**Final Exam (A), Economics II, Fall 2018, Answer Key**

Maximum score: 50 points

Instructor: Ivan Major

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| 1. | Real GDP per person in Richland is $20,000, while real GDP per person in Poorland is $10,000. However, Richland's real GDP per person is growing at 1 percent per year, and Poorland's real GDP per person is growing at 3 percent per year. After 50 years, real GDP per person in Richland minus real GDP in Poorland is:

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| A.  | positive and greater than $10,000. |

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| B.  | positive but less than $10,000. |

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| C.  | zero. |

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| **D.**  | negative. |

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| 2. | The population of Alpha totals one million people, 40 percent of whom are employed. Average output per worker in Alpha is $20,000. Real GDP per person in Alpha totals:

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| **A.**  | $8,000. |

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| B.  | $12,000. |

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| C.  | $20,000. |

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| D.  | $50,000. |

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| 3. | Human capital is:

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| A.  | the factories and machinery used by humans in the production process. |

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| **B.**  | the talents, training, and education of workers. |

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| C.  | the financial resources available to humans for investment. |

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| D.  | the factories and machinery made by workers. |

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| 4. | Alpha has $40,000 of capital per worker, while Beta has $5,000 of capital per worker. In all other respects, the two countries are the same. According to the principle of diminishing returns to capital, an additional unit of capital will increase output \_\_\_\_\_\_ in Alpha compared to Beta, holding other factors constant.

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| A.  | more |

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| **B.**  | less |

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| C.  | not at all |

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| D.  | by the same amount |

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| 5. | Where *Y* is GDP, C is consumption, *I* is investment, *G* is government spending, and there is no international trade, national saving equals:

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| A.  | *C* + *I* + *G*. |

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| **B.**  | *Y* - *C* - *G*. |

|  |  |
| --- | --- |
| C.  | *Y* + *C* + *G*. |

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| D.  | *Y* - *C* - *I*. |

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| 6. | Suppose the following information describes the economy:  Private saving equals \_\_\_\_; public saving equals \_\_\_\_\_\_; national saving equals \_\_\_\_.

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| A.  | 800; 200; 600 |

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| --- | --- |
| **B.**  | 800; 200; 1,000 |

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| --- | --- |
| C.  | 1,000; 800; 1,000 |

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| D.  | 1,500; 700; 2,700 |

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| 7. | Joe's Taco Hut can purchase a delivery truck for $20,000 and he estimates it will generate a net income (after taxes, maintenance and operating costs) of $2,000 per year. He has no other opportunities. He should:

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| A.  | purchase the truck only if the real interest rate is less than 2%. |

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| B.  | not purchase the truck if the real interest rate is greater than 2%. |

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| C.  | purchase the truck if the real interest rate is greater than 10%. |

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| **D.**  | purchase the truck if the real interest rate is less than 10%. |

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| 8. | Pat pays $10,000 for a newly issued two-year government bond with a $10,000 face value and a 6 percent coupon rate. One year later, after receiving the first coupon payment, Pat sells the bond. If the current one-year interest rate on government bonds is 5 percent, then the price Pat receives is:

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| A.  | $10,000. |

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| --- | --- |
| B.  | $500. |

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| **C.**  | greater than $10,000. |

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| D.  | less than $10,000. |

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| 9. | If bank reserves are 200, the public holds 400 in currency, and the desired reserve/deposit ratio is 0.25, the deposits are \_\_\_\_\_\_ and the money supply is \_\_\_\_\_.

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| A.  | 200; 600 |

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| B.  | 400; 800 |

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| --- | --- |
| C.  | 600; 1,000 |

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| **D.**  | 800; 1,200 |

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| 10. | According to the quantity equation, if velocity and real GDP are constant, and the Federal Reserve increases the money supply by 5 percent, then the price level:

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| A.  | decreases by 5 percent. |

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| B.  | decreases by more than 5 percent. |

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| C.  | increases by more than 5 percent. |

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| **D.**  | increases by 5 percent. |

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11. A recession occurs when either \_\_\_\_\_\_ or \_\_\_\_\_\_\_, or both.
**A.** potential output grows slowly; actual output falls below potential output
B. potential output grows slowly; actual output rises above potential output
C. potential output grows rapidly; actual output equals potential output
D. potential output grows rapidly; actual output falls below potential output

12. If the actual rate of unemployment equals the natural rate of unemployment, then:
A. potential output is greater than real GDP.
**B.** potential output equals real GDP.
C. potential output is less than real GDP.
D. there is a recessionary gap.

13. According to Okun's Law, when cyclical unemployment is positive, then the output gap:
A. is positive.
**B.** is negative.
C. equals zero.
D. equals the rate of cyclical unemployment.

14. Planned aggregate expenditure (*PAE*) equals:
**A.** *C* + *Ip* + *G* + *NX*.
B. *Cp* + *I* + *G* + *NX*.
C. *C* + *I* + *Gp* + *NX*.
D. *C* + *I* + *G* + *NXp*.

15. In the short-run Keynesian model, to close a recessionary gap of $1 billion dollars government purchases must be:
A. increased by $1 billion.
B. decreased by $1 billion.
C. increased by more than $1 billion.
**D.** increased by less than $1 billion.

16. A banking panic is an episode in which:
**A.** depositors, spurred by news or rumors of possible bankruptcy of one bank, rush to withdraw deposits from the banking system.
B. commercial banks, fearing Federal Reserve sanctions, unwillingly participate in open-market operations.
C. commercial banks, concerned about high interest rates, rush to borrow at the Federal Reserve discount rate.
D. depositors, afraid of increasing interest rates, attempt to engage in discount-window borrowing at the Federal Reserve.

17. During the Great Depression in the United States between 1929 and 1933, banks' reserve/deposit ratio \_\_\_\_\_\_ and the amount of currency held by the public \_\_\_\_, while the money supply \_\_\_\_\_\_.
A. increased; increased; increased
B. decreased; decreased; decreased
**C.** increased; increased; decreased
D. decreased; decreased; increased

18. Shifts in \_\_\_\_\_\_ can push the economy out of long-run equilibrium.
A. the *AD* curve only
B. the *AS* curve only
**C.** either the *AD* curve or the *AS* curve
D. the *PAE* line only

19. A sudden increase in household wealth is an example of a \_\_\_\_\_\_ demand shock, which would shift the *AD* curve to the \_\_\_\_\_\_.
A. negative; left
B. positive; left
C. negative; right
**D.** positive; right

20. The *AD* curve can be shifted by:
**A.** both fiscal and monetary policy.
B. neither fiscal nor monetary policy.
C. fiscal policy only.
D. monetary policy only.

21. Inflation inertia is the result of the behavior of \_\_\_\_ and the existence of \_\_\_\_\_\_.
A. the central bank; automatic stabilizers
B. real and nominal interest rates; an output gap
C. autonomous aggregate demand; the Fed's policy reaction function
**D.** inflation expectations; long-term wage and price contracts

22. When actual output equals potential output there is \_\_\_\_ output gap and the rate of inflation will tend to \_\_\_\_.
A. an expansionary; increase
B. an expansionary; decrease
**C.** no; remain the same
D. a recessionary; increase

23. When actual output is less than potential output, there is \_\_\_\_ output gap and the rate of inflation will tend to \_\_\_\_.
A. an expansionary; increase
B. an expansionary; decrease
**C.** a recessionary; decrease
D. a recessionary; increase

24. Starting from potential output, if firms become less optimistic about the future and decide to decrease their investment in new capital, then this will generate a(n) \_\_\_\_\_ gap and inflation will \_\_\_\_\_.
A. recessionary; increase
**B.** recessionary; decrease
C. expansionary; decrease
D. expansionary; increase

25. Starting from potential output, if consumer confidence decreases and consumers decide to spend less, then this will generate a(n) \_\_\_\_\_ gap and inflation will \_\_\_\_\_.
A. recessionary; increase
**B.** recessionary; decrease
C. expansionary; decrease
D. expansionary; increase

26. As the available technology improves, \_\_\_\_\_\_ shifts to the \_\_\_\_\_.
A. aggregate demand; left
B. aggregate demand; right
C. aggregate supply; left
**D.** aggregate supply; right

27. Changes in the expected rate of inflation will:
A. not shift the *AS* curve.
**B.** shift the *AS* curve upward or downward.
C. shift the *AS* curve leftward or rightward.
D. cause the *AS* curve to become downward-sloping.

28. Starting from long-run equilibrium, a positive inflation shock results in a short-run equilibrium with \_\_\_ inflation and \_\_\_\_ output.
A. higher; higher
B. higher; lower
**C.** lower; higher
D. lower; lower

29. Starting from full employment at the initial target inflation rate, if there is an adverse inflation shock, then the Federal Reserve must \_\_\_\_\_ in order to avoid a recession.
**A.** increase the target inflation rate.
B. decrease the target inflation rate.
C. maintain the initial target inflation rate.
D. shift the short-run aggregate supply curve up.

30. People's expectations of future inflation that do not change even if inflation rises temporarily are called \_\_\_\_\_ inflationary expectations.
A. aggregate
B. average
**C.** anchored
D. autonomous

31. Anchored inflationary expectations are beneficial to an economy because they:
A. reduce the inside lag of macroeconomic policymaking.
B. rapidly shift the central bank's monetary policy reaction function.
**C.** shorten recessions caused by adverse inflation shocks.
D. eliminate any changes in short-run aggregate supply.

32. Which of the following policies is likely to enhance a central bank's credibility?
**A.** announce inflation targets.
B. appoint inflation doves as central bankers.
C. make the central bank obligated to finance the national deficit.
D. appoint central bankers for short terms that coincide with those in the legislative and executive branches of government.

33. All of the following are ways to enhance central bank credibility **EXCEPT** to:
A. announce inflation targets.
B. appoint inflation hawks as central bankers.
C. put no obligation on the central bank to finance the national deficit.
**D.** make central bank actions subject to frequent review and veto by the executive and legislative branches of government.

34. If the rate of inflation equals zero then the real rate of interest:
A. equals zero.
**B.** equals the nominal rate of interest.
C. can be negative.
D. equals the target real interest rate.

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| 35. | A bilateral trade balance means: |
| A | half the trade deficit. |
| B | the measure of imports only—not exports. |
| **C** | the difference between the value of imports and exports between two trading nations. |
| D | the sum of the value of imports and exports traded between two nations. |

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| 36. | Which of the following is included in trade flows? |
| A | sales or purchases of goods by residents of different countries |
| B | sales of goods by domestic residents to foreign residents |
| C | purchases of services by domestic residents from foreigners |
| **D** | sales or purchases of goods by residents of different countries, sales of goods by domestic residents to foreign residents, and purchases of services by domestic residents from foreigners |

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| 37. | Which statement is correct? |
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| A | The bilateral trade balance is a good indicator of the inequality of imports and exports between the United States and China. |
| B | The bilateral trade balance vastly understates the gap in imports and exports between the United States and China. |
| **C** | The bilateral trade balance may overstate the gap in imports and exports between the United States and China because some of the manufacturing inputs used do not originate in China. |
| D | The bilateral trade balance shows that there is balanced trade between the United States and China. |

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| 38. | What is the best measure of a country's openness to international trade? |
| A | the ratio of its exports to its GDP |
| B | the ratio of its imports to its GDP |
| C | the ratio of its trade balance (exports minus imports) to its GDP |
| **D** | the ratio of its exports plus imports to its GDP |

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| 39. | FDI flows originate mostly in: |
| A | low-income nations. |
| B | East Asia. |
| **C** | high-income (OECD) nations. |
| D | the African continent. |

40. If monetary policy must be used to set the market equilibrium value of the exchange rate equal to the official value, it
**A.** is no longer available to stabilize the domestic economy.
B. will be unable to stabilize the market equilibrium value of the exchange rate.
C. will simultaneously stabilize the domestic economy.
D. will increase the rate of growth in the economy.

41. As the dollar exchange rate, *e,* decreases, the quantity of dollars supplied in the foreign exchange market \_\_\_\_, and the quantity of dollars demanded in the foreign exchange market \_\_\_\_.
A. increases; increases
B. increases; decreases
**C.** decreases; increases
D. decreases; decreases

42. The U.S. dollar exchange rate, *e,* where *e* is the nominal exchange rate expressed as Japanese yen per U.S. dollar, will depreciate when:
**A.** real GDP in the U.S. increases.
B. real GDP in Japan increases.
C. the U.S. Federal Reserve tightens monetary policy.
D. U.S. consumers decrease their preference for Japanese cars.

43. All else being equal, if Asian restaurants switch from serving French champagne to serving California wines, then the market equilibrium value of the exchange rate for the U.S. dollar will:
**A.** rise.
B. fall.
C. become fixed.
D. either rise or fall depending on whether the supply or demand for dollars changes more.

44. As U.S. real GDP rises, wealthier households may decide to buy \_\_\_\_\_\_ foreign goods and assets, which would cause a(n) \_\_\_\_\_\_ of the U.S. dollar.
A. more; appreciation
**B.** more; depreciation
C. fewer; appreciation
D. fewer; depreciation

45. As the U.S. dollar appreciates relative to other currencies, the dollar price of goods imported to the U.S. \_\_\_\_\_, causing net exports and GDP to \_\_\_\_\_\_.
A. rises; rise
B. rises; fall
C. falls; rise
**D.** falls; fall

46. When the Fed tightens U.S. monetary policy, domestic interest rates \_\_\_\_\_\_, making U.S. assets relatively more attractive to foreign investors, and \_\_\_\_\_\_ the equilibrium exchange rate.
**A.** rise; increasing
B. fall; increasing
C. fall; decreasing
D. rise; decreasing

47. In an open economy with flexible exchange rates, monetary policy affects consumption and investment by changing the \_\_\_\_\_\_ and affects net exports by changing the \_\_\_\_\_.
A. inflation rate; unemployment rate
B. exchange rate; real interest rate
C. growth of domestic real GDP; growth of foreign real GDP
**D.** real interest rate; exchange rate

48. Tight monetary policy will \_\_\_\_\_\_ net exports as a result of a \_\_\_\_\_\_ currency.
A. increase; stronger
B. increase; weaker
C. decrease; weaker
**D.** decrease; stronger

49. Easy monetary policy will \_\_\_\_\_\_ net exports as a result of a \_\_\_\_\_\_ currency.
A. increase; stronger
**B.** increase; weaker
C. decrease; weaker
D. decrease; stronger

50. A decrease in the real exchange rate will tend to \_\_\_\_\_\_ exports and to \_\_\_\_\_\_ imports.
**A.** increase; decrease
B. increase; increase
C. decrease; decrease
D. decrease; increase