

Name: _____

ECO 200 820 Principles of Macroeconomics

Final Exam

December 12, 2000

Form A

Part I: Multiple Choice

Read each question carefully and select the most appropriate response. Circle the appropriate letter of the response and fill in the corresponding circle on your answer sheet.

1. The crowding out effect occurs when
 - a) government borrowing increases interest rates and reduces private investment.
 - b) monetary restraint increases interest rates and reduces private investment.
 - c) balancing the budget causes a slowdown in economic growth, reducing private investment.
 - d) all of the above.

2. In Germany, a car is priced at DM 45,000. The exchange rate is 1.5 DM /\$. The price of car in dollars is
 - a) \$60,000.
 - b) \$56,000.
 - c) \$30,000.
 - d) \$6,000.

3. During the 1990s the U.S.
 - a) ran a trade surplus with the rest of the world.
 - b) imported the same amount as it exported.
 - c) ran a trade deficit with the rest of the world.

4. If nominal GDP increases then
 - a) production has definitely increased
 - b) prices have definitely increased
 - c) both prices and production have increased.
 - d) prices and/or production have increased.

5. If wages and prices are flexible, recessions can best be eliminated when
 - a) prices and wages both rise.
 - b) prices and wages both fall
 - c) prices rise and wages drop.
 - d) prices drop and wages rise

6. When tariffs are imposed in the U.S., the losers include:
 - a) The U.S. government.
 - b) Foreign consumers and U.S. producers of import-competing goods.
 - c) U.S. consumers and producers of import-competing goods.
 - d) U.S. consumers and foreign producers.

7. The Consumer Price Index overstates inflation because
 - a) it measures the prices of all goods and services in the GDP.
 - b) it does not account for the substitution of cheaper goods and services.
 - c) it does not account for quality improvements.
 - d) both b and c.
 - e) all of the above.

8. Suppose the marginal propensity to consume is .8. Which of the following will increase output by 500?
 - a) a tax decrease of 125.
 - b) a tax decrease of 100.
 - c) an increase in government spending of 125.
 - d) a decrease in government spending of 100.

9. Relative to an closed economy, fiscal policy in an open economy
 - a) is less effective because spending on imports decreases the size of the multiplier.
 - b) is more effective because spending on imports increases the size of the multiplier.
 - c) has no crowding out effect.
 - d) has a shorter implementation lag.

10. Along the Phillips curve
 - a) inflation and unemployment will be positively related (i.e. both increase or both decrease).
 - b) there is a tradeoff between inflation and unemployment.
 - c) lower tax rates may actually increase tax revenue.
 - d) the supply curve shifts left or right.

11. Which of the following would theoretically increase the money supply?
 - a) An open market purchase of Treasury bonds by the Fed.
 - b) An decrease in the required reserve ratio.
 - c) A increase in the discount rate.
 - d) both a and b.
 - e) both a and c.

12. Suppose \$200 is deposited in Key Bank. The required reserve ratio is 10%. What is the amount of potential deposit creation?
 - a) \$2000
 - b) \$1800
 - c) \$200
 - d) \$20

13. A slowdown in the growth rate of productivity implies
 - a) slower growth in real wages.
 - b) slower growth in the labor force.
 - c) rising GDP per capita.
 - d) all of the above.

14. In an open economy, rising interest rates in the U.S. will ____ foreign investment in the U.S., causing the money supply to ____.
 - a) encourage; decrease
 - b) discourage; decrease
 - c) encourage; increase
 - d) discourage; increase

15. The case for a "hands off" economic policy is based on the belief that
 - a) fiscal policy does not work.
 - b) monetary policy does not work.
 - c) forecast errors and time lags with policy make fine tuning the economy impossible.
 - d) only anticipated policies are effective.

16. NAFTA is a trade agreement involving
 - a) The United States and over 100 other nations.
 - b) The United States, Canada, and Mexico.
 - c) The United States and most of Europe.
 - d) The United States and the rest of the G-7.

17. Which of the following are arguments in favor of protectionism?
 - a) National defense may be jeopardized if the U.S. imports strategic supplies.
 - b) New industries must be protected while they are allowed to develop.
 - c) Trade barriers protect U.S. jobs from being lost to the cheaper foreign labor.
 - d) All of the above.

18. Supply-siders would favor
 - a) a reduction in small business regulation
 - b) any tax cut that increases disposable income.
 - c) a reduction in marginal tax rates.
 - d) fewer resources to infrastructure spending.

19. According to the Laffer curve
 - a) if tax rates are too high, a tax cut will actually increase tax revenue.
 - b) if tax rates are too high, a tax cut will actually decrease tax revenue.
 - c) all tax cuts will lead to revenue increases.
 - d) all tax cuts will lead to revenue decreases.(hint: draw the curve!)

20. When fighting inflation both the Keynesians and Monetarists
 - a) advocate decreasing the money supply, but for different reasons.
 - b) differ over whether monetary policy would even be effective.
 - c) advocate decreasing the money supply due to its effects on investment and consumption.
 - d) believe only fiscal policy will be effective.

21. The federal budget deficit differs from the national debt in that
 - a) the deficit covers a calendar year with the debt covers a fiscal year.
 - b) the deficit is the revenue shortfall within a year, while the debt is a cumulative measure of borrowing.
 - c) the deficit is adjusted for inflation while the national debt is in nominal terms.
 - d) the deficit only results from discretionary spending while the debt is caused by all types of spending.

22. By eliminating the need for a double coincidence of wants, money functions as
 - a) a store of value.
 - b) a standard of value.
 - c) a medium of exchange.

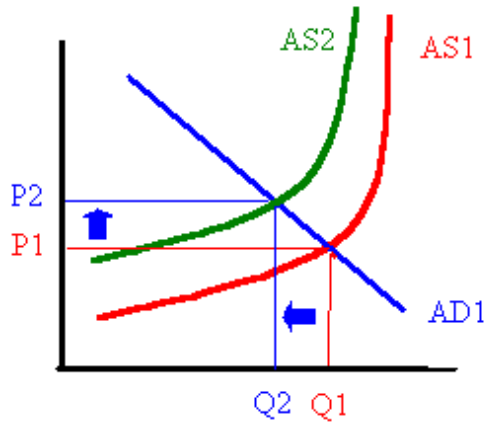
23. According to Keynesians, changing interest rates in the money market will affect aggregate demand because
 - a) changing interest rates shift the money demand curve.
 - b) of the crowding out effect of monetary policy.
 - c) interest rates change the levels of investment and consumption.
 - d) interest rates are part of the consumption function.

24. Suppose Mexico is experiencing higher inflation than the United States.
 - a) the Mexican peso will depreciate.
 - b) the dollar will depreciate.
 - c) the demand in Mexico for U.S. exports will decrease.
 - d) both b and c.

25. The current account deficit implies
 - a) a trade surplus.
 - b) a capital account surplus.
 - c) that the U.S. dollar is depreciating.
 - d) a fixed exchange rate system.

26. In a market economy, the incentive to use scarce resources more efficiently and develop substitutes comes from
- supply-side tax credits for this type of research.
 - rising prices as a good becomes increasingly scarce.
 - monetary and fiscal policy.
 - the desire to maximize the tradeoff along the Phillips curve.
27. A recession
- is a decline in output.
 - runs from the peak to the trough of a business cycle.
 - is accompanied by rising unemployment
 - is all of the above.
28. Which of the following shifts, ceteris paribus, will cause higher rates of both unemployment and inflation?
- An increase in aggregate supply.
 - A decrease in aggregate supply.
 - An increase in aggregate demand.
 - A decrease in aggregate demand.
29. According to the theory of rational expectations,
- only unanticipated policy actions will be effective.
 - the government should use fiscal and monetary policy to fine tune the economy.
 - the Fed should use discretion in conducting monetary policy.
30. Suppose the United State adult population is 215 million, the labor force is 150 million and the number unemployed is 15 million. The unemployment rate is
- 6.98%
 - 10%
 - 11.11%
 - 62.79%
31. Consider two goods, televisions and coffee, and two nations, Japan and Columbia. Japan has a comparative advantage in television production. This means that relative to Columbia, and with the same resources
- Japan is better at producing both televisions and coffee.
 - Japan can produce more coffee than Columbia.
 - Japan can produce more televisions than Columbia.
 - Japan produces televisions at a lower opportunity cost in terms of coffee.
32. Economic growth
- is measured by the percent increase in real GDP.
 - occurs in the long run when the production possibilities curve shifts outward.
 - depends on both the size and productivity of the labor force.
 - all of the above.
33. Suppose the consumption function = $1000 + .8Y$. If investment RISES by 100 then aggregate demand will shift _____ by _____.
- right; 500
 - left; 500
 - right; 800
 - left; 100
34. The components of aggregate expenditure include
- consumption, taxes, and savings.
 - consumption, investment, net exports, government expenditure.
 - consumption, investment, governments expenditures and taxes.
 - consumption, investment, disposable income

2. Consider an economy in the position below where AS shifts from AS1 to AS2, and Q1 is full employment output.

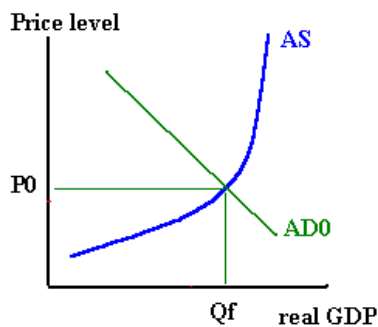


- a) Describe the condition of the economy due to the shift in AS.
- b) Suppose the government uses monetary or fiscal policy to bring output back to its original level. Show what happens on the graph above. Describe what happens to price and output.
- c) Explain why monetary policy and fiscal policy are not the best options for dealing with the problem describe in part (a)

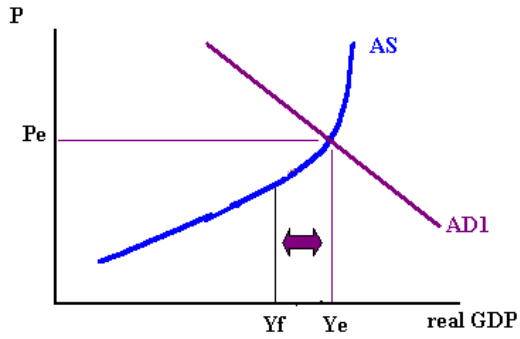
3. Use the tables below to answer the following questions. Each shows the production possibilities for each country.

United States		Mexico	
Shoes (millions of pairs)	microchips (millions)	Shoes (millions of pairs)	microchips (millions)
240	0	180	0
180	300	135	90
120	600	90	180
60	900	45	270
0	1200	0	360

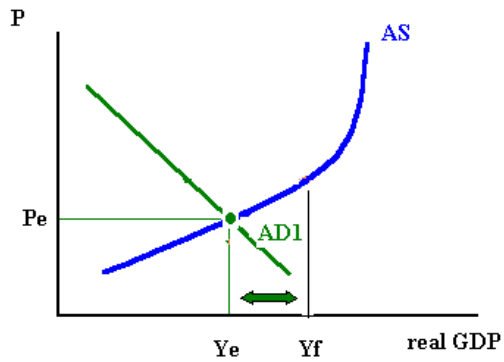
- a) What is the opportunity cost of one pair of shoes in the U.S.? In Mexico?
- b) Which country has an absolute advantage in the production of shoes? Which country has a comparative advantage in the production of shoes?
- c) Suppose the countries trade with each other. What is the range for the terms of trade that both countries will find acceptable?
4. For each case below, show how the changes on the graph provided. Explain how the state of the economy changes in the space provided, and whether or not the new equilibrium is desirable.
- a) Congress uses part of the projected budget surpluses to purchase new voting equipment for every county in the United States.



b) The FOMC votes to sell Treasury bonds on the open market.



c) Reserve requirements are abolished.



5. Consider the impact of exchange rates on the balance of trade.

a) Explain how the fall of the U.S. dollar relative to other world currencies would affect our balance of trade.

b) Briefly describe the tradeoff involved for a country in choosing between a flexible versus a fixed exchange rate system.

1. A	10. B	19. A	28. B
2. C	11. D	20. A	29. A
3. C	12. B	21. B	30. B
4. D	13. A	22. C	31. D
5. B	14. C	23. C	32. D
6. D	15. C	24. A	33. A
7. D	16. B	25. B	34. B
8. A	17. D	26. B	35. C
9. A	18. A, C	27. D	36. B

1.
 - a) $[(135-128)/128] \times 100 = 5.47\%$
 - b) 1997: $\$5/1.28 = \3.91 ; 1998: $\$6/1.35 = \4.44
 - c) Yes, the real wages has risen, indicating that your nominal raise has risen faster than inflation.
2.
 - a) The shift in the AS curve causes stagflation, with higher prices, lower output and lower unemployment
 - b) To increase output back to its original level, AD shifts right, which increases output but also prices
 - c) Monetary and fiscal policies change AD, which will increase both P and Y or decrease both P and Y. Thus a shift in AD cannot address both high unemployment and high inflation at the same time. It will help one problem but at the same time it will make the other problem worse.
3.
 - a) The U.S. must give up 60 pairs of shoes to produce 300 microchips, so the opportunity cost of 1 pair of shoes is $300/60 = 5$ microchips. Mexico must give up 45 pairs of shoes to produce 90 microchips, so the opportunity cost of 1 pair of shoes is $90/45 = 2$ microchips.
 - b) The U.S., using all of its resources for shoes can produce more than Mexico ($240 > 180$). Using all of its resources for chips, the U.S. also can produce more than Mexico ($1200 > 360$). Thus, the U.S. has an absolute advantage in both shoes and microchips. However, the opportunity cost of 1 pair of shoes is lower in Mexico than in the U.S. ($2 < 5$) so Mexico has a comparative advantage in shoes.
 - c) The terms of trade are between the domestic opportunity costs. Mexico will demand more than 2 microchips for a pair of shoes. The U.S. will not pay more than 5 microchips for a pair of shoes, so the terms of trade will range between: $2 \text{ microchips} < 1 \text{ pair of shoes} < 5 \text{ microchips}$.
4.
 - a) New voting equipment is an increase in G, so AD shifts right, and prices and output increase. The new equilibrium is above full employment so it is not desirable.
 - b) The FOMC sells Tbonds, decreasing the MS and AD, and thus prices and output. The new equilibrium is closer to full employment so it is desirable.
 - c) The decrease in reserve requirements (to zero) will increase the MS, increasing AD, prices, and output. The new equilibrium is closer to full employment so it is desirable.
5.
 - a) A falling \$ makes U.S. goods cheaper abroad, while making imports more expensive in the U.S. This increases U.S. exports and decreases U.S. imports, thus the balance of trade rises (with a smaller trade deficit).
 - b) The tradeoff is between a stable currency for trade vs. the ability to use domestic policy to focus on domestic economic goals. A flexible system allows monetary policy to be used to achieve domestic goals without concern over maintaining an exchange rate. Fixed systems must use monetary policy to keep exchanges rates at a fixed level. However in fixed systems, exchange rates are stable, which is beneficial for international trade. In a flexible system, the exchange rate rises and falls, creating more uncertainty in international trade.