

Intermediate Macroeconomics, Fall 2014
Practice Questions (1)

1. It is a national income accounting rule that all expenditure on purchases of products is necessarily equal to:
 - A) profits of firms.
 - B) wages of employees.
 - C) income of the producers of the products.
 - D) income of employees.

2. To reduce the money supply, the Federal Reserve:
 - A) buys government bonds.
 - B) sells government bonds.
 - C) creates demand deposits.
 - D) destroys demand deposits.

3. GDP is the market value of all _____ goods and services produced within an economy in a given period of time.
 - A) Used
 - B) intermediate
 - C) Consumer
 - D) Final

4. When a pizza maker lists the price of a pizza as \$10, this is an example of using money as a:
 - A) store of value.
 - B) unit of account.
 - C) medium of exchange.
 - D) flow of value.

5. Assume that a tire company sells four tires to an automobile company for \$400, another company sells a compact disc player for \$500, and the automobile company puts all of these items in or on a car that it sells for \$20,000. In this case, the amount from these transactions that should be counted in GDP is:
 - A) \$20,000.
 - B) \$20,000 less the automobile company's profit on the car.
 - C) \$20,900.
 - D) \$20,900 less the profits of all three companies on the items that they sold.

6. The government raises lump-sum taxes on income by \$100 billion, and the neoclassical economy adjusts so that output does not change. If the marginal propensity to consume is 0.6, private saving:
- A) rises by \$40 billion.
 - B) rises by \$60 billion.
 - C) falls by \$60 billion.
 - D) falls by \$40 billion.
7. If nominal GDP in 2009 equals \$14 trillion and real GDP in 2009 equals \$11 trillion, what is the value of the GDP deflator?
- A) 0.79
 - B) 1.03
 - C) 1.27
 - D) 1.30
8. If a neutral technological advance improves the production function, the neoclassical theory of distribution predicts:
- A) the real wage will rise and the real rental price of capital will fall.
 - B) both the real wage and the real rental price of capital will fall.
 - C) both the real wage and the real rental price of capital will rise.
 - D) the real wage will fall and the real rental price of capital will rise.
9. In the national income accounts, goods bought for future use are classified as which type of expenditure?
- A) Services
 - B) Investment
 - C) government purchases
 - D) net exports
10. If the nominal exchange rate falls 10 percent, the domestic price level rises 4 percent, and the foreign price level rises 6 percent, the real exchange rate will fall:
- A) 0 percent.
 - B) 8 percent.
 - C) 10 percent.
 - D) 12 percent.

11. An increase in the price of imported goods will show up in:
- A) the CPI but not in the GDP deflator.
 - B) the GDP deflator but not in the CPI.
 - C) both the CPI and the GDP deflator.
 - D) neither the CPI nor the GDP deflator.
12. In a small open economy, if the government adopts a policy that lowers imports, then that policy:
- A) raises the real exchange rate and increases net exports.
 - B) raises the real exchange rate and does not change net exports.
 - C) raises the real exchange rate and decreases net exports.
 - D) lowers the real exchange rate.
13. Unlike the real world, the classical model with fixed output assumes that:
- A) all factors of production are fully utilized.
 - B) all capital is fully utilized but some labor is unemployed.
 - C) all labor is fully employed but some capital lies idle.
 - D) some capital lies idle and some labor is unemployed.
14. In a small open economy, if the world interest rate increases then the supply of domestic currency on the foreign exchange market will _____ and the real exchange rate will _____, holding all else constant.
- A) decrease; decrease
 - B) decrease; increase
 - C) increase; decrease
 - D) increase; increase
15. The production function feature called “constant returns to scale” means that if we:
- A) multiply capital by z_1 and labor by z_2 , we multiply output by z_3 .
 - B) increase capital and labor by 10 percent each, we increase output by 10 percent.
 - C) increase capital and labor by 5 percent each, we increase output by 10 percent.
 - D) increase capital by 10 percent and increase labor by 5 percent, we increase output by 7.5 percent.

16. In the small open economy in equilibrium:
- A) saving is fixed and investment is determined by the investment function and the world interest rate.
 - B) investment is fixed and saving is determined by the saving function and the world interest rate.
 - C) saving is fixed and investment is determined by the trade balance.
 - D) investment is fixed and saving is determined by the trade balance.
17. If output is described by the production function $Y = AK^{0.2}L^{0.8}$, then the production function has:
- A) constant returns to scale.
 - B) diminishing returns to scale.
 - C) increasing returns to scale.
 - D) a degree of returns to scale that cannot be determined from the information given.
18. If consumption depends positively on the level of real balances, and real balances depend negatively on the nominal interest rate in a neoclassical model, then:
- A) the classical dichotomy still holds.
 - B) a rise in money growth leads to a fall in consumption and a rise in investment.
 - C) a rise in money growth leads to a rise in consumption and a fall in investment.
 - D) a rise in money growth leads to a rise in both consumption and investment.
19. If the consumption function is given by $C = 150 + 0.85Y$ and Y increases by 1 unit, then C increases by:
- A) 0.15 unit.
 - B) 0.5 unit.
 - C) 0.85 unit.
 - D) 1 unit.
20. Compared to periods of lower rates of inflation, during a hyperinflation *all* of the following occur *except*:
- A) shoeleather costs increase.
 - B) menu costs become larger.
 - C) relative prices do a better job of reflecting true scarcity.
 - D) tax distortions increase.

21. Assume that the consumption function is given by $C = 150 + 0.85(Y - T)$, the tax function is given by $T = t_0 + t_1Y$, and Y is 5,000. If t_1 decreases from 0.3 to 0.2, then consumption increases by:
- A) 85.
 - B) 425.
 - C) 500.
 - D) 525.
22. If inflation is 6 percent and a worker receives a 4 percent wage increase, then the worker's real wage:
- A) increased 4 percent.
 - B) increased 2 percent.
 - C) decreased 2 percent.
 - D) decreased 6 percent.
23. Assume that a firm is considering building a factory that will cost \$5 million. It believes that it can get a profit from this factory of \$600,000 per year for many years. The interest rate at which the firm can borrow money is 15 percent. After evaluating whether it should build the factory, the firm decides that it should:
- A) not build because the rate of return on the factory is only 6 percent.
 - B) not build because the rate of return on the factory is only 12 percent.
 - C) build because the rate of return on the factory is 30 percent.
 - D) build because the rate of return on the factory is 35 percent.
24. Devoting resources to avoiding the costs of expected inflation leads to:
- A) eliminating the costs of expected inflation.
 - B) fewer relative price changes.
 - C) economic inefficiency.
 - D) a decrease in the transaction velocity of money.
25. A country's exports may be written as equal to:
- A) GDP minus consumption minus investment minus government spending.
 - B) GDP minus consumption of domestic goods and services minus investment of domestic goods and services minus government purchases of domestic goods and services.
 - C) imports.
 - D) GDP minus imports.

26. According to the Fisher effect, the nominal interest rate moves one-for-one with changes in the:
- A) inflation rate.
 - B) expected inflation rate.
 - C) *ex ante* real interest rate.
 - D) *ex post* real interest rate.
27. Net capital outflow is equal to the amount that:
- A) foreign investors lend here.
 - B) domestic investors lend abroad.
 - C) foreign investors lend here minus the amount domestic investors lend abroad.
 - D) domestic investors lend abroad minus the amount that foreign investors lend here.
28. If the real interest rate and real national income are constant, according to the quantity theory and the Fisher effect, a 1 percent increase in money growth will lead to rises in:
- A) inflation of 1 percent and the nominal interest rate of less than 1 percent.
 - B) inflation of 1 percent and the nominal interest rate of 1 percent.
 - C) inflation of 1 percent and the nominal interest rate of more than 1 percent.
 - D) both inflation and the nominal interest rate of less than 1 percent.
29. In a small open economy, if exports equal \$20 billion, imports equal \$30 billion, and domestic national saving equals \$25 billion, then net capital outflow equals:
- A) -\$25 billion.
 - B) -\$10 billion.
 - C) \$10 billion.
 - D) \$25 billion.
30. If the money supply increases 12 percent, velocity decreases 4 percent, and the price level increases 5 percent, then the change in real GDP must be _____ percent.
- A) 3
 - B) 4
 - C) 9
 - D) 11

31. The world interest rate:
- A) is equal to the domestic interest rate.
 - B) makes domestic saving equal to domestic investment.
 - C) is the interest rate charged on loans by the World Bank.
 - D) is the interest rate prevailing in world financial markets.
32. If the quantity of real money balances is kY , where k is a constant, then velocity is:
- A) k .
 - B) $1/k$.
 - C) kP .
 - D) P/k .
33. A small open economy with perfect capital mobility is characterized by *all* of the following *except* that:
- A) its domestic interest rate always exceeds the world interest rate.
 - B) it engages in international trade.
 - C) its net capital outflows always equal the trade balance.
 - D) its government does not impede international borrowing or lending.
34. If an earthquake destroys some of the capital stock, the neoclassical theory of distribution predicts:
- A) the real wage will rise and the real rental price of capital will fall.
 - B) both the real wage and the real rental price of capital will fall.
 - C) both the real wage and the real rental price of capital will rise.
 - D) the real wage will fall and the real rental price of capital will rise.
35. In an open economy:
- A) a trade deficit is always good.
 - B) a trade deficit is always bad.
 - C) a trade deficit may be good or bad.
 - D) a trade surplus is always bad.
36. Assume that some large foreign countries decide to subsidize investment by instituting an investment tax credit. Then a small country's real exchange rate:
- A) will fall and its net exports will rise.
 - B) will rise and its net exports will fall.
 - C) and net exports will both fall.
 - D) and exports will both rise.

37. Two reasons why capital may *not* flow to poor countries are that the poorer countries may:
- A) have economies unlike those described by a Cobb-Douglas production function and not be subject to diminishing returns to capital.
 - B) have already accumulated high levels of capital relative to labor and may already have access to advanced technologies.
 - C) legally prevent the inflow of foreign capital and provide strong legal protection of private property.
 - D) have inferior production capabilities and not enforce property rights.
38. In a small open economy, if the introduction of automatic-teller machines reduces the demand for money, then net exports:
- A) fall and the real exchange rate falls.
 - B) fall but the real exchange rate remains unchanged.
 - C) remain unchanged but the real exchange rate falls.
 - D) and the real exchange rate remain unchanged.
39. If the real exchange rate is high, foreign goods:
- A) and domestic goods are both relatively expensive.
 - B) and domestic goods are both relatively cheap.
 - C) are relatively expensive and domestic goods are relatively cheap.
 - D) are relatively cheap and domestic goods are relatively expensive.
40. For a closed economy, when net capital outflow is measured along the horizontal axis and the real interest rate is measured along the vertical axis, net capital outflow is drawn as a:
- A) vertical line at 0.
 - B) horizontal line at the world real interest rate.
 - C) line that slopes up and to the right.
 - D) line that slopes down and to the right.