

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

- 1) The two major reasons for the tremendous growth in output in the U.S. economy over the last 125 years are 1) _____
A) population growth and low inflation.
B) low inflation and low trade deficits.
C) low unemployment and low inflation.
D) population growth and increased productivity.
- 2) The main reason that the United States has such a high standard of living is 2) _____
A) low unemployment. B) low inflation.
C) high government budget deficits. D) high average labor productivity.
- 3) Average labor productivity is the 3) _____
A) ratio of employed to unemployed workers.
B) amount of workers per machine.
C) amount of output per worker.
D) amount of machines per worker.
- 4) In analyzing macroeconomic data during the past year, you have discovered that average labor productivity fell, but total output increased. What was most likely to have caused this? 4) _____
A) There is nothing unusual in this outcome because this is what normally occurs.
B) Unemployment probably increased.
C) The capital/output ratio probably rose.
D) There was an increase in labor input.
- 5) In which of the following periods did average labor productivity in the United States grow the fastest? 5) _____
A) 1995 to 2008 B) 1973 to 1995 C) 1949 to 1973 D) 1929 to 1935
- 6) The most direct effect of an increase in the growth rate of average labor productivity would be an increase in 6) _____
A) the long-run economic growth rate. B) imported goods.
C) the inflation rate. D) the unemployment rate.
- 7) Short-run contractions and expansions in economic activity are called 7) _____
A) recessions. B) deficits.
C) expansions. D) the business cycle.
- 8) When national output rises, the economy is said to be in 8) _____
A) a deflation. B) a recession. C) an expansion. D) an inflation.
- 9) Which of the following best describes a typical business cycle? 9) _____
A) Trade surpluses are followed by trade deficits.
B) Stagflation is followed by inflationary economic growth.
C) Inflation is followed by unemployment.
D) Economic expansions are followed by economic contractions.

- 10) During recessions, the unemployment rate _____ and output _____.
A) rises; falls B) falls; rises C) falls; falls D) rises; rises 10) _____
- 11) The number of unemployed divided by the labor force equals
A) the labor force participation rate. B) the misery index.
C) the unemployment rate. D) the inflation rate. 11) _____
- 12) The unemployment rate is the
A) number of unemployed divided by the number of employed.
B) labor force divided by the number of unemployed.
C) number of unemployed divided by the labor force.
D) number of employed divided by the number of unemployed. 12) _____
- 13) The highest and most prolonged period of unemployment in the United States over the last 125 years occurred during
A) the Great Depression of the 1930s. B) the 1890s Depression.
C) the 1990-1991 recession. D) World War II. 13) _____
- 14) During the Great Depression, the unemployment rate for the United States peaked at approximately
A) 25%. B) 10%. C) 45%. D) 70%. 14) _____
- 15) A country is said to be experiencing inflation when
A) total output is falling over time.
B) total output is rising over time.
C) prices of most goods and services are falling over time.
D) prices of most goods and services are rising over time. 15) _____
- 16) From 1800 to 1940, the price level in the United States
A) declined slowly. B) increased slowly.
C) trended neither upward nor downward. D) fluctuated wildly. 16) _____
- 17) Before World War II, the average level of prices in the United States usually
A) rose during wartime and fell during peacetime.
B) fell during wartime and fell during peacetime.
C) rose during wartime and rose during peacetime.
D) fell during wartime and rose during peacetime. 17) _____
- 18) A country is said to be experiencing deflation when
A) prices of most goods and services are falling over time.
B) total output is rising over time.
C) prices of most goods and services are rising over time.
D) total output is falling over time. 18) _____
- 19) The inflation rate is the
A) price level divided by the level of output.
B) percent increase in the average level of prices over a year.
C) percent increase in the unemployment rate over a year.
D) percent increase in output over a year. 19) _____

- 20) If the price level was 100 in 2009 and 102 in 2010, the inflation rate was _____
A) 20%. B) 2%. C) 0.2%. D) 102%.
- 21) A closed economy is a national economy that _____
A) has extensive trading and financial relationships with other national economies.
B) has not established diplomatic relations with other national economies.
C) doesn't interact economically with the rest of the world.
D) has a stock market that is not open to traders from outside the country.
- 22) An open economy is a national economy that _____
A) has established diplomatic relations with most other national economies.
B) has extensive trading and financial relationships with other national economies.
C) doesn't interact economically with the rest of the world.
D) has a stock market that is open to traders from anywhere in the world.
- 23) An economy that doesn't interact economically with the rest of the world is called _____
economy.
A) a closed B) a surplus
C) an authoritarian D) an open
- 24) U.S. imports are goods and services _____
A) produced abroad and sold to foreigners.
B) produced in the United States and sold to foreigners.
C) produced abroad and sold to Americans.
D) produced in the United States and sold to Americans.
- 25) Following World War I and World War II, the United States had a _____
A) large trade surplus. B) small trade deficit.
C) small trade surplus. D) large trade deficit.
- 26) In the 1980s, 1990s, and 2000s, the United States has had a _____
A) large trade surplus. B) large trade deficit.
C) small trade deficit. D) small trade surplus.
- 27) A country has a trade surplus when _____
A) exports exceed imports. B) imports equal exports.
C) imports equal zero. D) imports exceed exports.
- 28) A country has a trade deficit when _____
A) exports exceed imports. B) imports exceed exports.
C) imports equal exports. D) exports are zero.
- 29) Data on exports and imports for the United States over the period from 1890 to 2008 show that _____
A) the percentage of total output exported by U.S. firms fell dramatically during World War I and World War II.
B) the United States had large trade deficits throughout this entire period.
C) the United States had large trade surpluses throughout this entire period.
D) a higher percentage of U.S. goods was exported in recent years than in earlier years.

- 30) A central bank is an institution that _____
A) pays for government expenditures. B) controls a nation's monetary policy.
C) determines a nation's fiscal policy. D) runs a country's stock market.
- 31) In the United States, monetary policy is determined by _____
A) the president. B) the Federal Reserve.
C) private citizens. D) the Treasury Department.
- 32) The peak in U.S. government spending as a percent of GDP occurred during _____
A) the 1960s war on poverty. B) the war against Iraq in the 2000s.
C) World War II. D) the Great Depression.
- 33) Why were the U.S. government budget deficits of the 1980s and early 1990s so unusual from a historical point of view? _____
A) It was the first time that deficits diverted funds from other productive uses, such as investment in modern equipment.
B) It was the first time the U.S. government had ever run deficits.
C) It was the first time that deficits were accompanied by very high rates of inflation.
D) In the past, deficits were usually that large only in wartime.
- 34) Critics of the government's fiscal policies argued that government deficits _____
A) caused the level of unemployment in the United States to increase during the 1980s.
B) were linked to the excess of imports over exports that occurred in the 1980s.
C) had directly contributed to a decline in the level of demand in the American economy.
D) prevented capital from flowing into the United States.
- 35) The difference between microeconomics and macroeconomics is that _____
A) microeconomics looks at supply and demand for goods, macroeconomics looks at supply and demand for services.
B) microeconomics looks at national issues, macroeconomics looks at global issues.
C) microeconomics looks at individual consumers, macroeconomics looks at national totals.
D) microeconomics looks at prices, macroeconomics looks at inflation.
- 36) Aggregation is the process of _____
A) forecasting the components of GDP.
B) predicting when recessions will occur.
C) calculating real GDP based on nominal GDP and the price index.
D) summing individual economic variables to obtain economywide totals.

ESSAY. Write your answer in the space provided or on a separate sheet of paper.

- 37) What are the major factors affecting the long-term growth of the economy's output?

38) Macroeconomic information for the economy of Anchovy is given below.

	Year 1	Year 2
Output (pizzas)	8000	9000
Employment (workers)	700	800
Unemployed (workers)	70	100
Labor force (workers)	770	900
Price per pizza	\$8.00	\$9

- (a) What was the growth rate of average labor productivity in Anchovy between Year 1 and Year 2?
- (b) What was the inflation rate in Anchovy between Year 1 and Year 2?
- (c) What was the unemployment rate in Year 1? In Year 2?

39) Using the CPI measure of the price level, which is 100 in the base year of 2007, calculate the annual inflation rates for

- (a) 2008, when the index is 103.7.
- (b) 2009, when the index is 105.5.
- (c) 2010, when the index is 107.7.

40) What is meant by *aggregation*? Why is aggregation important for macroeconomic analysis?

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

- 41) A country that has many well-trained macroeconomic analysts will not necessarily have more beneficial macroeconomic policies because 41) _____
 A) economists agree on so few government policies.
 B) there are few ways in which economists' complex models can be applied to the real world.
 C) economists' understanding of the economy remains poor.
 D) economic policy is usually made by politicians, not economists.
- 42) Many people perceive erroneously that most macroeconomists spend a lot of time engaged in 42) _____
 A) data development. B) macroeconomic research.
 C) macroeconomic analysis. D) forecasting.
- 43) The main goal of macroeconomic research is to 43) _____
 A) make general statements about how the economy works.
 B) analyze current macroeconomic data.
 C) predict how the macroeconomy will perform in the future.
 D) develop new data that can be used to understand better the operation of the economy.
- 44) A set of ideas about the economy that have been organized in a logical framework is called 44) _____
 A) data development. B) empirical analysis.
 C) a methodology. D) economic theory.
- 45) Assumptions for economic theories and models should be 45) _____
 A) logical rather than empirically testable.
 B) simple and reasonable rather than complex.
 C) maintained until overwhelming evidence to the contrary occurs.
 D) rejected if they are not totally realistic.

- 46) Testing a theory by comparing the theory's implications with data obtained in the real world is called _____ 46) _____
A) historical variance analysis. B) empirical analysis.
C) descriptive calibration. D) univariate analysis.
- 47) If the theory behind an economic model fits the data poorly, you would probably want to _____ 47) _____
A) start from scratch with a new model.
B) restate the research question.
C) use the theory to predict what would happen if the economic setting or economic policies change.
D) enrich the model with additional assumptions.

ESSAY. Write your answer in the space provided or on a separate sheet of paper.

- 48) Why is macroeconomic forecasting so difficult? Does this difficulty mean economics is a worthless field of study?
- 49) Match each of the following jobs to its major area: forecasting, analysis, research, or data development. Explain your answers.
(a) Economist at university, testing theories about the efficient allocation of resources in the foreign exchange market
(b) Economist at Wall Street firm trying to predict the rate of inflation next year using past data
(c) Economist at auto firm looking at demand for new automobiles
(d) Economist at the International Trade Commission trying to determine whether foreign firms are dumping goods in the United States
(e) Economist at the Commerce Department developing new methods for calculating price indexes
(f) Economist consulting in Eastern Europe about how to set up free-market financial systems.
- 50) Briefly describe the following tasks of macroeconomists: forecasting; analysis; research; and data development.

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- 51) Positive analysis of economic policy _____ 51) _____
A) is rare in questions of economic policy.
B) generates less agreement among economists than normative analysis.
C) examines the economic consequences of policies and addresses the question of whether those consequences are desirable.
D) examines the economic consequences of policies but does not address the question of whether those consequences are desirable.
- 52) Which of the statements below is primarily normative in nature? _____ 52) _____
A) The inequality of income that exists in the United States is partly caused by an unequal distribution of wealth.
B) The distribution of income in the United States should be more equal than it is.
C) There is an unequal distribution of income in the United States.
D) The distribution of income is more unequal in the United States than it is in Japan.

- 53) Equilibrium in the economy means 53) _____
A) quantities demanded and supplied are equal in all markets.
B) prices are not changing over time.
C) tax revenues equal government spending, so the government has no budget deficit.
D) unemployment is zero.
- 54) Adam Smith's idea of the "invisible hand" says that given a country's resources and its initial distribution of wealth, the use of markets will 54) _____
A) make people as economically well off as possible.
B) eliminate problems of hunger and dissatisfaction.
C) eliminate inequalities between the rich and the poor.
D) insulate a nation from the effects of political instability.
- 55) The two most comprehensive, widely accepted macroeconomic models are 55) _____
A) the classical model and the Keynesian model.
B) the supply-side model and the real business cycle model.
C) the Austrian model and the Keynesian model.
D) the classical model and the supply-side model.
- 56) Classical economists argue that 56) _____
A) government policies will be ineffective and counterproductive.
B) the government should actively intervene in the economy to eliminate business cycles.
C) wages and prices don't adjust quickly, so the economy is slow to return to equilibrium.
D) the government should have an active role in the economy.
- 57) The classical approach to macroeconomics assumes that 57) _____
A) wages, but not prices, adjust quickly to balance quantities supplied and demanded in markets.
B) wages and prices adjust quickly to balance quantities supplied and demanded in markets.
C) neither wages nor prices adjust quickly to balance quantities supplied and demanded in markets.
D) prices, but not wages, adjust quickly to balance quantities supplied and demanded in markets.
- 58) John Maynard Keynes disagreed with the classical economists because he believed that 58) _____
A) wages and prices adjust slowly.
B) government intervention in the economy cannot reduce business cycles.
C) international trade plays a major role in the macroeconomy.
D) unemployment will be eliminated quickly by the invisible hand of the market.
- 59) Keynes was motivated to create a macroeconomic theory different from classical theory because 59) _____
A) monetary policy was more important than the classicals acknowledged.
B) he believed in the idea of the invisible hand.
C) he believed in government intervention in the economy.
D) classical theory was inconsistent with the data in the Great Depression.
- 60) Keynes assumed that wages and prices were slow to adjust in order to explain 60) _____
A) why inflation fell in recessions. B) persistently high unemployment.
C) the high level of interest rates. D) high inflation.

- 61) How did Keynes propose to solve the problem of high unemployment? 61) _____
A) Increase the growth rate of the money supply.
B) Allow wages to decline, so that firms will want to hire more workers.
C) Have the government increase its demand for goods and services.
D) Put on wage and price controls, so wages won't rise and firms won't have to lay people off to cut costs.
- 62) The primary factor that caused most economists to lose their faith in the classical approach to macroeconomic policy was 62) _____
A) the evidence that classical ideas were useful during economic booms, but not during economic recessions.
B) the theoretical proof that classical ideas were invalid.
C) the presence of both high unemployment and high inflation during the 1970s.
D) the high levels of unemployment that occurred during the Great Depression.
- 63) The primary factor that caused some economists to lose their faith in the Keynesian approach to macroeconomic policy was 63) _____
A) theoretical proof that Keynes's ideas were invalid.
B) the high levels of unemployment that occurred during the Great Depression.
C) the presence of both high unemployment and high inflation during the 1970s.
D) evidence that Keynes's ideas were useful during economic recessions, but not during economic booms.

ESSAY. Write your answer in the space provided or on a separate sheet of paper.

- 64) Determine whether each of the following is a positive or normative statement.
(a) The Fed should lower interest rates to increase economic growth, because we're in a recession.
(b) Higher government budget deficits cause higher interest rates.
(c) The trade deficit should decline because of the fall in the value of the dollar.
(d) Because of our high inflation rate, we must reduce the rate of money growth.
(e) A generous unemployment insurance system is a primary cause of high unemployment in Europe.
(f) Increased average labor productivity in a country should lead to faster growth.
(g) Government budget deficits are too high in the United States and should be reduced.
- 65) Why is wage and price flexibility crucial to the idea of the "invisible hand?"
- 66) Compare and contrast the classical and Keynesian schools of thought for the following economic issues.
(a) The flexibility of wages and prices.
(b) The importance of macroeconomic policies.
- 67) In 1993, the debate heated up in the United States about the North American Free Trade Agreement (NAFTA), which proposed to reduce barriers to trade (such as taxes on or limits to imports) among Canada, the United States, and Mexico. Some people opposed strongly the agreement, arguing that an influx of foreign goods under NAFTA would disrupt the U.S. economy, harm domestic industries, and throw American workers out of work. How might a classical economist respond to these concerns? Would you expect a Keynesian economist to be more or less sympathetic to these concerns than the classical economist? Why?

Answer Key

Testname: UNTITLED1

- 1) D
- 2) D
- 3) C
- 4) D
- 5) C
- 6) A
- 7) D
- 8) C
- 9) D
- 10) A
- 11) C
- 12) C
- 13) A
- 14) A
- 15) D
- 16) C
- 17) A
- 18) A
- 19) B
- 20) B
- 21) C
- 22) B
- 23) A
- 24) C
- 25) A
- 26) B
- 27) A
- 28) B
- 29) D
- 30) B
- 31) B
- 32) C
- 33) D
- 34) B
- 35) C
- 36) D
- 37) The major factors are population growth and average labor productivity.
- 38) (a) Average labor productivity: Year 1: $8000/700 = 80/7$; Year 2: $9000/800 = 90/8$; growth rate = $[(90/8)/(80/7)] - 1 = -0.016 = -0.16\%$
(b) Inflation rate: $(9/8) - 1 = 0.125 = 12.5\%$
(c) Unemployment rates: Year 1: $70/770 = 0.091 = 9.1\%$; Year 2: $100/900 = 0.111 = 11.1\%$
- 39) (a) Inflation in 2008 = $(103.7 - 100)/100 \times 100\% = 3.7\%$.
(b) Inflation in 2009 = $(105.5 - 103.7)/100 \times 100\% = 1.7\%$.
(c) Inflation in 2010 = $(107.7 - 105.5)/100 \times 100\% = 2.1\%$.
- 40) Aggregation refers to the process of adding together individual economic variables to obtain economywide totals. Aggregation distinguishes microeconomics from macroeconomics. It allows us to study the economy as a whole, rather than looking at its individual parts.
- 41) D
- 42) D
- 43) A

Answer Key

Testname: UNTITLED1

- 44) D
- 45) B
- 46) B
- 47) A
- 48) Forecasting is difficult because our understanding of how the economy works is imperfect and because it's impossible to take into account all the factors that might affect future economic trends. This just means the field of economics is difficult and complex, not that it's worthless.
- 49) (a) Research
(b) Forecasting
(c) Analysis
(d) Analysis
(e) Data development
(f) Analysis
- 50) (a) Forecasting. Macroeconomists develop models to predict the future values of macroeconomic variables in one or more markets. These models are usually based on economic theory but are statistical in form and estimated using macroeconomic data.
(b) Analysis. Macroeconomists analyze changes in macroeconomic policies as well as other changes in macroeconomic market conditions. This analysis is based on economic theory, uses analytic reasoning techniques, and may rely on forecasting models.
(c) Research. The goal of macroeconomic research is to make general statements about how the economy works. Research economists formulate and test theories.
(d) Data development. Macroeconomic data development provides the data needed in macroeconomic research, analysis, and forecasting. Most macroeconomic data are collected and published by the government.
- 51) D
- 52) B
- 53) A
- 54) A
- 55) A
- 56) A
- 57) B
- 58) A
- 59) D
- 60) B
- 61) C
- 62) D
- 63) C
- 64) (a) Normative
(b) Positive
(c) Positive
(d) Normative
(e) Positive
(f) Positive
(g) Normative
- 65) Wage and price flexibility is crucial because in a free-market system, changes in wages and prices are the signals that coordinate the actions of people and businesses in the economy.

- 66) (a) The flexibility of wages and prices is a principal point of disagreement between classical economists and Keynesians. Classical economists believe that wages and prices are quite flexible; in response to a change in market conditions, wages and prices adjust quickly to their new market-clearing levels. Keynesians believe that wages and prices are rigid or sticky; in response to changes in the economy, wages and prices adjust slowly to their new market-clearing levels.
- (b) Classical and Keynesians also disagree about the use of macroeconomic policies. Given wage-price flexibility, classical economists believe that the market economy normally provides for full employment. They believe that government intervention in the form of macroeconomic fiscal and monetary policies is not needed to prevent recessions. Given slow adjustments in wages and prices, Keynesians believe that recessions could plague the economy for several years. They believe that efficient use of macroeconomic policies could return the economy to equilibrium more quickly.
- 67) A classical economist might argue that the economy would work more efficiently with NAFTA because it reduces trade barriers, making the invisible hand work even better. Workers could specialize even more than before so that total output produced by all three countries would be more. Though the industrial mix might change in each country, wages and prices across industries would adjust quickly, and people in industries that closed down in a particular country would quickly find new jobs.
- A Keynesian economist might be more sympathetic to concerns about NAFTA because of the belief that adjustment to the changes will not occur quickly. As a result, people in particular industries in a country may become unemployed. Wages won't adjust quickly to restore full employment, so some government action (like retraining programs to give displaced workers new skills) may be desirable.