

## Sample Questions (Final Exam)

**WARNING: This pool of questions over-represents the parts of the material that have not been tested so far or have been underrepresented in previous exams. It is intended to be used in conjunction with sample questions posted for midterm 1 and 2.**

**The actual final exam will be more balanced, and will have a lot of questions on Classical model, for example.**

*Identify the choice that best completes the statement or answers the question.*

1. Which of the following is a reason why the Consumer Price Index (CPI) is not calculated as a simple average of all prices?
  - a. Some goods experience large price changes and the CPI would be too variable if computed by a simple average.
  - b. Goods differ in their importance in the average consumer's budget.
  - c. Some goods never experience price changes and the CPI would not be variable enough if computed as a simple average.
  - d. It would be difficult to compute a price index using a simple average of all prices.
  - e. Actually, the CPI *is* a simple average of all prices.
2. Which of the following is *not* true about the Consumer Price Index (CPI)?
  - a. The U.S. income tax system is indexed based on the CPI.
  - b. The majority of labor union contracts have wages indexed by the CPI.
  - c. The CPI can be used to transform nominal variables into real variables.
  - d. The CPI can be used to measure the inflation rate.
  - e. Social security benefits are indexed by the CPI.
3. Assume that Ernesto earned a nominal wage rate of \$15 per hour in 2001, the base year for the CPI. If the CPI in 2002 was 102.6 and his nominal wage rate was \$16 per hour, what was his real wage rate in 2002?
  - a. \$14.62
  - b. \$15.00
  - c. \$15.59
  - d. \$16.00
  - e. His real wage for 2002 cannot be determined with the information given.
4. If the Consumer Price Index (CPI) increases from 100 to 200 and the nominal wage increases from \$100 to \$400, what is the change in the real wage in terms of the beginning year's dollars?
  - a. +\$200
  - b. +\$400
  - c. +\$100
  - d. +\$300
  - e. -\$200
5. The real interest rate on a loan
  - a. is the amount that the consumer agrees to pay
  - b. is always the same as the nominal rate
  - c. cannot be calculated
  - d. is only of concern when inflation occurs
  - e. is the percentage increase in the lender's purchasing power that results from making the loan

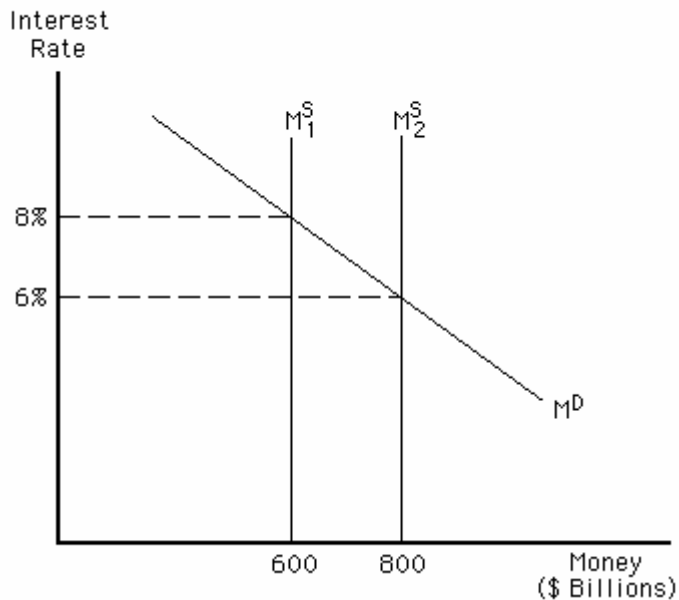
6. If inflation is perfectly anticipated, benefits are indexed, and there are no restrictions on contracts, which group loses purchasing power because of inflation?
- borrowers, lenders and retirees
  - only borrowers
  - neither lenders, borrowers, nor retirees
  - only lenders
  - only retirees
7. Suppose the nominal interest rate charged is 5 percent and the expected inflation rate is 2 percent. Which of the following is the expected real interest rate?
- 2 percent
  - 5 percent
  - 7 percent
  - 3 percent
  - 3 percent
8. If you lend money at a nominal interest rate of 9 percent and the inflation rate is 1 percent, what real interest rate will you earn?
- 3 percent
  - 4 percent
  - 8 percent
  - 12 percent
  - 15 percent
9. When the inflation rate ends up being lower than expected,
- everyone benefits because money is cheaper
  - everyone benefits because prices do not increase
  - lenders of fixed-rate mortgages generally benefit because they will make higher profits than they had calculated
  - borrowers with fixed-rate loans will benefit because their purchasing power will not decline as much
  - no one benefits because everyone made financial calculations based on the projected interest rate
10. Inflation will general redistribute purchasing power when
- it is fully expected
  - it is completely unexpected
  - it is greater than 3 percent
  - it is greater than 5 percent
  - it is greater than 10 percent
11. How is the typical market basket determined for the Consumer Price Index (CPI)?
- by the President
  - by the U.S. Congress
  - by a survey of the spending patterns of thousands of businesses
  - by a survey of the spending patterns of thousands of government agencies
  - by a survey of the spending patterns of thousands of households
12. If the CPI was 101.7 in 2001 and 101.5 in 2002, it can be concluded that
- 2001 was the base year
  - all goods were more expensive in 2002 than in 2001
  - all goods were less expensive in 2002 than in 2001
  - all goods were less expensive in 2001 than in 2002
  - the price level fell from 2001 to 2002

13. The classical model does a poor job of explaining the \_\_\_\_\_ because it assumes that the \_\_\_\_\_ always clears.
- long run; labor market.
  - long run; financial market.
  - short run; labor market.
  - short run; financial market.
14. If the government passed a law designating sea shells as money, sea shells
- would not be legal tender
  - would not function as money because they would be unable to serve as a unit of account
  - would not function as money because they would be unable to serve as a means of payment
  - would not function as money because they would be unable to serve as a store of wealth
  - would function as money as long as they were accepted in exchange for goods and services
15. *Fiat money* is
- money with intrinsic value like gold coins.
  - anything that serves as a means of payment by government declaration.
  - any currency made of paper.
  - a tangible asset like a house.
  - money that is backed by gold.
16. The standard definition of *money* is
- currency + checking account balances + saving account balances
  - currency + checking account balances + travelers' checks
  - currency + checking account balances + credit cards
  - currency + credit cards + certificates of deposit
  - currency only
17. Credit cards
- are considered money because they are a means of payment
  - are not considered money and thus are not of importance to the monetary authority
  - are not considered money but are important because they may affect how much people hold in M1 and M2
  - are counted in the money supply as part of M3
  - are considered money when held by the public
18. Macro National Bank, a commercial bank, holds \$1 million in vault cash, \$15 million in government and corporate bonds, \$40 million in demand deposits, \$10 million on deposit with a Federal Reserve bank, and \$8 million worth of property. What are Macro National Bank's total liabilities?
- \$40 million
  - \$48 million
  - \$50 million
  - \$51 million
  - \$65 million
19. If the Federal Reserve sets a required reserve ratio of 0.2 and a bank has \$100 million in loans and \$80 million in deposits, what is the level of required reserves for the bank?
- \$100 million
  - \$16 million
  - \$80 million
  - \$20 million
  - \$36 million
20. The Fed typically increases the money supply by

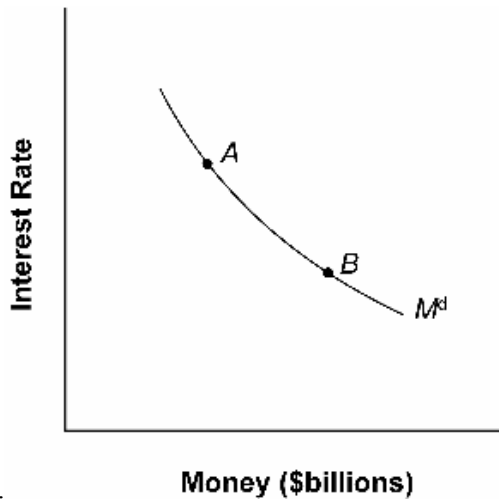
- a. selling government bonds
  - b. buying government loans
  - c. selling government loans
  - d. printing more currency
  - e. buying government bonds
21. Commercial banks can increase the money supply by
- a. accepting demand deposits
  - b. loaning out required reserves
  - c. loaning out excess reserves
  - d. selling bonds to the public
  - e. buying bonds from the Fed
22. If the required reserve ratio is 0.25 and the First National Bank holds \$10 million in demand deposits and \$5 million in reserves, how much more in demand deposits is this bank capable of creating?
- a. \$0
  - b. \$0.625 million
  - c. \$1.875 million
  - d. \$2.5 million
  - e. \$10 million
23. To determine the total change in deposits as a result of an injection of reserves, we must
- a. sum the number of loans a bank has made
  - b. multiply the injection of reserves by 10
  - c. multiply the number of loans by the expenditure multiplier
  - d. sum the reserves of each bank
  - e. multiply the injection of reserves by the demand deposit multiplier
24. Which of the following is *not* a tool for controlling the money supply?
- a. buying government bonds
  - b. selling government bonds
  - c. changing tax rates
  - d. changing the required reserve ratio
  - e. changing the discount rate
25. One problem with using discount rate changes to influence deposit creation or destruction is that
- a. small changes in the rate do not have much impact
  - b. the discount rate changes are covert
  - c. banks like to borrow from the Fed, and they will borrow even more after the changes
  - d. the Fed must change the discount rate each time they meet
  - e. banks do not have enough control over their demand deposits
26. The opportunity cost of holding money is
- a. the dollar cost necessary to change other assets into money
  - b. the time cost of accessing funds
  - c. the value of the goods and services a person is able to obtain with the money
  - d. the interest a person could have earned by holding other forms of wealth instead
  - e. zero, because opportunity costs only apply to real assets, goods and services
27. If there is an increase in the interest rate,
- a. there will be a rightward movement along a fixed money demand curve
  - b. there will be a leftward movement along a fixed money demand curve
  - c. the demand for money curve will shift rightward
  - d. the demand for money curve will shift leftward
  - e. there will be no movement of the demand for money curve and no movement along it

28. If the price of bonds rises,
- the Fed will decrease the money supply
  - the Fed will increase the money supply
  - the interest rate will rise
  - the interest rate will fall
  - inflation must be accelerating
29. If Pat pays \$500 for a one-year bond that carries an interest rate of 10 percent per year, how much will she be repaid at the end of the year?
- \$1,000
  - \$510
  - \$620
  - \$550
  - \$500
30. If Johanna purchases a bond for \$4,500 that promises to pay her \$5,000 one year later, what is the interest rate on the bond?
- 5.3 percent
  - 9.0 percent
  - 10.0 percent
  - 11.1 percent
  - The interest rate cannot be determined with the information given.
31. If the Fed wishes to increase the interest rate, it can do so by
- selling bonds
  - buying bonds
  - increasing the money supply
  - setting a higher prime lending rate
  - encouraging the public to buy bonds
32. A rise in the interest rate tends to
- reduce many kinds of spending
  - stimulate investment in high-profit industries
  - cause bond prices to increase
  - encourage confidence in the Fed's control over the economy
  - suggest a downturn in the economy is coming within 6 months

**Figure 12 - 6**



33. Refer to **Figure 12-6**. Suppose the Fed increases the money supply (to  $M_2^S$ ). As a result, the interest rate falls initially to 6 percent. After spending and GDP change, what will happen to the interest rate?
- It will remain at 6 percent.
  - It will rise as the money supply curve shifts back toward  $M_1^S$ .
  - It will rise as the money demand curve shifts to the right.
  - It will fall as the money supply curve shifts farther to the right.
  - It will fall as the money demand curve shifts to the left.
34. If the Fed wishes to maintain its interest rate target in the face of increased money demand it would likely
- increase the money supply.
  - decrease the money supply.
  - more stringently enforce already existing banking regulations.
  - propose new banking regulations.
  - become more lax when it enforces already existing banking regulations.
35. How does the interest rate determine the opportunity cost of holding money?
- the higher the interest rate, the more attractive money is to hold as an asset.
  - the higher the interest rate, the more attractive bonds are to hold as an asset.
  - the higher the interest rate, the more attractive stocks are to hold as an asset.
  - the higher the interest rate, the more interest foregone when holding assets as money.



36. Consider the figure above. Which of the following would cause a movement from point A to point B on the diagram?
- an increase in the price level.
  - a decrease in the interest rate.
  - an increase in the interest rate.
  - an increase in real income.
37. If the interest rate is below its equilibrium value, the price of
- bonds will fall.
  - money will fall.
  - bonds will rise.
  - stocks will fall.
38. If the equilibrium interest rate is 4% but the current interest rate is 6%,
- bond prices will rise.
  - money demand will decrease.
  - money demand will increase.
  - bond prices will fall.
39. The money market reaches equilibrium when
- money demand equals money supply.
  - bond prices reach zero.
  - the quantity of money demanded equals the quantity of money supplied.
  - interest rates reach zero.
40. Which of the following will decrease if the Fed sells bonds?
- autonomous consumption.
  - business investment.
  - real GDP.
  - none of the above.
41. If the interest rate \_\_\_\_\_, the cost of business investment \_\_\_\_\_.
- increases; increases.
  - increases; decreases.
  - decreases; increases.
  - decreases; remains constant.
42. As there is a movement upward and leftward along the AD curve,
- aggregate expenditure decreases
  - the price level remains constant

- c. equilibrium GDP increases
  - d. aggregate expenditure increases
  - e. the interest rate falls
43. A movement along the AD curve down and to the right is caused by
- a. a rightward shift of the money demand curve
  - b. falling consumer confidence
  - c. a decreasing price level
  - d. expansionary open market transactions by the Fed
  - e. a stable price level and increases in consumption, investment, or government spending
44. An increase in the price level
- a. increases investment spending, thereby shifting the AD curve to the left
  - b. does not shift the AD curve
  - c. causes the government's budget deficit to fall
  - d. increases investment spending, thereby shifting the AD curve to the right
  - e. shifts the AS curve outward
45. If the Fed conducts an open market purchase of bonds, which of the following will happen?
- a. The interest rate will decrease, the aggregate expenditure line will shift upward, and the aggregate demand curve will shift leftward.
  - b. The interest rate will increase, the aggregate expenditure line will shift upward, and the aggregate demand curve will shift rightward.
  - c. The interest rate will decrease, the aggregate expenditure line will shift upward, and the aggregate demand curve will shift rightward.
  - d. The interest rate will decrease, the aggregate expenditure line will shift downward, and the aggregate demand curve will shift rightward.
  - e. The interest rate will increase, the aggregate expenditure line will shift downward, and the aggregate demand curve will shift leftward.
46. As output increases, a typical firm's unit costs
- a. decrease because the firm buys its inputs in large quantities
  - b. increase because the supply of inputs increases
  - c. remain constant
  - d. increase due to the increasing scarcity of resources
  - e. decrease as firms take advantage of diseconomies of scale
47. Nominal wages react slowly to changes in output for the following reasons, except one. Which is the exception?
- a. The nominal wage may be fixed and independent of output because of labor contracts that last up to three years.
  - b. The real wage remains constant despite changes in output.
  - c. Firms with a reputation for paying stable nominal wages will find it easier to attract new workers.
  - d. Changing the nominal wage can be costly to firms.
  - e. Nominal wages may be set by slow-moving corporate bureaucracies.
48. Which of the following will shift the aggregate supply curve upward?
- a. a decrease in world oil prices
  - b. bad weather, which increases farmers' costs per unit of output
  - c. increases in consumer spending
  - d. an increase in the price level
  - e. technological changes that improve worker productivity
49. If the economy is on the aggregate supply curve but to the right of the aggregate demand curve, which of the following will be the first market force to lead the economy toward an equilibrium?

- a. At the current output level, prices will be too low and firms will increase their prices.
- b. At the current price level, output will be too low, inventories will diminish, and firms will increase their production.
- c. At the current output level, prices will be too high and firms will lower their prices.
- d. At the current price level, output will be too high and so prices will drop so that output will drop.
- e. At the current price level, output will be too high, inventories will pile up and firms will cut back on their production.

50. In the short run, a negative demand shock will

- a. decrease the price level but leave real GDP unchanged
- b. increase the price level but leave real GDP unchanged
- c. decrease both the price level and real GDP
- d. increase the price level and decrease real GDP
- e. decrease the wage rate

51. The economy's self-correcting mechanism is such that demand shocks are offset in the long run by shifts of aggregate supply and supply shocks are offset by shifts of aggregate demand.

- a. True
- b. False

52. The discovery and dissemination of a new cost-saving technology

- a. is an example of a positive demand shock
- b. would cause the long-run AS curve to shift leftward, thereby increasing both output and the price level
- c. would increase firms' unit costs
- d. would lead to an increase in output and a decrease in the price level
- e. is an example of a negative supply shock

53. Which of the following would shift the aggregate demand curve to the right?

- a. an increase in government purchases
- b. an increase in investment spending
- c. an open market purchase of bonds by the Fed
- d. all of the above

54. Which of the following would shift the AS curve downward?

- a. a decrease in the price level.
- b. a decrease in world oil prices.
- c. an increase in world oil prices.
- d. a natural disaster that raises unit costs for all firms.

55. To stabilize real GDP when the money demand curve shifts on its own, the Fed must change the money supply.

- a. True
- b. False

56. If money demand falls on its own (i.e., not in response to a spending shock), what must the Fed do to stabilize GDP?

- a. increase the money supply
- b. decrease the money supply
- c. leave the money supply and money demand unchanged
- d. increase money demand
- e. decrease money demand

57. If the Fed has a goal of stable real GDP and government spending increased, which of the following would occur?

- a. The money demand would not change, real GDP would not change, the interest rate would decrease, and there would be partial crowding out.

- b. Money demand would not change, real GDP would not change, the interest rate would increase, and there would be complete crowding out.
  - c. Money demand would increase, real GDP would not change, the interest rate would increase, and there would be partial crowding out.
  - d. Money demand would not change, real GDP would increase, the interest rate would decrease, and there would be complete crowding out.
  - e. Money demand would increase, real GDP would not change, the interest rate would decrease, and there would be complete crowding out.
58. If the Fed has a goal of stable real GDP and the government announces a tax cut, which of the following would occur?
- a. Money demand would not change, real GDP would not change, the interest rate would decrease, and there would be partial crowding out.
  - b. Money demand would not change, real GDP would not change, the interest rate would increase, and there would be complete crowding out.
  - c. Money demand would increase, real GDP would not change, the interest rate would increase, and there would be partial crowding out.
  - d. Money demand would not change, real GDP would increase, the interest rate would decrease, and there would be complete crowding out.
  - e. Money demand would increase, real GDP would not change, the interest rate would decrease, and there would be complete crowding out.
59. If the Fed responds to an increase in government spending with the goal of stable prices and output, which of the following would be the result?
- a. a larger multiplier effect than normal
  - b. partial crowding out
  - c. an increase in consumption and investment spending
  - d. no crowding out
  - e. complete crowding out
60. If the inflation rate is lower than expected, real income is redistributed from lenders to borrowers.
- a. True
  - b. False
61. An unstable inflation rate
- a. always redistributes real income from lenders to borrowers.
  - b. always redistributes real income from borrowers to lenders.
  - c. adds to the risk of borrowing and lending and interferes with long-run financial planning.
  - d. makes goods and services too expensive.
62. Government outlays consist of
- a. all governmental purchases resulting from contracts with the private sector and foreign organizations
  - b. government purchases, transfer payments, and interest on the national debt
  - c. any purchase by an organization that is not trying to earn a profit
  - d. government purchases and transfer payments minus the interest on the national debt
  - e. total receipts from all organizations doing business with any level of government
63. In the long run,
- a. continuing budget surpluses cause interest rates to fall, thereby stimulating investment spending
  - b. any deviation from a balanced budget will *immediately* plunge the economy into recession
  - c. there can be no economic growth unless the government's budget is in surplus
  - d. there can be no economic growth unless the government's budget is balanced
  - e. government spending must increase as a fraction of GDP
64. The tax cuts enacted in 2003

- a. were a good example of countercyclical policy because they were targeted at the corporate sector
- b. were a good example of countercyclical policy because they took effect during a recession
- c. were not a good example of countercyclical policy because they were weighted heavily toward long-run changes in the tax code
- d. brought the economy out of a recession
- e. caused a recession

65. The federal government

- a. runs a deficit when tax revenues are greater than government purchases.
- b. runs a surplus when tax revenues are smaller than government purchases.
- c. runs a deficit when tax revenues are greater than government outlays.
- d. runs a surplus when tax revenues are greater than government outlays.

Use the production function  $y = Ak^\alpha$  (where  $y$  is the output per worker,  $k$  is the capital per worker, and  $A$  is the residual) and information in the table below to answer next **two** questions

	China	Europe
Output per worker	$y_{\text{China}} = 450$	$y_{\text{Europe}} = 500$
Capital per worker	$k_{\text{China}} = 60$	$k_{\text{Europe}} = 70$

66. If  $\alpha = 0.5$ , what are the residuals of China ( $A_{\text{China}}$ ) and Europe ( $A_{\text{Europe}}$ )?

- a.  $A_{\text{China}} = 7.5$ ,  $A_{\text{Europe}} = 59.76$
- b.  $A_{\text{China}} = 58.09$ ,  $A_{\text{Europe}} = 7.14$
- c.  $A_{\text{China}} = 58.09$ ,  $A_{\text{Europe}} = 59.76$
- d.  $A_{\text{China}} = 7.5$ ,  $A_{\text{Europe}} = 59.76$

67. The European output per worker is 111% of the Chinese output per worker. If  $\alpha = 0.5$ , this 11% gap in output per worker is attributable to

- a. 1 percentage points difference in the residual ( $A$ ), 10 percentage points in the capital per worker ( $k^\alpha$ ), 0 percentage points of compounding.
- b. 3 percentage points difference in the residual ( $A$ ), 17 percentage points in the capital per worker ( $k^\alpha$ ), -9 percentage points of compounding.
- c. 3 percentage points difference in the residual ( $A$ ), 17 percentage points in the capital per worker ( $k^\alpha$ ), 0 percentage points of compounding.
- d. 3 percentage points difference in the residual ( $A$ ), 8 percentage points in the capital per worker ( $k^\alpha$ ), 0 percentage points of compounding.

68. What will happen to the LRAS curve if there is an increase in oil prices?

- a. It will shift right
- b. It will shift left
- c. It stays the same
- d. It is indeterminate

69. Consider an AD-AS model that starts in a long-run equilibrium. What will happen if the federal reserve decides to increase the federal funds rate?

- a. In the short run we will see output increase and inflation, in the long run we will see more inflation but output will return back to the long run level.

- b. In the short run we will see output decrease and deflation, in the long run we will see more deflation but output return back to the long run level.
  - c. In the short run we will see output decrease and inflation, in the long run we will see prices and output will return back to the long run levels
  - d. In the short run we will see output increase and deflation, in the long run we will see prices and output will return back to the long run levels
  - e. None of the above
70. In the Classical model without money market, households save a constant fraction of their disposable income and supply all their labor hours. If there is a technological improvement, then
- a. the dynamic equilibrium output, and saving will decrease ; capital and interest rate, will increase.
  - b. the dynamic equilibrium output, interest rate, saving, and capital will increase.
  - c. the dynamic equilibrium output, saving, and capital will increase.
  - d. the static equilibrium output, saving, and capital will increase; but the dynamic equilibrium capital will not change.
71. In the Classical model without money market, households save a constant fraction of their disposable income and supply all their labor hours. That is, the labor supply is equal to the population size. A technological progress which increases the marginal productivity of labor will lead to
- a. increases both the wage rate and equilibrium employment.
  - b. an increase in the wage rate.
  - c. a decrease in the wage rate and equilibrium employment.
  - d. an increase in equilibrium employment; but the effect on the wage is ambiguous.
  - e. none of the above

### Answer Key

- 1. ANS: B
- 2. ANS: B
- 3. ANS: B
- 4. ANS: C
- 5. ANS: E
- 6. ANS: C
- 7. ANS: E
- 8. ANS: C
- 9. ANS: C
- 10. ANS: B
- 11. ANS: E
- 12. ANS: E
- 13. ANS: C
- 14. ANS: E
- 15. ANS: B
- 16. ANS: B
- 17. ANS: C

18. ANS: A
19. ANS: B
20. ANS: E
21. ANS: C
22. ANS: D
23. ANS: E
24. ANS: C
25. ANS: A
26. ANS: D
27. ANS: B
28. ANS: D
29. ANS: D
30. ANS: D
31. ANS: A
32. ANS: A
33. ANS: C
34. ANS: A
35. ANS: D
36. ANS: B
37. ANS: A
38. ANS: A
39. ANS: C
40. ANS: D
41. ANS: A
42. ANS: A
43. ANS: C
44. ANS: B
45. ANS: C
46. ANS: D
47. ANS: B
48. ANS: B
49. ANS: E
50. ANS: C
51. ANS: B
52. ANS: D
53. ANS: D
54. ANS: B
55. ANS: A
56. ANS: B
57. ANS: B
58. ANS: B
59. ANS: E
60. ANS: B

- 61. ANS: C
- 62. ANS: B
- 63. ANS: A
- 64. ANS: C
- 65. ANS: D
- 66. ANS: C
- 67. ANS: D
- 68. ANS: B
- 69. ANS: B
- 70. ANS: C
- 71. ANS: B