

Part II

Test-Item File

CHAPTER 1

Economic Growth, Fluctuation, and Policy

1. The dollar value, adjusted for changes in the price level, of all goods and services produced by an economy in one year is called
- a) the gross domestic product.
 - b) the rate of inflation.
 - c) the real level of consumption.
 - d) the real gross domestic product.
 - e) the real rate of interest.

Answer: d Difficulty: 1 Topic: Macroeconomic Performance
Pages: 6-7

The following is a Generator question in the computerized version of this test-item file.

2. Let nominal GDP change from \$10,000 billion to \$11,000 billion over the course of one year. If prices have increased uniformly by 5 percent over the same year, real GDP
- a) has remained unchanged.
 - b) has increased by 5 percent.
 - c) has increased by 15 percent.
 - d) has increased by 10 percent.
 - e) has decreased by 10 percent.

Answer: b Difficulty: 1 Topic: Macroeconomic Performance
Pages: 6-7, 16

3. Let a price index increase from 136.2 to 140.3 to 144.5 over the course of two successive years. Average annual inflation over the period is then
- a) 5 percent.
 - b) 2 percent.
 - c) 3 percent.
 - d) 4.2 percent.
 - e) 8.3 percent.

Answer: c Difficulty: 1 Topic: Inflation Pages: 10-11, 16

4. Consider an asset costing \$55 and returning, by contract, \$11 per year. If the interest rate prevailing throughout the economy were 10%, you would expect to see
- a) the interest rate returned by the asset to climb to 30%.
 - b) the price of the asset to climb to \$100.
 - c) the price of the asset to climb to \$110.
 - d) the price of the asset to fall to \$45.
 - e) the price of the asset to fall to \$27.50.

Answer: c Difficulty: 2 Topic: Interest Rates Pages: 11-12

5. Roughly defined, the unemployment rate is
- a) the percentage of people looking for work who have not yet found work.
 - b) the percentage of the population that is not employed.
 - c) the percentage of the adult population that cannot find a job either at home or in business.
 - d) the percentage of the population that is, for one reason or another, unemployable at any job.
 - e) all of the above.

Answer: a Difficulty: 1 Topic: Unemployment Page: 9

6. The rate of inflation is
- a) the absolute change in a price level index from one year to the next.
 - b) the percentage change in a price level index from one year to the next.
 - c) the difference between GDP and the real level of GDP.
 - d) always equal to the rate of interest charged by banks to borrow money.
 - e) b and c.

Answer: b Difficulty: 1 Topic: Inflation Page: 10

7. The usual pattern of a business cycle is
- a) peak, trough, recovery, recession.
 - b) peak, recovery, trough, recession.
 - c) recession, peak, recovery, trough.
 - d) recession, trough, recovery, peak.
 - e) no pattern.

Answer: d Difficulty: 1 Topic: Fluctuations Pages: 6-7

8. Potential GDP is a measure of
- a) all the goods and services produced by an economy from its inception to the present.
 - b) the value of the goods and services that could be produced if the economy operated with all of its people employed.
 - c) the value of the goods and services that could be produced if the economy operated at the full capacity of its capital stock with its entire labor force fully employed.
 - d) the rate at which an economy's GDP could grow if its rate of investment is maximized.
 - e) the lowest level to which interest rates could fall and still maintain full employment.

Answer: c Difficulty: 1 Topic: Macroeconomic Performance Page: 19

9. Which of the following is not discussed by the text as a possible source of business cycle fluctuations?
- a) Private sector disturbances
 - b) Changes in monetary policy
 - c) Changes in fiscal policy
 - d) Energy supply disturbances
 - e) None of the above

Answer: e Difficulty: 1 Topic: Fluctuations Pages: 17-18

10. The term *rational expectations* is most accurately associated with the notion that
- a) economic policy is ineffective and should not be used in a discretionary way.
 - b) it is always possible to reduce inflation without recession by simply letting aggregate demand fall as it will do automatically.
 - c) tax adjustments have no effect, but changes in the money supply can stimulate growth in an economy.
 - d) people always use as much information as possible in forming and acting on their expectations of the future.
 - e) all of the above.

Answer: d Difficulty: 1 Topic: Currents Page: 20

11. Since 1966 in the United States, there have been
- a) six recessions, of which the one beginning in 1979 was the most severe.
 - b) five recessions of note with unemployment climbing above 9 percent.
 - c) six recessions, each of which was worse than the recession of the early 1920s.
 - d) six recessions, but only one that produced unemployment rates above 7 percent.
 - e) six recessions, of which the one beginning in 1981 was the most severe.

Answer: e Difficulty: 1 Topic: Fluctuations Page: 7

12. The recession experienced in the United States in the early 1980s was
- a) mild compared with the experience of the mid-1970s.
 - b) the worst economic downturn suffered since the Great Depression.
 - c) the fifth economic downturn since 1966.
 - d) only the fourth economic downturn suffered since the Second World War.
 - e) quite severe, but unemployment never climbed above 10 percent.

Answer: b Difficulty: 1 Topic: Macroeconomic Performance
Pages: 7-8

13. Six separate recessions marked the two decades from 1966 through 2002,
- a) but the long-term trend of real GDP in the United States was nonetheless upward.
 - b) and the result was a 20-year period during which real GDP did not climb at all in the United States.
 - c) and their effects were so serious that real GDP in the United States was actually lower in 1985 than it was in 1966.
 - d) and they caused the total number of people employed in the United States to be smaller in 1985 than it was in 1966.
 - e) none of the above.

Answer: a Difficulty: 1 Topic: Macroeconomic Performance Page: 7

14. Interest rates in the United States have
- a) held remarkably steady over the past two decades.
 - b) shown some variability over the past two decades but less in the early 1980s than the mid-1960s.
 - c) shown significant variability over the past two decades, with no discernible correlation with movement in GDP.
 - d) tended to peak just when the economy is turning out of a recession and into a period of prolonged recovery.
 - e) none of the above.

Answer: e Difficulty: 1 Topic: Interest Rates Pages: 11-13

15. The real money supply
- a) tends to grow over time because growing economies need increasingly large quantities of money to support their activity.
 - b) grows only in response to deliberate contractions in the money supply that lower the price level at a more rapid pace.
 - c) moves up or down only when the price level changes.
 - d) is impossible to measure because of the confusion caused by international transactions in the currencies of other countries.
 - e) is the primary policy tool of the Keynesian economist.

Answer: a Difficulty: 1 Topic: Money Supply Page: 13

16. When an economy turns into a recession so that GDP declines for a period of time, experience tells us to expect
- a) a rapid increase in the rate of unemployment and a rapid decline in the rate of inflation.
 - b) a potentially rapid decline in the rate of unemployment and an increase in the rate of inflation.
 - c) an increase in the rate of unemployment and a gradual increase in the rate of interest.
 - d) an increase in the rate of unemployment and gradual reductions in both the rate of inflation and the rate of interest.
 - e) an increase in the rate of unemployment and movement in interest rates and prices in either direction.

Answer: d Difficulty: 2 Topic: Fluctuations Pages: 9-13

17. The unemployment rate in the United States was highest in
- a) 1992.
 - b) 1982.
 - c) 1975.
 - d) 1979.
 - e) 1991.

Answer: b Difficulty: 1 Topic: Unemployment Page: 11

18. The rate of inflation in the United States was highest in
- a) 1992.
 - b) 1979.
 - c) 1982.
 - d) 1980.
 - e) 1975.

Answer: d Difficulty: 1 Topic: Inflation Page: 12

19. An aggregate supply schedule drawn to be consistent with no trade-off between inflation and unemployment would
- a) be horizontal at some price level determined by aggregate demand.
 - b) be horizontal at some price level determined by interest rates and government policy.
 - c) be vertical above an arbitrary level of GDP.
 - d) be vertical above a level of GDP determined by the capital stock, availability of labor, and technology embodied in production across the economy.
 - e) slope upward to some degree to reflect the influences of financial factors on demand.

Answer: d Difficulty: 2 Topic: Practical Macroeconomics
Pages: 19-21

20. With the presence of a short-run trade-off between inflation and unemployment, changes in international conditions that caused domestic aggregate demand to increase at every price level,
- a) prices and GDP would climb.
 - b) prices would climb and GDP would fall.
 - c) prices would climb but GDP would remain below its potential.
 - d) prices would fall and GDP would remain at its potential.
 - e) prices would climb to maintain GDP at its potential.

Answer: e Difficulty: 2 Topic: Practical Macroeconomics
Pages: 19-21

21. A reduction in aggregate demand with no trade-off between inflation and unemployment would
- a) cause wages and prices to fall so that the aggregate quantity demanded would support full employment.
 - b) cause wages to climb and prices to fall so that the aggregate quantity demanded would support full employment.
 - c) cause wages and prices to climb and portend a coming recession.
 - d) cause wages, prices, and GDP to decline in the long run.
 - e) none of the above.

Answer: a Difficulty: 2 Topic: Practical Macroeconomics
Pages: 19-21

22. A model that envisions no short-run trade-off between inflation and unemployment can explain recession only in terms of
- a) increases in aggregate demand.
 - b) decreases in aggregate demand.
 - c) an increase in the number of people looking for work without a corresponding increase in the number of jobs.
 - d) sudden surges in investment that cause the capital stock to increase too quickly.
 - e) none of the above.

Answer: e Difficulty: 2 Topic: Practical Macroeconomics

Pages: 19-21

23. To explain the Great Depression, a model with perfectly flexible wages and prices would have to assume that
- a) the people counted as unemployed during the period did not want to work, so that their potential contribution would not be part of potential GDP.
 - b) none of the capacity idled by the downturn was productive, so that its potential contribution would not be part of potential GDP.
 - c) some sort of disturbance caused potential GDP to fall dramatically over a period of one or two years.
 - d) all of the above.
 - e) none of the above.

Answer: d Difficulty: 3 Topic: Macroeconomic Performance

Pages: 19-21

24. In a model with short-run trade-offs between inflation and unemployment, real GDP is determined in the short run by
- a) the intersection of a vertical potential GDP schedule and the current price level.
 - b) the intersection of a horizontal potential GDP schedule with the current price level.
 - c) the intersection of a downward-sloping aggregate demand curve and the current price level.
 - d) the intersection of a downward-sloping aggregate demand curve and a vertical potential GDP schedule.
 - e) none of the above.

Answer: c Difficulty: 2 Topic: Practical Macroeconomics

Pages: 19-21

25. Long-run economic growth depends on the growth of all of the following except
- a) capital.
 - b) technology.
 - c) the labor force.
 - d) productivity growth.
 - e) none of the above.

Answer: e Difficulty: 1 Topic: Practical Macroeconomics
Pages: 19-21

26. A country's long-run growth rate is important for policy makers to understand and work to improve because of its contribution to a country's
- a) comparative advantage.
 - b) absolute advantage.
 - c) standard of living.
 - d) ability to conduct monetary policy.
 - e) none of the above.

Answer: c Difficulty: 1 Topic: Practical Macroeconomics
Pages: 19-21

27. The notion that expectations can significantly influence macroeconomic activity
- a) is an innovation of the rational expectations theorists.
 - b) is true, but only in the context of random, uncontrollable effects.
 - c) was introduced as a systematic influence that could be exploited by policy as early as the 1930s by Keynes.
 - d) is inconsistent with the core of practical macroeconomics.
 - e) none of the above.

Answer: a Difficulty: 2 Topic: Practical Macroeconomics
Pages: 19-21

28. An argument that links an increase in federal taxes with lower aggregate demand and therefore a contraction of GDP to a level below its potential
- a) is consistent with the conclusions that would be drawn from a model with inflation and unemployment trade-offs.
 - b) is consistent with the conclusions that would be drawn from a model without inflation and unemployment trade-offs.
 - c) is inconsistent with a model that incorporates rational expectations.
 - d) can be believed only if expressed in terms of long-run and not short-term effects.
 - e) none of the above.

Answer: b Difficulty: 2 Topic: Practical Macroeconomics

Pages: 19-21

29. An argument that links the inflation of the early 1970s with excessive government spending on the Vietnam War and thus on excessive aggregate demand
- a) is consistent with the conclusions that could be drawn from a model with inflation and unemployment trade-offs.
 - b) is not consistent with the conclusions that could be drawn from a model with trade-offs between inflation and unemployment and with GDP initially well below its potential.
 - c) is consistent with the general foundations of a rational-expectations model.
 - d) is consistent with the views that firms and consumers make the most of information available to them.
 - e) all of the above.

Answer: e Difficulty: 2 Topic: Practical Macroeconomics

Pages: 19-21

30. Recessions and booms are short-term disturbances that are self-correcting, since
- a) prices tend to rise less rapidly when output exceeds potential.
 - b) prices tend to rise more rapidly when output falls below potential.
 - c) prices tend to rise more rapidly when output exceeds potential.
 - d) prices tend to rise less rapidly when output falls below potential.
 - e) c and d.

Answer: e Difficulty: 2 Topic: Fluctuations Pages: 13-15

31. Which of the following are generally thought by macroeconomists to contribute to growth over the long run?
- a) Growing population
 - b) Rising employment
 - c) Increases in plant, equipment, and other capital
 - d) Improved technology
 - e) b, c, and d only

Answer: e Difficulty: 1 Topic: Growth Pages: 13-17

32. Total output produced by a nation must somehow be divided among competing sectors of the economy, that is, consumption, investment, government, and the foreign sector. The long-run growth model attributes the central role for this dividing process to
- a) wholesale and retail prices.
 - b) government officials.
 - c) interest rates.
 - d) households.
 - e) firms.

Answer: c Difficulty: 1 Topic: Growth Page: 17

33. Which of the following forces are potential sources for causing actual GDP to fluctuate above or below its potential?
- a) Spending on consumer durables
 - b) Capital stock replacement
 - c) Federal Reserve policy
 - d) Congressional budget policies
 - e) All of the above

Answer: e Difficulty: 1 Topic: Fluctuations Page: 17

The following is a Generator question in the computerized version of this test-item file.

34. Suppose that the price level for some economy were 100 in 2000, 110 in 2001, and 119 in 2002. The rate of inflation between 2000 and 2001 would be
- a) 19.0 percent.
 - b) 9.9 percent.
 - c) 10.0 percent.
 - d) 9.1 percent.
 - e) none of the above.

Answer: c Difficulty: 1 Topic: Inflation Page: 16

35. Suppose that the nominal GDP of an economy were \$10,000 in 2000 and \$10,500 in 2001. If the price index were 100 in 2000 and 105 in 2001, then real GDP
- a) would rise by 5 percent from 2000 to 2001.
 - b) would fall by 5 percent from 2000 to 2001.
 - c) would hold constant from 2000 to 2001.
 - d) would rise but by less than 1 percent, from 2000 to 2001.
 - e) cannot be determined from the information provided.

Answer: c Difficulty: 2 Topic: Macroeconomic Performance Page: 7

36. Let $Y = 11,000 - 10P$ represent an aggregate demand curve. If potential GDP were \$10,000, the price level that would produce aggregate demand just supporting that potential would be
- a) 110.
 - b) 100.
 - c) 90.
 - d) 105.
 - e) 75.

Answer: b Difficulty: 2 Topic: Macroeconomic Performance
Pages: 13-19

37. Suppose that aggregate demand were to change, over the course of a year during which potential GDP was frozen at \$10,000, from $Y = 11,000 - 10P$ to $Y = 11,100 - 10P$. The rate of inflation that would occur in the flexible price long-run growth model is
- a) 10 percent.
 - b) 15 percent.
 - c) 5 percent.
 - d) 0 percent.
 - e) 5 percent.

Answer: a Difficulty: 3 Topic: Macroeconomic Performance
Pages: 13-19

38. Suppose that potential GDP were to climb by 1 percent from an initial level of \$10,000 during a year in which aggregate demand changed from $Y = 11,000 - 10P$ to $Y = 11,100 - 10P$. The rate of inflation in the flexible price long-run growth model is
- a) 10 percent.
 - b) 5 percent.
 - c) 0 percent.
 - d) -5 percent.
 - e) 15 percent.

Answer: c Difficulty: 3 Topic: Macroeconomic Performance
Pages: 13-19

39. The Taylor rule accurately described Federal Reserve behavior since the mid-1980s by focusing on which of the following economic variables?
- a) Interest rate targets
 - b) Inflation targets
 - c) GDP gaps
 - d) a and b
 - e) b and c

Answer: e Difficulty: 1 Topic: Practical Macroeconomics Page: 21

40. If inflation were running at 15 percent and insurance companies were stuck with old policies that promised to lend money against cash value at 5 percent, then the real interest rate that these companies would receive on those loans is
- a) 20 percent.
 - b) 10 percent.
 - c) -10 percent.
 - d) -15 percent.
 - e) -20 percent.

Answer: c Difficulty: 2 Topic: Inflation Pages: 11-12

41. Let the aggregate demand schedule be given by $AD = 8,400 + 2,000/P$ and the potential GDP be equal to 10,000. The price level required to sustain equilibrium at potential GDP is then
- a) 1.00.
 - b) 1.10.
 - c) 1.25.
 - d) 1.50.
 - e) 1.65.

Answer: c Difficulty: 2 Topic: Macroeconomic Performance
Pages: 15-19

42. The Taylor principle emphasizes the importance of the relationship between which of the following economic variables?
- a) Real interest rates
 - b) Inflation rates
 - c) Nominal interest rates
 - d) a and b
 - e) b and c

Answer: d Difficulty: 1 Topic: Practical Macroeconomics Page: 21

43. Let aggregate demand in an economy with a potential GDP of 10,000 be represented initially by $AD = 8,400 + 2,000/P$. Suppose that over the course of one year, potential GDP rose to 10,500 and aggregate demand shifted to $AD = 9,000 + 2,000/P$. You should expect to have witnessed, over the course of that year,
- no price inflation.
 - price inflation of 6.67 percent.
 - price disinflation of 6.67 percent.
 - price inflation of 1.67 percent.
 - price disinflation of 1.67 percent.

Answer: b Difficulty: 2 Topic: Macroeconomic Performance
Pages: 15-19

The following is a Generator question in the computerized version of this test-item file.

44. Let the price level of a given economy increase from 100 to 107.2 over the course of one year. If the nominal rate of interest were 7.2 percent over that period, then the real rate of interest would have been
- 0 percent.
 - 5 percent.
 - 7.2 percent.
 - 12.2 percent.
 - 2.2 percent.

Answer: a Difficulty: 1 Topic: Inflation Pages: 11-12

45. Given a model of long-run growth, which of the following could be advanced as an explanation of an increase in GDP?
- A reduction in the capital stock
 - An improvement in technology
 - An increase in some input prices
 - A reduction in the supply of labor
 - All of the above

Answer: b Difficulty: 1 Topic: Growth Page: 16

46. Given the existence of short-run trade-offs between inflation and unemployment, short-run GDP can be expected to increase if
- a) aggregate demand falls.
 - b) aggregate demand rises.
 - c) potential GDP increases because the labor supply has increased.
 - d) potential GDP increases because of some technological improvement.
 - e) potential GDP increases because of an increase in the capital stock.

Answer: b Difficulty: 3 Topic: Practical Macroeconomics
Pages: 19-21

47. Suppose you observe an increase in both GDP and prices. If you hold to the long-run perspective of no trade-offs between inflation and unemployment, you can explain your observation
- a) entirely in terms of a downward shift in aggregate demand.
 - b) entirely in terms of an upward shift in aggregate demand.
 - c) entirely in terms of a reduction in potential GDP.
 - d) entirely in terms of an increase in potential GDP.
 - e) only in terms of changes in both aggregate demand and potential GDP.

Answer: e Difficulty: 2 Topic: Practical Macroeconomics
Pages: 19-21

48. Suppose you were to observe an increase in real GDP with no change in the price level. If you held the long-run perspective of no trade-offs between inflation and unemployment, you could explain your observation only in terms of
- a) a simultaneous reduction in aggregate demand and potential GDP.
 - b) an increase in aggregate demand alone.
 - c) an increase in potential GDP with no change in aggregate demand.
 - d) a simultaneous increase in aggregate demand and potential GDP.
 - e) an increase in aggregate demand accompanied by a reduction in potential GDP.

Answer: d Difficulty: 2 Topic: Practical Macroeconomics
Pages: 19-21

49. Suppose that you were to observe GDP climbing even while prices were falling. If you were to take a long-term perspective, you could explain your observation in terms of
- a) an increase in aggregate demand accompanied by a reduction in potential GDP.
 - b) a reduction in aggregate demand accompanied by a reduction in potential GDP.
 - c) an increase in aggregate demand alone.
 - d) an increase in potential GDP alone.
 - e) any of these depending on economic circumstance.

Answer: d Difficulty: 2 Topic: Currents and Review Pages: 14-19

50. An important distinction between microeconomics and macroeconomics is that
- a) only microeconomics is concerned with the behavior of firms.
 - b) only microeconomics is concerned with consumer behavior.
 - c) macroeconomics is not concerned with the organization of the labor markets and industry.
 - d) macroeconomics tries to explain the determination of variables that microeconomists take as given.
 - e) all of the above.

Answer: d Difficulty: 32 Topic: Macroeconomics Pages: 4-6

51. The long-run growth model
- a) analyzes the adjustment process the economy experiences after shocks.
 - b) is based on sticky prices.
 - c) analyzes the economy after complete adjustment has occurred in response to any disturbance.
 - d) clearly demonstrates the usefulness of fiscal and monetary policy in fighting recessions.
 - e) none of the above.

Answer: c Difficulty: 2 Topic: Growth Pages: 16-18

52. In the long-run growth model, a decline in defense spending would
- a) lead to an increase in real GDP in the short run.
 - b) lead to a fall in real GDP in the short run, unless it were offset by increased government spending.
 - c) have no significant impact on real GDP in the short run.
 - d) lead to a fall in real GDP whether it were offset by increased government spending or not.
 - e) none of the above.

Answer: c Difficulty: 2 Topic: Growth Pages: 15-18

53. In the complete model, the economy moves back to potential GDP via
- a) gradual adjustment of the price level to restore spending to the level consistent with full employment.
 - b) gradual shifts of the aggregate demand schedule due to increased investment spending that results from changes in the price level.
 - c) gradual shifts of the aggregate demand schedule due to increased net export spending that results from changes in the price level.
 - d) gradual movements in potential GDP that eventually bring it in line with the actual level of real GDP.
 - e) none of the above.

Answer: a Difficulty: 2 Topic: Fluctuations Pages: 15-18

54. An important difference between the complete model and the long-run growth model is that
- a) the growth model assumes real GDP equals potential GDP in the long run.
 - b) the complete model allows departures of GDP from potential GDP in the long run.
 - c) the complete model allows departures of real GDP from potential GDP in the short run.
 - d) the growth model allows GDP to change due to changes in potential GDP in the long run.
 - e) all of the above.

Answer: c Difficulty: 3 Topic: Fluctuations Pages: 15-19

55. In the 32 years from 1970 through 2000, the U.S. economy experienced how many recessions?
- a) 8.
 - b) 11.
 - c) 5.
 - d) 2.
 - e) 6.

Answer: e Difficulty: 1 Topic: Macroeconomic Performance
Pages: 6-12

CHAPTER 2

Measuring Economic Performance

1. The gross domestic product of an economy is
 - a) the total value of the spending on final goods and services produced domestically by households, businesses, government, and foreigners.
 - b) the total value of production across all sectors of the economy.
 - c) the total wage and profit income earned by the different groups of people that produce output within the economy.
 - d) all of the above.
 - e) none of the above.

2. The equivalence of measuring GDP by spending, production, and income is guaranteed by
 - a) mathematical proof based on the character of a capitalist society.
 - b) mathematical identity based on accounting procedures.
 - c) deductive reasoning but only under the conditions of some fairly severe restrictive assumptions.
 - d) the accurate computation of the present value of current investment.
 - e) none of the above.

Answer: d Difficulty: 1 Topic: GDP Pages: 27-28

Answer: b Difficulty: 1 Topic: GDP, NIPA Page: 28

3. Which of the following is not added to consumption to compute gross domestic product?
- a) Fixed investment
 - b) Inventory investment
 - c) Government purchases
 - d) Total exports
 - e) Total imports

Answer: e Difficulty: 1 Topic: GDP, Spending Pages: 29-32

4. Which of the following is not included in the computation of the consumption component of gross domestic product?
- a) Durable goods like cars and stereos
 - b) Household spending
 - c) Nondurable goods like milk and gasoline
 - d) Services like medical care and education
 - e) none of the above; all are included in the computation of consumption

Answer: b Difficulty: 1 Topic: GDP, Spending Page: 29

5. Inventories are included in the computation of gross domestic product as part of
- a) nonresidential fixed investment.
 - b) residential fixed investment.
 - c) depreciation allowances.
 - d) the total capital stock.
 - e) none of the above.

Answer: e Difficulty: 1 Topic: GDP, Spending Pages: 30-31

6. Which of the following phrases accurately defines depreciation in any one year?
- a) Capital stock at the end of the year minus capital stock at the beginning of the year
 - b) Capital stock at the beginning of the year minus gross investment for the year
 - c) Gross investment minus net investment
 - d) Capital stock at the beginning of the year minus capital stock at the end of the year plus gross investment
 - e) None of the above

Answer: c Difficulty: 1 Topic: GDP Page: 30

7. Which of the following is not a flow measure?

- a) Consumption
- b) Gross investment
- c) Net investment
- d) Exports
- e) None of the above

Answer: e Difficulty: 1 Topic: GDP Page: 27

8. Which of the following rules does not help economists avoid double counting in their computation of gross domestic product?

- a) Include only goods and services produced in the time period under study.
- b) Do not include intermediate goods in the computation of total production.
- c) Attribute to each industry only the difference between the value of its product and the value of its inputs.
- d) Exclude the value of any good or service exported to another country from which we purchase goods and services.
- e) Do not include transfer payments in the computation of total income.

Answer: d Difficulty: 1 Topic: GDP, Spending Pages: 36-37

9. Which of the following does not account for some of the differences between national income and gross domestic product?

- a) Foreign-earned income by U.S. residents
- b) Income taxes
- c) U.S.-earned income by foreign residents
- d) Depreciation
- e) Business transfers and subsidies

Answer: b Difficulty: 1 Topic: GDP, Income Page: 38

10. Starting with national income, which of the following procedures is included in the process that produces a value for disposable personal income?

- a) subtracting excise and sales taxes
- b) subtracting nonbusiness interest
- c) subtracting transfer payments from government
- d) subtracting income taxes
- e) adding contributions for social insurance that will eventually be repaid

Answer: d Difficulty: 2 Topic: GDP, Income Page: 37

11. When private and government saving in an economy exceed investment, then the government must
- a) print money.
 - b) accumulate financial assets through lending.
 - c) accumulate financial assets through borrowing.
 - d) lower taxes.
 - e) none of the above.

Answer: b Difficulty: 1 Topic: Government Page: 41

12. Government saving is
- a) the negative of the government deficit.
 - b) always equal to private investment.
 - c) the reciprocal of foreign saving.
 - d) the difference between tax revenue generated by the federal income tax and government spending.
 - e) the difference between GDP and the sum of consumption and inventory investment.

Answer: a Difficulty: 1 Topic: Government Page: 40

13. A current account deficit
- a) is never possible because the balance of payments must always balance.
 - b) can seldom be larger than 50 percent of a capital account surplus.
 - c) can help finance a government deficit indefinitely.
 - d) can help finance a government deficit if foreign lenders accumulate government bonds.
 - e) does not include investment earnings that are part of the capital account.

Answer: d Difficulty: 1 Topic: Government Page: 43

14. The capital account includes as a credit
- a) a domestic government bond purchased by a foreigner.
 - b) the value of any good or service purchased from a foreigner.
 - c) the total of all investment earnings accruing from U.S. holdings abroad.
 - d) official transfers of reserves between central banks.
 - e) none of the above.

Answer: a Difficulty: 1 Topic: Balance of Payments Pages: 45-47

15. The gross domestic product of the United States in 2001 was
- a) \$9,921.7 billion.
 - b) \$10,266.5 billion.
 - c) \$10,445.6 billion.
 - d) \$9,846.8 billion.
 - e) more than \$11 trillion.

Answer: c Difficulty: 1 Topic: GDP Page: 33

16. Final sales in the United States in 2002
- a) exceeded GDP because fixed investment was negative.
 - b) fell short of GDP because depreciation was so high.
 - c) fell short of GDP because fixed investment was large.
 - d) fell short of GDP because inventories increased over the course of the year.
 - e) exceeded GDP because inventory investment was negative.

Answer: d Difficulty: 1 Topic: GDP, Spending Page: 33

17. The value of final sales tends to be less volatile than GDP because
- a) it excludes residential investment.
 - b) it excludes inventory investment.
 - c) it excludes nonresidential investment.
 - d) it includes allowances for credit purchases of large consumer durables.
 - e) all of the above.

Answer: b Difficulty: 1 Topic: GDP, Spending Page: 31

18. Labor's share of GDP in the United States in 2001 was
- a) approximately three-quarters, but that was unusually low.
 - b) approximately three-quarters, and that was fairly typical.
 - c) approximately 60 percent, but that was unusually low.
 - d) approximately 60 percent, but that was unusually high.
 - e) only about 40 percent, and that is evidence of capitalist exploitation of labor.

Answer: b Difficulty: 1 Topic: GDP, Income Page: 40

19. In the United States, consumption expenditure, as a fraction of GDP, usually runs about
- a) 50 percent.
 - b) 55 percent.
 - c) 66 percent.
 - d) 70 percent.
 - e) 75 percent.

Answer: c Difficulty: 1 Topic: GDP, Spending Page: 33

20. Ranked in their relative importance in the consumption component of GDP in the United States, one finds
- a) durables, nondurables, and services.
 - b) services, durables, and nondurables.
 - c) nondurables, services, and durables.
 - d) nondurables, durables, and services.
 - e) services, nondurables, and durables.

Answer: e Difficulty: 1 Topic: GDP, Spending Page: 33

21. Which of the following describes events of the early 1980s in the United States?
- a) Real GDP fell from 1981 to 1982 but rose again in 1983 and 1984 to exceed the 1981 level.
 - b) Inventory investment declined in 1982; this caused real GDP to fall more than final sales.
 - c) Consumption of durables fell sharply in 1982, but services increased at an even faster rate.
 - d) All types of investment fell sharply in the 1982 recession.
 - e) All of the statements accurately describe events of the early 1980s.

Answer: e Difficulty: 2 Topic: GDP, Behavior Pages: 43-44

22. The sector with the largest real value added in the United States in the late 1990s was
- a) government.
 - b) manufacturing.
 - c) services.
 - d) wholesale and retail trade.
 - e) finance, insurance, and real estate.

Answer: e Difficulty: 1 Topic: GDP, Value-added Page: 37

23. Capital inflow from abroad into the United States since the late 1980s
- a) covered almost all of the annual deficits of all levels of government.
 - b) covered almost all of the total accumulated debt of the government and thereby made us a creditor nation once again.
 - c) diminished as the current account swelled, so that most of the government deficit must be covered by private saving.
 - d) influenced interest rates in a way that has curbed domestic, private saving.
 - e) none of the above.

Answer: a Difficulty: 2 Topic: Balance of Payments Page: 46

24. Suppose a company made \$40,000 in toys from \$1,000 in steel, \$5,000 in energy and other material, and \$10,000 in plastic. Let its wage bill be \$10,000, its rent \$5,000, and its profit \$9,000. Its value added would be
- a) zero.
 - b) \$9,000.
 - c) \$14,000.
 - d) \$24,000.
 - e) \$16,000.

Answer: d Difficulty: 2 Topic: GDP, Value Added Page: 36

25. If nominal GDP rose in one year from \$2,000 billion to \$2,400 billion at the same time that a price index rose from 200 to 220, then real GDP would
- a) have risen by approximately 20 percent.
 - b) have fallen by approximately 10 percent.
 - c) have risen by approximately 10 percent.
 - d) have fallen by approximately 20 percent.
 - e) not be determinable from the information provided.

Answer: c Difficulty: 1 Topic: Deflators Page: 34

26. Given the data provided in Figure 1 for the year 2002 in chained 2000 dollars, what was the level of real consumption?
- a) \$4,315.2
 - b) \$7,430.2
 - c) \$7,301.9
 - d) \$2,986.7
 - e) None of the above

Answer: c Difficulty: 2 Topic: GDP, Spending Page: 29

27. Given the data provided in Figure 1 for the year 2002 expressed in chained 2000 dollars, what was the level of fixed investment in billions of chained 2000 dollars?
- a) \$1,117.5
 - b) \$3.6
 - c) \$471.8
 - d) \$1,593
 - e) None of the above

Answer: e Difficulty: 2 Topic: GDP, Spending Page: 29

28. Compute the real GDP for 2002 in billions of 2000 dollars from the data provided in Figure 1.
- a) \$10,445.6
 - b) \$10,023.1
 - c) \$10,266.5
 - d) \$9,844.0
 - e) None of the above

Answer: a Difficulty: 2 Topic: GDP, Spending Page: 29

29. The new chain-weighted GDP figures were generated primarily to
- a) demonstrate the need for better national income accounting procedures.
 - b) correct the weight assigned to GDP components whose prices have fallen.
 - c) correct the weight assigned to GDP components whose prices have risen.
 - d) demonstrate the economy had actually grown less than it was given credit for.
 - e) demonstrate the economy had actually grown more than it was given credit for.

Answer: b Difficulty: 2 Topic: GDP Page: 35

30. The effects of the new chain-weighted GDP figures include all of the following except
- a) reduce the growth in total real investment.
 - b) increase the growth in total real investment.
 - c) correct the weights assigned to GDP components whose prices have risen.
 - d) show that the economy grew more during the 1980s than previously thought.
 - e) show that the economy grew less during the 1990s than previously thought.

Answer: b Difficulty: 2 Topic: GDP Page: 35

31. Compute the level of final sales of domestic product in billions of 2000 dollars for the year 2002 based on the data provided in Figure 1.
- a) \$10,445.6
 - b) \$10,023.1
 - c) \$10,266.5
 - d) \$9,844.0
 - e) None of the above

Answer: c Difficulty: 2 Topic: GDP, Spending Page: 29

32. Real government spending in 2002 amounted to 19.08 percent of real GDP expressed in 2000 dollars. Nominal government spending as a fraction of nominal GDP for 2002 must therefore have been
- a) Exactly 19.08 percent.
 - b) Something less than 19.08 percent.
 - c) Something greater than 19.08 percent.
 - d) Not possible to determine from the information provided.
 - e) None of the above.

Answer: a Difficulty: 2 Topic: GDP, Spending Page: 34

33. Suppose contributions for social insurance amounted to almost \$306 billion, corporate retained earnings equaled \$207 billion, nonbusiness interest swelled to \$150 billion, transfer payments reached almost \$417 billion, and income taxes raised just over \$435 billion. Given this information, which of the following statements is an accurate ranking of national income (NI), personal income (PI), and disposable personal income (DI)?
- a) $NI > PI > DI$.
 - b) $PI > NI > DI$.
 - c) $PI > DI > NI$.
 - d) $NI > DI > PI$.
 - e) Cannot tell from the information provided.

Answer: b Difficulty: 3 Topic: GDP, Income Page: 40

34. Given the information provided in Figure 2, private saving must equal
- a) \$5.
 - b) \$15.
 - c) \$10.
 - d) \$0.
 - e) none of the above.

Answer: a Difficulty: 2 Topic: GDP, Income Page: 42

35. Given the information provided in Figure 2, government saving must be
- a) -\$5.
 - b) \$5.
 - c) -\$15.
 - d) -\$10.
 - e) none of the above.

Answer: c Difficulty: 2 Topic: GDP, Income Page: 42

36. Given the information provided in Figure 2, total saving would equal what value if GDP rose to \$90 while government spending climbed to \$30?
- a) \$10
 - b) \$20
 - c) \$30
 - d) \$40
 - e) None of the above

Answer: d Difficulty: 2 Topic: GDP, Income Pages: 42-43

37. When economists speak of investment, they are speaking of
- a) the part of GDP used by households for current use.
 - b) the part of GDP, past and present, that has been set aside to add to productive capacity.
 - c) the part of GDP captured in the computation of the dollar value of goods but not services.
 - d) the part of GDP that the government devotes to the construction of roads, airports, and the like.
 - e) the part of current GDP used by business to add to productive capacity and by households to add to their stock of new houses.

Answer: e Difficulty: 1 Topic: GDP, Spending Pages: 29-31

38. Which of the following would *not* be included as part of investment?
- a) A new house just constructed for a family moving from their old house down the street and around the corner
 - b) A quantity of money used to purchase some IBM stock from a broker in anticipation that IBM will expand its capacity for producing personal computers
 - c) The purchase by United Technologies Corporation of a set of IBM computers for its executives
 - d) The construction of a new plant by IBM in Kingston, New York
 - e) None of the above

Answer: b Difficulty: 1 Topic: GDP, Spending Pages: 29-31

39. Let the current account deficit increase by \$200 billion. Which of the following adjustments would maintain a suitable macroeconomic equilibrium?
- a) Private saving increasing by \$100 billion and the federal deficit increasing by \$100 billion
 - b) Private saving increasing by \$100 billion and the federal deficit falling by \$100 billion
 - c) Private saving falling by \$100 billion and the federal deficit increasing by \$100 billion
 - d) Private saving falling by \$100 billion and the federal deficit falling by \$100 billion
 - e) The federal deficit increasing by \$200 billion with no change in private saving

Answer: d Difficulty: 2 Topic: Balance of Payments Pages: 45-46

40. Let imports exceed exports by \$100 billion. Compared with a situation of balanced trade at the same level of GDP, domestic income is
- lower than it would have been otherwise by the full \$100 billion.
 - higher than it would have been otherwise by the full \$100 billion.
 - lower than it would have been otherwise by an amount reflecting debt service on the foreign borrowing required to finance the \$100 billion trade deficit.
 - higher than it would have been otherwise by an amount reflecting the interest earnings accruing to domestic importers in exchange for opening new markets.
 - the same as it would have been otherwise.

Answer: c Difficulty: 3 Topic: GDP, Spending Page: 32

41. If domestic GDP is to remain constant, any \$1 increase in imports must be accompanied by
- a \$1 increase in exports.
 - a \$1 increase in government spending.
 - a \$1 increase in investment.
 - any of the above.
 - none of the above.

Answer: e Difficulty: 2 Topic: GDP, Spending Page: 32

42. To maintain equilibrium, any \$1,000 increase in investment could be accompanied by
- an equal increase in private saving.
 - an equal reduction in public saving.
 - an equal increase in government spending.
 - an equal increase in exports.
 - an equal reduction in imports.

Answer: e Difficulty: 2 Topic: GDP, Spending Pages: 41-42

43. In equilibrium, where $Y = \text{GDP}$, $C = \text{consumption}$, $G = \text{government spending}$, $E = \text{exports}$, and $M = \text{imports}$, $Y - C - G - (E - M)$ must equal
- private saving.
 - public saving.
 - the sum of private and public saving.
 - the sum of private and foreign saving.
 - the sum of public, private, and foreign saving.

Answer: e Difficulty: 2 Topic: GDP, Spending Page: 43

44. If you knew the level of the government budget deficit, the international trade deficit, and the level of domestic investment, what other piece of information would be required for you to be able to compute private saving?
- a) The level of private consumption
 - b) The total amount of taxes paid
 - c) The level of government spending
 - d) The level of public investment
 - e) None of the above, because you would already have enough information

Answer: e Difficulty: 2 Topic: GDP, Spending Page: 43

45. The large federal deficits of the 1980s and early 2000s were financed, in large measure, by
- a) large increases in private saving.
 - b) large increases in the trade deficit.
 - c) large reductions in foreign saving.
 - d) large increases in investment that spurred growth.
 - e) large increases in private, domestic consumption financed by credit cards.

Answer: b Difficulty: 2 Topic: Balance of Payment Pages: 45-46

46. In an economy where GDP equals 100, consumption equals 67, investment equals 14, and government purchases equal 21,
- a) exports must exceed imports by 2.
 - b) taxes must exceed government purchases by 2.
 - c) imports must exceed exports by 2.
 - d) net exports must equal 2.
 - e) none of the above.

Answer: c Difficulty: 1 Topic: GDP, Spending Page: 29

47. When real GDP growth exceeds nominal GDP growth,
- a) inflation is increasing.
 - b) inflation is decreasing.
 - c) unemployment is decreasing.
 - d) the price level is decreasing.
 - e) none of the above.

Answer: d Difficulty: 2 Topic: Inflation Pages: 34, 36

48. The main reason government outlays exceed government purchases is
- a) federal income taxes.
 - b) federal budget deficits.
 - c) transfer payments.
 - d) defense spending.
 - e) all of the above.

Answer: c Difficulty: 1 Topic: GDP, Income Page: 31

49. Simon Kuznets won the Nobel Prize in part for his contribution to
- a) the national income and product accounts system.
 - b) the theory of business fixed investment.
 - c) the theory of residential fixed investment.
 - d) the government budget identity.
 - e) b and c.

Answer: a Difficulty: 1 Topic: GDP Page: 28

50. All else equal, an increase in inventories will
- a) decrease GDP because the goods are not sold.
 - b) not affect GDP since income is not affected.
 - c) increase GDP by increasing investment.
 - d) not affect GDP because the goods are not sold.
 - e) b and d.

Answer: c Difficulty: 1 Topic: GDP, Spending Page: 31

51. If investment, net exports, and government saving sum to 100, then the level of private saving
- a) must equal 100.
 - b) must equal -100.
 - c) equals -100 only if government saving equals zero.
 - d) cannot be determined without further information.
 - e) none of the above.

Answer: d Difficulty: 2 Topic: GDP, Spending Page: 43

52. A ratio of the price of a representative basket of goods and services in some year relative to an arbitrary base year is
- a) the rate of unemployment.
 - b) the rate of inflation.
 - c) a price index.
 - d) an index of real wages.
 - e) a measure of the rate of growth of labor productivity.

Answer: c Difficulty: 1 Topic: Inflation Pages: 49-50

53. The weights used in computing the consumer price index are
- a) based on the expenditure of a selected, typical family on all goods and services in any given month.
 - b) based on the results of a survey of expenditure patterns of many businesses in the base year.
 - c) based on the responses of a surveyed group of families to changes in the prices of goods and services on a month-to-month basis.
 - d) based on the results of surveys of expenditure patterns of many families taken every 10 years or so.
 - e) none of the above.

Answer: d Difficulty: 1 Topic: Inflation Pages: 49-50

54. Suppose that the computation of a price index were to give energy consumption a 20 percent weight over the decade from 1973 through 1982. Suppose further that conservation during that time actually reduced the share of expenditure on energy while the relative price of energy rose. It could be concluded, in this case, that
- a) changes in the index would be an accurate measure of the rate of inflation affecting household budgets.
 - b) changes in the index would overestimate the rate of inflation affecting household budgets.
 - c) changes in the index would underestimate the rate of inflation affecting household budgets.
 - d) the index would not change at all.
 - e) none of the above can be determined from the information provided.

Answer: b Difficulty: 2 Topic: Inflation Pages: 49-50

55. If the consumer price index were 301 in 1983 and 311 in 1984 based on an index of 100 for 1967, then it could be concluded that
- a) inflation and prices were both high relative to 1967 inflation of about 4 percent and 1967 prices, respectively.
 - b) inflation was high, relative to a comfortable rate of 4 percent, but prices were not especially high when the 15-year span from 1967 to 1983 is considered.
 - c) inflation was low, relative to a comfortable rate of 4 percent, but prices were actually 311 percent higher than just 16 years before.
 - d) inflation was low, relative to a comfortable rate of 4 percent, but prices were actually 211 percent higher than they were in 1967.
 - e) none of the above.

Answer: d Difficulty: 2 Topic: Inflation Pages: 49-50

56. The consumer price index is frequently used
- a) to form the basis for cost-of-living increases in social security payments.
 - b) to form the basis of measurements of labor productivity.
 - c) to form the basis for cost-of-living clauses in labor contracts.
 - d) to form the basis of measures of international trade imbalances.
 - e) a and c.

Answer: e Difficulty: 1 Topic: Inflation Pages: 49-50

57. The producer price index
- a) is frequently cited as a source of information for future consumer price inflation.
 - b) is a measure of prices charged by producers at various stages of production.
 - c) is an excellent source of information about prices of crude raw materials and intermediate goods that are not explicitly included in the CPI.
 - d) is diminished in importance somewhat by the ambiguity of weights to be used in making the required definitional computation.
 - e) all of the above.

Answer: e Difficulty: 1 Topic: Inflation Pages: 49-50

58. If import prices were to decline during a period in which domestic prices were increasing, then we would expect that
- a) the GDP deflator is probably higher than the consumption and investment deflators.
 - b) the GDP deflator is almost certainly negative.
 - c) the government deflator is probably lower than the GDP deflator.
 - d) the index of export prices climbed markedly.
 - e) none of the above.

Answer: a Difficulty: 1 Topic: Inflation Page: 48

59. To be counted as employed in the Current Population Survey, an adult must have worked
- a) at least 15 minutes during the survey week.
 - b) at least 60 minutes during the survey week.
 - c) at least 5 hours during the survey week.
 - d) at least 40 hours during the survey month.
 - e) at least 30 hours during one of the previous four weeks.

Answer: b Difficulty: 1 Topic: Employment Pages: 51-52

60. The labor force is composed of all people 16 years or older who are
- a) either employed in the sense of the Current Population Survey or unemployed and looking for a job.
 - b) either fully employed for at least 35 hours a week or unemployed with work experience sometime in the past 52 weeks.
 - c) either employed in the sense of the Current Population Survey or unemployed with a record of being counted as employed in the survey sense sometime in the previous six months.
 - d) either fully employed, employed part time for more than 10 hours a week, or unemployed and looking for a job.
 - e) none of the above.

Answer: a Difficulty: 1 Topic: Employment Pages: 51-52

61. Which of the following would be counted as unemployed?
- a) A laid-off steel worker who has given up looking for a job
 - b) A housewife on vacation with her family
 - c) A housewife who does volunteer work at the local library
 - d) A housewife who works five hours a week for minimum wage at the local library
 - e) A retired schoolteacher who is seeking a part-time job at the local library

Answer: e Difficulty: 1 Topic: Employment Pages: 51-52

62. Which of the following people would be counted as employed by the Current Population Survey?
- a) A housewife who works 14 hours a day taking care of her young family
 - b) A housewife who fits 5 hours of volunteer work at the library into her schedule
 - c) A housewife who works 5 hours every Monday at the local convenience store for the minimum wage
 - d) A student in college who pays for part of her tuition by working for a faculty member for financial aid “tuition credit”
 - e) *None* of the above

Answer: c Difficulty: 1 Topic: Employment Pages: 51-52

63. The number of hours worked by American labor has
- a) an upward trend over time, but has fluctuated with the business cycle.
 - b) no apparent trend over time because of the ravages of the business cycle.
 - c) trended upward over the last two decades despite a marked decline from 1975 through 1979.
 - d) declined over the past 15 years because of the four recessions suffered by the American economy.
 - e) none of the above.

Answer: a Difficulty: 1 Topic: Employment Page: 52

CHAPTER 3

**Employment, Job Creation, and
Job Destruction**

1. The amount of unemployment in an economy can
 - a) change rapidly over time in response to changing demands on firms.
 - b) determine the natural rate of unemployment.
 - c) limit the amount of labor available as an input to production.
 - d) explain the cause and duration of recessions.
 - e) not be determined due to measurement problems.

Answer: a Difficulty: 2 Topic: Unemployment Page: 61

2. The Current Population Survey counts you as unemployed if you
 - a) are over 16 years old.
 - b) are looking for work.
 - c) did not work at all during the past week.
 - d) b and c.
 - e) a, b, and c.

Answer: e Difficulty: 1 Topic: Unemployment Page: 62

3. The Current Population Survey will not count you as unemployed if you
 - a) have been laid off from your job.
 - b) lose your job due to a cyclical downturn in the economy.
 - c) lose your job due to corporate downsizing.
 - d) have quit looking for a job due to weak labor market conditions.
 - e) have neither the right qualifications nor experience for the available jobs.

Answer: d Difficulty: 2 Topic: Unemployment Page: 62