EXAM 3: Version A

Econ 2203
Fall 2012

Instructions:

1. Write your **name** and the **version** (A or B) on your scantron.
2. Choose **the best available** answer and indicate your choice on your scantron sheet using a pencil.
3. When finished, turn in your scantron ONLY. Keep the exam copy. I will post your results on D2L once the exams have been scored.

1. If a shock to aggregate demand occurs, the period of the initial change in real GDP is called
   a. the short run.
   b. the medium run.
   c. the long run.
   d. a recovery.
   e. the steady state.

2. The short-run effect of an increase in government purchases is
   a. a rightward shift of the aggregate demand curve and an upward shift of the inflation adjustment line.
   b. a leftward shift of the aggregate demand curve and an upward shift of the inflation adjustment line.
   c. a rightward shift of the aggregate demand curve and a downward shift of the inflation adjustment line.
   d. a rightward shift of the aggregate demand curve and movement along the inflation adjustment line.
   e. a leftward shift of the aggregate demand curve and movement along the inflation adjustment line.

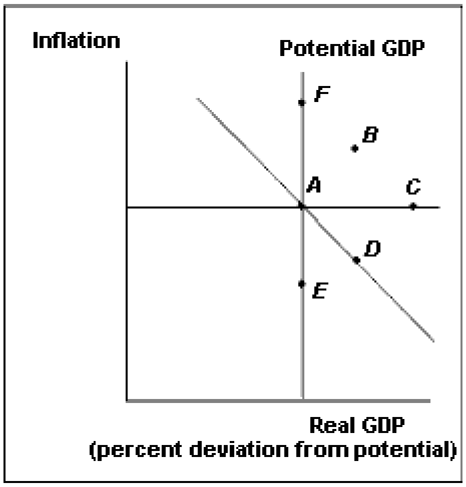
3. In the long-run the effect of a decrease in government purchases can be described as:
   a. the inflation adjustment line intersects the aggregate demand curve at the level of potential GDP.
   b. firms are adjusting their prices and inflation is increasing to its new level.
   c. real GDP is below potential GDP.
   d. there is no spending balance.
   e. firms are adjusting their prices and inflation is decreasing.

4. If real GDP is below potential GDP,
   a. long-run equilibrium will be achieved once the aggregate demand curve shifts to the right.
   b. the economy is in a short-run equilibrium.
   c. long-run equilibrium will be achieved once inflation has stopped declining.
   d. the economy is in a medium-run equilibrium.

5. The short-run effects of an increase in government purchases are that inflation will ____, and real GDP will ____.
   a. decrease; increase
   b. increase; remain unchanged
   c. remain unchanged; decrease
   d. remain unchanged; increase
   e. increase; increase

6. Which of the following would most likely lead to higher inflation in the long run?
   a. A decrease in consumer confidence
   b. An increase in imports
   c. An increase in taxes
   d. An increase in government spending
   e. An increase in the savings rate

Exhibit 25-1



7. Suppose the economy is initially at point *A* in Exhibit 25-1. If government purchases increase, which point best depicts where the economy will be in the medium run as a result of the change in spending?
   a. *F*
   b. *D*
   c. *B*
   d. *E*
   e. *C*

8. In the short run, when government purchases decrease, real GDP falls by more than the change in government purchases because
   a. prices increase.
   b. taxes increase.
   c. consumption decreases.
   d. investment decreases.
   e. taxes decrease.

9. The *IA* line does not shift in the short run because
   a. real and potential GDP are not equal.
   b. potential GDP does not change.
   c. prices are ‘sticky’ due to staggered wage and price adjustments.
   d. real GDP does not change.
   e. there is no spending balance.

10. The long-run *overall* effect of decreased government purchases is that
   a. investment is higher.
   b. consumption and net exports are the same, and investment is higher.
   c. consumption is lower, and investment is higher.
   d. consumption and net exports are higher.
   e. consumption, investment, and net exports are all higher.

11. If the Fed thinks inflation is too high, it will
    a. lower the target inflation rate and lower interest rates.
    b. lower the target inflation rate and raise interest rates.
    c. lower the target inflation rate and leave interest rates unchanged.
    d. raise the target inflation rate and raise interest rates.
    e. raise the target inflation rate and lower interest rates.

12. Compared to the baseline, the short-run effect of a monetary policy change to lower inflation is for
    a. consumption and net exports to decline, while investment stays constant.
    b. consumption, investment, net exports, and government purchases to decline.
    c. consumption, investment, and net exports to decline.
    d. consumption and investment to decline while net exports increase.
    e. consumption and net exports to increase while investment falls.

13. The short-run effect of an oil price increase is
    a. an upward shift of the inflation adjustment line and a leftward shift of the aggregate demand curve as the Fed raises interest rates.
    b. an upward shift of the inflation adjustment line and a leftward shift of the aggregate demand curve as the Fed lowers the target inflation rate.
    c. an upward shift of the inflation adjustment line and a leftward shift of the aggregate demand curve as spending falls.
    d. a downward shift of the inflation adjustment line.
    e. an upward shift of the inflation adjustment line.

14. When tax revenues are equal to spending, there is a
    a. budget deficit.
    b. government absorption.
    c. budget surplus.
    d. balanced budget.
    e. budget supplement.

15. Which of the following is *true*?
    a. Though not required by law, the government tends to run a balanced budget year after year.
    b. If there is a budget deficit, the government must borrow to pay for the excess spending.
    c. If there is a budget deficit, the government must ask the Fed to print money to finance excess spending.
    d. By law the federal budget must balance.
    e. If there is a budget deficit, the government must raise taxes.

16. The symbol *G* used throughout the text stands for
    a. federal government expenditures.
    b. purchases of goods and services by the federal government.
    c. federal plus state and local government purchases of goods and services.
    d. federal plus state and local government expenditures.
    e. the difference between expenditures and tax revenues for the federal, state, and local governments.

17. About half of the U.S. budget consists of social security, Medicare, and Medicaid. Which of the following is **<u>not</u>** true about these important expenditures?
    a. These are known as entitlement programs.
    b. The expenditures of these programs are expected to remain relatively constant in coming years.
    c. Social security and Medicare provide income and health care for the elderly, and Medicaid provides health care for people and families with very low incomes.
    d. All of the above represent true facts.
    e. None of the above are true facts.

18. Which of the following statements is *true*?
    a. There is no relationship between the federal deficit and the federal debt.
    b. A federal deficit adds to the federal debt.
    c. The change in the federal deficit each year equals the federal debt.
    d. The federal debt is the same as the federal deficit.
    e. The federal debt grew in the period when there was a federal budget surplus.

19. Which of the following would cause the *AD* curve to shift to the right?
    a. An increase in sales taxes
    b. An increase in potential GDP
    c. A decrease in unemployment compensation
    d. An increase in social security payments
    e. A decrease in military purchases

20. Discretionary fiscal policy
    a. does not require changes in law.
    b. does not require the involvement of Congress or the president.
    c. is the same as a tax increase.
    d. requires action on the part of the president and Congress.
    e. needs the approval of the Federal Reserve Board.

21. Which of the following is *not* an automatic stabilizer?
    a. Social security payments
    b. Unemployment compensation
    c. Taxes
    d. Welfare payments
    e. Military expenditures

22. Suppose, for a hypothetical economy, potential GDP equals $9,200 billion. If real GDP equals $9,400 billion, then according to the table below, the cyclical surplus equals

Real GDP (billions of dollars)	Surplus (billions of dollars)
9,000	280
9,100	300
9,200	320
9,300	340
9,400	360

a. $320 billion.
b. $40 billion.
c. –$40 billion.
d. $20 billion.
e. $360 billion.

23. One of the main liabilities on the Fed's balance sheet is reserves. Which of the following is the best definition of that item?
a. Reserves represent foreign currencies held at the Fed.
b. Reserves are deposits that banks hold at the Fed.
c. Reserves represent gold and other precious metals held at the Fed.
d. Reserves represent loans that the Fed has made to other countries.
e. None of these is an appropriate definition.

24. The interest rate on loans banks pay when they borrow from the Fed is called
a. the discount rate.
b. the three-month CD rate.
c. the prime rate.
d. the Treasury bill rate.
e. the federal funds rate.

25. As a result of the financial crisis, the Fed has begun buying securities in troubled markets, as it has been trying to provide more credit to the markets and thereby mitigate the crisis. This is known as
a. Quantitative easing.
b. FOMC.
c. Credit crunching.
d. Market deepening.
e. Market thinning
.

26. When the rate of interest increases,
a. the opportunity cost of money increases, and the quantity of money demanded increases.
b. the opportunity cost of money decreases, and the quantity of money demanded declines.
c. the demand for money is unaffected.
d. the opportunity cost of money decreases, and the quantity of money demanded increases.
e. the opportunity cost of money increases, and the quantity of money demanded declines.

27. If the Fed determines the amount of money in circulation, the interest rate is determined by the
    a. required reserve ratio.
    b. currency to deposit ratio.
    c. money multiplier.
    d. monetary base.
    e. demand for money.

28. Assume the Fed has complete control over the money supply. If the demand for money were greater than the supply of money, we would expect
    a. a decrease in the quantity of money demanded and a decrease in the rate of interest.
    b. a decrease in the quantity of money demanded and an increase in the rate of interest.
    c. an increase in the quantity of money supplied, a decrease in the quantity of money demanded, and an increase in the rate of interest.
    d. an increase in the quantity of money demanded and a decline in the rate of interest.
    e. a decrease in the quantity of money supplied, a decrease in the quantity of money demanded, and an increase in the rate of interest.

29. Throughout history, higher money growth has been associated with
    a. disinflation.
    b. stable economic growth.
    c. deflation.
    d. higher inflation.
    e. longer economic expansions.

30. The Fed changes the federal funds rate by
    a. directing banks to charge each other a new rate.
    b. asking banks to charge each other a new rate.
    c. asking Congress to make the change.
    d. increasing or decreasing the supply of reserves in the overnight market.
    e. directing banks to charge consumers a new rate.

31. When financial market analysts say that the Fed is "trying to cool off the economy," they are referring to the case in which the Fed
    a. raises the target rate of inflation.
    b. lowers the target rate of inflation.
    c. raises the federal funds rate because aggregate demand is greater than potential GDP at the target rate of inflation.
    d. raises the federal funds rate because aggregate demand is less than potential GDP at the target rate of inflation.
    e. lowers the federal funds rate because aggregate demand is less than potential at the target rate of inflation.

32. The Fed's interest rate decisions depend on the level of
    a. investment and the level of inflation.
    b. investment and the level of potential GDP.
    c. real GDP and the level of potential GDP.
    d. potential GDP and the level of inflation.
    e. inflation and the output gap.

Exhibit 29-1

Country	Output per Day of Work	
	Good A	Good B
China	10	5
India	9	3

33. According to the data in Exhibit 29-1, China has a(n)
    a. comparative advantage in neither good.
    b. absolute advantage in the production of both goods.
    c. comparative advantage in both goods.
    d. absolute advantage in good A but not in good B.
    e. comparative advantage in good A.

34. According to the data in Exhibit 29-1, China has a(n)
    a. comparative advantage in both goods.
    b. comparative advantage in good B.
    c. absolute advantage in good A but not in good B.
    d. comparative advantage in good A.
    e. comparative advantage in neither good.

35. According to the data in Exhibit 29-1, the opportunity cost of producing one more unit of good B in China is
    a. 3 units of good A.
    b. 1/3 unit of good A.
    c. 2 units of good A.
    d. 1/2 unit of good A.
    e. 10 units of good A.

36. According to the data in Exhibit 29-1, the opportunity cost of producing one more unit of good A in India is
    a. 1/2 unit of good B.
    b. 1/3 unit of good B.
    c. 3 units of good B.
    d. 2 units of good B.
    e. 5 units of good B.

37. According to the data in Exhibit 29-1, which of the following statements is *true*?
    a. Chinese workers cannot gain from trade with India.
    b. Labor productivity in both goods is higher in India than in China.
    c. Wages will be higher in India than in China.
    d. Labor productivity in both goods is higher in China than in India.
    e. Labor productivity in the production of good A is higher in India than in China.

38. According to Exhibit 29-1, which of the following is *true*?
   a. As workers are more productive in China, wages will be higher.
   b. As workers are more productive in China, China will have a comparative advantage in the production of both goods.
   c. As workers are less productive in India, wages will be lower, and they will have a comparative advantage in the production of both goods.
   d. Indian workers are less productive at producing both goods, so China will not find it advantageous to trade with India.
   e. Indian workers are less productive at producing both goods, so India will not be able to gain from trade with China.

39. If the Fed believes that real GDP is below potential GDP, it will
   a. lower interest rates to shift the *AD* curve to the right and the *IA* line upward.
   b. do nothing and wait for the *IA* line to shift and return real GDP to potential GDP at a lower inflation rate.
   c. lower interest rates to shift the *AD* curve to the right.
   d. lower interest rates to shift the *IA* line downward.
   e. lower interest rates to shift the *AD* curve to the right and the *IA* line downward.

40. Suppose real and potential GDP are initially equal. If the Fed increases the target inflation rate, then in the short run we would expect
   a. a decrease in the rate of inflation.
   b. an increase in the rate of inflation.
   c. a higher real rate of interest.
   d. lower unemployment.
   e. a higher nominal interest rate.

41. Suppose Rose has a comparative advantage over Sam in programming rather than in sales. If Rose sold programs rather than write them, then she would
   a. sacrifice her programming time and her profits would rise.
   b. not sacrifice her programming time and her profits would rise.
   c. sacrifice her programming time and her profits would fall.
   d. not sacrifice her programming time and her profits would fall.
   e. not sacrifice her programming time because she could make just as much profits by selling as she could by programming.

42. Rose has a comparative advantage in computer programming whereas Sam has a comparative advantage in sales. Therefore,
   a. Sam has a lower opportunity cost of spending his time selling than Rose does.
   b. Rose should specialize in sales.
   c. Sam should write computer programs.
   d. Rose has a higher opportunity cost of spending her time writing computer programs than Sam does.
   e. Sam has a higher opportunity cost of spending his time selling than Rose does.