Exam 1 Review

1. Macroeconomics does not try to answer the question of:
   A) why do some countries experience rapid growth.
   B) what is the rate of return on education.
   C) why do some countries have high rates of inflation.
   D) what causes recessions and depressions.

2. Macroeconomics is the study of the:
   A) activities of individual units of the economy.
   B) decision making by households and firms.
   C) economy as a whole.
   D) interaction of firms and households in the marketplace.

3. A severe recession is called a(n):
   A) depression.
   B) deflation.
   C) exogenous event.
   D) market-clearing assumption.

4. Deflation occurs when:
   A) real GDP decreases.
   B) the unemployment rate decreases.
   C) prices fall.
   D) prices increase, but at a slower rate.

5. A period of falling prices is called:
   A) deflation.
   B) inflation.
   C) a depression.
   D) a recession.

6. The unemployment rate:
   A) was zero during the 1990s in the United States.
   B) was zero on average between 1900 and 1950 in the United States.
   C) has never been zero in the United States.
   D) is usually zero when the economy is not in a recession or depression.
7. Exogenous variables are:
   A) fixed at the moment they enter the model.
   B) determined within the model.
   C) the outputs of the model.
   D) explained by the model.

8. Endogenous variables are:
   A) fixed at the moment they enter the model.
   B) determined within the model.
   C) the inputs of the model.
   D) from outside the model.

9. Variables that a model tries to explain are called:
   A) endogenous.
   B) exogenous.
   C) market clearing.
   D) fixed.

10. Variables that a model takes as given are called:
    A) endogenous.
    B) exogenous.
    C) market clearing.
    D) macroeconomic.

11. In a simple model of the supply and demand for pizza, when the price of cheese increases, the price of pizza ______ and the quantity purchased ______.
    A) increases; increases
    B) decreases; increases
    C) decreases; decreases
    D) increases; decreases

12. GDP is all of the following except the total:
    A) expenditure of everyone in the economy.
    B) income of everyone in the economy.
    C) expenditure on the economy's output of goods and services.
    D) output of the economy.
13. When a firm sells a product out of inventory, GDP:
   A) increases.
   B) decreases.
   C) is not changed.
   D) increases or decreases, depending on the year the product was produced.

14. When a firm sells a product out of inventory, investment expenditures ______ and consumption expenditures ______.
   A) increase; decrease
   B) decrease; increase
   C) decrease; remain unchanged
   D) remain unchanged; increase

15. Assume that a bakery hires more workers and pays them wages and that the workers produce more bread. GDP increases in all of the following cases except when the bread:
   A) is sold to households.
   B) is stored away for later sale.
   C) grows stale and is thrown away.
   D) is sold to other firms.

16. When bread is baked but put away for later sale, this is called:
   A) waste.
   B) saving.
   C) fixed investment.
   D) investment in inventory.

17. Assume that a tire company sells 4 tires to an automobile company for $400, another company sells a compact disc player for $500, and the automobile company puts all of these items in or on a car that it sells for $20,000. In this case, the amount from these transactions that should be counted in GDP is:
   A) $20,000.
   B) $20,000 less the automobile company's profit on the car.
   C) $20,900.
   D) $20,900 less the profits of all three companies on the items that they sold.

18. The value added of an item produced refers to:
   A) a firm's profits on the item sold.
   B) the value of the labor inputs in the production of an item.
   C) the value of a firm's output less the value of its costs.
   D) the value of a firm's output less the value of the intermediate goods that the firm purchases.
19. Assume that a firm buys all the parts that it puts into an automobile for $10,000, pays its workers $10,000 to fabricate the automobile, and sells the automobile for $22,000. In this case, the value added by the automobile company is:
   A) $10,000.
   B) $12,000.
   C) $20,000.
   D) $22,000.

20. In computing GDP,
   A) expenditures on used goods are included.
   B) production added to inventories is excluded.
   C) the amount of production in the underground economy is imputed.
   D) the value of intermediate goods is included in the market price of the final goods.

21. Real GDP is measured in _____ dollars _____ time.
   A) current; at a point in
   B) current; per unit of
   C) constant; at a point in
   D) constant; per unit of

22. Nominal GDP is measured in _____ dollars _____ time.
   A) current; at a point in
   B) current; per unit of
   C) constant; at a point in
   D) constant; per unit of

23. Assume that apples cost $0.50 in 2002 and $1 in 2009, whereas oranges cost $1 in 2002 and $1.50 in 2009. If 4 apples were produced in 2002 and 5 in 2009, whereas 3 oranges were produced in 2002 and 4 in 2009, then real GDP (in 2002 prices) in 2009 was:
   A) $5.
   B) $6.50.
   C) $9.50.
   D) $11.

24. The best measure of the economic satisfaction of the members of a society is:
   A) nominal GDP.
   B) real GDP.
   C) the rate of inflation.
   D) the value of corporate profits.
25. If nominal GDP in 2009 equals $14 trillion and real GDP in 2009 equals $11 trillion, what is the value of the GDP deflator?
   A) 0.79
   B) 1.03
   C) 1.27
   D) 1.30

26. If the GDP deflator in 2009 equals 1.25 and nominal GDP in 2009 equals $15 trillion, what is the value of real GDP in 2009?
   A) $12 trillion
   B) $12.5 trillion
   C) $15 trillion
   D) $18.75 trillion

27. The GDP deflator is equal to:
   A) the ratio of nominal GDP to real GDP.
   B) the ratio of real GDP to nominal GDP.
   C) real GDP minus national GDP.
   D) nominal GDP minus real GDP.

28. Assume that apples cost $0.50 in 2002 and $1 in 2009, whereas oranges cost $1 in 2002 and $1.50 in 2009. If 4 apples were produced in 2002 and 5 in 2009, whereas 3 oranges were produced in 2002 and 5 in 2009, then the GDP deflator in 2009, using a base year of 2002, was approximately:
   A) 1.5.
   B) 1.7.
   C) 1.9.
   D) 2.0.

29. If nominal GDP grew by 5 percent and real GDP grew by 3 percent, then the GDP deflator grew by approximately ______ percent.
   A) 2
   B) 3
   C) 5
   D) 8
30. If nominal GDP increased by 5 percent and the GDP deflator increased by 3 percent, then real GDP ______ by ______ percent.
A) increased; 2
B) decreased; 2
C) increased; 8
D) decreased; 8

31. Real GDP is a better measure of economic well-being than nominal GDP, because real GDP:
A) excludes the value of goods and services exported abroad.
B) includes the value of government transfer payments.
C) measures changes in the quantity of goods and services produced by holding prices constant.
D) adjusts the value of goods and services produced for changes in the foreign exchange rate.

32. If GDP (measured in billions of current dollars) is $5,465, consumption is $3,657, investment is $741, and government purchases are $1,098, then net exports are:
A) $131.
B) –$131.
C) $31.
D) –$31.

33. If GDP (measured in billions of current dollars) is $5,465, consumption is $3,657, investment is $741, and net exports are –$1,910, then government purchases are:
A) $2,977.
B) $1,910.
C) –$843.
D) $1,067.

34. If real GDP grew by 6 percent and population grew by 2 percent, then real GDP per person grew by approximately ______ percent.
A) 2
B) 3
C) 4
D) 8
35. In the national income accounts, consumption expenditures include *all* of the following *except* household purchases of:
   A) durable goods.
   B) nondurable goods.
   C) new residential housing.
   D) services.

36. In the national income accounts, net exports equal:
   A) exported goods minus imported goods.
   B) exported goods and services minus imported goods and services.
   C) exported goods minus imported services.
   D) exported goods and services plus imported goods and services.

37. Net national product equals GDP:
   A) plus net investment.
   B) minus net investment.
   C) plus depreciation.
   D) minus depreciation.

38. Disposable personal income:
   A) is computed by subtracting personal tax and nontax payments from personal income.
   B) is generally greater than personal income.
   C) includes corporate profits but not dividends.
   D) does not include government transfers to individuals.

39. The CPI is determined by computing:
   A) an average of prices of all goods and services.
   B) the price of a basket of goods and services that changes every year, relative to the same basket in a base year.
   C) the price of a fixed basket of goods and services, relative to the price of the same basket in a base year.
   D) nominal GDP relative to real GDP.

40. Prices of items included in the CPI are:
   A) averaged with the price of every item weighted equally.
   B) weighted according to amount of the item produced in GDP.
   C) weighted according to quantity of the item purchased by the typical household.
   D) chained to the base year by the year-to-year growth rate of the item.
41. The circular flow model shows that households use income for:
   A) consumption, saving, and factor payments.
   B) consumption, taxes, and factor payments.
   C) taxes, saving, and factor payments.
   D) consumption, taxes, and saving.

42. In the circular flow diagram, firms receive revenue from the _____ market, which is used to purchase inputs in the _____ market.
   A) goods; financial
   B) factor; financial
   C) goods; factor
   D) factor; goods

43. In the circular flow model, households receive income from the _____ market and save through the _____ market.
   A) goods; financial
   B) factor; financial
   C) goods; factor
   D) factor; goods

44. In the long run, the level of national income in an economy is determined by its:
   A) factors of production and production function.
   B) real and nominal interest rate.
   C) government budget surplus or deficit.
   D) rate of economic and accounting profit.

45. An economy's factors of production and its production function determine the economy's:
   A) labor force participation rate.
   B) budget surplus or deficit.
   C) population growth rate.
   D) output of goods and services.

46. In the long run, what determines the level of total production of goods and services in an economy?
   A) the interest rate and the amount of national saving
   B) the quantity of capital, quantity of labor, and production technology
   C) consumption, investment, and government spending
   D) the marginal products of capital and labor, constant returns to scale, and competition
47. The two most important factors of production are:
   A) goods and services.
   B) labor and energy.
   C) capital and labor.
   D) saving and investment.

48. Unlike the real world, the classical model with fixed output assumes that:
   A) all factors of production are fully utilized.
   B) all capital is fully utilized but some labor is unemployed.
   C) all labor is fully employed but some capital lies idle.
   D) some capital lies idle and some labor is unemployed.

49. A production function is a technological relationship between:
   A) factor prices and the marginal product of factors.
   B) factors of production and factor prices.
   C) factors of production and the quantity of output produced.
   D) factor prices and the quantity of output produced.

50. The production function feature called “constant returns to scale” means that if we:
   A) multiply capital by $z_1$ and labor by $z_2$, we multiply output by $z_3$.
   B) increase capital and labor by 10 percent each, we increase output by 10 percent.
   C) increase capital and labor by 5 percent each, we increase output by 10 percent.
   D) increase capital by 10 percent and increase labor by 5 percent, we increase output
      by 7.5 percent.

51. If an increase of an equal percentage in all factors of production results in an increase in output of the same percentage, then a production function has the property called:
   A) constant marginal product of labor.
   B) increasing marginal product of labor.
   C) constant returns to scale.
   D) increasing returns to scale.

52. If bread is produced by using a constant returns to scale production function, then if the:
   A) number of workers is doubled, twice as much bread will be produced.
   B) amount of equipment is doubled, twice as much bread will be produced.
   C) amounts of equipment and workers are both doubled, twice as much bread will be produced.
   D) amounts of equipment and workers are both doubled, four times as much bread will be produced.
53. At any particular point in time, the output of the economy:
   A) is fixed because the supplies of capital and labor and the technology are fixed.
   B) is fixed because the demand for goods and services is fixed.
   C) varies because the supplies of capital and labor vary.
   D) varies because the technology for turning capital and labor into goods and services varies.

54. The neoclassical theory of distribution:
   A) was developed by Karl Marx.
   B) is rejected by most economists today.
   C) shows that the national income of an economy is not equal to total output.
   D) is a theory of how national income is divided among the factors of production.

55. If \( Y = AK^{0.5}L^{0.5} \) and \( A, K, \) and \( L \) are all 100, the marginal product of capital is:
   A) 50.
   B) 100.
   C) 200.
   D) 1000.

56. Since 1960, the U.S. ratio of labor income to total income has:
   A) been about 2.5 to 1.
   B) been about 0.7.
   C) increased steadily.
   D) decreased steadily.

57. If the production function describing an economy is \( Y = 100K^{25}L^{75} \), then the share of output going to labor:
   A) is 25 percent.
   B) is 75 percent.
   C) depends on the quantities of labor and capital.
   D) depends on the state of technology.

58. In a Cobb–Douglas production function the marginal product of labor will increase if:
   A) the quantity of labor increases.
   B) the quantity of capital increases.
   C) capital’s share of output increases.
   D) average labor productivity decreases.
59. In a Cobb–Douglas production function the marginal product of capital will increase if:
   A) the quantity of labor increases.
   B) the quantity of capital increases.
   C) labor's share of output increases.
   D) average capital productivity decreases.

60. According to Goldin and Katz, the increasing income equality of recent decades is the result of:
   A) increases in the rates of technological advance and educational attainment.
   B) decreases in the rates of technological advance and educational attainment.
   C) a steady pace of technological advance and a slowdown in educational advance.
   D) a decrease in the rate of technological advance and an increase in the rate of educational advance.

61. Skill-biased technological change ______ the demand for high-skilled workers, while the slowdown in the pace of educational advancement reduces the supply of skilled workers, resulting in relatively _____ wages for skilled workers.
   A) increases; higher
   B) increases; lower
   C) decreases; higher
   D) decreases; lower

62. The public policy implication of Goldin and Katz’s analysis of growing income inequality is that reversing this trend will require that more of society's resources be put into:
   A) space exploration.
   B) capital expenditures.
   C) education.
   D) transfer payments.

63. If the consumption function is given by \( C = 150 + 0.85Y \) and \( Y \) increases by 1 unit, then \( C \) increases by:
   A) 0.15 units.
   B) 0.5 units.
   C) 0.85 units.
   D) 1 unit.
64. If the consumption function is given by $C = 150 + 0.85Y$ and $Y$ increases by 1 unit, then savings:
   A) decreases by 0.85 units.
   B) decreases by 0.15 units.
   C) increases by 0.15 units.
   D) increases by 0.85 units.

65. If the consumption function is given by $C = 150 + 0.85(Y - T)$ and $T$ increases by 1 unit, then savings:
   A) decreases by 0.85 units.
   B) decreases by 0.15 units.
   C) increases by 0.15 units.
   D) increases by 0.85 units.

66. Assume that the consumption function is given by $C = 150 + 0.85(Y - T)$ and the tax function is given by $T = t_0 + t_1Y$. If $t_0$ increases by 1 unit, then consumption:
   A) decreases by 0.85 units.
   B) decreases by 0.15 units.
   C) increases by 0.15 units.
   D) increases by 0.85 units.

67. Assume that the consumption function is given by $C = 150 + 0.85(Y - T)$, the tax function is given by $T = t_0 + t_1Y$, and $Y$ is 5,000. If $t_1$ decreases from 0.3 to 0.2, then consumption increases by:
   A) 85.
   B) 425.
   C) 500.
   D) 525.

68. Assume that the consumption function is given by $C = 200 + 0.7(Y - T)$, the tax function is given by $T = 100 + t_1Y$, and $Y = 50K^{0.5}L^{0.5}$, where $K = 100$ and $L = 100$. If $t_1$ increases from 0.2 to 0.25, then consumption decreases by:
   A) 70.
   B) 140.
   C) 175.
   D) 250.
69. Assume that the consumption function is given by \( C = 200 + 0.7(Y - T) \), the tax function is given by \( T = 100 + 0.2Y \), and \( Y = 50K^{0.5}L^{0.5} \), where \( K = 100 \). If \( L \) increases from 100 to 144, then consumption increases by:
   A) 560.
   B) 840.
   C) 1,120.
   D) 2,120.

70. Investment goods as measured in the GDP are purchased by:
   A) business firms alone.
   B) households alone.
   C) business firms and households.
   D) business firms, households, and governments.

71. The nominal interest rate is the:
   A) rate of interest that investors pay to borrow money.
   B) same as the real interest rate.
   C) rate of inflation minus the real rate of interest.
   D) real rate of interest minus the rate of inflation.

72. The real interest rate is the:
   A) rate of interest actually paid by consumers.
   B) rate of interest actually paid by banks.
   C) rate of inflation minus the nominal interest rate.
   D) nominal interest rate minus the rate of inflation.

73. People use money as a store of value when they:
   A) hold money to transfer purchasing power into the future.
   B) use money as a measure of economic transactions.
   C) use money to buy goods and services.
   D) hold money to gain power and esteem.

74. People use money as a unit of account when they:
   A) hold money to transfer purchasing power into the future.
   B) use money as a measure of economic transactions.
   C) use money to buy goods and services.
   D) hold money to gain power and esteem.
75. People use money as a medium of exchange when they:
   A) hold money to transfer purchasing power into the future.
   B) use money as a measure of economic transactions.
   C) use money to buy goods and services.
   D) hold money to gain power and esteem.

76. When a pizza maker lists the price of a pizza as $10, this is an example of using money as a:
   A) store of value.
   B) unit of account.
   C) medium of exchange.
   D) flow of value.

77. In the United States, monetary policy is controlled by:
   A) the President.
   B) the Congress.
   C) the Federal Reserve.
   D) the Treasury Department.

78. To increase the money supply, the Federal Reserve:
   A) buys government bonds.
   B) sells government bonds.
   C) buys corporate stocks.
   D) sells corporate stocks.

79. To reduce the money supply, the Federal Reserve:
   A) buys government bonds.
   B) sells government bonds.
   C) creates demand deposits.
   D) destroys demand deposits.

80. Open-market operations are:
   A) Commerce Department efforts to open foreign markets to international trade.
   B) Federal Reserve purchases and sales of government bonds.
   C) Securities and Exchange Commission rules requiring open disclosure of market trades.
   D) Treasury Department purchases and sales of the U.S. gold stock.
81. Currency equals:
   A) $M1$.
   B) the sum of funds in checking accounts.
   C) the sum of checking accounts and paper money.
   D) the sum of coins and paper money.

82. Demand deposits are funds held in:
   A) currency.
   B) certificates of deposit.
   C) checking accounts.
   D) money markets.

83. All of the following assets are included in $M1$ except:
   A) currency.
   B) demand deposits.
   C) traveler's checks.
   D) money market deposit accounts.

84. Credit cards:
   A) are part of the $M1$ money supply.
   B) are part of the $M2$ money supply.
   C) are part of both the $M1$ and $M2$ money supply.
   D) may affect the demand for money.

85. In the United States, the money supply is determined:
   A) only by the Fed.
   B) only by the behavior of individuals who hold money and of banks in which money
      is held.
   C) jointly by the Fed and by the behavior of individuals who hold money and of banks
      in which money is held.
   D) according to a constant-growth-rate rule.

86. The money supply consists of:
   A) currency plus reserves.
   B) currency plus the monetary base.
   C) currency plus demand deposits.
   D) the monetary base plus demand deposits.
87. Bank reserves equal:
   A) gold kept in bank vaults.
   B) gold kept at the central bank.
   C) currency plus demand deposits.
   D) deposits that banks have received but have not lent out.

88. In a system with 100-percent-reserve banking:
   A) all banks must hold reserves equal to 100 percent of their loans.
   B) no banks can make loans.
   C) the banking system completely controls the size of the money supply.
   D) no banks can accept deposits.

89. In a 100-percent-reserve banking system, if a customer deposits $100 of currency into a bank, then the money supply:
   A) increases by $100.
   B) decreases by $100.
   C) increases by more than $100.
   D) remains the same.

90. In a system with fractional-reserve banking:
   A) all banks must hold reserves equal to a fraction of their loans.
   B) no banks can make loans.
   C) the banking system completely controls the size of the money supply.
   D) all banks must hold reserves equal to a fraction of their deposits.

91. Banks create money in:
   A) a 100-percent-reserve banking system but not in a fractional-reserve banking system.
   B) a fractional-reserve banking system but not in a 100-percent-reserve banking system.
   C) both a 100-percent-reserve banking system and a fractional-reserve banking system.
   D) neither a 100-percent-reserve banking system nor a fractional-reserve banking system.

92. The banking system creates:
   A) liquidity.
   B) wealth.
   C) reserves.
   D) currency.
Answer Key

1. B
2. C
3. A
4. C
5. A
6. C
7. A
8. B
9. A
10. B
11. D
12. A
13. C
14. B
15. C
16. D
17. A
18. D
19. B
20. D
21. D
22. B
23. B
24. B
25. C
26. A
27. A
28. B
29. A
30. A
31. C
32. D
33. A
34. C
35. C
36. B
37. D
38. A
39. C
40. C
41. D
42. C
43. B
44. A
45. D
46. B
47. C
48. A
49. C
50. B
51. C
52. C
53. A
54. D
55. A
56. B
57. B
58. B
59. A
60. C
61. A
62. C
63. C
64. C
65. B
66. A
67. B
68. C
69. A
70. C
71. A
72. D
73. A
74. B
75. C
76. B
77. C
78. A
79. B
80. B
81. D
82. C
83. D
84. D
85. C
86. C
87. D
88. B
89. D
90. D
91. B
92. A