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

Maximum score: 50 points

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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 2 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. |
| **B.**  | positive but less than $10,000. |
| C.  | zero. |
| D.  | negative. |

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2. Suppose that the share of population employed in Country B is 50 percent, and that Countries B and C have the same real GDP per capita. Based on the information in the table, what share of Country C's population must be employed?



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| A.  | 5.0 percent |
| **B.**  | 20.0 percent |
| C.  | 40.0 percent |
| D.  | 50.0 percent |

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| 3. | Gamma has $30,000 of capital per worker, while Omega has $7,500 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 Gamma compared to Omega, holding other factors constant.

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| A.  | more |
| **B.**  | less |
| C.  | not at all |
| D.  | by the same amount |

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| 4. | The Boy Scouts have so far sold 100 tickets for their upcoming raffle, but they sell a constant additional 12 tickets every day. After three more days of selling tickets, the stock of tickets sold will be \_\_\_\_, and the flow of tickets sold will be \_\_\_\_.

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| A.  | 136; 12 |
| B.  | 36; 12 |
| C.  | 100; 36 |
| **D.**  | 136; 36 |

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| 5. | If household saving decreases by $4 million, business saving increases by $4 million, and the government budget deficit decreases by $4 million, then private saving \_\_\_\_\_\_ and public saving \_\_\_\_\_\_.

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| A.  | increases; increases |
| B.  | increases; decreases |
| **C.**  | does not change; increases |
| D.  | does not change; decreases |

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| 6. | 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 $4,000 per year. His other option is to go to work for someone else earning net income of $3,000 per year. He should:

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| A.  | purchase the truck if the real interest rate is less than 15%. |
| B.  | not purchase the truck if the real interest rate is greater than 1%. |
| C.  | purchase the truck if the real interest rate is greater than 5%. |
| **D.**  | purchase the truck if the real interest rate is less than 5%. |

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| 7. | Decentralized market-based financial systems improve the allocation of saving by:

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| A.  | insuring capital gains exceed dividend payments. |
| B.  | eliminating the need for commercial banks or other financial intermediaries. |
| C.  | matching net capital inflows to net capital outflows. |
| **D.**  | providing information and risk-sharing services. |

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| 8. | You originally required a risk premium of 6 percent in addition to the rate of return on safe assets before you would purchase shares of Techno Company stock. If you and other investors reduce the risk premium you require to 4 percent, the price of Techno Company stock will:

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| **A.**  | increase. |
| B.  | decrease. |
| C.  | equal the old risk premium plus the new risk premium. |
| D.  | equal the new risk premium plus the rate of return on safe assets. |

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| 9. | Based on the following information, the value of the M1 measure of the money supply is \_\_\_\_\_\_ and the value of the M2 measure of the money supply is \_\_\_\_\_\_.

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| A.  | $530 billion; $3,700 billion |
| B.  | $330 billion; $4,230 billion |
| C.  | $520 billion; $4,320 billion |
| **D.**  | $530 billion; $4,230 billion |

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| 10. | If real GDP equals 5,000, nominal GDP equals 10,000, and the price level equals 2, then what is velocity if the money stock equals 2,000?

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| A.  | 2 |
| B.  | 2.5 |
| C.  | 10 |
| **D.**  | 5 |

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11. Workers in durable-goods industries are \_\_\_\_\_\_ workers in service industries to lose their jobs during a recession.

A. much less likely than
**B.** more likely than
C. less likely than
D. equally likely as

12. An expansion occurs when either \_\_\_\_\_\_ or \_\_\_\_\_\_\_, or both.

**A.** potential output grows rapidly; actual output rises above 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

13. If potential output equals $8 billion and actual output equals $9 billion, then this economy has a(n):
A. budget deficit.
B. trade deficit.
**C.** expansionary gap.
D. recessionary gap.

14. The cyclical unemployment rate is zero when:

A. there is not a recessionary gap.
B. there is not an expansionary gap.
**C.** actual GDP and potential GDP are equal.
D. frictional unemployment equals structural unemployment.

15. If real GDP is greater than potential GDP, then:

A. the actual unemployment rate is greater than the natural unemployment rate.
B. the actual unemployment rate equals zero.
C. the output gap is negative.
**D.** the actual unemployment rate is lower than the natural unemployment rate.

16. Planned investment may differ from actual investment because of:

A. changes in government purchases and net exports.
B. the marginal propensity to consume.
**C.** unplanned changes in inventories.
D. fluctuations in preset prices.

17. The consumption function is relationship between consumption and:

A. planned aggregate expenditure.
B. total spending.
C. investment.
**D.** its determinants, such as disposable income.

18. When real output decreases, planned aggregate expenditures decrease because:

A. autonomous expenditures increase.
B. autonomous expenditures decrease.
C. induced expenditures increase.
**D.** induced expenditures decrease.

19. Data on output and planned aggregate expenditure in Macroland are given below.

 

Based on these data, the short-run equilibrium level of output is \_\_\_\_\_.
A. 2,000
B. 3,200
C. 4,100
**D.** 5,000

20. In the Keynesian model, a $5 billion decrease in autonomous planned investment leads to \_\_\_\_\_\_ in short-run equilibrium output.

A. a $5 billion increase
**B.** a greater than $5 billion decrease
C. no change
D. a $5 billion decrease

21. The central bank of the United States is:

A. Bank of America.
B. Bank of the United States.
C. Bank One.
**D.** the Federal Reserve System.

22. The two main responsibilities of the Federal Reserve System are to \_\_\_\_\_\_ and to \_\_\_\_\_\_.
A. apprehend counterfeiters; regulate the stock market
B. enable banks to make affordable mortgages; control the exchange rate of the U.S. dollar
C. insure bank deposits; print currency
**D.** conduct monetary policy; oversee financial markets

23. Bank depositors will not lose their deposits in a banking panic if:

A. there is fractional reserve banking.
**B.** there is 100% reserve banking.
C. there is a central bank.
D. the actual reserve/deposit ratio equal to the desired reserve/deposit ratio.

24. The interest rate that commercial banks charge each other for very short-term loans is called the:

A. prime rate.
**B.** federal funds rate.
C. Federal Reserve discount rate.
D. commercial paper rate.

25. Shifts in \_\_\_\_\_\_ can return the economy to 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.

1. Firms suddenly becoming pessimistic about future business prospects 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.

27. Firms that face menu costs react to a sustained increase in demand by:

**A.** increasing output and then raising the price at which they are willing to sell their output.
B. charging higher prices, without necessarily increasing the amount of output they are willing to sell.
C. charging lower prices, while simultaneously increasing the amount of output they are willing to sell.
D. increasing output and then reducing the price at which they are willing to sell their output.

1. A low rate of expected inflation tends to lead to a \_\_\_ rate of actual inflation and a high rate of expected inflation tends to lead to a \_\_\_\_ rate of actual inflation.

A. high; high
B. high; low
C. low; low
**D.** low; high

1. When actual output exceeds 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

1. Starting from potential output, if firms become more optimistic about the future and decide to increase 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.

1. Starting from potential output, if consumer confidence increases and consumers decide to spend more, then this will generate a(n) \_\_\_\_\_ gap and inflation will \_\_\_\_\_.

A. recessionary; increase
B. recessionary; decrease
C. expansionary; decrease
**D.** expansionary; increase

1. A sudden change in the normal behavior of inflation, unrelated to the nation's output gap is called:

A. short-run equilibrium.
B. long-run equilibrium.
**C.** an inflation shock.
D. inflation inertia.

1. When actual output exceeds potential output, there is \_\_\_\_\_\_ output gap and the inflation rate will \_\_\_\_.

**A.** an expansionary; exceed the expected rate of inflation
B. an expansionary; be lower than the expected rate of inflation
C. no; be equal to the expected rate of inflation
D. a recessionary; exceed the expected rate of inflation.

1. 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 keep inflation from becoming permanently higher.

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.

1. Following an adverse inflation shock the economy will return to its potential output level more rapidly if:

**A.** inflationary expectations are anchored.
B. inflationary expectations change quickly in response to the shock.
C. the Fed has frequently accommodated higher inflation in the past.
D. the Fed has frequently raised its target inflation rate in the past.

1. The greater the credibility of monetary policy the \_\_\_\_ likely inflationary expectations are to be anchored and the \_\_\_\_\_ the recessions caused by adverse inflation shocks.

**A.** more; shorter
B. more; longer
C. less; shorter
D. less; longer

1. An argument against a central bank policy of announcing numerical inflation targets is that inflation targeting policies:

A. enhance central bank credibility.
B. anchor inflationary expectations.
**C.** emphasize inflation at the expense of output stabilization.
D. increase uncertainty.

1. If the rate of inflation equals zero then the nominal rate of interest:

A. equals zero.
**B.** equals the real rate of interest.
C. can be negative.
D. equals the target real interest rate.

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| 1. An example of “value added” as an important concept for international trade was the case of imports of Barbie dolls from China. The value added by China is equal to:
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| A. the total value of imported raw and semi-finished materials into China plus the value of the export to the United States. |
| **B.** the total value of the export to the United States minus the total value of imported raw and semi-finished materials into China. |
| C. the total value of the export plus shipping costs. |
| D. the difference between the total value of exports to the United States minus total value of imports from the United States. |

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| 40. Which of the following statements explain(s) why Asian countries trade?(1) They have low wages; (2) In some Asian countries the workers are very productive; (3) They have an abundant supply of raw materials. |
| 1. (1) only
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| **B.** (1) and (2) only |
| 1. (2) only
 |
| 1. (3) only
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| 1. The U.S. trade-to-GDP ratio is:
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| A. | the highest in the industrialized world. |
| B. | greater than China's and Japan's. |
| **C.** | smaller than that of Germany. |
| D. | too high. |

1. If a country pegs its currency to a foreign currency, it no longer has the ability to use monetary policy to stabilize the economy because:

A. it no longer has a central bank.
**B.** monetary policy must be used to keep the exchange rate's market equilibrium value at its official value.
C. banks will begin to hold 100% of their deposits in reserves.
D. it must eliminate its currency from circulation and replace it with the foreign currency.

1. Because many European nations have adopted the euro as their common currency, they are \_\_\_\_\_\_ able to conduct independent \_\_\_\_\_\_ policy.

**A.** no longer; monetary
B. no longer; fiscal
C. increasingly; monetary
D. increasingly; fiscal

1. As the dollar exchange rate, *e,* increases, 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

1. The U.S. dollar exchange rate, *e,* where *e* is the nominal exchange rate expressed as Japanese yen per U.S. dollar, will appreciate when:

A. real GDP in the U.S. increases.
**B.** real GDP in Japan increases.
C. the U.S. Federal Reserve eases monetary policy.
D. U.S. consumers increase their preference for Japanese cars.

1. There is \_\_\_\_\_\_ connection between the strength of a country's currency and the strength of its \_\_\_\_\_\_.

**A.** no simple; economy
B. a direct; economy
C. an inverse; central bank independence
D. a solid; real wage growth

1. Someone who wants both the U.S. dollar to be \_\_\_\_\_\_ compared to other currencies and the value of U.S. net exports to be \_\_\_\_\_\_ wants two things that may be contradictory.

A. floating; large
B. weak; small
C. strong; small
**D.** strong; large

1. Easy monetary policy reduces the real interest rate, which \_\_\_\_\_\_ the demand for dollars, \_\_\_\_\_\_ the supply of dollars, and \_\_\_\_\_\_ the equilibrium value of the dollar.

A. increases; increases; increases
B. decreases; decreases; decreases
C. increases; decreases; increases
**D.** decreases; increases; decreases

1. In an open economy with flexible exchange rates, monetary policy affects \_\_\_\_\_\_ through changes in the real interest rate and affects \_\_\_\_\_\_ through changes in the exchange rate.

A. taxes and saving; net exports
B. net exports; taxes and saving
C. productivity and growth; consumption
**D.** consumption and investment; net exports

1. An increase in the real exchange rate will tend to \_\_\_\_\_\_ exports and to \_\_\_\_\_\_ imports.

A. increase; decrease
B. increase; increase
C. decrease; decrease
**D.** decrease; increase