Money*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 22) If interest rates are lower than what individuals consider normal, they will
- A) increase their transaction money demand.
 - B) increase their speculative money demand.
 - C) decrease their speculative money demand.
 - D) decrease their transaction money demand.

Answer: B

Diff: 2

Topic: *The Demand for Money*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 23) If interest rates increase to a very high level, people will most likely hold
- A) more bonds and less cash.
 - B) less bonds and less cash.
 - C) less bonds and more cash.
 - D) more bonds and more cash.

Answer: A

Diff: 2

Topic: *The Demand for Money*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 24) Which of the following will most likely cause a decrease in the quantity of money demand?
- A) an increase in the price level
 - B) an increase in the interest rate
 - C) an increase in income
 - D) a decrease in the interest rate

Answer: B

Diff: 1

Topic: *The Demand for Money*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 25) The transaction demand for money depends on all of the following EXCEPT
- A) income.
 - B) the price level.
 - C) the interest rate.
 - D) the amount of transactions spending.

Answer: C

Diff: 1

Topic: *The Demand for Money*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 26) The transaction demand for money depends on
- A) the money supply.
 - B) the price level.
 - C) bond prices.
 - D) the interest rate.

Answer: B

Diff: 1

Topic: *The Demand for Money*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 27) The speculative demand for money
- A) increases when income increases above normal.
 - B) decreases when interest rates decrease below normal.
 - C) increases when interest rates decrease below normal.
 - D) decreases when the price level decreases below normal.

Answer: C

Diff: 1

Topic: *The Demand for Money*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 28) The transaction demand for money
- A) decreases when interest rates decrease below normal.
 - B) increases when interest rates increase above normal.
 - C) decreases when interest rates increase above normal.
 - D) increases when the price level rises.

Answer: D

Diff: 1

Topic: *The Demand for Money*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 29) When the interest rate rises, bond values
- A) rise.
 - B) fall.
 - C) are unchanged because the interest rate paid on a bond is fixed.
 - D) will either increase or decrease depending on the type of bond.

Answer: B

Diff: 1

Topic: The Demand for Money

Skill: Conceptual

AACSB: Reflective Thinking

- 30) If the interest rate is higher than normal, people are more likely to hold
- A) bonds instead of money because as the interest rate starts to rise, the value of the bonds will increase.
 - B) bonds instead of money because the opportunity cost of money is high.
 - C) money instead of bonds because the brokerage fees and other costs of buying bonds are high when the interest rate is low.
 - D) money instead of bonds because there is a speculative motive for holding a larger amount of money.

Answer: B

Diff: 2

Topic: The Demand for Money

Skill: Conceptual

AACSB: Reflective Thinking

Refer to the information provided in Figure 11.1 below to answer the questions that follow.

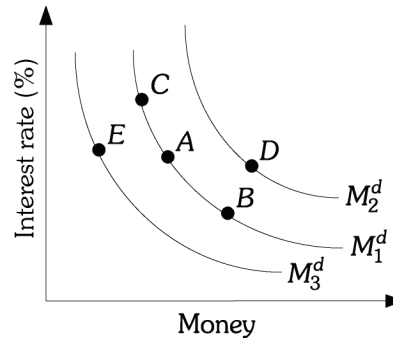


Figure 11.1

- 31) Refer to Figure 11.1. A movement from Point D to Point A can be caused by
- A) a decrease in the interest rate.
 - B) an increase in income.
 - C) a decrease in the price level.
 - D) an increase in the interest rate.

Answer: C

Diff: 1

Topic: The Demand for Money

Skill: Analytic

AACSB: Analytic Skills

- 32) Refer to Figure 11.1. A movement from Point *B* to Point *A* can be caused by
- A) a decrease in income.
 - B) an increase in the price level.
 - C) a decrease in the interest rate.
 - D) an increase in the interest rate.

Answer: D

Diff: 1

Topic: *The Demand for Money*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 33) Refer to Figure 11.1. A movement from Point *B* to Point *D* can be caused by
- A) a decrease in income.
 - B) an increase in the interest rate.
 - C) a decrease in the interest rate.
 - D) an increase in income.

Answer: D

Diff: 1

Topic: *The Demand for Money*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 34) Refer to Figure 11.1. All of the following events can cause a movement from Point *E* to Point *A* EXCEPT
- A) an increase in income.
 - B) an increase in the price level.
 - C) a decrease in the interest rate.
 - D) an increase in transactions.

Answer: C

Diff: 2

Topic: *The Demand for Money*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 35) Refer to Figure 11.1. The money demand curve will shift from M_2^d to M_1^d if

- A) the price level increases.
- B) income decreases.
- C) interest rates fall.
- D) interest rates rise.

Answer: B

Diff: 2

Topic: *The Demand for Money*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 36) Refer to Figure 11.1. The movement from *C* to *B* could be caused by
- A) a decrease in the interest rate.
 - B) an increase in the interest rate.
 - C) a decrease in income.
 - D) an increase in the price level.

Answer: A

Diff: 2

Topic: *The Demand for Money*

Skill: *Analytic*

AACSB: *Analytic Skills*

Refer to the information provided in Figure 11.2 below to answer the questions that follow.

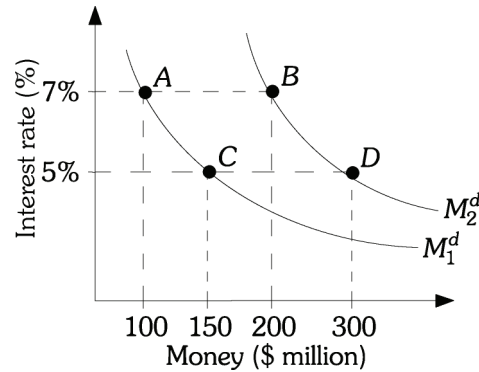


Figure 11.2

37) Refer to Figure 11.2. Suppose money demand is currently at Point A. An increase money demand could be caused by:

- A) an increase in the interest rate.
- B) an increase in income.
- C) a decrease in the interest rate.
- D) a decrease in income.

Answer: B

Diff: 1

Topic: The Demand for Money

Skill: Analytic

AACSB: Analytic Skills

38) Refer to Figure 11.2. Suppose money demand is currently at Point A. A decrease in the interest rate to 5%, ceteris paribus, will likely

- A) decrease the quantity of money demanded from \$200 million to \$100 million.
- B) increase the quantity of money demanded from \$100 million to \$200 million.
- C) increase the quantity of money demanded from \$100 million to \$150 million.
- D) increase the quantity of money demanded from \$150 million to \$300 million.

Answer: C

Diff: 1

Topic: The Demand for Money

Skill: Analytic

AACSB: Analytic Skills

39) Refer to Figure 11.2. Suppose the money demand is currently at Point D. A movement to point C could be caused by

- A) a decrease in the interest rate.
- B) a decrease in the price level.
- C) an increase in the interest rate.
- D) an increase in the price level.

Answer: B

Diff: 1

Topic: The Demand for Money

Skill: Analytic

AACSB: Analytic Skills

- 40) Refer to Figure 11.2. Suppose that money demand is currently at Point *B*. A movement to Point *D* could be caused by
- A) an increase in income, *ceteris paribus*
 - B) an increase in the price level, *ceteris paribus*
 - C) a decrease in the price level, *ceteris paribus*
 - D) a decrease in the interest rate, *ceteris paribus*

Answer: D

Diff: 1

Topic: *The Demand for Money*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 41) Which of the following causes the quantity demanded of money to increase?
- A) an increase in income
 - B) a decrease in income
 - C) a decrease in the price level
 - D) a decrease in the interest rate

Answer: D

Diff: 1

Topic: *The Demand for Money*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 42) The _____ motive shifts the money demand curve, and the _____ motive causes movements along the same money demand curve.
- A) speculative; transaction
 - B) transaction; precautionary
 - C) transaction; speculative
 - D) precautionary; transaction

Answer: C

Diff: 1

Topic: *The Demand for Money*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 43) If a bond is to pay off one year from now for \$220 and is purchased for \$200, what is the interest rate?
- A) 5%
 - B) 10%
 - C) 20%
 - D) 40%

Answer: B

Diff: 2

Topic: *The Demand for Money*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 44) If a bond is to pay off one year from now for \$840 and is purchased for \$800, what is the interest rate?
- A) 5%
 - B) 8%
 - C) 10%
 - D) 20%

Answer: A

Diff: 2

Topic: *The Demand for Money*

Skill: *Analytic*

AACSB: *Analytic Skills*

2 True/False

- 1) A mismatch between the timing of money inflow to the household and the timing of money outflow for household expenses is known as the nonsynchronization of income and spending.

Answer: TRUE

Diff: 2

Topic: *The Demand for Money*

Skill: *Definition*

- 2) Less switching from bonds to money means less interest revenue lost, but higher money management costs.

Answer: FALSE

Diff: 2

Topic: *The Demand for Money*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 3) The optimal money balance will increase as the interest rate rises, ceteris paribus.

Answer: FALSE

Diff: 2

Topic: *The Demand for Money*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 4) When interest rates fall, bond values rise.

Answer: TRUE

Diff: 1

Topic: *The Demand for Money*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 5) If people think interest rates are above their normal levels, they will want to hold bonds in anticipation of a capital gain when interest rates fall to their normal level.

Answer: TRUE

Diff: 2

Topic: *The Demand for Money*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 6) Investors may wish to hold bonds when interest rates are low with the hope of selling them when interest rates increase.

Answer: FALSE

Diff: 1

Topic: *The Demand for Money*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 7) A decrease in the price level will lead to an increase in the interest rate.

Answer: FALSE

Diff: 2

Topic: *The Demand for Money*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

8) An excess demand for money drives interest rates down.

Answer: FALSE

Diff: 1

Topic: The Demand for Money

Skill: Conceptual

AACSB: Reflective Thinking

11.2 The Equilibrium Interest Rate

1 Multiple Choice

Refer to the information provided in Figure 11.3 below to answer the questions that follow.

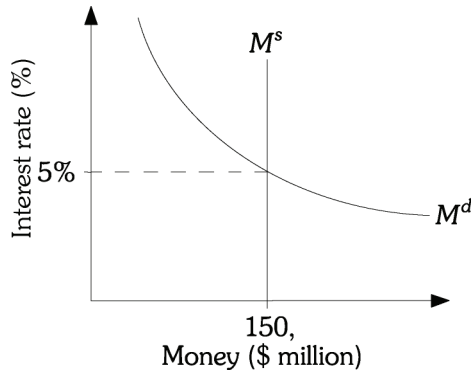


Figure 11.3

- 1) Refer to Figure 11.3. At an interest rate of 6%, there is a
- A) shortage of money and the interest rate will decline.
 - B) shortage of money and the interest rate will rise.
 - C) surplus of money and the interest rate will decline.
 - D) surplus of money and the interest rate will rise.

Answer: C

Diff: 1

Topic: The Equilibrium Interest Rate

Skill: Analytic

AACSB: Analytic Skills

- 2) Refer to Figure 11.3. At an interest rate of 3%, there is a
- A) shortage of money and the interest rate will decline.
 - B) shortage of money and the interest rate will rise.
 - C) surplus of money and the interest rate will decline.
 - D) surplus of money and the interest rate will rise.

Answer: B

Diff: 1

Topic: The Equilibrium Interest Rate

Skill: Analytic

AACSB: Analytic Skills

- 3) Refer to Figure 11.3. A decrease in the GDP, *ceteris paribus*, will likely
- A) increase the equilibrium interest rate without changing equilibrium money holdings.
 - B) decrease both the equilibrium interest rate and equilibrium money holdings.
 - C) increase the equilibrium interest rate and decrease equilibrium money holdings.
 - D) decrease the equilibrium interest rate without changing equilibrium money holdings.

Answer: D

Diff: 2

Topic: *The Equilibrium Interest Rate*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 4) Refer to Figure 11.3. An increase in the price level, *ceteris paribus*, will likely
- A) increase both the equilibrium interest rate and equilibrium money holdings.
 - B) decrease the equilibrium interest rate without changing equilibrium money holdings.
 - C) increase the equilibrium interest rate without changing equilibrium money holdings.
 - D) keep the equilibrium interest constant and increase equilibrium money holdings.

Answer: C

Diff: 2

Topic: *The Equilibrium Interest Rate*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 5) Refer to Figure 11.3. An increase in the money supply, *ceteris paribus*, will likely
- A) increase the equilibrium interest rate and decrease equilibrium money holdings.
 - B) increase the equilibrium interest rate without changing equilibrium money holdings.
 - C) decrease the equilibrium interest rate and increase equilibrium money holdings.
 - D) decrease the equilibrium interest rate without changing equilibrium money holdings.

Answer: C

Diff: 2

Topic: *The Equilibrium Interest Rate*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 6) Refer to Figure 11.3. A decrease in the money supply and an increase in the GDP will, for sure,
- A) increase the equilibrium interest rate.
 - B) decrease the equilibrium interest rate.
 - C) increase equilibrium money holdings.
 - D) decrease equilibrium money holdings.

Answer: A

Diff: 3

Topic: *The Equilibrium Interest Rate*

Skill: *Analytic*

AACSB: *Analytic Skills*

Refer to the information provided in Figure 11.4 below to answer the questions that follow.

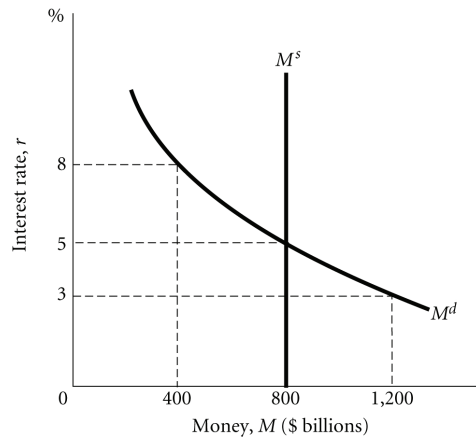


Figure 11.4

- 7) Refer to Figure 11.4. At an interest rate of 8%, there is
- A) an excess demand for money of \$400 billion.
 - B) an excess supply of money of \$800 billion.
 - C) an excess supply of money of \$400 billion.
 - D) an excess demand for money of \$800 billion.

Answer: C

Diff: 1

Topic: The Equilibrium Interest Rate

Skill: Analytic

AACSB: Analytic Skills

- 8) Refer to Figure 11.4. At an interest rate of 3%, there is
- A) an excess supply of money of \$400 billion.
 - B) an excess supply of money of \$800 billion.
 - C) an excess demand for money of \$800 billion.
 - D) an excess demand for money of \$400 billion.

Answer: D

Diff: 1

Topic: The Equilibrium Interest Rate

Skill: Analytic

AACSB: Analytic Skills

- 9) Refer to Figure 11.4. The money market will be in equilibrium at an interest rate of
- A) 0%.
 - B) 8%.
 - C) 5%.
 - D) 3%.

Answer: C

Diff: 1

Topic: The Equilibrium Interest Rate

Skill: Analytic

AACSB: Analytic Skills

- 10) Refer to Figure 11.4. At an interest rate of 8%, firms and households
- A) will attempt to increase their holdings of money by selling bonds.
 - B) are satisfied with the amount of money they are holding.
 - C) will attempt to increase both their holdings of money and their holdings of bonds.
 - D) will attempt to reduce their holdings of money by buying bonds.

Answer: D

Diff: 2

Topic: *The Equilibrium Interest Rate*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 11) Refer to Figure 11.4. At an interest rate of 3%, firms and households
- A) are satisfied with the amount of money they are holding.
 - B) will attempt to increase their holdings of money by selling bonds.
 - C) will attempt to increase both their holdings of money and their holdings of bonds.
 - D) will attempt to reduce their holdings of money by buying bonds.

Answer: B

Diff: 2

Topic: *The Equilibrium Interest Rate*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 12) Refer to Figure 11.4. At an interest rate of 5%, firms and households
- A) are satisfied with the amount of money they are holding.
 - B) will attempt to reduce their holdings of money by buying bonds.
 - C) will attempt to increase their holdings of money by selling bonds.
 - D) will attempt to increase both their holdings of money and their holdings of bonds.

Answer: A

Diff: 2

Topic: *The Equilibrium Interest Rate*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 13) What will happen to the equilibrium interest rate when both money supply and GDP decrease?
- A) The equilibrium interest rate increases.
 - B) The equilibrium interest rate decreases.
 - C) The equilibrium interest rate remains constant.
 - D) The impact on the equilibrium interest rate is ambiguous.

Answer: D

Diff: 2

Topic: *The Equilibrium Interest Rate*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 14) If the quantity of money demanded is greater than the quantity of money supplied, then the interest rate will
- A) change in an uncertain direction.
 - B) rise.
 - C) remain constant.
 - D) fall.

Answer: B

Diff: 2

Topic: *The Equilibrium Interest Rate*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 15) A shortage in the money market causes
- A) a decrease in the equilibrium interest rate.
 - B) an increase in the quantity demanded of money.
 - C) an increase in the equilibrium interest rate.
 - D) a decrease in the money supply.

Answer: C

Diff: 1

Topic: *The Equilibrium Interest Rate*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 16) A surplus in the money market causes
- A) a decrease in the equilibrium interest rate.
 - B) a decrease in the money supply.
 - C) an increase in the demand for money.
 - D) a decrease in the quantity demanded of money.

Answer: A

Diff: 1

Topic: *The Equilibrium Interest Rate*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

Refer to the information provided in Figure 11.5 below to answer the questions that follow.

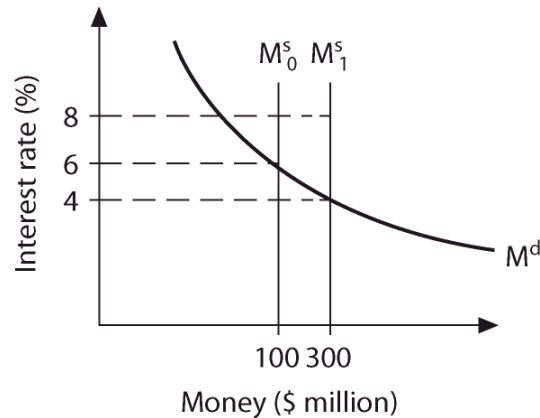


Figure 11.5

- 17) Refer to Figure 11.5. Assume the interest rate equals 4% and the money supply decreases from M_1^S to M_0^S . If the interest rate remains at 4%
- A) money demand will increase.
 - B) money demand will decrease.
 - C) there will be an excess demand for money of \$200 million.
 - D) there will be an excess supply of money of \$200 million.

Answer: C

Diff: 2

Topic: The Equilibrium Interest Rate

Skill: Analytic

AACSB: Analytic Skills

- 18) Refer to Figure 11.5. If the money supply decreases from M_1^S to M_0^S ,
- A) money demand must increase for the money market to return to equilibrium.
 - B) the interest rate will fall to 4%.
 - C) the interest rate will increase to 6%.
 - D) the money market will return to equilibrium only if the money supply is decreased to its original level.

Answer: C

Diff: 1

Topic: The Equilibrium Interest Rate

Skill: Analytic

AACSB: Analytic Skills

19) Refer to Figure 11.5. The money supply curve will shift from M_0^S to M_1^S if

- A) the Fed increases the reserve requirement.
- B) the Fed increases the discount rate.
- C) the equilibrium level of output increases.
- D) the Fed buys U.S. government securities in the open market.

Answer: D

Diff: 1

Topic: The Equilibrium Interest Rate

Skill: Analytic

AACSB: Analytic Skills

20) Refer to Figure 11.5. The money supply curve will shift from M_1^S to M_0^S if

- A) the Fed increases the reserve requirement.
- B) the Fed decreases the discount rate.
- C) the equilibrium level of output increases.
- D) the Fed buys U.S. government securities in the open market.

Answer: A

Diff: 1

Topic: The Equilibrium Interest Rate

Skill: Analytic

AACSB: Analytic Skills

21) Refer to Figure 11.5. If the money supply increases from M_0^S to M_1^S ,

- A) money demand must decrease for the money market to return to equilibrium.
- B) the interest rate will decrease to 4%.
- C) the interest rate will increase to 8%.
- D) the money market will return to equilibrium only if the money supply is increased to its original level.

Answer: B

Diff: 1

Topic: The Equilibrium Interest Rate

Skill: Analytic

AACSB: Analytic Skills

22) Refer to Figure 11.5. The money supply curve will shift from M_1^S to M_0^S if

- A) the Fed increases the discount rate.
- B) the price level increases.
- C) the equilibrium level of output decreases.
- D) the Fed buys U.S. government securities in the open market.

Answer: A

Diff: 1

Topic: The Equilibrium Interest Rate

Skill: Analytic

AACSB: Analytic Skills

- 23) If there is a surplus in the money market, the Fed can eliminate it by
- A) increasing money demand.
 - B) decreasing money demand.
 - C) increasing money supply.
 - D) decreasing money supply.

Answer: D

Diff: 1

Topic: The Equilibrium Interest Rate

Skill: Conceptual

AACSB: Reflective Thinking

- 24) A shortage in the money market can be eliminated through
- A) an increase in GDP.
 - B) an increase in the price level.
 - C) a decrease in interest rates.
 - D) an increase in money supply.

Answer: D

Diff: 2

Topic: The Equilibrium Interest Rate

Skill: Conceptual

AACSB: Reflective Thinking

- 25) When the Fed sells government securities, ceteris paribus, the money supply shifts to the _____ and the equilibrium interest rate _____.
- A) left; rises
 - B) right; rises
 - C) right; falls
 - D) left; falls

Answer: A

Diff: 2

Topic: The Equilibrium Interest Rate

Skill: Conceptual

AACSB: Reflective Thinking

- 26) Decreasing the required reserve ratio shifts the money supply curve to the _____ and _____ the equilibrium interest rate.
- A) left; increases
 - B) right; increases
 - C) left; decreases
 - D) right; decreases

Answer: D

Diff: 2

Topic: The Equilibrium Interest Rate

Skill: Conceptual

AACSB: Reflective Thinking

- 27) An increase in the level of aggregate output and the purchase of government securities by the Fed will have what effect on the equilibrium interest rate?
- A) no effect on the interest rate
 - B) a decrease in the interest rate
 - C) an increase in the interest rate
 - D) an indeterminate effect on the interest rate

Answer: D

Diff: 3

Topic: The Equilibrium Interest Rate

Skill: Analytic

AACSB: Analytic Skills

- 28) Which of the following pairs of events will definitely lead to an increase in the equilibrium interest rate?
- A) the sale of government securities by the Federal Reserve and an increase in the price level
 - B) a decrease in the discount rate and an increase in the level of aggregate output
 - C) the purchase of government securities by the Federal Reserve and a decrease in the price level
 - D) an increase in the required reserve ratio and a decrease in the level of aggregate output

Answer: A

Diff: 3

Topic: *The Equilibrium Interest Rate*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 29) Which of the following pairs of events will definitely lead to a decrease in the equilibrium interest rate?
- A) the purchase of government securities by the Federal Reserve and a increase in the level of aggregate output
 - B) an increase in the discount rate and an increase in the price level
 - C) a decrease in the required reserve ratio and a decrease in the level of aggregate output
 - D) the sale of government securities by the Federal Reserve and a decrease in the price level

Answer: C

Diff: 3

Topic: *The Equilibrium Interest Rate*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 30) An increase in the discount rate and an increase in the level of aggregate output will have what effect on the equilibrium interest rate?
- A) an increase in the interest rate
 - B) a decrease in the interest rate
 - C) no effect on the interest rate
 - D) an indeterminate effect on the interest rate

Answer: A

Diff: 3

Topic: *The Equilibrium Interest Rate*

Skill: *Analytic*

AACSB: *Analytic Skills*

Refer to the information provided in Figure 11.6 below to answer the questions that follow.

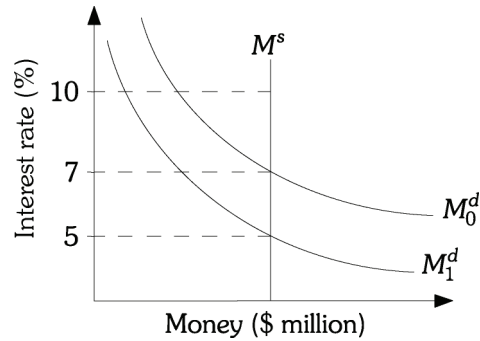


Figure 11.6

31) Refer to Figure 11.6. The demand for money curve will shift from M_1^d to M_0^d if

- A) the Fed sells government securities on the open market.
- B) the price level decreases.
- C) the interest rate increases.
- D) the aggregate level of output increases.

Answer: D

Diff: 2

Topic: The Equilibrium Interest Rate

Skill: Analytic

AACSB: Analytic Skills

32) Refer to Figure 11.6. If the demand for money curve shifts from M_1^d to M_0^d , the equilibrium

interest rate will

- A) increase from 5% to 7%.
- B) increase from 5% to 10%.
- C) decrease from 7% to 5%.
- D) remain at 7%.

Answer: A

Diff: 1

Topic: The Equilibrium Interest Rate

Skill: Analytic

AACSB: Analytic Skills

33) Refer to Figure 11.6. If the demand for money curve shifts from M_1^d to M_0^d and the interest

rate remains at 5%, there will be

- A) an excess demand for money.
- B) an excess supply of money.
- C) an equilibrium in the money market.
- D) an equilibrium in the bond market.

Answer: A

Diff: 1

Topic: The Equilibrium Interest Rate

Skill: Analytic

AACSB: Analytic Skills

34) Which of the following leads to an increase in the interest rate?

- A) a decrease in the price level
- B) a decrease in aggregate output
- C) a sale of government securities by the Fed
- D) a decrease in the discount rate

Answer: C

Diff: 2

Topic: The Equilibrium Interest Rate

Skill: Conceptual

AACSB: Reflective Thinking

35) Which of the following leads to a decrease in the interest rate?

- A) an increase in the price level
- B) a sale of government securities by the Fed
- C) an increase in the GDP
- D) a decrease in the required reserve ratio

Answer: D

Diff: 2

Topic: The Equilibrium Interest Rate

Skill: Conceptual

AACSB: Reflective Thinking

Refer to the information provided in Figure 11.7 below to answer the questions that follow.

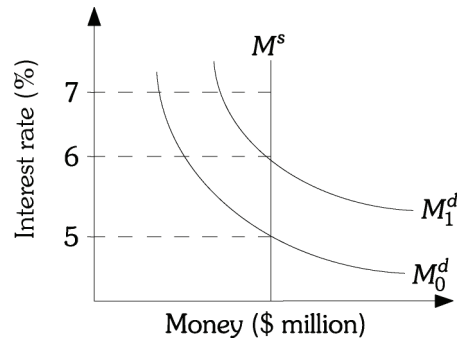


Figure 11.7

36) Refer to Figure 11.7. The demand for money curve will shift from M_0^d to M_1^d if

- A) the Fed sells government securities on the open market.
- B) the price level decreases.
- C) the interest rate increases.
- D) the level of aggregate output increases.

Answer: D

Diff: 2

Topic: The Equilibrium Interest Rate

Skill: Analytic

AACSB: Analytic Skills

- 37) Refer to Figure 11.7. If the demand for money curve shifts from M_0^d to M_1^d , the equilibrium interest rate will
- A) decrease from 7% to 5%.
 - B) increase from 5% to 7%.
 - C) increase from 5% to 6%.
 - D) remain at 5%.

Answer: C

Diff: 1

Topic: The Equilibrium Interest Rate

Skill: Analytic

AACSB: Analytic Skills

- 38) Refer to Figure 11.7. If the demand for money curve shifts from M_0^d to M_1^d and the interest rate remains at 5%, there will be
- A) an excess demand for money.
 - B) an excess supply of money.
 - C) an equilibrium in the money market.
 - D) an equilibrium in the bond market.

Answer: A

Diff: 2

Topic: The Equilibrium Interest Rate

Skill: Analytic

AACSB: Analytic Skills

- 39) A decrease in aggregate output, ceteris paribus, will cause the demand for money to _____ and the interest rate to _____.
- A) increase; increase
 - B) increase; decrease
 - C) decrease; decrease
 - D) decrease; increase

Answer: C

Diff: 2

Topic: The Equilibrium Interest Rate

Skill: Analytic

AACSB: Analytic Skills

- 40) An increase in the price level, ceteris paribus, will cause the demand for money to _____ and the interest rate to _____.
- A) increase; increase
 - B) increase; decrease
 - C) decrease; decrease
 - D) decrease; increase

Answer: A

Diff: 2

Topic: The Equilibrium Interest Rate

Skill: Analytic

AACSB: Analytic Skills

- 41) As the number of transactions in the economy decreases,
- A) the supply of money increases.
 - B) the supply of money decreases.
 - C) the demand for money increases.
 - D) the demand for money decreases.

Answer: D

Diff: 1

Topic: The Equilibrium Interest Rate

Skill: Conceptual

AACSB: Reflective Thinking

42) Which of the following events will lead to a decrease in the equilibrium interest rate?

- A) an increase in the level of aggregate output
- B) a decrease in the required reserve ratio
- C) an increase in the price level
- D) a sale of government securities by the Federal Reserve

Answer: B

Diff: 2

Topic: *The Equilibrium Interest Rate*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

43) Which of the following events will lead to an increase in the equilibrium interest rate?

- A) a decrease in the level of aggregate output
- B) a decrease in the discount rate
- C) an increase in the price level
- D) a purchase of government securities by the Federal Reserve

Answer: C

Diff: 2

Topic: *The Equilibrium Interest Rate*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

2 True/False

1) If the Federal Reserve wants interest rates to increase, it will sell bonds.

Answer: TRUE

Diff: 1

Topic: *The Equilibrium Interest Rate*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

2) A sale of government securities by the Federal Reserve will put downward pressure on the equilibrium interest rate.

Answer: FALSE

Diff: 1

Topic: *The Equilibrium Interest Rate*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

3) To increase the money supply and decrease interest rates, the Fed could purchase government securities.

Answer: TRUE

Diff: 1

Topic: *The Equilibrium Interest Rate*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

4) If money demand falls, then the interest rate will rise.

Answer: FALSE

Diff: 2

Topic: *The Equilibrium Interest Rate*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

5) If the Federal Reserve lowers the discount rate, then the money supply will rise.

Answer: TRUE

Diff: 2

Topic: *The Equilibrium Interest Rate*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

6) If the Federal Reserve lowers the required reserve ratio, then the money supply will fall.

Answer: FALSE

Diff: 2

Topic: *The Equilibrium Interest Rate*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

11.3 Looking Ahead: The Federal Reserve and Monetary Policy

1 Multiple Choice

1) In a period of high inflation, the Fed would most likely

A) decrease the discount rate.

B) tighten monetary policy.

C) decrease the required reserve ratio.

D) ease monetary policy.

Answer: B

Diff: 2

Topic: *Looking Ahead: The Federal Reserve and Monetary Policy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

2) In a period of high unemployment, the Fed would most likely

A) tighten monetary policy.

B) ease monetary policy.

C) ease fiscal policy.

D) tighten fiscal policy.

Answer: B

Diff: 2

Topic: *Looking Ahead: The Federal Reserve and Monetary Policy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

3) When economists refer to "easy" monetary policy, they mean that the Federal Reserve is taking actions that will

A) increase the demand for money.

B) decrease the demand for money.

C) expand the money supply.

D) contract the money supply.

Answer: C

Diff: 2

Topic: *Looking Ahead: The Federal Reserve and Monetary Policy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 4) An example of a tight monetary policy is
- A) a decrease in the reserve requirement.
 - B) the Fed selling government securities in the open market.
 - C) a decrease in the discount rate.
 - D) a decrease in the federal funds rate.

Answer: B

Diff: 1

Topic: Looking Ahead: The Federal Reserve and Monetary Policy

Skill: Conceptual

AACSB: Reflective Thinking

- 5) An example of a tight monetary policy is
- A) an increase in the reserve requirement.
 - B) the Fed buying government securities in the open market.
 - C) a decrease in the prime lending rate.
 - D) a decrease in the discount rate.

Answer: A

Diff: 1

Topic: Looking Ahead: The Federal Reserve and Monetary Policy

Skill: Conceptual

AACSB: Reflective Thinking

- 6) When economists refer to "tight" monetary policy, they mean that the Federal Reserve is taking actions that will
- A) increase the demand for money.
 - B) decrease the demand for money.
 - C) expand the money supply.
 - D) contract the money supply.

Answer: D

Diff: 2

Topic: Looking Ahead: The Federal Reserve and Monetary Policy

Skill: Conceptual

AACSB: Reflective Thinking

- 7) Which of the following is an example of an easy monetary policy?
- A) an increase in the reserve requirement
 - B) a decrease in the discount rate
 - C) an increase in the federal funds rate
 - D) the Fed selling government securities in the open market

Answer: B

Diff: 1

Topic: Looking Ahead: The Federal Reserve and Monetary Policy

Skill: Conceptual

AACSB: Reflective Thinking

2 True/False

- 1) Tight monetary policy stimulates the economy.

Answer: FALSE

Diff: 1

Topic: Looking Ahead: The Federal Reserve and Monetary Policy

Skill: Conceptual

AACSB: Reflective Thinking

2) If the Federal Reserve lowers the discount rate it is tightening monetary policy.

Answer: FALSE

Diff: 1

Topic: Looking Ahead: The Federal Reserve and Monetary Policy

Skill: Conceptual

AACSB: Reflective Thinking

3) If the Federal Reserve raises reserve requirements it is easing monetary policy.

Answer: FALSE

Diff: 1

Topic: Looking Ahead: The Federal Reserve and Monetary Policy

Skill: Conceptual

AACSB: Reflective Thinking

4) Monetary tightening causes the equilibrium interest rate to fall.

Answer: FALSE

Diff: 2

Topic: Looking Ahead: The Federal Reserve and Monetary Policy

Skill: Conceptual

AACSB: Reflective Thinking

5) When the Federal Reserve sells government securities it is tightening monetary policy.

Answer: TRUE

Diff: 2

Topic: Looking Ahead: The Federal Reserve and Monetary Policy

Skill: Conceptual

AACSB: Reflective Thinking

11.4 Appendix A: The Various Interest Rates in the U.S. Economy

1 Multiple Choice

1) The treasury bill rate is the interest rate paid

- A) on government securities that mature in less than a year.
- B) on government securities that mature in 5 years.
- C) on government securities that mature in 10 years.
- D) on government securities that mature in 30 years.

Answer: A

Diff: 1

Topic: Appendix A: The Various Interest Rates in the U.S. Economy

Skill: Definition

2) The interest rate that commercial banks charge each other for borrowing and lending reserves is called

- A) the commercial rate.
- B) the price interest rate.
- C) the federal funds rate.
- D) the discount rate.

Answer: C

Diff: 1

Topic: Appendix A: The Various Interest Rates in the U.S. Economy

Skill: Definition

- 3) Which of the following types of interest rates change daily?
- A) the prime rate
 - B) the federal funds rate
 - C) the discount rate
 - D) the corporate rate

Answer: B

Diff: 1

Topic: Appendix A: The Various Interest Rates in the U.S. Economy

Skill: Fact

- 4) On an unsecured loan, your bank will highly likely charge an interest rate
- A) below the prime rate.
 - B) above the prime rate.
 - C) below the discount rate.
 - D) below the federal funds rate.

Answer: B

Diff: 1

Topic: Appendix A: The Various Interest Rates in the U.S. Economy

Skill: Fact

- 5) Assume the one-year interest rate on a bond is 8% and the expected one-year rate a year from now is 12%. According to the expectations theory of the term structure of interest rates, the two-year rate will be
- A) 8%.
 - B) 10%.
 - C) 12%.
 - D) 22%.

Answer: B

Diff: 2

Topic: Appendix A: The Various Interest Rates in the U.S. Economy

Skill: Analytic

AACSB: Analytic Skills

- 6) Assume the current one-year interest rate on a bond is 2%, and the one-year expected rate a year from now is 3%. According to the expectations theory of the term structure of interest rates, the two-year interest rate is
- A) 2%.
 - B) 3%.
 - C) 5%.
 - D) 2.5%.

Answer: D

Diff: 2

Topic: Appendix A: The Various Interest Rates in the U.S. Economy

Skill: Analytic

AACSB: Analytic Skills

- 7) The interest rate on a two-year security will continue to adjust until it is equal to
- A) half the interest rate on a one-year security.
 - B) twice the interest rate on a one-year security.
 - C) an average of the current one-year rate and the expected one-year rate for next year.
 - D) the sum of the current one-year rate and the expected one-year rate for next year.

Answer: C

Diff: 2

Topic: Appendix A: The Various Interest Rates in the U.S. Economy

Skill: Conceptual

AACSB: Reflective Thinking

- 8) The Fed can influence long-term interest rates by
- A) influencing the current one-year rate.
 - B) affecting people's expectations of future short-term rates.
 - C) influencing the demand for money in the short run.
 - D) both A and B are correct

Answer: D

Diff: 2

Topic: Appendix A: The Various Interest Rates in the U.S. Economy

Skill: Conceptual

AACSB: Reflective Thinking

- 9) Government securities that mature in less than a year are called
- A) Federal funds bonds.
 - B) government bonds.
 - C) Federal Reserve bonds.
 - D) Treasury bills.

Answer: D

Diff: 1

Topic: Appendix A: The Various Interest Rates in the U.S. Economy

Skill: Definition

- 10) What is the most widely followed short-term interest rate?
- A) The federal funds rate
 - B) The three-month Treasury bill rate
 - C) The commercial paper rate
 - D) The government bond rate

Answer: B

Diff: 1

Topic: Appendix A: The Various Interest Rates in the U.S. Economy

Skill: Fact

- 11) Government securities with terms of more than one year are called
- A) Treasury bills.
 - B) federal funds bonds.
 - C) capital bills.
 - D) government bonds.

Answer: D

Diff: 1

Topic: Appendix A: The Various Interest Rates in the U.S. Economy

Skill: Fact

- 12) The interest rate that banks are charged when they borrow reserves from other banks is the
- A) federal funds rate.
 - B) AAA corporate bond rate.
 - C) commercial paper rate.
 - D) prime rate.

Answer: A

Diff: 1

Topic: Appendix A: The Various Interest Rates in the U.S. Economy

Skill: Fact

- 13) The federal funds rate is a
- A) one-month rate.
 - B) one-week rate.
 - C) one-day rate.
 - D) one-year rate.

Answer: C

Diff: 1

Topic: Appendix A: The Various Interest Rates in the U.S. Economy

Skill: Fact

- 14) Federal funds are
- A) interbank loans.
 - B) raised by taxes.
 - C) loans that banks get from the Fed.
 - D) bonds issued by the federal government.

Answer: A

Diff: 2

Topic: Appendix A: The Various Interest Rates in the U.S. Economy

Skill: Fact

- 15) The rate that the Fed controls most closely through its open-market operations is the
- A) prime rate.
 - B) federal funds rate.
 - C) commercial paper rate.
 - D) government bonds rate.

Answer: B

Diff: 2

Topic: Appendix A: The Various Interest Rates in the U.S. Economy

Skill: Fact

- 16) The rate that the least risky firms pay on bonds that they issue is the
- A) prime rate.
 - B) triple-A corporate bond rate.
 - C) commercial paper rate.
 - D) federal funds rate.

Answer: B

Diff: 1

Topic: Appendix A: The Various Interest Rates in the U.S. Economy

Skill: Fact

2 True/False

- 1) Federal funds rate is the tax rate on income.

Answer: FALSE

Diff: 1

Topic: Appendix A: The Various Interest Rates in the U.S. Economy

Skill: Conceptual

AACSB: Reflective Thinking

- 2) Commercial paper is a short term IOU of a corporation.

Answer: TRUE

Diff: 1

Topic: Appendix A: The Various Interest Rates in the U.S. Economy

Skill: Conceptual

AACSB: Reflective Thinking

- 3) The two year interest rate is an average of the expected interest rate each of the two years.

Answer: TRUE

Diff: 1

Topic: Appendix A: The Various Interest Rates in the U.S. Economy

Skill: Conceptual

AACSB: Reflective Thinking

- 4) The Fed can affect long term interest rates by affecting the expectations of people.

Answer: TRUE

Diff: 2

Topic: Appendix A: The Various Interest Rates in the U.S. Economy

Skill: Conceptual

AACSB: Reflective Thinking

11.5 Appendix B: The Demand for Money: A Numerical Example

1 Multiple Choice

Refer to the information provided in Table 11.1 below to answer the questions that follow .

Table 11.1

Number of switches	Average Money Holdings	Average Bond Holdings	Interest Earned
0	\$1,200	\$0	\$0
1	\$600	\$600	\$30
2	\$400	\$800	\$40
3	\$300	\$900	\$45
4	\$200	\$1,000	\$50

- 1) Refer to Table 11.1. If it costs \$11 each time a bond is sold, the optimal average money holdings are

A) \$600. B) \$400. C) \$300. D) \$200.

Answer: A

Diff: 2

Topic: Appendix B: The Demand for Money: A Numerical Example

Skill: Analytic

AACSB: Analytic Skills

- 2) Refer to Table 11.1. If it costs \$7 each time a bond is sold, the optimal average money holdings are

A) \$600. B) \$400. C) \$300. D) \$200.

Answer: B

Diff: 2

Topic: Appendix B: The Demand for Money: A Numerical Example

Skill: Analytic

AACSB: Analytic Skills

- 3) Refer to Table 11.1. If the period covered by Table 11.1 is one year, the interest rate paid on bonds

A) is 2%.
B) is 3%.
C) is 5%.
D) cannot be determined from this information.

Answer: C

Diff: 2

Topic: Appendix B: The Demand for Money: A Numerical Example

Skill: Analytic

AACSB: Analytic Skills

- 4) Refer to Table 11.1. If it costs \$9 each time a bond is sold, the optimal number of switches is
A) 1. B) 2. C) 3. D) 4.

Answer: B

Diff: 2

Topic: Appendix B: The Demand for Money: A Numerical Example

Skill: Analytic

AACSB: Analytic Skills

- 5) Refer to Table 11.1. If it costs \$13 each time a bond is sold, the highest profit available is
A) \$6. B) \$13. C) \$17. D) \$21.

Answer: C

Diff: 2

Topic: Appendix B: The Demand for Money: A Numerical Example

Skill: Analytic

AACSB: Analytic Skills

- 6) Refer to Table 11.1. At a price of _____ the optimal number of switches is _____.
A) \$7; 2 B) \$9; 1 C) \$11; 2 D) \$13; 3

Answer: A

Diff: 2

Topic: Appendix B: The Demand for Money: A Numerical Example

Skill: Analytic

AACSB: Analytic Skills

- 7) Refer to Table 11.1. At a price of _____ the optimal number of switches is _____.
A) \$7; 1 B) \$9; 3 C) \$11; 1 D) \$13; 0

Answer: C

Diff: 2

Topic: Appendix B: The Demand for Money: A Numerical Example

Skill: Analytic

AACSB: Analytic Skills

Chapter 12 Aggregate Demand in the Goods and Money Markets

12.1 Planned Investment and the Interest Rate

1 Multiple Choice

- 1) The market in which the equilibrium level of aggregate output is determined is the
- A) labor market.
 - B) bond market.
 - C) money market.
 - D) goods market.

Answer: D

Diff: 1

Topic: *Planned Investment and the Interest Rate*

Skill: *Conceptual*

- 2) The market in which the equilibrium level of the interest rate is determined is the
- A) money market.
 - B) goods market.
 - C) labor market.
 - D) services market.

Answer: A

Diff: 1

Topic: *Planned Investment and the Interest Rate*

Skill: *Conceptual*

- 3) The two links between the goods market and the money market are
- A) income and the inflation rate.
 - B) the interest rate and the unemployment rate.
 - C) income and the interest rate.
 - D) the inflation rate and the unemployment rate.

Answer: C

Diff: 2

Topic: *Planned Investment and the Interest Rate*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 4) Which of the following is determined in the goods market?
- A) the equilibrium interest rate
 - B) money demand
 - C) income
 - D) money supply

Answer: C

Diff: 1

Topic: *Planned Investment and the Interest Rate*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 5) Which of the following is determined in the money market?
- A) the equilibrium interest rate
 - B) income
 - C) employment
 - D) the government budget

Answer: A

Diff: 1

Topic: *Planned Investment and the Interest Rate*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 6) If planned investment is perfectly unresponsive to changes in the interest rate, the planned investment schedule
- A) has a negative slope.
 - B) is horizontal.
 - C) is vertical.
 - D) has a positive slope.

Answer: C

Diff: 2

Topic: *Planned Investment and the Interest Rate*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 7) If planned investment is perfectly responsive to changes in the interest rate, the planned investment schedule
- A) has a negative slope.
 - B) is horizontal.
 - C) is vertical.
 - D) has a positive slope.

Answer: B

Diff: 2

Topic: *Planned Investment and the Interest Rate*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 8) The money market and the goods market are linked through the impact of the interest rate on
- A) government spending.
 - B) planned investment.
 - C) money supply.
 - D) unplanned spending.

Answer: B

Diff: 2

Topic: *Planned Investment and the Interest Rate*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 9) Which of the following equations represents equilibrium in the goods market?
- A) $Y = M^s$.
 - B) $M^d = C + I + G$.
 - C) $M^d = M^s$.
 - D) $Y = C + I + G$.

Answer: D

Diff: 1

Topic: *Planned Investment and the Interest Rate*

Skill: *Definition*

Refer to the information provided in Figure 12.1 below to answer the questions that follow.

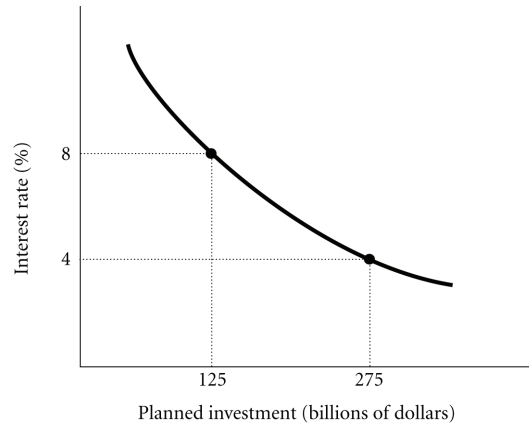


Figure 12.1

- 10) Refer to Figure 12.1. If the interest rate drops from 8% to 4%, planned investment
- A) increases, causing aggregate expenditure and aggregate output to fall.
 - B) increases, causing aggregate expenditure to fall.
 - C) decreases, causing both aggregate expenditure and aggregate output to rise.
 - D) increases, causing both aggregate expenditure and aggregate output to rise.

Answer: D

Diff: 2

Topic: Planned Investment and the Interest Rate

Skill: Analytic

AACSB: Analytic Skills

- 11) Refer to Figure 12.1. If the interest rate rises from 4% to 8%, planned investment
- A) decreases, causing both aggregate expenditure and aggregate output to fall.
 - B) increases, causing aggregate expenditure to fall.
 - C) decreases, causing both aggregate expenditure and aggregate output to rise.
 - D) increases, causing both aggregate expenditure and aggregate output to rise.

Answer: A

Diff: 2

Topic: Planned Investment and the Interest Rate

Skill: Analytic

AACSB: Analytic Skills

- 12) Refer to Figure 12.1. If the interest rate increases from 4% to 8%,
- A) aggregate expenditure increases.
 - B) equilibrium aggregate output decreases.
 - C) planned expenditure increases.
 - D) both aggregate expenditure and aggregate output increase.

Answer: B

Diff: 2

Topic: Planned Investment and the Interest Rate

Skill: Analytic

AACSB: Analytic Skills

- 13) Refer to Figure 12.1. If the interest rate decreases from 8% to 4%,
- A) aggregate expenditure increases.
 - B) equilibrium aggregate output decreases.
 - C) planned expenditure decreases.
 - D) the money supply will increase.

Answer: A

Diff: 2

Topic: Planned Investment and the Interest Rate

Skill: Analytic

AACSB: Analytic Skills

Refer to the information provided in Table 12.1 below to answer the questions that follow.

Table 12.1
A Hypothetical Investment Schedule

Interest Rate (%)	Planned Investment (\$ Billion)
3	400
6	360
9	320
12	280
15	240
18	200

- 14) Refer to Table 12.1. If the interest rate dropped from 15% to 6%, planned investment would _____ by \$ _____ billion.
- A) increase; 120 B) increase; 180 C) decrease; 120 D) decrease; 180

Answer: A

Diff: 1

Topic: Planned Investment and the Interest Rate

Skill: Analytic

AACSB: Analytic Skills

- 15) Refer to Table 12.1. Suppose the expenditure multiplier is 3. An increase in the interest rate from 6% to 9%, ceteris paribus, would
- A) increase planned expenditure by \$120 billion.
 - B) increase aggregate expenditure by \$120 billion.
 - C) decrease equilibrium output by \$120 billion.
 - D) decrease planned investment by \$120 billion.

Answer: C

Diff: 2

Topic: Planned Investment and the Interest Rate

Skill: Analytic

AACSB: Analytic Skills

- 16) Refer to Table 12.1. Suppose the expenditure multiplier is 4. A drop in the interest rate from 15% to 9%, ceteris paribus, would increase equilibrium output by \$ _____ billion.
- A) 320 B) 20 C) 240 D) 160

Answer: A

Diff: 3

Topic: Planned Investment and the Interest Rate

Skill: Analytic

AACSB: Analytic Skills

17) Refer to Table 12.1. Suppose the expenditure multiplier is 5 and the initial interest rate is 12%. A move to what interest rate will increase equilibrium output by 400 billion?

- A) 3% B) 6% C) 9% D) 18%

Answer: D

Diff: 3

Topic: *Planned Investment and the Interest Rate*

Skill: *Analytic*

AACSB: *Analytic Skills*

18) Refer to Table 12.1. Suppose the expenditure multiplier is 5, the initial interest rate is 9%, and the initial equilibrium output is \$600 billion. What is the interest rate that increases equilibrium output to \$800 billion?

- A) 12% B) 15% C) 6% D) 3%

Answer: C

Diff: 3

Topic: *Planned Investment and the Interest Rate*

Skill: *Analytic*

AACSB: *Analytic Skills*

19) Refer to Table 12.1. Suppose the expenditure multiplier is 10, and the initial interest rate is 15%. What would be the impact on the equilibrium output if the interest rate fell to 6%?

- A) It would increase by \$1,200 billion. B) It would decrease by \$1,200 billion.
C) It would decrease by \$3,600 billion. D) It would increase by \$3,600 billion.

Answer: A

Diff: 3

Topic: *Planned Investment and the Interest Rate*

Skill: *Analytic*

AACSB: *Analytic Skills*

20) Related to the *Economics in Practice* on p.221 [533]: According to a recent study by Simon Gilchrist, Fabio Natalucci, and Egon Zakrajsek, a one percentage point increase in the interest rate appropriate for a firm's borrowing will lead to a

- A) drop in investment spending of more than one percentage point.
B) rise in investment spending of more than one percentage point.
C) drop in investment spending of less than one percentage point.
D) rise in investment spending of less than one percentage point.

Answer: A

Diff: 2

Topic: *Planned Investment and the Interest Rate: Economics in Practice*

Skill: *Fact*

21) Related to the *Economics in Practice* on p.221 [533]: According to a recent study by Simon Gilchrist, Fabio Natalucci, and Egon Zakrajsek, investment expenditures are _____ changes in interest rates.

- A) highly sensitive to B) highly insensitive to
C) completely independent of D) positively related to

Answer: A

Diff: 2

Topic: *Planned Investment and the Interest Rate: Economics in Practice*

Skill: *Fact*

2 True/False

- 1) The interest rate affects the goods market through its impact on money demand.

Answer: FALSE

Diff: 1

Topic: *Planned Investment and the Interest Rate*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 2) Income is determined in the money market.

Answer: FALSE

Diff: 2

Topic: *Planned Investment and the Interest Rate*

Skill: *Conceptual*

- 3) The money market is linked to the goods market through the impact of interest rates on planned investment.

Answer: TRUE

Diff: 2

Topic: *Planned Investment and the Interest Rate*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

12.2 Equilibrium in Both the Goods and Money Markets

1 Multiple Choice

- 1) The interest rate is determined in the

- A) money market and has no influence on the goods market.
- B) money market and influences the level of planned investment and thus the goods market.
- C) goods market and has no influence on the money market.
- D) goods market and influences the level of planned investment and thus the money market.

Answer: B

Diff: 2

Topic: *Equilibrium in Both the Goods and Money Markets*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 2) Output is determined in

- A) the goods market and also influences money demand and the interest rate.
- B) the money market and also influences money demand and the interest rate.
- C) the goods market with no influence from the money market.
- D) the money market with no influence on the goods market.

Answer: A

Diff: 2

Topic: *Equilibrium in Both the Goods and Money Markets*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

3) When income increases, the money demand curve shifts to the _____, which _____ the interest rate with a fixed money supply.

A) right; increases

B) right; decreases

C) left; increases

D) left; decreases

Answer: A

Diff: 2

Topic: Equilibrium in Both the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

4) When income _____, the money _____ curve shifts to the right.

A) increases; demand

B) increases; supply

C) decreases; demand

D) decreases; supply

Answer: A

Diff: 1

Topic: Equilibrium in Both the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

2 True/False

1) When aggregate output falls, money demand and the interest rate fall.

Answer: TRUE

Diff: 2

Topic: Equilibrium in Both the Goods and Money Markets

Skill: Conceptual

AACSB: Reflective Thinking

2) The money market is linked to the goods and services market by the impact of income on the demand for money.

Answer: TRUE

Diff: 2

Topic: Equilibrium in Both the Goods and Money Markets

Skill: Conceptual

AACSB: Reflective Thinking

12.3 Policy Effects in the Goods and Money Markets

1 Multiple Choice

1) Fiscal policy affects the goods market through

A) changes in money supply.

B) changes in taxes and money supply.

C) changes in government spending and money supply.

D) changes in taxes and government spending.

Answer: D

Diff: 1

Topic: Policy Effects in the Goods and Money Markets

Skill: Conceptual

AACSB: Reflective Thinking

- 2) Fiscal policy affects the money market through its effect on
- A) income and money supply.
 - B) income and money demand.
 - C) money supply and money demand.
 - D) money supply and income.

Answer: B

Diff: 2

Topic: Policy Effects in the Goods and Money Markets

Skill: Conceptual

AACSB: Reflective Thinking

- 3) Monetary policy affects the goods market through its effect on
- A) the interest rate and planned investment.
 - B) the interest rate and money demand.
 - C) income and planned investment.
 - D) income and money demand.

Answer: A

Diff: 1

Topic: Policy Effects in the Goods and Money Markets

Skill: Conceptual

AACSB: Reflective Thinking

- 4) Which of the following is an example of an expansionary fiscal policy?
- A) the Fed selling government securities in the open market
 - B) the federal government increasing the marginal tax rate on incomes above \$200,000
 - C) the federal government increasing the amount of money spent on public health programs
 - D) the federal government reducing pollution standards to allow firms to produce more output

Answer: C

Diff: 1

Topic: Policy Effects in the Goods and Money Markets

Skill: Conceptual

AACSB: Reflective Thinking

- 5) The objective of a contractionary fiscal policy is to
- A) reduce unemployment.
 - B) increase growth in output.
 - C) reduce inflation.
 - D) increase stagflation.

Answer: C

Diff: 1

Topic: Policy Effects in the Goods and Money Markets

Skill: Conceptual

AACSB: Reflective Thinking

- 6) The objective of an expansionary fiscal policy is to
- A) reduce unemployment.
 - B) reduce inflation.
 - C) reduce growth in output.
 - D) reduce growth in international trade.

Answer: A

Diff: 1

Topic: Policy Effects in the Goods and Money Markets

Skill: Conceptual

AACSB: Reflective Thinking

- 7) A decrease in the money supply aimed at decreasing aggregate output is referred to as
- A) contractionary fiscal policy.
 - B) expansionary fiscal policy.
 - C) expansionary monetary policy.
 - D) contractionary monetary policy.

Answer: D

Diff: 1

Topic: Policy Effects in the Goods and Money Markets

Skill: Conceptual

AACSB: Reflective Thinking

- 8) An example of a contractionary monetary policy is
- A) an increase in the required reserve ratio.
 - B) a decrease in the discount rate.
 - C) a reduction in the taxes banks pay on their profits.
 - D) the Fed buying government securities in the open market.

Answer: A

Diff: 1

Topic: Policy Effects in the Goods and Money Markets

Skill: Conceptual

AACSB: Reflective Thinking

- 9) An example of an expansionary monetary policy is
- A) a decrease in the required reserve ratio.
 - B) the Fed selling bonds in the open market.
 - C) an increase in the required reserve ratio.
 - D) a law placing a ceiling on the maximum interest rate that banks can pay to depositors.

Answer: A

Diff: 1

Topic: Policy Effects in the Goods and Money Markets

Skill: Conceptual

AACSB: Reflective Thinking

- 10) An intended goal of contractionary fiscal and monetary policy is
- A) an increase in interest rates.
 - B) an increase in the price level.
 - C) a decrease in the unemployment rate.
 - D) a decrease in the level of aggregate output.

Answer: D

Diff: 1

Topic: Policy Effects in the Goods and Money Markets

Skill: Conceptual

AACSB: Reflective Thinking

Refer to the information provided in Figure 12.4 below to answer the questions that follow.

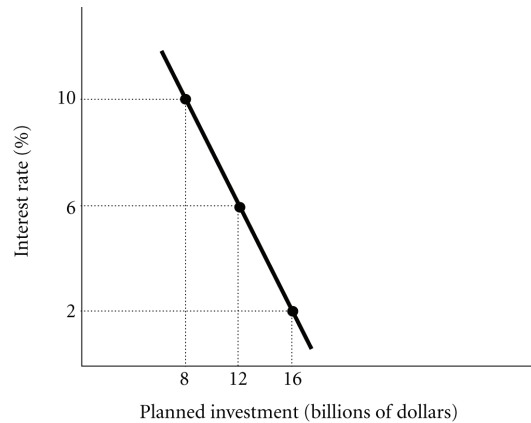


Figure 12.4

- 11) Refer to Figure 12.4. Planned investment could decrease from \$12 million to \$8 million if
- A) the government increases government purchases.
 - B) the Fed increases the money supply.
 - C) the government reduces government purchases.
 - D) the government increases net taxes.

Answer: A

Diff: 3

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

- 12) Refer to Figure 12.4. Planned investment could decrease from \$16 million to \$12 million if
- A) the government reduces government purchases.
 - B) the Fed buys bonds in the open market.
 - C) the government reduces net taxes.
 - D) firms expect their sales to decrease in the future.

Answer: C

Diff: 3

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

- 13) Refer to Figure 12.4. Planned investment could increase from \$8 million to \$12 million if
- A) the government increases government purchases.
 - B) the government decreases net taxes.
 - C) the Fed sells bonds in the open market.
 - D) the Fed reduces the required reserve ratio.

Answer: D

Diff: 3

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

- 14) Refer to Figure 12.4. Planned investment could decrease from \$12 million to \$8 million if
- A) the government increases net taxes.
 - B) the government increases government purchases.
 - C) the Fed buys bonds in the open market.
 - D) Both B and C

Answer: B

Diff: 3

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

- 15) Refer to Figure 12.4. Planned investment could decrease from \$16 million to \$12 million if
- A) the government reduces government purchases.
 - B) the Fed sells bonds in the open market.
 - C) the Fed lowers the discount rate.
 - D) B and C

Answer: B

Diff: 3

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

- 16) Refer to Figure 12.4. Planned investment could increase from \$8 million to \$12 million if
- A) the government increases government purchases.
 - B) the government increases net taxes.
 - C) the Fed sells bonds in the open market.
 - D) the Fed lowers the discount rate.

Answer: D

Diff: 3

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

- 17) Which of the following sequence of events follows an expansionary monetary policy?
- A) $r \uparrow \Rightarrow I \downarrow \Rightarrow AE \downarrow \Rightarrow Y \downarrow$.
 - B) $r \uparrow \Rightarrow I \uparrow \Rightarrow AE \downarrow \Rightarrow Y \uparrow$.
 - C) $r \downarrow \Rightarrow I \uparrow \Rightarrow AE \uparrow \Rightarrow Y \uparrow$.
 - D) $r \downarrow \Rightarrow I \downarrow \Rightarrow AE \downarrow \Rightarrow Y \downarrow$.

Answer: C

Diff: 2

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

- 18) Which of the following sequence of events follows a rise in the discount rate?
- A) $r \downarrow \Rightarrow I \downarrow \Rightarrow AE \downarrow \Rightarrow Y \uparrow$.
 - B) $r \uparrow \Rightarrow I \downarrow \Rightarrow AE \downarrow \Rightarrow Y \downarrow$.
 - C) $r \downarrow \Rightarrow I \uparrow \Rightarrow AE \uparrow \Rightarrow Y \uparrow$.
 - D) $r \uparrow \Rightarrow I \uparrow \Rightarrow AE \uparrow \Rightarrow Y \uparrow$.

Answer: B

Diff: 2

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

19) Which of the following sequence of events follows an expansionary fiscal policy?

- A) $AE \uparrow \Rightarrow Y \uparrow \Rightarrow M^d \downarrow \Rightarrow r \downarrow \Rightarrow I \downarrow \Rightarrow AE \downarrow$.
- B) $AE \uparrow \Rightarrow Y \uparrow \Rightarrow M^d \uparrow \Rightarrow r \uparrow \Rightarrow I \downarrow \Rightarrow AE \downarrow$.
- C) $AE \downarrow \Rightarrow Y \downarrow \Rightarrow M^d \downarrow \Rightarrow r \downarrow \Rightarrow I \uparrow \Rightarrow AE \uparrow$.
- D) $AE \downarrow \Rightarrow Y \uparrow \Rightarrow M^d \downarrow \Rightarrow r \downarrow \Rightarrow I \downarrow \Rightarrow AE \downarrow$.

Answer: B

Diff: 2

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

20) Which of the following sequence of events follows an increase in net taxes?

- A) $AE \uparrow \Rightarrow Y \uparrow \Rightarrow M^d \uparrow \Rightarrow r \uparrow \Rightarrow I \uparrow \Rightarrow AE \uparrow$.
- B) $AE \downarrow \Rightarrow Y \uparrow \Rightarrow M^d \downarrow \Rightarrow r \uparrow \Rightarrow I \downarrow \Rightarrow AE \downarrow$.
- C) $AE \uparrow \Rightarrow Y \uparrow \Rightarrow M^d \downarrow \Rightarrow r \downarrow \Rightarrow I \downarrow \Rightarrow AE \downarrow$.
- D) $AE \downarrow \Rightarrow Y \downarrow \Rightarrow M^d \downarrow \Rightarrow r \downarrow \Rightarrow I \uparrow \Rightarrow AE \uparrow$.

Answer: D

Diff: 2

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

21) If planned investment decreases as the interest rate increases, the size of the government spending multiplier will be

- A) zero.
- B) larger than the government spending multiplier that would result if planned investment were independent of the interest rate.
- C) the same as the government spending multiplier that would result if planned investment were independent of the interest rate.
- D) smaller than the government spending multiplier that would result if planned investment were independent of the interest rate.

Answer: D

Diff: 3

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

22) If planned investment decreases as the interest rate increases, the absolute value of the tax multiplier will be

- A) the same as the absolute value of the tax multiplier that would result if planned investment were independent of the interest rate.
- B) larger than the absolute value of the tax multiplier that would result if planned investment were independent of the interest rate.
- C) smaller than the absolute value of the tax multiplier that would result if planned investment were independent of the interest rate.
- D) zero.

Answer: C

Diff: 3

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

Refer to the information provided in Table 12.2 below and the following three assumptions to answer the questions that follow.

A Hypothetical Economy	
Consumption (C)	\$600 billion
Planned Investment (I)	\$300 billion
Government Spending	\$150 billion

Assume the following for the long run:

1. For every 1% increase (decrease) in interest rate, planned investment decreases (increases) by \$5 billion.
2. For every \$10 billion increase (decrease) in government spending, interest rate increases (decreases) by 1%.
3. The $MPC = 0.8$

23) Refer to Table 12.2. Assuming the economy is in equilibrium, how much is equilibrium output?

- A) \$750 billion. B) \$900 billion C) \$1,050 billion D) \$1,350 billion

Answer: C

Diff: 2

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

24) Refer to Table 12.2. When government spending increases by \$30 billion, the crowding-out effect can be represented by a

- A) \$30 billion decrease in investment. B) \$15 billion decrease in investment.
 C) 3% decrease in the interest rate. D) 1% increase in the interest rate.

Answer: B

Diff: 3

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

25) Refer to Table 12.2. Taking the crowding-out effect into consideration, if government spending increases by \$30 billion, equilibrium output

- A) increases by \$150 billion. B) increases by \$225 billion.
 C) decreases by \$150 billion. D) increases by \$75 billion.

Answer: D

Diff: 3

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

- 26) Refer to Table 12.2. Taking the crowding-out effect into consideration, if government spending increases by \$50 billion, the new equilibrium output is
- A) \$1,100 billion. B) \$1,175 billion. C) \$1,300 billion. D) \$1,000 billion.

Answer: B

Diff: 3

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

- 27) The severity of the crowding-out effect will be reduced if
- A) the Fed increases the money supply at the same time the federal government increases government spending.
- B) the Fed decreases the money supply at the same time the federal government increases government spending.
- C) the Fed does not change the money supply when the government increases government spending.
- D) business firms become pessimistic about the future.

Answer: A

Diff: 3

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

- 28) If the Fed decreases the money supply at the same time the federal government decreases government spending, the crowding-out effect
- A) will not be affected.
- B) will be increased.
- C) will be reduced.
- D) could either increase or decrease depending on the sensitivity of planned investment to the interest rate.

Answer: C

Diff: 2

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

- 29) The steeper the planned investment schedule (curve)
- A) the larger is the crowding-out effect.
- B) the smaller is the crowding-out effect.
- C) the larger is the change in planned investment as a result of changes in the interest rate.
- D) the smaller is the change in money demand as a result of changes in the interest rate.

Answer: B

Diff: 2

Topic: Policy Effects in the Goods and Money Markets

Skill: Conceptual

AACSB: Reflective Thinking

- 30) The flatter the planned investment schedule (curve)
- A) the smaller is the change in planned investment as a result of changes in the interest rate.
 - B) the smaller is the crowding-out effect.
 - C) the larger is the crowding-out effect.
 - D) the larger is the change in money demand as a result of changes in the interest rate.

Answer: C

Diff: 2

Topic: Policy Effects in the Goods and Money Markets

Skill: Conceptual

AACSB: Reflective Thinking

- 31) If planned investment does not fall when the interest rate rises, there will be
- A) a slight crowding-out effect.
 - B) a substantial crowding-out effect.
 - C) no crowding-out effect.
 - D) a complete crowding-out effect.

Answer: C

Diff: 2

Topic: Policy Effects in the Goods and Money Markets

Skill: Conceptual

AACSB: Reflective Thinking

- 32) Which of the following reduces the severity of the crowding-out effect whenever government spending increases?
- A) An expansionary monetary policy
 - B) An expansionary fiscal policy
 - C) A contractionary monetary policy
 - D) A contractionary fiscal policy

Answer: A

Diff: 2

Topic: Policy Effects in the Goods and Money Markets

Skill: Conceptual

AACSB: Reflective Thinking

- 33) There will be no crowding-out effect when the government increases spending and the planned investment schedule (curve) is
- A) vertical.
 - B) downward sloping.
 - C) upward sloping.
 - D) horizontal.

Answer: A

Diff: 2

Topic: Policy Effects in the Goods and Money Markets

Skill: Conceptual

AACSB: Reflective Thinking

- 34) If firms sharply increase the number of investment projects undertaken when interest rates fall and sharply reduce the number of investment projects undertaken when interest rates increase, then, ignoring the crowding out effect,
- A) expansionary fiscal policy will be very effective.
 - B) expansionary monetary policy will be very effective.
 - C) contractionary fiscal policy will be very effective.
 - D) contractionary monetary policy will not be very effective.

Answer: B

Diff: 3

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

- 35) If planned investment is sensitive to the interest rate, an increase in the interest rate causes the
- A) aggregate expenditure curve to shift down.
 - B) aggregate expenditure curve to shift up.
 - C) long-run aggregate supply curve to shift out.
 - D) investment demand schedule to shift to the right.

Answer: A

Diff: 2

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

- 36) Monetary policy can be effective only if
- A) the money supply reacts to changes in the interest rate.
 - B) planned investment reacts to changes in the interest rate.
 - C) money demand reacts to changes in the interest rate.
 - D) government spending reacts to changes in the interest rate.

Answer: B

Diff: 2

Topic: Policy Effects in the Goods and Money Markets

Skill: Conceptual

AACSB: Reflective Thinking

- 37) Dan, a writer for a business magazine, interviewed managers at 100 large corporations. All of the managers indicated that the primary determinant of planned investment is expected sales and not the interest rate. From this information, Dan concluded that
- A) fiscal policy would be very effective, but monetary policy would not be very effective.
 - B) neither expansionary nor contractionary fiscal policy would be very effective.
 - C) both expansionary and contractionary monetary policy would be very effective.
 - D) contractionary fiscal policy would not be very effective, but contractionary monetary policy would be very effective.

Answer: A

Diff: 2

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

- 38) Assume that investment spending depends on the interest rate. As the supply of money is increased, the interest rate _____ and planned investment spending _____.
- A) falls; increases
 - B) falls; decreases
 - C) rises; decreases
 - D) rises; increases

Answer: A

Diff: 2

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

- 39) If the interest rate is so high that it is hurting economic growth, the recommended policy action should be
- A) an expansionary fiscal policy.
 - B) an expansionary monetary policy.
 - C) a contractionary monetary policy.
 - D) the demand for money should be increased.

Answer: B

Diff: 2

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

- 40) Monetary policy affects the money market by
- A) changing the interest rate, which changes planned investment.
 - B) directly increasing consumption, which increases aggregate output.
 - C) changing the money supply, which changes the interest rate.
 - D) changing the level of aggregate output, which changes the level of planned expenditure.

Answer: C

Diff: 1

Topic: Policy Effects in the Goods and Money Markets

Skill: Conceptual

AACSB: Reflective Thinking

- 41) If the investment demand curve is vertical,
- A) both monetary and fiscal policy are ineffective.
 - B) both monetary and fiscal policy are effective.
 - C) monetary policy is effective, but fiscal policy is ineffective.
 - D) monetary policy is ineffective, but fiscal policy is effective.

Answer: D

Diff: 2

Topic: Policy Effects in the Goods and Money Markets

Skill: Conceptual

AACSB: Reflective Thinking

- 42) If the federal government is reducing net taxes to stimulate the economy at the same time the Fed is selling bonds in the open market, the effectiveness of the expansionary fiscal policy will be
- A) increased, because the Fed's actions will result in higher interest rates.
 - B) reduced, because the Fed's actions will result in higher interest rates.
 - C) increased, because the Fed's actions will result in lower interest rates.
 - D) reduced, because the Fed's actions will result in lower interest rates.

Answer: B

Diff: 3

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

- 43) If the Fed accommodates a fiscal expansion by increasing the money supply so that the interest rate increases only a little, the crowding-out effect will
- A) be zero.
 - B) increase.
 - C) decrease, but still be positive.
 - D) become infinitely large.

Answer: C

Diff: 3

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

Refer to the information provided in Figure 12.5 below to answer the questions that follow.

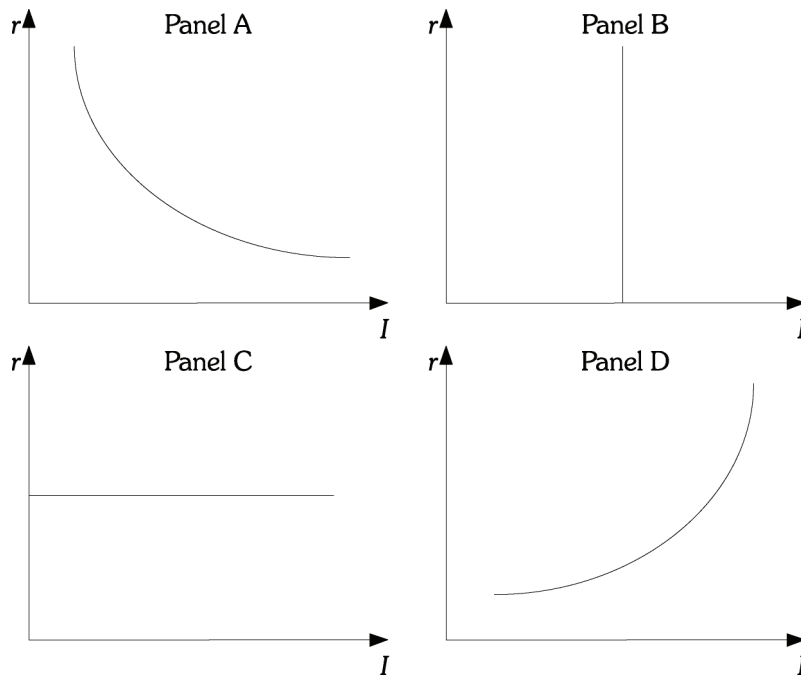


Figure 12.5

- 44) Refer to Figure 12.5. As a result of an expansionary fiscal policy, the largest crowding-out effect occurs if the planned investment schedule (curve) is similar to the one in Panel _____.
- A) A
 - B) B
 - C) C
 - D) D

Answer: C

Diff: 2

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

45) Refer to Figure 12.5. Assume the current equilibrium output is \$500 billion, the spending multiplier is 5, and the government increases purchases by \$10 billion. If the new equilibrium output increases to \$530 billion, most likely the planned investment schedule (curve) is similar to the one in Panel _____.

- A) A B) B C) C D) D

Answer: A

Diff: 3

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

46) Refer to Figure 12.5. Assume the current equilibrium output is \$500 billion, the spending multiplier is 5, and the government increased spending by \$10 billion. If the new equilibrium output increased to \$550 billion, most likely the planned investment schedule (curve) is similar to the one in Panel _____.

- A) A B) B C) C D) D

Answer: B

Diff: 3

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

47) Which of the following actions is an example of an expansionary fiscal policy?

- A) an increase in the discount rate
- B) a decrease in defense spending
- C) a sale of government securities in the open market
- D) a decrease in net taxes.

Answer: D

Diff: 1

Topic: Policy Effects in the Goods and Money Markets

Skill: Definition

48) Which of the following sequence of events occurs in response to an expansionary fiscal policy?

- A) Aggregate output decreases, causing money demand to decrease, causing the interest rate to decrease and planned investment to increase.
- B) Aggregate output decreases, causing money demand to increase, causing interest rates to increase and planned investment to decrease.
- C) Aggregate output increases, causing money demand to increase, causing interest rates to increase and planned investment to decrease.
- D) Aggregate output decreases, causing the demand for money to increase, causing interest rates to increase and planned investment to increase.

Answer: C

Diff: 2

Topic: Policy Effects in the Goods and Money Markets

Skill: Conceptual

AACSB: Reflective Thinking

Refer to the information provided in Figure 12.6 below to answer the questions that follow.

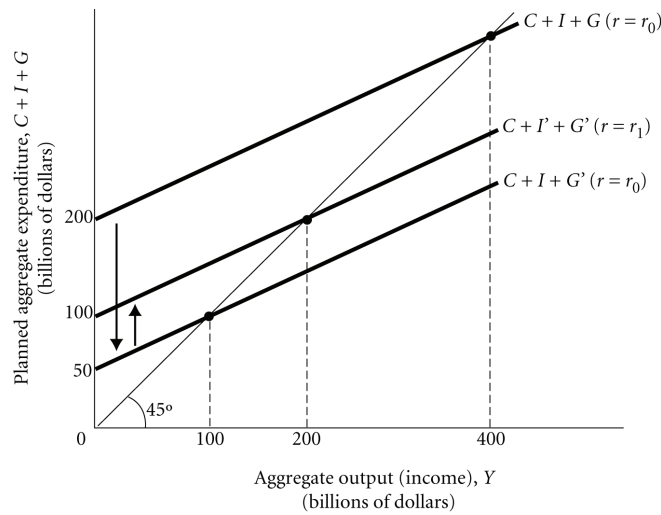


Figure 12.6

- 49) Refer to Figure 12.6. After government purchases are reduced, the planned aggregate expenditure function may shift from $C + I + G'$ to $C + I' + G'$ because the reduction in output will cause
- A) money supply to increase, the interest rate to decrease, and planned investment to increase.
 - B) money supply to decrease, the interest rate to decrease, and planned investment to increase.
 - C) money demand to decrease, the interest rate to decrease, and planned investment to increase.
 - D) money demand to increase, the interest rate to decrease, and planned investment to increase.

Answer: C

Diff: 2

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

- 50) Refer to Figure 12.6. The initial aggregate expenditure function is given by $C + I + G$. A decrease in government spending shifts the aggregate expenditure function to $C + I + G'$. If investment does NOT depend on the interest rate, the multiplier
- A) is .5.
 - B) is 1.33.
 - C) is 2.
 - D) cannot be determined from the information available.

Answer: C

Diff: 2

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

- 51) Refer to Figure 12.6. If investment does NOT depend on the interest rate, the change in government purchases that decreases income from \$400 billion to \$100 billion is
- A) an increase of \$150 billion.
 - B) a decrease of \$150 billion.
 - C) a decrease of \$300 billion.
 - D) cannot be determined from the information available.

Answer: B

Diff: 2

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

- 52) Refer to Figure 12.6. If investment DOES depend on the interest rate, the change in planned investment that the decrease in government spending brought about so that income fell from \$400 billion to \$200 billion rather than \$100 billion would have been

- A) an increase of \$50 billion.
- B) a decrease of \$100 billion.
- C) a decrease of \$200 billion.
- D) cannot be determined from the information available.

Answer: A

Diff: 3

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

Refer to the information provided in Figure 12.7 below to answer the questions that follow.

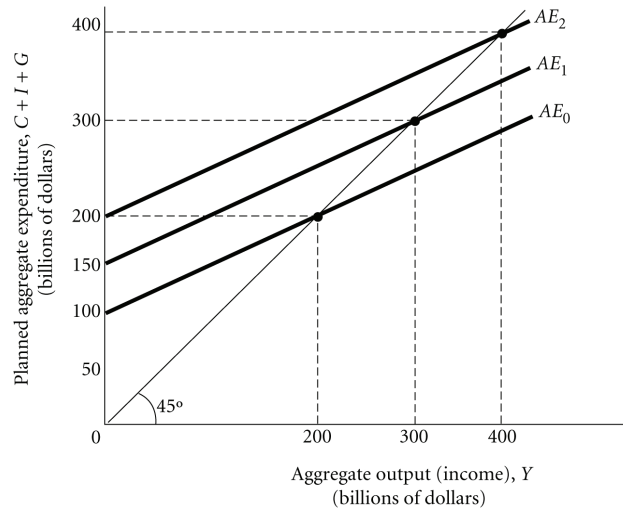


Figure 12.7

- 53) Refer to Figure 12.7. What is the multiplier in this economy?

- A) 2
- B) 4
- C) 5
- D) 10

Answer: A

Diff: 2

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

- 54) Refer to Figure 12.7. The initial aggregate expenditures are represented by the line AE_0 . If the government increases spending by \$100 billion and the aggregate expenditures curve shifts to AE_1 , we know for sure that
- A) there is \$100 billion decline in planned investment.
 - B) there is total crowding-out effect.
 - C) the planned investment schedule is vertical.
 - D) the planned investment schedule is downward sloping.

Answer: D

Diff: 3

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

- 55) Refer to Figure 12.7. The initial aggregate expenditures are represented by the line AE_0 . If the government increases spending by \$100 billion and the aggregate expenditures curve shifts to AE_2 , we know for sure that
- A) the interest rate does not change as a result of fiscal policy.
 - B) planned investment is perfectly insensitive to changes in the interest rate.
 - C) there is total crowding-out effect.
 - D) the planned investment schedule is horizontal.

Answer: B

Diff: 3

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

- 56) Refer to Figure 12.7. The initial aggregate expenditures are represented by the line AE_0 . If the government increases spending by \$100 billion and the aggregate expenditures curve remains AE_0 , we know for sure that
- A) the interest rate does not change as a result of fiscal policy.
 - B) planned investment is perfectly insensitive to changes in the interest rate.
 - C) there is total crowding-out effect.
 - D) the planned investment schedule is downward sloping.

Answer: C

Diff: 3

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

- 57) If investment depends on the interest rate, a decrease in net taxes will cause aggregate output to _____ than if investment doesn't depend on the interest rate.
- A) increase by more
 - B) increase by less
 - C) decrease by more
 - D) decrease by less

Answer: B

Diff: 2

Topic: Policy Effects in the Goods and Money Markets

Skill: Conceptual

AACSB: Reflective Thinking

- 58) A decrease in the money supply aimed at decreasing aggregate output is
- A) an expansionary fiscal policy.
 - B) a contractionary monetary policy.
 - C) a contractionary fiscal policy.
 - D) an expansionary monetary policy.

Answer: B

Diff: 1

Topic: Policy Effects in the Goods and Money Markets

Skill: Definition

- 59) Which of the following is the sequence of events following a contractionary monetary policy?
- A) Money demand increases \Rightarrow interest rates increase \Rightarrow planned investment falls and aggregate output falls.
 - B) Interest rates increase \Rightarrow planned investment decreases \Rightarrow aggregate output decreases \Rightarrow money demand decreases.
 - C) Interest rates decrease \Rightarrow planned investment decreases \Rightarrow aggregate output decreases \Rightarrow money demand decreases.
 - D) Aggregate output falls \Rightarrow the demand for money falls \Rightarrow interest rates rises \Rightarrow planned investment decreases.

Answer: B

Diff: 1

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

Refer to the information provided in Figure 12.8 below to answer the questions that follow.

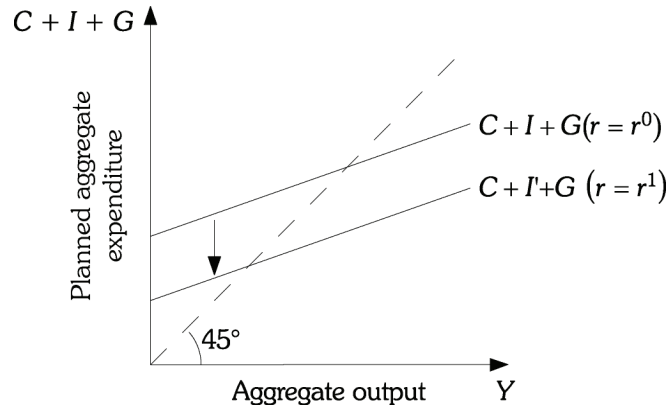


Figure 12.8

- 60) Refer to Figure 12.8. Interest rate r^1 is greater than interest rate r^0 . Which of the following would have caused the planned aggregate expenditure function to shift from $C + I + G$ to $C + I + G$?
- A) a contractionary monetary policy
 - B) a contractionary fiscal policy
 - C) a decrease in the cost of capital relative to labor
 - D) an expansionary monetary policy

Answer: A

Diff: 1

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

- 61) Which of the following actions is an example of an expansionary monetary policy?
- A) a reduction in federal spending on education
 - B) a purchase of government securities in the open market
 - C) an increase in the discount rate
 - D) an increase in income tax rates

Answer: B

Diff: 1

Topic: Policy Effects in the Goods and Money Markets

Skill: Conceptual

- 62) If you are concerned that the inflation rate is too high, which of the following policies would you recommend?
- A) a decrease in the money supply
 - B) an increase in the money supply
 - C) a decrease in income tax rates
 - D) an increase in government spending

Answer: A

Diff: 2

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

- 63) The combination of monetary and fiscal policies in use at a given time is referred to as the
- A) crowding-out mix.
 - B) policy mix.
 - C) discretionary mix.
 - D) package mix.

Answer: B

Diff: 1

Topic: Policy Effects in the Goods and Money Markets

Skill: Definition

- 64) A policy mix that consists of a contractionary fiscal policy and an expansionary monetary policy would
- A) be neutral with respect to the composition of aggregate spending in the economy.
 - B) lead to higher interest rates.
 - C) favor government spending over investment spending.
 - D) favor investment spending over government spending.

Answer: D

Diff: 2

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

- 65) A policy mix that consists of an expansionary fiscal policy and a contractionary monetary policy would
- A) be neutral with respect to the composition of aggregate spending in the economy.
 - B) favor investment spending over government purchases.
 - C) lead to lower interest rates.
 - D) favor government purchases over investment spending.

Answer: D

Diff: 2

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

- 66) A policy mix of an expansionary fiscal policy and a contractionary monetary policy would cause
- A) output to decrease and interest rates to decrease.
 - B) output to decrease and interest rates to increase.
 - C) output to decrease and interest rates to either increase, decrease, or remain unchanged.
 - D) output to either increase, decrease, or remain unchanged and interest rates to increase.

Answer: D

Diff: 2

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

- 67) A policy mix of an expansionary fiscal policy and an expansionary monetary policy would cause output to _____ and interest rates to _____.
- A) increase; increase
 - B) increase; increase, decrease, or remain unchanged
 - C) increase, decrease, or remain unchanged; increase
 - D) decrease; increase

Answer: B

Diff: 2

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

- 68) The policy mix of a contractionary fiscal policy and a contractionary monetary policy would cause output to _____, and interest rates to _____.
- A) decrease; increase, decrease, or remain unchanged
 - B) decrease; decrease
 - C) decrease; increase
 - D) increase, decrease, or remain unchanged; decrease

Answer: A

Diff: 2

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

- 69) The policy mix that would cause the interest rate to increase and investment to decrease, but have an indeterminate effect on aggregate output, is a mix of
- A) expansionary fiscal policy and expansionary monetary policy.
 - B) contractionary fiscal policy and expansionary monetary policy.
 - C) expansionary fiscal policy and contractionary monetary policy.
 - D) contractionary fiscal policy and contractionary monetary policy.

Answer: C

Diff: 3

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

- 70) The policy mix that would cause the interest rate to decrease and investment to increase, but have an indeterminate effect on aggregate output, is a mix of
- A) contractionary fiscal policy and expansionary monetary policy.
 - B) expansionary fiscal policy and contractionary monetary policy.
 - C) expansionary fiscal policy and expansionary monetary policy.
 - D) contractionary fiscal policy and contractionary monetary policy.

Answer: A

Diff: 3

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

- 71) If the Fed increases the money supply, there will initially be
- A) a surplus of money and the equilibrium interest rate will rise.
 - B) a surplus of money and the equilibrium interest rate will fall.
 - C) a shortage of money and the equilibrium interest rate will rise.
 - D) a shortage of money and the equilibrium interest rate will fall.

Answer: B

Diff: 2

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

- 72) If the Fed decreases the money supply, there will initially be
- A) a shortage of money and the equilibrium interest rate will rise.
 - B) a shortage of money and the equilibrium interest rate will fall.
 - C) a surplus of money and the equilibrium interest rate will rise.
 - D) a surplus of money and the equilibrium interest rate will fall.

Answer: A

Diff: 2

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

- 73) If GDP increases, there will initially be
- A) a shortage of money and the equilibrium interest rate will rise.
 - B) a shortage of money and the equilibrium interest rate will fall.
 - C) a surplus of money and the equilibrium interest rate will rise.
 - D) a surplus of money and the equilibrium interest rate will fall.

Answer: A

Diff: 2

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

- 74) If GDP decreases, there will initially be
- A) a surplus of money and the equilibrium interest rate will rise.
 - B) a surplus of money and the equilibrium interest rate will fall.
 - C) a shortage of money and the equilibrium interest rate will rise.
 - D) a shortage of money and the equilibrium interest rate will fall.

Answer: B

Diff: 2

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

2 True/False

- 1) Fiscal policy affects the money market through its impact on income and money demand.

Answer: TRUE

Diff: 1

Topic: Policy Effects in the Goods and Money Markets

Skill: Conceptual

AACSB: Reflective Thinking

2) Monetary policy affects the goods market through its impact on the interest rate and planned investment.

Answer: TRUE

Diff: 1

Topic: Policy Effects in the Goods and Money Markets

Skill: Conceptual

AACSB: Reflective Thinking

3) The tendency for increases in government purchases to cause reductions in private saving is known as the crowding-out effect.

Answer: FALSE

Diff: 1

Topic: Policy Effects in the Goods and Money Markets

Skill: Definition

4) As the interest sensitivity of investment demand increases, the size of the crowding-out effect increases.

Answer: TRUE

Diff: 2

Topic: Policy Effects in the Goods and Money Markets

Skill: Conceptual

AACSB: Reflective Thinking

5) If planned investment falls as the interest rate rises, there will be no crowding-out effect.

Answer: FALSE

Diff: 2

Topic: Policy Effects in the Goods and Money Markets

Skill: Conceptual

AACSB: Reflective Thinking

6) The more sensitive planned investment is to the interest rate, the less effective fiscal policy.

Answer: TRUE

Diff: 2

Topic: Policy Effects in the Goods and Money Markets

Skill: Conceptual

AACSB: Reflective Thinking

7) The more sensitive planned investment is to the interest rate, the less the effectiveness of monetary policy.

Answer: FALSE

Diff: 2

Topic: Policy Effects in the Goods and Money Markets

Skill: Conceptual

AACSB: Reflective Thinking

8) If the Fed wants to reduce the inflation rate, it should lower the discount rate.

Answer: FALSE

Diff: 1

Topic: Policy Effects in the Goods and Money Markets

Skill: Conceptual

AACSB: Reflective Thinking

9) If the Fed wants to reduce the inflation rate, it should sell bonds in the open market.

Answer: TRUE

Diff: 1

Topic: Policy Effects in the Goods and Money Markets

Skill: Conceptual

AACSB: Reflective Thinking

10) The policy mix of a contractionary monetary policy and a contractionary fiscal policy will, unambiguously, lead to a decrease in the interest rate.

Answer: FALSE

Diff: 2

Topic: Policy Effects in the Goods and Money Markets

Skill: Analytic

AACSB: Analytic Skills

12.4 The Aggregate Demand (AD) Curve

1 Multiple Choice

1) In an economy, when the price level falls, consumers and firms buy more goods and services.

This relationship is represented by the

A) aggregate expenditures curve.

B) aggregate demand curve.

C) short-run aggregate supply curve.

D) long-run aggregate supply curve.

Answer: B

Diff: 1

Topic: The Aggregate Demand (AD) Curve

Skill: Conceptual

AACSB: Reflective Thinking

2) The aggregate demand curve shows a _____ relationship between _____ and total quantity of output _____.

A) positive; the interest rate; demanded

B) negative; the price level; supplied

C) positive; the price level; demanded

D) negative; the price level; demanded

Answer: D

Diff: 1

Topic: The Aggregate Demand (AD) Curve

Skill: Conceptual

AACSB: Reflective Thinking

3) The aggregate demand curve shows that, ceteris paribus,

A) at higher price levels, total quantity of output demanded is higher.

B) at lower price levels, total quantity of output supplied is lower.

C) at lower price levels, total quantity of output demanded is higher.

D) at higher price levels, total quantity of output supplied is lower.

Answer: C

Diff: 1

Topic: The Aggregate Demand (AD) Curve

Skill: Conceptual

AACSB: Reflective Thinking

- 4) The aggregate demand curve
- A) is an upward sloping curve.
 - B) is a downward sloping curve.
 - C) may slope upward or downward.
 - D) is horizontal.

Answer: B

Diff: 1

Topic: The Aggregate Demand (AD) Curve

Skill: Conceptual

- 5) Money demand is a function of all of the following EXCEPT
- A) interest rate.
 - B) price level.
 - C) money supply.
 - D) aggregate output.

Answer: C

Diff: 1

Topic: The Aggregate Demand (AD) Curve

Skill: Conceptual

AACSB: Reflective Thinking

- 6) The quantity of aggregate output demanded will fall if
- A) the interest rate is reduced.
 - B) the price level increases.
 - C) the money supply is increased.
 - D) net taxes are reduced.

Answer: B

Diff: 1

Topic: The Aggregate Demand (AD) Curve

Skill: Conceptual

AACSB: Reflective Thinking

Refer to the information provided in Figure 12.10 below to answer the questions that follow.

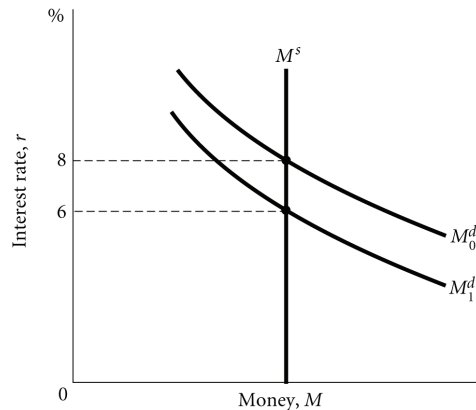


Figure 12.10

7) Refer to Figure 12.10. The money demand curve will shift from M_0^d to M_1^d , if

- A) the price level decreases.
- B) the interest rate decreases.
- C) the level of aggregate output increases.
- D) the inflation rate increases.

Answer: A

Diff: 2

Topic: The Aggregate Demand (AD) Curve

Skill: Analytic

AACSB: Analytic Skills

8) Refer to Figure 12.10. If the money demand curve shifts from M_0^d to M_1^d ,

- A) planned investment will decrease and aggregate output will decrease.
- B) planned investment will decrease and aggregate output will increase.
- C) planned investment will increase and aggregate output will decrease.
- D) planned investment will increase and aggregate output will increase.

Answer: D

Diff: 2

Topic: The Aggregate Demand (AD) Curve

Skill: Analytic

AACSB: Analytic Skills

9) Which of the following sequence of events is TRUE?

- A) $P \uparrow \Rightarrow M^d \downarrow \Rightarrow r \uparrow$
- B) $P \uparrow \Rightarrow M^d \uparrow \Rightarrow r \downarrow$
- C) $Y \uparrow \Rightarrow M^d \downarrow \Rightarrow r \uparrow$
- D) $Y \uparrow \Rightarrow M^d \uparrow \Rightarrow r \uparrow$

Answer: D

Diff: 2

Topic: The Aggregate Demand (AD) Curve

Skill: Analytic

AACSB: Analytic Skills

10) As the price level in the economy increases, which of the following sequence of events occurs?

- A) $M^d \uparrow \Rightarrow r \uparrow \Rightarrow I \uparrow \Rightarrow AE \downarrow$ B) $M^d \downarrow \Rightarrow r \uparrow \Rightarrow I \uparrow \Rightarrow AE \uparrow$
C) $M^d \uparrow \Rightarrow r \uparrow \Rightarrow I \downarrow \Rightarrow AE \downarrow$ D) $M^d \downarrow \Rightarrow r \uparrow \Rightarrow I \downarrow \Rightarrow AE \downarrow$

Answer: C

Diff: 2

Topic: The Aggregate Demand (AD) Curve

Skill: Analytic

AACSB: Analytic Skills

11) As the price level in the economy decreases, which of the following sequence of events occurs?

- A) $M^d \downarrow \Rightarrow r \uparrow \Rightarrow AD \downarrow$ B) $M^d \uparrow \Rightarrow r \uparrow \Rightarrow AD \uparrow$
C) $M^d \downarrow \Rightarrow r \downarrow \Rightarrow AD \downarrow$ D) $M^d \downarrow \Rightarrow r \downarrow \Rightarrow AD \uparrow$

Answer: D

Diff: 2

Topic: The Aggregate Demand (AD) Curve

Skill: Analytic

AACSB: Analytic Skills

12) Aggregate demand rises when the price level decreases because the lower price level causes

- A) the market demand for all goods and services to decrease.
B) the supply of money to decrease.
C) the demand for money to rise causing interest rates to fall.
D) the demand for money to fall causing interest rates to fall.

Answer: D

Diff: 1

Topic: The Aggregate Demand (AD) Curve

Skill: Conceptual

AACSB: Reflective Thinking

13) Aggregate demand decreases when the price level rises because the higher price level

- A) means that people can afford to buy more goods.
B) causes the demand for money to increase, causing interest rates to rise.
C) means that the prices of some goods fall relative to the prices of other goods.
D) causes the interest rate to fall.

Answer: B

Diff: 1

Topic: The Aggregate Demand (AD) Curve

Skill: Conceptual

AACSB: Reflective Thinking

14) Which of the following statements is TRUE?

- A) The aggregate demand curve is the sum of all market demand curves in the economy.
B) Each point on the aggregate demand curve corresponds to a point at which both the goods market and the money market are in equilibrium.
C) The aggregate demand curve is a market demand curve.
D) Only the goods market is in equilibrium at each point on the aggregate demand curve.

Answer: B

Diff: 2

Topic: The Aggregate Demand (AD) Curve

Skill: Conceptual

AACSB: Reflective Thinking

15) An increase in the money supply will cause planned investment to _____ and consumption to _____.

- A) decrease; decrease
- C) increase; increase

- B) decrease; increase
- D) increase; decrease

Answer: C

Diff: 1

Topic: The Aggregate Demand (AD) Curve

Skill: Conceptual

AACSB: Reflective Thinking

16) The level of aggregate output demanded falls when the price level rises, because the resulting increase in the interest rate will lead to

- A) higher investment spending and higher consumption spending.
- B) lower investment spending and higher consumption spending.
- C) higher investment spending and lower consumption spending.
- D) lower investment spending and lower consumption spending.

Answer: D

Diff: 2

Topic: The Aggregate Demand (AD) Curve

Skill: Conceptual

AACSB: Reflective Thinking

17) The aggregate demand curve slopes downward because at higher price level

- A) the purchasing power of consumers' assets declines and consumption increases.
- B) producers can get more for what they produce, and they increase production.
- C) the purchasing power of consumers' assets declines and consumption decreases.
- D) the purchasing power of consumers' assets increases and consumption increases.

Answer: C

Diff: 2

Topic: The Aggregate Demand (AD) Curve

Skill: Conceptual

AACSB: Reflective Thinking

18) When changes in the price level cause changes in the interest rate and, thus, changes in aggregate output demanded, we call this effect

- A) the multiplier effect.
- B) the real wealth effect.
- C) the real income effect.
- D) the consumption link.

Answer: D

Diff: 1

Topic: The Aggregate Demand (AD) Curve

Skill: Definition

19) When the general price level rises,

- A) consumption falls as a result of the real wealth effect.
- B) consumption increases as a result of the multiplier effect.
- C) investment rises as a result of the real wealth effect.
- D) investment rises as a result of the multiplier effect.

Answer: A

Diff: 1

Topic: The Aggregate Demand (AD) Curve

Skill: Conceptual

AACSB: Reflective Thinking

- 20) The change in consumption brought about by a change in purchasing power of savings that results from a change in the price level is the
- A) consumption effect.
 - B) money supply effect.
 - C) real wealth effect.
 - D) interest rate effect.

Answer: C

Diff: 1

Topic: The Aggregate Demand (AD) Curve

Skill: Definition

- 21) At every point along the aggregate demand curve, the level of aggregate output demanded is
- A) greater than planned aggregate expenditure.
 - B) less than planned aggregate expenditure.
 - C) equal to planned aggregate expenditure.
 - D) unrelated to the concept of planned aggregate expenditure.

Answer: C

Diff: 1

Topic: The Aggregate Demand (AD) Curve

Skill: Conceptual

AACSB: Reflective Thinking

- 22) At every point along the aggregate demand curve (assuming no foreign sector),
- A) $G = T$.
 - B) $S = I$.
 - C) $Y = C$.
 - D) $Y = C + I + G$.

Answer: D

Diff: 1

Topic: The Aggregate Demand (AD) Curve

Skill: Conceptual

AACSB: Reflective Thinking

- 23) A decrease in the quantity of money supplied at a given price level causes
- A) no change in aggregate demand.
 - B) a decrease in aggregate demand.
 - C) an increase in aggregate demand.
 - D) an increase in aggregate supply.

Answer: B

Diff: 1

Topic: The Aggregate Demand (AD) Curve

Skill: Conceptual

AACSB: Reflective Thinking

- 24) When the quantity of money supplied decreases, at a given price level
- A) the aggregate demand curve shifts leftward.
 - B) the aggregate demand curve shifts rightward.
 - C) the economy moves along the aggregate demand curve.
 - D) the aggregate demand does not change.

Answer: A

Diff: 1

Topic: The Aggregate Demand (AD) Curve

Skill: Conceptual

AACSB: Reflective Thinking

- 25) An increase in government purchases shifts the _____ curve to the _____.
- A) aggregate demand; left
 - B) aggregate supply; left
 - C) aggregate demand; right
 - D) aggregate supply; right

Answer: C

Diff: 1

Topic: The Aggregate Demand (AD) Curve

Skill: Conceptual

AACSB: Reflective Thinking

- 26) The aggregate demand curve would shift to the left if
- A) government spending were increased.
 - B) net taxes were increased.
 - C) the money supply were increased.
 - D) the cost of energy were to decrease.

Answer: B

Diff: 1

Topic: The Aggregate Demand (AD) Curve

Skill: Conceptual

AACSB: Reflective Thinking

- 27) A decrease in net taxes at a given price level leads to
- A) no change in aggregate demand.
 - B) an increase in aggregate demand.
 - C) a decrease in aggregate demand.
 - D) a decrease in aggregate supply.

Answer: B

Diff: 1

Topic: The Aggregate Demand (AD) Curve

Skill: Conceptual

AACSB: Reflective Thinking

- 28) A rightward shift in the aggregate demand curve can be caused by
- A) a decrease in government spending.
 - B) an increase in taxes.
 - C) a decrease in money supply.
 - D) the Fed buying government bonds.

Answer: D

Diff: 1

Topic: The Aggregate Demand (AD) Curve

Skill: Conceptual

AACSB: Reflective Thinking

- 29) The aggregate demand shifts to the left if
- A) the government increases spending.
 - B) the Fed sells government bonds.
 - C) the government decreases taxes.
 - D) the Fed decreases the required reserve ratio.

Answer: B

Diff: 1

Topic: The Aggregate Demand (AD) Curve

Skill: Conceptual

AACSB: Reflective Thinking

- 30) The aggregate demand increases, if
- A) the government increases spending.
 - B) the Fed sells government bonds.
 - C) the government increases taxes.
 - D) the Fed raises the discount rate.

Answer: A

Diff: 1

Topic: The Aggregate Demand (AD) Curve

Skill: Conceptual

AACSB: Reflective Thinking

- 31) The aggregate demand increases, if
- A) the government decreases spending.
 - B) the Fed sells government bonds.
 - C) the government decreases taxes.
 - D) the Fed increases the required reserve ratio.

Answer: C

Diff: 1

Topic: The Aggregate Demand (AD) Curve

Skill: Conceptual

AACSB: Reflective Thinking

- 32) The aggregate demand curve increases if
- A) the Fed increase the discount rate.
 - B) the Fed buys government bonds.
 - C) the Fed increases the required reserve ratio.
 - D) the government increases taxes.

Answer: B

Diff: 1

Topic: The Aggregate Demand (AD) Curve

Skill: Conceptual

AACSB: Reflective Thinking

Refer to the information provided in Figure 12.11 below to answer the questions that follow.

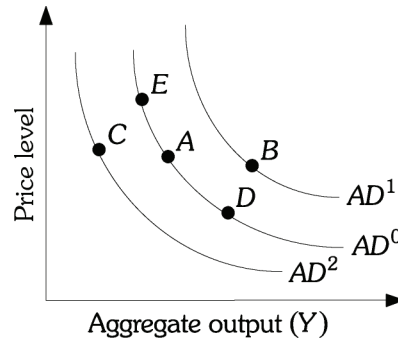


Figure 12.11

- 33) Refer to Figure 12.11. An aggregate demand shift from AD^2 to AD^0 can be caused by
- | | |
|-----------------------------------|------------------------------------|
| A) a decrease in the price level. | B) an increase in the price level. |
| C) a decrease in taxes. | D) a decrease in money supply. |

Answer: C

Diff: 1

Topic: The Aggregate Demand (AD) Curve

Skill: Analytic

AACSB: Analytic Skills

- 34) Refer to Figure 12.11. An aggregate demand shift from AD^1 to AD^0 can be caused by
- | | |
|---------------------------------------|------------------------------------|
| A) a decrease in government spending. | B) an increase in money supply. |
| C) a decrease in the price level. | D) an increase in the price level. |

Answer: A

Diff: 1

Topic: The Aggregate Demand (AD) Curve

Skill: Analytic

AACSB: Analytic Skills

- 35) Refer to Figure 12.11. Suppose the economy is at Point A , an increase in the price level can cause a movement to Point
- | | | | |
|----------|----------|----------|----------|
| A) E . | B) B . | C) C . | D) D . |
|----------|----------|----------|----------|

Answer: A

Diff: 2

Topic: The Aggregate Demand (AD) Curve

Skill: Analytic

AACSB: Analytic Skills

- 36) Refer to Figure 12.11. Suppose the economy is at Point A , a decrease in the price level can cause a movement to Point
- | | | | |
|----------|----------|----------|----------|
| A) E . | B) B . | C) C . | D) D . |
|----------|----------|----------|----------|

Answer: D

Diff: 2

Topic: The Aggregate Demand (AD) Curve

Skill: Analytic

AACSB: Analytic Skills

37) Refer to Figure 12.11. Suppose the economy is at Point *A*, a decrease in taxes can cause a movement to Point

- A) *E*. B) *B*. C) *C*. D) *D*.

Answer: B

Diff: 2

Topic: The Aggregate Demand (AD) Curve

Skill: Analytic

AACSB: Analytic Skills

38) Refer to Figure 12.11. Suppose the economy is at Point *A*, an increase in money demand could cause a movement to Point

- A) *E*. B) *B*. C) *C*. D) *D*.

Answer: C

Diff: 2

Topic: The Aggregate Demand (AD) Curve

Skill: Analytic

AACSB: Analytic Skills

39) Refer to Figure 12.11. Suppose the economy is at Point *A*, an decrease in government purchases can cause a movement to Point

- A) *E*. B) *B*. C) *C*. D) *D*.

Answer: C

Diff: 2

Topic: The Aggregate Demand (AD) Curve

Skill: Analytic

AACSB: Analytic Skills

40) Refer to Figure 12.11. Suppose the economy is at Point *A* an increase in government purchases can cause a movement to Point

- A) *E*. B) *B*. C) *C*. D) *D*.

Answer: B

Diff: 2

Topic: The Aggregate Demand (AD) Curve

Skill: Analytic

AACSB: Analytic Skills

2 True/False

1) The aggregate demand curve is the sum of all demand curves of all goods and services in the economy.

Answer: FALSE

Diff: 1

Topic: The Aggregate Demand (AD) Curve

Skill: Definition

2) The wealth effect explains why the aggregate supply curve is horizontal in the long run.

Answer: FALSE

Diff: 1

Topic: The Aggregate Demand (AD) Curve

Skill: Conceptual

AACSB: Reflective Thinking

- 3) A higher interest rate increases both planned investment and consumption spending.
Answer: FALSE
Diff: 1
Topic: *The Aggregate Demand (AD) Curve*
Skill: *Conceptual*
AACSB: *Reflective Thinking*
- 4) A decrease in net taxation increases aggregate demand.
Answer: TRUE
Diff: 1
Topic: *The Aggregate Demand (AD) Curve*
Skill: *Conceptual*
AACSB: *Reflective Thinking*
- 5) A decrease in the price level raises the real value of wealth.
Answer: TRUE
Diff: 1
Topic: *The Aggregate Demand (AD) Curve*
Skill: *Conceptual*
AACSB: *Reflective Thinking*
- 6) An increase in the supply of money will shift the aggregate demand curve to the right.
Answer: TRUE
Diff: 2
Topic: *The Aggregate Demand (AD) Curve*
Skill: *Conceptual*
AACSB: *Reflective Thinking*
- 7) A decrease in government spending shifts aggregate demand to the left.
Answer: TRUE
Diff: 2
Topic: *The Aggregate Demand (AD) Curve*
Skill: *Conceptual*
AACSB: *Reflective Thinking*
- 8) The aggregate demand curve shows that at higher price levels the total quantity of output demanded is greater.
Answer: FALSE
Diff: 2
Topic: *The Aggregate Demand (AD) Curve*
Skill: *Conceptual*
AACSB: *Reflective Thinking*
- 9) If the Fed buys government securities, it decrease the money supply and aggregate demand .
Answer: FALSE
Diff: 2
Topic: *The Aggregate Demand (AD) Curve*
Skill: *Conceptual*
AACSB: *Reflective Thinking*

10) An increase in the price level cause aggregate demand to increase.

Answer: FALSE

Diff: 1

Topic: The Aggregate Demand (AD) Curve

Skill: Conceptual

AACSB: Reflective Thinking

12.5 Appendix: The IS-LM Diagram

1 Multiple Choice

- 1) Each point on the LM curve represents the equilibrium point in the
- A) goods market for the given interest rate.
 - B) money market for the given value of aggregate output.
 - C) goods market for the given level of government spending.
 - D) money market for the given level of the money supply.

Answer: B

Diff: 1

Topic: Appendix: The IS-LM Diagram

Skill: Conceptual

AACSB: Reflective Thinking

Refer to the information provided in Figure 12.9 below to answer the questions that follow.

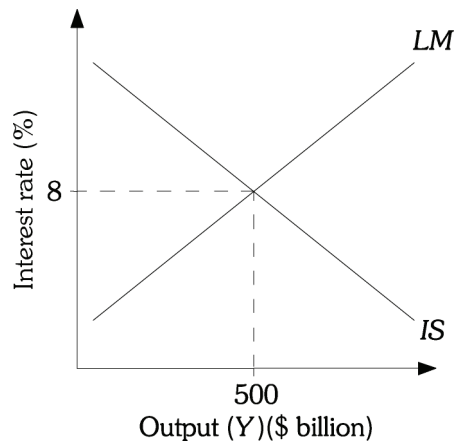


Figure 12.9

- 2) Refer to Figure 12.9. An expansionary fiscal policy shifts the _____ curve to the _____.
- A) IS; left
 - B) LM; right
 - C) IS; right
 - D) LM; left

Answer: C

Diff: 1

Topic: Appendix: The IS-LM Diagram

Skill: Conceptual

AACSB: Reflective Thinking

- 3) Refer to Figure 12.9. A contractionary monetary policy shifts the _____ curve to the _____.
- A) LM; right B) IS; right C) IS; left D) LM; left

Answer: D

Diff: 1

Topic: Appendix: The IS-LM Diagram

Skill: Conceptual

AACSB: Reflective Thinking

- 4) Refer to Figure 12.9. As a result of _____, the equilibrium interest rate increases and the equilibrium output level increases.

- A) an expansionary monetary policy B) a contractionary monetary policy
C) an expansionary fiscal policy D) a contractionary fiscal policy

Answer: C

Diff: 2

Topic: Appendix: The IS-LM Diagram

Skill: Analytic

AACSB: Analytic Skills

- 5) Refer to Figure 12.9. As a result of _____, the equilibrium interest rate increases and the equilibrium output level decreases.

- A) an expansionary monetary policy B) a contractionary monetary policy
C) an expansionary fiscal policy D) a contractionary fiscal policy

Answer: B

Diff: 2

Topic: Appendix: The IS-LM Diagram

Skill: Analytic

AACSB: Analytic Skills

- 6) Refer to Figure 12.9. Which policy mix would definitely increase the equilibrium interest rate?

- A) An expansionary monetary policy and an expansionary fiscal policy
B) A contractionary monetary policy and a contractionary fiscal policy
C) An expansionary fiscal policy and a contractionary monetary policy
D) An expansionary monetary policy and a contractionary fiscal policy

Answer: C

Diff: 3

Topic: Appendix: The IS-LM Diagram

Skill: Analytic

AACSB: Analytic Skills

- 7) Each point on the IS curve represents the equilibrium point in the

- A) goods market for the given level of government spending.
B) money market for the given value of aggregate output.
C) goods market for the given interest rate.
D) money market for the given level of the money supply.

Answer: C

Diff: 1

Topic: Appendix: The IS-LM Diagram

Skill: Conceptual

AACSB: Reflective Thinking

- 8) If the combination $r = 10\%$ and $Y = \$200$ billion is on the *IS* curve, we know that the combination $r = 10\%$ and $Y = \$300$ billion consists of an
- A) output level that is too high to maintain equilibrium in the goods market with an interest rate of 10%.
 - B) interest rate that is too high to maintain equilibrium in the money market with an output of \$300 billion.
 - C) interest rate that is too low to maintain equilibrium in the goods market with an output of \$300 billion.
 - D) output level that is too low to maintain equilibrium in the goods market with an interest rate of 10%.

Answer: A

Diff: 2

Topic: Appendix: The IS-LM Diagram

Skill: Conceptual

AACSB: Reflective Thinking

- 9) The curve that illustrates the positive relationship between the equilibrium values of aggregate output and the interest rate in the money market is the
- A) money demand curve.
 - B) money supply curve.
 - C) *LM* curve.
 - D) *IS* curve.

Answer: C

Diff: 1

Topic: Appendix: The IS-LM Diagram

Skill: Definition

- 10) If the combination $r = 5\%$ and $Y = \$100$ billion is on the *LM* curve, we know that the combination $r = 7\%$ and $Y = \$100$ billion consists of an
- A) output level that is too high to maintain equilibrium in the money market with an interest rate of 7%.
 - B) interest rate that is too high to maintain equilibrium in the money market with an output of \$100 billion.
 - C) interest rate that is too low to maintain equilibrium in the goods market with an output of \$100 billion.
 - D) output level that is too low to maintain equilibrium in the goods market with an interest rate of 7%.

Answer: B

Diff: 2

Topic: Appendix: The IS-LM Diagram

Skill: Conceptual

AACSB: Reflective Thinking

2 True/False

- 1) The *IS* curve shows combinations of income and interest rates consistent with equilibrium in the money market.

Answer: FALSE

Diff: 2

Topic: Appendix: The IS-LM Diagram

Skill: Conceptual

AACSB: Reflective Thinking

2) If the money supply decreases, then the LM curve decreases.

Answer: TRUE

Diff: 2

Topic: Appendix: The IS-LM Diagram

Skill: Conceptual

AACSB: Reflective Thinking

3) If government spending increases, then the IS curve increases.

Answer: TRUE

Diff: 2

Topic: Appendix: The IS-LM Diagram

Skill: Conceptual

AACSB: Reflective Thinking

4) If net taxes decrease, then the IS curve rises.

Answer: TRUE

Diff: 2

Topic: Appendix: The IS-LM Diagram

Skill: Conceptual

AACSB: Reflective Thinking

5) Expansionary fiscal policy decreases the IS curve.

Answer: FALSE

Diff: 2

Topic: Appendix: The IS-LM Diagram

Skill: Conceptual

AACSB: Reflective Thinking

Chapter 13 Aggregate Supply and the Equilibrium Price Level

13.1 The Aggregate Supply Curve

1 Multiple Choice

- 1) The graph that shows the relationship between the aggregate quantity of output supplied by all the firms in an economy and the overall price level is
- A) the aggregate supply curve.
 - B) the aggregate production function.
 - C) the production possibilities frontier.
 - D) the aggregate demand curve.

Answer: A

Diff: 1

Topic: The Aggregate Supply Curve

Skill: Definition

- 2) The quantity of output supplied at different price levels is represented by the
- A) production function.
 - B) aggregate demand curve.
 - C) aggregate supply curve.
 - D) aggregate expenditures curve.

Answer: C

Diff: 1

Topic: The Aggregate Supply Curve

Skill: Definition

- 3) The aggregate supply curve
- A) is the sum of the individual supply curves in the economy.
 - B) is a market supply curve.
 - C) embodies the same logic that lies behind an individual firm's supply curve.
 - D) relates output with the price level.

Answer: D

Diff: 1

Topic: The Aggregate Supply Curve

Skill: Conceptual

AACSB: Reflective Thinking

- 4) It is very important to distinguish between the short run and the long run when we are discussing
- A) the aggregate demand.
 - B) the aggregate expenditures.
 - C) the aggregate supply.
 - D) changes in the price level.

Answer: C

Diff: 2

Topic: The Aggregate Supply Curve

Skill: Conceptual

Refer to the information provided in Figure 13.3 below to answer the questions that follow.

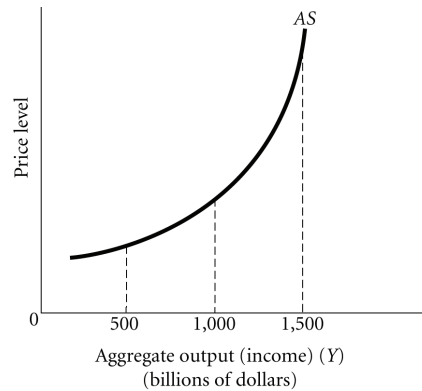


Figure 13.3

- 5) Refer to Figure 13.3. Between the output levels of \$500 billion and \$1,000 billion, the relationship between the price level and output is
- A) constant. B) negative. C) positive. D) indeterminate.

Answer: C

Diff: 1

Topic: The Aggregate Supply Curve

Skill: Analytic

AACSB: Analytic Skills

- 6) Refer to Figure 13.3. This economy reaches capacity at
- A) \$500 billion.
B) \$1,000 billion.
C) \$1,500 billion.
D) an output level that is indeterminate from this information because aggregate demand is not given.

Answer: C

Diff: 2

Topic: The Aggregate Supply Curve

Skill: Analytic

AACSB: Analytic Skills

- 7) Refer to Figure 13.3. At aggregate output levels below \$500 billion, this economy is most likely experiencing
- A) rapid increases in the growth rate of the money supply.
B) a boom.
C) excess demand.
D) excess capacity.

Answer: D

Diff: 2

Topic: The Aggregate Supply Curve

Skill: Analytic

AACSB: Analytic Skills

- 8) Refer to Figure 13.3. At aggregate output levels above \$1,500 billion, firms in this economy are most likely experiencing
- A) costs increasing as fast as output prices.
 - B) costs lagging behind increases in output prices.
 - C) costs falling as prices output increase.
 - D) costs rising faster than output prices.

Answer: A

Diff: 2

Topic: The Aggregate Supply Curve

Skill: Analytic

AACSB: Analytic Skills

Refer to the information provided in Figure 13.4 below to answer the questions that follow.

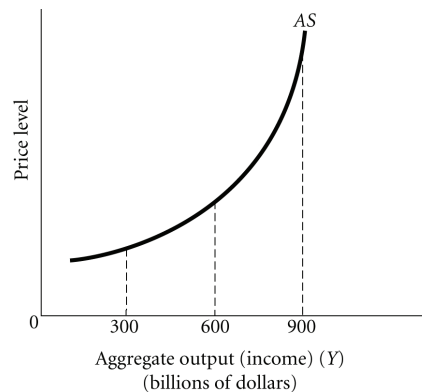


Figure 13.4

- 9) Refer to Figure 13.4. Between the output levels of \$300 billion and \$600 billion, the relationship between the price level and output is
- A) negative.
 - B) positive.
 - C) constant.
 - D) There is no relationship between the price level and output.

Answer: B

Diff: 2

Topic: The Aggregate Supply Curve

Skill: Analytic

AACSB: Analytic Skills

- 10) Refer to Figure 13.4. This economy reaches capacity at
- A) \$300 billion.
 - B) \$600 billion.
 - C) \$900 billion.
 - D) an output level that is indeterminate from this information because aggregate demand is not given.

Answer: C

Diff: 2

Topic: The Aggregate Supply Curve

Skill: Analytic

AACSB: Analytic Skills

- 11) What determines the slope of the aggregate supply curve is
- A) how fast the price of factors of production respond to changes in the price level.
 - B) how much more the economy can produce without any change in the price level.
 - C) how fast the output level changes after a technological advance.
 - D) none of the above

Answer: A

Diff: 2

Topic: The Aggregate Supply Curve

Skill: Conceptual

AACSB: Reflective Thinking

- 12) When the aggregate supply curve is horizontal,
- A) the price of factors of production is fixed, with little or no upward pressure on price.
 - B) the economy is close to full capacity.
 - C) resources are being utilized at full capacity.
 - D) the prices level increases with additional production.

Answer: A

Diff: 2

Topic: The Aggregate Supply Curve

Skill: Conceptual

AACSB: Reflective Thinking

- 13) When the aggregate supply curve is vertical, which of the following is NOT true?
- A) The economy is at capacity.
 - B) The economy is producing the maximum sustainable level of output.
 - C) Any increase in the price level will not cause an increase in aggregate output.
 - D) The economy is expanding quickly.

Answer: D

Diff: 2

Topic: The Aggregate Supply Curve

Skill: Conceptual

AACSB: Reflective Thinking

- 14) If the economy is operating on the relatively vertical segment of the aggregate supply curve, an increase in aggregate demand causes a _____ change in the price level and a _____ change in output.

A) small; small B) big; big C) big; small D) small; big

Answer: C

Diff: 2

Topic: The Aggregate Supply Curve

Skill: Analytic

AACSB: Analytic Skills

- 15) If the economy is operating way below capacity, an increase in aggregate demand causes a _____ change in the price level and _____ change in output.

A) big; big B) big; small C) small; big D) small; small

Answer: C

Diff: 2

Topic: The Aggregate Supply Curve

Skill: Analytic

AACSB: Analytic Skills

- 16) An increase in aggregate demand when the economy is operating at high levels of output is likely to result in
- A) a large increase in both output and the overall price level.
 - B) an increase in the overall price level but little or no increase in output.
 - C) an increase in output but little or no increase in the overall price level.
 - D) little or no increase in either output or the overall price level.

Answer: B

Diff: 2

Topic: *The Aggregate Supply Curve*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 17) An increase in aggregate demand when the economy is operating at full capacity is likely to result in
- A) an increase in both output and the overall price level.
 - B) an increase in output but no increase in the overall price level.
 - C) an increase in the overall price level but no increase in output.
 - D) no increase in either output or the overall price level.

Answer: C

Diff: 2

Topic: *The Aggregate Supply Curve*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 18) An increase in the price level is likely to increase the aggregate amount of output supplied in the short run because
- A) interest rate is high in the short-run.
 - B) wages and interest rates are relatively fixed in the short-run.
 - C) wages change in the short-run.
 - D) the aggregate supply curve is vertical in the short-run.

Answer: B

Diff: 2

Topic: *The Aggregate Supply Curve*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 19) When the economy is producing at full capacity, the aggregate supply curve becomes
- A) horizontal.
 - B) downward sloping.
 - C) vertical.
 - D) upward sloping.

Answer: C

Diff: 2

Topic: *The Aggregate Supply Curve*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

20) If input prices changed at exactly the same rate as output prices, the aggregate supply curve would be

- A) vertical.
- B) upward sloping.
- C) horizontal.
- D) downward sloping.

Answer: A

Diff: 2

Topic: The Aggregate Supply Curve

Skill: Conceptual

AACSB: Reflective Thinking

21) A movement down the aggregate supply curve is caused by a(n)

- A) decrease in aggregate supply.
- B) increase in aggregate supply.
- C) decrease in the price level.
- D) increase in the price level.

Answer: C

Diff: 1

Topic: The Aggregate Supply Curve

Skill: Conceptual

AACSB: Reflective Thinking

22) If there is a decrease in the percentage of employees whose wages adjust automatically with changes in the price level, the aggregate supply curve will become

- A) steeper.
- B) flatter.
- C) horizontal.
- D) vertical.

Answer: B

Diff: 2

Topic: The Aggregate Supply Curve

Skill: Conceptual

AACSB: Reflective Thinking

23) If there is an increase in the percentage of employees whose wages adjust automatically with changes in the price level, the aggregate supply curve will become

- A) steeper.
- B) flatter.
- C) horizontal.
- D) vertical.

Answer: A

Diff: 2

Topic: The Aggregate Supply Curve

Skill: Conceptual

AACSB: Reflective Thinking

24) Coal is used as a source of energy in many manufacturing processes. Assume a long strike by coal miners reduced the supply of coal and increased the price of coal. This would cause

- A) the short-run aggregate supply curve to shift to the right.
- B) the short-run aggregate supply curve to become flatter.
- C) the short-run aggregate supply curve to shift to the left.
- D) the short-run aggregate supply curve to become nearly vertical at all levels of output.

Answer: C

Diff: 2

Topic: The Aggregate Supply Curve

Skill: Analytic

AACSB: Analytic Skills

- 25) If the United States were to pass legislation that would make it easier for people to emigrate to the United States, this would cause
- A) the short-run aggregate supply curve to become nearly vertical at all levels of output.
 - B) the short-run aggregate supply curve to shift to the left.
 - C) the short-run aggregate supply curve to become flatter.
 - D) the short-run aggregate supply curve to shift to the right.

Answer: D

Diff: 2

Topic: *The Aggregate Supply Curve*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 26) All of the following shift the short-run aggregate supply curve EXCEPT
- A) a change in the price level.
 - B) a change in the price of oil.
 - C) a change in the price of raw material.
 - D) a change in wages as a result of a labor strike.

Answer: A

Diff: 1

Topic: *The Aggregate Supply Curve*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 27) Which of the following would cause the short-run aggregate supply curve to shift to the right?
- A) higher energy prices
 - B) an increase in taxes
 - C) increases in government regulation
 - D) retired workers reentering the labor force

Answer: D

Diff: 1

Topic: *The Aggregate Supply Curve*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

Refer to the information provided in Figure 13.5 below to answer the questions that follow.

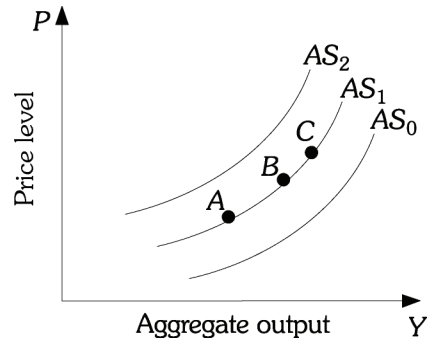


Figure 13.5

- 28) Refer to Figure 13.5. Hurricane Katrina destroyed a large portion of the infrastructure in the gulf south of United States. This caused
- A) the short-run aggregate supply curve to shift from AS_1 to AS_2 .
 - B) the short-run aggregate supply curve to shift from AS_1 to AS_0 .
 - C) the economy to move from Point B to Point A along AS_1 .
 - D) the economy to move from Point C to Point B along AS_1 .

Answer: A

Diff: 2

Topic: The Aggregate Supply Curve

Skill: Analytic

AACSB: Analytic Skills

- 29) Refer to Figure 13.5. An increase in aggregate supply is represented by
- A) a movement from Point B to Point A along AS_1 .
 - B) a movement from Point B to Point C along AS_1 .
 - C) a shift from AS_1 to AS_2 .
 - D) a shift from AS_1 to AS_0 .

Answer: D

Diff: 2

Topic: The Aggregate Supply Curve

Skill: Analytic

AACSB: Analytic Skills

- 30) Refer to Figure 13.5. During the 1980s, many firms in the United States were not investing in new capital. This would have caused
- A) the short-run aggregate supply curve to shift from AS_1 to AS_0 .
 - B) the short-run aggregate supply curve to shift from AS_1 to AS_2 .
 - C) the economy to move from Point B to Point A along AS_1 .
 - D) the economy to move from Point C to Point B along AS_1 .

Answer: B

Diff: 2

Topic: The Aggregate Supply Curve

Skill: Analytic

AACSB: Analytic Skills

- 31) Refer to Figure 13.5. A decrease in aggregate supply is represented by
- A) a movement from Point B to Point A along AS_1 .
 - B) a movement from Point B to Point C along AS_1 .
 - C) a shift from AS_1 to AS_2 .
 - D) a shift from AS_1 to AS_0 .

Answer: C

Diff: 2

Topic: The Aggregate Supply Curve

Skill: Analytic

AACSB: Analytic Skills

Refer to the information provided in Figure 13.6 below to answer the questions that follow.

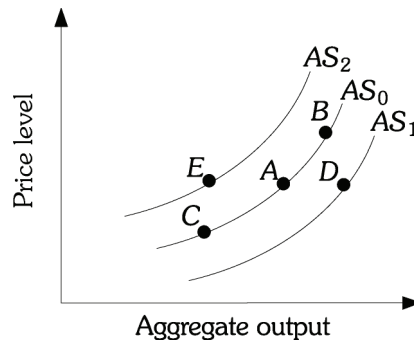


Figure 13.6

- 32) Refer to Figure 13.6. Which of the following causes the economy to move from Point A to Point E?
- A) an oil embargo that increases the price of oil
 - B) technological progress
 - C) an influx of immigrants
 - D) an increase in the price level

Answer: A

Diff: 2

Topic: The Aggregate Supply Curve

Skill: Analytic

AACSB: Analytic Skills

- 33) Refer to Figure 13.6. Suppose the economy is at Point A, an increase in the price level moves the economy to Point
- A) E.
 - B) B.
 - C) C.
 - D) D.

Answer: B

Diff: 2

Topic: The Aggregate Supply Curve

Skill: Analytic

AACSB: Analytic Skills

- 34) Refer to Figure 13.6. During the 1990s, many firms in the United States were investing in new capital. If the economy was originally at Point *A*, this would have caused a movement to Point
- A) *E*. B) *B*. C) *C*. D) *D*.

Answer: D

Diff: 2

Topic: *The Aggregate Supply Curve*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 35) Refer to Figure 13.6. Suppose the economy is at Point *A*, an increase in aggregate demand moves the economy to Point

A) *E*. B) *B*. C) *C*. D) *D*.

Answer: B

Diff: 2

Topic: *The Aggregate Supply Curve*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 36) Refer to Figure 13.6. Suppose the economy is at Point *A*, an oil price increase could move the economy to Point

A) *E*. B) *B*. C) *C*. D) *D*.

Answer: A

Diff: 2

Topic: *The Aggregate Supply Curve*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 37) The rationale underlying policies to deregulate the economy is that these policies would

- A) increase the aggregate demand curve.
- B) decrease the short-run aggregate supply curve.
- C) decrease the aggregate demand curve.
- D) increase the short-run aggregate supply curve.

Answer: D

Diff: 2

Topic: *The Aggregate Supply Curve*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 38) An oil price increase would

- A) increase the aggregate demand curve.
- B) decrease the short-run aggregate supply curve.
- C) decrease the aggregate demand curve.
- D) increase the short-run aggregate supply curve.

Answer: B

Diff: 2

Topic: *The Aggregate Supply Curve*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

2 True/False

- 1) If input prices change at exactly the same rate as output prices, the aggregate supply curve will be vertical.

Answer: TRUE

Diff: 2

Topic: *The Aggregate Supply Curve*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 2) If the price level falls, the aggregate supply decreases as a result of the aggregate demand curve shifting left.

Answer: FALSE

Diff: 2

Topic: *The Aggregate Supply Curve*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 3) An increase in the price of a key input in production, like oil, increases aggregate supply.

Answer: FALSE

Diff: 2

Topic: *The Aggregate Supply Curve*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 4) An increase in the price level will cause a decrease in the aggregate amount of output supplied.

Answer: FALSE

Diff: 2

Topic: *The Aggregate Supply Curve*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 5) A decrease in taxes on business investments will increase aggregate supply.

Answer: TRUE

Diff: 2

Topic: *The Aggregate Supply Curve*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

13.2 The Equilibrium Price Level

1 Multiple Choice

Refer to the information provided in Figure 13.7 below to answer the questions that follow.

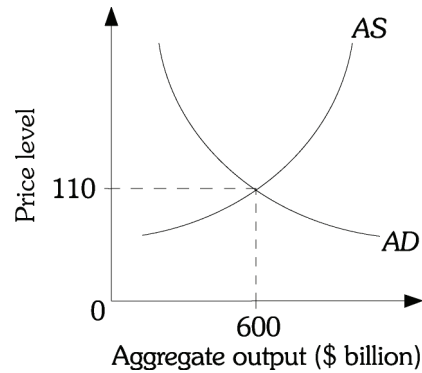


Figure 13.7

- 1) Refer to Figure 13.7. Suppose the equilibrium output is initially \$600 billion. An expansionary monetary policy _____ equilibrium output and _____ the price level.
- A) decreases; leaves unchanged B) leaves unchanged; increases
C) increases; increases D) increases; decreases

Answer: C

Diff: 2

Topic: The Equilibrium Price Level

Skill: Analytic

AACSB: Analytic Skills

- 2) Refer to Figure 13.7. Suppose the equilibrium output is initially \$600 billion. An oil embargo would probably
- A) increase both the equilibrium output and the price level.
B) decrease the equilibrium output and increase the price level.
C) increase the equilibrium output and decrease the price level.
D) decrease both the equilibrium output and the price level.

Answer: B

Diff: 2

Topic: The Equilibrium Price Level

Skill: Analytic

AACSB: Analytic Skills

- 3) Refer to Figure 13.7. Suppose the equilibrium output is initially \$600 billion. A decrease in wages and an increase in government spending will, for sure, increase
- A) both the equilibrium output and the price level.
 - B) the price level.
 - C) equilibrium output.
 - D) equilibrium output and decrease the price level.

Answer: C

Diff: 3

Topic: *The Equilibrium Price Level*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 4) Refer to Figure 13.7. Which of the following will, unambiguously, increase the price level?
- A) an increase in money supply and an influx of immigrants
 - B) a decrease in personal income tax and an increase in corporate profit tax
 - C) an increase in personal income tax and an oil embargo
 - D) an increase in government spending and a decrease in the price of raw material

Answer: B

Diff: 3

Topic: *The Equilibrium Price Level*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 5) Refer to Figure 13.7. To unambiguously decrease the price level
- A) the Fed could buy bonds and the government could increase the corporate profit tax.
 - B) personal income taxes could decrease and corporate profit taxes could increase.
 - C) the Fed could sell bonds and the government could lower the corporate profit tax.
 - D) government spending could increase and the price of raw materials could decrease.

Answer: C

Diff: 3

Topic: *The Equilibrium Price Level*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 6) To increase the price level the government could adopt policies that
- A) increase aggregate supply and aggregate demand.
 - B) decrease aggregate supply and aggregate demand.
 - C) increase aggregate supply and decrease aggregate demand.
 - D) decrease aggregate supply and increase aggregate demand.

Answer: D

Diff: 2

Topic: *The Equilibrium Price Level*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 7) To increase output the government could adopt policies that
- A) increase aggregate supply and aggregate demand.
 - B) decrease aggregate supply and aggregate demand.
 - C) increase aggregate supply and decrease aggregate demand.
 - D) decrease aggregate supply and increase aggregate demand.

Answer: A

Diff: 2

Topic: *The Equilibrium Price Level*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 8) To decrease the price level the government could
- A) encourage education and increase government spending.
 - B) adopt policies that increase input prices and increase net taxes.
 - C) lower the corporate profits tax and have the Fed raise the discount rate.
 - D) raise taxes on corporate profits and lower federal income taxes.

Answer: C

Diff: 2

Topic: *The Equilibrium Price Level*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 9) To decrease output the government could
- A) encourage education and increase government spending.
 - B) adopt policies that increase input prices and increase net taxes.
 - C) lower the corporate profits tax and have the Fed raise the discount rate.
 - D) raise taxes on corporate profits and lower federal income taxes.

Answer: B

Diff: 2

Topic: *The Equilibrium Price Level*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 10) To increase output the government could
- A) encourage education and decrease net taxes.
 - B) lower payroll taxes and increase government spending.
 - C) lower the corporate profits tax and have the Fed buy bonds in the open market.
 - D) all of the above

Answer: D

Diff: 2

Topic: *The Equilibrium Price Level*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

2 True/False

- 1) Whenever the aggregate supply curve intercepts the aggregate demand curve, the economy is producing full employment output.

Answer: FALSE

Diff: 2

Topic: *The Equilibrium Price Level*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 2) An increase in the price of inputs will most likely lead to a higher price level.

Answer: TRUE

Diff: 2

Topic: *The Equilibrium Price Level*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 3) If the Fed sells securities on the open market, the price level will rise.

Answer: FALSE

Diff: 2

Topic: *The Equilibrium Price Level*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 4) Decreasing government expenditures and decreasing taxes on corporate profits are two policies that both work to decrease the price level.

Answer: TRUE

Diff: 2

Topic: *The Equilibrium Price Level*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 5) Raising net taxes and an oil embargo will both have an effect towards increasing the price level.

Answer: FALSE

Diff: 2

Topic: *The Equilibrium Price Level*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

13.3 The Long-Run Aggregate Supply Curve

1 Multiple Choice

Refer to the information provided in Figure 13.8 below to answer the questions that follow.

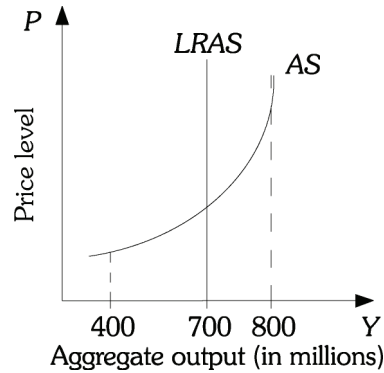


Figure 13.8

- 1) Refer to Figure 13.8. Which of the following statements characterizes an output level of \$800 billion?
- A) It is sustainable over the long run without inflation.
 - B) It is achievable only in the long run.
 - C) It is attainable in the short run but it is associated with increases in the price level.
 - D) It can be achieved only if investment is independent of the interest rate.

Answer: C

Diff: 2

Topic: The Long-Run Aggregate Supply Curve

Skill: Analytic

AACSB: Analytic Skills

- 2) Refer to Figure 13.8. Potential output
- A) is \$400 million.
 - B) is \$700 million.
 - C) is \$800 million.
 - D) cannot be determined from this information because aggregate demand is not given.

Answer: B

Diff: 2

Topic: The Long-Run Aggregate Supply Curve

Skill: Analytic

AACSB: Analytic Skills

- 3) Refer to Figure 13.8. The level of aggregate output that can be sustained in the long run without inflation
- A) is \$400 million.
 - B) is \$700 million.
 - C) is \$800 million.
 - D) cannot be determined from this information because aggregate demand is not given.

Answer: B

Diff: 2

Topic: *The Long-Run Aggregate Supply Curve*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 4) The level of aggregate output that can be sustained in the long run without inflation is known as
- A) nominal output.
 - B) real output.
 - C) money output.
 - D) potential output.

Answer: D

Diff: 1

Topic: *The Long-Run Aggregate Supply Curve*

Skill: *Definition*

- 5) If _____ equilibrium output _____, the price level rises.
- A) actual; is below potential GDP
 - B) potential; is equal to actual GDP
 - C) potential; exceeds actual GDP
 - D) actual; exceeds potential GDP

Answer: D

Diff: 2

Topic: *The Long-Run Aggregate Supply Curve*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 6) When the _____ increases, then potential output increases.
- A) long-run aggregate supply
 - B) short-run aggregate supply
 - C) long-run aggregate demand
 - D) short-run aggregate demand

Answer: A

Diff: 2

Topic: *The Long-Run Aggregate Supply Curve*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 7) Potential output is equal to
- A) long run aggregate demand.
 - B) short-run aggregate demand.
 - C) short-run aggregate supply.
 - D) long-run aggregate supply.

Answer: D

Diff: 1

Topic: *The Long-Run Aggregate Supply Curve*

Skill: *Definition*

- 8) The long-run aggregate supply curve is vertical, if
- A) wages and other costs fully adjust to changes in prices in the long-run.
 - B) the government follows optimal fiscal policy.
 - C) technology is fixed.
 - D) the Fed follows optimal monetary policy.

Answer: A

Diff: 1

Topic: *The Long-Run Aggregate Supply Curve*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

2 True/False

- 1) If the economy produces full employment output, an expansionary monetary policy increases output but not the price level.

Answer: FALSE

Diff: 2

Topic: *The Long-Run Aggregate Supply Curve*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 2) A recessionary gap means that aggregate planned expenditures are less than potential output.

Answer: TRUE

Diff: 1

Topic: *The Long-Run Aggregate Supply Curve*

Skill: *Definition*

- 3) An inflationary gap happens when aggregate planned expenditure is greater than full capacity.

Answer: TRUE

Diff: 1

Topic: *The Long-Run Aggregate Supply Curve*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 4) Keynes believed that fiscal policy and monetary policy are effective.

Answer: TRUE

Diff: 1

Topic: *The Long-Run Aggregate Supply Curve*

Skill: *Fact*

- 5) Potential output is the most that can be produced in an economy at a particular point in time.

Answer: FALSE

Diff: 2

Topic: *The Long-Run Aggregate Supply Curve*

Skill: *Definition*

- 6) If wages do not fully adjust to changes in prices, the aggregate supply curve is vertical.

Answer: FALSE

Diff: 1

Topic: *The Long-Run Aggregate Supply Curve*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

13.4 Monetary and Fiscal Policy Effects

1 Multiple Choice

- 1) If a decrease in net taxes in the United States resulted in a very large increase in aggregate output and a very small increase in the price level, then the U.S. economy must have been
- A) on the very steep part of the short-run aggregate supply curve.
 - B) on the very flat part of the short-run aggregate supply curve.
 - C) on the very steep part of the short-run aggregate demand curve.
 - D) on the very flat part of the short-run aggregate demand curve.

Answer: B

Diff: 2

Topic: *Monetary and Fiscal Policy Effects*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 2) If a decrease in the U.S. money supply resulted in a very large change in the price level and a very small change in aggregate output,
- A) then in the U.S. economy investment demand must not be sensitive to the interest rate.
 - B) then the U.S. economy must have been on the very steep part of its short-run aggregate supply curve.
 - C) then the U.S. economy must have been on the very flat part of its short-run aggregate supply curve.
 - D) then the U.S. aggregate demand curve must be very steep.

Answer: B

Diff: 2

Topic: *Monetary and Fiscal Policy Effects*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 3) An increase in government spending will completely crowd out investment if
- A) money supply is increased at the same time.
 - B) money demand is not sensitive to the interest rate.
 - C) the economy is operating at capacity.
 - D) the economy is operating well below capacity.

Answer: C

Diff: 3

Topic: *Monetary and Fiscal Policy Effects*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 4) Economic policies are ineffective concerning quantities of output directly when
- A) the aggregate supply curve is flat.
 - B) the aggregate demand is flat.
 - C) the aggregate supply is vertical.
 - D) the economy is not producing at capacity.

Answer: C

Diff: 1

Topic: Monetary and Fiscal Policy Effects

Skill: Conceptual

AACSB: Reflective Thinking

- 5) Economic policies are effective at changing output when
- A) the economy is not producing at capacity.
 - B) the economy is producing at its potential output.
 - C) the unemployment rate is at the natural rate.
 - D) the aggregate supply curve is vertical.

Answer: A

Diff: 1

Topic: Monetary and Fiscal Policy Effects

Skill: Conceptual

AACSB: Reflective Thinking

- 6) If the long-run aggregate supply curve is vertical, the multiplier effect of a change in net taxes on aggregate output in the long run
- A) depends on the price level.
 - B) is one.
 - C) is zero.
 - D) is infinitely large.

Answer: C

Diff: 2

Topic: Monetary and Fiscal Policy Effects

Skill: Conceptual

AACSB: Reflective Thinking

- 7) A sustained increase in the overall price level is
- A) stagflation.
 - B) a recession.
 - C) a price index.
 - D) inflation.

Answer: D

Diff: 1

Topic: Monetary and Fiscal Policy Effects

Skill: Definition

Refer to the information provided in Figure 13.9 below to answer the questions that follow.

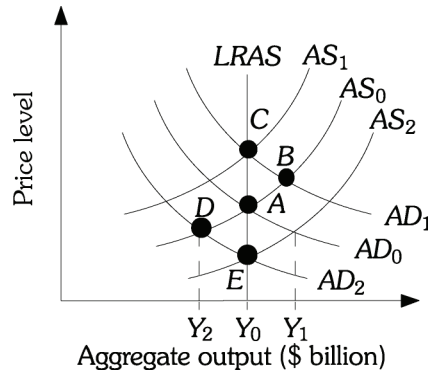


Figure 13.9

- 8) Refer to Figure 13.9. Suppose the economy is currently at Point A producing potential output Y_0 . If the government increases spending, the economy moves to Point _____ in the short-run and to Point _____ in the long-run.

A) D; E B) B; C C) C; B D) B; D

Answer: B

Diff: 2

Topic: Monetary and Fiscal Policy Effects

Skill: Analytic

AACSB: Analytic Skills

- 9) Refer to Figure 13.9. If the economy is currently at Point D producing output level Y_2 , which of the following is NOT true?

A) The economy is operating below full employment.
 B) Input prices are likely to fall.
 C) Aggregate supply shifts to the right and the economy ends up at Point E.
 D) The economy is operating above full employment.

Answer: D

Diff: 2

Topic: Monetary and Fiscal Policy Effects

Skill: Analytic

AACSB: Analytic Skills

- 10) Refer to Figure 13.9. If the economy is at point A currently producing Y_0 and the Fed decreases the money supply, the economy will move to Point _____ in the short run and to Point _____ in the long run.

A) B; C B) D; E C) E; D D) C; B

Answer: B

Diff: 2

Topic: Monetary and Fiscal Policy Effects

Skill: Analytic

AACSB: Analytic Skills

- 11) Refer to Figure 13.9. This economy cannot continue to produce Y_1 (or at point B) because
- A) the price of raw material and wages will increase shifting the aggregate supply curve to AS_1 .
 - B) the price of inputs will decrease, shifting the aggregate supply curve to AS_2 .
 - C) the price of raw material will increase, shifting the aggregate demand curve to AD_2 .
 - D) all of the above

Answer: A

Diff: 2

Topic: Monetary and Fiscal Policy Effects

Skill: Analytic

AACSB: Analytic Skills

- 12) Refer to Figure 13.9. For this economy to produce Y_1 and sustain it without inflation
- A) the price of oil must increase.
 - B) the government must implement an expansionary fiscal policy.
 - C) the government must implement an expansionary monetary policy.
 - D) potential output must increase.

Answer: D

Diff: 3

Topic: Monetary and Fiscal Policy Effects

Skill: Analytic

AACSB: Analytic Skills

- 13) Related to the *Economics in Practice* on p. 243 [555]: In the simple "Keynesian" view, maximum output is NOT defined by the
- A) existing labor force.
 - B) current capital stock.
 - C) existing state of technology.
 - D) level of consumption.

Answer: D

Diff: 1

Topic: Monetary and Fiscal Policy Effects: Economics in Practice

Skill: Fact

- 14) Related to the *Economics in Practice* on p. 243 [555]: In the simple "Keynesian" view, the aggregate supply curve
- A) is downward sloping.
 - B) is completely horizontal.
 - C) is completely vertical.
 - D) is horizontal in part, and vertical in part.

Answer: D

Diff: 1

Topic: Monetary and Fiscal Policy Effects: Economics in Practice

Skill: Fact

2 True/False

- 1) Expansionary economic policies are things the government can do to decrease aggregate demand or aggregate supply.

Answer: FALSE

Diff: 1

Topic: Monetary and Fiscal Policy Effects

Skill: Conceptual

AACSB: Reflective Thinking

2) If the economy is on the steep part of its aggregate supply curve, expansionary policy will mostly increase the price level.

Answer: TRUE

Diff: 2

Topic: *Monetary and Fiscal Policy Effects*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

3) Decrease in net taxes, increase in the money supply and increase in government spending are contractionary policies.

Answer: FALSE

Diff: 1

Topic: *Monetary and Fiscal Policy Effects*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

4) An earth quake and a foreign oil embargo would be contractionary policies.

Answer: FALSE

Diff: 2

Topic: *Monetary and Fiscal Policy Effects*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

5) If the aggregate supply curve is vertical in the long-run, then neither monetary nor fiscal policy will affect aggregate output in the long-run.

Answer: TRUE

Diff: 2

Topic: *Monetary and Fiscal Policy Effects*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

13.5 Causes of Inflation

1 Multiple Choice

Refer to the information provided in Figure 13.10 below to answer the questions that follow.

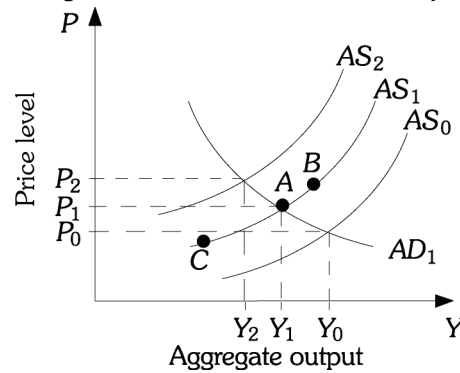


Figure 13.10

- 1) Refer to Figure 13.10. Cost-push inflation occurs if
- A) the economy moves from Point A to Point B on aggregate supply curve AS_1 .
 - B) the economy moves from Point A to Point C on the aggregate supply curve AS_1 .
 - C) the aggregate supply curve shifts from AS_1 to AS_0 .
 - D) the aggregate supply curve shifts from AS_1 to AS_2 .

Answer: D

Diff: 2

Topic: Causes of Inflation

Skill: Analytic

AACSB: Analytic Skills

- 2) Refer to Figure 13.10. Assume the economy is at Point A. Higher oil prices shift the aggregate supply curve to AS_2 . If the government decides to counter the effects of higher oil prices by increasing government spending, then the price level will be _____ than P_2 and output will be _____ than Y_2 .
- A) greater; greater
 - B) greater; less
 - C) less; less
 - D) less; greater

Answer: A

Diff: 2

Topic: Causes of Inflation

Skill: Analytic

AACSB: Analytic Skills

3) Refer to Figure 13.10. Assume the economy is at Point A. Higher oil prices shift the aggregate supply curve to AS₂. If the government decides to counter the effects of higher oil prices by increasing net taxes, then the price level will be _____ than P₂ and output will be _____ than Y₂.

A) greater; greater

B) greater; less

C) less; less

D) less; greater

Answer: C

Diff: 2

Topic: Causes of Inflation

Skill: Analytic

AACSB: Analytic Skills

4) Refer to Figure 13.10. Assume the economy is currently at Point A on aggregate supply curve AS₁. An increase in inflationary expectations that causes firms to increase their prices

A) shifts the aggregate supply curve to AS₀.

B) shifts the aggregate supply curve to AS₂.

C) moves the economy to Point C on aggregate supply curve AS₁.

D) moves the economy to Point B on aggregate supply curve AS₁.

Answer: B

Diff: 2

Topic: Causes of Inflation

Skill: Analytic

AACSB: Analytic Skills

5) A rightward shift in the aggregate demand curve generates a _____ inflation and _____ output.

A) demand-pull; lower

B) cost-push; higher

C) demand-pull; higher

D) cost-push; lower

Answer: C

Diff: 2

Topic: Causes of Inflation

Skill: Conceptual

AACSB: Reflective Thinking

6) A sudden increase in the price of oil causes a _____ inflation and _____ output.

A) demand-pull; lower

B) cost-push; higher

C) demand-pull; higher

D) cost-push; lower

Answer: D

Diff: 2

Topic: Causes of Inflation

Skill: Conceptual

AACSB: Reflective Thinking

- 7) An earthquake destroyed 50% of the Moldovian manufacturing base. The Moldovian government decided to use a contractionary fiscal policy to counter the effects of the earthquake on the economy. The use of the contractionary fiscal policy would have caused
- A) the price level to be lower and the output level to be higher than they would have been without the policy action.
 - B) both the price level and the output level to be higher than they would have been without the policy action.
 - C) both the price level and output level to be lower than what they would have been without the policy action.
 - D) the price level to be higher and the output level to be lower than they would have been without the policy action.

Answer: C

Diff: 3

Topic: Causes of Inflation

Skill: Analytic

AACSB: Analytic Skills

- 8) For an economy to experience both a recession and inflation at the same time,
- A) the aggregate supply curve must shift to the right.
 - B) the aggregate supply curve must shift to the left.
 - C) the aggregate demand curve must shift to the left.
 - D) the aggregate demand curve must shift to the right.

Answer: B

Diff: 2

Topic: Causes of Inflation

Skill: Conceptual

AACSB: Reflective Thinking

- 9) A(n) _____ in inflationary expectations that causes firms to decrease their prices shifts the aggregate supply curve to the _____.
- A) increase; right B) increase; left C) decrease; right D) decrease; left

Answer: C

Diff: 2

Topic: Causes of Inflation

Skill: Conceptual

AACSB: Reflective Thinking

- 10) An increase in inflationary expectations that causes firms to increase their prices shifts the
- A) aggregate supply curve to the left.
 - B) aggregate demand curve to the left.
 - C) aggregate supply curve to the right.
 - D) aggregate demand curve to the right.

Answer: A

Diff: 2

Topic: Causes of Inflation

Skill: Conceptual

AACSB: Reflective Thinking

- 11) During the fall of 1993, prices were increasing by 1% an hour in Bosnia. This is an example of
- A) an expectations inflation.
 - B) natural inflation.
 - C) hyperinflation.
 - D) monetary inflation.

Answer: C

Diff: 1

Topic: Causes of Inflation

Skill: Fact

- 12) During the early 1980s, prices were increasing by approximately 2,000% a year in Argentina. This is an example of
- A) hyperinflation.
 - B) monetary inflation.
 - C) an expectations inflation.
 - D) moderate inflation.

Answer: A

Diff: 1

Topic: Causes of Inflation

Skill: Fact

- 13) Economists generally agree that for a sustained inflation to occur,
- A) the government must be accommodating it by increasing government spending.
 - B) the Federal Reserve must be accommodating it by increasing the money supply.
 - C) the government must be accommodating it by decreasing taxes.
 - D) the Federal Reserve must be accommodating it by decreasing the money supply.

Answer: B

Diff: 2

Topic: Causes of Inflation

Skill: Fact

- 14) For the Fed to keep the interest rate unchanged as the government increases spending, the Fed must continue to
- A) increase the money supply.
 - B) decrease the money supply.
 - C) decrease the demand for money.
 - D) increase the demand for money.

Answer: A

Diff: 2

Topic: Causes of Inflation

Skill: Conceptual

AACSB: Reflective Thinking

- 15) Many economists believe that sustained inflation is accommodated by a(n)
- A) expansionary fiscal policy.
 - B) expansionary monetary policy.
 - C) contractionary fiscal policy.
 - D) contractionary monetary policy.

Answer: B

Diff: 2

Topic: Causes of Inflation

Skill: Fact

- 16) According to the "simple" Keynesian view, the aggregate supply curve is
- A) vertical until it reaches full capacity and then becomes horizontal.
 - B) downward sloping over all levels of output.
 - C) upward sloping over all levels of output.
 - D) horizontal until it reaches full capacity and then becomes vertical.

Answer: D

Diff: 1

Topic: Causes of Inflation

Skill: Fact

- 17) According to the "simple" Keynesian view, if the economy is at capacity, an expansionary policy will
- A) increase output, but not the price level.
 - B) increase the price level, but not output.
 - C) increase both the price level and output.
 - D) increase neither the price level nor output.

Answer: B

Diff: 1

Topic: Causes of Inflation

Skill: Fact

- 18) According to the "simple" Keynesian view, if the economy has excess capacity, an expansionary policy will _____, given that the economy continues to have excess capacity even after the policy.
- A) increase output, but not the price level
 - B) increase the price level, but not output
 - C) increase both the price level and output
 - D) increase neither the price level nor output

Answer: A

Diff: 1

Topic: Causes of Inflation

Skill: Fact

- 19) A(n) _____ gap occurs when planned aggregate expenditure is _____ capacity output.
- A) recessionary; greater than
 - B) recessionary; equal to
 - C) inflationary; greater than
 - D) inflationary; equal to

Answer: C

Diff: 1

Topic: Causes of Inflation

Skill: Definition

- 20) According to the "simple" Keynesian view, if the economy is below full capacity, an increase in aggregate demand will cause
- A) output to fall and the price level to increase in the short run.
 - B) the level of output to rise, but no change in the price level will occur in the short run.
 - C) the price level to increase, but no change in output will occur in the short run.
 - D) both output and the price level to rise in the short run.

Answer: B

Diff: 1

Topic: Causes of Inflation

Skill: Fact

2 True/False

- 1) Inflation due to a decrease in aggregate demand is called demand pull inflation.

Answer: FALSE

Diff: 1

Topic: Causes of Inflation

Skill: Definition

- 2) Inflation is an increase in the overall price level.

Answer: TRUE

Diff: 1

Topic: Causes of Inflation

Skill: Definition

- 3) Supply-side inflation is caused by increases in the aggregate supply curve.

Answer: FALSE

Diff: 2

Topic: Causes of Inflation

Skill: Conceptual

AACSB: Reflective Thinking

- 4) Rising output coupled with falling prices is called stagflation.

Answer: FALSE

Diff: 1

Topic: Causes of Inflation

Skill: Definition

- 5) Expectations of higher future prices cause firms to lower prices today to sell their product before prices rise.

Answer: FALSE

Diff: 2

Topic: Causes of Inflation

Skill: Conceptual

AACSB: Reflective Thinking

13.6 The Behavior of the Fed

1 Multiple Choice

- 1) _____ in government spending and _____ in taxes will cause the deficit to decrease.

A) A decrease; an increase

B) An increase; a decrease

C) A decrease; a decrease

D) An increase; an increase

Answer: A

Diff: 1

Topic: The Behavior of the Fed

Skill: Conceptual

AACSB: Reflective Thinking

- 2) A decrease in government spending and an increase in taxes will cause the
- A) deficit to decrease.
 - B) deficit to remain unchanged.
 - C) deficit to increase.
 - D) surplus to increase slightly.

Answer: A

Diff: 2

Topic: *The Behavior of the Fed*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 3) If the numerical value of the government spending multiplier is greater than the numerical value of the tax multiplier, then unequal increases in spending and taxes will
- A) decrease GDP.
 - B) not change GDP.
 - C) increase GDP.
 - D) cannot be determined from the given information

Answer: D

Diff: 2

Topic: *The Behavior of the Fed*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 4) If the numerical value of the government spending multiplier is greater than the numerical value of the tax multiplier, then equal decreases in spending and taxes will
- A) increase GDP.
 - B) decrease GDP.
 - C) increase GDP slightly.
 - D) not change GDP.

Answer: B

Diff: 2

Topic: *The Behavior of the Fed*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 5) If the numerical value of the government spending multiplier is greater than the numerical value of the tax multiplier, then equal increases in spending and taxes will
- A) increase GDP.
 - B) decrease GDP.
 - C) be contractionary.
 - D) not change GDP.

Answer: A

Diff: 2

Topic: *The Behavior of the Fed*

Skill: *Analytic*

AACSB: *Analytic Skills*

Refer to the information provided in Figure 15.3 below to answer the questions that follow.

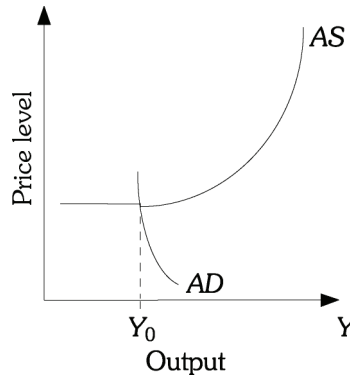


Figure 15.3

- 6) Refer to Figure 15.3. If the economy is currently at the intersection of *AS* and *AD*, the Fed is most likely to
- A) decrease the money supply to move the economy closer to capacity.
 - B) decrease the money supply to reduce the inflationary pressures.
 - C) increase the money supply to reduce inflationary pressures.
 - D) increase the money supply to reduce unemployment.

Answer: D

Diff: 2

Topic: *The Behavior of the Fed*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 7) Refer to Figure 15.3. If the economy is currently at the intersection of *AS* and *AD*, an expansionary monetary policy which does not shift *AD* to the upward sloping portion of the *AS* curve will
- A) be an inflationary policy.
 - B) not be an inflationary policy.
 - C) not be effective.
 - D) increase the price level without increasing output.

Answer: B

Diff: 2

Topic: *The Behavior of the Fed*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 8) Refer to Figure 15.3. If the economy is currently at the intersection of *AS* and *AD*, stagflation would be caused by
- A) an increase in *AS*.
 - B) a decrease in *AS*.
 - C) an increase in *AD*.
 - D) a decrease in *AD*.

Answer: B

Diff: 2

Topic: *The Behavior of the Fed*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 9) Refer to Figure 15.3. Stagflation would cause
- A) a higher price level and lower output.
 - B) a higher price level and higher output.
 - C) a lower price level and lower output.
 - D) a lower price level and higher output.

Answer: A

Diff: 2

Topic: *The Behavior of the Fed*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 10) Refer to Figure 15.3. Stagflation would NOT be caused by a
- A) decrease in AS.
 - B) higher price level with lower output.
 - C) higher price level with higher unemployment.
 - D) shift to the right of AD.

Answer: D

Diff: 2

Topic: *The Behavior of the Fed*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 11) When there is stagflation, the policy choices facing the FED are
- A) increasing monetary growth to increase GDP but that will make inflation worse.
 - B) increasing monetary growth to increase GDP and reduce inflation.
 - C) reducing monetary growth to reduce inflation, but that will make shortfall in GDP worse.
 - D) A and C

Answer: D

Diff: 2

Topic: *The Behavior of the Fed*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

Refer to the information provided in Figure 15.4 below to answer the questions that follow.

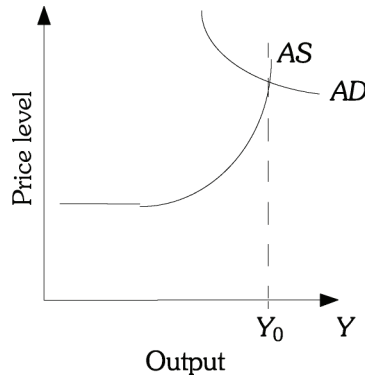


Figure 15.4

- 12) Refer to Figure 15.4. If the economy is currently at the intersection of *AS* and *AD*, the Fed should
- A) increase money supply to reduce the unemployment rate.
 - B) increase money supply to move closer to capacity.
 - C) decrease money supply to reduce inflationary pressures.
 - D) decrease money supply to increase output.

Answer: C

Diff: 2

Topic: *The Behavior of the Fed*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 13) Refer to Figure 15.4. If the economy is currently at the intersection of *AS* and *AD*, a contractionary monetary policy
- A) does not create a recession.
 - B) is an inflationary policy.
 - C) is a recessionary policy.
 - D) none of the above

Answer: A

Diff: 2

Topic: *The Behavior of the Fed*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 14) The Federal Reserve's policy to "lean against the wind" means that
- A) interest rates are decreased as the economy expands.
 - B) reserve requirements are decreased as the economy expands.
 - C) reserve requirements are decreased significantly during an economic expansion.
 - D) interest rates are increased gradually as the economy expands.

Answer: D

Diff: 1

Topic: *The Behavior of the Fed*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 15) The Federal Reserve's policy to "lean against the wind" means that
- A) the FED increases money growth as the economy slows.
 - B) the FED slows money growth as the economy slows.
 - C) the FED lowers taxes as the economy slows.
 - D) the FED raises required reserves as the economy slows.

Answer: A

Diff: 1

Topic: *The Behavior of the Fed*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 16) An economic condition characterized by high unemployment and excessive inflation is called
- A) stagflation.
 - B) recessionary downturn.
 - C) expansionary growth.
 - D) depression.

Answer: A

Diff: 1

Topic: *The Behavior of the Fed*

Skill: *Definition*

- 17) During periods of stagflation, a decrease in the money supply will
- A) decrease prices.
 - B) increase output.
 - C) increase exports.
 - D) increase prices.

Answer: A

Diff: 1

Topic: *The Behavior of the Fed*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 18) During periods of stagflation, a decrease in the money supply will
- A) lower inflation and the level of output.
 - B) increase inflation and the level of output.
 - C) increase inflation and lower the level of output.
 - D) increase exports.

Answer: A

Diff: 1

Topic: *The Behavior of the Fed*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 19) Related to the *Economics in Practice* on p. 255 [567]: Central bankers from around the globe are concerned about the risks that _____ food prices present for the global _____ outlook.
- A) rising; inflation
 - B) rising; deflation
 - C) falling; deflation
 - D) falling; inflation

Answer: A

Diff: 1

Topic: *The Behavior of the Fed: Economics in Practice*

Skill: *Fact*

- 20) Related to the *Economics in Practice* on p. 255 [567]: One way to control rising food prices and global inflation concerns is with
- A) expansionary fiscal policy.
 - B) contractionary monetary policy.
 - C) a combination of expansionary monetary policy and expansionary fiscal policy.
 - D) expansionary monetary policy.

Answer: B

Diff: 2

Topic: *The Behavior of the Fed: Economics in Practice*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

2 True/False

- 1) When it decreases the money supply during an inflation the Fed is "leaning against the wind."

Answer: TRUE

Diff: 2

Topic: *The Behavior of the Fed*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 2) An increase in aggregate demand causes stagflation.

Answer: FALSE

Diff: 1

Topic: *The Behavior of the Fed*

Skill: *Definition*

- 3) The FED is most likely to increase the money supply when there is excess capacity in the economy.

Answer: TRUE

Diff: 1

Topic: *The Behavior of the Fed*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 4) The danger with expansionary FED policy is that it may bring on an inflation.

Answer: TRUE

Diff: 1

Topic: *The Behavior of the Fed*

Skill: *Fact*

- 5) Contractionary FED policy increases aggregate demand.

Answer: FALSE

Diff: 1

Topic: *The Behavior of the Fed*

Skill: *Definition*

- 6) The FED is leaning against the wind when it raises the discount rate during a recession.

Answer: FALSE

Diff: 2

Topic: *The Behavior of the Fed*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

7) A decrease in money supply is an expansionary policy.

Answer: FALSE

Diff: 2

Topic: *The Behavior of the Fed*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

Chapter 14 The Labor Market in the Macroeconomy

14.1 The Labor Market: Basic Concepts

1 Multiple Choice

- 1) The functioning of the labor market primarily affects the shape of the
- A) aggregate demand curve.
 - B) money demand curve.
 - C) aggregate supply curve.
 - D) planned investment curve.

Answer: C

Diff: 1

Topic: The Labor Market: Basic Concepts

Skill: Conceptual

AACSB: Reflective Thinking

- 2) The type of unemployment that is due to changes in the structure of the economy is
- A) adjustable unemployment.
 - B) structural unemployment.
 - C) frictional unemployment.
 - D) cyclical unemployment.

Answer: B

Diff: 1

Topic: The Labor Market: Basic Concepts

Skill: Definition

- 3) The type of unemployment that arises during recessions is known as
- A) the natural rate of unemployment.
 - B) cyclical unemployment.
 - C) structural unemployment.
 - D) frictional unemployment.

Answer: B

Diff: 1

Topic: The Labor Market: Basic Concepts

Skill: Definition

- 4) The type of unemployment that is most likely to arise as a result of technological changes is
- A) cyclical unemployment.
 - B) seasonal unemployment.
 - C) frictional unemployment.
 - D) structural unemployment.

Answer: D

Diff: 1

Topic: The Labor Market: Basic Concepts

Skill: Definition

- 5) If you hear a person saying "I lost my job because I was replaced by a machine," you should conclude that this person is _____ unemployed.
- A) cyclically
 - B) structurally
 - C) frictionally
 - D) seasonally

Answer: B

Diff: 1

Topic: The Labor Market: Basic Concepts

Skill: Conceptual

AACSB: Reflective Thinking

6) If you hear a person saying "I lost my job at the GM plant because car manufacturing is slow due to a slowdown in the economy," you should conclude that this person is _____ unemployed.

- A) cyclically B) structurally C) frictionally D) seasonally

Answer: A

Diff: 1

Topic: The Labor Market: Basic Concepts

Skill: Conceptual

AACSB: Reflective Thinking

7) The labor force includes those people with a job and

- A) those people who are looking for work.
B) those people training for a job.
C) those people who formerly worked and are now retired.
D) homemakers.

Answer: A

Diff: 1

Topic: The Labor Market: Basic Concepts

Skill: Definition

8) The unemployment rate is

- A) the number unemployed divided by the labor force.
B) the number unemployed divided by the number employed.
C) the number unemployed divided by the population.
D) the difference between the population and the number employed divided by the population.

Answer: A

Diff: 1

Topic: The Labor Market: Basic Concepts

Skill: Definition

9) If a country has a population of 400 million, 160 million people employed and 40 million people looking for work, then its unemployment rate is

- A) 10%. B) 20%. C) 25%. D) 40%.

Answer: B

Diff: 2

Topic: The Labor Market: Basic Concepts

Skill: Analytic

AACSB: Analytic Skills

10) Employment tends to rise when

- A) aggregate output falls. B) unemployment rises.
C) aggregate output rises. D) labor productivity falls.

Answer: C

Diff: 2

Topic: The Labor Market: Basic Concepts

Skill: Conceptual

AACSB: Reflective Thinking

2 True/False

- 1) If a household member is not in the labor force, it is because he or she has decided his or her time is more valuable in nonmarket activities.

Answer: TRUE

Diff: 1

Topic: *The Labor Market: Basic Concepts*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 2) If a person is not employed but is looking for work, she is in the labor force.

Answer: TRUE

Diff: 1

Topic: *The Labor Market: Basic Concepts*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 3) Frictional unemployment is the type that arises due to recessions.

Answer: FALSE

Diff: 1

Topic: *The Labor Market: Basic Concepts*

Skill: *Definition*

- 4) Structural unemployment arises when the economy changes making some jobs obsolete.

Answer: TRUE

Diff: 1

Topic: *The Labor Market: Basic Concepts*

Skill: *Definition*

- 5) Cyclical unemployment is that which rises in recessions and shrinks during expansions.

Answer: TRUE

Diff: 1

Topic: *The Labor Market: Basic Concepts*

Skill: *Definition*

- 6) The unemployment rate will never be zero because the economy is dynamic and always changing.

Answer: TRUE

Diff: 1

Topic: *The Labor Market: Basic Concepts*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 7) The unemployment rate is the fraction of the labor force without a job.

Answer: TRUE

Diff: 1

Topic: *The Labor Market: Basic Concepts*

Skill: *Definition*

14.2 The Classical View of the Labor Market

1 Multiple Choice

- 1) Changes in the _____ market affect the shape of the short run aggregate supply curve.
A) money B) labor C) goods D) financial

Answer: B

Diff: 1

Topic: *The Classical View of the Labor Market*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 2) According to Classical economists, the only types of unemployment that exist in an economy are
A) structural and frictional unemployment.
B) cyclical and frictional.
C) seasonal and cyclical.
D) frictional and seasonal.

Answer: A

Diff: 1

Topic: *The Classical View of the Labor Market*

Skill: *Fact*

- 3) According to Classical economists, excessive unemployment does not persist in the economy because
A) wages will always adjust to ensure equilibrium in the labor market.
B) the labor demand does not change in the economy.
C) the labor supply does not change in the economy.
D) interest rates always change to insure equilibrium in the money market.

Answer: A

Diff: 2

Topic: *The Classical View of the Labor Market*

Skill: *Fact*

Refer to the information provided in Figure 14.1 below to answer the questions that follow.

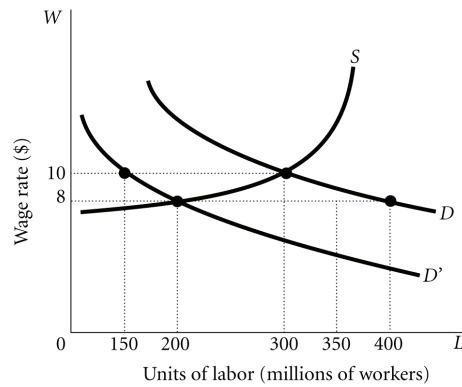


Figure 14.1

- 4) Refer to Figure 14.1. Suppose there is a decrease in the fertility rate and this causes some men and women to place a lower value on their time spent in nonmarket activities. This will cause
- A) the labor supply curve to shift to the left of S .
 - B) the labor supply curve to shift to the right of S .
 - C) the labor demand curve to shift from D to D' .
 - D) the labor demand curve to shift from D' to D .

Answer: B

Diff: 2

Topic: The Classical View of the Labor Market

Skill: Analytic

AACSB: Analytic Skills

- 5) Refer to Figure 14.1. If the demand for labor falls from D to D' and wages are sticky on the downward side, there will be unemployment of _____ million.
- A) 200
 - B) 150
 - C) 100
 - D) 50

Answer: B

Diff: 2

Topic: The Classical View of the Labor Market

Skill: Analytic

AACSB: Analytic Skills

- 6) Refer to Figure 14.1. The demand for labor falls from D to D' . If firms enter into social, or implicit, contracts with workers not to cut wages, then the wage rate will remain at \$10 and
- A) employment will fall to 150 million.
 - B) employment will fall to 200 million.
 - C) employment will remain at 300 million.
 - D) labor supply will decrease to restore the market to equilibrium.

Answer: A

Diff: 2

Topic: The Classical View of the Labor Market

Skill: Analytic

AACSB: Analytic Skills

- 7) Firms might pay efficiency wages above the equilibrium wage for all of the following reasons EXCEPT
- A) to reduce employee shirking.
 - B) to improve employee morale.
 - C) to reduce employee turnover.
 - D) to reduce taxes.

Answer: D

Diff: 2

Topic: The Classical View of the Labor Market

Skill: Conceptual

AACSB: Reflective Thinking

Refer to the information provided in Figure 14.2 below to answer the questions that follow.

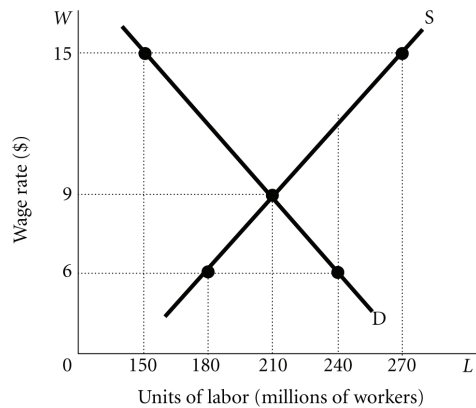


Figure 14.2

- 8) Refer to Figure 14.2. The equilibrium wage rate is \$_____ and the equilibrium number of people employed is _____ million people.
- A) 15; 270
 - B) 9; 210
 - C) 15; 150
 - D) 6; 180

Answer: B

Diff: 1

Topic: The Classical View of the Labor Market

Skill: Analytic

AACSB: Analytic Skills

- 9) Refer to Figure 14.2. At wage rate \$15, there is a _____ of labor equal to _____ million people.
- A) surplus; 150
 - B) shortage; 150
 - C) shortage; 120
 - D) surplus; 120

Answer: D

Diff: 2

Topic: The Classical View of the Labor Market

Skill: Analytic

AACSB: Analytic Skills

10) Refer to Figure 14.2. At wage rate \$6, there is a _____ of labor equal to _____ million people.

- A) shortage; 180 B) shortage; 60 C) surplus; 180 D) surplus; 60

Answer: B

Diff: 2

Topic: *The Classical View of the Labor Market*

Skill: *Analytic*

AACSB: *Analytic Skills*

11) Refer to Figure 14.2. According to Classical economists if the wage rate is

- A) \$15, the wage rate will decline to eliminate the surplus.
B) \$15, the wage rate will increase to eliminate the shortage.
C) \$6, the wage rate will decline to eliminate the surplus.
D) \$15, the wage rate will decline to eliminate the shortage.

Answer: A

Diff: 2

Topic: *The Classical View of the Labor Market*

Skill: *Analytic*

AACSB: *Analytic Skills*

12) Refer to Figure 14.2. Which of the following can change the equilibrium wage rate from \$9 to \$6?

- A) The value people put on their leisure time increases.
B) The value of what firms produce increases.
C) The productivity of workers decreases.
D) The productivity of workers increases.

Answer: C

Diff: 2

Topic: *The Classical View of the Labor Market*

Skill: *Analytic*

AACSB: *Analytic Skills*

13) Refer to Figure 14.2. Which of the following can change the equilibrium wage rate from \$9 to \$15?

- A) The value people put on their leisure time increases.
B) The value of what firms produce decreases.
C) The productivity of workers decreases.
D) the value of what firms produce increases.

Answer: A

Diff: 2

Topic: *The Classical View of the Labor Market*

Skill: *Analytic*

AACSB: *Analytic Skills*

14) Which of the following may shift the labor demand curve?

- A) an increase in the value of leisure
- B) a decrease in the value of leisure
- C) more people entering the labor force
- D) an increase in the value of output that firms produce

Answer: D

Diff: 1

Topic: *The Classical View of the Labor Market*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

15) Which of the following may shift the labor supply curve?

- A) an increase in worker productivity
- B) a decrease in the value people place on their time
- C) an increase in the price of the output of the firm
- D) an increase in the corporate tax rate

Answer: B

Diff: 1

Topic: *The Classical View of the Labor Market*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

16) Which of the following may shift the labor supply curve?

- A) an increase in the wage rate
- B) an increase in the value people place on their time
- C) an increase in the price of the output of the firm
- D) an increase in the corporate tax rate

Answer: B

Diff: 2

Topic: *The Classical View of the Labor Market*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

17) An increase in the productivity of workers shifts the labor _____ curve to the _____.

- A) supply; left
- B) supply; right
- C) demand; right
- D) demand; left

Answer: C

Diff: 1

Topic: *The Classical View of the Labor Market*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

18) A decrease in worker productivity

- A) reduces the demand for labor.
- B) increases the demand for labor.
- C) reduces the supply of labor.
- D) increases the supply of labor.

Answer: A

Diff: 1

Topic: *The Classical View of the Labor Market*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 19) Martin is not employed. The value Martin places on his leisure time is \$30 an hour. Martin looks for a job and all the offers he has are for less than \$30 an hour. Martin should supply
- A) exactly 40 hours per week in the labor market.
 - B) between 0 and 20 hours per week in the labor market.
 - C) between 20 and 40 hours per week in the labor market.
 - D) 0 hours in the labor market.

Answer: D

Diff: 2

Topic: *The Classical View of the Labor Market*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 20) Lisa is currently not employed. She places a value of \$12 an hour on her time in nonmarket activities. If Lisa is offered a job paying \$17 an hour,
- A) she should supply 0 hours in the labor market and allocate all of her time to nonmarket activities.
 - B) she should supply a positive number of hours in the labor market and allocate no time to nonmarket activities.
 - C) she should supply a positive number of hours in the labor market and to nonmarket activities.
 - D) she is indifferent between supplying hours to the labor market and using her time in nonmarket activities.

Answer: C

Diff: 2

Topic: *The Classical View of the Labor Market*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 21) Doug is currently not employed. He places a value of \$16 an hour on his time in nonmarket activities. If Doug is offered a job paying \$12 an hour,
- A) he should supply 0 hours in the labor market.
 - B) he should supply a positive number of hours in the labor market and allocate no time to nonmarket activities.
 - C) he is indifferent between supplying hours to the labor market and using his time in nonmarket activities.
 - D) he should supply a positive number of hours in the labor market and to nonmarket activities.

Answer: A

Diff: 2

Topic: *The Classical View of the Labor Market*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 22) John is contemplating whether he should take a job offered to him. John should
- A) not take the job if the value of his leisure is less than the wage rate the job pays.
 - B) not take the job if the value of his leisure is greater than the wage rate the job pays.
 - C) not take the job if taking the job implies he will enjoy less leisure.
 - D) take the job if taking the job implies he will enjoy more leisure.

Answer: B

Diff: 2

Topic: *The Classical View of the Labor Market*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 23) A new policy is implemented that guarantees every adult an annual income of \$10,000 whether they work or not. This will most likely shift the
- A) labor demand curve to the right.
 - B) labor supply curve to the left.
 - C) labor supply curve to the right.
 - D) labor demand curve to the left.

Answer: B

Diff: 2

Topic: *The Classical View of the Labor Market*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 24) The government lowers the marginal income tax rates so that after-tax wages are increased. This most likely will shift the labor
- A) supply curve to the right.
 - B) supply curve to the left.
 - C) demand curve to the right.
 - D) demand curve to the left.

Answer: A

Diff: 2

Topic: *The Classical View of the Labor Market*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 25) If a new governmental policy increases unemployment benefits, we would expect the labor _____ curve to shift to the _____.
- A) supply; right
 - B) demand; right
 - C) supply; left
 - D) demand; left

Answer: C

Diff: 2

Topic: *The Classical View of the Labor Market*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 26) One of the tenets of the classical view of the labor market is that the wage adjustments that are necessary to clear the labor market
- A) occur very infrequently.
 - B) occur quickly.
 - C) don't occur.
 - D) occur slowly.

Answer: B

Diff: 2

Topic: *The Classical View of the Labor Market*

Skill: *Fact*

- 27) If firms start offering more employment benefits, such as more stock options and a better dental plan, we would expect the labor _____ curve to shift to the _____.
- A) demand; right B) demand; left C) supply; right D) supply; left

Answer: C

Diff: 2

Topic: *The Classical View of the Labor Market*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 28) The classical view of the labor market is basically consistent with the assumption of _____ aggregate supply curve.
- A) a horizontal (or almost horizontal) B) a downward-sloping
C) an upward-sloping D) a vertical (or almost vertical)

Answer: D

Diff: 1

Topic: *The Classical View of the Labor Market*

Skill: *Fact*

- 29) Classical economists believe that the aggregate supply curve is vertical because
- A) wages are flexible and they always change to clear the labor market.
B) the labor market is always in equilibrium.
C) people who are not working are those who have chosen not to work at the prevailing wage rate.
D) all of the above

Answer: D

Diff: 1

Topic: *The Classical View of the Labor Market*

Skill: *Fact*

- 30) According to the Classical theory, an expansionary monetary policy _____ the price level and _____ output in the long run.
- A) decreases; increases B) increases; doesn't change
C) increases; increases D) doesn't change; doesn't change

Answer: B

Diff: 1

Topic: *The Classical View of the Labor Market*

Skill: *Fact*

- 31) Assume that the percentage of the labor force covered by labor contracts that set wages for a predetermined period of time increases. This will tend to
- A) decrease the effectiveness of both monetary and fiscal policy to change output.
B) increase the effectiveness of both monetary and fiscal policy to change output.
C) increase the effectiveness of fiscal policy, but decrease the effectiveness of monetary policy to change output.
D) have no impact on the effectiveness of either monetary or fiscal policy to change output.

Answer: B

Diff: 2

Topic: *The Classical View of the Labor Market*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 32) According to the classical economists, those who are not working
- A) have chosen not to work at the market wage.
 - B) are too productive to be hired at the current wage.
 - C) are unable to find a job at the current wage rate.
 - D) have given up looking for a job, but would accept a job at the current wage if one were offered to them.

Answer: A

Diff: 2

Topic: *The Classical View of the Labor Market*

Skill: *Fact*

- 33) Those who believe that wages adjust quickly to clear the labor market also believe that
- A) the AS curve is upward sloping.
 - B) the AD curve is steep.
 - C) the AD curve is flat.
 - D) the AS curve is vertical.

Answer: D

Diff: 2

Topic: *The Classical View of the Labor Market*

Skill: *Fact*

- 34) What definition of unemployment would you expect classical economists to use?
- A) anyone who is actively seeking work
 - B) anyone who is willing to work if the market wage increases
 - C) anyone who is willing to work at the current market wage, but has not yet been able to find employment
 - D) anyone who is currently not working

Answer: C

Diff: 2

Topic: *The Classical View of the Labor Market*

Skill: *Definition*

2 True/False

- 1) Those who believe that the wage rate does not adjust quickly to clear the labor market are likely to believe that the aggregate supply curve is vertical.

Answer: FALSE

Diff: 2

Topic: *The Classical View of the Labor Market*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 2) If the actual unemployment rate is below NAIRU, the change in the inflation rate will be positive.

Answer: TRUE

Diff: 2

Topic: *The Classical View of the Labor Market*

Skill: *Definition*

- 3) The classical view of the labor market holds that unemployment in the economy consists of frictional and structural unemployment.

Answer: TRUE

Diff: 1

Topic: *The Classical View of the Labor Market*

Skill: *Definition*

- 4) Classical economists believe that economic policies are ineffective because they don't affect aggregate demand in the economy.

Answer: FALSE

Diff: 1

Topic: *The Classical View of the Labor Market*

Skill: *Fact*

- 5) If firms pay wages higher than the market clearing wage, their profits will be reduced.

Answer: FALSE

Diff: 2

Topic: *The Classical View of the Labor Market*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

14.3 Explaining the Existence of Unemployment

1 Multiple Choice

- 1) Suppose the wage rate in the labor market is \$15 and the demand for labor decreases. If wages are sticky,
- A) unemployment decreases.
 - B) unemployment increases.
 - C) unemployment stays the same.
 - D) wages decrease to eliminate the surplus.

Answer: B

Diff: 2

Topic: *Explaining the Existence of Unemployment*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 2) Suppose the equilibrium wage rate in the labor market is \$10 and the demand for labor increases. If wages are sticky, there will be a
- A) surplus of labor and the wage rate declines.
 - B) shortage of labor and the wage rate increases.
 - C) shortage of labor and the wage rate stays the same.
 - D) surplus of labor and the wage rate increases.

Answer: C

Diff: 2

Topic: *Explaining the Existence of Unemployment*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 3) Suppose the wage rate in the labor market is \$8 and more people entered the labor force, which of the following statements is CORRECT?
- A) If wages are flexible, then wages will increase.
 - B) If wages are sticky, the unemployment rate increases.
 - C) If wages are sticky, the unemployment rate stays the same.
 - D) If wages are flexible, the unemployment rate increases.

Answer: B

Diff: 2

Topic: *Explaining the Existence of Unemployment*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 4) Suppose the wage rate in the labor market is \$15 and the productivity of workers increases, which of the following statements is INCORRECT?
- A) The labor demand curve shifts to the right.
 - B) If wages are flexible, there will be an increase in wages.
 - C) If wages are sticky, there will be a shortage in the labor market.
 - D) If wages are sticky, there will be a surplus in the labor market.

Answer: D

Diff: 2

Topic: *Explaining the Existence of Unemployment*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 5) If wages are sticky, an increase in labor
- A) demand decreases the wage rate.
 - B) supply increases the wage rate.
 - C) demand increases the wage rate.
 - D) demand leaves wage rates intact.

Answer: D

Diff: 2

Topic: *Explaining the Existence of Unemployment*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 6) An unspoken agreement between workers and firms that the firm will not cut wages is known as
- A) an implicit or social contract.
 - B) an explicit contract.
 - C) a relative-wage contract.
 - D) employment-at-will.

Answer: A

Diff: 1

Topic: *Explaining the Existence of Unemployment*

Skill: *Definition*

- 7) The social contract explanation for the existence of downwardly sticky wages focuses on
- A) employment contracts that stipulate workers' wages, usually for a period of one to three years.
 - B) the contention that workers in one industry may be unwilling to accept a wage cut, unless they know that workers in other industries are receiving similar cuts.
 - C) unspoken agreements between workers and firms that firms will not cut wages.
 - D) the incentive that firms have to hold wages above the market clearing rate.

Answer: C

Diff: 1

Topic: *Explaining the Existence of Unemployment*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 8) Intel Corporation, a major manufacturer of microchips, saw the demand for its product drop by 25%. Even though the demand for its product decreased, Intel did not cut the wages of its nonunionized workers. This is an example of
- A) employment-at-will.
 - B) an implicit or social contract not to cut wages.
 - C) an explicit contract not to cut wages.
 - D) a relative-wage contract.

Answer: B

Diff: 1

Topic: *Explaining the Existence of Unemployment*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 9) Frito Lay experienced a 20% drop in its sales. Even though the demand for its product decreased, Frito Lay did not cut the wages of its nonunionized workers. This is an example of
- A) an explicit contract not to cut wages.
 - B) employment-at-will.
 - C) poor management.
 - D) an implicit or social contract not to cut wages.

Answer: D

Diff: 1

Topic: *Explaining the Existence of Unemployment*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 10) Suppose that airline workers are laid off during a recession because of an unspoken agreement between airline workers and airline executives that wages will not be reduced. This example is consistent with the
- A) relative-wage explanation of unemployment.
 - B) explicit contract explanation of unemployment.
 - C) implicit contract explanation of unemployment.
 - D) efficiency wage explanation of unemployment.

Answer: C

Diff: 1

Topic: *Explaining the Existence of Unemployment*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 11) The relative-wage explanation for the existence of downwardly sticky wages emphasizes
- A) unspoken agreements between workers and firms that firms will not cut wages.
 - B) the incentive that firms may have to hold wages above the market clearing rate.
 - C) employment contracts that stipulate workers' wages, usually for a period of one to three years.
 - D) the contention that workers in one industry may be unwilling to accept a wage cut, unless they know that workers in other firms and industries are receiving similar cuts.

Answer: D

Diff: 2

Topic: *Explaining the Existence of Unemployment*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 12) According to the relative-wage explanation of unemployment, workers will be willing to accept wage cuts only if
- A) they know that unemployment is increasing in other industries.
 - B) they can be convinced that they are overpaid relative to workers doing similar jobs at other firms.
 - C) they know that workers in other firms and industries are receiving similar cuts.
 - D) the economy is in a prolonged recession.

Answer: C

Diff: 2

Topic: *Explaining the Existence of Unemployment*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 13) Workers in the textile industry are laid off during a recession because they are unwilling to accept a wage cut, unless they know that workers in other industries are receiving similar cuts. This example is consistent with the
- A) relative-wage explanation of unemployment.
 - B) explicit contract explanation of unemployment.
 - C) social contract explanation of unemployment.
 - D) efficiency wage explanation of unemployment.

Answer: A

Diff: 2

Topic: *Explaining the Existence of Unemployment*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 14) The percentage of workers whose wages are set by explicit contracts falls. This should
- A) make it more difficult for the labor market to reach an equilibrium after a change in the demand for labor.
 - B) make it easier for the labor market to reach an equilibrium after a change in the demand for labor.
 - C) have no impact on the movement of the labor market toward equilibrium after a change in the demand for labor.
 - D) cause the labor market to always be at an equilibrium, even if there is a change in the demand for labor.

Answer: B

Diff: 2

Topic: *Explaining the Existence of Unemployment*

Skill: *Analytic*

- 15) Even though explicit contracts may lead to layoffs during recessions, explicit contracts may still be efficient because such contracts
- A) guarantee that only the least-productive workers will be laid off.
 - B) reduce unemployment effects.
 - C) reduce negotiation costs.
 - D) will equitably spread the layoffs among junior and senior workers.

Answer: C

Diff: 2

Topic: *Explaining the Existence of Unemployment*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 16) Suppose that air traffic controllers, whose wages have been locked into place by a two-year contract, are laid off during a recession. This example is consistent with the
- A) social contract explanation of unemployment.
 - B) explicit contract explanation of unemployment.
 - C) efficiency wage explanation of unemployment.
 - D) relative-wage explanation of unemployment.

Answer: B

Diff: 2

Topic: *Explaining the Existence of Unemployment*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 17) Which of the following arguments is NOT offered to explain the existence of "sticky" wages?
- A) the social contract explanation
 - B) the relative-wage explanation
 - C) the fact that labor contracts don't exist
 - D) the explicit contract explanation

Answer: C

Diff: 1

Topic: *Explaining the Existence of Unemployment*

Skill: *Definition*

- 18) When a firm pays higher wages for its workers to improve workers' productivity, the firm pays
- A) sticky wages.
 - B) flexible wages.
 - C) efficiency wages.
 - D) minimum wages.

Answer: C

Diff: 1

Topic: *Explaining the Existence of Unemployment*

Skill: *Definition*

- 19) Which of the following is NOT a reason why firms pay efficiency wages?
- A) to reduce turnovers
 - B) to abide by minimum wage laws
 - C) to improve morale
 - D) to reduce shirking of work

Answer: B

Diff: 1

Topic: *Explaining the Existence of Unemployment*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

Refer to the information provided in Figure 14.3 below to answer the questions that follow.

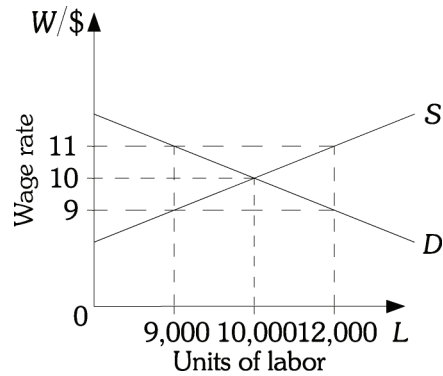


Figure 14.3

- 20) Refer to Figure 14.3. Assume that the productivity of workers increases as the wage rate increases. The efficiency wage
- A) would be below \$10.
 - B) would equal \$10.
 - C) would be above \$10.
 - D) could either be above or below \$10.

Answer: C

Diff: 2

Topic: Explaining the Existence of Unemployment

Skill: Analytic

AACSB: Analytic Skills

- 21) Refer to Figure 14.3. If this firm pays the efficient wage of \$11,
- A) the firm's demand for labor will increase until \$11 is also the equilibrium wage.
 - B) the supply of labor will decrease until \$11 is also the equilibrium wage.
 - C) there will be an excess supply of labor of 2,000.
 - D) there will be an excess supply of labor of 3,000.

Answer: D

Diff: 3

Topic: Explaining the Existence of Unemployment

Skill: Analytic

AACSB: Analytic Skills

- 22) Efficiency wage theory suggests that firms may hold wages above the market clearing rate because
- A) they believe that the productivity of workers increases with the wage rate.
 - B) unspoken agreements between workers and firms are in place.
 - C) it is required by law that they do so.
 - D) long-term contracts fix wage rates for a period of one to three years.

Answer: A

Diff: 2

Topic: Explaining the Existence of Unemployment

Skill: Conceptual

AACSB: Reflective Thinking

- 23) Firms may NOT hold wages above the market clearing rate because
- A) they believe that the productivity of workers increases with the wage rate.
 - B) they have agreed not to cut wages in an explicit agreement with their workers.
 - C) they have implicitly agreed not to cut wages because their workers care about relative wages .
 - D) they want to make sure they abide by minimum wage regulation.

Answer: D

Diff: 2

Topic: *Explaining the Existence of Unemployment*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 24) If productivity increases as wages increase and firms pay a wage above the market clearing wage, then
- A) these firms will go out of business in the long run because they will not be able to compete with firms paying lower wages.
 - B) these firms will face an excess demand for labor and will be able to hire the best workers in the market.
 - C) these firms will have lower profit levels than their competitors.
 - D) a potential benefit these firms may receive is a reduction in employee turnover.

Answer: D

Diff: 2

Topic: *Explaining the Existence of Unemployment*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 25) A firm may benefit by paying workers more than the market clearing wage because the higher wages may lead to all of the following EXCEPT
- A) lower worker turnover.
 - B) improved worker morale.
 - C) reduced shirking of work.
 - D) reduced taxed.

Answer: D

Diff: 2

Topic: *Explaining the Existence of Unemployment*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 26) If, as a result of imperfect information, firms set their wage rates below the market clearing wage rate
- A) unemployment increases.
 - B) there will be a surplus of workers.
 - C) there will be a shortage of workers.
 - D) there will be equilibrium in the labor market.

Answer: C

Diff: 1

Topic: *Explaining the Existence of Unemployment*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 27) If, as a result of imperfect information, firms set their wage rates above the market clearing wage rate,
- A) unemployment decreases.
 - B) there will be a surplus of workers.
 - C) there will be a shortage of workers.
 - D) there will be equilibrium in the labor market.

Answer: B

Diff: 1

Topic: *Explaining the Existence of Unemployment*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 28) Minimum wage laws contribute to a higher unemployment rate by
- A) raising wages above the market clearing level in some labor markets.
 - B) pushing wages below the market clearing level in some labor markets.
 - C) raising wages above the market clearing level in all labor markets.
 - D) pushing wages below the market clearing level in all labor markets.

Answer: A

Diff: 1

Topic: *Explaining the Existence of Unemployment*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 29) The minimum wage law contributes to a
- A) lower unemployment rate among teenaged workers.
 - B) lower unemployment rate among adult workers.
 - C) higher unemployment rate among high skilled workers.
 - D) higher unemployment rate among teenaged workers.

Answer: D

Diff: 1

Topic: *Explaining the Existence of Unemployment*

Skill: *Fact*

Refer to the information provided in Figure 14.4 below to answer the questions that follow.

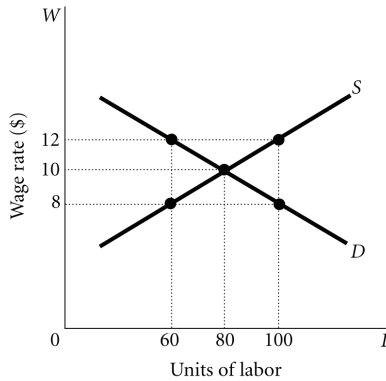


Figure 14.4

- 30) Refer to Figure 14.4. A minimum wage of \$12
- A) will lead to unemployment of 10.
 - B) will lead to unemployment of 20.
 - C) will lead to unemployment of 40.
 - D) will have no effect because the minimum wage is set above the equilibrium wage and for a minimum wage to have any effect on the labor market it must be below the equilibrium wage.

Answer: C

Diff: 1

Topic: Explaining the Existence of Unemployment

Skill: Analytic

AACSB: Analytic Skills

- 31) Refer to Figure 14.4. A minimum wage of \$8
- A) will lead to an excess demand for labor of 20.
 - B) will lead to an excess demand for labor of 40.
 - C) will lead to an excess demand for labor of 60.
 - D) will have no effect because the minimum wage is set below the equilibrium wage and for a minimum wage to have any effect on the labor market it must be above the equilibrium wage.

Answer: D

Diff: 2

Topic: Explaining the Existence of Unemployment

Skill: Analytic

AACSB: Analytic Skills

- 32) Refer to Figure 14.4. A firm might pay wages above \$10 per hour if it believes such a wage will result in all of the following EXCEPT
- A) reduce worker shirking.
 - B) reduce worker turnover.
 - C) improve worker moral.
 - D) agitate unions.

Answer: D

Diff: 2

Topic: Explaining the Existence of Unemployment

Skill: Analytic

AACSB: Analytic Skills

2 True/False

- 1) If the minimum wage is set above the market clearing wage, wages will be "sticky" in the downward direction.

Answer: TRUE

Diff: 2

Topic: *Explaining the Existence of Unemployment*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 2) Sticky wages reduce unemployment.

Answer: FALSE

Diff: 2

Topic: *Explaining the Existence of Unemployment*

Skill: *Fact*

- 3) Efficiency wages are an explanation for the existence of unemployment.

Answer: TRUE

Diff: 2

Topic: *Explaining the Existence of Unemployment*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 4) Cost of living adjustments in labor contracts offer no protection to workers from unexpected inflation.

Answer: FALSE

Diff: 2

Topic: *Explaining the Existence of Unemployment*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 5) Efficiency wages may lower employee turnover.

Answer: TRUE

Diff: 1

Topic: *Explaining the Existence of Unemployment*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

14.4 The Short-Run Relationship Between the Unemployment Rate and Inflation

1 Multiple Choice

- 1) The unemployment rate rises if
- | | |
|------------------------------------|--------------------------------|
| A) the demand for labor increases. | B) aggregate output increases. |
| C) the supply of labor increases. | D) aggregate demand increases. |

Answer: C

Diff: 1

Topic: *The Short-Run Relationship Between the Unemployment Rate and Inflation*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 2) What sequence of events results from a decrease in aggregate demand?
- A) The price level falls, inventories decline, firms respond by increasing output and employment.
 - B) The price level falls, inventories increase, firms respond by reducing output and employment.
 - C) The price level rises, inventories decline, firms respond by increasing output and employment.
 - D) The price level rises, inventories increase, firms respond by increasing output and employment.

Answer: B

Diff: 2

Topic: *The Short-Run Relationship Between the Unemployment Rate and Inflation*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 3) What sequence of events results from an increase in aggregate demand?
- A) The price level falls, inventories decline, firms respond by increasing output and employment.
 - B) The price level falls, inventories increase, firms respond by reducing output and employment.
 - C) The price level rises, inventories decline, firms respond by increasing output and employment.
 - D) The price level rises, inventories increase, firms respond by increasing output and employment.

Answer: C

Diff: 2

Topic: *The Short-Run Relationship Between the Unemployment Rate and Inflation*

Skill: *Analytic*

AACSB: *Analytic Skills*

Refer to the information provided in Figure 14.5 below to answer the questions that follow.

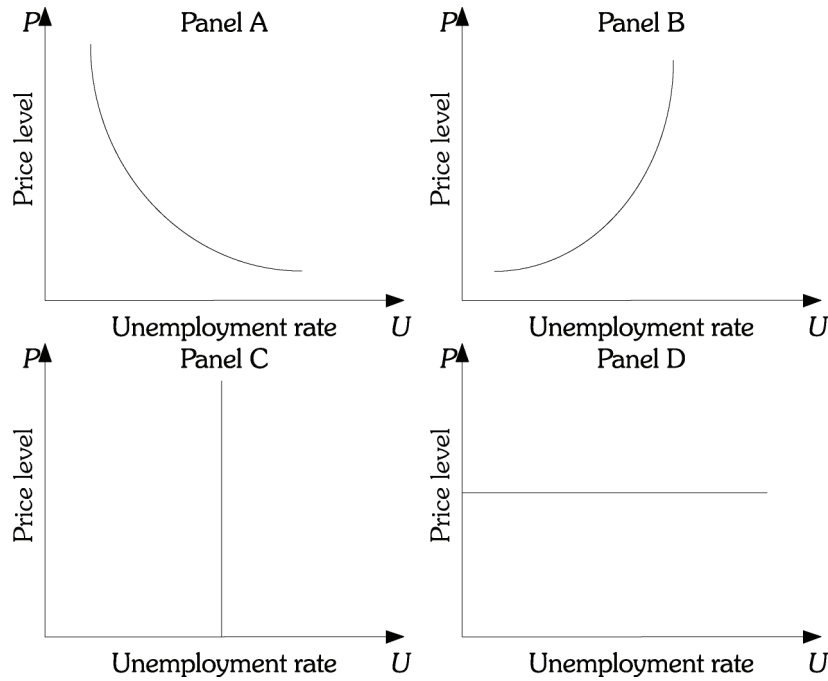


Figure 14.5

- 4) Refer to Figure 14.5. If aggregate demand shifts while aggregate supply is stable, the relationship between the price level and the unemployment rate is represented in Panel
 A) A. B) B. C) C. D) D.

Answer: A

Diff: 1

Topic: The Short-Run Relationship Between the Unemployment Rate and Inflation

Skill: Conceptual

AACSB: Reflective Thinking

- 5) As the unemployment rate increases in response to the economy moving away from capacity output, the aggregate price level
 A) is stable. B) falls.
 C) rises at an increasing rate. D) rises at a declining rate.

Answer: B

Diff: 2

Topic: The Short-Run Relationship Between the Unemployment Rate and Inflation

Skill: Conceptual

AACSB: Reflective Thinking

- 6) If aggregate demand changes while aggregate supply is stable, output and the unemployment rate are
- A) positively related.
 - B) not related in the short run.
 - C) not related neither in the long run nor in the short run.
 - D) negatively related.

Answer: D

Diff: 1

Topic: *The Short-Run Relationship Between the Unemployment Rate and Inflation*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 7) If the aggregate supply is vertical, an (a) _____ in the price level _____ unemployment rate.
- A) decrease; increases
 - B) increase; doesn't change
 - C) decrease; decreases
 - D) increase; increases

Answer: B

Diff: 1

Topic: *The Short-Run Relationship Between the Unemployment Rate and Inflation*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 8) Changes in the price level don't affect the unemployment rate if
- A) the economy is operating below capacity.
 - B) the economy is operating at capacity.
 - C) the aggregate supply curve is flat.
 - D) the aggregate demand curve is steep.

Answer: B

Diff: 2

Topic: *The Short-Run Relationship Between the Unemployment Rate and Inflation*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 9) The Phillips curve depicts the relationship between
- A) output and the price level.
 - B) aggregate demand and aggregate expenditures.
 - C) inflation and unemployment.
 - D) money supply and interest rates.

Answer: C

Diff: 1

Topic: *The Short-Run Relationship Between the Unemployment Rate and Inflation*

Skill: *Definition*

Refer to the information provided in Figure 14.6 below to answer the questions that follow.

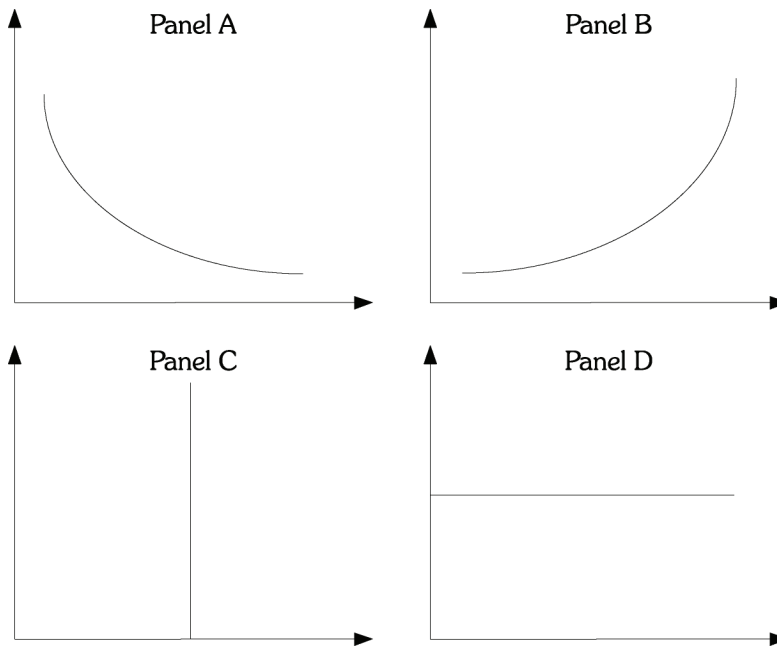


Figure 14.6

10) Refer to Figure 14.6. Assuming all shocks to the economy arise from demand changes, which panel represents the short-run relationship between output and the price level?

- A) A B) B C) C D) D

Answer: B

Diff: 1

Topic: The Short-Run Relationship Between the Unemployment Rate and Inflation

Skill: Conceptual

AACSB: Reflective Thinking

11) Refer to Figure 14.6. Which panel represents the short-run Phillips curve?

- A) A B) B C) C D) D

Answer: A

Diff: 1

Topic: The Short-Run Relationship Between the Unemployment Rate and Inflation

Skill: Conceptual

AACSB: Reflective Thinking

12) Refer to Figure 14.6. If unemployment is on the x-axis, which panel represents the long-run Phillips curve?

- A) A B) B C) C D) D

Answer: C

Diff: 1

Topic: The Short-Run Relationship Between the Unemployment Rate and Inflation

Skill: Conceptual

AACSB: Reflective Thinking

Refer to the information provided in Figure 14.7 below to answer the questions that follow.

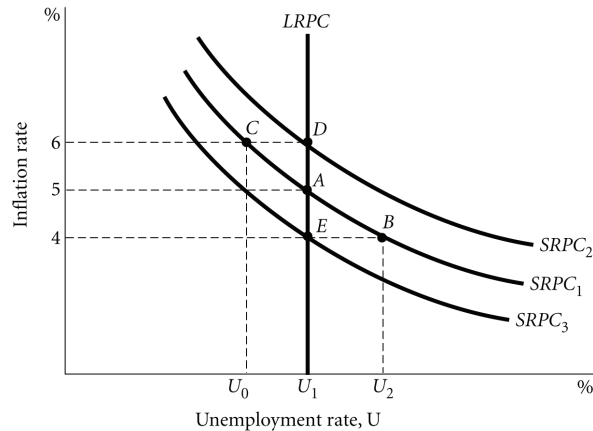


Figure 14.7

13) Refer to Figure 14.7. The unemployment rate at U_1

- A) is greater than the natural rate. B) is lower than the natural rate.
 C) equals the natural rate. D) equals zero.

Answer: C

Diff: 1

Topic: The Short-Run Relationship Between the Unemployment Rate and Inflation

Skill: Conceptual

AACSB: Reflective Thinking

14) Refer to Figure 14.7. If the natural unemployment rate equals 6%, the unemployment rate at U_2 could be

- A) 4%. B) 5%. C) 6%. D) 7%.

Answer: D

Diff: 2

Topic: The Short-Run Relationship Between the Unemployment Rate and Inflation

Skill: Analytic

AACSB: Analytic Skills

15) Refer to Figure 14.7. Suppose the economy is at Point A, an increase in money supply will move the economy to Point _____ in the short run.

- A) E B) B C) C D) D

Answer: C

Diff: 2

Topic: The Short-Run Relationship Between the Unemployment Rate and Inflation

Skill: Analytic

AACSB: Analytic Skills

16) Refer to Figure 14.7. If the economy is on $SRPC_1$, then the expected inflation rate is

- A) 4%
- B) 5%
- C) 6%
- D) none of the above

Answer: B

Diff: 2

Topic: *The Short-Run Relationship Between the Unemployment Rate and Inflation*

Skill: Analytic

AACSB: Analytic Skills

17) Refer to Figure 14.7. If the economy is on $SRPC_2$, then the expected inflation rate is

- A) 4%
- B) 5%
- C) 6%
- D) none of the above

Answer: C

Diff: 2

Topic: *The Short-Run Relationship Between the Unemployment Rate and Inflation*

Skill: Analytic

AACSB: Analytic Skills

18) Refer to Figure 14.7. Suppose the economy is initially at Point A. A contractionary fiscal policy moves the economy to Point _____ in the short run.

- A) E
- B) B
- C) C
- D) D

Answer: B

Diff: 2

Topic: *The Short-Run Relationship Between the Unemployment Rate and Inflation*

Skill: Analytic

AACSB: Analytic Skills

19) Refer to Figure 14.7. Suppose the economy is at Point C. What can possibly move the economy to Point D?

- A) a leftward shift in the AD curve
- B) a rightward shift in the AD curve
- C) a leftward shift in the AS curve
- D) a rightward shift in the AS curve

Answer: C

Diff: 3

Topic: *The Short-Run Relationship Between the Unemployment Rate and Inflation*

Skill: Analytic

AACSB: Analytic Skills

20) Refer to Figure 14.7. Which combinations of events could move the economy from Point A to Point C, and then from Point C to Point D?

- A) a contractionary fiscal policy followed by a leftward shift in the AS curve
- B) a contractionary fiscal policy followed by a rightward shift in the AS curve
- C) an expansionary fiscal policy followed by a leftward shift in the AS curve
- D) an expansionary fiscal policy followed by a rightward shift in the AS curve

Answer: C

Diff: 3

Topic: *The Short-Run Relationship Between the Unemployment Rate and Inflation*

Skill: Analytic

AACSB: Analytic Skills

21) Refer to Figure 14.7. Which combinations of events could move the economy from Point *A* to Point *B*, and then from Point *B* to Point *E*?

- A) a contractionary monetary policy followed by a leftward shift in the *AS* curve
- B) a contractionary monetary policy followed by a rightward shift in the *AS* curve
- C) an expansionary fiscal policy followed by a leftward shift in the *AS* curve
- D) an expansionary fiscal policy followed by a rightward shift in the *AS* curve

Answer: B

Diff: 3

Topic: *The Short-Run Relationship Between the Unemployment Rate and Inflation*

Skill: *Analytic*

AACSB: *Analytic Skills*

22) Refer to Figure 14.7. Suppose the economy is at Point *A*, a sudden increase in the price of oil without any change in the aggregate demand shifts the short-run Phillips curve (*SRPC*) from

- A) *SRPC*₁ to *SRPC*₂.
- B) *SRPC*₁ to *SRPC*₃.
- C) *SRPC*₂ to *SRPC*₁.
- D) *SRPC*₃ to *SRPC*₁.

Answer: A

Diff: 3

Topic: *The Short-Run Relationship Between the Unemployment Rate and Inflation*

Skill: *Analytic*

AACSB: *Analytic Skills*

23) Refer to Figure 14.7. If the economy is at Point *B*, the cost of raw material decreased dramatically, and the aggregate demand did not change, the economy could move to Point _____.

- A) *A*
- B) *E*
- C) *C*
- D) *D*

Answer: B

Diff: 3

Topic: *The Short-Run Relationship Between the Unemployment Rate and Inflation*

Skill: *Analytic*

AACSB: *Analytic Skills*

24) Refer to Figure 14.7. Suppose the economy is at Point *A*, and the cost of inputs is fixed. An increase in government spending could move the economy to Point _____.

- A) *E*
- B) *B*
- C) *C*
- D) *D*

Answer: C

Diff: 3

Topic: *The Short-Run Relationship Between the Unemployment Rate and Inflation*

Skill: *Analytic*

AACSB: *Analytic Skills*

25) If aggregate demand increases and expectations regarding inflation remain constant,

- A) the economy moves along the short-run Phillips curve.
- B) the short-run Phillips curve shifts to the right.
- C) the short-run Phillips curve shifts to the left.
- D) the long-run Phillips curve shifts to the right.

Answer: A

Diff: 2

Topic: *The Short-Run Relationship Between the Unemployment Rate and Inflation*

Skill: *Analytic*

AACSB: *Analytic Skills*

26) If inflation expectations change as a result of an expansionary fiscal policy, this causes

- A) the long-run Phillips curve to shift.
- B) the short-run Phillips curve to shift.
- C) the short-run Phillips curve to remain constant.
- D) a movement along the short-run Phillips curve.

Answer: B

Diff: 2

Topic: *The Short-Run Relationship Between the Unemployment Rate and Inflation*

Skill: *Analytic*

AACSB: *Analytic Skills*

27) If aggregate supply increases and aggregate demand remains unchanged,

- A) there will be a positive relationship between the price level and the level of aggregate output.
- B) there will be a negative relationship between the price level and the level of aggregate output.
- C) there will be no systematic relationship between the price level and the level of aggregate output.
- D) the price level will remain unchanged, but aggregate output will decrease.

Answer: B

Diff: 3

Topic: *The Short-Run Relationship Between the Unemployment Rate and Inflation*

Skill: *Analytic*

AACSB: *Analytic Skills*

28) The economy experiences both inflation and unemployment when

- A) aggregate demand decreases and aggregate supply increases.
- B) aggregate supply decreases and aggregate demand remains unchanged.
- C) aggregate demand decreases and aggregate supply remains unchanged.
- D) aggregate demand increases and aggregate supply decreases.

Answer: B

Diff: 2

Topic: *The Short-Run Relationship Between the Unemployment Rate and Inflation*

Skill: *Analytic*

AACSB: *Analytic Skills*

29) The economy experiences both a falling price level and falling unemployment when

- A) aggregate supply increases with aggregate demand stable.
- B) aggregate demand increases with aggregate supply stable.
- C) aggregate supply decreases with aggregate demand stable.
- D) aggregate demand decrease with aggregate supply stable.

Answer: A

Diff: 2

Topic: *The Short-Run Relationship Between the Unemployment Rate and Inflation*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 30) There is no systematic relationship between the price level and the level of aggregate output when
- A) aggregate demand is negatively sloped.
 - B) aggregate demand is changing, but aggregate supply is not.
 - C) both aggregate supply and aggregate demand are changing simultaneously.
 - D) aggregate supply is changing, but aggregate demand is not.

Answer: C

Diff: 2

Topic: *The Short-Run Relationship Between the Unemployment Rate and Inflation*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 31) If the AD curve shifts from year to year and the AS curve does not, then the short run Phillips curve would be
- A) downward sloping.
 - B) upward sloping.
 - C) shifting to the left.
 - D) shifting to the right.

Answer: A

Diff: 2

Topic: *The Short-Run Relationship Between the Unemployment Rate and Inflation*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 32) If the AS curve shifts from year to year, but the AD curve does not, then the Phillips curve would show
- A) a positive relationship between the inflation and unemployment rates.
 - B) a negative relationship between the inflation and unemployment rates.
 - C) no particular relationship between the inflation and unemployment rates.
 - D) a constant trade-off between the inflation and unemployment rates.

Answer: A

Diff: 2

Topic: *The Short-Run Relationship Between the Unemployment Rate and Inflation*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 33) If inflationary expectations decrease, the Phillips curve will
- A) shift to the right.
 - B) shift to the left.
 - C) become vertical.
 - D) become upward sloping.

Answer: B

Diff: 2

Topic: *The Short-Run Relationship Between the Unemployment Rate and Inflation*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 34) The United States began to pull out of a recession in the spring of 1991. Unemployment fell, but inflation did not increase. What was the most likely cause of this?
- A) Aggregate supply was increasing at a faster rate than aggregate demand.
 - B) Both aggregate demand and aggregate supply were decreasing.
 - C) Aggregate demand was increasing but aggregate supply was decreasing.
 - D) Aggregate demand was increasing at a faster rate than aggregate supply.

Answer: A

Diff: 2

Topic: *The Short-Run Relationship Between the Unemployment Rate and Inflation*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 35) Related to the *Economics in Practice* on p. 264 [576]: Increased applications to graduate school in 2008 were an indication that the
- A) labor demand was decreasing.
 - B) labor demand was increasing.
 - C) aggregate supply was increasing.
 - D) aggregate demand was increasing.

Answer: A

Diff: 2

Topic: *The Short-Run Relationship Between the Unemployment Rate and Inflation: Economics in Practice*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 36) Related to the *Economics in Practice* on p. 264 [576]: *Ceteris paribus*, applications to graduate school tend to _____ when the economy is experiencing _____.
- A) increase; inflation
 - B) increase; growth
 - C) decrease; recession
 - D) decrease; growth

Answer: D

Diff: 2

Topic: *The Short-Run Relationship Between the Unemployment Rate and Inflation: Economics in Practice*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

2 True/False

- 1) As the unemployment rate declines in response to the economy moving closer and closer to capacity output, the aggregate price level rises at a decreasing rate.

Answer: FALSE

Diff: 2

Topic: *The Short-Run Relationship Between the Unemployment Rate and Inflation*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 2) At the natural rate of unemployment, frictional unemployment is zero.

Answer: FALSE

Diff: 2

Topic: *The Short-Run Relationship Between the Unemployment Rate and Inflation*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 3) The Phillips curve suggests that if we want to raise the inflation rate, we must accept a higher unemployment rate in return.

Answer: FALSE

Diff: 2

Topic: *The Short-Run Relationship Between the Unemployment Rate and Inflation*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 4) If aggregate supply changes when aggregate demand is stable, then the Phillips curve is negatively sloped.

Answer: FALSE

Diff: 2

Topic: *The Short-Run Relationship Between the Unemployment Rate and Inflation*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 5) An increase in inflationary expectations shifts the economy's short run Phillips curve to the left.

Answer: FALSE

Diff: 2

Topic: *The Short-Run Relationship Between the Unemployment Rate and Inflation*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

14.5 The Long-Run Aggregate Supply Curve, Potential GDP, and the Natural Rate of Unemployment

1 Multiple Choice

- 1) In the long run, the Phillips curve will be vertical at the natural rate of unemployment if
- A) the long-run aggregate demand curve is vertical at potential GDP.
 - B) the long-run aggregate demand curve is horizontal at the natural rate of inflation.
 - C) the long-run aggregate supply curve is vertical at potential GDP.
 - D) the long-run supply curve is horizontal at the natural rate of inflation.

Answer: C

Diff: 2

Topic: *The Long-Run Aggregate Supply Curve, Potential GDP, and the Natural Rate of Unemployment*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 2) If the Phillips curve is vertical in the long run, then
- A) there is a trade-off between inflation and unemployment in the long run.
 - B) the inflation rate will always be zero in the long run.
 - C) the unemployment rate will be zero in the long run.
 - D) there is no trade-off between inflation and unemployment in the long run.

Answer: D

Diff: 2

Topic: *The Long-Run Aggregate Supply Curve, Potential GDP, and the Natural Rate of Unemployment*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

Refer to the information provided in Figure 14.8 below to answer the questions that follow.

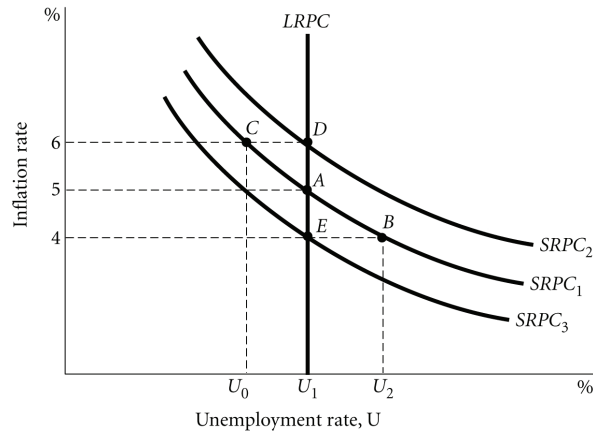


Figure 14.8

- 3) Refer to Figure 14.8. Expected inflation at Point A _____ expected inflation at Point C.
 A) is greater than
 B) is less than
 C) equals
 D) cannot be determined from the figure

Answer: C

Diff: 2

Topic: The Long-Run Aggregate Supply Curve, Potential GDP, and the Natural Rate of Unemployment

Skill: Analytic

AACSB: Analytic Skills

- 4) Refer to Figure 14.8. Expected inflation at Point B equals
 A) 4%.
 B) 5%.
 C) 6%.
 D) cannot be determined from the figure

Answer: B

Diff: 2

Topic: The Long-Run Aggregate Supply Curve, Potential GDP, and the Natural Rate of Unemployment

Skill: Analytic

AACSB: Analytic Skills

- 5) Refer to Figure 14.8. Along $SRPC_2$, expected inflation equals
 A) 4%.
 B) 5%.
 C) 6%.
 D) cannot be determined from the figure

Answer: C

Diff: 2

Topic: The Long-Run Aggregate Supply Curve, Potential GDP, and the Natural Rate of Unemployment

Skill: Analytic

AACSB: Analytic Skills

- 6) Refer to Figure 14.8. Along $SRPC_3$, expected inflation equals
- A) 4%.
 - B) 5%.
 - C) 6%.
 - D) cannot be determined from the figure

Answer: A

Diff: 2

Topic: *The Long-Run Aggregate Supply Curve, Potential GDP, and the Natural Rate of Unemployment*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 7) If the measured unemployment rate is 8% and the natural unemployment rate is 3%, then
- A) frictional unemployment is 5%.
 - B) cyclical unemployment is 5%.
 - C) frictional unemployment is 11%.
 - D) structural unemployment is 11%.

Answer: B

Diff: 1

Topic: *The Long-Run Aggregate Supply Curve, Potential GDP, and the Natural Rate of Unemployment*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 8) Economists who argue that the AS curve is vertical in the long run at potential GDP also argue that the Phillips curve in the long run is
- A) vertical at the natural rate of unemployment.
 - B) upward sloping.
 - C) downward sloping.
 - D) horizontal at the natural rate of inflation.

Answer: A

Diff: 1

Topic: *The Long-Run Aggregate Supply Curve, Potential GDP, and the Natural Rate of Unemployment*

Skill: *Fact*

- 9) The measured unemployment rate can be pushed below the natural rate, but
- A) only in the long run and only if the price level is constant.
 - B) only in the long run and not without inflation.
 - C) only in the short run and only if the price level is constant.
 - D) only in the short run and not without inflation.

Answer: D

Diff: 1

Topic: *The Long-Run Aggregate Supply Curve, Potential GDP, and the Natural Rate of Unemployment*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 10) If the economy is at potential output, actual inflation
- A) is greater than expected inflation.
 - B) equals expected inflation.
 - C) is less than expected inflation.
 - D) equals the natural rate of unemployment.

Answer: B

Diff: 2

Topic: *The Long-Run Aggregate Supply Curve, Potential GDP, and the Natural Rate of Unemployment*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

2 True/False

- 1) As a result of a shifting aggregate supply curve during the 1990s, the U.S. economy experienced a negative trade-off between inflation and unemployment.

Answer: FALSE

Diff: 1

Topic: *The Long-Run Aggregate Supply Curve, Potential GDP, and the Natural Rate of Unemployment*

Skill: *Fact*

- 2) A vertical aggregate supply curve implies a vertical Phillips curve.

Answer: TRUE

Diff: 1

Topic: *The Long-Run Aggregate Supply Curve, Potential GDP, and the Natural Rate of Unemployment*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 3) If the unemployment rate rises above the natural rate of unemployment in the short run, the inflation rate will rise.

Answer: FALSE

Diff: 2

Topic: *The Long-Run Aggregate Supply Curve, Potential GDP, and the Natural Rate of Unemployment*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 4) If unemployment is below the natural rate of unemployment, then output is below potential output.

Answer: FALSE

Diff: 1

Topic: *The Long-Run Aggregate Supply Curve, Potential GDP, and the Natural Rate of Unemployment*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 5) The natural rate of unemployment is unemployment that occurs as a normal part of the functioning of the economy.

Answer: TRUE

Diff: 1

Topic: *The Long-Run Aggregate Supply Curve, Potential GDP, and the Natural Rate of Unemployment*

Skill: *Definition*

Chapter 15 Policy Timing, Deficit Targeting, and Stock Market Effects

15.1 Time Lags Regarding Monetary and Fiscal Policy

1 Multiple Choice

- 1) The time it takes to see if there has been a shock to the economy is
- A) a recognition lag.
 - B) an implementation lag.
 - C) a response lag.
 - D) none of the above

Answer: A

Diff: 1

Topic: Time Lags Regarding Monetary and Fiscal Policy

Skill: Definition

- 2) The time it takes the FED or Congress to change economic policy is
- A) a recognition lag.
 - B) an implementation lag.
 - C) a response lag.
 - D) none of the above

Answer: B

Diff: 1

Topic: Time Lags Regarding Monetary and Fiscal Policy

Skill: Definition

- 3) The time it takes for a new economic policy to affect behavior in the economy is
- A) a recognition lag.
 - B) an implementation lag.
 - C) a response lag.
 - D) none of the above

Answer: C

Diff: 1

Topic: Time Lags Regarding Monetary and Fiscal Policy

Skill: Definition

- 4) If the government spending multiplier were 3.5, a \$2 billion decrease in government spending would lower GDP by
- A) \$70 billion after one year.
 - B) \$2 billion after two years.
 - C) \$1.5 billion after one year.
 - D) \$7 billion after one year.

Answer: D

Diff: 1

Topic: Time Lags Regarding Monetary and Fiscal Policy

Skill: Analytic

AACSB: Analytic Skills

- 5) The implementation lag for fiscal policy is longer than for monetary policy because
- A) it takes longer for the FED to act than Congress.
 - B) it takes longer for Congress to act than the FED.
 - C) fiscal policy changes more quickly affect behavior than monetary policy changes.
 - D) monetary policy changes more quickly affect behavior than than fiscal policy changes.

Answer: B

Diff: 2

Topic: Time Lags Regarding Monetary and Fiscal Policy

Skill: Conceptual

AACSB: Reflective Thinking

- 6) Policy lags mean that
- A) economic policy may be inappropriate when it takes affect.
 - B) economic policy will be ineffective.
 - C) fiscal policy is more effective than monetary policy.
 - D) monetary policy is more effective than fiscal policy.

Answer: A

Diff: 2

Topic: Time Lags Regarding Monetary and Fiscal Policy

Skill: Definition

- 7) The implementation lag for fiscal policy is
- A) shorter than the implementation lag for monetary policy.
 - B) longer than the implementation lag for monetary policy.
 - C) the same length a the implementation lag for monetary policy.
 - D) the same length as the recognition lag for fiscal policy.

Answer: B

Diff: 2

Topic: Time Lags Regarding Monetary and Fiscal Policy

Skill: Conceptual

AACSB: Reflective Thinking

- 8) Economic policy may be inappropriate when it takes effect for all of the following reasons EXCEPT
- A) recognition lags.
 - B) implementation lags.
 - C) response lags.
 - D) anticipation lags.

Answer: D

Diff: 1

Topic: Time Lags Regarding Monetary and Fiscal Policy

Skill: Conceptual

AACSB: Reflective Thinking

- 9) Time lags that often erode effectiveness of monetary and fiscal policy measures represent
- A) the change in export and import prices.
 - B) the foreign response to price changes.
 - C) delays in the response of the economy to stabilization policy.
 - D) the change in exchange rates.

Answer: C

Diff: 1

Topic: Time Lags Regarding Monetary and Fiscal Policy

Skill: Definition

- 10) The recognition lag of stabilization policy represents
- A) the time that is necessary to put the desired policy into effect.
 - B) the time needed for the Federal Reserve Board to meet.
 - C) the time that it takes for the economy to adjust to the new conditions after a new policy is introduced.
 - D) the time that it takes for policy makers to recognize a change in the economy.

Answer: D

Diff: 1

Topic: Time Lags Regarding Monetary and Fiscal Policy

Skill: Definition

- 11) The implementation lag of stabilization policy represents
- A) the time that is necessary to put the desired policy into effect once economists and policy makers recognize the need.
 - B) the time needed for the economy to adjust to new conditions after new policies are introduced.
 - C) the time needed for the Federal Reserve to meet.
 - D) the time that is needed for policy makers to recognize the need to do something.

Answer: A

Diff: 1

Topic: Time Lags Regarding Monetary and Fiscal Policy

Skill: Definition

Refer to the information provided in Figure 15.1 below to answer the questions that follow.

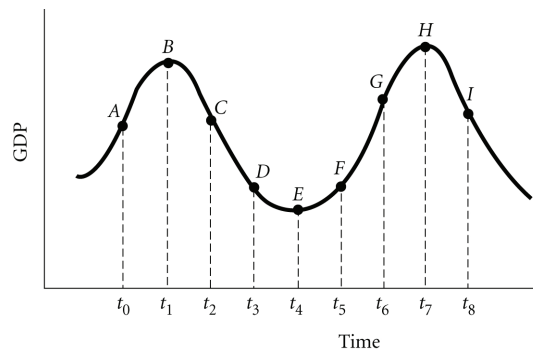


Figure 15.1

- 12) Refer to Figure 15.1. If the economy is actually at Point C but policy makers think that it is still at Point B, this is an example of
- A) economic policies ineffectiveness.
 - B) recognition lag.
 - C) implementation lag.
 - D) response lag.

Answer: B

Diff: 2

Topic: Time Lags Regarding Monetary and Fiscal Policy

Skill: Analytic

AACSB: Analytic Skills

13) Refer to Figure 15.1. Suppose it takes policy makers from time t_2 to time t_4 to take an action to stimulate the economy. This is an example of

- A) cyclical lag.
- B) recognition lag.
- C) implementation lag.
- D) response lag.

Answer: C

Diff: 2

Topic: Time Lags Regarding Monetary and Fiscal Policy

Skill: Analytic

AACSB: Analytic Skills

14) Refer to Figure 15.1. Suppose it takes policy makers from time t_2 to time t_3 to see that the economy has started contracting. This is an example of

- A) a recognition lag.
- B) an implementation lag.
- C) a response lag.
- D) a policy lag.

Answer: A

Diff: 2

Topic: Time Lags Regarding Monetary and Fiscal Policy

Skill: Analytic

AACSB: Analytic Skills

15) Refer to Figure 15.1. If policy makers decide on a policy at point t_3 but it does not affect the economy until period t_6 , then the policy choice is likely to be

- A) inappropriate.
- B) optimal.
- C) ineffective.
- D) none of the above

Answer: A

Diff: 2

Topic: Time Lags Regarding Monetary and Fiscal Policy

Skill: Analytic

AACSB: Analytic Skills

16) Refer to Figure 15.1. If policy makers decide on a policy at point t_3 but it does not affect the economy until period t_6 , then the policy choice is likely to be

- A) stabilizing.
- B) destabilizing.
- C) optimal.
- D) automatically stabilizing.

Answer: B

Diff: 2

Topic: Time Lags Regarding Monetary and Fiscal Policy

Skill: Analytic

AACSB: Analytic Skills

17) Refer to Figure 15.1. If policy makers take an action at time t_4 , the impact on the economy will not be at time t_4 because

- A) economic policies are ineffective.
- B) of the recognition lag.
- C) of the implementation lag.
- D) of the response lag.

Answer: D

Diff: 2

Topic: Time Lags Regarding Monetary and Fiscal Policy

Skill: Analytic

AACSB: Analytic Skills

- 18) Refer to Figure 15.1. If policy makers decide at time t_5 that the economy is expanding too fast, but the policy changes start affecting the economy at t_7 , then the policy will be
- A) inappropriate. B) well timed. C) ineffective. D) optimal.

Answer: A

Diff: 2

Topic: Time Lags Regarding Monetary and Fiscal Policy

Skill: Analytic

AACSB: Analytic Skills

- 19) Refer to Figure 15.1. If the condition of the economy at point E is realized by policy makers when the economy is at point G , policy is likely to be inappropriate due to
- A) crowding out. B) the recognition lag.
C) the implementation lag. D) the response lag.

Answer: B

Diff: 2

Topic: Time Lags Regarding Monetary and Fiscal Policy

Skill: Analytic

AACSB: Analytic Skills

- 20) In general, fiscal policy has a longer _____ lag than monetary policy but shorter _____ lag.
- A) recognition; response B) implementation; recognition
C) implementation; response D) response; implementation

Answer: C

Diff: 1

Topic: Time Lags Regarding Monetary and Fiscal Policy

Skill: Fact

- 21) In general, monetary policy has a longer _____ lag than fiscal policy but shorter _____ lag.
- A) recognition; response B) implementation; recognition
C) implementation; response D) response; implementation

Answer: D

Diff: 1

Topic: Time Lags Regarding Monetary and Fiscal Policy

Skill: Fact

- 22) Fiscal policy and monetary policy have a similar _____ time lag.
- A) implementation B) structural
C) recognition D) response

Answer: C

Diff: 1

Topic: Time Lags Regarding Monetary and Fiscal Policy

Skill: Fact

Refer to the information provided in Figure 15.2 below to answer the questions that follow.

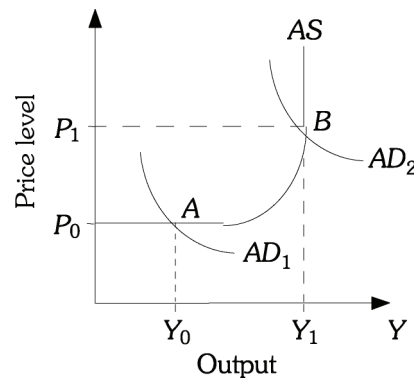


Figure 15.2

- 23) Refer to Figure 15.2. If the economy is currently at Point *B* and policy makers implement a policy which shifts the aggregate demand curve to *AD*₁, the time the economy needs to make the adjustment is known as the
- | | |
|------------------------|---------------------|
| A) implementation lag. | B) recognition lag. |
| C) response lag. | D) frictional lag. |

Answer: C

Diff: 2

Topic: Time Lags Regarding Monetary and Fiscal Policy

Skill: Conceptual

AACSB: Reflective Thinking

- 24) Refer to Figure 15.2. If economic policy causes aggregate demand curve shifts from *AD*₂ to *AD*₁, then
- | |
|---|
| A) output decreases to Y_0 and the price level decreases to P_0 . |
| B) output decreases to less than Y_1 . |
| C) the price level decreases lower than P_0 and output decreases to Y_0 . |
| D) none of the above |

Answer: A

Diff: 1

Topic: Time Lags Regarding Monetary and Fiscal Policy

Skill: Analytic

AACSB: Analytic Skills

- 25) Refer to Figure 15.2. If the economy is currently at Point *B* and policy makers implement a policy which decreases the aggregate demand curve to *AD*₁,
- | | |
|-------------------------------|----------------------------------|
| A) the price level will rise. | B) the price level will fall. |
| C) GDP will rise. | D) the inflation rate will rise. |

Answer: B

Diff: 1

Topic: Time Lags Regarding Monetary and Fiscal Policy

Skill: Analytic

AACSB: Analytic Skills

- 26) The FED responded to the _____ of 1991 with an expansionary monetary policy.
A) recession B) inflation C) stagflation D) boom

Answer: A

Diff: 2

Topic: Time Lags Regarding Monetary and Fiscal Policy

Skill: Fact

- 27) The implementation lag for fiscal policy tends to be much longer than for monetary policy because fiscal policy requires
A) changes in required reserves.
B) changes in open-market operations.
C) changes in congressional-approved spending and tax programs.
D) changes in exports and imports.

Answer: C

Diff: 2

Topic: Time Lags Regarding Monetary and Fiscal Policy

Skill: Conceptual

AACSB: Reflective Thinking

- 28) The _____ lag for monetary policy tends to be much shorter than for fiscal policy because only monetary policy requires rather immediate changes in open market operations.
A) recognition B) implementation
C) response D) reorganization

Answer: B

Diff: 2

Topic: Time Lags Regarding Monetary and Fiscal Policy

Skill: Conceptual

AACSB: Reflective Thinking

- 29) The implementation lag for monetary policy tends to be much shorter than for fiscal policy for all of the following reasons EXCEPT
A) fiscal policy changes requires both houses of Congress and the President to act.
B) monetary changes only require the Fed to act..
C) fiscal policy usually requires committee hearings in both houses of Congress.
D) fiscal policy changes only require the Fed to act.

Answer: D

Diff: 2

Topic: Time Lags Regarding Monetary and Fiscal Policy

Skill: Conceptual

AACSB: Reflective Thinking

- 30) During periods of slow growth, the Federal Reserve will likely
A) increase the money supply to increase interest rates.
B) increase the money supply to decrease interest rates.
C) decrease the money supply to increase interest rates.
D) decrease the money supply to decrease interest rates.

Answer: B

Diff: 2

Topic: Time Lags Regarding Monetary and Fiscal Policy

Skill: Conceptual

AACSB: Reflective Thinking

- 31) During periods of high growth and inflationary pressures, the Federal Reserve will likely
- A) decrease the money supply to increase interest rates.
 - B) increase the money supply to decrease interest rates.
 - C) increase the money supply to increase interest rates.
 - D) decrease the money supply to decrease interest rates.

Answer: A

Diff: 2

Topic: Time Lags Regarding Monetary and Fiscal Policy

Skill: Conceptual

AACSB: Reflective Thinking

- 32) The critics of stabilization policy such as Milton Friedman argue that monetary policy is comparable to "the Fool in the Shower." This means that
- A) policy initiatives are perfectly timed.
 - B) policy initiatives are perfect in maintaining the economy.
 - C) policy initiatives are often destabilizing because of time lags.
 - D) policy initiatives always impact at the proper time in stabilizing the economy.

Answer: C

Diff: 2

Topic: Time Lags Regarding Monetary and Fiscal Policy

Skill: Conceptual

AACSB: Reflective Thinking

2 True/False

- 1) The time it takes policy makers to implement an economic policy to stimulate the economy is known as the reorganization lag.

Answer: FALSE

Diff: 1

Topic: Time Lags Regarding Monetary and Fiscal Policy

Skill: Definition

- 2) Monetary policy has an equal implementation lag as fiscal policy.

Answer: FALSE

Diff: 1

Topic: Time Lags Regarding Monetary and Fiscal Policy

Skill: Conceptual

AACSB: Reflective Thinking

- 3) The time it takes a change in economic policy to induce people and firms to change their behavior is the implementation lag.

Answer: FALSE

Diff: 1

Topic: Time Lags Regarding Monetary and Fiscal Policy

Skill: Definition

- 4) The time it takes policy makers to see that the economy is going into a recession or an inflation is known as the recognition lag.

Answer: TRUE

Diff: 1

Topic: Time Lags Regarding Monetary and Fiscal Policy

Skill: Definition

- 5) The implementation lag of monetary policy is longer than that of fiscal policy because Congress can act more quickly than the FED.

Answer: FALSE

Diff: 1

Topic: Time Lags Regarding Monetary and Fiscal Policy

Skill: Conceptual

AACSB: Reflective Thinking

- 6) The multiplier means that the response to fiscal policy is not completed immediately.

Answer: TRUE

Diff: 2

Topic: Time Lags Regarding Monetary and Fiscal Policy

Skill: Conceptual

AACSB: Reflective Thinking

- 7) The lags of monetary and fiscal policy imply that government stabilization policy is likely to be optimal.

Answer: FALSE

Diff: 1

Topic: Time Lags Regarding Monetary and Fiscal Policy

Skill: Conceptual

AACSB: Reflective Thinking

15.2 Fiscal Policy: Deficit Targeting

1 Multiple Choice

- 1) The legislative intent of the Gramm–Rudman–Hollings Act was to
- A) reduce the federal deficit by a set amount each year.
 - B) increase federal interstate highway expenditures.
 - C) increase defense-related expenditures.
 - D) decrease personal and corporate taxes.

Answer: A

Diff: 1

Topic: Fiscal Policy: Deficit Targeting

Skill: Fact

- 2) The _____ sought to reduce the federal deficit by \$36 billion each year between 1987 and 1991.
- A) Sherman Antitrust Act
 - B) McCain–Feingold bill
 - C) Cellar–Kefauver Act
 - D) Gramm–Rudman–Hollings Act

Answer: D

Diff: 1

Topic: Fiscal Policy: Deficit Targeting

Skill: Fact

- 3) Under the original Gramm–Rudman–Hollings Act, a congressionally enacted budget deficit that was larger than the targeted amount would
- A) result in automatic tax cuts.
 - B) result in automatic spending increases.
 - C) result in both automatic tax cuts and spending increases.
 - D) result in automatic spending cuts.

Answer: D

Diff: 1

Topic: Fiscal Policy: Deficit Targeting

Skill: Fact

- 4) The _____ declared that part of the Gramm–Rudman–Hollings Act was illegal and that the mandated automatic spending cuts had to be approved by the Congress.
- A) U.S. Senate
 - B) U.S. Supreme Court
 - C) Federal Reserve Board
 - D) president

Answer: B

Diff: 1

Topic: Fiscal Policy: Deficit Targeting

Skill: Fact

- 5) The _____ of 1993 sought to reduce the federal deficit by \$504.8 billion by 1998.
- A) Gramm–Rudman–Hollings Act
 - B) Bush–Cheney Act
 - C) Fiscal Forecast bill
 - D) Omnibus Budget Reconciliation Act

Answer: D

Diff: 1

Topic: Fiscal Policy: Deficit Targeting

Skill: Fact

- 6) The deficit reduction projections contained in the 1993 Omnibus Budget Reconciliation Act were to be achieved through
- A) decreases in government spending of \$504.8 billion.
 - B) increases in taxes of \$504.8 billion.
 - C) federal spending cuts of \$254.7 billion and tax increases of \$250.1 billion.
 - D) increases in exports of \$504.8 billion.

Answer: C

Diff: 1

Topic: Fiscal Policy: Deficit Targeting

Skill: Fact

- 7) The recommended tax increases proposed under the Omnibus Budget Reconciliation Act of 1993 were to be mostly levied on
- A) high–income taxpayers.
 - B) middle–income taxpayers.
 - C) all income level taxpayers.
 - D) low–income taxpayers.

Answer: A

Diff: 1

Topic: Fiscal Policy: Deficit Targeting

Skill: Fact

- 8) A reason why the deficit increases during recessions is
- A) higher welfare payments.
 - B) higher tax revenues.
 - C) lower tax rates.
 - D) both A and C are correct

Answer: A

Diff: 1

Topic: Fiscal Policy: Deficit Targeting

Skill: Conceptual

AACSB: Reflective Thinking

- 9) The reason why the deficit decreases during economic expansions is
- A) higher welfare payments.
 - B) higher tax revenues.
 - C) lower welfare payments.
 - D) both B and C are correct

Answer: D

Diff: 1

Topic: Fiscal Policy: Deficit Targeting

Skill: Conceptual

AACSB: Reflective Thinking

- 10) The deficit response index (DRI) measures the amount by which the deficit changes with a
- A) change in spending.
 - B) one-dollar change in GDP.
 - C) change in taxes.
 - D) change in foreign investment.

Answer: B

Diff: 1

Topic: Fiscal Policy: Deficit Targeting

Skill: Definition

- 11) If the deficit response index (DRI) is -0.15 , it means that a \$1 billion increase in GDP will decrease the deficit by
- A) \$.15 billion.
 - B) \$.67 billion.
 - C) \$1.5 billion.
 - D) \$6.7 billion.

Answer: A

Diff: 2

Topic: Fiscal Policy: Deficit Targeting

Skill: Analytic

AACSB: Analytic Skills

- 12) Assume that government spending decreased by \$50 billion to meet a deficit reduction target. If the expenditure multiplier is 5, then GDP will decrease by \$250 billion. If the deficit response index (DRI) is -0.4 , this decrease in GDP will increase the deficit by
- A) \$20 billion.
 - B) \$25 billion.
 - C) \$40 billion.
 - D) \$100 billion.

Answer: D

Diff: 2

Topic: Fiscal Policy: Deficit Targeting

Skill: Analytic

AACSB: Analytic Skills

Refer to the information provided in Scenario 15.1 below to answer the questions that follow.

SCENARIO 15.1: Consider the following hypothetical economy. The deficit response index (DRI) is -0.1 , the economy is producing potential GDP at \$1 trillion, and the MPC is 0.5.

- 13) Refer to Scenario 15.1. The spending multiplier in this economy is
A) 2. B) 3. C) 4. D) 5.

Answer: A

Diff: 2

Topic: Fiscal Policy: Deficit Targeting

Skill: Analytic

AACSB: Analytic Skills

- 14) Refer to Scenario 15.1. If GDP increases to \$1.2 trillion, the deficit
A) decreases by \$80 billion. B) decreases by \$20 billion.
C) increases by \$20 trillion. D) increases by \$80 billion.

Answer: B

Diff: 3

Topic: Fiscal Policy: Deficit Targeting

Skill: Analytic

AACSB: Analytic Skills

- 15) Refer to Scenario 15.1. If GDP decreases to \$900 billion, the deficit
A) decreases by \$90 billion. B) increases by \$10 billion.
C) decreases by \$100 billion. D) increases by \$50 billion.

Answer: B

Diff: 3

Topic: Fiscal Policy: Deficit Targeting

Skill: Analytic

AACSB: Analytic Skills

- 16) Refer to Scenario 15.1. Suppose the budget is balanced and the government increases spending by \$25 billion. The budget will be in
A) deficit by \$20 billion. B) surplus by \$5 billion.
C) surplus by \$30 billion. D) deficit by \$25 billion.

Answer: A

Diff: 3

Topic: Fiscal Policy: Deficit Targeting

Skill: Analytic

AACSB: Analytic Skills

- 17) Refer to Scenario 15.1. Suppose the budget is balanced and the government decreases spending by \$10 billion. The budget will be in
A) surplus by \$2 billion. B) surplus by \$20 billion.
C) deficit by \$4 billion. D) deficit by \$8 billion.

Answer: D

Diff: 3

Topic: Fiscal Policy: Deficit Targeting

Skill: Analytic

AACSB: Analytic Skills

- 18) It is likely that, to decrease the deficit by \$75 billion, the government must cut spending by
- A) \$75 billion.
 - B) less \$75 billion.
 - C) more \$75 billion.
 - D) \$7.5 billion.

Answer: C

Diff: 2

Topic: Fiscal Policy: Deficit Targeting

Skill: Analytic

AACSB: Analytic Skills

- 19) It is likely that, to decrease the deficit by \$75 billion, the government must increase taxes by
- A) more than \$75 billion.
 - B) less than \$75 billion.
 - C) \$75 billion.
 - D) the same amount as government spending.

Answer: A

Diff: 2

Topic: Fiscal Policy: Deficit Targeting

Skill: Conceptual

AACSB: Reflective Thinking

- 20) Automatic destabilizing policies would tend to
- A) negate inflation and stimulate expansion.
 - B) promote the nation's exports.
 - C) reinforce inflationary pressures and deepen recessionary conditions.
 - D) decrease the nation's imports.

Answer: C

Diff: 1

Topic: Fiscal Policy: Deficit Targeting

Skill: Conceptual

AACSB: Reflective Thinking

- 21) The enacted Gramm–Rudman–Hollings Act would tend to have an
- A) automatic stabilizing impact upon the economy.
 - B) automatic destabilizing impact upon the economy.
 - C) overall neutral impact upon the economy.
 - D) overall positive impact upon the economy during any stage of a business cycle.

Answer: B

Diff: 1

Topic: Fiscal Policy: Deficit Targeting

Skill: Conceptual

AACSB: Reflective Thinking

- 22) A Constitutional amendment requiring that the federal government budget be balanced annually would have
- A) an automatic stabilizing impact upon the economy.
 - B) an automatic destabilizing impact upon the economy.
 - C) overall neutral impact upon the economy.
 - D) overall positive impact upon the economy during any stage of a business cycle.

Answer: B

Diff: 1

Topic: Fiscal Policy: Deficit Targeting

Skill: Conceptual

AACSB: Reflective Thinking

- 23) While targeting the deficit, which of the following is likely to occur after a positive aggregate demand shock?
- A) $AD \uparrow \Rightarrow Y \downarrow \Rightarrow T \downarrow \Rightarrow \text{deficit} \uparrow \Rightarrow G \downarrow \Rightarrow AD \downarrow \Rightarrow Y \downarrow$
 - B) $AD \uparrow \Rightarrow Y \downarrow \Rightarrow T \downarrow \Rightarrow \text{deficit} \downarrow \Rightarrow G \downarrow \Rightarrow AD \downarrow \Rightarrow Y \downarrow$
 - C) $AD \downarrow \Rightarrow Y \downarrow \Rightarrow T \downarrow \Rightarrow \text{deficit} \uparrow \Rightarrow G \downarrow \Rightarrow AD \downarrow \Rightarrow Y \uparrow$
 - D) $AD \uparrow \Rightarrow Y \uparrow \Rightarrow T \uparrow \Rightarrow \text{deficit} \downarrow \Rightarrow G \uparrow \Rightarrow AD \uparrow \Rightarrow Y \uparrow$

Answer: D

Diff: 3

Topic: Fiscal Policy: Deficit Targeting

Skill: Analytic

AACSB: Analytic Skills

- 24) While targeting the deficit, which of the following is likely to occur after a negative aggregate demand shock?
- A) $AD \downarrow \Rightarrow Y \downarrow \Rightarrow T \downarrow \Rightarrow \text{deficit} \uparrow \Rightarrow G \downarrow \Rightarrow AD \downarrow \Rightarrow Y \downarrow$
 - B) $AD \downarrow \Rightarrow Y \downarrow \Rightarrow T \downarrow \Rightarrow \text{deficit} \uparrow \Rightarrow G \uparrow \Rightarrow AD \uparrow \Rightarrow Y \uparrow$
 - C) $AD \downarrow \Rightarrow Y \downarrow \Rightarrow T \downarrow \Rightarrow \text{deficit} \uparrow \Rightarrow G \downarrow \Rightarrow AD \uparrow \Rightarrow Y \uparrow$
 - D) $AD \downarrow \Rightarrow Y \downarrow \Rightarrow T \uparrow \Rightarrow \text{deficit} \uparrow \Rightarrow G \uparrow \Rightarrow AD \downarrow \Rightarrow Y \downarrow$

Answer: A

Diff: 3

Topic: Fiscal Policy: Deficit Targeting

Skill: Analytic

AACSB: Analytic Skills

- 25) Without targeting the deficit, which of the following is likely to occur after a negative aggregate demand shock?
- A) $Y \downarrow \Rightarrow T \downarrow \Rightarrow \text{deficit} \uparrow \Rightarrow G \downarrow \Rightarrow AD \uparrow \Rightarrow Y \uparrow$
 - B) $Y \downarrow \Rightarrow T \downarrow \Rightarrow \text{deficit} \uparrow$
 - C) $Y \downarrow \Rightarrow T \downarrow \Rightarrow \text{deficit} \uparrow \Rightarrow G \downarrow \Rightarrow AD \downarrow \Rightarrow Y \downarrow$
 - D) $Y \downarrow \Rightarrow T \downarrow \Rightarrow \text{deficit} \downarrow$

Answer: B

Diff: 2

Topic: Fiscal Policy: Deficit Targeting

Skill: Analytic

AACSB: Analytic Skills

- 26) The adverse impact of a negative aggregate demand shock is reduced when the government does not target the deficit because
- A) targeting the deficit causes further negative aggregate demand shocks.
 - B) negative aggregate demand shocks do not affect the deficit.
 - C) the economy is always producing potential output.
 - D) not targeting the deficit causes positive aggregate demand shocks.

Answer: A

Diff: 2

Topic: Fiscal Policy: Deficit Targeting

Skill: Analytic

AACSB: Analytic Skills

- 27) Stagflation is an economic condition characterized by
- A) high inflation and low unemployment.
 - B) high inflation and high unemployment.
 - C) low inflation and low unemployment.
 - D) low inflation and high unemployment.

Answer: B

Diff: 1

Topic: Fiscal Policy: Deficit Targeting

Skill: Definition

- 28) The Federal Reserve is likely to _____ the money supply during periods of _____.
- A) increase; low inflation.
 - B) decrease; moderate expansion with low inflation.
 - C) decrease; low output and low inflation.
 - D) increase; excessive expansion and low inflation.

Answer: A

Diff: 1

Topic: Fiscal Policy: Deficit Targeting

Skill: Conceptual

AACSB: Reflective Thinking

- 29) The Federal Reserve is likely to increase the money supply during
- A) a period of excess capacity.
 - B) a period of high inflation.
 - C) a period of high economic growth.
 - D) a period of excess expansion.

Answer: A

Diff: 1

Topic: Fiscal Policy: Deficit Targeting

Skill: Conceptual

AACSB: Reflective Thinking

- 30) A measure of how the government deficit changes in response to a change in the nation's GDP is called
- A) a deficit response index.
 - B) a multiplier effect.
 - C) a deficit-reduction index.
 - D) a policy lag.

Answer: A

Diff: 1

Topic: Fiscal Policy: Deficit Targeting

Skill: Definition

- 31) If the deficit response index (DRI) equals -0.5 and the government wants to reduce the deficit by \$100 million, GDP needs to
- A) increase by \$500 million.
 - B) increase by \$200 million.
 - C) decreases by \$50 million.
 - D) increase by \$150 million.

Answer: B

Diff: 1

Topic: Fiscal Policy: Deficit Targeting

Skill: Analytic

AACSB: Analytic Skills

- 32) If the deficit response index (DRI) equals -0.2 and the government wants to reduce the deficit by \$30 billion, GDP needs to
- A) increase by \$150 billion.
 - B) increase by \$60 billion.
 - C) increase by \$600 billion.
 - D) decrease by \$15 billion.

Answer: A

Diff: 1

Topic: Fiscal Policy: Deficit Targeting

Skill: Analytic

AACSB: Analytic Skills

- 33) An increase in consumer or investment spending is called a
- A) negative demand shock.
 - B) automatic stabilizer.
 - C) nonautomatic stabilizer.
 - D) positive demand shock.

Answer: D

Diff: 1

Topic: Fiscal Policy: Deficit Targeting

Skill: Conceptual

AACSB: Reflective Thinking

- 34) The economic impact of _____ during expansionary periods is to moderate growth.
- A) implementation lags
 - B) positive demand shocks
 - C) automatic stabilizers
 - D) tax cuts

Answer: C

Diff: 1

Topic: Fiscal Policy: Deficit Targeting

Skill: Conceptual

AACSB: Reflective Thinking

- 35) The economic impact of automatic stabilizers during recessionary periods is to
- A) have no impact on the recession.
 - B) moderate the recession.
 - C) make the recession worse.
 - D) increase taxes.

Answer: B

Diff: 1

Topic: Fiscal Policy: Deficit Targeting

Skill: Conceptual

AACSB: Reflective Thinking

- 36) The economic impact of automatic stabilizers during inflationary periods is to
- A) accelerate inflationary pressures.
 - B) increase exports.
 - C) have no impact on inflation.
 - D) moderate inflationary pressures.

Answer: D

Diff: 1

Topic: Fiscal Policy: Deficit Targeting

Skill: Conceptual

AACSB: Reflective Thinking

- 37) The economic impact of _____ during recessionary periods is to decrease taxes.
- A) negative demand shocks
 - B) automatic stabilizers
 - C) recognition lags
 - D) increasing the reserve rate

Answer: B

Diff: 1

Topic: Fiscal Policy: Deficit Targeting

Skill: Conceptual

AACSB: Reflective Thinking

- 38) The economic impact of automatic stabilizers during recessionary periods is to
- A) increase unemployment.
 - B) increase taxes.
 - C) increase government spending.
 - D) decrease money growth.

Answer: C

Diff: 1

Topic: Fiscal Policy: Deficit Targeting

Skill: Conceptual

AACSB: Reflective Thinking

- 39) Government spending rising during a recession is an example of
- A) an automatic destabilizer.
 - B) an automatic stabilizer.
 - C) discretionary economic policy.
 - D) policy lags.

Answer: B

Diff: 1

Topic: Fiscal Policy: Deficit Targeting

Skill: Conceptual

AACSB: Reflective Thinking

- 40) An example of automatic stabilizers is
- A) government spending rising in a recession.
 - B) taxes rising in a recession.
 - C) taxes falling in an expansion.
 - D) all of the above

Answer: A

Diff: 1

Topic: Fiscal Policy: Deficit Targeting

Skill: Conceptual

AACSB: Reflective Thinking

- 41) An example of automatic stabilizers is
- A) government spending rising during an expansion.
 - B) government spending falling during a recession.
 - C) taxes rising in an expansion.
 - D) deficit targeting.

Answer: C

Diff: 1

Topic: Fiscal Policy: Deficit Targeting

Skill: Conceptual

AACSB: Reflective Thinking

2 True/False

- 1) The budget deficit decreases during economic booms and increases during recessions.

Answer: TRUE

Diff: 1

Topic: Fiscal Policy: Deficit Targeting

Skill: Conceptual

AACSB: Reflective Thinking

- 2) The nation's total federal debt represents the total of all accumulated deficits minus surpluses over time.

Answer: TRUE

Diff: 1

Topic: Fiscal Policy: Deficit Targeting

Skill: Definition

- 3) The legislative intent of the Gramm–Rudman–Hollings Act was to increase the nation's spending on public transfers.

Answer: FALSE

Diff: 1

Topic: Fiscal Policy: Deficit Targeting

Skill: Fact

- 4) The Omnibus Budget Reconciliation Act of 1993 sought to sharply increase government spending for health care reform and reduce taxes.

Answer: FALSE

Diff: 1

Topic: Fiscal Policy: Deficit Targeting

Skill: Fact

- 5) The deficit response index (DRI) measures the change in the budget deficit in response to changes in the nation's GDP.

Answer: TRUE

Diff: 1

Topic: Fiscal Policy: Deficit Targeting

Skill: Definition

6) A negative demand shock increases consumer and investment spending and tends to increase the budget deficit.

Answer: FALSE

Diff: 2

Topic: Fiscal Policy: Deficit Targeting

Skill: Conceptual

AACSB: Reflective Thinking

7) The budget deficit decreases during economic booms and increases during recessions.

Answer: TRUE

Diff: 1

Topic: Fiscal Policy: Deficit Targeting

Skill: Conceptual

AACSB: Reflective Thinking

8) Discretionary government policy ensures the stabilization of the economy.

Answer: FALSE

Diff: 2

Topic: Fiscal Policy: Deficit Targeting

Skill: Conceptual

AACSB: Reflective Thinking

9) If the deficit response index is $-.25$ and the government spending multiplier is 4, then a \$20 billion reduction in government spending would not change the government budget deficit.

Answer: TRUE

Diff: 2

Topic: Fiscal Policy: Deficit Targeting

Skill: Analytic

AACSB: Analytic Skills

15.3 The Stock Market and the Economy

1 Multiple Choice

1) A firm issues bonds to

A) borrow money.

C) lend money.

B) earn a return.

D) influence monetary policy.

Answer: A

Diff: 1

Topic: The Stock Market and the Economy

Skill: Conceptual

AACSB: Reflective Thinking

2) A firm might issue stock to

A) finance a capital project.

C) to increase its debt.

B) decrease the number of owners.

D) employ more people.

Answer: A

Diff: 1

Topic: The Stock Market and the Economy

Skill: Conceptual

AACSB: Reflective Thinking

- 3) A bond is
- A) a share of ownership in a company.
 - B) a document that formally promises to repay a loan.
 - C) a promise to pay a dividend.
 - D) a non-contingent payment.

Answer: B

Diff: 1

Topic: *The Stock Market and the Economy*

Skill: *Definition*

- 4) If interest rates rise, then
- A) the value of bonds fall.
 - B) the value of bonds rise.
 - C) the interest payment bonds rises.
 - D) the interest payment on bonds falls.

Answer: A

Diff: 1

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 5) If interest rates fall, then
- A) the price of fixed-income securities fall.
 - B) the price of fixed-income securities rise.
 - C) the coupon on bonds fall.
 - D) the coupon on bonds rise.

Answer: B

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 6) Interest rates and bond prices are
- A) positively related.
 - B) negatively related.
 - C) unrelated.
 - D) fixed.

Answer: B

Diff: 1

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 7) The face value of a bond is
- A) what the issuer agrees to pay.
 - B) the amount the issuer borrows.
 - C) the interest payment on the bond.
 - D) the amount of the dividend at maturity.

Answer: B

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Definition*

- 8) Firms can finance capital spending by doing all of the following EXCEPT
- A) selling stock in the company.
 - B) issuing bonds.
 - C) borrowing from a bank.
 - D) paying dividends.

Answer: D

Diff: 1

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 9) The maturity date of a bond is
- A) the date the bond holder has held the bond long enough to get interest.
 - B) the date the borrower promises to pay the face value to the lender.
 - C) the date the first interest payment is due.
 - D) the end of each period.

Answer: B

Diff: 1

Topic: *The Stock Market and the Economy*

Skill: *Definition*

- 10) When interest rates rise,
- A) bond holders suffer a loss.
 - B) bond issuers receive a gain.
 - C) bond brokers receive a commission.
 - D) shareholders gain.

Answer: A

Diff: 1

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 11) To finance a capital expenditure a firm can,
- A) buy bonds.
 - B) engage in monetary policy.
 - C) sell stock in the company.
 - D) all of the above

Answer: C

Diff: 1

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 12) Among the factors that determine the price of a share of stock in a firm is
- A) expected dividends.
 - B) the number of workers the firm has.
 - C) the number of years the firm has existed.
 - D) the time to maturity of a bond.

Answer: A

Diff: 1

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 13) The coupon rate on a bond is
- A) the rate of return calculated as the coupon divided by the face value.
 - B) the rate of return calculated as the coupon divided by the market value.
 - C) the rate of return calculated as the coupon rate divided by the maturity date.
 - D) the rate of return calculated as the coupon rate divided by expect future earnings.

Answer: A

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Definition*

- 14) A bond is also called a fixed-income security because its
- A) face value does not change.
 - B) its market value does not change.
 - C) coupon payment does not change.
 - D) it is discounted.

Answer: C

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 15) When a bond matures, the issuer must pay the bondholder
- A) the last coupon payment.
 - B) the last dividend.
 - C) the face value.
 - D) the face value plus the last coupon payment.

Answer: D

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 16) Each period the bond issuer pays the bond holder the
- A) coupon.
 - B) face value.
 - C) market value.
 - D) dividend.

Answer: A

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Definition*

- 17) If the risk associated with a company goes up, you would expect the price of its stock to
- A) rise.
 - B) fall.
 - C) be unaffected.
 - D) fall to zero.

Answer: B

Diff: 1

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

18) If the expected future earnings of a company goes up, you would expect the price of its stock to

- A) rise. B) fall. C) be unaffected. D) fall to zero.

Answer: A

Diff: 1

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

19) If the interest rate falls, you would expect the price of any stock to

- A) rise. B) fall. C) be unaffected. D) fall to zero.

Answer: A

Diff: 1

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

20) You would expect the price of a share of stock to rise if

- A) the expected dividend of the stock rose. B) the economy went into recession.
C) the price level was declining. D) interest rates rise.

Answer: A

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

21) One would expect the price of a share of stock to fall if

- A) the interest rate rises.
B) expected dividends paid on the stock rise.
C) the risk of the business falls.
D) the economy expands.

Answer: A

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

22) Dividends

- A) must be paid annually.
B) are a return on the money risked on a share of stock.
C) are set by the Securities and Exchange commission.
D) are guaranteed.

Answer: B

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Definition*

- 23) A capital gain is
- A) when you can sell an asset for more than you paid for it.
 - B) when you increase the plant and equipment you own.
 - C) when your dividends rise.
 - D) when your coupon payment rises.

Answer: A

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 24) A share of stock
- A) is a fractional ownership of the firm.
 - B) gives the owner with other owners the right to pick the management of the company.
 - C) does not promise a fixed annual payment.
 - D) all of the above

Answer: D

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 25) The bond issuer is
- A) the firm who is borrowing the money.
 - B) the person who is lending the money.
 - C) the institution that insures the bond.
 - D) the institution that brokers the sale of the bonds.

Answer: A

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Definition*

- 26) The bondholder is
- A) the person who loaned the money to the bond issuer.
 - B) the person who borrowed the money.
 - C) the institution that brokers the sale of the bond from the lender to the borrower.
 - D) the institution that insures bonds.

Answer: A

Diff: 1

Topic: *The Stock Market and the Economy*

Skill: *Definition*

- 27) Which of the following statements is FALSE
- A) Interest rates and bond prices are inversely related.
 - B) The face value of a bond must be paid back at its maturity date.
 - C) The coupon rate of a bond changes with the interest rate.
 - D) The coupon is paid to the bondholder each period.

Answer: C

Diff: 1

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

28) If you buy a \$2,000 one year bond with a \$100 coupon and the interest rate goes up immediately, then you would expect to

- A) receive a capital gain.
- B) suffer a capital loss.
- C) receive a capital flow.
- D) suffer a capital outflow.

Answer: B

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

29) If a \$5,000 bond has a 5% coupon rate, then the coupon payment each period is

- A) \$50.
- B) \$250.
- C) \$1,000.
- D) \$5,000.

Answer: B

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Analytic*

AACSB: *Analytic Skills*

30) If you buy a \$5,000 one year bond with a \$200 coupon and the interest rate goes down immediately, then you would expect to

- A) receive a capital gain.
- B) suffer a capital loss.
- C) receive a capital flow.
- D) suffer a capital outflow.

Answer: A

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

31) If a \$1,000 bond has a 5% coupon rate, then the coupon payment each period is

- A) \$5.
- B) \$50.
- C) \$5000.
- D) \$1,000.

Answer: B

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Analytic*

AACSB: *Analytic Skills*

32) The Standard and Poor's 500 index is

- A) an index of a basket of consumer good purchased by the typical consumer.
- B) an index based on the stock prices of 30 actively traded large companies.
- C) an index based on the 500 largest firms traded in the three biggest stock markets.
- D) an index of 5,000 companies traded on the national association of securities dealers automatic quotation system.

Answer: C

Diff: 1

Topic: *The Stock Market and the Economy*

Skill: *Fact*

- 33) The Dow–Jones Industrial Average index is all of the following EXCEPT
- A) an index based on 30 actively traded large companies on the New York Stock Exchange.
 - B) the most widely followed U.S. stock index.
 - C) the oldest U.S. stock index.
 - D) representative of the U.S. economy.

Answer: D

Diff: 1

Topic: *The Stock Market and the Economy*

Skill: *Fact*

- 34) If you think the price of a share of stock reflects its true value, but you buy it anyway because you expect to be able to sell it later at a higher price, then you are participating in
- A) a stock market price bubble.
 - B) insider trading.
 - C) hedging.
 - D) fraud.

Answer: A

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 35) If a share of stock is correctly valued today, a bubble in the stock market is when you purchase a stock because
- A) you expect future dividends to rise.
 - B) you expect interest rates to fall.
 - C) you expect other people will be willing to pay more for the stock in the future.
 - D) you expect interest rates to rise.

Answer: C

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 36) The right to name the board of directors of a corporation belongs to its
- A) employees.
 - B) stock holders.
 - C) bond holders.
 - D) all of the above

Answer: B

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 37) The owners of a company are it's
- A) bond holders.
 - B) employees.
 - C) stockholders.
 - D) A and C

Answer: C

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Definition*

38) The general trend in the S&P 500 stock index since 1948 has been

- A) flat.
- B) increasing.
- C) decreasing
- D) there has been no trend but it has been very volatile.

Answer: B

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Fact*

39) From 1995 to 2000 the stock market as measured by the S&P 500 index

- A) bust a bubble.
- B) had a record boom.
- C) declined in real terms.
- D) was flat.

Answer: B

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Fact*

40) Which of the following chances has the biggest expected return

- A) a 50% chance of winning \$1,600 and a 50% chance of winning \$0.
- B) a 100% chance of getting \$800.
- C) a 50% chance of winning \$1,600, 25% chance of winning \$3,200 and a 25% chance of losing \$3,200.
- D) All of the above have the same expected return.

Answer: D

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Analytic*

AACSB: *Analytic Skills*

41) Which of the following chances has the biggest expected return

- A) a 60% chance of winning \$2,400 and a 40% chance of winning \$0.
- B) a 100% chance of getting \$1,200.
- C) a 50% chance of winning \$1,200, 20% chance of winning \$2,400 and a 30% chance of losing \$2,400.
- D) All of the above have the same expected return.

Answer: A

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 42) Which of the following chances has the biggest expected return
- A) a 40% chance of winning \$200 and a 60% chance of winning \$0.
 - B) a 100% chance of getting \$100.
 - C) a 50% chance of winning \$200, 30% chance of winning \$400 and a 20% chance of losing \$400.
 - D) All of the above have the same expected return.

Answer: C

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 43) A person who strongly wishes to avoid risk would pick which of the following choices?
- A) a 50% chance of winning \$750 or a 50% chance of winning \$0.
 - B) a 100% of getting \$375.
 - C) a 50% chance of getting \$750, 25% chance of getting \$1,500 and a 25% chance of losing \$1,500.
 - D) All of the above are equal to a person who wishes to avoid risk.

Answer: B

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 44) If interest rates are positive, which of the following has the highest current value
- A) \$350 a year from now.
 - B) \$350 now.
 - C) \$350 two years from now.
 - D) All of the above have the same current value.

Answer: B

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 45) If interest rates are positive, one dollar to day is worth
- A) more than a dollar a year from now.
 - B) less than a dollar a year from now.
 - C) the same as a dollar a year from now.
 - D) nothing.

Answer: A

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 46) A boom in the stock market affects the economy because
- A) wealth of households grow as the stock market booms.
 - B) brokers make a lot of money.
 - C) the FED feels it can increase the money supply without worry.
 - D) the stock market boom takes pressure off social security.

Answer: A

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 47) A boom in the stock market affects the economy because
- A) firms invest more as demand grows.
 - B) consumers consume more as stock prices increase.
 - C) wealth of consumers grows as stock prices increase.
 - D) all of the above

Answer: D

Diff: 1

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 48) A boom in the stock market affects the economy because
- A) firms invest more as demand grows.
 - B) consumers consume less with their money tied up in assets.
 - C) the stock market causes the money supply to rise.
 - D) interest rates fall.

Answer: A

Diff: 1

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 49) The boom in the economy in the late 1990s was fueled by
- A) the Clinton federal tax increase.
 - B) the boom in the stock market.
 - C) reductions in government spending.
 - D) falling prices.

Answer: B

Diff: 1

Topic: *The Stock Market and the Economy*

Skill: *Fact*

- 50) The saving rate is lower during a stock market boom because
- A) people are unsure about the economy.
 - B) wealth is increasing by stocks rising, so people feel less of a need to save.
 - C) people can not save as much when they are buying stocks.
 - D) dividends fall.

Answer: B

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 51) The P/E of a stock is
- A) its price divided by its dividend.
 - B) its price divided by its retained earnings.
 - C) its price divided by its risk.
 - D) its price divide by it most recently reported earnings expressed annually.

Answer: D

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Definition*

- 52) If you owned a bond and interest rates fell, you would get
- A) a capital gain.
 - B) a capital loss.
 - C) a higher coupon payment.
 - D) a lower coupon payment.

Answer: A

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 53) If you own a share of stock in a company and the risk associated with its business rises you would expect
- A) a capital gain.
 - B) a capital loss.
 - C) a higher dividend.
 - D) a bubble.

Answer: B

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 54) The value of a \$1,000 payment is highest if you receive that payment
- A) in one year.
 - B) in two years.
 - C) in three years.
 - D) in four years.

Answer: A

Diff: 1

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 55) Rising stock prices increase investment because
- A) the rising prices increase firm profits and make investment out of retained earnings easier.
 - B) firms can raise more money per share of stock sold.
 - C) rising stock prices guarantee an increased level of retained earnings.
 - D) interest rates are lower.

Answer: B

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 56) A \$1.00 change in the value of stocks changes consumption and investment by about
- A) \$1.10. B) \$1.00. C) \$.10. D) \$.04.

Answer: D

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Fact*

- 57) The economic expansion in the second half of the 1990s was
- A) held back by the stock market boom.
 B) fueled by the stock market boom.
 C) was unrelated to the stock market boom.
 D) delayed by the stock market boom.

Answer: B

Diff: 1

Topic: *The Stock Market and the Economy*

Skill: *Fact*

- 58) The stock market boom between 1995 and 2000 caused the economy to
- A) boom. B) go into recession.
 C) go into depression. D) suffer a hyper-inflation.

Answer: A

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Fact*

- 59) When there is a stock market crash
- A) wealth and consumption rise. B) wealth rises and consumption falls.
 C) wealth falls and consumption rises. D) wealth and consumption fall.

Answer: D

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 60) When there is a stock market boom
- A) wealth and investment rise. B) wealth rises and investment falls.
 C) wealth falls and investment rises. D) wealth and investment fall.

Answer: A

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 61) When there is a stock market crash
- A) consumption and investment rise.
 - B) consumption rises and investment falls.
 - C) consumption falls and investment rises.
 - D) consumption and investment fall.

Answer: D

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 62) When there is a run up in stock prices
- A) saving increases.
 - B) investment increases.
 - C) inflation increases.
 - D) interest rates decrease.

Answer: B

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 63) If the stock market crashes, then the economy must
- A) boom.
 - B) go into depression.
 - C) go into a recession.
 - D) cannot be determined

Answer: D

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 64) A stock market boom decreases the Federal budget deficit or increases the Federal budget surplus because
- A) a stock market boom increases uncertainty.
 - B) a stock market boom increases federal spending on supervision of the financial markets.
 - C) a stock market boom increases federal tax receipts.
 - D) interest rates are lower.

Answer: C

Diff: 1

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 65) A stock market boom reduces saving because
- A) it reduces consumer wealth.
 - B) it makes saving more risky.
 - C) saving increases through stock prices rising so people feel less of a need to save.
 - D) interest rates rise.

Answer: C

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 66) The stock market boom from 1995 to 2000 caused the economy to
- A) grow faster than it would have otherwise.
 - B) grow slower than it would have otherwise.
 - C) suffer a recession.
 - D) suffer a depression.

Answer: A

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Fact*

- 67) According to the textbook, in reaction to the stock market boom of 1995 to 2000, the FED
- A) kept interest rates lower than they would have otherwise.
 - B) kept interest rates higher than they would have otherwise.
 - C) caused a hyper-inflation.
 - D) caused a depression.

Answer: B

Diff: 1

Topic: *The Stock Market and the Economy*

Skill: *Fact*

- 68) The FED cares about stock market prices because
- A) part of their job is to enforce stock fraud laws.
 - B) stock market prices affect the economy which the FED cares about.
 - C) the stock market indexes are a good measure of inflation.
 - D) money supply increases.

Answer: B

Diff: 1

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 69) The central bank cares about stock market prices because
- A) stock market prices measure inflation.
 - B) if stock market prices contract, so does GDP.
 - C) if stock market prices rise, the economy becomes more speculative.
 - D) they affect the economy.

Answer: D

Diff: 1

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 70) Related to the *Economics in Practice* on p. 293 [605]: A stock bubble will pop only when
- A) skeptical investors act simultaneously.
 - B) the P/E ratio doubles in less than a year.
 - C) a new bubble forms for a different set of stocks.
 - D) the bond market slows.

Answer: A

Diff: 2

Topic: *The Stock Market and the Economy: Economics in Practice*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

71) Related to the *Economics in Practice* on p. 293 [605]: The Fed taking an activist approach to deal with stock bubbles would include which of the following actions?

- A) open market purchases
- B) interest rate increases
- C) increased government spending
- D) lowering reserve requirements

Answer: B

Diff: 2

Topic: *The Stock Market and the Economy: Economics in Practice*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

2 True/False

1) A bond is a debt of the issuer.

Answer: TRUE

Diff: 1

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

2) A bond holder is part owner of the firm.

Answer: FALSE

Diff: 1

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

3) A \$2,000 bond with a 5% coupon rate pays \$100 each period.

Answer: TRUE

Diff: 1

Topic: *The Stock Market and the Economy*

Skill: *Analytic*

AACSB: *Analytic Skills*

4) At the date of maturity the bond holder owes the bond issuer the last coupon payment plus the face value of the bond.

Answer: FALSE

Diff: 1

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

5) A stock is part ownership in the company.

Answer: TRUE

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

6) The further in the future the payment the more it will be discounted and the less value it has today.

Answer: TRUE

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Analytic*

AACSB: *Analytic Skills*

7) If interest rates fall, then bond prices rise.

Answer: TRUE

Diff: 1

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

8) If the risk associated with the business of a company rises, then its stock price will rise.

Answer: FALSE

Diff: 1

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

9) The bond holders select the management of a firm.

Answer: FALSE

Diff: 1

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

10) A \$100 bond today is always worth less than \$100 a year from today.

Answer: FALSE

Diff: 1

Topic: *The Stock Market and the Economy*

Skill: *Analytic*

AACSB: *Analytic Skills*

11) The coupon is what the bond holders owes the bond issuer.

Answer: FALSE

Diff: 1

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

12) Firms usually issue stock to finance the day to day operation of the company.

Answer: FALSE

Diff: 1

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 13) Corporations are required to pay dividends.
Answer: FALSE
Diff: 1
Topic: *The Stock Market and the Economy*
Skill: *Conceptual*
AACSB: *Reflective Thinking*
- 14) A stock bubble exists when the price of a stock is greater than the discounted value of its expected future dividends.
Answer: TRUE
Diff: 2
Topic: *The Stock Market and the Economy*
Skill: *Conceptual*
AACSB: *Reflective Thinking*
- 15) A stock bubble is against insider trading laws and if you participate in one you can be arrested.
Answer: FALSE
Diff: 1
Topic: *The Stock Market and the Economy*
Skill: *Fact*
- 16) A stock market boom increases wealth and thus consumption.
Answer: TRUE
Diff: 1
Topic: *The Stock Market and the Economy*
Skill: *Conceptual*
AACSB: *Reflective Thinking*
- 17) A stock market boom increases wealth and thus saving.
Answer: FALSE
Diff: 1
Topic: *The Stock Market and the Economy*
Skill: *Fact*
- 18) A stock market boom leads to greater investment by firms.
Answer: TRUE
Diff: 1
Topic: *The Stock Market and the Economy*
Skill: *Conceptual*
AACSB: *Reflective Thinking*
- 19) The Dow-Jones Industrial Average index is the broadest U.S. stock market index.
Answer: FALSE
Diff: 1
Topic: *The Stock Market and the Economy*
Skill: *Fact*

20) The Standard & Poor's 500 index is a broad index of the 500 largest firms from the New York Stock Exchange, the NASDAQ stock market and the American Stock Exchange.

Answer: TRUE

Diff: 1

Topic: *The Stock Market and the Economy*

Skill: *Fact*

21) From 1995 to 2000, the U.S. stock market crashed.

Answer: FALSE

Diff: 1

Topic: *The Stock Market and the Economy*

Skill: *Fact*

22) Bonds are fixed income securities because the coupon payment does not change with interest rates.

Answer: TRUE

Diff: 1

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

23) The face value of a bond must be paid back to the bondholder each period.

Answer: FALSE

Diff: 1

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

24) If the stock market crashes, then the economy will go into a recession.

Answer: FALSE

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

25) If the stock market booms, saving rate will increase.

Answer: FALSE

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

26) If the stock market booms, investment will rise.

Answer: TRUE

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

27) If the stock market crashes, consumption will fall.

Answer: TRUE

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

28) The savings rate is lower during a stock market boom because people's wealth is rising due to stock prices rising.

Answer: TRUE

Diff: 2

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

29) When there is a stock market boom, stockholders have capital losses.

Answer: FALSE

Diff: 1

Topic: *The Stock Market and the Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

Chapter 16 Household and Firm Behavior in the Macroeconomy: A Further Look

16.1 Households: Consumption and Labor Supply Decisions

1 Multiple Choice

- 1) Households are said to have positive wealth when
- A) the market value of their assets is zero.
 - B) the value of their assets is greater than the debts they owe.
 - C) the value of their assets is equal to the debts they owe.
 - D) the value of their assets is less than the debts they owe.

Answer: B

Diff: 1

Topic: Households: Consumption and Labor Supply Decisions

Skill: Conceptual

AACSB: Reflective Thinking

- 2) Generally speaking, wealth
- A) starts out negative, turns positive, then approaches zero near the end of life.
 - B) starts out positive, turns negative, then turns positive again near the end of life.
 - C) starts out zero, turns positive, then turns negative near the end of life.
 - D) starts out negative, approaches zero, then turns negative again near the end of life.

Answer: A

Diff: 1

Topic: Households: Consumption and Labor Supply Decisions

Skill: Conceptual

AACSB: Reflective Thinking

- 3) The idea of the _____ is that people make lifetime consumption plans.
- A) life-cycle theory of consumption
 - B) invisible hand
 - C) law of demand
 - D) classical theory of investment

Answer: A

Diff: 1

Topic: Households: Consumption and Labor Supply Decisions

Skill: Conceptual

AACSB: Reflective Thinking

- 4) According to the life-cycle theory of consumption, people tend to consume _____ they earn during their main working years.
- A) more than
 - B) less than
 - C) the same as
 - D) an amount unrelated to what

Answer: B

Diff: 1

Topic: Households: Consumption and Labor Supply Decisions

Skill: Conceptual

AACSB: Reflective Thinking

5) According to the life-cycle theory of consumption, people tend to consume _____ they earn during their early and later years.

- A) more than
B) less than
C) the same as
D) an amount unrelated to what

Answer: A

Diff: 1

Topic: Households: Consumption and Labor Supply Decisions

Skill: Conceptual

AACSB: Reflective Thinking

6) According to the life-cycle theory of consumption, people tend to _____ during their main working years.

- A) save
B) dissave
C) consume more than they earn
D) accumulate negative wealth

Answer: A

Diff: 1

Topic: Households: Consumption and Labor Supply Decisions

Skill: Conceptual

AACSB: Reflective Thinking

7) According to the life-cycle theory of consumption, people tend to dissave during their _____ years.

- A) main working
B) early
C) later
D) both B and C

Answer: D

Diff: 1

Topic: Households: Consumption and Labor Supply Decisions

Skill: Conceptual

AACSB: Reflective Thinking

8) The path of consumption over a lifetime is likely to be _____ the path of income.

- A) much more stable than
B) much less stable than
C) about the same as
D) completely unrelated to

Answer: A

Diff: 1

Topic: Households: Consumption and Labor Supply Decisions

Skill: Conceptual

AACSB: Reflective Thinking

9) The larger the percentage of people who work, the _____ output per capita.

- A) higher the potential
B) lower the potential
C) higher the actual
D) lower the actual

Answer: A

Diff: 1

Topic: Households: Consumption and Labor Supply Decisions

Skill: Conceptual

AACSB: Reflective Thinking

- 10) The average level of one's expected future income stream is
- A) disposable income.
 - B) permanent income.
 - C) gross income.
 - D) taxable income.

Answer: B

Diff: 1

Topic: Households: Consumption and Labor Supply Decisions

Skill: Definition

- 11) A medical student is likely to consume more than a high school student because the
- A) medical student bases consumption on current income while the high school student does not.
 - B) high school student bases consumption on permanent income while the medical student does not.
 - C) medical student's permanent income is likely higher than the high school student's permanent income.
 - D) medical student and the high school student both base consumption on current income.

Answer: C

Diff: 2

Topic: Households: Consumption and Labor Supply Decisions

Skill: Conceptual

AACSB: Reflective Thinking

- 12) Permanent income is
- A) current income.
 - B) expected future income.
 - C) the average level of expected future income.
 - D) accumulated wealth.

Answer: C

Diff: 1

Topic: Households: Consumption and Labor Supply Decisions

Skill: Definition

- 13) A change in tax rates is likely to affect individuals' behavior regarding consumption and saving if
- A) the change is for one year only.
 - B) the change is not too big.
 - C) the change will not increase the budget deficit.
 - D) the change is permanent.

Answer: D

Diff: 2

Topic: Households: Consumption and Labor Supply Decisions

Skill: Conceptual

AACSB: Reflective Thinking

- 14) The opportunity cost of leisure will rise if
- A) the wage rate increases.
 - B) the wage rate decreases.
 - C) nonlabor income increases.
 - D) nonlabor income decreases.

Answer: A

Diff: 1

Topic: Households: Consumption and Labor Supply Decisions

Skill: Conceptual

AACSB: Reflective Thinking

- 15) The substitution effect of a wage rate increase suggests that
- A) individuals will supply more work.
 - B) individuals will supply less work.
 - C) individuals will consume more leisure.
 - D) individuals will supply more work and consume more leisure.

Answer: A

Diff: 2

Topic: Households: Consumption and Labor Supply Decisions

Skill: Conceptual

AACSB: Reflective Thinking

- 16) The income effect of a wage rate increase should lead to
- A) an increase in the quantity of labor supplied and a decrease in leisure.
 - B) an increase in the quantity of labor supplied and an increase in leisure.
 - C) a decrease in quantity of labor supplied and an increase in leisure.
 - D) a decrease in the quantity of labor supplied and a decrease in leisure.

Answer: C

Diff: 2

Topic: Households: Consumption and Labor Supply Decisions

Skill: Conceptual

AACSB: Reflective Thinking

- 17) If the income effect is less than the substitution effect and the wage rate increases, individuals
- A) will supply more work.
 - B) will supply less work.
 - C) will consume more leisure.
 - D) cannot be determined from the given information

Answer: A

Diff: 2

Topic: Households: Consumption and Labor Supply Decisions

Skill: Conceptual

AACSB: Reflective Thinking

- 18) If the income effect is greater than the substitution effect, the labor supply curve
- A) is horizontal.
 - B) is vertical.
 - C) has a negative slope.
 - D) has a positive slope.

Answer: C

Diff: 2

Topic: Households: Consumption and Labor Supply Decisions

Skill: Conceptual

AACSB: Reflective Thinking

- 19) If the income effect is equal to the substitution effect, the labor supply curve
- A) is horizontal.
 - B) is vertical.
 - C) has a negative slope.
 - D) has a positive slope.

Answer: B

Diff: 2

Topic: Households: Consumption and Labor Supply Decisions

Skill: Conceptual

AACSB: Reflective Thinking

- 20) Mickey got a raise from \$14 an hour to \$20 an hour. As a result of the wage increase, Mickey desires to work more hours and take less hours of leisure. For Mickey
- A) the substitution effect dominates the income effect.
 - B) the income effect dominates the substitution effect.
 - C) the substitution effect must equal the income effect.
 - D) the substitution effect must be zero.

Answer: A

Diff: 2

Topic: Households: Consumption and Labor Supply Decisions

Skill: Analytic

AACSB: Analytic Skills

- 21) Caroline's hourly wage rate was reduced from \$22 to \$16. As a result of the wage decrease, Caroline desires to work more hours and take fewer hours of leisure. For Caroline
- A) the income effect must be zero.
 - B) the substitution effect dominates the income effect.
 - C) the income effect dominates the substitution effect.
 - D) the substitution effect must equal the income effect.

Answer: C

Diff: 2

Topic: Households: Consumption and Labor Supply Decisions

Skill: Analytic

AACSB: Analytic Skills

- 22) Empirical evidence with respect to the labor supply decision suggests that
- A) the income effect seems to dominate for most people, which means that the aggregate labor supply responds negatively to an increase in the wage rate.
 - B) the substitution effect seems to dominate for most people, which means that the aggregate labor supply responds positively to an increase in the wage rate.
 - C) the substitution effect seems to dominate for most people, which means that the aggregate labor supply responds negatively to an increase in the wage rate.
 - D) the income effect seems to dominate for most people, which means that the aggregate labor supply responds positively to an increase in the wage rate.

Answer: B

Diff: 2

Topic: Households: Consumption and Labor Supply Decisions

Skill: Fact

- 23) If the wage rate falls, consumption
- A) rises because the income and substitution effects are working in opposite directions to change consumption.
 - B) falls because the income and substitution effects are both working in the same direction to decrease consumption.
 - C) rises because the income and substitution effects are both working in the same direction to increase consumption.
 - D) falls because the income and substitution effects are working in opposite directions to change consumption.

Answer: B

Diff: 2

Topic: Households: Consumption and Labor Supply Decisions

Skill: Conceptual

AACSB: Reflective Thinking

- 24) The wage rate that is adjusted for changes in the price level over time is the
- A) expected future wage rate.
 - B) nominal wage rate.
 - C) real wage rate.
 - D) money wage rate.

Answer: C

Diff: 1

Topic: Households: Consumption and Labor Supply Decisions

Skill: Definition

- 25) Arnold's nominal wage increased by 3%, and the prices of goods that Arnold buys increased by 5%. Arnold's real wage has
- A) increased.
 - B) remained constant.
 - C) decreased.
 - D) changed by 8%, but the direction of the change is ambiguous.

Answer: C

Diff: 1

Topic: Households: Consumption and Labor Supply Decisions

Skill: Conceptual

AACSB: Reflective Thinking

- 26) When the substitution effect is greater than the income effect, Juanita will *not* supply more work if
- A) the wage rate and the price level increase proportionately.
 - B) the percentage increase in the price level is greater than the percentage change in wages.
 - C) wages are falling faster than prices.
 - D) all of the above

Answer: D

Diff: 1

Topic: Households: Consumption and Labor Supply Decisions

Skill: Conceptual

AACSB: Reflective Thinking

Refer to the information provided in Table 16.1 below to answer the questions that follow.

Table 16.1

Year	Wage Rate	Price Index
2006	\$7.00	1.0
2007	\$10.00	1.4
2008	\$13.00	1.9

- 27) Refer to Table 16.1. What is the real wage rate in 2007 using 2006 as the base year?
- A) \$9.80
 - B) \$7.14
 - C) \$10.00
 - D) \$14.00

Answer: B

Diff: 2

Topic: Households: Consumption and Labor Supply Decisions

Skill: Analytic

AACSB: Analytic Skills

- 28) Refer to Table 16.1. What is the real wage rate in 2008 using 2006 as the base year?
A) \$8.86 B) \$13.30 C) \$6.84 D) \$9.29

Answer: C

Diff: 2

Topic: Households: Consumption and Labor Supply Decisions

Skill: Analytic

AACSB: Analytic Skills

- 29) Refer to Table 16.1. What is the real wage rate in 2008 using 2007 as the base year?
A) \$9.28 B) \$17.64 C) \$19.00 D) \$9.58

Answer: D

Diff: 3

Topic: Households: Consumption and Labor Supply Decisions

Skill: Analytic

AACSB: Analytic Skills

- 30) Refer to Table 16.1. What is the real wage rate in 2006 using 2008 as the base year?
A) \$6.84 B) \$13.30 C) \$6.00 D) \$11.40

Answer: B

Diff: 3

Topic: Households: Consumption and Labor Supply Decisions

Skill: Analytic

AACSB: Analytic Skills

- 31) Refer to Table 16.1. From 2006 to 2008 nominal wages
A) rise. B) fall. C) stay the same. D) rise then fall.

Answer: A

Diff: 1

Topic: Households: Consumption and Labor Supply Decisions

Skill: Analytic

AACSB: Analytic Skills

- 32) Refer to Table 16.1. From 2006 to 2008 the real wage
A) rises. B) falls.
C) stays the same. D) rises then falls.

Answer: D

Diff: 1

Topic: Households: Consumption and Labor Supply Decisions

Skill: Analytic

AACSB: Analytic Skills

- 33) Refer to Table 16.1. From 2007 to 2008 the real wage
A) rises. B) falls.
C) stays the same. D) rises then falls.

Answer: B

Diff: 2

Topic: Households: Consumption and Labor Supply Decisions

Skill: Analytic

AACSB: Analytic Skills

- 34) Holding everything else constant, the more wealth a household has,
- A) the less it will consume, both now and in the future.
 - B) the more it will consume now, but the less it will consume in the future.
 - C) the less it will consume now, but the more it will consume in the future.
 - D) the more it will consume, both now and in the future.

Answer: D

Diff: 2

Topic: Households: Consumption and Labor Supply Decisions

Skill: Conceptual

AACSB: Reflective Thinking

- 35) Which of the following is an example of nonlabor income?
- A) proprietors' income
 - B) wages
 - C) inheritance
 - D) a month-pay bonus

Answer: C

Diff: 1

Topic: Households: Consumption and Labor Supply Decisions

Skill: Conceptual

AACSB: Reflective Thinking

- 36) An unexpected decrease in nonlabor income will have _____ effect on a household's consumption.
- A) an uncertain
 - B) a negative
 - C) a positive
 - D) no

Answer: B

Diff: 1

Topic: Households: Consumption and Labor Supply Decisions

Skill: Conceptual

AACSB: Reflective Thinking

- 37) An unexpected decrease in wealth or nonlabor income leads to
- A) an uncertain effect on labor supply.
 - B) an increase in labor supply.
 - C) a decrease in labor supply.
 - D) a zero effect on labor supply.

Answer: B

Diff: 1

Topic: Households: Consumption and Labor Supply Decisions

Skill: Conceptual

AACSB: Reflective Thinking

- 38) Which of the following causes an individual to increase his/her supply of labor?
- A) a decrease in the real wage
 - B) an increase in his/her wealth
 - C) a decrease in nonlabor income
 - D) Both A and C are correct.

Answer: C

Diff: 1

Topic: Households: Consumption and Labor Supply Decisions

Skill: Conceptual

AACSB: Reflective Thinking

- 39) A rise in the interest rate
- A) decreases the opportunity cost of consuming today.
 - B) increases the opportunity cost of consuming in the future.
 - C) increases the opportunity cost of consuming today.
 - D) decreases the opportunity cost of consuming in the future.

Answer: C

Diff: 1

Topic: Households: Consumption and Labor Supply Decisions

Skill: Fact

- 40) When interest rates increase, the substitution effect suggests that individuals will
- A) consume less today.
 - B) save less today.
 - C) consume less in the future.
 - D) save more and consume more today.

Answer: A

Diff: 2

Topic: Households: Consumption and Labor Supply Decisions

Skill: Conceptual

AACSB: Reflective Thinking

- 41) Assume that households have positive wealth. Which of the following explains how the income effect of an interest rate increase affects consumption?
- A) As the interest rate increases, the opportunity cost of current consumption falls, and therefore current consumption increases.
 - B) As the interest rate increases, permanent income increases and future consumption increases.
 - C) As the interest rate increases, expected future income increases and future consumption increases.
 - D) As the interest rate increases, nonlabor income increases and current consumption increases.

Answer: D

Diff: 2

Topic: Households: Consumption and Labor Supply Decisions

Skill: Analytic

AACSB: Analytic Skills

- 42) At the beginning of 2008, Joey planned to buy a new iPhone, LCD TV, and motorcycle by borrowing money. Joey already owes \$25,000 on other loans. He also planned to buy new clothing and DVDs out of current income. An increase in interest rates, during 2008, will most likely
- A) cause Joey to decide to borrow less money, but not change what he planned to spend on goods purchased with current income.
 - B) cause Joey to decide to borrow more money and to spend more on goods purchased with current income.
 - C) cause Joey to decide to borrow more money, but not change what he planned to spend on goods purchased with current income.
 - D) cause Joey to decide to borrow less money and to spend less on goods purchased with current income.

Answer: D

Diff: 3

Topic: Households: Consumption and Labor Supply Decisions

Skill: Analytic

AACSB: Analytic Skills

- 43) Assume that Brenda has positive wealth. As the interest rate decreased, Brenda reduced her current consumption. For Brenda,
- A) the substitution effect of an interest rate decrease outweighs the income effect
 - B) the income effect of an interest rate decrease outweighs the substitution effect.
 - C) the substitution effect of an interest rate increase must be zero.
 - D) the income effect of an interest rate decrease must equal the substitution effect.

Answer: B

Diff: 2

Topic: Households: Consumption and Labor Supply Decisions

Skill: Conceptual

AACSB: Reflective Thinking

- 44) If an individual is a debtor,
- A) the substitution effect of an interest rate increase is zero.
 - B) the income effect of an interest rate increase is zero.
 - C) the income and substitution effects of an increase in the interest rate work in the same direction.
 - D) the income and substitution effects of an increase in the interest rate work in opposite directions.

Answer: C

Diff: 2

Topic: Households: Consumption and Labor Supply Decisions

Skill: Fact

- 45) Assume that the substitution effect dominates the income effect. When the government raises tax rates, after-tax real wage rates
- A) fall, consumption decreases, and labor supply increases.
 - B) fall, consumption decreases, and labor supply decreases.
 - C) rise, consumption increases, and labor supply increases.
 - D) fall, consumption increases, and labor supply decreases.

Answer: B

Diff: 2

Topic: Households: Consumption and Labor Supply Decisions

Skill: Conceptual

AACSB: Reflective Thinking

- 46) Assume that the substitution effect dominates the income effect. An increase in both consumption and labor supply would result from
- A) a decrease in tax rates.
 - B) a decrease in transfer payments.
 - C) an increase in tax rates.
 - D) an increase in transfer payments.

Answer: A

Diff: 3

Topic: Households: Consumption and Labor Supply Decisions

Skill: Analytic

AACSB: Analytic Skills

- 47) A decrease in transfer payments will result in
- A) a decrease in both consumption and labor supply.
 - B) a decrease in consumption and an increase in labor supply.
 - C) an increase in consumption and a decrease in labor supply.
 - D) an increase in both consumption and labor supply.

Answer: B

Diff: 2

Topic: Households: Consumption and Labor Supply Decisions

Skill: Conceptual

AACSB: Reflective Thinking

- 48) An increase in consumption and a decrease in labor supply would result from
- A) an increase in tax rates.
 - B) a decrease in transfer payments.
 - C) an increase in transfer payments.
 - D) a decrease in government spending.

Answer: C

Diff: 2

Topic: Households: Consumption and Labor Supply Decisions

Skill: Analytic

AACSB: Analytic Skills

- 49) Which of the following causes an increase in labor supply?
- A) when wages and the price level increase proportionately
 - B) a decrease in income tax rates
 - C) a decrease in the general price level
 - D) a decrease in transfer payments

Answer: D

Diff: 2

Topic: Households: Consumption and Labor Supply Decisions

Skill: Conceptual

AACSB: Reflective Thinking

- 50) Which of the following factors is NOT one of the determinants of a household's budget constraint?
- A) consumer's preferences
 - B) income
 - C) wealth
 - D) prices

Answer: A

Diff: 1

Topic: Households: Consumption and Labor Supply Decisions

Skill: Conceptual

AACSB: Reflective Thinking

- 51) Empirical data suggest that during recessions, individuals reduce more of their consumption of
- A) nondurable goods.
 - B) durable goods.
 - C) services.
 - D) necessities.

Answer: B

Diff: 1

Topic: Households: Consumption and Labor Supply Decisions

Skill: Fact

- 52) Over time, spending on _____ is "smoother" than spending on _____.
A) durable goods; services
B) nondurable goods; durable goods
C) services; nondurable goods
D) durable goods; service

Answer: B

Diff: 1

Topic: Households: Consumption and Labor Supply Decisions

Skill: Fact

- 53) When your income decreases, which of the following items are you likely to postpone buying first?
A) health insurance
B) food
C) new CD player
D) gas

Answer: C

Diff: 1

Topic: Households: Consumption and Labor Supply Decisions

Skill: Conceptual

AACSB: Reflective Thinking

- 54) Purchases of new houses are the most volatile type of expenditures because they are very sensitive to _____, which is highly volatile.
A) the interest rate
B) disposable income
C) the inflation rate
D) GDP

Answer: A

Diff: 1

Topic: Households: Consumption and Labor Supply Decisions

Skill: Fact

- 55) The highest labor-force participation rate is among
A) prime-age women.
B) prime-age men
C) prime-age men and women.
D) non-prime-age men.

Answer: B

Diff: 1

Topic: Households: Consumption and Labor Supply Decisions

Skill: Fact

- 56) The unconstrained supply of labor refers to the amount a household _____ within a given period at the current wage rate if it could find the work.
A) would like to work
B) chooses not to work
C) is forced to work
D) actually works

Answer: A

Diff: 2

Topic: Households: Consumption and Labor Supply Decisions

Skill: Definition

- 57) The _____ refers to the amount a household actually works within a given period at the current wage rate.
A) constrained supply of labor
B) labor-force participation rate
C) natural rate of unemployment
D) unconstrained supply of labor

Answer: A

Diff: 2

Topic: Households: Consumption and Labor Supply Decisions

Skill: Definition

- 58) The largest increase in the labor-force participation rate since 1970 is among
- A) prime-age men.
 - B) teenagers over the age of 16.
 - C) prime-age women.
 - D) males in their 20s.

Answer: C

Diff: 1

Topic: Households: Consumption and Labor Supply Decisions

Skill: Fact

- 59) Assume households have positive wealth. If the income effect is greater than the substitution effect, a decrease in interest rates will
- A) increase saving and decrease consumption spending by households.
 - B) decrease saving and increase consumption spending by households.
 - C) decrease both saving and consumption spending by households.
 - D) increase both saving and consumption spending by households.

Answer: A

Diff: 2

Topic: Households: Consumption and Labor Supply Decisions

Skill: Analytic

AACSB: Analytic Skills

- 60) If the substitution effect is greater than the income effect, a decrease in interest rates will
- A) increase saving and decrease consumption spending by households.
 - B) decrease saving and increase consumption spending by households.
 - C) decrease both saving and consumption spending by households.
 - D) increase both saving and consumption spending by households.

Answer: B

Diff: 2

Topic: Households: Consumption and Labor Supply Decisions

Skill: Analytic

AACSB: Analytic Skills

- 61) Monetary policy is less effective than it was in the past because
- A) investment has become less sensitive to interest rate changes.
 - B) the substitution effect of an interest rate change on consumption has increased.
 - C) the income effect of an interest rate change on consumption has increased.
 - D) the government deficit has decreased.

Answer: C

Diff: 2

Topic: Households: Consumption and Labor Supply Decisions

Skill: Fact

- 62) Which of the following is TRUE of a change in nonlabor income?
- A) There is no substitution effect because a change in nonlabor income does not change the trade-off between work and leisure.
 - B) There is no income effect because a change in nonlabor income does not change the trade-off between work and leisure.
 - C) There is no substitution effect because a change in nonlabor income does not change a household's permanent income.
 - D) There is no income effect because a change in nonlabor income does not change a household's permanent income.

Answer: A

Diff: 3

Topic: Households: Consumption and Labor Supply Decisions

Skill: Conceptual

AACSB: Reflective Thinking

- 63) The portion of a corporation's profits that the firm pays out each period to shareholders is known as
- A) capital gains.
 - B) dividends.
 - C) interest.
 - D) retained earnings.

Answer: B

Diff: 1

Topic: Households: Consumption and Labor Supply Decisions

Skill: Definition

- 64) An increase in dividend payments will
- A) have no effect on labor supply.
 - B) lead to an increase in labor supply.
 - C) lead to a decrease in labor supply.
 - D) either lead to an increase or decrease in labor supply depending on the relative magnitude of the income and substitution effects.

Answer: C

Diff: 1

Topic: Households: Consumption and Labor Supply Decisions

Skill: Conceptual

AACSB: Reflective Thinking

- 65) If a policymaker wants to change taxes to encourage individuals to increase their labor supply, the policymaker should
- A) reduce taxes by a lump-sum amount.
 - B) increase taxes by a lump sum.
 - C) reduce the income tax rates that individuals pay.
 - D) increase the income tax rates that individuals pay.

Answer: C

Diff: 3

Topic: Households: Consumption and Labor Supply Decisions

Skill: Analytic

AACSB: Analytic Skills

66) Which of the following is NOT a transfer payment?

- A) social Security payments
- B) welfare benefits
- C) unemployment compensation
- D) dividends

Answer: D

Diff: 1

Topic: Households: Consumption and Labor Supply Decisions

Skill: Conceptual

AACSB: Reflective Thinking

67) Cash payments made by the government directly to households are

- A) dividends.
- B) transfer payments.
- C) compensating differential payments.
- D) national income payments.

Answer: B

Diff: 1

Topic: Households: Consumption and Labor Supply Decisions

Skill: Definition

68) A decrease in nonlabor income leads to _____ in consumption and _____ in labor supply.

- A) a decrease; a decrease
- B) a decrease; an increase
- C) an increase; a decrease
- D) an increase; an increase

Answer: B

Diff: 1

Topic: Households: Consumption and Labor Supply Decisions

Skill: Conceptual

AACSB: Reflective Thinking

2 True/False

1) An unexpected decrease in nonlabor income will have a negative effect on a household's consumption.

Answer: TRUE

Diff: 2

Topic: Households: Consumption and Labor Supply Decisions

Skill: Conceptual

AACSB: Reflective Thinking

2) The idea of the life-cycle theory of consumption is that people make lifetime consumption plans.

Answer: TRUE

Diff: 1

Topic: Households: Consumption and Labor Supply Decisions

Skill: Conceptual

AACSB: Reflective Thinking

3) If the substitution effect dominates the income effect, an increase in transfer payments will have a positive effect on both consumption and labor supply.

Answer: FALSE

Diff: 2

Topic: Households: Consumption and Labor Supply Decisions

Skill: Conceptual

AACSB: Reflective Thinking

4) According to the life-cycle theory of consumption, people tend to consume less than they earn during their main working years.

Answer: TRUE

Diff: 1

Topic: Households: Consumption and Labor Supply Decisions

Skill: Conceptual

AACSB: Reflective Thinking

5) The path of consumption over a lifetime is likely to be much more stable than the path of income.

Answer: TRUE

Diff: 1

Topic: Households: Consumption and Labor Supply Decisions

Skill: Conceptual

AACSB: Reflective Thinking

6) According to the life-cycle theory of consumption, people tend to save during their main working years.

Answer: TRUE

Diff: 1

Topic: Households: Consumption and Labor Supply Decisions

Skill: Conceptual

AACSB: Reflective Thinking

7) The real wage rate is the nominal wage rate adjusted for inflation since some base year.

Answer: TRUE

Diff: 1

Topic: Households: Consumption and Labor Supply Decisions

Skill: Definition

8) If the wage rate increases, the substitution effect is for a person to work less and the income effect is for a person to take less leisure.

Answer: FALSE

Diff: 1

Topic: Households: Consumption and Labor Supply Decisions

Skill: Conceptual

AACSB: Reflective Thinking

9) Generally speaking, wealth starts out negative, turns positive, then approaches zero near the end of life.

Answer: TRUE

Diff: 1

Topic: Households: Consumption and Labor Supply Decisions

Skill: Conceptual

AACSB: Reflective Thinking

10) The smaller the percentage of people who work, the higher the potential output per capita.

Answer: FALSE

Diff: 1

Topic: Households: Consumption and Labor Supply Decisions

Skill: Conceptual

AACSB: Reflective Thinking

11) Any increase in nonlabor income unambiguously leads to a decrease in consumption and a decrease in labor supply.

Answer: FALSE

Diff: 2

Topic: Households: Consumption and Labor Supply Decisions

Skill: Conceptual

AACSB: Reflective Thinking

12) A decrease in corporate profits, resulting in a decline in dividend payments, will decrease consumption and decrease labor supply.

Answer: FALSE

Diff: 2

Topic: Households: Consumption and Labor Supply Decisions

Skill: Conceptual

AACSB: Reflective Thinking

13) Output is likely to respond more to sales increases in high-output periods than in low-output periods, provided that firms have enough capital and labor to support the output increase.

Answer: TRUE

Diff: 2

Topic: Households: Consumption and Labor Supply Decisions

Skill: Analytic

AACSB: Analytic Skills

16.2 Firms: Investment and Employment Decisions

1 Multiple Choice

1) Change in inventories equals the difference between

A) production and investment.

B) sales and investment.

C) production and sales.

D) investment and depreciation.

Answer: C

Diff: 1

Topic: Firms: Investment and Employment Decisions

Skill: Definition

2) A capital-intensive technology is a technique of production that

A) uses a large amount of capital relative to labor.

B) uses a large amount of labor relative to capital.

C) relies entirely on physical inputs; no human labor is required.

D) is used only in cases where few skilled workers are available.

Answer: A

Diff: 1

Topic: Firms: Investment and Employment Decisions

Skill: Definition

- 3) A firm that chooses to use a labor-intensive technology does so because
- A) labor is cheaper than capital.
 - B) capital is cheaper than labor.
 - C) labor is relatively cheaper than capital.
 - D) capital is more productive than labor.

Answer: C

Diff: 1

Topic: Firms: Investment and Employment Decisions

Skill: Conceptual

AACSB: Reflective Thinking

- 4) When a labor-intensive technology is used, an expansion is likely to
- A) increase the demand for labor while increasing the demand for capital only modestly.
 - B) increase the demand for labor and decrease the demand for capital.
 - C) substantially increase the demand for both labor and capital.
 - D) substantially increase the demand for capital while increasing the demand for labor only modestly.

Answer: A

Diff: 2

Topic: Firms: Investment and Employment Decisions

Skill: Analytic

AACSB: Analytic Skills

- 5) When forming their expectations, firms gather information about all the following factors EXCEPT
- A) the projected demand for their specific line of products.
 - B) the overall health of the macroeconomy.
 - C) the future plans of their competitors.
 - D) the historical supply of their competitors' line of products.

Answer: D

Diff: 2

Topic: Firms: Investment and Employment Decisions

Skill: Conceptual

AACSB: Reflective Thinking

- 6) The phrase that was coined by John Maynard Keynes to describe the feelings of investors was the _____ of entrepreneurs.
- A) optimism
 - B) animal spirits
 - C) pessimism
 - D) karma

Answer: B

Diff: 1

Topic: Firms: Investment and Employment Decisions

Skill: Fact

- 7) The tendency for investment to increase when aggregate output increases is the result of the _____ effect.
- A) accelerator
 - B) multiplier
 - C) substitution
 - D) income

Answer: A

Diff: 2

Topic: Firms: Investment and Employment Decisions

Skill: Definition

- 8) The tendency for _____ to decrease when _____ decreases is the result of the accelerator effect.
- A) investment; aggregate output B) consumption; investment
 C) saving; consumption D) aggregate output; saving

Answer: A

Diff: 2

Topic: Firms: Investment and Employment Decisions

Skill: Definition

- 9) The costs that a firm incurs when it changes its production level are _____ costs.
- A) adjustment B) accelerated C) sunk D) depreciation

Answer: A

Diff: 1

Topic: Firms: Investment and Employment Decisions

Skill: Definition

Refer to the information provided in Figure 16.1 below to answer the questions that follow.

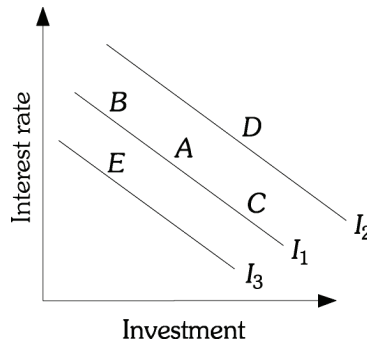


Figure 16.1

- 10) Refer to Figure 16.1. Which of the following could cause a movement from Point B to Point C?
- A) an increase in the interest rate B) positive growth in the GDP
 C) negative growth in the GDP D) a decrease in the interest rate

Answer: D

Diff: 1

Topic: Firms: Investment and Employment Decisions

Skill: Analytic

AACSB: Analytic Skills

- 11) Refer to Figure 16.1. Which of the following could cause a movement from Point C to Point B?
- A) an increase in the interest rate B) positive growth in the GDP
 C) negative growth in the GDP D) a decrease in the interest rate

Answer: A

Diff: 1

Topic: Firms: Investment and Employment Decisions

Skill: Analytic

AACSB: Analytic Skills

- 12) Refer to Figure 16.1. Growth in GDP causes a _____ through the accelerator effect.
- A) shift from I_2 to I_3
 - B) shift from I_3 to I_2
 - C) shift from Point C to Point B
 - D) shift from Point B to Point C

Answer: B

Diff: 2

Topic: Firms: Investment and Employment Decisions

Skill: Conceptual

AACSB: Reflective Thinking

- 13) Refer to Figure 16.1. If the economy is currently at Point C, pessimism about future growth in GDP moves the economy to Point
- A) B.
 - B) C.
 - C) D.
 - D) E.

Answer: D

Diff: 2

Topic: Firms: Investment and Employment Decisions

Skill: Analytic

AACSB: Analytic Skills

- 14) Refer to Figure 16.1. Suppose the economy is currently at Point B. If investors are optimistic about future growth in GDP, investment
- A) moves to Point C.
 - B) moves to Point A.
 - C) moves to Point D.
 - D) stays at Point B.

Answer: C

Diff: 2

Topic: Firms: Investment and Employment Decisions

Skill: Analytic

AACSB: Analytic Skills

- 15) If a firm is able to produce the same amount of output even after reducing its labor workforce, this implies that the firm has
- A) unplanned inventories.
 - B) excess capital.
 - C) excess labor.
 - D) planned inventories.

Answer: C

Diff: 2

Topic: Firms: Investment and Employment Decisions

Skill: Conceptual

AACSB: Reflective Thinking

- 16) A firm is less likely to invest in new capital if
- A) the productivity of capital is high.
 - B) it has no excess capital.
 - C) it does not expect future sales to grow.
 - D) it is expanding into new markets.

Answer: C

Diff: 2

Topic: Firms: Investment and Employment Decisions

Skill: Conceptual

AACSB: Reflective Thinking

- 17) The unemployment rate does not tend to fall as soon as the economy pulls out of a recession. Which of the following best explains this?
- A) Firms are holding excess labor, so as the economy pulls out of the recession, firms do not need to hire new workers immediately.
 - B) Firms' optimism about the state of the economy increased prior to the economy pulling out of the recession, so firms increased their employment earlier.
 - C) Firms are not able to find qualified workers to fill the job vacancies.
 - D) During recessionary periods, firms switch to more capital-intensive production techniques, so they do not need to increase employment as the economy pulls out of the recession.

Answer: A

Diff: 3

Topic: Firms: Investment and Employment Decisions

Skill: Analytic

AACSB: Analytic Skills

- 18) Which of the following relationships is correct?
- A) Stock of Inventories (End of Period) = Stock of Inventories (Beginning of Period) - Production + Sales
 - B) Stock of Inventories (End of Period) = Stock of Inventories (Beginning of Period) - Production - Sales
 - C) Stock of Inventories (End of Period) = Stock of Inventories (Beginning of Period) + Production - Sales
 - D) Stock of Inventories (End of Period) = Stock of Inventories (Beginning of Period) + Production + Sales

Answer: C

Diff: 1

Topic: Firms: Investment and Employment Decisions

Skill: Definition

- 19) At the beginning of 2008, the Shades of Gray Company has 8,000 pairs of sunglasses in stock. During 2008, the company produces 120,000 pairs of sunglasses and sells 112,000 pairs of sunglasses. The Shades of Gray Company's stock of inventory at the end of 2008 is _____ pairs of sunglasses.
- A) 0 B) 4,000 C) 8,000 D) 16,000

Answer: D

Diff: 2

Topic: Firms: Investment and Employment Decisions

Skill: Analytic

AACSB: Analytic Skills

- 20) The desired level of inventories is the level at which the extra cost (in lost sales) from lowering inventories by a small amount is
- A) greater than the extra gain (in interest revenue and decreased storage costs).
 - B) zero.
 - C) less than the extra gain in (in interest revenue and decreased storage costs).
 - D) just equal to the extra gain (in interest revenue and decreased storage costs).

Answer: D

Diff: 2

Topic: Firms: Investment and Employment Decisions

Skill: Conceptual

AACSB: Reflective Thinking

21) The Unique Toy Company rents space by the square foot in a warehouse to store its inventory. The owner of the warehouse just doubled the rent he charges the Unique Toy Company. Everything else equal, the rent increase is likely to _____ Unique's optimal level of inventory.

- A) not change B) increase C) decrease D) reduce to zero

Answer: C

Diff: 2

Topic: Firms: Investment and Employment Decisions

Skill: Analytic

AACSB: Analytic Skills

22) An unexpected increase in inventories has

- A) no effect on future production. B) a positive effect on future production.
C) a negative effect on current production. D) a negative effect on future production.

Answer: D

Diff: 2

Topic: Firms: Investment and Employment Decisions

Skill: Conceptual

AACSB: Reflective Thinking

23) If a firm's sales turn out to be more than expected, inventories will be

- A) lower than expected, and there will be more production in the future.
B) lower than expected, and there will be less production in the future.
C) higher than expected, and there will be more production in the future.
D) higher than expected, and there will be less production in the future.

Answer: A

Diff: 2

Topic: Firms: Investment and Employment Decisions

Skill: Analytic

AACSB: Analytic Skills

24) Which of the following statements is true?

- A) Production and sales will fluctuate by the same amount and in the same direction over time.
B) Production will not fluctuate over time, but a firm's sales will fluctuate over time.
C) Production will fluctuate somewhat over time, but not as much as sales fluctuates over time.
D) Production and sales will both fluctuate by the same amount over time, but in different directions.

Answer: C

Diff: 2

Topic: Firms: Investment and Employment Decisions

Skill: Conceptual

AACSB: Reflective Thinking

- 25) Due to an increase in the birthrate, the Solid Wood Furniture Company expects an increase in the sale of its cribs over the next few years. The Solid Wood Furniture Company will most likely
- A) keep current production constant, but plan to increase production in the future.
 - B) increase current production.
 - C) decrease current production so that it can increase production in the future.
 - D) not change its current investment plans, but plan to increase investment in the future.

Answer: B

Diff: 2

Topic: Firms: Investment and Employment Decisions

Skill: Analytic

AACSB: Analytic Skills

- 26) Generally speaking, investment does _____ when GDP does _____.
- A) well; poorly
 - B) poorly; well
 - C) well; well
 - D) not change; well

Answer: C

Diff: 1

Topic: Firms: Investment and Employment Decisions

Skill: Conceptual

AACSB: Reflective Thinking

- 27) Which of the following types of expenditures is more volatile than plant and equipment investment?
- A) consumption of durable goods
 - B) consumption of services
 - C) housing investment
 - D) consumption of nondurable goods

Answer: C

Diff: 1

Topic: Firms: Investment and Employment Decisions

Skill: Fact

- 28) Which of the following types of investments is the most volatile?
- A) inventory investment
 - B) plant investment
 - C) housing investment
 - D) equipment investment

Answer: A

Diff: 1

Topic: Firms: Investment and Employment Decisions

Skill: Fact

- 29) Productivity fluctuates along a business cycle because
- A) firms usually keep excess labor.
 - B) workers tend to become more productive during expansions.
 - C) workers tend to become less productive during expansions.
 - D) Both B and C are correct.

Answer: A

Diff: 1

Topic: Firms: Investment and Employment Decisions

Skill: Conceptual

AACSB: Reflective Thinking

- 30) Provided that firms have sufficient capital and labor to support an output increase, monetary and fiscal policy are likely to be the most effective when
- A) prices and inventory stocks are both high.
 - B) output and inventory stocks are both high.
 - C) output is low and inventory stocks are low.
 - D) output is low and inventory stocks are high.

Answer: C

Diff: 2

Topic: *Firms: Investment and Employment Decisions*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 31) If inventory stocks are low and firms have enough capital and labor to support an output increase,
- A) monetary and fiscal policy will be very effective.
 - B) fiscal policy will be effective, but monetary policy will be ineffective.
 - C) monetary policy will be effective, but fiscal policy will be ineffective.
 - D) neither monetary nor fiscal policy will be effective.

Answer: A

Diff: 2

Topic: *Firms: Investment and Employment Decisions*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 32) There is an increase in aggregate demand, and firms do not have sufficient capital and labor to support an output increase. In this case, inventory stocks will
- A) continue to fall, and there will be a large increase in the price level.
 - B) continue to increase, and there will be a large increase in the price level.
 - C) continue to fall, and the price level will fall.
 - D) remain unchanged, and the price level will remain unchanged.

Answer: A

Diff: 2

Topic: *Firms: Investment and Employment Decisions*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 33) The two channels through which monetary policy can influence behavior in the goods market are
- A) investment and government spending.
 - B) investment and consumption.
 - C) government spending and consumption.
 - D) taxation and investment.

Answer: B

Diff: 2

Topic: *Firms: Investment and Employment Decisions*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 34) If firms believe that a downturn in sales and output is temporary and that increased output will be needed in the future, they may choose to
- A) fire all their workers.
 - B) sell off the plant.
 - C) close a plant permanently.
 - D) reassign their workers to different jobs.

Answer: D

Diff: 2

Topic: Firms: Investment and Employment Decisions

Skill: Conceptual

AACSB: Reflective Thinking

- 35) At low levels of output, the economy can expand with little or no increase in the overall price level because
- A) at low levels of output the aggregate supply curve is negatively sloped.
 - B) people will be expecting the price level to fall.
 - C) there is excess supply so prices are kept low.
 - D) firms likely hold excess labor and capital, and production can be increased without causing input prices to increase.

Answer: D

Diff: 2

Topic: Firms: Investment and Employment Decisions

Skill: Conceptual

AACSB: Reflective Thinking

- 36) Which of the following is a way in which a firm can add to its capital stock?
- A) expanding its labor force
 - B) plant and equipment investment
 - C) purchasing raw materials
 - D) unplanned inventory disinvestment

Answer: B

Diff: 1

Topic: Firms: Investment and Employment Decisions

Skill: Conceptual

AACSB: Reflective Thinking

- 37) Purchases by firms of additional machines, factories, or buildings within a given period is
- A) planned inventory investment.
 - B) unplanned inventory investment.
 - C) plant and equipment investment.
 - D) investment in human capital.

Answer: C

Diff: 1

Topic: Firms: Investment and Employment Decisions

Skill: Definition

- 38) Related to the *Economics in Practice* on p. 305 [617]: Lower home prices
- A) threaten the economy's growth by making consumers feel less wealthy.
 - B) accelerate the economy's growth by making consumers feel more wealthy.
 - C) threaten the economy's growth despite making consumers feel more wealthy.
 - D) accelerate the economy's growth despite making consumers feel less wealthy.

Answer: A

Diff: 2

Topic: Firms: Investment and Employment Decisions: *Economics in Practice*

Skill: Conceptual

AACSB: Reflective Thinking

- 39) Related to the *Economics in Practice* on p. 305 [617]: Lower home prices
- A) make it more difficult for home owners to borrow against the value of their homes.
 - B) erode the value of banks' collateral.
 - C) prompt banks to tighten lending standards.
 - D) all of the above

Answer: D

Diff: 2

Topic: *Firms: Investment and Employment Decisions: Economics in Practice*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

2 True/False

- 1) According to the accelerator effect, there is a tendency for investment to decrease when aggregate output decreases, thus accelerating the decline of output.

Answer: TRUE

Diff: 1

Topic: *Firms: Investment and Employment Decisions*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 2) The most volatile type of investment is inventory investment.

Answer: TRUE

Diff: 1

Topic: *Firms: Investment and Employment Decisions*

Skill: *Fact*

- 3) The optimal level of inventories is the level at which the extra cost (in lost sales) from lowering inventories by a small amount is greater than the gain (in interest revenue and decreased storage costs).

Answer: FALSE

Diff: 2

Topic: *Firms: Investment and Employment Decisions*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 4) An unexpected increase in inventories has a negative effect on future production.

Answer: TRUE

Diff: 1

Topic: *Firms: Investment and Employment Decisions*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 5) If the substitution effect is larger than the income effect, a decrease in tax rates will lead to an increase in the labor supply.

Answer: TRUE

Diff: 2

Topic: *Firms: Investment and Employment Decisions*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 6) A permanent tax cut of 10% would cause an increase in consumption, output, and the price level and a decrease in unemployment equal to that caused by a temporary tax cut of 10%.

Answer: FALSE

Diff: 2

Topic: Firms: Investment and Employment Decisions

Skill: Analytic

AACSB: Analytic Skills

- 7) Investment affects output, but output does not affect investment.

Answer: FALSE

Diff: 2

Topic: Firms: Investment and Employment Decisions

Skill: Conceptual

AACSB: Reflective Thinking

- 8) Labor intensive technology is a production technique that uses a large amount of labor relative to capital.

Answer: TRUE

Diff: 2

Topic: Firms: Investment and Employment Decisions

Skill: Definition

- 9) Capital intensive technology is a production technique that uses a small amount of capital relative to labor.

Answer: FALSE

Diff: 2

Topic: Firms: Investment and Employment Decisions

Skill: Definition

- 10) A phrase coined by John Maynard Keynes to describe investors' feelings is "Animal Spirits."

Answer: TRUE

Diff: 2

Topic: Firms: Investment and Employment Decisions

Skill: Fact

- 11) The costs that a firm incurs when it changes its production level are adjustment costs.

Answer: TRUE

Diff: 1

Topic: Firms: Investment and Employment Decisions

Skill: Definition

16.3 Productivity and the Business Cycle

1 Multiple Choice

- 1) The amount of output produced by an average worker in one hour is
- A) a production quota. B) the marginal revenue product of labor.
C) the marginal product of labor. D) labor productivity.

Answer: D

Diff: 1

Topic: Productivity and the Business Cycle

Skill: Definition

- 2) Productivity tends to
- A) rise during contractions.
 - B) rise during expansions.
 - C) fall during expansions.
 - D) rise throughout the business cycle.

Answer: B

Diff: 1

Topic: *Productivity and the Business Cycle*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 3) Productivity tends to
- A) rise during contractions.
 - B) fall during expansions.
 - C) fall during contractions.
 - D) rise throughout the business cycle.

Answer: C

Diff: 1

Topic: *Productivity and the Business Cycle*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 4) Nancy's Nail Salon employs five workers. Each worker works eight hours per day. The five workers are able to serve 20 customers per day. The labor productivity is therefore _____ customer(s) per person/hour.
- A) 0.5
 - B) 1
 - C) 2
 - D) 4

Answer: A

Diff: 2

Topic: *Productivity and the Business Cycle*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 5) A firm is holding excess labor. This will
- A) increase the amount of capital employed.
 - B) decrease the productivity of capital.
 - C) increase labor productivity.
 - D) reduce labor productivity.

Answer: D

Diff: 1

Topic: *Productivity and the Business Cycle*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 6) During economic expansions,
- A) employment rises by a higher percentage than output, and the ratio of output to workers falls.
 - B) output rises by a larger percentage than employment, and the ratio of output to workers rises.
 - C) employment rises by a larger percentage than output, and the ratio of output to workers rises.
 - D) output rises by a larger percentage than employment, and the ratio of output to workers falls.

Answer: B

Diff: 1

Topic: *Productivity and the Business Cycle*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 7) During economic downswings,
- A) output falls faster than employment, and the ratio of output to workers falls.
 - B) employment falls faster than output, and the ratio of output to workers falls.
 - C) employment falls faster than output, and the ratio of output to workers rises.
 - D) output falls faster than employment, and the ratio of output to workers rises.

Answer: A

Diff: 1

Topic: *Productivity and the Business Cycle*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 8) When the economy is in a slump, labor productivity tends to fall because firms have
- A) excess capital.
 - B) excess labor.
 - C) too little capital.
 - D) too little labor.

Answer: B

Diff: 1

Topic: *Productivity and the Business Cycle*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 9) Which of the following statements is TRUE?
- A) The long-run potential of the economy declines as output per worker falls during a recession.
 - B) The long-run potential of the economy increases as output per worker rises during an expansion.
 - C) The long-run potential of the economy increases as output per worker rises during an expansion, but the long-run potential of the economy doesn't change as output per worker falls during a recession.
 - D) Changes in output per worker over the business cycle have nothing to do with the long-run potential of the economy.

Answer: D

Diff: 2

Topic: *Productivity and the Business Cycle*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 10) When output increases by 1%, the number of jobs does not tend to rise by 1% in the short run. Which of the following statements represents one of the reasons why this is true?
- A) A firm is likely to meet some of the increase in output by increasing the number of hours worked per job.
 - B) A firm is likely to meet some of the increase in output by decreasing the number of hours worked per job.
 - C) Firms are likely to meet some of the increase in output by reducing labor productivity.
 - D) Firms are likely to meet part of the increase in output by eliminating any excess capital they may have.

Answer: A

Diff: 2

Topic: *Productivity and the Business Cycle*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 11) When output increases by 1%, the unemployment rate does not tend to fall by 1% in the short run because
- A) a firm is likely to meet some of the increase in output by increasing the number of hours worked per job.
 - B) the number of people who become employed is less than the number of new jobs created.
 - C) as output increases, the size of the labor force increases.
 - D) all of the above

Answer: D

Diff: 2

Topic: *Productivity and the Business Cycle*

Skill: *Analytic*

AACSB: *Analytic Skills*

Refer to the information provided in Figure 16.2 below to answer the questions that follow.

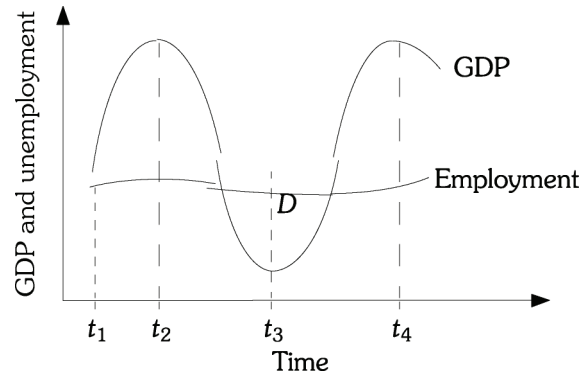


Figure 16.2

- 12) Refer to Figure 16.2. Between times t_3 and t_4 , labor is
- A) more productive because growth in employment exceeds growth in output.
 - B) more productive because growth in employment is less than growth in output.
 - C) less productive because growth in employment exceeds growth in output.
 - D) less productive because growth in employment is less than growth in output.

Answer: B

Diff: 3

Topic: Productivity and the Business Cycle

Skill: Analytic

AACSB: Analytic Skills

- 13) Refer to Figure 16.2. Labor productivity at time t_3 is
- A) larger than labor productivity at time t_1 .
 - B) less than labor productivity at time t_4 .
 - C) larger than labor productivity at time t_2 .
 - D) larger than labor productivity at time t_2 , but less than labor productivity at time t_4 .

Answer: B

Diff: 3

Topic: Productivity and the Business Cycle

Skill: Analytic

AACSB: Analytic Skills

- 14) Refer to Figure 16.2. Labor productivity at time t_2 is
- A) larger than labor productivity at time t_1 .
 - B) less than labor productivity at time t_4 .
 - C) less than labor productivity at time t_3 .
 - D) larger than labor productivity at time t_1 , but less than labor productivity at time t_3 .

Answer: A

Diff: 3

Topic: Productivity and the Business Cycle

Skill: Analytic

AACSB: Analytic Skills

2 True/False

- 1) Productivity fluctuates over the business cycle, tending to fall during expansions and rise during contractions.

Answer: FALSE

Diff: 1

Topic: *Productivity and the Business Cycle*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 2) Labor productivity rises during a recession as firms retain their more experienced workers.

Answer: FALSE

Diff: 1

Topic: *Productivity and the Business Cycle*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 3) As the economy starts to expand, labor productivity rises as firm start using any excess labor they kept during the recession.

Answer: TRUE

Diff: 1

Topic: *Productivity and the Business Cycle*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

16.4 The Short-Run Relationship Between Output and Unemployment

1 Multiple Choice

- 1) Which of the following is TRUE of a change in dividend payments?
- A) There is no substitution effect because a change in dividend payments does not change the trade-off between work and leisure.
 - B) There is no income effect because a change in dividend payments does not change the trade-off between work and leisure.
 - C) There is no substitution effect because a change in dividend payments does not change a household's permanent income.
 - D) There is no income effect because a change in dividend payments does not change a household's permanent income.

Answer: A

Diff: 3

Topic: *The Relationship Between Output and Unemployment*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 2) The government reduces the corporate profits tax. As a result, corporate profits increase. This will
- A) have no effect on households.
 - B) increase the nonlabor income of households, causing consumption to increase and labor supply to increase.
 - C) increase the nonlabor income of households, causing consumption to increase and labor supply to decrease.
 - D) increase the nonlabor income of households, causing consumption to increase and labor supply to increase or decrease depending on the relative magnitude of the income and substitution effects.

Answer: C

Diff: 3

Topic: *The Relationship Between Output and Unemployment*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 3) The government increases the corporate profits tax. As a result, corporate profits decrease. This will
- A) have no effect on households.
 - B) decrease the nonlabor income of households, causing consumption to decrease and labor supply to decrease.
 - C) decrease the nonlabor income of households, causing consumption to decrease and labor supply to increase.
 - D) decrease the nonlabor income of households, causing consumption to decrease and labor supply to decrease or increase depending on the relative magnitude of the income and substitution effects.

Answer: C

Diff: 3

Topic: *The Relationship Between Output and Unemployment*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 4) Okun's Law states that the unemployment rate decreases about
- A) 1 percentage point for every 1% increase in GDP.
 - B) 3 percentage points for every 1% increase in GDP.
 - C) 1 percentage point for every 3% increase in GDP.
 - D) 1 percentage point for every 2% increase in GDP.

Answer: C

Diff: 1

Topic: *The Relationship Between Output and Unemployment*

Skill: *Fact*

- 5) According to Okun's Law, if GDP increased by 6%, the unemployment rate would decrease by
- A) 1 percentage point.
 - B) 2 percentage points.
 - C) 3 percentage points.
 - D) 6 percentage points.

Answer: B

Diff: 1

Topic: *The Relationship Between Output and Unemployment*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 6) If Okun's Law holds true, then a 9% increase in GDP would lead to a _____ percentage point decrease in the unemployment rate.
- A) 3 B) 2 C) 1 D) 6

Answer: A

Diff: 1

Topic: *The Relationship Between Output and Unemployment*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 7) Although the relationship between output and the unemployment rate is not as simple as Okun's Law represents it to be, it is true that
- A) a 1% increase in output tends to correspond to a greater than 1% decrease in the unemployment rate.
- B) a 1% increase in output tends to correspond to a less than 1% decrease in the unemployment rate.
- C) a 1% increase in output tends to correspond to a 1% decrease in the unemployment rate.
- D) a 1% increase in output will have no effect on the unemployment rate.

Answer: B

Diff: 1

Topic: *The Relationship Between Output and Unemployment*

Skill: *Fact*

- 8) Okun's Law has
- A) been proven to be completely incorrect—there isn't a negative relationship between GDP and the unemployment rate.
- B) proven to be correct over time in that as GDP increases by 3%, there has been a 1 percentage point decline in unemployment.
- C) not turned out to be a law—the relationship between changes in GDP and the unemployment rate is more complex than Okun's Law indicates.
- D) been proven false, because there is a positive relationship between changes in GDP and the unemployment rate.

Answer: C

Diff: 1

Topic: *The Relationship Between Output and Unemployment*

Skill: *Fact*

- 9) Which of the following is NOT one of the "slippages" between changes in output and changes in the unemployment rate?
- A) As the size of the labor force increases, the interest rate increases, and therefore output falls.
- B) The percentage increase in the number of jobs is less than the percentage increase in output.
- C) The labor force increases when output increases.
- D) The change in the number of jobs and the change in the number of people employed are not equal.

Answer: A

Diff: 2

Topic: *The Relationship Between Output and Unemployment*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 10) An increase in output will cause the unemployment rate to fall by a larger percentage if
- A) firms are holding excess labor.
 - B) firms aren't holding excess labor.
 - C) firms have their workers work more overtime.
 - D) firms hire workers who were already employed by other firms to work for them part-time.

Answer: B

Diff: 2

Topic: *The Relationship Between Output and Unemployment*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 11) In general, the relationship between output and unemployment
- A) has been quite stable over the long run.
 - B) depends on the state of the economy at the time of the output change.
 - C) has been completely unpredictable over time.
 - D) is a simple one, as represented by Okun's Law.

Answer: B

Diff: 1

Topic: *The Relationship Between Output and Unemployment*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 12) People who have two jobs,
- A) are counted twice in the job data, but only once in the persons–employed data.
 - B) are counted twice in both the job data and the persons–employed data.
 - C) are counted once in the job data, but twice in the persons–employed data.
 - D) are counted once in both the job data and the persons–employed data.

Answer: A

Diff: 1

Topic: *The Relationship Between Output and Unemployment*

Skill: *Fact*

- 13) The slippage between output and the unemployment rate occurs because the unemployment rate is calculated from data on
- A) the number of jobs.
 - B) the number of people who do not want to work.
 - C) the number of people employed.
 - D) the civilian adult population.

Answer: C

Diff: 1

Topic: *The Relationship Between Output and Unemployment*

Skill: *Fact*

- 14) The unemployment rate is
- A) the difference between the number of people in the labor force and the number of people employed.
 - B) one plus the employment rate.
 - C) one minus the employment rate.
 - D) the ratio of the labor force to the number of people unemployed.

Answer: C

Diff: 1

Topic: *The Relationship Between Output and Unemployment*

Skill: *Definition*

- 15) The employment rate is the ratio of the number of people
- A) unemployed to the number of people employed.
 - B) unemployed to the number of people in the labor force.
 - C) in the labor force to the number of people employed.
 - D) employed to the number of people in the labor force.

Answer: D

Diff: 1

Topic: *The Relationship Between Output and Unemployment*

Skill: *Definition*

- 16) If the number of people employed is 190 million and the number of people in the labor force is 200 million, then the employment rate is
- A) 5%.
 - B) 10%.
 - C) 90%.
 - D) 95%.

Answer: D

Diff: 1

Topic: *The Relationship Between Output and Unemployment*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 17) If the employment rate is 93%, then the unemployment rate is
- A) 7%.
 - B) 13%.
 - C) 97%.
 - D) unknown based on the information given.

Answer: A

Diff: 1

Topic: *The Relationship Between Output and Unemployment*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 18) The decline in the measured unemployment rate that results when people who want to work, but who cannot find work, drop out of the ranks of the unemployed and the labor force is the
- A) leisure-preference effect.
 - B) discouraged-worker effect.
 - C) surplus labor effect.
 - D) disguised unemployment effect.

Answer: B

Diff: 2

Topic: *The Relationship Between Output and Unemployment*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 19) If discouraged workers were counted as unemployed, then as output increased the unemployment rate would
- A) not change at all.
 - B) fall by more than if discouraged workers are not counted as unemployed.
 - C) fall by less than if discouraged workers are not counted as unemployed.
 - D) increase by less than if discouraged workers are not counted as unemployed.

Answer: B

Diff: 1

Topic: *The Relationship Between Output and Unemployment*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 20) The measured unemployment rate does not fall as much as one might expect when output increases because, as the economy expands,
- A) more people enter the labor force.
 - B) firms want to hire additional workers.
 - C) more people find jobs.
 - D) more people leave the labor force.

Answer: A

Diff: 1

Topic: *The Relationship Between Output and Unemployment*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 21) As the economy expands, the labor force _____, and as the economy contracts, the labor force _____.
- A) increases; decreases
 - B) increases; increases
 - C) decreases; decreases
 - D) decreases; increases

Answer: A

Diff: 1

Topic: *The Relationship Between Output and Unemployment*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

2 True/False

- 1) Recent research and data have shown that the relationship between output and unemployment is as stable as Okun's Law predicts.

Answer: FALSE

Diff: 1

Topic: *The Relationship Between Output and Unemployment*

Skill: *Fact*

- 2) When an economy expands the unemployment rate is slow to drop because the labor force expands too.

Answer: TRUE

Diff: 1

Topic: *The Relationship Between Output and Unemployment*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

3) When firms hold excess labor, the unemployment rate drops faster during an expansion.

Answer: FALSE

Diff: 1

Topic: *The Relationship Between Output and Unemployment*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

4) The relationship between output growth and unemployment depends on the state of the economy.

Answer: TRUE

Diff: 1

Topic: *The Relationship Between Output and Unemployment*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

5) For every 3% growth in output, the unemployment rate always declines 1%.

Answer: FALSE

Diff: 1

Topic: *The Relationship Between Output and Unemployment*

Skill: *Fact*

16.5 The Size of the Multiplier

1 Multiple Choice

1) Firms report that their workers are working six hours of overtime per week. The government reports that the unemployment rate is 3.5%. In this situation, the multiplier is likely to be

A) negative.

B) large.

C) small.

D) infinitely large.

Answer: C

Diff: 2

Topic: *The Size of the Multiplier*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

2) As the economy approaches full employment, the size of the multiplier will

A) remain unchanged.

B) become negative.

C) become larger.

D) become smaller.

Answer: D

Diff: 1

Topic: *The Size of the Multiplier*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

3) The government spending multiplier is likely to be smaller during periods of

A) high output and high unemployment.

B) high output and low unemployment.

C) low output and low unemployment.

D) low output and high unemployment.

Answer: B

Diff: 1

Topic: *The Size of the Multiplier*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 4) The government spending multiplier is likely to be larger during periods of
- A) high output and low unemployment.
 - B) low output and low unemployment.
 - C) low output and high unemployment.
 - D) high output and high unemployment.

Answer: C

Diff: 1

Topic: *The Size of the Multiplier*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 5) If the economy has automatic stabilizers built in, the multiplier will
- A) be smaller than it would have been in the absence of automatic stabilizers.
 - B) be larger than it would have been in the absence of automatic stabilizers.
 - C) be zero.
 - D) be infinitely larger than it would have been in the absence of automatic stabilizers.

Answer: A

Diff: 2

Topic: *The Size of the Multiplier*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 6) Which of the following statements is TRUE?
- A) Increases in the interest rate crowd out both consumption and investment spending, and this reduces the size of the multiplier.
 - B) Increases in the interest rate crowd out both consumption and investment spending, and this increases the size of the multiplier.
 - C) Increases in the interest rate have no effect on the size of the multiplier because higher interest rates cause consumption to increase, which offsets the crowding out of investment.
 - D) Increases in the interest rate cause the size of the multiplier to be smaller if the economy is on the flat portion of the AS curve and to be larger if the economy is on the steep portion of the AS curve.

Answer: A

Diff: 2

Topic: *The Size of the Multiplier*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 7) Which of the following statements is TRUE?
- A) The multiplier effects for policy changes that are perceived to be temporary are smaller than those for policy changes that are perceived to be permanent.
 - B) The multiplier effects for policy changes that are perceived to be temporary are larger than those for policy changes that are perceived to be permanent.
 - C) The multiplier effects for policy changes that are perceived to be temporary are the same as those for policy changes that are perceived to be permanent.
 - D) There is no relationship between the size of the multiplier effect and whether policy changes are perceived to be temporary or permanent.

Answer: A

Diff: 2

Topic: *The Size of the Multiplier*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 8) Suppose that the value of the multiplier has increased in recent years. Which of the following could have caused this?
- A) Consumption has become more sensitive to changes in the interest rate.
 - B) The costs of inventory storage have fallen.
 - C) Changes in the way the unemployment compensation fund is financed have made it more expensive for firms to lay off workers.
 - D) "Buy America" campaigns launched by many unions have succeeded in reducing the demand for imported goods.

Answer: D

Diff: 2

Topic: *The Size of the Multiplier*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 9) If it becomes more expensive for firms to hold excess capital and labor, the multiplier will
- A) decrease.
 - B) remain unchanged.
 - C) increase.
 - D) either increase or decrease depending on the value of the *MPC*.

Answer: C

Diff: 2

Topic: *The Size of the Multiplier*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 10) Firms have inventories that they can draw down to meet an increase in demand. This will
- A) have no effect on the multiplier, because the *MPC* remains unchanged.
 - B) increase the size of the multiplier, because firms will be able to respond more quickly to a change in demand.
 - C) decrease the size of the multiplier, because output will not immediately respond to changes in demand.
 - D) either increase or decrease the multiplier, depending on the size of the *MPC*.

Answer: C

Diff: 3

Topic: *The Size of the Multiplier*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 11) Suppose that input prices respond very quickly to output price. This will
- A) reduce the value of the multiplier.
 - B) increase the value of the multiplier.
 - C) have no effect on the value of the multiplier.
 - D) either increase or decrease the value of the multiplier depending on the value of the *MPC*.

Answer: A

Diff: 3

Topic: *The Size of the Multiplier*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

12) In practice, the size of the multiplier is about

- A) 1. B) 1.4. C) 2.5. D) 3.

Answer: B

Diff: 1

Topic: The Size of the Multiplier

Skill: Fact

13) The multiplier reaches its peak about _____ months after a spending increase began.

- A) 3 B) 6 to 9 C) 9 to 12 D) 12 to 15

Answer: C

Diff: 1

Topic: The Size of the Multiplier

Skill: Fact

14) If the economy is on the steep part of the AS curve, the multiplier will be

- A) larger than it would be if the economy were on the flat portion of the AS curve.
B) smaller than it would be if the economy were on the flat portion of the AS curve.
C) constant regardless of where the economy is on the AS curve.
D) infinite, as compared to zero if the economy is on the flat portion of the AS curve.

Answer: B

Diff: 2

Topic: The Size of the Multiplier

Skill: Conceptual

AACSB: Reflective Thinking

15) Firms believe that the current economic downturn will be long-lasting and have decided to hold very little excess labor. The government reports that the unemployment rate is 12.5%. The government has decided to stimulate the economy by increasing government spending. In this situation the multiplier is likely to be

- A) negative. B) zero. C) small. D) large.

Answer: D

Diff: 2

Topic: The Size of the Multiplier

Skill: Conceptual

AACSB: Reflective Thinking

2 True/False

1) The presence of automatic stabilizers increases the size of the multiplier.

Answer: FALSE

Diff: 1

Topic: The Size of the Multiplier

Skill: Conceptual

AACSB: Reflective Thinking

2) The closer the economy is to full employment, the larger the multiplier is.

Answer: FALSE

Diff: 1

Topic: The Size of the Multiplier

Skill: Conceptual

AACSB: Reflective Thinking

3) Temporary policy changes have more effect than permanent ones.

Answer: FALSE

Diff: 1

Topic: *The Size of the Multiplier*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

4) The less inventories firms hold, the larger the multiplier.

Answer: TRUE

Diff: 2

Topic: *The Size of the Multiplier*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

5) The "crowding out" effect decreases planned investment and decreases the value of the multiplier.

Answer: TRUE

Diff: 2

Topic: *The Size of the Multiplier*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

Chapter 17 Long-Run Growth

17.1 The Growth Process: From Agriculture to Industry

1 Multiple Choice

- 1) Economic growth is defined as an increase in
- A) nominal GDP.
 - B) investment.
 - C) household consumption.
 - D) real output.

Answer: D

Diff: 1

Topic: *The Growth Process: From Agriculture to Industry*

Skill: *Definition*

- 2) Economic growth is
- A) an increase in labor force.
 - B) a one-year increase in investment.
 - C) sustained increase in output over a long period of time.
 - D) sustained increase in workers' productivity.

Answer: C

Diff: 1

Topic: *The Growth Process: From Agriculture to Industry*

Skill: *Definition*

- 3) The period of rapid and sustained increase in real output per capita that began in the Western World with the Industrial Revolution is known as the period of
- A) social progress.
 - B) technological change.
 - C) creative destruction.
 - D) modern economic growth.

Answer: D

Diff: 1

Topic: *The Growth Process: From Agriculture to Industry*

Skill: *Definition*

- 4) Which of the following indicators is used more often to measure economic growth?
- A) Real GDP
 - B) Nominal GDP
 - C) Population
 - D) Per capita real GDP

Answer: D

Diff: 1

Topic: *The Growth Process: From Agriculture to Industry*

Skill: *Fact*

- 5) Economic growth is the process of
- A) producing more consumer products.
 - B) increasing real output.
 - C) expanding the production possibilities frontier.
 - D) all of the above

Answer: D

Diff: 1

Topic: The Growth Process: From Agriculture to Industry

Skill: Definition

Refer to the information provided in Figure 17.1 below to answer the questions that follow.

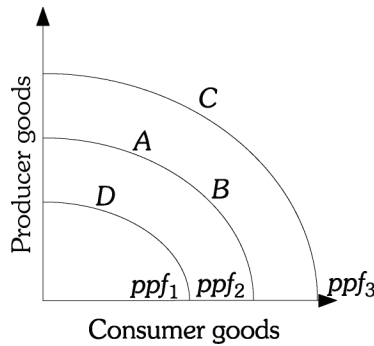


Figure 17.1

- 6) Refer to Figure 17.1. Economic growth is represented by
- A) a movement from Point A to Point B along ppf_1 .
 - B) a movement from Point B to Point C.
 - C) a movement from Point B to Point A.
 - D) a shift in the production possibilities frontier from ppf_2 to ppf_1 .

Answer: B

Diff: 1

Topic: The Growth Process: From Agriculture to Industry

Skill: Analytic

AACSB: Analytic Skills

- 7) Refer to Figure 17.1. Which of the following causes the ppf to shift from ppf_2 to ppf_3 ?
- A) technological progress
 - B) a decrease in capital stock
 - C) a decrease in the labor force
 - D) an increase in the population

Answer: A

Diff: 2

Topic: The Growth Process: From Agriculture to Industry

Skill: Analytic

AACSB: Analytic Skills

- 8) Refer to Figure 17.1. Which of the following causes the *ppf* to shift from *ppf*₂ to *ppf*₁?
- A) technological progress
 - B) a decrease in capital stock
 - C) an increase in the labor force
 - D) an increase in per capita income

Answer: B

Diff: 2

Topic: *The Growth Process: From Agriculture to Industry*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 9) Refer to Figure 17.1. An economic decline is represented by a movement from
- A) point A to point B.
 - B) point D to point A.
 - C) point C to point A
 - D) point B to point A.

Answer: C

Diff: 2

Topic: *The Growth Process: From Agriculture to Industry*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 10) Refer to Figure 17.1. Economic growth is represented by
- A) a movement from point D to point C.
 - B) a movement from point A to point C.
 - C) a movement from point D to point A.
 - D) all of the above

Answer: D

Diff: 2

Topic: *The Growth Process: From Agriculture to Industry*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 11) Refer to Figure 17.1. Which of the following CANNOT cause a movement from Point A to Point C?
- A) an expansionary monetary policy
 - B) technological progress
 - C) an increase in capital stock
 - D) an increase in the productivity of workers

Answer: A

Diff: 2

Topic: *The Growth Process: From Agriculture to Industry*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 12) Which of the following is a source of economic growth?
- A) more resources
 - B) active economic policies
 - C) technology
 - D) both A and C

Answer: D

Diff: 1

Topic: *The Growth Process: From Agriculture to Industry*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 13) Economic growth allows a society to consume
- A) more goods per person.
 - B) a higher quality of goods.
 - C) a wider variety of goods.
 - D) all of the above

Answer: D

Diff: 1

Topic: *The Growth Process: From Agriculture to Industry*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 14) Economic growth allows a society to consume
- A) more goods per person.
 - B) more than it should.
 - C) more than is sustainable.
 - D) exactly what it needs.

Answer: A

Diff: 1

Topic: *The Growth Process: From Agriculture to Industry*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 15) For economic growth to increase living standards,
- A) society must discover ways of using available resources more efficiently.
 - B) the choices available to consumers must increase.
 - C) the rate of growth must exceed the rate of population increase.
 - D) society must acquire more resources.

Answer: C

Diff: 2

Topic: *The Growth Process: From Agriculture to Industry*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

Refer to the information provided in Figure 17.2 below to answer the questions that follow.

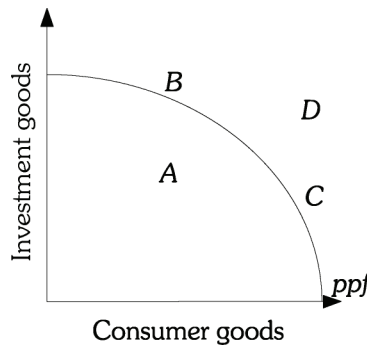


Figure 17.2

- 16) Refer to Figure 17.2. The highest unemployment rate occurs when the economy is at Point
- A) A
 - B) B
 - C) C
 - D) D

Answer: A

Diff: 1

Topic: *The Growth Process: From Agriculture to Industry*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

17) Refer to Figure 17.2. An economy that chooses to be at Point _____ can achieve higher economic growth rate in the future.

- A) A B) B C) C D) D

Answer: B

Diff: 2

Topic: *The Growth Process: From Agriculture to Industry*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

18) Refer to Figure 17.2. Point _____ can not be produced by the people of this society.

- A) A B) B C) C D) D

Answer: D

Diff: 2

Topic: *The Growth Process: From Agriculture to Industry*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

19) The strict definition of economic growth that serves to increase living standards is

- A) an increase in real GDP per capita.
B) an increase in nominal GDP per capita.
C) an increase in capital accumulation per capita.
D) an increase in investment per capita.

Answer: A

Diff: 2

Topic: *The Growth Process: From Agriculture to Industry*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

20) In Polynomia, real GDP increased by 8% and the population increased by 3% in 2008. In 2008, Polynomia experienced

- A) economic growth, but not an increase in living standards.
B) economic growth and an increase in living standards.
C) no economic growth, but an increase in living standards.
D) an economic decline.

Answer: B

Diff: 1

Topic: *The Growth Process: From Agriculture to Industry*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

21) In Vidalia, real GDP increased by 6% and the population increased by 9% in 2008. In 2008, Vidalia experienced

- A) economic growth, but not an increase in living standards.
B) economic growth and an increase in living standards.
C) no economic growth, but an increase in living standards.
D) an economic decline.

Answer: A

Diff: 1

Topic: *The Growth Process: From Agriculture to Industry*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 22) The relationship $Y = f(L,K)$ is
- A) a production function.
 - B) a technological relationship between inputs and total output.
 - C) a technological relationship between inputs and GDP.
 - D) all of the above

Answer: D

Diff: 1

Topic: *The Growth Process: From Agriculture to Industry*

Skill: *Definition*

2 True/False

- 1) Average productivity of labor is measured as the additional output produced by an additional worker.

Answer: FALSE

Diff: 1

Topic: *The Growth Process: From Agriculture to Industry*

Skill: *Definition*

- 2) Human capital increases with on-the-job training.

Answer: TRUE

Diff: 2

Topic: *The Growth Process: From Agriculture to Industry*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 3) The production possibility frontier shows the maximum output a nation can produce with available resources.

Answer: TRUE

Diff: 1

Topic: *The Growth Process: From Agriculture to Industry*

Skill: *Definition*

- 4) Technological progress shifts the production possibility curve away from the origin.

Answer: TRUE

Diff: 1

Topic: *The Growth Process: From Agriculture to Industry*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 5) If a society gets more capital, its production possibility curve increases.

Answer: TRUE

Diff: 1

Topic: *The Growth Process: From Agriculture to Industry*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 6) If a society acquires more human capital, per capita production will fall unless it gets more physical capital too.

Answer: FALSE

Diff: 1

Topic: *The Growth Process: From Agriculture to Industry*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

17.2 The Sources of Economic Growth

1 Multiple Choice

- 1) The mathematical representation of the technological relationship between inputs and national output is known as the
- A) aggregate supply function.
 - B) production possibilities frontier.
 - C) aggregate production function.
 - D) input-output table.

Answer: C

Diff: 1

Topic: *The Sources of Economic Growth*

Skill: *Definition*

- 2) The aggregate production function is the mathematical representation of the technological relationship between
- A) national output and fiscal policy.
 - B) national output and inputs.
 - C) fiscal and monetary policy changes and national output.
 - D) the rate of capital accumulation and national output.

Answer: B

Diff: 1

Topic: *The Sources of Economic Growth*

Skill: *Definition*

- 3) The aggregate production function is $Y = 2K^{0.5}L^{0.5}$. If there are 225 units of capital and 196 units of labor, aggregate output is
- A) 420 units.
 - B) 508 units.
 - C) 700 units.
 - D) 842 units.

Answer: A

Diff: 2

Topic: *The Sources of Economic Growth*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 4) The aggregate production function is $Y = 5K^{0.5}L^{0.5}$. If there are 49 units of capital and 16 units of labor, aggregate output is
- A) 60 units
 - B) 70 units.
 - C) 140 units.
 - D) 325 units.

Answer: C

Diff: 2

Topic: *The Sources of Economic Growth*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 5) The aggregate production function is $Y = 3KL$. If there are 30 units of capital and 40 units of labor, aggregate output is
- A) 3,600 units. B) 2,500 units. C) 2,100 units. D) 400 units.

Answer: A

Diff: 2

Topic: *The Sources of Economic Growth*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 6) Convergence theory suggests that gaps in _____ tend to close over time.
- A) national income B) population levels
C) unemployment rates D) inflation rates

Answer: A

Diff: 1

Topic: *The Sources of Economic Growth*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 7) Which of the following countries had the highest average growth rate per year from 1999–2007?
- A) China B) the United States
C) Zimbabwe D) Japan

Answer: A

Diff: 1

Topic: *The Sources of Economic Growth*

Skill: *Fact*

- 8) The average productivity of labor measures
- A) total output produced by workers.
B) the additional output produced by an additional worker.
C) output per worker.
D) capital per worker.

Answer: C

Diff: 2

Topic: *The Sources of Economic Growth*

Skill: *Definition*

Refer to the information provided in Figure 17.3 below to answer the questions that follow.

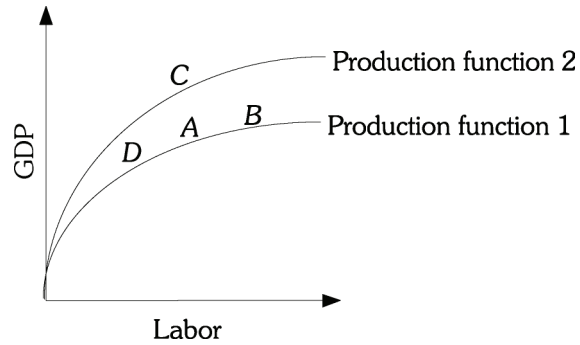


Figure 17.3

- 9) Refer to Figure 17.3. Which of the following movements represents an increase in the labor force?

A) A to D B) B to C C) A to B D) A to C

Answer: C

Diff: 2

Topic: The Sources of Economic Growth

Skill: Analytic

AACSB: Analytic Skills

- 10) Refer to Figure 17.3. Which of the following movements represents an increase in the productivity of labor?

A) A to C B) A to B C) D to A D) C to B

Answer: A

Diff: 2

Topic: The Sources of Economic Growth

Skill: Analytic

AACSB: Analytic Skills

- 11) Refer to Figure 17.3. Which of the following movements represents a decrease in the productivity of labor?

A) A to C B) A to B C) B to D D) C to A

Answer: D

Diff: 2

Topic: The Sources of Economic Growth

Skill: Analytic

AACSB: Analytic Skills

- 12) Refer to Figure 17.3. Which of the following movements represents a decrease in the labor force?

A) A to D B) D to C C) A to B D) A to C

Answer: A

Diff: 2

Topic: The Sources of Economic Growth

Skill: Analytic

AACSB: Analytic Skills

13) Refer to Figure 17.3. Which of the following movements represents an increase the amount of capital?

A) A to D

B) D to C

C) A to B

D) A to C

Answer: D

Diff: 2

Topic: *The Sources of Economic Growth*

Skill: *Analytic*

AACSB: *Analytic Skills*

14) If the capital stock remains fixed while the supply of labor increases, it is likely that

A) the productivity of labor will rise.

B) the productivity of labor will fall.

C) the productivity of labor will not change.

D) output per capita will rise.

Answer: B

Diff: 2

Topic: *The Sources of Economic Growth*

Skill: *Analytic*

AACSB: *Analytic Skills*

15) Diminishing returns to a factor implies that with capital fixed,

A) as labor increases output always increases.

B) as output increases, labor increases.

C) as labor increases, output decreases.

D) as labor increases, labor productivity eventually decreases.

Answer: D

Diff: 1

Topic: *The Sources of Economic Growth*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

16) Thomas Malthus and David Ricardo believed that to increase agricultural output, people would be forced to

A) farm more-productive land, in which case the returns to successive increases in population would increase.

B) farm less-productive land, in which case the returns to successive increases in population would diminish.

C) farm less-productive land, in which case the returns to successive increases in population would increase.

D) farm more-productive land, in which case the returns to successive increases in population would diminish.

Answer: B

Diff: 1

Topic: *The Sources of Economic Growth*

Skill: *Fact*

- 17) Thomas Malthus and David Ricardo believed that to increase agricultural output, people would be forced to
- A) farm land more intensively, in which case the returns to successive increases in population would diminish.
 - B) farm land less intensively, in which case the returns to successive increases in population would increase.
 - C) farm land more intensively, in which case the returns to successive increases in population would increase.
 - D) farm land less intensively, in which case the returns to successive increases in population would diminish.

Answer: A

Diff: 1

Topic: *The Sources of Economic Growth*

Skill: *Fact*

- 18) Thomas Malthus and David Ricardo believed that returns to successive increase in population would decline because to increase agricultural output, people would be forced
- A) to farm the land more intensively and to farm less productive land.
 - B) to farm the land less intensively and to farm more productive land.
 - C) to farm the land more intensively and to farm more productive land.
 - D) to farm farm land less intensively and to farm less productive land.

Answer: A

Diff: 1

Topic: *The Sources of Economic Growth*

Skill: *Fact*

- 19) Both Malthus and Ricardo failed to account for the effect of _____ on agricultural production.
- A) diminishing returns
 - B) technological change
 - C) capital depreciation
 - D) increasing returns

Answer: B

Diff: 1

Topic: *The Sources of Economic Growth*

Skill: *Fact*

- 20) With a fixed amount of capital, 300 workers produce 9,000 cars. The average labor productivity is
- A) 0.03.
 - B) 3.
 - C) 27.
 - D) 30.

Answer: D

Diff: 1

Topic: *The Sources of Economic Growth*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 21) If labor productivity in a steel mine is 3.5 tons per worker, then 400 steel workers with a fixed amount of capital produce
- A) 87.5 tons.
 - B) 1,400 tons.
 - C) 1,750 tons.
 - D) 4,000 tons.

Answer: B

Diff: 1

Topic: *The Sources of Economic Growth*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 22) An increase in the capital stock
- A) can increase output, even if it is not accompanied by an increase in the labor force.
 - B) provides valuable services directly, but not indirectly.
 - C) can increase output, but only if it is accompanied by an increase in the labor force.
 - D) cannot increase output, even if it is accompanied by an increase in the labor force.

Answer: A

Diff: 2

Topic: *The Sources of Economic Growth*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 23) An increase in capital stock
- A) enhances labor productivity.
 - B) provides valuable services directly.
 - C) causes economic growth.
 - D) all of the above

Answer: D

Diff: 2

Topic: *The Sources of Economic Growth*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 24) Labor productivity increases when
- A) labor and output increase proportionately.
 - B) capital increases and labor remains constant.
 - C) output decreases and labor increases.
 - D) capital/labor ratio decreases.

Answer: B

Diff: 2

Topic: *The Sources of Economic Growth*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 25) Which of the following statements is TRUE?
- A) Investment in private capital is a source of economic growth, but investment in public capital is not.
 - B) Investment in public capital is a source of economic growth, but investment in private capital is not.
 - C) Investment in both private and public capital is conducive to economic growth and higher productivity.
 - D) Neither investment in private nor public capital has any effect on economic growth and productivity.

Answer: C

Diff: 2

Topic: *The Sources of Economic Growth*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 26) A company uses 200 workers and 50 units of capital to produce 1,000 units of output. Its average labor productivity is
- A) 4. B) 5. C) 20. D) 25.

Answer: B

Diff: 2

Topic: *The Sources of Economic Growth*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 27) A company uses 100 workers and 30 units of capital to produce 500 units of output. If this company increases its capital to 50 units and, as a result, its output increases by 300 units, the productivity of labor _____ to _____ units per worker.
- A) increases; 8 B) increases; 1 C) increases; 3 D) decreases; 4

Answer: A

Diff: 2

Topic: *The Sources of Economic Growth*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 28) An important source of increasing productivity is
- A) an increase in the ratio of capital to labor.
B) an increase in the ratio of labor to capital.
C) a decrease in the ratio of capital to labor.
D) faster growth in the labor force than in the capital stock.

Answer: A

Diff: 2

Topic: *The Sources of Economic Growth*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 29) In all economies experiencing modern economic growth,
- A) labor expands at a more rapid pace than capital.
B) capital and labor expand at a constant rate.
C) capital expands at a more rapid pace than labor.
D) capital expands, but labor remains constant.

Answer: C

Diff: 2

Topic: *The Sources of Economic Growth*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 30) Which of the following is an investment in infrastructure?
- A) Southstar Steel has two office buildings separated by one-half mile. The company lays a fiber optic cable between the buildings to take advantage of new technology.
 - B) The federal government makes it easier for college students to obtain loans and this increases the number of students attending college.
 - C) The city of Robesonia builds a new sewage treatment plant.
 - D) Residents of a suburban housing development hire a private security force because they have been concerned about crime.

Answer: C

Diff: 2

Topic: *The Sources of Economic Growth*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 31) Increased investments in infrastructure or public capital would most likely
- A) cause a decrease in the growth rate, because they would require a reduction in private investment.
 - B) have no impact on growth, because they do not affect the private sector.
 - C) increase growth.
 - D) reduce growth in a developing country.

Answer: C

Diff: 2

Topic: *The Sources of Economic Growth*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 32) An increase in human capital
- A) increases the productivity of labor.
 - B) decreases the productivity of labor.
 - C) increases the productivity of labor only if there is a corresponding technological change.
 - D) increases the capital-labor ratio.

Answer: A

Diff: 1

Topic: *The Sources of Economic Growth*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 33) Which of the following is NOT an investment in human capital?
- A) local governments begin providing free hepatitis vaccinations to any resident who wants one
 - B) the Precision Tool Company teaches all its workers how to repair all the machines in the factory
 - C) older workers return to school to update their skills
 - D) the Ferris Advertising Agency replaces its secretaries' typewriters with personal computers

Answer: D

Diff: 2

Topic: *The Sources of Economic Growth*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 34) Which of the following is NOT an investment in human capital?
- A) an individual decides to enroll in a vocational training program
 - B) a firm engages in on-the-job training
 - C) the government expands its programs to improve health care
 - D) the government increases the level of unemployment benefits

Answer: D

Diff: 2

Topic: *The Sources of Economic Growth*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 35) Suppose that growth in output that can be attributed to growth in labor and capital is 6%. If output grows at a rate of 6%, it must be the case that
- A) the economy is not experiencing technological progress.
 - B) growth in labor force exceeds growth in capital.
 - C) growth in capital exceeds growth in labor.
 - D) the economy is experiencing technological progress.

Answer: A

Diff: 2

Topic: *The Sources of Economic Growth*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 36) Suppose that growth in output that can be attributed to growth in labor and capital is 2%. If output grows at a rate of 5%, it must be the case that
- A) growth in labor exceeds growth in capital.
 - B) growth in capital exceeds growth in labor.
 - C) the economy is experiencing technological progress.
 - D) the economy is not spending enough on acquiring human capital.

Answer: C

Diff: 2

Topic: *The Sources of Economic Growth*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 37) Thinking up a new idea is an example of
- A) an invention.
 - B) an innovation.
 - C) human capital accumulation.
 - D) social overhead capital.

Answer: A

Diff: 1

Topic: *The Sources of Economic Growth*

Skill: *Definition*

38) A firm used to produce a product using three units of labor and one unit of capital. The firm discovers that it can produce more output at a lower cost if it combines two units of labor with two units of capital. This is an example of

- A) an innovation.
- B) an invention.
- C) increasing returns.
- D) economic growth.

Answer: A

Diff: 1

Topic: *The Sources of Economic Growth*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

39) A researcher discovered the adhesive that allows a piece of paper to be attached to a surface temporarily and then removed and reattached many times. It was many years before a use was found for this adhesive. Which of the following is TRUE?

- A) The discovery represents an invention and the finding of a use for the adhesive represents an innovation.
- B) The discovery represents an innovation and the finding of a use for the adhesive represents an invention.
- C) This is an example of an invention only.
- D) This is an example of an innovation only.

Answer: A

Diff: 1

Topic: *The Sources of Economic Growth*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

40) Since 1978, growth in China has been

- A) quite rapid despite a relatively weak set of property rights protections.
- B) quite rapid because of a relatively strong set of property rights protections.
- C) relatively slow because of a relatively weak set of property rights protections.
- D) relatively slow despite a relatively strong set of property rights protections.

Answer: A

Diff: 1

Topic: *The Sources of Economic Growth*

Skill: *Fact*

41) Any investment made in a country by residents outside that country is

- A) foreign direct investment.
- B) foreign exchange.
- C) gross private domestic investment.
- D) net exports.

Answer: A

Diff: 1

Topic: *The Sources of Economic Growth*

Skill: *Definition*

42) Which of the following will result in increased productivity?

- A) advances in managerial knowledge
- B) government regulations
- C) taxation
- D) population increases

Answer: A

Diff: 1

Topic: *The Sources of Economic Growth*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

43) Relaxed trucking regulations increase the maximum weight a tractor-trailer combination can haul, from 40 tons to 60 tons. This change in regulations reduces the transportation costs per ton and is

- A) capital saving only.
- B) labor saving only.
- C) an external diseconomy of scale.
- D) both capital saving and labor saving.

Answer: D

Diff: 1

Topic: *The Sources of Economic Growth*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

44) The introduction of robotics is an example of

- A) a labor-saving innovation.
- B) a capital-saving innovation.
- C) an external economy of scale.
- D) an external diseconomy of scale.

Answer: A

Diff: 1

Topic: *The Sources of Economic Growth*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

45) An accounting firm purchased two computers and found that two workers using the computers could do the same work it used to take four workers to do. This introduction of computers is an example of

- A) a labor-saving innovation.
- B) a capital-saving innovation.
- C) both capital and labor saving innovation.
- D) neither a capital nor a labor saving innovation.

Answer: A

Diff: 1

Topic: *The Sources of Economic Growth*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

46) Improved production management doubles the number of air conditioners that can be produced. This managerial innovation is

- A) capital saving.
- B) labor saving.
- C) both capital saving and labor saving.
- D) an external economy of scale.

Answer: C

Diff: 1

Topic: *The Sources of Economic Growth*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

47) External economies of scale are cost savings achieved when

- A) firms become more efficient.
- B) the size of industries become larger.
- C) capital/labor ratio becomes smaller.
- D) there are capital-saving innovations.

Answer: B

Diff: 1

Topic: *The Sources of Economic Growth*

Skill: *Definition*

- 48) Which of the following is an example of an external economy of scale?
- A) As more firms hired computer programmers, more schools began training computer programmers and firms were able to spend less money on training employees to be computer programmers.
 - B) A moving company buys computers for its office staff and as a result can reduce its office staff by 10%.
 - C) As a shirt manufacturer buys more cotton cloth, the cloth supplier reduces the price per yard of cloth.
 - D) The U.S. government eliminates restrictions on hiring non-U.S. citizens.

Answer: A

Diff: 2

Topic: *The Sources of Economic Growth*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 49) If there are constant returns to scale, a 3% increase in inputs should increase output by 3%. But if as a result of increasing inputs by 3% output increased by 5%, then
- A) all 5% of the increase in output resulted from the increase in inputs.
 - B) all 5% of the increase in output must have resulted from an increase in factor productivity.
 - C) 2% of the increase in output resulted from the increase in inputs, and 3% of the increase in output resulted from an increase in factor productivity.
 - D) 3% of the increase in output resulted from the increase in inputs, and 2% of the increase in output resulted from an increase in factor productivity.

Answer: D

Diff: 2

Topic: *The Sources of Economic Growth*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 50) Which of the following factors would NOT contribute to an increase in measured factor productivity?
- A) an advance in managerial knowledge
 - B) the imposition of additional environmental regulations
 - C) an increase in expenditures on research and development
 - D) the introduction of robotics

Answer: B

Diff: 2

Topic: *The Sources of Economic Growth*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 51) Increased environmental regulation is likely to
- A) increase measured productivity, but decrease output.
 - B) increase measured productivity and increase output.
 - C) have no effect on either productivity or output.
 - D) decrease measured productivity and decrease output.

Answer: D

Diff: 1

Topic: *The Sources of Economic Growth*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

2 True/False

- 1) If an economy experiences growth in productivity without growth in its labor force, it will grow.

Answer: TRUE

Diff: 1

Topic: *The Sources of Economic Growth*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 2) A decrease in capital/labor ratio enhances economic growth.

Answer: FALSE

Diff: 2

Topic: *The Sources of Economic Growth*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 3) Convergence theory suggests that when less developed countries begin to develop, they typically have higher growth rates as they catch up with more developed nations.

Answer: TRUE

Diff: 1

Topic: *The Sources of Economic Growth*

Skill: *Definition*

- 4) From 1999–2007, China had an average growth rate per year that was more than three times as high as that in the U.S.

Answer: TRUE

Diff: 1

Topic: *The Sources of Economic Growth*

Skill: *Fact*

- 5) Labor productivity can increase even if the labor force increases.

Answer: TRUE

Diff: 2

Topic: *The Sources of Economic Growth*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 6) An increase in human capital will decrease output.

Answer: FALSE

Diff: 2

Topic: *The Sources of Economic Growth*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 7) To increase growth the government could alter the tax code to encourage savings.

Answer: TRUE

Diff: 1

Topic: *The Sources of Economic Growth*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

8) An invention is an advance in knowledge.

Answer: TRUE

Diff: 1

Topic: *The Sources of Economic Growth*

Skill: *Definition*

9) Since 1978, growth in China has been quite strong despite a relatively weak set of property rights protections.

Answer: TRUE

Diff: 1

Topic: *The Sources of Economic Growth*

Skill: *Fact*

10) Foreign direct investment is any investment made in a country by residents outside that country.

Answer: TRUE

Diff: 1

Topic: *The Sources of Economic Growth*

Skill: *Definition*

11) In 2007, the World Bank estimated that there were 72 million primary aged school children in the world who were not in school.

Answer: TRUE

Diff: 1

Topic: *The Sources of Economic Growth*

Skill: *Fact*

12) A key problem facing Sub-Saharan Africa in terms of human capital is health.

Answer: TRUE

Diff: 1

Topic: *The Sources of Economic Growth*

Skill: *Fact*

17.3 Growth and Productivity in the United States

1 Multiple Choice

1) The U.S. economy experienced the weakest economic growth

A) during the 1930s.

B) during the 1940s.

C) during the 1960s.

D) during the 1970s.

Answer: A

Diff: 1

Topic: *Growth and Productivity in the United States*

Skill: *Fact*

2) The U.S. economy experienced the strongest economic growth during the

A) 1930s.

B) 1940s.

C) 1960s.

D) 1990s.

Answer: B

Diff: 1

Topic: *Growth and Productivity in the United States*

Skill: *Fact*

- 3) Which part of the world experienced the strongest economic growth during the periods of the 1980s and 1990s?
- A) European countries
 - B) North America excluding Mexico
 - C) Africa
 - D) Asia excluding Japan

Answer: D

Diff: 1

Topic: Growth and Productivity in the United States

Skill: Fact

- 4) According to Edward Denison, the largest source of growth in the U.S. economy during the period 1973–1979 was
- A) increase in inputs.
 - B) increase in economies of scale.
 - C) increase in productivity.
 - D) increase in pollution abatement techniques.

Answer: A

Diff: 1

Topic: Growth and Productivity in the United States

Skill: Fact

- 5) According to Edward Denison, increases in inputs in the U.S. during the 1970s was responsible for _____ of the growth rate in output.
- A) less than 50%
 - B) more than 50% but less than 60%
 - C) only 20%
 - D) over 90%

Answer: D

Diff: 1

Topic: Growth and Productivity in the United States

Skill: Fact

- 6) According to Edward Denison, about _____ of the U.S. growth in output over the entire period from 1929 to 1982 has come from increases in factors of production and about _____ has come from increases in productivity.
- A) one-half; one-half
 - B) one-third; two-thirds
 - C) two-thirds; one-third
 - D) one-fourth; three-fourths

Answer: A

Diff: 1

Topic: Growth and Productivity in the United States

Skill: Fact

- 7) According to Edward Denison, the least amount of growth in the U.S. attributed to increases in productivity was during the
- A) 1920s.
 - B) 1940s.
 - C) 1970s.
 - D) 1990s.

Answer: C

Diff: 1

Topic: Growth and Productivity in the United States

Skill: Fact

- 8) Between 1950 and 1990,
- A) real GDP increased at a faster rate than population, so real GDP per capita increased.
 - B) real GDP increased, but population increased at a faster rate, so real GDP per capita fell.
 - C) real GDP fell and population increased, so real per capita GDP fell.
 - D) real GDP fell at a faster rate than the decrease in the population, so real GDP per capita increased.

Answer: A

Diff: 1

Topic: *Growth and Productivity in the United States*

Skill: *Fact*

- 9) The most remarkable growth performance since 1982 has taken place in
- A) Japan.
 - B) France.
 - C) the United States.
 - D) Asia excluding Japan.

Answer: D

Diff: 1

Topic: *Growth and Productivity in the United States*

Skill: *Fact*

- 10) Which of the following was NOT one of the likely causes of the productivity problem in the 1970s?
- A) a reduction in government regulation
 - B) reduced research and development spending
 - C) a slowdown in investment spending
 - D) low saving rates

Answer: A

Diff: 2

Topic: *Growth and Productivity in the United States*

Skill: *Fact*

- 11) Which of the following was NOT one of the likely causes of the productivity problem in the 1970s?
- A) the increase in energy prices in the 1970s
 - B) high saving rates
 - C) an increase in government regulation
 - D) a slowdown in investment spending

Answer: B

Diff: 2

Topic: *Growth and Productivity in the United States*

Skill: *Fact*

- 12) Which of the following was one of the likely causes of the productivity problem of the 1970s?
- A) rapid growth in investment spending
 - B) a reduction in government regulation
 - C) low saving rates
 - D) an increase in research and development spending

Answer: C

Diff: 2

Topic: *Growth and Productivity in the United States*

Skill: *Fact*

- 13) Higher energy prices in the 1970s reduced labor productivity because
- A) energy and capital are substitute inputs.
 - B) the rise in energy prices tended to push firms away from labor-intensive measures and toward more capital-intensive techniques.
 - C) a great deal of investment went into transforming the existing capital stock into more energy-efficient forms.
 - D) labor productivity has been lower when used with more capital-intensive techniques.

Answer: C

Diff: 2

Topic: *Growth and Productivity in the United States*

Skill: *Fact*

- 14) Which of the following caused the productivity problem of the 1970s in the U.S.?
- A) low saving rate
 - B) increased governmental regulations
 - C) low spending on research and development
 - D) all of the above

Answer: D

Diff: 1

Topic: *Growth and Productivity in the United States*

Skill: *Fact*

- 15) Many economists believe that the U.S. growth since the mid-1990s with little inflationary pressure is due to
- A) expansionary fiscal and monetary policies.
 - B) continuous increases in the productivity of labor.
 - C) continuous reductions in aggregate supply.
 - D) increases in the aggregate demand that exceeded increases in the aggregate supply.

Answer: B

Diff: 2

Topic: *Growth and Productivity in the United States*

Skill: *Fact*

2 True/False

- 1) Edward Denison has estimated that growth of knowledge was the single most important factor contributing to increases in the productivity of inputs from 1929 to 1982.

Answer: TRUE

Diff: 1

Topic: *Growth and Productivity in the United States*

Skill: *Fact*

- 2) The 1970s was a period of high productivity growth in the United States.

Answer: FALSE

Diff: 1

Topic: *Growth and Productivity in the United States*

Skill: *Fact*

3) Economists agree that the cause of the slow economic growth during the 1970s was the tight monetary policy.

Answer: FALSE

Diff: 1

Topic: *Growth and Productivity in the United States*

Skill: *Fact*

4) The U.S. growth rate in the 19th century was faster than it was in the 20th century.

Answer: TRUE

Diff: 1

Topic: *Growth and Productivity in the United States*

Skill: *Fact*

5) Geography plays a role in a nation's or region's productivity.

Answer: TRUE

Diff: 1

Topic: *Growth and Productivity in the United States*

Skill: *Fact*

6) Zuliu Hu and Mohsin Khan have stated that the productivity gains in China over the past 20 years are, in large part, a result of market reforms from incorporating business into the public sector.

Answer: FALSE

Diff: 1

Topic: *Growth and Productivity in the United States*

Skill: *Fact*

17.4 Economic Growth and Public Policy in the United States

1 Multiple Choice

1) Some economists claim that the Social Security system in the United States is biased against saving. Their argument is that

- A) the Social Security system discourages people from making risky, but profitable, investments.
- B) private pension plans are better managed than the Social Security funds and are used for more productive investments.
- C) the Social Security system reduces the incentive for people to save by providing guaranteed retirement incomes.
- D) Social Security taxes are used to finance only investments in public infrastructure and are not available for business investment.

Answer: C

Diff: 2

Topic: *Economic Growth and Public Policy*

Skill: *Fact*

- 2) Public subsidization of research and development has been justified on the grounds that
- A) there are no private returns to research and development.
 - B) social returns to research and development exceed the private returns.
 - C) only large corporations have the financial resources to undertake research and development.
 - D) basic research cannot be undertaken by private firms.

Answer: B

Diff: 2

Topic: Economic Growth and Public Policy

Skill: Fact

- 3) Those who argue that research and development spending, especially on basic research, should be subsidized by the public sector believe that
- A) the benefits from research and development cannot be adequately captured by those undertaking the research.
 - B) private spending on research and development is too high.
 - C) the social returns from research and development are high compared with the social returns from other public investment projects.
 - D) the rate of return on investments in research and development is very high.

Answer: A

Diff: 2

Topic: Economic Growth and Public Policy

Skill: Conceptual

AACSB: Reflective Thinking

- 4) Which of the following policies has NOT been suggested as a means of increasing the rate of economic growth in the United States?
- A) increasing research and development spending
 - B) reducing government regulation
 - C) lowering the savings rate
 - D) enactment of an industrial policy

Answer: C

Diff: 2

Topic: Economic Growth and Public Policy

Skill: Fact

- 5) Which of the following policies should the government NOT adopt if its goal is to enhance economic growth?
- A) improve the quality of education
 - B) impose more regulation on producers
 - C) enact policies to increase the saving rate
 - D) enact policies to encourage research and development

Answer: B

Diff: 2

Topic: Economic Growth and Public Policy

Skill: Conceptual

AACSB: Reflective Thinking

- 6) Government involvement in the allocation of capital across manufacturing sectors is
- A) supply management.
 - B) industrial policy.
 - C) regulatory policy.
 - D) balanced growth policy.

Answer: B

Diff: 1

Topic: Economic Growth and Public Policy

Skill: Definition

- 7) The public policy of "targeting" industries for special and rapid investment is
- A) international trade policy.
 - B) growth policy.
 - C) fiscal policy.
 - D) industrial policy.

Answer: D

Diff: 1

Topic: Economic Growth and Public Policy

Skill: Definition

- 8) Which of the following is an example of an industrial policy?
- A) a subsidy to agricultural producers that makes it easier for them to export their products
 - B) an increase in the age at which people are eligible for full Social Security retirement benefits
 - C) an investment tax credit that is available to all firms
 - D) an across the board increase in the tax on imported goods

Answer: A

Diff: 1

Topic: Economic Growth and Public Policy

Skill: Conceptual

AACSB: Reflective Thinking

- 9) Critics of industrial policy argue that the government should not be involved in the allocation of capital across manufacturing sectors because
- A) the Japanese government is already practicing industrial policy, and because of its experience, it is much better at it than the United States would be.
 - B) the United States is losing out in international competition.
 - C) the government does not have enough information on the profitability and riskiness of industrial investments to make the correct decisions.
 - D) investments are always risky, and the U.S. government cannot afford to bear the risk.

Answer: C

Diff: 2

Topic: Economic Growth and Public Policy

Skill: Fact

- 10) Those who favor industrial policy argue that
- A) because other countries follow this practice, the United States must also use industrial policy so as not to lose out in international competition.
 - B) the government should help finance investment in the private sector because it has such easy access to funds.
 - C) it is an effective way to reduce the government deficit.
 - D) the government is the best judge of how risky investments are because it has more information than firms.

Answer: A

Diff: 2

Topic: *Economic Growth and Public Policy*

Skill: *Fact*

- 11) Related to the *Economics in Practice* on p. 329 [641]: In the United States, firms are increasingly looking at _____ to lower health care costs.
- A) trying to change production technology
 - B) increasing capital investment
 - C) eliminating medical benefits
 - D) sending employees to other countries

Answer: A

Diff: 1

Topic: *Economic Growth and Public Policy: Economics in Practice*

Skill: *Fact*

- 12) Related to the *Economics in Practice* on p. 329 [641]: In the United States, a growing number of companies have discovered they can save money and improve employee productivity by
- A) opening on-site medical clinics.
 - B) passing on health care costs to employees.
 - C) only paying for catastrophic health care expenses.
 - D) not providing health care benefits.

Answer: A

Diff: 1

Topic: *Economic Growth and Public Policy: Economics in Practice*

Skill: *Fact*

- 13) Related to the *Economics in Practice* on p. 332 [644]: Improvements in technology have arguably made it _____ to accurately measure productivity changes.
- A) increasingly difficult
 - B) much easier
 - C) perfectly possible
 - D) impossible

Answer: A

Diff: 1

Topic: *Economic Growth and Public Policy: Economics in Practice*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 14) Related to the *Economics in Practice* on p. 332 [644]: _____ may be underreported due to improvements in technology.
- A) Productivity changes
B) The size of the labor force
C) The capital-to-labor ratio
D) Production quantities

Answer: A

Diff: 1

Topic: *Economic Growth and Public Policy: Economics in Practice*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

2 True/False

- 1) The purpose of the *investment tax credit* enacted in 1961 is to provide tax reduction for firms that invest in new capital.

Answer: TRUE

Diff: 1

Topic: *Economic Growth and Public Policy*

Skill: *Fact*

- 2) Economic growth always leads to a more equitable distribution of income.

Answer: FALSE

Diff: 1

Topic: *Economic Growth and Public Policy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 3) Economists estimate that the rate of return on research and development is 5%.

Answer: FALSE

Diff: 1

Topic: *Economic Growth and Public Policy*

Skill: *Fact*

- 4) Industrial policy refers to the government's choosing the industries which should receive capital.

Answer: TRUE

Diff: 1

Topic: *Economic Growth and Public Policy*

Skill: *Definition*

- 5) The "No Child Left Behind Act" of 2001 increases state accountability for student performance.

Answer: TRUE

Diff: 1

Topic: *Economic Growth and Public Policy*

Skill: *Fact*

- 6) There is considerable dispute about how to measure educational progress.

Answer: TRUE

Diff: 1

Topic: *Economic Growth and Public Policy*

Skill: *Fact*

17.5 Growth and the Environment and Issues of Sustainability

1 Multiple Choice

- 1) The relation between growth, as measured in _____, is an inverted U.
A) per capita income and pollution
B) income and expenditure
C) saving and investment
D) human capital and physical capital

Answer: A

Diff: 2

Topic: *Growth and the Environment and Issues of Sustainability*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 2) As growth progresses and countries become richer, pollution
A) tends to fall.
B) rises exponentially.
C) rarely changes.
D) levels double.

Answer: A

Diff: 1

Topic: *Growth and the Environment and Issues of Sustainability*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 3) An explanation for the "inverted U" is that increased industrialization and growth initially _____ the environment, and in the long run, environmental quality _____.
A) degrades; continues to get worse
B) improves; improves even more
C) improves; gets worse
D) degrades; improves

Answer: D

Diff: 2

Topic: *Growth and the Environment and Issues of Sustainability*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 4) In 2000, the United Nations unanimously adopted the _____, a set of quantifiable, time-based targets for developing countries to meet.
A) 21st Century Equity Initiative
B) Global Warming Reduction Act
C) Millennium Development Goals
D) Carbon Footprint Eradication Measure

Answer: C

Diff: 1

Topic: *Growth and the Environment and Issues of Sustainability*

Skill: *Fact*

- 5) The Millennium Development Goals adopted by the United Nations included targets for which of the following?
A) education
B) income growth
C) environmental protection
D) all of the above

Answer: D

Diff: 1

Topic: *Growth and the Environment and Issues of Sustainability*

Skill: *Fact*

- 6) According to predictions made by the Club of Rome in 1972, the collapse of the world economy will occur because of
- A) the world's limited capacity to produce food.
 - B) the depletion of nonrenewable resources.
 - C) the ever-increasing birthrate in developed countries.
 - D) low saving rates and, therefore, low rates of capital accumulation.

Answer: B

Diff: 1

Topic: *Growth and the Environment and Issues of Sustainability*

Skill: *Fact*

- 7) A weakness in the Club of Rome's study entitled *The Limits to Growth* is that
- A) it assumed the rate of population growth would slow.
 - B) it did not account for technological change.
 - C) it assumed a constant demand for products.
 - D) it assumed a declining investment rate.

Answer: B

Diff: 1

Topic: *Growth and the Environment and Issues of Sustainability*

Skill: *Fact*

- 8) Much of the growth in _____ is due to export-manufacturing, and _____ have based their growth on resource extraction.
- A) Sub-Saharan Africa; most Central American nations
 - B) Southeast Asia; many African nations
 - C) Western Europe; the former Soviet-bloc countries
 - D) South America; North American countries

Answer: B

Diff: 1

Topic: *Growth and the Environment and Issues of Sustainability*

Skill: *Fact*

2 True/False

- 1) As growth progresses and countries become richer, pollution tends to fall.

Answer: TRUE

Diff: 1

Topic: *Growth and the Environment and Issues of Sustainability*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 2) The Millennium Development Goals adopted by the United Nations included targets for conservation management.

Answer: TRUE

Diff: 1

Topic: *Growth and the Environment and Issues of Sustainability*

Skill: *Fact*

3) In general, environmental pollution generally declines after growth has led to high per capita incomes.

Answer: TRUE

Diff: 1

Topic: Growth and the Environment and Issues of Sustainability

Skill: Fact

4) Much of Southeast Asia has fueled its growth through export-led manufacturing.

Answer: TRUE

Diff: 1

Topic: Growth and the Environment and Issues of Sustainability

Skill: Fact

Chapter 18 Debates in Macroeconomics: Monetarism, New Classical Theory, and Supply-Side Economics

18.1 Keynesian Economics

1 Multiple Choice

- 1) Who wrote the *General Theory of Employment, Interest, and Money*?
- A) Adam Smith
 - B) David Ricardo
 - C) Milton Friedman
 - D) John Maynard Keynes

Answer: D

Diff: 1

Topic: Keynesian Economics

Skill: Fact

- 2) Keynesian economics includes the idea that
- A) economic policies are ineffective.
 - B) the economy is basically stable.
 - C) prices adjust to clear the markets.
 - D) labor markets don't always clear due to wage rigidities.

Answer: D

Diff: 1

Topic: Keynesian Economics

Skill: Fact

- 3) Among the propositions of the Keynesian school of thought is
- A) economic policies are ineffective.
 - B) aggregate supply management is the key to a stable economy.
 - C) aggregate demand determines equilibrium output.
 - D) rational expectations.

Answer: C

Diff: 1

Topic: Keynesian Economics

Skill: Fact

- 4) Keynes believed which of the following?
- A) The government has a role to play in fighting inflation, but not in fighting unemployment.
 - B) The government has a role to play in fighting unemployment, but not in fighting inflation.
 - C) The government does not have a role to play in fighting inflation or unemployment.
 - D) The government has a role to play in fighting inflation and unemployment.

Answer: D

Diff: 1

Topic: Keynesian Economics

Skill: Fact

- 5) Many economists challenged the idea of activist government intervention in the economy following the
- A) inflation of the 1970s and early 1980s.
 - B) recession of 1974–1975.
 - C) recession of 1980–1982.
 - D) all of the above

Answer: D

Diff: 1

Topic: Keynesian Economics

Skill: Fact

2 True/False

- 1) Keynesians believe that government policies can improve economic performance.

Answer: TRUE

Diff: 1

Topic: Keynesian Economics

Skill: Fact

- 2) Keynesians believe that the economy will never reach a full employment equilibrium.

Answer: FALSE

Diff: 1

Topic: Keynesian Economics

Skill: Fact

- 3) Lowering taxes is a contractionary Keynesian policy.

Answer: FALSE

Diff: 2

Topic: Keynesian Economics

Skill: Definition

- 4) Keynesians believe the economy can be managed using monetary and fiscal policy.

Answer: TRUE

Diff: 1

Topic: Keynesian Economics

Skill: Fact

- 5) Many economists challenged the idea of passive government involvement in the economy following the inflation of the 1970s and early 1980s, and the recessions of 1974–1975 and 1980–1982.

Answer: FALSE

Diff: 1

Topic: Keynesian Economics

Skill: Fact

18.2 Monetarism

1 Multiple Choice

1) Which of the following schools of economic thought will recommend an expansionary fiscal policy to reduce the unemployment rate?

- A) the monetary schools
- B) the classical school
- C) the Keynesian school
- D) the rational expectation school

Answer: C

Diff: 1

Topic: Monetarism

Skill: Fact

2) The ratio of nominal GDP to the stock of money is the

- A) money multiplier.
- B) velocity of money.
- C) real GDP.
- D) GDP deflator.

Answer: B

Diff: 1

Topic: Monetarism

Skill: Definition

3) The velocity of money is

- A) the number of times a dollar bill exchanges hands in a year.
- B) the ratio of deposits to money supply.
- C) the number of times the Fed increases money supply in a year.
- D) the relationship between money supply and money demand.

Answer: A

Diff: 1

Topic: Monetarism

Skill: Definition

4) The velocity of money is the ratio of

- A) real GDP to the stock of money.
- B) the overall price level to the stock of money.
- C) nominal GDP to the stock of money.
- D) nominal GDP to the overall price level.

Answer: C

Diff: 1

Topic: Monetarism

Skill: Definition

5) A velocity of 6 means money changes hands, on average, every

- A) 6 years.
- B) 6 months.
- C) 2 months.
- D) 1/6 of a month.

Answer: C

Diff: 2

Topic: Monetarism

Skill: Conceptual

AACSB: Reflective Thinking

- 6) A velocity of _____ means money changes hands, on average, every 4 months.
A) 0.25 B) 1.25 C) 3 D) 4

Answer: C

Diff: 2

Topic: Monetarism

Skill: Conceptual

AACSB: Reflective Thinking

- 7) If nominal GDP is \$400 billion and the money supply is \$50 billion, the velocity of money is
A) 0.125. B) 8. C) 12. D) 20.

Answer: B

Diff: 1

Topic: Monetarism

Skill: Analytic

AACSB: Analytic Skills

- 8) The velocity of money is 4. If nominal GDP is \$1,200 billion then the stock of money
A) is \$300 billion. B) is \$400 billion.
C) is \$500 billion. D) is \$4,800 billion.

Answer: A

Diff: 1

Topic: Monetarism

Skill: Analytic

AACSB: Analytic Skills

- 9) Suppose that the stock of money is \$150 billion and nominal GDP is \$750 billion. The velocity of money is
A) 4. B) 5. C) 16.7. D) 600.

Answer: B

Diff: 1

Topic: Monetarism

Skill: Analytic

AACSB: Analytic Skills

- 10) If the stock of money is \$60 billion, velocity is 5, and real output is \$100 billion, what is the price level?
A) 0.12 B) 1.4 C) 3 D) 6

Answer: C

Diff: 2

Topic: Monetarism

Skill: Analytic

AACSB: Analytic Skills

- 11) If the stock of money is \$40 billion, velocity is 3, and real output is \$60 billion, what is the price level?
A) 0.5 B) 2 C) 2.5 D) 4

Answer: B

Diff: 2

Topic: Monetarism

Skill: Analytic

AACSB: Analytic Skills

- 12) If real output is \$25 billion, the price level is 5, and velocity is 5, what is the stock of money?
A) \$1 billion B) \$10 billion C) \$25 billion D) \$625 billion

Answer: C

Diff: 2

Topic: Monetarism

Skill: Analytic

AACSB: Analytic Skills

- 13) If real output is \$10 billion, the price level is 3, and velocity is 6, what is the stock of money?
A) \$1.8 billion B) \$5 billion C) \$19 billion D) \$180 billion

Answer: B

Diff: 2

Topic: Monetarism

Skill: Analytic

AACSB: Analytic Skills

- 14) If the stock of money is \$100 billion, velocity is 4, and the price level is 5, what is income?
A) \$5 billion B) \$80 billion C) \$125 billion D) \$2,000 billion

Answer: B

Diff: 2

Topic: Monetarism

Skill: Analytic

AACSB: Analytic Skills

- 15) If the stock of money is \$250 billion, velocity is 5, and the price level is 10, what is real output?
A) \$5 billion B) \$125 billion C) \$500 billion D) \$12,500 billion

Answer: B

Diff: 2

Topic: Monetarism

Skill: Analytic

AACSB: Analytic Skills

- 16) If income is \$20 billion, the price level is 5, and the stock of money is \$10 billion, what is the income velocity of money?
A) 0.4 B) 2.5 C) 4 D) 10

Answer: D

Diff: 2

Topic: Monetarism

Skill: Analytic

AACSB: Analytic Skills

- 17) If income is \$30 billion, the price level is 3, and the stock of money is \$18 billion, what is the velocity of money?
A) 1.4 B) 1.8 C) 5 D) 180

Answer: C

Diff: 2

Topic: Monetarism

Skill: Analytic

AACSB: Analytic Skills

- 18) The quantity theory of money implies that a 3% increase in the money supply will eventually cause
- A) a 3% increase in real GDP.
 - B) a 3% increase in disposable income.
 - C) a 3% increase in the price level.
 - D) a 3% decrease in the unemployment rate.

Answer: C

Diff: 2

Topic: Monetarism

Skill: Conceptual

AACSB: Reflective Thinking

- 19) Which of the following is assumed constant in the quantity theory of money?
- A) money supply
 - B) velocity
 - C) the price level
 - D) output

Answer: B

Diff: 1

Topic: Monetarism

Skill: Fact

- 20) According to the quantity theory of money, nominal GDP will double if the money supply is
- A) reduced by one-half.
 - B) reduced threefold.
 - C) doubled.
 - D) tripled.

Answer: C

Diff: 2

Topic: Monetarism

Skill: Conceptual

AACSB: Reflective Thinking

- 21) The quantity theory of money can be written as
- A) $MV = PY$.
 - B) $M/V = PY$.
 - C) $MV = P/Y$.
 - D) $MP = VP$.

Answer: A

Diff: 1

Topic: Monetarism

Skill: Definition

- 22) Velocity is not constant if
- A) the money supply does not depend on the interest rate.
 - B) the supply of money depends on the interest rate.
 - C) the price level increases as aggregate output increases.
 - D) the demand for money depends on the interest rate.

Answer: D

Diff: 2

Topic: Monetarism

Skill: Conceptual

AACSB: Reflective Thinking

- 23) If the demand for money depends on the interest rate, velocity is
- A) not constant, and the quantity theory of money does hold.
 - B) not constant, and the quantity theory of money does not hold.
 - C) constant, and the quantity theory of money does not hold.
 - D) constant, and the quantity theory of money does hold.

Answer: B

Diff: 2

Topic: Monetarism

Skill: Conceptual

AACSB: Reflective Thinking

- 24) If the equation for the quantity theory of money is looked on as a demand-for-money equation, then the demand for money depends on
- A) nominal income but not on the interest rate.
 - B) nominal income and the interest rate.
 - C) real income but not on the interest rate.
 - D) real income and the interest rate.

Answer: A

Diff: 2

Topic: Monetarism

Skill: Conceptual

AACSB: Reflective Thinking

- 25) If the demand for money depends on the interest rate, then a 15% increase in the money supply will increase
- A) nominal GDP by 15%.
 - B) nominal GDP by less than 15%.
 - C) nominal GDP by more than 30%.
 - D) real GDP by 30%.

Answer: B

Diff: 2

Topic: Monetarism

Skill: Conceptual

AACSB: Reflective Thinking

- 26) Assume that the demand for money depends on the interest rate. A decrease in the money supply will cause
- A) the interest rate to increase, the quantity demanded of money to decrease, and the velocity of money to decrease.
 - B) the interest rate to increase, the quantity demanded of money to decrease, and the velocity of money to increase.
 - C) the interest rate to decrease, the quantity demanded of money to decrease, and the velocity of money to increase.
 - D) the interest rate to decrease, the quantity demanded of money to increase, and the velocity of money to decrease.

Answer: B

Diff: 2

Topic: Monetarism

Skill: Analytic

AACSB: Analytic Skills

- 27) Which of the following statements is NOT consistent with the quantity theory of money?
- A) The velocity of money can be affected by how frequently workers are paid.
 - B) The velocity of money can be affected by the development of new financial instruments, such as interest-bearing checking accounts.
 - C) The velocity of money can be affected by the manner in which the banking system clears transactions between banks.
 - D) Velocity can change with changes in the interest rate.

Answer: D

Diff: 2

Topic: Monetarism

Skill: Conceptual

AACSB: Reflective Thinking

- 28) Velocity will be constant if the demand for money with respect to the interest rate is
- A) unitary elastic.
 - B) perfectly inelastic.
 - C) perfectly elastic.
 - D) elastic, but not perfectly elastic.

Answer: B

Diff: 2

Topic: Monetarism

Skill: Conceptual

AACSB: Reflective Thinking

- 29) Empirical evidence suggests that, since 1960, the velocity of money has been
- A) constant.
 - B) decreasing.
 - C) rising.
 - D) fluctuating around zero.

Answer: C

Diff: 1

Topic: Monetarism

Skill: Fact

- 30) Which of the following is TRUE?
- A) Measuring money supply using M2 reduces fluctuations in velocity.
 - B) Measuring money supply using M1 reduces fluctuations in velocity.
 - C) Measuring money supply using M2 increases fluctuations in velocity.
 - D) Velocity does not depend on which money supply measurement we use.

Answer: A

Diff: 2

Topic: Monetarism

Skill: Conceptual

AACSB: Reflective Thinking

- 31) The Fed increases money supply. In this case, the time lag problem of monetary policy may
- A) increase the velocity of money in the short run.
 - B) increase real GDP in the short run.
 - C) decrease the velocity of money in the short run.
 - D) none of the above

Answer: C

Diff: 3

Topic: Monetarism

Skill: Conceptual

AACSB: Reflective Thinking

- 32) It is difficult to test whether the velocity of money is constant over time, because
- A) there has been very little variation in the money supply over time.
 - B) there may be a time lag between a change in the money supply and its effects on nominal GDP.
 - C) there is only one definition of the money supply.
 - D) it is difficult to measure the value of nominal GDP over time.

Answer: B

Diff: 3

Topic: Monetarism

Skill: Conceptual

AACSB: Reflective Thinking

- 33) One of the main insights of monetarism is that
- A) sustained inflation is a purely monetary phenomenon.
 - B) the government can effectively manage aggregate demand by using its spending and taxing powers.
 - C) velocity is unstable and subject to wide fluctuations.
 - D) inflation can continue indefinitely without the cooperation of the Federal Reserve.

Answer: A

Diff: 1

Topic: Monetarism

Skill: Fact

- 34) The "strict monetarist" view indicates that an increase in money supply
- A) increases both P and Y .
 - B) increases Y only.
 - C) increases P only.
 - D) increases P and decreases Y .

Answer: C

Diff: 2

Topic: Monetarism

Skill: Fact

- 35) Inflation cannot continue indefinitely without
- A) increases in the interest rate.
 - B) increases in aggregate output.
 - C) increases in investment.
 - D) increases in the money supply.

Answer: D

Diff: 1

Topic: Monetarism

Skill: Conceptual

AACSB: Reflective Thinking

- 36) The leading spokesman for monetarism over the last few decades was
- A) John Kenneth Galbraith.
 - B) Milton Friedman.
 - C) Robert E. Lucas.
 - D) Paul Samuelson.

Answer: B

Diff: 1

Topic: Monetarism

Skill: Fact

- 37) A monetarist would advocate _____ money supply during recessions and _____ money supply during periods of high inflation.
- A) increasing; increasing
 - B) decreasing; increasing
 - C) increasing; decreasing
 - D) none of the above

Answer: D

Diff: 1

Topic: Monetarism

Skill: Fact

- 38) Monetarists argue that the money supply should
- A) grow at a rate equal to the average growth of real output.
 - B) grow at a rate slower than the average growth of real output.
 - C) grow at a rate greater than the average growth of real output.
 - D) be held constant over the business cycle.

Answer: A

Diff: 1

Topic: Monetarism

Skill: Fact

- 39) Monetarists and Keynesians
- A) disagree on the speed at which wages change.
 - B) agree on the impact of fiscal policy on the economy.
 - C) disagree on how the Fed changes money supply.
 - D) agree on the usefulness of discretionary policy.

Answer: A

Diff: 2

Topic: Monetarism

Skill: Fact

- 40) Monetarists believe
- A) the economy is stable.
 - B) the economy is rigid.
 - C) the economy does not equilibrate quickly.
 - D) the economy is unstable.

Answer: A

Diff: 2

Topic: Monetarism

Skill: Fact

- 41) Monetarists believe that real output is determined by
- A) government spending.
 - B) the rate of growth of the money supply.
 - C) government planning.
 - D) aggregate supply.

Answer: D

Diff: 2

Topic: Monetarism

Skill: Fact

2 True/False

- 1) Monetarists believe that the underlying economy is stable.

Answer: TRUE

Diff: 1

Topic: Monetarism

Skill: Conceptual

AACSB: Reflective Thinking

- 2) A monetarist would advocate decreasing the growth rate of money supply during a recession.

Answer: FALSE

Diff: 1

Topic: Monetarism

Skill: Fact

- 3) Fluctuations in velocity tend to increase when measured using M1 instead of M2.

Answer: TRUE

Diff: 2

Topic: Monetarism

Skill: Conceptual

AACSB: Reflective Thinking

- 4) From the perspective of monetarists, sustained inflation is a purely monetary phenomenon, even if velocity is not constant over time.

Answer: TRUE

Diff: 2

Topic: Monetarism

Skill: Conceptual

AACSB: Reflective Thinking

- 5) Most monetarists advocate an activist monetary stabilization policy.

Answer: FALSE

Diff: 1

Topic: Monetarism

Skill: Fact

- 6) Inflation can continue indefinitely without increases in the money supply.

Answer: FALSE

Diff: 1

Topic: Monetarism

Skill: Conceptual

AACSB: Reflective Thinking

- 7) Most empirical data support the idea that money demand depends on the interest rate.

Answer: TRUE

Diff: 1

Topic: Monetarism

Skill: Fact

8) The velocity of money is the number of times a dollar bill changes hands, on average, during a year.

Answer: TRUE
Diff: 1
Topic: Monetarism
Skill: Definition

9) The quantity theory of money assumes the velocity of money is constant.

Answer: TRUE
Diff: 1
Topic: Monetarism
Skill: Definition

10) A velocity of 4 means money stays with each owner for an average of 4 years.

Answer: FALSE
Diff: 1
Topic: Monetarism
Skill: Conceptual
AACSB: Reflective Thinking

11) If nominal GDP is \$200 billion and the stock of money is \$40 billion, the velocity is 5.

Answer: TRUE
Diff: 1
Topic: Monetarism
Skill: Analytic
AACSB: Analytic Skills

12) If nominal GDP is \$500 billion, velocity is \$500 billion divided by the stock of money.

Answer: TRUE
Diff: 1
Topic: Monetarism
Skill: Analytic
AACSB: Analytic Skills

18.3 New Classical Macroeconomics

1 Multiple Choice

- 1) Traditional macroeconomic models assume that people's expectations of inflation
- A) are determined by looking at all the relevant information and forecasting the future inflation rate.
 - B) will be zero in the future.
 - C) are set by assuming a continuation of present inflation.
 - D) are set by merely guessing what the future inflation rate will be.

Answer: C
Diff: 2
Topic: New Classical Macroeconomics
Skill: Conceptual
AACSB: Reflective Thinking

- 2) The New Classical theoretical critique of the existing macroeconomic models is based on
- A) the way people form their expectations.
 - B) the nature of the tradeoff between inflation and growth.
 - C) wages and labor market equilibrium.
 - D) the link between the money market and the goods market.

Answer: A

Diff: 1

Topic: New Classical Macroeconomics

Skill: Fact

- 3) The problem with the traditional macroeconomic treatment of expectations of inflation is that
- A) the model is not consistent with the microeconomic assumption that individuals are rational, forward-looking people.
 - B) the model assumes that individuals will merely guess at what the inflation rate will be.
 - C) in the model people always assume that inflation will be zero.
 - D) the way people formulate expectations in that model assumes that individuals are highly sophisticated in their economic thinking.

Answer: A

Diff: 2

Topic: New Classical Macroeconomics

Skill: Conceptual

AACSB: Reflective Thinking

- 4) Empirically, new classical economists criticized macroeconomic theories in terms of their inability in explaining
- A) the Great Depression.
 - B) the stagflation of the 1970s.
 - C) hyperinflation.
 - D) the high inflation of the 1980s.

Answer: B

Diff: 1

Topic: New Classical Macroeconomics

Skill: Fact

- 5) The rational-expectations hypothesis suggests that the forecasts that people make concerning future inflation rates
- A) are always correct.
 - B) consistently overestimate the actual rate of inflation in the future.
 - C) are correct on average, but are subject to errors that are distributed randomly.
 - D) consistently underestimate the actual rate of inflation in the future.

Answer: C

Diff: 1

Topic: New Classical Macroeconomics

Skill: Fact

- 6) The rational-expectations hypothesis suggests that errors in forecasting future inflation rates are due to
- A) random, unpredictable events.
 - B) the fact that people assume that the current inflation rate will continue into the future.
 - C) the fact that people consistently underestimate future inflation.
 - D) the fact that people consistently overestimate future inflation.

Answer: A

Diff: 2

Topic: New Classical Macroeconomics

Skill: Fact

- 7) People are said to have rational expectations if they
- A) use all available information in forming their expectations.
 - B) assume that this year's inflation rate will be equal to the average inflation rate over the past 10 years.
 - C) merely guess at the inflation rate.
 - D) assume that this year's inflation rate will be the same as last year's inflation rate.

Answer: A

Diff: 2

Topic: New Classical Macroeconomics

Skill: Definition

- 8) If firms have rational expectations and if they set prices and wages on this basis, then prices and wages
- A) will always be at market-clearing levels.
 - B) will, on average, be set at market-clearing levels.
 - C) will always be above market-clearing levels.
 - D) will never be set at market-clearing levels.

Answer: B

Diff: 3

Topic: New Classical Macroeconomics

Skill: Conceptual

AACSB: Reflective Thinking

- 9) If firms have rational expectations and if they set prices and wages on this basis, then on average
- A) prices and wages will be set at levels that do not clear the goods and labor markets.
 - B) prices will be set at levels that ensure equilibrium in the goods market, but wages will be set at levels that do not clear the labor market.
 - C) prices and wages will be set at levels that ensure equilibrium in the goods and labor markets.
 - D) wages will be set at levels that ensure equilibrium in the labor market, but prices will be set at levels that do not clear the goods market.

Answer: C

Diff: 3

Topic: New Classical Macroeconomics

Skill: Conceptual

AACSB: Reflective Thinking

- 10) If all firms have rational expectations and wages and prices are flexible, there will be
- A) high unemployment because firms set their wages above the equilibrium wage rate.
 - B) a shortage of labor because firms set their wage below the equilibrium wage rate.
 - C) no unemployment.
 - D) high unemployment because firms know the "true model."

Answer: C

Diff: 2

Topic: New Classical Macroeconomics

Skill: Conceptual

AACSB: Reflective Thinking

- 11) According to the rational expectation hypothesis, disequilibrium may exist in the labor market because
- A) of unpredictable shocks.
 - B) firms don't know the "true model."
 - C) workers don't know the "true model."
 - D) of predictable shocks.

Answer: A

Diff: 2

Topic: New Classical Macroeconomics

Skill: Conceptual

AACSB: Reflective Thinking

- 12) According to monetarists
- A) the economy is relatively stable.
 - B) economic policy is effective in increasing output.
 - C) the economy is very unstable.
 - D) government spending is the main source of inflation.

Answer: A

Diff: 2

Topic: New Classical Macroeconomics

Skill: Fact

- 13) According to the rational expectations hypothesis, the occurrence of unemployment is due to
- A) imperfect information.
 - B) unpredictable shocks.
 - C) downwardly rigid wages.
 - D) a deficient level of aggregate demand.

Answer: B

Diff: 2

Topic: New Classical Macroeconomics

Skill: Conceptual

AACSB: Reflective Thinking

- 14) According to the rational expectations hypothesis, unemployment
- A) does not exist in the short run.
 - B) may exist, and when it does, it stays for a long period of time.
 - C) may exist, and if it does, it will be temporary.
 - D) does not exist in the long run.

Answer: C

Diff: 2

Topic: New Classical Macroeconomics

Skill: Conceptual

AACSB: Reflective Thinking

- 15) Those who believe in the rational expectations hypothesis advocate
- A) active fiscal policy during recessions.
 - B) active monetary policy during recessions.
 - C) active monetary policy during inflationary periods only.
 - D) no policy intervention.

Answer: D

Diff: 2

Topic: New Classical Macroeconomics

Skill: Conceptual

AACSB: Reflective Thinking

- 16) According to the Lucas supply function, if the expected price level is larger than the actual price level
- A) real output increases.
 - B) real output decreases.
 - C) nominal output increases.
 - D) nominal output decreases.

Answer: B

Diff: 1

Topic: New Classical Macroeconomics

Skill: Conceptual

AACSB: Reflective Thinking

Refer to the information provided in Figure 18.1 below to answer the questions that follow.

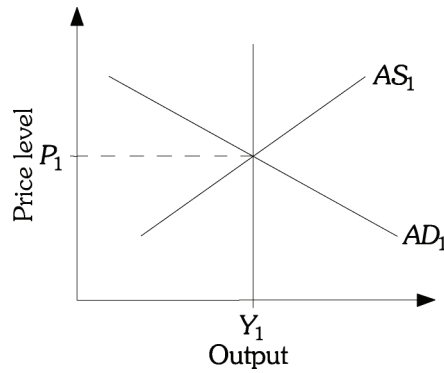


Figure 18.1

- 17) Refer to Figure 18.1. According to Keynes, an increase in government spending or an increase in money supply will
- A) shift AS_1 to the right.
 - B) shift LAS to the right.
 - C) shift AD_1 to the right.
 - D) shift AD_1 to the left.

Answer: C

Diff: 2

Topic: New Classical Macroeconomics

Skill: Analytic

AACSB: Analytic Skills

- 18) Refer to Figure 18.1. According to the monetarists, a recession can be caused when
- A) AD_1 shifts to the right.
 - B) AD_1 shifts to the left.
 - C) AS_1 shifts to the left.
 - D) LAS shifts to the left.

Answer: B

Diff: 2

Topic: New Classical Macroeconomics

Skill: Analytic

AACSB: Analytic Skills

- 19) Refer to Figure 18.1. According to the new classical economists, under rational expectations an expected increase in government spending would

- A) shift AS_1 to the right.
- B) shift AD_1 to the right.
- C) shift AD_1 to the left.
- D) none of the above

Answer: D

Diff: 2

Topic: New Classical Macroeconomics

Skill: Analytic

AACSB: Analytic Skills

- 20) Refer to Figure 18.1. According to the new classical economists, under rational expectations an expected decrease in government spending would

- A) shift AS_1 to the right.
- B) shift AD_1 to the right.
- C) shift AD_1 to the left.
- D) would not change AD and AS .

Answer: D

Diff: 2

Topic: New Classical Macroeconomics

Skill: Analytic

AACSB: Analytic Skills

- 21) Refer to Figure 18.1. According to the new classical economists, under rational expectations an expected decrease in taxes would

- A) shift AS_1 to the right.
- B) shift AD_1 to the right.
- C) shift AD_1 to the left.
- D) would not change AD or AS .

Answer: D

Diff: 2

Topic: New Classical Macroeconomics

Skill: Analytic

AACSB: Analytic Skills

- 22) Refer to Figure 18.1. According to Keynes, an expansionary monetary policy in the long run and after all the adjustments have been made

- A) does not increase equilibrium output.
- B) increases equilibrium output above Y_1 .
- C) decreases equilibrium output below Y_1 .
- D) increases equilibrium output above Y_1 and decreases the price level below P_1 .

Answer: B

Diff: 2

Topic: New Classical Macroeconomics

Skill: Analytic

AACSB: Analytic Skills

- 23) Refer to Figure 18.1. According to monetarists, an expansionary fiscal policy in the long run and after all the adjustments have been made
- A) does not increase equilibrium output or the price level.
 - B) increases equilibrium output above Y_1 , but does not change the price level.
 - C) increases the price level above P_1 , but does not change equilibrium output.
 - D) increases equilibrium output above Y_1 and decreases the price level below P_1 .

Answer: C

Diff: 2

Topic: New Classical Macroeconomics

Skill: Analytic

AACSB: Analytic Skills

- 24) Which of the following represents the Lucas supply function?
- A) $Y = f(P^e - P)$
 - B) $Y = f(P^e + P)$
 - C) $Y = f(P + P^e)$
 - D) $Y = f(P - P^e)$

Answer: D

Diff: 1

Topic: New Classical Macroeconomics

Skill: Definition

- 25) With the Lucas supply function, a price surprise means
- A) actual price is greater than expected price.
 - B) actual price is less than expected price.
 - C) actual price equals expected price.
 - D) actual price is either greater than or lower than expected price.

Answer: D

Diff: 2

Topic: New Classical Macroeconomics

Skill: Conceptual

AACSB: Reflective Thinking

- 26) According to the Lucas supply function, if a firm mistakenly perceives that all prices are going up because its own output price is going up, it will
- A) decrease its production.
 - B) increase its production.
 - C) keep its production level constant.
 - D) increase expectations regarding its own output price.

Answer: C

Diff: 2

Topic: New Classical Macroeconomics

Skill: Conceptual

AACSB: Reflective Thinking

- 27) Assume that the substitution effect dominates the income effect. When workers experience a positive price surprise, they
- A) correctly perceive that their real wage rate has fallen, which leads them to work fewer hours.
 - B) incorrectly perceive that their real wage rate has fallen, which leads them to work fewer hours.
 - C) correctly perceive that their real wage rate has risen, which leads them to work more hours.
 - D) incorrectly perceive that their real wage rate has risen, which leads them to work more hours.

Answer: D

Diff: 3

Topic: *New Classical Macroeconomics*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 28) According to the Lucas supply function, workers who experience a positive price surprise will work fewer hours when
- A) there is no substitution effect from a positive price surprise.
 - B) there is no income effect from a positive price surprise.
 - C) the substitution effect dominates the income effect.
 - D) the income effect dominates the substitution effect.

Answer: D

Diff: 3

Topic: *New Classical Macroeconomics*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 29) According to the Lucas supply function, workers who experience a positive price surprise will work more hours when
- A) there is no substitution effect from a positive price surprise.
 - B) there is no income effect from a positive price surprise.
 - C) the substitution effect dominates the income effect.
 - D) the income effect dominates the substitution effect.

Answer: C

Diff: 3

Topic: *New Classical Macroeconomics*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 30) According to the Lucas supply function, the amount of output produced is not related to the price level if
- A) people's expectations of the price level are higher than the actual price level.
 - B) people's expectations of the price level are on target.
 - C) people's expectations of the price level are lower than the actual price level.
 - D) people's expectations of the price level are either higher or lower than the actual price level.

Answer: B

Diff: 2

Topic: *New Classical Macroeconomics*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 31) According to the Lucas supply function, the economy will produce more output when
- A) prices are unexpectedly higher than when prices are at their expected level.
 - B) wages are below the expected level.
 - C) prices are unexpectedly lower than when prices are at their expected level.
 - D) prices are exactly equal to the expected level.

Answer: A

Diff: 3

Topic: New Classical Macroeconomics

Skill: Conceptual

AACSB: Reflective Thinking

- 32) The Lucas supply function, in combination with the assumption that expectations are rational, implies that announced policy changes
- A) will have no effect on the actual price level.
 - B) will have no effect on real output.
 - C) will have no effect on the expected price level.
 - D) will have no effect on nominal output.

Answer: B

Diff: 3

Topic: New Classical Macroeconomics

Skill: Conceptual

AACSB: Reflective Thinking

- 33) According to the Lucas supply function, if people's expectations are on target, then the amount of output they produce
- A) is not related to the price level.
 - B) is directly related to the price level.
 - C) will always be below potential GDP.
 - D) will always be above potential GDP.

Answer: A

Diff: 3

Topic: New Classical Macroeconomics

Skill: Conceptual

AACSB: Reflective Thinking

- 34) The Lucas supply function, in combination with the assumption that expectations are rational, implies that
- A) neither anticipated monetary policy changes nor anticipated fiscal policy changes will have an effect on real output.
 - B) an anticipated monetary policy change will have an effect on real output, but an anticipated fiscal policy change will not have an effect on real output.
 - C) both anticipated monetary and fiscal policy changes will affect real output.
 - D) an anticipated monetary policy change will have no effect on real output, but an anticipated fiscal policy change will have an effect on real output.

Answer: A

Diff: 3

Topic: New Classical Macroeconomics

Skill: Conceptual

AACSB: Reflective Thinking

- 35) The Lucas supply function, in combination with the assumption that expectations are rational, implies that
- A) anticipated policy changes have a significant effect on real output.
 - B) unanticipated policy changes have no effect on real output.
 - C) anticipated policy changes have no effect on real output.
 - D) the effect that policy changes have on real output is the same, regardless of whether those changes are anticipated or not.

Answer: C

Diff: 2

Topic: *New Classical Macroeconomics*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 36) According to the Lucas supply function, in combination with the assumption that expectations are rational, change in government policy can affect real output only if
- A) the policy change is correctly anticipated by the public.
 - B) the policy change is a surprise.
 - C) the policy change is a mix of both fiscal and monetary policy changes.
 - D) expansionary policy changes are made.

Answer: B

Diff: 2

Topic: *New Classical Macroeconomics*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 37) The Lucas supply function, in combination with the assumption that expectations are rational, implies that an announced change in monetary policy affects
- A) the actual price level, but not the expected price level.
 - B) neither the actual price level nor the expected price level.
 - C) the expected price level, but not the actual price level.
 - D) both the actual price level and the expected price level.

Answer: D

Diff: 2

Topic: *New Classical Macroeconomics*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 38) The Lucas supply function, in combination with the assumption that expectations are rational, implies that an announced monetary policy change will lead to
- A) a positive price surprise.
 - B) no price surprise.
 - C) a negative price surprise.
 - D) a positive price surprise for expansionary monetary policy and a negative price surprise for contractionary monetary policy.

Answer: B

Diff: 2

Topic: *New Classical Macroeconomics*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 39) The Lucas supply function, in combination with the assumption that expectations are rational, implies that an announced monetary policy change will
- A) not change output.
 - B) decrease output, but never increase output.
 - C) either increase or decrease output, depending on the type of monetary policy change.
 - D) increase output, but never decrease output.

Answer: A

Diff: 2

Topic: New Classical Macroeconomics

Skill: Conceptual

AACSB: Reflective Thinking

Refer to the information provided in Figure 18.2 below to answer the questions that follow.

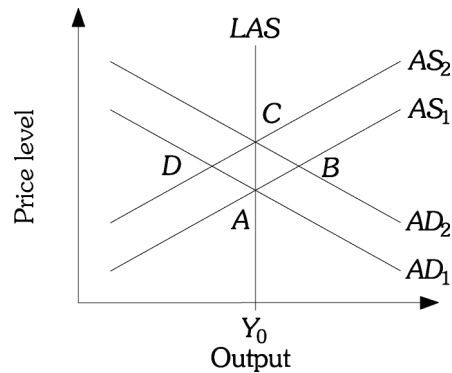


Figure 18.2

- 40) Refer to Figure 18.2. Suppose the economy is at Point A. According to the rational expectation theory, an unanticipated increase in money supply
- A) moves the economy to Point B.
 - B) moves the economy to Point C.
 - C) moves the economy to Point D.
 - D) leaves the economy at Point A.

Answer: A

Diff: 2

Topic: New Classical Macroeconomics

Skill: Analytic

AACSB: Analytic Skills

- 41) Refer to Figure 18.2. Suppose the economy is at Point A. According to the new classical theory, an anticipated increase in aggregate demand
- A) moves the economy to Point B.
 - B) moves the economy to Point D.
 - C) moves the economy to Point C.
 - D) leaves the economy at Point A.

Answer: C

Diff: 2

Topic: New Classical Macroeconomics

Skill: Analytic

AACSB: Analytic Skills

- 42) The Lucas supply model, in combination with the assumption that expectations are rational, leads to the conclusion that
- A) expansionary policies, but not contractionary policies, can have an impact on real output.
 - B) contractionary policies, but not expansionary policies, can have an impact on real output.
 - C) only unanticipated policy changes can have an impact on output.
 - D) neither anticipated nor unanticipated policy changes can have an impact on output.

Answer: C

Diff: 2

Topic: *New Classical Macroeconomics*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 43) The argument in favor of rational expectations is that
- A) people will continue to acquire information as long as the marginal benefit of that information is positive.
 - B) individuals have a very good idea of what to expect from the government in terms of monetary policy but not fiscal policy.
 - C) it is costless for individuals and firms to form rational expectations.
 - D) if expectations were not rational, there would be unexploited profit opportunities available.

Answer: D

Diff: 2

Topic: *New Classical Macroeconomics*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 44) The primary argument against the rational-expectations assumption is that
- A) the costs of formulating rational expectations are very low.
 - B) it requires households and firms to know too much.
 - C) it assumes that unexploited opportunities for profit persist in the economy.
 - D) people expect certain outcomes from the government's policy actions.

Answer: B

Diff: 2

Topic: *New Classical Macroeconomics*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 45) According to the new classical theory, economic policies are
- A) effective only if anticipated.
 - B) ineffective if unanticipated.
 - C) ineffective if anticipated.
 - D) ineffective, whether anticipated or unanticipated.

Answer: C

Diff: 2

Topic: *New Classical Macroeconomics*

Skill: *Fact*

- 46) According to new classical economists, if the Fed increases the money supply after it announces it, output _____ and the price level _____.
- A) increases; remains constant
 - B) remains constant; increases
 - C) remains constant; remains constant
 - D) increases; increase

Answer: B

Diff: 1

Topic: New Classical Macroeconomics

Skill: Conceptual

AACSB: Reflective Thinking

- 47) According to the real business cycle theory, _____ are responsible for economic growth.
- A) expansionary fiscal and monetary policies
 - B) positive shifts in the *AD* curve
 - C) trade and income policies
 - D) positive shifts in the *AS* curve

Answer: D

Diff: 1

Topic: New Classical Macroeconomics

Skill: Fact

- 48) According to the real business cycle theory, technological advances
- A) increase the marginal product of labor, which causes real wages and output to decline.
 - B) decrease the marginal product of labor, which causes real wages and output to increase.
 - C) increase the marginal product of labor, which causes real wages to increase and output to decline.
 - D) increase the marginal product of labor, which causes real wages and output to increase.

Answer: D

Diff: 1

Topic: New Classical Macroeconomics

Skill: Conceptual

AACSB: Reflective Thinking

- 49) Supporters of supply-side economics claim that Reagan's tax policies were quite successful in stimulating the economy because
- A) almost immediately after the tax cuts, the economy expanded and the recession of 1980–1982 came to an end.
 - B) inflation rates fell sharply from the high rates of 1980 and 1981.
 - C) throughout most of the 1980s, federal receipts continued to rise even though tax rates had been cut.
 - D) all of the above

Answer: D

Diff: 1

Topic: New Classical Macroeconomics

Skill: Fact

- 50) Critics of supply-side economics agree that shortly after the Reagan tax cuts were put into place, the economy began to expand. These critics, though, argue that the expansion did not result from the supply-side policies, but rather from
- A) the fact that the Federal Reserve dramatically increased the money supply at the same time that the tax cuts became effective.
 - B) the self-correcting nature of the economy.
 - C) the increases in government spending that occurred at the same time the tax cuts became effective.
 - D) a very large increase in the demand for U.S. exports at the same time that U.S. imports fell dramatically.

Answer: A

Diff: 2

Topic: *New Classical Macroeconomics*

Skill: *Fact*

- 51) Related to the *Economics in Practice* on p. 346 [658]: Surveys by the bank of England suggest that consumers tend to expect future inflation to be
- A) what they perceive past inflation to have been.
 - B) equal to the actual estimates of past inflation made by the government.
 - C) directly related to the interest rate.
 - D) relatively unpredictable.

Answer: A

Diff: 1

Topic: *New Classical Macroeconomics: Economics in Practice*

Skill: *Fact*

- 52) Related to the *Economics in Practice* on p. 346 [658]: Surveys by the bank of England suggest that two important factors in influencing consumer perceptions of inflation are _____ and _____.
- A) the value of the British pound; the value of the euro
 - B) food prices; the stock of money
 - C) interest rates; the unemployment rate
 - D) gas prices; media attention to price increases

Answer: D

Diff: 1

Topic: *New Classical Macroeconomics: Economics in Practice*

Skill: *Fact*

2 True/False

- 1) A rational-expectations theorist argues for increased government involvement in the economy to ensure stable price and employment growth.

Answer: FALSE

Diff: 1

Topic: *New Classical Macroeconomics*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 2) The rational-expectations hypothesis implies that there is no need for government stabilization policies.
Answer: TRUE
Diff: 1
Topic: *New Classical Macroeconomics*
Skill: *Fact*
- 3) According to the rational-expectation theory, an unanticipated increase in money supply increases both output and prices.
Answer: TRUE
Diff: 2
Topic: *New Classical Macroeconomics*
Skill: *Conceptual*
AACSB: *Reflective Thinking*
- 4) According to the new classical theory, anticipated policies do not affect the economy.
Answer: TRUE
Diff: 1
Topic: *New Classical Macroeconomics*
Skill: *Fact*
- 5) The real business cycle theory places little emphasis on shocks to technology.
Answer: FALSE
Diff: 1
Topic: *New Classical Macroeconomics*
Skill: *Fact*
- 6) The Keynesian hypothesis assumes that people know the "true model" of the economy and form their expectations of the future based on this model.
Answer: FALSE
Diff: 1
Topic: *New Classical Macroeconomics*
Skill: *Definition*
- 7) The Lucas supply function incorporates the idea that output depends on the difference between the actual price level and the expected price level.
Answer: TRUE
Diff: 1
Topic: *New Classical Macroeconomics*
Skill: *Definition*
- 8) A price surprise is equal to the expected price level minus the actual price level.
Answer: FALSE
Diff: 1
Topic: *New Classical Macroeconomics*
Skill: *Definition*

18.4 Supply-Side Economics

1 Multiple Choice

- 1) According to supply-side economics, the government needs to focus on policies to
- A) stimulate demand.
 - B) decrease demand.
 - C) stimulate supply.
 - D) decrease supply.

Answer: C

Diff: 1

Topic: Supply-Side Economics

Skill: Fact

- 2) Which of the following would be considered a supply-side policy?
- A) an increase in the minimum wage that would cause consumer spending to increase
 - B) an increase in government spending that would lead to increased aggregate demand
 - C) investment tax credits for businesses to encourage investment
 - D) a decrease in the growth of the money supply

Answer: C

Diff: 1

Topic: Supply-Side Economics

Skill: Conceptual

AACSB: Reflective Thinking

- 3) The curve that assumes that there is some tax rate beyond which the supply response is large enough to lead to a decrease in tax revenue for further increases in the tax rate is the
- A) aggregate supply curve.
 - B) Lucas supply curve.
 - C) aggregate production function.
 - D) Laffer curve.

Answer: D

Diff: 1

Topic: Supply-Side Economics

Skill: Definition

- 4) If tax rates are cut so that people have an increased incentive to work and businesses have an increased incentive to invest,
- A) aggregate supply will increase, aggregate output will increase, and the price level will increase.
 - B) aggregate supply will increase, aggregate output will increase, and the price level will decrease.
 - C) both aggregate supply and demand will increase, aggregate output will increase, and the price level will increase.
 - D) aggregate supply will increase, aggregate demand will decrease, aggregate output will increase, and the price level will decrease.

Answer: B

Diff: 2

Topic: Supply-Side Economics

Skill: Analytic

AACSB: Analytic Skills

- 5) According to supply-side economists, as tax rates are reduced, labor supply should increase. This implies that
- A) the income effect of a wage change is greater than the substitution effect of a wage change.
 - B) the substitution effect of a wage change is greater than the income effect of a wage change.
 - C) there is no income effect when tax rates are changed.
 - D) there is no substitution effect when tax rates are changed.

Answer: B

Diff: 2

Topic: Supply-Side Economics

Skill: Analytic

AACSB: Analytic Skills

Refer to the information provided in Figure 18.3 below to answer the questions that follow.

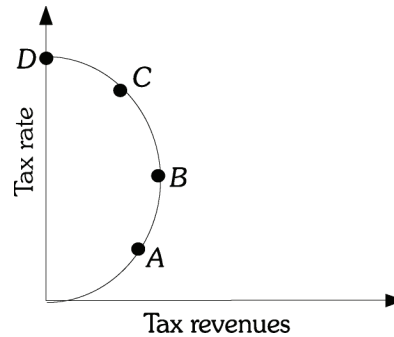


Figure 18.3

- 6) Refer to Figure 18.3. A cut in tax rates will decrease tax revenue if the economy moves from Point
- A) A to B.
 - B) B to A.
 - C) C to B.
 - D) A to D.

Answer: B

Diff: 1

Topic: Supply-Side Economics

Skill: Analytic

AACSB: Analytic Skills

- 7) Refer to Figure 18.3. A decrease in tax rates will definitely decrease tax revenue if the economy is at a point such as _____ on the Laffer Curve.
- A) A
 - B) B
 - C) C
 - D) both A and B

Answer: D

Diff: 1

Topic: Supply-Side Economics

Skill: Analytic

AACSB: Analytic Skills

- 8) Refer to Figure 18.3. The tax rate that will maximize tax revenue is associated with point
 A) A B) B C) C D) D

Answer: B

Diff: 1

Topic: Supply-Side Economics

Skill: Analytic

AACSB: Analytic Skills

- 9) Refer to Figure 18.3. At point B
 A) an increase in tax rates will increase tax revenue.
 B) a decrease in tax rates will increase tax revenue.
 C) any change in tax rates will decrease tax revenue.
 D) any change in tax revenue will increase tax revenue.

Answer: C

Diff: 1

Topic: Supply-Side Economics

Skill: Analytic

AACSB: Analytic Skills

- 10) According to the Laffer curve, if the economy is on the positively sloped section of the curve, then
 A) both an increase and a decrease in tax rates will increase tax revenue.
 B) a decrease in the tax rate will increase tax revenue.
 C) an increase in the tax rate will increase tax revenue.
 D) both an increase and a decrease in tax rates will decrease tax revenues.

Answer: C

Diff: 1

Topic: Supply-Side Economics

Skill: Analytic

AACSB: Analytic Skills

- 11) According to the Laffer curve, as tax rates increase, tax revenues
 A) initially increase and then decrease. B) decrease continuously.
 C) initially decrease and then increase. D) rise continuously.

Answer: A

Diff: 1

Topic: Supply-Side Economics

Skill: Conceptual

AACSB: Reflective Thinking

- 12) According to the Laffer curve,
 A) an increase in tax rates will always increase tax revenues.
 B) a decrease in tax rates will always decrease tax revenues.
 C) a decrease in tax rates will always increase tax revenues.
 D) an increase in tax rates will have an inconsistent effect on tax revenues.

Answer: D

Diff: 1

Topic: Supply-Side Economics

Skill: Conceptual

AACSB: Reflective Thinking

- 13) The Economic Recovery Tax Act of 1981 allowed firms to depreciate their capital at a very rapid rate for tax purposes. This
- A) increased the tax liability of firms and discouraged them from investing.
 - B) decreased tax liability and encouraged investment.
 - C) increased the tax liability of firms and encouraged them to invest.
 - D) decreased tax liability and discouraged investment.

Answer: B

Diff: 2

Topic: Supply-Side Economics

Skill: Fact

- 14) The implicit assumption behind the Economic Recovery Tax Act of 1981, which cut the individual income tax rate by 25% over three years, was that
- A) the economy was on the negatively sloped portion of the Laffer curve.
 - B) the economy was on the positively sloped portion of the Laffer curve.
 - C) tax rate reductions will stimulate demand in the economy and move the economy to full employment.
 - D) tax rate reductions will decrease supply in the economy and therefore choke off the high rate of inflation that the economy was experiencing.

Answer: A

Diff: 2

Topic: Supply-Side Economics

Skill: Analytic

AACSB: Analytic Skills

- 15) The Economic Recovery Tax Act of 1981 cut corporate taxes in a way that was designed to
- A) encourage firms to hire more workers.
 - B) stimulate capital investment.
 - C) encourage firms to use fewer nonrenewable resources.
 - D) reduce corporate profits.

Answer: B

Diff: 1

Topic: Supply-Side Economics

Skill: Fact

2 True/False

- 1) Supply side economists think the equilibrium output is determined by the supply of money.

Answer: FALSE

Diff: 2

Topic: Supply-Side Economics

Skill: Conceptual

AACSB: Reflective Thinking

- 2) Reduction of government regulation is a stimulative aggregate supply policy.

Answer: TRUE

Diff: 2

Topic: Supply-Side Economics

Skill: Conceptual

AACSB: Reflective Thinking

3) The Laffer curve shows the relationship between the tax rate and the inflation rate.

Answer: FALSE

Diff: 1

Topic: Supply-Side Economics

Skill: Definition

4) According to the Laffer curve, an increase in the tax rate may decrease tax revenues.

Answer: TRUE

Diff: 1

Topic: Supply-Side Economics

Skill: Conceptual

AACSB: Reflective Thinking

5) Nearly \$2 trillion was added to the national debt between 1983 and 1992.

Answer: TRUE

Diff: 1

Topic: Supply-Side Economics

Skill: Fact

18.5 Testing Alternative Macroeconomic Models

1 Multiple Choice

1) Which of the following is NOT one of the reasons why it is difficult to empirically test alternative macroeconomic models against one another?

- A) The rational-expectations assumption is difficult to test.
- B) Macroeconomic models differ in ways that are hard to standardize for.
- C) Macroeconomic models cannot be expressed in mathematical terms.
- D) The amount of data available is fairly small.

Answer: C

Diff: 2

Topic: Testing Alternative Macroeconomic Models

Skill: Conceptual

AACSB: Reflective Thinking

2) It is difficult to empirically test alternative macroeconomic models against one another because

- A) macroeconomic models do not predict the same outcomes from policies.
- B) macroeconomic models differ in ways that are hard to standardize for.
- C) macroeconomic models cannot be expressed in mathematical terms.
- D) macroeconomic models are always expressed in scientific terms.

Answer: B

Diff: 2

Topic: Testing Alternative Macroeconomic Models

Skill: Conceptual

AACSB: Reflective Thinking

- 3) A problem with comparing macroeconomic models is that
- A) people may change how they react when economic policies are changed.
 - B) macroeconomic models do not predict the same outcomes from policies.
 - C) macroeconomic models cannot be expressed in mathematical terms.
 - D) macroeconomic models must meet government standards for uniformity.

Answer: A

Diff: 2

Topic: Testing Alternative Macroeconomic Models

Skill: Conceptual

AACSB: Reflective Thinking

2 True/False

- 1) Macroeconomic models differ in ways that are hard to standardize.

Answer: TRUE

Diff: 2

Topic: Testing Alternative Macroeconomic Models

Skill: Fact

- 2) Too much data is available to test macroeconomic models.

Answer: FALSE

Diff: 2

Topic: Testing Alternative Macroeconomic Models

Skill: Fact

- 3) Expectations are hard to test even though economists know the model the public uses when forming expectations.

Answer: FALSE

Diff: 2

Topic: Testing Alternative Macroeconomic Models

Skill: Conceptual

AACSB: Reflective Thinking

- 4) Any test of rational expectations is a joint test of the underlying model that expectations are formed rationally.

Answer: TRUE

Diff: 2

Topic: Testing Alternative Macroeconomic Models

Skill: Conceptual

AACSB: Reflective Thinking

- 5) Competing macroeconomic models may be hard to test because people may change how they react when economic policies are changed.

Answer: TRUE

Diff: 2

Topic: Testing Alternative Macroeconomic Models

Skill: Conceptual

AACSB: Reflective Thinking

Chapter 19 International Trade, Comparative Advantage, and Protectionism

19.1 Trade Surpluses and Deficits

1 Multiple Choice

- 1) A country has a trade surplus when
- A) its exports exceed its imports.
 - B) its exports equal its imports.
 - C) its government spending exceeds its tax revenues.
 - D) its exports are less than its imports.

Answer: A

Diff: 1

Topic: Trade Surpluses and Deficits

Skill: Definition

- 2) A country's trade is balanced when
- A) its imports exceeds its exports.
 - B) its government expenditures are equal to its tax revenues.
 - C) its net exports equal to zero.
 - D) its net exports are greater than zero.

Answer: C

Diff: 1

Topic: Trade Surpluses and Deficits

Skill: Definition

- 3) A country has a trade deficit when
- A) its exports exceed its imports.
 - B) its exports equal its imports.
 - C) its exports are less than its imports.
 - D) government spending is greater than tax receipts.

Answer: C

Diff: 1

Topic: Trade Surpluses and Deficits

Skill: Definition

- 4) If a country has a trade surplus of \$40 billion, which of the following can be true?
- A) The country's exports are \$160 billion and its imports are \$120 billion.
 - B) The country's exports are \$110 billion and its imports are \$150 billion.
 - C) The country's exports are \$120 billion and its imports are \$140 billion.
 - D) The country's exports are \$140 billion and its imports are \$40 billion.

Answer: A

Diff: 1

Topic: Trade Surpluses and Deficits

Skill: Conceptual

AACSB: Reflective Thinking

5) If a country has a trade deficit of \$30 billion, which of the following can be true?

- A) The country's exports are \$150 billion and its imports are \$120 billion.
- B) The country's exports are \$110 billion and its imports are \$140 billion.
- C) The country's exports are \$120 billion and its imports are \$140 billion.
- D) The country's exports are \$140 billion and its imports are \$40 billion.

Answer: B

Diff: 1

Topic: Trade Surpluses and Deficits

Skill: Conceptual

AACSB: Reflective Thinking

6) In the year _____, the United States switched from running a trade surplus to running a trade deficit.

- A) 1950
- B) 1966
- C) 1976
- D) 1994

Answer: C

Diff: 1

Topic: Trade Surpluses and Deficits

Skill: Fact

2 True/False

1) If Belgium has exports of 50 billion euros and imports of 40 billion euros, then it is running a trade deficit.

Answer: FALSE

Diff: 2

Topic: Trade Surpluses and Deficits

Skill: Conceptual

AACSB: Reflective Thinking

2) If Japan has a exports of 70 billion yen and imports of 60 billion yen, it is running a trade surplus.

Answer: TRUE

Diff: 2

Topic: Trade Surpluses and Deficits

Skill: Conceptual

AACSB: Reflective Thinking

3) If a country's imports are greater than its exports, a country has a trade deficit.

Answer: TRUE

Diff: 2

Topic: Trade Surpluses and Deficits

Skill: Conceptual

AACSB: Reflective Thinking

4) A country's balance of trade must be balanced.

Answer: FALSE

Diff: 2

Topic: Trade Surpluses and Deficits

Skill: Conceptual

AACSB: Reflective Thinking

5) If a country's imports are less than its exports, a country has a trade surplus.

Answer: TRUE

Diff: 2

Topic: Trade Surpluses and Deficits

Skill: Conceptual

AACSB: Reflective Thinking

19.2 The Economic Basis for Trade: Comparative Advantage

1 Multiple Choice

1) The purpose of the Corn Laws was to

- A) encourage imports and discourage exports, and thus keep the price of food low.
- B) encourage both exports and imports in order to integrate the British economy with the rest of Europe.
- C) discourage both imports and exports in order to promote economic self-sufficiency in Britain.
- D) discourage imports and encourage exports, and thus keep the price of food high.

Answer: D

Diff: 1

Topic: The Economic Basis for Trade: Comparative Advantage

Skill: Fact

2) The theory of comparative advantage is credited to

- A) Adam Smith.
- B) David Ricardo.
- C) John Maynard Keynes.
- D) Milton Friedman.

Answer: B

Diff: 1

Topic: The Economic Basis for Trade: Comparative Advantage

Skill: Fact

3) Country A would have an absolute advantage compared to Country B in the production of corn if

- A) corn can be produced at lower cost in terms of other goods than it could be in Country B.
- B) Country A uses fewer resources to produce corn than Country B does.
- C) the demand for corn is higher in Country A than in Country B.
- D) corn sells for a higher price in Country A than in Country B.

Answer: B

Diff: 1

Topic: The Economic Basis for Trade: Comparative Advantage

Skill: Conceptual

AACSB: Reflective Thinking

4) The advantage in the production of a product enjoyed by one country over another when it uses fewer resources to produce that product than the other country does is

- A) an absolute advantage.
- B) a comparative advantage.
- C) a relative advantage.
- D) a productive advantage.

Answer: A

Diff: 1

Topic: The Economic Basis for Trade: Comparative Advantage

Skill: Definition

- 5) According to the theory of comparative advantage, a country
- A) exports the goods in which its has a comparative advantage.
 - B) imposes tariffs on goods in which it does not have comparative advantage.
 - C) imports the goods in which it has a comparative advantage.
 - D) exports goods in which it has absolute advantage.

Answer: A

Diff: 1

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Fact*

- 6) China has a comparative advantage in textile and an absolute advantage in radios. Japan has a comparative advantage in radios and an absolute advantage in textiles. According to this scenario
- A) Japan should export both radios and textiles.
 - B) China should import both radios and textiles.
 - C) China should export textiles and import radios.
 - D) Japan should export textiles and import radios.

Answer: C

Diff: 2

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 7) Country A has a comparative advantage compared to Country B in the production of shoes, if
- A) Country A can produce shoes at a lower monetary cost than Country B can.
 - B) Country A can produce shoes using fewer resources than Country B can.
 - C) the demand for shoes is higher in Country A than in Country B.
 - D) Country A can produce shoes at a lower cost in terms of other goods than Country B can.

Answer: D

Diff: 2

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 8) According to the theory of comparative advantage, a country should
- A) specialize and export goods with the highest opportunity cost.
 - B) specialize and export goods with the lowest production cost.
 - C) specialize and export goods with the lowest opportunity cost.
 - D) specialize and export goods with the lowest average cost.

Answer: C

Diff: 1

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Fact*

- 9) When one country can produce a product at a lower cost in terms of other goods, that country is said to have
- A) an absolute advantage.
 - B) a comparative advantage.
 - C) a productive advantage.
 - D) an unfair advantage.

Answer: B

Diff: 2

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Definition*

- 10) The United States imports televisions from Japan and Japan imports computer chips from the United States. If the theory of comparative advantage guides trade between the two countries, it must be true that
- A) the opportunity cost of producing televisions in Japan is higher than that in the United States.
 - B) the opportunity cost of producing computer chips in the United States is higher than that in Japan.
 - C) the United States has comparative advantage in producing computer chips.
 - D) the United States has comparative advantage in producing televisions.

Answer: C

Diff: 2

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 11) If Russia has an absolute advantage in the production of wheat and China has an absolute advantage in the production of textiles, then
- A) neither country has anything to gain from specialization and trade.
 - B) it is reasonable to expect that specialization will benefit both countries, but trade will not.
 - C) it is reasonable to expect that specialization and trade will benefit both countries.
 - D) it is reasonable to expect that trade will benefit both countries, but specialization will not.

Answer: C

Diff: 2

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 12) If Brazil has a comparative advantage in the production of coffee compared to the United States, then
- A) Brazil also has an absolute advantage in the production of coffee.
 - B) the United States has an absolute advantage in the production of coffee.
 - C) Brazil can produce coffee at a lower opportunity cost than the United States.
 - D) the United States cannot produce coffee.

Answer: C

Diff: 2

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 13) The United States has a comparative advantage in the production of wheat, and Haiti has a comparative advantage in the production of sugar. If both countries specialize based on the theory of comparative advantage,
- A) only the production of wheat will increase.
 - B) the production and consumption of both goods will increase.
 - C) only the production of both goods will increase.
 - D) only the consumption of both goods will increase.

Answer: B

Diff: 2

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 14) Suppose that Japan and India are both engaged in the production of radios and rice, and that Japan has an absolute advantage in the production of both goods. If India has a lower opportunity cost for producing rice, then
- A) India has a comparative advantage in rice production, but there will be no gains from specialization and trade.
 - B) Japan has a comparative advantage in the production of both goods.
 - C) India has a comparative advantage in the production of rice, but it is outweighed by Japan's absolute advantage in rice production.
 - D) India has a comparative advantage in the production of rice, and specialization and trade between the two countries can be mutually beneficial.

Answer: D

Diff: 2

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 15) If the slopes of the production possibility frontiers involving sugar and rice in countries A and B are equal,
- A) the opportunity cost of producing sugar is less in Country A.
 - B) the opportunity cost of producing rice is less in Country B.
 - C) specialization does not benefit either country.
 - D) each country will produce identical quantities of sugar and rice.

Answer: C

Diff: 2

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 16) Suppose that Argentina and Chile are both engaged in the production of copper and wheat, and that Argentina has an absolute advantage in the production of both goods. If Chile has a comparative advantage in the production of copper, then Chile
- A) has a lower opportunity cost for copper, which means that it should specialize in production of copper and engage in trade.
 - B) has a lower opportunity cost for producing copper, but specialization is not feasible because Argentina has a lower monetary cost of copper production.
 - C) has a higher opportunity cost for copper, which means it should specialize in the production of wheat and engage in trade.
 - D) should continue to produce copper, but only for domestic consumption, because trade is not a viable option.

Answer: A

Diff: 2

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Analytic*

AACSB: *Analytic Skills*

Refer to the information provided in Table 19.1 below to answer the questions that follow.

Table 19.1

Mexico		Guatemala	
Oranges bushel/acre	Bananas bushel/acre	Oranges bushel/acre	Bananas bushel/acre
200	0	50	0
160	40	40	20
120	80	30	40
80	120	20	60
40	160	10	80
0	200	0	100

- 17) Refer to Table 19.1. In Mexico, the opportunity cost of 1 bushel of bananas is
- A) 1/2 bushel of oranges.
 - B) 1 bushels of oranges.
 - C) 2 bushel of oranges.
 - D) 5 bushels of oranges.

Answer: B

Diff: 1

Topic: The Economic Basis for Trade: Comparative Advantage

Skill: Analytic

AACSB: Analytic Skills

- 18) Refer to Table 19.1. In Guatemala, the opportunity cost of 1 bushel of oranges is
- A) 1/2 bushel of bananas.
 - B) 1 bushels of bananas.
 - C) 2 bushel of bananas.
 - D) 4 bushels of bananas.

Answer: C

Diff: 1

Topic: The Economic Basis for Trade: Comparative Advantage

Skill: Analytic

AACSB: Analytic Skills

- 19) Refer to Table 19.1. In Mexico, the opportunity cost of 1 bushel of oranges is
- A) 1/2 bushel of bananas.
 - B) 1 bushels of bananas.
 - C) 2 bushel of bananas.
 - D) 5 bushels of bananas.

Answer: B

Diff: 1

Topic: The Economic Basis for Trade: Comparative Advantage

Skill: Analytic

AACSB: Analytic Skills

- 20) Refer to Table 19.1. In Guatemala, the opportunity cost of 1 bushel of bananas is
- A) 1/2 bushel of oranges.
 - B) 1 bushels of oranges.
 - C) 2 bushel of oranges.
 - D) 4 bushels of oranges.

Answer: A

Diff: 1

Topic: The Economic Basis for Trade: Comparative Advantage

Skill: Analytic

AACSB: Analytic Skills

- 21) Refer to Table 19.1. The opportunity cost of producing a bushel of oranges in Mexico is
- A) twice as much as that in Guatemala.
 - B) half as much as that in Guatemala.
 - C) the same as that in Guatemala.
 - D) four times as much as that in Guatemala.

Answer: B

Diff: 2

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 22) Refer to Table 19.1. Guatemala has
- A) a comparative advantage in orange production.
 - B) an absolute advantage in orange production.
 - C) an absolute advantage in banana production.
 - D) a comparative advantage in banana production.

Answer: D

Diff: 1

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 23) Refer to Table 19.1. Guatemala has
- A) a comparative advantage but not an absolute advantage in orange production.
 - B) a comparative advantage but not an absolute advantage in banana production.
 - C) an absolute advantage and a comparative advantage in banana production.
 - D) an absolute advantage and a comparative advantage in orange production.

Answer: B

Diff: 1

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 24) Refer to Table 19.1. Mexico has
- A) a comparative advantage but not an absolute advantage in orange production.
 - B) a comparative advantage but not an absolute advantage in banana production.
 - C) an absolute advantage and a comparative advantage in banana production.
 - D) an absolute advantage and a comparative advantage in orange production.

Answer: D

Diff: 2

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Analytic*

AACSB: *Analytic Skills*

25) Refer to Table 19.1. Guatemala should specialize in and export _____, and Mexico should specialize in and export _____.

- A) oranges; oranges
- C) bananas; oranges

- B) bananas; bananas
- D) oranges; bananas

Answer: C

Diff: 2

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Analytic*

AACSB: *Analytic Skills*

26) Refer to Table 19.1. Before specialization, Mexico produces 120 bushels of oranges and 80 bushels of bananas, and Guatemala produces 40 bushels of oranges and 20 bushels of bananas. After specialization, the increase in orange production is

- A) 10 bushels of oranges.
- C) 25 bushels of oranges.

- B) 20 bushels of oranges.
- D) 40 bushels of oranges.

Answer: D

Diff: 3

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Analytic*

AACSB: *Analytic Skills*

27) Refer to Table 19.1. Before specialization, Mexico produces 160 bushels of oranges and 40 bushels of bananas, and Guatemala produces 30 bushels of oranges and 40 bushels of bananas. After specialization, the increase in banana production is

- A) 10 bushels of bananas.
- C) 20 bushels of bananas.

- B) 15 bushels of bananas.
- D) 40 bushels of bananas.

Answer: C

Diff: 3

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Analytic*

AACSB: *Analytic Skills*

28) Refer to Table 19.1. For both countries to benefit from trade, the terms of trade must be between _____ bushel(s) of oranges to bushel(s) of bananas.

- A) 1:1/2 and 1:4

- B) 2:3 and 2:1

- C) 1:1 and 1:1/2

- D) 1:1 and 1:2.

Answer: D

Diff: 3

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Analytic*

AACSB: *Analytic Skills*

Refer to the information provided in Table 19.2 below to answer the questions that follow.

Table 19.2

China		Thailand	
Tractors	Motorcycles	Tractors	Motorcycles
0	300	0	300
5	250	5	225
10	200	10	150
15	150	15	75
20	100	20	0
25	50	—	—
30	0	—	—

- 29) Refer to Table 19.2. In China, the opportunity cost of
- A) a tractor is 1 motorcycle.
 - B) a motorcycle is 10 tractors.
 - C) a tractor is 10 motorcycles.
 - D) a motorcycle is 1/30 of a tractor.

Answer: C

Diff: 1

Topic: The Economic Basis for Trade: Comparative Advantage

Skill: Analytic

AACSB: Analytic Skills

- 30) Refer to Table 19.2. In Thailand, the opportunity cost of
- A) a motorcycle is 1/15 of a tractor.
 - B) a motorcycle is 15 tractors.
 - C) a motorcycle is 1/30 of a tractor.
 - D) a tractor is 20 motorcycles.

Answer: A

Diff: 1

Topic: The Economic Basis for Trade: Comparative Advantage

Skill: Analytic

AACSB: Analytic Skills

- 31) Refer to Table 19.2. _____ has a comparative advantage in motorcycles and _____ has an absolute advantage in motorcycles.
- A) China; neither
 - B) Neither; neither
 - C) Thailand; neither
 - D) Thailand; China

Answer: C

Diff: 1

Topic: The Economic Basis for Trade: Comparative Advantage

Skill: Analytic

AACSB: Analytic Skills

- 32) Refer to Table 19.2. If both countries specialize and trade with each other, Thailand will export _____ and China will import _____.
- A) motorcycles; tractors
 - B) tractors; motorcycles
 - C) tractors; tractors
 - D) motorcycles; motorcycles

Answer: D

Diff: 2

Topic: The Economic Basis for Trade: Comparative Advantage

Skill: Analytic

AACSB: Analytic Skills

- 33) Refer to Table 19.2. The most that Thailand will be willing to pay for a tractor is
- A) 5 motorcycles.
 - B) 10 motorcycles.
 - C) 15 motorcycles.
 - D) 20 motorcycles.

Answer: C

Diff: 3

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 34) Refer to Table 19.2. The most that China will be willing to pay for a motorcycle is
- A) 1/20 of a tractor.
 - B) 1/10 of a tractor.
 - C) 1/30 of a tractor.
 - D) 1/5 of a tractor.

Answer: B

Diff: 3

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 35) Refer to Table 19.2. Which terms of trade benefits both countries?
- A) 1 tractor for 10 motorcycles
 - B) 1 tractor for 12.5 motorcycles
 - C) 1 motorcycle for 10 tractors
 - D) 1 motorcycle for 1/5 of a tractor

Answer: B

Diff: 3

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 36) The terms of trade refers to
- A) the documents that two countries sign in order to facilitate trade.
 - B) the conditions imposed by the importing country regarding the quality of the imported goods.
 - C) the exchange rate determined by the exporting and the importing countries.
 - D) the ratio at which one country trades a domestic product for imported product.

Answer: D

Diff: 1

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Definition*

- 37) Specialization and trade allow a country to
- A) produce and consume on its production possibility frontier.
 - B) produce and consume inside its production possibility frontier.
 - C) produce and consume outside its production possibility frontier.
 - D) produce on its production possibility frontier and consume outside it.

Answer: D

Diff: 1

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 38) The main advantage of trade between two countries is that
- A) trade makes both countries more self-sufficient.
 - B) employment in both countries will increase.
 - C) both countries have consumption choices beyond their current resource and production constraints.
 - D) trade will lead to a more equitable distribution of income in both countries.

Answer: C

Diff: 1

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 39) According to comparative advantage, trade between two countries
- A) maximizes the amount of inputs that are used in the production of all products.
 - B) guarantees that consumption levels will be equal in the two countries.
 - C) will benefit all the industries in each of the countries.
 - D) allows each of the trading countries to use its resources most efficiently.

Answer: D

Diff: 1

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 40) When countries specialize in producing those goods in which they have a comparative advantage, they
- A) maximize their combined output, but they do not necessarily allocate their resources more efficiently.
 - B) maximize their combined output and allocate their resources more efficiently.
 - C) allocate their resources more efficiently, but they do not necessarily maximize their combined output.
 - D) do not necessarily maximize their combined output, and they also do not necessarily allocate their resources more efficiently.

Answer: B

Diff: 2

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

Refer to the information provided in Figure 19.1 below to answer the questions that follow.

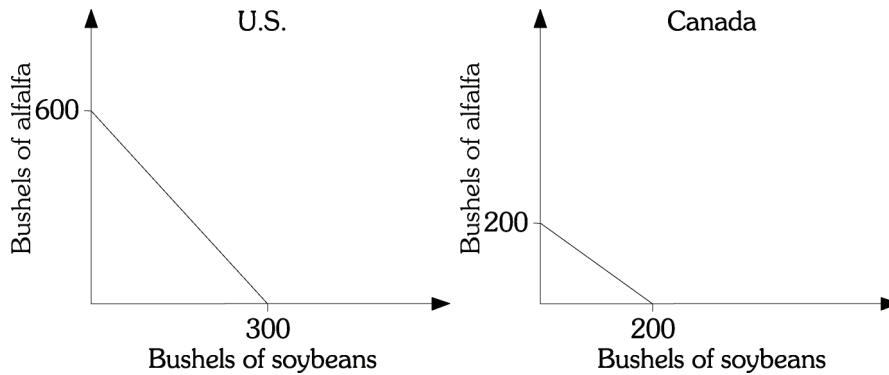


Figure 19.1

41) Refer to Figure 19.1. Which of the following statements is TRUE?

- A) The United States has both an absolute advantage and a comparative advantage in the production of soybeans and alfalfa.
- B) The United States has an absolute advantage in the production of soybeans and alfalfa, but a comparative advantage only in the production of soybeans.
- C) The United States has an absolute advantage in the production of soybeans and alfalfa, but a comparative advantage only in the production of alfalfa.
- D) The United States has a comparative advantage in the production of both soybeans and alfalfa, but an absolute advantage only in the production of soybeans.

Answer: C

Diff: 1

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Analytic*

AACSB: *Analytic Skills*

42) Refer to Figure 19.1. Which of the following statements is TRUE?

- A) Only Canada can benefit from trade because the United States has an absolute advantage in the production of both soybeans and alfalfa.
- B) Trade will benefit both countries because the United States has a comparative advantage in the production of soybeans and Canada has a comparative advantage in the production of alfalfa.
- C) Trade will benefit both countries because the United States has a comparative advantage in the production of alfalfa and Canada has a comparative advantage in the production of soybeans.
- D) Trade will benefit neither country because the United States has an absolute advantage in the production of both soybeans and alfalfa, but Canada has a comparative advantage in the production of both soybeans and alfalfa.

Answer: C

Diff: 2

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Analytic*

AACSB: *Analytic Skills*

43) Refer to Figure 19.1. The opportunity cost of producing a bushel of alfalfa in the United States is

- A) twice as much as that in Canada.
- B) half as much as that in Canada.
- C) the same as that in Canada.
- D) four times as much as that in Canada.

Answer: B

Diff: 2

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Analytic*

AACSB: *Analytic Skills*

44) Refer to Figure 19.1. The opportunity cost of producing a bushel of alfalfa in the United States is

- A) half a bushel of soybeans.
- B) 1 bushel of soybeans.
- C) 2 bushels of soybeans.
- D) 300 bushels of soybeans.

Answer: A

Diff: 2

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Analytic*

AACSB: *Analytic Skills*

45) Refer to Figure 19.1. The opportunity cost of producing a bushel of alfalfa in Canada is

- A) half a bushel of soybeans.
- B) 1 bushel of soybeans.
- C) 2 bushels of soybeans.
- D) zero.

Answer: B

Diff: 2

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Analytic*

AACSB: *Analytic Skills*

46) Refer to Figure 19.1. The opportunity cost of producing a bushel of soybeans in the United States is

- A) half a bushel of alfalfa.
- B) 1 bushel of alfalfa.
- C) 2 bushels of alfalfa.
- D) 300 bushels of alfalfa.

Answer: C

Diff: 2

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Analytic*

AACSB: *Analytic Skills*

Refer to the information provided in Figure 19.2 below to answer the questions that follow.

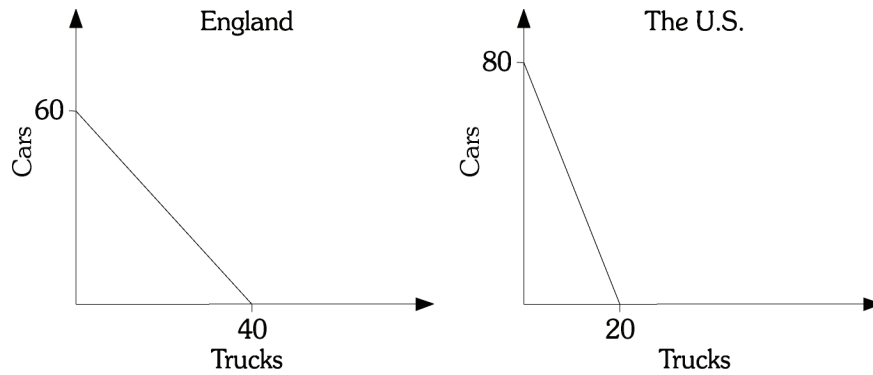


Figure 19.2

47) Refer to Figure 19.2. The opportunity cost of a truck is _____ car(s) in the United States and _____ car(s) in England.

- A) 6; 4 B) 4; 1.5 C) 4; 6 D) .25; 1.5

Answer: B

Diff: 1

Topic: The Economic Basis for Trade: Comparative Advantage

Skill: Analytic

AACSB: Analytic Skills

48) Refer to Figure 19.2. the theory of comparative advantage suggests that

- A) England should import trucks and export cars.
 B) England should export both trucks and cars.
 C) the United States should export both trucks and cars.
 D) the United States should export cars and import trucks.

Answer: D

Diff: 2

Topic: The Economic Basis for Trade: Comparative Advantage

Skill: Analytic

AACSB: Analytic Skills

49) Refer to Figure 19.2. The opportunity cost of a car is _____ truck(s) in the United States and _____ truck(s) in England

- A) 6; 4 B) 4; 1.5 C) 4; 6 D) .25; .67

Answer: D

Diff: 1

Topic: The Economic Basis for Trade: Comparative Advantage

Skill: Analytic

AACSB: Analytic Skills

- 50) Refer to Figure 19.2. England has
- A) a comparative advantage in producing trucks.
 - B) an absolute advantage in producing cars.
 - C) a comparative advantage in producing cars.
 - D) no comparative advantage in producing either cars or trucks.

Answer: A

Diff: 2

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 51) Refer to Figure 19.2. the U.S. has
- A) a comparative advantage in producing trucks.
 - B) an absolute advantage in producing trucks.
 - C) a comparative advantage in producing cars.
 - D) no comparative advantage in producing either cars or trucks.

Answer: C

Diff: 2

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 52) Assume that Blade Runner specializes in producing in-line skates and Hang Ten specializes in producing surfboards. After trade Blade Runner exports 800 pairs of in-line skates and imports 200 surfboards. The terms of trade
- A) are 1:4 in-line skates to surfboards.
 - B) are 4:1 in-line skates to surfboards.
 - C) are 1/4:1 in-line skates to surfboards.
 - D) cannot be determined from this information.

Answer: B

Diff: 3

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 53) When trade is free, patterns of trade and trade flows result from
- A) the collective decisions of a few importers and exporters, as well as the governments of the countries in which they reside.
 - B) the collective decisions of a few importers and exporters, as well as millions of private households and firms.
 - C) the independent decisions of thousands of importers and exporters, as well as millions of private households and firms.
 - D) the independent decisions of thousands of importers and exporters, as well as the governments of the countries in which they reside.

Answer: C

Diff: 2

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 54) If you are traveling in China and you purchase a meal that costs 140 yuan and the current exchange rate is 7 yuan to the dollar, then the price of the meal in U.S. currency is
- A) \$200. B) \$20. C) \$10. D) \$2

Answer: B

Diff: 1

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 55) Suppose a U.S. dollar exchanges for 2 British pounds, then each pound is worth
- A) \$.25. B) \$.50. C) \$1. D) \$4.

Answer: B

Diff: 1

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 56) If the price of a car in the United States is \$26,000, and the exchange rate between the dollar and the British pound rises from \$1.50 to \$2.00 per pound, then the price of the American car in Britain will
- A) fall.
B) rise.
C) remain the same.
D) be irrelevant, because the British government will impose restrictions on imports from the United States.

Answer: A

Diff: 2

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 57) If the price of a car in the United States is \$22,000, and the exchange rate between the dollar and the Japanese yen falls from 125 yen to 105 yen per dollar, then the price of the American car in Japan will
- A) fall.
B) rise.
C) remain the same.
D) be irrelevant, because the Japanese government will impose restrictions on imports from the United States.

Answer: B

Diff: 2

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 58) For any pair of countries, there is
- A) a range of exchange rates that can lead automatically to both countries realizing the gains from specialization and comparative advantage.
 - B) one single exchange rate that will lead indirectly to one country realizing the gains from specialization and comparative advantage, but not the other country.
 - C) a range of exchange rates that can lead indirectly to one country realizing the gains from specialization and comparative advantage, but not the other country.
 - D) one single exchange rate that will lead automatically to both countries realizing the gains from specialization and comparative advantage.

Answer: A

Diff: 2

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

Refer to the information provided in Table 19.3 below to answer the questions that follow.

	United States	Belgium
Raspberries	\$9	9 euros
Chocolate	\$12	27 euros

- 59) Refer to Table 19.3. If the exchange rate is \$1 = 1 euro, then
- A) the United States will import both raspberries and chocolate.
 - B) Belgium will import both raspberries and chocolate.
 - C) the United States will import chocolate and Belgium will import raspberries.
 - D) Belgium will import chocolate.

Answer: D

Diff: 2

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 60) Refer to Table 19.3. If the exchange rate is \$1 = 3 euros, then
- A) the United States will import both raspberries and chocolate.
 - B) Belgium will import both raspberries and chocolate.
 - C) the United States will import chocolate and Belgium will import raspberries.
 - D) the United States will import raspberries and Belgium will import chocolate.

Answer: A

Diff: 2

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 61) Refer to Table 19.3. If the exchange rate is $\$1 = 2$ euros, then
- A) the United States will import both raspberries and chocolate.
 - B) Belgium will import both raspberries and chocolate.
 - C) the United States will import raspberries and Belgium will import chocolate.
 - D) Belgium will import chocolate.

Answer: C

Diff: 2

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 62) Refer to Table 19.3. Trade will flow in both directions between countries only if the price of the euro is between
- A) \$.40 and \$.50.
 - B) \$1.00 and \$2.25.
 - C) \$.60 and \$.75.
 - D) \$.44 and \$1.00

Answer: D

Diff: 3

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 63) If the exchange rate between the United States and Japan changes from $\$1 = 100$ yen to $\$1 = 110$ yen, then, *ceteris paribus*, the price of American goods in Japan
- A) could either increase or decrease.
 - B) will decrease.
 - C) will remain the same.
 - D) will increase.

Answer: D

Diff: 2

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 64) If the exchange rate between the United States and Mexico changes from $\$1 = 100$ peso to $\$1 = 5$ pesos, *ceteris paribus*,
- A) the United States imports from Mexico increase.
 - B) Mexican exports to the United States increase.
 - C) the United States exports to Mexico increase.
 - D) the trade deficit in the United States increases.

Answer: C

Diff: 2

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 65) If trade between the United States and Canada is balanced and the U.S. dollar appreciates against the Canadian dollar, *ceteris paribus*, we would expect
- A) a trade surplus in the United States.
 - B) a trade surplus in Canada.
 - C) a trade deficit in Canada.
 - D) a trade deficit in both countries.

Answer: B

Diff: 2

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 66) Suppose that the United States and Italy both produce wine and shoes. In the United States, wine sells for \$10 a bottle and shoes sell for \$40 a pair. In Italy, wine sells for 15 euros a bottle and shoes sell for 20 euros a pair. If the current exchange rate is 0.8 euro to the dollar, then
- A) Italy will import both shoes and wine from the United States.
 - B) the United States will import both shoes and wine from Italy.
 - C) the United States will import shoes from Italy and Italy will import wine from the United States.
 - D) the United States will import wine from Italy and Italy will import shoes from the United States.

Answer: C

Diff: 3

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 67) Suppose that the United States and Italy both produce wine and shoes. In the United States, wine sells for \$10 a bottle and shoes sell for \$40 a pair. In Italy, wine sells for 15 euros a bottle and shoes sell for 20 euros a pair. Given this information, trade will flow in both directions if the price of a dollar is between
- A) .5 and .75 euro.
 - B) .67 and 2 euros.
 - C) 1.5 and 2.5 euros.
 - D) 2.0 and 3.0 euros.

Answer: B

Diff: 3

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Analytic*

AACSB: *Analytic Skills*

2 True/False

- 1) In general, for any two countries, there are many exchange rates that will lead to gains from trade, based on comparative advantage.

Answer: TRUE

Diff: 2

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 2) Trade allows the people of a country to consume outside their production possibility curve.

Answer: TRUE

Diff: 1

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 3) If the exchange rate between the United States and Greece changes from \$1 = 1 euro to \$1 = 2 euros, then holding everything else constant, the price of U.S. goods in Greece will increase.

Answer: TRUE

Diff: 2

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 4) If Spain decreases subsidies to its olive growers, the price of olives in the U.S. will fall.
Answer: FALSE
Diff: 2
Topic: *The Economic Basis for Trade: Comparative Advantage*
Skill: *Conceptual*
AACSB: *Reflective Thinking*
- 5) A country is said to enjoy a comparative advantage over another country in the production of a product if it uses fewer resources to produce that product than the other country does.
Answer: FALSE
Diff: 1
Topic: *The Economic Basis for Trade: Comparative Advantage*
Skill: *Conceptual*
AACSB: *Reflective Thinking*
- 6) A country enjoys a comparative advantage in the production of a good if that good can be produced at a lower cost in terms of other goods.
Answer: TRUE
Diff: 1
Topic: *The Economic Basis for Trade: Comparative Advantage*
Skill: *Conceptual*
AACSB: *Reflective Thinking*
- 7) For any pair of nations and goods, if each country has an absolute advantage in the production of one product, it is reasonable to expect that specialization and trade will benefit both countries.
Answer: TRUE
Diff: 1
Topic: *The Economic Basis for Trade: Comparative Advantage*
Skill: *Conceptual*
AACSB: *Reflective Thinking*
- 8) For any pair of countries, there is only one single exchange rate that can lead automatically to both countries realizing the gains from specialization and comparative advantage.
Answer: FALSE
Diff: 1
Topic: *The Economic Basis for Trade: Comparative Advantage*
Skill: *Conceptual*
AACSB: *Reflective Thinking*
- 9) Within the range of exchange rates that permits specialization and trade to take place, the exchange rate will determine which country gains the most from trade.
Answer: TRUE
Diff: 2
Topic: *The Economic Basis for Trade: Comparative Advantage*
Skill: *Conceptual*
AACSB: *Reflective Thinking*

10) If exchange rates end up in the right ranges, the free market will drive each country to shift resources into those sectors in which it enjoys a comparative advantage.

Answer: TRUE

Diff: 2

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

11) Only those products in which a country has an absolute advantage will be competitive in world markets.

Answer: FALSE

Diff: 1

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

12) If the domestic price is below the world price of a certain product, the domestic country will export the product.

Answer: TRUE

Diff: 2

Topic: *The Economic Basis for Trade: Comparative Advantage*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

19.3 The Sources of Comparative Advantage

1 Multiple Choice

- 1) The quantity and quality of labor, land, and natural resources of a country are its
- A) capital stock.
 - B) productive capacity.
 - C) factor endowments.
 - D) economic potential.

Answer: C

Diff: 1

Topic: *The Sources of Comparative Advantage*

Skill: *Definition*

- 2) The software industry depends on highly trained workers, who are abundantly available in Country A. The heavy equipment industry depends on the availability of a large stock of physical capital with which Country B is well endowed. According to Heckscher -Ohlin theorem
- A) Country A should export heavy equipment.
 - B) Country B should import software.
 - C) Country B should import heavy equipment.
 - D) Country A should import software.

Answer: B

Diff: 2

Topic: *The Sources of Comparative Advantage*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 3) A significant portion of actual world trade patterns results from
- A) different factor endowments between countries.
 - B) the different tastes and preferences of people in different countries.
 - C) the industrial policies of governments.
 - D) different sizes of the countries.

Answer: A

Diff: 2

Topic: *The Sources of Comparative Advantage*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 4) An example of an acquired comparative advantage is
- A) the United States producing more agricultural products than other countries because land is more abundant in the United States than in other countries.
 - B) United States consumers buying television sets produced in Japan because Japanese companies have a reputation for producing a higher-quality TV than those produced in the United States.
 - C) United States companies selling to other countries chemical products that cannot be sold in the United States.
 - D) the United States purchasing coconuts from other countries, because they cannot be produced in the United States.

Answer: B

Diff: 2

Topic: *The Sources of Comparative Advantage*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 5) An example of acquired comparative advantage is that
- A) the United States imports coffee beans because coffee beans cannot be grown in the United States.
 - B) some U.S. consumers prefer German cars over American cars because German cars have a reputation for being very safe.
 - C) China specializes in the production of labor-intensive goods because of the amount of labor available in the country relative to capital.
 - D) the U.S. government provides a subsidy to firms that are trying to increase their exports to other countries.

Answer: B

Diff: 2

Topic: *The Sources of Comparative Advantage*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 6) Which of the following phenomena CANNOT be explained by the simple comparative advantage theory?
- A) A country that does not have much farmland tends to import agricultural goods.
 - B) A country with a lot of skilled labor tends to export highly technical goods.
 - C) A country tends to export the goods that it can produce at a lower opportunity cost.
 - D) A country imports and exports the same goods.

Answer: D

Diff: 2

Topic: *The Sources of Comparative Advantage*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 7) The Heckscher–Ohlin theorem looks to _____ to explain trade flows.
- A) relative factor endowments
 - B) the existence of trade barriers
 - C) acquired comparative advantage
 - D) the differences in preferences among consumers

Answer: A

Diff: 1

Topic: *The Sources of Comparative Advantage*

Skill: *Fact*

- 8) Which of the following is NOT a valid explanation for the existence of international trade?
- A) the existence of natural comparative advantage
 - B) the existence of acquired comparative advantage
 - C) some economies of scale that are available when producing for a domestic market may not be available when producing for a world market
 - D) industries may differentiate their products in order to please the wide variety of tastes that exist worldwide

Answer: C

Diff: 1

Topic: *The Sources of Comparative Advantage*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

2 True/False

- 1) A country with a lot of human capital is likely to have a comparative advantage in highly technical goods.

Answer: TRUE

Diff: 1

Topic: *The Sources of Comparative Advantage*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 2) The Heckscher–Ohlin theorem says that a country is likely to have a comparative advantage in a labor intensive product, if it has a large labor supply.

Answer: TRUE

Diff: 1

Topic: *The Sources of Comparative Advantage*

Skill: *Fact*

3) The Heckscher–Ohlin theorem explains why the U.S. both imports and exports cars.

Answer: FALSE

Diff: 1

Topic: *The Sources of Comparative Advantage*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

4) International trade can be spurred by economies of scale giving a cost advantage to one large producer exporting to the whole world.

Answer: TRUE

Diff: 1

Topic: *The Sources of Comparative Advantage*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

5) Acquired comparative advantage come from factor endowments.

Answer: FALSE

Diff: 1

Topic: *The Sources of Comparative Advantage*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

19.4 Trade Barriers: Tariffs, Export Subsidies, and Quotas

1 Multiple Choice

1) A tariff is

A) a limit on the quantity of a good that can be imported into a country.

B) a tax on imports.

C) a government payment made to domestic firms to encourage exports.

D) a payment made by the government to producers of the product.

Answer: B

Diff: 1

Topic: *Trade Barriers: Tariffs, Export Subsidies, and Quotas*

Skill: *Definition*

2) Government payments made to domestic firms in order to encourage exports are called

A) tariffs.

B) bribes.

C) quotas.

D) subsidies.

Answer: D

Diff: 1

Topic: *Trade Barriers: Tariffs, Export Subsidies, and Quotas*

Skill: *Definition*

3) It costs a computer manufacturer \$3,000 to produce a personal computer. This manufacturer sells these computers abroad for \$2,500. This is an example of

A) a negative tariff.

B) export subsidy.

C) dumping.

D) a trade–related economy of scale.

Answer: C

Diff: 1

Topic: *Trade Barriers: Tariffs, Export Subsidies, and Quotas*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 4) If the United States decreases the tariff on imported tuna steaks, this will
- A) reduce the number of tuna steaks imported into the United States and reduce production of tuna steaks in the United States.
 - B) increase the number of tuna steaks imported in the United States and increase the production of tuna steaks in the United States.
 - C) reduce the number of tuna steaks imported in the United States and increase the production of tuna steaks in the United States.
 - D) increase the number of tuna steaks imported in the United States and reduce the production of tuna steaks in the United States.

Answer: D

Diff: 2

Topic: Trade Barriers: Tariffs, Export Subsidies, and Quotas

Skill: Conceptual

AACSB: Reflective Thinking

- 5) The United States placed a limit on the amount of cars that can be imported into the United States. This is an example of
- A) a tariff.
 - B) an export subsidy.
 - C) a quota.
 - D) dumping.

Answer: C

Diff: 1

Topic: Trade Barriers: Tariffs, Export Subsidies, and Quotas

Skill: Conceptual

AACSB: Reflective Thinking

- 6) Which of the following is TRUE?
- A) An import quota generates government revenue.
 - B) Tariffs on imports generate government revenue as long as the domestic price is larger than the world price plus the tariff.
 - C) Tariffs on imports do not generate government revenue if the domestic price is larger than the world price plus the tariff.
 - D) Tariffs on imports never generate government revenue.

Answer: B

Diff: 2

Topic: Trade Barriers: Tariffs, Export Subsidies, and Quotas

Skill: Conceptual

AACSB: Reflective Thinking

- 7) Which of the following statements is FALSE?
- A) If the United States imposes a tariff on Japanese car imports, the price of cars in the United States is likely to increase.
 - B) If the United States imposes a quota on Japanese car imports, the price of cars in the United States is likely to increase.
 - C) If Japan imposes a subsidy on car exports to the United States, the price of cars in the United States is likely to increase.
 - D) If Japan imposes a "voluntary export restraint" on car exports to the United States, the price of cars in the United States is likely to increase.

Answer: C

Diff: 3

Topic: Trade Barriers: Tariffs, Export Subsidies, and Quotas

Skill: Conceptual

AACSB: Reflective Thinking

- 8) Dumping involves a country selling its exports
- A) at a price lower than its cost of production.
 - B) to nations without a comparative advantage in producing the products.
 - C) to nations that regularly impose tariffs.
 - D) to nations that have no need for the products.

Answer: A

Diff: 1

Topic: Trade Barriers: Tariffs, Export Subsidies, and Quotas

Skill: Definition

- 9) The U.S. tariff law that set off an international trade war in the 1930s was the
- A) Taft-Hartley tariff.
 - B) Bentsen-Gephardt tariff.
 - C) Smoot-Hawley tariff.
 - D) Landrum-Griffin tariff.

Answer: C

Diff: 1

Topic: Trade Barriers: Tariffs, Export Subsidies, and Quotas

Skill: Fact

- 10) The international agreement signed by the United States and 22 other countries in 1947 to promote the liberalization of foreign trade is known by its initials as
- A) GATT.
 - B) START.
 - C) SALT.
 - D) IMF.

Answer: A

Diff: 1

Topic: Trade Barriers: Tariffs, Export Subsidies, and Quotas

Skill: Fact

- 11) Every president who has held office since the General Agreement on Tariffs and Trade was signed has
- A) argued for free-trade policies, but only Eisenhower and Reagan successfully resisted all calls for protection from various sectors of the economy.
 - B) argued that certain domestic industries deserve protection, yet each one has been reluctant to use his powers to protect individual sectors of the economy.
 - C) argued for free-trade policies, yet each one has used his powers to protect various sectors of the economy.
 - D) argued for free-trade policies, but only Kennedy and Carter successfully resisted all calls for protection from various sectors of the economy.

Answer: C

Diff: 1

Topic: Trade Barriers: Tariffs, Export Subsidies, and Quotas

Skill: Fact

- 12) In 2003, the WTO ruled that U.S. tariffs on _____ were unfair and allowed retaliatory tariffs on U.S. products.
- A) steel imported from the EU
 - B) beef imported from Argentina
 - C) automobiles imported from Japan
 - D) diamonds imported from South Africa

Answer: A

Diff: 1

Topic: Trade Barriers: Tariffs, Export Subsidies, and Quotas

Skill: Fact

- 13) Over time, the general movement in the United States has been toward
- A) higher tariffs and stricter import quotas.
 - B) managed trade.
 - C) relatively more free trade.
 - D) complete elimination of tariffs, import quotas, and export subsidies.

Answer: C

Diff: 1

Topic: Trade Barriers: Tariffs, Export Subsidies, and Quotas

Skill: Fact

- 14) If a nation has most-favored-nation status conferred on it, then exports from that country
- A) will be priced higher than products exported from countries without most-favored-nation status.
 - B) are exempt from all safety regulations.
 - C) are sold below cost.
 - D) are taxed at the lowest negotiated tariff rates.

Answer: D

Diff: 1

Topic: Trade Barriers: Tariffs, Export Subsidies, and Quotas

Skill: Fact

- 15) Economic integration
- A) occurs when two or more nations join to form a free-trade zone.
 - B) occurs when countries develop an acquired comparative advantage that makes their industries more competitive in international markets.
 - C) occurs when countries are granted most-favored-nation status.
 - D) occurs when one country voluntarily agrees to reduce its exports to another country.

Answer: A

Diff: 1

Topic: Trade Barriers: Tariffs, Export Subsidies, and Quotas

Skill: Definition

- 16) The idea of the U.S.-Canadian Free-Trade Agreement that removed all barriers to trade including tariffs and quotas between the United States and Canada by 1998 was to
- A) increase the price of Canadian goods sold in the United States.
 - B) increase the price of U.S. goods sold in Canada.
 - C) increase the amount that the United States exports to Canada and the amount that the United States imports from Canada.
 - D) increase the amount that the United States exports to Canada and decrease the amount that the United States imports from Canada.

Answer: C

Diff: 1

Topic: Trade Barriers: Tariffs, Export Subsidies, and Quotas

Skill: Fact

17) In 1991, what group of countries began the process of forming the largest free-trade zone in the world?

- A) the European Community
- B) the North Atlantic Treaty Organization
- C) the United States, Canada, and Mexico
- D) the Organization of Petroleum Exporting Countries

Answer: A

Diff: 1

Topic: Trade Barriers: Tariffs, Export Subsidies, and Quotas

Skill: Fact

18) Which of the following can be considered a free-trade zone?

- A) countries that are members of GATT
- B) the United States
- C) all English-speaking nations
- D) the industrialized OECD nations

Answer: B

Diff: 1

Topic: Trade Barriers: Tariffs, Export Subsidies, and Quotas

Skill: Fact

19) Related to the *Economics in Practice* on p. 366 [678]: A rise in global food prices would most likely result in pressure to

- A) increase tariffs on imported food.
- B) decrease tariffs on imported food.
- C) decrease quotas on imported food.
- D) decrease export duties on food.

Answer: B

Diff: 2

Topic: Trade Barriers: Tariffs, Export Subsidies, and Quotas: *Economics in Practice*

Skill: Conceptual

AACSB: Analytic Skills

2 True/False

1) An export subsidy raises the domestic price of the product.

Answer: TRUE

Diff: 1

Topic: Trade Barriers: Tariffs, Export Subsidies, and Quotas

Skill: Conceptual

AACSB: Reflective Thinking

2) A tariff is a tax on imports.

Answer: TRUE

Diff: 1

Topic: Trade Barriers: Tariffs, Export Subsidies, and Quotas

Skill: Definition

3) Dumping refers to a country selling its exports at a price lower than its selling price at home.

Answer: FALSE

Diff: 1

Topic: Trade Barriers: Tariffs, Export Subsidies, and Quotas

Skill: Definition

4) A quota is a restriction that allows women and minorities to import a certain percentage of imports.

Answer: FALSE

Diff: 1

Topic: Trade Barriers: Tariffs, Export Subsidies, and Quotas

Skill: Definition

5) Tariffs, quotas and exports subsidies all increase domestic production.

Answer: TRUE

Diff: 1

Topic: Trade Barriers: Tariffs, Export Subsidies, and Quotas

Skill: Conceptual

AACSB: Reflective Thinking

6) A quota on sugar harms domestic producers of sugar.

Answer: FALSE

Diff: 2

Topic: Trade Barriers: Tariffs, Export Subsidies, and Quotas

Skill: Conceptual

AACSB: Reflective Thinking

7) Related to the *Economics in Practice* on p. 366 [678]: To keep domestic food markets well-stocked, China has recently increased export duties on food products.

Answer: TRUE

Diff: 1

Topic: Trade Barriers: Tariffs, Export Subsidies, and Quotas: *Economics in Practice*

Skill: Fact

19.5 Free Trade or Protection?

1 Multiple Choice

1) The case for free trade is based on the

A) theory of balanced growth.

C) argument for a diversified economy.

B) theory of absolute advantage.

D) theory of comparative advantage.

Answer: D

Diff: 1

Topic: Free Trade or Protection?

Skill: Fact

2) Which of the following statements is NOT true?

A) Trade is beneficial because it allows more efficient production.

B) Trade is beneficial because it allows consumers to buy goods at cheaper prices.

C) Trade is beneficial because it allows all domestic industries to increase production.

D) Trade is beneficial because it allows consumption beyond the production possibility frontier.

Answer: C

Diff: 2

Topic: Free Trade or Protection?

Skill: Conceptual

AACSB: Reflective Thinking

- 3) A tariff imposed on imported shoes will cause the domestic price of shoes to _____ and the domestic production of shoes to _____.
- A) increase; increase
 B) increase; decrease
 C) decrease; increase
 D) decrease; decrease

Answer: A

Diff: 1

Topic: Free Trade or Protection?

Skill: Conceptual

AACSB: Reflective Thinking

Refer to the information provided in Figure 19.3 below to answer the questions that follow.

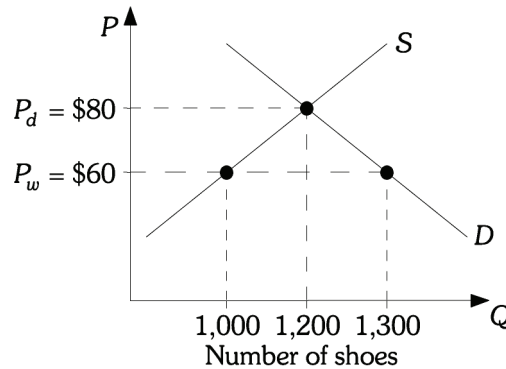


Figure 19.3

- 4) Refer to Figure 19.3. The domestic price of shoes is \$80. After trade the price of a pair of shoes is \$60. After trade this country will import
- A) 100 pairs of shoes.
 B) 200 pairs of shoes.
 C) 300 pairs of shoes.
 D) 1,300 pairs of shoes.

Answer: C

Diff: 2

Topic: Free Trade or Protection?

Skill: Analytic

AACSB: Analytic Skills

- 5) Refer to Figure 19.3. The domestic price of shoes is \$80. After trade the price of a pair of shoes is \$60. Now domestic production costs fall so that the equilibrium domestic price of a pair of shoes is \$70. This would cause
- A) the number of pairs of shoes imported into this country to increase.
 B) the number of pairs of shoes imported into this country to decrease.
 C) the number of pairs of shoes exported from this country to increase.
 D) the number of pairs of shoes exported from this country to decrease.

Answer: B

Diff: 2

Topic: Free Trade or Protection?

Skill: Analytic

AACSB: Analytic Skills

- 6) Refer to Figure 19.3. The domestic price of shoes is \$80. After trade the price of a pair of shoes is \$60. If shoes are a normal good and income in this country rises, then we would expect
- A) the number of pairs of shoes imported into this country to increase.
 - B) the number of pairs of shoes imported into this country to decrease.
 - C) the number of pairs of shoes exported from this country to increase.
 - D) the number of pairs of shoes exported from this country to decrease.

Answer: A

Diff: 2

Topic: Free Trade or Protection?

Skill: Analytic

AACSB: Analytic Skills

Refer to the information provided in Figure 19.4 below to answer the questions that follow.

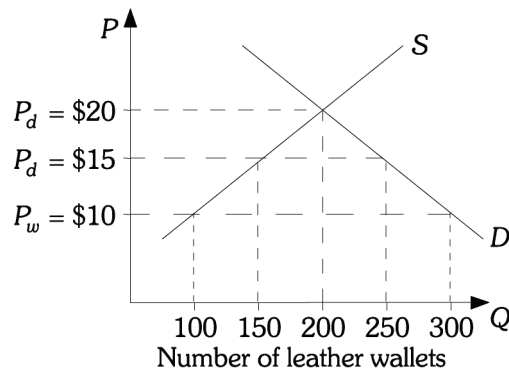


Figure 19.4

- 7) Refer to Figure 19.4. The domestic price of a leather wallet is \$20. With free trade the price of a leather wallet is \$10 and after a tariff is imposed the price is \$15. If there is free trade, this country will import _____ leather wallets.

- A) 50
- B) 100
- C) 200
- D) 300

Answer: C

Diff: 2

Topic: Free Trade or Protection?

Skill: Analytic

AACSB: Analytic Skills

- 8) Refer to Figure 19.4. The domestic price of a leather wallet is \$20. With free trade the price of a leather wallet is \$10 and after a tariff is imposed the price is \$15. After the tariff is imposed, this country will import _____ leather wallets.

- A) 50
- B) 100
- C) 150
- D) 200

Answer: B

Diff: 2

Topic: Free Trade or Protection?

Skill: Analytic

AACSB: Analytic Skills

- 9) Refer to Figure 19.4. The domestic price of a leather wallet is \$20. With free trade the price of a leather wallet is \$10 and after a tariff is imposed the price is \$15. After the tariff is imposed, tariff revenue in this country will be
- A) \$50. B) \$250. C) \$500. D) \$750.

Answer: C

Diff: 2

Topic: Free Trade or Protection?

Skill: Analytic

AACSB: Analytic Skills

- 10) Refer to Figure 19.4. The domestic price of a leather wallet is \$20. With free trade the price of a leather wallet is \$10 and after a tariff is imposed the price is \$15. After the tariff is imposed,
- A) domestic production and consumption will increase by 50 wallets and domestic consumption will increase by 50 wallets.
- B) domestic production will increase by 150 wallets and domestic consumption will decrease by 250 wallets.
- C) domestic production will increase by 100 wallets and domestic consumption will decrease by 100 wallets.
- D) domestic production will increase by 50 wallets and domestic consumption will decrease by 50 wallets.

Answer: D

Diff: 2

Topic: Free Trade or Protection?

Skill: Analytic

AACSB: Analytic Skills

- 11) Refer to Figure 19.4. The domestic price of a leather wallet is \$20. With free trade the price of a leather wallet is \$10 and after a tariff is imposed the price is \$15. If the tariff is raised so that it now equals \$10, tariff revenue in this country will be
- A) \$0. B) \$1,000. C) \$2,000. D) \$3,000.

Answer: A

Diff: 2

Topic: Free Trade or Protection?

Skill: Analytic

AACSB: Analytic Skills

- 12) Refer to Figure 19.4. The domestic price of a leather wallet is \$20. With free trade the price of a leather wallet is \$10 and after a tariff is imposed the price is \$15. With free trade domestic production is
- A) 0. B) 100. C) 150. D) 300.

Answer: B

Diff: 2

Topic: Free Trade or Protection?

Skill: Analytic

AACSB: Analytic Skills

13) Refer to Figure 19.4. The domestic price of a leather wallet is \$20. With free trade the price of a leather wallet is \$10 and after a tariff is imposed the price is \$15. With the tariff domestic production is

- A) 100. B) 150. C) 200. D) 300.

Answer: B

Diff: 2

Topic: Free Trade or Protection?

Skill: Analytic

AACSB: Analytic Skills

Refer to the information provided in Figure 19.5 below to answer the questions that follow.

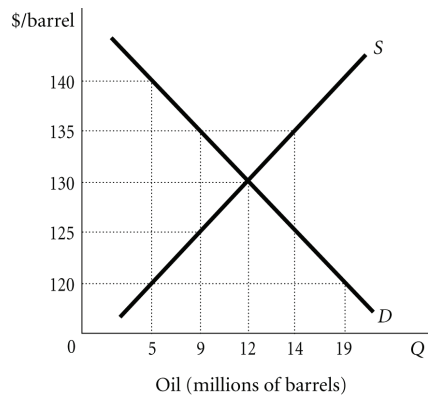


Figure 19.5

14) Refer to Figure 19.5. The domestic price of oil is \$130 per barrel. If the world price of oil is \$135 per barrel, this country will

- A) import 23 million barrels. B) import 9 million barrels.
 C) export 5 million barrels. D) export 14 million barrels.

Answer: C

Diff: 2

Topic: Free Trade or Protection?

Skill: Analytic

AACSB: Analytic Skills

15) Refer to Figure 19.5. The domestic price of oil is \$130 per barrel. This country imports 14 million barrels if the world price of oil is \$_____.

- A) 120 B) 125 C) 135 D) 140

Answer: A

Diff: 2

Topic: Free Trade or Protection?

Skill: Analytic

AACSB: Analytic Skills

- 16) Refer to Figure 19.5. The domestic price of oil is \$130 per barrel, and the world price of oil is \$120 per barrel. If the domestic government imposes a tariff of \$_____ per barrel, it will eliminate all oil imports and achieve tariff revenues of \$_____.
- A) 10; zero B) 5; 20 million C) 5; 45 million D) 10; 120 million

Answer: A

Diff: 2

Topic: Free Trade or Protection?

Skill: Analytic

AACSB: Analytic Skills

Refer to the information provided in Figure 19.6 below to answer the questions that follow.

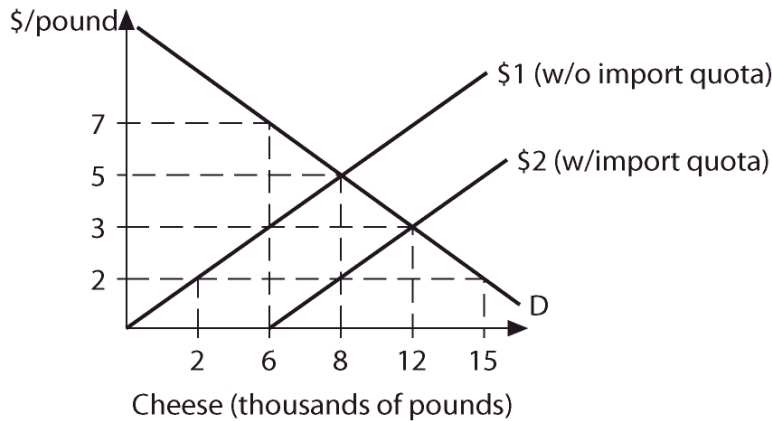


Figure 19.6

- 17) Refer to Figure 19.6. Before imposing an import quota, the equilibrium price of cheese is \$_____ per pound and the equilibrium quantity is _____ pounds.
- A) 3; 12,000 B) 5; 8,000 C) 5; 6,000 D) 3; 6,000

Answer: B

Diff: 1

Topic: Free Trade or Protection?

Skill: Analytic

AACSB: Analytic Skills

- 18) Refer to Figure 19.6. Suppose the government imposes an import quota of 6,000 pounds of cheese. The equilibrium price changes to \$_____ per pound, and the equilibrium quantity changes to _____ pounds.
- A) 3; 12,000 B) 3; 6,000 C) 5; 8,000 D) 7; 6,000

Answer: A

Diff: 2

Topic: Free Trade or Protection?

Skill: Analytic

AACSB: Analytic Skills

19) Refer to Figure 19.6. If the government does not impose an import quota of 6,000 pounds of cheese and the world price of cheese is \$2 per pound, this country will _____ pounds of cheese.

- A) import 7,000
- C) import 13,000

- B) import 10,000
- D) none of the above

Answer: C

Diff: 2

Topic: Free Trade or Protection?

Skill: Analytic

AACSB: Analytic Skills

20) Refer to Figure 19.6. From a no trade position, an import quota of 6,000 pounds

- A) increases domestic supply by 3,000 pounds and lowers the price by \$2 per pound.
- B) decreases domestic supply by 2,000 pounds and lowers the price by \$2 per pound.
- C) decreases domestic supply by 2,000 pounds and raises the price by \$1 per pound.
- D) decreases domestic supply by 3,000 pounds and lowers the price by \$2 per pound.

Answer: B

Diff: 2

Topic: Free Trade or Protection?

Skill: Analytic

AACSB: Analytic Skills

21) Related to the *Economics in Practice* on p. 369 [681]: If the candle makers in the petition were able to gain protection for their industry, the French economy would most likely

- A) benefit in the short run.
- B) become more efficient.
- C) benefit only if the protection was in the form of a tariff.
- D) have to pay higher prices for candles.

Answer: D

Diff: 1

Topic: Free Trade or Protection?: Economics in Practice

Skill: Conceptual

AACSB: Reflective Thinking

22) Related to the *Economics in Practice* on p. 369 [681]: Satirist Frederic Bastiat's essay arguing for a quota on sunlight in order to protect domestic candle makers suggests that it is pointless to

- A) participate in international trade
- B) protect industries that cannot compete effectively
- C) legislate based on economic theory
- D) create barriers to trade in some markets but not others

Answer: B

Diff: 2

Topic: Free Trade or Protection?: Economics in Practice

Skill: Analytic

AACSB: Analytic Skills

2 True/False

- 1) It is a valid argument that industries need to be protected from foreign competition because foreign wages are substantially lower than wages paid to U.S. workers.

Answer: FALSE

Diff: 2

Topic: *Free Trade or Protection?*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 2) Free trade allows the people of a country to consume outside their production possibility frontier.

Answer: TRUE

Diff: 2

Topic: *Free Trade or Protection?*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 3) Free trade decreases world production and consumption.

Answer: FALSE

Diff: 2

Topic: *Free Trade or Protection?*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 4) Protection is often temporary to help infant industries.

Answer: FALSE

Diff: 2

Topic: *Free Trade or Protection?*

Skill: *Fact*

- 5) Protection makes the people of a country better off.

Answer: FALSE

Diff: 2

Topic: *Free Trade or Protection?*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 6) According to some environmental groups, free trade policies are potentially harmful to the environment.

Answer: TRUE

Diff: 1

Topic: *Free Trade or Protection?*

Skill: *Fact*

Chapter 20 Open–Economy Macroeconomics: The Balance of Payments and Exchange Rates

20.1 The Balance of Payments

1 Multiple Choice

- 1) The price of one country's currency in terms of another country's currency is the
- A) balance of trade.
 - B) exchange rate.
 - C) terms of trade.
 - D) currency valuation.

Answer: B

Diff: 1

Topic: *The Balance of Payments*

Skill: *Definition*

- 2) The agreements that were reached at the Bretton Woods conference in 1944 established a system
- A) in which the values of currencies were fixed in terms of a specific number of ounces of gold, which in turn determined their values in international trading.
 - B) of floating exchange rates determined by the supply and demand of one nation's currency relative to the currency of other nations.
 - C) of essentially fixed exchange rates under which each country agreed to intervene in the foreign exchange market when necessary to maintain the agreed–upon value of its currency.
 - D) that prohibited governments from intervening in the foreign exchange markets.

Answer: C

Diff: 1

Topic: *The Balance of Payments*

Skill: *Fact*

- 3) In the early part of the twentieth century, nearly all currencies
- A) were backed by gold.
 - B) were held together by a system of fixed exchange rates in which the value of those currencies was set in relation to the British pound.
 - C) were held together by a system of fixed exchange rates in which the value of those currencies was set in relation to the U.S. dollar.
 - D) were held together by a system of flexible exchange rates in which the value of those currencies fluctuated in response to the relative supply of and demand for them.

Answer: A

Diff: 1

Topic: *The Balance of Payments*

Skill: *Fact*

- 4) In 1971, most countries, including the United States,
- A) returned to the gold standard.
 - B) adopted a new system of fixed exchange rates.
 - C) adopted a single, internationally accepted currency whose use is limited to international transactions.
 - D) gave up trying to fix exchange rates formally and began allowing them to be determined essentially by supply and demand.

Answer: D

Diff: 1

Topic: *The Balance of Payments*

Skill: *Fact*

- 5) Which of the following increases the price of the dollar relative to the Mexican peso?
- A) an increase in the supply of dollars
 - B) an increase in the demand for pesos
 - C) an increase in the demand for dollars
 - D) a decrease in the supply of pesos.

Answer: C

Diff: 2

Topic: *The Balance of Payments*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 6) Which of the following decreases the price of the dollar relative to the British pound?
- A) a decrease in the supply of dollars
 - B) a decrease in the demand for pounds
 - C) an increase in the demand for dollars
 - D) an increase in the supply of dollars.

Answer: D

Diff: 2

Topic: *The Balance of Payments*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 7) An increase in the supply of dollars and an increase in the demand for Japanese yen
- A) increases the dollar price of yen.
 - B) decreases the dollar price of yen.
 - C) increases the yen price of dollars.
 - D) does not change the exchange rate between dollars and yen.

Answer: A

Diff: 2

Topic: *The Balance of Payments*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 8) An increase in the supply of dollars and an increase in the demand for Japanese yen
- A) increases the value of the dollar.
 - B) increases the value of the yen.
 - C) increases the yen price of dollars.
 - D) does not change the exchange rate between dollars and yen.

Answer: B

Diff: 2

Topic: *The Balance of Payments*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 9) A decrease in the supply of dollars and a decrease in the demand for Japanese yen
- A) increases the value of the dollar.
 - B) increases the value of the yen.
 - C) increases the yen price of dollars.
 - D) does not change the exchange rate between dollars and yen.

Answer: A

Diff: 2

Topic: *The Balance of Payments*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 10) The value of the dollar relative to the euro would increase, if
- A) the demand for dollars increases and the supply of euros increases.
 - B) the demand for dollars decreases and the supply of euros increases.
 - C) the supply of dollars increases and the demand for euros increases.
 - D) the supply of dollars increases and the demand for euros decreases.

Answer: A

Diff: 2

Topic: *The Balance of Payments*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 11) The value of the dollar relative to the euro would decrease, if
- A) the demand for dollars increases and the supply of euros increases.
 - B) the demand for dollars decreases and the supply of euros increases.
 - C) the supply of dollars increases and the demand for euros increases.
 - D) the supply of dollars increases and the demand for euros decreases.

Answer: C

Diff: 2

Topic: *The Balance of Payments*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 12) The record of a country's transactions in goods, services, and assets with the rest of the world is its
- A) balance of payments.
 - B) balance of trade.
 - C) capital account.
 - D) current account.

Answer: A

Diff: 1

Topic: *The Balance of Payments*

Skill: *Definition*

- 13) Any transaction that causes foreign exchange to leave a country is a
- A) credit item in that country's balance of trade.
 - B) debit item in that country's balance of payments.
 - C) credit item in that country's balance of payments.
 - D) debit item in that country's balance of trade.

Answer: B

Diff: 1

Topic: *The Balance of Payments*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

14) Imports

- A) bring foreign exchange, and thus they are registered as credit in the balance of payments.
- B) bring foreign exchange, and thus they are registered as debit in the balance of payments.
- C) cause foreign exchange to leave the country, and thus they are registered as credit in the balance of payments.
- D) cause foreign exchange to leave the country, and thus they are registered as debit in the balance of payments.

Answer: D

Diff: 1

Topic: *The Balance of Payments*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

15) Exports

- A) bring foreign exchange, and thus they are registered as credit in the balance of payments.
- B) bring foreign exchange, and thus they are registered as debit in the balance of payments.
- C) cause foreign exchange to leave the country, and thus they are registered as credit in the balance of payments.
- D) cause foreign exchange to leave the country, and thus they are registered as debit in the balance of payments.

Answer: A

Diff: 1

Topic: *The Balance of Payments*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

16) The difference between a country's merchandise exports and its merchandise imports is the

- A) balance of payments.
- B) capital account.
- C) current account.
- D) balance of trade.

Answer: D

Diff: 1

Topic: *The Balance of Payments*

Skill: *Definition*

17) When a country's exports of goods are greater than its imports of goods in a given period, it has a

- A) trade deficit.
- B) capital account surplus.
- C) trade surplus.
- D) current account deficit.

Answer: C

Diff: 1

Topic: *The Balance of Payments*

Skill: *Definition*

18) When a country's exports of goods are less than its imports of goods in a given period, it has a

- A) trade deficit.
- B) capital account deficit.
- C) trade surplus.
- D) current account surplus.

Answer: A

Diff: 1

Topic: *The Balance of Payments*

Skill: *Definition*

- 19) The balance of payments is divided into two major accounts, the
- A) current account and the trade account.
 - B) current account and the capital account.
 - C) current account and the reserve account.
 - D) trade account and the capital account.

Answer: B

Diff: 1

Topic: *The Balance of Payments*

Skill: *Fact*

- 20) Which of the following is an item in the U.S. current account?
- A) net investment income
 - B) the change in foreign private assets in the United States
 - C) the change in private U.S. assets abroad
 - D) the change in foreign government assets in the United States

Answer: A

Diff: 2

Topic: *The Balance of Payments*

Skill: *Fact*

- 21) An Italian citizen buys a U.S. bond. This transaction will be entered as
- A) a credit in the U.S. current account.
 - B) a credit in the U.S. capital account.
 - C) a debit in the U.S. current account.
 - D) a debit in the U.S. capital account.

Answer: B

Diff: 1

Topic: *The Balance of Payments*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 22) A U.S. individual buys shares in a Swiss company. This transaction will be entered as
- A) a credit in the U.S. current account.
 - B) a debit in the U.S. current account.
 - C) a credit in the U.S. capital account.
 - D) a debit in the U.S. capital account.

Answer: D

Diff: 1

Topic: *The Balance of Payments*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 23) A U.S. firm builds a factory in South Africa. This will be entered as a
- A) debit in the U.S. capital account.
 - B) debit in the U.S. current account.
 - C) credit in the U.S. capital account.
 - D) credit in the U.S. current account.

Answer: A

Diff: 1

Topic: *The Balance of Payments*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 24) When an American buys an asset abroad, the transaction
- A) is registered as a credit in the capital account, and it decreases private U.S. assets abroad.
 - B) is registered as a debit in the current account, and it decreases private U.S. assets abroad.
 - C) is registered as a credit in the capital account, and it increases private U.S. assets abroad.
 - D) is registered as a debit in the capital account, and it increases private U.S. assets abroad.

Answer: D

Diff: 2

Topic: *The Balance of Payments*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 25) When a foreigner buys shares in a U.S. company, the transaction
- A) is registered as a credit in the capital account, and it decreases foreign private assets in the United States.
 - B) is registered as a debit in the current account, and it decreases private U.S. assets abroad.
 - C) is registered as a credit in the capital account, and it increases foreign private assets in the United States.
 - D) is registered as a debit in the capital account, and it increases private U.S. assets abroad.

Answer: C

Diff: 2

Topic: *The Balance of Payments*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 26) Which of the following statements is TRUE?
- A) A country runs a capital account deficit if it imports more than it exports.
 - B) If the current account is in surplus, the capital account must be in deficit.
 - C) The overall sum of all the entries in the balance of payments must be positive.
 - D) A country runs a current account surplus if it sells more of its assets abroad than it buys abroad.

Answer: B

Diff: 2

Topic: *The Balance of Payments*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 27) Which of the following statements is TRUE?
- A) An increase in exports causes a balance of payments surplus.
 - B) A decrease in exports causes a balance of payments deficit.
 - C) A decrease in imports causes a balance of payments surplus.
 - D) The balance of payments is always in balance.

Answer: D

Diff: 2

Topic: *The Balance of Payments*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 28) When foreign assets in the United States decrease,
- A) the United States residents are reducing their debt to the rest of the world.
 - B) the United States residents are increasing their stock of assets.
 - C) the United States residents are increasing their debt to the rest of the world.
 - D) foreign residents debts to the United States residents also increase.

Answer: A

Diff: 2

Topic: *The Balance of Payments*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 29) When foreign assets in the United States increase,
- A) the United States residents are reducing their debt to the rest of the world.
 - B) the United States residents are increasing their debt to the rest of the world.
 - C) foreign residents debt to the United States residents also decrease.
 - D) the United States residents are reducing their stock of assets.

Answer: B

Diff: 2

Topic: *The Balance of Payments*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 30) When United States residents acquire assets abroad, they are in essence
- A) borrowing money, and foreign debts to the United States decrease.
 - B) borrowing money, and foreign debts to the United States increase.
 - C) lending money, and foreign debts to the United States decrease.
 - D) lending money, and foreign debts to the United States increase.

Answer: D

Diff: 2

Topic: *The Balance of Payments*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 31) Until the mid-1970s the United States consistently ran
- A) current account deficits and capital account surpluses.
 - B) current account surpluses and capital account deficits.
 - C) deficits in both the current account and the capital account.
 - D) surpluses in both the current account and the capital account.

Answer: B

Diff: 1

Topic: *The Balance of Payments*

Skill: *Fact*

- 32) In the United States, which of the following is NOT directly determined by U.S. income?
- A) consumption
 - B) income tax revenue
 - C) exports
 - D) imports

Answer: C

Diff: 1

Topic: *The Balance of Payments*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

2 True/False

- 1) The current international monetary system is based on a gold standard.
Answer: FALSE
Diff: 1
Topic: *The Balance of Payments*
Skill: *Fact*
- 2) The record of a country's transactions in goods, services, and assets with the rest of the world is its balance of trade.
Answer: FALSE
Diff: 1
Topic: *The Balance of Payments*
Skill: *Definition*
- 3) The overall sum of all the entries in the balance of payments must be zero.
Answer: TRUE
Diff: 1
Topic: *The Balance of Payments*
Skill: *Fact*
- 4) A current account deficit means that foreigners do not like our goods.
Answer: FALSE
Diff: 1
Topic: *The Balance of Payments*
Skill: *Conceptual*
AACSB: *Reflective Thinking*
- 5) When an American buys a factory in China, the transaction is registered a credit in the U.S. capital account.
Answer: FALSE
Diff: 1
Topic: *The Balance of Payments*
Skill: *Conceptual*
AACSB: *Reflective Thinking*
- 6) A current account deficit implies a capital account surplus.
Answer: TRUE
Diff: 1
Topic: *The Balance of Payments*
Skill: *Fact*
- 7) Included in the U.S. current account is interest that U.S. residents receive on overseas assets.
Answer: TRUE
Diff: 1
Topic: *The Balance of Payments*
Skill: *Fact*
- 8) The balance of trade is part of the current account which is part of the balance of payments.
Answer: TRUE
Diff: 1
Topic: *The Balance of Payments*
Skill: *Fact*

20.2 Equilibrium Output (Income) in an Open Economy

1 Multiple Choice

- 1) Planned aggregate expenditure in an open economy equals
- | | |
|----------------------------|----------------------------|
| A) $C + I + G - IM$. | B) $C + I + G + EX$. |
| C) $C + I + G + EX + IM$. | D) $C + I + G + EX - IM$. |

Answer: D

Diff: 1

Topic: Equilibrium Output (Income) in an Open Economy

Skill: Definition

- 2) If planned aggregate expenditures are \$400 billion, consumption is \$120 billion, investment is \$60 billion, government spending is \$70 billion, there is a
- | | |
|------------------------------------|------------------------------------|
| A) trade surplus of \$150 billion. | B) trade surplus of \$250 billion. |
| C) trade deficit of \$650 billion. | D) trade balance. |

Answer: A

Diff: 1

Topic: Equilibrium Output (Income) in an Open Economy

Skill: Analytic

AACSB: Analytic Skills

- 3) If planned aggregate expenditures are \$300 billion, consumption is \$180 billion, investment is \$75 billion, government spending is \$45 billion, there is a
- | | |
|------------------------------------|------------------------------------|
| A) trade surplus of \$300 billion. | B) trade surplus of \$600 billion. |
| C) trade deficit of \$300 billion. | D) trade balance. |

Answer: D

Diff: 1

Topic: Equilibrium Output (Income) in an Open Economy

Skill: Analytic

AACSB: Analytic Skills

- 4) If planned aggregate expenditures are \$240 billion, consumption is \$140 billion, investment is \$70 billion, government spending is \$50 billion, there is a
- | | |
|-----------------------------------|-----------------------------------|
| A) trade deficit of \$10 billion. | B) trade surplus of \$20 billion. |
| C) trade deficit of \$20 billion. | D) trade balance. |

Answer: C

Diff: 1

Topic: Equilibrium Output (Income) in an Open Economy

Skill: Analytic

AACSB: Analytic Skills

- 5) If the MPM is 0.1, then a \$3,500 increase in income will
- | | |
|----------------------------------|-------------------------------|
| A) increase imports by \$35,000. | B) increase imports by \$350. |
| C) increase exports by \$35,000. | D) increase exports by \$350. |

Answer: B

Diff: 1

Topic: Equilibrium Output (Income) in an Open Economy

Skill: Analytic

AACSB: Analytic Skills

- 6) If income increases by \$450, we know that the change in
- A) consumption, saving, and imports is greater than \$450.
 - B) consumption, saving, and imports equals \$450.
 - C) consumption and saving is greater than \$450.
 - D) consumption, saving, imports, and exports is less than \$450.

Answer: B

Diff: 1

Topic: Equilibrium Output (Income) in an Open Economy

Skill: Conceptual

AACSB: Reflective Thinking

- 7) If the MPS is 0.25 and the MPC is 0.6, then the MPM
- A) is 0.85.
 - B) is 0.35.
 - C) is 0.15
 - D) cannot be determined from the given information.

Answer: C

Diff: 1

Topic: Equilibrium Output (Income) in an Open Economy

Skill: Analytic

AACSB: Analytic Skills

- 8) Algebraically, the relationship between imports and income can be written as
- A) $IM = Y/m$.
 - B) $Y = mIM$.
 - C) $IM = m/Y$.
 - D) $IM = mY$.

Answer: D

Diff: 1

Topic: Equilibrium Output (Income) in an Open Economy

Skill: Conceptual

AACSB: Reflective Thinking

- 9) The level of U.S. exports depends directly on
- A) the level of income in the United States.
 - B) the size of the spending multiplier in other countries.
 - C) the size of the spending multiplier in the United States.
 - D) the level of income in other countries.

Answer: D

Diff: 1

Topic: Equilibrium Output (Income) in an Open Economy

Skill: Conceptual

AACSB: Reflective Thinking

Refer to the information provided in Figure 20.1 below to answer the questions that follow.

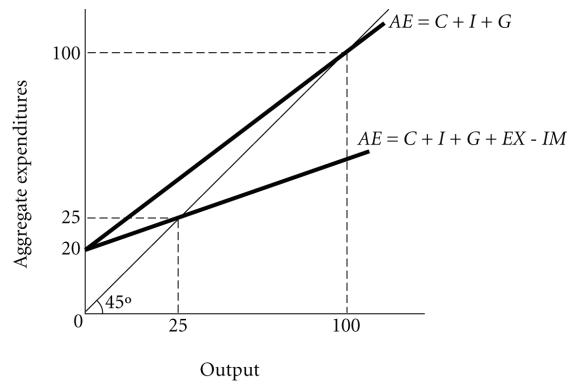


Figure 20.1

- 10) Refer to Figure 20.1. What is the *MPC* in this economy?
- A) 0.5
B) 0.75
C) 0.8
D) cannot be determined from the graph

Answer: C

Diff: 2

Topic: Equilibrium Output (Income) in an Open Economy

Skill: Analytic

AACSB: Analytic Skills

- 11) Refer to Figure 20.1. What is the *MPM* in this economy?
- A) 0.2
B) 0.25
C) 0.6
D) cannot be determined from the graph

Answer: C

Diff: 3

Topic: Equilibrium Output (Income) in an Open Economy

Skill: Analytic

AACSB: Analytic Skills

- 12) Refer to Figure 20.1. The open economy multiplier is
- A) 1.25. B) 2. C) 4. D) 8.

Answer: A

Diff: 3

Topic: Equilibrium Output (Income) in an Open Economy

Skill: Analytic

AACSB: Analytic Skills

- 13) Refer to Figure 20.1. If the economy is closed and the government increases spending by 15, the new equilibrium output is
- A) 150. B) 175. C) 180. D) 200.

Answer: B

Diff: 2

Topic: Equilibrium Output (Income) in an Open Economy

Skill: Analytic

AACSB: Analytic Skills

14) Refer to Figure 20.1. If the economy is open and the government increases spending by 15, the new equilibrium output is

- A) 81.25. B) 100. C) 112.50. D) 125.

Answer: A

Diff: 3

Topic: Equilibrium Output (Income) in an Open Economy

Skill: Analytic

AACSB: Analytic Skills

15) The open economy multiplier will decrease if

- A) the *MPC* decreases. B) the *MPM* decreases.
C) either the *MPM* or the *MPC* decreases. D) the *MPM* increases.

Answer: D

Diff: 2

Topic: Equilibrium Output (Income) in an Open Economy

Skill: Conceptual

AACSB: Reflective Thinking

16) If an economy's *MPC* is 0.95 and the *MPM* is 0.15, then an increase in government spending of \$1,000 will increase income by

- A) \$1,000. B) \$4,500. C) \$5,000. D) \$8,000.

Answer: C

Diff: 2

Topic: Equilibrium Output (Income) in an Open Economy

Skill: Analytic

AACSB: Analytic Skills

17) If an economy's *MPC* is 0.8 and the *MPM* is 0.55, then an increase in government spending of \$2,000 will increase income by

- A) \$5,500. B) \$8,000. C) \$10,000. D) \$20,000.

Answer: B

Diff: 2

Topic: Equilibrium Output (Income) in an Open Economy

Skill: Analytic

AACSB: Analytic Skills

18) The open economy multiplier is

- A) $1/[1 - (MPC - MPM)]$. B) $1/[1 - MPC - MPM]$.
C) $1/[1 - (MPM - MPC)]$. D) $MPM/[1 - (MPC - MPM)]$.

Answer: A

Diff: 1

Topic: Equilibrium Output (Income) in an Open Economy

Skill: Definition

19) The marginal propensity to consume domestic goods is the

- A) $MPC - MPM$. B) $MPC + MPM$. C) $MPC - MPS$. D) $MPC + MPS$.

Answer: A

Diff: 1

Topic: Equilibrium Output (Income) in an Open Economy

Skill: Definition

- 20) The open-economy multiplier _____ the closed-economy multiplier.
- A) is larger than
 - B) equals
 - C) is smaller than
 - D) can be smaller or larger, depending on the size of *MPM* and *MPC*

Answer: C

Diff: 1

Topic: Equilibrium Output (Income) in an Open Economy

Skill: Fact

- 21) A \$100 million increase in government spending causes
- A) an equal amount of change in equilibrium output in an open and a closed economy.
 - B) a larger change in an open economy than in a closed economy.
 - C) a larger change in a closed economy than in an open economy.
 - D) a larger change in a closed economy than in an open economy if the *MPM* is zero.

Answer: C

Diff: 2

Topic: Equilibrium Output (Income) in an Open Economy

Skill: Conceptual

AACSB: Reflective Thinking

- 22) Which of the following statements is true?
- A) The larger a nation's marginal propensity to consume, the smaller the open-economy multiplier.
 - B) The smaller a nation's marginal propensity to import, the smaller the open-economy multiplier.
 - C) The larger a nation's marginal propensity to export, the smaller the open-economy multiplier.
 - D) The larger a nation's marginal propensity to import, the smaller the open-economy multiplier.

Answer: D

Diff: 2

Topic: Equilibrium Output (Income) in an Open Economy

Skill: Conceptual

AACSB: Reflective Thinking

- 23) Which of the following is/are likely to affect the demand for imports?
- A) the relative prices of domestically produced and foreign-produced goods
 - B) the after-tax real wage
 - C) interest rates
 - D) all of the above

Answer: D

Diff: 2

Topic: Equilibrium Output (Income) in an Open Economy

Skill: Conceptual

AACSB: Reflective Thinking

24) Which of the following is likely to increase the exports of a country?

- A) an increase in income in the domestic country
- B) a decrease in income in the domestic country
- C) a decrease in income in foreign countries
- D) an increase in income in foreign countries

Answer: D

Diff: 2

Topic: Equilibrium Output (Income) in an Open Economy

Skill: Conceptual

AACSB: Reflective Thinking

25) The tendency for an increase in the economic activity of one country to lead to a worldwide increase in economic activity is the

- A) multiplier effect.
- B) trickle-down effect.
- C) trade feedback effect.
- D) spontaneous growth effect.

Answer: C

Diff: 1

Topic: Equilibrium Output (Income) in an Open Economy

Skill: Definition

26) An increased growth rate in Malaysia has increased the Malaysian demand for U.S.-produced coal. Malaysia increases its imports of U.S.-produced coal by \$20 million. U.S. net exports will

- A) increase by \$20 million.
- B) increase by less than \$20 million.
- C) increase by more than \$20 million.
- D) increase by \$20 million or more.

Answer: B

Diff: 2

Topic: Equilibrium Output (Income) in an Open Economy

Skill: Analytic

AACSB: Analytic Skills

27) Assume that a \$1.00 increase in exports increases GDP by \$3.00, and a \$1.00 increase in income increases import spending by \$0.15. In this case, a \$1,000 million increase in exports will increase net exports by

- A) \$550 million.
- B) \$1,000 million.
- C) \$700 million.
- D) \$1,350 million.

Answer: A

Diff: 2

Topic: Equilibrium Output (Income) in an Open Economy

Skill: Analytic

AACSB: Analytic Skills

28) The trade feedback effect illustrates the fact that

- A) an increase in U.S. economic activity leads to a decrease in the economic activity of other countries.
- B) U.S. imports depress the imports of other countries.
- C) imports and exports are unrelated to one another.
- D) imports affect exports and exports affect imports.

Answer: D

Diff: 2

Topic: Equilibrium Output (Income) in an Open Economy

Skill: Conceptual

AACSB: Reflective Thinking

- 29) Economic activity increases in Western Europe, and this causes economic activity to increase in the United States. This is an example of
- A) the price feedback effect.
 - B) the trade feedback effect.
 - C) the export feedback effect.
 - D) the import feedback effect.

Answer: B

Diff: 1

Topic: Equilibrium Output (Income) in an Open Economy

Skill: Conceptual

AACSB: Reflective Thinking

- 30) The trade feedback effect includes all of the following steps EXCEPT
- A) an increase in U.S. economic activity stimulates U.S. imports.
 - B) an increase in foreign imports stimulates U.S. exports.
 - C) an increase in U.S. exports stimulates U.S. economic activity.
 - D) an increase in foreign income stimulates U.S. imports.

Answer: D

Diff: 1

Topic: Equilibrium Output (Income) in an Open Economy

Skill: Conceptual

AACSB: Reflective Thinking

- 31) If exchange rates are fixed, then an increase in Canada's export prices causes
- A) U.S. import prices to fall.
 - B) U.S. import prices to rise.
 - C) Canadian import prices to fall.
 - D) Canadian import prices to rise.

Answer: B

Diff: 1

Topic: Equilibrium Output (Income) in an Open Economy

Skill: Conceptual

AACSB: Reflective Thinking

- 32) The U.S. and Japan heavily trade with each other. Which of the following is TRUE?
- A) U.S. prices increase \Rightarrow U.S. exports increase \Rightarrow Japanese prices decrease.
 - B) U.S. prices increase \Rightarrow U.S. imports increase \Rightarrow Japanese prices increase.
 - C) U.S. prices decrease \Rightarrow U.S. imports increase \Rightarrow Japanese prices increase.
 - D) U.S. prices decrease \Rightarrow U.S. exports decrease \Rightarrow Japanese prices increase.

Answer: B

Diff: 2

Topic: Equilibrium Output (Income) in an Open Economy

Skill: Analytic

AACSB: Analytic Skills

- 33) The U.S. and Canada heavily trade with each other. Which of the following is TRUE?
- A) Canadian prices increase \Rightarrow Canadian exports increase \Rightarrow U.S. prices decrease.
 - B) Canadian prices increase \Rightarrow Canadian exports decrease \Rightarrow U.S. prices increase.
 - C) Canadian prices decrease \Rightarrow Canadian exports decrease \Rightarrow U.S. prices decrease.
 - D) Canadian prices decrease \Rightarrow Canadian exports decrease \Rightarrow U.S. prices increase.

Answer: B

Diff: 2

Topic: Equilibrium Output (Income) in an Open Economy

Skill: Analytic

AACSB: Analytic Skills

- 34) Japan imports over 90% of its consumption of oil. If the price of oil increases, Japan's
- A) aggregate demand curve shifts to the right.
 - B) aggregate supply curve shift to the right.
 - C) aggregate supply curve shifts to the left.
 - D) aggregate planned expenditures increase.

Answer: C

Diff: 2

Topic: Equilibrium Output (Income) in an Open Economy

Skill: Conceptual

AACSB: Reflective Thinking

- 35) If two countries don't trade with each other, an increase in the price level in one country
- A) increases the price level in the other country.
 - B) decreases the price level in the other country.
 - C) increases the price level in the other country then decreases it.
 - D) does not affect the price level in the other country.

Answer: D

Diff: 1

Topic: Equilibrium Output (Income) in an Open Economy

Skill: Conceptual

AACSB: Reflective Thinking

- 36) U.S. exports tend to decrease when
- A) economic activity abroad is decreasing.
 - B) foreign GDPs are rising.
 - C) U.S. prices are low relative to those in the rest of the world.
 - D) the inflation rate in the United States is lower than the inflation rates in other countries.

Answer: A

Diff: 1

Topic: Equilibrium Output (Income) in an Open Economy

Skill: Conceptual

AACSB: Reflective Thinking

- 37) U.S. exports tend to increase when
- A) economic activity abroad is increasing.
 - B) foreign GDPs are falling.
 - C) U.S. prices are rising compared to the rest of the world.
 - D) the value of the dollar rises.

Answer: A

Diff: 1

Topic: Equilibrium Output (Income) in an Open Economy

Skill: Conceptual

AACSB: Reflective Thinking

- 38) U.S. exports tend to decrease when
- A) economic activity abroad is increasing.
 - B) foreign GDPs are rising.
 - C) U.S. prices are rising relative to those in the rest of the world.
 - D) the U.S. dollar is weak compared to foreign currencies.

Answer: C

Diff: 1

Topic: Equilibrium Output (Income) in an Open Economy

Skill: Conceptual

AACSB: Reflective Thinking

- 39) U.S. exports tend to increase when
- A) economic activity abroad is decreasing.
 - B) foreign GDPs are falling.
 - C) U.S. prices are falling compared to those in the rest of the world.
 - D) the U.S. dollar is strong compared to foreign currencies.

Answer: C

Diff: 1

Topic: Equilibrium Output (Income) in an Open Economy

Skill: Conceptual

AACSB: Reflective Thinking

- 40) When the prices of a country's imports increase, the prices of domestic goods may increase. This occurs because
- A) an increase in the prices of imported inputs will cause aggregate supply to increase.
 - B) if import prices rise relative to domestic prices, households will tend to substitute domestically produced goods and services for imports.
 - C) if import prices rise relative to domestic prices, households will tend to substitute imports for domestically produced goods and services.
 - D) an increase in the prices of imported inputs will cause aggregate demand to decrease.

Answer: B

Diff: 2

Topic: Equilibrium Output (Income) in an Open Economy

Skill: Analytic

AACSB: Analytic Skills

- 41) Suppose that an increase in the price level of one country drives up prices in other countries. This, in turn, increases the price level in the first country. This process is the
- A) J-curve effect.
 - B) trade feedback effect.
 - C) price feedback effect.
 - D) balance of trade effect.

Answer: C

Diff: 2

Topic: Equilibrium Output (Income) in an Open Economy

Skill: Definition

2 True/False

- 1) If the MPC is 0.95 and the MPM is 0.05, the open economy multiplier is 10.

Answer: TRUE

Diff: 1

Topic: *Equilibrium Output (Income) in an Open Economy*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 2) If the MPC is 0.75 and the MPM is 0.25, the open economy multiplier is 2.

Answer: TRUE

Diff: 1

Topic: *Equilibrium Output (Income) in an Open Economy*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 3) A decrease in the price level in the United States relative to the price level in Mexico causes an appreciation of the dollar against the peso.

Answer: TRUE

Diff: 1

Topic: *Equilibrium Output (Income) in an Open Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 4) The 2007 price level in Great Britain was relatively higher than the price level in the United States. Thus, a U.S. manufacturing facility looking to buy coal for its plant would most likely buy coal at home in the United States.

Answer: TRUE

Diff: 2

Topic: *Equilibrium Output (Income) in an Open Economy*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 5) An increase in Germany's interest rate and an increase in Germany's price level relative to U.S. price level have the same effect on the exchange rate between the two countries.

Answer: FALSE

Diff: 2

Topic: *Equilibrium Output (Income) in an Open Economy*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 6) When the United States acquires assets abroad, it is in essence borrowing money, and foreign debts to the United States decrease.

Answer: FALSE

Diff: 1

Topic: *Equilibrium Output (Income) in an Open Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 7) A depreciation in a country's currency will immediately reduce its trade deficit.
Answer: FALSE
Diff: 2
Topic: *Equilibrium Output (Income) in an Open Economy*
Skill: *Conceptual*
AACSB: *Reflective Thinking*
- 8) An excess supply of euros will cause a depreciation of the euro.
Answer: TRUE
Diff: 1
Topic: *Equilibrium Output (Income) in an Open Economy*
Skill: *Conceptual*
AACSB: *Reflective Thinking*
- 9) If the \$/yen exchange rate rises, then so does the value of the dollar.
Answer: FALSE
Diff: 1
Topic: *Equilibrium Output (Income) in an Open Economy*
Skill: *Conceptual*
AACSB: *Reflective Thinking*
- 10) The trade feedback effect is due to exports from one country causing that country to increase its imports.
Answer: TRUE
Diff: 1
Topic: *Equilibrium Output (Income) in an Open Economy*
Skill: *Conceptual*
AACSB: *Reflective Thinking*
- 11) The open-economy government spending multiplier is smaller than the closed economy government spending multiplier.
Answer: TRUE
Diff: 1
Topic: *Equilibrium Output (Income) in an Open Economy*
Skill: *Conceptual*
AACSB: *Reflective Thinking*
- 12) The marginal propensity to import is the change in imports divided by the change in income.
Answer: TRUE
Diff: 1
Topic: *Equilibrium Output (Income) in an Open Economy*
Skill: *Definition*
- 13) Imports equal the MPM times income.
Answer: TRUE
Diff: 1
Topic: *Equilibrium Output (Income) in an Open Economy*
Skill: *Conceptual*
AACSB: *Reflective Thinking*

14) Declining economic activity abroad will increase U.S. exports.

Answer: FALSE

Diff: 1

Topic: *Equilibrium Output (Income) in an Open Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

20.3 The Open Economy with Flexible Exchange Rates

1 Multiple Choice

1) A flexible exchange rate between two countries is determined by

- A) the governments of both countries.
- B) the International Monetary Fund.
- C) the demand and supply of both countries' currencies.
- D) Bretton Woods agreement.

Answer: C

Diff: 1

Topic: *The Open Economy with Flexible Exchange Rates*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

2) Exchange rates that are determined by the unregulated forces of supply and demand are

- A) fixed exchange rates.
- B) pegged exchange rates.
- C) managed exchange rates.
- D) floating exchange rates.

Answer: D

Diff: 1

Topic: *The Open Economy with Flexible Exchange Rates*

Skill: *Definition*

3) The most common reason for exchanging one currency for another is

- A) to purchase goods produced in another country.
- B) to engage in fixed capital investment in another country.
- C) to purchase stocks and bonds in another country.
- D) to engage in currency speculation.

Answer: A

Diff: 1

Topic: *The Open Economy with Flexible Exchange Rates*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

4) An increase in U.S. exports to Japan _____ the demand for U.S. dollars and _____ the supply of yen.

- A) increases; increases
- B) decreases; increases
- C) increases; decreases
- D) decreases; decreases

Answer: A

Diff: 2

Topic: *The Open Economy with Flexible Exchange Rates*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 13) Refer to Figure 20.3. Which of the following will shift the supply of pounds from S_1 to S_0 ?
- A) an increase in U.S. income
 - B) a decrease in the British price level
 - C) British people wanting to buy more U.S. goods and assets
 - D) a decrease in British income

Answer: C

Diff: 2

Topic: *The Open Economy with Flexible Exchange Rates*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 14) Income decreases in the United States. This will cause a(n)
- A) increase in the supply of pounds.
 - B) decrease in the supply of pounds.
 - C) increase in the demand for pounds.
 - D) decrease in the demand for pounds.

Answer: D

Diff: 2

Topic: *The Open Economy with Flexible Exchange Rates*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 15) The supply of dollars in the foreign exchange market is likely to be upward sloping because as the price of a dollar (the exchange rate) falls,
- A) Americans demand fewer foreign goods because these goods have become more expensive to American consumers.
 - B) Americans demand more foreign goods because these goods have become less expensive to American consumers.
 - C) foreigners demand more American goods because these goods have become less expensive to foreign consumers.
 - D) foreigners demand more foreign goods because these goods have become more expensive to foreign consumers.

Answer: A

Diff: 3

Topic: *The Open Economy with Flexible Exchange Rates*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 16) If the profitability of investment in the United States increases, we would expect
- A) the demand for dollars to increase.
 - B) the demand for dollars to decrease.
 - C) the supply of foreign currency in the United States to decrease.
 - D) the demand for foreign currency in the United States to increase.

Answer: A

Diff: 2

Topic: *The Open Economy with Flexible Exchange Rates*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 17) More German companies start to invest in the United States. This will lead to a(n)
- A) decrease in the demand for dollars and an increase in the demand for euro.
 - B) increase in the supply of dollars and a decrease in the demand for euro.
 - C) increase in the demand for dollars and a decrease in the supply of euro.
 - D) increase in the demand for dollars and an increase in the supply of euro.

Answer: D

Diff: 2

Topic: *The Open Economy with Flexible Exchange Rates*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 18) The rise in value of the Mexican peso relative to the Canadian dollar is a(n)
- A) depreciation of the peso.
 - B) appreciation of the peso.
 - C) weakening of the peso.
 - D) floating of the peso.

Answer: B

Diff: 1

Topic: *The Open Economy with Flexible Exchange Rates*

Skill: *Conceptual*

- 19) Suppose the exchange rate between the United States and Japan changed from \$1 = 150 yen to \$1 = 140 Yen, which of the following statements is TRUE?
- A) the dollar depreciated
 - B) the yen depreciated
 - C) the price of yen in dollars decreased
 - D) the price of dollars in yen increased

Answer: A

Diff: 1

Topic: *The Open Economy with Flexible Exchange Rates*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 20) Under a system of floating exchange rates, an excess demand for a particular currency will lead to a(n)
- A) depreciation of that currency.
 - B) long-term shortage of that currency.
 - C) appreciation of that currency.
 - D) long-term surplus of that currency.

Answer: C

Diff: 2

Topic: *The Open Economy with Flexible Exchange Rates*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 21) Under a system of floating exchange rates, a shortage in a currency will lead to a(n)
- A) depreciation of that currency.
 - B) appreciation of that currency.
 - C) long-term surplus of that currency.
 - D) long-term shortage of that currency.

Answer: B

Diff: 2

Topic: *The Open Economy with Flexible Exchange Rates*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 22) The _____ states that if the costs of transportation are small, the price of the same good in different countries should be roughly the same.
- A) price feedback effect
 - B) trade feedback effect
 - C) balance of trade effect
 - D) law of one price

Answer: D

Diff: 1

Topic: *The Open Economy with Flexible Exchange Rates*

Skill: *Definition*

- 23) The theory of international exchange that holds that exchange rates are set so that the price of similar goods in different countries is the same is the
- A) purchasing power parity theory.
 - B) price feedback theory.
 - C) trade feedback theory.
 - D) J-curve theory.

Answer: A

Diff: 1

Topic: *The Open Economy with Flexible Exchange Rates*

Skill: *Definition*

- 24) Suppose that the price of a plasma TV is \$1,200 in the United States and 13,200 pesos in Mexico. If the current exchange rate is 10 pesos to the dollar, then purchasing power parity theory would predict that in the long run
- A) Mexico will begin to import plasma TVs from the United States.
 - B) the exchange value of the peso will depreciate.
 - C) the exchange value of the peso will appreciate.
 - D) the exchange value of the dollar will depreciate.

Answer: B

Diff: 2

Topic: *The Open Economy with Flexible Exchange Rates*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 25) A Big Mac costs \$3 in the United States and 2 euros in Spain. The purchasing power parity theory would predict that the exchange rate in the long run is
- A) \$1 = 1.5 euros.
 - B) \$1 = 0.67 euro.
 - C) \$1 = 6 euros.
 - D) 1 euro = \$0.67.

Answer: B

Diff: 3

Topic: *The Open Economy with Flexible Exchange Rates*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 26) If a nation's interest rates are relatively high compared to those of other countries, then the exchange value of its currency will tend to
- A) depreciate under a system of floating exchange rates.
 - B) depreciate under a system of fixed exchange rates.
 - C) appreciate under a system of fixed exchange rates.
 - D) appreciate under a system of floating exchange rates.

Answer: D

Diff: 2

Topic: *The Open Economy with Flexible Exchange Rates*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

Refer to the information provided in Figure 20.4 below to answer the questions that follow.

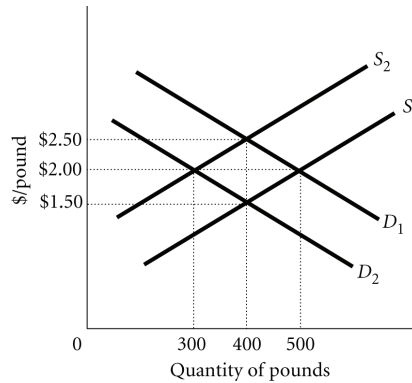


Figure 20.4

- 27) Refer to Figure 20.4. If the demand and supply of pounds are D_1 and S_1 , the equilibrium is
- A) \$2.50 per pound and the quantity is 400 pounds.
 - B) \$2.00 per pound and the quantity is 500 pounds.
 - C) 2 pounds per \$ and the quantity is 500 pounds.
 - D) \$1.50 per pound and the quantity is 300 pounds.

Answer: B

Diff: 1

Topic: The Open Economy with Flexible Exchange Rates

Skill: Analytic

AACSB: Analytic Skills

- 28) Refer to Figure 20.4. The demand and supply of pounds are D_2 and S_2 . An increase in British demand for U.S. exports, ceteris paribus, could
- A) increase the exchange rate (\$/pound) to \$2.50.
 - B) decrease the exchange rate (\$/pound) to \$1.50.
 - C) decrease the equilibrium quantity from 400 to 300 pounds.
 - D) increase the demand for pounds from D_2 to D_1 .

Answer: B

Diff: 3

Topic: The Open Economy with Flexible Exchange Rates

Skill: Analytic

AACSB: Analytic Skills

- 29) Refer to Figure 20.4. The demand and supply of pounds are D_1 and S_1 . If the demand shifts to D_2 and supply remains unchanged at S_1
- A) the dollar depreciates and the equilibrium quantity of pounds increases.
 - B) the dollar depreciates and the equilibrium quantity of pounds decreases.
 - C) the dollar appreciates and the equilibrium quantity of pounds decreases.
 - D) the dollar appreciates and the equilibrium quantity of pounds increases.

Answer: C

Diff: 3

Topic: The Open Economy with Flexible Exchange Rates

Skill: Analytic

AACSB: Analytic Skills

30) Refer to Figure 20.4. The demand and supply of pounds are D_1 and S_1 . If the supply shifts to S_2 and demand remains unchanged at D_1

- A) the dollar depreciates and the equilibrium quantity of pounds increases.
- B) the dollar depreciates and the equilibrium quantity of pounds decreases.
- C) the dollar appreciates and the equilibrium quantity of pounds decreases.
- D) the dollar appreciates and the equilibrium quantity of pounds increases.

Answer: B

Diff: 3

Topic: *The Open Economy with Flexible Exchange Rates*

Skill: *Analytic*

AACSB: *Analytic Skills*

31) Refer to Figure 20.4. The demand and supply of pounds are S_2 and D_2 . Which of the following can change the equilibrium exchange rate (\$/pound) to \$2.50 and the equilibrium quantity to 400 pounds?

- A) an increase in income in the United States
- B) a sudden dislike of British products in the United States
- C) an increase in the price level in Great Britain
- D) a decrease in the price level in the United States

Answer: A

Diff: 3

Topic: *The Open Economy with Flexible Exchange Rates*

Skill: *Analytic*

AACSB: *Analytic Skills*

32) Refer to Figure 20.4. The demand and supply of pounds are S_2 and D_2 . Which of the following can change the equilibrium exchange rate (\$/pound) to \$1.50 and the equilibrium quantity to 400 pounds?

- A) British purchases of U.S.-made cars increase
- B) United States purchases of British-made cars increase
- C) the price level in Great Britain decreases
- D) income in Great Britain decreases

Answer: A

Diff: 3

Topic: *The Open Economy with Flexible Exchange Rates*

Skill: *Analytic*

AACSB: *Analytic Skills*

33) The J-curve effect refers to the observation that

- A) the trade balance usually gets worse before it improves after a currency depreciation.
- B) GDP usually decreases before it increases after a currency appreciation.
- C) the trade balance usually gets worse before it improves after a currency appreciation.
- D) GDP usually decreases before it increases after a currency depreciation.

Answer: A

Diff: 1

Topic: *The Open Economy with Flexible Exchange Rates*

Skill: *Definition*

- 34) The J-curve effect suggests that the depreciation of a nation's currency may
- A) increase its exports and decrease its imports.
 - B) increase its imports and decrease its exports.
 - C) have an ambiguous effect on its balance of trade.
 - D) lead to economic ruin.

Answer: C

Diff: 1

Topic: *The Open Economy with Flexible Exchange Rates*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 35) Why does the depreciation of a country's currency tend to increase its price level?
- A) domestic buyers tend to substitute imports for domestic products
 - B) a currency depreciation makes a country's products less competitive in world markets, so exports fall
 - C) a currency depreciation makes imported inputs more expensive
 - D) a currency depreciation makes imported inputs less expensive

Answer: C

Diff: 2

Topic: *The Open Economy with Flexible Exchange Rates*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 36) A currency depreciation is more likely to improve a country's balance of trade if the demand for that country's exports is _____ and the demand for that country's imports is _____.
- A) elastic; elastic
 - B) inelastic; elastic
 - C) elastic; inelastic
 - D) inelastic; inelastic

Answer: A

Diff: 3

Topic: *The Open Economy with Flexible Exchange Rates*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 37) The openness of the economy and flexible exchange rates
- A) increase the effectiveness of a contractionary monetary policy, but reduce the effectiveness of an expansionary monetary policy.
 - B) reduce the effectiveness of both expansionary and contractionary monetary policies.
 - C) increase the effectiveness of both expansionary and contractionary monetary policies.
 - D) increase the effectiveness of an expansionary monetary policy, but reduce the effectiveness of a contractionary monetary policy.

Answer: C

Diff: 3

Topic: *The Open Economy with Flexible Exchange Rates*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 38) Fiscal policies are
- A) less effective when the exchange rate is flexible and the economy is closed.
 - B) less effective when the exchange rate is flexible and the economy is open.
 - C) more effective when the exchange rate is flexible and the economy is closed.
 - D) less effective when the exchange rate is fixed and the economy is open.

Answer: B

Diff: 2

Topic: *The Open Economy with Flexible Exchange Rates*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 39) If the Fed reduces the money supply to reduce inflation, a floating exchange rate will aid the Fed in fighting inflation because
- A) as the money supply is decreased, the interest rate will increase, and the price of U.S. exports will fall and the price of U.S. imports will rise.
 - B) as the money supply is decreased, the interest rate will increase, and the price of U.S. exports will rise and the price of U.S. imports will fall.
 - C) as the money supply is decreased, the interest rate will increase, and the price of both U.S. exports and U.S. imports will rise.
 - D) as the money supply is decreased, the interest rate will increase, and the price of U.S. exports and U.S. imports will fall.

Answer: B

Diff: 2

Topic: *The Open Economy with Flexible Exchange Rates*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 40) Expansionary monetary policy
- A) tends to lead to an appreciation of a nation's currency.
 - B) usually has no effect on a currency's exchange value.
 - C) tends to lead to a depreciation of a nation's currency.
 - D) tends to lead to a depreciation of the currencies of other nations.

Answer: C

Diff: 2

Topic: *The Open Economy with Flexible Exchange Rates*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 41) Which of the following policies tends to cause the dollar to appreciate?
- A) an expansionary monetary policy
 - B) an expansionary fiscal policy
 - C) a contractionary fiscal policy
 - D) a combination of an expansionary monetary policy and a contractionary fiscal policy

Answer: B

Diff: 1

Topic: *The Open Economy with Flexible Exchange Rates*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

2 True/False

- 1) The law of one price states that if the costs of transportation are small, then the price of the same good in different countries should be roughly the same.
Answer: TRUE
Diff: 1
Topic: *The Open Economy with Flexible Exchange Rates*
Skill: *Definition*

- 2) The effect of a sustained increase in government spending or investment on aggregate output is larger in an open economy than in a closed economy.
Answer: FALSE
Diff: 2
Topic: *The Open Economy with Flexible Exchange Rates*
Skill: *Conceptual*
AACSB: *Reflective Thinking*

- 3) Purchasing power parity theory holds that exchange rates are set so that the price of similar goods in different countries reflects the relative interest rates in those countries.
Answer: FALSE
Diff: 1
Topic: *The Open Economy with Flexible Exchange Rates*
Skill: *Definition*

- 4) Fiscal policy is more effective when the exchange rate is flexible and the economy is open.
Answer: FALSE
Diff: 2
Topic: *The Open Economy with Flexible Exchange Rates*
Skill: *Conceptual*
AACSB: *Reflective Thinking*

- 5) Monetary policy is more effective when the exchange rate is flexible and the economy is open.
Answer: TRUE
Diff: 2
Topic: *The Open Economy with Flexible Exchange Rates*
Skill: *Conceptual*
AACSB: *Reflective Thinking*

- 6) Expansionary monetary policy causes the exchange rate to depreciate.
Answer: TRUE
Diff: 2
Topic: *The Open Economy with Flexible Exchange Rates*
Skill: *Conceptual*
AACSB: *Reflective Thinking*

20.4 Appendix: World Monetary Systems Since 1900

1 Multiple Choice

- 1) The gold standard was the major system of exchange rate determination
- A) prior to 1785.
 - B) before 1914.
 - C) following World War II.
 - D) until 1971.

Answer: B

Diff: 1

Topic: Appendix: World Monetary Systems Since 1900

Skill: Fact

- 2) Under the gold standard, no gold would enter or leave the country if
- A) the country's overall balance of payments was in surplus.
 - B) the country's overall balance of payments was in deficit.
 - C) the country's overall balance of payments remained in balance.
 - D) the country's overall balance of payments was either in surplus or in deficit.

Answer: C

Diff: 1

Topic: Appendix: World Monetary Systems Since 1900

Skill: Conceptual

AACSB: Reflective Thinking

- 3) Under the gold standard, if gold was flowing from the U.S. to Great Britain, the U.S. would experience all of the following EXCEPT
- A) higher interest rates.
 - B) decreasing aggregate demand.
 - C) higher prices.
 - D) falling income.

Answer: C

Diff: 2

Topic: Appendix: World Monetary Systems Since 1900

Skill: Analytic

AACSB: Analytic Skills

- 4) The Bretton Woods system was the major system of exchange rate determination
- A) from the end of World War II until 1971.
 - B) before 1914.
 - C) between World War I and World War II.
 - D) after 1971.

Answer: A

Diff: 1

Topic: Appendix: World Monetary Systems Since 1900

Skill: Fact

- 5) The International Monetary Fund (IMF) was created as a part of the
- A) gold standard.
 - B) Bretton Woods agreement.
 - C) free-float arrangement.
 - D) managed floating system.

Answer: B

Diff: 1

Topic: Appendix: World Monetary Systems Since 1900

Skill: Fact

- 6) Under the Bretton Woods system, countries experiencing large and persistent current account deficits were obliged to
- A) devalue their currencies.
 - B) revalue their currencies.
 - C) expand their economies.
 - D) lower their prices.

Answer: A

Diff: 2

Topic: Appendix: World Monetary Systems Since 1900

Skill: Fact

- 7) A "managed floating" system of exchange rate determination
- A) was the primary system for determining exchange rates before 1914.
 - B) was the primary system for determining exchange rates between World War I and World War II.
 - C) was the primary system for determining exchange rates from the end of World War II until 1971.
 - D) has been the primary system for determining exchange rates since 1971.

Answer: D

Diff: 1

Topic: Appendix: World Monetary Systems Since 1900

Skill: Fact

2 True/False

- 1) The gold standard was the major system of exchange rate determination before 1914.

Answer: TRUE

Diff: 1

Topic: Appendix: World Monetary Systems Since 1900

Skill: Fact

- 2) Under the gold standard, gold would leave the country if the country's overall balance of payments was in surplus.

Answer: FALSE

Diff: 1

Topic: Appendix: World Monetary Systems Since 1900

Skill: Fact

- 3) The Bretton Woods system was the major system of exchange rate determination between World War I and World War II.

Answer: FALSE

Diff: 1

Topic: Appendix: World Monetary Systems Since 1900

Skill: Fact

- 4) Under the Bretton Woods system, currencies were fixed in terms of the U.S. dollar.

Answer: TRUE

Diff: 1

Topic: Appendix: World Monetary Systems Since 1900

Skill: Fact

5) Since 1971, the world's exchange rate system can be described as a "freely floating" system.

Answer: FALSE

Diff: 1

Topic: Appendix: World Monetary Systems Since 1900

Skill: Fact

Chapter 21 Economic Growth in Developing and Transitional Economies

21.1 Life in the Developing Nations: Population and Poverty

1 Multiple Choice

- 1) Chronic food shortages, explosive population growth, and hyperinflations are problems facing
- A) industrial countries.
 - B) first world countries.
 - C) developing countries.
 - D) developed countries.

Answer: C

Diff: 1

Topic: Life in the Developing Nations: Population and Poverty

Skill: Fact

- 2) In developing countries,
- A) financial markets are well developed.
 - B) central banks are effective in controlling the macroeconomy.
 - C) labor productivity in agriculture is high.
 - D) infant mortality is high.

Answer: D

Diff: 1

Topic: Life in the Developing Nations: Population and Poverty

Skill: Fact

- 3) In 2006, per capita income was roughly _____ times lower in low-income countries than in high-income countries.
- A) 12
 - B) 31
 - C) 56
 - D) 181

Answer: C

Diff: 1

Topic: Life in the Developing Nations: Population and Poverty

Skill: Fact

- 4) In 2006, the infant mortality rate was _____ per 1,000 births in low-income countries.
- A) 6.9
 - B) 29.9
 - C) 39.8
 - D) 114

Answer: D

Diff: 1

Topic: Life in the Developing Nations: Population and Poverty

Skill: Fact

- 5) In 2005, the number of internet users was _____ per 1,000 people in high-income countries.
- A) 194
 - B) 523
 - C) 774
 - D) 851

Answer: B

Diff: 1

Topic: Life in the Developing Nations: Population and Poverty

Skill: Fact

- 6) The term "Fourth World" is used to describe countries that
- A) are stagnant and have fallen far behind the economic advances of the rest of the world.
 - B) have experienced rapid economic growth.
 - C) are more developed than "Third World" countries.
 - D) are closer to developed countries than transitional economies.

Answer: A

Diff: 1

Topic: *Life in the Developing Nations: Population and Poverty*

Skill: *Definition*

- 7) In 2006, the literacy rate of people over the age of 15 was 60.8% for people in countries classified as
- A) low-income.
 - B) lower middle-income.
 - C) upper middle-income.
 - D) high-income.

Answer: A

Diff: 1

Topic: *Life in the Developing Nations: Population and Poverty*

Skill: *Fact*

- 8) Which of the following statements is FALSE?
- A) Developing countries have a lower per capita income compared to developed countries.
 - B) Developing countries have a lower infant mortality rate compared to developed countries.
 - C) Developing countries have lower life expectancy compared to developed countries.
 - D) A smaller percentage of the population live in urban areas in developing countries compared to developed countries.

Answer: B

Diff: 1

Topic: *Life in the Developing Nations: Population and Poverty*

Skill: *Fact*

- 9) In the United States, the poorest 20% of the families receive under _____% of total income.
- A) 1
 - B) 5
 - C) 8
 - D) 10

Answer: B

Diff: 1

Topic: *Life in the Developing Nations: Population and Poverty*

Skill: *Fact*

- 10) The term "brain drain" means the tendency for
- A) talented people in developing countries to become educated and remain in developed countries.
 - B) talented people in developed countries to become educated and remain in developing countries.
 - C) harm to be done to citizens due to the lack of nutrition in developing countries.
 - D) developing countries to have limited social overhead capital.

Answer: A

Diff: 1

Topic: *Life in the Developing Nations: Population and Poverty*

Skill: *Definition*

- 11) Which of the following is NOT a characteristic that is associated with developed countries?
- A) a high per capita GNP
 - B) low infant mortality rates
 - C) high life expectancy
 - D) an income distribution that is very close to being equal

Answer: D

Diff: 2

Topic: *Life in the Developing Nations: Population and Poverty*

Skill: *Fact*

- 12) Characteristics of economic development include all of the following EXCEPT
- A) improvements in basic education.
 - B) an increase in the standard of living.
 - C) a decrease in the percentage of the labor force in urban areas.
 - D) an increase in life expectancy.

Answer: C

Diff: 2

Topic: *Life in the Developing Nations: Population and Poverty*

Skill: *Fact*

- 13) Which of the following characteristics is generally representative of developed countries relative to developing nations?
- A) A higher level of per capita GNI
 - B) A shorter life expectancy
 - C) A higher rate of infant mortality
 - D) A smaller percentage of children enrolled in school

Answer: A

Diff: 1

Topic: *Life in the Developing Nations: Population and Poverty*

Skill: *Fact*

- 14) Which of the following characteristics is generally representative of developing countries relative to developed countries?
- A) a smaller percentage of the labor force in urban areas
 - B) a lower infant mortality rate
 - C) a greater degree of equality in the income distribution
 - D) a lower rate of illiteracy

Answer: A

Diff: 1

Topic: *Life in the Developing Nations: Population and Poverty*

Skill: *Fact*

- 15) Which of the following characteristics is generally representative of developed countries relative to developing countries?
- A) a larger percentage of the labor force in rural areas
 - B) a lower infant mortality rate
 - C) lower productivity in the agriculture sector
 - D) a lower rate of literacy

Answer: B

Diff: 1

Topic: *Life in the Developing Nations: Population and Poverty*

Skill: *Fact*

16) Which of the following characteristics is generally representative of developing countries relative to developed countries?

- A) a greater degree of equality in the income distribution
- B) a larger percentage of the labor force in urban areas
- C) a lower infant mortality rate
- D) lower productivity in the agricultural sector

Answer: D

Diff: 1

Topic: *Life in the Developing Nations: Population and Poverty*

Skill: *Fact*

17) Which of the following statements is FALSE?

- A) Low productivity in the agricultural sector in developing countries means that farm output per person is barely sufficient to feed a farmer's own family.
- B) Income tends to be more equally distributed in developing countries than in developed countries.
- C) The percentage of the labor force employed in urban areas is greater in developed nations than in developing nations.
- D) Developed nations account for only about one-quarter of the world's population, but they consume about three-quarters of the world's output.

Answer: B

Diff: 2

Topic: *Life in the Developing Nations: Population and Poverty*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

18) In the distribution of world income, the richest one-fifth of the world's population earns about _____ of the world income.

- A) 40%
- B) 65%
- C) 79%
- D) 98%

Answer: C

Diff: 1

Topic: *Life in the Developing Nations: Population and Poverty*

Skill: *Fact*

19) In the distribution of world income, the poorest one-fifth of the world's population earns about _____ of the world income.

- A) 0.5%
- B) 2%
- C) 5%
- D) 12%

Answer: A

Diff: 1

Topic: *Life in the Developing Nations: Population and Poverty*

Skill: *Fact*

20) Although the developed nations account for only about one-quarter of the world's population, they are estimated to consume what proportion of the world's output?

- A) one-quarter
- B) one-half
- C) two-thirds
- D) three-quarters

Answer: D

Diff: 1

Topic: *Life in the Developing Nations: Population and Poverty*

Skill: *Fact*

- 21) Although the developing nations account for about three-fourths of the world's people, they are estimated to receive what percentage of the world's income?
- A) one-fourth B) one-third C) two-fifths D) one-half

Answer: A

Diff: 1

Topic: *Life in the Developing Nations: Population and Poverty*

Skill: *Fact*

- 22) Recent studies suggest that _____ of the population of the developing nations have annual incomes insufficient to provide for adequate nutrition.
- A) 10% B) 25% C) 40% D) 75%

Answer: C

Diff: 1

Topic: *Life in the Developing Nations: Population and Poverty*

Skill: *Fact*

- 23) In 2006, the largest population group (2.4 billion people) belonged to countries classified as
- A) low-income. B) lower middle-income.
C) upper middle-income. D) high-income.

Answer: A

Diff: 1

Topic: *Life in the Developing Nations: Population and Poverty*

Skill: *Fact*

- 24) Which of the following factors has been suggested as an explanation for the lack of economic growth in many poor nations?
- A) insufficient capital formation
B) the supply of human resources is too high.
C) inadequate level of resources
D) a lack of dependence on the already developed nations

Answer: A

Diff: 1

Topic: *Life in the Developing Nations: Population and Poverty*

Skill: *Fact*

- 25) The lack of capital in developing nations causes
- A) labor productivity to remain low.
B) the savings rate to be too high.
C) output to be low in the present but high in the future.
D) consumption rates to be too high.

Answer: A

Diff: 1

Topic: *Life in the Developing Nations: Population and Poverty*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 26) An economy is not able to develop because of a lack of capital. Which of the following strategies would you suggest this economy pursue?
- A) lower interest rates
 - B) impose quotas on how much capital can be imported from other countries to reduce dependency on foreign capital
 - C) increase the political stability of the economy
 - D) nationalize private enterprises because the government sector is not motivated by profit maximization

Answer: C

Diff: 2

Topic: *Life in the Developing Nations: Population and Poverty*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 27) A developing economy is considering restricting the amount of money its citizens can invest abroad. What might the purpose of this restriction be?
- A) to increase the dependency of the economy on developed economics
 - B) to increase capital formation by forcing its citizens to invest in their own country
 - C) to reduce the nation's trade deficit so that interest rates will be reduced and capital formation will increase
 - D) to increase the degree of equality in the income distribution

Answer: B

Diff: 2

Topic: *Life in the Developing Nations: Population and Poverty*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 28) India is on the World Bank's list of _____ countries and its capital city is one of the top ten centers of commerce in the world.
- A) low-income
 - B) lower middle-income
 - C) upper middle-income
 - D) high-income

Answer: A

Diff: 1

Topic: *Life in the Developing Nations: Population and Poverty*

Skill: *Fact*

2 True/False

- 1) Investment in social overhead capital refers to investment in areas like education and nutrition.

Answer: FALSE

Diff: 1

Topic: *Life in the Developing Nations: Population and Poverty*

Skill: *Definition*

- 2) The International Monetary Fund (IMF) makes loans to encourage economic development.

Answer: FALSE

Diff: 2

Topic: *Life in the Developing Nations: Population and Poverty*

Skill: *Fact*

3) Social overhead capital is basic infrastructure projects such as roads, power generation and irrigation systems.

Answer: TRUE

Diff: 1

Topic: *Life in the Developing Nations: Population and Poverty*

Skill: *Definition*

4) Income distributions in developing countries are often so skewed that the richest households of very poor nations surpass the living standards of many high-income families in the developed economies.

Answer: TRUE

Diff: 1

Topic: *Life in the Developing Nations: Population and Poverty*

Skill: *Fact*

5) Developing countries are characterized by low population growth rates.

Answer: FALSE

Diff: 2

Topic: *Life in the Developing Nations: Population and Poverty*

Skill: *Fact*

6) In 2006, low-income countries had the highest infant mortality rates and lowest literacy rates in the world.

Answer: TRUE

Diff: 1

Topic: *Life in the Developing Nations: Population and Poverty*

Skill: *Fact*

7) According to the World Bank, in 2006 the smallest population group (810 million people) belonged to countries classified as upper middle-income.

Answer: TRUE

Diff: 1

Topic: *Life in the Developing Nations: Population and Poverty*

Skill: *Fact*

8) Despite India being on the World Bank's list of low-income countries, its capital city, Mumbai, is one of the top ten centers of commerce in the world.

Answer: TRUE

Diff: 1

Topic: *Life in the Developing Nations: Population and Poverty*

Skill: *Fact*

21.2 Economics Development: Sources and Strategies

1 Multiple Choice

- 1) All of the following are factors that limit a poor nation's economic growth EXCEPT
- A) insufficient capital formation.
 - B) insufficient controls on free trade.
 - C) lack of entrepreneurial ability.
 - D) lack of human capital.

Answer: B

Diff: 1

Topic: Economics Development: Sources and Strategies

Skill: Conceptual

AACSB: Reflective Thinking

- 2) The vicious-circle-of-poverty hypothesis states that poor countries
- A) are unable to save and invest enough to accumulate capital stock that would help them grow.
 - B) cannot develop because they lack the ability to educate their workers.
 - C) cannot develop because their economic policies are ineffective.
 - D) cannot develop because people don't consume due to lack of goods and services.

Answer: A

Diff: 1

Topic: Economics Development: Sources and Strategies

Skill: Definition

- 3) Capital flight refers to the fact that both human and financial capital
- A) flow into developing countries to build much needed infrastructure.
 - B) leave developing countries in search of a higher rate of return.
 - C) leave developed countries in search of a higher rate of return.
 - D) flow into developing countries to invest in risk free investments.

Answer: B

Diff: 1

Topic: Economics Development: Sources and Strategies

Skill: Definition

- 4) A "brain drain" is
- A) the tendency of workers in developing countries to reject new technologies.
 - B) the tendency of talented people in developing countries to get education in developed countries and to stay there after graduation.
 - C) the impact of poverty on the productivity of workers in developing countries.
 - D) the impact of malnutrition on education and productivity in developing countries.

Answer: B

Diff: 1

Topic: Economics Development: Sources and Strategies

Skill: Definition

- 5) Compensation sent back to family in the home country by recent emigrants is known as
- A) remittances.
 - B) transaction costs.
 - C) outsourcing.
 - D) capital flight.

Answer: A

Diff: 1

Topic: Economics Development: Sources and Strategies

Skill: Definition

6) _____ is/are estimated at approximately \$100 billion per year.

- A) Remittances sent from the United States
- B) Capital flight from the United States
- C) Social overhead capital in the United States
- D) The value of brain drain flowing into the United States

Answer: A

Diff: 1

Topic: Economics Development: Sources and Strategies

Skill: Fact

7) In 2007, remittances from illegal immigrants in the United States to Mexico

- A) began to fall because of increased crackdowns on illegal immigration.
- B) continued to rise despite increased crackdowns on illegal immigration.
- C) began to fall despite a decrease in enforcement of immigration laws.
- D) continued to rise because of the decrease in enforcement of immigration laws.

Answer: A

Diff: 1

Topic: Economics Development: Sources and Strategies

Skill: Fact

8) Building roads, power generators, and irrigation systems are projects that are referred to as

- A) social overhead capital.
- B) human capital.
- C) physical capital.
- D) financial capital.

Answer: A

Diff: 1

Topic: Economics Development: Sources and Strategies

Skill: Definition

9) The government's role in a developing country is important during the country's development process for all of the following reasons EXCEPT

- A) building social overhead capital cannot be taken on by the private sector.
- B) building infrastructure is a huge project that only the government can undertake.
- C) many social projects are associated with the free-rider problem, which minimizes the rate of return to the private sector.
- D) the government is the only institution with a vested interest in a country's development.

Answer: D

Diff: 2

Topic: Economics Development: Sources and Strategies

Skill: Conceptual

AACSB: Reflective Thinking

10) Statistics show that the less developed a country is

- A) the larger is the share of industrial output in its total output.
- B) the larger is the share of agricultural output in its total output.
- C) the larger is the per capita income.
- D) the larger is the GDP.

Answer: B

Diff: 1

Topic: Economics Development: Sources and Strategies

Skill: Fact

11) The process of developing local industries to manufacture goods to replace imports is known as

- A) export promotion.
- B) import substitution.
- C) export favoritism.
- D) import promotion.

Answer: B

Diff: 1

Topic: Economics Development: Sources and Strategies

Skill: Definition

12) A decline in a country's terms of trade means

- A) the domestic price of its exports increases and the world price of its imports decreases.
- B) the domestic price of its imports increases and the world price of its exports decreases.
- C) the domestic price of its imports decreases and the world price of its exports decreases.
- D) the domestic price of both its imports and exports decreases.

Answer: B

Diff: 2

Topic: Economics Development: Sources and Strategies

Skill: Conceptual

AACSB: Reflective Thinking

13) A decrease in the domestic price of a country's imports and an increase in the world price of its exports

- A) decreases the country's terms of trade.
- B) has no effect on the country's terms of trade.
- C) increases the country's terms of trade.
- D) increases the country's imports and exports.

Answer: C

Diff: 2

Topic: Economics Development: Sources and Strategies

Skill: Analytic

AACSB: Analytic Skills

14) The policy in which industrial production is oriented towards foreign consumers is called

- A) import substitution.
- B) export promotion.
- C) export orientation.
- D) import promotion.

Answer: B

Diff: 2

Topic: Economics Development: Sources and Strategies

Skill: Definition

15) One of the most successful countries in implementing export promotion policies is

- A) the United States.
- B) Germany.
- C) China.
- D) Japan.

Answer: D

Diff: 1

Topic: Economics Development: Sources and Strategies

Skill: Fact

- 16) Which agency lends money to countries to promote their economic development?
- A) the International Monetary Fund
 - B) the Federal Reserve
 - C) the World Bank
 - D) the League of Nations

Answer: C

Diff: 1

Topic: Economics Development: Sources and Strategies

Skill: Fact

- 17) Which agency lends money to countries to help them stabilize their exchange rates?
- A) the International Monetary Fund
 - B) the World Bank
 - C) the Federal Reserve
 - D) the Bureau de Change

Answer: A

Diff: 1

Topic: Economics Development: Sources and Strategies

Skill: Fact

- 18) Which of the following is a goal of structural adjustment programs?
- A) decrease the size of the private sector through privatization
 - B) increase the budget deficit
 - C) control inflation and encourage saving
 - D) decrease literacy rates

Answer: C

Diff: 2

Topic: Economics Development: Sources and Strategies

Skill: Conceptual

AACSB: Reflective Thinking

- 19) The practice of lending very small amounts of money, without collateral, and accepting small savings deposits is known as
- A) microfinance
 - B) capital flight
 - C) debt rescheduling
 - D) a stabilization program

Answer: A

Diff: 1

Topic: Economics Development: Sources and Strategies

Skill: Definition

- 20) With microfinance, the mechanism of _____ is a way to avoid the problem of imperfect information.
- A) requiring no collateral
 - B) peer lending
 - C) making only small loans
 - D) accepting savings deposits

Answer: B

Diff: 2

Topic: Economics Development: Sources and Strategies

Skill: Conceptual

AACSB: Reflective Thinking

- 21) Compared to traditional bank loans, microfinance loans have all of the following characteristics EXCEPT
- A) they are much smaller.
 - B) they require no collateral.
 - C) they are made more frequently to women than to men.
 - D) they have repayments that begin at a much later date.

Answer: D

Diff: 1

Topic: Economics Development: Sources and Strategies

Skill: Fact

- 22) From 1978 to 2003, _____ grew on average 8 percent per year, a rate faster than any other country in the world.
- A) India
 - B) China
 - C) the United States
 - D) Russia

Answer: B

Diff: 1

Topic: Economics Development: Sources and Strategies

Skill: Fact

- 23) China and India both have rapidly developing economies. Which of the following characteristics is shared by India and China?
- A) both have embraced free-market economies
 - B) property rights are well established in both countries
 - C) both are democratic countries
 - D) both have high literacy rates

Answer: A

Diff: 1

Topic: Economics Development: Sources and Strategies

Skill: Fact

- 24) Most of China's recent growth has been fueled by _____, and most of India's recent growth has been fueled by _____.
- A) manufacturing; services
 - B) services; manufacturing
 - C) manufacturing; manufacturing
 - D) services; services

Answer: A

Diff: 1

Topic: Economics Development: Sources and Strategies

Skill: Fact

- 25) Related to the *Economics in Practice* on p. 406 [718]: In Indonesia, children and allies of President Suharto were affiliated with many companies. When Suharto unexpectedly fell ill, the stock prices of these companies dropped significantly, suggesting that
- A) these companies thrived under President Suharto despite their connection with Suharto's allies and relatives.
 - B) later regimes in Indonesia will be more concerned about economic efficiency and less corrupt.
 - C) President Suharto's removal from power was based not only on illness but also on concern over corruption.
 - D) investor opinion of many of these firms was based on their connections with President Suharto and not the economic efficiency of those companies.

Answer: D

Diff: 2

Topic: *Economics Development: Sources and Strategies: Economics in Practice*

Skill: *Analytic*

AACSB: *Analytic Skills*

2 True/False

- 1) In a developing economy, scarcity of capital may have more to do with a lack of incentive for citizens to save and invest productively than with any absolute scarcity of income available for capital accumulation.

Answer: TRUE

Diff: 1

Topic: *Economics Development: Sources and Strategies*

Skill: *Fact*

- 2) The following situation is an example of an import substitution strategy. Costa Rica has a comparative advantage in the production of coffee and, as a result, the Costa Rican government grants incentives to coffee planters to improve their performance in the international marketplace.

Answer: FALSE

Diff: 3

Topic: *Economics Development: Sources and Strategies*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 3) In general, as a nation's income increases, fertility rates fall.

Answer: TRUE

Diff: 1

Topic: *Economics Development: Sources and Strategies*

Skill: *Fact*

- 4) Remittances can be used as investment capital for small businesses.

Answer: TRUE

Diff: 1

Topic: *Economics Development: Sources and Strategies*

Skill: *Fact*

- 5) Human capital shortages are NOT a barrier to economic growth in developing countries.
Answer: FALSE
Diff: 1
Topic: *Economics Development: Sources and Strategies*
Skill: *Fact*
- 6) A frequently cited barrier to economic development is the apparent shortage of entrepreneurial activity in developing nations.
Answer: TRUE
Diff: 1
Topic: *Economics Development: Sources and Strategies*
Skill: *Fact*
- 7) Most economists believe that import–substitution strategies have been quite successful around the world.
Answer: FALSE
Diff: 1
Topic: *Economics Development: Sources and Strategies*
Skill: *Fact*
- 8) Policies designed to promote import substitution often encouraged labor–intensive production methods, which encouraged the creation of jobs.
Answer: FALSE
Diff: 1
Topic: *Economics Development: Sources and Strategies*
Skill: *Fact*
- 9) Economic growth guarantees economic development.
Answer: FALSE
Diff: 1
Topic: *Economics Development: Sources and Strategies*
Skill: *Conceptual*
AACSB: *Reflective Thinking*
- 10) Developing countries often pursue agricultural policies that discourage farm production.
Answer: TRUE
Diff: 1
Topic: *Economics Development: Sources and Strategies*
Skill: *Fact*
- 11) Economic theories of population growth suggest that fertility decisions made by poor families should be viewed as uninformed and uncontrolled.
Answer: FALSE
Diff: 1
Topic: *Economics Development: Sources and Strategies*
Skill: *Fact*

12) Governments in many developing countries often maintain artificially low food prices because the direct political influence of the relatively large rural population outweighs the influence of the relatively small urban population.

Answer: FALSE

Diff: 1

Topic: *Economics Development: Sources and Strategies*

Skill: *Fact*

13) Export promotion policies try to encourage firms to produce more of products the country has a comparative advantage in.

Answer: TRUE

Diff: 1

Topic: *Economics Development: Sources and Strategies*

Skill: *Fact*

14) Microfinance is aimed at introducing entrepreneurs among the very poorest parts of the developing world to the capital market.

Answer: TRUE

Diff: 1

Topic: *Economics Development: Sources and Strategies*

Skill: *Fact*

15) India is a democratic country with a history of rule-of-law and an English speaking heritage, all factors thought to give a development advantage.

Answer: TRUE

Diff: 1

Topic: *Economics Development: Sources and Strategies*

Skill: *Fact*

16) China has developed a rapid approach to development.

Answer: FALSE

Diff: 1

Topic: *Economics Development: Sources and Strategies*

Skill: *Fact*

17) Related to the *Economic in Practice* on p. 406 [718]: Corruption often leads to more efficient firms producing the goods and services in a society.

Answer: FALSE

Diff: 1

Topic: *Economics Development: Sources and Strategies: Economics in Practice*

Skill: *Fact*

21.3 Issues in Economic Development

1 Multiple Choice

- 1) Studies by the World Bank during the 1970s indicate that
- A) growth in GDP always leads to economic development.
 - B) growth in GDP does not guarantee improvements in development indicators.
 - C) growth in GDP improves education, nutrition and health.
 - D) growth in GDP decreases the GDP per capita.

Answer: B

Diff: 2

Topic: Issues in Economic Development

Skill: Fact

- 2) The population in developing countries grows at a rate of _____% a year, whereas the population in developed countries grows at a rate of _____% a year.
- A) 1.7; 0.5 B) 1; 2 C) 2.5; 1.5 D) 1.5; 0.1

Answer: A

Diff: 2

Topic: Issues in Economic Development

Skill: Fact

- 3) When rapid population growth changes the age composition of a population, which of the following is likely to happen?
- A) the percentage of dependent children decreases relative to productive working adults
 - B) saving rates decrease
 - C) investment increases
 - D) consumption decreases

Answer: B

Diff: 2

Topic: Issues in Economic Development

Skill: Conceptual

AACSB: Reflective Thinking

- 4) There are 100 million people in a country. On average, the number of births is 7 million and the number of deaths is 5 million. The natural rate of population increase in this country is
- A) 12%. B) 7%. C) 5%. D) 2%.

Answer: D

Diff: 1

Topic: Issues in Economic Development

Skill: Analytic

AACSB: Analytic Skills

- 5) Related to the *Economics in Practice* on p. 411 [723]: In the Kerala region of India, fishermen used cell phones to help connect buyers and sellers, reducing waste. All of the following describe ways in which technology is likely to improve information flow and increase economic efficiency EXCEPT:
- A) Fax technology makes it possible to transmit signed contracts in seconds, allowing the parties to the contract to begin performing their contract duties more quickly.
 - B) High-speed Internet connections allow engineers in developing countries to collaborate with firms all around the world.
 - C) E-mail now makes criminals who commit certain kinds of fraud very difficult to identify and arrest.
 - D) Video conferencing decreases the need for expensive business travel.

Answer: C

Diff: 2

Topic: *Issues in Economic Development: Economics in Practice*

Skill: *Analytic*

AACSB: *Analytic Skills*

- 6) Related to the *Economics in Practice* on p. 411 [723]: By 2001, the majority of the fishing fleet in the Indian state of Kerala had mobile phones. As a result of the introduction of mobile phone service to this fishing industry, profits _____ and consumer prices _____.
- A) rose; fell
 - B) fell; rose
 - C) rose; rose
 - D) fell; fell

Answer: A

Diff: 1

Topic: *Issues in Economic Development: Economics in Practice*

Skill: *Fact*

2 True/False

- 1) Rapid population growth tends to make the population younger in developing economies.

Answer: TRUE

Diff: 1

Topic: *Issues in Economic Development*

Skill: *Fact*

- 2) GDP growth leads development.

Answer: FALSE

Diff: 1

Topic: *Issues in Economic Development*

Skill: *Fact*

- 3) Developed counties have a higher population growth than developing countries.

Answer: FALSE

Diff: 1

Topic: *Issues in Economic Development*

Skill: *Fact*

21.4 The Transition to a Market Economy

1 Multiple Choice

- 1) The tragedy of commons relates to the idea that
- A) central planning sets all production targets.
 - B) all wages, prices, and interest rates are controlled by government.
 - C) collective ownership may not provide the proper private incentives for efficiency because individuals do not bear the full costs of their own decisions, but enjoy the full benefits.
 - D) central planning sets all distribution targets.

Answer: C

Diff: 1

Topic: *The Transition to a Market Economy*

Skill: *Definition*

- 2) The tragedy of commons relates to the idea that
- A) central planning sets all production targets.
 - B) all wages, prices, and interest rates are controlled by government.
 - C) common owned resources tend to be overused.
 - D) central planning sets all distribution targets.

Answer: C

Diff: 1

Topic: *The Transition to a Market Economy*

Skill: *Definition*

- 3) The so-called tragedy of commons relates to the idea that
- A) no one has an incentive to maintain collectively owned property.
 - B) collectively owned resources tend to be under used.
 - C) collective ownership provides the proper private incentives for efficiency because individuals bear the full costs of their own decisions and enjoy the full benefits.
 - D) central planning sets all production and distribution targets.

Answer: A

Diff: 1

Topic: *The Transition to a Market Economy*

Skill: *Definition*

- 4) The Russian transition to a market economy required
- A) controls over prices.
 - B) market-supporting institutions such as a developed banking system, functional financial markets, a code of commercial law, and developed processes for insurability of business activities.
 - C) controls over wages and interest rates.
 - D) controls planning overall production.

Answer: B

Diff: 2

Topic: *The Transition to a Market Economy*

Skill: *Fact*

- 5) In a centrally planned economy,
- A) unemployment has always been very widespread.
 - B) wages tend to be exceptionally high for low-skill jobs and low for high-skill jobs.
 - C) the labor market does not function freely and there is essentially no such thing as unemployment.
 - D) laborers have remained unemployed because of technology displacement.

Answer: C

Diff: 2

Topic: *The Transition to a Market Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 6) Within a fully employed, centrally planned economy that provides basic housing, food, and clothing at very affordable levels for all,
- A) there is no need for unemployment insurance, welfare, or other social programs.
 - B) there is a real need for government social welfare programs.
 - C) there is a need for government to permit market-determined prices.
 - D) there is a need for government to permit market-determined wages.

Answer: A

Diff: 2

Topic: *The Transition to a Market Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 7) The Russian transition to a market economy with free labor markets and uncontrolled prices means that
- A) prices will still be controlled by government.
 - B) full employment and low prices can be maintained.
 - C) wages will still be determined by government.
 - D) unemployment and higher prices are inevitable.

Answer: D

Diff: 2

Topic: *The Transition to a Market Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 8) The transition to a market-oriented economy characterized by rising unemployment and higher prices suggests that
- A) government must continue to centrally plan all resource allocations to production.
 - B) a social safety net including unemployment compensation, and food, clothing, and housing subsidies for those in need will be politically popular.
 - C) government must set wages, prices, and interest rates.
 - D) government must continue to centrally plan the distribution of all output into consumption.

Answer: B

Diff: 2

Topic: *The Transition to a Market Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 9) Most authorities agree that the transition to a market economy can be achieved
- A) without external financial and technical assistance.
 - B) only with forceful central planning by the government.
 - C) only with external financial and technical assistance.
 - D) only with government controls on wages and prices.

Answer: C

Diff: 2

Topic: *The Transition to a Market Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 10) The transition from socialism to market capitalism by the shock therapy approach suggests that
- A) the transition proceed immediately and impact all economic variables at once.
 - B) government always centrally plan the economy.
 - C) the transition be gradual with sequential changes in government controls, etc.
 - D) government always control wages, prices, and interest rates.

Answer: A

Diff: 2

Topic: *The Transition to a Market Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 11) The immediate and total deregulation of prices, liberalization of trade, privatization, and development of financial institutions represent
- A) the gradualism transition approach from socialism to a market economy.
 - B) a cooperative socialist model.
 - C) the shock therapy transition approach from socialism to a market economy.
 - D) an authoritarian socialist model.

Answer: C

Diff: 2

Topic: *The Transition to a Market Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 12) Advocates of a gradualism transition approach from socialism to a market economy recommend
- A) moderate changes starting with the development of market institutions, the gradual decontrol of prices, and the privatization of only the cost efficient firms.
 - B) continued government controls over wages forever.
 - C) an immediate and total change in all economic conditions.
 - D) continued government controls over prices forever.

Answer: A

Diff: 2

Topic: *The Transition to a Market Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

2 True/False

- 1) Collective ownership of resources leads to economic efficiency.

Answer: FALSE

Diff: 1

Topic: *The Transition to a Market Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 2) Collectively owned resources tend to be over used as no one has an incentive to conserve them or use them optimally.

Answer: TRUE

Diff: 1

Topic: *The Transition to a Market Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 3) Transition from socialism by shock therapy is a gradual process.

Answer: FALSE

Diff: 1

Topic: *The Transition to a Market Economy*

Skill: *Conceptual*

AACSB: *Reflective Thinking*

- 4) Moving from socialism to capitalism as fast as possible is known as shock therapy.

Answer: TRUE

Diff: 1

Topic: *The Transition to a Market Economy*

Skill: *Definition*

- 5) Market socialism is characterized by collective ownership of firms but market allocation of goods.

Answer: TRUE

Diff: 2

Topic: *The Transition to a Market Economy*

Skill: *Definition*