1) Gross domestic product is calculated by summing up
A) the total quantity of goods and services in the economy.
B) the total quantity of goods and services produced in the economy during a period of time.
C) the total market value of goods and services in the economy.
D) the total market value of final goods and services produced in the economy during a period of time.

Table 8-1

Product	Quantity	Price
Sweatshirts	50	$35.00
Dental examinations	40	75.00
Coffee drinks	1,000	4.00
Coffee beans	2,000	0.50

2) ***Refer to Table 8-1.*** Suppose that a simple economy produces only four goods and services: sweatshirts, dental examinations, coffee drinks, and coffee beans. Assume all of the coffee beans are used in the production of the coffee drinks. Using the information in the above table, nominal GDP for this simple economy equals
A) 3,090 units.
B) $7,250.
C) $8,750.
D) $9,750.

Table 8-4

Consumption expenditures	$800
Investment expenditures	300
Government purchases	300
Government transfer payments	400
Exports	300
Imports	100

3) ***Refer to Table 8-4***. Consider the data above (in billions of dollars) for an economy: Gross domestic product (in billions of dollars) for this economy equals
A) $2,200.
B) $2,100.
C) $1,600.
D) $1,400.

Table 8-11

Year	Guns Produced	Price of Guns	Butter Produced	Price of Butter
2005	80	$5	40	$4
2013	90	6	60	10

Consider the following data for Tyrovia, a country that produces only two products: guns and butter.

4) ***Refer to Table 8-11.*** Real GDP for Tyrovia for 2013 using 2005 as the base year equals
A) $1,140.
B) $880.
C) $690.
D) $560.

5) ***Refer to Table 8-11.*** Nominal GDP for Tyrovia in 2013 equals
A) $1,140.
B) $880.
C) $690.
D) $560.

6) If nominal GDP is $5 trillion and real GDP is $4 trillion, the GDP deflator is
A) 12.5.
B) 80.
C) 125.
D) 800.

7) Which of the following cause the unemployment rate as measured by the Bureau of Labor Statistics to understate the true extent of joblessness?
A) inflation
B) discouraged workers
C) people employed in the underground economy
D) unemployed persons falsely report themselves to be actively looking for a job

8) Full employment is *not* considered to be zero unemployment, because
A) some cyclical unemployment always exists.
B) some people do not want a job.
C) there are not enough jobs for everyone who wants one.
D) people do not find jobs instantaneously.

9) A consumer price index of 160 in 1996 with a base year of 1982-1984 would mean that the cost of the market basket
A) equaled $160 in 1996.
B) equaled $160 in 1983.
C) rose 160% from the cost of the market basket in the base year.
D) rose 60% from the cost of the market basket in the base year.

10) Imagine that you borrow $5,000 for one year and at the end of the year you repay the $5,000 plus $600 of interest. If the inflation rate was 4%, what was the real interest rate you paid?
A) 16 percent
B) 12 percent
C) 8 percent
D) 6 percent

11) If disposable income increases by $100 million, and consumption increases by $90 million, then the marginal propensity to consume is
A) 0.9.

B) 0.8.
C) 0.75.
D) 0.6.

12) If an increase in investment spending of $50 million results in a $400 million increase in equilibrium real GDP, then
A) the multiplier is 0.125.
B) the multiplier is 3.5.
C) the multiplier is 8.
D) the multiplier is 50.

13) The major shortcoming of a barter economy is
A) the requirement of a double coincidence of wants.
B) the requirement of specialization and exchange.
C) that goods and services are not traded.
D) that money loses value from inflation.

14) Which of the following functions of money would be violated if inflation were high?
A) unit of account
B) store of value
C) certificate of gold
D) medium of exchange

15) If you transfer all of your currency to your checking account, then initially, M1 will ________ and M2 will ________.
A) increase; not change
B) not change; increase
C) not change; not change
D) decrease; increase

16) The required reserves of a bank equal its ________ the required reserve ratio.
A) deposits divided by
B) deposits multiplied by
C) loans divided by
D) loans multiplied by

Scenario 14-2

Imagine that Kristy deposits $10,000 of currency into her checking account deposit at Bank A and that the required reserve ratio is 20%.

17) ***Refer to Scenario 14-2.*** As a result of Kristy's deposit, Bank A's reserves immediately increase by
A) $2,000.
B) $8,000.
C) $10,000.
D) $50,000.

18) ***Refer to Scenario 14-2.*** As a result of Kristy's deposit, Bank A's required reserves increase by

A) $2,000.
B) $8,000.
C) $10,000.
D) $50,000.

19) ***Refer to Scenario 14-2.*** As a result of Kristy's deposit, Bank A's excess reserves increase by
A) $2,000.
B) $8,000.
C) $10,000.
D) $50,000.

20) ***Refer to Scenario 14-2.*** As a result of Kristy's deposit, Bank A can make a maximum loan of
A) $2,000.
B) $8,000.
C) $10,000.
D) $50,000.

21) ***Refer to Scenario 14-2.*** As a result of Kristy's deposit, checking account deposits in the banking system as a whole (including the original deposit) could eventually increase up to a maximum of
A) $8,000.
B) $10,000.
C) $50,000.
D) $100,000.

22) The main tool that the Federal Reserve uses to conduct monetary policy is
A) open market operations.
B) discount policy.
C) setting reserve requirements.
D) acting as the lender of last resort.
E) check clearing.

23) The purchase of $1 million of Treasury securities by the Federal Reserve, if there is no change in the quantity of currency, will cause reserves at banks to
A) increase by $1 million.
B) increase by less than $1 million.
C) decrease by $1 million.
D) decrease by less than $1 million.

24) An increase in the price level causes
A) the money demand curve to shift to the left.
B) the money demand curve to shift to the right.
C) a movement up along the money demand curve.
D) a movement down along the money demand curve.

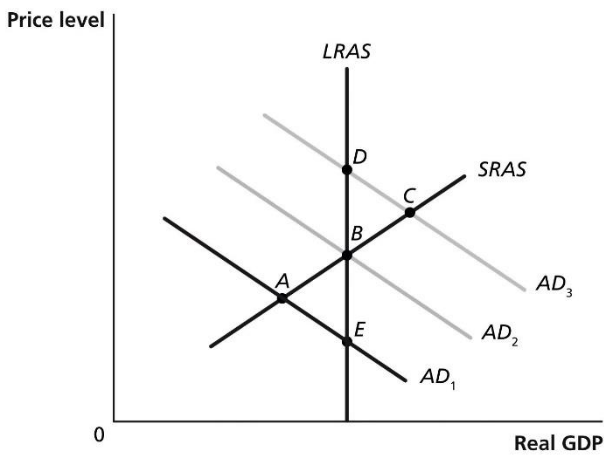
25) The monetary policy target the Federal Reserve focuses primarily on today is
A) the unemployment rate.
B) M1.
C) the inflation rate.

D) the interest rate.
E) M2.

26) If the Fed raises the interest rate, this will ________ inflation and ________ real GDP in the short run.
A) reduce; raise
B) increase; lower
C) increase; raise
D) reduce; lower

27) An increase in the interest rate should ________ the demand for dollars and the value of the dollar, and net exports should ________.
A) decrease; decrease
B) decrease; increase
C) increase; decrease
D) increase; increase
E) increase; not change

Figure 15-7



28) ***Refer to Figure 15-7.*** Suppose the economy is in a recession and the Fed pursues an expansionary monetary policy. Using the static *AD-AS* model in the figure above, this would be depicted as a movement from
A) *A* to *B*.
B) *B* to *C*.
C) *C* to *B*.
D) *A* to *E*.
E) *C* to *D*.

29) ***Refer to Figure 15-7.*** Suppose the economy is in short-run equilibrium above potential GDP, the unemployment rate is very low, and wages and prices are rising. Using the static *AD-AS* model in the figure above, the correct Fed policy for this situation would be depicted as a movement from
A) *A* to *B*.
B) *B* to *C*.
C) *C* to *B*.

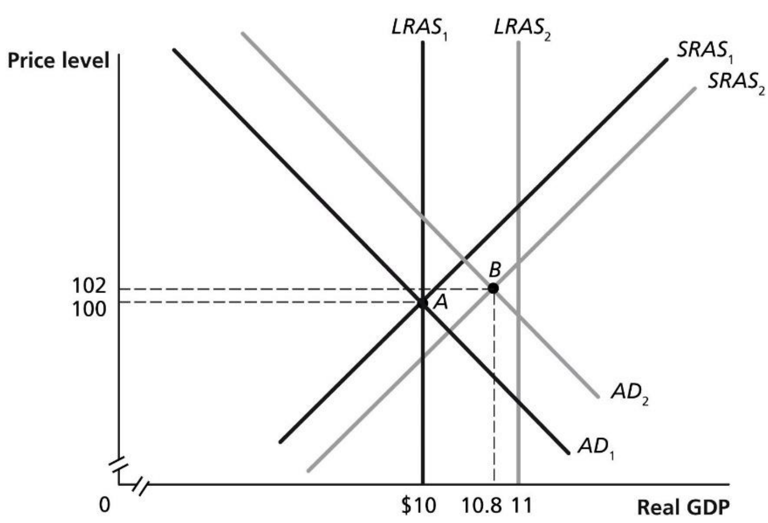
D) *A* to *E*.
E) *C* to *D*.

30) Expansionary monetary policy to prevent real GDP from falling below potential real GDP would cause the inflation rate to be relatively ________ and real GDP to be relatively ________.
A) higher; higher
B) higher; lower
C) lower; higher
D) lower; lower

31) Suppose the equilibrium real federal funds rate is 2 percent, the target rate of inflation is 2 percent, the current inflation rate is 4 percent, and real GDP is 2 percent above potential real GDP. If the weights for the inflation gap and the output gap are both 1/2, then according to the Taylor rule the federal funds target rate equals
A) 4 percent.
B) 6 percent.
C) 8 percent.
D) 10 percent.

32) Which of the following would *not* be considered an automatic stabilizer?
A) legislation increasing funding for job retraining passed during a recession
B) decreasing unemployment insurance payments due to decreased jobless during an expansion
C) rising income tax collections due to rising incomes during an expansion
D) declining food stamp payments due to more persons finding jobs during an expansion

Figure 16-5



33) ***Refer to Figure 16-5.*** In the dynamic model of *AD-AS* in the figure above, if the economy is at point *A* in year 1 and is expected to go to point *B* in year 2, Congress and the president would most likely
A) decrease government spending.
B) increase government spending.
C) increase oil prices.

D) increase taxes.
E) lower interest rates.

34) ***Refer to Figure 16-5.*** In the dynamic model of *AD-AS* in the figure above, if the economy is at point *A* in year 1 and is expected to go to point *B* in year 2, and no fiscal or monetary policy is pursued, then at point *B*
A) the unemployment rate is very low.
B) firms are operating below capacity.
C) the economy is above full employment.
D) income and profits are rising.
E) there is pressure on wages and prices to rise.

35) If the tax multiplier is -1.5 and a $200 billion tax increase is implemented, what is the change in GDP, holding everything else constant? (Assume the price level stays constant.)
A) a $300 billion decrease in GDP
B) a $300 billion increase in GDP
C) a $30 billion increase in GDP
D) a $133.33 billion decrease in GDP
E) a $133.33 billion increase in GDP

36) An increase in government purchases of $200 billion will shift the aggregate demand curve to the right by
A) $200 billion.
B) less than $200 billion.
C) more than $200 billion.
D) None of the above are correct. This policy shifts the long-run aggregate supply curve.

37) Which of the following best describes supply-side economics?
A) Labor productivity affects aggregate supply.
B) Education affects labor productivity which affects aggregate supply.
C) Education affects the incentive to work, save, and invest and, therefore, aggregate supply.
D) Tax rates, particularly marginal tax rates, affect the incentive to work, save, and invest and, therefore, aggregate supply.

38) If workers and firms expect that inflation will be 3 percent next year, and real wages are not changing over time, by how much will nominal wages increase?
A) 3 percent
B) more than 3 percent
C) less than 3 percent
D) depends on actual inflation for next year

39) If workers and firms raise their inflation expectations,
A) unemployment will fall.
B) actual inflation will fall to match expected inflation.
C) the short-run Phillips curve will be vertical.
D) the short-run Phillips curve will shift upward.

40) Some economists argue that the short-run Phillips curve is not vertical, and that monetary policy can

be effective in the short run. Which one of the following is *not* one of the reasons for this skepticism?
A) Empirical evidence shows workers and firms have rational expectations.
B) Contracts with workers and suppliers may hinder firms' abilities to adjust to price changes.
C) Wages and prices may not adjust rapidly enough to keep the short-run Phillips curve vertical.
D) Individuals may not be able to use information of Fed Policy to make a reliable forecast of inflation.

41) The experience of Paul Volcker's fight against inflation during the late 1970s and early 1980s indicates that firms and workers may have
A) had adaptive expectations.
B) had rational expectations but didn't trust Fed announcements.
C) preferred high unemployment to high inflation.
D) Both A and B are correct answers.

42) Which of the following transactions would be included in Japan's current account?
A) A Japanese citizen purchases 50 shares of Google stock.
B) An American citizen purchases 50 shares of Toshiba stock.
C) A Japanese citizen purchases a new Toyota made in Japan.
D) An American citizen purchases a new Toyota made in Japan.

43) If the dollar appreciates against the Mexican peso,
A) Mexican imports to the U.S. become more expensive.
B) U.S. exports to Mexico become less expensive.
C) U.S. exports to Mexico become more expensive.
D) The value of Mexican imports to the United States does not change.

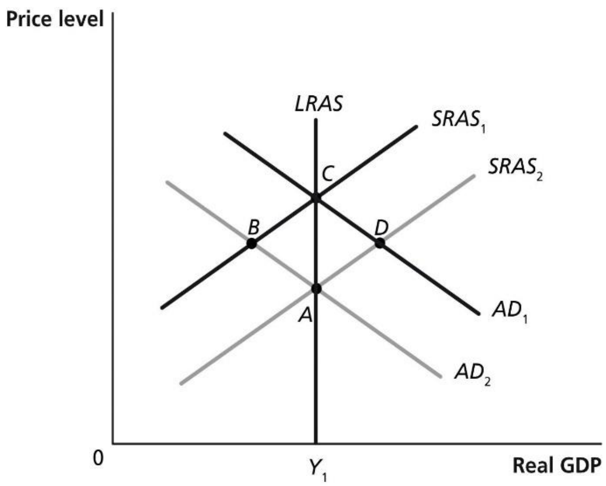
44) If net foreign investment is negative, which of the following must be true?
A) Capital outflows are greater than capital inflows.
B) Domestic investment must be greater than national saving.
C) Net exports are positive.
D) Private saving is greater than public saving.

45) What impact might an increase in the budget deficit have on interest rates and exchange rates?
A) Interest rates and exchange rates increase.
B) Interest rates increase and exchange rates decrease.
C) Interest rates decrease and exchange rates increase.
D) Interest rates and exchange rates decrease.

<u>Short Answer</u>

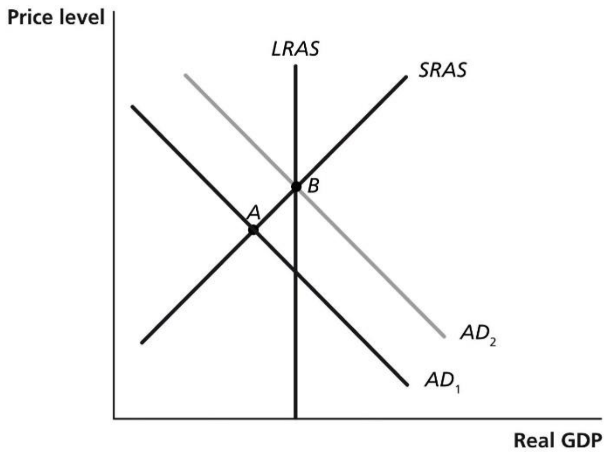
[Note: Parts of the free response questions below ask you to structure your own answers. There will be no such questions on the final. Instead the free response questions on the final will be like on the midterms. They will ask you to draw curves and fill in blanks: we will structure the answers, you will fill in the critical parts of those answers. Nonetheless, the content of the questions below reflects the sort of material that you will be expected to know on the final, even if the format is different.]

1. a) Starting from long-run equilibrium, use the basic aggregate demand and aggregate supply diagram to show what happens in both the long run and the short run when there is an increase in wealth.
Answer:

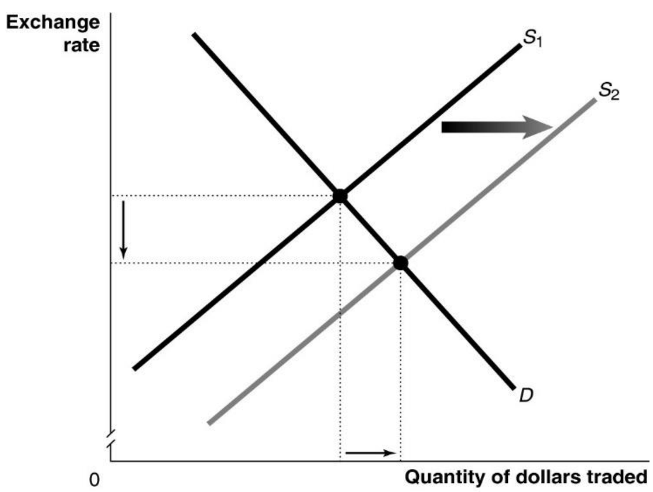


Before the increase in demand, the economy begins at point *A* with GDP at Y_1. The increase in wealth shifts the aggregate demand curve to the right from AD_2 to AD_1. As a result, prices rise and output increases. Unemployment also falls as the economy rises above potential GDP (point *D*). The growing economy causes workers and firms to adjust their expectations about wages and prices upward. As wages and prices rise, this will shift the short-run aggregate supply curve to the left. Eventually, the economy moves to point *C*, with real GDP restored back to potential GDP at Y_1 and prices even higher. The unemployment rate goes back to the natural level

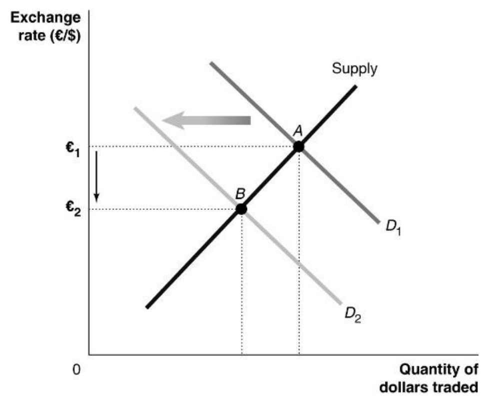
b) Use a graph to show the effects of an expansionary monetary policy moving an economy out of recession and to potential real GDP. Explain what happens to aggregate demand, real GDP, and the price level.
Answer: If the economy is in recession, it is currently at point *A*, below potential real GDP. An expansionary monetary policy will shift the aggregate demand curve to the right from AD_1 to AD_2, increasing real GDP and the price level until it reaches potential real GDP at point *B*.



2. a) Explain and show graphically how an increase in incomes in the United States will affect equilibrium in the foreign exchange market?
Answer: Higher incomes in the United States will increase demand for imports in the United States. The increased demand for imported goods will result in an increase in the supply of dollars (shift the supply curve to the right) as Americans trade in their dollars for the currencies of the countries from which they wish to purchase goods. The increase in supply results in a decrease in the equilibrium exchange rate (the dollar depreciates), and an increase in the equilibrium quantity of dollars traded.



b) Explain and show graphically the effect of a decrease in U.S. budget deficits that decrease U.S. interest rates on the demand and supply of U.S. dollars for euros.
Answer: A decrease in U.S. interest rates would decrease the desire to invest in financial assets in the United States relative to the rest of the world. The demand for dollars would fall, causing the exchange rate for the dollar to fall. The lower exchange rate would increase net exports, leading to a smaller current account deficit.



3) a) Suppose a presidential candidate makes a statement in a debate whereby he promises that he would encourage the Fed to permanently lower the unemployment rate to 3%. His opponent claims that this type of policy idea is mired in the 1960s and would require rising inflation. Explain what the opponent means.
Answer: 3% is below the natural rate of unemployment. According to Friedman's interpretation of the Phillips curve, keeping unemployment below the natural rate requires keeping inflation above expected inflation. As the public comes to expect higher inflation, the Fed would have to engineer still higher inflation, so as to have inflation come in above new, higher expected inflation. So to keep the unemployment rate permanently below the natural rate, the Fed would have to continuously keep raising inflation.
b) Use the following information to draw a graph showing the short-run and long-run Phillips curves, and be sure your graph shows the point where the short-run and long-run Phillips curves intersect.

Natural rate of unemployment = 4 percent
Current rate of unemployment = 5 percent
Expected inflation rate = 3 percent
Current inflation rate = 2 percent

Answer: