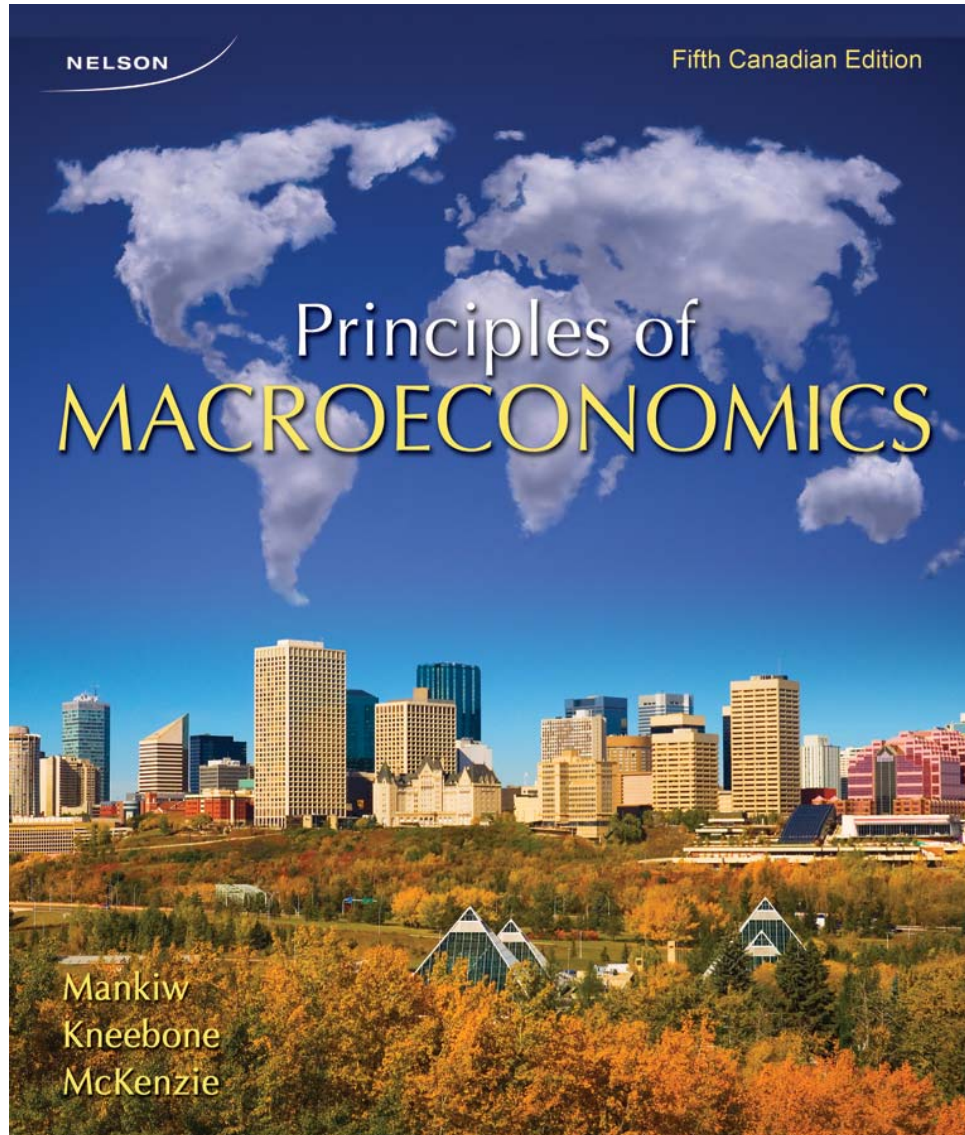


NETA TEST BANK

to accompany



Prepared by

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Principles of Macroeconomics, Fifth Canadian Edition
by Mankiw, Kneebone & McKenzie

Test Bank by Constantin Colonescu.

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Preface

The **Nelson Education Teaching Advantage (NETA) program** is delivering research-based resources that promote student engagement and higher-order thinking and enable the success of Canadian students and educators. The primary NETA components are a *Guide for Classroom Engagement* and our *Testing Advantage* resources.

NETA Test Bank

Nelson Education Ltd. understands that a good quality multiple-choice test bank can provide the means to measure **higher-level thinking** skills as well as recall. Recognizing the importance of multiple-choice testing in today's classroom, we have created the Nelson Education Testing Advantage program (NETA) to ensure the value of our high quality test banks.

The test bank for *Principles of Macroeconomics*, fifth Canadian edition, was prepared by Constantin Colonescu, Grant MacEwan University, and was developed through the NETA training by Ackroyd/ Macdonald/McCollum/Montague/Morante/Ogilvie/Venkateswaran. This test bank offers the Premium Nelson Education Testing Advantage. NETA was created in partnership with David DiBattista, a 3M National Teaching Fellow, professor of psychology at Brock University, and researcher in the area of multiple-choice testing. NETA ensures that subject-matter experts who author test banks have had training in two areas: avoiding common errors in test construction, and developing multiple-choice test questions that “get beyond remembering” to assess higher-level thinking. In addition, Professor DiBattista confirms the subject-matter expert's understanding of and adherence to the NETA principles through a review.

All Premium NETA test banks include David DiBattista's guide for instructors, “Multiple Choice Tests: Getting Beyond Remembering.” This guide has been designed to assist you in using Nelson test banks to achieve your desired outcomes in your course.

This test bank also contains over 3000 questions in multiple-choice, true/false, and essay type format. The lines below each multiple-choice question in this Test Bank provide the following information:

ANS:	Correct answer
RAT:	A rationale, if needed
PTS:	Points that can be assigned for each question (default is 1 point)
REF:	Page reference to text
DIF:	Difficulty type
NOT:	A specific notational reference to the Test Bank question, for instructors wishing to keep track of questions previously used.
BLM:	The Bloom category applicable to the question (Remember or Higher order)

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Chapter 1—Ten Principles of Economics

MULTIPLE CHOICE

1. What is the word that comes from the Greek word for "one who manages a household"?
- a. market
 - b. consumer
 - c. producer
 - d. economy

ANS: D PTS: 1 DIF: Easy REF: p.3
BLM: Remember NOT: Macro TB_1-1

2. From which Greek words is the word economy derived?
- a. "environment"
 - b. "one who manages a household"
 - c. "one who participates in a market"
 - d. "conservation"

ANS: B PTS: 1 DIF: Easy REF: p.3
BLM: Remember NOT: Macro TB_1-2

3. Which of the following statements is NOT true? Households and economies both
- a. must allocate scarce resources.
 - b. face many decisions.
 - c. must allocate the goods and services they produce.
 - d. must have a central decision maker.

ANS: D PTS: 1 DIF: Average REF: p.3
BLM: Remember NOT: Macro TB_1-3

4. With what concept does economics deal primarily with?
- a. scarcity
 - b. poverty
 - c. change
 - d. power

ANS: A PTS: 1 DIF: Easy REF: p.4
BLM: Remember NOT: Macro TB_1-4

5. Which of the following is NOT included in the decisions that every society must make?
- a. what goods will be produced
 - b. who will produce the goods
 - c. what determines consumer preferences
 - d. who will consume the goods

ANS: C PTS: 1 DIF: Average REF: p.4
BLM: Remember NOT: Macro TB_1-5

6. For what reason do both households and societies face many decisions?
- a. because resources are scarce
 - b. because populations may increase or decrease over time
 - c. because wages for households and therefore society fluctuate with business cycles
 - d. because people, by nature, tend to disagree

ANS: A PTS: 1 DIF: Average REF: p.4
BLM: Remember NOT: Macro TB_1-6

7. When is a good considered scarce in a society?
- a. when more output of the good is possible
 - b. when everyone in that society cannot have all they want of the good
 - c. when the government restricts production of the good
 - d. when only the richest people in the economy can buy all they want of the good

ANS: B PTS: 1 DIF: Average REF: p.4
BLM: Remember NOT: Macro TB_1-7

8. When does scarcity exist?
- a. when there is less than an infinite amount of a resource or good
 - b. when society can meet the wants of every individual
 - c. when there is less of a good or resource available than people wish to have
 - d. when the government fails to produce goods

ANS: C PTS: 1 DIF: Average REF: p.4
BLM: Remember NOT: Macro TB_1-8

9. Which of the following would NOT be true in a world without scarcity?
- a. There would be no need for the science of economics.
 - b. Everyone would have all the goods and services they wanted.
 - c. There would have to be an infinite supply of every resource.
 - d. There would be opportunity costs.

ANS: C PTS: 1 DIF: Average REF: p.4
BLM: Higher Order NOT: Macro TB_1-9

10. Approximately what percentage of the world's economies experience scarcity?
- a. 25%
 - b. 50%
 - c. 75%
 - d. 100%

ANS: D PTS: 1 DIF: Easy REF: p.4
BLM: Remember NOT: Macro TB_1-10

11. What is the economy experiencing when a society cannot produce all the goods and services people wish to have?
- a. scarcity
 - b. communism
 - c. externalities
 - d. market failure

ANS: A PTS: 1 DIF: Easy REF: p.4
BLM: Higher Order NOT: Macro TB_1-11

12. For society, when is a good NOT scarce?
- a. if at least one individual in society can obtain all he or she wants of the good
 - b. if firms are producing at full capacity
 - c. if all members of society can have all they want of it
 - d. if those who have enough income can buy all they want of the good

ANS: C PTS: 1 DIF: Average REF: p.4
BLM: Higher Order NOT: Macro TB_1-12

13. Which of the following goods best meets the definition of scarcity?
- a. air
 - b. water in the ocean
 - c. water in a city
 - d. wood in a forest

ANS: C PTS: 1 DIF: Average REF: p.4
BLM: Remember NOT: Macro TB_1-13

14. What does economics study?
- a. business
 - b. how society manages its scarce resources
 - c. central planning
 - d. government regulation

ANS: B PTS: 1 DIF: Easy REF: p.4
BLM: Remember NOT: Macro TB_1-14

15. What does economics study?
- a. how society manages its scarce resources
 - b. the government's role in society
 - c. how to increase production
 - d. How firms make profits

ANS: A PTS: 1 DIF: Easy REF: p.4
BLM: Remember NOT: Macro TB_1-15

16. In most societies, who allocates resources?

- a. a single central planner
- b. those who own the resources
- c. those firms that use resources to provide goods and services
- d. the combined actions of millions of households and firms

ANS: D PTS: 1 DIF: Average REF: p.4
BLM: Remember NOT: Macro TB_1-16

17. Economists study

- a. how people make decisions.
- b. how governments interact with one another.
- c. the forces and trends that affect only the economy as a whole.
- d. how societies change over time.

ANS: D PTS: 1 DIF: Average REF: p.4
BLM: Remember NOT: Macro TB_1-17

18. Which of the following is NOT a major area of study for economists?

- a. how people make decisions
- b. how countries choose national leaders
- c. how people interact with each other
- d. how forces and trends affect the overall economy

ANS: B PTS: 1 DIF: Average REF: p.4
BLM: Remember NOT: Macro TB_1-18

19. What concept is illustrated by the adage, "There is no such thing as a free lunch"?

- a. tradeoffs
- b. scarcity
- c. productivity
- d. efficiency

ANS: A PTS: 1 DIF: Average REF: p.4
BLM: Remember NOT: Macro TB_1-19

20. What does the adage, "There is no such thing as a free lunch," mean?

- a. Even people on welfare have to pay for food.
- b. The cost of living is always increasing.
- c. To get something we like, we usually have to give up another thing we like.
- d. All costs are included in the price of a product.

ANS: C PTS: 1 DIF: Average REF: p.4
BLM: Remember NOT: Macro TB_1-20

21. What do economists illustrate when they use the phrase "There is no such thing as a free lunch"?

- a. how inflation increases prices
- b. that to get one thing, we must give up something else
- c. that nothing is free in a market economy
- d. that if something looks too good to be true, it probably is

ANS: B PTS: 1 DIF: Average REF: p.4
BLM: Remember NOT: Macro TB_1-21

22. Which best represents the concept represented by the adage, "There is no such thing as a free lunch"?
- a. Melissa can only attend the concert if she takes her sister with her.
 - b. Greg is hungry and homeless.
 - c. Brian must repair the tire on his bike before he can ride it to class.
 - d. Kendra must decide between going to Miami or Cancun for spring break.

ANS: D PTS: 1 DIF: Challenging REF: p.4
BLM: Remember NOT: Macro TB_1-22

23. Guns and butter are used to represent the classic societal tradeoff between spending on which two items?
- a. durable and nondurable goods
 - b. imports and exports
 - c. national defense and consumer goods
 - d. law enforcement and agriculture

ANS: C PTS: 1 DIF: Average REF: p.4-5
BLM: Remember NOT: Macro TB_1-23

24. Henry decides to spend 2 hours playing golf rather than working at his job which pays \$8 per hour. What is Henry's tradeoff?
- a. the \$16 he could have earned working for 2 hours
 - b. nothing, because he enjoys playing golf more than working
 - c. the increase in skill he obtains from playing golf for those 2 hours
 - d. nothing, because he spent \$16 for green fees to play golf

ANS: A PTS: 1 DIF: Average REF: p.4-5
BLM: Higher Order NOT: Macro TB_1-24

25. When society requires that firms reduce pollution, what happens?
- a. There is a tradeoff because of reduced incomes to the firms' owners, workers, and customers.
 - b. There is no tradeoff, since everyone benefits from reduced pollution.
 - c. There is no tradeoff for society as a whole, since the cost of reducing pollution falls only on the firms affected by the requirements.
 - d. There is a tradeoff only if some firms are forced to close.

ANS: A PTS: 1 DIF: Challenging REF: p.4-5
BLM: Higher Order NOT: Macro TB_1-25

26. Daniel decides to spend the last two hours of the night before his economics exam studying instead of sleeping. For Daniel, what would his tradeoff be?
- a. nothing, since no dollar value can be put on sleep
 - b. nothing, since studying would be more beneficial than sleep
 - c. the six hours of sleep he could have had if he had gone to bed before midnight
 - d. the two hours of rest he would have gotten

ANS: D PTS: 1 DIF: Average REF: p.4-5
BLM: Higher Order NOT: Macro TB_1-26

27. How does a tradeoff exist between a clean environment and a higher level of income?
- a. Studies show that individuals with higher levels of income actually pollute less than low-income individuals.
 - b. To pay for pollution clean-up, the government must increase taxes which lowers income.
 - c. Laws that reduce pollution raise costs of production and reduce incomes.
 - d. By employing individuals to clean up pollution, employment and income both rise.

ANS: C PTS: 1 DIF: Challenging REF: p.4-5
BLM: Higher Order NOT: Macro TB_1-27

28. Which of the following would NOT be a result of laws that require firms to reduce pollution?
- a. lower spending by government
 - b. higher prices to consumers
 - c. lower wages to workers
 - d. smaller profit to firms

ANS: A PTS: 1 DIF: Average REF: p.4-5
BLM: Remember NOT: Macro TB_1-28

29. What will pollution regulations do?
- a. increase profit to firms
 - b. impose a tradeoff on society
 - c. allow firms to raise workers' wages
 - d. lower prices for consumers

ANS: B PTS: 1 DIF: Average REF: p.4-5
BLM: Remember NOT: Macro TB_1-29

30. Which of the following best defines efficiency?
- a. absolute fairness
 - b. equal distribution
 - c. minimum waste
 - d. consumer sovereignty

ANS: C PTS: 1 DIF: Easy REF: p.5
BLM: Remember NOT: Macro TB_1-30

31. What does efficiency mean?
- a. Society is conserving resources in order to save them for the future.
 - b. Society's goods and services are distributed fairly among society's members.
 - c. Society has lessened its dependence on foreign energy sources.
 - d. Society is getting the most it can from its scarce resources.

ANS: D PTS: 1 DIF: Average REF: p.5
BLM: Remember NOT: Macro TB_1-31

32. In which of the following situations would economists use the word equity?
- a. Each member of society has the same income.
 - b. Society is getting the most it can from its scarce resources.
 - c. Those in society who have the least will receive the most.
 - d. The benefits of society's resources are distributed fairly among society's members.

ANS: D PTS: 1 DIF: Average REF: p.5
BLM: Remember NOT: Macro TB_1-32

33. What is one definition of equity?
- a. equality
 - b. efficiency
 - c. fairness
 - d. similarity

ANS: C PTS: 1 DIF: Easy REF: p.5
BLM: Remember NOT: Macro TB_1-33

34. What happens when government policies are being designed?
- a. There is usually a tradeoff between equity and efficiency.
 - b. Equity and efficiency goals are usually independent of each other.
 - c. Equity can usually be achieved without an efficiency loss.
 - d. Increasing efficiency usually results in more equity.

ANS: A PTS: 1 DIF: Average REF: p.5
BLM: Remember NOT: Macro TB_1-34

35. When government policies such as the welfare system try to help the neediest members of society, what happens?
- a. It increases equity and reduces efficiency.
 - b. It reduces charitable contributions in an economy.
 - c. It increases the productivity of the needy in the society.
 - d. It causes market failure to occur.

ANS: A PTS: 1 DIF: Average REF: p.5
BLM: Higher Order NOT: Macro TB_1-35

36. When the government implements programs such as progressive income tax rates, which of the following is likely to occur?
- a. Equity is increased and efficiency is increased.
 - b. Equity is increased and efficiency is decreased.
 - c. Equity is decreased and efficiency is increased.
 - d. Equity is decreased and efficiency is decreased.

ANS: B PTS: 1 DIF: Average REF: p.5
BLM: Higher Order NOT: Macro TB_1-36

37. When the government attempts to cut the economic pie into more equal slices, what happens?
- a. It is easier to cut the pie, and therefore the economy can produce a larger pie.
 - b. The government can more easily allocate the pie to those most in need.
 - c. The pie gets smaller, and there will be less pie for everyone.
 - d. The economy will spend too much time cutting and loses the ability to produce enough pie for everyone.

ANS: C PTS: 1 DIF: Challenging REF: p.5
BLM: Remember NOT: Macro TB_1-37

38. When the government attempts to improve equity in an economy, what is often the result?
- a. an increase in overall output in the economy
 - b. additional government revenue since overall income will increase
 - c. an actual reduction in equity
 - d. reduced efficiency in the economy

ANS: D PTS: 1 DIF: Average REF: p.5
BLM: Remember NOT: Macro TB_1-38

39. When the government redistributes income from the rich to the poor, what is the result?
- a. Efficiency is improved, but equity is not.
 - b. Both rich people and poor people benefit directly.
 - c. People work less and produce fewer goods and services.
 - d. Rich people consume fewer goods, but poor people consume more goods, resulting in no real change.

ANS: C PTS: 1 DIF: Average REF: p.5
BLM: Remember NOT: Macro TB_1-39

40. In economics, what is the cost of something?
- a. the dollar amount of obtaining it
 - b. always measured in units of time given up to get it
 - c. what you give up to get it
 - d. usually higher than people think it will be

ANS: C PTS: 1 DIF: Easy REF: p.5
BLM: Remember NOT: Macro TB_1-40

41. What is the term for what you give up to obtain an item?
- a. opportunity cost
 - b. explicit cost
 - c. true cost
 - d. direct cost

ANS: A PTS: 1 DIF: Easy REF: p.6
BLM: Remember NOT: Macro TB_1-41

42. Paul receives \$300 as a birthday gift. In deciding how to spend the money, he narrows his options down to four choices, Option A, Option B, Option C, and Option D. Each option costs \$200. Finally he decides on Option B. What is the opportunity cost of Option B?
- a. the value to him of the Option he would have chosen if Option B were not available
 - b. the value to him of Options A, C, and D combined
 - c. \$300
 - d. \$200

ANS: A PTS: 1 DIF: Average REF: p.6
BLM: Higher Order NOT: Macro TB_1-42

43. What is the opportunity cost of going to college?
- a. the total spent on food, clothing, books, transportation, tuition, lodging, and other expenses
 - b. the value of the best opportunity a student gives up to attend college
 - c. zero for students who are fortunate enough to have all of their college expenses paid by someone else
 - d. zero, since a college education will allow a student to earn a larger income after graduation

ANS: C PTS: 1 DIF: Average REF: p.6
BLM: Higher Order NOT: Macro TB_1-43

44. For most students, what is the largest single cost of a university education?
- a. the wages given up to attend school
 - b. tuition, fees, and books
 - c. room and board
 - d. transportation, parking, and entertainment

ANS: A PTS: 1 DIF: Average REF: p.6
BLM: Higher Order NOT: Macro TB_1-44

45. What is the largest single cost of going to university?
- a. books
 - b. room and board
 - c. tuition
 - d. lost wages

ANS: D PTS: 1 DIF: Easy REF: p.6
BLM: Higher Order NOT: Macro TB_1-45

46. What is the opportunity cost of an item?
- a. the number of hours needed to earn money to buy it
 - b. what you give up to get that item
 - c. usually more than the dollar value of the item
 - d. usually less than the dollar value of the item

ANS: B PTS: 1 DIF: Easy REF: p.6
BLM: Remember NOT: Macro TB_1-46

47. Maurice receives \$100 as a birthday gift. In deciding how to spend the money, he narrows his options down to four choices, Option A, Option B, Option C, and Option D. Each option costs \$100. Finally he decides on Option B. What is the opportunity cost of Option B?
- a. the value to him of the Option he would have chosen if Option B were not available
 - b. the value to him of Options A, C, and D combined
 - c. \$300
 - d. \$100

ANS: A PTS: 1 DIF: Average REF: p.6
BLM: Higher Order NOT: Macro TB_1-47

48. Mallory decides to spend 3 hours working overtime rather than watching a video with her friends. She earns \$8 an hour. What is her opportunity cost of working?
- a. the \$24 she earns working
 - b. the \$24 minus the enjoyment she would have received from watching the video
 - c. the enjoyment she would have received had she watched the video
 - d. nothing, since she would have received less than \$24 of enjoyment from the video

ANS: C PTS: 1 DIF: Challenging REF: p.6
BLM: Higher Order NOT: Macro TB_1-48

49. Russell spends an hour studying instead of playing tennis. What is the opportunity cost to him of studying?
- a. the improvement in his grades from studying for the hour
 - b. the difference between the improvement in his grades from studying minus the enjoyment of playing tennis
 - c. the enjoyment and exercise he would have received had he played tennis
 - d. Zero, Since Russell chose to study rather than to play tennis, the value of studying must have been greater than the value of playing tennis

ANS: C PTS: 1 DIF: Average REF: p.6
BLM: Higher Order NOT: Macro TB_1-49

50. What do we know about college-age athletes who drop out of college to play professional sports?
- a. They are not rational decision makers.
 - b. They are well aware that their opportunity cost of attending college is very high.
 - c. They are concerned more about present circumstances than their future.
 - d. They underestimate the value of a college education.

ANS: B PTS: 1 DIF: Average REF: p.6
BLM: Remember NOT: Macro TB_1-50

51. How do people make decisions at the margin?
- a. by following tradition
 - b. by experience
 - c. by calculating dollar costs
 - d. by comparing costs and benefits

ANS: D PTS: 1 DIF: Easy REF: p.6
BLM: Remember NOT: Macro TB_1-51

52. What does the word "margin" mean?

- a. edge
- b. distance
- c. space
- d. measure

ANS: A PTS: 1 DIF: Easy REF: p.6
BLM: Remember NOT: Macro TB_1-52

53. What does making decisions "at the margin" mean?

- a. that people make those decisions that do not impose a marginal cost
- b. that people evaluate how easily a decision can be reversed if problems arise
- c. that people compare the marginal costs and marginal benefits of each decision
- d. that people always calculate the marginal dollar costs for each decision

ANS: C PTS: 1 DIF: Average REF: p.6
BLM: Remember NOT: Macro TB_1-53

54. What is a marginal change?

- a. a long-term trend
- b. a large, significant adjustment
- c. a change for the worse, and so is usually short-term
- d. a small incremental adjustment

ANS: D PTS: 1 DIF: Easy REF: p.6
BLM: Remember NOT: Macro TB_1-54

55. Which of the following is the best example of a marginal change?

- a. After graduating from university, Audrey's income increases from \$500 per month to \$3,000 per month.
- b. Morgan gets a raise at her part-time job and is now paid \$7.25 per hour instead of \$7.00.
- c. Housing prices in an area increase by 40% when a new highway is built in a small town.
- d. A hard freeze wipes out half of the tobacco crop in Ontario and the price of cigarettes doubles.

ANS: B PTS: 1 DIF: Challenging REF: p.6-7
BLM: Higher Order NOT: Macro TB_1-55

56. Which of the following is the best example of a marginal change?

- a. After graduating from university, Neville's income increases from \$1,000 per month to \$1,100 per month.
- b. Marliss is granted a raise at her part-time job and is now paid \$8.25 per hour instead of \$8.00.
- c. Housing prices in an area increase by 50% when a new freeway is built in a small town.
- d. A hard freeze wipes out half of the potato crop in Prince Edward Island and the price of potatoes doubles.

ANS: B PTS: 1 DIF: Challenging REF: p.6-7
BLM: Higher Order NOT: Macro TB_1-56

57. Which of the following is the best example of a marginal change?
- The price of water rose in Calgary by 2% last year.
 - Kim gets a big promotion at work. She also gets a raise from \$25,000 per year to \$40,000 per year.
 - Mark graduates from university and takes a job. His income increases from \$10,000 per year to \$50,000 per year.
 - A drought hits Saskatchewan and the price of wheat increases from \$4.00 per bushel to \$8.00 per bushel.

ANS: A PTS: 1 DIF: Challenging REF: p.6
BLM: Higher Order NOT: Macro TB_1-57

58. A marginal change is illustrated by which of the following?
- Nancy retires and takes a part-time job. She was working 40 hours per week and now works 10 hours per week.
 - Provincial University has announced that due to provincial budget deficits, tuition must rise by 25% next year.
 - Ryan moved to a new apartment and now pays 40% more rent than before.
 - Vancouver, which usually receives 10 inches of rain per year, received 11 inches last year.

ANS: D PTS: 1 DIF: Challenging REF: p.6
BLM: Higher Order NOT: Macro TB_1-58

59. After much consideration, you have chosen Cancun over Ft. Lauderdale for your Spring Break trip this year. For this decision to change, which of the following must occur?
- The marginal benefit of Cancun must increase.
 - The marginal cost of Cancun must decrease.
 - The marginal benefit of Ft. Lauderdale must increase.
 - The marginal cost of Ft. Lauderdale must increase.

ANS: C PTS: 1 DIF: Challenging REF: p.6-7
BLM: Higher Order NOT: Macro TB_1-59

60. The average cost per seat on a bus trip from Montreal to Toronto is \$140. Suppose no refreshments are served and 3 seats are empty. How could the bus company increase its profit?
- if it charged no less than \$140 for the 3 remaining seats
 - if it charged more than \$140 for the 3 remaining seats
 - if it charged any ticket price above \$0 for the remaining seats
 - if it left the seats empty

ANS: C PTS: 1 DIF: Average REF: p.6-7
BLM: Higher Order NOT: Macro TB_1-60

61. The average cost per seat on an airplane trip from Calgary to Edmonton is \$105. Suppose no refreshments are served and 7 seats are empty. How could the airline company increase its profit?
- if it charged no less than \$105 for the 7 remaining seats
 - if it charged more than \$105 for the 7 remaining seats
 - if it charged any ticket price above \$0 for the remaining seats
 - if it left the seats empty

ANS: C PTS: 1 DIF: Average REF: p.6-7
BLM: Higher Order NOT: Macro TB_1-61

62. When does a rational decision maker take an action?
- a. only if the marginal benefit is less than the marginal cost
 - b. only if the marginal benefit is greater than the marginal cost
 - c. only if the average benefit is greater than the average cost
 - d. only if the marginal benefit is greater than both the average cost and the marginal cost

ANS: B PTS: 1 DIF: Average REF: p.6-7
BLM: Remember NOT: Macro TB_1-62

63. Mike has spent \$500 purchasing and repairing an old fishing boat, which he expects to sell for \$800 once the repairs are complete. He discovers that he needs an additional repair, which will cost \$400, in order to complete the repairs. He can sell the boat as it is now for \$300. What should he do?
- a. He should cut his losses and take the \$300.
 - b. He should never sell something for less than it cost.
 - c. He should complete the repairs and sell the boat.
 - d. It doesn't matter which action he takes; the outcome is the same either way.

ANS: C PTS: 1 DIF: Challenging REF: p.6-7
BLM: Higher Order NOT: Macro TB_1-63

64. Mike has spent \$800 purchasing and repairing an old motorcycle, which he expects to sell for \$1200 once the repairs are complete. He discovers that he needs an additional repair, which will cost \$200, in order to complete the repairs. He can sell the motorcycle as it is now for \$400. What should he do?
- a. He should cut his losses and take the \$400.
 - b. He should never sell something for less than it cost.
 - c. He should complete the repairs and sell the motorcycle.
 - d. It doesn't matter which action he takes; the outcome is the same either way.

ANS: C PTS: 1 DIF: Challenging REF: p.6-7
BLM: Higher Order NOT: Macro TB_1-64

65. Carol has spent \$2,000 purchasing and repairing an old car, which she expects to sell for \$2,400 once the repairs are complete. She discovers that she needs an additional repair, which will cost \$400, in order to complete the repairs. She can sell the car as it is now for \$2,000. What should she do?
- a. She should cut her losses and take the \$2,400.
 - b. She should never sell something for less than it cost.
 - c. She should complete the repairs and sell the car.
 - d. It doesn't matter which action she takes; the outcome is the same either way.

ANS: D PTS: 1 DIF: Challenging REF: p.6-7
BLM: Higher Order NOT: Macro TB_1-65

66. Tim has spent \$2,500 purchasing and repairing a Hummer, which he expects to sell for \$3,500 once the repairs are complete. He discovers that he needs an additional repair, which will cost \$1,100, in order to complete the repairs. He can sell the Hummer as it is now for \$900. What should he do?
- a. He should cut his losses and take the \$900.
 - b. He should never sell something for less than it cost.
 - c. He should complete the repairs and sell the Hummer.
 - d. It doesn't matter which action he takes; the outcome is the same either way.

ANS: C PTS: 1 DIF: Challenging REF: p.6-7
BLM: Higher Order NOT: Macro TB_1-66

67. Monica has spent \$30,000 purchasing and repairing an old cabin, which she expects to sell for \$40,000 once the repairs are complete. She discovers that she needs an additional repair, which will cost \$20,000, in order to complete the repairs. She can sell the cabin as it is now for \$25,000. What should she do?
- a. She should cut her losses and take the \$25,000.
 - b. She should never sell something for less than it cost.
 - c. She should complete the repairs and sell the cabin.
 - d. It doesn't matter which action she takes; the outcome is the same either way.

ANS: A PTS: 1 DIF: Challenging REF: p.6-7
BLM: Higher Order NOT: Macro TB_1-67

68. Stan buys a 1966 Mustang, which he plans to restore and sell. He anticipates that the cost of the car and the repairs will be \$10,000 and that he can sell it for \$13,000. When he has spent \$10,000, he discovers he needs to replace the engine, which will cost \$4,000. He can sell the car without the new engine for \$9,000. What should Stan do?
- a. complete the repairs and sell the car for \$13,000
 - b. cut his losses and sell the car now for \$9,000
 - c. never try such an expensive project again
 - d. be totally indifferent between finishing the project and selling the car now

ANS: D PTS: 1 DIF: Challenging REF: p.6-7
BLM: Higher Order NOT: Macro TB_1-68

69. Stan buys a 1966 Mustang, which he plans to restore and sell. He anticipates that the cost of the car and the repairs will be \$8,000 and that he can sell it for \$10,000. When he has spent \$7,000, he discovers he needs to replace the engine, which will cost \$4,000. He can sell the car without the new engine for \$9,000. What should Stan do?
- a. complete the repairs and sell the car for \$10,000
 - b. cut his losses and sell the car now for \$9,000
 - c. never try such an expensive project again
 - d. be totally indifferent between finishing the project and selling the car now

ANS: B PTS: 1 DIF: Challenging REF: p.6-7
BLM: Higher Order NOT: Macro TB_1-69

70. Lisa buys a 1982 BMW, which she plans to restore and sell. She anticipates that the cost of the car and the repairs will be \$14,000 and that she can sell it for \$20,000. When she has spent \$11,000, she discovers she needs to replace the engine, which will cost \$5,000. She can sell the car without the new engine for \$14,000. What should Lisa do?
- a. complete the repairs and sell the car for \$20,000
 - b. cut her losses and sell the car now for \$14,000
 - c. never try such an expensive project again
 - d. be totally indifferent between finishing the project and selling the car now

ANS: A PTS: 1 DIF: Challenging REF: p.6-7
BLM: Higher Order NOT: Macro TB_1-70

71. Lisa buys a 1982 BMW, which she plans to restore and sell. She anticipates that the cost of the car and the repairs will be \$14,000 and that she can sell it for \$15,000. When she has spent \$10,000, she discovers she needs to replace the engine, which will cost \$4,000. She can sell the car without the new engine for \$11,000. What should Lisa do?
- a. complete the repairs and sell the car for \$15,000
 - b. cut her losses and sell the car now for \$11,000
 - c. never try such an expensive project again
 - d. be totally indifferent between finishing the project and selling the car now

ANS: D PTS: 1 DIF: Challenging REF: p.6-7
BLM: Higher Order NOT: Macro TB_1-71

72. A donut shop sells fresh baked donuts from 5 a.m. until 3 p.m. every day but Sunday. The cost of making and selling a dozen glazed donuts is \$1.00. Since this shop does not sell day-old donuts the next day, what should the manager do if he still has 10 dozen left at 2:30 p.m.?
- a. lower the price of the remaining donuts even if the price falls below \$1.00
 - b. lower the price of the remaining donuts as long as it's more than \$1.00
 - c. lower the price on all donuts so they will all be sold earlier in the day
 - d. throw them away and produce 10 fewer dozen tomorrow

ANS: A PTS: 1 DIF: Challenging REF: p.6-7
BLM: Higher Order NOT: Macro TB_1-72

73. A donut shop sells fresh baked donuts from 5 a.m. until 3 p.m. every day but Sunday. The cost of making and selling a dozen glazed donuts is \$2.00. Since this shop does not sell day-old donuts the next day, what should the manager do if she still has 10 dozen left at 2:30 p.m.?
- a. lower the price of the remaining donuts even if the price falls below \$2.00
 - b. lower the price of the remaining donuts as long as it's more than \$2.00
 - c. lower the price on all donuts so they will all be sold earlier in the day
 - d. throw them away and produce 10 fewer dozen tomorrow

ANS: A PTS: 1 DIF: Challenging REF: p.6-7
BLM: Higher Order NOT: Macro TB_1-73

74. A furniture maker currently produces 100 tables per week and sells them for a profit. She is considering expanding her operation in order to make more tables. Should she expand?
- a. Yes, because making tables is profitable.
 - b. No, because she may not be able to sell the additional tables.
 - c. It depends on the marginal cost of producing more tables and the marginal revenue she will earn from selling more tables.
 - d. It depends on the average cost of producing more tables and the average revenue she will earn from selling more tables.

ANS: C PTS: 1 DIF: Average REF: p.7
BLM: Higher Order NOT: Macro TB_1-74

75. In the nation of Dictatorland, farmers traditionally feed grain to their livestock. Central planners, however, decided to increase the price of grain to make grain farmers happy and to reduce the price of bread made from that grain to make city dwellers happy. Now the price of bread is lower than the price of grain. What might we now expect?
- farmers to continue to feed grain to their livestock
 - farmers to start feeding bread to their livestock
 - city dwellers to start buying grain to make bread to eat
 - city dwellers to start buying grain to make bread to sell

ANS: B PTS: 1 DIF: Average REF: p.7
BLM: Higher Order NOT: Macro TB_1-75

76. Your professor loves her work, teaching economics. She has been offered other positions in the corporate world making 25 percent more, but has decided to stay in teaching. What might change her decision?
- if the marginal cost of teaching increased
 - if the marginal benefit of teaching increased
 - if the marginal cost of teaching decreased
 - if the marginal cost of a corporate job increased

ANS: A PTS: 1 DIF: Challenging REF: p.6-7
BLM: Higher Order NOT: Macro TB_1-76

77. Suppose your management professor has been offered a corporate job with a 30% pay increase. He has decided to take the job. What happened for him?
- The marginal cost of leaving was greater than the marginal benefit.
 - The marginal benefit of leaving was greater than the marginal cost.
 - The marginal benefit of teaching was greater than the marginal cost.
 - The marginal cost of teaching was greater than the marginal benefit.

ANS: B PTS: 1 DIF: Challenging REF: p.6-7
BLM: Higher Order NOT: Macro TB_1-77

78. Suppose your management professor has been offered a corporate job with a 30% pay increase. He has decided not to take the job. What happened for him?
- The marginal cost of leaving was greater than the marginal benefit.
 - The marginal benefit of leaving was greater than the marginal cost.
 - The marginal benefit of leaving was less than the marginal cost.
 - The marginal benefit of teaching was greater than the marginal cost.

ANS: C PTS: 1 DIF: Challenging REF: p.6-7
BLM: Higher Order NOT: Macro TB_1-78

79. When policymakers make policies that change the costs and benefits that people face, what can the policymakers do?
- alter behaviours
 - make people ignore incentives
 - create inflation
 - reduce government revenue

ANS: A PTS: 1 DIF: Average REF: p.7
BLM: Remember NOT: Macro TB_1-79

80. According to economists, what do people respond to?

- a. laws
- b. incentives
- c. threats more than rewards
- d. positives, but not negatives

ANS: B PTS: 1 DIF: Easy REF: p.7
BLM: Remember NOT: Macro TB_1-80

81. What did Ralph Nader's book *Unsafe at Any Speed* cause the U.S. government to require?

- a. safety glass in all new cars
- b. seat belts in all new cars
- c. air bags in all new cars
- d. stricter drunk driving laws

ANS: B PTS: 1 DIF: Easy REF: p.8
BLM: Remember NOT: Macro TB_1-81

82. What has been the result of laws requiring that drivers wear seat belts?

- a. a reduction in both driver deaths and pedestrian deaths
- b. fewer accidents and fewer deaths per accident
- c. fewer driver deaths, fewer accidents, and fewer pedestrian deaths
- d. little change in the number of driver deaths, but more accidents and more pedestrian deaths

ANS: D PTS: 1 DIF: Average REF: p.8
BLM: Remember NOT: Macro TB_1-82

83. What has been one effect of a government-imposed seat belt law?

- a. fewer pedestrian deaths
- b. safer driving
- c. an increase in the number of accidents
- d. everyone now wears seat belts

ANS: C PTS: 1 DIF: Easy REF: p.8
BLM: Remember NOT: Macro TB_1-83

84. Which of the following does NOT result when seat belt laws alter a driver's cost-benefit calculation?

- a. Fewer drivers are killed
- b. More pedestrians are killed
- c. Drivers drive faster
- d. More accidents occur

ANS: A PTS: 1 DIF: Average REF: p.8
BLM: Remember NOT: Macro TB_1-84

85. In the former Soviet Union, producers were paid for meeting output targets, not for selling products. Under those circumstances, what were the economic incentives for producers?
- a. to produce good quality products so that society benefits from the resources used
 - b. to conserve on costs, so as to maintain efficiency in the economy
 - c. to produce enough to meet the output target, without regard for quality or cost
 - d. to produce those products that society desires most

ANS: C PTS: 1 DIF: Average REF: p.8
BLM: Remember NOT: Macro TB_1-85

86. How can trade benefit a family?
- a. by allowing the family to buy a greater variety of goods and services at a lower cost
 - b. by allowing each person to buy only the goods and services they want most
 - c. it can benefit only if the family is not in economic competition with other families
 - d. trade can only benefit entire nations, not individuals

ANS: A PTS: 1 DIF: Average REF: p.8-9
BLM: Remember NOT: Macro TB_1-86

87. Which is the most accurate statement about trade?
- a. Trade can make every nation better off.
 - b. Trade makes some nations better off and others worse off.
 - c. Trading for a good can make a nation better off only if the nation cannot produce that good itself.
 - d. Trade helps rich nations and hurts poor nations.

ANS: A PTS: 1 DIF: Average REF: p.8-9
BLM: Remember NOT: Macro TB_1-87

88. Which of the following statements about trade is NOT true?
- a. Trade increases competition.
 - b. One country wins and one country loses.
 - c. Canada can benefit from trade with any country.
 - d. Trade allows people to buy a greater variety of goods and services at lower cost.

ANS: B PTS: 1 DIF: Average REF: p.8-9
BLM: Remember NOT: Macro TB_1-88

89. What is NOT a benefit from trade?
- a. the ability to specialize
 - b. a greater variety of goods and services becoming available
 - c. less competition
 - d. lower prices

ANS: C PTS: 1 DIF: Average REF: p.8-9
BLM: Remember NOT: Macro TB_1-89

90. What does trade between Canada and India do?
- a. benefits both Canada and India
 - b. is a losing proposition for Canada because India has cheaper labour
 - c. is like a sports contest: one side wins and the other side loses
 - d. is a losing proposition for India because Canadian workers are more productive

ANS: A PTS: 1 DIF: Average REF: p.8-9
BLM: Remember NOT: Macro TB_1-90

91. How can Canada benefit from trade?
- a. only with nations that can produce goods Canada cannot produce
 - b. with any nation
 - c. with any nation not in economic competition with Canada
 - d. only with less developed nations

ANS: B PTS: 1 DIF: Average REF: p.8-9
BLM: Remember NOT: Macro TB_1-91

92. What happens if Japan chooses to engage in trade?
- a. It will only benefit if it trades with countries that produce goods it cannot produce.
 - b. It cannot benefit if it trades with less developed countries.
 - c. It should first attempt to produce the good itself.
 - d. It can benefit by trading with any other country.

ANS: D PTS: 1 DIF: Average REF: p.8-9
BLM: Remember NOT: Macro TB_1-92

93. If Canada decides to trade with Mexico, what do we know?
- a. Mexico will be better off, but trade with a less developed country could not help Canada.
 - b. It will not benefit Mexico because workers in Canada are more productive.
 - c. It will benefit Mexico because workers in Canada are more productive.
 - d. Mexico and Canada can both be better off.

ANS: D PTS: 1 DIF: Average REF: p.8-9
BLM: Remember NOT: Macro TB_1-93

94. If France is better than Belarus at producing wine, but Belarus is better than France at producing crystal, what should happen?
- a. Belarus should sell crystal to France, and should buy French wine.
 - b. Belarus should impose a tariff on French wine in order to protect jobs in the Belarusian crystal industry.
 - c. Belarus should subsidize its wine industry so that it can compete with French wine.
 - d. Belarus should put a quota on the amount of French wine imported.

ANS: A PTS: 1 DIF: Challenging REF: p.8-9
BLM: Remember NOT: Macro TB_1-94

95. Which of the following is the best statement about markets?
- a. Markets are usually a good way to organize economic activity.
 - b. Markets are usually inferior to central planning as a way to organize economic activity.
 - c. Markets fail and are therefore not an acceptable way to organize economic activity.
 - d. Markets are a good way to organize economic activity in developed nations, but not in less developed nations.

ANS: A PTS: 1 DIF: Average REF: p.9
BLM: Higher Order NOT: Macro TB_1-96

96. Which would NOT be true in a market economy?
- a. Firms decide whom to hire and what to produce.
 - b. Government policies do not affect the decisions of firms and households.
 - c. Households decide which firms to work for and what to buy with their incomes.
 - d. Profit and self-interest guide the decisions of firms and households.

ANS: B PTS: 1 DIF: Average REF: p.9
BLM: Remember NOT: Macro TB_1-96

97. In what economy are the decisions of firms and households guided by profit and self-interest?
- a. a command economy
 - b. a traditional economy
 - c. a market economy
 - d. in every economy

ANS: C PTS: 1 DIF: Easy REF: p.9
BLM: Remember NOT: Macro TB_1-97

98. A friend of yours asks you why market prices are better than government-determined prices. What do you say?
- a. because they generally reflect the value of a good to society, but not the cost of making it
 - b. because they generally reflect the cost of making a good to society, but not its value
 - c. because they generally reflect both the value of a good to society and the cost of making it
 - d. because they generally reflect neither the value of a good to society nor the cost of making it

ANS: C PTS: 1 DIF: Easy REF: p.9
BLM: Remember NOT: Macro TB_1-98

99. In a market economy, what guides economic activity?
- a. the government
 - b. corporations
 - c. central planners
 - d. prices

ANS: D PTS: 1 DIF: Average REF: p.9-11
BLM: Remember NOT: Macro TB_1-99

100. In a market economy, decisions are guided by individual self-interest. What impact does this have?
- a. There is still the ability to achieve desirable economic well-being for society as a whole.
 - b. There is a strong need for government intervention in the market.
 - c. There is less efficiency in market economies than in command economies.
 - d. There is more need for a strong legal system to control individual greed.

ANS: A PTS: 1 DIF: Challenging REF: p.9
BLM: Remember NOT: Macro TB_1-100

101. How do prices direct economic activity in a market economy?
- a. by influencing the actions of buyers and sellers
 - b. by reducing scarcity of the goods and services produced
 - c. by eliminating the need for government intervention
 - d. by allocating goods and services produced in the most equitable way

ANS: A PTS: 1 DIF: Average REF: p.10
BLM: Remember NOT: Macro TB_1-101

102. In a market economy, what do prices reflect?
- a. the popularity of a good in society
 - b. the cost to society of making the good
 - c. the quantity society will ultimately choose to produce
 - d. the level of wealth in society

ANS: B PTS: 1 DIF: Average REF: p.10
BLM: Remember NOT: Macro TB_1-102

103. What is one advantage that market economies have over central planning?
- a. Market economies provide an equal distribution of goods and services to consumers.
 - b. Market economies establish government economic control.
 - c. Market economies solve the problem of scarcity.
 - d. Market economies are more efficient.

ANS: D PTS: 1 DIF: Average REF: p.9-10
BLM: Remember NOT: Macro TB_1-103

104. Which is the most correct statement about the invisible hand?
- a. The invisible hand always ensures both equity and efficiency.
 - b. The invisible hand cannot ensure either equity or efficiency.
 - c. The invisible hand is more effective at ensuring efficiency than it is at ensuring equity.
 - d. The invisible hand is more effective at ensuring equity than it is at ensuring efficiency.

ANS: C PTS: 1 DIF: Challenging REF: p.910
BLM: Higher Order NOT: Macro TB_1-104

105. According to Adam Smith, what is the success of decentralized market economies primarily due to?
- a. the basic benevolence of society
 - b. society's justice (legal) system
 - c. individuals' self-interest
 - d. basic human survival instincts

ANS: C PTS: 1 DIF: Average REF: p.9-10
BLM: Remember NOT: Macro TB_1-105

106. How is the self-interest of the participants in an economy guided into promoting general economic self-interest?
- a. by the invisible hand
 - b. by market power
 - c. by government intervention
 - d. by property rights

ANS: A PTS: 1 DIF: Easy REF: p.9-10
BLM: Remember NOT: Macro TB_1-106

107. Which of the following observations was made famous by Adam Smith in his book *The Wealth of Nations*?
- a. There is no such thing as a free lunch.
 - b. People buy more when prices are low than when prices are high.
 - c. No matter how much people earn, they tend to spend more than they earn.
 - d. Households and firms interacting in markets are guided by an "invisible hand" that leads them to desirable market outcomes.

ANS: D PTS: 1 DIF: Average REF: p.9-10
BLM: Remember NOT: Macro TB_1-107

108. Who coined the term "invisible hand"?
- a. Adam Smith.
 - b. David Ricardo.
 - c. John Maynard Keynes.
 - d. Milton Friedman.

ANS: A PTS: 1 DIF: Easy REF: p.9-10
BLM: Remember NOT: Macro TB_1-108

109. How does the "invisible hand" direct economic activity?
- a. through advertising
 - b. through prices
 - c. through central planning
 - d. through government regulations

ANS: B PTS: 1 DIF: Average REF: p.9-10
BLM: Remember NOT: Macro TB_1-109

110. How does a market economy reward people?
- a. according to their need for goods and services
 - b. according to how willing they are to work
 - c. according to their ability to produce things that other people are willing to pay for
 - d. according to their ability to produce things of cultural importance

ANS: C PTS: 1 DIF: Average REF: p.9-10
BLM: Remember NOT: Macro TB_1-110

111. What can hinder the invisible hand's ability to coordinate the decisions of the firms and households in the economy?

- a. government actions that distort prices
- b. increased competition in the market
- c. extended periods of unemployment
- d. a dramatic reduction in consumer spending

ANS: A PTS: 1 DIF: Challenging REF: p.9-10
BLM: Remember NOT: Macro TB_1-111

112. When was Adam Smith's book *The Wealth of Nations* published?

- a. 1692.
- b. 1776.
- c. 1816.
- d. 1936.

ANS: B PTS: 1 DIF: Easy REF: p.10
BLM: Remember NOT: Macro TB_1-112

113. When people act in their own self-interest, what typically happens in a market system according to Adam Smith?

- a. They help only themselves.
- b. They harm others.
- c. They help others, but not as much as they would have if they were not self-interested.
- d. They help others even more than when they seek to help others.

ANS: D PTS: 1 DIF: Average REF: p.10
BLM: Remember NOT: Macro TB_1-113

114. How does the invisible hand primarily work to promote general well-being in the economy?

- a. through government intervention
- b. through the political process
- c. through self interest
- d. through altruism

ANS: C PTS: 1 DIF: Easy REF: p.9
BLM: Remember NOT: Macro TB_1-114

115. Why do taxes adversely affect the allocation of resources in society?

- a. because they do not always fall more heavily on the rich
- b. because the taxes collected are not enough to finance government spending
- c. because not everyone pays taxes
- d. because they distort prices and thus the decisions of households and firms

ANS: D PTS: 1 DIF: Average REF: p.10
BLM: Remember NOT: Macro TB_1-115

116. What is a primary function of prices in a market economy?
- a. to provide participants with economic information
 - b. to provide participants with spending limits
 - c. to provide participants with accounting capabilities
 - d. to provide participants with an equitable distribution of goods

ANS: A PTS: 1 DIF: Average REF: p.10
BLM: Remember NOT: Macro TB_1-116

117. What happens when the government prevents prices from adjusting naturally to supply and demand?
- a. It stabilizes the economy by reducing market uncertainties.
 - b. It adversely affects the allocation of resources.
 - c. The improvement in equity justifies the reduction in efficiency.
 - d. The improvement in efficiency justifies the reduction in equity.

ANS: B PTS: 1 DIF: Challenging REF: p.10
BLM: Remember NOT: Macro TB_1-117

118. What is one component necessary for markets to work?
- a. government intervention
 - b. a benevolent society
 - c. property rights
 - d. abundant resources

ANS: C PTS: 1 DIF: Average REF: p.12
BLM: Remember NOT: Macro TB_1-118

119. What is one necessary role of government in a market economy?
- a. to tax goods and services that are most desired by consumers
 - b. to maintain welfare programs for the poor
 - c. to provide services such as pensions
 - d. to enforce property rights

ANS: D PTS: 1 DIF: Average REF: p.12
BLM: Remember NOT: Macro TB_1-119

120. How does the government enforce property rights?
- a. by requiring property owners to pay property taxes
 - b. by providing police and courts
 - c. by allowing people to decide whether or not they wish to own property
 - d. by providing a system of recording property deeds

ANS: B PTS: 1 DIF: Easy REF: p.12
BLM: Remember NOT: Macro TB_1-120

121. What would happen without government's protection of property rights?
- a. Businesses would have less incentive to provide goods and services.
 - b. There would be less government regulation of businesses and prices would be lower for consumers.
 - c. Taxes would be lower causing less market inefficiencies.
 - d. Businesses would have more freedom with production processes.

ANS: A PTS: 1 DIF: Challenging REF: p.12
BLM: Remember NOT: Macro TB_1-121

122. What does the term market failure refer to?
- a. a situation in which the market on its own fails to allocate resources efficiently
 - b. an unsuccessful advertising campaign that reduces buyer demand
 - c. a situation in which competition among firms becomes ruthless
 - d. a firm that is forced out of business because of losses

ANS: A PTS: 1 DIF: Average REF: p.12
BLM: Remember NOT: Macro TB_1-122

123. Which of the following is NOT a reason for the government to intervene in the market?
- a. to promote efficiency
 - b. to enforce property rights
 - c. to promote equity
 - d. to protect an industry

ANS: D PTS: 1 DIF: Average REF: p.12
BLM: Remember NOT: Macro TB_1-123

124. What are two reasons for a government to intervene in a market?
- a. to raise revenues and to promote stability
 - b. to promote equity and to promote efficiency
 - c. to promote equity and to promote stability
 - d. to promote efficiency and to promote stability

ANS: B PTS: 1 DIF: Average REF: p.12
BLM: Remember NOT: Macro TB_1-124

125. What are two causes of market failure?
- a. externalities and market power
 - b. market power and incorrect forecasts of consumer demand
 - c. externalities and foreign competition
 - d. incorrect forecasts of consumer demand and foreign competition

ANS: A PTS: 1 DIF: Average REF: p.12
BLM: Remember NOT: Macro TB_1-125

126. What is the term used to describe a situation in which markets fail to allocate resources efficiently?
- a. economic meltdown
 - b. market failure
 - c. corporate bankruptcy
 - d. disequilibrium

ANS: B PTS: 1 DIF: Easy REF: p.13
BLM: Remember NOT: Macro TB_1-126

127. What is an example of market power?
- a. a fast food restaurant in a university town
 - b. a wheat farmer in Saskatchewan
 - c. the last gas station in Manitoba for 100 miles
 - d. a shoe store in Ontario

ANS: C PTS: 1 DIF: Average REF: p.13
BLM: Higher Order NOT: Macro TB_1-127

128. What is an example of a firm with market power?
- a. a deli in Winnipeg
 - b. a cable TV provider in Victoria
 - c. a clothing store in Vancouver
 - d. a farmer in Quebec

ANS: B PTS: 1 DIF: Average REF: p.13
BLM: Higher Order NOT: Macro TB_1-128

129. What can cause market failure?
- a. low consumer demand
 - b. government intervention and price controls
 - c. externalities and market power
 - d. high prices and foreign competition

ANS: C PTS: 1 DIF: Average REF: p.13
BLM: Remember NOT: Macro TB_1-129

130. What is an externality?
- a. the impact of one person's actions on the well-being of a bystander
 - b. the impact of a person's actions on that person's well-being
 - c. the impact of society's decisions on the well-being of society
 - d. the impact of society's decisions on the well-being of one person in the society

ANS: A PTS: 1 DIF: Easy REF: p.13
BLM: Remember NOT: Macro TB_1-130

131. What is an example of an externality?
- a. the impact of bad weather on the income of farmers
 - b. the impact of the personal income tax on a person's ability to purchase goods and services
 - c. the impact of pollution from a factory on the health of people in the vicinity of the factory
 - d. the impact of increases in health care costs on the health of individuals in society

ANS: C PTS: 1 DIF: Average REF: p.13
BLM: Higher Order NOT: Macro TB_1-131

132. Which of the following is most likely to generate an externality?
- a. Teachers at a local high school have pizza delivered every Friday for lunch.
 - b. A young man from a small town attends medical school to become a doctor.
 - c. A newlywed couple buys a TV for their family room.
 - d. John buys a tractor to mow his newly purchased 5-acre lot.

ANS: B PTS: 1 DIF: Challenging REF: p.13
BLM: Higher Order NOT: Macro TB_1-132

133. If an externality is present in a market, what may enhance economic efficiency?
- a. government intervention
 - b. increased competition
 - c. better informed market participants
 - d. more defined property rights

ANS: A PTS: 1 DIF: Average REF: p.13
BLM: Remember NOT: Macro TB_1-133

134. If a copper refinery does NOT bear the entire cost of the smoke it emits, what will happen?
- a. It will not emit any smoke so as to avoid the entire cost of the smoke.
 - b. It will emit lower levels of smoke.
 - c. It will emit an acceptable level of smoke.
 - d. It will emit too much smoke.

ANS: D PTS: 1 DIF: Average REF: p.13
BLM: Higher Order NOT: Macro TB_1-134

135. Which of these consumption activities will most likely impose an external cost?
- a. An executive plays a vigorous game of golf.
 - b. A student in a dorm plays her CDs at 120 decibels late at night.
 - c. A young mother exercises to an aerobics video.
 - d. A construction worker eats a sandwich during his lunch break.

ANS: B PTS: 1 DIF: Average REF: p.13
BLM: Higher Order NOT: Macro TB_1-135

136. Which of these activities will most likely result in an external benefit?
- a. A university student buys a deck of cards to play solitaire in her dorm room.
 - b. An elderly woman plants a flower garden on the vacant lot next to her house.
 - c. An executive purchases a book to read on a business trip.
 - d. A ten-year-old buys new Nikes with his allowance money he has saved.

ANS: B PTS: 1 DIF: Average REF: p.13
BLM: Higher Order NOT: Macro TB_1-136

137. If education produces external benefits for society, which of the following might NOT be an appropriate policy for society to establish regarding education?

- a. tax incentives for schooling
- b. mandatory minimum levels of education
- c. programs that promote the hiring of high school dropouts
- d. public subsidies of education

ANS: C PTS: 1 DIF: Average REF: p.13
BLM: Higher Order NOT: Macro TB_1-137

138. Complete the following statement: In the presence of a market failure,

- a. government action might not improve on the market outcome because sometimes public policies simply reward the politically powerful.
- b. government action might not improve on the market outcome because some leaders are not fully informed about the effects of their actions.
- c. government action can sometimes improve on the market outcome.
- d. government action will always improve on the market outcome.

ANS: D PTS: 1 DIF: Easy REF: p.13
BLM: Higher Order NOT: Macro TB_1-138

139. What happens if a sawmill creates too much air pollution?

- a. Interference by the government will surely make the matter worse.
- b. A sense of social responsibility will cause the owners of the mill to reduce pollution.
- c. The government can raise economic well-being by providing health care to those affected by the pollution.
- d. The government can raise economic well-being through environmental regulation.

ANS: D PTS: 1 DIF: Average REF: p.13
BLM: Higher Order NOT: Macro TB_1-139

140. What is the term when a single entity has the ability to influence market prices?

- a. competition
- b. market power
- c. efficiency
- d. productivity

ANS: B PTS: 1 DIF: Easy REF: p.13
BLM: Remember NOT: Macro TB_1-140

141. What is market power?

- a. the power of a single person or group to influence market prices
- b. the ability of a person or group of people to successfully market new products
- c. the power of the government to regulate a market
- d. the relative importance of a market to the overall economy

ANS: A PTS: 1 DIF: Easy REF: p.13
BLM: Remember NOT: Macro TB_1-141

142. What is an example of a monopoly?
- a. a jewellery store in Burnaby, British Columbia
 - b. a souvenir shop in Cancun, Mexico
 - c. an electric company in Outlook, Saskatchewan
 - d. a doctor in St. John's, New Brunswick

ANS: C PTS: 1 DIF: Average REF: p.13
BLM: Higher Order NOT: Macro TB_1-142

143. Which of the following businesses most likely has market power?
- a. a furniture store in Kingston
 - b. a vineyard in the Okanagan Valley
 - c. a maple sugar candy store in Sherbrooke, Quebec
 - d. a hospital in Nelson, British Columbia

ANS: D PTS: 1 DIF: Average REF: p.13
BLM: Higher Order NOT: Macro TB_1-143

144. What could justify higher income tax rates on rich people in Canada?
- a. on the basis of market efficiency
 - b. on the basis of the lack of other sources of government revenue
 - c. on the basis of equity for society
 - d. on the basis of government bias against the wealthy

ANS: C PTS: 1 DIF: Average REF: p.13
BLM: Higher Order NOT: Macro TB_1-144

145. What is the primary determinant of a country's standard of living?
- a. the ability to reduce foreign competition
 - b. the ability to produce goods and services
 - c. the total supply of money in the economy
 - d. the average age of the country's labour force

ANS: B PTS: 1 DIF: Average REF: p.13
BLM: Remember NOT: Macro TB_1-145

146. In 2003, what was the average Canadian income?
- a. \$25,368.
 - b. \$29,000.
 - c. \$36,800
 - d. \$41,240

ANS: C PTS: 1 DIF: Easy REF: p.13
BLM: Remember NOT: Macro TB_1-146

147. In Canada, incomes have historically grown about 2% per year. At this rate, how long will it take for incomes to double?
- a. 10 years.
 - b. 25 years.
 - c. 35 years.
 - d. 50 years.

ANS: C PTS: 1 DIF: Average REF: p.14
BLM: Remember NOT: Macro TB_1-147

148. The income of a typical worker in a country is most closely linked to which of the following?
- a. population
 - b. productivity
 - c. the number of labour unions
 - d. government policies

ANS: B PTS: 1 DIF: Average REF: p.13-14
BLM: Remember NOT: Macro TB_1-148

149. If the average income of an Australian is higher than the average income of a Russian, what is the most likely reason?
- a. Productivity is higher in Australia than in Russia.
 - b. Australia has a more industrial economy than Russia.
 - c. There is more competition in Australia than in Russia.
 - d. Labour unions are more aggressive in Australia than in Russia.

ANS: A PTS: 1 DIF: Challenging REF: p.13-14
BLM: Remember NOT: Macro TB_1-149

150. Suppose that the average income of a Kenyan is higher than the average income of a South African. What might you conclude?
- a. South African firms are faced with stricter government regulations than Kenyan firms.
 - b. Total income is divided among fewer workers in Kenya since it has a smaller labour force than South Africa.
 - c. Kenya's climate allows for longer growing seasons and therefore Kenya can produce large quantities of grain.
 - d. Productivity in Kenya is higher than in South Africa.

ANS: D PTS: 1 DIF: Challenging REF: p.13-14
BLM: Higher Order NOT: Macro TB_1-150

151. A typical worker in Italy can produce 24 units of product in an 8 hour day, where a typical worker in Poland produces 25 units of product in a 10 hour day. What can we conclude?
- a. Worker productivity in Poland is higher than in Italy.
 - b. The standard of living will be higher in Italy than in Poland.
 - c. Productivity for the Polish worker is 3 units per hour and 2 1/2 units per hour for the Italian worker.
 - d. There will be no difference between the standard of living in Italy and Poland.

ANS: B PTS: 1 DIF: Challenging REF: p.13-14
BLM: Higher Order NOT: Macro TB_1-151

152. A worker in Bangladesh can earn \$1 per day making cotton cloth on a hand loom. A worker in Canada can earn \$100 per day making cotton cloth with a mechanical loom. What accounts for the difference in wages?
- Canadian textile workers belong to a union.
 - There is little demand for cotton cloth in Bangladesh and great demand in Canada.
 - Labour is more productive making cotton cloth with a mechanical loom than with a hand loom.
 - Bangladesh has a low-wage policy to make its textile industry more competitive in world markets.

ANS: C PTS: 1 DIF: Challenging REF: p.13-14
BLM: Higher Order NOT: Macro TB_1-152

153. Over the past century, by how much has the average income in Canada risen?
- twofold
 - fivefold
 - eightfold
 - tenfold

ANS: C PTS: 1 DIF: Easy REF: p.14
BLM: Remember NOT: Macro TB_1-153

154. What causes almost all variation in living standards in different countries?
- population growth rates
 - endowments of natural resources
 - national government budgets
 - productivity

ANS: D PTS: 1 DIF: Average REF: p.13-14
BLM: Remember NOT: Macro TB_1-154

155. What is the definition of productivity?
- amount of goods and services produced from each hour of a worker's time
 - amount of labour that can be saved by replacing workers with machines.
 - actual amount of effort workers put into an hour of working time
 - estimated amount of effort workers put into an hour of working time

ANS: A PTS: 1 DIF: Easy REF: p.13-14
BLM: Remember NOT: Macro TB_1-155

156. What is the amount of goods and services produced from each hour of a worker's time?
- total output
 - productivity
 - marginal product
 - efficiency

ANS: B PTS: 1 DIF: Easy REF: p.13-14
BLM: Remember NOT: Macro TB_1-156

157. Which of the following display a direct or positive relationship?

- a. a country's productivity and its standard of living
- b. a country's government spending and its tax rates
- c. a country's total population and its per-capita income
- d. a country's prices for its goods and services and its exports

ANS: A PTS: 1 DIF: Average REF: p.13-14
BLM: Higher Order NOT: Macro TB_1-157

158. If the government wanted to enact a policy to increase living standards, what might it do?

- a. allow corporate tax write-offs for money spent on worker safety
- b. make it more difficult to receive unemployment benefits
- c. increase educational opportunities for workers
- d. prohibit unions from organizing

ANS: C PTS: 1 DIF: Average REF: p.13-14
BLM: Higher Order NOT: Macro TB_1-158

159. To improve living standards, what should policymakers do?

- a. impose restriction on foreign competition
- b. formulate policies designed to increase productivity
- c. impose tougher immigration policies
- d. provide tax breaks for the middle class

ANS: B PTS: 1 DIF: Average REF: p.13-14
BLM: Remember NOT: Macro TB_1-159

160. To increase living standards, what should public policy do?

- a. ensure that workers are well educated and have the necessary tools and technology
- b. make unemployment benefits more liberal
- c. move workers into jobs directly from high school
- d. ensure that workers have access to union membership and benefits

ANS: A PTS: 1 DIF: Average REF: p.13-14
BLM: Higher Order NOT: Macro TB_1-160

161. To raise productivity, what could policymakers do?

- a. increase spending on education
- b. lower tax credits to firms for capital improvements
- c. reduce the number of imports allowed into the economy
- d. eliminate minimum wage laws

ANS: A PTS: 1 DIF: Average REF: p.13-14
BLM: Higher Order NOT: Macro TB_1-161

162. What is an increase in the overall level of prices in an economy called?

- a. economic growth
- b. inflation
- c. monetary policy
- d. supply shocks

ANS: B PTS: 1 DIF: Easy REF: p.14
BLM: Remember NOT: Macro TB_1-162

163. What is the definition of inflation?

- a. a period of rising productivity in the economy
- b. a period of rising income in the economy
- c. an increase in the overall level of output in the economy
- d. an increase in the overall level of prices in the economy

ANS: D PTS: 1 DIF: Easy REF: p.14
BLM: Remember NOT: Macro TB_1-163

164. What happened when the German government increased the quantity of money in the German economy in the 1920s?

- a. Germany experienced hyperinflation.
- b. Many people in Germany became rich.
- c. Unemployment increased.
- d. Germany was able to repay all its foreign debts.

ANS: A PTS: 1 DIF: Easy REF: p.14
BLM: Remember NOT: Macro TB_1-164

165. What happened to prices in Germany during the early 1920s?

- a. They doubled annually.
- b. They doubled monthly.
- c. They tripled monthly.
- d. They tripled annually.

ANS: C PTS: 1 DIF: Average REF: p.14
BLM: Remember NOT: Macro TB_1-165

166. Which was one of the worst episodes of inflation?

- a. in the United States in the 1960s.
- b. in Argentina in the 1950s.
- c. in Russia in the 1930s.
- d. in Germany in the 1920s.

ANS: D PTS: 1 DIF: Average REF: p.14
BLM: Remember NOT: Macro TB_1-166

167. What is almost always the cause of large or persistent inflation?

- a. an increase in demand for domestic production
- b. growth in the quantity of money
- c. foreign competition
- d. higher worker productivity

ANS: B PTS: 1 DIF: Average REF: p.14
BLM: Remember NOT: Macro TB_1-167

168. What was inflation in Canada in the 1990s?

- a. almost zero
- b. about 2 percent per year
- c. approached double digits
- d. caused by too much consumer spending

ANS: B PTS: 1 DIF: Average REF: p.14
BLM: Remember NOT: Macro TB_1-168

169. During the 1990s, the United Kingdom experienced low levels of inflation while Turkey experienced high levels of inflation. What best explains the difference?

- a. The United Kingdom is more industrialized than Turkey.
- b. The United Kingdom printed money at a slower rate than Turkey.
- c. Workers in the United Kingdom are more productive than workers in Turkey.
- d. There were more cases of market failure in Turkey than in the United Kingdom.

ANS: B PTS: 1 DIF: Easy REF: p.14
BLM: Remember NOT: Macro TB_1-169

170. What does inflation cause?

- a. incomes to fall
- b. productivity to increase
- c. the government to lower taxes
- d. the value of money to fall

ANS: D PTS: 1 DIF: Average REF: p.14
BLM: Remember NOT: Macro TB_1-170

171. Which is the most correct statement about the relationship between inflation and unemployment?

- a. In the short run, reducing inflation is associated with falling unemployment.
- b. In the short run, reducing inflation is associated with rising unemployment.
- c. In the long run, reducing inflation is associated with falling unemployment.
- d. In the long run, reducing inflation is associated with rising unemployment.

ANS: B PTS: 1 DIF: Challenging REF: p.15
BLM: Remember NOT: Macro TB_1-171

172. What is the curve that illustrates the tradeoff between inflation and unemployment?

- a. Laffer curve
- b. Lorenz curve
- c. Phillips curve
- d. Fisher curve

ANS: C PTS: 1 DIF: Easy REF: p.15
BLM: Remember NOT: Macro TB_1-172

173. In the short run, what does the Phillips curve illustrate?

- a. the tradeoff between inflation and unemployment
- b. the tradeoff between equity and efficiency
- c. labour productivity in an economy
- d. the level of government intervention in a market economy

ANS: A PTS: 1 DIF: Average REF: p.15
BLM: Remember NOT: Macro TB_1-173

174. Although the Phillips curve is controversial, what do most economists believe?

- a. that society faces a tradeoff between unemployment and inflation in the short run only
- b. that society faces a tradeoff between unemployment and inflation in the long run only
- c. that no tradeoff exists between unemployment and inflation
- d. that society faces a continuous tradeoff between unemployment and inflation

ANS: A PTS: 1 DIF: Challenging REF: p.15
BLM: Remember NOT: Macro TB_1-174

175. Which of the following policy targets will NOT affect the combination of inflation and unemployment the economy experiences?

- a. taxes.
- b. government spending.
- c. the money supply.
- d. market prices.

ANS: D PTS: 1 DIF: Average REF: p.15
BLM: Remember NOT: Macro TB_1-175

176. What does the Phillips curve help explain?

- a. the business cycle
- b. supply and demand
- c. government spending
- d. money supply changes

ANS: A PTS: 1 DIF: Easy REF: p.15
BLM: Remember NOT: Macro TB_1-176

177. What is the business cycle?

- a. the relationship between unemployment and inflation
- b. the irregular fluctuations in economic activity
- c. the positive relationship between the quantity of money in an economy and inflation
- d. the predictable changes in economic activity due to changes in government spending and taxes

ANS: B PTS: 1 DIF: Easy REF: p.15
BLM: Remember NOT: Macro TB_1-177

178. Which of the following is consistent with the Phillips curve?
- If we increase the rate of inflation from 3 percent to 6 percent, then the rate of unemployment will temporarily fall.
 - If we increase the rate of inflation from 3 percent to 6 percent, then the rate of unemployment will temporarily rise.
 - If we increase the rate of inflation from 3 percent to 6 percent, then the rate of unemployment will permanently fall.
 - If we increase the rate of inflation from 3 percent to 6 percent, then the rate of unemployment will permanently rise.

ANS: A PTS: 1 DIF: Average REF: p.15
BLM: Higher Order NOT: Macro TB_1-178

TRUE/FALSE

1. Scarcity means that there is less of a good or resource available than people wish to have.

ANS: T PTS: 1 DIF: Easy REF: p.4
NOT: Macro TB_1-179

2. Economics is the study of how fairly goods and services are distributed within society.

ANS: F PTS: 1 DIF: Easy REF: p.4
NOT: Macro TB_1-180

3. With careful planning, we can usually get something that we like without having to give up something else that we like.

ANS: F PTS: 1 DIF: Average REF: p.4-5
NOT: Macro TB_1-181

4. Equity means everyone in the economy should receive an equal share of the goods and services produced.

ANS: F PTS: 1 DIF: Average REF: p.5
NOT: Macro TB_1-182

5. Equity refers to how the pie is divided, and efficiency refers to the size of the economic pie.

ANS: T PTS: 1 DIF: Average REF: p.5
NOT: Macro TB_1-183

6. Tuition is the single-largest cost of attending college for most students.

ANS: F PTS: 1 DIF: Average REF: p.6
NOT: Macro TB_1-184

7. The cost of an action is measured in terms of foregone opportunities.

ANS: T PTS: 1 DIF: Average REF: p.6
NOT: Macro TB_1-185

8. A marginal change is a small incremental adjustment to an existing plan of action.

ANS: T PTS: 1 DIF: Average REF: p.6
NOT: Macro TB_1-186

9. If the average cost of transporting a passenger on the train from Brockville to Toronto is \$75, it would be irrational for the railroad to allow any passenger to ride for less than \$75.

ANS: F PTS: 1 DIF: Average REF: p.6-7
NOT: Macro TB_1-187

10. A rational decision maker takes an action if and only if the marginal cost exceeds the marginal benefit.

ANS: F PTS: 1 DIF: Average REF: p.7
NOT: Macro TB_1-188

11. Trade allows each person to specialize in the activities he or she does best, thus increasing each individual's productivity.

ANS: T PTS: 1 DIF: Average REF: p.9
NOT: Macro TB_1-189

12. Trade with any nation can be mutually beneficial.

ANS: T PTS: 1 DIF: Easy REF: p.9
NOT: Macro TB_1-190

13. A market economy cannot produce a socially desirable outcome because individuals are motivated by their own selfish interests.

ANS: F PTS: 1 DIF: Average REF: p.9-10
NOT: Macro TB_1-191

14. Since taxes affect only the price paid by the buyer, they cannot have an adverse impact on the allocation of society's resources.

ANS: F PTS: 1 DIF: Average REF: p.10
NOT: Macro TB_1-192

15. The government can potentially improve market outcomes if market inequalities or market failure exists.

ANS: T PTS: 1 DIF: Average REF: p.13
NOT: Macro TB_1-193

16. Market failure refers to a situation in which the market does not allocate resources efficiently.

ANS: T PTS: 1 DIF: Average REF: p.13
NOT: Macro TB_1-194

17. Productivity is defined as the quantity of goods and services produced from each hour of a worker's time.

ANS: T PTS: 1 DIF: Average REF: p.14
NOT: Macro TB_1-195

18. Productivity is the primary determinant of a country's living standards.

ANS: T PTS: 1 DIF: Average REF: p.14
NOT: Macro TB_1-196

19. Inflation increases the value of money.

ANS: F PTS: 1 DIF: Average REF: p.14
NOT: Macro TB_1-197

20. Government spending is the ultimate source of inflation.

ANS: F PTS: 1 DIF: Average REF: p.15
NOT: Macro TB_1-198

21. The Phillips curve shows the short-run tradeoff between inflation and economic growth.

ANS: F PTS: 1 DIF: Average REF: p.15
NOT: Macro TB_1-199

SHORT ANSWER

1. What would happen to the study of economics if scarcity disappeared?

ANS:

Since economics is the study of how society allocates its scarce resources, if there were no scarcity, there would be no need for economics. Everyone could have all the goods and services they wanted. No one would have to make decisions based on tradeoffs, because there would be no opportunity cost associated with the decision. (It is difficult to conceive of a situation where time is not scarce, however).

PTS: 1 DIF: Average REF: p. 15 NOT: Macro TB_1-200

2. One tradeoff society faces is between efficiency and equity. Define each term. If the Canadian government redistributes income from the rich to the poor, explain how this action affects equity as well as efficiency in the economy.

ANS:

Efficiency is the property of society getting the most it can from its scarce resources. Equity is defined as the property of distributing economic prosperity fairly among the members of society. Often, these two goals conflict. When the government redistributes income from the rich to the poor, it reduces the reward for working hard. Fewer goods and services are produced and the economic pie gets smaller. When the government tries to cut the economic pie into more equal slices, the pie gets smaller. Policies aimed at achieving a more equal distribution of economic well-being, such as the welfare system, try to help those members of society who are most in need. The individual income tax asks the financially successful to contribute more than others to support the government.

PTS: 1 DIF: Average REF: p. 5 NOT: Macro TB_1-201

3. Define opportunity cost. What is the opportunity cost to you of attending college? What was your opportunity cost of coming to class today?

ANS:

Whatever must be given up to obtain some item is its opportunity cost. Basically, this would be a person's second choice. The opportunity cost of a person attending college is the value of the best alternative use of that person's time. For most students this would be the income the student gives up by not working. A student's opportunity cost of coming to class was the value of the best opportunity the student gave up.

PTS: 1 DIF: Average REF: p. 5-6 NOT: Macro TB_1-202

4. With the understanding that people respond to incentives, outline the possible outcome for teachers if the K-12 school year is extended to 11 months per year instead of the existing 10 months per year.

ANS:

The concept of working longer per year would be perceived by many teachers as a definite increase in the cost of teaching. Even with additional compensation, many teachers look at summers off as a major benefit of the education profession. If this benefit were eliminated or even diminished, some teachers may perceive that the marginal cost of teaching would now be greater than the marginal benefit and would choose to leave teaching.

PTS: 1 DIF: Average REF: p. 7 NOT: Macro TB_1-203

5. Under what conditions might government intervention in an economy improve the market outcome?

ANS:

If there is a market failure, such as an externality or monopoly, government regulation might improve the well-being of society by promoting efficiency. If the distribution of income or wealth is considered to be unfair by society, government intervention might achieve a more equitable distribution of economic well-being.

PTS: 1 DIF: Challenging REF: p. 14-15 NOT: Macro TB_1-204

6. Explain how an attempt by the government to lower inflation could cause unemployment to increase in the short-run.

ANS:

To lower inflation, the government may choose to reduce the money supply in the economy. When the money supply is reduced, prices do not adjust immediately. Lower spending, combined with prices that are too high, reduces sales and causes workers to be laid off. Hence, the lower price level is associated with higher unemployment.

PTS: 1

DIF: Challenging

REF: p. 14-15

NOT: Macro TB_1-205

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Chapter 2—Thinking Like an Economist

MULTIPLE CHOICE

1. Which is the best statement about the way economists study the economy?
 - a. They study the past, but do not try to predict the future.
 - b. They use a probabilistic approach based on correlations between economic events.
 - c. They devise theories, collect data, and then analyze the data to test the theories.
 - d. They use controlled experiments much the same way a biologist or physicist does.

ANS: C PTS: 1 DIF: Average REF: p.22
BLM: Remember NOT: Macro TB_2-1

2. Which are terms used by an economist?
 - a. vector spaces and axioms
 - b. torts and venues
 - c. ego and cognitive dissonance
 - d. comparative advantage and elasticity

ANS: D PTS: 1 DIF: Average REF: p.22
BLM: Remember NOT: Macro TB_2-2

3. What is meant by scientific method?
 - a. the use of modern electronic testing equipment to understand the world
 - b. the dispassionate development and testing of theories about how the world works
 - c. the use of controlled experiments in understanding the way the world works
 - d. finding evidence to support preconceived theories about how the world works

ANS: B PTS: 1 DIF: Average REF: p.22
BLM: Remember NOT: Macro TB_2-3

4. Who said, "The whole of science is nothing more than the refinement of everyday thinking."?
 - a. Isaac Newton
 - b. Albert Einstein
 - c. Sigmund Freud
 - d. Stephen Hawking.

ANS: B PTS: 1 DIF: Easy REF: p.22
BLM: Remember NOT: Macro TB_2-4

5. What observation did Albert Einstein once make about science?
 - a. "The whole of science is nothing more than the refinement of everyday thinking."
 - b. "The whole of science is nothing more than an interesting intellectual exercise."
 - c. "In order to understand science, one must rely solely on abstraction."
 - d. "In order to understand science, one must transcend everyday thinking."

ANS: A PTS: 1 DIF: Average REF: p.22
BLM: Remember NOT: Macro TB_2-5

6. If Sir Isaac Newton's development of the theory of gravity after observing an apple fall from a tree, what is this an example of?
- a. controlled experiments used to develop scientific theories
 - b. being in the right place at the right time
 - c. an idea whose time had come
 - d. the interplay between observation and theory in science

ANS: D PTS: 1 DIF: Average REF: p.22
BLM: Remember NOT: Macro TB_2-6

7. What is a common thread between economics and other sciences such as physics?
- a. Experiments are most often conducted in a lab.
 - b. Real-world observations often lead to theories.
 - c. A Ph.D. is required to truly understand any science.
 - d. Both deal primarily with abstract concepts.

ANS: B PTS: 1 DIF: Average REF: p.22-23
BLM: Remember NOT: Macro TB_2-7

8. Why is the use of theory and observation more difficult in economics than in sciences such as physics?
- a. due to the difficulty in evaluating an economic experiment
 - b. due to the difficulty in devising an economic experiment
 - c. due to the difficulty in actually performing an experiment in an economic system
 - d. due to the difficulty in collecting sufficient data

ANS: C PTS: 1 DIF: Average REF: p.22
BLM: Remember NOT: Macro TB_2-8

9. Because it is difficult for economists to use experiments to generate data, what must they generally do?
- a. do without data
 - b. use whatever data the world gives them
 - c. select a committee of economists to make up data for all economists to use
 - d. use hypothetical, computer-generated data

ANS: B PTS: 1 DIF: Average REF: p.22
BLM: Remember NOT: Macro TB_2-9

10. What happens when economists test theories?
- a. They must make do with whatever data the world gives them.
 - b. They can manipulate economic conditions easier than other scientific fields.
 - c. They can enlist the government's help to manipulate economic conditions.
 - d. They can achieve statistically valid results with much smaller sample sizes.

ANS: A PTS: 1 DIF: Average REF: p.22
BLM: Remember NOT: Macro TB_2-10

11. What is one difficulty economists face that some other scientists do not?
- a. Unlike other sciences, economic studies must include the largest economic player, the government.
 - b. Economists unfortunately receive less government funding than other scientists.
 - c. Corporations are reluctant to disclose necessary information for economic research.
 - d. Experiments are often difficult in economics.

ANS: D PTS: 1 DIF: Average REF: p.22
BLM: Remember NOT: Macro TB_2-11

12. Where do the most common data for testing economic theories come from?
- a. carefully controlled and conducted laboratory experiments
 - b. traditional economies
 - c. historical episodes of economic change
 - d. centrally planned economies

ANS: C PTS: 1 DIF: Average REF: p.22
BLM: Remember NOT: Macro TB_2-12

13. For economists, what are often used as substitutes for laboratory experiments?
- a. natural experiments offered by history
 - b. computer-generated experiments
 - c. studies conducted by other disciplines such as sociologists
 - d. well-constructed simulations

ANS: A PTS: 1 DIF: Average REF: p.22
BLM: Remember NOT: Macro TB_2-13

14. Why do economists make assumptions?
- a. to diminish the chance of wrong answers
 - b. to make the world easier to understand
 - c. because all scientists make assumptions
 - d. to make certain that all necessary variables are included

ANS: B PTS: 1 DIF: Average REF: p.23
BLM: Remember NOT: Macro TB_2-14

15. What does the art of scientific thinking include?
- a. knowledge of human behaviour
 - b. understanding every scientific field—physics, biology, and economics
 - c. deciding which assumptions to make
 - d. being able to mathematically express natural forces

ANS: C PTS: 1 DIF: Average REF: p.23
BLM: Remember NOT: Macro TB_2-15

16. If an economist develops a theory about international trade based on the assumption that there are only two countries and two goods, what is most likely?
- a. The theory can be useful only in situations involving two countries and two goods.
 - b. It is a total waste of time, since the actual world has many countries trading many goods.
 - c. The theory can be useful in helping economists understand the complex world of international trade involving many countries and many goods.
 - d. The theory can be useful in the classroom, but has no use in the real world.

ANS: C PTS: 1 DIF: Average REF: p.23
BLM: Higher Order NOT: Macro TB_2-16

17. Why are historical episodes valuable to economists?
- a. They allow economists to see how far the discipline has evolved.
 - b. Hindsight is always 20/20.
 - c. It is easier to evaluate a past situation than to predict a future situation.
 - d. They allow economists to evaluate economic theories of the present.

ANS: D PTS: 1 DIF: Average REF: p.23
BLM: Remember NOT: Macro TB_2-17

18. What would be the best statement about a theory based on assumptions that are NOT true?
- a. If the assumptions underlying the theory are not true, the theory must be false.
 - b. The ideas may be good in theory, but not in practice.
 - c. The theory is a good one if it helps us to understand how the world works.
 - d. The theory is a good one if no logical mistakes were made in developing it.

ANS: C PTS: 1 DIF: Challenging REF: p.22
BLM: Higher Order NOT: Macro TB_2-18

19. What is the goal of theories?
- a. to provide an interesting, but not useful, framework of analysis
 - b. to provoke stimulating debate in scientific journals
 - c. to demonstrate that the developer of the theory is capable of logical thinking
 - d. to help scientists understand how the world works

ANS: D PTS: 1 DIF: Easy REF: p.23
BLM: Remember NOT: Macro TB_2-19

20. When economists attempt to simplify the real world and make it easier to understand, what do they do?
- a. They make assumptions.
 - b. They make mistakes in judgment.
 - c. They make predictions.
 - d. They make evaluations.

ANS: A PTS: 1 DIF: Easy REF: p.23
BLM: Remember NOT: Macro TB_2-20

21. What can good assumptions do?
- a. cause economists to leave out important variables that make their theories worthless
 - b. simplify the complex world and make it easier to understand
 - c. further complicate an already difficult topic
 - d. allow economists to see the 'big picture' instead of only small segments
- ANS: B PTS: 1 DIF: Average REF: p.23
BLM: Remember NOT: Macro TB_2-21
22. Which of the following best describes the decision by a scientist of which assumption to make?
- a. the easiest part of the scientific method.
 - b. the flip of a coin.
 - c. almost impossible.
 - d. part art.
- ANS: D PTS: 1 DIF: Easy REF: p.23
BLM: Remember NOT: Macro TB_2-22
23. Which is true about the art of scientific thinking?
- a. it is easier with a solid mathematical background.
 - b. it is the ability to make an abstract subject easy to understand.
 - c. it involves deciding which assumptions to make.
 - d. it is not necessary to be an economist.
- ANS: C PTS: 1 DIF: Easy REF: p.23
BLM: Remember NOT: Macro TB_2-23
24. What happens when scientists make good assumptions?
- a. They greatly simplify the problem without substantially affecting the answer.
 - b. They further complicate an already complicated subject.
 - c. They can leave out necessary variables that may result in incorrect answers.
 - d. They may not be able to reach an appropriate conclusion.
- ANS: A PTS: 1 DIF: Average REF: p.23
BLM: Remember NOT: Macro TB_2-24
25. What is an example of a product that experiences infrequent price changes?
- a. stocks on the Toronto Stock Exchange
 - b. gasoline prices
 - c. the newsstand price of magazines
 - d. electricity
- ANS: C PTS: 1 DIF: Average REF: p.23
BLM: Remember NOT: Macro TB_2-25
26. When studying the effects of public policy changes, what have economists often observed?
- a. There is a difference between the long run and short run.
 - b. Unemployment and inflation are directly related in the short run.
 - c. With stock prices, what goes up must come down.
 - d. If the policy is well-designed, it will always be effective.
- ANS: A PTS: 1 DIF: Average REF: p.23-24
BLM: Remember NOT: Macro TB_2-26

27. When studying the effects of public policy changes, what do economists do?
- a. They often falsify results if the desired effect is not reached.
 - b. They may make different assumptions for the long run and the short run.
 - c. They attempt to consider only the direct effects and not indirect effects.
 - d. They can immediately change policies if they are ineffective.

ANS: B PTS: 1 DIF: Average REF: p.23-24
BLM: Remember NOT: Macro TB_2-27

28. What do good economic models do?
- a. They often leave out important variables, causing serious errors.
 - b. They omit many details to allow us to see what is truly important.
 - c. They are designed to give a complete picture of a given relationship.
 - d. They leave economics to be interpreted in many ways by governments

ANS: B PTS: 1 DIF: Average REF: p.24
BLM: Remember NOT: Macro TB_2-28

29. Why do economists use models?
- a. to learn how the economy works
 - b. to make their profession appear more precise
 - c. to make economics accessible to the public
 - d. to make sure that all of the details of the economy are included in their analysis

ANS: A PTS: 1 DIF: Easy REF: p.24
BLM: Remember NOT: Macro TB_2-29

30. Which is true about models used by economists?
- a. they cannot be useful to economists if they are based on false assumptions
 - b. they make the economics profession more difficult than necessary
 - c. they allow economists to learn how the economy works
 - d. they must include every possible variable in the economy to be useful to economists

ANS: C PTS: 1 DIF: Average REF: p.24
BLM: Remember NOT: Macro TB_2-30

31. How do economists begin building an economic model?
- a. by writing grants for government funding
 - b. by conducting controlled experiments in a lab
 - c. by making assumptions
 - d. by reviewing statistical forecasts

ANS: C PTS: 1 DIF: Average REF: p.24
BLM: Remember NOT: Macro TB_2-31

32. What is a model?
- a. a theoretical abstraction with very little value
 - b. a useful tool to only the ones who constructed it
 - c. a realistic and carefully constructed theory
 - d. a simplification of real life

ANS: D PTS: 1 DIF: Easy REF: p.24
BLM: Remember NOT: Macro TB_2-32

33. Which of the following is NOT true concerning models?

- a. Models simplify reality.
- b. Models can explain how the economy is organized.
- c. Models assume away irrelevant details.
- d. Models cannot be used to make predictions.

ANS: D PTS: 1 DIF: Average REF: p.24
BLM: Higher Order NOT: Macro TB_2-33

34. Which of the following is NOT true about most economic models?

- a. They are built using the tools of mathematics.
- b. They are useful to economists, but not to policymakers.
- c. They do not include every feature of the economy.
- d. They are built using assumptions.

ANS: B PTS: 1 DIF: Average REF: p.24
BLM: Higher Order NOT: Macro TB_2-34

35. Which of the following is the most accurate statement about economic models?

- a. Economic models attempt to mirror reality exactly.
- b. Economic models are useful, but should not be used for policymaking.
- c. Economic models omit many details to allow us to see what is truly important.
- d. Economic models cannot be used in the real world because they omit details.

ANS: C PTS: 1 DIF: Average REF: p.24
BLM: Higher Order NOT: Macro TB_2-35

36. What are the foundation stones from which economic models are built?

- a. economic policies
- b. the legal system
- c. assumptions
- d. statistical forecasts

ANS: C PTS: 1 DIF: Easy REF: p.24
BLM: Remember NOT: Macro TB_2-36

37. What is a circular-flow diagram?

- a. a visual model of how the economy is organized
- b. a mathematical model of how the economy works
- c. a model that shows the effects of government on the economy
- d. a visual model of the relationship among money, prices, and businesses

ANS: A PTS: 1 DIF: Average REF: p.24
BLM: Remember NOT: Macro TB_2-37

38. What does a circular-flow diagram do?

- a. It illustrates cost-benefit analysis.
- b. It explains how the economy is organized.
- c. It shows the flow of traffic in an economic region.
- d. It explains how banks circulate money in the economy.

ANS: B PTS: 1 DIF: Average REF: p.25
BLM: Remember NOT: Macro TB_2-38

39. What are factors of production?
- a. the mathematical calculations firms make to determine production
 - b. weather and social and political conditions that affect production
 - c. the physical relationships between economic inputs and outputs
 - d. inputs into the production process

ANS: D PTS: 1 DIF: Easy REF: p.25
BLM: Remember NOT: Macro TB_2-39

40. In the simple circular-flow diagram, who are the decision makers?
- a. firms and government
 - b. households and firms
 - c. households and government
 - d. households, firms, and government

ANS: B PTS: 1 DIF: Easy REF: p.25
BLM: Remember NOT: Macro TB_2-40

41. What do the two loops in the circular-flow diagram represent?
- a. the flow of goods and the flow of services
 - b. the flow of dollars and the flow of financial assets
 - c. the flow of inputs and outputs and the flow of dollars
 - d. the flow of capital goods and the flow of consumer goods

ANS: C PTS: 1 DIF: Average REF: p.25
BLM: Remember NOT: Macro TB_2-41

42. In a circular-flow diagram, which flows are involved?
- a. Taxes flow from households to firms, and transfer payments flow from firms to households.
 - b. Income payments flow from firms to households, and sales revenue flows from households to firms.
 - c. Resources flow from firms to households, and goods and services flow from households to firms.
 - d. Inputs and outputs flow in the same direction as the flow of dollars, from firms to households.

ANS: B PTS: 1 DIF: Challenging REF: p.25
BLM: Remember NOT: Macro TB_2-42

43. Which is true in the circular-flow diagram?
- a. firms are sellers in the resource market and the product market.
 - b. firms are buyers in the product market.
 - c. households are sellers in the resource market.
 - d. spending on goods and services flows from firms to households.

ANS: C PTS: 1 DIF: Challenging REF: p.25
BLM: Remember NOT: Macro TB_2-43

44. In the circular-flow diagram, which flows are involved?

- a. Income from factors of production flows from firms to households.
- b. Goods and services flow from households to firms.
- c. Factors of production flow from firms to households.
- d. Spending on goods and services flow from firms to households.

ANS: A PTS: 1 DIF: Challenging REF: p.25
BLM: Remember NOT: Macro TB_2-44

45. Which of the following would NOT be considered a factor of production?

- a. labour
- b. land
- c. capital
- d. money

ANS: D PTS: 1 DIF: Easy REF: p.25
BLM: Remember NOT: Macro TB_2-45

46. What is another name for goods and services produced by firms?

- a. factors of production
- b. output
- c. inputs
- d. resources

ANS: B PTS: 1 DIF: Easy REF: p.25
BLM: Remember NOT: Macro TB_2-46

47. What are factors of production?

- a. They are used to produce goods and services.
- b. They are owned by firms.
- c. They are abundant in most economies.
- d. They are used by both firms and households.

ANS: A PTS: 1 DIF: Easy REF: p.25
BLM: Remember NOT: Macro TB_2-47

48. What is another term for factors of production?

- a. inputs
- b. output
- c. goods
- d. services

ANS: A PTS: 1 DIF: Easy REF: p.25
BLM: Remember NOT: Macro TB_2-48

49. According to a simple circular-flow diagram, in how many markets do households and firms interact?

- a. one type of market
- b. two types of markets
- c. three types of markets
- d. Households and firms do not interact

ANS: B PTS: 1 DIF: Easy REF: p.25
BLM: Remember NOT: Macro TB_2-49

50. In the simple circular-flow diagram, what do markets consist of?
- the market for goods and services, the financial market, and the market for the factors of production
 - factors of production and the financial market
 - the market for goods and services and the financial market
 - the market for goods and services and the market for factors of production

ANS: D PTS: 1 DIF: Average REF: p.25
 BLM: Remember NOT: Macro TB_2-50

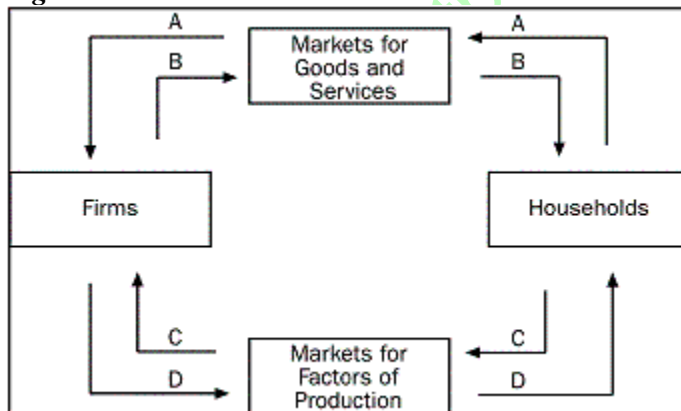
51. In the goods and services market, how do households and firms interact?
- Households and firms are both buyers.
 - Households are sellers and firms are buyers.
 - Households are buyers and firms are sellers.
 - Households and firms are both sellers.

ANS: C PTS: 1 DIF: Average REF: p.25
 BLM: Remember NOT: Macro TB_2-51

52. In the factors of production market, how do households and firms interact?
- Households are sellers and firms are buyers.
 - Households are buyers and firms are sellers.
 - Households and firms are both buyers.
 - Households and firms are both sellers.

ANS: A PTS: 1 DIF: Average REF: p.25
 BLM: Remember NOT: Macro TB_2-52

Figure 2-1



53. **Refer to Figure 2-1.** Which arrow shows the flow of goods and services?
- arrow A
 - arrow B
 - arrow C
 - arrow D

ANS: B PTS: 1 DIF: Average REF: p.25
 BLM: Higher Order NOT: Macro TB_2-53

54. **Refer to Figure 2-1.** Which arrow shows the flow of spending by households?
- arrow A
 - arrow B
 - arrow C
 - arrow D

ANS: A PTS: 1 DIF: Average REF: p.25
 BLM: Higher Order NOT: Macro TB_2-54

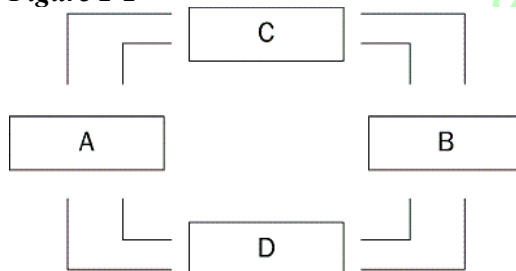
55. **Refer to Figure 2-1.** Which arrow shows the flow of the factors of production?
- arrow A
 - arrow B
 - arrow C
 - arrow D

ANS: C PTS: 1 DIF: Average REF: p.25
 BLM: Higher Order NOT: Macro TB_2-55

56. **Refer to Figure 2-1.** Which arrow shows the flow of income payments?
- arrow A
 - arrow B
 - arrow C
 - arrow D

ANS: D PTS: 1 DIF: Average REF: p.25
 BLM: Higher Order NOT: Macro TB_2-56

Figure 2-2



57. **Refer to Figure 2-2.** What do boxes A and B represent?
- firms and households
 - government and the foreign sector
 - the goods and services market and the factors of production market
 - households and government

ANS: A PTS: 1 DIF: Challenging REF: p.25
 BLM: Higher Order NOT: Macro TB_2-57

58. **Refer to Figure 2-2.** What do boxes C and D represent?

- a. households and firms
- b. the goods and services market and the factors of production market
- c. the goods and services market and the financial market
- d. households and government

ANS: B PTS: 1 DIF: Challenging REF: p.25
BLM: Higher Order NOT: Macro TB_2-58

59. **Refer to Figure 2-2.** In which market are households sellers?

- a. the factors of production market
- b. the goods and services market
- c. both of the above markets
- d. neither of the above markets

ANS: A PTS: 1 DIF: Easy REF: p.25
BLM: Remember NOT: Macro TB_2-59

60. **Refer to Figure 2-2.** In which market are firms sellers?

- a. the goods and services market
- b. the factors of production market
- c. both of the above markets
- d. neither of the above markets

ANS: A PTS: 1 DIF: Easy REF: p.25
BLM: Remember NOT: Macro TB_2-60

61. **Refer to Figure 2-2.** Who owns the factors of production?

- a. the government
- b. firms
- c. households
- d. corporations

ANS: C PTS: 1 DIF: Easy REF: p.25
BLM: Remember NOT: Macro TB_2-61

62. **Refer to Figure 2-2.** What does the inner loop represent?

- a. the flow of inputs to firms and output to households
- b. the flow of output to firms and inputs to households
- c. the flow of spending to firms and factor payments to households
- d. the flow of spending to households and factor payments to firms

ANS: A PTS: 1 DIF: Challenging REF: p.25
BLM: Remember NOT: Macro TB_2-62

63. **Refer to Figure 2-2.** What does the outer loop represent?

- a. the flow of goods
- b. the flow of spending
- c. the flow of factors of production
- d. the flow of services

ANS: B PTS: 1 DIF: Average REF: p.25
BLM: Remember NOT: Macro TB_2-63

64. **Refer to Figure 2-2.** Which is true about money spent by households?

- a. it is earned from the sale of factors of production.
- b. it becomes profit to firms.
- c. it cannot be tracked in the diagram.
- d. it is used to purchase factors of production.

ANS: A PTS: 1 DIF: Average REF: p.25
BLM: Remember NOT: Macro TB_2-64

65. What happens in the markets for factors of production?

- a. Households provide firms with labour, land, and capital.
- b. Households provide firms with savings for investment.
- c. Firms provide households with goods and services.
- d. The government provides firms with inputs for the production process.

ANS: A PTS: 1 DIF: Average REF: p.25
BLM: Remember NOT: Macro TB_2-65

66. What happens in the markets for goods and services?

- a. Households provide firms with savings for investment.
- b. Households provide firms with labour, land, and capital.
- c. Firms provide households with the output they produced.
- d. The government provides firms with inputs for the production process.

ANS: C PTS: 1 DIF: Average REF: p.25
BLM: Remember NOT: Macro TB_2-66

67. What are the four sectors in a more complex circular-flow diagram?

- a. households, government, financial markets, and international trade
- b. households, firms, government, and financial markets
- c. households, firms, financial markets, and international trade
- d. households, firms, government, and international trade

ANS: D PTS: 1 DIF: Average REF: p.26
BLM: Remember NOT: Macro TB_2-67

68. In economics, what does capital refer to?

- a. the finances necessary for firms to produce their products
- b. buildings and machines used in the production process
- c. the money households use to purchase firms' output
- d. the value of stock market shares to investors

ANS: B PTS: 1 DIF: Average REF: p.24-26
BLM: Remember NOT: Macro TB_2-68

69. What is revenue received by firms from sales that is not used to pay for factors of production?

- a. rent
- b. wages
- c. profit
- d. interest

ANS: C PTS: 1 DIF: Average REF: p.24-25
BLM: Remember NOT: Macro TB_2-69

70. What does a point on a country's production possibilities frontier represent?
- a. a combination of two goods that an economy will never be able to produce.
 - b. a combination of two goods that an economy can produce using all available resources and technology.
 - c. a combination of two goods that an economy can produce using some of its resources and technology.
 - d. a combination of two goods that an economy may be able to produce sometime in the future with additional resources and technology.

ANS: B PTS: 1 DIF: Challenging REF: p.26
BLM: Remember NOT: Macro TB_2-70

71. For what reason are production possibilities frontiers usually bowed outward?
- a. The more resources a society uses to produce one good, the fewer resources it has available to produce another good.
 - b. It reflects the fact that the opportunity cost of producing a good falls as one produces more and more of it.
 - c. It is because of the effects of technological change.
 - d. Resources are specialized, that is, some are better at producing particular goods rather than other goods.

ANS: D PTS: 1 DIF: Average REF: p.26-28
BLM: Remember NOT: Macro TB_2-71

72. For what reason are production possibilities frontiers usually bowed outward?
- a. constant opportunity cost
 - b. increasing opportunity cost
 - c. decreasing opportunity cost
 - d. increasing productivity

ANS: B PTS: 1 DIF: Average REF: p.26-28
BLM: Remember NOT: Macro TB_2-72

73. Suppose an economy produces two goods, food and machines. This economy always operates on its production possibilities frontier. Last year, it produced 50 units of food and 30 machines. This year, it is producing 55 units of food and 33 machines. Which of the following would *NOT* explain the increase in output?
- a. a reduction in unemployment
 - b. an increase in the labour force
 - c. an improvement in technology
 - d. an increase in worker productivity

ANS: A PTS: 1 DIF: Average REF: p.26-28
BLM: Higher Order NOT: Macro TB_2-73

74. Suppose an economy produces two goods, food and machines. This economy always operates on its production possibilities frontier. Last year, it produced 72 units of food and 28 machines. This year, it is producing 75 units of food and 30 machines. Which of the following would *NOT* explain the increase in output?
- a. a reduction in unemployment
 - b. an increase in the labour force
 - c. an improvement in technology
 - d. an increase in worker productivity

ANS: A PTS: 1 DIF: Average REF: p.26-28
BLM: Higher Order NOT: Macro TB_2-74

75. Suppose an economy produces two goods, food and machines. This economy always operates on its production possibilities frontier. Last year, it produced 91 units of food and 48 machines. This year, it is producing 92 units of food and 53 machines. Which of the following would *NOT* explain the increase in output?
- a. a reduction in unemployment
 - b. an increase in the labour force
 - c. an improvement in technology
 - d. an increase in worker productivity

ANS: A PTS: 1 DIF: Average REF: p.26-28
BLM: Higher Order NOT: Macro TB_2-75

76. The country of Econoland produces two goods, textbooks and widgets. Last year it produced 200 textbooks and 500 widgets. This year it produced 250 textbooks and 600 widgets. Given no other information, which of the following could *NOT* explain the change?
- a. Econoland experienced a reduction in unemployment.
 - b. Econoland experienced an improvement in widget-making technology.
 - c. Econoland acquired more resources.
 - d. Econoland experienced a high level of emigration out of the country.

ANS: D PTS: 1 DIF: Average REF: p.26-28
BLM: Higher Order NOT: Macro TB_2-76

77. The country of Econoland produces two goods, textbooks and widgets. Last year it produced 300 textbooks and 600 widgets. This year it produced 350 textbooks and 700 widgets. Given no other information, which of the following could *NOT* explain the change?
- a. Econoland experienced a reduction in unemployment.
 - b. Econoland experienced an improvement in widget-making technology.
 - c. Econoland acquired more resources.
 - d. Econoland experienced a high level of emigration out of the country.

ANS: D PTS: 1 DIF: Average REF: p.26-28
BLM: Higher Order NOT: Macro TB_2-77

78. Suppose there are two countries, Freedonia and Sylvania, which have identical amounts of resources, identical technologies, and identical populations. Both produce two types of goods, consumer goods and capital goods, and they both always operate on their production possibilities frontiers. The only difference is that this year Freedonia chooses to produce relatively more consumer goods than Sylvania. What will happen as a result?
- a. Freedonia will have a higher living standard this year but will grow slower than Sylvania.
 - b. Freedonia will have a higher living standard this year and will grow faster than Sylvania.
 - c. Sylvania will have a higher living standard this year but will grow slower than Freedonia.
 - d. Sylvania will have a higher living standard this year and will grow faster than Freedonia.

ANS: A PTS: 1 DIF: Challenging REF: p.26-28
BLM: Higher Order NOT: Macro TB_2-78

79. Suppose there are two countries, Freedonia and Sylvania, which have identical amounts of resources, identical technologies, and identical populations. Both produce two types of goods, consumer goods and capital goods, and they both always operate on their production possibilities frontiers. The only difference is that this year Sylvania chooses to produce relatively more consumer goods than Freedonia. What will happen as a result?
- a. Freedonia will have a higher living standard this year but will grow slower than Sylvania.
 - b. Freedonia will have a higher living standard this year and will grow faster than Sylvania.
 - c. Sylvania will have a higher living standard this year but will grow slower than Freedonia.
 - d. Sylvania will have a higher living standard this year and will grow faster than Freedonia.

ANS: C PTS: 1 DIF: Challenging REF: p.26-28
BLM: Higher Order NOT: Macro TB_2-79

80. What is the production possibilities frontier?
- a. a map that shows the frontier beyond which agriculture is unprofitable
 - b. a map that shows areas of the world in which capitalist production is now possible
 - c. a graph that shows the various combinations of resources that can be used to produce a given level of output
 - d. a graph that shows the various combinations of output the economy can possibly produce given the available resources and technology

ANS: D PTS: 1 DIF: Average REF: p.26-28
BLM: Remember NOT: Macro TB_2-80

81. Which of the following is the most accurate statement about production possibilities?
- a. An economy can produce only on the production possibilities frontier.
 - b. An economy can produce at any point inside or outside a production possibilities frontier.
 - c. An economy can produce at any point on or inside the production possibilities frontier, but not outside the frontier.
 - d. An economy can produce at any point inside the production possibilities frontier, but not on or outside the frontier.

ANS: C PTS: 1 DIF: Challenging REF: p.26-28
BLM: Remember NOT: Macro TB_2-81

82. When is an economic outcome said to be efficient?
- a. if the economy is using all of the resources it has available
 - b. if the economy is conserving on resources and not using all it has
 - c. if the economy is getting all it can from the scarce resources it has available
 - d. if the economy is able to produce more than its current production without additional resources

ANS: C PTS: 1 DIF: Average REF: p.26-28
BLM: Remember NOT: Macro TB_2-82

83. When constructing a production possibilities frontier, which of the following is NOT an assumption?
- a. The economy produces only 2 goods.
 - b. All the economy's factors of production are being used.
 - c. The economy has a fixed level of technology.
 - d. The economy may increase its available factors of production.

ANS: D PTS: 1 DIF: Average REF: p.26-28
BLM: Remember NOT: Macro TB_2-83

84. On a production possibilities frontier, when is production efficient?
- a. if the production point is on the frontier
 - b. if the production point is outside the frontier
 - c. if the production point is on or inside the frontier
 - d. if the production point is inside the frontier

ANS: A PTS: 1 DIF: Average REF: p.26-28
BLM: Remember NOT: Macro TB_2-84

85. What does it mean if an economy is producing efficiently?
- a. there is no way to produce more of one good without producing less of the other.
 - b. it is possible to produce more of both goods.
 - c. it is possible to produce more of one good without producing less of the other.
 - d. it is not possible to produce more of one good at any cost.

ANS: A PTS: 1 DIF: Average REF: p.26-28
BLM: Remember NOT: Macro TB_2-85

86. Which of the following concepts is NOT illustrated by the production possibilities frontier?
- a. efficiency
 - b. opportunity cost
 - c. equity
 - d. tradeoffs

ANS: C PTS: 1 DIF: Average REF: p.27
BLM: Higher Order NOT: Macro TB_2-86

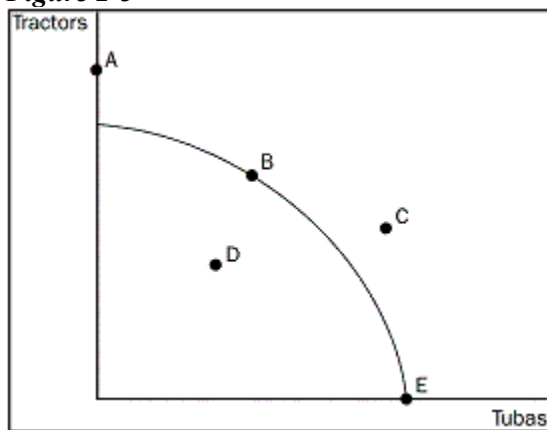
87. When a production possibilities frontier is linear, what does it show?
- a truer picture of real life than a bowed out production possibilities frontier
 - that resources are perfectly shiftable from the production of one good to another
 - an example of increasing opportunity cost
 - An example of decreasing opportunity cost

ANS: B PTS: 1 DIF: Average REF: p.27
BLM: Remember NOT: Macro TB_2-87

88. Suppose a nation is currently producing at a point inside its production possibilities frontier. What do we know?
- The nation is producing beyond its capacity, and inflation will occur.
 - The nation is not using all available resources or has inefficiencies.
 - The nation is producing an efficient combination of goods.
 - There will be a large opportunity cost if the nation tries to increase production.

ANS: B PTS: 1 DIF: Average REF: p.27
BLM: Remember NOT: Macro TB_2-88

Figure 2-3



89. **Refer to Figure 2-3.** At which point or points can the economy produce?
- point B, D, E
 - point A, B, D, E
 - point D, C
 - point D

ANS: A PTS: 1 DIF: Average REF: p.27
BLM: Higher Order NOT: Macro TB_2-89

90. **Refer to Figure 2-3.** Which point represents the maximum possible production of tubas?
- point A
 - point B
 - point C
 - point E

ANS: D PTS: 1 DIF: Average REF: p.27
BLM: Higher Order NOT: Macro TB_2-90

91. **Refer to Figure 2-3.** At which point or points can the economy NOT produce?
- a. point A
 - b. point C
 - c. point A, C
 - d. point A, C, D

ANS: C PTS: 1 DIF: Challenging REF: p.27
BLM: Higher Order NOT: Macro TB_2-91

92. **Refer to Figure 2-3.** Which point or points are efficient?
- a. point B, E
 - b. point A, B, E
 - c. point D
 - d. point C

ANS: A PTS: 1 DIF: Challenging REF: p.27
BLM: Higher Order NOT: Macro TB_2-92

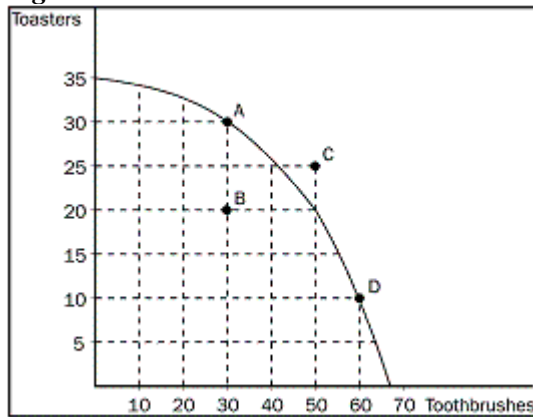
93. **Refer to Figure 2-3.** Which point or points are inefficient?
- a. point A, C
 - b. point D, C
 - c. point C
 - d. point D

ANS: D PTS: 1 DIF: Average REF: p.27
BLM: Higher Order NOT: Macro TB_2-93

94. What is the opportunity cost of obtaining more of one good as shown on the production possibilities frontier?
- a. the amount of the other good that must be given up.
 - b. the market price of the additional amount produced.
 - c. the amount of resources that must be devoted to its production.
 - d. the number of dollars that must be spent to produce it.

ANS: A PTS: 1 DIF: Average REF: p.27
BLM: Higher Order NOT: Macro TB_2-94

Figure 2-4



95. **Refer to Figure 2-4.** What is the opportunity cost to the economy of getting 30 additional toothbrushes by moving from point A to point D?
- 10 toasters
 - 15 toasters
 - 20 toasters
 - 25 toasters

ANS: C PTS: 1
BLM: Higher Order

DIF: Average REF: p.27
NOT: Macro TB_2-95

96. **Refer to Figure 2-4.** What is the opportunity cost of getting 15 additional toasters by moving from point D to point C?
- 10 toothbrushes
 - 20 toothbrushes
 - 30 toothbrushes
 - It is impossible for the economy to move from point D to point C.

ANS: D PTS: 1
BLM: Higher Order

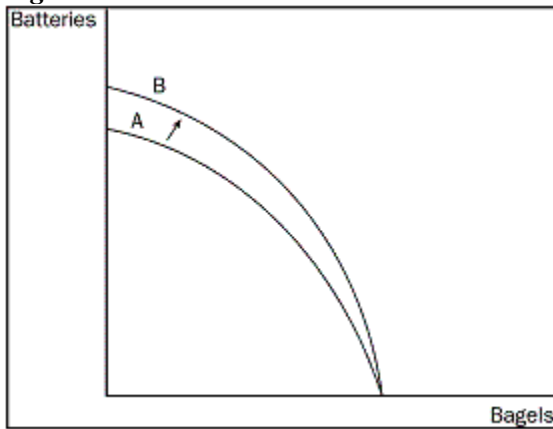
DIF: Challenging REF: p.27
NOT: Macro TB_2-96

97. **Refer to Figure 2-4.** What is the opportunity cost in terms of toothbrushes of getting 10 additional toasters by moving from point B to point A?
- 20 toothbrushes
 - 10 toothbrushes
 - 5 toothbrushes
 - zero, since the economy has the additional resources to produce 10 additional toasters

ANS: D PTS: 1
BLM: Higher Order

DIF: Challenging REF: p.27
NOT: Macro TB_2-97

Figure 2-5



98. **Refer to Figure 2-5.** The shift of the frontier from A to B was most likely caused by which of the following?
- technological improvement in the production of batteries
 - more labour available in the economy
 - a general technological breakthrough
 - more capital available in the economy

ANS: A

PTS: 1

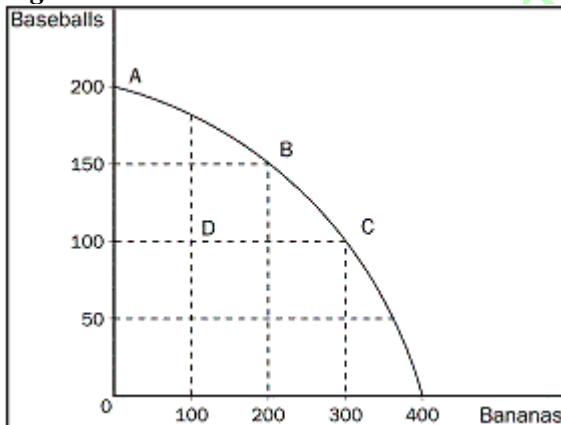
DIF: Average

REF: p.27

BLM: Higher Order

NOT: Macro TB_2-98

Figure 2-6



99. **Refer to Figure 2-6.** What is the opportunity cost to society of the movement from point A to point C?
- 50 baseballs
 - 100 baseballs
 - 100 bananas
 - 300 bananas

ANS: B

PTS: 1

DIF: Average

REF: p.27

BLM: Higher Order

NOT: Macro TB_2-99

100. **Refer to Figure 2-6.** What is the opportunity cost to society of moving from point B to point D?
- a. 100 bananas
 - b. 50 baseballs
 - c. both 100 bananas and 50 baseballs
 - d. nothing, since this economy would have unused resources

ANS: C PTS: 1 DIF: Average REF: p.27
BLM: Higher Order NOT: Macro TB_2-100

101. **Refer to Figure 2-6.** What was the most likely cause of the movement from point C to point D?
- a. unemployment
 - b. a decrease in society's preference for bananas
 - c. a decrease in society's preference for playing baseball
 - d. a shift to a longer working day

ANS: A PTS: 1 DIF: Average REF: p.27
BLM: Higher Order NOT: Macro TB_2-101

102. **Refer to Figure 2-6.** If this economy put all available resources into the production of bananas, how many could it produce?
- a. 200 bananas and also 150 baseballs
 - b. 300 bananas and also 100 baseballs
 - c. 400 bananas and no baseballs
 - d. It is impossible to know unless we know the quantity of resources available.

ANS: C PTS: 1 DIF: Average REF: p.27
BLM: Higher Order NOT: Macro TB_2-102

103. How can the production possibilities frontiers shift outward?
- a. if government increases the amount of money in the economy
 - b. if there is an increase in technology
 - c. if resources can be moved from the production of one good to another
 - d. if opportunity costs are reduced

ANS: B PTS: 1 DIF: Average REF: p.28-29
BLM: Remember NOT: Macro TB_2-103

104. When is the production possibilities frontier bowed outward?
- a. if resources are not perfectly shiftable
 - b. if the amount of resources increases
 - c. if the level of technology increases
 - d. if opportunity costs are constant

ANS: A PTS: 1 DIF: Average REF: p.28-29
BLM: Remember NOT: Macro TB_2-104

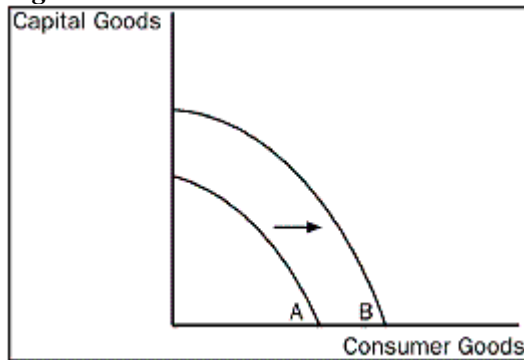
105. When a production possibilities frontier shifts outward, what concept is being demonstrated?
- a. tradeoffs
 - b. efficiency
 - c. economic growth
 - d. opportunity cost

ANS: C PTS: 1 DIF: Average REF: p.28-29
BLM: Remember NOT: Macro TB_2-105

106. When an economy is operating inside its production possibilities frontier, what do we know?
- a. There are unused resources or inefficiencies in the economy.
 - b. The economy is operating with efficiency.
 - c. Moving to a point on its production possibilities frontier would be economic growth.
 - d. To produce more of one good, the economy would have to give up some of the other good.

ANS: A PTS: 1 DIF: Average REF: p.27
BLM: Remember NOT: Macro TB_2-106

Figure 2-7



107. **Refer to Figure 2-7.** Which of the following would most likely have caused the production possibilities frontier to shift outward from A to B?
- a. an increase in resources necessary to produce capital goods
 - b. an improvement in the technology of producing consumer goods
 - c. an increase in the overall level of technology in the economy
 - d. an increase in unemployment

ANS: C PTS: 1 DIF: Average REF: p.28-29
BLM: Higher Order NOT: Macro TB_2-107

108. **Refer to Figure 2-7.** What would best describe the movement from frontier A to B?
- a. a downturn in the economy
 - b. economic growth
 - c. a more equitable distribution of income
 - d. an improvement in the allocation of resources

ANS: B PTS: 1 DIF: Average REF: p.28-29
BLM: Higher Order NOT: Macro TB_2-108

109. What would unemployment cause an economy to do?
- produce inside its production possibilities frontier
 - produce on its production possibilities frontier
 - produce outside its production possibilities frontier
 - unemployment could actually cause a, b, or c, depending on how severe it is

ANS: A PTS: 1 DIF: Average REF: p.27
 BLM: Higher Order NOT: Macro TB_2-109

Table 2-1

Production Possibilities for Toyland

Dolls	Fire Trucks
400	0
300	200
200	350
100	450
0	500

110. **Refer to Table 2-1.** What is the opportunity cost to Toyland of increasing the production of dolls from 200 to 300?
- 200 fire trucks
 - 150 fire trucks
 - 100 fire trucks
 - It is impossible to tell what the opportunity cost is since in this example costs are not constant.

ANS: B PTS: 1 DIF: Average REF: p.27
 BLM: Higher Order NOT: Macro TB_2-110

111. **Refer to Table 2-1.** What is the opportunity cost to Toyland of increasing the production of dolls from 300 to 400?
- 200 fire trucks
 - 150 fire trucks
 - 100 fire trucks
 - It is impossible to tell what the opportunity cost is since in this example costs are not constant.

ANS: A PTS: 1 DIF: Average REF: p.27
 BLM: Higher Order NOT: Macro TB_2-111

112. **Refer to Table 2-1.** What is the opportunity cost to Toyland of increasing the production of dolls from 100 to 200?
- 200 fire trucks
 - 150 fire trucks
 - 100 fire trucks
 - It is impossible to tell what the opportunity cost is since in this example costs are not constant.

ANS: C PTS: 1 DIF: Average REF: p.27
 BLM: Higher Order NOT: Macro TB_2-112

113. **Refer to Table 2-1.** What is the opportunity cost to Toyland of increasing the production of dolls from 0 to 100?
- a. 200 fire trucks
 - b. 150 fire trucks
 - c. 100 fire trucks
 - d. 50 fire trucks

ANS: D PTS: 1

DIF: Average REF: p.27

BLM: Higher Order

NOT: Macro TB_2-113

114. **Refer to Table 2-1.** What is the opportunity cost to Toyland of increasing the production of fire trucks from 0 to 200?
- a. 200 dolls
 - b. 150 dolls
 - c. 100 dolls
 - d. 50 dolls

ANS: C PTS: 1

DIF: Average REF: p.27

BLM: Higher Order

NOT: Macro TB_2-114

115. **Refer to Table 2-1.** What is the opportunity cost to Toyland of increasing the production of fire trucks from 450 to 500?
- a. 200 dolls
 - b. 150 dolls
 - c. 100 dolls
 - d. 50 dolls

ANS: C PTS: 1

DIF: Average REF: p.27

BLM: Higher Order

NOT: Macro TB_2-115

116. **Refer to Table 2-1.** Which of the following statements accurately describes the production possibilities for Toyland?
- a. The opportunity cost of an additional 100 dolls is 50 fire trucks.
 - b. The opportunity cost of an additional 100 dolls is 100 fire trucks.
 - c. Without additional information, it is impossible to determine the opportunity cost of an additional doll.
 - d. The opportunity cost of an additional 100 dolls increases as more dolls are produced.

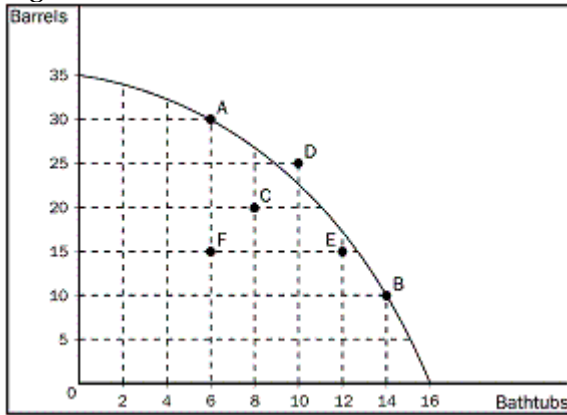
ANS: D PTS: 1

DIF: Average REF: p.27

BLM: Higher Order

NOT: Macro TB_2-116

Figure 2-8



117. **Refer to Figure 2-8.** What would be an efficient combination of bathtubs and barrels?
- 30 barrels and 6 bathtubs
 - 20 barrels and 8 bathtubs
 - 25 barrels and 10 bathtubs
 - 15 barrels and 12 bathtubs

ANS: A PTS: 1
BLM: Higher Order

DIF: Challenging REF: p.27
NOT: Macro TB_2-117

118. **Refer to Figure 2-8.** What is the opportunity cost of moving from point A to point B?
- 8 bathtubs
 - 20 barrels
 - the difference between the 8 bathtubs you get and the 20 barrels you give up
 - the difference between the 20 barrels you get and the 8 bathtubs you give up

ANS: B PTS: 1
BLM: Higher Order

DIF: Challenging REF: p.27
NOT: Macro TB_2-118

119. **Refer to Figure 2-8.** If this economy puts all of its resources into the production of bathtubs, how many could it produce?
- 20 barrels and 12 bathtubs
 - 35 barrels and no bathtubs
 - no barrels and 16 bathtubs
 - This economy would not choose to put all of its resources into the production of one good.

ANS: C PTS: 1
BLM: Higher Order

DIF: Average REF: p.27
NOT: Macro TB_2-119

120. **Refer to Figure 2-8.** Which of the following combinations is impossible for this economy to produce?
- 30 barrels and 6 bathtubs
 - 25 barrels and 10 bathtubs
 - 20 barrels and 8 bathtubs
 - 10 barrels and 14 bathtubs

ANS: B PTS: 1
BLM: Higher Order

DIF: Challenging REF: p.27
NOT: Macro TB_2-120

121. **Refer to Figure 2-8.** What would happen if this economy moved from point C to point E?
- a. It still would not be producing efficiently.
 - b. There would be no gain in either bathtubs or barrels.
 - c. it would be producing more barrels and more bathtubs than at point C.
 - d. It is not possible for this economy to move from point C to point E without additional resources.

ANS: A PTS: 1 DIF: Challenging REF: p.27
BLM: Higher Order NOT: Macro TB_2-121

122. Into which two broad subfields is the field of economics traditionally divided?
- a. national economics and international economics
 - b. consumer economics and producer economics
 - c. private sector economics and public sector economics
 - d. microeconomics and macroeconomics

ANS: D PTS: 1 DIF: Easy REF: p.29
BLM: Remember NOT: Macro TB_2-122

123. What does microeconomics study?
- a. the behaviour of consumers
 - b. how individual households and firms make decisions
 - c. how government affects the economy
 - d. how the economy as a whole works

ANS: B PTS: 1 DIF: Easy REF: p.29
BLM: Remember NOT: Macro TB_2-123

124. What does macroeconomics study?
- a. individual decision makers
 - b. economic history
 - c. economy-wide phenomena
 - d. how firms maximize profit

ANS: C PTS: 1 DIF: Easy REF: p.29
BLM: Remember NOT: Macro TB_2-124

125. Which of the following would be considered a topic of study in macroeconomics?
- a. the impact of agricultural price support programs in the cotton industry
 - b. the effect on U.S. steel producers of an import quota imposed on foreign steel
 - c. the effect of an increase in the price of imported oil on the U.S. inflation rate
 - d. the effect of an increase in the price of imported coffee beans on the U.S. coffee industry

ANS: C PTS: 1 DIF: Average REF: p.29
BLM: Remember NOT: Macro TB_2-125

126. Which of the following might a microeconomist NOT study?
- a. the effects of rent control on housing in Toronto
 - b. how a college student makes financial decisions
 - c. how tariffs on shoes affects the shoe industry
 - d. the effect on the economy when unemployment rates change

ANS: D PTS: 1 DIF: Average REF: p.29
BLM: Higher Order NOT: Macro TB_2-126

127. Which of the following would a macroeconomist NOT study?
- a. impact of minimum-wage laws on employment in the fast food industry
 - b. effect of changes in saving rates on GDP
 - c. impact of monetary policy on the rate of inflation
 - d. effect of tax policy on the rate of economic growth

ANS: A PTS: 1 DIF: Average REF: p.29
BLM: Higher Order NOT: Macro TB_2-127

128. Complete the following statement: When economists are trying to explain the world they are
- a. scientists.
 - b. policy advisors.
 - c. in the realm of normative economics.
 - d. in over their heads.

ANS: A PTS: 1 DIF: Easy REF: p.30
BLM: Remember NOT: Macro TB_2-128

129. Complete the following statement: When economists are trying to help improve the world they are
- a. concerned with positive economics.
 - b. policy advisors.
 - c. scientists.
 - d. politicians.

ANS: B PTS: 1 DIF: Easy REF: p.30
BLM: Remember NOT: Macro TB_2-129

130. Which is the best statement about the roles of economists?
- a. Economists are best viewed as policymakers.
 - b. Economists are best viewed as scientists.
 - c. In trying to explain the world, economists are policymakers; in trying to improve the world, they are scientists.
 - d. In trying to explain the world, economists are scientists; in trying to improve the world, they are policymakers.

ANS: D PTS: 1 DIF: Average REF: p.30
BLM: Remember NOT: Macro TB_2-130

131. For economists, what are the two types of statements about the world?
- a. assumptions and theories
 - b. true statements and false statements
 - c. specific statements and general statements
 - d. positive statements and normative statements

ANS: D PTS: 1 DIF: Easy REF: p.30
BLM: Remember NOT: Macro TB_2-131

132. How do economists view positive statements?
- a. affirmative, justifying existing economic policy
 - b. optimistic, putting the best possible interpretation on things
 - c. descriptive, making a claim about how the world is
 - d. prescriptive, making a claim about how the world ought to be

ANS: C PTS: 1 DIF: Average REF: p.30
BLM: Remember NOT: Macro TB_2-132

133. How do economists consider normative statements?
- a. descriptive, making a claim about how the world is
 - b. statements about the normal condition of the world
 - c. prescriptive, making a claim about how the world ought to be
 - d. statements that establish production goals for the economy

ANS: C PTS: 1 DIF: Average REF: p.30
BLM: Remember NOT: Macro TB_2-133

134. Which of the following is an example of a positive statement?
- a. Prices rise when the government prints too much money.
 - b. If welfare payments increase, the world will be a better place.
 - c. Inflation is more harmful to the economy than unemployment.
 - d. The benefits to the economy of improved equity are greater than the costs of reduced efficiency.

ANS: A PTS: 1 DIF: Average REF: p.30
BLM: Higher Order NOT: Macro TB_2-134

135. What does a normative statement describe?
- a. how the world was in the past
 - b. how the world is
 - c. how the world will be in the future
 - d. how the world ought to be

ANS: D PTS: 1 DIF: Easy REF: p.30
BLM: Remember NOT: Macro TB_2-135

136. Which of the following is an example of a normative statement?
- a. If the price of a product decreases, quantity demanded increases.
 - b. Reducing tax rates on the wealthy would be good for the country.
 - c. If the national saving rate were to increase, so would the rate of economic growth.
 - d. An increase in minimum wages will increase unemployment.

ANS: B PTS: 1 DIF: Average REF: p.30
BLM: Higher Order NOT: Macro TB_2-136

137. What type of statement is "Prices rise when the government prints too much money"?
- a. positive economic statement
 - b. statement made by the Harper administration
 - c. normative economic statement
 - d. welfare statement

ANS: A PTS: 1 DIF: Average REF: p.30
BLM: Higher Order NOT: Macro TB_2-137

138. What do economists from the Department of Finance provide?
- a. the annual Economic Report of the Prime Minister
 - b. the Senate with the annual budget
 - c. enforcement of the competition laws
 - d. advice on tax policy to the Prime Minister

ANS: D PTS: 1 DIF: Easy REF: p.31
BLM: Remember NOT: Macro TB_2-138

139. When economists are speaking as policy advisors, which statements are they more likely to use?
- a. normative statements
 - b. positive statements
 - c. objective statements
 - d. descriptive statements

ANS: A PTS: 1 DIF: Easy REF: p.30-31
BLM: Higher Order NOT: Macro TB_2-139

140. What does evaluating a positive statement involve?
- a. evaluating values as well as facts
 - b. examining evidence
 - c. our views on ethics and religion
 - d. consideration of the government's policy goals

ANS: B PTS: 1 DIF: Easy REF: p.30
BLM: Remember NOT: Macro TB_2-140

141. Which of the following is NOT a positive statement?
- a. Higher gasoline prices will reduce gasoline consumption.
 - b. Equity is more important than efficiency.
 - c. Trade restrictions lower our standard of living.
 - d. If a nation wants to avoid inflation, it should not print too much money.

ANS: B PTS: 1 DIF: Average REF: p.30
BLM: Higher Order NOT: Macro TB_2-141

142. Two economists, Adam and Joan, are discussing the possibility of substantially reforming the current federal tax system. Adam thinks the current system is fine but Joan is in favour of reform. Which of the following is the LEAST likely explanation for the disagreement?
- a. Adam is a positive economist and Joan is a normative economist.
 - b. Adam and Joan have different positive views about the effect of changing the tax system.
 - c. Adam and Joan have different values, and so have different normative views about policy.
 - d. Adam is better off under the current system and Joan would be better off if the reforms were implemented.

ANS: A PTS: 1 DIF: Average REF: p.30
BLM: Higher Order NOT: Macro TB_2-142

143. When do you know an economist has crossed the line from scientist to policy adviser?
- a. when he explains just the facts
 - b. when he makes positive statements
 - c. when he makes normative statements
 - d. when he cannot reach a conclusion

ANS: C PTS: 1 DIF: Easy REF: p.31
BLM: Higher Order NOT: Macro TB_2-143

144. What do economists at Industry Canada do?
- a. prepare the federal budget
 - b. write government regulations
 - c. help design and enforce Canada's antimonopoly laws
 - d. write the annual Economic Report

ANS: D PTS: 1 DIF: Average REF: p.31
BLM: Remember NOT: Macro TB_2-144

145. What do economists at the Canadian International Development Agency do?
- a. give advice on overseas development projects
 - b. collect data to help other economists
 - c. help formulate labour market policies
 - d. set monetary policy

ANS: A PTS: 1 DIF: Average REF: p.31
BLM: Remember NOT: Macro TB_2-145

146. What do economists at the Bank of Canada do?
- a. analyze data on labour markets
 - b. help negotiate trade agreements
 - c. analyze macroeconomic developments
 - d. enforce antimonopoly laws

ANS: C PTS: 1 DIF: Average REF: p.31
BLM: Remember NOT: Macro TB_2-146

147. Economists in which department help enforce antitrust laws?

- a. Environment Canada
- b. Industry Canada
- c. Ministry of Finance
- d. Canadian International Development Agency

ANS: B PTS: 1 DIF: Average REF: p.31
BLM: Remember NOT: Macro TB_2-147

148. Economists outside the government also offer policy advice. Which institution below does NOT publish reports by economists?

- a. C.D. Howe Institute
- b. Fraser Institute
- c. Institute for Research on Public Policy
- d. H.M Holmes Institute

ANS: D PTS: 1 DIF: Average REF: p.31
BLM: Remember NOT: Macro TB_2-148

149. What do economists at Foreign Affairs Canada and International Trade Canada do?

- a. help negotiate trade agreements with other countries
- b. offer advice on overseas economic development projects
- c. do not usually work together
- d. are concerned usually with the workings of labour markets

ANS: A PTS: 1 DIF: Easy REF: p.31
BLM: Remember NOT: Macro TB_2-149

150. What do the duties of the economists employed by Human Resources Canada include?

- a. advising Parliament
- b. designing tax policy
- c. writing the annual Economic Report
- d. studying the relationship between average wages and gender

ANS: D PTS: 1 DIF: Average REF: p.31
BLM: Remember NOT: Macro TB_2-150

151. Who designs tax policy?

- a. Ministry of Finance
- b. Bank of Canada
- c. Human Resources
- d. Department of Justice

ANS: A PTS: 1 DIF: Easy REF: p.31
BLM: Remember NOT: Macro TB_2-151

152. What is a duty of Human Resources Canada?

- a. to analyze data on workers
- b. to design tax policy
- c. to enforce the country's antitrust laws
- d. to advise the Prime Minister

ANS: A PTS: 1 DIF: Easy REF: p.31
BLM: Remember NOT: Macro TB_2-152

153. What does The Bank of Canada do?

- a. designs tax policy
- b. enforces the country's antitrust laws
- c. sets the country's monetary policy
- d. analyzes the data on workers

ANS: C PTS: 1 DIF: Easy REF: p.31
BLM: Remember NOT: Macro TB_2-153

154. What does Human Resources Canada do?

- a. enforce the country's antitrust laws
- b. analyze economic developments in Canada
- c. set the country's monetary policy
- d. help formulate labour market policies

ANS: D PTS: 1 DIF: Easy REF: p.31
BLM: Remember NOT: Macro TB_2-154

155. What famous economist said: "The ideas of economists and political philosophers are more powerful than commonly understood"?

- a. Gregory Mankiw
- b. John Maynard Keynes
- c. Paul Krugman
- d. David Ricardo

ANS: B PTS: 1 DIF: Easy REF: p.32
BLM: Remember NOT: Macro TB_2-155

156. What are the 2 basic reasons why economists often appear to give conflicting advice to policymakers?

- a. differences in opinions and education
- b. differences in scientific judgments and values
- c. differences in scientific judgments and education
- d. differences in opinions and values

ANS: B PTS: 1 DIF: Average REF: p.33
BLM: Remember NOT: Macro TB_2-156

157. Why did George Bernard Shaw, among others, criticize economists?
- a. because they have too much influence over government decisions
 - b. because many ideas are too theoretical and therefore do not work in "real life"
 - c. because they tend to speak a different language, causing most people to not understand them
 - d. because they seem to give conflicting advice to policymakers

ANS: D PTS: 1 DIF: Average REF: p.35
BLM: Remember NOT: Macro TB_2-157

158. What are tariffs and quotas?
- a. policies that restrict trade
 - b. instruments implemented to increase trade efficiency
 - c. measures endorsed by almost all economists
 - d. policies meant to improve the well-being of consumers

ANS: D PTS: 1 DIF: Challenging REF: p.36
BLM: Remember NOT: Macro TB_2-158

159. What did a survey that asked the opinion of academic, business, and government economists on ten propositions about economic policy find?
- a. The respondents were almost equally divided on the propositions.
 - b. The respondents favoured the propositions by a slight margin.
 - c. The respondents disagreed with the propositions by a slight margin.
 - d. There was overwhelming endorsement of the propositions among the respondents.

ANS: D PTS: 1 DIF: Average REF: p.36
BLM: Remember NOT: Macro TB_2-159

160. What do almost all economists agree about rent control?
- a. improves the availability and quality of housing
 - b. allows the market for housing to work more efficiently
 - c. adversely affects the availability and quality of housing
 - d. is a very inexpensive way to help the most needy members of society

ANS: C PTS: 1 DIF: Average REF: p.36
BLM: Remember NOT: Macro TB_2-160

161. Which of the following is the best explanation for why policies such as rent control and import quotas persist in spite of the fact that experts are united in their opposition to such policies?
- a. Economists have not yet convinced the general public that the policies are undesirable.
 - b. Economists are simply wrong about the economic impact of these policies.
 - c. Economists have different values than do most people.
 - d. Economists are usually of a different political party than are lawmakers.

ANS: A PTS: 1 DIF: Average REF: p.36
BLM: Remember NOT: Macro TB_2-161

162. What are the 3 propositions about which most economists agree most often (in order from first to third)?

- a. rent control, tariffs and quotas, and floating exchange rates
- b. tariffs and quotas, floating exchange rates, and fiscal policy
- c. rent control, fiscal policy, and tariffs and quotas
- d. fiscal policy, rent control, and floating exchange rates

ANS: A PTS: 1 DIF: Challenging REF: p.36
BLM: Remember NOT: Macro TB_2-162

163. What is the single most important purpose of your textbook?

- a. to teach you about the effects of the government's economic policies
- b. to teach you the language of economics
- c. to teach you the economist's way of thinking
- d. to teach you how to make money

ANS: C PTS: 1 DIF: Easy REF: p.37-38
BLM: Remember NOT: Macro TB_2-163

164. How would any economist who says all policy decisions are easy be best described?

- a. they must understand the relationship between a market economy and the government.
- b. they must be running for office.
- c. they have a Ph.D. in economics.
- d. they cannot be trusted.

ANS: D PTS: 1 DIF: Easy REF: p.37
BLM: Remember NOT: Macro TB_2-164

165. What did John Maynard Keynes believe the ideas of economists to be?

- a. generally incorrect
- b. powerful
- c. pie-in-the-sky ideals
- d. not taken seriously

ANS: B PTS: 1 DIF: Easy REF: p.38
BLM: Remember NOT: Macro TB_2-165

166. How did John Maynard Keynes refer to economics?

- a. as an easy subject at which very few excel.
- b. as an easy subject but not as easy as philosophy or the pure sciences.
- c. as an easy subject which very few can enjoy.
- d. as an easy subject which deals primarily with common sense.

ANS: A PTS: 1 DIF: Easy REF: p.38
BLM: Remember NOT: Macro TB_2-166

167. How did the great economist John Maynard Keynes explain his comment that although economics is an easy subject compared with the higher branches of philosophy or pure science, it is a subject at which few excel?
- a. Most people who study economics are not very bright.
 - b. Good economists must possess a rare combination of gifts.
 - c. Economics is actually quite boring; hence, people tend to lose interest in it.
 - d. Good thinkers become frustrated with economics because it is not logical or relevant.

ANS: B PTS: 1 DIF: Average REF: p.38
BLM: Remember NOT: Macro TB_2-167

168. Why do economists use graphs?
- a. to find how variables are related in the real world
 - b. to negate economic ideas that cannot be proved with equations or words
 - c. to visually express ideas more clearly than might be the case if they are expressed with equations or words
 - d. to make economic theory more relevant

ANS: D PTS: 1 DIF: Average REF: p.42
BLM: Remember NOT: Macro TB_2-168

169. In a pie chart, what does each "slice" of the pie represent?
- a. a specific percentage of the total pie
 - b. an equal share of the total pie
 - c. the amount of the pie each of the two variables represents
 - d. one-half of the total pie

ANS: A PTS: 1 DIF: Easy REF: p.43
BLM: Remember NOT: Macro TB_2-169

170. Why are graphs such as bar graphs limited?
- a. They can only show variables that are positively related.
 - b. They are extremely difficult to understand.
 - c. They provide information for only a single variable.
 - d. They provide information on no more than 2 variables.

ANS: C PTS: 1 DIF: Average REF: p.43
BLM: Remember NOT: Macro TB_2-170

171. In order to provide information on two variables, what must an economist use?
- a. a bar graph
 - b. pie chart
 - c. the coordinate system
 - d. a time-series graph

ANS: C PTS: 1 DIF: Easy REF: p.44
BLM: Remember NOT: Macro TB_2-171

172. What is a type of graph that can be used to display the relationship between two variables?
- a. a pie chart
 - b. a bar graph
 - c. a time-series graph
 - d. the coordinate system

ANS: D PTS: 1 DIF: Average REF: p.42
BLM: Remember NOT: Macro TB_2-172

173. Of what use is a coordinate system?
- a. to show the flow of income and products in an economic system
 - b. to organize labour and other resources in the production process
 - c. to allow economists to show two variables on a single graph
 - d. to teach economists how to draw graphs consistently

ANS: C PTS: 1 DIF: Average REF: p.42
BLM: Remember NOT: Macro TB_2-173

174. What is an ordered pair?
- a. the process of checking calculations twice before placing them on a graph
 - b. two numbers that can be represented by a single point on a graph
 - c. two numbers that are represented by side-by-side points on a graph
 - d. two points on a graph that are equal distances from the origin

ANS: B PTS: 1 DIF: Average REF: p.42
BLM: Remember NOT: Macro TB_2-174

175. What is the first number in an ordered pair?
- a. the y-coordinate
 - b. the x-coordinate
 - c. either x or y, depending on the quadrant
 - d. not useful to know, since most graphs in economics use p and q, not x and y

ANS: B PTS: 1 DIF: Easy REF: p.42
BLM: Remember NOT: Macro TB_2-175

176. What is the ordered pair that represents the origin on a graph?
- a. (1, 1)
 - b. (0, 0)
 - c. (0, 1)
 - d. (1, 0)

ANS: B PTS: 1 DIF: Average REF: p.42
BLM: Remember NOT: Macro TB_2-176

177. What is the x-coordinate?
- a. the first number of an ordered pair and represents the point's horizontal location
 - b. the second number of an ordered pair and represents the point's horizontal location
 - c. the first number of an ordered pair and represents the point's vertical location
 - d. the second number of an ordered pair and represents the point's vertical location

ANS: A PTS: 1 DIF: Challenging REF: p.43
BLM: Remember NOT: Macro TB_2-177

178. What is the y-coordinate?
- a. the first number of an ordered pair and represents the point's horizontal location
 - b. the second number of an ordered pair and represents the point's horizontal location
 - c. the first number of an ordered pair and represents the point's vertical location
 - d. the second number of an ordered pair and represents the point's vertical location

ANS: D PTS: 1 DIF: Challenging REF: p.43
BLM: Remember NOT: Macro TB_2-178

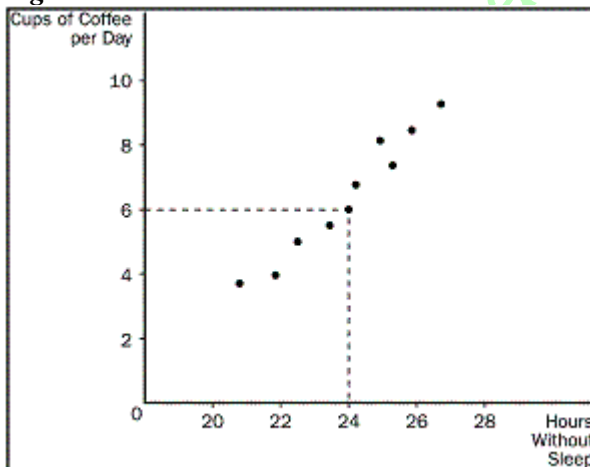
179. What does the x-coordinate give?
- a. the diagonal location of the point
 - b. the vertical location of the point
 - c. the horizontal location of the point
 - d. the quadrant location of the point

ANS: C PTS: 1 DIF: Easy REF: p.43
BLM: Remember NOT: Macro TB_2-179

180. What is the point where both x and y are zero?
- a. the origin
 - b. the null
 - c. the zero coordinate
 - d. the center

ANS: A PTS: 1 DIF: Easy REF: p.43
BLM: Remember NOT: Macro TB_2-180

Figure 2-9



181. **Refer to Figure 2-9.** What is the graph shown known as?
- a. a time series
 - b. a bar graph
 - c. a scatterplot
 - d. a pie chart

ANS: C PTS: 1 DIF: Average REF: p.44
BLM: Higher Order NOT: Macro TB_2-181

182. **Refer to Figure 2-9.** What is the correct designation of point A?

- a. (6, 0)
- b. (0, 24)
- c. (6, 24)
- d. (24, 6)

ANS: D PTS: 1

DIF: Average REF: p.44

BLM: Higher Order

NOT: Macro TB_2-182

183. **Refer to Figure 2-9.** What do cups of coffee per day and the hours that someone can go without sleep have?

- a. a positive correlation
- b. a negative correlation
- c. a random correlation
- d. no correlation

ANS: A PTS: 1

DIF: Average REF: p.44

BLM: Higher Order

NOT: Macro TB_2-183

184. **Refer to Figure 2-9.** What would you say about the relationship between coffee and hours without sleep?

- a. The less coffee a person drinks per day, the more time he can go without sleep.
- b. There is no relationship between how much coffee per day a person drinks and how long they can go without sleep.
- c. The more coffee a person drinks per day, the longer he can go without sleep.
- d. The relationship between cups of coffee per day and time without sleep is too unpredictable to consider.

ANS: C PTS: 1

DIF: Challenging REF: p.44

BLM: Higher Order

NOT: Macro TB_2-184

185. **Refer to Figure 2-9.** What are the curves shown?

- a. supply curves
- b. demand curves
- c. preference curves
- d. income-consumption curves

ANS: B PTS: 1

DIF: Easy REF: p.45

BLM: Higher Order

NOT: Macro TB_2-185

186. What happens when 2 variables have a negative correlation?

- a. They tend to move in opposite directions.
- b. They tend to move in the same direction.
- c. One variable will move while the other remains constant.
- d. The movement of the two variables is unpredictable.

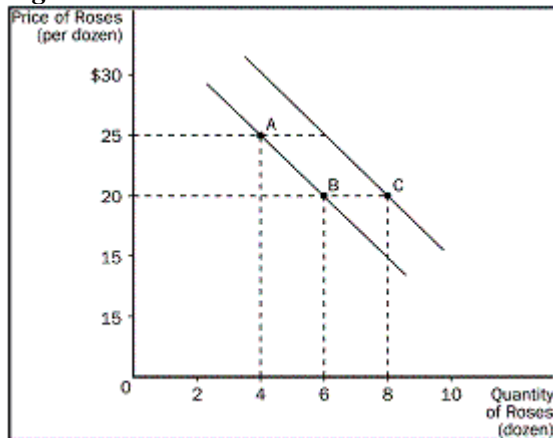
ANS: A PTS: 1

DIF: Easy REF: p.45

BLM: Higher Order

NOT: Macro TB_2-186

Figure 2-10



187. **Refer to Figure 2-10.** What is the movement from point A to point B?

- a. a shift of the curve
- b. a change in preferences
- c. a movement along the curve
- d. a change in consumer income.

ANS: C PTS: 1

DIF: Average REF: p.46

BLM: Higher Order

NOT: Macro TB_2-187

188. **Refer to Figure 2-10.** What is the movement from point B to point C?

- a. a shift of the curve
- b. a change in price
- c. a movement along the curve
- d. a change in costs to the firm

ANS: A PTS: 1

DIF: Average REF: p.46

BLM: Higher Order

NOT: Macro TB_2-188

189. **Refer to Figure 2-10.** What is the slope of the curve between points A and B?

- a. $5/2$
- b. $2/5$
- c. $-2/5$
- d. $-5/2$

ANS: D PTS: 1

DIF: Average REF: p.47

BLM: Higher Order

NOT: Macro TB_2-189

190. **Refer to Figure 2-10.** What could have caused the movement from point B to point C?

- a. inflation
- b. a change in income
- c. a change in the price of roses
- d. a change in the cost of producing roses

ANS: B PTS: 1

DIF: Challenging REF: p.46-47

BLM: Higher Order

NOT: Macro TB_2-190

191. **Refer to Figure 2-10.** How are the price of roses and the quantity of roses related?
- a. directly related and therefore move in the same direction
 - b. directly related and therefore move in opposite directions
 - c. inversely related and therefore move in opposite directions
 - d. independent of each other

ANS: C PTS: 1 DIF: Challenging REF: p.47
BLM: Higher Order NOT: Macro TB_2-191

192. What does a demand curve show?
- a. the relationship between income and quantity demanded
 - b. the relationship between price and income
 - c. the relationship between price and quantity demanded
 - d. the relationship among income, price, and quantity demanded

ANS: C PTS: 1 DIF: Average REF: p.45
BLM: Remember NOT: Macro TB_2-192

193. What does a relatively steep demand curve mean?
- a. quantity demand will adjust slightly to a price change
 - b. quantity demand will adjust greatly to a price change
 - c. quantity demand will not adjust to a price change
 - d. the change in quantity demand will exactly equal a change in price

ANS: A PTS: 1 DIF: Challenging REF: p.45-47
BLM: Remember NOT: Macro TB_2-193

194. If Steven chooses to buy more bagels per month at each price, what will happen to his demand curve?
- a. shift inward
 - b. shift outward
 - c. not shift, but he will move along his demand curve from left to right
 - d. not shift, but he will move along his demand curve from right to left

ANS: B PTS: 1 DIF: Challenging REF: p.46
BLM: Higher Order NOT: Macro TB_2-194

195. What happens when a relevant variable that is not named on either axis changes?
- a. There will be a movement along the curve.
 - b. The curve may or may not change. It depends on how the variables are related.
 - c. The curve will be unaffected since only the variables on the axis affect the curve.
 - d. The curve will shift.

ANS: D PTS: 1 DIF: Average REF: p.46
BLM: Remember NOT: Macro TB_2-195

196. What happens when a variable on an axis of a graph changes?
- a. The curve will not shift.
 - b. The curve will shift.
 - c. The curve may or may not change. It depends on how the variables are related.
 - d. The curve will shift if the variable is on the vertical axis, but not on the horizontal axis.

ANS: A PTS: 1 DIF: Average REF: p.46
BLM: Remember NOT: Macro TB_2-196

197. How is the slope of a straight line calculated?

- a. rise divided by run
- b. run divided by rise
- c. the average of rise and run.
- d. rise plus run

ANS: A PTS: 1 DIF: Average REF: p.47
BLM: Remember NOT: Macro TB_2-197

198. How is the slope of a line calculated?

- a. change in x/change in y
- b. change in y/change in x
- c. x/y
- d. $x + y$

ANS: B PTS: 1 DIF: Average REF: p.47
BLM: Remember NOT: Macro TB_2-198

199. What will the slope of a fairly flat upward-sloping line be?

- a. a small positive number
- b. a large positive number
- c. a small negative number
- d. a large negative number

ANS: A PTS: 1 DIF: Challenging REF: p.47
BLM: Remember NOT: Macro TB_2-199

200. Which of the following statements about slope is NOT correct?

- a. Slope explains how much one variable responds to changes in another variable.
- b. Slope can be computed by $\Delta x / \Delta y$.
- c. Slope is positive if the 2 variables are moving in the same direction.
- d. Slope does not change if the line is linear.

ANS: B PTS: 1 DIF: Challenging REF: p.47
BLM: Higher Order NOT: Macro TB_2-200

201. Which of the following is NOT a problem associated with graphing in economics?

- a. omitted variables
- b. holding everything else constant
- c. reverse causality
- d. the ability to show a relationship between 2 variables

ANS: D PTS: 1 DIF: Average REF: p.48-50
BLM: Remember NOT: Macro TB_2-201

202. Bill has noticed that increases in unemployment insurance claims are associated with recessions, and therefore advocates limits on unemployment insurance so as to prevent recessions. Martha has noticed that most drug addicts once attended schools, and therefore advocates getting rid of schools so as to prevent drug addiction. What do we know about the reasoning of Bill and Martha?
- The reasoning of both Bill and Martha suffers from the omitted variable problem.
 - The reasoning of both Bill and Martha suffers from the reverse causality problem.
 - Bill's reasoning suffers from the reverse causality problem and Martha's reasoning suffers from the omitted variable problem.
 - Martha's reasoning suffers from the reverse causality problem and Bill's reasoning suffers from the omitted variable problem.

ANS: A

PTS: 1

DIF: Average

REF: p.48-50

BLM: Higher Order

NOT: Macro TB_2-202

TRUE/FALSE

1. While the scientific method is applicable to studying natural sciences, it is not useful in studying an economic system.

ANS: F

PTS: 1

DIF: Average

REF: p.22

NOT: Macro TB_2-203

2. Since natural experiments offered by history cannot be used in economics, carefully constructed laboratory experiments must be used.

ANS: F

PTS: 1

DIF: Average

REF: p.22

NOT: Macro TB_2-204

3. An economic model can accurately explain how the economy is organized because it is designed to include every feature of the real world.

ANS: F

PTS: 1

DIF: Average

REF: p.24

NOT: Macro TB_2-205

4. All scientific models, including economic models, simplify reality in order to improve our understanding of it.

ANS: T

PTS: 1

DIF: Average

REF: p.24

NOT: Macro TB_2-206

5. A circular-flow diagram is a visual model of how an economy is organized.

ANS: T

PTS: 1

DIF: Average

REF: p.24-25

NOT: Macro TB_2-207

6. In a simple circular-flow diagram, firms own the factors of production and use them to produce goods and services.

ANS: F

PTS: 1

DIF: Average

REF: p.24-25

NOT: Macro TB_2-208

7. In a simple circular-flow diagram, the two types of markets in which households and firms interact are the markets for goods and services and the markets for factors of production.

ANS: T PTS: 1 DIF: Average REF: p.24-25
NOT: Macro TB_2-209

8. In the markets for goods and services, as in the markets for the factors of production, households are buyers and firms are sellers.

ANS: F PTS: 1 DIF: Average REF: p.24-25
NOT: Macro TB_2-210

9. In a circular-flow diagram, one loop shows the flow of real goods, services, and factors of production, and the other loop shows the corresponding flow of dollars.

ANS: T PTS: 1 DIF: Average REF: p.24-25
NOT: Macro TB_2-211

10. A production possibilities frontier is a graph that shows the various combinations of outputs the economy can possibly produce given its factors of production and technology.

ANS: T PTS: 1 DIF: Average REF: p.26-28
NOT: Macro TB_2-212

11. An economy can produce at any point on or outside the production possibilities frontier, but it cannot produce at points inside the frontier.

ANS: F PTS: 1 DIF: Easy REF: p.26-28
NOT: Macro TB_2-213

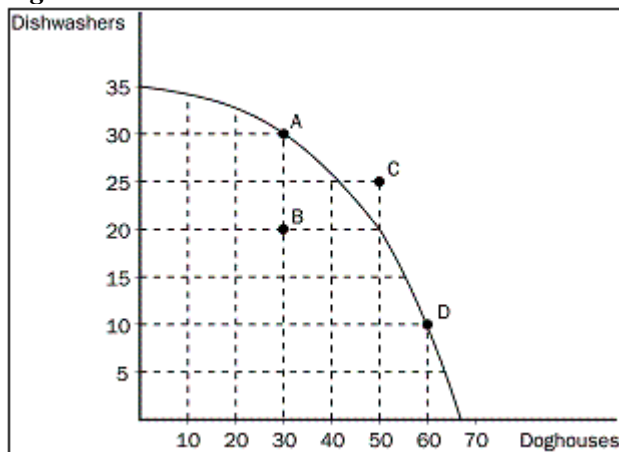
12. An efficient outcome in economics is one in which the economy is conserving the largest possible amount of resources, while still meeting the needs of society.

ANS: F PTS: 1 DIF: Average REF: p.26-28
NOT: Macro TB_2-214

13. An economy is being efficient if it is impossible to produce more of one good without producing less of another.

ANS: T PTS: 1 DIF: Average REF: p.26-28
NOT: Macro TB_2-215

Figure 2-11



14. **Refer to Figure 2-11.** Points A, B, and D represent feasible or attainable outcomes for society.

ANS: T PTS: 1 DIF: Average REF: p.27
NOT: Macro TB_2-216

15. **Refer to Figure 2-11.** The opportunity cost to the economy of moving from point A to point B is 10 dishwashers.

ANS: T PTS: 1 DIF: Average REF: p.27
NOT: Macro TB_2-217

16. **Refer to Figure 2-11.** The opportunity cost of more doghouses increases as more doghouses are produced.

ANS: T PTS: 1 DIF: Average REF: p.27
NOT: Macro TB_2-218

17. The tradeoff between the production of different goods can change because of technological improvement over time.

ANS: T PTS: 1 DIF: Challenging REF: p.28-29
NOT: Macro TB_2-219

18. Economic growth causes a production possibilities frontier to shift outward.

ANS: T PTS: 1 DIF: Average REF: p.28-29
NOT: Macro TB_2-220

19. The field of economics is divided into two subfields: microeconomics and macroeconomics.

ANS: T PTS: 1 DIF: Average REF: p.29
NOT: Macro TB_2-221

20. Normative statements describe how the world is, while positive statements prescribe how the world should be.

ANS: F PTS: 1 DIF: Average REF: p.30
NOT: Macro TB_2-222

21. "Society would be better if the welfare system were abolished" is a normative statement, not a positive statement.

ANS: T PTS: 1 DIF: Easy REF: p.30
NOT: Macro TB_2-223

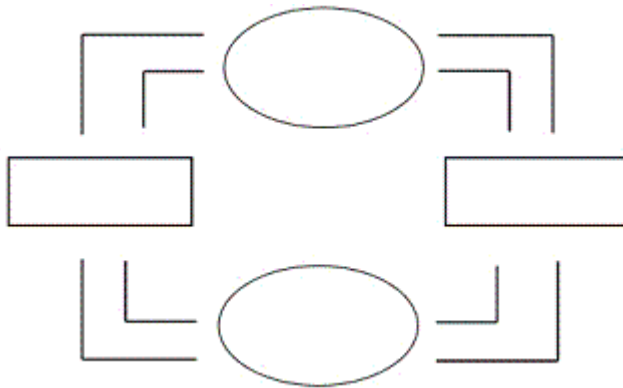
22. When economists are trying to explain the world they are acting as scientists, and when they are trying to improve it, they are policymakers.

ANS: T PTS: 1 DIF: Average REF: p.31
NOT: Macro TB_2-224

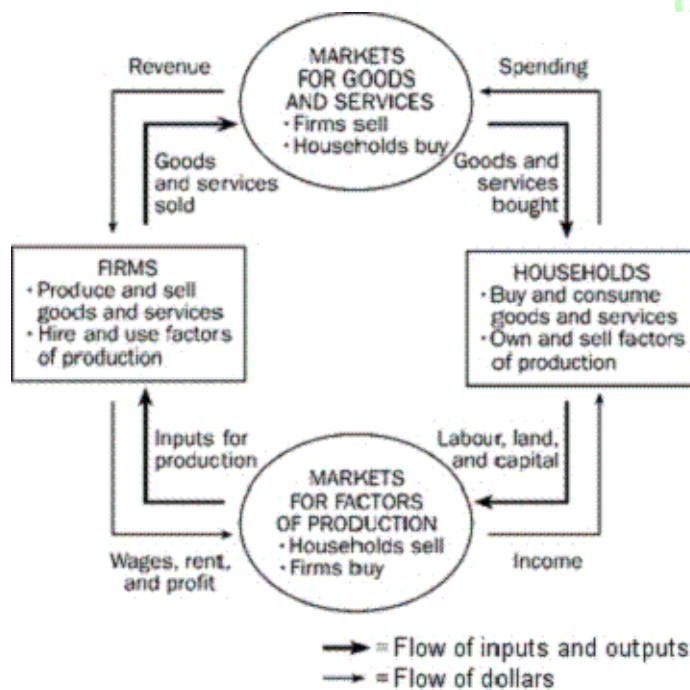
ryerson.testbank@gmail.com

SHORT ANSWER

- Using this outline, draw a circular-flow diagram representing the interactions between households and firms in a simple economy. Explain briefly the various parts of the diagram.



ANS:



This diagram should duplicate the essential characteristics of the diagram in the text, with an explanation of the meaning of each flow and each market. It is important that the student understands that the inner loop represents the flow of real goods and services and that the outer loop represents the corresponding flow of payments.

PTS: 1

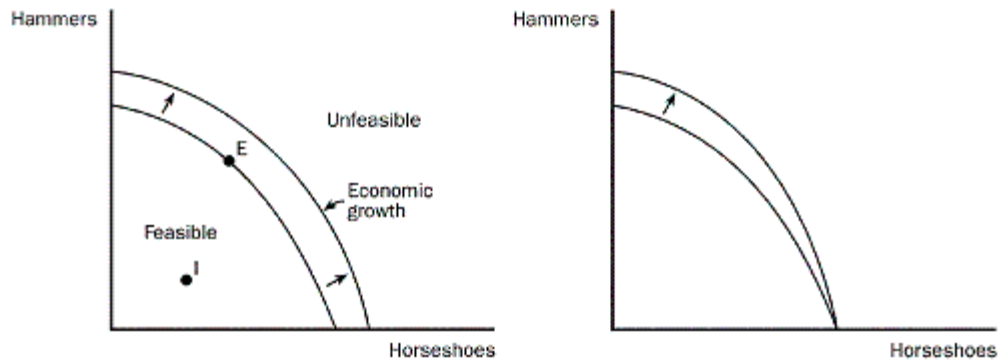
DIF: Average

REF: p. 25

NOT: Macro TB_2-225

2. Draw a production possibilities frontier showing increasing opportunity cost for hammers and horseshoes.
 - a. On a graph, identify the area of feasible outcomes and the area of unfeasible outcomes.
 - b. On the graph, label a point that is efficient as point "E" and a point that is inefficient as point "I".
 - c. On a graph, illustrate the effect of the discovery of a new vein of iron ore, a resource needed to make both horseshoes and hammers, on this economy.
 - d. On a graph for hammers and horseshoes, illustrate the effect a new computerized assembly line in the production of hammers would have.

ANS:



The graph on the left answers a, b and c. The graph on the right answers d.

PTS: 1

DIF: Average

REF: p. 27-29

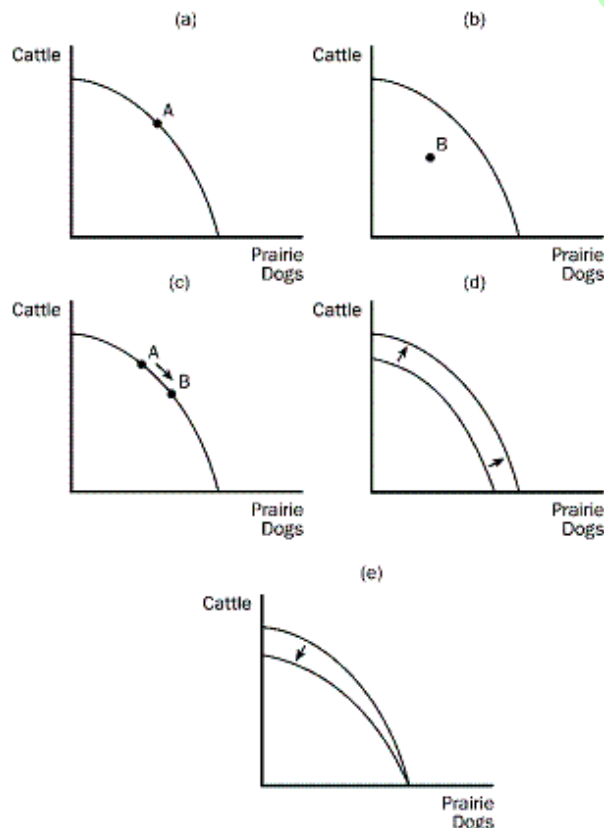
NOT: Macro TB_2-226

3. The prairie dog has always been considered a problem for Canadian cattle ranchers. They dig holes that cattle and horses can step in and they eat grass necessary for cattle. Recently, ranchers have discovered that there is a demand for prairie dogs as pets. In some areas, prairie dogs can sell for as high as \$150. Cattlemen are now fencing off prairie dog towns on their land so these towns will not be disturbed by their cattle.

Draw a production possibilities frontier showing a rancher's production option between cattle production and prairie dog production showing increasing opportunity cost and show what would happen in each of the following situations. (Use a separate graph for each situation.)

- The outcome is efficient, with ranchers choosing to produce equal numbers of cattle and prairie dogs.
- As a protest against the government introducing the gray wolf back into the wild in their province, ranchers decide not to use 25% of the available grassland for grazing.
- The price of prairie dogs increases to \$200 each, so ranchers decide to allot additional land for prairie dogs.
- The government grants new leases to ranchers, giving them 10,000 new acres of grassland each for grazing.
- A drought destroys most of the available grass for grazing of cattle, but not prairie dogs since they also eat plant roots.

ANS:



PTS: 1

DIF: Average

REF: p. 27-29

NOT: Macro TB_2-227

4. Identify each of the following topics as being part of microeconomics or macroeconomics:
- a. the impact of a change in consumer income on the purchase of luxury automobiles
 - b. the effect of a change in the price of Coke on the purchase of Pepsi
 - c. the impact of a war in the Middle East on the rate of inflation in Canada
 - d. factors influencing the rate of economic growth
 - e. factors influencing the demand for tractors
 - f. the impact of tax policy on national saving
 - g. the effect of pollution taxes on the Canadian copper industry
 - h. the degree of competition in the cable television industry
 - i. the effect of a balanced-budget amendment on economic stability
 - j. the impact of deregulation on the savings and loan industry

ANS:

a, b, e, g, h, and j are microeconomic topics. c, d, f, and i are macroeconomic topics.

PTS: 1

DIF: Average

REF: p. 29-30

NOT: Macro TB_2-228

5. Which of the following statements are positive, and which are normative?
- a. The minimum wage creates unemployment among young and unskilled workers.
 - b. The minimum wage ought to be abolished.
 - c. If the price of a product in a market decreases, other things equal, quantity demanded will increase.
 - d. A little bit of inflation is worse for society than a little bit of unemployment.
 - e. There is a tradeoff between inflation and unemployment in the short run.
 - f. If consumer income increases, other things equal, the demand for automobiles will increase.
 - g. The Canadian income distribution is not equitable.
 - h. Canadian workers deserve more liberal unemployment benefits.
 - i. If interest rates increase, investment will decrease.
 - j. If welfare benefits were reduced, the country would be better off.

ANS:

a, c, e, f, and i are positive statements. b, d, g, h, and j are normative statements.

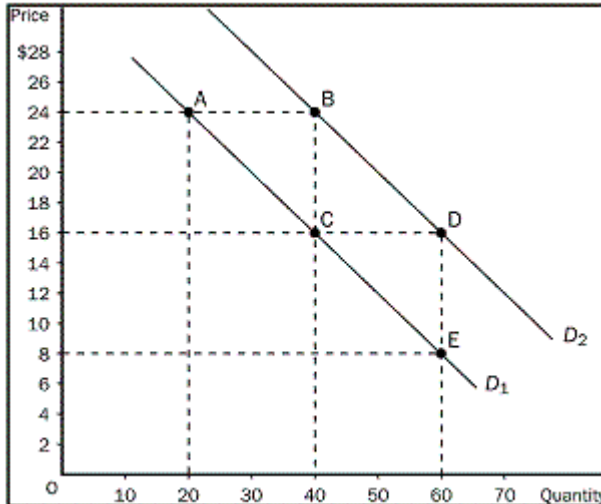
PTS: 1

DIF: Average

REF: p. 30-31

NOT: Macro TB_2-229

6. Use the following demand curve to answer the following questions.
- How would point A be represented as an ordered pair?
 - What type of curve is this?
 - Does this curve show a positive or negative correlation between price and quantity?
 - Compute the slope of D_1 between points A and C.
 - What is the slope of D_1 between points C and E? Why would you not have to calculate this answer?
 - What is it called if we move from D_1 to D_2 ?
 - How do you know that the slope of D_2 is the same as the slope of D_1 ?



ANS:

- (20, 24)
- a demand curve
- a negative correlation between price and quantity
- 8/20 or -2/5.
- 2/5; because the slope of a straight line is constant.
- an increase in demand.
- The 2 lines are parallel.

PTS: 1

DIF: Average

REF: p. 45-47

NOT: Macro TB_2-230

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Chapter 3—Interdependence and the Gains from Trade

MULTIPLE CHOICE

1. What is the best reason for people to provide you with goods and services?
- They are acting out of generosity.
 - They are acting because they like you.
 - They do so because they get something in return.
 - They are required to do so by government.

ANS: C PTS: 1 DIF: Easy REF: p.51
BLM: Remember NOT: Macro TB_3-1

2. A rancher can produce only hamburgers, while a farmer can produce only French fries. If the rancher and the farmer like both foods, which of the following is most likely?
- They cannot gain from trade.
 - They could gain from trade under certain circumstances, but not always.
 - They could gain from trade because each would enjoy a greater variety of food.
 - They could gain from trade only if each were indifferent between hamburgers and French fries.

ANS: C PTS: 1 DIF: Average REF: p.52
BLM: Higher Order NOT: Macro TB_3-2

3. Regan grows flowers and makes vases. Jayson also grows flowers and makes vases, but Regan is better at producing both. In this case, who could benefit from trade?
- Both Jayson and Regan.
 - Jayson, but not Regan.
 - Regan, but not Jayson.
 - Neither Jayson nor Regan.

ANS: A PTS: 1 DIF: Average REF: p.52
BLM: Higher Order NOT: Macro TB_3-3

4. If there is no trade, which of the following is most likely?
- A country is better off because it will become self-sufficient.
 - A country's production possibilities frontier is also its consumption possibilities frontier.
 - A country can still benefit from international specialization.
 - More product variety is available in a country.

ANS: B PTS: 1 DIF: Average REF: p.52
BLM: Remember NOT: Macro TB_3-4

5. If there is trade, which of the following is most likely?
- a. A country is worse off because it becomes dependent on other countries.
 - b. A country will produce a greater variety of goods and services to trade.
 - c. A country's consumption possibilities frontier can be outside its production possibilities frontier.
 - d. A country will experience a lower unemployment rate.

ANS: C PTS: 1 DIF: Average REF: p.52
BLM: Remember NOT: Macro TB_3-5

6. When can a country's consumption possibilities frontier be outside its production possibilities frontier?
- a. If additional resources become available.
 - b. If there is an increase in the level of technology.
 - c. If the country engages in trade.
 - d. If resources are shiftable.

ANS: C PTS: 1 DIF: Challenging REF: p.55
BLM: Remember NOT: Macro TB_3-6

7. When will a production possibilities frontier be linear and not bowed out?
- a. If no tradeoffs exist.
 - b. If the tradeoff between the two goods is always at a constant rate.
 - c. If unemployment is zero.
 - d. If resources are allocated efficiently.

ANS: B PTS: 1 DIF: Average REF: p.54
BLM: Remember NOT: Macro TB_3-7

8. What is the difference between production possibilities frontiers that are bowed out and those that are linear?
- a. Bowed out production possibilities frontiers illustrate tradeoffs where linear production possibilities frontiers do not.
 - b. Bowed out production possibilities frontiers show increasing opportunity cost where linear ones show constant opportunity cost.
 - c. Bowed out production possibilities frontiers are the result of perfectly shiftable resources where linear production possibilities frontiers are not.
 - d. Linear production possibilities frontiers illustrate real world conditions more than bowed out production possibilities frontiers.

ANS: B PTS: 1 DIF: Challenging REF: p.54
BLM: Remember NOT: Macro TB_3-8

9. Which of the following is NOT correct?
- a. Trade allows for specialization.
 - b. Trade is good for nations.
 - c. Trade is based on absolute advantage.
 - d. Trade allows individuals to consume outside of their individual production possibilities curve.

ANS: C PTS: 1 DIF: Average REF: p.54-56
BLM: Higher Order NOT: Macro TB_3-9

10. If labour in Mexico is less productive than labour in the United States in all areas of production, which of the following is correct?
- Neither nation can benefit from trade.
 - Mexico can benefit from trade but the United States cannot.
 - Mexico will not have a comparative advantage in any good.
 - Both nations can benefit from trade.

ANS: D PTS: 1 DIF: Average REF: p.54-56
 BLM: Remember NOT: Macro TB_3-10

Table 3-1

	Labour Hours Needed to Make 1 Kg of:		Kilograms produced in 40 hours:	
	Meat	Potatoes	Meat	Potatoes
Farmer	8	2	5	20
Rancher	4	5	10	8

11. **Refer to Table 3-1.** What is the opportunity cost of 1 pound of meat for the Farmer?
- 1/4 hour of labour.
 - 4 hours of labour.
 - 4 kg of potatoes.
 - 1/4 kg of potatoes.

ANS: C PTS: 1 DIF: Challenging REF: p.57-59
 BLM: Higher Order NOT: Macro TB_3-11

12. **Refer to Table 3-1.** What is the opportunity cost of 1 kg of meat for the Rancher?
- 4 hours of labour.
 - 5 hours of labour.
 - 5/4 kg of potatoes.
 - 4/5 kg of potatoes.

ANS: D PTS: 1 DIF: Challenging REF: p.57-59
 BLM: Higher Order NOT: Macro TB_3-12

13. **Refer to Table 3-1.** What is the opportunity cost of 1 kg of potatoes for the Farmer?
- 8 hours of labour.
 - 2 hours of labour.
 - 4 kg of meat.
 - 1/4 kg of meat.

ANS: D PTS: 1 DIF: Challenging REF: p.57-59
 BLM: Higher Order NOT: Macro TB_3-13

14. **Refer to Table 3-1.** What is the opportunity cost of 1 kg of potatoes for the Rancher?
- 4 hours of labour.
 - 5 hours of labour.
 - 5/4 kg of meat.
 - 4/5 kg of meat.

ANS: C PTS: 1 DIF: Challenging REF: p.57-59
 BLM: Higher Order NOT: Macro TB_3-14

15. **Refer to Table 3-1.** Which of the following is correct?
- a. The Farmer has an absolute advantage in meat, and the Rancher has an absolute advantage in potatoes.
 - b. The Farmer has an absolute advantage in potatoes, and the Rancher has an absolute advantage in meat.
 - c. The Farmer has an absolute advantage in meat, and the Rancher has an absolute advantage in meat.
 - d. The Farmer has an absolute advantage in neither good, and the Rancher has an absolute advantage in both goods.

ANS: B

PTS: 1

DIF: Average

REF: p.57-59

BLM: Higher Order

NOT: Macro TB_3-15

16. **Refer to Table 3-1.** Which of the following is correct?
- a. The Rancher has an absolute advantage in both goods, and the Rancher has a comparative advantage in meat.
 - b. The Rancher has an absolute advantage in meat, and the Rancher has a comparative advantage in potatoes.
 - c. The Rancher has an absolute advantage in meat, and the Rancher has a comparative advantage in neither good.
 - d. The Rancher has an absolute advantage in both goods, and the Rancher has a comparative advantage in potatoes.

ANS: B

PTS: 1

DIF: Challenging

REF: p.57-59

BLM: Higher Order

NOT: Macro TB_3-16

17. **Refer to Table 3-1.** Which of the following is correct?
- a. The Farmer has an absolute advantage in potatoes, and the Rancher has a comparative advantage in meat.
 - b. The Farmer has an absolute advantage in meat, and the Rancher has a comparative advantage in potatoes.
 - c. The Farmer has an absolute advantage in neither good, and the Rancher has a comparative advantage in potatoes.
 - d. The Farmer has an absolute advantage in neither good, and the Rancher has a comparative advantage in meat.

ANS: A

PTS: 1

DIF: Challenging

REF: p.57-59

BLM: Higher Order

NOT: Macro TB_3-17

18. **Refer to Table 3-1.** Which of the following is correct?
- a. The Rancher has a comparative advantage in neither good, and the Farmer has a comparative advantage in both goods.
 - b. The Rancher has a comparative advantage in both goods, and the Farmer has a comparative advantage in neither good.
 - c. The Rancher has a comparative advantage in meat, and the Farmer has a comparative advantage in potatoes.
 - d. The Rancher has a comparative advantage in potatoes, and the Farmer has a comparative advantage in meat.

ANS: C

PTS: 1

DIF: Challenging

REF: p.57-59

BLM: Higher Order

NOT: Macro TB_3-18

19. **Refer to Table 3-1.** How could the Farmer and Rancher both benefit?
- By the Farmer specializing in meat and the Rancher specializing in potatoes.
 - By the Farmer specializing in potatoes and the Rancher specializing in meat.
 - By the Farmer specializing in neither good and the Rancher specializing in both goods.
 - They cannot benefit by specialization and trade.

ANS: B

PTS: 1

DIF: Average

REF: p.57-59

BLM: Higher Order

NOT: Macro TB_3-19

Table 3-2

	Labour Hours Needed to Make 1 kilogram of:		Kilograms Produced in 40 Hours:	
	Meat	Potatoes	Meat	Potatoes
Farmer	4	1	10	40
Rancher	4	5	10	8

20. **Refer to Table 3-2.** What is the opportunity cost of 1 kilogram of meat for the Farmer?
- 1/4 hour of labour.
 - 4 hours of labour.
 - 4 kilograms of potatoes.
 - 1/4 kilogram of potatoes.

ANS: C

PTS: 1

DIF: Challenging

REF: p.57-59

BLM: Higher Order

NOT: Macro TB_3-20

21. **Refer to Table 3-2.** What is the opportunity cost of 1 kilogram of meat for the Rancher?
- 4 hours of labour.
 - 5 hours of labour.
 - 5/4 kilograms of potatoes.
 - 4/5 kilogram of potatoes.

ANS: D

PTS: 1

DIF: Challenging

REF: p.57-59

BLM: Higher Order

NOT: Macro TB_3-21

22. **Refer to Table 3-2.** What is the opportunity cost of 1 kilogram of potatoes for the Farmer?
- 8 hours of labour.
 - 2 hours of labour.
 - 4 kilograms of meat.
 - 1/4 kilogram of meat.

ANS: D

PTS: 1

DIF: Challenging

REF: p.57-59

BLM: Higher Order

NOT: Macro TB_3-22

23. **Refer to Table 3-2.** What is the opportunity cost of 1 kilogram of potatoes for the Rancher?
- a. 4 hours of labour.
 - b. 5 hours of labour.
 - c. 5/4 pounds of meat.
 - d. 4/5 pound of meat.

ANS: C PTS: 1
BLM: Higher Order

DIF: Challenging REF: p.57-59
NOT: Macro TB_3-23

24. **Refer to Table 3-62.** Which of the following is correct?
- a. The Farmer has an absolute advantage in meat, and the Rancher has an absolute advantage in potatoes.
 - b. The Farmer has an absolute advantage in potatoes, and the Rancher has an absolute advantage in meat.
 - c. The Farmer has an absolute advantage in neither good, and the Rancher has an absolute advantage in both goods.
 - d. The Farmer has an absolute advantage in potatoes, and the Rancher has an absolute advantage in neither good.

ANS: D PTS: 1
BLM: Higher Order

DIF: Average REF: p.57-59
NOT: Macro TB_3-24

25. **Refer to Table 3-2.** Which of the following is correct?
- a. The Rancher has an absolute advantage in both goods, and the Farmer has a comparative advantage in meat.
 - b. The Rancher has an absolute advantage in meat, and the Farmer has a comparative advantage in potatoes.
 - c. The Rancher has an absolute advantage in meat, and the Farmer has a comparative advantage in neither good.
 - d. The Rancher has an absolute advantage in neither good, and the Farmer has a comparative advantage in potatoes.

ANS: D PTS: 1
BLM: Higher Order

DIF: Challenging REF: p.57-59
NOT: Macro TB_3-25

26. **Refer to Table 3-2.** Which of the following is correct?
- a. The Farmer has an absolute advantage in neither good, and the Rancher has a comparative advantage in meat.
 - b. The Farmer has an absolute advantage in meat, and the Rancher has a comparative advantage in potatoes.
 - c. The Farmer has an absolute advantage in potatoes, and the Rancher has a comparative advantage in meat.
 - d. The Farmer has an absolute advantage in neither good, and the Rancher has a comparative advantage in potatoes.

ANS: C PTS: 1
BLM: Higher Order

DIF: Challenging REF: p.57-59
NOT: Macro TB_3-26

27. **Refer to Table 3-2.** Which of the following is correct?
- The Rancher has a comparative advantage in neither good, and the Farmer has a comparative advantage in both goods.
 - The Rancher has a comparative advantage in both goods, and the Farmer has a comparative advantage in neither good.
 - The Rancher has a comparative advantage in meat, and the Farmer has a comparative advantage in potatoes.
 - The Rancher has a comparative advantage in potatoes, and the Farmer has a comparative advantage in meat.

ANS: C

PTS: 1

DIF: Challenging REF: p.57-59

BLM: Higher Order

NOT: Macro TB_3-27

28. **Refer to Table 3-2.** How could the Farmer and Rancher both benefit?
- By the Farmer specializing in meat and the Rancher specializing in potatoes.
 - By the Farmer specializing in potatoes and the Rancher specializing in meat.
 - By the Farmer specializing in neither good and the Rancher specializing in both goods.
 - They cannot benefit by specialization and trade.

ANS: B

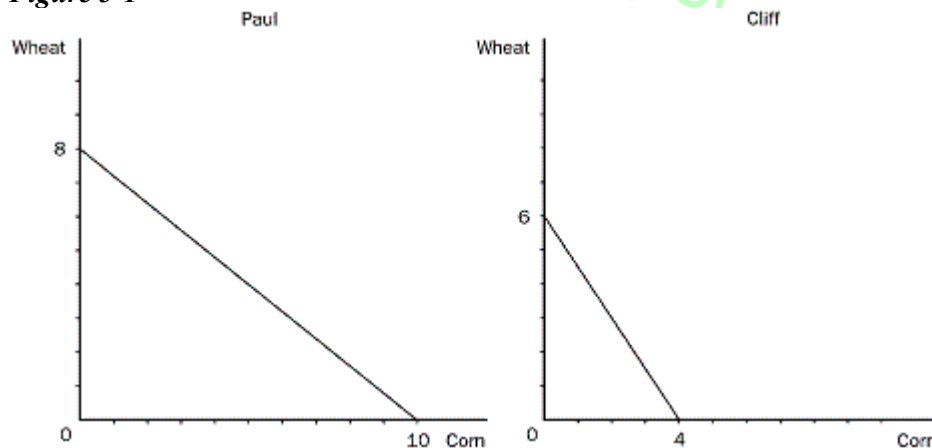
PTS: 1

DIF: Average REF: p.57-59

BLM: Higher Order

NOT: Macro TB_3-28

Figure 3-1



29. **Refer to Figure 3-1.** If Paul divides his time equally between corn and wheat, what will he be able to produce?
- 2 bushels of wheat and 2 bushels of corn.
 - 3 bushels of wheat and 3 bushels of corn.
 - 4 bushels of wheat and 5 bushels of corn.
 - 4 bushels of wheat and 6 bushels of corn.

ANS: C

PTS: 1

DIF: Average REF: p.53

BLM: Higher Order

NOT: Macro TB_3-9

30. **Refer to Figure 3-1.** What is the opportunity cost of 1 bushel of wheat for Cliff?
- a. $\frac{1}{3}$ bushel of corn.
 - b. $\frac{2}{3}$ bushel of corn.
 - c. 1 bushel of corn.
 - d. $\frac{3}{2}$ bushels of corn.

ANS: B PTS: 1 DIF: Average REF: p.53
BLM: Higher Order NOT: Macro TB_3-30

31. **Refer to Figure 3-1.** Assume that both Paul and Cliff divide their time equally between the production of corn and wheat, and they do not trade. If they were the only producers of corn and wheat, what would the total production of wheat and corn be?
- a. 8 bushels of wheat and 7 bushels of corn.
 - b. 7 bushels of wheat and 6 bushels of corn.
 - c. 6 bushels of wheat and 8 bushels of corn.
 - d. 7 bushels of wheat and 7 bushels of corn.

ANS: D PTS: 1 DIF: Challenging REF: p.53
BLM: Higher Order NOT: Macro TB_3-31

32. **Refer to Figure 3-1.** Assume that Cliff and Paul were both producing wheat and corn, and each was dividing their time equally between the two. Then they decide to specialize in the product they have a comparative advantage in. What would happen to the total production of corn?
- a. Increase by 1 bushel.
 - b. Increase by 3 bushels.
 - c. Increase by 5 bushels.
 - d. Decrease by 2 bushels.

ANS: B PTS: 1 DIF: Challenging REF: p.53
BLM: Higher Order NOT: Macro TB_3-32

33. **Refer to Figure 3-1.** Assume that Cliff and Paul were both producing wheat and corn, and each was dividing their time equally between the two. Then they decide to specialize in the product they have a comparative advantage in and trade 3 bushels of wheat for 3 bushels of corn. What would Cliff now be able to consume?
- a. 4 bushels of wheat and 3 bushels of corn.
 - b. 3 bushels of wheat and 4 bushels of corn.
 - c. 3 bushels of wheat and 3 bushels of corn.
 - d. 2 bushels of wheat and 3 bushels of corn.

ANS: C PTS: 1 DIF: Challenging REF: p.53
BLM: Higher Order NOT: Macro TB_3-33

34. **Refer to Figure 3-1.** Which of the following is true for Cliff and Paul?
- a. Paul has an absolute advantage in both wheat and corn.
 - b. Paul has an absolute advantage in wheat and Cliff has an absolute advantage in corn.
 - c. Cliff has an absolute advantage in wheat and Paul has an absolute advantage in corn.
 - d. Cliff has an absolute advantage in both wheat and corn.

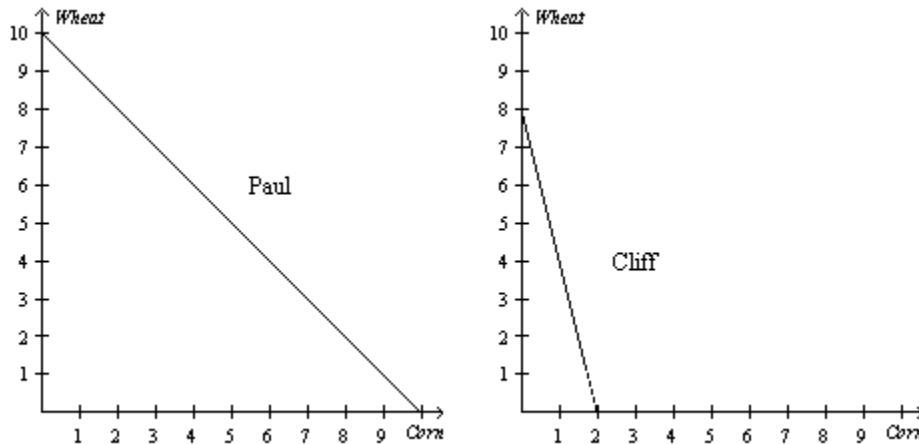
ANS: A PTS: 1 DIF: Average REF: p.53
BLM: Higher Order NOT: Macro TB_3-34

35. **Refer to Figure 3-1.** Which of the following is true for Cliff and Paul?
- Paul has a comparative advantage in both wheat and corn.
 - Paul has a comparative advantage in wheat and Cliff has a comparative advantage in corn.
 - Cliff has a comparative advantage in wheat and Paul has a comparative advantage in corn.
 - Cliff has a comparative advantage in both wheat and corn.

ANS: C PTS: 1
BLM: Higher Order

DIF: Challenging REF: p.53
NOT: Macro TB_3-35

Figure 3-2



36. **Refer to Figure 3-2.** If Paul divides his time equally between corn and wheat, what will he be able to produce?
- 4 bushels of wheat and 1 bushel of corn.
 - 4 bushels of wheat and 5 bushels of corn.
 - 5 bushels of wheat and 4 bushels of corn.
 - 5 bushels of wheat and 5 bushels of corn.

ANS: D PTS: 1
BLM: Higher Order

DIF: Average REF: p.57-59
NOT: Macro TB_3-36

37. **Refer to Figure 3-2.** What is the opportunity cost of 1 bushel of wheat for Cliff?
- 1/4 bushel of corn.
 - 1/2 bushel of corn.
 - 1 bushel of corn.
 - 4 bushels of corn.

ANS: A PTS: 1
BLM: Higher Order

DIF: Average REF: p.57-59
NOT: Macro TB_3-37

38. **Refer to Figure 3-2.** Assume that both Paul and Cliff divide their time equally between the production of corn and wheat, and they do not trade. If they were the only producers of corn and wheat, what would the total production of wheat and corn be?
- a. 7 bushels of wheat and 8 bushels of corn.
 - b. 8 bushels of wheat and 7 bushels of corn.
 - c. 9 bushels of wheat and 6 bushels of corn.
 - d. 18 bushels of wheat and 12 bushels of corn.

ANS: D PTS: 1 DIF: Average REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-38

39. **Refer to Figure 3-2.** Assume that Cliff and Paul were both producing wheat and corn, and both were dividing their time equally between the two. Then they decide to specialize in the product for which they have a comparative advantage. What would happen to the production of corn?
- a. Increase by 1 bushel.
 - b. Increase by 2 bushels.
 - c. Increase by 3 bushels.
 - d. Increase by 4 bushels.

ANS: D PTS: 1 DIF: Average REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-39

40. **Refer to Figure 3-2.** Assume that Cliff and Paul were both producing wheat and corn, and both were dividing their time equally between the two. Then they decide to specialize in the product for which they have a comparative advantage and trade 3 bushels of wheat for 3 bushels of corn. What would Cliff now be able to consume?
- a. 5 bushels of wheat and 3 bushels of corn.
 - b. 4 bushels of wheat and 3 bushels of corn.
 - c. 3 bushels of wheat and 5 bushels of corn.
 - d. 3 bushels of wheat and 3 bushels of corn.

ANS: A PTS: 1 DIF: Average REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-40

41. **Refer to Figure 3-2.** Which of the following is true for Cliff and Paul?
- a. Paul has an absolute advantage in both wheat and corn.
 - b. Paul has an absolute advantage in wheat and Cliff has an absolute advantage in corn.
 - c. Cliff has an absolute advantage in wheat and Paul has an absolute advantage in corn.
 - d. Cliff has an absolute advantage in both wheat and corn.

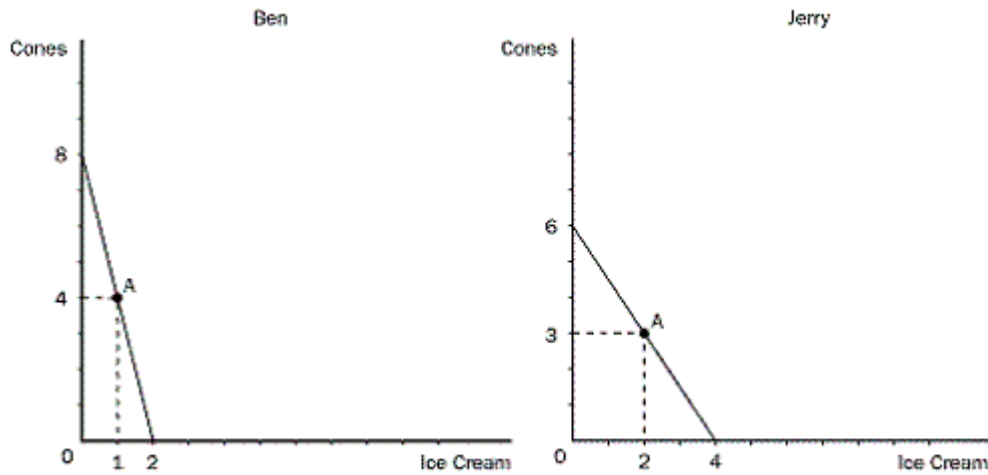
ANS: A PTS: 1 DIF: Average REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-41

42. **Refer to Figure 3-2.** Which of the following is true for Cliff and Paul?
- a. Paul has a comparative advantage in both wheat and corn.
 - b. Paul has an absolute advantage in wheat and Cliff has a comparative advantage in corn.
 - c. Cliff has a comparative advantage in wheat and Paul has a comparative advantage in corn.
 - d. Cliff has a comparative advantage in both wheat and corn.

ANS: C PTS: 1 DIF: Average REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-42

Figure 3-3

Ice cream is measured in kilograms.



43. **Refer to Figure 3-3.** For Ben, what is the opportunity cost of 1 kg of ice cream?
- 1/4 kg of cones.
 - 1/2 kg of cones.
 - 2 kg of cones.
 - 4 kg of cones.

ANS: D PTS: 1

DIF: Challenging REF: p.53

BLM: Higher Order

NOT: Macro TB_3-43

44. **Refer to Figure 3-3.** For Jerry, what is the opportunity cost of 1 pound of ice cream?
- 3/2 kg of cones.
 - 1/3 kg of cones.
 - 1 kg of cones.
 - 2 kg of cones.

ANS: A PTS: 1

DIF: Challenging REF: p.53

BLM: Higher Order

NOT: Macro TB_3-44

45. **Refer to Figure 3-3.** For Ben, what is the opportunity cost of 1 kg of cones?
- 2 kg of ice cream.
 - 1/2 kg of ice cream.
 - 4 kg of ice cream.
 - 1/4 kg of ice cream.

ANS: D PTS: 1

DIF: Challenging REF: p.53

BLM: Higher Order

NOT: Macro TB_3-45

46. **Refer to Figure 3-3.** For Jerry, what is the opportunity cost of 1 kg of cones?
- a. 2/3 kg of ice cream.
 - b. 3 kg of ice cream.
 - c. 1 kg of ice cream.
 - d. 2 kg of ice cream.

ANS: A PTS: 1 DIF: Challenging REF: p.53
BLM: Higher Order NOT: Macro TB_3-46

47. **Refer to Figure 3-3.** Which of the following is correct?
- a. Ben has a comparative advantage in cones and Jerry has a comparative advantage in ice cream.
 - b. Ben has a comparative advantage in ice cream and Jerry has a comparative advantage in cones.
 - c. Ben has a comparative advantage in neither good and Jerry has a comparative advantage in both goods.
 - d. Ben has a comparative advantage in both goods and Jerry has a comparative advantage in neither good.

ANS: A PTS: 1 DIF: Challenging REF: p.53
BLM: Higher Order NOT: Macro TB_3-47

48. **Refer to Figure 3-3.** Which of the following is correct?
- a. Ben has an absolute advantage in ice cream and Jerry has an absolute advantage in cones.
 - b. Ben has an absolute advantage in cones and Jerry has an absolute advantage in ice cream.
 - c. Ben has an absolute advantage in neither good and Jerry has an absolute advantage in both goods.
 - d. Ben has an absolute advantage in both goods and Jerry has an absolute advantage in neither good.

ANS: B PTS: 1 DIF: Average REF: p.53
BLM: Higher Order NOT: Macro TB_3-48

49. **Refer to Figure 3-3.** Which of the following is correct?
- a. Ben has a comparative advantage in ice cream and Jerry has an absolute advantage in both goods.
 - b. Ben has a comparative advantage in cones and Jerry has an absolute advantage in ice cream.
 - c. Ben has a comparative advantage in ice cream and Jerry has an absolute advantage in neither good.
 - d. Ben has a comparative advantage in ice cream and Jerry has an absolute advantage in cones.

ANS: B PTS: 1 DIF: Average REF: p.53
BLM: Higher Order NOT: Macro TB_3-49

50. **Refer to Figure 3-3.** Which of the following is correct?
- a. Ben has an absolute advantage in cones and Jerry has a comparative advantage in ice cream.
 - b. Ben has an absolute advantage in both goods and Jerry has a comparative advantage in cones.
 - c. Ben has an absolute advantage in ice cream and Jerry has a comparative advantage in cones.
 - d. Ben has an absolute advantage in neither good and Jerry has a comparative advantage in ice cream.

ANS: A PTS: 1 DIF: Average REF: p.53
BLM: Higher Order NOT: Macro TB_3-50

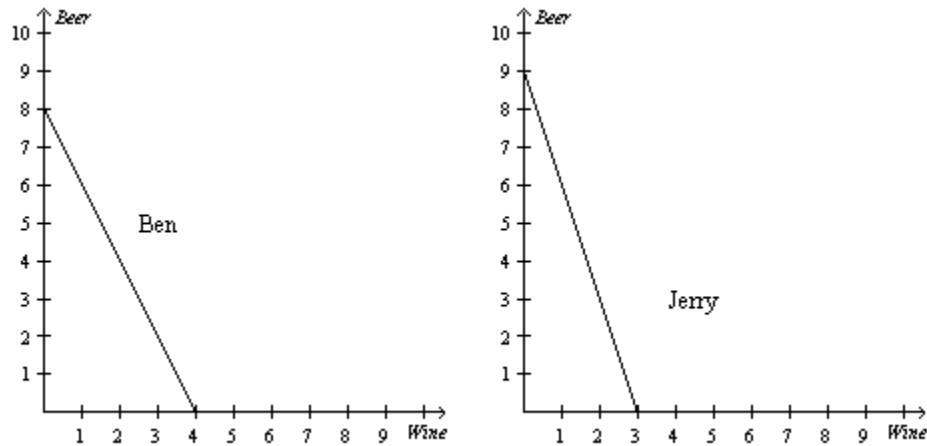
51. **Refer to Figure 3-3.** Suppose that Ben and Jerry have both decided to produce at point A on their production possibilities frontiers. What do we know?
- a. This is not an efficient combination for either Ben or Jerry.
 - b. Ben and Jerry are both allocating 1/2 their time to the production of each good.
 - c. no other production point is as efficient for both Ben and Jerry to produce as point A.
 - d. Both should always attempt to produce an equal number of cones and ice cream.

ANS: B PTS: 1 DIF: Challenging REF: p.53
BLM: Higher Order NOT: Macro TB_3-51

52. **Refer to Figure 3-3.** Ben and Jerry were currently both producing at point A on their production possibilities frontier and then Ben decided he would be willing to trade 4 pounds of cones to get 2 pounds of ice cream from Jerry. If both decided to specialize in what they had a comparative advantage in and trade, what would be the gains from trade?
- a. 1 pound of cones for Ben and 1 pound of ice cream for Jerry.
 - b. 1 pound of ice cream for Ben and 1 pound of cones for Jerry.
 - c. 2 pounds of ice cream for Ben and 2 pounds of cones for Jerry.
 - d. 2 pounds of ice cream for Ben and 1 pound of cones for Jerry.

ANS: B PTS: 1 DIF: Challenging REF: p.53
BLM: Higher Order NOT: Macro TB_3-52

Figure 3-4



53. **Refer to Figure 3-4.** For Ben, what is the opportunity cost of 1 bottle of wine?
- 1/4 bottle of beer.
 - 1/2 bottle of beer.
 - 2 bottles of beer.
 - 4 bottles of beer.

ANS: C PTS: 1
BLM: Higher Order

DIF: Average REF: p.57-59
NOT: Macro TB_3-53

54. **Refer to Figure 3-4.** For Ben, the opportunity cost of 1 bottle of beer is
- 1/2 bottle of wine.
 - 1/4 bottle of wine.
 - 2 bottles of wine.
 - 4 bottles of wine.

ANS: A PTS: 1
BLM: Higher Order

DIF: Average REF: p.57-59
NOT: Macro TB_3-54

55. **Refer to Figure 3-4.** For Jerry, what is the opportunity cost of 1 bottle of wine?
- 1 bottle of beer.
 - 1/2 bottle of beer.
 - 1/3 bottle of beer.
 - 3 bottles of beer.

ANS: B PTS: 1
BLM: Higher Order

DIF: Average REF: p.57-59
NOT: Macro TB_3-55

56. **Refer to Figure 3-4.** For Jerry, what is the opportunity cost of 1 bottle of beer?
- 1 bottle of wine.
 - 1/2 bottle of wine.
 - 1/3 bottle of wine.
 - 3 bottles of wine.

ANS: B PTS: 1
BLM: Higher Order

DIF: Average REF: p.57-59
NOT: Macro TB_3-56

57. **Refer to Figure 3-4.** Which of the following is correct?
- a. Ben has a comparative advantage in beer, and Jerry has a comparative advantage in wine.
 - b. Ben has a comparative advantage in wine, and Jerry has a comparative advantage in beer.
 - c. Ben has a comparative advantage in neither good, and Jerry has a comparative advantage in wine.
 - d. Ben has a comparative advantage in both goods, and Jerry has a comparative advantage in neither.

ANS: B PTS: 1 DIF: Average REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-57

58. **Refer to Figure 3-4.** Which of the following is correct?
- a. Ben has an absolute advantage in wine, and Jerry has an absolute advantage in neither good.
 - b. Ben has an absolute advantage in beer, and Jerry has an absolute advantage in wine.
 - c. Ben has an absolute advantage in wine, and Jerry has an absolute advantage in beer.
 - d. Ben has an absolute advantage in neither good, and Jerry has an absolute advantage in both goods.

ANS: C PTS: 1 DIF: Average REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-58

59. **Refer to Figure 3-4.** Which of the following is correct?
- a. Ben has a comparative advantage in wine, and Jerry has an absolute advantage in both goods.
 - b. Ben has a comparative advantage in beer, and Jerry has an absolute advantage in both goods.
 - c. Ben has a comparative advantage in beer, and Jerry has an absolute advantage in wine.
 - d. Ben has a comparative advantage in wine, and Jerry has an absolute advantage in beer.

ANS: D PTS: 1 DIF: Average REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-59

60. **Refer to Figure 3-4.** Which of the following is correct?
- a. Ben has an absolute advantage in wine, and Jerry has a comparative advantage in neither good.
 - b. Ben has an absolute advantage in both goods, and Jerry has a comparative advantage in beer.
 - c. Ben has an absolute advantage in wine, and Jerry has a comparative advantage in beer.
 - d. Ben has an absolute advantage in beer, and Jerry has a comparative advantage in wine.

ANS: C PTS: 1 DIF: Average REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-60

61. **Refer to Figure 3-4.** Suppose Ben and Jerry both spend half their time producing beer and half their time producing wine. What do we know?
- This is not an efficient allocation of time for either Ben or Jerry.
 - Ben will produce 4 bottles of beer and 2 bottles of wine.
 - Jerry will produce 1.5 bottles of beer and 4.5 bottles of wine.
 - Ben will produce 8 bottles of beer and 4 bottles of wine.

ANS: B

PTS: 1

DIF: Average

REF: p.57-59

BLM: Higher Order

NOT: Macro TB_3-61

Table 3-3

Labour Hours needed to make one unit of:			Amount produced in 160 hours:	
	Quilts	Dresses	Quilts	Dresses
Helen	40	10	4	16
Carolyn	80	16	2	10

62. **Refer to Table 3-3.** What is the opportunity cost of 1 quilt for Helen?
- 2 dresses.
 - 3 dresses.
 - 4 dresses.
 - 5 dresses.

ANS: C

PTS: 1

DIF: Challenging

REF: p.57-59

BLM: Higher Order

NOT: Macro TB_3-62

63. **Refer to Table 3-3.** What is the opportunity cost of 1 quilt for Carolyn?
- 2 dresses.
 - 3 dresses.
 - 4 dresses.
 - 5 dresses.

ANS: D

PTS: 1

DIF: Challenging

REF: p.57-59

BLM: Higher Order

NOT: Macro TB_3-63

64. **Refer to Table 3-3.** What is the opportunity cost of 1 dress for Helen?
- 1 quilt.
 - 1/2 quilt.
 - 1/4 quilt.
 - 4 quilts.

ANS: C

PTS: 1

DIF: Challenging

REF: p.57-59

BLM: Higher Order

NOT: Macro TB_3-64

65. **Refer to Table 3-3.** What is the opportunity cost of 1 dress for Carolyn?
- 5 quilts.
 - 1 quilt.
 - 1/5 quilt.
 - 4 quilts.

ANS: C

PTS: 1

DIF: Challenging

REF: p.57-59

BLM: Higher Order

NOT: Macro TB_3-65

66. **Refer to Table 3-3.** Which of the following is correct?
- a. Helen has a comparative advantage in quilts and Carolyn has an absolute advantage in neither good.
 - b. Helen has a comparative advantage in dresses and Carolyn has an absolute advantage in quilts.
 - c. Helen has a comparative advantage in quilts and Carolyn has an absolute advantage in dresses.
 - d. Helen has a comparative advantage in dresses and Carolyn has an absolute advantage in both goods.

ANS: A PTS: 1 DIF: Challenging REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-66

67. **Refer to Table 3-3.** Which of the following is correct?
- a. Helen has an absolute advantage in dresses and Carolyn has a comparative advantage in quilts.
 - b. Helen has an absolute advantage in both goods and Carolyn has a comparative advantage in dresses.
 - c. Helen has an absolute advantage in quilts and Carolyn has a comparative advantage in dresses.
 - d. Helen has an absolute advantage in both goods and Carolyn has a comparative advantage in quilts.

ANS: B PTS: 1 DIF: Challenging REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-67

68. **Refer to Table 3-3.** Which of the following is correct?
- a. Helen has an absolute advantage in dresses and Carolyn has an absolute advantage in quilts.
 - b. Helen has an absolute advantage in quilts and Carolyn has an absolute advantage in dresses.
 - c. Helen has an absolute advantage in neither good and Carolyn has an absolute advantage in both goods.
 - d. Helen has an absolute advantage in both goods and Carolyn has an absolute advantage in neither good.

ANS: D PTS: 1 DIF: Challenging REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-68

69. **Refer to Table 3-3.** How could Helen and Carolyn both benefit?
- a. By Helen specializing in dresses and Carolyn specializing in quilts.
 - b. By Helen specializing in neither good and Carolyn specializing in both goods.
 - c. By Helen specializing in quilts and Carolyn specializing in dresses.
 - d. By Helen specializing in both goods and Carolyn specializing in neither good.

ANS: C PTS: 1 DIF: Challenging REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-69

70. **Refer to Table 3-3.** Which of the following is correct?
- Helen has a comparative advantage in dresses and Carolyn has a comparative advantage in quilts.
 - Helen has a comparative advantage in quilts and Carolyn has a comparative advantage in dresses.
 - Helen has a comparative advantage in neither good and Carolyn has a comparative advantage in both goods.
 - Helen has a comparative advantage in both goods and Carolyn has a comparative advantage in neither good.

ANS: B

PTS: 1

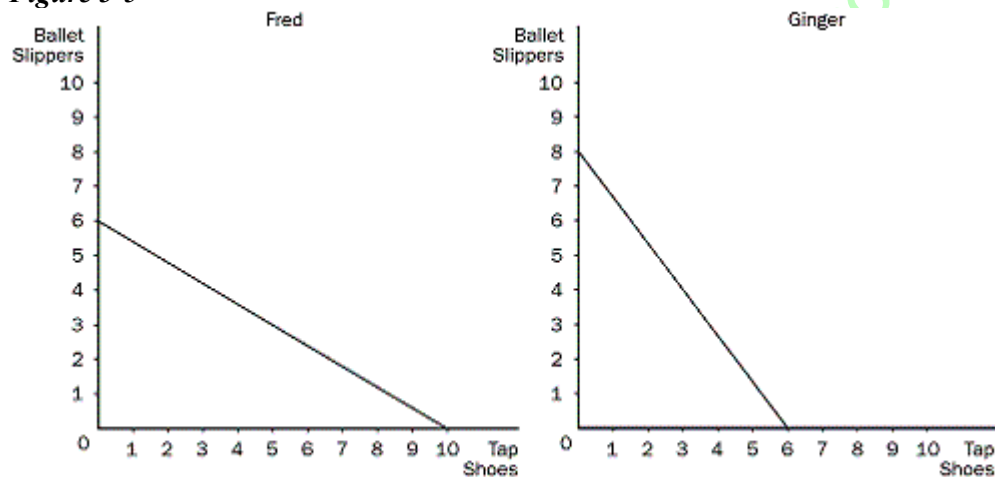
DIF: Challenging REF: p.57-59

BLM: Higher Order

NOT: Macro TB_3-70

These graphs illustrate the production possibilities available for dancing shoes to Fred and Ginger with 40 hours of labour.

Figure 3-5



71. **Refer to Figure 3-5.** What is the opportunity cost of 1 pair of tap shoes for Fred?
- $\frac{1}{3}$ pair of ballet slippers.
 - $\frac{1}{5}$ pair of ballet slippers.
 - $\frac{3}{5}$ pair of ballet slippers.
 - $\frac{5}{3}$ pairs of ballet slippers.

ANS: C

PTS: 1

DIF: Average REF: p.57-59

BLM: Higher Order

NOT: Macro TB_3-71

72. **Refer to Figure 3-5.** What is the opportunity cost of 1 pair of tap shoes for Ginger?
- $\frac{1}{4}$ pair of ballet slippers.
 - $\frac{1}{3}$ pair of ballet slippers.
 - $\frac{3}{4}$ pair of ballet slippers.
 - $\frac{4}{3}$ pairs of ballet slippers.

ANS: D

PTS: 1

DIF: Average REF: p.57-59

BLM: Higher Order

NOT: Macro TB_3-72

73. **Refer to Figure 3-5.** What is the opportunity cost of 1 pair of ballet slippers for Ginger?
- a. 1/4 pair of tap shoes.
 - b. 1/3 pair of tap shoes.
 - c. 3/4 pair of tap shoes.
 - d. 4/3 pairs of tap shoes.

ANS: C PTS: 1
BLM: Higher Order

DIF: Average REF: p.57-59
NOT: Macro TB_3-73

74. **Refer to Figure 3-5.** What is the opportunity cost of 1 pair of ballet slippers for Fred?
- a. 1/3 pair of tap shoes.
 - b. 1/5 pair of tap shoes.
 - c. 3/5 pair of tap shoes.
 - d. 5/3 pairs of tap shoes.

ANS: D PTS: 1
BLM: Higher Order

DIF: Average REF: p.57-59
NOT: Macro TB_3-74

75. **Refer to Figure 3-5.** Which of the following is correct?
- a. Ginger has an absolute advantage in ballet slippers and Fred has an absolute advantage in tap shoes.
 - b. Ginger has an absolute advantage in tap shoes and Fred has an absolute advantage in ballet slippers.
 - c. Ginger has an absolute advantage in neither good and Fred has an absolute advantage in both goods.
 - d. Ginger has an absolute advantage in both goods and Fred has an absolute advantage in neither good.

ANS: A PTS: 1
BLM: Higher Order

DIF: Average REF: p.57-59
NOT: Macro TB_3-75

76. **Refer to Figure 3-5.** Ginger has a comparative advantage in
- a. Ginger has a comparative advantage in tap shoes and Fred has a comparative advantage in ballet slippers.
 - b. Ginger has a comparative advantage in both goods and Fred has a comparative advantage in neither good.
 - c. Ginger has a comparative advantage in ballet slippers and Fred has a comparative advantage in tap shoes.
 - d. Ginger has a comparative advantage in neither good and Fred has a comparative advantage in both goods.

ANS: C PTS: 1
BLM: Higher Order

DIF: Challenging REF: p.57-59
NOT: Macro TB_3-76

77. **Refer to Figure 3-5.** What should Fred produce?
- a. Only tap shoes.
 - b. Only ballet slippers.
 - c. Both ballet slippers and tap shoes.
 - d. Neither ballet slippers nor tap shoes.

ANS: A PTS: 1
BLM: Higher Order

DIF: Average REF: p.57-59
NOT: Macro TB_3-77

78. **Refer to Figure 3-5.** Ginger has an absolute advantage in
- Ginger has an absolute advantage in tap shoes and Fred has a comparative advantage in ballet slippers.
 - Ginger has an absolute advantage in both goods and Fred has a comparative advantage in neither good.
 - Ginger has an absolute advantage in ballet slippers and Fred has a comparative advantage in tap shoes.
 - Ginger has an absolute advantage in neither good and Fred has a comparative advantage in both goods.

ANS: C PTS: 1 DIF: Challenging REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-78

79. **Refer to Figure 3-5.** Ginger should specialize in
- Ginger should specialize in tap shoes and Fred should specialize in ballet slippers.
 - Ginger should specialize in both goods and Fred should specialize in neither good.
 - Ginger should specialize in ballet slippers and Fred should specialize in tap shoes.
 - Ginger should specialize in neither good and Fred should specialize in both goods.

ANS: C PTS: 1 DIF: Challenging REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-79

80. **Refer to Figure 3-5.** If Fred and Ginger devote 1/2 of their time (20 hours) to the production of each good, what would the total production be?
- 7 ballet slippers and 8 tap shoes.
 - 8 ballet slippers and 8 tap shoes.
 - 9 ballet slippers and 6 tap shoes.
 - 10 ballet slippers and 8 tap shoes.

ANS: A PTS: 1 DIF: Average REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-80

81. **Refer to Figure 3-5.** If Fred and Ginger both specialize in the good in which they have a comparative advantage, what would the total production be?
- 6 ballet slippers and 6 tap shoes.
 - 8 ballet slippers and 6 tap shoes.
 - 8 ballet slippers and 8 tap shoes.
 - 8 ballet slippers and 10 tap shoes.

ANS: D PTS: 1 DIF: Average REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-81

82. **Refer to Figure 3-5.** If Fred and Ginger both specialize in the good in which they have a comparative advantage, what would the total consumption be?
- 4 ballet slippers and 6 tap shoes.
 - 6 ballet slippers and 6 tap shoes.
 - 8 ballet slippers and 8 tap shoes.
 - 8 ballet slippers and 10 tap shoes.

ANS: D PTS: 1 DIF: Average REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-82

83. Suppose a gardener produces both green beans and corn in her garden. If she must give up 13 bushels of corn to get 5 bushels of green beans, what is the opportunity cost of 1 bushel of green beans?
- a. 0.38 bushel of corn.
 - b. 2.6 bushels of corn.
 - c. 8 bushels of corn.
 - d. 18 bushels of corn.

ANS: B PTS: 1 DIF: Average REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-83

84. Suppose a gardener produces both green beans and corn in her garden. If the opportunity cost of one bushel of corn is $\frac{3}{5}$ bushel of green beans, what is the opportunity cost of 1 bushel of green beans?
- a. $\frac{5}{3}$ bushels of corn.
 - b. $\frac{2}{5}$ bushel of corn.
 - c. $\frac{5}{2}$ bushels of corn.
 - d. $\frac{8}{5}$ bushels of corn.

ANS: A PTS: 1 DIF: Average REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-84

85. Using all available resources, if a farmer can produce either 85 cantaloupes or 70 watermelons, what is the opportunity cost of 1 cantaloupe to the farmer?
- a. .82 watermelons.
 - b. 1.21 watermelons.
 - c. 15 watermelons.
 - d. There is not enough information given to answer this question.

ANS: A PTS: 1 DIF: Average REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-85

86. Currently, a farmer can either grow 40 bushels of wheat or 120 bushels of corn per acre. If he were able to trade 80 bushels of corn for 30 bushels of wheat, would he be better off or worse off?
- a. Worse off because his opportunity cost of wheat would increase from 2.7 bushels of corn to 3 bushels of corn.
 - b. Better off because his opportunity cost of wheat would fall from 80 bushels to 50 bushels.
 - c. Better off because his opportunity cost of wheat would fall from 3 bushels of corn to 2.7 bushels.
 - d. There is not enough information to answer this question.

ANS: C PTS: 1 DIF: Challenging REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-86

87. If Shawn can produce donuts at a lower opportunity cost than Sue, which of the following is correct?
- a. Shawn has a comparative advantage in the production of donuts.
 - b. Sue has a comparative advantage in the production of donuts.
 - c. Shawn should be retrained and produce a different product.
 - d. It is obvious that Shawn is capable of producing more donuts than Sue.

ANS: A PTS: 1 DIF: Average REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-87

Table 3-4

	Labour Hours Needed to Make One Unit of:		Amount Produced in 24 Hours:	
	Baskets	Birdhouses	Baskets	Birdhouses
Alberta	6	2	4	12
Manitoba	3	4	8	6

88. **Refer to Table 3-4.** What is the opportunity cost of 1 basket for Alberta?

- a. $\frac{1}{3}$ birdhouse.
- b. 1 birdhouse.
- c. 3 birdhouses.
- d. 4 birdhouses.

ANS: C PTS: 1

DIF: Challenging REF: p.57-59

BLM: Higher Order

NOT: Macro TB_3-88

89. **Refer to Table 3-4.** What is the opportunity cost of 1 basket for Manitoba?

- a. $\frac{1}{4}$ birdhouse.
- b. $\frac{3}{4}$ birdhouse.
- c. 1 birdhouse.
- d. $\frac{4}{3}$ birdhouses.

ANS: B PTS: 1

DIF: Challenging REF: p.57-59

BLM: Higher Order

NOT: Macro TB_3-89

90. **Refer to Table 3-4.** What is the opportunity cost of 1 birdhouse for Alberta?

- a. $\frac{1}{3}$ basket.
- b. 1 basket.
- c. $\frac{4}{3}$ baskets.
- d. 3 baskets.

ANS: A PTS: 1

DIF: Challenging REF: p.57-59

BLM: Higher Order

NOT: Macro TB_3-90

91. **Refer to Table 3-4.** What is the opportunity cost of 1 birdhouse for Manitoba?

- a. $\frac{3}{4}$ basket.
- b. 1 basket.
- c. $\frac{4}{3}$ baskets.
- d. 3 baskets.

ANS: C PTS: 1

DIF: Challenging REF: p.57-59

BLM: Higher Order

NOT: Macro TB_3-91

92. **Refer to Table 3-4.** Which of the following is correct?
- a. Alberta has an absolute advantage in birdhouses and Manitoba has an absolute advantage in baskets.
 - b. Alberta has an absolute advantage in baskets and Manitoba has an absolute advantage in birdhouses.
 - c. Alberta has an absolute advantage in neither good and Manitoba has an absolute advantage in both goods.
 - d. Alberta has an absolute advantage in both goods and Manitoba has an absolute advantage in neither good.

ANS: A PTS: 1 DIF: Challenging REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-92

93. **Refer to Table 3-4.** Which of the following is correct?
- a. Alberta has a comparative advantage in baskets and Manitoba has a comparative advantage in birdhouses.
 - b. Alberta has a comparative advantage in birdhouses and Manitoba has a comparative advantage in baskets.
 - c. Alberta has a comparative advantage in neither good and Manitoba has a comparative advantage in both goods.
 - d. Alberta has a comparative advantage in both goods and Manitoba has a comparative advantage in neither good.

ANS: B PTS: 1 DIF: Challenging REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-93

94. **Refer to Table 3-4.** If Alberta and Manitoba trade based on the principle of comparative advantage, what will be exported?
- a. Alberta will export baskets and Manitoba will export birdhouses.
 - b. Alberta will export birdhouses and Manitoba will export baskets.
 - c. Alberta will export neither good and Manitoba will export both goods.
 - d. Alberta will export both goods and Manitoba will export neither good.

ANS: B PTS: 1 DIF: Challenging REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-94

95. **Refer to Table 3-4.** If Alberta and Manitoba trade based on the principle of comparative advantage, what will happen?
- a. All individuals in both provinces will gain.
 - b. No one in either province will gain.
 - c. Some individuals within both provinces will be made worse off.
 - d. One province will be better off and the other province will be worse off.

ANS: C PTS: 1 DIF: Average REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-95

96. On what is comparative advantage based?

- a. capital costs.
- b. labour costs.
- c. dollar price.
- d. opportunity costs.

ANS: D PTS: 1 DIF: Easy REF: p.57-59
BLM: Remember NOT: Macro TB_3-96

97. On what is trade based?

- a. absolute advantage.
- b. comparative advantage.
- c. production costs.
- d. relative dollar prices.

ANS: B PTS: 1 DIF: Easy REF: p.57-59
BLM: Remember NOT: Macro TB_3-97

98. For two people who are planning to trade, it is impossible to:

- a. have a comparative advantage in both goods.
- b. have an absolute advantage in both goods.
- c. specialize in the production of one good.
- d. trade so that both people will be better off.

ANS: A PTS: 1 DIF: Average REF: p.57-59
BLM: Remember NOT: Macro TB_3-98

99. For two people who are planning to trade two different goods, each will have a comparative advantage in a different good unless,

- a. they have exactly the same opportunity cost.
- b. they have agreed in advance on who will produce what and how much each will produce.
- c. the terms of trade are such that neither can gain from trade.
- d. one person has an absolute advantage in both products.

ANS: A PTS: 1 DIF: Average REF: p.57-59
BLM: Remember NOT: Macro TB_3-99

100. Suppose that Korea produces shoes and soccer balls. Which of the following is correct?

- a. It should specialize in the product in which it has an absolute advantage.
- b. It would NOT be possible to have an absolute advantage in both goods.
- c. It would be difficult to benefit from trade since Korea is efficient in the production of both goods.
- d. The opportunity cost of shoes will be the inverse of its opportunity cost of soccer balls.

ANS: D PTS: 1 DIF: Average REF: p.57-59
BLM: Remember NOT: Macro TB_3-100

101. What does comparative advantage reflect?

- a. productivity.
- b. relative opportunity cost.
- c. efficiency.
- d. terms of trade advantage.

ANS: B PTS: 1 DIF: Average REF: p.57-59
BLM: Remember NOT: Macro TB_3-101

102. Which of the following is NOT true concerning comparative advantage?

- a. The comparative advantage is determined by which person can produce a good using fewer inputs.
- b. The principle of comparative advantage applies to countries as well as people.
- c. Economists use the principle of comparative advantage to advocate free trade.
- d. Gains from trade are based on the principle of comparative advantage.

ANS: A PTS: 1 DIF: Average REF: p.57-59
BLM: Remember NOT: Macro TB_3-102

103. Assume that Greece has a comparative advantage in fish and Germany has a comparative advantage in cars. What will happen if these two countries specialize and trade according to their comparative advantage?

- a. All individuals in both countries will benefit.
- b. Greece will specialize in and export cars.
- c. Germany will produce more cars than in the absence of trade.
- d. Germany will produce more fish than in the absence of trade.

ANS: C PTS: 1 DIF: Average REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-103

104. Assume that Greece has a comparative advantage in fish and Germany has a comparative advantage in cars. If these two countries specialize and trade according to their comparative advantage, which of the following would NOT be true?

- a. Greece will specialize in and export fish.
- b. Some individuals in each country will be hurt.
- c. More of each good can be consumed in both countries.
- d. Greece will benefit from trade more than Germany.

ANS: D PTS: 1 DIF: Average REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-104

105. Belarus has a comparative advantage in the production of linen, but Russia has an absolute advantage in the production of linen. If these two countries decide to trade, which of the following is correct?

- a. Belarus should export linen to Russia.
- b. Russia should export linen to Belarus.
- c. For these two countries, trading linen would be a "stand-off" so they should trade another product.
- d. Without additional information about Russia, this question cannot be answered.

ANS: A PTS: 1 DIF: Average REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-105

106. What should a country do if it has a comparative advantage in a product?
- a. It should import that product.
 - b. It should export that product.
 - c. It should keep the product for domestic use since it is relatively inexpensive to produce.
 - d. Without additional information, an import/export decision cannot be made.

ANS: B PTS: 1 DIF: Easy REF: p.57-59
BLM: Remember NOT: Macro TB_3-106

107. Suppose a producer requires a smaller quantity of inputs to produce a good. Which of the following is correct?
- a. The producer should import that good.
 - b. The producer has a comparative advantage in the production of that good.
 - c. The producer has an absolute advantage in the production of that good.
 - d. The producer has both an absolute and comparative advantage in the production of that good.

ANS: C PTS: 1 DIF: Average REF: p.57-59
BLM: Remember NOT: Macro TB_3-107

108. Suppose a producer can produce a product with lower opportunity cost. Which of the following is correct?
- a. The producer has a comparative advantage in the production of that good.
 - b. The producer has an absolute advantage in the production of that good.
 - c. The producer has both an absolute and comparative advantage in the production of that good.
 - d. The producer should import that product.

ANS: A PTS: 1 DIF: Average REF: p.57-59
BLM: Remember NOT: Macro TB_3-108

109. What is the opportunity cost of an item?
- a. The number of hours needed to earn money to buy it.
 - b. What you give up to get that item.
 - c. Always less than the dollar value of the item.
 - d. Always equal to the dollar value of the item.

ANS: B PTS: 1 DIF: Easy REF: p.57-59
BLM: Remember NOT: Macro TB_3-109

110. What is the term that means whatever must be given up to obtain an item?
- a. efficiency.
 - b. externality.
 - c. opportunity cost.
 - d. market failure.

ANS: C PTS: 1 DIF: Easy REF: p.57-59
BLM: Remember NOT: Macro TB_3-110

111. How is absolute advantage found?
- a. By comparing opportunity costs.
 - b. By calculating the dollar cost of production.
 - c. By comparing the productivity of one nation to that of another.
 - d. By first determining which country has a comparative advantage.

ANS: C PTS: 1 DIF: Average REF: p.57-59
BLM: Remember NOT: Macro TB_3-111

112. Which of the following is correct? Trade
- a. Trade allows a person to consume at a point outside his production possibilities frontier.
 - b. Trade limits a person's ability to produce goods and services on her own.
 - c. Trade must benefit both traders equally.
 - d. Trade is based on absolute advantage.

ANS: A PTS: 1 DIF: Easy REF: p.57-59
BLM: Remember NOT: Macro TB_3-112

113. Trade can benefit society as a whole because it allows for each of the following EXCEPT:
- a. a more efficient use of resources.
 - b. goods to be obtained at a lower opportunity cost.
 - c. people to specialize in activities in which they have a comparative advantage.
 - d. some countries to gain political control over trading partners.

ANS: D PTS: 1 DIF: Average REF: p.57-59
BLM: Remember NOT: Macro TB_3-113

114. What happens when countries specialize according to their comparative advantage?
- a. It is possible to increase world output of all goods.
 - b. It is possible to increase world output of some goods only by reducing the output of others.
 - c. One country is likely to gain from trade while others lose.
 - d. All countries will lose from trade.

ANS: A PTS: 1 DIF: Average REF: p.57-59
BLM: Remember NOT: Macro TB_3-114

115. Which of the following would NOT occur if each person specializes in the good for which they have a comparative advantage?
- a. Each person's production possibilities frontier will shift outward.
 - b. Total production in the economy will increase.
 - c. Everyone can be better off with specialization and trade.
 - d. The size of the economic pie will increase.

ANS: A PTS: 1 DIF: Average REF: p.57-59
BLM: Remember NOT: Macro TB_3-115

116. For what reason does total output in an economy increase when each person specializes?
- a. Because there is much less competition for the same resources.
 - b. Because each person spends more time producing that product for which they have a comparative advantage.
 - c. Because a wider variety of products can be produced with specialization.
 - d. Because more people will be producing products than before.

ANS: B PTS: 1 DIF: Average REF: p.57-59
BLM: Remember NOT: Macro TB_3-116

117. Mike and Sandy are two woodworkers who both make tables and chairs. In 1 month, Mike can make 4 tables or 20 chairs, where Sandy can make 6 tables or 18 chairs. What do we know?
- a. Mike has an absolute advantage in chairs.
 - b. Mike has a comparative advantage in tables.
 - c. Sandy has an absolute advantage in chairs.
 - d. Sandy has a comparative advantage in chairs.

ANS: A PTS: 1 DIF: Challenging REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-117

118. Mike and Sandy are two woodworkers who both make tables and chairs. In 1 month, Mike can make 4 tables or 20 chairs, where Sandy can make 6 tables or 18 chairs. What do we know?
- a. Mike has a comparative advantage in tables.
 - b. Sandy has an absolute advantage in chairs.
 - c. Mike has an absolute advantage in tables.
 - d. Sandy has a comparative advantage in tables.

ANS: D PTS: 1 DIF: Challenging REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-118

119. Mike and Sandy are two woodworkers who both make tables and chairs. In 1 month, Mike can make 4 tables or 20 chairs, where Sandy can make 6 tables or 18 chairs. What is the opportunity cost of 1 chair?
- a. $\frac{1}{5}$ table for Mike and $\frac{1}{3}$ table for Sandy.
 - b. 5 tables for Mike and 3 tables for Sandy.
 - c. $\frac{1}{3}$ table for Mike and $\frac{1}{5}$ table for Sandy.
 - d. 3 tables for Mike and 5 tables for Sandy.

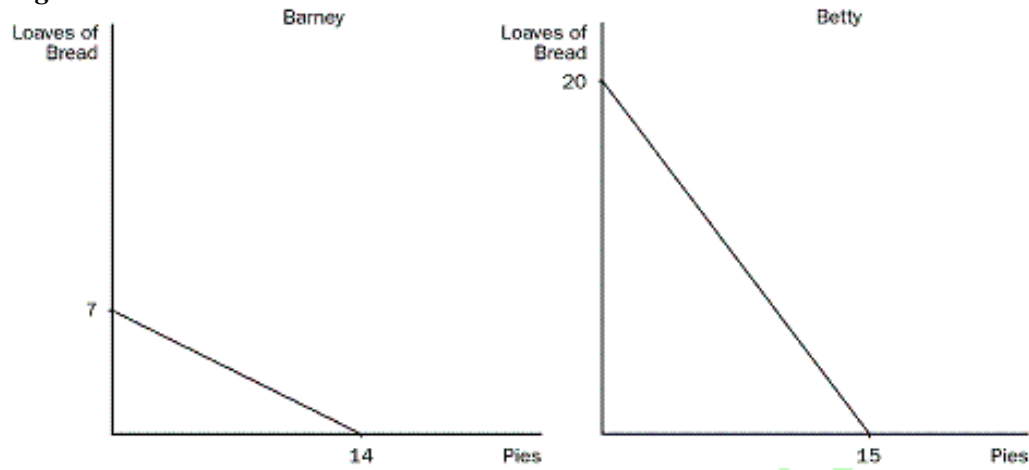
ANS: A PTS: 1 DIF: Challenging REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-119

120. Mike and Sandy are two woodworkers who both make tables and chairs. In 1 month, Mike can make 4 tables or 20 chairs, where Sandy can make 6 tables or 18 chairs. What is the opportunity cost of 1 table?
- a. $\frac{1}{5}$ chair for Mike and $\frac{1}{3}$ chair for Sandy.
 - b. 5 chairs for Mike and 3 chairs for Sandy.
 - c. $\frac{1}{3}$ chair for Mike and $\frac{1}{5}$ chair for Sandy.
 - d. 3 chairs for Mike and 5 chairs for Sandy.

ANS: B PTS: 1 DIF: Challenging REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-120

These figures illustrate the production possibilities available to Barney and Betty with 8 hours of labour in their bakery.

Figure 3-6



121. **Refer to Figure 3-6.** What is the opportunity cost of 1 loaf of bread for Barney?

- a. 1/4 pie.
- b. 1/2 pie.
- c. 1 pie.
- d. 2 pies.

ANS: D PTS: 1 DIF: Challenging REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-121

122. **Refer to Figure 3-6.** What is the opportunity cost of 1 pie for Betty?

- a. 1/4 loaf of bread.
- b. 3/4 loaf of bread.
- c. 1 loaf of bread.
- d. 4/3 loaves of bread.

ANS: D PTS: 1 DIF: Average REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-122

123. **Refer to Figure 3-6.** Which of the following is correct?

- a. Barney has an absolute advantage in both goods and Betty has an absolute advantage in neither good.
- b. Barney has an absolute advantage in loaves of bread and Betty has an absolute advantage in pies.
- c. Barney has an absolute advantage in neither good and Betty has an absolute advantage in both goods.
- d. Barney has an absolute advantage in pies and Betty has an absolute advantage in loaves of bread.

ANS: C PTS: 1 DIF: Challenging REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-123

124. **Refer to Figure 3-6.** Which of the following is correct?
- Barney has a comparative advantage in both goods and Betty has a comparative advantage in neither good.
 - Barney has a comparative advantage in loaves of bread and Betty has a comparative advantage in pies.
 - Barney has a comparative advantage in neither good and Betty has a comparative advantage in both goods.
 - Barney has a comparative advantage in pies and Betty has a comparative advantage in loaves of bread.

ANS: D PTS: 1
BLM: Higher Order

DIF: Challenging REF: p.57-59
NOT: Macro TB_3-124

125. **Refer to Figure 3-6.** If Barney and Betty both specialize in the good in which they have a comparative advantage, what would the total production be?
- 7 loaves of bread and 15 pies.
 - 20 loaves of bread and 14 pies.
 - 27 loaves of bread and 29 pies.
 - 34 loaves of bread and 22 pies.

ANS: B PTS: 1
BLM: Higher Order

DIF: Challenging REF: p.57-59
NOT: Macro TB_3-125

Table 3-5

	Hours needed to make one unit of:		Amount produced in 2400 hours:	
	Cars	Airplanes	Cars	Airplanes
Canada	40	160	60	15
Japan	50	150	48	16

126. **Refer to Table 3-5.** What is the opportunity cost of 1 car for Japan?
- 4 airplanes.
 - 3 airplanes.
 - 1/3 airplane.
 - 1/4 airplane.

ANS: C PTS: 1
BLM: Higher Order

DIF: Average REF: p.57-59
NOT: Macro TB_3-126

127. **Refer to Table 3-5.** What is the opportunity cost of 1 airplane for Japan?
- 4 cars.
 - 3 cars.
 - 1/3 car.
 - 1/4 car.

ANS: B PTS: 1
BLM: Higher Order

DIF: Average REF: p.57-59
NOT: Macro TB_3-127

128. **Refer to Table 3-5.** What is the opportunity cost of 1 car for Canada?

- a. 4 airplanes.
- b. 3 airplanes.
- c. 1/3 airplane.
- d. 1/4 airplane.

ANS: D PTS: 1

DIF: Average REF: p.57-59

BLM: Higher Order

NOT: Macro TB_3-128

129. **Refer to Table 3-5.** What is the opportunity cost of 1 airplane for Canada?

- a. 4 cars.
- b. 3 cars.
- c. 1/3 car.
- d. 1/4 car.

ANS: A PTS: 1

DIF: Average REF: p.57-59

BLM: Higher Order

NOT: Macro TB_3-129

130. **Refer to Table 3-5.** Which of the following is correct?

- a. Japan has a comparative advantage in airplanes and Canada has an absolute advantage in cars.
- b. Japan has a comparative advantage in cars and Canada has an absolute advantage in airplanes.
- c. Japan has a comparative advantage in cars and Canada has an absolute advantage in neither good.
- d. Japan has a comparative advantage in airplanes and Canada has an absolute advantage in both goods.

ANS: A PTS: 1

DIF: Average REF: p.57-59

BLM: Higher Order

NOT: Macro TB_3-130

131. **Refer to Table 3-5.** Which of the following is correct?

- a. Japan has an absolute advantage in both goods and Canada has a comparative advantage in cars.
- b. Japan has an absolute advantage in both goods and Canada has a comparative advantage in neither good.
- c. Japan has an absolute advantage in cars and Canada has a comparative advantage in airplanes.
- d. Japan has an absolute advantage in airplanes and Canada has a comparative advantage in cars.

ANS: D PTS: 1

DIF: Average REF: p.57-59

BLM: Higher Order

NOT: Macro TB_3-131

132. **Refer to Table 3-5.** Which of the following is correct?

- a. Canada has an absolute advantage in airplanes and Japan has an absolute advantage in cars.
- b. Canada has an absolute advantage in neither good and Japan has an absolute advantage in both goods.
- c. Canada has an absolute advantage in cars and Japan has an absolute advantage in airplanes.
- d. Canada has an absolute advantage in neither good and Japan has an absolute advantage in cars.

ANS: C

PTS: 1

DIF: Average

REF: p.57-59

BLM: Higher Order

NOT: Macro TB_3-132

133. **Refer to Table 3-5.** Which of the following is correct?

- a. Canada has a comparative advantage in airplanes and Japan has a comparative advantage in airplanes.
- b. Canada has a comparative advantage in cars and Japan has a comparative advantage in airplanes.
- c. Canada has a comparative advantage in airplanes and Japan has a comparative advantage in cars.
- d. Canada has a comparative advantage in neither good and Japan has a comparative advantage in cars.

ANS: B

PTS: 1

DIF: Average

REF: p.57-59

BLM: Higher Order

NOT: Macro TB_3-133

134. **Refer to Table 3-5.** How could Canada and Japan both benefit?

- a. By Canada specializing in airplanes and Japan specializing in airplanes.
- b. By Canada specializing in cars and Japan specializing in airplanes.
- c. By Canada specializing in airplanes and Japan specializing in cars.
- d. By Canada specializing in neither good and Japan specializing in both goods.

ANS: B

PTS: 1

DIF: Average

REF: p.57-59

BLM: Higher Order

NOT: Macro TB_3-134

135. **Refer to Table 3-5.** If Canada and Japan trade based on the principle of comparative advantage, what product will Canada export to Japan?

- a. Cars
- b. both airplanes and cars
- c. Airplanes
- d. Canada should buy both products from Japan.

ANS: A

PTS: 1

DIF: Average

REF: p.57-59

BLM: Higher Order

NOT: Macro TB_3-135

136. **Refer to Table 3-5.** If Canada and Japan trade based on the principle of comparative advantage, what product will Japan export to Canada?
- a. Cars
 - b. both airplanes and cars
 - c. Airplanes
 - d. Japan should buy both products from Canada.

ANS: C PTS: 1 DIF: Average REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-136

137. **Refer to Table 3-5.** If Canada and Japan trade based on the principle of comparative advantage, which of the following is correct?
- a. Canada will export cars and Japan will export airplanes.
 - b. Canada will export airplanes and Japan will export cars.
 - c. Canada will export cars and Japan will export cars.
 - d. Canada will export airplanes and Japan will export airplanes.

ANS: A PTS: 1 DIF: Average REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-137

138. **Refer to Table 3-5.** If Japan and Canada trade based on the principle of comparative advantage, which of the following is correct?
- a. All individuals in both countries will gain.
 - b. Car producers in Japan and airplane producers in Canada will gain.
 - c. Some individuals within each society will be made worse off.
 - d. One country will be better off and the other country will be worse off.

ANS: C PTS: 1 DIF: Average REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-138

139. **Refer to Table 3-5.** If Japan and Canada trade based on the principle of comparative advantage, which of the following is correct?
- a. All individuals in both countries will gain.
 - b. Both countries can have more airplanes and cars.
 - c. Japan will specialize in cars and Canada will specialize in airplanes.
 - d. Both countries will consume on their own production possibilities frontier.

ANS: B PTS: 1 DIF: Average REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-139

Table 3-6

	Labour hours needed to make one unit of		Amount produced in 40 hours	
	Cheese	Bread	Cheese	Bread
England	1	2	40	20
Spain	2	8	20	5

140. **Refer to Table 3-6.** What is the opportunity cost of 1 unit of cheese in England?
- a. 4 breads.
 - b. 2 breads.
 - c. 1/2 bread.
 - d. 1/4 bread.

ANS: C PTS: 1 DIF: Challenging REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-140

141. **Refer to Table 3-6.** What is the opportunity cost of 1 unit of bread in England?
- a. 4 cheeses.
 - b. 2 cheeses.
 - c. 1 cheese.
 - d. 1/2 cheese.

ANS: B PTS: 1 DIF: Challenging REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-141

142. **Refer to Table 3-6.** What is the opportunity cost of 1 unit of cheese in Spain?
- a. 2 breads.
 - b. 1 bread.
 - c. 1/2 bread.
 - d. 1/4 bread.

ANS: D PTS: 1 DIF: Challenging REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-142

143. **Refer to Table 3-6.** What is the opportunity cost of 1 unit of bread in Spain?
- a. 4 cheeses.
 - b. 2 cheeses.
 - c. 1 cheese.
 - d. 1/4 cheese.

ANS: A PTS: 1 DIF: Challenging REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-143

144. **Refer to Table 3-6.** Which of the following is correct?

- a. England has a comparative advantage in bread and Spain has a comparative advantage in cheese.
- b. England has a comparative advantage in cheese and Spain has a comparative advantage in bread.
- c. England has a comparative advantage in both goods and Spain has a comparative advantage in neither good.
- d. England has a comparative advantage in neither good and Spain has a comparative advantage in both goods.

ANS: A

PTS: 1

DIF: Average

REF: p.57-59

BLM: Higher Order

NOT: Macro TB_3-144

145. **Refer to Table 3-6.** Which of the following is correct?

- a. England has an absolute advantage in bread and Spain has an absolute advantage in cheese.
- b. England has an absolute advantage in cheese and Spain has an absolute advantage in bread.
- c. England has an absolute advantage in neither good and Spain has an absolute advantage in both goods.
- d. England has an absolute advantage in both goods and Spain has an absolute advantage in neither good.

ANS: D

PTS: 1

DIF: Challenging

REF: p.57-59

BLM: Higher Order

NOT: Macro TB_3-145

146. **Refer to Table 3-6.** Which of the following is correct?

- a. England has a comparative advantage in bread and Spain has an absolute advantage in cheese.
- b. England has a comparative advantage in bread and Spain has an absolute advantage in neither good.
- c. England has a comparative advantage in cheese and Spain has an absolute advantage in both goods.
- d. England has a comparative advantage in both goods and Spain has an absolute advantage in cheese.

ANS: B

PTS: 1

DIF: Challenging

REF: p.57-59

BLM: Higher Order

NOT: Macro TB_3-146

147. **Refer to Table 3-6.** Which of the following is correct?

- a. England has an absolute advantage in bread and Spain has a comparative advantage in bread.
- b. England has an absolute advantage in bread and Spain has a comparative advantage in neither good.
- c. England has an absolute advantage in cheese and Spain has a comparative advantage in both goods.
- d. England has an absolute advantage in both goods and Spain has a comparative advantage in cheese.

ANS: D

PTS: 1

DIF: Challenging

REF: p.57-59

BLM: Higher Order

NOT: Macro TB_3-147

148. **Refer to Table 3-6.** How could England and Spain benefit?
- a. By England specializing in bread and Spain specializing in cheese.
 - b. By England specializing in cheese and Spain specializing in bread.
 - c. By England specializing in both goods and Spain specializing in neither good.
 - d. By England specializing in neither good and Spain specializing in both goods.
- ANS: A PTS: 1 DIF: Challenging REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-148
149. **Refer to Table 3-6.** If England and Spain trade based on the principle of comparative advantage, which product will England export to Spain?
- a. Cheese
 - b. Bread
 - c. both cheese and bread
 - d. England cannot benefit from trade with Spain.
- ANS: B PTS: 1 DIF: Average REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-149
150. **Refer to Table 3-6.** If England and Spain trade based on the principle of comparative advantage, which product will Spain export to England?
- a. Bread
 - b. both bread and cheese
 - c. Cheese
 - d. Spain cannot benefit from trade with England.
- ANS: C PTS: 1 DIF: Average REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-150
151. **Refer to Table 3-6.** If England and Spain trade based on the principle of comparative advantage, which of the following is correct?
- a. England will export bread and Spain will export cheese.
 - b. England will export bread and Spain will export bread.
 - c. England will export cheese and Spain will export cheese.
 - d. England will export cheese and Spain will export bread.
- ANS: A PTS: 1 DIF: Challenging REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-151
152. **Refer to Table 3-6.** If England and Spain trade based on the principle of comparative advantage, which of the following is correct?
- a. England will import bread and Spain will import cheese.
 - b. England will import bread and Spain will import bread.
 - c. England will import cheese and Spain will import bread.
 - d. England will import cheese and Spain will import cheese.
- ANS: C PTS: 1 DIF: Challenging REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-152

153. **Refer to Table 3-6.** If England and Spain specialize and trade according to their respective comparative advantage, which of the following is correct?
- a. All individuals in both countries will benefit.
 - b. Spain will specialize in and export bread.
 - c. England will produce more bread than in the absence of trade.
 - d. England will produce more cheese than in the absence of trade.

ANS: C PTS: 1 DIF: Challenging REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-153

154. What is the term for a good that is produced abroad and sold domestically?
- a. a quota.
 - b. a tariff.
 - c. an import.
 - d. an export.

ANS: C PTS: 1 DIF: Easy REF: p.62
BLM: Remember NOT: Macro TB_3-154

155. Suppose that a worker in Freedonia can produce either 6 units of corn or 2 units of wheat per year, and a worker in Sylvania can produce either 2 units of corn or 6 units of wheat per year. Each nation has 10 workers. Without trade, Freedonia produces and consumes 30 units of corn and 10 units of wheat per year. Sylvania produces and consumes 10 units of corn and 30 units of wheat. Then suppose that trade is initiated between the two countries, and Freedonia sends 30 units of corn to Sylvania in exchange for 30 units of wheat. What maximum amounts will Freedonia now be able to consume?
- a. 30 units of corn and 30 units of wheat.
 - b. no corn and 30 units of wheat.
 - c. 60 units of corn and 30 units of wheat.
 - d. no corn and 60 units of wheat.

ANS: A PTS: 1 DIF: Challenging REF: p.53
BLM: Higher Order NOT: Macro TB_3-155

156. Suppose that a worker in Freedonia can produce either 6 units of corn or 2 units of wheat per year, and a worker in Sylvania can produce either 2 units of corn or 6 units of wheat per year. Each nation has 10 workers. For many years the two countries traded, each completely specializing in producing the grain for which it has a comparative advantage. Now, however, war has broken out between them and all trade has stopped. Without trade, Freedonia produces and consumes 30 units of corn and 10 units of wheat per year. Sylvania produces and consumes 10 units of corn and 30 units of wheat. By how much has the combined yearly output of the two countries declined?
- a. 10 units of corn and 10 units of wheat.
 - b. 20 units of corn and 20 units of wheat.
 - c. 30 units of corn and 30 units of wheat.
 - d. 40 units of corn and 40 units of wheat.

ANS: B PTS: 1 DIF: Challenging REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-156

157. Suppose that a worker in Radioland can produce either 4 radios or 1 television per year, and a worker in Teeveeland can produce either 2 radios or 4 televisions per year. Each nation has 100 workers. Also suppose that each country completely specializes in producing the good for which it has a comparative advantage. If Radioland trades 100 radios to Teeveeland in exchange for 100 televisions each year, what is each country's maximum consumption of new radios and televisions per year?
- 300 televisions and 100 radios in Radioland and 300 radios and 100 televisions in Teeveeland.
 - 300 televisions and 100 radios in Teeveeland and 300 radios and 100 televisions in Radioland.
 - 100 televisions and 200 radios in Radioland and 100 radios and 200 televisions in Teeveeland.
 - 400 televisions and 100 radios in Teeveeland and 400 radios and 100 televisions in Radioland.

ANS: B PTS: 1 DIF: Challenging REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-157

158. Suppose that a worker in Radioland can produce either 4 radios or 1 television per year, and a worker in Teeveeland can produce either 2 radios or 5 televisions per year. Each nation has 100 workers. If Radioland trades 100 televisions to Teeveeland in exchange for 100 radios each year, what is the impact on each country's maximum consumption of new radios and televisions per year?
- Higher than it would be in the absence of trade because of the gains from trade.
 - The same as it would be in the absence of trade.
 - Less than it would be in the absence of trade because neither country is specializing in the product for which it has a comparative advantage.
 - Less than it would be in the absence of trade because Teeveeland has an absolute advantage in both goods and so would lose if it trades with Radioland.

ANS: C PTS: 1 DIF: Challenging REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-158

159. Suppose that a worker in Agland can produce either 10 units of organic grain or 2 units of incense per year, and a worker in Zenland can produce either 5 units of organic grain or 15 units of incense per year. There are 20 workers in Agland and 10 workers in Zenland. Currently the two countries do not trade. Agland produces and consumes 100 units of grain and 20 units of incense per year. Zenland produces and consumes 50 units of grain and no incense per year. The combined output of the two countries is therefore 150 units of grain and 20 units of incense per year. If the two countries decided to trade, and completely specialized in producing the good for which each has a comparative advantage, what would the combined yearly output of the two countries be?
- 50 units of grain and 40 units of incense.
 - 200 units of grain and 150 units of incense.
 - 150 units of grain and 20 units of incense.
 - 200 units of grain and 300 units of incense.

ANS: B PTS: 1 DIF: Challenging REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-159

160. Suppose that a worker in Cornland can grow either 40 bushels of corn or 10 bushels of oats per year, and a worker in Oatland can grow either 5 bushels of corn or 50 bushels of oats per year. There are 20 workers in Cornland and 20 workers in Oatland. If the two countries do not trade, Cornland will produce and consume 400 bushels of corn and 100 bushels of oats, while Oatland will produce and consume 50 bushels of corn and 500 bushels of oats. Combined output for the two countries would therefore be 450 bushels of corn and 600 bushels of oats. If the two countries do trade, each will completely specialize in producing the crop for which it has a comparative advantage. If trade occurs, by what amount will the combined output for the two countries *increase*?
- a. 800 bushels of corn and 1000 bushels of oats.
 - b. 400 bushels of corn and 500 bushels of oats.
 - c. 350 bushels of corn and 400 bushels of oats.
 - d. There would not be any increase.

ANS: C PTS: 1 DIF: Challenging REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-160

161. Suppose that a worker in Cornland can grow either 40 bushels of corn or 10 bushels of oats per year, and a worker in Oatland can grow either 20 bushels of corn or 5 bushels of oats per year. There are 20 workers in Cornland and 20 workers in Oatland. Which of the following statements is correct?
- a. Both countries could gain from trade with each other.
 - b. Neither country would gain from trade because Cornland has an absolute advantage in both goods.
 - c. Neither country would gain from trade because neither one has a comparative advantage.
 - d. Only Oatland could possibly gain from trade.

ANS: C PTS: 1 DIF: Challenging REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-161

162. Suppose that a worker in Boatland can produce either 5 units of wheat or 25 units of fish per year, and a worker in Farmland can produce either 25 units of wheat or 5 units of fish per year. There are 10 workers in each country. Political pressure from the fish lobby in Farmland and the wheat lobby in Boatland has prevented trade between the two countries on the grounds that cheap imports would kill the fish industry in Farmland and the wheat industry in Boatland. As a result, Boatland produces and consumes 25 units of wheat and 125 units of fish per year while Farmland produces and consumes 125 units of wheat and 25 units of fish per year. If the political pressures were overcome and trade were to occur, each country would completely specialize in the product for which it has a comparative advantage. If trade were to occur, by how much would the combined output of the two countries increase?
- a. 25 wheat and 25 fish.
 - b. 50 wheat and 50 fish.
 - c. 75 wheat and 75 fish.
 - d. 100 wheat and 100 fish.

ANS: D PTS: 1 DIF: Challenging REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-162

163. Suppose that a worker in Boatland can produce either 5 units of wheat or 25 units of fish per year, and a worker in Farmland can produce either 25 units of wheat or 5 units of fish per year. There are 10 workers in each country. No trade occurs between the two countries. Boatland produces and consumes 25 units of wheat and 125 units of fish per year while Farmland produces and consumes 125 units of wheat and 25 units of fish per year. If trade were to occur, Boatland would trade 100 units of fish to Farmland in exchange for 100 units of wheat. If Boatland no longer grew any of its own wheat, how many units of fish could it now consume along with the 100 units of imported wheat?
- 25 units
 - 75 units
 - 150 units
 - 250 units

ANS: C PTS: 1 DIF: Challenging REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-163

164. Suppose that the country of Xenophobia chose to isolate itself from the rest of the world. Its ruler proclaimed that Xenophobia should become self-sufficient, and so would not engage in foreign trade. From an economic perspective, when would this idea make sense?
- If Xenophobia had an absolute advantage in all goods.
 - If Xenophobia had no absolute advantages in any goods.
 - Never as long as Xenophobia had a comparative advantage in any good.
 - Never as long as Xenophobia had an absolute advantage in at least half the goods traded.

ANS: C PTS: 1 DIF: Average REF: p.57-59
BLM: Higher Order NOT: Macro TB_3-164

165. What are imports?
- people who work in foreign countries.
 - an example of an economic model.
 - whatever is given up to obtain some item.
 - goods produced abroad and sold domestically.

ANS: D PTS: 1 DIF: Easy REF: p.62
BLM: Remember NOT: Macro TB_3-165

166. What are exports?
- a limit placed on the quantity of goods brought into a country.
 - goods produced abroad and sold domestically.
 - a country's ability to produce a good.
 - goods produced domestically and sold abroad.

ANS: D PTS: 1 DIF: Easy REF: p.62
BLM: Remember NOT: Macro TB_3-166

167. Which of the following is correct regarding Adam Smith?
- He wrote *An Inquiry into the Nature and Causes of the Wealth of Nations*.
 - He opposed free trade.
 - He wrote the General Theory of Economics.
 - He believed people were irrational.

ANS: A PTS: 1 DIF: Easy REF: p.59
BLM: Remember NOT: Macro TB_3-167

168. According to Adam Smith, what should a person never attempt to make at home?
- a. What it will cost him more to make than to buy.
 - b. Everything one person needs to live.
 - c. What one doesn't know how to make.
 - d. Any necessity of life.

ANS: A PTS: 1 DIF: Average REF: p.59
BLM: Remember NOT: Macro TB_3-168

169. Who developed the principle of comparative advantage?
- a. Paul Samuelson.
 - b. David Ricardo.
 - c. John Maynard Keynes.
 - d. Adam Smith.

ANS: B PTS: 1 DIF: Easy REF: p.59
BLM: Remember NOT: Macro TB_3-169

170. Which of the following is correct regarding David Ricardo?
- a. He wrote books opposing the ideas of Adam Smith.
 - b. He was the founder of modern economics.
 - c. He argued in favour of Britain following a free-trade policy.
 - d. He wrote *An Inquiry into the Nature and Causes of the Wealth of Nations*.

ANS: C PTS: 1 DIF: Easy REF: p.59
BLM: Remember NOT: Macro TB_3-170

171. Which of the following is correct regarding David Ricardo?
- a. He opposed the Corn Laws as a member of Parliament.
 - b. He disputed Adam Smith's theory of specialization and trade in the early 1800s.
 - c. He developed the principle of comparative advantage in 1817, which has been largely disproved by modern economists.
 - d. He was an early supporter of trade restrictions.

ANS: A PTS: 1 DIF: Easy REF: p.59
BLM: Remember NOT: Macro TB_3-171

172. Which book did David Ricardo write?
- a. Inquiry into the Nature and Causes of the Wealth of Nations.
 - b. Principles of Political Economy and Taxation.
 - c. The General Theory of Prices and Employment.
 - d. Why Nations Trade.

ANS: B PTS: 1 DIF: Easy REF: p.59
BLM: Remember NOT: Macro TB_3-172

173. What do economists generally support?

- a. trade restrictions.
- b. government management of trade.
- c. export subsidies.
- d. free international trade.

ANS: D PTS: 1 DIF: Easy REF: p.62
BLM: Remember NOT: Macro TB_3-173

174. What could benefit Canada?

- a. By restricting imports and promoting exports.
- b. By promoting imports and restricting exports.
- c. By restricting both imports and exports.
- d. By not restricting trade.

ANS: D PTS: 1 DIF: Average REF: p.60-61
BLM: Remember NOT: Macro TB_3-174

TRUE/FALSE

1. Trade allows a country to consume outside its production possibilities frontier.

ANS: T PTS: 1 DIF: Average REF: p.55
NOT: Macro TB_3-175

2. It takes Barbara 3 hours to make a pie and 4 hours to make a shirt. It takes Gary 2 hours to make a pie and 5 hours to make a shirt. Barbara should specialize in making shirts and Gary should specialize in making pies, then they should trade.

ANS: T PTS: 1 DIF: Average REF: p.57-59
NOT: Macro TB_3-176

3. It takes Russell 6 hours to produce a bushel of corn and 2 hours to wash and polish a car. It takes Wilma 6 hours to produce a bushel of corn and 1 hour to wash and polish a car. Wilma and Russell cannot gain from specialization and trade, since it takes each of them 6 hours to produce 1 bushel of corn.

ANS: F PTS: 1 DIF: Average REF: p.57-59
NOT: Macro TB_3-177

4. For a country producing 2 goods, the opportunity cost of one good will be the inverse of the opportunity cost of the other good.

ANS: T PTS: 1 DIF: Average REF: p.57-59
NOT: Macro TB_3-178

5. The producer who has the smaller opportunity cost of producing a good is said to have an absolute advantage in producing that good.

ANS: F PTS: 1 DIF: Average REF: p.57-59
NOT: Macro TB_3-179

6. Trade is based on absolute advantage.

ANS: F PTS: 1 DIF: Easy REF: p.57-59
NOT: Macro TB_3-180

7. Rusty can edit 2 pages in one minute, and can type 80 words in one minute. Emily can edit 1 page in one minute, and can type 100 words in one minute. Rusty has an absolute and comparative advantage in editing, and Emily has an absolute and comparative advantage in typing.

ANS: T PTS: 1 DIF: Average REF: p.57-59
NOT: Macro TB_3-181

8. Two countries can achieve gains from trade even if one country has an absolute advantage in the production of both goods.

ANS: T PTS: 1 DIF: Average REF: p.57-59
NOT: Macro TB_3-182

9. Differences in opportunity cost allow for gains from trade.

ANS: T PTS: 1 DIF: Easy REF: p.57-59
NOT: Macro TB_3-183

10. When each person specializes in producing the good for which he or she has a comparative advantage, each person can gain from trade but total production in the economy is unchanged.

ANS: F PTS: 1 DIF: Average REF: p.57-59
NOT: Macro TB_3-184

11. Unless two people who are producing two goods have exactly the same opportunity costs, each will have a comparative advantage in a different good.

ANS: T PTS: 1 DIF: Easy REF: p.57-59
NOT: Macro TB_3-185

12. As long as two people have different opportunity costs, each can gain from trade by being able to obtain a good at a price lower than his or her opportunity cost.

ANS: T PTS: 1 DIF: Average REF: p.57-59
NOT: Macro TB_3-186

13. Trade allows a person to obtain goods at prices that are less than that person's opportunity cost because each person concentrates on the activity for which he or she has the lower opportunity cost.

ANS: T PTS: 1 DIF: Average REF: p.57-59
NOT: Macro TB_3-187

14. Jonathan can make a birdhouse in 3 hours. He can make a bird feeder in 1 hour. The opportunity cost to Jonathan of making a birdhouse is 1/3 bird feeder.

ANS: F PTS: 1 DIF: Average REF: p.57-59
NOT: Macro TB_3-188

15. Mark is a computer company executive, and earns \$200 per hour managing the company and promoting its products. His daughter Regan is a high school student, and earns \$6 per hour helping her grandmother on the farm. Mark's computer is broken. He can repair it himself in one hour. Regan can repair it in 10 hours. Mark has a comparative advantage repairing the computer.

ANS: F PTS: 1 DIF: Average REF: p.57-59
NOT: Macro TB_3-189

16. Suppose it takes a Chinese worker 2 hours to produce a ceramic pot, and 20 hours to produce a tablecloth. Suppose that it takes a Canadian worker 2 hours to produce a ceramic pot and 10 hours to produce a tablecloth. It will pay China to produce extra pots and export them to Canada in return for imported Canadian tablecloths.

ANS: T PTS: 1 DIF: Average REF: p.57-59
NOT: Macro TB_3-190

17. If it takes Canadian workers fewer hours to produce every good than it takes German workers, Canada cannot gain from trade with Germany.

ANS: F PTS: 1 DIF: Average REF: p.57-59
NOT: Macro TB_3-191

18. Adam Smith developed the theory of comparative advantage as we know it today.

ANS: F PTS: 1 DIF: Average REF: p.59
NOT: Macro TB_3-192

19. Goods produced abroad and sold domestically are called exports and goods produced domestically and sold abroad are called imports.

ANS: F PTS: 1 DIF: Easy REF: p.62
NOT: Macro TB_3-193

20. International trade may make some individuals in a nation better off, while other individuals are made worse off.

ANS: T PTS: 1 DIF: Average REF: p.60
NOT: Macro TB_3-194

21. Some countries win in international trade, while other countries lose.

ANS: F PTS: 1 DIF: Average REF: p.60
NOT: Macro TB_3-195

SHORT ANSWER

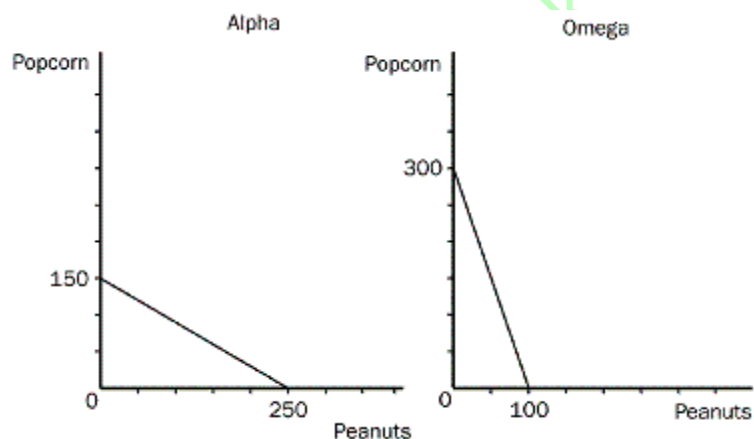
1. Explain the difference between absolute advantage and comparative advantage. Which is more important in determining trade patterns and why?

ANS:

Absolute advantage refers to productivity, as in the producer who can produce a product at a lower cost in terms of the resources used in production. Comparative advantage refers to the producer who can produce a product at a lower opportunity cost. Comparative advantage is the principle upon which trade patterns are based. Comparative advantage is based on opportunity cost, and opportunity cost measures the real cost to an individual or country of producing a particular product. Opportunity cost is therefore the information necessary for an individual or nation to determine whether to produce a good or buy it from someone else.

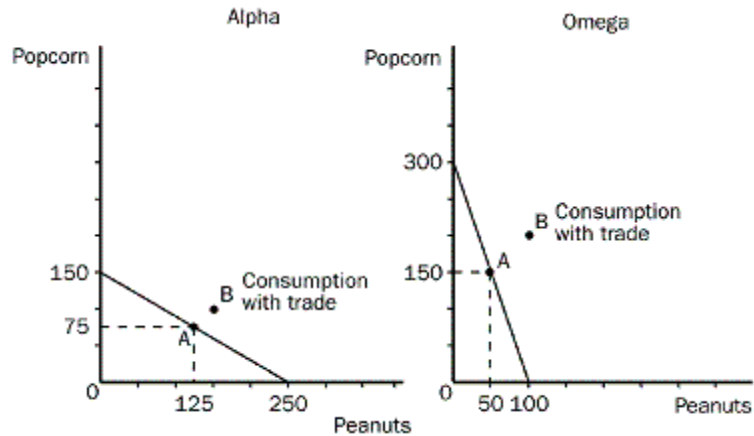
PTS: 1 DIF: Challenging REF: p. 57-59 NOT: Macro TB_3-196

2. The only two countries in the world, Alpha and Omega, face the following production possibilities frontiers.



- Assume that each country decides to use half of its resources in the production of each good. Show these points on the graphs for each country as point A.
- If these countries choose not to trade, what would be the total world production of popcorn and peanuts?
- Now suppose that each country decides to specialize in the good in which each has a comparative advantage. By specializing, what is the total world production of each product now?
- If each country decides to trade 100 units of popcorn for 100 units of peanuts, show on the graphs the gain each country would receive from trade. Label these points B.

ANS:



- Alpha would be producing 125 units of peanuts and 75 units of popcorn (point A on its PPF) and Omega would be producing 50 units of peanuts and 150 units of popcorn (point A on its PPF).
- The total world production of peanuts would be 175 units and the total world production of popcorn would be 225 units.
- The total world production of peanuts would now be 250 units and the total world production of popcorn would now be 300 units.
- Alpha would be producing 250 units of peanuts and would trade 100 of them to Omega, leaving Alpha with 150 units of peanuts. Alpha would then receive 100 units of popcorn from Omega. Omega would be producing 300 units of popcorn and would trade 100 of them to Alpha, leaving Omega with 200 units of popcorn. Omega would then receive 100 units of peanuts from Alpha.

PTS: 1

DIF: Average

REF: p. 57-59

NOT: Macro TB_3-197

- Julia can fix a meal in 1 hour, and her opportunity cost of 1 hour is \$50. Jacques can fix the same kind of meal in 2 hours, and his opportunity cost of 1 hour is \$20. Will both Julia and Jacques be better off if she pays him \$45 per meal to fix her meals? Explain.

ANS:

Since Julia's opportunity cost of preparing a meal is \$50, and Jacques's opportunity cost of preparing a meal is \$40, each of them will be better off by \$5 per meal if this arrangement is made.

PTS: 1

DIF: Average

REF: p. 57-59

NOT: Macro TB_3-198

4. Gary and Diane must prepare a presentation for their marketing class. As part of their presentation, they must do a series of calculations and prepare 50 PowerPoint slides. It would take Gary 10 hours to do the required calculations and 10 hours to prepare the slides. It would take Diane 12 hours to do the calculations and 20 hours to prepare the slides.
- How much time would it take the two to complete the project if they divide the calculations equally and the slides equally?
 - How much time would it take the two to complete the project if they use comparative advantage and specialize in calculating or preparing slides?
 - If Diane and Gary have the same opportunity cost of \$5 per hour, is there a better solution than for each to specialize in calculating or preparing slides?

ANS:

- If both tasks are divided equally, it will take 11 hours for the calculations and 15 hours for the slide preparation, for a total of 26 hours.
- If Diane specializes in calculating and Gary specializes in preparing slides, it will take 22 hours to complete the project.
- If Diane specializes in calculating, her opportunity cost will be \$60; hence, Diane would be better off if she paid Gary any amount less than \$60 to do the calculating. Since Gary's opportunity cost of doing the calculations is only \$50, he would be better off if Diane paid him between \$50 and \$60 dollars to do the calculations. In this case, the total time spent on the project would be 20 hours.

PTS: 1

DIF: Average

REF: p. 57-59

NOT: Macro TB_3-199

5. Suppose that a worker in Taiwan can make 2 TVs or 10 pairs of shoes per week, and a worker in Korea can make 3 TVs or 20 pairs of shoes per week.
- In what sense do TVs and shoes cost less in Korea than in Taiwan?
 - In what sense do TVs cost less in Taiwan than in Korea?
 - If Taiwan and Korea were to engage in trade, which country would export which good?
 - How would the answer to the above question change if a worker in Korea could make 4 TVs per week?

ANS:

- In terms of labour time spent making TVs and shoes, both goods cost less in Korea than in Taiwan, 0.33 weeks per TV and 0.05 weeks per pair of shoes in Korea, and 0.5 weeks per TV and 0.1 weeks per pair of shoes in Taiwan.
- In terms of opportunity cost, TVs cost less in Taiwan than in Korea: 5 pairs of shoes per TV in Taiwan and 6.67 pairs of shoes per TV in Korea.
- Since Taiwan has a comparative advantage in TVs, it will export TVs. Since Korea has a comparative advantage in making pairs of shoes, it will export shoes.
- No country would have a comparative advantage since opportunity costs will be the same for both countries and therefore engaging in trade would benefit neither country.

PTS: 1

DIF: Average

REF: p. 57-59

NOT: Macro TB_3-200

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Chapter 4—The Market Forces of Supply and Demand

MULTIPLE CHOICE

1. When evaluating differences or similarities between an increase in supply and an increase in quantity supplied, what do we know?
 - a. The former is a shift of the curve and the latter is a movement along the curve.
 - b. The former is a movement along the curve and the latter is a shift of the curve.
 - c. Both are shifts of the supply curve.
 - d. Both are movements along the curve.

ANS: A PTS: 1 DIF: Average REF: p.81
BLM: Higher Order NOT: Macro TB_4b-1

2. Workers at a bicycle assembly plant currently make minimum wage. If the provincial government increases the minimum wage by \$1.00 an hour, what will likely happen?
 - a. Demand for bicycle assembly workers will increase.
 - b. Supply of bicycles will shift to the right.
 - c. Supply of bicycles will shift to the left.
 - d. The firm must increase output to maintain profit levels.

ANS: C PTS: 1 DIF: Average REF: p.81
BLM: Higher Order NOT: Macro TB_4b-2

3. If a car manufacturer purchases new labour-saving technology for its assembly line, what would we NOT expect?
 - a. less labour to be used
 - b. the supply of cars produced to increase
 - c. costs to the firm to fall
 - d. the price of cars to be increased by the firm

ANS: D PTS: 1 DIF: Average REF: p.81
BLM: Higher Order NOT: Macro TB_4b-3

4. Recent forest fires in the western provinces are expected to cause the price of lumber to rise in the next 6 months. As a result, what can we expect to happen to the supply of lumber?
 - a. fall in 6 months, but not now
 - b. increase in 6 months when the price goes up
 - c. fall now
 - d. increase now to meet as much demand as possible

ANS: C PTS: 1 DIF: Challenging REF: p.81
BLM: Higher Order NOT: Macro TB_4b-4

5. If suppliers expect the price of their product to fall in the future, what will they do?
- a. decrease supply now
 - b. increase supply now
 - c. increase supply in the future but not now
 - d. nothing, since there is nothing they can do to affect the price in the future

ANS: B PTS: 1 DIF: Average REF: p.81
BLM: Higher Order NOT: Macro TB_4b-5

6. Funsters Inc., the largest toy company in Canada, sells its most popular doll for \$35. It has just learned that its leading competitor Toysorama is mass producing an excellent copy and plans to flood the market with their \$10 doll in 6 weeks. What should Funsters do?
- a. increase the supply of their doll now before the other doll hits the market
 - b. fight fire with fire and decrease supply for 6 weeks, then increase the supply of its doll too
 - c. continue business as usual, since consumers will not buy the cheaper imitation
 - d. discontinue this doll

ANS: A PTS: 1 DIF: Challenging REF: p.81
BLM: Higher Order NOT: Macro TB_4b-6

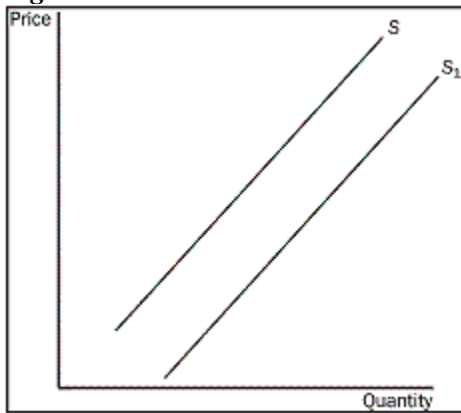
7. Wheat is the main input in the production of flour. If the price of wheat increases, all else equal, what would we expect?
- a. the supply of flour to be unaffected
 - b. the supply of flour to decrease
 - c. the supply of flour to increase
 - d. the demand for flour to decrease

ANS: B PTS: 1 DIF: Average REF: p.81
BLM: Higher Order NOT: Macro TB_4b-7

8. Wheat is the main input in the production of flour. If the price of wheat decreases, all else equal, what would we expect?
- a. the supply of flour to be unaffected
 - b. the supply of flour to decrease
 - c. the supply of flour to increase
 - d. the demand for flour to decrease

ANS: C PTS: 1 DIF: Average REF: p.81
BLM: Higher Order NOT: Macro TB_4b-8

Figure 4-1



9. **Refer to Figure 4-1.** What is the movement from S to S_1 called?

- a. a decrease in supply
- b. a decrease in quantity supplied
- c. an increase in supply
- d. an increase in quantity supplied

ANS: C PTS: 1
BLM: Higher Order

DIF: Average REF: p.80
NOT: Macro TB_4b-9

10. **Refer to Figure 4-1.** What is the movement from S_1 to S called?

- a. a decrease in supply
- b. a decrease in quantity supplied
- c. an increase in supply
- d. an increase in quantity supplied

ANS: A PTS: 1
BLM: Higher Order

DIF: Average REF: p.80
NOT: Macro TB_4b-10

11. **Refer to Figure 4-1.** What could cause the movement from S_1 to S ?

- a. a decrease in the price of the good
- b. an improvement in technology
- c. an increase in income
- d. an increase in input prices

ANS: D PTS: 1
BLM: Higher Order

DIF: Average REF: p.80
NOT: Macro TB_4b-11

12. **Refer to Figure 4-1.** What could cause the movement from S to S_1 ?

- a. a decrease in the price of the good
- b. an improvement in technology
- c. an increase in income
- d. an increase in input prices

ANS: B PTS: 1
BLM: Higher Order

DIF: Average REF: p.80
NOT: Macro TB_4b-12

13. What is the unique point at which the supply and demand curves intersect?
- a. market unity
 - b. an agreement
 - c. cohesion
 - d. equilibrium

ANS: D PTS: 1 DIF: Easy REF: p.82
BLM: Remember NOT: Macro TB_4b-13

14. What is the price where quantity supplied equals quantity demanded?
- a. coordinating price
 - b. monopoly price
 - c. equilibrium price
 - d. balancing point

ANS: C PTS: 1 DIF: Easy REF: p.82
BLM: Remember NOT: Macro TB_4b-14

15. What is another term for equilibrium price?
- a. balancing price
 - b. market-clearing price
 - c. constant price
 - d. satisfactory price

ANS: B PTS: 1 DIF: Easy REF: p.82
BLM: Remember NOT: Macro TB_4b-15

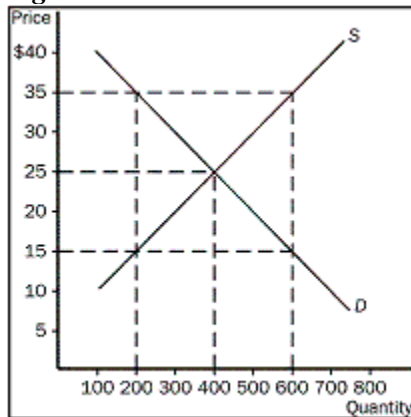
16. What happens at the equilibrium price?
- a. Buyers have an incentive to buy more.
 - b. It is possible for there to be a shortage.
 - c. Firms have an incentive to increase production.
 - d. Everyone in the market has been satisfied.

ANS: D PTS: 1 DIF: Average REF: p.82
BLM: Remember NOT: Macro TB_4b-16

17. What happens if there is a shortage of a good at the current price?
- a. Sellers are producing more than buyers wish to buy.
 - b. The market must be in equilibrium.
 - c. The price is below the equilibrium price.
 - d. Quantity demanded equals quantity supplied.

ANS: C PTS: 1 DIF: Average REF: p.83
BLM: Remember NOT: Macro TB_4b-17

Figure 4-2



18. **Refer to Figure 4-2.** What are the equilibrium price and quantity?

a. \$35 and 200
b. \$35 and 600
c. \$25 and 400
d. \$15 and 200

ANS: C

PTS: 1

DIF: Average

REF: p.82

BLM: Higher Order

NOT: Macro TB_4b-18

19. **Refer to Figure 4-2.** What happens at a price of \$35?

a. There would be a shortage of 400 units.
b. There would be a shortage of 200 units.
c. There would be a surplus of 200 units.
d. There would be a surplus of 400 units.
e. The market would be in equilibrium.

ANS: D

PTS: 1

DIF: Average

REF: p.83

BLM: Higher Order

NOT: Macro TB_4b-19

20. **Refer to Figure 4-2.** What happens at a price of \$15?

a. There would be a shortage of 400 units.
b. There would be a surplus of 400 units.
c. There would be a shortage of 200 units.
d. There would be a shortage of 400 units.

ANS: A

PTS: 1

DIF: Average

REF: p.83

BLM: Higher Order

NOT: Macro TB_4b-20

21. **Refer to Figure 4-2.** What happens at the equilibrium price?

a. 200 units would be supplied and demanded
b. 400 units would be supplied and demanded
c. 600 units would be supplied and demanded
d. 600 units would be supplied, but only 200 would be demanded

ANS: B

PTS: 1

DIF: Average

REF: p.82

BLM: Higher Order

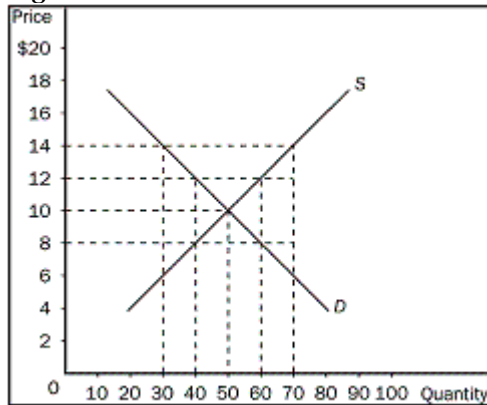
NOT: Macro TB_4b-21

22. **Refer to Figure 4-2.** What happens at a price of \$35?
- A shortage would exist and the price would tend to fall.
 - A shortage would exist and the price would tend to rise.
 - A surplus would exist and the price would tend to rise.
 - A surplus would exist and the price would tend to fall.

ANS: D PTS: 1
BLM: Higher Order

DIF: Average REF: p.83
NOT: Macro TB_4b-22

Figure 4-3



23. **Refer to Figure 4-3.** In this market, what are the equilibrium price and quantity?
- \$14 and 70
 - \$12 and 40
 - \$10 and 50
 - \$8 and 50

ANS: C PTS: 1
BLM: Higher Order

DIF: Average REF: p.82
NOT: Macro TB_4b-23

24. **Refer to Figure 4-3.** If the price in this market is currently \$14, what would happen?
- There would be a shortage of 20 units and the price would tend to rise.
 - There would be a surplus of 20 units and the price would tend to fall.
 - There would be a shortage of 40 units and the price would tend to rise.
 - There would be a surplus of 40 units and the price would tend to fall.

ANS: D PTS: 1
BLM: Higher Order

DIF: Average REF: p.82-83
NOT: Macro TB_4b-24

25. **Refer to Figure 4-3.** If price in this market is currently \$8, what would happen?
- Quantity supplied would be 40 and quantity demanded would be 60.
 - Quantity supplied would be 60 and quantity demanded would be 40.
 - Quantity supplied would be 50 and quantity demanded would be 50.
 - Quantity supplied would be 70 and quantity demanded would be 30.

ANS: A PTS: 1
BLM: Higher Order

DIF: Average REF: p.82-83
NOT: Macro TB_4b-25

Table 4-2

PRICE	QUANTITY DEMANDED	QUANTITY SUPPLIED
\$10	10	60
\$ 8	20	45
\$ 6	30	30
\$ 4	40	15
\$ 2	50	0

26. **Refer to Table 4-2.** What would the equilibrium price and quantity be?
- \$4 and 40.
 - \$6 and 30
 - \$8 and 30
 - \$10 and 35

ANS: B PTS: 1 DIF: Average REF: p.82
BLM: Higher Order NOT: Macro TB_4b-26

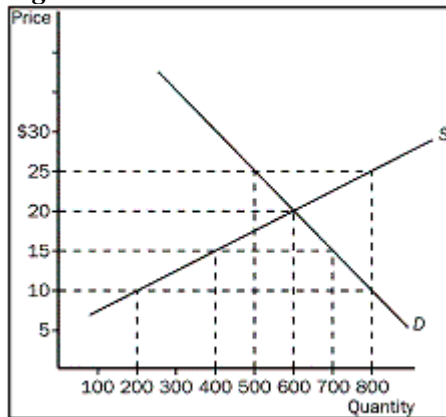
27. **Refer to Table 4-2.** If the price were \$8, what would happen?
- A surplus of 50 units would exist and the price would tend to fall.
 - A surplus of 10 units would exist and the price would tend to fall.
 - A surplus of 25 units would exist and the price would tend to fall.
 - A shortage of 25 units would exist and the price would tend to rise.

ANS: C PTS: 1 DIF: Average REF: p.83
BLM: Higher Order NOT: Macro TB_4b-27

28. **Refer to Table 4-2.** If the price were \$2, what would happen?
- A shortage of 25 units would exist and the price would tend to fall.
 - A surplus of 50 units would exist and the price would tend to rise.
 - A surplus of 25 units would exist and the price would tend to fall.
 - A shortage of 50 units would exist and the price would tend to rise.

ANS: D PTS: 1 DIF: Average REF: p.83
BLM: Higher Order NOT: Macro TB_4b-28

Figure 4-4



29. **Refer to Figure 4-4.** In this market, what would the equilibrium price and quantity be?
- \$15 and 400
 - \$20 and 600
 - \$25 and 500
 - \$25 and 800

ANS: B

PTS: 1

DIF: Average REF: p.82

BLM: Higher Order

NOT: Macro TB_4b-29

30. **Refer to Figure 4-4.** If the price is \$25, what would the quantity demanded be?
- 400
 - 500
 - 600
 - 800

ANS: B

PTS: 1

DIF: Average REF: p.82

BLM: Higher Order

NOT: Macro TB_4b-30

31. **Refer to Figure 4-4.** If the price is \$15, what would the quantity supplied be?
- 200
 - 400
 - 500
 - 700

ANS: B

PTS: 1

DIF: Average REF: p.82

BLM: Higher Order

NOT: Macro TB_4b-31

32. **Refer to Figure 4-4.** If the price is \$25, what would happen?
- There would be a surplus of 300 and the price would fall.
 - There would be a surplus of 200 and the price would fall.
 - There would be a shortage of 200 and the price would rise.
 - There would be a shortage of 300 and the price would rise.

ANS: A

PTS: 1

DIF: Average REF: p.82-83

BLM: Higher Order

NOT: Macro TB_4b-32

33. **Refer to Figure 4-4.** If the price is \$10, what would happen?
- a. There would be a shortage of 200 and the price would rise.
 - b. There would be a surplus of 200 and the price would fall.
 - c. There would be a shortage of 600 and the price would rise.
 - d. There would be a surplus of 600 and the price would fall.

ANS: C PTS: 1 DIF: Average REF: p.82-83
BLM: Higher Order NOT: Macro TB_4b-33

34. **Refer to Figure 4-4.** At a price of \$20, which would NOT be true?
- a. The market would be in equilibrium.
 - b. Equilibrium price would be equal to equilibrium quantity.
 - c. There would be no pressure for price to change.
 - d. 600 units would be bought and sold.

ANS: B PTS: 1 DIF: Average REF: p.82-83
BLM: Higher Order NOT: Macro TB_4b-34

35. Why do markets move toward equilibrium of supply and demand?
- a. because of the actions of buyers and sellers
 - b. because of government regulations placed on market participants
 - c. because of increased competition among sellers
 - d. because of buyers' ability to affect market decisions

ANS: A PTS: 1 DIF: Average REF: p.82-83
BLM: Remember NOT: Macro TB_4b-35

36. Suppose roses are currently selling for \$40.00 per dozen. The equilibrium price of roses is \$30.00 per dozen. What would we expect?
- a. a shortage to exist and the market price of roses to increase
 - b. a shortage to exist and the market price of roses to decrease
 - c. a surplus to exist and the market price of roses to increase
 - d. a surplus to exist and the market price of roses to decrease

ANS: D PTS: 1 DIF: Challenging REF: p.83
BLM: Higher Order NOT: Macro TB_4b-36

37. Suppose roses are currently selling for \$40.00 per dozen. The equilibrium price of roses is \$50.00 per dozen. What would we expect?
- a. a shortage to exist and the market price of roses to increase
 - b. a shortage to exist and the market price of roses to decrease
 - c. a surplus to exist and the market price of roses to increase
 - d. a surplus to exist and the market price of roses to decrease

ANS: A PTS: 1 DIF: Challenging REF: p.83
BLM: Higher Order NOT: Macro TB_4b-37

38. What happens when there is a surplus in a market?
- a. There is upward pressure on price.
 - b. There is downward pressure on price.
 - c. The market could still be in equilibrium.
 - d. There are too many buyers chasing too few goods.

ANS: B PTS: 1 DIF: Average REF: p.83
BLM: Remember NOT: Macro TB_4b-38

39. If a surplus exists in a market, what do we know?
- a. The actual price is above equilibrium price and quantity supplied is greater than quantity demanded.
 - b. The actual price is above equilibrium price and quantity demanded is greater than quantity supplied.
 - c. The actual price is below equilibrium price and quantity demanded is greater than quantity supplied.
 - d. The actual price is below equilibrium price and quantity supplied is greater than quantity demanded.

ANS: A PTS: 1 DIF: Challenging REF: p.83
BLM: Remember NOT: Macro TB_4b-39

40. What happens when there is a shortage in a market?
- a. There is downward pressure on price.
 - b. There is upward pressure on price.
 - c. The market could still be in equilibrium.
 - d. The price must be above equilibrium.

ANS: B PTS: 1 DIF: Average REF: p.83
BLM: Remember NOT: Macro TB_4b-40

41. If a shortage exists in a market, what do we know?
- a. The actual price is below equilibrium price and quantity demanded is greater than quantity supplied.
 - b. The actual price is above equilibrium price and quantity demanded is greater than quantity supplied.
 - c. The actual price is above equilibrium price and quantity supplied is greater than quantity demanded.
 - d. The actual price is below equilibrium price and quantity supplied is greater than quantity demanded.

ANS: A PTS: 1 DIF: Challenging REF: p.83
BLM: Remember NOT: Macro TB_4b-41

42. What do comparative statics involve?
- a. comparisons of varying prices
 - b. evaluation of buyers' reluctance to pay the market price
 - c. comparing the old equilibrium and the new equilibrium
 - d. evaluating the friction that develops between buyers and sellers

ANS: C PTS: 1 DIF: Average REF: p.84
BLM: Remember NOT: Macro TB_4b-42

43. What is step one in the Three-Step program for analyzing changes in equilibrium?
- Decide which direction the curve shifts.
 - Decide whether the event shifts the supply or demand curve.
 - Use the supply-and-demand diagram to see how the shift changes the original equilibrium.
 - Analyze how equilibrium price and quantity have changed.

ANS: B PTS: 1 DIF: Easy REF: p.84-85
BLM: Remember NOT: Macro TB_4b-43

44. What will result from a decrease in resource costs to firms in a market?
- a decrease in equilibrium price and an increase in equilibrium quantity
 - a decrease in equilibrium price and a decrease in equilibrium quantity
 - an increase in equilibrium price and no change in equilibrium quantity
 - an increase in equilibrium price and an increase in equilibrium quantity

ANS: A PTS: 1 DIF: Challenging REF: p.84
BLM: Remember NOT: Macro TB_4b-44

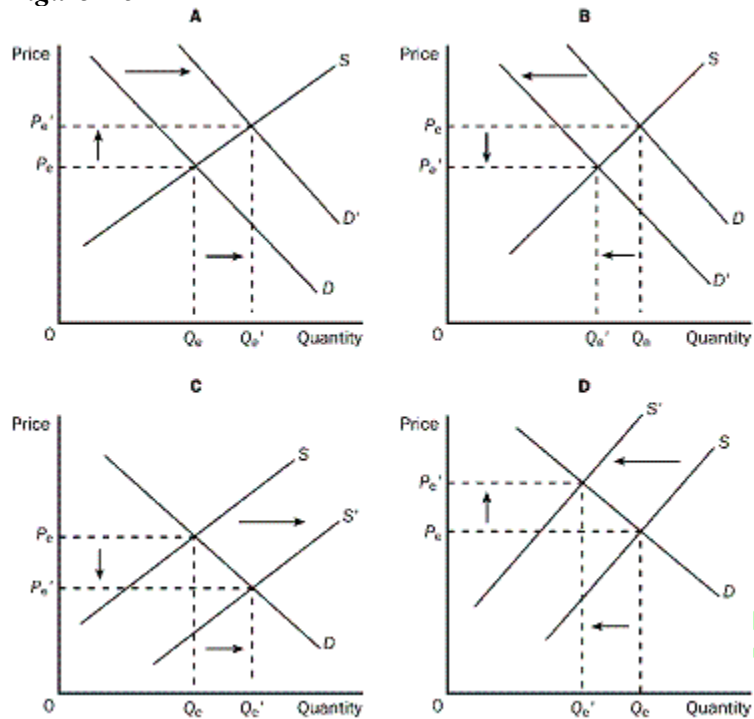
45. You have been asked by your economics professor to graph the market for lumber and then to analyze the change that would occur in equilibrium price as a result of recent forest fires in the West. What would your first step be?
- to decide which direction to shift the curve
 - to decide whether the fires affected demand or supply
 - to graph the shift to see the affect on equilibrium
 - to decide whether the fires shift demand or supply

ANS: D PTS: 1 DIF: Average REF: p.84
BLM: Remember NOT: Macro TB_4b-45

46. Which of the following is NOT one of the steps in analyzing how some event affects a market?
- Determine the number of market participants.
 - Decide whether the curve shifts to the right or to the left.
 - Determine whether the event shifts the supply, the demand, or both curves.
 - Use a supply-demand diagram to examine how the shift(s) affect the equilibrium.

ANS: A PTS: 1 DIF: Average REF: p.84
BLM: Remember NOT: Macro TB_4b-46

Figure 4-5



47. **Refer to Figure 4-5.** Which of the four graphs represents the market for peanut butter after a major hurricane hits the peanut-growing area?

a. graph A
b. graph B
c. graph C
d. graph D

ANS: D

PTS: 1

DIF: Average

REF: p.84-87

BLM: Higher Order

NOT: Macro TB_4b-47

48. **Refer to Figure 4-5.** Which of the four graphs represents the market for winter boots in June?

a. graph A
b. graph B
c. graph C
d. graph D

ANS: B

PTS: 1

DIF: Average

REF: p.84-87

BLM: Higher Order

NOT: Macro TB_4b-48

49. **Refer to Figure 4-5.** Which of the four graphs represents the market for pizza delivery in a university town in September?

a. graph A
b. graph B
c. graph C
d. graph D

ANS: A

PTS: 1

DIF: Average

REF: p.84-87

BLM: Higher Order

NOT: Macro TB_4b-49

50. **Refer to Figure 4-5.** Which of the four graphs represents the market for cars after new technology was installed on assembly lines?

- a. graph A
- b. graph B
- c. graph C
- d. graph D

ANS: C

PTS: 1

DIF: Average

REF: p.84-87

BLM: Higher Order

NOT: Macro TB_4b-50

51. **Refer to Figure 4-5.** Graph A shows which of the following?

- a. an increase in demand
- b. an increase in quantity demanded
- c. an increase in supply
- d. a decrease in consumer income.

ANS: A

PTS: 1

DIF: Easy

REF: p.84-87

BLM: Higher Order

NOT: Macro TB_4b-51

52. **Refer to Figure 4-5.** Graph C shows which of the following?

- a. an increase in demand
- b. an increase in quantity demanded
- c. an increase in supply
- d. an increase in input prices.

ANS: C

PTS: 1

DIF: Easy

REF: p.84-87

BLM: Higher Order

NOT: Macro TB_4b-52

53. **Refer to Figure 4-5.** Which of the four graphs shown illustrates an increase in quantity supplied?

- a. graph A
- b. graph B
- c. graph C
- d. graph D

ANS: A

PTS: 1

DIF: Easy

REF: p.84-87

BLM: Higher Order

NOT: Macro TB_4b-53

54. **Refer to Figure 4-5.** Which of the four graphs shown illustrates a decrease in quantity demanded?

- a. graph A
- b. graph B
- c. graph C
- d. graph D

ANS: D

PTS: 1

DIF: Easy

REF: p.84-87

BLM: Higher Order

NOT: Macro TB_4b-54

55. Which chain of events occurs in the correct order?

- a. quantity supplied increases, price increases, demand increases
- b. price increases, demand increases, quantity supplied increases
- c. demand increases, price increases, quantity supplied increases
- d. demand increases, quantity supplied increases, price increases.

ANS: C PTS: 1 DIF: Challenging REF: p.84-87
BLM: Remember NOT: Macro TB_4b-55

56. Suppose there is an earthquake that destroys several corn canneries. Which of the following would NOT occur as a direct result of this event?

- a. Sellers would not be willing to produce and sell as much as before at each relevant price.
- b. The supply would decrease.
- c. Buyers would not be willing to buy as much as before at each relevant price.
- d. The equilibrium price would rise.

ANS: C PTS: 1 DIF: Average REF: p.80
BLM: Higher Order NOT: Macro TB_4b-56

57. What would an early frost in the vineyards of the Okanagan Valley cause?

- a. an increase in the demand for wine, increasing price
- b. an increase in the supply of wine, decreasing price
- c. a decrease in the demand for wine, decreasing price
- d. a decrease in the supply of wine, increasing price

ANS: D PTS: 1 DIF: Average REF: p.84-87
BLM: Higher Order NOT: Macro TB_4b-57

58. Which of the following would definitely result in a higher price in the market for Snickers?

- a. demand increases and supply decreases
- b. demand and supply both decrease
- c. demand decreases and supply increases
- d. demand and supply both increase

ANS: A PTS: 1 DIF: Average REF: p.84-87
BLM: Higher Order NOT: Macro TB_4b-58

59. Which of the following will definitely cause equilibrium quantity to fall?

- a. demand increases and supply decreases
- b. demand and supply both decrease
- c. demand decreases and supply increases
- d. demand and supply both increase

ANS: B PTS: 1 DIF: Average REF: p.84-87
BLM: Remember NOT: Macro TB_4b-59

60. If the demand for a product increases, what would we expect?
- a. equilibrium price to increase and equilibrium quantity to decrease
 - b. equilibrium price to decrease and equilibrium quantity to increase
 - c. equilibrium price and equilibrium quantity to both increase
 - d. equilibrium price and equilibrium quantity to both decrease

ANS: C PTS: 1 DIF: Average REF: p.84-87
BLM: Remember NOT: Macro TB_4b-60

61. If the demand for a product decreases, what would we expect?
- a. equilibrium price to increase and equilibrium quantity to decrease
 - b. equilibrium price to decrease and equilibrium quantity to increase
 - c. equilibrium price and equilibrium quantity to both increase
 - d. equilibrium price and equilibrium quantity to both decrease

ANS: D PTS: 1 DIF: Average REF: p.84-87
BLM: Remember NOT: Macro TB_4b-61

62. If the supply of a product increases, what would we expect?
- a. equilibrium price to increase and equilibrium quantity to decrease
 - b. equilibrium price to decrease and equilibrium quantity to increase
 - c. equilibrium price and equilibrium quantity to both increase
 - d. equilibrium price and equilibrium quantity to both decrease

ANS: B PTS: 1 DIF: Average REF: p.84-87
BLM: Remember NOT: Macro TB_4b-62

63. If the supply of a product decreases, what would we expect?
- a. equilibrium price to increase and equilibrium quantity to decrease
 - b. equilibrium price to decrease and equilibrium quantity to increase
 - c. equilibrium price and equilibrium quantity to both increase
 - d. equilibrium price and equilibrium quantity to both decrease

ANS: A PTS: 1 DIF: Average REF: p.84-87
BLM: Remember NOT: Macro TB_4b-63

64. Suppose that the number of buyers in a market increases and a technological advancement occurs. What would we expect to happen in the market?
- a. The equilibrium price would increase, but the impact on the amount sold in the market would be ambiguous.
 - b. The equilibrium price would decrease, but the impact on the amount sold in the market would be ambiguous.
 - c. Equilibrium quantity would increase, but the impact on equilibrium price would be ambiguous.
 - d. Both equilibrium price and equilibrium quantity would increase.

ANS: C PTS: 1 DIF: Challenging REF: p.84-87
BLM: Higher Order NOT: Macro TB_4b-64

65. Suppose that the number of buyers in a market decreases and a technological advancement occurs. What would we expect to happen in the market?
- a. The equilibrium price would increase, but the impact on the amount sold in the market would be ambiguous.
 - b. The equilibrium price would decrease, but the impact on the amount sold in the market would be ambiguous.
 - c. Equilibrium quantity would increase, but the impact on equilibrium price would be ambiguous.
 - d. Both equilibrium price and equilibrium quantity would increase.

ANS: B PTS: 1 DIF: Challenging REF: p.84-87
BLM: Higher Order NOT: Macro TB_4b-65

66. Suppose that the incomes of buyers in a particular market for a normal good decrease and there is also a reduction in input prices. What would we expect to occur in this market?
- a. The equilibrium price would increase, but the impact on the amount sold in the market would be ambiguous.
 - b. The equilibrium price would decrease, but the impact on the amount sold in the market would be ambiguous.
 - c. Both equilibrium price and equilibrium quantity would increase.
 - d. Equilibrium quantity would increase, but the impact on equilibrium price would be ambiguous.

ANS: B PTS: 1 DIF: Challenging REF: p.84-87
BLM: Higher Order NOT: Macro TB_4b-66

67. Suppose that the incomes of buyers in a particular market for a normal good decrease and there is also an increase in input prices. What would we expect to occur in this market?
- a. The equilibrium price would increase, but the impact on the amount sold in the market would be ambiguous.
 - b. The equilibrium price would decrease, but the impact on the amount sold in the market would be ambiguous.
 - c. Equilibrium quantity would increase, but the impact on equilibrium price would be ambiguous.
 - d. Equilibrium quantity would decrease, but the impact on equilibrium price would be ambiguous.

ANS: D PTS: 1 DIF: Challenging REF: p.84-87
BLM: Higher Order NOT: Macro TB_4b-67

68. Suppose that the incomes of buyers in a particular market for a normal good increase and there is also a reduction in input prices. What would we expect to occur in this market?
- a. The equilibrium price would increase, but the impact on the amount sold in the market would be ambiguous.
 - b. The equilibrium price would decrease, but the impact on the amount sold in the market would be ambiguous.
 - c. Both equilibrium price and equilibrium quantity would increase.
 - d. Equilibrium quantity would increase, but the impact on equilibrium price would be ambiguous.

ANS: D PTS: 1 DIF: Challenging REF: p.84-87
BLM: Higher Order NOT: Macro TB_4b-68

69. Suppose that the incomes of buyers in a particular market for a normal good increase and there is also an increase in input prices. What would we expect to occur in this market?
- a. The equilibrium price would increase, but the impact on the amount sold in the market would be ambiguous.
 - b. The equilibrium price would decrease, but the impact on the amount sold in the market would be ambiguous.
 - c. Equilibrium quantity would increase, but the impact on equilibrium price would be ambiguous.
 - d. Equilibrium price would increase, but the impact on equilibrium quantity would be ambiguous.

ANS: D PTS: 1 DIF: Challenging REF: p.84-87
BLM: Higher Order NOT: Macro TB_4b-69

70. Suppose that demand decreases AND supply decreases. What would you expect to occur in the market for the good?
- a. Equilibrium price would increase, but the impact on equilibrium quantity would be ambiguous.
 - b. Equilibrium price would decrease, but the impact on equilibrium quantity would be ambiguous.
 - c. Equilibrium quantity would decrease, but the impact on equilibrium price would be ambiguous.
 - d. Both equilibrium price and equilibrium quantity would increase.

ANS: C PTS: 1 DIF: Challenging REF: p.84-87
BLM: Higher Order NOT: Macro TB_4b-70

71. Suppose that demand increases AND supply decreases. What would happen in the market for the good?
- a. Equilibrium price would decrease, but the impact on equilibrium quantity would be ambiguous.
 - b. Equilibrium price would increase, but the impact on equilibrium quantity would be ambiguous.
 - c. Both equilibrium price and quantity would increase.
 - d. Both equilibrium price and quantity would decrease.

ANS: B PTS: 1 DIF: Challenging REF: p.84-87
BLM: Higher Order NOT: Macro TB_4b-71

72. Which of the following would result in an increase in equilibrium price and an ambiguous change in equilibrium quantity?
- a. an increase in supply and demand
 - b. an increase in supply and a decrease in demand
 - c. a decrease in supply and an increase in demand
 - d. a decrease in supply and demand

ANS: C PTS: 1 DIF: Challenging REF: p.84-87
BLM: Remember NOT: Macro TB_4b-72

73. What would happen when supply and demand both increase?
- equilibrium price will increase
 - equilibrium price will decrease
 - equilibrium quantity may increase, decrease, or remain unchanged
 - equilibrium price may increase, decrease, or remain unchanged

ANS: D PTS: 1 DIF: Challenging REF: p.84-87
 BLM: Remember NOT: Macro TB_4b-73

Table 4-3

	An Increase in Supply	A Decrease in Supply
An Increase in Demand	A	B
A Decrease in Demand	C	D

74. **Refer to Table 4-3.** What is the space that would represent an increase in equilibrium quantity and an indeterminate change in equilibrium price?
- space A
 - space B
 - space C
 - space D

ANS: A PTS: 1 DIF: Challenging REF: p.84-87
 BLM: Higher Order NOT: Macro TB_4b-74

75. **Refer to Table 4-3.** What is the space that would represent an increase in equilibrium price and an indeterminate change in equilibrium quantity?
- space A
 - space B
 - space C
 - space D

ANS: B PTS: 1 DIF: Challenging REF: p.84-87
 BLM: Higher Order NOT: Macro TB_4b-75

76. **Refer to Table 4-3.** What is the space that would represent a decrease in equilibrium price and an indeterminate change in equilibrium quantity?
- space A
 - space B
 - space C
 - space D

ANS: C PTS: 1 DIF: Challenging REF: p.84-87
 BLM: Higher Order NOT: Macro TB_4b-76

77. **Refer to Table 4-3.** What is the space that would represent a decrease in equilibrium quantity and an indeterminate change in equilibrium price?

- a. space A
- b. space B
- c. space C
- d. space D

ANS: D

PTS: 1

DIF: Challenging REF: p.84-87

BLM: Higher Order

NOT: Macro TB_4b-77

78. Which of the following would cause both the equilibrium price and equilibrium quantity of number two grade potatoes (an inferior good) to increase?

- a. an increase in consumer income
- b. a decrease in consumer income
- c. greater government restrictions on agricultural chemicals
- d. fewer government restrictions on agricultural chemicals

ANS: B

PTS: 1

DIF: Challenging REF: p.84-87

BLM: Higher Order

NOT: Macro TB_4b-78

79. Which of the following would unambiguously cause a decrease in the equilibrium price of cotton shirts?

- a. an increase in the price of wool shirts and a decrease in the price of raw cotton
- b. a decrease in the price of wool shirts and a decrease in the price of raw cotton
- c. an increase in the price of wool shirts and an increase in the price of raw cotton
- d. a decrease in the price of wool shirts and an increase in the price of raw cotton

ANS: B

PTS: 1

DIF: Challenging REF: p.84-87

BLM: Higher Order

NOT: Macro TB_4b-79

80. What would happen to the equilibrium price and quantity of coffee if the wages of coffee-bean pickers fell and the price of tea fell?

- a. price will fall and the effect on quantity is ambiguous
- b. price will rise and the effect on quantity is ambiguous
- c. quantity will fall and the effect on price is ambiguous
- d. quantity will rise and the effect on price is ambiguous

ANS: A

PTS: 1

DIF: Challenging REF: p.84-87

BLM: Higher Order

NOT: Macro TB_4b-80

81. What would happen to the equilibrium price and quantity of coffee if the wages of coffee-bean pickers rose and the price of tea rose?

- a. price will fall and the effect on quantity is ambiguous
- b. price will rise and the effect on quantity is ambiguous
- c. quantity will fall and the effect on price is ambiguous
- d. quantity will rise and the effect on price is ambiguous

ANS: B

PTS: 1

DIF: Challenging REF: p.84-87

BLM: Higher Order

NOT: Macro TB_4b-81

82. New oak tables are normal goods. What would happen to the equilibrium price and quantity in the market for oak tables if the price of maple tables rises, the price of oak wood rises, more buyers enter the market for oak tables, and the price of wood saws increased?
- a. price will fall and the effect on quantity is ambiguous
 - b. price will rise and the effect on quantity is ambiguous
 - c. quantity will fall and the effect on price is ambiguous
 - d. quantity will rise and the effect on price is ambiguous

ANS: B PTS: 1 DIF: Challenging REF: p.84-87
BLM: Higher Order NOT: Macro TB_4b-82

83. New oak tables are normal goods. What would happen to the equilibrium price and quantity in the market for oak tables if the price of maple tables rises, the price of oak wood rises, some buyers exit the market for oak tables, and the price of wood saws increased?
- a. price will fall and the effect on quantity is ambiguous
 - b. price will rise and the effect on quantity is ambiguous
 - c. quantity will fall and the effect on price is ambiguous
 - d. quantity will rise and the effect on price is ambiguous

ANS: C PTS: 1 DIF: Challenging REF: p.84-87
BLM: Higher Order NOT: Macro TB_4b-83

84. What will happen to the equilibrium price and quantity of new cars if the price of gasoline rises, the price of steel rises, public transportation becomes cheaper and more comfortable, and auto workers negotiate higher wages?
- a. price will fall and the effect on quantity is ambiguous
 - b. price will rise and the effect on quantity is ambiguous
 - c. quantity will fall and the effect on price is ambiguous
 - d. quantity will rise and the effect on price is ambiguous

ANS: C PTS: 1 DIF: Challenging REF: p.84-87
BLM: Higher Order NOT: Macro TB_4b-84

85. What will happen to the equilibrium price and quantity of new cars if the price of gasoline falls, the price of steel falls, public transportation becomes more expensive and less comfortable, and the wages of auto workers decrease?
- a. price will fall and the effect on quantity is ambiguous
 - b. price will rise and the effect on quantity is ambiguous
 - c. quantity will fall and the effect on price is ambiguous
 - d. quantity will rise and the effect on price is ambiguous

ANS: D PTS: 1 DIF: Challenging REF: p.84-87
BLM: Higher Order NOT: Macro TB_4b-85

86. Music compact discs are normal goods. What will happen to the equilibrium price and quantity of music compact discs if musicians accept lower royalties, compact disc players become cheaper, more firms start producing music compact discs, and music lovers experience an increase in income?
- a. price will fall and the effect on quantity is ambiguous
 - b. price will rise and the effect on quantity is ambiguous
 - c. quantity will fall and the effect on price is ambiguous
 - d. quantity will rise and the effect on price is ambiguous

ANS: D PTS: 1 DIF: Challenging REF: p.84-87
BLM: Higher Order NOT: Macro TB_4b-86

87. Music compact discs are normal goods. What will happen to the equilibrium price and quantity of music compact discs if musicians receive higher royalties, compact disc players become more expensive, fewer firms produce music compact discs, and music lovers experience a decrease in income?
- a. price will fall and the effect on quantity is ambiguous
 - b. price will rise and the effect on quantity is ambiguous
 - c. quantity will fall and the effect on price is ambiguous
 - d. quantity will rise and the effect on price is ambiguous

ANS: C PTS: 1 DIF: Challenging REF: p.84-87
BLM: Higher Order NOT: Macro TB_4b-87

88. New cars are normal goods. What will happen to the equilibrium price of new cars if the price of gasoline rises, the price of steel falls, public transportation becomes cheaper and more comfortable, auto workers accept lower wages, and automobile insurance becomes more expensive?
- a. price will rise
 - b. price will fall
 - c. price will stay exactly the same
 - d. price change will be ambiguous

ANS: B PTS: 1 DIF: Challenging REF: p.84-87
BLM: Higher Order NOT: Macro TB_4b-88

89. New cars are normal goods. What will happen to the equilibrium price of new cars if the price of gasoline falls, the price of steel increases, public transportation becomes more expensive and less comfortable, auto workers receive higher wages, and automobile insurance becomes less expensive?
- a. price will rise
 - b. price will fall
 - c. price will stay exactly the same
 - d. price change will be ambiguous

ANS: A PTS: 1 DIF: Challenging REF: p.84-87
BLM: Higher Order NOT: Macro TB_4b-89

90. What will happen to the equilibrium price of new textbooks if more students attend university, paper becomes cheaper, textbook authors accept lower royalties, and fewer used textbooks are sold?
- a. price will rise
 - b. price will fall
 - c. price will stay exactly the same
 - d. price change will be ambiguous

ANS: D PTS: 1 DIF: Challenging REF: p.84-87
BLM: Higher Order NOT: Macro TB_4b-90

91. Consider the market for new DVDs. If DVD players became cheaper, buyers expected DVD prices to fall next year, used DVDs became more expensive, and DVD production technology improved, then what could we safely conclude would happen to the equilibrium price of a new DVD?
- a. It would rise.
 - b. It would fall.
 - c. It would stay the same.
 - d. We couldn't be sure what it might do.

ANS: D PTS: 1 DIF: Challenging REF: p.84-87
BLM: Higher Order NOT: Macro TB_4b-91

92. What would happen to the equilibrium price and quantity of peanut butter if the price of peanuts went up, the price of jelly (a complementary good) fell, fewer firms decided to produce peanut butter, and health officials announced that eating peanut butter was bad for you?
- a. price will fall and the effect on quantity is ambiguous
 - b. price will rise and the effect on quantity is ambiguous
 - c. quantity will fall and the effect on price is ambiguous
 - d. quantity will rise and the effect on price is ambiguous

ANS: C PTS: 1 DIF: Challenging REF: p.84-87
BLM: Higher Order NOT: Macro TB_4b-92

93. What would happen to the equilibrium price and quantity of peanut butter if the price of peanuts went up, the price of jelly (a complementary good) fell, fewer firms decided to produce peanut butter, and health officials announced that eating peanut butter was good for you?
- a. price will fall and the effect on quantity is ambiguous
 - b. price will rise and the effect on quantity is ambiguous
 - c. quantity will fall and the effect on price is ambiguous
 - d. effect on both price and quantity is ambiguous

ANS: D PTS: 1 DIF: Challenging REF: p.84-87
BLM: Higher Order NOT: Macro TB_4b-93

94. What would happen to the equilibrium price and quantity of peanut butter if the price of peanuts fell, the price of jelly (a complementary good) increased, more firms decided to produce peanut butter, and health officials announced that eating peanut butter was good for you?
- a. price will fall and the effect on quantity is ambiguous
 - b. price will rise and the effect on quantity is ambiguous
 - c. quantity will fall and the effect on price is ambiguous
 - d. quantity will increase and the effect on price is ambiguous

ANS: D PTS: 1 DIF: Challenging REF: p.84-87
BLM: Higher Order NOT: Macro TB_4b-94

95. What would happen to the equilibrium price and quantity of peanut butter if the price of peanuts fell, the price of jelly (a complementary good) increased, more firms decided to produce peanut butter, and health officials announced that eating peanut butter was bad for you?
- a. price will fall and the effect on quantity is ambiguous
 - b. quantity will fall and the effect on price is ambiguous
 - c. quantity will increase and the effect on price is ambiguous
 - d. effect on both price and quantity is ambiguous

ANS: D PTS: 1 DIF: Challenging REF: p.84-87
BLM: Higher Order NOT: Macro TB_4b-95

96. Pens are normal goods. What will happen to the equilibrium price of pens if the prices of pencils rises, consumers experience an increase in income, writing in ink becomes fashionable, people expect the price of pens to rise in the near future, the population increases, fewer firms manufacture pens, and the wages of pen-makers increase?
- a. price will rise
 - b. price will fall
 - c. price will stay exactly the same
 - d. price change will be ambiguous

ANS: A PTS: 1 DIF: Challenging REF: p.84-87
BLM: Higher Order NOT: Macro TB_4b-96

97. Pens are normal goods. What will happen to the equilibrium price of pens if the prices of pencils falls, consumers experience an increase in income, writing in ink becomes fashionable, people expect the price of pens to fall in the near future, the population increases, fewer firms manufacture pens, and the wages of pen-makers decrease?
- a. price will rise
 - b. price will fall
 - c. price will stay exactly the same
 - d. price change will be ambiguous

ANS: D PTS: 1 DIF: Challenging REF: p.84-87
BLM: Higher Order NOT: Macro TB_4b-97

98. Beef is a normal good. You observe that both the equilibrium price and quantity of beef has fallen over time. Which of the following would be most consistent with this observation?
- a. Consumers have experienced an increase in income and beef-production technology has improved.
 - b. The price of chicken has risen and the price of steak sauce has fallen.
 - c. Consumer tastes have changed so as to prefer beef less than before.
 - d. The demand curve for beef must be positively sloped.

ANS: C PTS: 1 DIF: Challenging REF: p.84-87
BLM: Higher Order NOT: Macro TB_4b-98

99. Beef is a normal good. You observe that both the equilibrium price and quantity of beef have risen over time. Which of the following would be most consistent with this observation?
- a. Consumers have experienced an increase in income and beef-production technology has improved.
 - b. The price of chicken has risen and the price of steak sauce has fallen.
 - c. Consumer tastes have changed so as to prefer beef less than before.
 - d. The demand curve for beef must be positively sloped.

ANS: B

PTS: 1

DIF: Challenging REF: p.84-87

BLM: Higher Order

NOT: Macro TB_4b-99

100. Which of the following would be most likely to increase the price of a new house?
- a. Higher wages for carpenters, higher wood prices, increases in consumer incomes, higher apartment rents, increases in population, and expectations of higher house prices in the future.
 - b. Lower wages for carpenters, lower wood prices, increases in consumer incomes, higher apartment rents, increases in population, and expectations of higher house prices in the future.
 - c. Lower wages for carpenters, higher wood prices, decreases in consumer incomes, higher apartment rents, decreases in population, and expectations of higher house prices in the future.
 - d. Lower wages for carpenters, lower wood prices, decreases in consumer incomes, lower apartment rents, decreases in population, and expectations of lower house prices in the future.

ANS: A

PTS: 1

DIF: Challenging REF: p.82

BLM: Higher Order

NOT: Macro TB_4b-100

101. Which of the following would be most likely to decrease the price of a new house?
- a. Higher wages for carpenters, higher wood prices, increases in consumer incomes, higher apartment rents, increases in population, and expectations of higher house prices in the future.
 - b. Higher wages for carpenters, lower wood prices, reductions in consumer incomes, lower apartment rents, decreases in population, and expectations of lower house prices in the future.
 - c. Lower wages for carpenters, higher wood prices, decreases in consumer incomes, higher apartment rents, decreases in population, and expectations of higher house prices in the future.
 - d. Lower wages for carpenters, lower wood prices, decreases in consumer incomes, lower apartment rents, decreases in population, and expectations of lower house prices in the future.

ANS: D

PTS: 1

DIF: Challenging REF: p.84-87

BLM: Higher Order

NOT: Macro TB_4b-101

102. What will happen to the equilibrium price and quantity of traditional camera film if traditional cameras become more expensive, digital cameras become cheaper, the cost of the resources needed to manufacture traditional film falls, and more firms decide to manufacture traditional film?
- a. price will fall and the effect on quantity is ambiguous
 - b. price will rise and the effect on quantity is ambiguous
 - c. quantity will fall and the effect on price is ambiguous
 - d. quantity will increase and the effect on price is ambiguous

ANS: A PTS: 1 DIF: Challenging REF: p.84-87
BLM: Higher Order NOT: Macro TB_4b-102

103. What will happen to the equilibrium price and quantity of traditional camera film if traditional cameras become less expensive, digital cameras become more expensive, the cost of the resources needed to manufacture traditional film increases, and fewer firms decide to manufacture traditional film?
- a. price will fall and the effect on quantity is ambiguous
 - b. price will rise and the effect on quantity is ambiguous
 - c. quantity will fall and the effect on price is ambiguous
 - d. quantity will increase and the effect on price is ambiguous

ANS: B PTS: 1 DIF: Challenging REF: p.84-87
BLM: Higher Order NOT: Macro TB_4b-103

104. Suppose that health officials have argued that eating too much beef might be harmful to human health. As a result, there has been a significant decrease in the amount of beef produced. Which of the following best explains the decrease in production?
- a. Beef producers, concerned about the health of their customers, decided to produce relatively less beef.
 - b. Government officials, concerned about consumer health, ordered beef producers to produce relatively less beef.
 - c. Individual consumers, concerned about their own health, decreased their demand for beef, which lowered the relative price of beef, making it less attractive to produce.
 - d. Anti-beef protesters have made it difficult for both buyers and sellers of beef to meet in the marketplace.

ANS: C PTS: 1 DIF: Challenging REF: p.84-87
BLM: Higher Order NOT: Macro TB_4b-104

105. What are the signals that guide the allocation of resources in a market economy?
- a. laws
 - b. buyers and sellers
 - c. property rights
 - d. prices

ANS: D PTS: 1 DIF: Easy REF: p.89
BLM: Remember NOT: Macro TB_4b-105

106. For market economies, which would NOT be correct?
- a. Prices guide economic decisions and thereby allocate scarce resources.
 - b. Prices ensure that quantity supplied and quantity demanded are in balance.
 - c. Prices ensure that anyone who wants a product can get it.
 - d. Prices influence how much of a good buyers choose to purchase and how much sellers choose to produce.

ANS: C PTS: 1 DIF: Average REF: p.89
BLM: Remember NOT: Macro TB_4b-106

The following questions support each other in the understanding of Market Demand. They should be answered in the order of which they appear.

107. **Market demand** is given as $Q_d = 200 - 3P$. Market supply is given as $Q_s = 2P + 100$. In a perfectly competitive equilibrium, what will be price and quantity traded in the market?
- a. price will be \$140 and quantity will be 20
 - b. price will be \$20 and quantity will be 140
 - c. price will be \$60 and quantity will be 20
 - d. price will be \$120 and quantity will be 340

ANS: B PTS: 1 DIF: Challenging REF: p.82-83
BLM: Higher Order NOT: Macro TB_4b-107

108. **Market demand** is given as $Q_d = 200 - 3P$. Market supply is given as $Q_s = 2P + 100$. What would result if the market price were \$30?
- a. a shortage of 110
 - b. a surplus of 110
 - c. a surplus of 50
 - d. a shortage of 50

ANS: C PTS: 1 DIF: Challenging REF: p.82-83
BLM: Higher Order NOT: Macro TB_4b-108

109. **Market demand** is given as $Q_d = 200 - 3P$. Market supply is given as $Q_s = 2P + 100$. What would result if the market price were \$15?
- a. a shortage of 25
 - b. a surplus of 25
 - c. a surplus of 130
 - d. a shortage of 130

ANS: A PTS: 1 DIF: Challenging REF: p.82-83
BLM: Higher Order NOT: Macro TB_4b-109

110. **Market demand** is given as $Q_d = 60 - P$. Market supply is given as $Q_s = 3P$. In a perfectly competitive equilibrium, what will be price and quantity traded in the market?
- a. price will be \$20 and quantity will be 40
 - b. price will be \$45 and quantity will be 15
 - c. price will be \$40 and quantity will be 20
 - d. price will be \$15 and quantity will be 45

ANS: D PTS: 1 DIF: Challenging REF: p.82-83
BLM: Higher Order NOT: Macro TB_4b-110

111. **Market demand** is given as $Q_d = 60 - P$. Market supply is given as $Q_s = 3P$. What would result if the market price were \$10?
- a. a shortage of 20
 - b. a surplus of 20
 - c. a surplus of 30
 - d. a shortage of 30

ANS: A PTS: 1
BLM: Higher Order

DIF: Challenging REF: p.82-83
NOT: Macro TB_4b-111

112. **Market demand** is given as $Q_d = 60 - P$. Market supply is given as $Q_s = 3P$. What would result if the market price were \$30?
- a. a shortage of 60
 - b. a surplus of 60
 - c. a surplus of 30
 - d. a shortage of 30

ANS: B PTS: 1
BLM: Higher Order

DIF: Challenging REF: p.82-83
NOT: Macro TB_4b-112

113. **Market demand** is given as $Q_d = 100 - 2P$. Market supply is given as $Q_s = P + 10$. In a perfectly competitive equilibrium, what will be price and quantity traded in the market?
- a. price will be \$25 and quantity will be 50
 - b. price will be \$40 and quantity will be 30
 - c. price will be \$30 and quantity will be 40
 - d. price will be \$35 and quantity will be 30

ANS: C PTS: 1
BLM: Higher Order

DIF: Challenging REF: p.82-83
NOT: Macro TB_4b-113

114. **Market demand** is given as $Q_d = 100 - 2P$. Market supply is given as $Q_s = P + 10$. What would result if the market price were \$20?
- a. a shortage of 30
 - b. a surplus of 60
 - c. a surplus of 30
 - d. a shortage of 60

ANS: A PTS: 1
BLM: Higher Order

DIF: Challenging REF: p.82-83
NOT: Macro TB_4b-114

115. **Market demand** is given as $Q_d = 100 - 2P$. Market supply is given as $Q_s = P + 10$. What would result if the market price were \$40?
- a. a shortage of 30
 - b. a surplus of 60
 - c. a surplus of 30
 - d. a shortage of 60

ANS: C PTS: 1
BLM: Higher Order

DIF: Challenging REF: p.82-83
NOT: Macro TB_4b-115

116. **Market demand** is given as $Q_d = 120 - P$. Market supply is given as $Q_s = 4P$. In a perfectly competitive equilibrium, what will be price and quantity traded in the market?
- a. price will be \$96 and quantity will be 25
 - b. price will be \$24 and quantity will be 96
 - c. price will be \$36 and quantity will be 84
 - d. price will be \$36 and quantity will be 83

ANS: B

PTS: 1

DIF: Challenging REF: p.82-83

BLM: Higher Order

NOT: Macro TB_4b-116

117. **Market demand** is given as $Q_d = 120 - P$. Market supply is given as $Q_s = 4P$. What would result if the market price were \$15?
- a. a shortage of 45
 - b. a surplus of 45
 - c. a surplus of 60
 - d. a shortage of 60

ANS: A

PTS: 1

DIF: Challenging REF: p.82-83

BLM: Higher Order

NOT: Macro TB_4b-117

118. **Market demand** is given as $Q_d = 120 - P$. Market supply is given as $Q_s = 4P$. What would result if the market price were \$35?
- a. a shortage of 85
 - b. a surplus of 85
 - c. a surplus of 55
 - d. a shortage of 55

ANS: C

PTS: 1

DIF: Challenging REF: p.82-83

BLM: Higher Order

NOT: Macro TB_4b-118

119. **Market demand** is given as $Q_d = 40 - 2P$. Market supply is given as $Q_s = 2P$. In a perfectly competitive equilibrium, what will be price and quantity traded in the market?
- a. price will be \$20 and quantity will be 10
 - b. price will be \$20 and quantity will be 40
 - c. price will be \$10 and quantity will be 20
 - d. price will be \$40 and quantity will be 20

ANS: C

PTS: 1

DIF: Challenging REF: p.82-83

BLM: Higher Order

NOT: Macro TB_4b-119

120. **Market demand** is given as $Q_d = 40 - 2P$. Market supply is given as $Q_s = 2P$. What would result if the market price were \$7?
- a. a shortage of 14
 - b. a surplus of 14
 - c. a surplus of 12
 - d. a shortage of 12

ANS: D

PTS: 1

DIF: Challenging REF: p.82-83

BLM: Higher Order

NOT: Macro TB_4b-120

121. **Market demand** is given as $Q_d = 40 - 2P$. Market supply is given as $Q_s = 2P$. What would result if the market price were \$13?
- a. a shortage of 14
 - b. a surplus of 14
 - c. a surplus of 12
 - d. a shortage of 12

ANS: C PTS: 1
BLM: Higher Order

DIF: Challenging REF: p.82-83
NOT: Macro TB_4b-121

122. **Market demand** is given as $Q_d = 300 - 6P$. Market supply is given as $Q_s = 4P$. In a perfectly competitive equilibrium, what will be price and quantity traded in the market?
- a. price will be \$20 and quantity will be 80
 - b. price will be \$120 and quantity will be 40
 - c. price will be \$100 and quantity will be 120
 - d. price will be \$30 and quantity will be 120

ANS: D PTS: 1
BLM: Higher Order

DIF: Challenging REF: p.82-83
NOT: Macro TB_4b-122

123. **Market demand** is given as $Q_d = 300 - 6P$. Market supply is given as $Q_s = 4P$. What would result if the market price were \$40?
- a. a shortage of 100
 - b. a surplus of 100
 - c. a surplus of 160
 - d. a shortage of 160

ANS: B PTS: 1
BLM: Higher Order

DIF: Challenging REF: p.82-83
NOT: Macro TB_4b-123

124. **Market demand** is given as $Q_d = 300 - 6P$. Market supply is given as $Q_s = 4P$. What would result if the market price were \$25?
- a. a shortage of 50
 - b. a surplus of 50
 - c. a surplus of 200
 - d. a shortage of 200

ANS: A PTS: 1
BLM: Higher Order

DIF: Challenging REF: p.82-83
NOT: Macro TB_4b-124

125. **Market demand** is given as $Q_d = 75 - P$. Market supply is given as $Q_s = 3P + 15$. In a perfectly competitive equilibrium, what will be price and quantity traded in the market?
- a. price will be \$60 and quantity will be 58
 - b. price will be \$15 and quantity will be 60
 - c. price will be \$60 and quantity will be 15
 - d. price will be \$15 and quantity will be 80

ANS: B PTS: 1
BLM: Higher Order

DIF: Challenging REF: p.82-83
NOT: Macro TB_4b-125

126. **Market demand** is given as $Q_d = 75 - P$. Market supply is given as $Q_s = 3P + 15$. What would result if the market price were \$10?

- a. a shortage of 20
- b. a surplus of 20
- c. a surplus of 45
- d. a shortage of 45

ANS: A PTS: 1

BLM: Higher Order

DIF: Challenging REF: p.82-83

NOT: Macro TB_4b-126

127. **Market demand** is given as $Q_d = 75 - P$. Market supply is given as $Q_s = 3P + 15$. What would result if the market price were \$25?

- a. a shortage of 45
- b. a surplus of 45
- c. a surplus of 40
- d. a shortage of 40

ANS: C PTS: 1

BLM: Higher Order

DIF: Challenging REF: p.82-83

NOT: Macro TB_4b-127

128. **Market demand** is given as $Q_d = 140 - 5P$. Market supply is given as $Q_s = 2P$. In a perfectly competitive equilibrium, what will be price and quantity traded in the market?

- a. price will be \$20 and quantity will be 40
- b. price will be \$120 and quantity will be 40
- c. price will be \$40 and quantity will be 120
- d. price will be \$40 and quantity will be 20

ANS: A PTS: 1

BLM: Higher Order

DIF: Challenging REF: p.82-83

NOT: Macro TB_4b-128

129. **Market demand** is given as $Q_d = 140 - 5P$. Market supply is given as $Q_s = 2P$. What would result if the market price were \$25?

- a. a shortage of 35
- b. a surplus of 35
- c. a surplus of 70
- d. a shortage of 70

ANS: B PTS: 1

BLM: Higher Order

DIF: Challenging REF: p.82-83

NOT: Macro TB_4b-129

130. **Market demand** is given as $Q_d = 140 - 5P$. Market supply is given as $Q_s = 2P$. What would result if the market price were \$5?

- a. a shortage of 35
- b. a surplus of 35
- c. a surplus of 105
- d. a shortage of 105

ANS: D PTS: 1

BLM: Higher Order

DIF: Challenging REF: p.82-83

NOT: Macro TB_4b-130

131. **Market demand** is given as $Q_d = 220 - 4P$. Market supply is given as $Q_s = 2P + 40$. In a perfectly competitive equilibrium, what will be price and quantity traded in the market?
- a. price will be \$100 and quantity will be 240
 - b. price will be \$30 and quantity will be 100
 - c. price will be \$45 and quantity will be 130
 - d. price will be \$130 and quantity will be 300

ANS: B

PTS: 1

DIF: Challenging REF: p.82-83

BLM: Higher Order

NOT: Macro TB_4b-131

132. **Market demand** is given as $Q_d = 220 - 4P$. Market supply is given as $Q_s = 2P + 40$. What would result if the market price were \$10?
- a. a shortage of 120
 - b. a surplus of 120
 - c. a surplus of 80
 - d. a shortage of 80

ANS: A

PTS: 1

DIF: Challenging REF: p.82-83

BLM: Higher Order

NOT: Macro TB_4b-132

133. **Market demand** is given as $Q_d = 220 - 4P$. Market supply is given as $Q_s = 2P + 40$. What would result if the market price were \$50?
- a. a shortage of 120
 - b. a surplus of 120
 - c. a surplus of 140
 - d. a shortage of 81400

ANS: B

PTS: 1

DIF: Challenging REF: p.82-83

BLM: Higher Order

NOT: Macro TB_4b-133

134. **Market demand** is given as $Q_d = 250 - .5P$. Market supply is given as $Q_s = 2P$. In a perfectly competitive equilibrium, what will be price and quantity traded in the market?
- a. price will be \$200 and quantity will be 150
 - b. price will be \$35 and quantity will be 70
 - c. price will be \$100 and quantity will be 200
 - d. price will be \$150 and quantity will be 300

ANS: C

PTS: 1

DIF: Challenging REF: p.82-83

BLM: Higher Order

NOT: Macro TB_4b-134

135. **Market demand** is given as $Q_d = 250 - .5P$. Market supply is given as $Q_s = 2P$. What would result if the market price were \$50?
- a. a shortage of 100
 - b. a surplus of 100
 - c. a surplus of 125
 - d. a shortage of 125

ANS: D

PTS: 1

DIF: Challenging REF: p.82-83

BLM: Higher Order

NOT: Macro TB_4b-135

136. **Market demand** is given as $Q_d = 250 - .5P$. Market supply is given as $Q_s = 2P$. What would result if the market price were \$140?

- a. a shortage of 100
- b. a surplus of 100
- c. a surplus of 280
- d. a shortage of 280

ANS: B PTS: 1

DIF: Challenging REF: p.82-83

BLM: Higher Order

NOT: Macro TB_4b-136

137. What are the forces that make market economies work?

- a. price and quantity
- b. demand and supply
- c. cost and benefit
- d. employment and income

ANS: B PTS: 1

DIF: Easy

REF: p.69

BLM: Remember NOT: Macro TB_4b-1

138. Which of the following are the words most commonly used by economists?

- a. surplus and shortage
- b. scarcity and human wants
- c. supply and demand
- d. price and quantity

ANS: C PTS: 1

DIF: Easy

REF: p.69

BLM: Remember NOT: Macro TB_4b-2

139. What could be one result of a cold snap in Florida?

- a. an increase in farm machinery prices
- b. an increase in the price of diesel fuel used in farming
- c. an increase in migrant farm workers' wages
- d. an increase in the price of oranges

ANS: D PTS: 1

DIF: Average

REF: p.69

BLM: Higher Order NOT: Macro TB_4b-3

140. In a free market, who determines how much of a good will be sold and the price at which it is sold?

- a. suppliers
- b. demanders
- c. the government
- d. suppliers and demanders together

ANS: D PTS: 1

DIF: Easy

REF: p.69

BLM: Remember NOT: Macro TB_4b-4

141. What is a market?
- a. a group of demanders and suppliers of a particular good or service
 - b. a group of people with common desires
 - c. a place where only sellers meet
 - d. a place where only buyers come together
- ANS: A PTS: 1 DIF: Easy REF: p.70
BLM: Remember NOT: Macro TB_4b-5
142. What is the term for the behaviour of people as they interact with one another in markets?
- a. economics
 - b. interaction
 - c. demand and supply
 - d. social psychology
- ANS: C PTS: 1 DIF: Easy REF: p.70
BLM: Remember NOT: Macro TB_4b-6
143. Which of the following is correct?
- a. Buyers determine supply and sellers determine demand.
 - b. Buyers determine demand and sellers determine supply.
 - c. Buyers and sellers as one group determine supply.
 - d. Buyers and sellers as one group determine demand.
- ANS: B PTS: 1 DIF: Average REF: p.70
BLM: Remember NOT: Macro TB_4b-7
144. For each good produced in a market economy, what do demand and supply determine?
- a. the price of the good, but not the quantity
 - b. the quantity of the good, but not the price
 - c. both price and quantity
 - d. neither price nor quantity is determined by demand and supply, because prices are ultimately set by producers.
- ANS: C PTS: 1 DIF: Average REF: p.70
BLM: Remember NOT: Macro TB_4b-8
145. What happens in a market economy?
- a. Demand is determined by supply.
 - b. Supply is determined by demand.
 - c. Price is determined by quantity.
 - d. Quantity is determined by price.
- ANS: D PTS: 1 DIF: Average REF: p.70
BLM: Remember NOT: Macro TB_4b-9

146. Who is it that ultimately determines the demand for a product or service?
- a. those who buy the product or service
 - b. the government
 - c. the producers who create the product or service
 - d. those who supply the raw materials used in the production of the good or service

ANS: A PTS: 1 DIF: Average REF: p.70
BLM: Remember NOT: Macro TB_4b-10

147. Who or what allocates an economy's scarce resources?
- a. economic planners
 - b. producers who use resources
 - c. prices for resources
 - d. government regulation of scarce resources

ANS: C PTS: 1 DIF: Average REF: p.70
BLM: Remember NOT: Macro TB_4b-11

148. What happens in a competitive market?
- a. There is only one seller of the product.
 - b. Each seller of the product is free to set the price of his product.
 - c. Each seller attempts to compete with other sellers, causing fewer sellers in the market.
 - d. There are so many buyers and sellers that each has a negligible impact on price.

ANS: D PTS: 1 DIF: Average REF: p.70
BLM: Remember NOT: Macro TB_4b-12

149. What happens in a competitive market?
- a. Only a few sellers sell the same product.
 - b. Each seller has limited control over the price of his product.
 - c. If one buyer chooses to purchase a large quantity of the product, the price will rise.
 - d. If one seller withholds his product from the market, prices will rise.

ANS: B PTS: 1 DIF: Average REF: p.70
BLM: Remember NOT: Macro TB_4b-13

150. In a competitive market, why does each seller have limited control over the price of his product?
- a. because other sellers are offering similar products
 - b. because in competitive markets, buyers have more influence over price than sellers
 - c. because the products sold in competitive markets are generally in abundant supply
 - d. because sellers in competitive markets prefer to meet and set a price that each will profit from

ANS: A PTS: 1 DIF: Average REF: p.70
BLM: Remember NOT: Macro TB_4b-14

151. For a competitive market, which of the following is true?
- a. A seller who charges more than the going price can increase her profit.
 - b. If a seller charges more than the going price, buyers will go elsewhere.
 - c. A seller often charges less than the going price to increase sales and profit.
 - d. A buyer can influence the price of the product, but only when purchasing from several sellers.

ANS: B PTS: 1 DIF: Average REF: p.70
BLM: Remember NOT: Macro TB_4b-15

152. Which of the following is NOT a characteristic of a perfectly competitive market?
- a. similar products
 - b. numerous sellers
 - c. market power
 - d. numerous buyers

ANS: C PTS: 1 DIF: Easy REF: p.70-71
BLM: Remember NOT: Macro TB_4b-16

153. In what type of market does price takers refer to buyers and sellers?
- a. a perfectly competitive market
 - b. a monopolistically competitive market
 - c. an oligopolistic market
 - d. a monopolistic market

ANS: A PTS: 1 DIF: Average REF: p.70-71
BLM: Remember NOT: Macro TB_4b-17

154. What is the term for buyers and sellers who have no influence on market price?
- a. price makers
 - b. market pawns
 - c. price takers
 - d. powerless

ANS: C PTS: 1 DIF: Easy REF: p.70-71
BLM: Remember NOT: Macro TB_4b-18

155. Why does market price prevail in a perfectly competitive market?
- a. because there are wealthy buyers
 - b. because the market is unregulated
 - c. because there are distinctive products
 - d. because no one has market power

ANS: D PTS: 1 DIF: Easy REF: p.70-71
BLM: Remember NOT: Macro TB_4b-19

156. What is an example of a perfectly competitive market?

- a. cable TV market
- b. soybean market
- c. new car market
- d. blue jean market

ANS: B PTS: 1 DIF: Average REF: p.70-71
BLM: Higher Order NOT: Macro TB_4b-20

157. What would the market for ice cream generally be considered?

- a. a monopolistic market
- b. a competitive market
- c. more organized than an auction
- d. a market where individual sellers have significant pricing power

ANS: B PTS: 1 DIF: Easy REF: p.70-71
BLM: Higher Order NOT: Macro TB_4b-21

158. If a seller in a competitive market chooses to charge more than the market price, what would happen?

- a. Buyers would tend to buy more from this seller.
- b. The owners of the raw materials used in production would raise the prices for the raw materials.
- c. Other sellers would also raise their price.
- d. Buyers will tend to make purchases from other sellers.

ANS: D PTS: 1 DIF: Average REF: p.70-71
BLM: Higher Order NOT: Macro TB_4b-22

159. If buyers and/or sellers are price takers, what can they do individually?

- a. They have no influence on market price.
- b. They have ultimate control over market price.
- c. Buyers will be able to find prices lower than those determined in the market.
- d. They can somewhat influence the market price.

ANS: A PTS: 1 DIF: Average REF: p.70-71
BLM: Remember NOT: Macro TB_4b-23

160. There are thousands of wheat farmers who produce and sell wheat and there are millions of consumers who use wheat and wheat products. What would the market for wheat be considered?

- a. oligopolistic
- b. monopolistic
- c. perfectly competitive
- d. monopolistically competitive

ANS: C PTS: 1 DIF: Easy REF: p.70-71
BLM: Higher Order NOT: Macro TB_4b-24

161. What type of market is a monopoly?

- a. with one seller
- b. with few sellers
- c. with one buyer
- d. with many buyers

ANS: A PTS: 1 DIF: Easy REF: p.71
BLM: Remember NOT: Macro TB_4b-25

162. Which of the following would be an example of a monopoly?

- a. a bakery in a large city
- b. local cement companies
- c. a local cable television company
- d. a potato farmer

ANS: C PTS: 1 DIF: Easy REF: p.71
BLM: Remember NOT: Macro TB_4b-26

163. What represents the behaviour of buyers?

- a. demand
- b. supply
- c. a market
- d. competition

ANS: A PTS: 1 DIF: Easy REF: p.68
BLM: Remember NOT: Macro TB_4b-27

164. What is the amount of the good buyers are willing and able to purchase?

- a. demand
- b. quantity supplied
- c. quantity demanded
- d. supply

ANS: C PTS: 1 DIF: Average REF: p.71
BLM: Remember NOT: Macro TB_4b-28

165. Alyssa rents 5 movies per month when the price is \$3.00 each and 7 movies per month when the price is \$2.50. What has Alyssa demonstrated?

- a. law of price
- b. law of supply
- c. actions of an irrational consumer
- d. law of demand

ANS: D PTS: 1 DIF: Average REF: p.71
BLM: Higher Order NOT: Macro TB_4b-29

166. What does the law of demand imply?

- a. price and quantity supplied are inversely related
- b. price and quantity demanded are inversely related
- c. price and quantity demanded are positively related
- d. price and quantity supplied are positively related

ANS: B PTS: 1 DIF: Average REF: p.71
BLM: Remember NOT: Macro TB_4b-30

167. What does the law of demand imply?

- a. When price rises, quantity demanded falls.
- b. When price rises, quantity demanded rises also.
- c. When price falls, quantity supplied rises.
- d. When price falls, quantity supplied falls also.

ANS: A PTS: 1 DIF: Average REF: p.71
BLM: Remember NOT: Macro TB_4b-31

168. Which of the following demonstrates the law of demand?

- a. Jon buys more pretzels at \$1.50 each since he got a \$1 raise at work.
- b. Melissa buys fewer muffins at \$0.75 each than at \$1 each.
- c. Dave buys more donuts at \$0.25 each than at \$0.50 each.
- d. Kendra buys fewer Snickers at \$0.60 each since the price of Milky Ways fell to \$0.50 each.

ANS: C PTS: 1 DIF: Average REF: p.71
BLM: Higher Order NOT: Macro TB_4b-32

169. What impact would a higher price for batteries tend to have?

- a. increase the demand for flashlights
- b. increase the demand for electricity
- c. decrease the demand for electricity
- d. increase the demand for batteries

ANS: B PTS: 1 DIF: Average REF: p.71
BLM: Higher Order NOT: Macro TB_4b-33

170. What is the law of demand?

- a. When the price of a good falls, buyers respond by purchasing more.
- b. When income levels increase, buyers respond by purchasing more.
- c. When buyers' tastes for the good increase, they purchase more of the good.
- d. When the price of a good or service rises, buyers respond by purchasing more.

ANS: A PTS: 1 DIF: Easy REF: p.71
BLM: Remember NOT: Macro TB_4b-34

171. Which of the following reflects the downward-sloping demand curve?
- a. Price is positively related to quantity supplied.
 - b. There is an inverse relationship between price and quantity demanded.
 - c. There is a direct relationship between price and quantity demanded.
 - d. When the price falls, buyers willingly buy less.

ANS: B PTS: 1 DIF: Average REF: p.71-72
BLM: Remember NOT: Macro TB_4b-35

172. What is a table called that shows the relationship between the price of a good and the quantity demanded?
- a. demand table
 - b. demand schedule
 - c. price-quantity table
 - d. quantity demanded schedule

ANS: B PTS: 1 DIF: Easy REF: p.72
BLM: Remember NOT: Macro TB_4b-36

173. Which best describes the relationship shown by a demand table?
- a. the price of a good and the quantity supplied.
 - b. income and the quantity of the good demanded.
 - c. the price of a good and the quantity buyers are willing and able to purchase.
 - d. the determinants of demand and the quantity demanded.

ANS: C PTS: 1 DIF: Easy REF: p.72
BLM: Remember NOT: Macro TB_4b-37

174. How do the variables price and quantity demanded relate to each other?
- a. Price and quantity demanded are independent of each other.
 - b. Price is the dependent variable and quantity demanded is the independent variable.
 - c. Price is the independent variable and quantity demanded is the dependent variable.
 - d. Price and quantity demanded are both dependent variables, since both depend on the actions of buyers and sellers.

ANS: C PTS: 1 DIF: Challenging REF: p.73
BLM: Remember NOT: Macro TB_4b-38

175. How is a demand curve constructed?
- a. Demand is on the vertical axis and quantity is on the horizontal axis.
 - b. Price is on the horizontal axis and quantity is on the vertical axis.
 - c. Price is on the vertical axis and demand is on the horizontal axis.
 - d. Price is on the vertical axis and quantity is on the horizontal axis.

ANS: D PTS: 1 DIF: Easy REF: p.73
BLM: Remember NOT: Macro TB_4b-39

176. What is the downward-sloping line that relates prices and quantity demanded?
- a. demand schedule
 - b. demand curve
 - c. quantity demanded line
 - d. quantity demanded curve

ANS: B PTS: 1 DIF: Easy REF: p.73
BLM: Remember NOT: Macro TB_4b-40

177. What does a demand curve illustrate?
- a. the tradeoff between inflation and unemployment
 - b. the positive relationship between price and quantity demanded
 - c. the negative relationship between price and quantity demanded
 - d. the maximum quantity of two goods an economy is capable of producing with available resources and technology

ANS: C PTS: 1 DIF: Average REF: p.73
BLM: Remember NOT: Macro TB_4b-41

178. What is a demand curve?
- a. the downward-sloping line relating the price of the good to the quantity demanded
 - b. the upward-sloping line relating price to quantity supplied
 - c. the curve that relates income to quantity demanded
 - d. showing the same relationship between two goods as a production possibilities frontier

ANS: A PTS: 1 DIF: Average REF: p.72-73
BLM: Remember NOT: Macro TB_4b-42

179. What is the sum of all individual demand curves for a product?
- a. total demand
 - b. consumption demand
 - c. summation demand
 - d. market demand

ANS: D PTS: 1 DIF: Easy REF: p.72-73
BLM: Remember NOT: Macro TB_4b-43

180. What is the market demand?
- a. the sum of all individual demands
 - b. the demand for every product in an industry
 - c. the average quantity demanded at each price
 - d. difficult to determine and is generally an estimation for most markets

ANS: A PTS: 1 DIF: Easy REF: p.73
BLM: Remember NOT: Macro TB_4b-44

181. To find the market demand for a product, how are individual demand curves summed?
- a. vertically
 - b. diagonally
 - c. horizontally
 - d. by averaging

ANS: C PTS: 1 DIF: Easy REF: p.73
BLM: Remember NOT: Macro TB_4b-45

182. What is market demand?
- a. It is a vertical summation of individual demand curves.
 - b. It is a horizontal summation of individual demand curves.
 - c. It is not responsive to change in tastes and preferences.
 - d. It is determined solely by the number of buyers and sellers in the market.

ANS: B PTS: 1 DIF: Easy REF: p.73
BLM: Remember NOT: Macro TB_4b-46

183. What does a market demand curve reflect?
- a. how much all buyers are willing and able to buy at each possible price
 - b. how quantity demanded changes when the number of buyers changes
 - c. the fact that the level of income is inversely related to quantity demanded
 - d. when the buyers are willing to buy the most

ANS: A PTS: 1 DIF: Average REF: p.73
BLM: Remember NOT: Macro TB_4b-47

184. Which of the following would NOT affect an individual's demand curve?
- a. expectations
 - b. income
 - c. price of related goods
 - d. the number of buyers

ANS: D PTS: 1 DIF: Easy REF: p.73
BLM: Higher Order NOT: Macro TB_4b-48

185. What does the number of buyers in a market affect?
- a. the market demand for a good
 - b. individual demand curves for a good
 - c. both individual demand curves and the market demand for a good
 - d. neither individual nor market demand

ANS: A PTS: 1 DIF: Average REF: p.73
BLM: Remember NOT: Macro TB_4b-49

Table 4-1

The table shows individual demand schedules for a market.

Price of the Good	Aaron	Angela	Austin	Alyssa
\$0.00	20	16	10	8
0.50	18	12	6	6
1.00	14	10	2	5
1.50	12	8	0	4
2.00	6	6	0	2
2.50	0	4	0	0

186. **Refer to Table 4-1.** When the price of the good is \$1.00, what is the quantity demanded in this market?
- 42 units
 - 31 units
 - 24 units
 - 14 units

ANS: B PTS: 1 DIF: Average REF: p.73
BLM: Higher Order NOT: Macro TB_4b-50

187. **Refer to Table 4-1.** What happens if the price increases from \$1.00 to \$1.50?
- The market demand increases by 20 units.
 - The quantity demanded in the market decreases by 2 units.
 - Individual demands will increase.
 - The quantity demanded in the market decreases by 7 units.

ANS: D PTS: 1 DIF: Average REF: p.73
BLM: Higher Order NOT: Macro TB_4b-51

188. When economists are interested in how markets work, what do they most often work with?
- the market demand curve
 - individuals' demand curves
 - individuals' demand schedules
 - targeted consumers' demand curves

ANS: A PTS: 1 DIF: Easy REF: p.73
BLM: Remember NOT: Macro TB_4b-52

189. Which of the following would NOT be a determinant of demand?
- the price of related goods
 - income
 - expectations
 - the prices of the inputs used to produce the good

ANS: D PTS: 1 DIF: Easy REF: p.75
BLM: Remember NOT: Macro TB_4b-53

190. Which of the following is NOT a determinant of demand?

- a. tastes
- b. technology
- c. income
- d. the price of related goods

ANS: B PTS: 1 DIF: Easy REF: p.75
BLM: Remember NOT: Macro TB_4b-54

191. If a good is "normal," what will an increase in income result in?

- a. no change in the demand for the good
- b. an increase in the demand for the good
- c. a decrease in the demand for the good
- d. a lower market price

ANS: B PTS: 1 DIF: Average REF: p.74
BLM: Remember NOT: Macro TB_4b-55

192. If Francis receives a decrease in his pay, what would we expect?

- a. Francis's demand for each good he purchases to remain unchanged
- b. Francis's demand for normal goods to increase
- c. Francis's demand for luxury goods to increase
- d. Francis's demand for inferior goods to increase

ANS: D PTS: 1 DIF: Average REF: p.74
BLM: Higher Order NOT: Macro TB_4b-56

193. If Francis receives an increase in his pay, what would we expect?

- a. Francis's demand for each good he purchases to remain unchanged
- b. Francis's demand for normal goods to decrease
- c. Francis's demand for luxury goods to increase
- d. Francis's demand for inferior goods to increase

ANS: C PTS: 1 DIF: Average REF: p.74
BLM: Higher Order NOT: Macro TB_4b-57

194. On what basis is a good considered either a normal good or an inferior good?

- a. the quality of the good
- b. the price of the good
- c. personal preference toward the good
- d. the amount of a person's income

ANS: C PTS: 1 DIF: Average REF: p.74
BLM: Higher Order NOT: Macro TB_4b-58

195. You lose your job and as a result, you buy fewer mystery books. What does this show that you consider mystery books to be?

- a. a normal good
- b. an inferior good
- c. a luxury good
- d. a complementary good

ANS: A PTS: 1

DIF: Average REF: p.74

BLM: Higher Order

NOT: Macro TB_4b-59

196. Currently you purchase 6 packages of hot dogs a month. You graduate in December and will start your new job on January 2. You have no plans to purchase hot dogs in January. What are hot dogs for you?

- a. a "college-only" good
- b. a normal good
- c. an inferior good
- d. a consumer good

ANS: C PTS: 1

DIF: Average REF: p.74

BLM: Higher Order

NOT: Macro TB_4b-60

197. What is an example of an inferior good?

- a. neckties
- b. one ply toilet paper
- c. cloth napkins
- d. cut flowers

ANS: B PTS: 1

DIF: Easy REF: p.74

BLM: Higher Order

NOT: Macro TB_4b-61

198. If a decrease in income increases the demand for a good, what is the good called?

- a. a substitute good
- b. a complementary good
- c. a normal good
- d. an inferior good

ANS: D PTS: 1

DIF: Average REF: p.74

BLM: Remember NOT: Macro TB_4b-62

199. If the price of a substitute to good X increases, what will happen?

- a. Demand for good X will decrease.
- b. Market price of good X will decrease.
- c. Demand for good X will increase.
- d. Quantity demanded for good X will increase.

ANS: C PTS: 1

DIF: Average REF: p.74-75

BLM: Higher Order

NOT: Macro TB_4b-63

200. Suppose that a decrease in the price of X results in less of good Y sold. What are X and Y called?
- a. complementary goods
 - b. normal goods
 - c. inferior goods
 - d. substitute goods

ANS: D PTS: 1 DIF: Challenging REF: p.74-75
BLM: Higher Order NOT: Macro TB_4b-64

201. Complete the following: Two goods are substitutes if a decrease in the price of one good
- a. increases the demand for the other good.
 - b. reduces the demand for the other good.
 - c. reduces the quantity demanded of the other good.
 - d. increases the quantity demanded of the other good.

ANS: B PTS: 1 DIF: Challenging REF: p.74-75
BLM: Higher Order NOT: Macro TB_4b-65

202. Complete the following: Two goods are complements if a decrease in the price of one good
- a. increases the quantity demanded of the other good.
 - b. reduces the demand for the other good.
 - c. reduces the quantity demanded of the other good.
 - d. raises the demand for the other good.

ANS: D PTS: 1 DIF: Challenging REF: p.74-75
BLM: Higher Order NOT: Macro TB_4b-66

203. What is an example of complementary goods?
- a. hamburgers and hot dogs
 - b. lawnmowers and automobiles
 - c. hamburgers and fries
 - d. wine and beer

ANS: C PTS: 1 DIF: Average REF: p.74-75
BLM: Higher Order NOT: Macro TB_4b-67

204. If goods A and B are complements, what will result from an increase in the price of A?
- a. more of good A sold
 - b. more of good B sold
 - c. less of good B sold
 - d. no difference in the quantity sold of either good

ANS: C PTS: 1 DIF: Average REF: p.74-75
BLM: Higher Order NOT: Macro TB_4b-68

205. What is an example of substitute goods?

- a. butter and margarine
- b. tennis balls and tennis rackets
- c. televisions and tractors
- d. peanut butter and jelly

ANS: A PTS: 1

DIF: Average REF: p.75

BLM: Higher Order

NOT: Macro TB_4b-69

206. Holding all else constant, what will result from a higher price for ski lift tickets?

- a. increased number of skiers
- b. decreased supply of ski resorts
- c. decreased demand for other winter recreational activities
- d. decreased ski sales

ANS: D PTS: 1

DIF: Average REF: p.74-75

BLM: Higher Order

NOT: Macro TB_4b-70

207. For economists, what are people's tastes and demand?

- a. beyond the realm of economics
- b. negatively related
- c. not related
- d. positively related

ANS: D PTS: 1

DIF: Average REF: p.75

BLM: Remember NOT: Macro TB_4b-71

208. When it comes to people's tastes, what do economists generally believe?

- a. Tastes are based on forces beyond the realm of economics.
- b. Tastes are based on historical and psychological forces.
- c. Tastes can only be studied through well-constructed, real-life models.
- d. Since tastes do not directly affect demand, there is little need to explain people's tastes.

ANS: B PTS: 1

DIF: Average REF: p.75

BLM: Remember NOT: Macro TB_4b-72

209. What can be said about economists in general?

- a. they do not try to explain people's tastes, but do try to explain what happens when tastes change.
- b. they must be able to explain people's tastes to explain what happens when tastes change.
- c. they do not believe that people's tastes determine demand and therefore ignore the subject of tastes.
- d. they believe that tastes and demand move in opposite directions.

ANS: A PTS: 1

DIF: Average REF: p.75

BLM: Remember NOT: Macro TB_4b-73

210. What impact does a person's expectations about the future have?

- a. cannot affect demand because expectations change
- b. can affect future demand
- c. can affect current demand
- d. cannot shift a demand curve

ANS: C PTS: 1 DIF: Average REF: p.75-76
BLM: Remember NOT: Macro TB_4b-74

211. You love peanut butter. You hear on the news that 50% of the peanut crop in North America has been wiped out, which will cause the price to double by the end of the year. What happens as a result?

- a. Your demand for peanut butter will increase by the end of the year.
- b. Your demand for peanut butter increases today.
- c. Your demand for peanut butter falls as you look for a substitute good.
- d. You decide to give up peanut butter completely.

ANS: B PTS: 1 DIF: Average REF: p.75-76
BLM: Higher Order NOT: Macro TB_4b-75

212. You have decided to purchase a new Mustang convertible. A friend tells you that Ford will be offering a \$3000 rebate on Mustangs starting next month. As a result of this information, what will happen to your demand curve for Mustangs?

- a. could shift either right or left
- b. shifts right today
- c. curve will be unaffected
- d. shifts left today

ANS: D PTS: 1 DIF: Average REF: p.75-76
BLM: Higher Order NOT: Macro TB_4b-76

213. You have decided to purchase a new Mustang convertible. A friend tells you that Ford will stop offering a \$3000 rebate on Mustangs starting next month. As a result of this information, what will happen to your demand curve for Mustangs?

- a. could shift either right or left
- b. shifts right today
- c. curve will be unaffected
- d. shifts left today

ANS: B PTS: 1 DIF: Average REF: p.75-76
BLM: Higher Order NOT: Macro TB_4b-77

214. Which of the following is NOT a determinant of demand?

- a. the price of a resource
- b. the price of a complementary good
- c. the price of the good next month
- d. the price of a substitute good

ANS: A PTS: 1 DIF: Easy REF: p.75
BLM: Remember NOT: Macro TB_4b-78

215. What will happen in the rice market if buyers are expecting higher prices in the near future?
- a. The demand for rice will increase.
 - b. The demand for rice will decrease.
 - c. The demand for rice will be unaffected.
 - d. The supply of rice will increase.

ANS: A PTS: 1 DIF: Average REF: p.75-76
BLM: Higher Order NOT: Macro TB_4b-79

216. Which of the following would NOT shift the demand curve for a good or service?
- a. a change in income
 - b. a change in the price of the good or service
 - c. a change in expectations about the price of the good or service
 - d. a change in the price of a related good

ANS: B PTS: 1 DIF: Average REF: p.75-76
BLM: Remember NOT: Macro TB_4b-80

217. Morgan tells you that the price of DVDs at the video store will be going up next week. How will you probably respond?
- a. by decreasing your current demand for DVDs
 - b. by increasing your current demand for DVDs.
 - c. by not changing your current demand for DVDs
 - d. by refusing to ever buy any more DVDs at that store

ANS: B PTS: 1 DIF: Average REF: p.75-76
BLM: Higher Order NOT: Macro TB_4b-81

218. Ryan tells you that he thinks the price of potato chips, his favourite food, will decrease in the near future. How will he probably respond?
- a. by decreasing his current demand for chips
 - b. by not changing his current demand for chips
 - c. by increasing his current demand for chips
 - d. by currently refusing to buy any more chips

ANS: A PTS: 1 DIF: Average REF: p.75-76
BLM: Higher Order NOT: Macro TB_4b-82

219. If the number of buyers in the market decreases, what will happen?
- a. Demand in the market will increase.
 - b. Demand in the market will decrease.
 - c. Supply in the market will increase.
 - d. Supply in the market will decrease.

ANS: B PTS: 1 DIF: Average REF: p.75-76
BLM: Higher Order NOT: Macro TB_4b-83

220. Suppose that the Canadian Medical Association announces that men who shave their heads are less likely to die of heart failure. What could we expect to happen?
- a. the current demand for hair gel to increase
 - b. the current demand for razors to increase
 - c. the current demand for combs to increase
 - d. the current demand for hair dye for men to increase

ANS: B PTS: 1 DIF: Average REF: p.75
BLM: Higher Order NOT: Macro TB_4b-84

221. Suppose that scientists find evidence that proves chocolate pudding lowers cholesterol. What would we expect to see?
- a. no change in the demand for chocolate pudding
 - b. a decrease in the demand for chocolate pudding
 - c. an increase in the demand for chocolate pudding
 - d. a decrease in the supply of chocolate pudding

ANS: C PTS: 1 DIF: Average REF: p.75
BLM: Higher Order NOT: Macro TB_4b-85

222. If buyers now wanted to purchase larger quantities of Vanilla Coke, what do we know about its demand curve?
- a. The demand curve for Vanilla Coke would shift to the left.
 - b. We would move down the demand curve for Vanilla Coke.
 - c. The demand curve for Vanilla Coke would shift to the right.
 - d. We would move up the demand curve for Vanilla Coke.

ANS: C PTS: 1 DIF: Average REF: p.75
BLM: Higher Order NOT: Macro TB_4b-86

223. Once the demand curve for a product or service is drawn, what is possible?
- a. It can shift either right or left.
 - b. It remains stable over time at a given price.
 - c. It can shift if the price changes.
 - d. It can only be accurate at one price.

ANS: A PTS: 1 DIF: Average REF: p.75
BLM: Remember NOT: Macro TB_4b-87

224. What happens when the price of a good or service changes?
- a. Supply shifts in the opposite direction.
 - b. Demand shifts in the opposite direction.
 - c. Demand shifts in the same direction.
 - d. There is a movement along a stable demand curve.

ANS: D PTS: 1 DIF: Average REF: p.75-76
BLM: Remember NOT: Macro TB_4b-88

225. Suppose that Carolyn receives a pay increase. What would we expect?

- a. Carolyn's demand for normal goods to remain unchanged.
- b. Carolyn's demand for inferior goods to decrease.
- c. Carolyn's demand for luxury goods to decrease.
- d. Carolyn's demand for normal goods to decrease.

ANS: B PTS: 1 DIF: Average REF: p.75-76
BLM: Higher Order NOT: Macro TB_4b-89

226. Nancy likes pasta today more than she did yesterday. What do we know?

- a. Nancy must now consider pasta a luxury.
- b. Nancy must have received an increase in income.
- c. Nancy is now willing to pay more than before for pasta.
- d. The supply of pasta must have increased.

ANS: C PTS: 1 DIF: Average REF: p.75-76
BLM: Higher Order NOT: Macro TB_4b-90

227. What will happen to the demand curve for lemonade in a very hot summer in Toronto?

- a. It will shift to the left.
- b. It will shift to the right.
- c. It will remain stable but we would move down the curve.
- d. It will remain stable but we would move up the curve.

ANS: B PTS: 1 DIF: Average REF: p.75
BLM: Higher Order NOT: Macro TB_4b-91

228. If a study by the CMA found that brown sugar caused weight loss while white sugar caused weight gain, what would we see?

- a. an increase in demand for brown sugar and a decrease in demand for white sugar
- b. no change in either demand because weight loss is not a nonprice determinant of demand
- c. an increase in demand for brown sugar, but no change in the demand for white sugar.
- d. a decrease in the demand for white sugar, but no change in the demand for brown sugar

ANS: A PTS: 1 DIF: Challenging REF: p.75
BLM: Higher Order NOT: Macro TB_4b-92

229. Kingston is a small college city in Ontario. What happens to the market demand curve for fast food in Kingston at the end of August each year?

- a. It shifts right.
- b. It shifts left.
- c. It remains constant, but moves down the curve.
- d. It remains constant, but moves up the curve.

ANS: A PTS: 1 DIF: Average REF: p.75
BLM: Higher Order NOT: Macro TB_4b-93

230. What will a country with an aging population generally experience?
- a. no change in either market demand or individual demand for prescription drugs
 - b. a decrease in the market demand for prescription drugs
 - c. an increase in individual demand for prescription drugs, but no change in market demand
 - d. an increase in the market demand for prescription drugs

ANS: D PTS: 1 DIF: Average REF: p.75
BLM: Higher Order NOT: Macro TB_4b-94

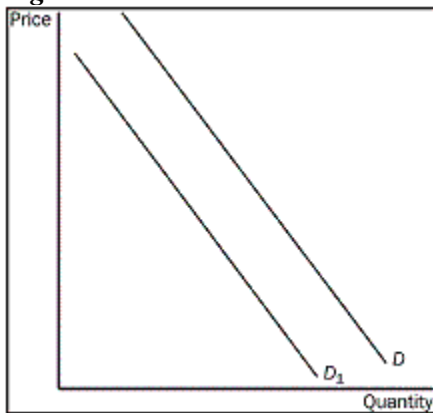
231. What would result from an increase in the number of scholarships issued for university education?
- a. an increase the supply of education
 - b. a decrease the supply of education
 - c. an increase the demand for education
 - d. a decrease the demand for education

ANS: C PTS: 1 DIF: Average REF: p.75
BLM: Higher Order NOT: Macro TB_4b-95

232. What might be the reason when quantity demanded has increased at every price?
- a. The number of buyers in the market has decreased.
 - b. Income has increased and this good is an inferior good.
 - c. The consumer prefers another good more than this good.
 - d. The price of a substitute good has increased.

ANS: D PTS: 1 DIF: Challenging REF: p.75
BLM: Higher Order NOT: Macro TB_4b-96

Figure 4-6



233. **Refer to Figure 4-6.** What is the shift from D to D_1 called?
- a. an increase in demand
 - b. a decrease in demand
 - c. a decrease in quantity demanded
 - d. an increase in quantity demanded

ANS: B PTS: 1 DIF: Average REF: p.75-76
BLM: Higher Order NOT: Macro TB_4b-97

234. **Refer to Figure 4-6.** What is the shift from D_1 to D called?

- a. an increase in demand
- b. a decrease in demand
- c. a decrease in quantity demanded
- d. an increase in quantity demanded

ANS: A PTS: 1 DIF: Average REF: p.75-76
BLM: Higher Order NOT: Macro TB_4b-98

235. **Refer to Figure 4-6.** What could cause the shift from D to D_1 ?

- a. an increase in price
- b. a decrease in the price of a complement
- c. an increase in technology
- d. a decrease in the price of a substitute

ANS: D PTS: 1 DIF: Challenging REF: p.75-76
BLM: Higher Order NOT: Macro TB_4b-99

236. **Refer to Figure 4-6.** What could cause the shift from D_1 to D ?

- a. an increase in price
- b. a decrease in the price of a complement
- c. an increase in technology
- d. a decrease in the price of a substitute

ANS: B PTS: 1 DIF: Challenging REF: p.75-76
BLM: Higher Order NOT: Macro TB_4b-100

237. **Refer to Figure 4-6.** If the demand curve shifts from D_1 to D , what do we know?

- a. Firms would be willing to supply less than before.
- b. People are less willing to buy the product at any price than before.
- c. People are now more willing to buy the product at any price than before.
- d. The price of the product has decreased, causing consumers to buy more of the product.

ANS: C PTS: 1 DIF: Average REF: p.75-76
BLM: Higher Order NOT: Macro TB_4b-101

238. **Refer to Figure 4-6.** If the demand curve shifts from D to D_1 , what do we know?

- a. Firms would be willing to supply less than before.
- b. People are less willing to buy the product at any price than before.
- c. People are now more willing to buy the product at any price than before.
- d. The price of the product has decreased, causing consumers to buy more of the product.

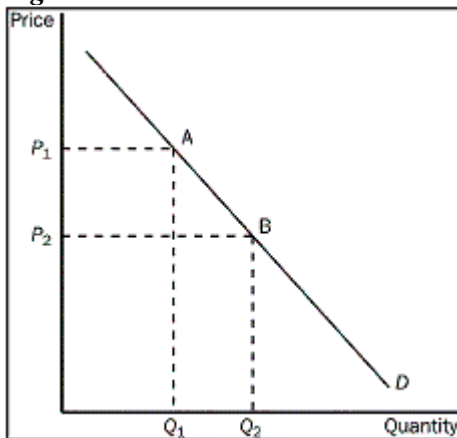
ANS: B PTS: 1 DIF: Average REF: p.75-76
BLM: Higher Order NOT: Macro TB_4b-102

239. When we move up or down a given demand curve, what is held constant?

- a. Only price is held constant.
- b. Income and the price of the good are held constant.
- c. All nonprice determinants of demand are assumed to be constant.
- d. All determinants of quantity demanded are held constant.

ANS: C PTS: 1 DIF: Challenging REF: p.75-76
BLM: Remember NOT: Macro TB_4b-103

Figure 4-7



240. **Refer to Figure 4-7.** What would cause the movement from point A to point B on the graph?
- a. an increase in price
 - b. a decrease in price
 - c. a decrease in the price of a substitute good
 - d. an increase in income

ANS: B PTS: 1

DIF: Average REF: p.76

BLM: Higher Order

NOT: Macro TB_4b-104

241. **Refer to Figure 4-7.** What would cause the movement from point B to point A on the graph?
- a. an increase in price
 - b. a decrease in price
 - c. a decrease in the price of a substitute good
 - d. an increase in income

ANS: A PTS: 1

DIF: Average REF: p.76

BLM: Higher Order

NOT: Macro TB_4b-105

242. **Refer to Figure 4-7.** What does the movement from point B to point A on the graph show?
- a. a decrease in demand
 - b. an increase in demand
 - c. a decrease in quantity demanded
 - d. an increase in quantity demanded

ANS: C PTS: 1

DIF: Average REF: p.76

BLM: Higher Order

NOT: Macro TB_4b-106

243. **Refer to Figure 4-7.** What does the movement from point A to point B on the graph show?
- a. a decrease in demand
 - b. an increase in demand
 - c. a decrease in quantity demanded
 - d. an increase in quantity demanded

ANS: D PTS: 1

DIF: Average REF: p.76

BLM: Higher Order

NOT: Macro TB_4b-107

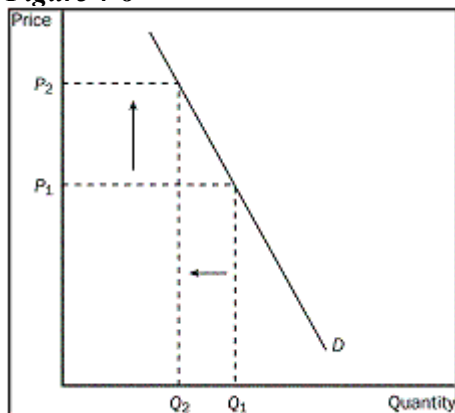
244. What do most studies indicate that tobacco and marijuana tend to be?
- substitute goods
 - complementary goods
 - not related since one is legal and one is illegal
 - inferior goods

ANS: B PTS: 1 DIF: Average REF: p.76-77
BLM: Remember NOT: Macro TB_4b-108

245. Suppose you like banana cream pie made with vanilla pudding. Assuming all other things are constant, you notice that the price of bananas is higher. How would your demand for vanilla pudding be affected by this?
- It would decrease.
 - It would increase.
 - It would be unaffected.
 - There is insufficient information given to answer the question.

ANS: A PTS: 1 DIF: Average REF: p.76-77
BLM: Higher Order NOT: Macro TB_4b-109

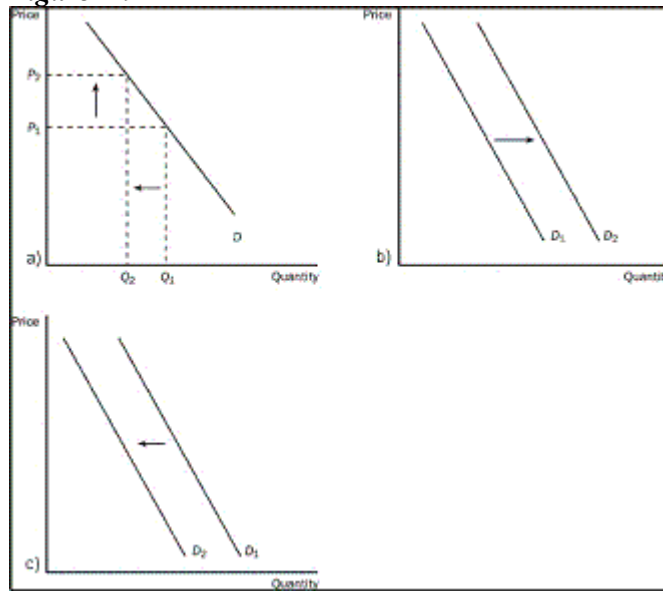
Figure 4-8



246. **Refer to Figure 4-8.** The graph shows the demand for cigarettes. Which most likely happened?
- The price of marijuana rose.
 - Mandatory health warnings were placed on cigarette packages.
 - Several foreign countries banned Canadian cigarettes in their countries.
 - A tax was placed on cigarettes.

ANS: D PTS: 1 DIF: Challenging REF: p.76-77
BLM: Higher Order NOT: Macro TB_4b-110

Figure 4-9



247. **Refer to Figure 4-9.** Which graph could be used to show the result of 5 percent of the country's smokers deciding to stop smoking?

a. a.
b. b.
c. c.
d. Each graph could be used to show the result.

ANS: C PTS: 1 DIF: Challenging REF: p.76-77
BLM: Higher Order NOT: Macro TB_4b-111

248. If cigarettes and marijuana had been found to be substitutes, what would a tax placed on cigarettes do?

a. decrease the demand for marijuana
b. increase the demand for marijuana
c. decrease the quantity demanded of marijuana
d. increase the quantity demanded of marijuana

ANS: B PTS: 1 DIF: Challenging REF: p.76-77
BLM: Higher Order NOT: Macro TB_4b-112

249. What is one reason that government taxes on cigarettes reduce smoking?

a. Cigarette companies are successful in passing much of the tax on to consumers.
b. Cigarette companies do not pass much of the tax on to consumers.
c. There are many good substitutes for cigarettes.
d. Higher prices suggest less harmful cigarettes.

ANS: A PTS: 1 DIF: Average REF: p.76-77
BLM: Remember NOT: Macro TB_4b-113

250. For teens, what does a 10 percent increase in the price of cigarettes lead to?

- a. a 6 percent drop in teenage smoking
- b. a 12 percent drop in teenage smoking
- c. a 18 percent drop in teenage smoking
- d. a 24 percent drop in teenage smoking

ANS: B PTS: 1 DIF: Average REF: p.76-77
BLM: Higher Order NOT: Macro TB_4b-114

251. What does a 10 percent increase in the price of cigarettes lead to?

- a. 18 percent drop in smoking
- b. 12 percent drop in smoking
- c. 6 percent drop in smoking
- d. 4 percent drop in smoking

ANS: D PTS: 1 DIF: Average REF: p.76-77
BLM: Higher Order NOT: Macro TB_4b-115

252. What is the side of the market that deals with the willingness and ability to produce and sell?

- a. demand
- b. competition
- c. supply
- d. a monopoly

ANS: C PTS: 1 DIF: Easy REF: p.77
BLM: Remember NOT: Macro TB_4b-116

253. What is the relationship between price and quantity supplied?

- a. negative, or inverse.
- b. positive, or direct
- c. nonexistent
- d. the same as the relationship between price and quantity demanded

ANS: B PTS: 1 DIF: Easy REF: p.77
BLM: Remember NOT: Macro TB_4b-117

254. Other things equal, what happens when the price of a good rises?

- a. The quantity demanded of the good increases.
- b. The supply increases.
- c. The quantity supplied of the good rises.
- d. The demand curve shifts to the left.

ANS: C PTS: 1 DIF: Average REF: p.77
BLM: Remember NOT: Macro TB_4b-118

255. What will happen if the price of a good is low?

- a. Firms would increase profit by increasing output.
- b. Quantity supplied could be zero.
- c. The supply curve for the good will shift to the left.
- d. Firms should raise the price of the product.

ANS: B PTS: 1 DIF: Average REF: p.77-78
BLM: Remember NOT: Macro TB_4b-119

256. What relationship is shown by the supply schedule?

- a. between price and quantity supplied
- b. between price and quantity demanded
- c. between supply and quantity
- d. between profit and price

ANS: A PTS: 1 DIF: Easy REF: p.78
BLM: Remember NOT: Macro TB_4b-120

257. What determines a market supply curve?

- a. vertically summing individual supply curves
- b. horizontally summing individual supply curves
- c. finding the average quantity supplied of the market's individual supply curves
- d. Unlike market demand, there is no such thing as a market supply curve

ANS: B PTS: 1 DIF: Easy REF: p.79
BLM: Remember NOT: Macro TB_4b-121

258. What does the market supply curve show?

- a. the total quantity supplied at any price
- b. the average quantity supplied at any price
- c. a ratio between price and quantity supplied for the market
- d. the price sellers will receive from consumers at given quantities

ANS: A PTS: 1 DIF: Easy REF: p.79
BLM: Remember NOT: Macro TB_4b-122

259. What does fewer sellers in the market cause?

- a. the supply curve to shift to the left
- b. the supply curve to shift to the right
- c. a movement up a stationary supply curve
- d. a movement down a stationary supply curve

ANS: A PTS: 1 DIF: Average REF: p.79
BLM: Remember NOT: Macro TB_4b-123

260. For a seller, which of the following is NOT positively related?

- a. the price of the good and the seller's profit
- b. the price of the good and quantity supplied
- c. the seller's profit and product cost
- d. the seller's profit and quantity supplied

ANS: C PTS: 1 DIF: Average REF: p.79-80
BLM: Remember NOT: Macro TB_4b-124

261. Which of the following determines a market supply curve but not an individual supply curve?

- a. number of sellers
- b. expectations
- c. input prices
- d. technology

ANS: A PTS: 1 DIF: Average REF: p.79-81
BLM: Remember NOT: Macro TB_4b-125

262. Which of the following cause and effect events is in order for a seller?
- a. Technology improves, profit falls, the supply curve shifts left.
 - b. An input price falls, profit rises, and the supply curve shifts right.
 - c. An input price rises, profit falls, and the supply curve shifts right.
 - d. An input price rises, profit rises, and the supply curve shifts left.

ANS: B PTS: 1 DIF: Challenging REF: p.79-81
BLM: Higher Order NOT: Macro TB_4b-126

263. What might cause a movement along the supply curve?
- a. a change in technology
 - b. a change in input prices
 - c. a change in expectations about future prices
 - d. a change in the price of the good or service

ANS: D PTS: 1 DIF: Average REF: p.81
BLM: Remember NOT: Macro TB_4b-127

264. Lead is an important input in the production of crystal. If the price of lead decreases, all else equal, what would we expect?
- a. the supply of crystal to be unaffected
 - b. the supply of crystal to decrease
 - c. the supply of crystal to increase
 - d. the supply of lead to increase

ANS: C PTS: 1 DIF: Challenging REF: p.81
BLM: Higher Order NOT: Macro TB_4b-128

265. Suppose you make jewellery. If the price of gold falls, what would we expect you to do?
- a. be willing and able to produce less jewellery than before at each possible price
 - b. be willing and able to produce more jewellery than before at each possible price
 - c. face a greater demand for your jewellery
 - d. face a weaker demand for your jewellery

ANS: B PTS: 1 DIF: Average REF: p.81
BLM: Higher Order NOT: Macro TB_4b-129

266. Suppose you make jewellery. If the price of gold increases, what would we expect you to do?
- a. be willing and able to produce less jewellery than before at each possible price
 - b. be willing and able to produce more jewellery than before at each possible price
 - c. face a greater demand for your jewellery
 - d. face a weaker demand for your jewellery

ANS: A PTS: 1 DIF: Average REF: p.81
BLM: Higher Order NOT: Macro TB_4b-130

267. What will a technological advancement do?

- a. shift the supply curve to the right
- b. shift the demand curve to the left
- c. shift the demand curve to the right
- d. shift the supply curve to the left

ANS: A PTS: 1 DIF: Average REF: p.81
BLM: Remember NOT: Macro TB_4b-131

268. A dress manufacturer is expecting higher prices for dresses in the near future. What would we expect?

- a. the dress manufacturer to supply more dresses now
- b. the dress manufacturer to supply fewer dresses now
- c. the demand for this manufacturer's dresses to fall
- d. no change in the dress manufacturer's current supply

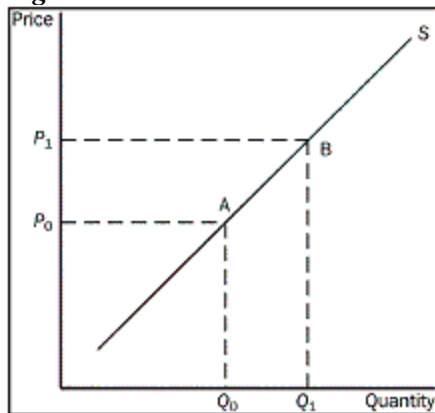
ANS: B PTS: 1 DIF: Average REF: p.81
BLM: Higher Order NOT: Macro TB_4b-132

269. Holding the non-price determinants of supply constant, what would a change in price do?

- a. result in a change in supply
- b. have no effect on the quantity supplied
- c. result in a shift of demand
- d. result in a movement along a stable supply curve

ANS: D PTS: 1 DIF: Average REF: p.81
BLM: Remember NOT: Macro TB_4b-133

Figure 4-10



270. **Refer to Figure 4-10.** What would cause the movement from point A to point B on the graph?

- a. a decrease in the price of the good
- b. an increase in the price of the good
- c. an increase in technology
- d. a decrease in input prices

ANS: B PTS: 1 DIF: Average REF: p.81
BLM: Higher Order NOT: Macro TB_4b-134

271. **Refer to Figure 4-10.** What would cause the movement from point B to point A on the graph?
- a. a decrease in the price of the good
 - b. an increase in the price of the good
 - c. an increase in technology
 - d. a decrease in input prices

ANS: A PTS: 1 DIF: Average REF: p.81
BLM: Higher Order NOT: Macro TB_4b-135

272. **Refer to Figure 4-10.** What is the movement from point A to point B on the graph called?
- a. a decrease in supply
 - b. an increase in supply
 - c. an increase in the quantity supplied
 - d. a decrease in the quantity supplied

ANS: C PTS: 1 DIF: Average REF: p.81
BLM: Higher Order NOT: Macro TB_4b-136

273. **Refer to Figure 4-10.** What is the movement from point B to point A on the graph called?
- a. a decrease in supply
 - b. an increase in supply
 - c. an increase in the quantity supplied
 - d. a decrease in the quantity supplied

ANS: D PTS: 1 DIF: Average REF: p.81
BLM: Higher Order NOT: Macro TB_4b-137

TRUE/FALSE

1. A market is a group of buyers and sellers of a particular product.

ANS: T PTS: 1 DIF: Easy REF: p.70
NOT: Macro TB_4a-137

2. In a perfectly competitive market, buyers and sellers are price setters.

ANS: F PTS: 1 DIF: Easy REF: p.70
NOT: Macro TB_4a-138

3. A local cable TV company might be a monopolist.

ANS: T PTS: 1 DIF: Average REF: p.71
NOT: Macro TB_4a-139

4. The quantity demanded of a product is the amount that buyers are willing and able to purchase at a particular price.

ANS: T PTS: 1 DIF: Average REF: p.71
NOT: Macro TB_4a-140

5. The law of demand states that the quantity demanded of a product is positively related to price.

ANS: F PTS: 1 DIF: Average REF: p.71
NOT: Macro TB_4a-141

6. The market demand is the average of all of the individual demands for a particular good or service.

ANS: F PTS: 1 DIF: Average REF: p.72-73
NOT: Macro TB_4a-142

7. If the demand for a good falls when income falls, the good is called an inferior good.

ANS: F PTS: 1 DIF: Average REF: p.74
NOT: Macro TB_4a-143

8. When an increase in the price of one good lowers the demand for another good, the two goods are called complements.

ANS: T PTS: 1 DIF: Average REF: p.74-75
NOT: Macro TB_4a-144

9. Baseballs and baseball bats are substitute goods.

ANS: F PTS: 1 DIF: Average REF: p.74-75
NOT: Macro TB_4a-145

10. An increase in the price of pizza will shift the demand curve for pizza to the left.

ANS: F PTS: 1 DIF: Average REF: p.75-76
NOT: Macro TB_4a-146

11. Whenever a determinant of demand other than price changes, the demand curve shifts.

ANS: T PTS: 1 DIF: Average REF: p.75-76
NOT: Macro TB_4a-147

12. A reduction in the price of a product and an increase in the number of buyers in the market affect the demand curve in the same general way.

ANS: F PTS: 1 DIF: Average REF: p.75-77
NOT: Macro TB_4a-148

13. The quantity supplied of a good or service is the amount that sellers are willing and able to sell at a particular price.

ANS: T PTS: 1 DIF: Easy REF: p.77
NOT: Macro TB_4a-149

14. The law of supply states that other things equal, when the price of a good rises, the quantity supplied of the good falls.
- ANS: F PTS: 1 DIF: Average REF: p.78
NOT: Macro TB_4a-150
15. A supply curve slopes upward because, all else equal, a higher price means a greater quantity supplied.
- ANS: T PTS: 1 DIF: Average REF: p.78
NOT: Macro TB_4a-151
16. If a company making frozen orange juice expects the price of their product to be higher next month, they will supply more to the market this month.
- ANS: F PTS: 1 DIF: Average REF: p.80
NOT: Macro TB_4a-152
17. If there is an improvement in the technology of producing a product, the supply curve for that product will shift to the left.
- ANS: F PTS: 1 DIF: Average REF: p.80-81
NOT: Macro TB_4a-153
18. A movement along a supply curve is called a change in supply while a shift of the curve is called a change in quantity supplied.
- ANS: F PTS: 1 DIF: Average REF: p.80-81
NOT: Macro TB_4a-138
19. A reduction in an input price will cause a change in quantity supplied, but not a change in supply.
- ANS: F PTS: 1 DIF: Average REF: p.80-81
NOT: Macro TB_4a-139
20. Quantity demanded is equal to quantity supplied, at the equilibrium price.
- ANS: T PTS: 1 DIF: Easy REF: p.82
NOT: Macro TB_4a-140
21. Surpluses drive price up while shortages drive price down.
- ANS: F PTS: 1 DIF: Average REF: p.82-83
NOT: Macro TB_4a-141
22. A shortage will occur at any price below equilibrium price and a surplus will occur at any price above equilibrium price.
- ANS: T PTS: 1 DIF: Average REF: p.82-83
NOT: Macro TB_4a-142

23. In a market, the price of any good adjusts until quantity demanded equals quantity supplied.

ANS: T PTS: 1 DIF: Average REF: p.83
NOT: Macro TB_4a-143

24. The behaviour of buyers and sellers drives markets toward equilibrium.

ANS: T PTS: 1 DIF: Average REF: p.83
NOT: Macro TB_4a-144

25. It is not possible for demand and supply to shift at the same time.

ANS: F PTS: 1 DIF: Average REF: p.86-87
NOT: Macro TB_4a-145

26. Anyone willing to pay the market price for a resource may have it.

ANS: T PTS: 1 DIF: Average REF: p.89
NOT: Macro TB_4a-146

27. Price, which is determined by all buyers and sellers as they interact in the marketplace, allocates the economy's scarce resources.

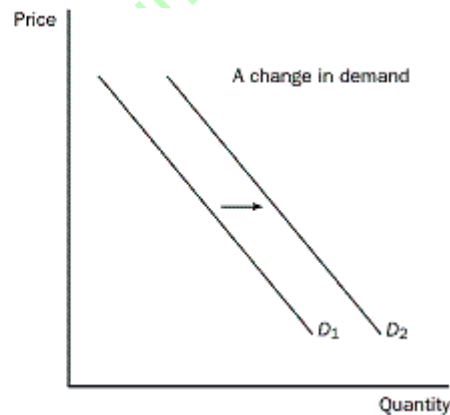
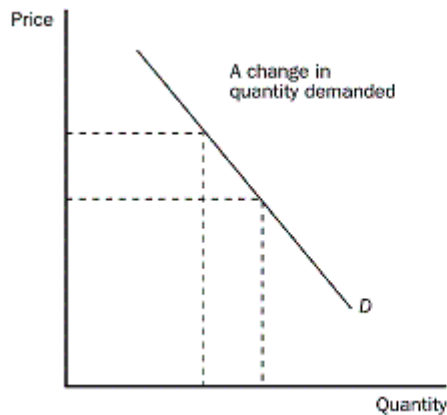
ANS: T PTS: 1 DIF: Average REF: p.89
NOT: Macro TB_4a-147

SHORT ANSWER

1.
 - A. What is the difference between a "change in demand" and a "change in quantity demanded"? Graph your answer.
 - B. For each of the following changes, determine whether there will be a movement along the demand curve (a change in quantity demanded) or a shift in the demand curve (a change in demand).
 - a. a change in the price of a related good
 - b. a change in tastes
 - c. a change in the number of buyers
 - d. a change in price
 - e. a change in expectations
 - f. a change in income

ANS:

- A. A change in demand refers to a shift in the demand curve. A change in quantity demanded refers to a movement along a fixed demand curve.
- B. A change in price causes a change in quantity demanded. All of the other changes listed shift the demand curve.



PTS: 1

DIF: Average

REF: p.76-77

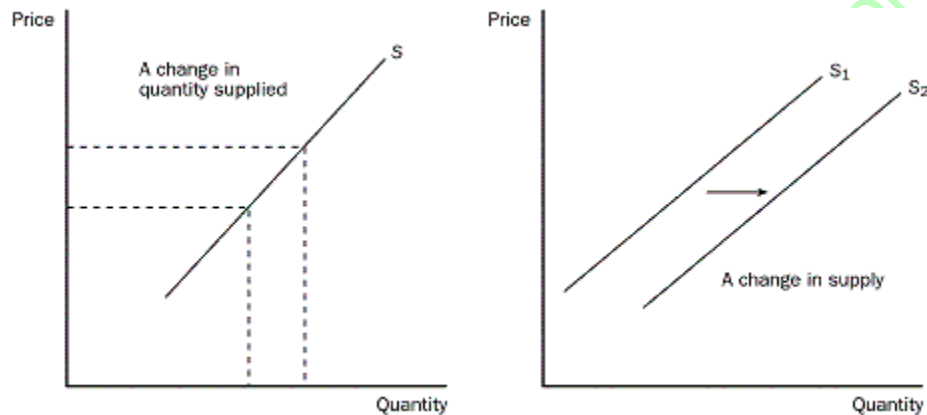
NOT: Macro TB_4a-154

2.

- A. What is the difference between a "change in supply" and a "change in quantity supplied"? Graph your answer.
- B. For each of the following changes, determine whether there will be a change in quantity supplied or a change in supply.
- a change in the resource cost
 - a change in producer expectations
 - a change in price
 - a change in technology
 - a change in the number of sellers

ANS:

- A. A change in supply refers to a shift in the supply curve. A change in quantity supplied refers to a movement along a fixed supply curve.



- B. A change in price causes a change in quantity supplied. All of the other changes listed shift the supply curve.

PTS: 1

DIF: Average

REF: p.78-81

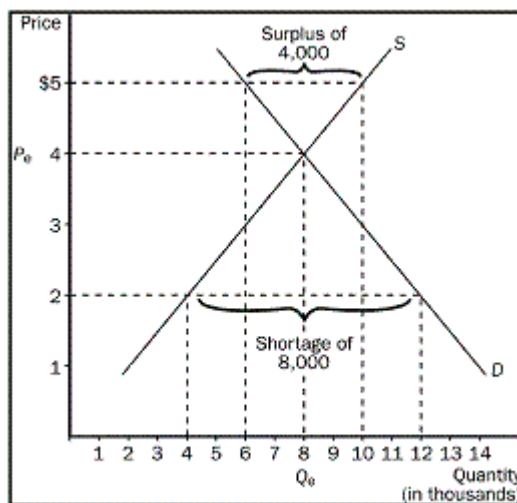
NOT: Macro TB_4a-155

3. This question deals with demand and supply and refers you to the table below.
- a. Given the table, graph the demand and supply curves for flashlights. Make certain to label equilibrium price and equilibrium quantity.

Price	Quantity Demanded/Month	Quantity Supplied/Month
\$5	6,000	10,000
\$4	8,000	8,000
\$3	10,000	6,000
\$2	12,000	4,000
\$1	14,000	2,000

- b. What is the equilibrium price and equilibrium quantity?
- c. Suppose the price is currently at \$5. What problem would exist in the economy? What would you expect to happen to price? Show this on your graph.
- d. Suppose the price is currently \$2. What problem exists in the economy? What would you expect to happen to price? Show this on your graph.

ANS:



- a.
- b. Equilibrium price would be \$4 and equilibrium quantity would be 8,000.
- c. A surplus of 4,000 flashlights would be the problem in the economy and we would expect the price to fall.
- d. A shortage of 8,000 flashlights would be the problem in the economy and we would expect the price to rise.

PTS: 1

DIF: Average

REF: p.82-83

NOT: Macro TB_4a-156

4. Fill in the accompanying table, showing whether equilibrium price and equilibrium quantity go up, down or stay the same.

	No Change in Supply	An Increase in Supply	A Decrease in Supply
No Change in Demand			
An Increase in Demand			
A Decrease in Demand			

ANS:

	No Change in Supply	An Increase in Supply	A Decrease in Supply
No Change in Demand	P same Q same	P down Q up	P up Q down
An Increase in Demand	P up Q up	P ambiguous Q up	P up Q ambiguous
A Decrease in Demand	P down Q down	P down Q ambiguous	P ambiguous Q down

PTS: 1

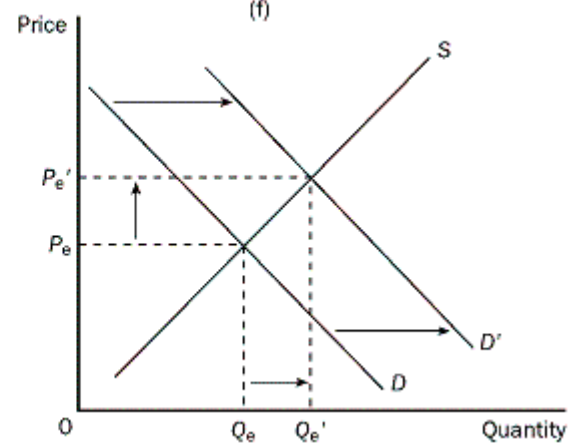
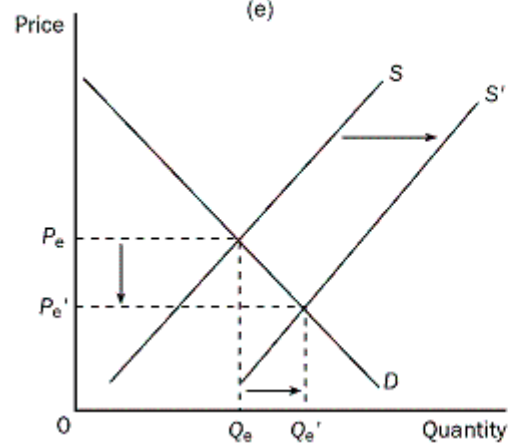
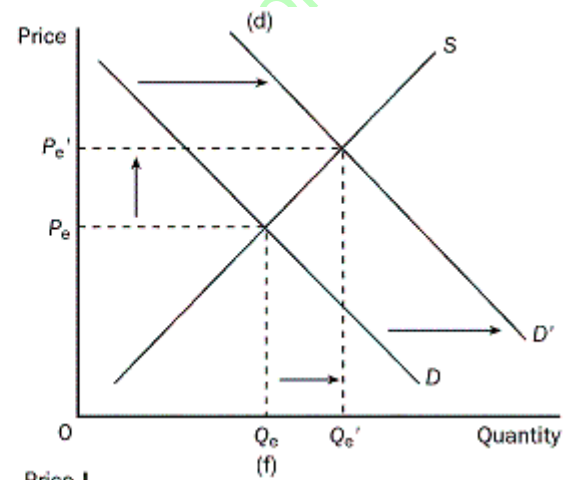
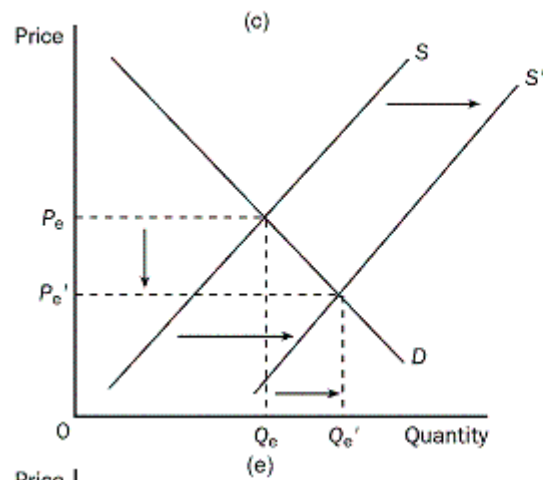
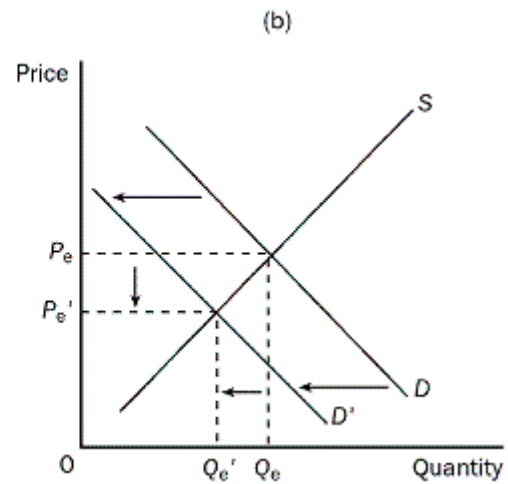
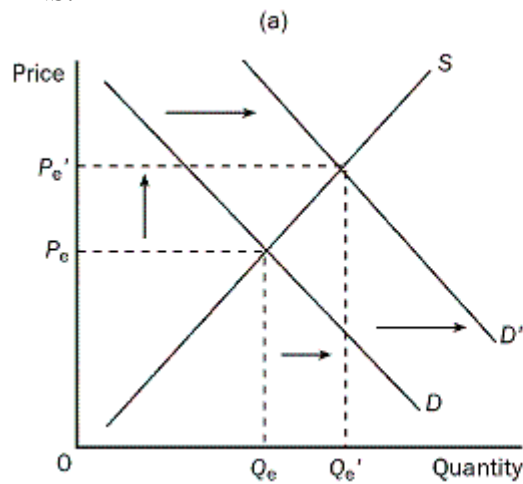
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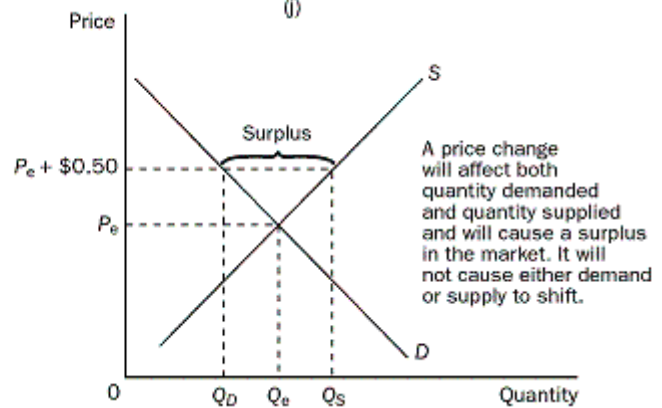
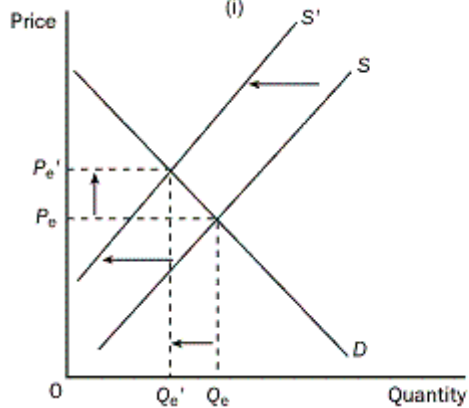
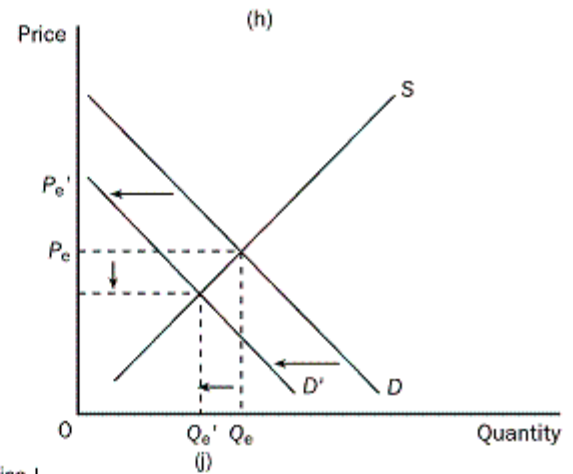
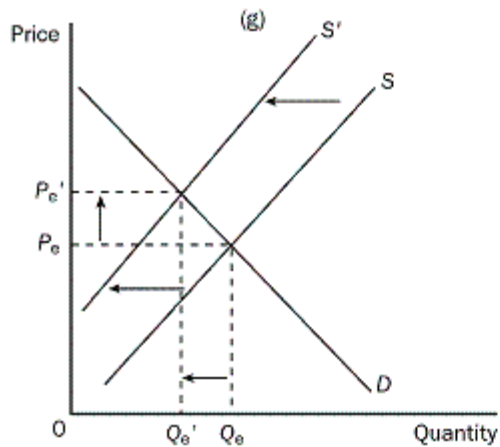
REF: p.82-83

NOT: Macro TB_4a-157

5. Suppose we are analyzing the market for hot chocolate. Graphically illustrate the impact each of the following would have on demand or supply. Also show how equilibrium price and quantity have changed.
- Winter starts and the weather turns sharply colder.
 - The price of tea, a substitute for hot chocolate, falls.
 - The price of cocoa beans decreases.
 - The price of whipped cream falls.
 - A better method of harvesting cocoa beans is introduced.
 - The Canadian Medical Association announces that hot chocolate cures acne.
 - Protesting farmers dump millions of gallons of milk, causing the price of milk to rise.
 - Consumer income falls because of a recession and hot chocolate is considered a normal good.
 - Producers expect the price of hot chocolate to increase next month.
 - Currently, the price of hot chocolate is \$0.50 per cup above equilibrium.

ANS:





PTS: 1

DIF: Average

REF: p.82-83

NOT: Macro TB_4a-158

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Chapter 5—Measuring a Nation's Income

MULTIPLE CHOICE

1. What do macroeconomists study?
- decisions of households and firms
 - economy-wide phenomena
 - the interaction of households and firms in markets
 - regulations of firms and unions

ANS: B PTS: 1 DIF: Easy REF: p.97-98
BLM: Remember NOT: Macro TB_5-1

2. Which of the following headlines would be most closely related to what macroeconomists study?
- Unemployment rate rises from 5 percent to 5.5 percent.
 - The price of gold grows by 3.1 percent in the third quarter.
 - The number of tourists visiting Canadian national parks has declined.
 - The price of oranges rises after an early frost.

ANS: A PTS: 1 DIF: Easy REF: p.98
BLM: Higher Order NOT: Macro TB_5-2

3. Which of the following questions is more likely to be studied by a macroeconomist than a microeconomist?
- Why do prices in general rise by more in some countries than others?
 - Why do wages differ across industries?
 - Does education increase a worker's income on average?
 - Is there usually a gain from trade between two countries?

ANS: A PTS: 1 DIF: Easy REF: p.98
BLM: Higher Order NOT: Macro TB_5-3

4. Which of the following topics are studied in macroeconomics?
- national output, the inflation rate, and the trade deficit
 - the price of Cisco stock, wage differences between genders, and antitrust laws
 - differences in market structure and how consumers maximize utility
 - the effect of trade tariffs on prices and patterns of international trade

ANS: A PTS: 1 DIF: Easy REF: p.98
BLM: Remember NOT: Macro TB_5-4

5. What is the goal of macroeconomics?
- to explain how economic changes affect prices of particular goods
 - to devise policies to deal with market failures, such as externalities and monopoly
 - to explain changes that affect households and firms in general
 - to explain how income taxes influence labour supply

ANS: C PTS: 1 DIF: Easy REF: p.98
BLM: Remember NOT: Macro TB_5-5

6. For which of the following purposes do economists use the tools of supply and demand?
- a. for analyzing individual markets, but not the overall economy
 - b. for analyzing a small firm's decision making
 - c. for analyzing a consumer's decision making
 - d. for analyzing individual markets as well as the economy as a whole

ANS: D PTS: 1 DIF: Easy REF: p.98
BLM: Remember NOT: Macro TB_5-6

7. Which of the following statistics is the best single measure of an economy's well-being?
- a. the unemployment rate
 - b. the inflation rate
 - c. GDP
 - d. the trade deficit

ANS: C PTS: 1 DIF: Easy REF: p.98
BLM: Remember NOT: Macro TB_5-7

8. What is the relationship between income and expenditure for an economy?
- a. Income is greater than expenditure.
 - b. Income is less than expenditure.
 - c. Income equals expenditure.
 - d. Income could be greater or less than expenditure.

ANS: C PTS: 1 DIF: Easy REF: p.98
BLM: Remember NOT: Macro TB_5-8

9. If Robert works as a lawyer, how should his contributions to GDP be calculated?
- a. using his income from providing legal services, not his expenditure on goods and services
 - b. using his expenditure, not his income
 - c. using both his income and his expenditure
 - d. using either his income or his expenditure, not both

ANS: D PTS: 1 DIF: Easy REF: p.98-99
BLM: Higher Order NOT: Macro TB_5-9

10. If GDP rises, what happens?
- a. Income and expenditure must both rise.
 - b. Income and expenditure must both fall.
 - c. Income must rise, but expenditure may rise or fall.
 - d. Expenditure must rise, but income may rise or fall.

ANS: A PTS: 1 DIF: Easy REF: p.98-99
BLM: Higher Order NOT: Macro TB_5-10

11. In a simple circular-flow diagram, how are total income and total expenditure interrelated?
- a. They are seldom equal because of the dynamic changes that occur in an economy.
 - b. They are equal only when all goods and services produced are sold.
 - c. They are always equal because every transaction has a buyer and a seller.
 - d. They are always equal because of accounting rules.

ANS: C PTS: 1 DIF: Easy REF: p.99
BLM: Remember NOT: Macro TB_5-11

12. In a simple circular-flow diagram, how are total income and total expenditures in an economy interrelated?
- They are equal because firms re-invest their revenue.
 - They are equal only if there is no saving.
 - They never equal because some people's income does not come from production activities.
 - They are equal because every transaction has a buyer and a seller.

ANS: D PTS: 1 DIF: Easy REF: p.99
BLM: Remember NOT: Macro TB_5-12

13. According to the simple circular-flow model, which of the following do firms buy from households?
- natural resources, such as oil and minerals
 - goods and services
 - inventions and innovations
 - labour

ANS: D PTS: 1 DIF: Easy REF: p.99
BLM: Remember NOT: Macro TB_5-13

14. What does the simple circular-flow diagram illustrate?
- that expenditure generates income so that income and the value of production are equal
 - that the economy's income exceeds its expenditure
 - that the expenditure of an economy exceeds its income
 - that money "flows" from households to firms and not the other way around

ANS: A PTS: 1 DIF: Easy REF: p.99
BLM: Remember NOT: Macro TB_5-14

15. In an economy consisting of only households and firms, how can GDP be computed?
- by adding up the total expenditures of households and subtracting savings
 - by adding up the income paid by firms only in exchange for labour
 - by adding up either total income paid by firms, or total expenditures of households, but not both
 - by adding up both the total expenditures of households and total income paid by firms

ANS: C PTS: 1 DIF: Easy REF: p.99
BLM: Remember NOT: Macro TB_5-15

16. Why does expenditure equal income?
- because firms are required by law to pay out all their revenue as income to someone
 - because ultimately firms are owned by households
 - because for every sale there is a buyer and a seller
 - because the demand and supply of goods and services must be equal

ANS: C PTS: 1 DIF: Easy REF: p.99
BLM: Remember NOT: Macro TB_5-16

17. Which of the following is the correct definition of GDP?
- the market value of all goods produced within a country
 - the market value of all final goods and services produced by the citizens of a country
 - the market value of all final goods and services consumed within a country over a number of years
 - the market value of all final goods and services produced within a country in a given period of time

ANS: D PTS: 1 DIF: Easy REF: p.100
BLM: Remember NOT: Macro TB_5-17

18. How is GDP computed?
- Add up the quantities of all final goods and services.
 - Add up the cost of producing final goods and services.
 - Use weights determined by a survey regarding how much people value different sorts of goods and services to compute GDP as a weighted average.
 - Add up the market values of all final goods and services produced within a country in a given period of time.

ANS: D PTS: 1 DIF: Easy REF: p.100
BLM: Remember NOT: Macro TB_5-19

19. In order to include many different products in an aggregate measure, how is GDP computed?
- using values of goods based on surveys of consumers
 - using primarily costs of production
 - using primarily market prices
 - using weights that are computed by how much of a particular good is produced relative to total output

ANS: C PTS: 1 DIF: Easy REF: p.100
BLM: Remember NOT: Macro TB_5-19

20. Why is GDP computed using market prices as the value of final goods and services?
- because market prices do not change much, so it is easy to make comparisons between years
 - because if market prices are out of line with how people value goods, the government sets ceilings and floors on them
 - because costs change too much to reflect the value of goods and services
 - because market prices reflect the value of goods and services

ANS: D PTS: 1 DIF: Easy REF: p.100
BLM: Higher Order NOT: Macro TB_5-20

21. Which of the following is **NOT** included in GDP?
- unpaid cleaning and maintenance of houses
 - services such as those provided by lawyers and hairstylists
 - final goods that are produced, but not sold by the end of the year
 - production of foreign citizens living in Canada

ANS: A PTS: 1 DIF: Average REF: p.101
BLM: Remember NOT: Macro TB_5-21

22. How is the value of housing service provided by the economy's stock of houses included in GDP?
- a. It is not included in GDP since it is not sold on the market.
 - b. It is counted and is valued as the mortgage payment made on the house.
 - c. It is counted and uses only the purchase price of the house in the year it is sold.
 - d. It is counted and is based on an estimate of its rental value.

ANS: D PTS: 1 DIF: Average REF: p.100-101
BLM: Remember NOT: Macro TB_5-22

23. Suppose that an apartment complex converts to a condominium where the renters are now owners of their former apartments. What is included in GDP?
- a. The rent was included in GDP; the purchases of the condominiums are not.
 - b. The rent was included in GDP, and so is the purchase of the condominiums.
 - c. The rent was not included in GDP; the purchases of the condominiums are.
 - d. The rent was not included in GDP; the purchases are not included either.

ANS: A PTS: 1 DIF: Average REF: p.100-101
BLM: Higher Order NOT: Macro TB_5-23

24. Suppose that an apartment complex converts to a condominium where the renters are now owners of their former apartments. Suppose that an estimate of the value of the condominium owners' housing services is now the same as their former rent. What happens to GDP?
- a. GDP necessarily increases.
 - b. GDP necessarily decreases.
 - c. GDP is unaffected because neither the rent nor the estimate of the value of housing services is included in GDP.
 - d. GDP is unaffected because previously rent was included in GDP, and now it is replaced by the estimate of the value of housing services.

ANS: D PTS: 1 DIF: Average REF: p.100-101
BLM: Higher Order NOT: Macro TB_5-24

25. Which of the following non-market goods or services is included as an estimate in Canadian GDP?
- a. the value of unpaid housework
 - b. the value of vegetables that people grow in their gardens
 - c. the estimated rental value of owner-occupied homes
 - d. the estimated value of illegal drugs

ANS: C PTS: 1 DIF: Average REF: p.100-101
BLM: Remember NOT: Macro TB_5-25

26. Over the past few decades Canadians have chosen to cook less at home and eat more at restaurants. What effect has this practice had on GDP?
- a. It has increased measured GDP.
 - b. It has reduced measured GDP.
 - c. It has not affected measured GDP.
 - d. It has had an ambiguous effect on GDP.

ANS: A PTS: 1 DIF: Average REF: p.100-101
BLM: Higher Order NOT: Macro TB_5-26

27. Over time, people have come to rely more on market-produced goods and less on goods that they produce for themselves. What would this change do by itself?
- a. It would make GDP fall over time.
 - b. It would not make any change in GDP over time.
 - c. It would make GDP rise over time.
 - d. It would change GDP, but in an uncertain direction.

ANS: C PTS: 1 DIF: Challenging REF: p.100-101
BLM: Higher Order NOT: Macro TB_5-27

28. If Ralph pays someone to mow his lawn and Norton mows his own lawn, what is the impact on GDP?
- a. The answer depends on what Norton reports to survey takers.
 - b. What Ralph pays to have his lawn mowed and the estimated value to Norton of mowing his own lawn are both included in GDP.
 - c. Neither what Ralph pays nor the estimated value of Norton's mowing is included in GDP.
 - d. Only what Ralph pays to have his lawn mowed is included in GDP.

ANS: D PTS: 1 DIF: Easy REF: p.100-101
BLM: Higher Order NOT: Macro TB_5-28

29. Sally prepared her own meals during the first quarter of 2010, and then ate at restaurants every day in the second quarter of 2010. What is the impact on GDP of Sally's change of habit?
- a. It necessarily raises GDP.
 - b. It necessarily reduces GDP.
 - c. It raises GDP because the restaurant meals are more expensive.
 - d. It has no impact on GDP.

ANS: A PTS: 1 DIF: Average REF: p.100-101
BLM: Higher Order NOT: Macro TB_5-29

30. If Susan decides to change the oil in her car herself instead of having Speedy Lube change the oil for her, what is the impact on GDP?
- a. It necessarily rises.
 - b. It necessarily falls.
 - c. It will be unaffected because the same service is produced in either case.
 - d. It will be unaffected because car maintenance is not included in GDP.

ANS: B PTS: 1 DIF: Average REF: p.100-101
BLM: Higher Order NOT: Macro TB_5-30

31. A professional gambler moves from a province where gambling is illegal to a province where gambling is legal. What impact does this move have on Canada's GDP?
- a. It raises GDP.
 - b. It decreases GDP.
 - c. It does not change GDP because gambling is never included in GDP.
 - d. It does not change GDP because in either case his income is included.

ANS: A PTS: 1 DIF: Easy REF: p.100-101
BLM: Higher Order NOT: Macro TB_5-31

32. A professional gambler moves from a province where gambling is legal to a province where gambling is illegal. What impact does this move have on Canada's GDP?
- a. It raises GDP.
 - b. It decreases GDP.
 - c. It does not change GDP because gambling is never included in GDP.
 - d. It does not change GDP because in either case his income is included.

ANS: B PTS: 1 DIF: Easy REF: p.100-101
BLM: Higher Order NOT: Macro TB_5-32

33. If a province made an illegal activity such as gambling or prostitution legal, then, other things the same, what would happen to GDP?
- a. It would increase.
 - b. It would decrease.
 - c. It would not change because both legal and illegal production are included in GDP.
 - d. It would not change because these activities are never included in GDP.

ANS: A PTS: 1 DIF: Easy REF: p.100-101
BLM: Higher Order NOT: Macro TB_5-33

34. If a province with legalized gambling made gambling illegal, then, other things the same, what would happen to GDP?
- a. It would decrease.
 - b. It would increase.
 - c. It would not change because both legal and illegal production are included in GDP.
 - d. It does not change because gambling is never included in GDP.

ANS: A PTS: 1 DIF: Easy REF: p.100-101
BLM: Higher Order NOT: Macro TB_5-34

35. Roommates Grace and Kelly are sharing household chores and think they have an even exchange. Other things the same, if instead they paid each other for the chores the other did, what would happen to GDP?
- a. It would fall.
 - b. It would rise.
 - c. It would be unaffected because paid or not, household chores are not included in GDP.
 - d. It would be unaffected because paid or not, household chores are included in GDP.

ANS: B PTS: 1 DIF: Easy REF: p.100-101
BLM: Higher Order NOT: Macro TB_5-35

36. How are intermediate goods accounted for when calculating GDP?
- a. The value of all intermediate goods is included in GDP.
 - b. The value of intermediate goods is included in GDP only if they were produced in the previous year.
 - c. The value of intermediate goods is included in GDP only if they are purchased by firms rather than households.
 - d. The value of intermediate goods is not included in GDP unless they are part of inventory.

ANS: D PTS: 1 DIF: Easy REF: p.100-101
BLM: Remember NOT: Macro TB_5-36

37. How are intermediate goods treated in GDP computations?
- They are included so we can get a measure of sales.
 - They are excluded because their value is already counted in the value of final goods.
 - They are excluded because they are too difficult to measure.
 - They are included because they are final goods for the firm producing them.
- ANS: B PTS: 1 DIF: Easy REF: p.100-101
BLM: Remember NOT: Macro TB_5-37
38. How does the value of total sales of all firms in the country for a year compare with GDP?
- It equals GDP for the year.
 - It is larger than GDP for the year.
 - It is smaller than GDP for the year.
 - It could be larger or smaller than GDP for the year.
- ANS: B PTS: 1 DIF: Average REF: p.101-102
BLM: Higher Order NOT: Macro TB_5-38
39. How are grapes treated in GDP terms?
- They are always counted as intermediate goods
 - They are counted as intermediate goods only if they are used to produce another good like wine.
 - They are counted as intermediate goods only if they are consumed.
 - They are counted as intermediate goods whether they are used to produce other goods or consumed.
- ANS: B PTS: 1 DIF: Easy REF: p.101-102
BLM: Higher Order NOT: Macro TB_5-39
40. How is flour treated in GDP terms?
- It is counted as an intermediate good.
 - It is counted as an intermediate good if it is used by a company to make bread.
 - It is counted as a final good if it is used by a consumer who bakes bread for his own consumption.
 - It is counted as a final good.
- ANS: D PTS: 1 DIF: Easy REF: p.101-102
BLM: Higher Order NOT: Macro TB_5-40
41. How is gasoline treated in GDP terms?
- It is counted as an intermediate good.
 - It is counted as a final good if a company uses it to provide transportation services.
 - It is counted as a final good if a consumer uses it to mow her yard.
 - It is counted as an intermediate good if a consumer uses it to mow a friend's yard without pay.
- ANS: C PTS: 1 DIF: Easy REF: p.101-102
BLM: Higher Order NOT: Macro TB_5-41

42. How are goods that go into inventory and are not sold during the current period treated in GDP terms?
- They are counted as intermediate goods and so are not included in current-period GDP.
 - They are counted in current GDP only if the firm that produced them sells them to another firm.
 - They are included in current-period GDP as inventory investment.
 - They are included in current-period GDP as consumption.

ANS: C PTS: 1 DIF: Easy REF: p.101
BLM: Remember NOT: Macro TB_5-42

43. The local Chevrolet dealership has an increase in inventory of 25 cars in 2009. How will the sale of all 25 cars, in 2010, affect the GDP?
- The value of the cars will be counted as part of GDP in 2009, but not in 2010.
 - The value of the cars will not affect the 2009 GDP, but will be included in 2010 GDP.
 - The value of the cars will be included both in 2009 and 2010 GDP.
 - The value of the cars will not be included in GDP in 2009 or 2010.

ANS: A PTS: 1 DIF: Average REF: p.101
BLM: Higher Order NOT: Macro TB_5-43

44. A movie company makes 500 000 DVDs in the second quarter. It sells 300 000 of them before the end of the second quarter, and holds the others in its warehouse. How is the second quarter GDP affected?
- The DVDs are included in second-quarter GDP.
 - The DVDs that are not purchased in the second quarter are not counted in the second-quarter GDP.
 - Since all the 500 000 DVDs will eventually be bought by consumers, they are included as consumption in the third quarter.
 - The DVDs will be counted as a change in inventory in the second quarter, and when sold in the third quarter will raise GDP.

ANS: A PTS: 1 DIF: Average REF: p.101
BLM: Higher Order NOT: Macro TB_5-44

45. George buys and lives in a newly constructed home he paid \$200 000 for in 2010. He sells the house in 2011 for \$225 000. How is GDP impacted?
- The 2011 sale increases 2011 GDP by \$225 000 and does nothing to 2010 GDP.
 - The 2011 sale increases 2011 GDP by \$25 000 and does nothing to 2010 GDP.
 - The 2011 sale does not increase 2011 GDP and does nothing to 2010 GDP.
 - The 2011 sale increases 2011 GDP by \$225 000, and 2010 GDP is revised upward by \$25 000.

ANS: C PTS: 1 DIF: Average REF: p.101-102
BLM: Higher Order NOT: Macro TB_5-45

46. Darla, a U.S. citizen, only works in Canada. How does the value added to production from her employment impact GDP and GNP?
- It is included in both Canadian GDP and Canadian GNP.
 - It is included only in Canadian GDP.
 - It is included only in Canadian GNP.
 - It is not included in either Canadian GDP or Canadian GNP.

ANS: B PTS: 1 DIF: Average REF: p.102
BLM: Higher Order NOT: Macro TB_5-46

47. Greg, a Canadian citizen, works only in the United States. How does the value added to production from his employment impact GDP and GNP?
- a. It is included in both Canadian GDP and Canadian GNP.
 - b. It is included only in Canadian GDP.
 - c. It is included only in Canadian GNP.
 - d. It is not included in either Canadian GDP or Canadian GNP.

ANS: C PTS: 1 DIF: Average REF: p.102
BLM: Higher Order NOT: Macro TB_5-47

48. Anna, a Canadian citizen, works only in Germany. How is the value added to production from her employment included in GDP?
- a. It is only included in Canadian GDP.
 - b. It is only included in German GDP.
 - c. It is included in both German and Canadian GDP.
 - d. It is included in neither German nor Canadian GDP.

ANS: B PTS: 1 DIF: Average REF: p.102
BLM: Higher Order NOT: Macro TB_5-48

49. An Italian company opens a pasta company in Ottawa. Where are the profits from this pasta company included?
- a. in both Canadian and Italian GNP
 - b. in both Canadian and Italian GDP
 - c. in Canadian GNP and Italian GDP
 - d. in Canadian GDP and Italian GNP

ANS: D PTS: 1 DIF: Average REF: p.102
BLM: Higher Order NOT: Macro TB_5-49

50. A Canadian company owns a fast food restaurant in Romania. Where is the value of goods and services it produces included?
- a. in both Romanian and Canadian GDP
 - b. partly in Romanian GDP and partly in Canadian GDP
 - c. in Romanian GDP, but not Canadian GDP
 - d. in Canadian GDP, but not Romanian GDP

ANS: C PTS: 1 DIF: Average REF: p.102
BLM: Higher Order NOT: Macro TB_5-50

51. Which of the following is included in GDP?
- a. the sale of stocks and bonds
 - b. the sale of used goods
 - c. the sale of services such as visits to a doctor
 - d. interest income from a savings account

ANS: C PTS: 1 DIF: Average REF: p.101-102
BLM: Higher Order NOT: Macro TB_5-51

52. Which of the following is included in GDP?

- a. the sale of stocks and bonds
- b. the estimated rental value of owner-occupied housing
- c. unpaid production of goods and services at home
- d. the sale of an old piece of jewellery

ANS: B PTS: 1 DIF: Average REF: p.100-102
BLM: Higher Order NOT: Macro TB_5-52

53. Which of the following is included in Canadian GDP?

- a. the difference in the price of the sale of an existing home and its original purchase price
- b. goods produced by foreign citizens working in Canada
- c. known illegal activities
- d. goods produced by a Canadian company in France

ANS: B PTS: 1 DIF: Average REF: p.100-101
BLM: Higher Order NOT: Macro TB_5-53

54. Which of the following is counted in Canadian GDP?

- a. goods and services produced by Canadian citizens working in foreign countries
- b. both the peaches used by a bakery to make peach pies and the peach pies
- c. final goods and services purchased by the government
- d. imported final goods and services purchased by Canadian government

ANS: C PTS: 1 DIF: Average REF: p.100-101
BLM: Higher Order NOT: Macro TB_5-54

55. Which of the following is counted in GDP?

- a. the estimated value of housework
- b. the value of illegally produced goods and services
- c. the value of newly issued stocks and bonds
- d. the estimated value of housing services

ANS: D PTS: 1 DIF: Average REF: p.100-101
BLM: Remember NOT: Macro TB_5-55

56. How is Canadian GNP calculated from Canadian GDP?

- a. by including income earned by foreigners in Canada and excluding income earned by Canadian citizens abroad
- b. by including income earned by Canadian citizens abroad and excluding income earned by foreigners in Canada
- c. by including income earned by foreigners in Canada
- d. by excluding income earned by Canadian citizens abroad

ANS: B PTS: 1 DIF: Average REF: p.102
BLM: Remember NOT: Macro TB_5-56

57. How is NNP calculated?

- a. by subtracting saving from the total income of citizens of a nation
- b. by subtracting business expenses and taxes from the total profits earned by citizens of a nation
- c. by subtracting depreciation from the total income of citizens of a nation
- d. by subtracting depreciation from the total profits earned by citizens of a nation

ANS: C PTS: 1 DIF: Average REF: p.102
BLM: Remember NOT: Macro TB_5-57

58. In the national income accounts, what is depreciation called?

- a. "total tax depreciation"
- b. "capital consumption allowance"
- c. "consumption of circulating capital"
- d. "loss due to wear"

ANS: B PTS: 1 DIF: Average REF: p.102
BLM: Remember NOT: Macro TB_5-58

59. Which of the following best defines national income?

- a. all income produced within a country
- b. the total income earned by a nation's residents from the production of goods and services within the borders of the country
- c. the total income earned by a nation's residents in the production of goods and services
- d. the income received by the national government

ANS: C PTS: 1 DIF: Average REF: p.102
BLM: Remember NOT: Macro TB_5-59

60. National income differs from net national product in that it includes business subsidies. Which of the following does national income exclude, as opposed to net national product?

- a. profits of corporations
- b. indirect business taxes
- c. retained earnings of corporations
- d. depreciation

ANS: B PTS: 1 DIF: Average REF: p.102
BLM: Remember NOT: Macro TB_5-60

61. What is the income that households and non-corporate businesses receive called?

- a. disposable personal income
- b. proprietors' income
- c. national income
- d. personal income

ANS: D PTS: 1 DIF: Average REF: p.102
BLM: Remember NOT: Macro TB_5-61

62. What does personal income include and exclude?
- a. It includes retained earnings, corporate income taxes, and social insurance contributions, and excludes interest and transfer payments received by households from government.
 - b. It excludes retained earnings, corporate income taxes, social insurance contributions, and interest, and includes transfer payments received by households from government.
 - c. It excludes retained earnings, corporate income taxes, and social insurance contributions, and includes interest and transfer payments received by households from government.
 - d. It includes retained earnings, corporate income taxes, social insurance contributions, and interest, and excludes transfer payments received by households from government.

ANS: C PTS: 1 DIF: Average REF: p.102
BLM: Remember NOT: Macro TB_5-62

63. Which of the following best defines disposable personal income?
- a. the income that households have left after paying taxes and nontax payments to the government
 - b. the income that businesses have left after paying taxes and nontax payments to the government
 - c. the income that households and noncorporate businesses have left after paying taxes and nontax payments to the government
 - d. the income that households and businesses have left after paying taxes and nontax payments to the government

ANS: C PTS: 1 DIF: Average REF: p.102
BLM: Remember NOT: Macro TB_5-63

64. Which of the following best defines retained earnings?
- a. the part of income that households retain after paying taxes
 - b. the part of income that businesses retain after paying taxes
 - c. the part of income that corporations pay to their owners in the form of dividends
 - d. the part of income that corporations do not pay to their owners in the form of dividends

ANS: D PTS: 1 DIF: Average REF: p.102
BLM: Remember NOT: Macro TB_5-64

Use the following table to answer the following questions.

Table 5-1

GDP	\$200
Income Earned by Citizens Abroad	15
Income Foreigners Earned Here	25
Depreciation	7
Indirect Business Taxes	12
Business Subsidies	4
Statistical Discrepancy	0
Retained Earnings	8
Corporate Income Taxes	10
Social Insurance Contributions	14
Interest Paid to Households by Government	6
Transfer Payments to Households from Government	20
Personal Taxes	35
Nontax Payments to Government	10

65. **Refer to Table 5-1.** What is the GNP for this economy?
- \$185
 - \$193
 - \$207
 - \$215

ANS: A PTS: 1 DIF: Average REF: p.102
BLM: Higher Order NOT: Macro TB_5-65

66. **Refer to Table 5-1.** What is the NNP for this economy?
- \$164
 - \$170
 - \$178
 - \$192

ANS: C PTS: 1 DIF: Challenging REF: p.102
BLM: Higher Order NOT: Macro TB_5-66

67. **Refer to Table 5-1.** What is the national income for this economy?
- \$170
 - \$185
 - \$192
 - \$215

ANS: A PTS: 1 DIF: Challenging REF: p.102
BLM: Higher Order NOT: Macro TB_5-67

68. **Refer to Table 5-1.** What is the personal income for this economy?

- a. \$154
- b. \$164
- c. \$170
- d. \$178

ANS: B PTS: 1
BLM: Higher Order

DIF: Challenging REF: p.102
NOT: Macro TB_5-68

69. **Refer to Table 5-1.** What is the disposable personal income for this economy?

- a. \$119
- b. \$154
- c. \$164
- d. \$170

ANS: A PTS: 1
BLM: Higher Order

DIF: Challenging REF: p.102
NOT: Macro TB_5-69

Use the following table to answer the following questions.

Table 5-2

GDP	\$440
Income Earned by Citizens Abroad	20
Income Foreigners Earned Here	50
Depreciation	16
Capital Consumption Allowance	16
Indirect Business Taxes	20
Business Subsidies	8
Statistical Discrepancy	0
Retained Earnings	25
Corporate Income Taxes	18
Social Insurance Contributions	35
Interest Paid to Households by Government	12
Transfer Payments to Households from Government	22
Personal Taxes	70
Nontax Payments to Government	5

70. **Refer to Table 5-2.** What is the GNP for this economy?

- a. \$420
- b. \$435
- c. \$440
- d. \$460

ANS: A PTS: 1
BLM: Higher Order

DIF: Average REF: p.102
NOT: Macro TB_5-70

71. **Refer to Table 5-2. What is the NNP for this economy?**

- a. \$380
- b. \$388
- c. \$404
- d. \$405

ANS: C PTS: 1
BLM: Higher Order

DIF: Challenging REF: p.102
NOT: Macro TB_5-71

72. **Refer to Table 5-2. What is the national income for this economy?**

- a. \$386
- b. \$392
- c. \$396
- d. \$398

ANS: A PTS: 1
BLM: Higher Order

DIF: Challenging REF: p.102
NOT: Macro TB_5-72

73. **Refer to Table 5-2. What is the disposable personal income for this economy?**

- a. \$353
- b. \$343
- c. \$278
- d. \$273

ANS: D PTS: 1
BLM: Higher Order

DIF: Challenging REF: p.102
NOT: Macro TB_5-74

74. **Refer to Table 5-2. What is the personal income for this economy?**

- a. \$417
- b. \$367
- c. \$349
- d. \$348

ANS: D PTS: 1
BLM: Higher Order

DIF: Challenging REF: p.102
NOT: Macro TB_5-73

75. The government reports that "GDP increased by 1.6 percent in the last quarter." What does this statement mean?

- a. GDP increased by 6.4 percent for the year.
- b. GDP increased at an annual rate of 6.4 percent during the last quarter.
- c. GDP increased at an annual rate of 1.6 percent during the last quarter.
- d. GDP increased at an annual rate of 0.4 percent during the last quarter.

ANS: C PTS: 1
BLM: Higher Order

DIF: Easy REF: p.103
NOT: Macro TB_5-75

76. If the government reports that "GDP increased at an annual rate of 6.0 percent for the fourth quarter of 2010," by how much did GDP increase?
- a. 6.0 percent during 2010
 - b. 24.0 percent during 2010
 - c. 6.0 percent during the fourth quarter of 2010
 - d. 1.5 percent during the fourth quarter of 2010

ANS: D PTS: 1 DIF: Easy REF: p.103
BLM: Higher Order NOT: Macro TB_5-76

77. If Canadian GDP in the fourth quarter is \$1.6 trillion, what does this number reflect?
- a. the actual amount of final goods and services produced in the fourth quarter
 - b. about four times the annual GDP rate
 - c. a somewhat lower amount than the amount actually produced in the fourth quarter, because GDP is seasonally adjusted, and non-seasonally adjusted GDP for the fourth quarter is typically higher
 - d. about four times the amount actually produced in that quarter, plus what had been removed for seasonal adjustment

ANS: D PTS: 1 DIF: Average REF: p.103
BLM: Higher Order NOT: Macro TB_5-77

78. In Canada GDP is reported each quarter. How are these numbers computed?
- a. These numbers are adjusted to make them measure at annual and seasonally adjusted rates.
 - b. These numbers are adjusted to make them annual rates, but no adjustment for seasonal variations is made.
 - c. These numbers are quarterly rates that have been seasonally adjusted.
 - d. These numbers are at quarterly rates and have not been seasonally adjusted.

ANS: A PTS: 1 DIF: Easy REF: p.103
BLM: Remember NOT: Macro TB_5-78

79. In the nation of Ophelia, quarterly GDP is always higher in the second quarter than in other quarters. In order to account for this predictable jump in GDP, what will Ophelia's government statisticians most likely do?
- a. make sure to account for inventory changes during the second quarter
 - b. report real GDP, not nominal GDP
 - c. focus on GNP rather than GDP during the second quarter
 - d. make a seasonal adjustment for the second quarter data

ANS: D PTS: 1 DIF: Average REF: p.103
BLM: Remember NOT: Macro TB_5-79

80. In computing GDP, what is investment?
- a. spending on stocks, bonds, and other financial assets
 - b. spending on real estate and financial assets
 - c. spending on new capital equipment, inventories, and structures, including new housing
 - d. spending on capital equipment, inventories, and structures, excluding household purchases of new housing

ANS: C PTS: 1 DIF: Average REF: p.104
BLM: Higher Order NOT: Macro TB_5-80

81. What government level(s) is (are) considered when computing government purchases for GDP accounting purposes?
- a. the federal government only
 - b. provincial and federal governments only
 - c. local, provincial, and federal governments
 - d. local and provincial governments, but not the federal government

ANS: C PTS: 1 DIF: Easy REF: p.104
BLM: Remember NOT: Macro TB_5-81

82. If you buy a burger and fries at your favourite fast food restaurant, what happens to GDP and consumption spending?
- a. Neither GDP nor consumption spending will be affected because you would have eaten at home if you hadn't eaten at the restaurant.
 - b. GDP will be higher, but consumption spending will be unchanged.
 - c. GDP will be unchanged, but consumption spending will be higher.
 - d. Both GDP and consumption spending will be higher.

ANS: D PTS: 1 DIF: Easy REF: p.104
BLM: Higher Order NOT: Macro TB_5-82

83. How is the estimated rental value of owner-occupied housing treated in GDP computations?
- a. included as consumption
 - b. included as investment
 - c. not included in GDP
 - d. included as investment only if the house is new

ANS: A PTS: 1 DIF: Average REF: p.103-104
BLM: Remember NOT: Macro TB_5-83

84. When a firm produces consumer goods and adds some to inventory rather than selling it, how is the increase in inventory counted in GDP?
- a. It is not counted in the current quarter GDP.
 - b. It is counted in the current quarter GDP as investment.
 - c. It is counted in the current quarter GDP as consumption.
 - d. It is counted in the current quarter GDP as a statistical discrepancy.

ANS: B PTS: 1 DIF: Easy REF: p.104
BLM: Remember NOT: Macro TB_5-84

85. A firm produces consumer goods and adds some to inventory in the third quarter. In the fourth quarter the firm sells the goods at a retail outlet, leaving the firm's inventory diminished. As a result of these actions, what component(s) of GDP change in the fourth quarter?
- a. only investment and it decreases
 - b. only consumption and it increases
 - c. investment decreases and consumption increases
 - d. neither investment nor consumption changes

ANS: C PTS: 1 DIF: Challenging REF: p.104
BLM: Higher Order NOT: Macro TB_5-85

86. A Canadian publisher purchases new computers. What impact does this purchase have on investment and GDP?
- a. It makes investment and GDP higher.
 - b. It makes investment higher and leaves GDP unchanged.
 - c. It makes investment higher and reduces GDP.
 - d. It makes neither investment nor GDP higher.

ANS: A PTS: 1 DIF: Easy REF: p.104
BLM: Higher Order NOT: Macro TB_5-86

87. A Manitoba farmer buys a new tractor made in Alberta by a German company. What is the impact on investment and GDP?
- a. Canadian investment and German GDP increase, but Canadian GDP is unaffected.
 - b. Canadian investment and GDP increase, but German GDP is unaffected.
 - c. Canadian investment, Canadian GDP, and German GDP are unaffected, because tractors are intermediate goods.
 - d. Canadian investment, Canadian GDP, and German GDP all increase.

ANS: B PTS: 1 DIF: Average REF: p.104
BLM: Higher Order NOT: Macro TB_5-87

88. If a Canadian citizen buys a television made in Korea made by a Korean firm, what is the impact on net exports and GDP?
- a. Canadian net exports decrease, and Canadian GDP decreases.
 - b. Canadian net exports are unaffected, and Canadian GDP decreases.
 - c. Canadian net exports are unaffected, and Canadian GDP is unaffected.
 - d. Canadian net exports decrease but Canadian GDP is unaffected.

ANS: D PTS: 1 DIF: Average REF: p.104-105
BLM: Higher Order NOT: Macro TB_5-88

89. If a Canadian household buys a \$75 handbag in Italy, Canadian consumption increases by \$75. What happens to Canadian imports/exports and GDP?
- a. Canadian imports increase by \$75, and Canadian GDP increases by \$75.
 - b. Canadian imports increase by \$75, but Canadian GDP is unaffected.
 - c. Canadian imports are unaffected, and Canadian GDP is unaffected.
 - d. Canadian exports increase by \$75, and Canadian GDP increases by \$75.

ANS: B PTS: 1 DIF: Average REF: p.104-105
BLM: Higher Order NOT: Macro TB_5-89

90. Stephanie buys a designer dress produced by a Canadian-owned fashion shop in France. As a result, Canadian consumption increases. What happens as a result?
- a. Canadian net exports decrease, Canadian GNP increases, and French GDP is unaffected.
 - b. Canadian net exports decrease, Canadian GDP increases, and Canadian GNP is unaffected.
 - c. Canadian net exports decrease, Canadian GDP is unaffected, and Canadian GNP increases.
 - d. Canadian net exports are unaffected, Canadian GDP is unaffected, and French GDP increases.

ANS: C PTS: 1 DIF: Challenging REF: p.102 | p.104-105
BLM: Higher Order NOT: Macro TB_5-90

91. A German citizen buys an automobile produced in Canada by a Japanese company. What happens as a result?
- Canadian net exports increase, Canadian GNP and GDP are unaffected, Japanese GNP increases, German net exports decrease, and German GNP and GDP are unaffected.
 - Canadian net exports, GNP, and GDP increase; Japanese GDP increases; German net exports decrease; and German GDP is unaffected.
 - Canadian net exports and GDP increase, Japanese GNP increases, German net exports decrease, and German GDP and GNP are unaffected.
 - Canadian net exports, GNP, and GDP are unaffected; Japanese GNP increases; German net exports decrease; and German GDP and GNP decrease.

ANS: C PTS: 1 DIF: Challenging REF: p.102 | p.104-105
BLM: Higher Order NOT: Macro TB_5-91

92. After the terrorist attacks on September 11, 2001, governments raised expenditures to increase security at airports. How are these purchases of goods and services treated in GDP?
- They are not included in GDP since they are not productive.
 - They are not included in GDP since governments will have to raise taxes to pay for them.
 - They are included in GDP since government expenditures are included in GDP.
 - They are included in GDP only to the extent that the federal, and not provincial or local governments, paid for them.

ANS: C PTS: 1 DIF: Average REF: p.104
BLM: Higher Order NOT: Macro TB_5-92

93. A wind farm in Manitoba buys a large turbine generator from a Swedish-owned factory located in Ontario that uses local workers. What happens as a result?
- Canadian investment, GDP, and GNP all increase by the same amount.
 - Canadian investment increases, but GDP and GNP are unaffected by the purchase.
 - Canadian investment and GDP increase by the same amount, but Canadian GNP increases by a smaller amount.
 - Canadian investment and GNP increase by the same amount, but Canadian GDP increases by a smaller amount.

ANS: C PTS: 1 DIF: Challenging REF: p.102 | p.104-105
BLM: Higher Order NOT: Macro TB_5-93

94. Which of the following best defines a transfer payment?
- government spending on imported goods
 - money that Canadian citizens working abroad send back to their families in Canada
 - payments to governments, other than taxes
 - a form of government spending that is not made in exchange for a currently produced good or service

ANS: D PTS: 1 DIF: Easy REF: p.104
BLM: Remember NOT: Macro TB_5-94

95. Which of the following represents a transfer payment?
- a. You transfer \$1000 from your bank account to a mutual fund.
 - b. The bank transfers \$10 quarterly interest to your savings account.
 - c. The government sends your grandfather his pension cheque.
 - d. Your employer automatically transfers \$100 each month from your wages to a nontaxable medical spending account.

ANS: C PTS: 1 DIF: Easy REF: p.104
BLM: Higher Order NOT: Macro TB_5-95

96. If the Canadian government pays an economist at the federal Ministry of Finance \$50 000 in salary in 2010 and \$30 000 in retirement benefits in 2011, how are the payments treated?
- a. Each payment will be included in GDP as government purchases for the respective years.
 - b. The 2010 payment is included in 2010 GDP as government purchases, but the 2011 payment is not included in 2011 GDP.
 - c. The 2010 payment is included in 2010 GDP as government purchases, and the 2011 payment is included in 2011 GDP as government transfer payments.
 - d. The 2010 payment is included in 2010 GDP as government purchases, and the 2011 payment is allocated to previous years' GDP according to the amount of work performed each year.

ANS: B PTS: 1 DIF: Average REF: p.104
BLM: Higher Order NOT: Macro TB_5-96

97. To encourage formation of small businesses, the government could provide subsidies. How would these subsidies be treated?
- a. They would be included in GDP because they are part of government expenditures.
 - b. They would be included in GDP because they are part of investment expenditures.
 - c. They would not be included in GDP because they are transfer payments.
 - d. They would not be included in GDP because the government raises taxes to pay for them.

ANS: C PTS: 1 DIF: Easy REF: p.104
BLM: Remember NOT: Macro TB_5-97

98. With respect to GDP, how are transfer payments treated?
- a. They are included in GDP because they represent income to individuals.
 - b. They are not included in GDP because they are not payments for currently produced goods or services.
 - c. They are included in GDP because the income will be spent for consumption.
 - d. They are not included in GDP because taxes will have to be raised to pay for them.

ANS: B PTS: 1 DIF: Easy REF: p.104
BLM: Remember NOT: Macro TB_5-98

99. With respect to GDP, how are welfare payments treated?
- a. They are included in GDP because they represent payment for work performed in the past.
 - b. They are included in GDP because they represent potential consumption.
 - c. They are excluded from GDP because they do not represent current government purchases of goods and services.
 - d. They are excluded from GDP because they are not private pensions.

ANS: C PTS: 1 DIF: Easy REF: p.104
BLM: Remember NOT: Macro TB_5-99

100. With respect to GDP, how is unemployment compensation treated?
- a. It is included as part of GDP because it represents income.
 - b. It is not included as part of GDP because it is a transfer payment.
 - c. It is included as part of GDP because the recipients must have worked in the past to qualify.
 - d. It is not included as part of GDP because the payments reduce business profits.

ANS: B PTS: 1 DIF: Easy REF: p.104
BLM: Higher Order NOT: Macro TB_5-100

101. Which of the following is included in Canadian GDP?
- a. Canadian exports of goods and services
 - b. CPP/QPP payments
 - c. the sale of used goods
 - d. Canadian imports of goods and services

ANS: A PTS: 1 DIF: Easy REF: p.103-104
BLM: Remember NOT: Macro TB_5-101

102. Which of the following is included in the consumption component of GDP?
- a. CPP/QPP payments
 - b. purchases of foreign goods and services
 - c. purchases of newly constructed homes
 - d. goods produced, but not sold during the reference period

ANS: B PTS: 1 DIF: Easy REF: p.103-104
BLM: Remember NOT: Macro TB_5-102

103. Which of the following is included in the investment component of GDP?
- a. purchases of previously owned homes
 - b. purchases of government bonds
 - c. purchases of new cars
 - d. changes in inventory

ANS: D PTS: 1 DIF: Average REF: p.103-104
BLM: Remember NOT: Macro TB_5-103

104. Which of the following is included in the investment component of GDP?
- a. purchases of stocks and bonds
 - b. purchases of capital equipment that was manufactured in a foreign country by a foreign firm
 - c. the estimated rental value of owner-occupied housing
 - d. purchases of new durable goods and appliances

ANS: B PTS: 1 DIF: Average REF: p.103-104
BLM: Remember NOT: Macro TB_5-104

105. Which of these will increase Canadian net exports?
- a. A Canadian resident buys a skateboard manufactured in Canada by a German firm.
 - b. A US resident buys a Blackberry manufactured in Canada.
 - c. A Canadian resident buys a souvenir in Paris.
 - d. A Canadian resident buys Microsoft stock.

ANS: B PTS: 1 DIF: Easy REF: p.103-104
BLM: Remember NOT: Macro TB_5-105

106. Which of these would be included in Canadian consumption?
- a. A Canadian resident buys a car manufactured in Brazil.
 - b. A French resident buys a new house in Canada
 - c. Beverly buys a newly issued stock in a Canadian corporation
 - d. Samantha produces some art work to decorate her house.

ANS: A PTS: 1 DIF: Easy REF: p.103-104
BLM: Higher Order NOT: Macro TB_5-106

107. In 2008 what was, approximately, Canadian GDP?
- a. \$1100 billion
 - b. \$1400 billion
 - c. \$1600 billion
 - d. \$1800 billion

ANS: C PTS: 1 DIF: Average REF: p.105
BLM: Remember NOT: Macro TB_5-107

108. In 2008 what was, approximately, GDP per person in Canada?
- a. \$32 000
 - b. \$37 000
 - c. \$48 000
 - d. \$57 000

ANS: C PTS: 1 DIF: Average REF: p.105
BLM: Remember NOT: Macro TB_5-108

109. In Canada in 2008, what percentage of GDP was consumption?
- a. 45 percent
 - b. 56 percent
 - c. 65 percent
 - d. 75 percent

ANS: B PTS: 1 DIF: Average REF: p.105
BLM: Remember NOT: Macro TB_5-109

110. In 2008, what were Canadian net exports?
- a. negative and about 10 percent the size of GDP
 - b. negative and about 3 percent the size of GDP
 - c. positive and about 1 percent the size of GDP
 - d. positive and about 10 percent the size of GDP

ANS: C PTS: 1 DIF: Average REF: p.105
BLM: Remember NOT: Macro TB_5-110

111. In 2008, what size was Canadian investment?

- a. 15 percent of GDP
- b. 17 percent of GDP
- c. 19 percent of GDP
- d. 23 percent of GDP

ANS: D PTS: 1 DIF: Average REF: p.105
BLM: Remember NOT: Macro TB_5-111

112. In 2008, how large were Canadian government purchases of goods and services?

- a. 5 percent of GDP
- b. 12 percent of GDP
- c. 20 percent of GDP
- d. 26 percent of GDP

ANS: C PTS: 1 DIF: Average REF: p.105
BLM: Remember NOT: Macro TB_5-112

113. In a given year, an economy has consumption of \$4000, investment of \$2000, government purchases of \$1500, exports of \$500, imports of \$600, taxes of \$1200, transfer payments of \$400, and depreciation of \$300. What is the GDP?

- a. \$6400
- b. \$7400
- c. \$7600
- d. \$8900

ANS: B PTS: 1 DIF: Average REF: p.105
BLM: Higher Order NOT: Macro TB_5-113

114. In 2008, how large were Canadian government purchases of goods and services?

- a. larger than consumption, but smaller than investment
- b. larger than investment, but smaller than consumption
- c. smaller than both consumption and investment
- d. larger than both consumption and investment

ANS: C PTS: 1 DIF: Average REF: p.105
BLM: Remember NOT: Macro TB_5-114

115. What would be the cause of total spending rising from one year to the next?

- a. The economy must be producing a larger output of goods and services.
- b. Prices at which goods and services are sold must be higher.
- c. Either the economy must be producing a larger output of goods and services, or the prices at which goods and services are sold must be higher, or both.
- d. Employment or productivity must be rising.

ANS: C PTS: 1 DIF: Easy REF: p.106
BLM: Higher Order NOT: Macro TB_5-115

116. Which of the following best describes real GDP?
- a. Real GDP evaluates current production at current prices.
 - b. Real GDP evaluates current production at the prices that prevailed in some specific year in the past.
 - c. Real GDP is not a valid measure of the economy's performance, since prices change from year to year.
 - d. Real GDP is a measure of the value of goods only; hence, it excludes the value of services.

ANS: B PTS: 1 DIF: Easy REF: p.106
BLM: Remember NOT: Macro TB_5-116

117. What is the difference between nominal and real GDP?
- a. Nominal GDP values production at current prices, while real GDP values production at constant prices.
 - b. Nominal GDP values production at constant prices, while real GDP values production at current prices.
 - c. Nominal GDP values production at market prices, while real GDP values production at the cost of the resources used in the production process.
 - d. Nominal GDP consistently underestimates the value of production, while real GDP consistently overestimates the value of production.

ANS: A PTS: 1 DIF: Easy REF: p.106-107
BLM: Remember NOT: Macro TB_5-117

118. If real GDP doubles and the GDP deflator doubles, what will happen to nominal GDP?
- a. It will stay the same.
 - b. It will double.
 - c. It will triple.
 - d. It will quadruple.

ANS: D PTS: 1 DIF: Average REF: p.107
BLM: Higher Order NOT: Macro TB_5-118

Consider the following table for the country of Ophir:

<u>Year</u>	<u>Nominal GDP</u>	<u>GDP Deflator</u>
2009	\$4000	100
2010	\$4100	105
2011	\$4200	110

119. What can we conclude from this information?
- a. Real GDP was higher in 2011 than in 2010, and real GDP in 2010 was higher than in 2009.
 - b. Real GDP was higher in 2010 than in 2009, and real GDP in 2010 was higher than in 2011.
 - c. Real GDP was higher in 2009 than in 2010, and real GDP in 2010 was higher than in 2011.
 - d. Real GDP was higher in 2009 than in 2011, and real GDP in 2010 was higher than in 2009.

ANS: C PTS: 1 DIF: Challenging REF: p.107
BLM: Higher Order NOT: Macro TB_5-119

120. Suppose GDP consists of wheat and rice. In 2006, 20 bushels of wheat are sold at \$4 per bushel, and 10 bushels of rice are sold at \$2 per bushel. If the price of wheat was \$2 per bushel and the price of rice was \$1 per bushel in 2001, the base year, what can we conclude?
- a. Nominal 2006 GDP is \$100, real 2006 GDP is \$50, and the GDP deflator is 50.
 - b. Nominal 2006 GDP is \$100, real 2006 GDP is \$50, and the GDP deflator is 200.
 - c. Nominal 2006 GDP is \$50, real 2006 GDP is \$100, and the GDP deflator is 200.
 - d. Nominal 2006 GDP is \$40, real 2006 GDP is \$100, and the GDP deflator is 50.

ANS: B PTS: 1 DIF: Average REF: p.107
BLM: Higher Order NOT: Macro TB_5-120

121. Suppose that the country of Samiam produces only eggs and ham. In 2010 it produced 100 units of eggs at \$3 each and 50 units of ham at \$4 each. In 2006, the base year, eggs sold for \$1.50 per unit and ham sold for \$5 per unit. What can we conclude?
- a. Nominal GDP is \$500, real GDP is \$400, and the GDP deflator is 80.
 - b. Nominal GDP is \$500, real GDP is \$400 and the GDP deflator is 125.
 - c. Nominal GDP is \$400, real GDP is \$400, and the GDP deflator is 100.
 - d. Nominal GDP is \$400, real GDP is \$500, and the GDP deflator is 125.

ANS: B PTS: 1 DIF: Average REF: p.107
BLM: Higher Order NOT: Macro TB_5-121

122. In the country of Mainia, GDP consists of cranberries and maple syrup. In 2010, 50 units of cranberries are sold at \$20 per unit, and 100 units of maple syrup are sold at \$10 per unit. If the price of cranberries was \$10 per unit and the price of maple syrup was \$15.00 per unit in the base year, what can we conclude?
- a. Nominal GDP is \$2500, real GDP is \$2000, and the GDP deflator is 83.3.
 - b. Nominal GDP is \$2000, real GDP is \$2500, and the GDP deflator is 125.
 - c. Nominal GDP is \$2000, real GDP is \$2000, and the GDP deflator is 100.
 - d. Nominal GDP is 2500, real GDP is 2500, and the GDP deflator is 100.

ANS: C PTS: 1 DIF: Average REF: p.107
BLM: Higher Order NOT: Macro TB_5-122

123. Suppose that Nova Scotia produces cheese and fish. In 2010, 20 units of cheese are sold at \$5 each and 8 units of fish are sold at \$50 each. In 2006, the base year, the price of cheese was \$10 per unit, and the price of fish was \$75 per unit. What can we conclude?
- a. Nominal GDP is \$500, real GDP is \$800, and the GDP deflator is 62.5
 - b. Nominal GDP is \$500, real GDP is \$800, and the GDP deflator is 160
 - c. Nominal GDP is \$800, real GDP is \$500, and the GDP deflator is 160
 - d. Nominal GDP is \$800, real GDP is \$500, and the GDP deflator is 62.5

ANS: A PTS: 1 DIF: Average REF: p.107
BLM: Higher Order NOT: Macro TB_5-123

Use the following table to answer the following questions.

Table 5-3.

Prices and Quantities

Year	Price of Burgers	Quantity of Burgers	Price of Magazines	Quantity of Magazines
2008	\$4.00	100	\$2.00	180
2009	\$5.00	120	\$2.50	200
2010	\$6.00	150	\$3.50	200

124. **Refer to Table 5-3. What is the nominal GDP for 2009?**

a. \$900
b. \$1000
c. \$1100
d. \$1250

ANS: C PTS: 1 DIF: Average REF: p.107
BLM: Higher Order NOT: Macro TB_5-124

125. **Refer to Table 5-3. What is the nominal GDP?**

a. \$680 for 2008, \$880 for 2009, and \$1200 for 2010
b. \$760 for 2008, \$880 for 2009, and \$1000 for 2010
c. \$760 for 2008, \$1100 for 2009, and \$1600 for 2010
d. \$960 for 2008, \$1280 for 2009, and \$1300 for 2010

ANS: C PTS: 1 DIF: Average REF: p.107
BLM: Higher Order NOT: Macro TB_5-125

126. **Refer to Table 5-3. Using 2008 as the base year, what can we conclude for 2009?**

a. Real GDP is \$880 and the GDP deflator is 80.
b. Real GDP is \$880 and the GDP deflator is 95
c. Real GDP is \$880 and the GDP deflator is 125
d. Real GDP is \$950 and the GDP deflator is 95.

ANS: C PTS: 1 DIF: Average REF: p.107
BLM: Higher Order NOT: Macro TB_5-126

127. **Refer to Table 5-3. Using 2009 as the base year, what can we conclude for 2008?**

a. Real GDP is \$760 and the GDP deflator is 100.
b. Real GDP is \$760 and the GDP deflator is 125.
c. Real GDP is \$880 and the GDP deflator is 80.
d. Real GDP is \$950 and the GDP deflator is 80.

ANS: D PTS: 1 DIF: Challenging REF: p.107
BLM: Higher Order NOT: Macro TB_5-127

128. **Refer to Table 5-3.** Using the GDP deflator to measure the average level of prices and using 2006 as the base year, what is the economy's inflation rate?
- a. 20 percent for 2009 and 12.5 percent for 2010
 - b. 20 percent for 2009 and 30 percent for 2010
 - c. 25 percent for 2009 and 28 percent for 2010
 - d. 44.7 percent for 2009 and 45.5 for 2010

ANS: C PTS: 1 DIF: Average REF: p.107
BLM: Higher Order NOT: Macro TB_5-128

129. What prices are used to compute real GDP?
- a. current-year prices
 - b. constant prices
 - c. future-year prices
 - d. the ratio of current-year prices to constant prices

ANS: B PTS: 1 DIF: Easy REF: p.107
BLM: Remember NOT: Macro TB_5-129

130. How are nominal GDP and real GDP related?
- a. Nominal GDP measures base-year production using base-year prices, while real GDP measures current production using current prices.
 - b. Nominal GDP measures current production using base-year prices, while real GDP measures current production using current prices.
 - c. Nominal GDP measures current production using current prices, while real GDP measures current production using base-year prices.
 - d. Nominal GDP measures current production using current prices, while real GDP measures base-year production using base-year prices.

ANS: C PTS: 1 DIF: Average REF: p.108
BLM: Remember NOT: Macro TB_5-130

131. How do nominal GDP and real GDP compare as gauges of economic well-being?
- a. Nominal GDP is a better gauge of economic well-being than is real GDP.
 - b. Real GDP is a better gauge of economic well-being than is nominal GDP.
 - c. Real GDP and nominal GDP are equally good measures of economic well-being.
 - d. Whether real GDP or nominal GDP is a better measure of economic well-being depends on what sort of goods are produced.

ANS: B PTS: 1 DIF: Easy REF: p.108
BLM: Higher Order NOT: Macro TB_5-131

132. When economists talk about growth in the economy, how do they measure that growth?
- a. with the absolute change in nominal GDP
 - b. with the percentage change in real GDP
 - c. with the absolute change in real GDP
 - d. with the percentage change in nominal GDP

ANS: B PTS: 1 DIF: Easy REF: p.108
BLM: Remember NOT: Macro TB_5-132

133. Which of the following best defines the GDP deflator?

- a. the ratio of real GDP to nominal GDP
- b. the ratio of real GDP to nominal GDP multiplied by 100
- c. the ratio of nominal GDP to real GDP
- d. the ratio of nominal GDP to real GDP multiplied by 100

ANS: D PTS: 1 DIF: Easy REF: p.108
BLM: Remember NOT: Macro TB_5-133

134. If nominal GDP is \$1 trillion and real GDP is \$0.8 trillion, what is the GDP deflator?

- a. 0.8
- b. 1.25
- c. 80
- d. 125

ANS: D PTS: 1 DIF: Easy REF: p.108
BLM: Higher Order NOT: Macro TB_5-134

135. If the GDP deflator is 200 and nominal GDP is \$1 trillion billion, what is real GDP?

- a. \$5 billion
- b. \$200 billion
- c. \$500 billion
- d. \$2 trillion

ANS: C PTS: 1 DIF: Easy REF: p.108
BLM: Higher Order NOT: Macro TB_5-135

136. If a small country has current nominal GDP of \$20 billion and the GDP deflator is 50, what is its real GDP?

- a. \$100 billion
- b. \$40 billion
- c. \$10 billion
- d. \$4 billion

ANS: B PTS: 1 DIF: Easy REF: p.108
BLM: Higher Order NOT: Macro TB_5-136

137. If a small country has current nominal GDP of \$25 billion and the GDP deflator is 125, what is its real GDP?

- a. \$312.5 billion
- b. \$207.5 billion
- c. \$31.25 billion
- d. \$20 billion

ANS: D PTS: 1 DIF: Easy REF: p.108
BLM: Higher Order NOT: Macro TB_5-137

138. A country reported a nominal GDP of \$100 billion in 2007 and \$75 billion in 2006, and reported a GDP deflator of 125 in 2007 and 120 in 2006. What happened to real output and prices from 2006 to 2007?
- a. Real output and prices both rose.
 - b. Real output rose and prices fell.
 - c. Real output fell and prices rose.
 - d. Real output and prices both fell.

ANS: A PTS: 1 DIF: Average REF: p.108
BLM: Higher Order NOT: Macro TB_5-138

139. A country reported nominal GDP of \$200 billion in 2007 and \$180 billion in 2006, and reported a GDP deflator of 125 in 2007 and 105 in 2006. What happened to real output and prices from 2006 to 2007?
- a. Real output and prices both rose.
 - b. Real output rose and prices fell.
 - c. Real output fell and prices rose.
 - d. Real output and prices both fell.

ANS: C PTS: 1 DIF: Average REF: p.108
BLM: Higher Order NOT: Macro TB_5-139

140. A country reported a nominal GDP of \$115 billion in 2007 and \$125 billion in 2006, and reported a GDP deflator of 85 in 2007 and 100 in 2006. What happened to real output and prices from 2006 to 2007?
- a. Real output and prices both rose.
 - b. Real output fell and prices rose.
 - c. Real output rose and prices fell.
 - d. Real output and prices both fell.

ANS: C PTS: 1 DIF: Average REF: p.108
BLM: Higher Order NOT: Macro TB_5-140

141. A country reported a nominal GDP of \$85 billion in 2007 and \$100 billion in 2006, and reported a GDP deflator of 100 in 2007 and 105 in 2006. What happened to real output and prices from 2006 to 2007?
- a. Real output and prices both rose.
 - b. Real output rose and prices fell.
 - c. Real output and prices both fell.
 - d. Real output fell and prices rose.

ANS: C PTS: 1 DIF: Average REF: p.108
BLM: Higher Order NOT: Macro TB_5-141

142. Which of the following can the GDP deflator be used to identify?
- the increase in nominal GDP that is due to an increase in prices rather than an increase in production
 - the increase in real GDP that is due to an increase in prices rather than an increase in production
 - the increase in the cost of living for typical Canadian consumers
 - the reduction in government spending required to balance the federal budget
- ANS: A PTS: 1 DIF: Easy REF: p.108
BLM: Higher Order NOT: Macro TB_5-142
143. Dave, a student who knits ski caps with tassels, sells the same number of caps this year as last year, but at 20 percent higher prices. What can we conclude?
- He must be better off than last year because his income is higher.
 - We do not have enough information to tell whether he is better off this year than last year.
 - He cannot be better off than last year because he sold the same number of caps both years.
 - He is better off this year only if there was no inflation over the past year.
- ANS: B PTS: 1 DIF: Easy REF: p.108
BLM: Higher Order NOT: Macro TB_5-143
144. A farmer produces the same output in 2007 as in 2006. His input prices increase by 50 percent, but so does his product price. What can we conclude?
- The farmer is better off in 2007.
 - The farmer was better off in 2006.
 - The farmer is equally well off in 2007 as in 2006.
 - We cannot tell whether the farmer is better off in 2007 or in 2006 without additional information.
- ANS: D PTS: 1 DIF: Average REF: p.108
BLM: Higher Order NOT: Macro TB_5-144
145. Which of the following best describes the evolution of Canadian economy over the past decades?
- Real GDP in 2006 was less than three times its level in 1970.
 - The output of goods and services grew on average about 1 percent per year from 1970 to 2006.
 - Real GDP was approximately constant over the past decades, only prices have increased.
 - Continued growth in real GDP has allowed an improvement in Canadians' standard of living.
- ANS: D PTS: 1 DIF: Easy REF: p.109
BLM: Higher Order NOT: Macro TB_5-145
146. Which of the following best describes the evolution of Canadian economy over the past decades?
- Real GDP grew on average about 3 percent per year from 1970 to 2006.
 - Real GDP was approximately constant over the past decades.
 - The growth of real GDP has been steady over time.
 - There were no recessions over the period 1970 to 2005.
- ANS: A PTS: 1 DIF: Easy REF: p.109
BLM: Higher Order NOT: Macro TB_5-146

147. Recessions are associated with which of the following?

- a. higher prices
- b. increased profits
- c. higher employment
- d. falling real GDP

ANS: D PTS: 1 DIF: Easy REF: p.109
BLM: Remember NOT: Macro TB_5-147

148. GDP is used as the basic measure of a society's economic well-being. What is a better measure of the economic well-being of individuals in society?

- a. GDP per person
- b. the consumption component of GDP
- c. government expenditures per person
- d. the level of business investment

ANS: A PTS: 1 DIF: Easy REF: p.113
BLM: Remember NOT: Macro TB_5-148

149. During a federal election campaign, the incumbent argues that he should be re-elected because GDP grew by 12 percent during his 4-year term in office. You know that population grew by 4 percent over the period, and that the GDP deflator increased by 6 percent during the past 4 years. What can you conclude about real GDP per person?

- a. It grew by more than 12 percent.
- b. It grew, but by less than 12 percent.
- c. It was unchanged.
- d. It decreased.

ANS: B PTS: 1 DIF: Easy REF: p.113
BLM: Higher Order NOT: Macro TB_5-149

The information below was reported by the World Bank. On the basis of this information, which list below contains the correct ordering of GDP per person from highest to lowest?

Country	Nominal GDP, 2000	Population, 2000
Japan	\$4 800 000 million	127 million
Switzerland	\$240 000 million	7.2 million
United States	\$9 800 000 million	280 million

150. The information below was reported by the World Bank. On the basis of this information, which list below contains the correct ordering of GDP per person from highest to lowest?

Country	Nominal GDP, 2000	Population, 2000
Japan	\$4 800 000 million	127 million
Switzerland	\$240 000 million	7.2 million
United States	\$9 800 000 million	280 million

- a. Japan, Switzerland, United States
- b. Japan, United States, Switzerland
- c. United States, Switzerland, Japan
- d. United States, Japan, Switzerland

ANS: B PTS: 1 DIF: Average REF: p.113
BLM: Higher Order NOT: Macro TB_5-150

The information below was reported by the World Bank. On the basis of this information, which list below contains the correct ordering of GDP per person from highest to lowest?

Country	Nominal GDP, 2000	Population, 2000
Kenya	\$10 400 million	30.1 million
Tanzania	\$9000 million	33.7 million
Zimbabwe	\$7200 million	12.6 million

151. The information below was reported by the World Bank. On the basis of this information, which list below contains the correct ordering of GDP per person from highest to lowest?

Country	Nominal GDP, 2000	Population, 2000
Kenya	\$10 400 million	30.1 million
Tanzania	\$9000 million	33.7 million
Zimbabwe	\$7200 million	12.6 million

- a. Kenya, Tanzania, Zimbabwe
- b. Kenya, Zimbabwe, Tanzania
- c. Zimbabwe, Kenya Tanzania
- d. Zimbabwe, Tanzania, Kenya

ANS: C PTS: 1 DIF: Average REF: p.113
BLM: Higher Order NOT: Macro TB_5-151

152. Many things that society values, such as good health, high-quality education, enjoyable recreation opportunities, and desirable moral attributes of the population, are **NOT** measured as part of GDP. According to most economists, why is GDP a useful measure of society's well-being?
- a. GDP is not a useful measure of society's well-being because it does not measure many things that society values.
 - b. GDP is a useful measure of society's well-being because providing these other attributes is the responsibility of government.
 - c. GDP is a useful measure of society's well-being because it measures a nation's ability to produce the things that contribute to well-being.
 - d. GDP is an excellent measure of society's well-being because these other values cannot actually be measured.

ANS: C PTS: 1 DIF: Average REF: p.113-114
BLM: Higher Order NOT: Macro TB_5-152

153. Suppose that 25 years ago a country had nominal GDP of 1000, a GDP deflator of 200, and a population of 100. Today that country has a nominal GDP of 3000, a deflator of 400, and a population of 150. What happened to the real GDP per person?
- a. It more than doubled.
 - b. It rose, but less than doubled.
 - c. It fell.
 - d. It has not changed.

ANS: D PTS: 1 DIF: Easy REF: p.113
BLM: Higher Order NOT: Macro TB_5-153

154. Suppose that over the past 25 years a country's nominal GDP grew to three times its former size. In the meantime, population grew 50 percent and prices rose 100 percent. What happened to real GDP per person?
- a. It more than doubled.
 - b. It rose, but less than doubled.
 - c. It has not changed.
 - d. It fell.

ANS: C PTS: 1 DIF: Easy REF: p.113
BLM: Higher Order NOT: Macro TB_5-154

155. According to international studies, larger GDP per person is associated with which other measures of well-being?
- a. longer life expectancy and a higher rate of population growth
 - b. longer life expectancy and a higher percentage of the population that is literate
 - c. very nearly the same life expectancy and a higher quality of the environment
 - d. very nearly the same life expectancy and a higher percentage of the population that is literate

ANS: B PTS: 1 DIF: Average REF: p.114-115
BLM: Remember NOT: Macro TB_5-155

156. What is the relationship between a country's wealth and other measures of well-being such as life expectancy and literacy?
- In rich countries, people typically live into their late seventies, while in poor countries people typically live only until their fifties or early sixties.
 - In rich countries, as well as in poor countries, most people can read.
 - Poor countries tend to have higher infant mortality rates than do rich countries; therefore, population in poor countries increases at a lower rate.
 - In rich countries income inequality is less than in poor countries.

ANS: A PTS: 1 DIF: Easy REF: p.115
BLM: Remember NOT: Macro TB_5-156

157. What do international GDP and socioeconomic data show?
- They are inconclusive about the relationship between GDP and the economic well-being of citizens.
 - They suggest that GDP is a weak measure of a country's well-being.
 - They leave no doubt that a nation's GDP is closely associated with its citizens' standard of living.
 - They indicate that there are few real differences in living standards around the world, in spite of the large differences in GDP between nations.

ANS: C PTS: 1 DIF: Easy REF: p.114-115
BLM: Remember NOT: Macro TB_5-157

158. According to economists, why is it useful to measure the behaviour of the economy with statistics such as GDP?
- It can be used to forecast economic recessions and prevent them.
 - It measures the total value of a country's wealth.
 - It can be helpful in developing macroeconomic science, but is not useful for policymaking.
 - It is a crucial step toward developing the science of macroeconomics.

ANS: D PTS: 1 DIF: Easy REF: p.115
BLM: Higher Order NOT: Macro TB_5-158

TRUE/FALSE

1. Macroeconomic statistics include the inflation rate, the unemployment rate, GDP, and retail sales.

ANS: T PTS: 1 DIF: Easy REF: p.97
NOT: Macro TB_5-159

2. The basic tools of supply and demand analysis are as central to macroeconomic analysis as they are to microeconomic analysis.

ANS: T PTS: 1 DIF: Easy REF: p.98
NOT: Macro TB_5-160

3. Income exceeds production.

ANS: F PTS: 1 DIF: Easy REF: p.98-99
NOT: Macro TB_5-161

PROBLEM

1. A flour mill produces \$1000 worth of flour, of which \$700 goes to a bakery and \$300 to consumers. A water supplier produces \$300 worth of water, of which \$200 goes to the bakery and \$100 to consumers. The bakery produces \$1500 worth of bread and sells all of it to consumers. The three companies pay wages as follows: the mill pays \$400, the water supplier \$200, and the bakery \$200. There are no other costs of production.
 - a. Calculate GDP based on the value of production.
 - b. Calculate profits to the owners of each of the three companies (profit = revenue minus costs).
 - c. Calculate GDP based on income.

ANS:

- a. GDP is the value of all final goods and services. Final goods are \$300 worth of flour, \$100 water, and \$1500 bread.
 $GDP = 300 + 100 + 1500 = \$1900$
- b. Profits are as follows: the mill, $1000 - 400 = \$600$; the water supplier, $300 - 200 = \$100$, and the bakery $1500 - 700 - 200 - 200 = \$400$
- c. GDP is also the sum of all incomes in the economy: income = profits + wages = $600 + 100 + 400 + 400 + 200 + 200 = \$1900$. This result must be the same as calculated before.

PTS: 1

NOT: Macro TB_5-189

The following table shows GDP data of a hypothetical economy that produces only two items: maple syrup and trips to a local touristic attraction.

Year	Price of Maple Syrup	Price of Trips	Quantity of Maple Syrup	Number of Trips	Nominal GDP	Real GDP	GDP Deflator
2007	\$11	\$250	300	425			
2008	13	258	310	570			
2009	12	260	324	550			
2010	14	262	410	580			

2. Calculate nominal GDP, real GDP, and GDP deflator and fill in the corresponding columns.

ANS:

- a. Nominal GDP = Sum of current prices $\times$ Current quantities; Real GDP = Sum of base year (2007) prices $\times$ Current quantities; GDP deflator = $\text{Nominal GDP} / \text{Real GDP} \times 100$

Year	Price of Maple Syrup	Price of Trips	Quantity of Maple Syrup	Number of Trips	Nominal GDP	Real GDP	GDP Deflator (%)
2007	\$11	\$250	300	425	\$109 550	\$109 550	1
2008	13	258	310	570	\$151 090	\$145 910	1.035
2009	12	260	324	550	\$146 888	\$141 064	1.041
2010	14	262	410	580	\$157 700	\$149 510	1.054

PTS: 1

NOT: Macro TB_5-163

3. Calculate the percentage changes in nominal GDP, real GDP, and GDP deflator.

ANS:

The percentage change in nominal GDP from year 2008 to year 2009 is calculated using the formula $[(\text{Nominal GDP in 2009} - \text{Nominal GDP in 2008}) / \text{Nominal GDP in 2008}] \times 100$. The results are summarized in the following table.

PTS: 1 NOT: Macro TB_5-164

4. Draw a graph to show the evolution of this economy in terms of real GDP, nominal GDP, and GDP deflator over the period 2007-2010.

ANS:

Year	Nominal GDP	Real GDP	GDP Deflator (%)	Change in Nominal GDP (%)	Change in Real GDP (%)	Change in GDP Deflator (%)
2007	\$109 550	\$109 550	1			
2008	\$151 090	\$145 910	1.035	37.92	33.19	3.55
2009	\$146 888	\$141 064	1.041	-2.78	-3.32	0.56
2010	\$157 700	\$149 510	1.054	7.36	5.99	1.30

PTS: 1 NOT: Macro TB_5-165

5. Statistics Canada provides the following data on domestic expenditure. Fill in the missing data in the table.

Gross domestic product, expenditure-based (\$millions, at market prices)

Year	2005	2006	2007	2008	2009
Gross domestic product					
Personal expenditure on consumer goods and services	758 966	801 742	851 603	890 351	898 728
Government current expenditure on goods and services	259 857	277 608	293 608	314 329	333 942
Government gross fixed capital formation	37 067	41 151	45 321	50 955	59 078
Government inventories	27	-41	15	29	-3
Business gross fixed capital formation	255 596	283 382	301 885	313 574	269 394
Business investment in inventories	10 587	9 403	8 251	5 443	-8,177
Exports of goods and services	519 435	524 075	534 718	563 948	438 553
Deduct: Imports of goods and services	468 270	487 674	505 055	539 012	464 722

ANS:

GDP is the sum of all expenditure items in the table except imports, which is subtracted.

Expenditure-based GDP	1 373 265	1 449 646	1 530 346	1 599 617	1 526 793

PTS: 1

NOT: Macro TB_5-166

6. Statistics Canada provides the following data on domestic income. Calculate GDP based on these data and compare your results with those in the table of Problem 3. Statistical discrepancy is equal to half the difference between the expenditure and income-based GDP calculations. Calculate statistical discrepancy.

Year	2005	2006	2007	2008	2009
Income-based GDP (\$millions)					
Wages, salaries, and supplementary labour income	695 093	743 392	784 885	818 613	819 066
Corporation profits before taxes	186 585	197 286	200 943	216 970	146 897
Government business enterprise profits before taxes	15 293	14 805	15 493	16 355	12 975
Interest and miscellaneous investment income	61 421	66 404	71 589	83 998	63 947
Accrued net income of farm operators from farm production	1 210	-35	503	3 228	880
Net income of non-farm unincorporated business, including rent	84 024	86 785	89 908	91 331	98 999
Inventory valuation adjustment	-730	-3 262	2 449	-6 214	2 541
Taxes less subsidies on factors of production	61 982	64 536	67 900	71 094	70 604
Net domestic product					
Taxes less subsidies on products	93 302	96 052	98 816	94 840	93 030
Capital consumption allowances	176 246	185 201	196 346	209 383	218 785
Statistical discrepancy					
Source: Statistics Canada, CANSIM, table (for fee) 380-0001 and Catalogue no. 13-001-X. Last modified: 2010-05-31.					

ANS:

Net domestic product is the sum of all items above it in the table

Net domestic product	1 104 878	1 169 911	1 233 670	1 295 375	1 215 909

Income-based GDP is equal to Net domestic product plus “Taxes less subsidies on products” plus Capital consumption allowances.

Income-based GDP	1 374 426	1 451 164	1 528 832	1 599 598	1 527 724
Statistical discrepancy	580.5	759	-757	-9.5	465.5

PTS: 1

NOT: Macro TB_5-167

7. David lives in Canada. He operates a pizza business in his native town. Robert is Canadian, but he works in the United States. On a typical day, David makes \$275 in sales, of which he pays to the government \$25 in sales taxes. Robert makes \$150 in wages, of which he pays the US government \$15 in income taxes. There are no other costs or taxes. Based on this information, compute David and Robert's contribution to the following measures of income:
- Canadian GDP
 - Canadian GNP
 - US GDP
 - US GNP

ANS:

We can use the income-based definition of GDP

- Canadian GDP increases by \$275 from David, but is unaffected by Robert's income
- Canadian GNP increases by $275 + 150 = \$425$
- US GDP increases by \$150
- US GNP is not affected

PTS: 1

NOT: Macro TB_5-168

Chapter 6—Measuring the Cost of Living

MULTIPLE CHOICE

1. Babe Ruth, the famous baseball player, earned \$80 000 in 1931. Today, the best baseball players can earn 200 times as much as Babe Ruth in 1931. However, prices have also risen since 1931. What can we conclude from this information?
 - a. The best baseball players today are better off than Babe Ruth was in 1931.
 - b. Because prices have also risen, the standard of living of baseball stars hasn't changed since 1931.
 - c. One cannot make judgments about changes in the standard of living based on changes in prices and changes in incomes.
 - d. One cannot determine whether baseball stars today enjoy a higher standard of living than Babe Ruth did in 1931 without additional information regarding increases in prices since 1931.

ANS: D PTS: 1 DIF: Easy REF: p.121
BLM: Higher Order NOT: Macro TB_5-1

2. How does a rise in consumer price index affect a typical family?
 - a. The typical family has to spend more dollars to maintain the same standard of living.
 - b. The typical family can spend fewer dollars to maintain the same standard of living.
 - c. The typical family finds that its standard of living is not affected.
 - d. The typical family can offset the effects of rising prices by saving more.

ANS: A PTS: 1 DIF: Easy REF: p.122
BLM: Higher Order NOT: Macro TB_5-2

3. Which of the following is the consumer price index used for?
 - a. to track changes in the level of wholesale prices in the economy
 - b. to monitor changes in the cost of living
 - c. to monitor changes in the level of real GDP
 - d. to track changes in the stock market

ANS: B PTS: 1 DIF: Easy REF: p.122
BLM: Remember NOT: Macro TB_5-3

4. Which of the following is the consumer price index used for?
 - a. to differentiate between gross national product and gross domestic product
 - b. to turn dollar figures into meaningful measures of purchasing power
 - c. to characterize the types of goods and services that consumers purchase
 - d. to measure the quantity of goods and services that the economy produces

ANS: B PTS: 1 DIF: Easy REF: p.124
BLM: Remember NOT: Macro TB_5-4

5. Which of the following situations is described by the term “inflation”?
- a. The overall level of prices in the economy is increasing.
 - b. Incomes in the economy are increasing.
 - c. Stock-market prices are rising.
 - d. The economy is growing rapidly.

ANS: A PTS: 1 DIF: Easy REF: p.122
BLM: Remember NOT: Macro TB_5-5

6. When the overall level of prices in the economy is increasing, what is the economy experiencing?
- a. economic growth
 - b. inflation
 - c. unemployment
 - d. deflation

ANS: B PTS: 1 DIF: Easy REF: p.122
BLM: Remember NOT: Macro TB_5-6

7. Which of the following best defines the inflation rate?
- a. the price level
 - b. the change in the price level
 - c. the price level divided by the price level in the previous period
 - d. the percentage change in the price level from the previous period

ANS: D PTS: 1 DIF: Easy REF: p.122
BLM: Remember NOT: Macro TB_5-7

8. What does the CPI measure?
- a. the overall price of inputs purchased by a typical producer
 - b. the overall price of goods and services bought by a typical consumer
 - c. the overall price of goods and services produced in the economy
 - d. the overall price of stocks on the Toronto Stock Exchange

ANS: B PTS: 1 DIF: Easy REF: p.122
BLM: Remember NOT: Macro TB_5-8

9. Which of the following agencies calculates the CPI?
- a. the National Price Board
 - b. the Department of Weight and Measurements
 - c. Statistics Canada
 - d. the Ministry of Finance

ANS: C PTS: 1 DIF: Easy REF: p.122
BLM: Remember NOT: Macro TB_5-9

10. How often is the CPI calculated?
- a. weekly
 - b. monthly
 - c. quarterly
 - d. yearly

ANS: B PTS: 1 DIF: Easy REF: p.122
BLM: Remember NOT: Macro TB_5-10

11. What is the basket of goods used to construct the CPI?
- a random sample of all goods and services produced in the economy
 - the goods and services typically bought by consumers, according to Statistics Canada surveys
 - goods and services weighted by the ratio of expenditures on them relative to the consumption component of GDP
 - the least and the most expensive goods and services in each major category of consumer expenditures

ANS: B PTS: 1 DIF: Easy REF: p.124
BLM: Remember NOT: Macro TB_5-11

12. Which of the following goods are supposed to be included in the CPI?
- all goods and services produced in the economy
 - all goods and services that typical consumers buy
 - all goods and services in the consumption component of the GDP accounts
 - all the goods, but not the services, in the consumption component of the GDP accounts

ANS: B PTS: 1 DIF: Easy REF: p.124
BLM: Remember NOT: Macro TB_5-12

13. In the CPI, how are goods and services weighted?
- according to how much consumers buy of each item
 - according to whether the goods and services are necessities or luxuries
 - according to the levels of production of the goods and services in the domestic economy
 - according to the expenditures on them in the GDP national income accounts

ANS: A PTS: 1 DIF: Easy REF: p.124
BLM: Remember NOT: Macro TB_5-13

14. How are the weights on the various goods and services in the CPI basket determined?
- Each good and service is weighted according to its quantity.
 - A survey is conducted to determine how much of each good and service typical consumers purchase.
 - The weights equal the ratio of expenditures on each good or service divided by the total consumption expenditures in the GDP accounts.
 - Each good and service is weighted according to its price.

ANS: B PTS: 1 DIF: Easy REF: p.124
BLM: Remember NOT: Macro TB_5-14

15. In sequence, what are the steps involved in calculating the consumer price index and the inflation rate?
- choose a base year, determine the basket, compute the index, compute the basket's cost, and compute the inflation rate
 - choose a base year, find the prices, determine the basket, compute the basket's cost, and compute the inflation rate
 - determine the basket, find the prices, compute the basket's cost, choose a base year and compute the index, and compute the inflation rate
 - determine the basket, find the prices, compute the index, choose a base year and compute the inflation rate

ANS: C PTS: 1 DIF: Easy REF: p.122-124
 BLM: Remember NOT: Macro TB_5-15

Use the table below to answer the following questions.

Table 6-1

year	peaches	pecans
2010	\$14 per bushel	\$9 per bushel
2011	\$12 per bushel	\$14 per bushel

16. **Refer to Table 6-1.** Suppose that the typical consumer basket consists of 5 bushels of peaches and 10 bushels of pecans and that the base year is 2010. What is the consumer price index for 2010?
- 100
 - 160
 - 200
 - There is insufficient information to answer this question.

ANS: A PTS: 1 DIF: Easy REF: p.123-124
 BLM: Higher Order NOT: Macro TB_5-16

17. **Refer to Table 6-1.** Suppose that the typical consumer basket consists of 5 bushels of peaches and 10 bushels of pecans and that the base year is 2010. What is the consumer price index for 2011?
- 80
 - 100
 - 125
 - 200

ANS: C PTS: 1 DIF: Average REF: p.123-124
 BLM: Higher Order NOT: Macro TB_5-17

18. **Refer to Table 6-1.** What was the inflation rate in 2011?
- 25 percent
 - 20 percent
 - 5 percent
 - 4 percent

ANS: A PTS: 1 DIF: Average REF: p.123-124
 BLM: Higher Order NOT: Macro TB_5-18

Use the table below to answer the following questions.

Table 6-2

year	price of pork	price of corn
2010	\$20	\$12
2011	\$25	\$18

19. **Refer to Table 6-2.** Suppose that the basket of goods in the CPI consisted of 3 units of pork and 4 units of corn. What is the consumer price index for 2011 if the base year is 2010?
- 120
 - 109.22
 - 136.11
 - 150

ANS: C PTS: 1 DIF: Average REF: p.123-124
BLM: Higher Order NOT: Macro TB_5-19

20. **Refer to Table 6-2.** Suppose that the basket of goods in the CPI consisted of 3 units of pork and 4 units of corn. What is the inflation rate for 2011?
- 21.33 percent
 - 25 percent
 - 28.89 percent
 - 36.11 percent

ANS: D PTS: 1 DIF: Average REF: p.123-124
BLM: Higher Order NOT: Macro TB_5-20

21. The market basket used to calculate the CPI in Aquilonia is 4 loaves of bread, 6 litres of milk, 2 shirts, and 2 pairs of pants. In 2005 the price of bread was \$1.00 per loaf, the price of milk was \$1.50 per litre, the price of a shirt was \$6.00, and the price of a pair of pants was \$10.00. In 2006 the price of bread was \$1.75 per loaf, the price of milk was \$2.25 per litre, the price of a shirt was \$7.50, and the price of a pair of pants was \$13.00. What was the inflation rate, as measured by the CPI, for Aquilonia between 2005 and 2006?
- 20 percent
 - 24.4 percent
 - 30 percent
 - 36.67 percent

ANS: D PTS: 1 DIF: Challenging REF: p.123-124
BLM: Higher Order NOT: Macro TB_5-21

Use the following information to answer the following questions.

In the country of Shem, the CPI is calculated using a market basket consisting of 5 apples, 4 loaves of bread, 3 robes, and 2 litres of gasoline. The per-unit prices of these goods have been as follows:

Table 6-3

Year	Apples	Bread	Robes	Gasoline
2007	\$1.00	\$2.00	\$10.00	\$1.00
2008	\$1.00	\$1.50	\$9.00	\$1.50
2009	\$2.00	\$2.00	\$11.00	\$2.00
2010	\$3.00	\$3.00	\$15.00	\$2.50

22. **Refer to Table 6-3.** What was the inflation rate, as measured by the CPI, between 2007 and 2008?
- 8.89 percent
 - 7.14 percent
 - 3.75 percent
 - 11.25 percent
 - It is impossible to determine without knowing the base year.

ANS: A PTS: 1 DIF: Challenging REF: p.123-124
BLM: Higher Order NOT: Macro TB_5-22

23. **Refer to Table 6-3.** What was the inflation rate, as measured by the CPI, between 2008 and 2009?
- 28.5 percent
 - 34.2 percent
 - 47 percent
 - It is impossible to determine without knowing the base year.

ANS: B PTS: 1 DIF: Challenging REF: p.123-124
BLM: Higher Order NOT: Macro TB_5-23

24. **Refer to Table 6-3.** What was the inflation rate, as measured by the CPI, between 2009 and 2010?
- 40 percent
 - 40.25 percent
 - 46.46 percent
 - It is impossible to determine without knowing the base year.

ANS: A PTS: 1 DIF: Challenging REF: p.123-124
BLM: Higher Order NOT: Macro TB_5-24

25. **Refer to Table 6-3.** For the CPI, what is the base year?
- the benchmark against which other years are compared, and it changes each year
 - the benchmark against which other years are compared, and it changes occasionally
 - the year the CPI first appeared
 - the year before the year for which the CPI is calculated

ANS: B PTS: 1 DIF: Easy REF: p.123-124
BLM: Higher Order NOT: Macro TB_5-25

26. For any given year, what is the CPI?
- a. the price of the basket of goods and services in the given year divided by the price of the basket in the base year, then multiplied by 100
 - b. the price of the basket of goods and services in the given year divided by the price of the basket in the previous year, then multiplied by 100
 - c. the price of the basket of goods and services in the base year divided by the price of the basket in the given year, then multiplied by 100
 - d. the price of the basket of goods and services in the previous year divided by the price of the basket in the given year, then multiplied by 100

ANS: A PTS: 1 DIF: Average REF: p.123
BLM: Remember NOT: Macro TB_5-26

27. How is the inflation rate calculated?
- a. from a survey of consumer spending
 - b. by adding up the price increases of all goods and services
 - c. by computing a simple average of the price increase in all goods and services
 - d. by determining the percentage increase in the price index from the preceding period

ANS: D PTS: 1 DIF: Easy REF: p.124
BLM: Remember NOT: Macro TB_5-27

28. If this year the CPI is 125 and last year it was 120, what do we know?
- a. Most goods have become more expensive.
 - b. The price level has increased.
 - c. The inflation rate has increased.
 - d. Some goods have become cheaper.

ANS: B PTS: 1 DIF: Easy REF: p.124
BLM: Higher Order NOT: Macro TB_5-28

29. If the consumer price index was 100 in the base year and 107 the following year, what was the inflation rate?
- a. 107 percent
 - b. 10.7 percent
 - c. 7 percent
 - d. 0.7 percent

ANS: C PTS: 1 DIF: Easy REF: p.124
BLM: Higher Order NOT: Macro TB_5-29

30. If the price index in the first year was 90, in the second year was 100, and in the third year was 95, what did the economy experience?
- a. 10 percent inflation between the first and second years and 5 percent inflation between the second and third years
 - b. 10 percent inflation between the first and second years and 5 percent deflation between the second and third years
 - c. 11 percent inflation between the first and second years and 5 percent inflation between the second and third years
 - d. 11 percent inflation between the first and second years and 5 percent deflation between the second and third years

ANS: D PTS: 1 DIF: Average REF: p.124
BLM: Higher Order NOT: Macro TB_5-30

31. The price index in the first year is 100, in the second year is 90, and in the third year is 80. What is the deflation rate between the first and second year, and between the second and third year?
- a. 11 percent between the first and second year, 11 percent between the second and third year
 - b. 11 percent between the first and second year, 12 percent between the second and third year
 - c. 10 percent between the first and second year, 11 percent between the second and third year
 - d. 10 percent between the first and second year, 12 percent between the second and third year

ANS: C PTS: 1 DIF: Average REF: p.124
BLM: Higher Order NOT: Macro TB_5-31

32. The price index in the first year is 125, in the second year is 150, and in the third year is 200. What is the inflation rate between the first and second year and between the second and third year?
- a. 20 percent between the first and second year, 33 percent between the second and third year
 - b. 25 percent between the first and second year, 75 percent between the second and third year
 - c. 25 percent between the first and second year, 50 percent between the second and third year
 - d. 50 percent between the first and second year, 100 percent between the second and third year

ANS: A PTS: 1 DIF: Average REF: p.124
BLM: Higher Order NOT: Macro TB_5-32

33. Which change in the price index shows the greatest rate of inflation?
- a. 100 to 110
 - b. 150 to 170
 - c. 180 to 189
 - d. 220 to 235

ANS: B PTS: 1 DIF: Average REF: p.124
BLM: Higher Order NOT: Macro TB_5-33

34. Which change in the price index shows the greatest rate of inflation?
- a. 80 to 100
 - b. 100 to 120
 - c. 150 to 170
 - d. 200 to 220

ANS: A PTS: 1 DIF: Average REF: p.124
BLM: Higher Order NOT: Macro TB_5-34

35. From October 2009 to October 2010, the CPI in country A rose from 116.5 to 119.8. In country B, it rose from 97.2 to 102.3. What were the inflation rates in the two countries?
- a. 3.3 percent in A and 6.7 percent in B
 - b. 3.3 percent in A and 5.1 percent in B
 - c. 2.8 percent in A and 6.7 percent in B
 - d. 2.8 percent in A and 5.2 percent in B

ANS: D PTS: 1 DIF: Average REF: p.124
BLM: Higher Order NOT: Macro TB_5-35

36. The price index in 2009 is 120, and in 2010 it is 127.2. What is the inflation rate?
- a. 5 percent
 - b. 6 percent
 - c. 8 percent
 - d. The inflation rate is impossible to determine without knowing the base year.

ANS: B PTS: 1 DIF: Average REF: p.124
BLM: Higher Order NOT: Macro TB_5-36

37. The price index is 320 in one year and 360 in the next. What was the inflation rate?
- a. 6.7 percent
 - b. 8 percent
 - c. 11.1 percent
 - d. 12.5 percent

ANS: D PTS: 1 DIF: Average REF: p.124
BLM: Higher Order NOT: Macro TB_5-37

38. The price index is 270 in one year and 300 in the next. What is the inflation rate?
- a. 1 percent
 - b. 9.3 percent
 - c. 10 percent
 - d. 11.1 percent

ANS: C PTS: 1 DIF: Average REF: p.124
BLM: Higher Order NOT: Macro TB_5-38

39. The price index is 180 in one year and 210 in the next. What is the inflation rate?
- a. 11.1 percent
 - b. 14.3 percent
 - c. 16.7 percent
 - d. 19.0 percent

ANS: C PTS: 1 DIF: Average REF: p.124
BLM: Higher Order NOT: Macro TB_5-39

40. Which of the following prices change when an inflation rate is calculated using the CPI?
- a. all prices
 - b. the prices of all final goods and services
 - c. the prices of all consumer goods
 - d. the prices of some consumer goods

ANS: D PTS: 1 DIF: Challenging REF: p.124
BLM: Higher Order NOT: Macro TB_5-40

41. From 2000 to 2001 the CPI for medical care rose from 260.8 to 272.8. What was the inflation rate for medical care?
- a. 12 percent
 - b. 11.1 percent
 - c. 4.9 percent
 - d. 4.6 percent

ANS: D PTS: 1 DIF: Average REF: p.124
BLM: Higher Order NOT: Macro TB_5-41

For the following questions consider the table below, which shows the CPI for various categories of goods and services.

Table 6-4

	2006	2007
Food and Beverages	168.4	173.6
Housing	169.6	176.2
Transportation	153.3	154.3
Gasoline	139.6	141.4

42. **Refer to Table 6-4.** Among these categories, what was the highest rate of inflation?
- a. 6.6 percent
 - b. 5.2 percent
 - c. 3.9 percent
 - d. 3.1 percent

ANS: C PTS: 1 DIF: Average REF: p.124
BLM: Higher Order NOT: Macro TB_5-42

43. **Refer to Table 6-4.** Of those categories, which one had the lowest rate of inflation?
- a. Food and Beverages
 - b. Housing
 - c. Gasoline
 - d. Transportation

ANS: D PTS: 1 DIF: Average REF: p.124
BLM: Higher Order NOT: Macro TB_5-43

Table 6-5

The table below pertains to an economy with only two goods—books and calculators. The fixed basket consists of 5 books and 10 calculators.

Year	Price of Books	Price of Calculators
2005	\$24	\$8
2006	\$30	\$12
2007	\$12	\$15

44. **Refer to Table 6-5.** Using 2005 as the base year, what is the consumer price index?
- 100 in 2005, 135 in 2006, and 155 in 2007
 - 100 in 2005, 270 in 2006, and 310 in 2007
 - 200 in 2005, 270 in 2006, and 310 in 2007
 - 200 in 2005, 540 in 2006, and 620 in 2007

ANS: A PTS: 1 DIF: Average REF: p.123-124
BLM: Higher Order NOT: Macro TB_5-44

45. **Refer to Table 6-5.** Using 2006 as the base year, what is the consumer price index?
- 78.22 in 2005, 100 in 2006, and 121.10 in 2007
 - 74.07 in 2005, 100 in 2006, and 114.81 in 2007
 - 100 in 2005, 135 in 2006, and 155 in 2007
 - 200 in 2005, 270 in 2006, and 310 in 2007

ANS: B PTS: 1 DIF: Average REF: p.123-124
BLM: Higher Order NOT: Macro TB_5-45

46. **Refer to Table 6-5.** Using 2007 as the base year, what is the consumer price index?
- 52.66 in 2005, 84.25 in 2006, and 106.5 in 2007
 - 64.52 in 2005, 87.10 in 2006, and 100 in 2007
 - 52.66 in 2005, 90.89 in 2006, and 100 in 2007
 - 100 in 2005, 135 in 2006, and 155 in 2007

ANS: B PTS: 1 DIF: Average REF: p.123-124
BLM: Higher Order NOT: Macro TB_5-46

47. **Refer to Table 24-5.** Using 2005 as the base year, what is the inflation rate?
- 13.3 percent for 2006 and 14.8 percent for 2007
 - 13.3 percent for 2006 and 55 percent for 2007
 - 35 percent for 2006 and 14.8 percent for 2007
 - 35 percent for 2006 and 55 percent for 2007

ANS: C PTS: 1 DIF: Average REF: p.123-124
BLM: Higher Order NOT: Macro TB_5-47

48. What is by far the largest category of goods and services in the CPI basket?

- a. shelter
- b. recreation, education, and reading
- c. transportation
- d. food

ANS: A PTS: 1 DIF: Average REF: p.124
BLM: Remember NOT: Macro TB_5-48

49. What are the categories of Canadian consumer spending, ranked from largest to smallest?

- a. food, alcoholic beverages and tobacco products, housing, transportation, and health and personal care
- b. health and personal care, housing, food, alcoholic beverages and tobacco products, and transportation
- c. housing, food, alcoholic beverages and tobacco products, transportation, and health and personal care
- d. housing, transportation, food, health and personal care, and alcoholic beverages and tobacco products

ANS: D PTS: 1 DIF: Average REF: p.124
BLM: Remember NOT: Macro TB_5-49

50. For the average Canadian consumer, what percentage of spending does food make up?

- a. 4.1 percent
- b. 10.6 percent
- c. 12 percent
- d. 16.9 percent

ANS: D PTS: 1 DIF: Average REF: p.124
BLM: Remember NOT: Macro TB_5-50

51. Which of the following makes up the smallest category of consumer spending in Canada?

- a. food
- b. transportation
- c. alcoholic beverages and tobacco products
- d. shelter

ANS: C PTS: 1 DIF: Easy REF: p.124
BLM: Remember NOT: Macro TB_5-51

52. For the average Canadian consumer, what percentage of total consumption does shelter and food expenditures make up, respectively?

- a. 26.8, 16.9
- b. 16.9, 26.8
- c. 19.8, 16.9
- d. 16.9, 19.8

ANS: A PTS: 1 DIF: Easy REF: p.124
BLM: Remember NOT: Macro TB_5-52

53. If the cost of shelter increases by 10 percent, then, other things the same, how much is the CPI likely to increase?
- a. by about 10 percent
 - b. by about 7 percent
 - c. by about 3 percent
 - d. by about 1 percent

ANS: C PTS: 1 DIF: Challenging REF: p.124
BLM: Higher Order NOT: Macro TB_5-53

54. If the cost of health and personal care increases by 50 percent, then, other things the same, how much is the CPI likely to increase?
- a. by about 1 percent
 - b. by about 2 percent
 - c. by about 3 percent
 - d. by about 4 percent

ANS: B PTS: 1 DIF: Challenging REF: p.124
BLM: Higher Order NOT: Macro TB_5-54

55. If the cost of transportation and the cost of food both increase by 30 percent, other things the same, how much is the CPI likely to increase?
- a. by about 3 percent
 - b. by about 6 percent
 - c. by about 9 percent
 - d. by about 11 percent

ANS: D PTS: 1 DIF: Challenging REF: p.124
BLM: Higher Order NOT: Macro TB_5-55

56. What does the rate of core inflation **EXCLUDE**?
- a. clothing and footwear
 - b. alcoholic beverages and tobacco products
 - c. the most volatile components from the CPI basket of goods and services
 - d. the least volatile components from the CPI basket of goods and services

ANS: C PTS: 1 DIF: Easy REF: p.125
BLM: Remember NOT: Macro TB_5-56

57. What is the goal of the consumer price index?
- a. to measure changes in the costs of production
 - b. to measure changes in the cost of living
 - c. to measure changes in the relative prices of consumer goods
 - d. to measure changes in the production of consumer goods

ANS: B PTS: 1 DIF: Easy REF: p.125
BLM: Remember NOT: Macro TB_5-57

58. Which of the following best characterizes the consumer price index?
- a. It is a measure of a nation's standard of living.
 - b. It shows the increase in productivity.
 - c. It measures the increase in the prices of all final goods and services produced within the borders of a country.
 - d. It is an imperfect measure of the cost of living.

ANS: D PTS: 1 DIF: Easy REF: p.125
BLM: Higher Order NOT: Macro TB_5-58

59. Which of the following is **NOT** a widely acknowledged problem with the CPI as a measure of the cost of living?
- a. substitution bias
 - b. introduction of new goods
 - c. unmeasured quality change
 - d. unmeasured price change

ANS: D PTS: 1 DIF: Easy REF: p.125-126
BLM: Remember NOT: Macro TB_5-59

60. What does the "substitution bias" in the consumer price index refer to?
- a. substitution of new goods for old goods in the purchases of consumers
 - b. substitution of quality for quantity in consumer purchases over time
 - c. the fact that consumers substitute toward goods that have become relatively less expensive
 - d. substitution of new prices for old prices in the basket of goods from one year to the next

ANS: C PTS: 1 DIF: Easy REF: p.125-126
BLM: Remember NOT: Macro TB_5-60

61. When the relative price of a good increases, how will consumers respond?
- a. by buying more of it and its substitutes
 - b. by buying less of it and its substitutes
 - c. by buying less of it and more of its substitutes
 - d. by buying more of it and less of its substitutes

ANS: C PTS: 1 DIF: Average REF: p.125-126
BLM: Higher Order NOT: Macro TB_5-61

62. Suppose the price of a litre of milk rises from \$1 to \$1.25 and the price of a T-shirt rises from \$8 to \$10. If the CPI rises from 150 to 175, what will people likely buy?
- a. more milk and more T-shirts
 - b. more milk and fewer T-shirts
 - c. less milk and more T-shirts
 - d. less milk and fewer T-shirts

ANS: D PTS: 1 DIF: Average REF: p.125-126
BLM: Higher Order NOT: Macro TB_5-62

63. Suppose the price of a carton of ice cream rises from \$4 to \$5 and the price of coffee rises from \$2 to \$2.50. If the CPI rises from 150 to 200, what will people likely buy?
- a. more ice cream and more coffee
 - b. more ice cream and less coffee
 - c. less ice cream and more coffee
 - d. less ice cream and less coffee

ANS: A

PTS: 1

DIF: Average

REF: p.125-126

BLM: Higher Order

NOT: Macro TB_5-63

64. By not taking into account the possibility of consumer substitution, how is the CPI biased?
- a. It understates the cost of living.
 - b. It overstates the cost of living.
 - c. It may overstate or understate the cost of living depending on how much prices rise.
 - d. It doesn't accurately reflect the cost of living, but it is unclear if it overstates or understates the cost of living.

ANS: B

PTS: 1

DIF: Easy

REF: p.125-126

BLM: Higher Order

NOT: Macro TB_5-64

65. Because the CPI is based on a fixed basket of goods, the introduction of new goods and services in the economy causes the CPI to overestimate the cost of living. Why is this?
- a. because new goods and services are always of higher quality than existing goods and services
 - b. because new goods and services cost less than existing goods and services
 - c. because new goods and services cost more than existing goods and services
 - d. because when a new good is introduced, it gives consumers greater choice, thus reducing the amount they must spend to maintain their standard of living

ANS: D

PTS: 1

DIF: Easy

REF: p.125-126

BLM: Higher Order

NOT: Macro TB_5-65

66. When the quality of a good improves, what happens to the purchasing power of the dollar?
- a. It increases, so the CPI overstates the change in the cost of living if the quality change is not accounted for.
 - b. It increases, so the CPI understates the change in the cost of living if the quality change is not accounted for.
 - c. It decreases, so the CPI overstates the change in the cost of living if the quality change is not accounted for.
 - d. It decreases, so the CPI understates the change in the cost of living if the quality change is not accounted for.

ANS: A

PTS: 1

DIF: Average

REF: p.125-126

BLM: Higher Order

NOT: Macro TB_5-66

67. When the quality of a good deteriorates, what happens to the purchasing power of the dollar?
- a. It increases, so the CPI overstates the change in the cost of living if the quality change is not accounted for.
 - b. It increases, so the CPI understates the change in the cost of living if the quality change is not accounted for.
 - c. It decreases, so the CPI overstates the change in the cost of living if the quality change is not accounted for.
 - d. It decreases, so the CPI understates the change in the cost of living if the quality change is not accounted for.

ANS: D PTS: 1 DIF: Average REF: p.125-126
BLM: Higher Order NOT: Macro TB_5-67

68. Suppose that lawn mowers are part of the market basket used to compute the CPI. Then suppose that the quality of lawn mowers improves while the price of lawn mowers stays the same. If Statistics Canada precisely adjusts the CPI for the improvement in quality, then, other things equal, what will happen?
- a. The CPI will rise.
 - b. The CPI will fall.
 - c. The CPI will stay the same.
 - d. Lawn mowers will no longer be included in the market basket.

ANS: B PTS: 1 DIF: Challenging REF: p.125-126
BLM: Higher Order NOT: Macro TB_5-68

69. Which of the following problems in the construction of the CPI is the invention of pocket-sized computers most relevant to?
- a. substitution bias
 - b. introduction of new goods
 - c. unmeasured quality change
 - d. income bias

ANS: B PTS: 1 DIF: Easy REF: p.125-126
BLM: Higher Order NOT: Macro TB_5-69

70. Which of the following problems in the construction of the CPI is the creation of the mobile phone most relevant to?
- a. substitution bias
 - b. introduction of new goods
 - c. unmeasured quality change
 - d. income bias

ANS: B PTS: 1 DIF: Easy REF: p.125-126
BLM: Higher Order NOT: Macro TB_5-70

71. Suppose that dairy products have risen in price less than prices in general over the past several years. Which of the following problems in the construction of the CPI is this price increase most relevant to?
- a. substitution bias
 - b. introduction of new goods
 - c. unmeasured quality change
 - d. income bias

ANS: A PTS: 1
BLM: Higher Order

DIF: Easy REF: p.125-126
NOT: Macro TB_5-71

72. For some racquet sports there have been increases in the size of the racquets and the methods and materials used for making them have improved. Which of the following problems in the construction of the CPI is this change in racquets most relevant to?
- a. substitution bias
 - b. introduction of new goods
 - c. unmeasured quality change
 - d. income bias

ANS: C PTS: 1
BLM: Higher Order

DIF: Easy REF: p.125-126
NOT: Macro TB_5-72

73. Laura buys word processing software in 2010 for \$50. Laura's twin brother Laurence buys an upgrade of the same software in 2011 for \$50. Which of the following problems in the construction of the CPI does this situation best represent?
- a. substitution bias
 - b. unmeasured quality change
 - c. introduction of new goods
 - d. income bias

ANS: B PTS: 1
BLM: Higher Order

DIF: Easy REF: p.125-126
NOT: Macro TB_5-73

74. Samantha goes to the grocery store to make her monthly purchase of ginger ale. As she enters the soft drink section, she notices that the price of ginger ale has been increased 15 percent, so she decides to buy some peppermint tea instead. Which of the following problems in the construction of the CPI is this situation most relevant to?
- a. substitution bias
 - b. introduction of new goods
 - c. unmeasured quality change
 - d. income effect

ANS: A PTS: 1
BLM: Higher Order

DIF: Easy REF: p.125-126
NOT: Macro TB_5-74

75. Suppose that in 2010, OPEC succeeds in raising world oil prices by 300 percent. This price increase causes inventors to look at alternative sources of fuel for internal-combustion engines. A hydrogen-powered engine is developed, and it is cheaper to operate than gasoline engines. Which of the following problems in the construction of the CPI would this situation represent?
- substitution bias and introduction of new goods
 - introduction of new goods and unmeasured quality change
 - unmeasured quality change and new goods
 - income bias and substitution bias

ANS: A PTS: 1 DIF: Easy REF: p.125-126
BLM: Higher Order NOT: Macro TB_5-75

76. Consumers begin purchasing houses incorporating steel studs instead of wooden studs after the price of lumber increases. Which of the following problems in the construction of the CPI does this situation best represent?
- substitution bias
 - introduction of new goods
 - unmeasured quality change
 - income bias

ANS: A PTS: 1 DIF: Easy REF: p.125-126
BLM: Higher Order NOT: Macro TB_5-76

77. What do economists believe about the bias in the CPI as a measure of the cost of living?
- Economists agree that the bias in the CPI is a very serious problem.
 - There is still debate among economists on whether CPI understates or overstates increases in the cost of living.
 - Economists agree on the severity of the CPI bias, but there is still debate on what to do about it.
 - There is still debate among economists on the severity of the CPI bias and what to do about it.

ANS: D PTS: 1 DIF: Easy REF: p.125-126
BLM: Remember NOT: Macro TB_5-77

78. Research done at the Bank of Canada suggests that the sources of bias in CPI, taken together, cause the Canadian CPI to overstate increases in the cost of living by about how much?
- 3.4 percentage points
 - 2.1 percentage points
 - 1.6 percentage points
 - 0.6 of a percentage point

ANS: D PTS: 1 DIF: Easy REF: p.126
BLM: Higher Order NOT: Macro TB_5-78

79. Why are measurement problems in the consumer price index as an indicator of the cost of living important?
- a. because high rates of inflation cause voters to become unhappy
 - b. because politicians have manipulated the measurement problems to their advantage
 - c. because many government programs use the CPI to adjust for changes in the overall level of prices
 - d. because if the price level is overstated, consumers will be taken advantage of by sellers of consumer goods

ANS: C PTS: 1 DIF: Easy REF: p.126
BLM: Higher Order NOT: Macro TB_5-79

80. What does the GDP deflator reflect?
- a. the level of prices in the base year relative to the current level of prices
 - b. the current level of prices relative to the level of prices in the base year
 - c. the level of real output in the base year relative to the current level of real output
 - d. the current level of real output relative to the level of real output in the base year

ANS: B PTS: 1 DIF: Easy REF: p.126-128
BLM: Remember NOT: Macro TB_5-80

81. Which of the following is an important difference between the GDP deflator and the consumer price index?
- a. The GDP deflator reflects the prices of goods and services bought by producers, whereas the consumer price index reflects the prices of goods and services bought by consumers.
 - b. The GDP deflator reflects the prices of all final goods and services produced domestically, whereas the consumer price index reflects the prices of some goods and services bought by consumers.
 - c. The GDP deflator reflects the prices of all final goods and services produced by a nation's citizens, whereas the consumer price index reflects the prices of final goods and services bought by consumers.
 - d. The GDP deflator reflects the prices of all goods and services bought by producers and consumers, whereas the consumer price index reflects the prices of final goods and services bought by consumers.

ANS: B PTS: 1 DIF: Challenging REF: p.126-128
BLM: Higher Order NOT: Macro TB_5-81

82. If the prices of Australian-made shoes imported into Canada increase, what happens to the GDP deflator and the consumer price index?
- a. Both the GDP deflator and the consumer price index will increase.
 - b. Neither the GDP deflator nor the consumer price index will increase.
 - c. The GDP deflator will increase, but the consumer price index will not increase.
 - d. The consumer price index will increase, but the GDP deflator will not increase.

ANS: D PTS: 1 DIF: Average REF: p.126-128
BLM: Higher Order NOT: Macro TB_5-82

83. If there is a reduction in the price of large tractors imported into Canada from Russia, what happens to the GDP deflator and the consumer price index?
- a. The GDP deflator will decrease, and the consumer price index will increase.
 - b. The GDP deflator will increase, but the consumer price index will remain unchanged.
 - c. Both the GDP deflator and the consumer price index will increase.
 - d. Neither the GDP deflator nor the consumer price index will increase.

ANS: D PTS: 1 DIF: Average REF: p.126-128
BLM: Higher Order NOT: Macro TB_5-83

84. In Canada, if the price of imported oil rises so that the price of gasoline and heating oil rise, what happens to the GDP deflator and the consumer price index?
- a. The GDP deflator rises much more than the consumer price index rises.
 - b. The consumer price index rises much more than the GDP deflator rises.
 - c. The GDP deflator and the consumer price index rise by about the same amount.
 - d. The consumer price index rises slightly more than the GDP deflator rises.

ANS: B PTS: 1 DIF: Average REF: p.126-128
BLM: Higher Order NOT: Macro TB_5-84

85. Most, but not all, athletic apparel sold in Canada is imported from other nations. If the price of athletic apparel increases, what will happen to the GDP deflator?
- a. It will increase less than will the consumer price index.
 - b. It will increase more than will the consumer price index.
 - c. It will not increase, but the consumer price index will increase.
 - d. It will increase, but the consumer price index will not increase.

ANS: A PTS: 1 DIF: Easy REF: p.126-128
BLM: Higher Order NOT: Macro TB_5-85

86. Suppose that Canadian mining companies purchase German-made ore trucks at a reduced price. By itself what will this do to the GDP deflator and the consumer price index?
- a. The consumer price index will fall, and the GDP deflator will fall.
 - b. The consumer price index and the GDP deflator will be unaffected.
 - c. The consumer price index will fall, and the GDP deflator will be unaffected.
 - d. The consumer price index will be unaffected, and the GDP deflator will fall.

ANS: B PTS: 1 DIF: Easy REF: p.126-128
BLM: Higher Order NOT: Macro TB_5-86

87. The price of imported athletic shoes produced by a Canadian company operating in Thailand increases. By itself, what effect will this change have on the Canadian GDP deflator and CPI?
- a. The GDP deflator and the CPI will both increase.
 - b. The GDP deflator will increase, and the CPI will be unaffected.
 - c. The GDP deflator and the CPI will both be unaffected.
 - d. The GDP deflator will be unaffected, and the CPI will increase.

ANS: D PTS: 1 DIF: Average REF: p.126-128
BLM: Higher Order NOT: Macro TB_5-87

88. A Brazilian company produces soccer balls in Canada and exports all of them. If the price of the soccer balls increases, what happens to the GDP deflator and the CPI?
- a. The GDP deflator and the CPI both increase.
 - b. The GDP deflator is unchanged, and the CPI increases.
 - c. The GDP deflator increases, and the CPI is unchanged.
 - d. The GDP deflator and the CPI are both unchanged.

ANS: C PTS: 1 DIF: Average REF: p.126-128
BLM: Higher Order NOT: Macro TB_5-88

89. A German automobile company produces cars in Canada, some of which are exported to other nations. If the price of these cars increases, what happens to the GDP deflator and the CPI?
- a. The GDP deflator and the CPI will both increase.
 - b. The GDP deflator will increase, and the CPI will be unchanged.
 - c. The GDP deflator will be unchanged, and the CPI will increase.
 - d. The GDP deflator and the CPI will both be unchanged.

ANS: A PTS: 1 DIF: Easy REF: p.126-128
BLM: Higher Order NOT: Macro TB_5-89

90. Suppose the price of CD players increases dramatically, causing a 1 percent increase in the CPI. By how much will the GDP deflator most likely increase?
- a. more than 1 percent
 - b. less than 1 percent
 - c. 1 percent
 - d. It is impossible to make an informed guess without more information.

ANS: B PTS: 1 DIF: Easy REF: p.126-128
BLM: Higher Order NOT: Macro TB_5-90

91. Suppose that increases in the prices of Canadian medical care cause the CPI to increase by 2 percent, while all other prices remain the same. By how much will the GDP deflator increase?
- a. more than 2 percent
 - b. 2 percent
 - c. less than 2 percent
 - d. There is insufficient information. The change in GDP deflator could be more, equal, or less than 2 percent.

ANS: C PTS: 1 DIF: Average REF: p.126-128
BLM: Higher Order NOT: Macro TB_5-91

92. How do the GDP deflator and the consumer price index compare to each other?
- The GDP deflator compares the price of a fixed basket of goods and services to the price of the basket in the base year, but the consumer price index compares the price of currently produced goods and services to the price of the same goods and services in the base year.
 - The consumer price index compares the price of a fixed basket of goods and services to the price of the basket in the base year, but the GDP deflator compares the price of currently produced goods and services to the price of the same goods and services in the base year.
 - Both the GDP deflator and the consumer price index compare the price of a fixed basket of goods and services to the price of the basket in the base year.
 - Both the GDP deflator and the consumer price index compare the price of currently produced goods and services to the price of the same goods and services in the base year.

ANS: B PTS: 1 DIF: Easy REF: p.126-128
BLM: Higher Order NOT: Macro TB_5-92

93. How often does the basket of goods in the consumer price index change?
- occasionally, as does the basket of goods used to compute the GDP deflator
 - yearly, as does the basket of goods used to compute the GDP deflator
 - occasionally, while the basket of goods used to compute the GDP deflator changes yearly
 - yearly, while the basket of goods used to compute the GDP deflator changes occasionally

ANS: C PTS: 1 DIF: Easy REF: p.126-128
BLM: Remember NOT: Macro TB_5-93

94. Which of the following best describes the evolution of the GDP deflator and the consumer price index over the past decades?
- In the late 1970s, the late 1980s, and early 1990s, the GDP deflator showed high rates of inflation, but the consumer price index showed low rates of inflation.
 - In the late 1970s, both the GDP deflator and the consumer price index showed high rates of inflation, and in the late 1980s and early 1990s, both measures showed low inflation.
 - In the late 1970s, both the GDP deflator and the consumer price index showed low rates of inflation, and in the late 1980s and early 1990s, both measures showed high rates of inflation.
 - In the late 1970s, the late 1980s, and early 1990s, both the GDP deflator and the consumer price index showed high rates of inflation.

ANS: B PTS: 1 DIF: Easy REF: p.128
BLM: Higher Order NOT: Macro TB_5-94

95. How do the CPI and the GDP deflator relate to each other?
- They generally move together.
 - They generally show different patterns of movement.
 - They show identical changes.
 - They show unrelated patterns of movement.

ANS: A PTS: 1 DIF: Easy REF: p.127-128
BLM: Remember NOT: Macro TB_5-95

96. What is the purpose of measuring the overall level of prices in the economy?
- a. to allow the measurement of GDP
 - b. to allow consumers to know what kinds of prices to expect in the future
 - c. to allow comparison between dollar figures from different points in time
 - d. to allow government officials to determine whether the value of the dollar has increased or decreased

ANS: C PTS: 1 DIF: Easy REF: p.128
BLM: Higher Order NOT: Macro TB_5-96

97. Babe Ruth's 1931 salary was \$80 000. The price index for 1931 is 15.2 and the price index for 2010 is 195. What would Ruth's 1931 salary be equivalent to in 2010?
- a. \$536 000
 - b. \$635 000
 - c. \$828 000
 - d. \$1 026 000

ANS: D PTS: 1 DIF: Easy REF: p.128
BLM: Higher Order NOT: Macro TB_5-97

98. In 1931, American President Herbert Hoover was paid a salary of \$75 000. The price index for 1931 is 15.2, and the price index for 2006 is 195. George W. Bush, the President in 2006, had a salary of \$400 000. What is President Hoover's salary equivalent in 2006 dollars?
- a. It is much smaller than that of President Bush.
 - b. It is about the same as that of President Bush.
 - c. It is much larger than that of President Bush.
 - d. One cannot make a meaningful comparison of 2006 salaries and 1931 salaries.

ANS: C PTS: 1 DIF: Easy REF: p.128
BLM: Higher Order NOT: Macro TB_5-98

99. Suppose that the CPI is currently 400 and was 100 in 1969. Then, according to the CPI, \$100 today purchases the same amount of goods and services as what amount in 1969?
- a. \$25
 - b. \$40
 - c. \$60
 - d. \$400

ANS: A PTS: 1 DIF: Easy REF: p.128
BLM: Higher Order NOT: Macro TB_5-99

100. Suppose that the CPI is currently 200 and was 40 in 1950. Then, according to the CPI, \$1 in 1950 purchased the same amount of goods and services as what amount today?
- a. \$5
 - b. \$4
 - c. \$3
 - d. \$0.2

ANS: A PTS: 1 DIF: Easy REF: p.128
BLM: Higher Order NOT: Macro TB_5-100

101. You know that a chocolate bar cost five cents in 1962. You also know the CPI for 1962 and the CPI for today. Which of the following would you use to compute the price of the candy bar in today's prices?

a. $5 \text{ cents} \times (1962 \text{ CPI} / \text{today's CPI})$
b. $5 \text{ cents} \times (1962 \text{ CPI} / (\text{today's CPI} - 1962 \text{ CPI}))$
c. $5 \text{ cents} \times (\text{today's CPI} / 1962 \text{ CPI})$
d. $5 \text{ cents} \times \text{today's CPI} - \text{five cents} \times 1962 \text{ CPI}$

ANS: C PTS: 1 DIF: Easy REF: p.128
BLM: Higher Order NOT: Macro TB_5-101

102. You know that a chocolate bar costs 60 cents today. You also know the CPI for 1962 and the CPI for today. Which of the following would you use to compute the price of the candy bar in 1962 prices?

a. $60 \text{ cents} \times (\text{today's CPI} - 1962 \text{ CPI})$
b. $60 \text{ cents} \times (1962 \text{ CPI} - \text{today's CPI})$
c. $60 \text{ cents} \times (\text{today's CPI} / 1962 \text{ CPI})$
d. $60 \text{ cents} \times (1962 \text{ CPI} / \text{today's CPI})$

ANS: D PTS: 1 DIF: Average REF: p.128
BLM: Higher Order NOT: Macro TB_5-102

103. The 2002 CPI was 177 and the 1982 CPI was 96.5. If your parents put aside \$1000 for you in 1982, how much would you have needed in 2002 in order to buy what you could have with the \$1000 in 1982?

a. \$1834.20
b. \$1777.77
c. \$1714.81
d. \$960

ANS: A PTS: 1 DIF: Easy REF: p.128
BLM: Higher Order NOT: Macro TB_5-103

The following questions are based on the following information:

Scenario 6-1

Grant Smith was a doctor in 1944 and made about \$12 000 a year. His daughter Lisa Smith also is a doctor and she made about \$175 000 in 2006. The price index in 1944 was 17.6 and the price index was 192 in 2006.

104. **Refer to Scenario 6-1.** What is Grant's income in 2006 dollars?

a. \$19 128
b. \$21 240
c. \$120 682
d. \$130 909

ANS: D PTS: 1 DIF: Easy REF: p.128
BLM: Higher Order NOT: Macro TB_5-104

105. **Refer to Scenario 6-1.** What is Lisa's income in 1944 dollars?

- a. \$19 322
- b. \$17 401
- c. \$16 042
- d. \$15 667

ANS: C PTS: 1 DIF: Easy REF: p.128
BLM: Higher Order NOT: Macro TB_5-105

106. **Refer to Scenario 6-1.** What was the ratio of Grant's real income to Lisa's real income?

- a. 2:15
- b. 3:5
- c. 7:10
- d. 7.5:10

ANS: B PTS: 1 DIF: Easy REF: p.128
BLM: Higher Order NOT: Macro TB_5-106

107. Ingrid takes a job in 1981 at a salary of \$10 000. By 2010, she has been promoted, with a salary of \$50 000. If the price index in 1981 is 50, and the price index in 2010 is 180, what is Ingrid's 2010 salary in 1981 dollars?

- a. \$13 889
- b. \$18 000
- c. \$26 000
- d. \$36 000

ANS: A PTS: 1 DIF: Average REF: p.128
BLM: Higher Order NOT: Macro TB_5-107

108. In 1990 Professor Fellswoop made \$12 000, in 2000 he earned \$24 000, and in 2010 he earned \$36 000. If the CPI was 40 in 1990, 60 in 2000, and 100 in 2010, then in real terms, when was Professor Fellswoop's salary highest and lowest?

- a. highest in 1990; lowest in 2000
- b. highest in 2010; lowest in 2000
- c. highest in 2000; lowest in 1990
- d. highest in 2010; lowest in 1990

ANS: C PTS: 1 DIF: Average REF: p.128
BLM: Higher Order NOT: Macro TB_5-108

109. In 1969 Don bought a Dodge Dart for \$2500. He drove this car until 2006, when he bought a Honda Civic for \$22 000. If the price index in 1969 was 36.7 and the price index in 2006 was 190, what is the price of the Dodge Dart in 2006 prices?

- a. \$3583
- b. \$4500
- c. \$9762
- d. \$12 943

ANS: D PTS: 1 DIF: Easy REF: p.128
BLM: Higher Order NOT: Macro TB_5-109

110. Ethel purchased a bag of groceries in 1970 for \$8. She purchased the same bag of groceries in 2006 for \$25. If the price index was 38.8 in 1970 and 180 in 2006, what's the price of a 1970 bag of groceries in 2006 prices?
- a. \$25.00
 - b. \$29.11
 - c. \$37.11
 - d. \$38.80

ANS: C PTS: 1
BLM: Higher Order

DIF: Easy REF: p.128
NOT: Macro TB_5-112

111. In 1964 in London, Ontario, one could buy a chili dog and a root beer for \$1.25; today the same chili dog and root beer cost \$3.75. Which of the following sets of CPIs would mean that the cost in today's dollars was the same as in 1964?
- a. 60 in 1964 and 141.6 today
 - b. 75 in 1964 and 126.4 today
 - c. 80 in 1964 and 112 today
 - d. 90 in 1964 and 270 today

ANS: D PTS: 1
BLM: Higher Order

DIF: Average REF: p.128
NOT: Macro TB_5-111

112. In 1972 in Sarnia, Ontario, one could buy a bag of chips, a pound of hamburger, a package of buns, and a small bag of charcoal for about \$2.50. If the same goods today cost about \$6.00, which of the following sets of CPIs would make the cost in today's dollars the same for both years?
- a. 60 in 1972 and 150 today
 - b. 65 in 1972 and 156 today
 - c. 90 in 1972 and 145.8 today
 - d. 100 in 1972 and 41.67 today

ANS: B PTS: 1
BLM: Higher Order

DIF: Average REF: p.128
NOT: Macro TB_5-112

113. In 1972 in Kelowna, BC, one could buy model rocket engines for \$1.50. If those same engines cost \$3.00 today, which of the following sets of CPI's would make the engine prices in today's dollars the same for both years?
- a. 60 in 1972 and 100 today
 - b. 60 in 1972 and 110 today
 - c. 60 in 1972 and 120 today
 - d. 60 in 1972 and 130 today

ANS: C PTS: 1
BLM: Higher Order

DIF: Average REF: p.128
NOT: Macro TB_5-113

114. In 1949 the city of Sherbrooke, Quebec, built a hospital for about \$500 000. In 1987 the city restored its courthouse for about \$2.4 million. A price index for nonresidential construction was 14 in 1949, 92 in 1987, and 114.5 in 2000. According to these numbers, what did the hospital cost approximately?
- a. \$3.6 million in 2000 dollars, which is less than the cost of the courthouse restoration in 2000 dollars
 - b. \$3.6 million in 2000 dollars, which is more than the cost of the courthouse restoration in 2000 dollars
 - c. \$4.1 million in 2000 dollars, which is less than the cost of the courthouse restoration in 2000 dollars
 - d. \$4.1 million in 2000 dollars, which is more than the cost of the courthouse restoration in 2000 dollars

ANS: D PTS: 1 DIF: Average REF: p.128
BLM: Higher Order NOT: Macro TB_5-114

115. Andrew is offered a job in Calgary where the CPI is 120 and a job in Toronto where the CPI is 150. Andrew's job offer in Calgary is for \$65 000. Which of the following salaries would the Toronto job have to pay so that both jobs would have the same purchasing power?
- a. \$52 000
 - b. \$60 266
 - c. \$65 625
 - d. \$81 250

ANS: D PTS: 1 DIF: Average REF: p.128
BLM: Higher Order NOT: Macro TB_5-115

116. Leslie is offered a job in Vancouver that pays \$50 000. She is also offered a job in Halifax that pays \$60 000. Which of the following sets of CPIs comes closest to giving both salaries the same purchasing power?
- a. 83.3 in Vancouver and 100 in Halifax
 - b. 89.3 in Vancouver and 100 in Halifax
 - c. 100 in Vancouver and 124.5 in Halifax
 - d. 100 in Vancouver and 140 in Halifax

ANS: A PTS: 1 DIF: Average REF: p.128
BLM: Higher Order NOT: Macro TB_5-116

117. Tiffany is offered a job in Winnipeg that pays \$90 000. She is offered a similar job in Montreal for \$60 000. Which of the following sets of CPIs comes closest to giving both salaries the same purchasing power?
- a. 90 in Winnipeg and 80 in Montreal
 - b. 90 in Winnipeg and 72 in Montreal
 - c. 90 in Winnipeg and 66 in Montreal
 - d. 60 in Winnipeg and 40 in Montreal

ANS: D PTS: 1 DIF: Average REF: p.128
BLM: Higher Order NOT: Macro TB_5-117

118. Suppose the average price of gas in 2009 was \$0.95 per litre and \$0.97 in 2010. The inflation rate was 3 percent in 2010. What was the 2010 price of gas in 2009 dollars?

a. \$0.922
b. \$0.941
c. \$0.978
d. \$0.999

ANS: B PTS: 1 DIF: Easy REF: p.128
BLM: Higher Order NOT: Macro TB_5-118

119. When does a cost-of-living allowance (COLA) automatically raise the wage rate?

a. when GDP increases
b. when the consumer price index increases
c. when taxes increase
d. when the consumer price index is announced

ANS: B PTS: 1 DIF: Easy REF: p.129-130
BLM: Higher Order NOT: Macro TB_5-119

120. Which of the following best defines “indexation”?

a. It is a process of adjusting the nominal interest rate so that it is equal to the real interest rate.
b. It is the use of a law or contract to automatically correct a dollar amount for the effects of inflation.
c. It is the use of a price index to deflate dollar values.
d. It is an adjustment made by Statistics Canada to the CPI so that the index is in line with the GDP deflator.

ANS: B PTS: 1 DIF: Easy REF: p.129-130
BLM: Remember NOT: Macro TB_5-120

121. Mavis Corporation has an agreement with its workers to completely index the wages of its employees to inflation in the CPI. Mavis currently pays its production line workers \$10 an hour and is scheduled to index their wages today. If the CPI is currently about 120 and was 100 a year ago, by how much should Mavis increase the hourly wages of its workers?

a. \$0.58
b. \$0.65
c. \$1.00
d. \$2.00

ANS: D PTS: 1 DIF: Average REF: p.129-130
BLM: Higher Order NOT: Macro TB_5-121

122. Ruth collected pension benefits of \$220 a month in 2008. If the price index rose from 90 to 105 in the period 2009–2010, what should her pension benefits for 2010 be?

a. \$231.00
b. \$252.43
c. \$253.00
d. \$256.67

ANS: D PTS: 1 DIF: Average REF: p.129-130
BLM: Higher Order NOT: Macro TB_5-122

123. Welfare payments are indexed for inflation using the CPI. A recent newspaper editorial claimed that welfare recipients are harmed by years of low inflation because they do not receive as large an increase in their payments as they do in years of high inflation. Is the newspaper editorial correct?
- a. The newspaper editorial is correct.
 - b. The newspaper editorial is correct if the market basket consumed by welfare recipients is the same as the market basket used to compute the CPI.
 - c. The newspaper editorial is correct if the prices of the goods consumed by welfare recipients increase faster than the prices of the goods in the market basket used to compute the CPI.
 - d. The newspaper editorial is correct if the prices of the goods consumed by welfare recipients increase slower than the prices of the goods in the market basket used to compute the CPI.

ANS: C PTS: 1 DIF: Average REF: p.129-130
BLM: Higher Order NOT: Macro TB_5-123

124. Are Canada Pension Plan benefits and Old Age Security benefits, adjusted for inflation?
- a. Canada Pension Plan benefits are, Old Age Security benefits are not
 - b. Canada Pension Plan benefits are not, Old Age Security benefits are
 - c. both Canada Pension Plan benefits and Old Age Security benefits are
 - d. neither Canada Pension Plan nor Old Age Security benefits are

ANS: C PTS: 1 DIF: Easy REF: p.130
BLM: Remember NOT: Macro TB_5-124

125. What kind of payment does interest represent?
- a. a payment now for money to be transferred in the future
 - b. a payment in the future for a transfer of money in the past
 - c. a payment in the past for money transferred now
 - d. a payment at the time of the transfer of money

ANS: B PTS: 1 DIF: Easy REF: p.130
BLM: Higher Order NOT: Macro TB_5-125

126. Which of the following best describes the relationship between inflation and interest rates?
- a. There is no relationship between inflation and interest rates.
 - b. The interest rate is determined by the rate of inflation.
 - c. In order to fully understand inflation, we need to know how to correct for the effects of interest rates.
 - d. In order to fully understand interest rates, we need to know how to correct for the effects of inflation.

ANS: D PTS: 1 DIF: Easy REF: p.130-131
BLM: Remember NOT: Macro TB_5-126

127. Which of the following best describes the relationship between the nominal interest rate and the real interest rate?

- a. The real interest rate is the nominal interest rate times the rate of inflation.
- b. The real interest rate is the nominal interest rate minus the rate of inflation.
- c. The real interest rate is the nominal interest rate plus the rate of inflation.
- d. The real interest rate is the nominal interest rate divided by the rate of inflation.

ANS: B PTS: 1 DIF: Easy REF: p.131
BLM: Remember NOT: Macro TB_5-127

128. If the nominal interest rate is 10 percent and the rate of inflation is 3 percent, what is the real interest rate?

- a. -7 percent
- b. -5 percent
- c. 5 percent
- d. 7 percent

ANS: D PTS: 1 DIF: Easy REF: p.131
BLM: Higher Order NOT: Macro TB_5-128

129. If the nominal interest rate is 5 percent and the rate of inflation is 10 percent, what is the real interest rate?

- a. -5 percent
- b. -2 percent
- c. 2 percent
- d. 5 percent

ANS: A PTS: 1 DIF: Easy REF: p.131
BLM: Higher Order NOT: Macro TB_5-129

130. If the nominal interest rate is 8 percent and the rate of inflation is 2 percent, what is the real interest rate?

- a. 16 percent
- b. 10 percent
- c. 6 percent
- d. 4 percent

ANS: C PTS: 1 DIF: Easy REF: p.131
BLM: Higher Order NOT: Macro TB_5-130

131. What does the nominal interest rate tell you?

- a. how fast the number of dollars in your bank account rises over time
- b. how fast the purchasing power of your bank account rises over time
- c. the number of dollars in your bank account
- d. the purchasing power of your bank account

ANS: A PTS: 1 DIF: Easy REF: p.131
BLM: Higher Order NOT: Macro TB_5-131

132. What does the real interest rate tell you?

- a. how fast the number of dollars in your bank account rises over time
- b. how fast the purchasing power of your bank account rises over time
- c. the number of dollars in your bank account
- d. the purchasing power of your bank account

ANS: B PTS: 1 DIF: Easy REF: p.131
BLM: Higher Order NOT: Macro TB_5-132

133. Which of the following best describes the correlation between nominal and real interest rates?

- a. Nominal and real interest rates usually move together.
- b. Nominal and real interest rates seldom move together.
- c. Nominal and real interest rates often do not move together.
- d. Nominal and real interest rates are identical.

ANS: C PTS: 1 DIF: Easy REF: p.131
BLM: Remember NOT: Macro TB_5-133

134. Which of the following best explains whether interest rates are positive or negative?

- a. Real interest rates can be either positive or negative, but nominal interest rates must be positive.
- b. Real interest rates and nominal interest rates must be positive.
- c. Real interest rates must be positive, but nominal interest rates can be either positive or negative.
- d. Real interest rates and nominal interest rates can be either positive or negative.

ANS: A PTS: 1 DIF: Easy REF: p.131
BLM: Higher Order NOT: Macro TB_5-134

135. If the real interest rate is 7 percent and the expected inflation rate is 2 percent, what would a person expect to have after a year?

- a. 10 percent more dollars, which will purchase 6 percent more goods
- b. 9 percent more dollars, which will purchase 5 percent more goods
- c. 9 percent more dollars, which will purchase 7 percent more goods
- d. 5 percent more dollars, which will purchase 9 percent more goods

ANS: C PTS: 1 DIF: Average REF: p.131
BLM: Higher Order NOT: Macro TB_5-135

136. Suppose that the real interest rate was 3 percent and the inflation rate was 1 percent. What happened with the value of savings?

- a. The dollar value of savings increased at 2 percent, and the value of savings measured in goods increased at 3 percent.
- b. The dollar value of savings increased at 1 percent, and the value of savings measured in goods increased at 2 percent.
- c. The dollar value of savings increased at 3 percent, and the value of savings measured in goods increased at 1 percent.
- d. The dollar value of savings increased at 4 percent, and the value of savings measured in goods increased at 3 percent.

ANS: D PTS: 1 DIF: Average REF: p.131
BLM: Higher Order NOT: Macro TB_5-136

137. Suppose that the nominal interest rate was 3 percent and the inflation rate was 1 percent. What happened with the value of savings?
- The dollar value of savings increased at 1 percent, and the value of savings measured in goods increased at 2 percent.
 - The dollar value of savings increased at 2 percent, and the value of savings measured in goods increased at 3 percent.
 - The dollar value of savings increased at 3 percent, and the value of savings measured in goods increased at 2 percent.
 - The dollar value of savings increased at 4 percent, and the value of savings measured in goods increased at 3 percent.

ANS: C PTS: 1 DIF: Average REF: p.131
BLM: Higher Order NOT: Macro TB_5-137

138. Suppose that the nominal interest rate is 5 percent and the expected inflation rate is 3 percent. What happens with the value of savings?
- The dollar value of savings increases by 8 percent and the value of savings measured in goods is expected to increase by 3 percent.
 - The dollar value of savings increases by 8 percent and the value of savings measured in goods is expected to increase by 5 percent.
 - The dollar value of savings increases by 5 percent and the value of savings in goods is expected to increase by 2 percent.
 - The dollar value of savings increases by 5 percent and the value of savings in goods is expected to increase by 3 percent.
 - The dollar value of savings increases by 2 percent and the value of savings measured in goods is expected to increase by 5 percent.

ANS: C PTS: 1 DIF: Average REF: p.131
BLM: Higher Order NOT: Macro TB_5-138

139. Ralph puts money in the bank and earns a 5 percent nominal interest rate. What happens if the inflation rate is 3 percent?
- Ralph will have 3 percent more money, which will purchase 2 percent more goods.
 - Ralph will have 3 percent more money, which will purchase 8 percent more goods.
 - Ralph will have 5 percent more money, which will purchase 2 percent more goods.
 - Ralph will have 5 percent more money, which will purchase 8 percent more goods.

ANS: C PTS: 1 DIF: Average REF: p.131
BLM: Higher Order NOT: Macro TB_5-139

140. In Japan in 2000 nominal interest rates were 1.5 percent and the inflation rate was -0.5 percent. What was the real interest rate?
- 2 percent
 - 1 percent
 - 1 percent
 - 2 percent

ANS: D PTS: 1 DIF: Easy REF: p.131
BLM: Higher Order NOT: Macro TB_5-140

141. Samantha deposits \$2000 into a saving account that pays an annual interest rate of 5 percent. Over the course of a year, the inflation rate is 2 percent. What happens at the end of the year?
- a. Samantha has \$100 more in her account, and her purchasing power has increased by about \$40.
 - b. Samantha has \$100 more in her account, and her purchasing power has increased by about \$60.
 - c. Samantha has \$140 more in her account, and her purchasing power has increased about \$100.
 - d. Samantha has \$140 more in her account, and her purchasing power has increased about \$40.

ANS: B PTS: 1 DIF: Average REF: p.131
BLM: Higher Order NOT: Macro TB_5-141

142. Ms. Smith borrowed \$1000 from her bank for one year at an interest rate of 10 percent per year. During that year the price level went up by 15 percent. What happens when the loan is repaid?
- a. Ms. Smith will repay the bank fewer dollars than she initially borrowed.
 - b. Ms. Smith's repayment will give the bank less purchasing power than it originally loaned her.
 - c. Ms. Smith's repayment will give the bank greater purchasing power than it originally loaned her.
 - d. Ms. Smith's repayment will give the bank the same purchasing power that it originally loaned her.

ANS: B PTS: 1 DIF: Average REF: p.131
BLM: Higher Order NOT: Macro TB_5-142

143. Jake loaned Elwood \$6000 for one year at a nominal interest rate of 12 percent. After Elwood repaid the loan in full, Jake complained that he could buy 5 percent fewer goods with the money Elwood gave him than he could before he loaned Elwood the \$6000. What was the rate of inflation during the year?
- a. 2.5 percent
 - b. 7 percent
 - c. 8 percent
 - d. 17 percent

ANS: D PTS: 1 DIF: Challenging REF: p.131
BLM: Higher Order NOT: Macro TB_5-143

144. In the country of Hyrkania, the CPI in 2005 was 140 and the CPI in 2006 was 154. Jake, a resident of Hyrkania, borrowed money in 2005 and repaid the loan in 2006. If the nominal interest rate on the loan was 14 percent, what was the real interest rate?
- a. 18 percent
 - b. 14 percent
 - c. 10 percent
 - d. 4 percent

ANS: D PTS: 1 DIF: Challenging REF: p.131
BLM: Higher Order NOT: Macro TB_5-144

145. Which of the following best describes nominal interest rates in the 1970s and 1990s?
- a. high in the 70s and 90s
 - b. low in the 70s and 90s
 - c. high in the 70s and low in the 90s
 - d. low in the 70s and high in the 90s

ANS: C PTS: 1 DIF: Average REF: p.131
BLM: Remember NOT: Macro TB_5-145

146. Which of the following best describes real interest rates in the 1970s and 1990s?
- a. high in the 70s and 90s
 - b. low in the 70s and 90s
 - c. high in the 70s and low in the 90s
 - d. low in the 70s and high in the 90s

ANS: D PTS: 1 DIF: Average REF: p.131
BLM: Remember NOT: Macro TB_5-146

147. Which of the following best describes nominal interest rates and real interest rates in the 1970s and 1990s?
- a. Nominal interest rates were high in the 1970s, and real interest rates were high in the 1990s.
 - b. Nominal interest rates were high in the 1970s, and real interest rates were low in the 1990s.
 - c. Nominal interest rates were high in the 1990s, and real interest rates were high in the 1970s.
 - d. Nominal interest rates were high in the 1990s, and real interest rates were low in the 1970s.

ANS: A PTS: 1 DIF: Average REF: p.131
BLM: Remember NOT: Macro TB_5-147

148. In the late 1970s, nominal interest rates were high and inflation rates were very high. As a result, what were real interest rates?
- a. very high
 - b. moderately high
 - c. low, and in some years they were negative
 - d. low, but never negative

ANS: C PTS: 1 DIF: Average REF: p.131
BLM: Remember NOT: Macro TB_5-148

149. Which of the following happened in the early 2000s?
- a. Real interest rates were high, and nominal interest rates were low.
 - b. Real interest rates were low, and nominal interest rates were high.
 - c. Both real interest rates and nominal interest rates were high.
 - d. Both real interest rates and nominal interest rates were low.

ANS: D PTS: 1 DIF: Easy REF: p.131
BLM: Remember NOT: Macro TB_5-149

TRUE/FALSE

1. The CPI for 2000 is computed as 100 times the ratio of the price of the market basket in 2000 divided by the price of the market basket in the base year.

ANS: T PTS: 1 DIF: Easy REF: p.123
NOT: Macro TB_5-150

2. The CPI is computed by finding the price of a market basket of goods whose contents vary each year.

ANS: F PTS: 1 DIF: Easy REF: p.123
NOT: Macro TB_5-151

3. If the current-year CPI is 140, then, since the base year, the price level has increased 40 percent.

ANS: T PTS: 1 DIF: Easy REF: p.123
NOT: Macro TB_5-152

4. The inflation rate is computed as $100 \times (\text{the current year CPI} - \text{the CPI of the previous year}) \div \text{the CPI of the previous year}$.

ANS: T PTS: 1 DIF: Easy REF: p.123
NOT: Macro TB_5-153

5. Food, health and personal care, and clothing and footwear account for over 50 percent of the goods and services in the CPI basket of goods.

ANS: F PTS: 1 DIF: Easy REF: p.124
NOT: Macro TB_5-154

6. Substitution bias in computing the CPI tends to make the CPI overstate the true increase in the cost of living.

ANS: T PTS: 1 DIF: Easy REF: p.125
NOT: Macro TB_5-155

7. There is no longer much debate among economists concerning the severity of and the solution to the problems in using the CPI to measure the cost of living.

ANS: F PTS: 1 DIF: Easy REF: p.125-126
NOT: Macro TB_5-156

8. Since it accounts for changes in the prices of imports and the GDP deflator does not, the CPI is based on more goods and services than the GDP deflator.

ANS: F PTS: 1 DIF: Easy REF: p.126-127
NOT: Macro TB_5-157

9. Although they sometimes diverge, generally the CPI and GDP deflator move in the same direction.

ANS: T PTS: 1 DIF: Easy REF: p.126-127
NOT: Macro TB_5-158

10. Suppose that the CPI today is 120 and that it was 80 five years ago. Then, in today's prices something that cost \$1 five years ago now costs \$1.50.

ANS: T PTS: 1 DIF: Easy REF: p.128
NOT: Macro TB_5-159

11. Henry Ford paid his workers \$5 a day in 1914 when the CPI was 10. Today with the price index at 177 the \$5 a day is worth \$88.50.

ANS: T PTS: 1 DIF: Average REF: p.128
NOT: Macro TB_5-160

12. If you currently make \$25 000 a year and the CPI rises from 110 today to 150 in five years, then you need to be making \$35 000 to have kept pace with consumer price inflation.

ANS: F PTS: 1 DIF: Easy REF: p.128
NOT: Macro TB_5-161

13. The Canadian income tax system is indexed to the CPI.

ANS: F PTS: 1 DIF: Easy REF: p.130
NOT: Macro TB_5-162

14. If the nominal interest rate is 5 percent and the inflation rate is 2 percent, then the real interest rate is 3 percent.

ANS: T PTS: 1 DIF: Easy REF: p.131
NOT: Macro TB_5-163

15. In the 1970s, nominal interest rates were high and real interest rates were low. In the 1990s, nominal interest rates were low and real interest rates were high.

ANS: T PTS: 1 DIF: Easy REF: p.131
NOT: Macro TB_5-164

16. If nominal interest rates rise, it must be because inflation rose.

ANS: F PTS: 1 DIF: Easy REF: p.131
NOT: Macro TB_5-165

SHORT ANSWER

1. In a simple economy, people consume only two goods—food and clothing. The market basket of goods used to compute the CPI has 50 units of food and 10 units of clothing.

	food	clothing
2009 price	\$4	\$10
2010 price	\$6	\$20

- What are the percentage increases in the price of food and in the price of clothing?
- What is the percentage increase in the CPI?
- Do these price changes affect all consumers to the same extent? Explain.

ANS:

- The price of food increased by 50 percent. The price of clothing increased by 100 percent.
- In 2009 the market basket cost \$300 and in 2010 it cost \$500. The percentage increase in the CPI is $200/300 = 66.7$ percent
- Since the price of clothing increased relatively more than did the price of food, people who purchase a lot of clothing and little food became worse off relative to people who purchase a lot of food and little clothing.

PTS: 1 DIF: Average REF: p.123 NOT: Macro TB_5-166

2. Which is likely to have the larger effect on the CPI, a 2 percent increase in food or a 3 percent increase in diamond rings? Explain.

ANS:

The 2 percent increase in food will increase the CPI by more because the portion of the market basket that is for food is much larger than the portion for diamond rings.

PTS: 1 DIF: Average REF: p.124 NOT: Macro TB_5-167

3. List the three major problems in using the CPI as a measure of the cost of living.

ANS:

- (1) Substitution bias. The CPI ignores the fact that consumers substitute toward goods that have become relatively less expensive.
- (2) Introduction of new goods. Because the CPI uses a fixed basket of goods, it does not take into account the increased well-being of consumers created when new goods are introduced.
- (3) Unmeasured quality change. Not all quality changes can be measured.

PTS: 1 DIF: Average REF: p.125-126 NOT: Macro TB_5-168

4. Why does the GDP deflator give a different rate of inflation than does the CPI?

ANS:

The GDP deflator and the CPI differ in two important ways. The GDP deflator uses as a basket of all final goods and services produced in the domestic economy, while the CPI basket includes goods and services purchased by typical consumers. Therefore, changes in the price of imported goods affect the CPI, but not the GDP deflator. Also, changes in the price of domestically produced capital goods affect the GDP deflator, but not the CPI. Changes in the price of domestically produced consumer goods are likely to affect the CPI more than the GDP deflator because it is likely that those goods make up a larger part of consumer budgets than of GDP.

PTS: 1 DIF: Challenging REF: p.126-127 NOT: Macro TB_5-169

5. Compute how much each of the following is worth in terms of today's dollars using 177 as the price index for today.
- In 1926 the CPI was 17.7 and the price of a movie ticket was \$0.25
 - In 1932 the CPI was 13.1 and a cook earned \$15.00 a week
 - In 1943 the CPI was 17.4 and a gallon of gas cost \$0.19

ANS:

- The movie ticket is worth $\$0.25 \times 177/17.7 = \$2.50$ in today's dollars
- The cook's weekly wage is worth $\$15.00 \times 177/13.1 = \$202.67$ in today's dollars
- The gallon of gas is worth $\$0.19 \times 177/17.4 = \$1.93$ in today's dollars

PTS: 1 DIF: Average REF: p.128 NOT: Macro TB_5-170

6. Jay and Joyce meet George, the banker, to work out the details of a mortgage. They all expect that inflation will be 2 percent over the term of the loan, and they agree on a nominal interest rate of 6 percent. As it turns out, the inflation rate is 5 percent over the term of the loan.
- What was the expected real interest rate?
 - What was the actual real interest rate?
 - Who benefited and who lost because of the unexpected inflation?

ANS:

- The expected real interest rate was 4 percent.
- The actual real interest rate was 1 percent.
- George, the banker, lost because he receives less real interest income than he expected. Jay and Joyce gain because they pay less real interest expense than they expected.

PTS: 1 DIF: Average REF: p.131 NOT: Macro TB_5-171

PROBLEM

1. The formula to calculate CPI between a base year (say, Year 0) and another, specified year, say Year 1, is $CPI = (\text{Expenditure on basket in Year 1}) / (\text{Expenditure on basket in Year 0})$. Suppose an economy produces only two goods, food (f) and clothing (c). Let quantities and prices in Year 0 be q^f , q^c , p^f and p^c , respectively, and let us adopt similar notations for Year 1, with the caveat that, for CPI, the quantities remain the same as in Year 0.
 - a. Calculate, using the notations in the problem, the expenditure on the basket in Year 0, the expenditure on the basket in Year 1, and the CPI.
 - b. Find the formulas for the share of each of the two goods in the expenditure on the basket in Year 0. Let w^f and w^c be the two shares. Show that the sum of the two shares is equal to 1. Let us multiply each of these shares by 100 and call them weights. Check that their sum is equal to 100.
 - c. Using the notations w^f and w^c for the two weights, re-write the CPI formula.
 - d. Replace w^f and w^c in the formula that you just wrote and compare the result to the formula of definition for CPI. Are they identical? If not, what changes do you need to operate in order to make them identical?
 - e. Did you need to know quantities in Year 1 in order to compute CPI?

ANS:

- a. Let E^0 be expenditure in Year 0. $E^0 = p^f q^f + p^c q^c$, and $E^1 = p^{f1} q^f + p^{c1} q^c$. $CPI = 100 \times (E^1 / E^0)$.
- b. Let s^f be the share of food in the CPI basket. Then, $s^f = p^f q^f / E^0$, and $s^c = p^c q^c / E^0$; $w^f = 100s^f$ and $w^c = 100s^c$. The sum of the two weights is $w^f + w^c = 100(p^f q^f + p^c q^c) / E^0 = 100(p^f q^f + p^c q^c) / (p^f q^f + p^c q^c) = 100$.
- c. Let us write, incorrectly, the CPI formula as the sum of weights times prices in dollars: $CPI = w^f p^{f1} + w^c p^{c1}$. We will see that this formula is wrong.
- d. When using the incorrect formula determined at point c) above, we get $CPI = w^f p^{f1} + w^c p^{c1} = 100[(p^f q^f / E^0) p^{f1} + (p^c q^c / E^0) p^{c1}]$. If we compare this with the correct formula $CPI = 100[(p^{f1} q^f) / E^0 + (p^{c1} q^c) / E^0]$, we see that, for making them identical, we need to divide each term in the incorrect formula by the base year prices. Thus, the CPI formula using weights must use Year 1 *relative* prices, not dollar prices. With this observation, the correct CPI formula using weights is $CPI = w^f (p^{f1} / p^f) + w^c (p^{c1} / p^c)$.
- e. The current year quantities are not needed for computing CPI, because the basket of goods is always the same. The basket does not have to be the base year quantities, but we need a base year for reference prices.

PTS: 1 NOT: Macro TB_5-172

2. Suppose an economy consumes only two goods, food and clothing. The following table shows quantities consumed and prices for three years: Year 0 (the base year), Year 1, and Year 2.

Item	Year 0		Year 1		Year 2	
	Quantity (units)	Price (\$/unit)	Quantity (units)	Price (\$/unit)	Quantity (units)	Price (\$/unit)
Food	50	5	75	6	80	4
Clothing	100	12	110	11	115	14

- If the CPI basket is the Year 0 one, compute the expenditure on the basket in years 0, 1, and 2.
- Compute the CPIs in years 1 and two, with Year 0 being the base year.
- For Year 0, compute the shares in expenditure of each of the two goods. Check that the sum of the two shares equals 1. If you multiply those shares by 100, we call them weights. Using the weights, calculate the CPI for Year 0. It should be equal to 100.
- Using the weights, re-calculate the CPIs for the next two years and compare your result with that at question a.

ANS:

- $E^0 = 5 \times 50 + 12 \times 100 = \$1450$; $E^1 = 6 \times 50 + 11 \times 100 = \$1400$; $E^2 = 4 \times 50 + 14 \times 100 = \$1600$.
- $CPI^1 = (1400/1450) \times 100 = 96.6$; $CPI^2 = (1600/1450) \times 100 = 110.3$
- $s^f = 250/1450 = 0.172$; $s^c = 1200/1450 = 0.828$; $w^f = 17.2$; $w^c = 82.8$.
- $CPI^1 = 17.2(6/5) + 82.8(11/12) = 96.5$; $CPI^2 = 17.2(4/5) + 82.8(14/12) = 110.3$

PTS: 1

NOT: Macro TB_5-173

3. The following table shows the consumption goods categories that Statistics Canada uses to compute the consumer price index, their weights as percentages in a typical consumer's total expenditure, as well as some hypothetical prices of those generic goods. Since the weights are adjusted such that their sum is 100, the year 1 prices are given as price ratios p^1/p^0 , where p^0 is the base year price.

Category of goods and services (i)	Weight in CPI formula (w_i) (percent)	Price ratio p^1/p^0 (p_i) Year 1	Price ratio p^2/p^0 (p_i) Year 2
Food	16.9	1.2	1.3
Shelter	26.8	0.9	0.85
Household operations and furnishings	10.6	1.5	1.4
Clothing and footwear	5.4	1.08	1.92
Transportation	19.8	0.98	1.1
Health and personal care	4.5	2.3	2.4
Recreation, education, and reading	12.0	1.09	1.1
Alcoholic beverages and tobacco products	4.1	2.02	2.1

- Calculate the consumer price index in Year 1 and Year 2.
- Calculate the inflation rate in Year 1, Year 2, and between Year 1 and Year 2.
- Explain how the weights in column 2 were determined. Discuss the meaning of "Price of food."

ANS:

- Since we are given the weights of various goods in the consumption basket, we can use the "weights" formula for CPI, which is $\text{CPI} = \text{Sum of weight times relative price over all items}$.
 $\text{CPI}^1 = 16.9 \times 1.2 + 26.8 \times 0.9 + \dots + 4.1 \times 2.02 = 117.2$; $\text{CPI}^2 = 16.9 \times 1.3 + \dots + 4.1 \times 2.1 = 124.3$
- The inflation rate in year 1 with respect to year 0 is $\pi^1 = [(117.2 - 100)/100] \times 100 = 17\%$,
 $\pi^2 = [(124.3 - 100)/100] \times 100 = 24\%$; $\pi^{2,1} = [(124.3 - 117.2)/117.2] \times 100 = 6\%$.
- The weights were determined by dividing expenditure on each good in the base year to total expenditure on all goods in the base year. Since "food" includes many food items, "Price of food" must be a price index itself.

PTS: 1 NOT: Macro TB_5-174

4. Suppose an economy produces and consumes only two goods, houses and entertainment. The following table shows quantities consumed and prices for three years: Year 0 (the base year), Year 1, and Year 2.

Item	Year 0		Year 1		Year 2	
	Quantity (units)	Price (1000\$/unit)	Quantity (units)	Price (\$/unit)	Quantity (units)	Price (\$/unit)
Houses	1000	280	900	295	1050	297
Entertainment	700	24	780	25	785	25

- Using the base year basket, compute the CPI for Year 1 and Year 2
- Compute GDP deflator for Year 1 and Year 2
- Compute inflation rates based on CPI and GDP deflator

ANS:

- $$CPI^1 = (295 \times 1000 + 25 \times 700) / (280 \times 1000 + 24 \times 700) \times 100 = 105.3;$$

$$CPI^2 = (297 \times 1000 + 25 \times 700) / (280 \times 1000 + 24 \times 700) \times 100 = 106$$
- $$GDP \text{ deflator}^1 = (295 \times 900 + 25 \times 780) / (280 \times 900 + 24 \times 780) \times 100 = 105.3;$$

$$GDP \text{ deflator}^2 = (297 \times 1050 + 25 \times 785) / (280 \times 1050 + 24 \times 785) \times 100 = 105.9$$
- Since in this case the CPI and GDP deflator are very close, inflation rates will also be close.
The inflation rates relative to the base year are $\pi^1 = [(105.3 - 100) / 100] \times 100 = 5.3\%$, and $\pi^2 = 5.9\%$.

PTS: 1

NOT: Macro TB_5-175

5. Ruth wants to save an amount of money to buy a new computer in two years from now. She estimates that the price of the computer will be \$800, and she wants to save the money in two tranches at the beginning of each of the next two years. For simplicity, suppose interest is computed only at the end of the year and Ruth wants to save equal amounts every year. If the interest rate is 10% per year, how much does Ruth need to save every year?

ANS:

Let x be the amount that Ruth saves each year. This amount must satisfy the equation $x(1+0.1)(1+0.1) + x(1+0.1) = 800$. After calculating the numbers in parentheses, the equation becomes $2.31x = 800$, hence $x = \$346.32$.

PTS: 1

NOT: Macro TB_5-176

Chapter 7—Production and Growth

MULTIPLE CHOICE

1. Which of the following measures a nation's standard of living?
- real GDP
 - real GDP per person
 - nominal GDP
 - nominal GDP per person

ANS: B PTS: 1 DIF: Easy REF: p.139
BLM: Remember NOT: Macro TB_7-1

2. Which of the following statements best explains the importance of real GDP per person?
- It shows the rate of economic growth.
 - It measures a country's wealth.
 - It provides a measure of the cost of living.
 - It is a useful measure of well-being.

ANS: D PTS: 1 DIF: Easy REF: p.140
BLM: Remember NOT: Macro TB_7-2

3. If one wants to know how the material well-being of the average person has changed over time in a given country, which of the following should one look at?
- the level of real GDP
 - the growth rate of nominal GDP
 - the growth rate of real GDP
 - the growth rate of real GDP per person

ANS: D PTS: 1 DIF: Easy REF: p.140-141
BLM: Higher order NOT: Macro TB_7-3

4. How does income in developing countries like Pakistan and Bangladesh compare with that in Japan and Canada?
- It's about 1/10 or less of that in developed countries like Japan and Canada.
 - It's about 1/8 of that in developed countries like Japan and Canada.
 - It's about 1/5 of that in developed countries like Japan and Canada.
 - It's about 1/3 to 1/2 of that in developed countries like Japan and Canada.

ANS: A PTS: 1 DIF: Easy REF: p.139-141
BLM: Remember NOT: Macro TB_7-4

5. Over the past century in Canada, by how much has real GDP per person grown?
- by about 1 percent per year
 - by about 2 percent per year
 - by about 4 percent per year
 - by about 6 percent per year

ANS: B PTS: 1 DIF: Easy REF: p.139
BLM: Remember NOT: Macro TB_7-5

6. In how many years will real GDP per person in Canada double, given its average growth rate during the past century?
- a. 100 years on average
 - b. 70 years
 - c. 35 years
 - d. 25 years

ANS: C PTS: 1 DIF: Easy REF: p.139
BLM: Higher order NOT: Macro TB_7-6

7. Over the past 100 years, Canadian real GDP per person has doubled about every 35 years. If in the next 100 years it doubles every 25 years, then what will Canadian real GDP per person be a century from now?
- a. 4 times higher than it is now
 - b. 8 times higher than it is now
 - c. 12 times higher than it is now
 - d. 16 times higher than it is now

ANS: D PTS: 1 DIF: Average REF: p.139
BLM: Higher order NOT: Macro TB_7-7

8. Which of the following statements best characterizes the variations in real GDP per person and its rate of growth across countries?
- a. Real GDP per person differs widely across countries, but the growth rate of real GDP per person is similar across countries.
 - b. Real GDP per person is very similar across countries, but the growth rate of real GDP per person differs widely across countries.
 - c. Real GDP per person and the growth rate of real GDP per person are similar across countries.
 - d. Real GDP per person and the growth rate of real GDP per person vary widely across countries.

ANS: D PTS: 1 DIF: Easy REF: p.139
BLM: Remember NOT: Macro TB_7-8

9. Over the past century in Canada, by how much has average income as measured by real GDP per person grown?
- a. about 3.5 percent per year, which implies a doubling about every 20 years
 - b. about 2 percent per year, which implies a doubling about every 35 years
 - c. about 4 percent per year, which implies a doubling about every 17.5 years
 - d. about 1 percent per year, which implies a doubling about every 70 years

ANS: B PTS: 1 DIF: Easy REF: p.139
BLM: Remember NOT: Macro TB_7-9

10. As measured by real GDP per person, how much higher is average income in Canada today than it was a century ago?
- a. 2 times higher
 - b. 4 times higher
 - c. 6 times higher
 - d. 8 times higher

ANS: D PTS: 1 DIF: Easy REF: p.139
BLM: Remember NOT: Macro TB_7-10

11. How does income per person in Canada compare with income per person in China and India?
- a. It is about 2 times that in China and 6 times that in India.
 - b. It is about 4 times that in China and 8 times that in India.
 - c. It is about 6 times that in China and 10 times that in India.
 - d. It is about 10 times that in China and 6 times that in India.
 - e. It is about 8 times that in China and 4 times that in India.

ANS: C PTS: 1 DIF: Easy REF: p.140
BLM: Higher order NOT: Macro TB_7-11

12. Of the following countries, which grew the slowest between 1870 and 2003?
- a. Germany
 - b. the United Kingdom
 - c. Canada
 - d. the United States

ANS: B PTS: 1 DIF: Easy REF: p.141
BLM: Remember NOT: Macro TB_7-12

13. Compared to the income of the typical Canadian 136 years previously, how much was the income of the typical Pakistani in 2006?
- a. about 2 times as much
 - b. about the same
 - c. about 2/3 as much
 - d. about 1/2 as much
 - e. about 1/4 as much

ANS: B PTS: 1 DIF: Easy REF: p.141
BLM: Higher order NOT: Macro TB_7-13

14. Which of the following countries had the highest growth rate over the past 100 years?
- a. Brazil
 - b. Germany
 - c. Canada
 - d. United States

ANS: A PTS: 1 DIF: Average REF: p.141
BLM: Remember NOT: Macro TB_7-14

15. How large were the growth rates of Japan and Brazil over the past 100 years?
- a. 1.5 percent
 - b. 1.75 percent
 - c. 2.0 percent
 - d. 2.25 percent

ANS: D PTS: 1 DIF: Easy REF: p.141
BLM: Remember NOT: Macro TB_7-15

16. Which of the following nations experienced average rates of economic growth of less than 2.0 percent between 1900 and 2006?
- a. Brazil
 - b. Mexico
 - c. China
 - d. Argentina

ANS: D PTS: 1 DIF: Easy REF: p.140
BLM: Remember NOT: Macro TB_7-16

17. In 1870, what was the richest country in the world?
- a. Canada
 - b. the United States
 - c. the United Kingdom
 - d. Germany

ANS: C PTS: 1 DIF: Easy REF: p.141
BLM: Remember NOT: Macro TB_7-17

18. In Canada, approximately how much higher is GDP per person today than it was a century ago?
- a. 3 times higher
 - b. 9 times higher
 - c. 50 times higher
 - d. 1518 times higher

ANS: D PTS: 1 DIF: Average REF: p.141
BLM: Higher order NOT: Macro TB_7-18

19. Which of the following statements best describes the relationship between the initial wealth and the growth rate of a country?
- a. Countries with the highest growth rates over the last 100 years are the ones that had the highest level of real GDP 100 years ago.
 - b. Countries that were rich a century ago had little fluctuation around their average growth rates during the past 100 years.
 - c. Though the catch-up effect may suggest otherwise, the data show no strong relationship between initial conditions and growth rates.
 - d. Over the last 100 years, Japan had the highest real GDP growth rate, and now it has the highest real GDP per person.

ANS: C PTS: 1 DIF: Average REF: p.141
BLM: Remember NOT: Macro TB_7-19

20. Which of the following best explains productivity?
- a. Productivity is equal to nominal GDP per person.
 - b. Productivity is equal to real GDP per person.
 - c. Productivity is the quantity of goods or services that a worker can produce in one hour.
 - d. Productivity is the growth rate of real GDP per person.

ANS: C PTS: 1 DIF: Average REF: p.142-143
BLM: Remember NOT: Macro TB_7-20

21. What is the average amount of goods and services produced from each hour of a worker's time called?
- a. per capita GDP
 - b. per capita GNP
 - c. productivity
 - d. human capital

ANS: C PTS: 1 DIF: Easy REF: p.143
BLM: Remember NOT: Macro TB_7-21

22. How is a nation's standard of living determined?
- a. by its productivity
 - b. by its gross domestic product
 - c. by its national income
 - d. by how much it has relative to others

ANS: A PTS: 1 DIF: Easy REF: p.143
BLM: Remember NOT: Macro TB_7-22

23. Last year, real GDP per person in Olympus was \$5500. The year before, it was \$4500. What was the growth rate of real GDP per person?
- a. 18.18 percent
 - b. 20 percent
 - c. 22.2 percent
 - d. 24 percent

ANS: C PTS: 1 DIF: Easy REF: p.141
BLM: Higher order NOT: Macro TB_7-23

24. Last year, real GDP in Oceania was \$620 billion and the population was 2.3 million. The year before, real GDP was \$502.0 billion and the population was 2.0 million. What was the approximate growth rate of real GDP per person?
- a. 16 percent
 - b. 13 percent
 - c. 10 percent
 - d. 7 percent

ANS: D PTS: 1 DIF: Challenging REF: p.141
BLM: Higher order NOT: Macro TB_7-24

25. In 2010 real GDP in Latania was \$750 billion and the population was 3 million. In 2011 real GDP was \$990 billion and the population was 3.3 million. What was the approximate growth rate of real GDP per person?
- a. 11 percent
 - b. 14 percent
 - c. 17 percent
 - d. 20 percent

ANS: D PTS: 1 DIF: Challenging REF: p.141
BLM: Higher order NOT: Macro TB_7-25

26. In 2007 Freedonia had a population of 2700 and real GDP of about \$1 080 000. In 2006 it had a population of 2500 and real GDP of about \$1 000 000. What was the approximate growth rate of real GDP per person in Freedonia between 2006 and 2007?
- a. 0 percent
 - b. 2.5 percent
 - c. 5 percent
 - d. 7.5 percent

ANS: A PTS: 1 DIF: Challenging REF: p.141
BLM: Higher order NOT: Macro TB_7-26

27. How does productivity explain the differences in standard of living across countries?
- a. Productivity tends to be lower in countries with high population; therefore in those countries standards of living are lower.
 - b. Productivity explains very little of the differences across countries in the standard of living.
 - c. Productivity explains some, but not most, of the differences across countries in the standard of living.
 - d. Productivity explains most of the differences across countries in the standard of living.

ANS: D PTS: 1 DIF: Average REF: p.143
BLM: Remember NOT: Macro TB_7-27

28. Which of the following is a correct way to measure productivity?
- a. divide the number of hours worked by output
 - b. divide output by the number of hours worked
 - c. compute output growth
 - d. divide the change in output by the change in number of hours worked

ANS: B PTS: 1 DIF: Easy REF: p.143
BLM: Remember NOT: Macro TB_7-28

29. Cedar Valley Furniture uses 5 workers working 8 hours to produce 80 rocking chairs. What is the productivity of these workers?
- a. 2 chairs per hour
 - b. 1 hour per chair
 - c. 80 chairs
 - d. 10 chairs per day

ANS: A PTS: 1 DIF: Easy REF: p.143
BLM: Higher order NOT: Macro TB_7-29

30. Why are Canadian workers more productive than the Chinese?

- a. because Canada is a federal state
- b. because Canadians have more capital to work with
- c. because prices are higher in Canada than in China
- d. because the most productive Chinese workers have emigrated to Canada

ANS: B PTS: 1 DIF: Easy REF: p.143
BLM: Higher order NOT: Macro TB_7-30

31. Which of the following best describes the relationship between productivity and standard of living?

- a. International trade makes a country's productivity irrelevant.
- b. A country's standard of living and its productivity are closely related.
- c. Productivity only increases revenue to investors, while general well-being is not affected.
- d. A rich country can enjoy high standard of living without the need for high productivity.

ANS: B PTS: 1 DIF: Easy REF: p.143
BLM: Higher order NOT: Macro TB_7-31

32. Tom works 6 hours a day and Jerry works 8 hours. Tom can produce 6 baskets of goods while Jerry can produce 7 baskets. Which of the following can we conclude?

- a. Tom's productivity is greater than Jerry's.
- b. Tom's and Jerry's productivities are equal because they both work one day.
- c. Tom's and Jerry's productivities cannot be compared.
- d. Tom's productivity is lower than Jerry's.

ANS: A PTS: 1 DIF: Easy REF: p.143
BLM: Higher order NOT: Macro TB_7-32

33. Laurie works 8 hours and produces 7 units of goods per hour. Iris works 6 hours and produces 10 units of goods per hour. Which of the following can we conclude?

- a. Laurie's productivity and output are greater than Iris's.
- b. Laurie's productivity is greater than Iris's, but Laurie's output is less.
- c. Iris's productivity and output are greater than Laurie's.
- d. Iris's productivity is greater than Laurie's, but Iris's output is less.

ANS: C PTS: 1 DIF: Average REF: p.143
BLM: Higher order NOT: Macro TB_7-33

34. Dawn looks over reports on five of her workers. Carol made 25 baskets in 5 hours. Peter made 36 baskets in 6 hours. Rob made 40 baskets in 10 hours. Jack made 55 baskets in 10 hours. Darby made 22 baskets in 3 hours. Who has the greatest productivity?

- a. Darby
- b. Peter
- c. Rob
- d. Jack

ANS: A PTS: 1 DIF: Easy REF: p.143
BLM: Higher order NOT: Macro TB_7-34

35. Which of the following is a direct determinant of productivity?

- a. human capital
- b. wage
- c. price of output
- d. unemployment rate

ANS: A PTS: 1 DIF: Easy REF: p.144-145
BLM: Higher order NOT: Macro TB_7-35

36. What do economists call the inputs used to produce goods and services?

- a. productivity indicators
- b. capitalization producers
- c. production functions
- d. factors of production

ANS: D PTS: 1 DIF: Easy REF: p.144
BLM: Remember NOT: Macro TB_7-36

37. What do economists call the equipment and structures available to produce goods and services?

- a. physical capital
- b. human capital
- c. the production function
- d. technology

ANS: A PTS: 1 DIF: Easy REF: p.144
BLM: Remember NOT: Macro TB_7-37

38. What would an economist call the saws, lathes, and drill presses that woodworkers at Cedar Valley Furniture use to produce chests and cabinets?

- a. human capital
- b. physical capital
- c. natural resources
- d. technological knowledge

ANS: B PTS: 1 DIF: Easy REF: p.144
BLM: Higher order NOT: Macro TB_7-38

39. Which of the following would **NOT** be considered physical capital?

- a. a new factory building
- b. a computer used to help Mercury Delivery Service keep track of their orders
- c. on-the-job training
- d. a desk used in an accountant's office

ANS: C PTS: 1 DIF: Easy REF: p.144
BLM: Higher order NOT: Macro TB_7-39

40. Which of the following would be considered physical capital?

- a. the pizza oven at the Liquidity Preferences Tavern
- b. soy beans used to make soy milk
- c. the skills and knowledge of a barber
- d. the number of hours people spend in the gym

ANS: A PTS: 1 DIF: Easy REF: p.144
BLM: Higher order NOT: Macro TB_7-40

41. Which of the following best defines human capital?

- a. the knowledge and skills that workers acquire through education, training, and experience
- b. the stock of equipment and structures that is used to produce goods and services
- c. the total number of hours worked in an economy
- d. the same thing as technological knowledge

ANS: A PTS: 1 DIF: Easy REF: p.144
BLM: Remember NOT: Macro TB_7-41

42. Which of the following is considered human capital?

- a. the number of computers available in schools and universities
- b. the average percentage of income people give to charity
- c. the number of persons in the labour force
- d. knowledge acquired from on-the-job training

ANS: D PTS: 1 DIF: Easy REF: p.144
BLM: Higher order NOT: Macro TB_7-42

43. Which of the following is human capital?

- a. breakfasts served in a company's cafeteria
- b. understanding how to use a company's accounting software
- c. computers that show training videos for new corporate employees
- d. the average number of holiday days per year

ANS: B PTS: 1 DIF: Average REF: p.144
BLM: Higher order NOT: Macro TB_7-43

44. Which of the following is considered human capital?

- a. better working conditions
- b. safety in the workplace
- c. the things you have learned this semester
- d. machinery that requires a human to operate

ANS: C PTS: 1 DIF: Easy REF: p.144
BLM: Higher order NOT: Macro TB_7-44

45. Jessica Smith is a teacher. Which of the following is a part of her human capital?

- a. her work experience
- b. the textbooks she uses
- c. the software she uses when delivering her lectures
- d. the amount of time she spends with her students

ANS: A PTS: 1 DIF: Easy REF: p.144
BLM: Higher order NOT: Macro TB_7-45

46. Which of the following best describes natural resources?
- a. They are native abilities that workers might possess.
 - b. They are production inputs such as land, rivers, and mineral deposits.
 - c. They refer to knowledge that is freely available and is used in production.
 - d. They are public schools and universities where workers are prepared for life, for which companies do not have to pay.

ANS: B PTS: 1 DIF: Easy REF: p.144-145
BLM: Remember NOT: Macro TB_7-46

47. Which of the following lists contains, in this order, natural resources, human capital, and physical capital?
- a. for a restaurant: the land where it stands; the things the chef learned at cooking school; the freezers where the steaks are kept
 - b. for a furniture company: wood; the company cafeteria; saws
 - c. for a railroad: fuel; railroad engines; railroad tracks
 - d. for an oil company: the oil it brings to surface; the rigs; the refineries using its oil

ANS: A PTS: 1 DIF: Easy REF: p.144-145
BLM: Higher order NOT: Macro TB_7-47

48. Which of the following is an example of a nonrenewable resource?
- a. coal
 - b. honey
 - c. livestock
 - d. lumber

ANS: A PTS: 1 DIF: Easy REF: p.144
BLM: Higher order NOT: Macro TB_7-48

49. In a market economy, what is scarcity of resources most clearly reflected in?
- a. supply
 - b. demand
 - c. market prices
 - d. the stock of the resource

ANS: C PTS: 1 DIF: Average REF: p.144
BLM: Higher order NOT: Macro TB_7-49

50. In a market economy, when do we know that a resource has become scarcer?
- a. when its price rises relative to other prices
 - b. when it is nonrenewable and some of it is used
 - c. when substitutes exist
 - d. when there are no substitutes

ANS: A PTS: 1 DIF: Average REF: p.146
BLM: Higher order NOT: Macro TB_7-50

51. In a market economy, what does the real, or inflation-adjusted, price of a resource measure?
- a. contribution to revenue
 - b. relative scarcity
 - c. relative importance
 - d. contribution to efficiency

ANS: B PTS: 1 DIF: Easy REF: p.146
BLM: Remember NOT: Macro TB_7-51

52. Which of the following indicates greater scarcity of a natural resource?
- a. simply an increase in its current dollar price
 - b. an increase in its price that is greater than the rate of inflation, but only if the increase in price is created by a reduction in supply
 - c. an increase in its price that is greater than the rate of inflation
 - d. an increase in its price that is greater than the rate of inflation, but only if the stock of the resource has fallen

ANS: C PTS: 1 DIF: Average REF: p.146
BLM: Higher order NOT: Macro TB_7-52

53. Which of the following has been happening to the market prices of most natural resources (adjusted for inflation)?
- a. They have been rising.
 - b. They have been stable or rising.
 - c. They have been stable or falling.
 - d. They have been falling.

ANS: C PTS: 1 DIF: Average REF: p.146
BLM: Remember NOT: Macro TB_7-53

54. Based on historical data on the prices of natural resources, which of the following best describes how natural resources limit economic growth?
- a. Prices have been increasing, which shows that natural resources become scarcer and this impedes growth.
 - b. Prices of natural resources have been fluctuating, which shows that there is no correlation between growth and natural resources.
 - c. Prices of natural resources have been decreasing in constant dollars, which shows that natural resources are not scarcer than they were in the past, thus economic growth is not limited by natural resources.
 - d. Prices do not show whether resources limit growth because the natural resources that economies use are not the same today as those in the past.

ANS: C PTS: 1 DIF: Easy REF: p.146
BLM: Remember NOT: Macro TB_7-54

55. Which of the following best explains the falling relative prices of most of the natural resources?
- a. Most are renewable; therefore, the supply of natural resources is increasing.
 - b. Our ability to conserve natural resources is increasing faster than their depletion.
 - c. The demand for natural resources is diminishing due to the discovery of new substitutes.
 - d. Prices of natural resources, adjusted for inflation, are in fact increasing.

ANS: B PTS: 1 DIF: Average REF: p.146
BLM: Higher order NOT: Macro TB_7-55

56. Which of the following would we expect to happen with prices or quantities of natural resources if they were becoming scarcer?
- a. We would expect prices to be rising relative to other prices, as they have been.
 - b. We would expect prices to be rising relative to other prices, but this has not occurred.
 - c. We would expect known quantities to be increasing, as they have been.
 - d. We would expect known quantities to be falling, but they have not been.

ANS: B PTS: 1 DIF: Easy REF: p.146
BLM: Higher order NOT: Macro TB_7-56

57. A leading environmental group recently published a report contending that humans are running a "resource deficit" because we are using natural resources faster than they can be regenerated. The group claims that this means that economic growth will eventually stop, and will even be reversed. How would an economist respond to this report?
- a. An economist would agree with the report, and would point to rising natural resource prices as evidence.
 - b. An economist would agree with the report, but wouldn't think it was important because growth will not slow down for several centuries.
 - c. An economist would disagree with the report, in part because it ignores the mitigating effects of technological change.
 - d. An economist would disagree with the report because labour and capital are the primary determinants of growth, and since they are plentiful, growth will not slow down.

ANS: C PTS: 1 DIF: Average REF: p.146
BLM: Higher order NOT: Macro TB_7-57

58. Which of the following best states economists' understanding of the facts concerning the relationship between natural resources and economic growth?
- a. A country with no or few domestic natural resources is destined to be poor.
 - b. Differences in natural resources have virtually no role in explaining differences in standards of living.
 - c. Some countries can be rich mostly because of their natural resources, and countries without natural resources need not be poor, but can never have very high standards of living.
 - d. Abundant domestic natural resources may help make a country rich, but even countries with few natural resources can have high standards of living.

ANS: D PTS: 1 DIF: Average REF: p.146
BLM: Higher order NOT: Macro TB_7-58

59. In the country of Krypton, the price of lead increased from \$20 per kilogram to \$22 per kilogram during a time when the overall price level increased by 8 percent. During this period, what happened to the real price of lead?
- a. It increased.
 - b. It decreased.
 - c. It stayed the same.
 - d. It might have increased, decreased, or stayed the same; more information is needed to be sure.

ANS: A PTS: 1 DIF: Average REF: p.146
BLM: Higher order NOT: Macro TB_7-59

60. Which of the following best defines proprietary technology?
- a. It is knowledge that is known but no longer used much.
 - b. It is knowledge that is known, but has only recently been discovered.
 - c. It is knowledge that is known widely by those in a profession.
 - d. It is knowledge that is known only by the company that discovers it.

ANS: D PTS: 1 DIF: Easy REF: p.144
BLM: Remember NOT: Macro TB_7-60

61. A management professor discovers a way for corporate management to operate more efficiently. He publishes his findings in a journal. How are his findings best defined?
- a. proprietary and common knowledge
 - b. neither proprietary nor common knowledge
 - c. proprietary, but not common, knowledge
 - d. common, but not proprietary, knowledge

ANS: D PTS: 1 DIF: Easy REF: p.144
BLM: Higher order NOT: Macro TB_7-61

62. Your company discovers a better way to produce mousetraps, but your better methods are not apparent from the mousetraps themselves. What kind of knowledge is this?
- a. common technological knowledge
 - b. common, but not technological, knowledge
 - c. proprietary technological knowledge
 - d. proprietary, but not technological, knowledge

ANS: C PTS: 1 DIF: Easy REF: p.144
BLM: Higher order NOT: Macro TB_7-62

63. Which of the following best defines technological knowledge?
- a. It is the same as human capital.
 - b. It is available information on how to produce things.
 - c. It is the resources expended transmitting society's understanding to the labour force.
 - d. It is knowledge about new, unexploited natural resources.

ANS: B PTS: 1 DIF: Easy REF: p.144-145
BLM: Remember NOT: Macro TB_7-63

64. Which of the following terms refers to the relationship between the quantity of output created and the quantity of inputs needed to create it?
- a. the capital accumulation function
 - b. technological knowledge
 - c. the production function
 - d. human capital

ANS: C PTS: 1 DIF: Easy REF: p.145
BLM: Remember NOT: Macro TB_7-64

65. If your firm has constant returns to scale, what would happen to your firm's output if you doubled all your inputs?
- a. It would not change.
 - b. It would increase, but by less than double.
 - c. It would double.
 - d. It would more than double.

ANS: C PTS: 1 DIF: Easy REF: p.145
BLM: Higher order NOT: Macro TB_7-65

66. Suppose you bake cookies. One day, you double the time you spend; double the number of chocolate chips, flour, eggs, and all your other inputs; and bake twice as many cookies. What kind of production function is this?
- a. decreasing returns to scale
 - b. zero returns to scale
 - c. constant returns to scale
 - d. increasing returns to scale

ANS: C PTS: 1 DIF: Average REF: p.145
BLM: Higher order NOT: Macro TB_7-66

67. If there are constant returns to scale, how is the production function written?
- a. $xY = 2xAF(L, K, H, N)$
 - b. $Y/L = A F(xL, xK, xH, xN)$
 - c. $Y/L = A F(1, K/L, H/L, N/L)$
 - d. $L = AF(Y, K, H, N)$

ANS: C PTS: 1 DIF: Average REF: p.145
BLM: Higher order NOT: Macro TB_7-67

68. If a production function has constant returns to scale, how can output be doubled?
- a. by doubling labour
 - b. by doubling any one of the inputs
 - c. by doubling all of the inputs
 - d. by increasing all inputs by more than double

ANS: C PTS: 1 DIF: Easy REF: p.145
BLM: Higher order NOT: Macro TB_7-68

69. If the production function for an economy had constant returns to scale, the labour force doubled, and all other inputs stayed the same, what would happen to real GDP?
- a. It would stay the same.
 - b. It would increase by 50 percent.
 - c. It would increase, but by something less than double.
 - d. It would double.

ANS: C PTS: 1 DIF: Average REF: p.145
BLM: Higher order NOT: Macro TB_7-69

70. If the number of workers in an economy doubled, all other inputs stayed the same, and there were constant returns to scale, what would happen to productivity?
- a. It would fall to half its former value.
 - b. It would fall but by less than half.
 - c. It would stay the same.
 - d. It would rise but less than double.

ANS: B PTS: 1 DIF: Challenging REF: p.145
BLM: Higher order NOT: Macro TB_7-70

71. Suppose that an economy with constant returns to scale doubled its physical capital stock, doubled its available natural resources, and doubled its human capital, but kept the size of the labour force the same. How does the change in output compare to the change in productivity?
- a. Output would stay the same and so would its productivity.
 - b. Output and productivity would increase, but by less than double.
 - c. Output and productivity would increase by more than double.
 - d. Output would increase by less than double, but productivity would double.

ANS: B PTS: 1 DIF: Challenging REF: p.145
BLM: Higher order NOT: Macro TB_7-71

72. Using the production function and notation in the text, what does K/L measure?
- a. natural resources per worker
 - b. human capital per worker
 - c. output per worker
 - d. physical capital per worker

ANS: D PTS: 1 DIF: Average REF: p.145
BLM: Remember NOT: Macro TB_7-72

73. Which of the following does Y/L refer to?
- a. productivity
 - b. output
 - c. the availability of natural resources
 - d. the amount of human capital

ANS: A PTS: 1 DIF: Easy REF: p.145
BLM: Remember NOT: Macro TB_7-73

74. Suppose that over the past ten years productivity grew faster in Oceania than in Freedonia and the population of both countries was unchanged. Which of the following can we conclude?
- a. that real GDP per person must be higher in Oceania than in Freedonia
 - b. that real GDP per person grew faster in Oceania than in Freedonia
 - c. that the standard of living must be higher in Oceania than in Freedonia
 - d. that Oceania must have had a greater capital stock than Freedonia

ANS: B PTS: 1 DIF: Average REF: p.143
BLM: Higher order NOT: Macro TB_7-74

75. Suppose that real GDP grew more in Country A than in Country B last year. Which of the following does this imply concerning productivity or standard of living?
- a. Country A must have a higher standard of living than country B.
 - b. Country A's productivity must have grown faster than country B's.
 - c. Country A must have a higher real GDP than Country B.
 - d. Country A's productivity must have been higher only if the population in the two countries grew at the same rate.

ANS: D PTS: 1 DIF: Challenging REF: p.143
BLM: Higher order NOT: Macro TB_7-75

76. Which of the following would increase productivity, everything else being the same?
- a. an increase in population
 - b. an increase in the number of hours of work per week
 - c. an increase in prices
 - d. an increase in physical capital per worker

ANS: D PTS: 1 DIF: Easy REF: p.145
BLM: Higher order NOT: Macro TB_7-76

77. One of the Ten Principles of Economics in Chapter 1 is that people face tradeoffs. The growth that arises from capital accumulation is not a free lunch. What is the opportunity cost of that capital accumulation?
- a. People need to work longer hours, thus having less time for leisure.
 - b. People need to consume less goods and services now in order to enjoy more consumption in the future.
 - c. People need to recycle resources so that future generations can produce goods and services with the accumulated capital.
 - d. People need to devote less time in school and more at work.

ANS: B PTS: 1 DIF: Easy REF: p.147
BLM: Higher order NOT: Macro TB_7-77

78. Which of the following is one of the consequences of accumulating capital?
- a. Accumulating capital requires that society sacrifice consumption in the present.
 - b. Accumulating capital allows society to consume more in the present.
 - c. Accumulating capital decreases saving rates.
 - d. Accumulating capital increases income inequality.

ANS: A PTS: 1 DIF: Easy REF: p.147
BLM: Higher order NOT: Macro TB_7-78

79. How can a government encourage growth and, in the long run, raise the country's economic standard of living?
- a. by encouraging population growth
 - b. by encouraging consumption
 - c. by encouraging saving and investment
 - d. by increasing government spending

ANS: C PTS: 1 DIF: Easy REF: p.147
BLM: Higher order NOT: Macro TB_7-79

80. Which of the following best explains how investment and growth rates related across countries?
- a. They are negatively related.
 - b. They are positively related.
 - c. They are negatively related for rich countries, but positively related for poor countries.
 - d. They are positively related for rich countries, but negatively related for poor countries.

ANS: B PTS: 1 DIF: Easy REF: p.147
BLM: Higher order NOT: Macro TB_7-80

81. In the traditional view, which of the following production processes is considered when studying economic growth?
- a. constant returns
 - b. increasing returns
 - c. diminishing returns
 - d. diminishing returns for low levels of capital, and increasing returns for high levels of capital

ANS: C PTS: 1 DIF: Easy REF: p.147
BLM: Remember NOT: Macro TB_7-81

82. What does diminishing returns to capital imply?
- a. Capital produces fewer goods as it ages.
 - b. New ideas are not as useful as old ideas.
 - c. Increases in the capital stock eventually decrease output.
 - d. Increases in the capital stock increase output by ever smaller amounts.

ANS: D PTS: 1 DIF: Average REF: p.147-148
BLM: Higher order NOT: Macro TB_7-82

83. What is the effect of a higher saving rate in the long run?
- a. It decreases the capital stock.
 - b. People must consume less in the future.
 - c. It increases productivity.
 - d. It leads to higher growth in real GDP.

ANS: C PTS: 1 DIF: Average REF: p.148
BLM: Higher order NOT: Macro TB_7-83

84. Suppose a country were to increase its saving rate. In the long run, which of the following would also increase?
- a. its level of income
 - b. its growth rate of income
 - c. its growth rate of productivity
 - d. its growth rate in capital stock

ANS: A PTS: 1 DIF: Average REF: p.148
BLM: Remember NOT: Macro TB_7-84

85. If a country's saving rate increases, which of the following happens in the long run?
- a. Both productivity growth and income growth increase.
 - b. Only productivity growth increases.
 - c. Only income growth increases.
 - d. Neither productivity growth nor income growth increase.

ANS: D PTS: 1 DIF: Average REF: p.147-149
BLM: Remember NOT: Macro TB_7-85

86. If a country's saving rate increases, which of the following happens in the long run?
- a. Its productivity is higher, but real GDP per person is not higher.
 - b. Its real GDP per person is higher, but productivity is not higher.
 - c. Its productivity and real GDP per person are both higher.
 - d. Neither its productivity nor real GDP per person are higher.

ANS: C PTS: 1 DIF: Average REF: p.147-149
BLM: Remember NOT: Macro TB_7-86

87. Suppose Mexico increases its saving rate. Which of the following will happen in the long run?
- a. The growth rates of productivity and real GDP per person will increase.
 - b. Productivity and real GDP per person will increase.
 - c. The growth rate of productivity will increase, and real GDP per person will increase.
 - d. Productivity will increase, and the growth rate of real GDP per person will increase.

ANS: B PTS: 1 DIF: Average REF: p.147-149
BLM: Higher order NOT: Macro TB_7-87

88. Suppose that Poland undertakes policy to increase its saving rate. Which of the following will this policy most likely do?
- a. It will have no impact on GDP growth.
 - b. It will lead to somewhat higher GDP growth for a few years.
 - c. It will lead to substantially higher GDP growth for a period of several decades.
 - d. It will lead to a permanently higher growth rate.

ANS: C PTS: 1 DIF: Easy REF: p.147-149
BLM: Higher order NOT: Macro TB_7-88

89. Other things equal, how do relatively poor countries tend to grow?
- a. slower than relatively rich countries; this is called the poverty trap
 - b. slower than relatively rich countries; this is called the Malthus effect
 - c. faster than relatively rich countries; this is called the catch-up effect
 - d. faster than relatively rich countries; this is called the constant-returns-to-scale effect

ANS: C PTS: 1 DIF: Easy REF: p.147-149
BLM: Remember NOT: Macro TB_7-89

90. Suppose that there are diminishing returns to capital. Suppose also that two countries are the same except one has less capital and so less real GDP per person than the other. Suppose that the saving rate in both countries increases from 5 percent to 6 percent. Which of the following would we expect over the next ten years?
- The growth rate will not change in either country.
 - The country with less capital will grow faster.
 - The country with more capital will grow faster.
 - Both countries will grow at the same rate.

ANS: B PTS: 1 DIF: Average REF: p.147-149
BLM: Higher order NOT: Macro TB_7-90

91. Suppose that there are diminishing returns to capital. Suppose also that two countries are the same except one has less capital and so less real GDP per person. Suppose that both increase their saving rate from 3 percent to 4 percent. Which of the following will happen in the long run?
- Both countries will have permanently higher growth rates of real GDP per person, and the growth rate will be higher in the country with more capital.
 - Both countries will have permanently higher growth rates of real GDP per person, and the growth rate will be higher in the country with less capital.
 - Both countries will have higher levels of real GDP per person, and the temporary increase in growth in the level of real GDP per person will have been greater in the country with more capital.
 - Both countries will have higher levels of real GDP per person, and the temporary increase in growth in the level of real GDP per person will have been greater in the country with less capital.

ANS: D PTS: 1 DIF: Challenging REF: p.147-149
BLM: Higher order NOT: Macro TB_7-91

92. Real GDP per person is \$25 000 in Aquilonia, \$10 000 in Nemedia, \$15 000 in Shem, and \$20 000 in Zexa. Saving per person is \$2000 in all three countries. Other things equal, what would we expect?
- All four countries will grow at the same rate.
 - Aquilonia will grow the fastest.
 - Nemedia will grow the fastest.
 - Shem will grow the fastest.

ANS: C PTS: 1 DIF: Challenging REF: p.147-149
BLM: Higher order NOT: Macro TB_7-92

93. Other things the same, if a country increased its saving rate, in 40 years which of the following would that country likely have?
- higher productivity and a higher growth rate of real GDP
 - higher productivity but not a higher growth rate of real GDP
 - the same productivity and growth of real GDP it began with
 - higher productivity growth rate and higher real GDP

ANS: B PTS: 1 DIF: Average REF: p.147-149
BLM: Higher order NOT: Macro TB_7-93

94. Which of the following best defines the catch-up effect?
- a. It is the idea that saving will always "catch up" with investment spending.
 - b. It is the idea that it is easier for a country to grow fast and "catch up" with richer countries if it starts out relatively poor.
 - c. It is the idea that rich countries aid relatively poor countries so as to help them "catch up."
 - d. It is the idea that if investment spending is low, increased saving will help investment to "catch up."

ANS: B PTS: 1 DIF: Easy REF: p.148
BLM: Remember NOT: Macro TB_7-94

95. Which of the following best explains the logic behind the catch-up effect?
- a. Workers in countries with low incomes will work more hours than workers in countries with high incomes.
 - b. The capital stock in rich countries deteriorates at a higher rate because it already has a lot of capital.
 - c. New capital adds more to production in a country that doesn't have much capital than in a country that already has much capital.
 - d. Poor countries tend to save a higher share of their income than rich countries.

ANS: C PTS: 1 DIF: Easy REF: p.148-149
BLM: Remember NOT: Macro TB_7-95

96. Which of the following countries benefited a lot from the catch-up effect in the last half of the twentieth century?
- a. Ethiopia
 - b. Saudi Arabia
 - c. South Korea
 - d. Germany

ANS: C PTS: 1 DIF: Easy REF: p.149
BLM: Remember NOT: Macro TB_7-96

97. Which of the following is consistent with the catch-up effect?
- a. The United States had a lower growth rate before 1900 than after.
 - b. Japan has a higher growth rate than Germany.
 - c. Although Canada has a relatively high level of output per person, its growth rate is still high compared to some poorer countries, such as Pakistan.
 - d. After World War II, Canada had lower growth rates than war-ravaged European countries.

ANS: D PTS: 1 DIF: Easy REF: p.148-149
BLM: Higher order NOT: Macro TB_7-97

98. From 1960 to 1990, what happened to the growth rates of Canada and South Korea?
- South Korea had a higher growth rate than Canada because it had a higher ratio of investment to GDP.
 - Canada had a higher growth rate than South Korea because it had a higher ratio of investment to GDP.
 - South Korea had a higher growth rate than Canada, even though it had a similar ratio of investment to GDP.
 - Canada had a higher growth rate than South Korea, even though it had a similar ratio of investment to GDP.

ANS: C PTS: 1 DIF: Average REF: p.149
BLM: Remember NOT: Macro TB_7-98

99. According to the traditional view of the production process, how does output per worker change when capital per worker increases?
- It increases. This increase is larger at larger values of capital per worker.
 - It increases. This increase is smaller at larger values of capital per worker.
 - It increases. This increase is the same at all values of capital per worker.
 - It decreases. This decrease is larger at larger values of capital per worker.

ANS: B PTS: 1 DIF: Average REF: p.148
BLM: Remember NOT: Macro TB_7-99

100. According to the traditional view, in what direction is the slope of the production function, with capital per worker on the horizontal axis and output per worker on the vertical axis?
- The slope is positive and becomes steeper as capital per worker rises.
 - The slope is positive and becomes flatter as capital per worker rises.
 - The slope is constant.
 - The slope is negative and becomes steeper as capital per worker rises.

ANS: B PTS: 1 DIF: Easy REF: p.148
BLM: Remember NOT: Macro TB_7-100

101. If your Canadian-based firm opens and operates a new watch factory in Panama, what type of investment is your firm engaging in?
- foreign portfolio investment
 - foreign financial investment
 - foreign direct investment
 - foreign capital investment

ANS: C PTS: 1 DIF: Easy REF: p.149-150
BLM: Higher order NOT: Macro TB_7-101

102. In the 1800s, Europeans purchased stock in Canadian companies, which used the funds to build railroads and factories. What type of investments did the Europeans make?
- foreign portfolio investments
 - indirect domestic investments
 - foreign direct investments
 - foreign indirect investments

ANS: A PTS: 1 DIF: Easy REF: p.149
BLM: Higher order NOT: Macro TB_7-102

103. In which of the following types of investment do foreigners buy shares in domestic companies?
- a. foreign direct investment
 - b. foreign portfolio investment
 - c. foreign capital investment
 - d. foreign indirect investment

ANS: B PTS: 1 DIF: Easy REF: p.149
BLM: Higher order NOT: Macro TB_7-103

104. Suppose Canadian-based Nortel builds and operates a new factory in Mexico. What would the future production from such an investment do?
- a. increase Mexico's GDP more than it would increase Mexico's GNP
 - b. increase Mexico's GNP more than it would increase Mexico's GDP
 - c. not affect Mexico's GNP, but it would increase Mexico's GDP
 - d. have no effect on either Mexico's GDP or its GNP

ANS: A PTS: 1 DIF: Average REF: p.149-150
BLM: Higher order NOT: Macro TB_7-104

105. Suppose Japanese-based Sony Corporation builds and operates a new chip factory in Canada. What would the future production from such an investment do?
- a. increase Canadian GNP more than it would increase Canadian GDP
 - b. increase Canadian GDP more than it would increase Canadian GNP
 - c. not affect Canadian GNP, but it would increase Canadian GDP
 - d. have no effect on Canadian GNP or GDP

ANS: B PTS: 1 DIF: Average REF: p.149-150
BLM: Higher order NOT: Macro TB_7-105

106. Why would the opening of a new Canadian-owned factory in Egypt tend to increase Egypt's GDP more than it increases Egypt's GNP?
- a. Some of the income from the factory accrues to people who live in Egypt.
 - b. GDP is income earned by residents only, whereas GNP is income earned by residents and nonresidents.
 - c. All of the income from the factory is included in Egypt's GDP, but not all is included in GNP.
 - d. Foreign direct investment is part of GDP, but it is not part of GNP.

ANS: D PTS: 1 DIF: Average REF: p.149-150
BLM: Higher order NOT: Macro TB_7-106

107. Which of the following is an implication of investment from abroad?
- a. Poor countries become poorer because profits go to the foreign owners.
 - b. Foreign investment increases the destination country's stock of capital; therefore, it promotes growth.
 - c. Foreign investment increases GDP but not GNP.
 - d. Foreign investment is unfair because only foreigners benefit from it.

ANS: B PTS: 1 DIF: Easy REF: p.149-150
BLM: Higher order NOT: Macro TB_7-107

108. Which of the following organizations tries to encourage the flow of investment to poor countries?
- a. World Bank
 - b. Organization of Less Developed Countries
 - c. Alliance of Developing Countries
 - d. International Development Alliance

ANS: A PTS: 1 DIF: Easy REF: p.150
BLM: Remember NOT: Macro TB_7-108

109. On average, by how much does each year of schooling raise a person's wage in Canada?
- a. about 5 percent
 - b. about 10 percent
 - c. about 15 percent
 - d. about 20 percent

ANS: B PTS: 1 DIF: Easy REF: p.150
BLM: Remember NOT: Macro TB_7-109

110. Which of the following is generally an opportunity cost of investment in human capital?
- a. future job security
 - b. forgone wages at present
 - c. increased earning potential
 - d. the costs of living during the years of school

ANS: B PTS: 1 DIF: Easy REF: p.150-151
BLM: Higher order NOT: Macro TB_7-110

111. Which of the following is an externality aspect of education?
- a. Education produces a return to society that is greater than the return to the individual.
 - b. Education produces a return to society that is less than the return to the individual.
 - c. Education produces costs to society that the individual does not take into account.
 - d. Only education acquired abroad by immigrants has an externality effect.

ANS: A PTS: 1 DIF: Easy REF: p.150-151
BLM: Higher order NOT: Macro TB_7-111

112. Which of the following is an example of the "brain drain"?
- a. A country's most highly educated workers immigrate to rich countries.
 - b. A country has such a poor educational system that knowledge is lost over time.
 - c. The population of a country grows so fast that the educational system can't keep up.
 - d. A country steals patented technology from another country.

ANS: A PTS: 1 DIF: Easy REF: p.150-151
BLM: Higher order NOT: Macro TB_7-112

113. Economist Robert Fogel focused on which of the following factors as one determinant of long-run economic growth?
- a. education
 - b. research and development
 - c. nutrition
 - d. trade restrictions

ANS: C PTS: 1 DIF: Easy REF: p.151
BLM: Remember NOT: Macro TB_7-113

114. According to economic historian Robert Fogel, what proportion of the British population in 1780 was so malnourished that they could not perform manual labour?
- a. 40 percent
 - b. 30 percent
 - c. 20 percent
 - d. 15 percent

ANS: C PTS: 1 DIF: Easy REF: p.151
BLM: Remember NOT: Macro TB_7-114

115. What do property rights refer to?
- a. a document stating the rights of ownership that accompany owning property
 - b. the ability of people to exercise authority over the resources they own
 - c. the right of the government to exercise authority over property owners
 - d. the fact that some countries have greater natural resources

ANS: B PTS: 1 DIF: Easy REF: p.153
BLM: Remember NOT: Macro TB_7-115

116. How does the political environment affect economic growth?
- a. Political instability can reduce foreign investment, thus reducing growth.
 - b. Economic growth only depends on markets and production, while politics has no impact.
 - c. Policies designed to prevent imports from other countries generally increase economic growth.
 - d. Policies designed to restrict the immigration of foreign workers generally promote growth because wages earned by foreigners are not part of GNP.

ANS: A PTS: 1 DIF: Easy REF: p.153
BLM: Higher order NOT: Macro TB_7-116

117. The dictator of Turan has recently begun to arbitrarily seize farms belonging to his political opponents, and he has given the farms to his friends. His friends don't know much about farming. The courts in Turan have ruled that the seizures are illegal, but the dictator has ignored the rulings. Other things equal, what would we expect to happen to the growth rate in Turan?
- a. It will fall temporarily, but will return to where it was when the new owners learn how to farm.
 - b. It will increase because the total amount of human capital in the country will increase as the new owners learn how to farm.
 - c. It will fall and remain lower for a long time.
 - d. It will not be affected unless widespread civil disorder or civil war results.

ANS: C PTS: 1 DIF: Challenging REF: p.153
BLM: Higher order NOT: Macro TB_7-117

118. Which of the following is an effect of inward-oriented policies?
- a. They impede growth because they restrict investment.
 - b. They have generally increased productivity and growth in the countries that pursued them.
 - c. They promote production of goods and services; the country that adopts them can produce most efficiently.
 - d. They are likely to create more jobs for domestic workers.

ANS: A PTS: 1 DIF: Easy REF: p.154
BLM: Higher order NOT: Macro TB_7-118

119. Which of the following is a characteristic of inward-oriented policies?
- a. They are generally supported by economists.
 - b. They are primarily concerned with the development of human capital.
 - c. They are in some ways like prohibiting the use of certain technologies.
 - d. They are generally rejected by domestic producers in import-competing industries.

ANS: C PTS: 1 DIF: Easy REF: p.154
BLM: Higher order NOT: Macro TB_7-119

120. The president of a developing country proposes that his country needs to help domestic firms by imposing trade restrictions. What kind of policies are these?
- a. These are outward-oriented policies and most economists believe they would have beneficial effects on growth.
 - b. These are outward-oriented policies and most economists believe they would have adverse effects on growth.
 - c. These are inward-oriented policies and most economists believe they would have beneficial effects on growth.
 - d. These are inward-oriented policies and most economists believe they would have adverse effects on growth.

ANS: D PTS: 1 DIF: Average REF: p.154
BLM: Higher order NOT: Macro TB_7-120

121. Recently there have been violent protests against the World Bank and the World Trade Organization. The protesters argue that these institutions promote free trade and also encourage corporations in rich countries to invest in poor countries. The protesters contend that these practices make rich countries richer and poor countries poorer. How would economists feel about these protesters' views?
- a. They would disagree with the protesters because these practices will help make both rich and poor countries richer.
 - b. They would disagree with the protesters about free trade, but would agree with the protesters about corporate investment.
 - c. They would disagree with the protesters about corporate investment, but would agree with the protesters about free trade.
 - d. They would agree with the protesters.

ANS: A PTS: 1 DIF: Average REF: p.154
BLM: Higher order NOT: Macro TB_7-121

122. Which of the following is an effect of outward-oriented policies?

- a. Some countries gain and some lose from trade.
- b. They have generally led to high growth for the countries that pursued them.
- c. They impede growth in poor countries, but create more jobs.
- d. They increase GDP, but also increase overall unemployment.

ANS: B PTS: 1 DIF: Average REF: p.154
BLM: Higher order NOT: Macro TB_7-122

123. When a country removes trade barriers and exports pork chops and imports stereos, which of the following will most likely happen?

- a. Its growth will slow down.
- b. Its productivity will decrease.
- c. It will essentially be transforming pork chops into stereos.
- d. Its economic well-being will decrease, while that of the country that sells stereos will increase.

ANS: C PTS: 1 DIF: Average REF: p.154
BLM: Higher order NOT: Macro TB_7-123

124. Once one person discovers an idea, the idea generally enters society's pool of knowledge. Therefore, knowledge is generally what kind of good?

- a. a societal good
- b. a private good
- c. a public good
- d. a normal good

ANS: C PTS: 1 DIF: Easy REF: p.154
BLM: Higher order NOT: Macro TB_7-124

125. Senator Noitall says that in order to help poor countries develop, Canada should (1) prevent Canadian corporations from investing in poor countries because they take profits that the poor countries should have; (2) not import goods from poor countries that use child labour; (3) work to promote political stability in poor countries; and (4) reduce poor countries' reliance on market forces in their economies. Which of these ideas is likely to help poor countries grow?

- a. 1
- b. 2
- c. 3
- d. 4

ANS: C PTS: 1 DIF: Average REF: p.153-156
BLM: Higher order NOT: Macro TB_7-125

126. What is a valid policy to use for increasing the rate of economic growth?

- a. reduce reliance on market forces because they allocate goods and services in an unfair manner
- b. encourage trade with neighbouring countries
- c. increase the fraction of GDP devoted to consumption
- d. restrict investment in domestic industries by foreigners because they take some of the profits out of the country

ANS: B PTS: 1 DIF: Challenging REF: p.153-156
BLM: Higher order NOT: Macro TB_7-126

127. In medieval Europe an important technological advance was the use of the padded horse collar for ploughing. Once this idea was thought of, other people used it. What does this example illustrate about knowledge?
- a. It is generally a public good.
 - b. It is generally a societal good.
 - c. It is generally a private good.
 - d. It is generally a normal good.

ANS: A PTS: 1 DIF: Easy REF: p.154
BLM: Higher order NOT: Macro TB_7-127

128. Which of the following is the source of most technological progress?
- a. private research by firms and individual inventors
 - b. private research by firms and government
 - c. government research
 - d. government-sponsored research by universities

ANS: A PTS: 1 DIF: Easy REF: p.154-156
BLM: Remember NOT: Macro TB_7-128

129. According to an economist, what kind of goods are national defence and knowledge?
- a. private goods
 - b. public goods
 - c. normal goods
 - d. societal goods

ANS: B PTS: 1 DIF: Easy REF: p.154
BLM: Higher order NOT: Macro TB_7-129

130. A patent turns a new idea into which of the following goods?
- a. a public good, which increases the incentive to engage in research
 - b. a public good, which decreases the incentive to engage in research
 - c. a private good, which increases the incentive to engage in research
 - d. a private good, which decreases the incentive to engage in research

ANS: C PTS: 1 DIF: Easy REF: p.156
BLM: Higher order NOT: Macro TB_7-130

131. Drug companies can usually obtain patents on new drugs. Patents turn new ideas into which of the following goods?
- a. private goods, which increase the incentive to engage in research
 - b. private goods, which decrease the incentive to engage in research
 - c. public goods, which increase the incentive to engage in research
 - d. public goods, which decrease the incentive to engage in research

ANS: A PTS: 1 DIF: Easy REF: p.156
BLM: Higher order NOT: Macro TB_7-131

132. The economic development minister of a country has a list of things she thinks may explain her country's low growth of real GDP per person relative to other countries. She asks you to pick the one you think most likely explains her country's low growth. Which of the following contributes to low growth?
- a. strong private property rights
 - b. tariffs and quotas
 - c. encouraging foreign investment
 - d. low population growth

ANS: B PTS: 1 DIF: Average REF: p.154
BLM: Higher order NOT: Macro TB_7-132

133. According to Malthus's view, which of the following is a consequence of increased population?
- a. increased GDP per person
 - b. more people imply more ideas and more labour force, which promotes growth
 - c. depletion of productive resources and lower standards of living
 - d. increase in productivity in the food sector, which is necessary to support the increase in population

ANS: C PTS: 1 DIF: Average REF: p.157-158
BLM: Remember NOT: Macro TB_7-133

134. From 1966 to 1973, at what rate did Canadian productivity grow?
- a. 2.3 percent
 - b. 2.5 percent
 - c. 1.8 percent
 - d. 1.3 percent

ANS: C PTS: 1 DIF: Easy REF: p.156
BLM: Remember NOT: Macro TB_7-134

135. From 1974 to 1982, what was the growth in Canadian productivity?
- a. 2.5 percent
 - b. 1.8 percent
 - c. 1.3 percent
 - d. 0.5 percent

ANS: D PTS: 1 DIF: Easy REF: p.156
BLM: Remember NOT: Macro TB_7-135

136. Which of the following best describes the evolution of productivity growth in Canada?
- a. From 1974 to 1982 Canadian productivity growth was slower than from 1966 to 1973. This continued a downward trend in productivity growth.
 - b. From 1974 to 1982 Canadian productivity growth was slower than from 1966 to 1973. It appears that this was the result of a slowdown in technological progress.
 - c. From 1966 to 1973 Canadian productivity growth was slower than from 1974 to 1982. This continued an upward trend in productivity growth.
 - d. From 1974 to 1982 Canadian productivity growth was slower than from 1966 to 1973. It appears that this was the result of a slowdown in capital formation.

ANS: B PTS: 1 DIF: Easy REF: p.156-157
BLM: Remember NOT: Macro TB_7-136

137. There is some controversy concerning what the source of the Canadian productivity slowdown was in the period of 1974 to 1982. Which of the following is the most likely explanation?
- a. a decrease in the growth of human capital per person
 - b. capital wearing out so that capital per person fell
 - c. changes in technological progress
 - d. the continued depletion of natural resources

ANS: C PTS: 1 DIF: Average REF: p.156-157
BLM: Remember NOT: Macro TB_7-137

138. All else equal, which of the following would tend to cause GDP per person to rise?
- a. high population growth
 - b. investment in human capital
 - c. rapid growth in the number of workers
 - d. policies to reduce imports

ANS: B PTS: 1 DIF: Easy REF: p.158
BLM: Higher order NOT: Macro TB_7-138

139. What will a rapid increase in the number of workers, other things the same, likely do in the short term?
- a. raise real GDP per person but decrease real GDP
 - b. decrease both real GDP and real GDP per person
 - c. raise both real GDP and real GDP per person
 - d. raise real GDP but decrease real GDP per person

ANS: D PTS: 1 DIF: Easy REF: p.158
BLM: Higher order NOT: Macro TB_7-139

140. Which of the following is an important fact about population growth?
- a. There are no substantial differences between rates of growth in population among countries.
 - b. In developed countries, population tends to grow slower than in developing countries.
 - c. Higher rate of growth in population implies higher productivity.
 - d. Economists generally believe that a country that increases its population growth rate will increase its economic growth rate.

ANS: B PTS: 1 DIF: Easy REF: p.158
BLM: Remember NOT: Macro TB_7-140

141. Economist Michael Kremer provides some support for the hypothesis that an increase in population might foster economic prosperity. Which of the following best explains this hypothesis?
- a. More people can produce more ideas, which contribute to increasing productivity.
 - b. More people are able to produce more output, everything else being the same.
 - c. A larger population implies more demand for goods and services, which stimulates the economy.
 - d. When there is a large number of children, governments need to invest more in education, which fosters economic growth.

ANS: A PTS: 1 DIF: Challenging REF: p.159
BLM: Higher order NOT: Macro TB_7-141

142. Why do birth rates tend to be lower in developed countries than in developing countries?
- a. because people are older in developed countries
 - b. because education is more expensive in developed countries
 - c. because women in developed countries have greater access to jobs and it becomes too costly to spend time with children
 - d. because government policies in developing countries reward families with children

ANS: C PTS: 1 DIF: Average REF: p.158-159
BLM: Remember NOT: Macro TB_7-142

143. What is the key difference between Thomas Malthus and Michael Kremer's theories about population growth?
- a. Kremer argued that with greater population, society would generate more ideas so that growth of real GDP per person could continue. Malthus argued that increasing population would outstrip agricultural production and economies will eventually decline irreversibly.
 - b. Kremer argued that increases in population would reduce the amount of human and physical capital per worker so that eventually the standard of living would decline. Malthus argued that increases in technology would allow increased output growth so that even with population growth, society would enjoy a higher standard of living.
 - c. Malthus argued that with greater population, society would generate more ideas so that growth of real GDP per person could continue. Kremer argued that increasing population would outstrip agricultural production.
 - d. Malthus argued that increases in population would reduce the amount of human and physical capital per worker so that eventually the standard of living would decline. Kremer argued that increases in technology would allow increased output growth so that even with population growth, society would enjoy a higher standard of living.

ANS: A PTS: 1 DIF: Easy REF: p.157-159
BLM: Higher order NOT: Macro TB_7-143

144. Economists differ in their views of the role of the government in promoting economic growth. According to the text, at the very least, what should the government do?
- a. lend support to the invisible hand by maintaining property rights and political stability
 - b. limit foreign investment to industries that don't already exist
 - c. impose trade restrictions to protect the interests of domestic producers and consumers
 - d. subsidize key industries

ANS: A PTS: 1 DIF: Easy REF: p.160
BLM: Remember NOT: Macro TB_7-144

TRUE/FALSE

1. The average person in a rich country, such as Germany, has income about ten times that of an average person in a poor country, such as Nigeria.

ANS: T PTS: 1 DIF: Easy REF: p.141

NOT: Macro TB_7-145

2. Both the standard of living and the growth of real GDP per person vary widely across countries.

ANS: T PTS: 1 DIF: Easy REF: p.141

NOT: Macro TB_7-146

3. In Canada real GDP per person is about \$42 000, while in poor countries real GDP per person may be less than \$5000.

ANS: T PTS: 1 DIF: Easy REF: p.141

NOT: Macro TB_7-147

4. Although growth rates across countries vary, rankings of countries by income remain pretty much the same over time.

ANS: F PTS: 1 DIF: Easy REF: p.141

NOT: Macro TB_7-148

5. International data on the history of real GDP growth rates show that the rich countries get richer and the poor countries get poorer.

ANS: F PTS: 1 DIF: Easy REF: p.141

NOT: Macro TB_7-149

6. Productivity can be found as number of hours worked divided by output.

ANS: F PTS: 1 DIF: Easy REF: p.143

NOT: Macro TB_7-150

7. Indonesians have a lower standard of living than Canadians because they have a lower level of productivity.

ANS: T PTS: 1 DIF: Easy REF: p.143

NOT: Macro TB_7-151

8. A forest is an example of a nonrenewable resource.

ANS: F PTS: 1 DIF: Easy REF: p.144

NOT: Macro TB_7-152

9. Changes in the prices of most natural resources compared to other goods indicate that natural resources are generally becoming scarcer.

ANS: F PTS: 1 DIF: Easy REF: p.146
NOT: Macro TB_7-153

10. A country without a lot of domestic natural resources can have a high standard of living.

ANS: T PTS: 1 DIF: Easy REF: p.144
NOT: Macro TB_7-154

11. Constant returns to scale is the point on a production function where increasing inputs will no longer increase output.

ANS: F PTS: 1 DIF: Average REF: p.145
NOT: Macro TB_7-155

12. An increase in the saving rate does not permanently increase the growth rate of real GDP per person.

ANS: T PTS: 1 DIF: Average REF: p.147-149
NOT: Macro TB_7-156

13. Other things the same, countries with low income are likely to increase their income more by adding another unit of capital than are countries that have high income.

ANS: T PTS: 1 DIF: Easy REF: p.147-149
NOT: Macro TB_7-157

14. Over about the past 30 years, the ratio of investment to GDP in South Korea was higher than in Canada and so South Korea had substantially higher growth.

ANS: F PTS: 1 DIF: Easy REF: p.149
NOT: Macro TB_7-158

15. In ten years when you are the owner of a major Canadian corporation, if your corporation opens and operates a branch in a foreign country you will be engaging in foreign direct investment.

ANS: T PTS: 1 DIF: Easy REF: p.149
NOT: Macro TB_7-159

16. Investment in both human and physical capital has opportunity costs.

ANS: T PTS: 1 DIF: Easy REF: p.151
NOT: Macro TB_7-160

17. A country that made its courts less corrupt and its government more stable would likely see its standard of living rise.

ANS: T PTS: 1 DIF: Easy REF: p.153
NOT: Macro TB_7-161

18. Economists generally believe that outward-oriented policies are more likely to foster growth than inward-oriented policies.

ANS: T PTS: 1 DIF: Easy REF: p.154
NOT: Macro TB_7-162

19. One reason that governments may find it useful to sponsor universities and basic research is that, to a large extent, knowledge is a public good.

ANS: T PTS: 1 DIF: Easy REF: p.154
NOT: Macro TB_7-163

20. If the productivity slowdown had not occurred in 1973, the income of the average Canadian today would be about 70 percent higher.

ANS: T PTS: 1 DIF: Easy REF: p.156
NOT: Macro TB_7-164

21. The productivity slowdown appears to be primarily the result of a decrease in the capital to labour ratio.

ANS: F PTS: 1 DIF: Easy REF: p.156-157
NOT: Macro TB_7-165

22. The annual population growth rate in developed countries is about 1 percent, while the growth rate in developing countries is about 3 percent.

ANS: T PTS: 1 DIF: Easy REF: p.158
NOT: Macro TB_7-166

23. In countries where women are discriminated against, policies that increase their career and educational opportunities are likely to increase the birth rate.

ANS: F PTS: 1 DIF: Easy REF: p.158
NOT: Macro TB_7-167

24. Michael Kramer found that world growth rates have increased as population has.

ANS: T PTS: 1 DIF: Easy REF: p.159
NOT: Macro TB_7-168

SHORT ANSWER

1. Use the data below to find out the growth of income per person (over the entire period, not an annual basis) between the two years listed.

Year	Real GDP	Population
1990	\$4 915 600 million	233 million
2010	\$9 243 800 million	283.5 million

ANS:

Income per person in 1990 was $\$4\,915\,600/233 = \text{about } \$21\,097$. Income per person in 2010 was $\$9\,243\,800/283.5 = \text{about } \$32\,606$. Income per person grew by $(32\,606 - 21\,097)/21\,097 = \text{about } 54.5$ percent.

PTS: 1

DIF: Easy

REF: p.141

NOT: Macro TB_7-169

2. Why is productivity related to the standard of living? In your answer be sure to explain what productivity and standard of living mean. Make a list of things that determine labour productivity.

ANS:

The standard of living is a measure of how well people live. Income per person is an important dimension of the standard of living and is positively correlated with other things such as nutrition and life expectancy that make people better off. Productivity measures how much people can produce in an hour. As productivity increases, people can produce more (and use less to produce the same amount) and so their standard of living increases.

The factors that determine labour productivity include the amounts of physical capital (equipment and structures), human capital (knowledge and skills), and natural resources available to workers, as well as the state of technological knowledge in society.

PTS: 1

DIF: Average

REF: p.142-143

NOT: Macro TB_7-170

3. What is a production function? Write an equation for a typical production function, and explain what each of the terms represents.

ANS:

A production function is a mathematical representation of the relationship between the quantity of inputs used in production and the quantity of output from production. A typical production function could be written as $Y = A F(L, K, H, N)$, where Y denotes the quantity of output, L the quantity of labour, K the quantity of physical capital, H the quantity of human capital, N the quantity of natural resources, and A is a variable that reflects the available production technology.

PTS: 1

DIF: Challenging

REF: p.145

NOT: Macro TB_7-171

4. What is the difference between human capital and technology?

ANS:

Technology is society's understanding of production techniques. Human capital is the labour force's understanding of these ideas. A society may have lots of information about how to produce goods, but still have lots of people who know little of this information. For example, in Canada there exists information about how best to use a butter churn and how to make lye soap, but most people know nothing about it.

PTS: 1

DIF: Average

REF: p.144-145

NOT: Macro TB_7-172

5. The catch-up effect says that countries with low income can grow faster than countries with higher income. However, in statistical studies that include many diverse countries we do not observe the catch-up-effect unless we control for other variables that affect productivity. Considering the determinants of productivity, list and explain some things that would tend to prohibit or limit a poor country's ability to catch up with the rich ones.

ANS:

The argument that poor countries will tend to catch up with rich ones is based on the idea that another unit of capital will increase output more in a country that has little capital than one that has much capital. So, for a given share of GDP devoted to investment, a poor country will grow faster than a rich one.

This argument assumes that other things are the same, but share of GDP invested may be lower in a poor country and the productivity of investment may be less. A politically unstable environment where property rights are unprotected or not secure tends to discourage investment. A country that has limited trade because of legal restrictions or geography cannot focus on producing what it produces best and so has lower productivity. To get the most out of investment, or even simply to use some types of new investment, requires having workers who have acquired some basic human capital.

PTS: 1

DIF: Challenging

REF: p.147-149

NOT: Macro TB_7-173

6. A puzzle: The share of GDP devoted to investment was similar for Canada and South Korea over the past 40 years. However, South Korea had a 6 percent growth rate of average annual income, while Canada had only a 2 percent growth rate over that past 40 years. How can this be explained?

ANS:

The solution to the puzzle is based on the concept of diminishing returns to capital. A country that has a lot of income, and so a lot of capital, gains less by adding more capital than does a country that currently has little capital. It is easy to envision how a capital poor country could increase its output considerably with even a little more capital.

PTS: 1

DIF: Average

REF: p.147-149

NOT: Macro TB_7-174

7. In addition to investment in physical and human capital, what other public policies might a country adopt to increase productivity?

ANS:

In addition to investment in physical and human capital, a country might increase productivity by (a) specifying and enforcing property rights, (b) encouraging free trade, (c) controlling population growth, and (d) promoting research and development.

PTS: 1 DIF: Average REF: p.153-158 NOT: Macro TB_7-175

8. Why are property rights important for the growth of a nation's standard of living?

ANS:

Property rights are an important prerequisite for the price system to work in a market economy. If an individual or company is not confident that claims over property or over the income from property can be protected, or that contracts can be enforced, there will be little incentive for individuals to save, invest, or start new businesses. Likewise, there will be little incentive for foreigners to invest in the real or financial assets of the country. The distortion of incentives will reduce efficiency in resource allocation and will reduce saving and investment which in turn will reduce the standard of living.

PTS: 1 DIF: Average REF: p.153 NOT: Macro TB_7-176

9. How do inward-oriented policies affect a nation's growth?

ANS:

Most economists believe that poor nations are better off pursuing outward-oriented policies that promote free trade. Countries that use their comparative advantage in trade are, in effect, helping themselves through the gains from trade in the same way that nations that develop new technology raise their standard of living. Hence, a country that eliminates trade restrictions will experience the same kind of economic growth that would occur after a major technological advance. Inward-oriented trade policies are akin to a country choosing to restrict the use of superior technologies.

PTS: 1 DIF: Easy REF: p.154 NOT: Macro TB_7-177

10. Some economists argue that it is possible to raise the standard of living by reducing population growth. As an economist interested in incentives rather than coercion, what kind of policy would you recommend to slow population growth?

ANS:

Since bearing a child has an opportunity cost, policies designed to increase the opportunity cost of bearing children would likely reduce population growth rates. In particular, women with the opportunity to receive a good education and desirable employment tend to want to have fewer children than do those with fewer opportunities outside the home. Hence, policies designed to increase educational and employment opportunities for women will likely reduce population growth rates without coercion.

PTS: 1 DIF: Easy REF: p.157-158 NOT: Macro TB_7-178

11. Compare and contrast the population theories of Malthus and Kremer.

ANS:

The difference is that Malthus predicted that population growth would have a greater impact than growth in the ability to increase output. He believed that people would continue to populate the earth until output reached a subsistence level. On the other hand Kremer argues that population growth increased productivity allowing people to improve their standard of living despite growing population. Kremer argues that with more population comes more innovations. The improvements in technology more than offset any adverse impact of the increase in population on the standard of living.

PTS: 1 DIF: Average REF: p.157-159 NOT: Macro TB_7-179

12. What might the African governments do to foster higher economic growth?

ANS:

They could make, perhaps with outside support, better efforts to achieve peace and thus encourage investment and saving. They could focus government spending on essential things like public order, the judicial system, and basic health and education. By focusing on these basic functions, they could decrease tax rates on production and trade.

PTS: 1 DIF: Easy REF: p.153 NOT: Macro TB_7-180

PROBLEM

1. Some civil society groups and activists propose a zero-economic-growth policy in order to preserve the environment. Write an essay to discuss the pros and cons of this proposal. You may wish to refer, among other ideas, to the following:
- Economic growth needs to compensate for the increase in population.
 - If population becomes older, the number of active persons decreases; therefore, productivity must increase to sustain a high standard of living.
 - An increase in standard of living is only possible if an economy becomes more productive (income per person is closely related to labour productivity).
 - It is hoped that economic growth will eventually eradicate poverty.
 - Economic measures of well-being, such as GDP per capita, are imperfect mainly because they disregard external costs of economic activity, as well as other aspects of life that people value, such as leisure, fairness, and income equality.

ANS:

There is no “correct” answer to this problem. The essay should refer to the points made above; it should be creative and well articulated.

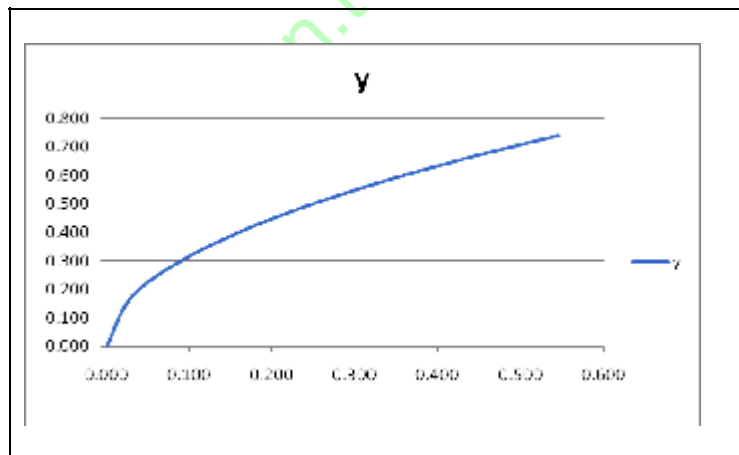
PTS: 1 NOT: Macro TB_7-181

2. Suppose an economy uses only two inputs in production, capital and labour. The following table describes a production function, where y stands for output per worker and k is capital per worker.
- Draw approximately this production function with y on the vertical axis.
 - Show that this production function exhibits diminishing returns to scale.
 - Suppose there are two countries, A and B. The economies of the two countries can be described by this production function. If Country A has initially a capital-labour ratio $k = 0.167$ and Country B has $k = 0.412$, show that an equal increase in capital produces more extra output in country A than in Country B.

y	k
0.000	0.000
0.173	0.030
0.302	0.091
0.408	0.167
0.480	0.231
0.535	0.286
0.577	0.333
0.612	0.375
0.642	0.412
0.667	0.444
0.688	0.474
0.707	0.500
0.724	0.524
0.739	0.545

ANS:

- Here is a graph of the given production function:



- b. Take, for instance, $k = 0.167$ and the corresponding $y = 0.408$. For the next value of k , which is $k = 0.231$, the increase in k is equal to $0.231/0.167=1.383$, while the corresponding increase in y is only $0.480/0.408=1.176$. Thus, when k increases 1.383 times, y increases only 1.176 times, which shows the diminishing returns to scale of this production function.
- c. Let us take first Country A. When k increases from 0.167 to 0.131, the change in k is $\Delta k = 0.064$ and the corresponding change in y is $\Delta y = 0.480 - 0.408 = 0.072$. The change in output per unit change in capital (the slope of the production function, or the marginal product of capital) is $\Delta y/\Delta k = 0.072/0.064 = 1.125$ units of output per unit of additional capital. For Country B, the marginal product of capital is determined in a similar way, and the result is $\Delta y/\Delta k = 0.781$. Since the marginal product of capital is less in Country B than in Country A, we say that there is a catch-up effect.

PTS: 1

NOT: Macro TB_7-182

3. The purpose of this problem is to make you acquainted with Statistics Canada's web site. Open <http://www.statcan.gc.ca/start-debut-eng.html> and look for Economic Account, then open the link "Gross Domestic Product" page. Open "Summary Tables," then open the table "Real Gross Domestic Product, Expenditure-Based, by Province and Territory." Answer the following questions based on this table.
 - a. Which three provinces had the greatest real GDP per capita in 2008?
 - b. Calculate the shares of each of these provinces in Canada's real GDP in 2008.
 - c. Now, look for another table (you can use the "Search" function), "Consumer price index, historical summary, by province or territory." In which province was the consumer price index the highest in each of the years 2006 to 2009? Can you think of an explanation for that?

ANS:

- a. Ontario, Quebec, and Alberta
- b. 0.4, 0.2, 0.14
- c. The province experiencing the highest increase in prices, as reflected by consumer price index, is Alberta. An explanation may be that after the increase in the price of oil, Alberta's economy boomed, many people moved to Alberta, and this caused the increase in prices, led by the housing prices.

PTS: 1

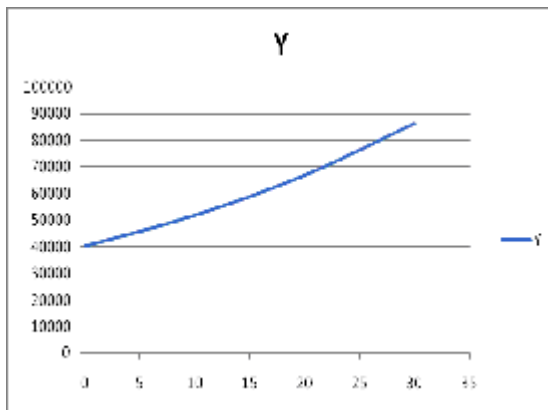
NOT: Macro TB_7-183

4. The real GDP per capita in an economy increases at a rate of 2.6 percent. Calculate the number of years that it takes for real GDP to double. Assuming that the current GDP per capita is \$40 000 and the growth rate will be on average 2.6 percent, how much will GDP per capita be after 10 years? After 20 years? After 30 years? Draw a graph to show approximately the evolution of this economy for the next 30 years.

ANS:

Let us denote real GDP per capita by Y . At a rate of 2.6 percent, it will double in n years. The formula that gives the new value of real GDP per capita, which we know it must be $2Y$, is $Y(1+0.026)^N = 2Y$. We divide this equation by Y , to get $(1+0.026)^N = 2$. If we take logarithms of both sides of the equation and apply the rules of logarithms, we find $N \times \ln(1.026) = \ln(2)$. Solving this equation for N the result is $N = 27$ years.

If $Y = \$40000$, after 10 years it becomes $40000(1+0.026)^{10} = \$51705$; after 20 years it will be $\$66835$, and in 30 years it will become $\$86393$.



PTS: 1

NOT: Macro TB_7-184

5. The following table shows real GDP per person in a few countries over a period of about one century.

Country	Period	Real GDP per Person at Beginning of Period*	Real GDP per Person at End of Period*	Growth Rate (per Year)
Japan	1890–2003	\$1794	\$40 110	2.79%
Brazil	1900–2003	929	10 483	2.38
Mexico	1900–2003	1383	12 543	2.16
China	1900–2003	855	6 993	2.06
Germany	1870–2003	2605	38 484	2.05
Canada	1870–2003	2834	41 679	2.04
United States	1870–2003	4782	52 555	1.82
Argentina	1900–2003	2736	15 304	1.69
India	1900–2003	806	4 036	1.58
United Kingdom	1870–2003	5738	38 750	1.45
Indonesia	1900–2003	1064	4 499	1.41
Pakistan	1900–2003	880	2 887	1.16
Bangladesh	1900–2003	744	2 621	1.16

*Real GDP is measured in 2003 Canadian dollars.

- Does this data support the catch-up theory of economic growth? Explain your answer.
- What additional information would be necessary when testing the catch-up theory?

ANS:

- The catch-up theory of growth suggests that countries having initially a lower real GDP per person tend to have higher rates of growth because of the diminishing returns characteristic of the production function. The table shows six countries that initially had real GDP per person lower than the United States and grew faster, and five having lower initial real GDP per person that grew slower. Thus, at least at a first sight, this data do not provide sufficient evidence that the catch-up theory holds.
- The path of economic growth in a country has multiple determinants, each of them shifting at times the production function up and down. The data in the table show the cumulative result of all those factors, which may hide the catch-up effect. In order to test the catch-up effect, one would need to account for the most important of those other factors and to try to separate their effects from the presumed catch-up effect.

PTS: 1 NOT: Macro TB_7-185

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Chapter 8—Saving, Investment, and the Financial System

MULTIPLE CHOICE

1. When opening a restaurant, you may need to buy ovens, freezers, tables, and cash registers. What do economists call these expenditures?
- capital investment
 - investment in human capital
 - business consumption expenditures
 - inventories

ANS: A PTS: 1 DIF: Easy REF: p.165
BLM: Higher Order NOT: Macro TB_8-1

2. When a country saves a larger portion of its GDP, will it have more or less investment?
- It will have less investment, and so it will have more capital and higher productivity.
 - It will have less investment, and so it will have less capital and higher productivity.
 - It will have more investment, and so it will have more capital and higher productivity.
 - It will have more investment, and so it will have less capital and higher productivity.

ANS: C PTS: 1 DIF: Easy REF: p.166
BLM: Higher Order NOT: Macro TB_8-2

3. Which of the following terms refers to institutions that help to match one person's saving with another person's investment?
- the Bank of Canada
 - the banking system
 - the monetary system
 - the financial system

ANS: D PTS: 1 DIF: Easy REF: p.166
BLM: Remember NOT: Macro TB_8-3

4. Alfred's income exceeds his expenditures. Which of the following best describes Alfred?
- He is a saver who demands money from the financial system.
 - He is a saver who supplies money to the financial system.
 - He is a borrower who demands money from the financial system.
 - He is a borrower who supplies money to the financial system.

ANS: B PTS: 1 DIF: Easy REF: p.166
BLM: Higher Order NOT: Macro TB_8-4

5. Lucy wants to start her own psychiatric practice, but her expenditures exceed her income. Which of the following best describes Lucy?
- She is a saver who demands money from the financial system.
 - She is a saver who supplies money to the financial system.
 - She is a borrower who demands money from the financial system.
 - She is a borrower who supplies money to the financial system.

ANS: C PTS: 1 DIF: Easy REF: p.166
BLM: Higher Order NOT: Macro TB_8-5

6. What is a bond?
- a. a financial intermediary
 - b. a certificate of indebtedness
 - c. a certificate of partial ownership in an enterprise
 - d. a mortgage

ANS: B PTS: 1 DIF: Easy REF: p.167
BLM: Remember NOT: Macro TB_8-6

7. Which of the following terms refers to a certificate of indebtedness that specifies the obligations of the borrower to the holder?
- a. bond
 - b. stock
 - c. mutual fund
 - d. savings plan

ANS: A PTS: 1 DIF: Easy REF: p.167
BLM: Remember NOT: Macro TB_8-7

8. If the government's expenditures exceeded its receipts, what would it most likely do?
- a. It would lend money to a bank or other financial intermediary.
 - b. It would borrow money from a bank or other financial intermediary.
 - c. It would directly buy bonds from the public.
 - d. It would directly sell bonds to the public.

ANS: D PTS: 1 DIF: Average REF: p.167
BLM: Remember NOT: Macro TB_8-8

9. Suppose Microsoft sells a bond. What is the company doing?
- a. borrowing directly from the public
 - b. borrowing indirectly from the public
 - c. lending directly to the public
 - d. lending indirectly to the public

ANS: A PTS: 1 DIF: Average REF: p.167
BLM: Higher Order NOT: Macro TB_8-9

10. Which of the following best describes a characteristic of a bond?
- a. The maturity of a bond refers to the amount to be paid back.
 - b. The principal of the bond refers to the person selling the bond.
 - c. A bond buyer cannot sell a bond before it matures.
 - d. The interest paid by a bond depends on its price.

ANS: D PTS: 1 DIF: Easy REF: p.167
BLM: Remember NOT: Macro TB_8-10

11. What is the face value of a bond?
- a. the market price of the bond
 - b. the difference between the amount owned by the issuer and the market price of the bond
 - c. the amount owned by the issuer
 - d. the interest earned by the owner of the bond

ANS: C PTS: 1 DIF: Average REF: p.167
BLM: Remember NOT: Macro TB_8-11

12. Which of the following terms refers to the length of time until a bond matures?
- a. duration
 - b. term
 - c. maturity
 - d. intermediation

ANS: B PTS: 1 DIF: Easy REF: p.167
BLM: Remember NOT: Macro TB_8-12

13. How is a perpetuity distinguished from other bonds?
- a. It pays continuously compounded interest.
 - b. It pays interest only when it matures.
 - c. It never matures.
 - d. It will be used to purchase another bond when it matures unless the owner specifies otherwise.

ANS: C PTS: 1 DIF: Easy REF: p.167
BLM: Higher Order NOT: Macro TB_8-13

14. Which of the following is a characteristic of the bond market?
- a. Some bonds have terms as short as a few months.
 - b. Because they are risky, bonds pay a low rate of interest.
 - c. Corporations buy bonds to raise funds.
 - d. Bonds are rarely used as financial instruments.

ANS: A PTS: 1 DIF: Easy REF: p.167
BLM: Higher Order NOT: Macro TB_8-14

15. What are junk bonds?
- a. Junk bonds are those that yield low interest rates.
 - b. Junk bonds are those that never mature.
 - c. Junk bonds refer to bonds that have been resold many times.
 - d. Junk bonds are those issued by financially weak corporations.

ANS: D PTS: 1 DIF: Easy REF: p.167
BLM: Remember NOT: Macro TB_8-15

16. How does the risk of long-term bonds compare with short-term bonds?
- a. Long-term bonds are generally less risky than short-term bonds and so pay higher interest.
 - b. Long-term bonds are generally less risky than short-term bonds and so pay lower interest.
 - c. Long-term bonds are generally more risky than short-term bonds and so pay higher interest.
 - d. Long-term bonds are generally more risky than short-term bonds and so pay lower interest.

ANS: C PTS: 1 DIF: Easy REF: p.167
BLM: Higher Order NOT: Macro TB_8-16

17. In terms of riskiness, how do long-term bonds and short-term bonds compare?
- a. Short-term bonds are more risky and so pay higher interest.
 - b. Short-term bonds are less risky and so pay lower interest.
 - c. Short-term bonds are less risky and so pay higher interest.
 - d. Short-term bonds have about the same degree of risk and so pay about the same interest.

ANS: B PTS: 1 DIF: Easy REF: p.167
BLM: Higher Order NOT: Macro TB_8-17

18. Which of the following bonds is most likely to default?
- a. a junk bond
 - b. a municipal bond
 - c. a federal government bond
 - d. a corporate bond issued by Procter & Gamble

ANS: A PTS: 1 DIF: Easy REF: p.167
BLM: Higher Order NOT: Macro TB_8-18

19. Assume that the bonds below have the same term and principal and that the province or local government that issues the municipal bond has a good credit rating. Which listing of bonds is ordered from the one that pays the most interest to the one that pays the least interest?
- a. corporate bond, municipal bond, federal government bond
 - b. corporate bond, federal government bond, municipal bond
 - c. municipal bond, federal government bond, corporate bond
 - d. federal government bond, municipal bond, corporate bond

ANS: A PTS: 1 DIF: Average REF: p.167
BLM: Higher Order NOT: Macro TB_8-19

20. Assuming that other things remain the same, what will happen to the interest on a bond as the bond's maturity increases?
- a. As maturity increases, the bond will have less interest because it has less risk.
 - b. As maturity increases, the bond will have less interest because it has more risk.
 - c. As maturity increases, the bond will have more interest because it has more risk.
 - d. There is no relation between term to maturity and risk.

ANS: C PTS: 1 DIF: Average REF: p.167
BLM: Higher Order NOT: Macro TB_8-20

21. Which of the following bond buyers did **NOT** buy the bond that best met his or her objective?
- a. Mia wanted a bond with a high interest rate, regardless of the risk. She purchased a junk bond.
 - b. Anna wanted the least risky bond available. She purchased a federal bond.
 - c. Bill wanted to purchase a bond that was unlikely to default. He purchased a bond that Standard & Poor's rated a low credit risk.
 - d. To reduce risk, Toby purchased a long-term bond rather than a short-term one.

ANS: D PTS: 1 DIF: Easy REF: p.167
BLM: Higher Order NOT: Macro TB_8-21

22. Stephanie is interested only in the rate of interest and is willing to take a great deal of risk in exchange for a high return. Which of the following bonds she should look for?
- a. federal bonds with short terms
 - b. provincial bonds with long terms
 - c. corporate bonds with short terms
 - d. corporate bonds with long terms

ANS: D PTS: 1 DIF: Easy REF: p.167
BLM: Higher Order NOT: Macro TB_8-22

23. Which of the following bonds would you expect to pay the highest interest rate?
- a. a bond issued by the federal government
 - b. a bond issued by Bombardier
 - c. a bond issued by Manitoba
 - d. a bond issued by a new restaurant chain

ANS: D PTS: 1 DIF: Easy REF: p.167
BLM: Higher Order NOT: Macro TB_8-23

24. Jerry has the choice of two bonds, one that pays 3 percent interest and one that pays 6 percent interest. Which of the following situations is most likely?
- a. The 6 percent bond is less risky than the 3 percent bond.
 - b. The 6 percent bond is a Canadian government bond, and the 3 percent bond is a junk bond.
 - c. The 6 percent bond has a longer term than the 3 percent bond.
 - d. The 6 percent bond is a Canadian government bond, and the 3 percent bond is a provincial bond.

ANS: C PTS: 1 DIF: Average REF: p.167
BLM: Higher Order NOT: Macro TB_8-24

25. Which of the following refers to the sale of stocks and bonds to raise money?
- a. debt finance
 - b. equity finance
 - c. debt finance for stocks and equity finance for bonds
 - d. equity finance for stocks and debt finance for bonds

ANS: D PTS: 1 DIF: Easy REF: p.168
BLM: Remember NOT: Macro TB_8-25

26. Papa Mario's Pizza Company sells common stock. What type of financing are they using?
- a. They are using equity financing and the return shareholders earn is fixed.
 - b. They are using equity financing and the return shareholders earn depends on how profitable the company is.
 - c. They are using debt financing and the return debt holders earn is fixed.
 - d. They are using debt financing and the return debt holders earn depends on how profitable the company is.

ANS: B PTS: 1 DIF: Easy REF: p.168
BLM: Higher Order NOT: Macro TB_8-26

27. Which of the following does stock represent?
- a. certificate of insurance
 - b. mortgage
 - c. ownership in a company
 - d. debt finance

ANS: C PTS: 1 DIF: Easy REF: p.168
BLM: Remember NOT: Macro TB_8-27

28. What do people who buy newly issued stock in a corporation such as Rockwood Pottery Ltd. provide?
- a. They buy debt finance and so become part owners of Rockwood.
 - b. They buy debt finance and so become creditors of Rockwood.
 - c. They buy equity finance and so become part owners of Rockwood.
 - d. They buy equity finance and so become creditors of Rockwood.

ANS: C PTS: 1 DIF: Easy REF: p.168
BLM: Higher Order NOT: Macro TB_8-28

29. If Huedepool Beer runs into financial difficulty, how are bondholders and shareholders paid?
- a. Shareholders are paid before bondholders.
 - b. Shareholders are paid after bondholders.
 - c. Shareholders and bondholders are paid proportional shares of the company's assets.
 - d. Shareholders receive all the company's assets.

ANS: B PTS: 1 DIF: Easy REF: p.168
BLM: Higher Order NOT: Macro TB_8-29

30. What do stockholders receive every year?
- a. a fixed share of the price of the stock
 - b. the face value of the stock at the maturity date
 - c. a share of the company's profit
 - d. interest

ANS: C PTS: 1 DIF: Easy REF: p.168
BLM: Higher Order NOT: Macro TB_8-30

31. Which of the following people purchased the correct asset to meet their objective?
- a. Michelle wanted to be a part owner of Mamma Rosa's Pizza, so she purchased a bond issued by Mamma Rosa's Pizza.
 - b. Tim wanted a high return, even if it meant taking some risk, so he purchased stock issued by Specific Electric instead of bonds issued by Specific Electric.
 - c. Jennifer wanted to buy equity in Honda, so she purchased bonds sold by Honda.
 - d. George wanted to lend money at a specified rate of interest to Research In Motion (RIM), so he purchased RIM stock.

ANS: B PTS: 1 DIF: Easy REF: p.168
BLM: Higher Order NOT: Macro TB_8-31

32. Compared to bonds, what does stock offer the holder?
- a. lower risk
 - b. partial ownership
 - c. lower return
 - d. higher return

ANS: B PTS: 1 DIF: Easy REF: p.168
BLM: Higher Order NOT: Macro TB_8-32

33. Which of the following determines the price of stocks traded on exchanges?
- a. the Corporate Stock Administration
 - b. the NASDAQ
 - c. the supply and demand for the stock
 - d. the Montreal Stock Exchange

ANS: C PTS: 1 DIF: Easy REF: p.168
BLM: Higher Order NOT: Macro TB_8-33

34. Assuming that all else remains equal, when people become more optimistic about a company's future, which of the following is most likely to happen to the company's stock?
- a. The supply of the stock and the price will both rise.
 - b. The supply of the stock and the price will both fall.
 - c. The demand for the stock and the price will both rise.
 - d. The demand for the stock and the price will both fall.

ANS: C PTS: 1 DIF: Average REF: p.168
BLM: Higher Order NOT: Macro TB_8-34

35. Suppose that the government finds a major defect in one of a company's products and demands that it be taken off the market. Which of the following would we expect?
- a. The supply of the stock and the price will both rise.
 - b. The supply of the stock and the price will both fall.
 - c. The demand for the stock and the price will both rise.
 - d. The demand for the stock and the price will both fall.

ANS: D PTS: 1 DIF: Average REF: p.168
BLM: Higher Order NOT: Macro TB_8-35

36. World Wide Delivery Service Corporation develops a way to speed up its deliveries and reduce its costs. Which of the following would we expect?
- a. This would raise the demand for existing shares of the stock, causing its price to rise.
 - b. This would decrease the demand for existing shares of the stock, causing its price to fall.
 - c. This would raise the supply of the existing shares of stock, causing its price to rise.
 - d. This would raise the supply of the existing shares of stock, causing its price to fall.

ANS: A PTS: 1 DIF: Average REF: p.168
BLM: Higher Order NOT: Macro TB_8-36

37. Other things being constant, when a business issues more stock, which of the following happens?
- a. The supply of the stock is greater and thus the price will fall.
 - b. The supply of the stock is less and thus the price will rise.
 - c. The demand for the stock is greater and thus the price will rise.
 - d. The demand for the stock is less and thus the price will fall.

ANS: A PTS: 1 DIF: Average REF: p.168
BLM: Higher Order NOT: Macro TB_8-37

38. What does a general, persistent decline in stock prices signal about an economy?
- a. that the economy is about to enter a boom period because people will be able to buy stock for less money
 - b. that the economy is about to enter a recession because low stock prices may mean that people are expecting low corporate profits
 - c. nothing about the business cycle because stock prices can fall for many reasons
 - d. that the economy is about to enter a recession because low stock prices mean that corporations have had low profits in the past

ANS: B PTS: 1 DIF: Average REF: p.168
BLM: Higher Order NOT: Macro TB_8-38

39. Which of the following best defines stock indexes?
- a. They are the average of a group of stock prices.
 - b. They are the average of a group of stock yields.
 - c. They are reports in the newspaper that report on the price of the stock and earnings of the corporation.
 - d. They are measures of the risk relative to the profitability of corporations.

ANS: A PTS: 1 DIF: Easy REF: p.168
BLM: Remember NOT: Macro TB_8-39

40. Since what year has the Dow Jones Industrial Average been computed regularly?
- a. 1976
 - b. 1948
 - c. 1913
 - d. 1896

ANS: D PTS: 1 DIF: Easy REF: p.168
BLM: Remember NOT: Macro TB_8-40

41. How many stock prices are used to compute the Dow Jones Industrial Average?
- a. 30 major U.S. corporations
 - b. 100 major U.S. corporations
 - c. 500 representative U.S. corporations
 - d. 1000 representative U.S. corporations

ANS: A PTS: 1 DIF: Easy REF: p.168
BLM: Remember NOT: Macro TB_8-41

42. Which of the following is the single most important piece of information about a stock?
- a. price-earnings ratio
 - b. dividend
 - c. volume
 - d. price

ANS: D PTS: 1 DIF: Easy REF: p.169
BLM: Remember NOT: Macro TB_8-42

43. What is the “volume” as reported in stock tables?
- a. the number of shares traded
 - b. the percentage of shares outstanding traded
 - c. the number of shares traded times the price they sold at
 - d. the number of shares of a company traded divided by the shares of all companies traded

ANS: A PTS: 1 DIF: Easy REF: p.169
BLM: Remember NOT: Macro TB_8-43

44. Which of the following terms refers to the profits paid out to shareholders?
- a. retained earnings
 - b. dividends
 - c. interest
 - d. shares

ANS: B PTS: 1 DIF: Easy REF: p.169
BLM: Remember NOT: Macro TB_8-44

45. Which of the following terms refers to the profits **NOT** paid out to shareholders?
- a. retained earnings
 - b. dividends
 - c. revenue
 - d. costs

ANS: A PTS: 1 DIF: Easy REF: p.169
BLM: Remember NOT: Macro TB_8-45

46. What is a dividend yield?
- a. It is the dividend as a percentage of the stock price.
 - b. It is the stock price as a percentage of the dividend.
 - c. It is the dividend as a percentage of the retained earnings per share.
 - d. It is the retained earnings per share as a percentage of the dividend.

ANS: A PTS: 1 DIF: Easy REF: p.169
BLM: Remember NOT: Macro TB_8-46

47. Mount Adams Jazz Corporation has a price of \$50, a dividend of \$0.60, and retained earnings of \$1.00 per share. What is the dividend yield on this stock?
- a. 3.2 percent
 - b. 2 percent
 - c. 1.2 percent
 - d. 0.8 percent

ANS: C PTS: 1 DIF: Easy REF: p.169
BLM: Higher Order NOT: Macro TB_8-47

48. Queen City Sausage stock is selling at \$40 per share. It has retained earnings of \$2.00 per share, and dividends of \$0.50 per share. What is the price-earnings ratio?
- a. 100
 - b. 20
 - c. 16
 - d. 0.06

ANS: C PTS: 1 DIF: Challenging REF: p.169
BLM: Higher Order NOT: Macro TB_8-48

49. Stock in Synergistic Corporation is selling at \$25 per share. It had earnings of \$5 a share and a dividend yield of 5 percent. What is the dividend?
- a. \$0.05
 - b. \$0.25
 - c. \$1.25
 - d. \$125

ANS: C PTS: 1 DIF: Challenging REF: p.169
BLM: Higher Order NOT: Macro TB_8-49

50. Buskins Corporation has issued 2 million shares. Its earnings were \$10 million of which it retained \$6 million. What was the dividend per share?
- a. \$2
 - b. \$3
 - c. \$5
 - d. \$8

ANS: A PTS: 1 DIF: Easy REF: p.169
BLM: Higher Order NOT: Macro TB_8-50

51. Which of the following best defines a corporation's earnings?
- a. They are the amount of revenue the corporation receives for the sale of its products, minus its costs of production, as measured by its accountants, minus the dividends paid out.
 - b. They are the amount of revenue the corporation receives for the sale of its products, minus its direct and indirect costs of production, as measured by its economists, minus the dividends paid out.
 - c. They are the amount of revenue the corporation receives for the sale of its products, minus its costs of production, as measured by its accountants.
 - d. They are the amount of revenue it receives for the sale of its products, minus its direct and indirect costs of production, as measured by its economists.

ANS: C PTS: 1 DIF: Average REF: p.169
BLM: Remember NOT: Macro TB_8-51

52. Which of the following best defines retained earnings?
- a. They are the amounts paid out as dividends.
 - b. They are the amount of revenues a corporation receives for the sale of its products, minus its costs of production, as measured by its accountants.
 - c. They are interest paid to creditors.
 - d. They are profits not paid out to shareholders.

ANS: D PTS: 1 DIF: Easy REF: p.169
BLM: Remember NOT: Macro TB_8-52

53. Which of the following terms refers to the amount of revenue a firm receives for the sale of its products, minus its costs of production, as measured by its accountants?
- a. earnings
 - b. retained earnings
 - c. economic, or real, profit
 - d. dividend

ANS: A PTS: 1 DIF: Easy REF: p.169
BLM: Remember NOT: Macro TB_8-53

54. What has the typical price-earnings ratio been historically?
- a. about 3
 - b. about 8
 - c. about 15
 - d. about 20

ANS: C PTS: 1 DIF: Easy REF: p.169
BLM: Remember NOT: Macro TB_8-54

55. What does a high price-earnings ratio indicate?
- a. Either the stock is undervalued or people have become more optimistic about the corporation's prospects.
 - b. Either the stock is overvalued or people have become more optimistic about the corporation's prospects.
 - c. Either the stock is overvalued or people have become less optimistic about the corporation's prospects.
 - d. Either the stock is undervalued or people have become less optimistic about the corporation's prospects.

ANS: B PTS: 1 DIF: Easy REF: p.169
BLM: Higher Order NOT: Macro TB_8-55

56. PacknCamp Corporation has a price of \$50, has issued 2 000 000 shares, has increased its cumulated retained earnings by \$2 million, and has a dividend yield of 2 percent. What is the price-earnings ratio of PacknCamp?
- a. 50, which is high compared to historical standards of the market
 - b. 50, which is low compared to historical standards of the market
 - c. 25, which is low compared to historical standards of the market
 - d. 25, which is high compared to historical standards of the market

ANS: D PTS: 1 DIF: Challenging REF: p.169
BLM: Higher Order NOT: Macro TB_8-56

57. What does a low P/E for a stock indicate?
- a. People may expect earnings to fall in the future perhaps because the firm will be faced with increased competition.
 - b. Its dividends have been low so that no one is willing to pay very much for it.
 - c. The corporation is possibly overvalued.
 - d. It is a good time for buying the company's stock.

ANS: A PTS: 1 DIF: Easy REF: p.169
BLM: Higher Order NOT: Macro TB_8-57

58. Suppose Sarah Lee Corporation stock has a P/E ratio of 8. Which of the following best describes this P/E ratio?
- a. The P/E ratio is low, indicating that buyers may expect earnings to rise.
 - b. The P/E ratio is low, indicating that buyers may expect earnings to fall.
 - c. The P/E ratio is high, indicating that buyers may expect earnings to rise.
 - d. The P/E ratio is high, indicating that buyers may expect earnings to fall.

ANS: B PTS: 1 DIF: Average REF: p.169
BLM: Higher Order NOT: Macro TB_8-58

Use the following table to answer the following questions.

Table 8-1

Stock	Sym	Yld %	PE	Vol 100s	Hi	Lo	Close	Net Chg
GenMills	GIS	2.5	35	13758	44.3	43.5	43.97	-0.63
Gillette	G	2.2	31	30428	31.1	29.7	30	0.17
Graco	GGG	1.2	16	705	24.2	23.1	23.95	-0.53
Hershey	HSY	2.1	38	5418	63.4	61.7	62.45	0.72

59. **Refer to Table 8-1.** In dollar terms, which company paid the highest dividend per share?

- a. GenMills
- b. Gillette
- c. Graco
- d. Hershey

ANS: D PTS: 1 DIF: Challenging REF: p.169
BLM: Higher Order NOT: Macro TB_8-59

60. **Refer to Table 8-1.** What were Hershey's earnings per share?

- a. \$0.61
- b. \$1.31
- c. \$1.64
- d. \$38

ANS: C PTS: 1 DIF: Challenging REF: p.169
BLM: Higher Order NOT: Macro TB_8-60

61. **Refer to Table 8-1.** Assume that the closing price was also the average price at which each stock transaction took place. What was the total dollar volume of Gillette stock traded that day?

- a. \$912 840 000
- b. \$91 284 000
- c. \$9 128 400
- d. \$912 840

ANS: B PTS: 1 DIF: Average REF: p.169
BLM: Higher Order NOT: Macro TB_8-61

Table 8-2.

Stock	Sym	Yld%	PE	Vol 100s	Hi	Lo	Close	Net Chg
Boeing and Co.	BA	1.55	30.48	4 531 600	64.78	63.70	64.62	+.93
Eli Lily and Co.	LLY	2.60	29.71	3 765 700	58.98	58.21	58.52	+.16
H.J. Heinz and Co.	HNZ	3.30	15.33	1 350 200	36.55	36.26	36.33	+.21
Kellogg Co.	K	2.22	20.50	1 990 600	45.72	45.20	45.50	+.24

62. **Refer to Table 8-2.** Which company had the highest dollar dividend?

- a. Boeing Co.
- b. Eli Lily and Co.
- c. H.J. Heinz and Co.
- d. Kellogg Co.

ANS: B PTS: 1
BLM: Higher Order

DIF: Average REF: p.169
NOT: Macro TB_8-62

63. **Refer to Table 8-2.** Which company had the lowest dollar dividend?

- a. Boeing Co.
- b. Eli Lily and Co.
- c. H.J. Heinz and Co.
- d. Kellogg Co.

ANS: A PTS: 1
BLM: Higher Order

DIF: Average REF: p.169
NOT: Macro TB_8-63

64. **Refer to Table 8-2.** Which company had the highest earnings per share?

- a. Boeing Co.
- b. Eli Lily and Co.
- c. H.J. Heinz and Co.
- d. Kellogg Co.

ANS: C PTS: 1
BLM: Higher Order

DIF: Challenging REF: p.169
NOT: Macro TB_8-64

65. **Refer to Table 8-2.** Which company had the lowest earnings per share?

- a. Boeing Co.
- b. Eli Lily and Co.
- c. H.J. Heinz and Co.
- d. Kellogg Co.

ANS: B PTS: 1
BLM: Higher Order

DIF: Challenging REF: p.169
NOT: Macro TB_8-65

66. Which of the following best defines financial intermediaries?
- a. They are the same as financial markets.
 - b. They are individuals who make a profit by buying a stock low and selling it high.
 - c. They are a more general name for financial assets, such as stocks, bonds, and chequing accounts.
 - d. They are financial institutions through which savers can indirectly provide funds to borrowers.

ANS: D PTS: 1 DIF: Easy REF: p.170
BLM: Remember NOT: Macro TB_8-66

67. Which of the following best characterizes the lending strategy of banks?
- a. Banks make most their profits from account fees.
 - b. Banks lend mostly to large and familiar companies rather than smaller local firms.
 - c. Banks charge borrowers a slightly lower interest rate than they pay to depositors.
 - d. Banks lend money both for investment and consumption purposes.

ANS: D PTS: 1 DIF: Easy REF: p.170
BLM: Higher Order NOT: Macro TB_8-67

68. Which of the following is a financial intermediary?
- a. a mutual fund
 - b. the stock market
 - c. a Canadian government bond
 - d. a stock exchange company

ANS: A PTS: 1 DIF: Easy REF: p.170
BLM: Higher Order NOT: Macro TB_8-68

69. What is a medium of exchange?
- a. a stock exchange company
 - b. an item that makes transactions easier
 - c. a financial market
 - d. a stock or bond

ANS: B PTS: 1 DIF: Easy REF: p.170
BLM: Remember NOT: Macro TB_8-69

70. Which of the following is both a store of value and a common medium of exchange?
- a. corporate bonds
 - b. mutual funds
 - c. chequing account balances
 - d. a pension plan

ANS: C PTS: 1 DIF: Easy REF: p.170
BLM: Remember NOT: Macro TB_8-70

71. Which of the following best defines a mutual fund?
- a. It is a financial market where small firms agree to sell stocks and bonds to raise funds.
 - b. It is a fund set aside by a local government to lend to small firms who want to invest in projects that are beneficial to the firm and community.
 - c. It is an institution that sells stocks and bonds on behalf of small and less known firms who would otherwise have to pay high interest to obtain credit.
 - d. It is an institution that sells shares to the public and uses the proceeds to buy a selection of various types of stocks and bonds.

ANS: D PTS: 1 DIF: Easy REF: p.170
BLM: Remember NOT: Macro TB_8-71

72. Which of the following is the primary advantage of mutual funds?
- a. They usually make a return that "beats the market."
 - b. They allow people with small amounts of money to diversify.
 - c. They provide customers with a medium of exchange.
 - d. They allow investing in venture companies.

ANS: B PTS: 1 DIF: Easy REF: p.170
BLM: Higher Order NOT: Macro TB_8-72

73. As a money management fee, how much do mutual funds usually charge their customers?
- a. between 0.5 and 3.0 percent of assets each year
 - b. between 1.5 and 3.0 percent of assets each year
 - c. nothing, because they receive commissions from the firms whose stock they buy
 - d. a flat fee of about \$50

ANS: A PTS: 1 DIF: Easy REF: p.170
BLM: Remember NOT: Macro TB_8-73

74. Which of the following is a secondary advantage of mutual funds?
- a. An investor can avoid investment charges and fees.
 - b. They give ordinary people access to loanable funds for investing.
 - c. They usually outperform stock market indexes.
 - d. They give ordinary people access to the skills of professional money managers.

ANS: D PTS: 1 DIF: Easy REF: p.170
BLM: Remember NOT: Macro TB_8-74

75. Which of the following best describes the pattern in the returns of index funds?
- a. They typically have about the same rate of return as more actively managed funds.
 - b. They typically have lower rates of return than more actively managed funds.
 - c. There is no pattern; they may have either higher or lower rates than more actively managed funds.
 - d. They typically have higher rates of return than more actively managed funds.

ANS: D PTS: 1 DIF: Easy REF: p.170-171
BLM: Remember NOT: Macro TB_8-75

76. Which of the following happens when a person buys shares in a mutual fund?
- Indirectly, the person becomes owner or creditor to many companies.
 - The person lends to, and borrows from the other shareholders in the mutual fund.
 - The person receives a fixed interest as long as he or she does not sell the shares.
 - The person lends money to the federal government.

ANS: A PTS: 1 DIF: Average REF: p.168-171
 BLM: Higher Order NOT: Macro TB_8-76

77. Which of the following identities shows that GDP is both total income and total expenditure?
- $GDP = Y$
 - $Y = PI + DI + NX$
 - $GDP = GNP - NX$
 - $Y = C + I + G + NX$

ANS: D PTS: 1 DIF: Easy REF: p.173
 BLM: Higher Order NOT: Macro TB_8-77

78. What makes $Y = C + I + G + NX$ an identity?
- Each symbol identifies a variable.
 - The right-hand and left-hand sides are equal.
 - The equality holds due to the way the variables are defined.
 - This relationship is identical for all economies.

ANS: C PTS: 1 DIF: Easy REF: p.173
 BLM: Higher Order NOT: Macro TB_8-78

79. Which of the following best defines a closed economy?
- an economy that does not trade with other economies
 - an economy that does not have free markets
 - an economy that does not allow immigration
 - an economy that does not grow

ANS: A PTS: 1 DIF: Easy REF: p.173
 BLM: Remember NOT: Macro TB_8-79

80. Which of the following equations will always represent GDP in an open economy?
- $S = I - G$
 - $I = Y - C + G$
 - $Y = C + I + G$
 - $Y = C + I + G + NX$

ANS: D PTS: 1 DIF: Easy REF: p.173
 BLM: Higher Order NOT: Macro TB_8-80

81. Which of the following equations most simply represents GDP in a closed economy?
- $Y = C + I + G + NX$
 - $S = I - G$
 - $I = Y - C + G$
 - $Y = C + I + G$

ANS: D PTS: 1 DIF: Easy REF: p.173
 BLM: Higher Order NOT: Macro TB_8-81

82. Which of the following expressions represents national saving in a closed economy?
- a. $Y - I - G - NX$
 - b. $Y - C - G$
 - c. $Y - I - C$
 - d. $G + C - Y$

ANS: B PTS: 1 DIF: Easy REF: p.173
BLM: Higher Order NOT: Macro TB_8-82

83. In a closed economy, what does national saving equal?
- a. income minus consumption
 - b. income minus the sum of consumption and government expenditures
 - c. income minus consumption minus taxes
 - d. income minus government expenditures

ANS: B PTS: 1 DIF: Average REF: p.173
BLM: Remember NOT: Macro TB_8-83

84. In a closed economy, how does national saving compare with investment?
- a. National saving is usually greater than investment.
 - b. National saving is equal to investment.
 - c. National saving is usually less than investment because of the leakage of taxes.
 - d. National saving is usually less than investment.

ANS: B PTS: 1 DIF: Easy REF: p.173
BLM: Remember NOT: Macro TB_8-84

85. In a closed economy, what remains after paying for consumption and government purchases?
- a. national disposable income
 - b. national saving
 - c. public saving
 - d. private saving

ANS: B PTS: 1 DIF: Easy REF: p.173-174
BLM: Higher Order NOT: Macro TB_8-85

86. In a closed economy, what does $(T - G)$ represent?
- a. national saving
 - b. investment
 - c. private saving
 - d. public saving

ANS: D PTS: 1 DIF: Easy REF: p.173-174
BLM: Remember NOT: Macro TB_8-86

87. In a closed economy, what does $(Y - T - C)$ represent?
- a. national saving
 - b. government tax revenue
 - c. public saving
 - d. private saving

ANS: D PTS: 1 DIF: Easy REF: p.174
BLM: Remember NOT: Macro TB_8-87

88. Suppose that in a closed economy GDP is equal to 12,000, taxes are equal to 1500, consumption equals 6800, and government expenditures equal 2500. What is national saving?
- a. 4200
 - b. 2700
 - c. 1200
 - d. 1000

ANS: B PTS: 1 DIF: Average REF: p.174
BLM: Higher Order NOT: Macro TB_8-88

89. Suppose that in a closed economy GDP is equal to 15,000, taxes are equal to 2500, consumption equals 7500, and government expenditures equal 3000. What is public saving?
- a. -600
 - b. -500
 - c. 500
 - d. 600

ANS: B PTS: 1 DIF: Average REF: p.174
BLM: Higher Order NOT: Macro TB_8-89

90. Suppose that in a closed economy GDP is equal to 10,000, taxes are equal to 2500, consumption equals 6500, and government expenditures equal 2000. What is private saving?
- a. 1500
 - b. 1000
 - c. 500
 - d. 0

ANS: B PTS: 1 DIF: Challenging REF: p.174
BLM: Higher Order NOT: Macro TB_8-90

91. Suppose that in a closed economy GDP is 10,000, consumption is 6500, and taxes are 2000. What value of government expenditures would make national saving equal 1000?
- a. 2500
 - b. 3500
 - c. 7500
 - d. 9000

ANS: A PTS: 1 DIF: Average REF: p.174
BLM: Higher Order NOT: Macro TB_8-91

92. Suppose that consumption is 7500, taxes are 1800, and government expenditures are 2200. If national savings are 1500 and the economy is closed, what is the GDP?
- a. 9500
 - b. 10 000
 - c. 10 500
 - d. 11 200

ANS: A PTS: 1 DIF: Average REF: p.174
BLM: Higher Order NOT: Macro TB_8-92

93. The country of Hykania does not trade with any other country. Its GDP is \$20 billion. Its government purchases \$3 billion worth of goods and services each year, collects \$3 billion in taxes, and provides \$2 billion in transfer payments to households. Private saving in Hyrkania is \$4 billion. What is investment in Hyrkania?
- a. \$4 billion
 - b. \$3 billion
 - c. \$2 billion
 - d. There is not enough information to answer the question.

ANS: C PTS: 1 DIF: Challenging REF: p.173-174
BLM: Higher Order NOT: Macro TB_8-93

94. The country of Nemediia does not trade with any other country. Its GDP is \$20 billion. Its government collects \$4 billion in taxes and pays out \$3 billion to households in the form of transfer payments. Consumption equals \$15 billion, and investment equals \$2 billion. What is the value of the goods and services purchased by the government of Nemediia?
- a. \$3 billion
 - b. \$5 billion
 - c. \$17billion
 - d. There is not enough information to answer the question.

ANS: A PTS: 1 DIF: Challenging REF: p.173-174
BLM: Higher Order NOT: Macro TB_8-94

95. The country of Aquilonia does not trade with any other country. Its GDP is \$30 billion. Its government purchases \$5 billion worth of goods and services each year, collects \$7 billion in taxes, and provides \$3 billion in transfer payments to households. Private saving in Aquilonia is \$5 billion. What is consumption?
- a. \$18 billion
 - b. \$21 billion
 - c. \$13 billion
 - d. There is not enough information to answer the question.

ANS: B PTS: 1 DIF: Challenging REF: p.173-174
BLM: Higher Order NOT: Macro TB_8-95

96. The country of Meritor uses the merit as its currency. Recent national income statistics shows that it has GDP of 700 million merits, no government transfer payments, taxes of 210 million merits, a budget surplus of 60 million merits, and investment of 100 million merits. What is the sum of its consumption and government expenditures?
- a. 600 million merits
 - b. 560 million merits
 - c. 490 million merits
 - d. 470

ANS: A PTS: 1 DIF: Challenging REF: p.173-174
BLM: Higher Order NOT: Macro TB_8-96

97. In the small closed economy of San Lucretia, the currency is the denar. Statistics for last year show that private saving was 60 billion denars, taxes were 70 billion denars, government purchases of goods and services were 80 billion denars, there were no transfer payments by the government, and GDP was 400 billion denars. What was investment in San Lucretia?
- a. 50 billion denars
 - b. 60 billion denars
 - c. 70 billion denars
 - d. 80 billion denars

ANS: A

PTS: 1

DIF: Average

REF: p.173-174

BLM: Higher Order

NOT: Macro TB_8-97

98. Consider three different closed economies with the following national income statistics. Country A has taxes of \$40 billion, transfers of \$20 billion, and government expenditures on goods and services of \$30 billion. Country B has private savings of \$60 billion, and investment expenditures of \$50 billion. Country C has GDP of \$300 billion, investment of \$70 billion, consumption of \$180 billion, taxes of \$60 billion, and transfers of \$20 billion. Based on this information, which country has a \$10 billion deficit?
- a. Country A
 - b. Country B
 - c. Country C
 - d. all three countries

ANS: D

PTS: 1

DIF: Challenging

REF: p.173-174

BLM: Higher Order

NOT: Macro TB_8-98

99. In examining the national income accounts of the closed economy of Nepotocracy, you see that it in 2007 it had taxes of \$100 billion, transfers of \$40 billion, and government purchases of goods and services of \$80 billion. You also notice that in 2006 it had private saving of \$50 billion and investment of \$70 billion. In which year did Nepotocracy have a budget deficit of \$20 billion?
- a. 2007 and 2006
 - b. 2007 but not 2006
 - c. 2006 but not 2007
 - d. neither 2006 nor 2007

ANS: B

PTS: 1

DIF: Challenging

REF: p.173-174

BLM: Higher Order

NOT: Macro TB_8-99

100. You have two sets of estimates of national account numbers for a closed economy for next year. In the first set, government expenditures will be \$30 billion, transfer payments will be \$10 billion, and taxes will be \$45 billion. Under the second set, GDP will be \$200 billion, taxes will be \$50 billion, transfer payments will be \$20 billion, consumption will be \$120 billion, and investment will be \$40 billion. Based on these numbers, what are the respective estimated results?
- a. \$15 billion surplus and a \$10 billion surplus
 - b. \$15 billion surplus and a \$10 billion deficit
 - c. \$5 billion surplus and a \$10 billion surplus
 - d. \$5 billion surplus and a \$10 billion deficit

ANS: D

PTS: 1

DIF: Challenging

REF: p.173-174

BLM: Higher Order

NOT: Macro TB_8-100

101. In a closed economy, what is private saving?
- a. the amount of income that households have left after paying for their taxes and consumption
 - b. the amount of income that businesses have left after paying for the factors of production
 - c. the amount of tax revenue that the government has left after paying for its spending
 - d. always equal to investment

ANS: A PTS: 1 DIF: Easy REF: p.174
BLM: Remember NOT: Macro TB_8-101

102. In a closed economy, what is public saving?
- a. the amount of income that households have left after paying for taxes and consumption
 - b. the amount of income that businesses have left after paying for the factors of production
 - c. the amount of tax revenue that the government has left after paying for its spending
 - d. the amount of total income minus total expenditure.

ANS: C PTS: 1 DIF: Easy REF: p.174
BLM: Remember NOT: Macro TB_8-102

103. What is public saving equal to?
- a. national saving
 - b. net exports
 - c. taxes minus government spending
 - d. government saving minus taxes

ANS: D PTS: 1 DIF: Easy REF: p.173-174
BLM: Higher Order NOT: Macro TB_8-103

104. Which of the following terms refers to the situation when the tax revenue of the federal government exceeds government spending?
- a. budget deficit
 - b. budget surplus
 - c. national debt
 - d. trade deficit

ANS: B PTS: 1 DIF: Easy REF: p.174
BLM: Remember NOT: Macro TB_8-104

105. When is a budget surplus created?
- a. when the government sells more bonds than it buys back
 - b. when the government spends more than it receives in tax revenue
 - c. when private savings are greater than zero
 - d. when the government spends less than the tax revenue

ANS: D PTS: 1 DIF: Easy REF: p.174
BLM: Higher Order NOT: Macro TB_8-105

106. In the language of macroeconomics, what does “investment” refer to?

- a. saving
- b. the purchase of new capital
- c. the purchase of stocks, bonds, or mutual funds
- d. the purchase of durable goods

ANS: B PTS: 1 DIF: Easy REF: p.174
BLM: Remember NOT: Macro TB_8-106

107. Which of the following would a macroeconomist consider as investment?

- a. Ernest purchases a bond issued by Star-Kist.
- b. Jerry purchases stock issued by IBM.
- c. Alice builds a new restaurant.
- d. Alice buys an amount of gold.

ANS: C PTS: 1 DIF: Easy REF: p.174
BLM: Higher Order NOT: Macro TB_8-107

108. Henry buys a bond issued by Ralston Purina, which uses the funds to buy new machinery for one of its factories. Who is investing and who is saving?

- a. Henry and Ralston Purina are both investing.
- b. Henry and Ralston Purina are both saving.
- c. Henry is investing; Ralston Purina is saving.
- d. Henry is saving; Ralston Purina is investing.

ANS: D PTS: 1 DIF: Average REF: p.174-175
BLM: Higher Order NOT: Macro TB_8-108

109. What is the source of the supply of and demand for loanable funds, respectively?

- a. saving and investment
- b. investment and saving
- c. saving and saving
- d. investment and investment

ANS: A PTS: 1 DIF: Easy REF: p.175
BLM: Remember NOT: Macro TB_8-109

110. Which of the following does the slope of the demand for loanable funds curve represent?

- a. the positive relation between the real interest rate and investment
- b. the negative relation between the real interest rate and investment
- c. the positive relation between the real interest rate and saving
- d. the negative relation between the real interest rate and saving

ANS: B PTS: 1 DIF: Easy REF: p.176
BLM: Remember NOT: Macro TB_8-110

111. Fred is considering expanding his dress shop. Which of the following will happen if interest rates rise?
- a. He is less likely to expand. This illustrates why the supply of loanable funds slopes downward.
 - b. He is more likely to expand. This illustrates why the supply of loanable funds slopes upward.
 - c. He is less likely to expand. This illustrates why the demand for loanable funds slopes downward.
 - d. He is more likely to expand. This illustrates why the demand for loanable funds slopes upward.

ANS: C PTS: 1 DIF: Easy REF: p.176
BLM: Higher Order NOT: Macro TB_8-111

112. The Eye of Horus Incense Company has \$10 million in cash, which it has accumulated from retained earnings. It was planning to use the money to build a new factory. Recently, the rate of interest has increased. How does this fact influence the company's decision?
- a. The increase in the rate of interest should not influence the decision to build the factory because the Eye of Horus doesn't have to borrow any money.
 - b. The increase in the rate of interest should not influence the decision to build the factory because its shareholders are expecting a new factory.
 - c. The increase in the rate of interest should make it more likely that the Eye of Horus will build the factory because a higher interest rate will make the factory more valuable.
 - d. The increase in the rate of interest should make it less likely that the Eye of Horus will build the factory because the opportunity cost of the \$10 million is now higher.

ANS: D PTS: 1 DIF: Challenging REF: p.176
BLM: Higher Order NOT: Macro TB_8-112

113. What does the slope of the supply of loanable funds curve represent?
- a. the positive relation between the real interest rate and investment
 - b. the positive relation between the real interest rate and saving
 - c. the negative relation between the real interest rate and investment
 - d. the negative relation between the real interest rate and saving

ANS: B PTS: 1 DIF: Easy REF: p.176
BLM: Remember NOT: Macro TB_8-113

114. What does a higher interest rate induce people to do?
- a. save more, so the supply of loanable funds slopes upward
 - b. save less, so the supply of loanable funds slopes downward
 - c. invest more, so the supply of loanable funds slopes upward
 - d. invest less, so the supply of loanable funds slopes downward

ANS: A PTS: 1 DIF: Easy REF: p.176
BLM: Higher Order NOT: Macro TB_8-114

115. How does the supply of loanable funds slope?

- a. upward because an increase in the interest rate induces people to save more
- b. downward because an increase in the interest rate induces people to save less
- c. downward because an increase in the interest rate induces people to invest less
- d. upward because an increase in the interest rate induces people to invest more

ANS: A PTS: 1 DIF: Easy REF: p.176
BLM: Remember NOT: Macro TB_8-115

116. If the current market interest rate for loanable funds is below the equilibrium level, which of the following is most likely to happen?

- a. The quantity of loanable funds demanded will exceed the quantity of loanable funds supplied and the interest rate will rise.
- b. The quantity of loanable funds supplied will exceed the quantity of loanable funds demanded and the interest rate will rise.
- c. The quantity of loanable funds demanded will exceed the quantity of loanable funds supplied and the interest rate will fall.
- d. The quantity of loanable funds supplied will exceed the quantity of loanable funds demanded and the interest rate will fall.

ANS: A PTS: 1 DIF: Average REF: p.176
BLM: Higher Order NOT: Macro TB_8-116

117. If the current market interest rate for loanable funds is above the equilibrium level, which of the following will most likely happen?

- a. The quantity of loanable funds demanded will exceed the quantity of loanable funds supplied and the interest rate will rise.
- b. The quantity of loanable funds supplied will exceed the quantity of loanable funds demanded and the interest rate will rise.
- c. The quantity of loanable funds demanded will exceed the quantity of loanable funds supplied and the interest rate will fall.
- d. The quantity of loanable funds supplied will exceed the quantity of loanable funds demanded and the interest rate will fall.

ANS: D PTS: 1 DIF: Average REF: p.176
BLM: Higher Order NOT: Macro TB_8-117

118. If the current market interest rate for loanable funds is below the equilibrium level, which of the following would we expect to happen?

- a. Because there is a surplus of loanable funds, the interest rate will rise.
- b. Because there is a shortage of loanable funds, the interest rate will rise.
- c. Because there is a shortage of loanable funds, the interest rate will fall.
- d. Because there is a surplus of loanable funds, the interest rate will fall.

ANS: B PTS: 1 DIF: Average REF: p.176
BLM: Higher Order NOT: Macro TB_8-118

119. If the current market interest rate for loanable funds is above the equilibrium level, which of the following would we expect to happen?
- Because there is a surplus of loanable funds, the interest rate will rise.
 - Because there is a shortage of loanable funds, the interest rate will rise.
 - Because there is a shortage of loanable funds, the interest rate will fall.
 - Because there is a surplus of loanable funds, the interest rate will fall.

ANS: D PTS: 1 DIF: Average REF: p.176
BLM: Higher Order NOT: Macro TB_8-119

120. If there is shortage of loanable funds, which of the following is most likely to happen?
- The supply for loanable funds shifts right and the demand shifts left.
 - The supply for loanable funds shifts left and the demand shifts right.
 - Neither curve shifts, but the quantity of loanable funds supplied increases and the quantity demanded decreases as the interest rate rises to equilibrium.
 - Neither curve shifts, but the quantity of loanable funds supplied decreases and the quantity demanded increases as the interest rate falls to equilibrium.

ANS: C PTS: 1 DIF: Challenging REF: p.176
BLM: Higher Order NOT: Macro TB_8-120

121. If there is surplus of loanable funds, which of the following is most likely to happen?
- The supply for loanable funds shifts right and the demand shifts left.
 - The supply for loanable funds shifts left and the demand shifts right.
 - Neither curve shifts, but the quantity of loanable funds supplied increases and the quantity demanded decreases as the interest rate rises to equilibrium.
 - Neither curve shifts, but the quantity of loanable funds supplied decreases and the quantity demanded increases as the interest rate falls to equilibrium.

ANS: D PTS: 1 DIF: Challenging REF: p.176
BLM: Higher Order NOT: Macro TB_8-121

122. Suppose equilibrium exists in the market for loanable funds. Using the following table, what is the quantity of funds supplied in this market?

GDP	\$8.7 trillion
Consumption Spending	\$3.5 trillion
Taxes minus Transfers	\$2.7 trillion
Government Purchases	\$3.0 trillion

- \$2.2 trillion
- \$2.5 trillion
- \$2.8 trillion
- \$3.1 trillion

ANS: A PTS: 1 DIF: Average REF: p.174-176
BLM: Higher Order NOT: Macro TB_8-122

123. Suppose the market for loanable funds is in equilibrium. Using the table below, what is the quantity of funds demanded?

GDP	\$100 billion
Consumption	\$65 billion
Taxes minus Transfers	\$15 billion
Government Purchases	\$20 billion

- a. \$25 billion
- b. \$20 billion
- c. \$15 billion
- d. \$10 billion

ANS: C PTS: 1 DIF: Average REF: p.174-176
 BLM: Higher Order NOT: Macro TB_8-123

124. Which of the following best defines the nominal interest rate?

- a. It is the interest rate corrected for inflation.
- b. It is the interest rate as usually reported by banks.
- c. It is the real rate of return to the lender.
- d. It is the real cost of borrowing to the borrower.

ANS: B PTS: 1 DIF: Easy REF: p.177
 BLM: Remember NOT: Macro TB_8-124

125. If the nominal interest rate is 6 percent and the rate of inflation is 2 percent, what is the real interest rate?

- a. 12 percent
- b. 10 percent
- c. 8 percent
- d. 4 percent

ANS: D PTS: 1 DIF: Easy REF: p.177
 BLM: Higher Order NOT: Macro TB_8-125

126. If the inflation rate is 3 percent and the real interest rate is 5 percent, what is the nominal interest rate?

- a. 2 percent
- b. 3 percent
- c. 5 percent
- d. 8 percent

ANS: D PTS: 1 DIF: Easy REF: p.177
 BLM: Higher Order NOT: Macro TB_8-126

127. If the nominal interest rate is 10 percent and the inflation rate is 4 percent, what is the real interest rate?

- a. 0.44 percent
- b. 2.6 percent
- c. 6 percent
- d. 14 percent

ANS: C PTS: 1 DIF: Easy REF: p.177
 BLM: Higher Order NOT: Macro TB_8-127

128. If the nominal interest rate is 8 percent and the real interest rate is 2 percent, what is the inflation rate?
- a. 4 percent
 - b. 6 percent
 - c. 10 percent
 - d. 16 percent

ANS: B PTS: 1 DIF: Easy REF: p.177
BLM: Higher Order NOT: Macro TB_8-128

129. Generally, when economists talk of the "interest rate," which of the following are they talking about?
- a. the real interest rate
 - b. the current nominal interest rate
 - c. the real interest rate minus the inflation rate
 - d. the equilibrium nominal interest rate

ANS: A PTS: 1 DIF: Easy REF: p.177
BLM: Remember NOT: Macro TB_8-129

130. Which of the following would most likely happen in the market for loanable funds if the government were to increase the tax on interest income?
- a. The supply of loanable funds would shift right.
 - b. The demand for loanable funds would shift right.
 - c. The supply of loanable funds would shift left.
 - d. The demand for loanable funds would shift left.

ANS: C PTS: 1 DIF: Average REF: p.177-179
BLM: Higher Order NOT: Macro TB_8-130

131. Which of the following would most likely happen in the market for loanable funds if the government were to decrease the tax rate on interest income?
- a. The supply of and demand for loanable funds would shift to the right.
 - b. The supply of and demand for loanable funds would shift to the left.
 - c. The supply of loanable funds would shift to the right and the demand for loanable funds would shift to the left.
 - d. The supply of loanable funds would shift to the right and the demand for loanable funds will remain unchanged.

ANS: D PTS: 1 DIF: Average REF: p.177-179
BLM: Higher Order NOT: Macro TB_8-131

132. Suppose that the government were to replace the income tax with a consumption tax. What would happen to the interest rate and investment, respectively?
- a. increase and increase
 - b. decrease and decrease
 - c. increase and decrease
 - d. decrease and increase

ANS: D PTS: 1 DIF: Challenging REF: p.178
BLM: Higher Order NOT: Macro TB_8-132

133. Which of the following would **NOT** result from replacing the income tax with a consumption tax?
- a. The interest rate would decrease.
 - b. Investment would decrease.
 - c. The standard of living would eventually rise.
 - d. The supply of loanable funds would shift right.

ANS: B PTS: 1 DIF: Easy REF: p.178
BLM: Higher Order NOT: Macro TB_8-133

134. In 1995, MP Bill Gatt proposed that the income tax be replaced with a consumption tax. If his program had been passed, how would the equilibrium interest rate and the quantity of loanable funds have been affected?
- a. The equilibrium interest rate and quantity of loanable funds would be lower.
 - b. The equilibrium interest rate and quantity of loanable funds would be higher.
 - c. The equilibrium interest rate would be higher and the equilibrium quantity of loanable funds would be lower.
 - d. The equilibrium interest rate would be lower and the equilibrium quantity of loanable funds would be higher.

ANS: D PTS: 1 DIF: Average REF: p.178
BLM: Higher Order NOT: Macro TB_8-134

135. Which of the following would most likely happen in the market for loanable funds if the government were to increase the tax on interest income?
- a. Interest rates would rise.
 - b. Interest rates would be unaffected.
 - c. Interest rates would fall.
 - d. The change in the interest rate would be ambiguous.

ANS: A PTS: 1 DIF: Average REF: p.177-179
BLM: Higher Order NOT: Macro TB_8-135

136. Which of the following would most likely happen in the market for loanable funds if the government were to decrease the tax on interest income?
- a. There would be an increase in the amount of loanable funds borrowed.
 - b. There would be a reduction in the amount of loanable funds borrowed.
 - c. There would be no change in the amount of loanable funds borrowed.
 - d. The change in loanable funds borrowed would be ambiguous.

ANS: A PTS: 1 DIF: Average REF: p.177-179
BLM: Higher Order NOT: Macro TB_8-136

137. If Parliament reduced the tax rate on interest income, which of the following would most likely happen to investment and saving?
- a. Investment would increase, and saving would decrease.
 - b. Investment would decrease, and saving would increase.
 - c. Investment and saving would both increase.
 - d. Investment and saving would both decrease.

ANS: C PTS: 1 DIF: Average REF: p.177-179
BLM: Higher Order NOT: Macro TB_8-137

138. Suppose a country has a consumption tax that is similar to a provincial sales tax. If its government eliminates the consumption tax and replaces it with an income tax that includes an income tax on interest from savings, which of the following would most likely happen?
- a. There would be no change in the interest rate or saving.
 - b. The interest rate would decrease, and saving would increase.
 - c. The interest rate would increase, and saving would decrease.
 - d. The interest rate would increase, and saving would increase.

ANS: C PTS: 1 DIF: Challenging REF: p.176
BLM: Higher Order NOT: Macro TB_8-138

139. Suppose the Canadian government allowed taxpayers to earn their first \$5000 of interest free of income tax. How would this shift the supply of, or demand for, loanable funds?
- a. The supply of loanable funds would shift to the right.
 - b. The supply of loanable funds would shift to the left.
 - c. The demand for loanable funds would shift to the right.
 - d. The demand for loanable funds would shift to the left.

ANS: A PTS: 1 DIF: Average REF: p.177-179
BLM: Higher Order NOT: Macro TB_8-139

140. If other things are the same, will countries that tax saving less have lower or higher interest rates and investment than other countries?
- a. lower interest rates and higher investment
 - b. lower interest rates and lower investment
 - c. higher interest rates and higher investment
 - d. higher interest rates and lower investment

ANS: A PTS: 1 DIF: Average REF: p.177-179
BLM: Higher Order NOT: Macro TB_8-140

141. Suppose that Parliament were to institute an investment tax credit. Which of the following would most likely happen in the market for loanable funds?
- a. The demand for loanable funds would shift left.
 - b. The supply of loanable funds would shift left.
 - c. The demand for loanable funds would shift right.
 - d. The supply of loanable funds would shift right.

ANS: C PTS: 1 DIF: Easy REF: p.180
BLM: Higher Order NOT: Macro TB_8-141

142. Suppose that Parliament were to repeal an investment tax credit. Which of the following would most likely happen in the market for loanable funds?
- a. The demand and supply of loanable funds would shift right.
 - b. The demand and supply of loanable funds would shift left.
 - c. The supply of loanable funds would shift right.
 - d. The demand for loanable funds would shift left.

ANS: D PTS: 1 DIF: Easy REF: p.180
BLM: Higher Order NOT: Macro TB_8-142

143. Suppose a country repeals its investment tax credit. Which of the following is most likely to happen in the market for loanable funds?
- The demand for and the supply of loanable funds would shift to the right.
 - The demand for and the supply of loanable funds would shift to the left.
 - The supply of loanable funds would shift to the right and the demand for loanable funds would shift to the left.
 - The supply of loanable funds would remain unchanged, and the demand for loanable funds would shift to the left.

ANS: D PTS: 1 DIF: Average REF: p.180
BLM: Higher Order NOT: Macro TB_8-143

144. If Parliament instituted an investment tax credit, which of the following would most likely happen to the interest rate and saving?
- The interest rate would rise, and saving would rise.
 - The interest rate would fall, and saving would fall.
 - The interest rate would rise, and saving would fall.
 - The interest rate would fall, and saving would rise.

ANS: A PTS: 1 DIF: Average REF: p.179-180
BLM: Higher Order NOT: Macro TB_8-144

145. Suppose Parliament instituted an investment tax credit. Which of the following would most likely happen in the market for loanable funds?
- The interest rate and investment would both fall.
 - The interest rate and investment would both rise.
 - The interest rate would rise, and investment would fall.
 - The interest rate would fall; therefore, investment would rise.

ANS: B PTS: 1 DIF: Average REF: p.179-180
BLM: Higher Order NOT: Macro TB_8-145

146. Suppose a poor country decides to institute an investment tax credit. As a result, which of the following is most likely to happen?
- Interest rates would rise, and investment would fall.
 - Interest rates would fall, and investment would rise.
 - Both interest rates and investment would fall.
 - Both interest rates and investment would rise.

ANS: D PTS: 1 DIF: Average REF: p.179-180
BLM: Higher Order NOT: Macro TB_8-146

147. Which of the following best describes the relationship between government deficit and government debt?
- If the government currently has a budget deficit, currently it must have also a debt.
 - If the government currently has a budget deficit, the debt is increasing.
 - If the government currently has a budget deficit, government expenditures must be less than taxes.
 - If the government currently has a budget deficit, national savings must be higher.

ANS: B PTS: 1 DIF: Average REF: p.179-181
BLM: Higher Order NOT: Macro TB_8-147

148. What is the effect of an increase in budget deficit?

- a. It changes the supply of loanable funds.
- b. It changes the demand for loanable funds.
- c. It changes both the supply of and demand for loanable funds.
- d. It does not influence the supply of or the demand for loanable funds.

ANS: A PTS: 1 DIF: Easy REF: p.180-181
BLM: Higher Order NOT: Macro TB_8-148

149. Assuming that other things remain the same, what effect does a government budget deficit have on saving?

- a. It increases both private and national saving.
- b. It increases public saving but reduces national saving.
- c. It reduces both public and national saving.
- d. It reduces private saving, but increases national saving.

ANS: C PTS: 1 DIF: Average REF: p.180-181
BLM: Higher Order NOT: Macro TB_8-149

150. In the past few years, the Canadian government has gone from a deficit to a surplus. Assuming other things remain the same, what does this change mean?

- a. that the supply of loanable funds shifted right
- b. that the supply of loanable funds shifted left
- c. that the demand for loanable funds shifted right
- d. that the demand for loanable funds shifted left

ANS: C PTS: 1 DIF: Average REF: p.181
BLM: Higher Order NOT: Macro TB_8-150

151. Which of the following is most likely to happen if Canada increases its budget deficit?

- a. Private saving will decrease and so shift the supply of loanable funds left.
- b. Investment will decrease and so shift the demand for loanable funds left.
- c. Public saving will decrease and so shift the supply of loanable funds left.
- d. Private saving will increase and so shift the supply of loanable funds to the right.

ANS: C PTS: 1 DIF: Average REF: p.181
BLM: Higher Order NOT: Macro TB_8-151

152. Which of the following would an increase in the budget deficit most likely cause?

- a. a shortage of loanable funds at the original interest rate, which would lead to falling interest rates
- b. a surplus of loanable funds at the original interest rate, which would lead to rising interest rates
- c. a shortage of loanable funds at the original interest rate, which would lead to rising interest rates
- d. a surplus of loanable funds at the original interest rate, which would lead to falling interest rates

ANS: C PTS: 1 DIF: Challenging REF: p.181
BLM: Higher Order NOT: Macro TB_8-152

153. What would an increase in the budget deficit most likely do to investment spending?
- a. It would make investment spending fall.
 - b. It would make investment spending rise.
 - c. It would not affect investment spending.
 - d. It may increase, decrease, or not affect investment spending.

ANS: A PTS: 1 DIF: Easy REF: p.181
BLM: Higher Order NOT: Macro TB_8-153

154. Assuming that other things remain the same, if the government increases transfer payments to households, which of the following will most likely happen?
- a. Investment will rise.
 - b. The rate of interest will rise.
 - c. Public saving will rise.
 - d. The market for loanable funds will be unaffected.

ANS: B PTS: 1 DIF: Challenging REF: p.181
BLM: Higher Order NOT: Macro TB_8-154

155. You are required to testify before Parliament concerning the effects of an increase in the government surplus. Which of the following is the correct thing for you to say?
- a. The debt and interest rates will rise.
 - b. The debt and interest rates will fall.
 - c. The debt will rise, and interest rates will fall.
 - d. The debt will fall, and interest rates will rise.

ANS: B PTS: 1 DIF: Easy REF: p.181
BLM: Higher Order NOT: Macro TB_8-155

156. Which of the following terms refers to the fall in investment due to government borrowing?
- a. the Barro reduction
 - b. the Solow residual
 - c. the Ricardian principle
 - d. crowding out

ANS: D PTS: 1 DIF: Easy REF: p.181
BLM: Higher Order NOT: Macro TB_8-156

157. When the government runs a budget deficit, which of the following is most likely to happen?
- a. Interest rates become lower than they would be otherwise.
 - b. National saving gets higher than it would be otherwise.
 - c. Investment gets lower than it would be otherwise.
 - d. Government debt decreases by the amount of the deficit.

ANS: C PTS: 1 DIF: Easy REF: p.181
BLM: Higher Order NOT: Macro TB_8-157

158. Suppose that investment rises and interest rates fall. Which of the following best explains these changes?

- a. The government went from surplus to deficit.
- b. The government instituted an investment tax credit.
- c. The government reduced the tax rate on savings.
- d. The government repealed an investment tax credit.

ANS: C PTS: 1 DIF: Average REF: p.181
BLM: Higher Order NOT: Macro TB_8-158

159. Suppose that interest rates and investment both rise. Which of the following best explains these changes?

- a. The government is running a larger deficit.
- b. The government has instituted an investment tax credit.
- c. The government has replaced the income tax with a consumption tax.
- d. The government has reduced its deficit.

ANS: B PTS: 1 DIF: Average REF: p.181
BLM: Higher Order NOT: Macro TB_8-159

160. Suppose that interest rates fall and investment falls. Which of the following best explains these changes?

- a. The government went from a surplus to a deficit.
- b. The government has repealed an investment tax credit.
- c. The government has replaced a consumption tax with an income tax.
- d. The government is allowing nontaxable savings deposits of up to \$5000 per year.

ANS: B PTS: 1 DIF: Average REF: p.179
BLM: Higher Order NOT: Macro TB_8-160

161. When will a change in the tax laws that increases the supply of loanable funds have a bigger effect on investment?

- a. when the demand for loanable funds is more elastic and the supply of loanable funds is more inelastic
- b. when the demand for loanable funds is more inelastic and the supply of loanable funds is more elastic
- c. when both the demand for and supply of loanable funds are more elastic
- d. when both the demand for and supply of loanable funds are more inelastic

ANS: A PTS: 1 DIF: Challenging REF: p.179
BLM: Higher Order NOT: Macro TB_8-161

162. Which of the following best explains why the debt-to-GDP ratio is important?

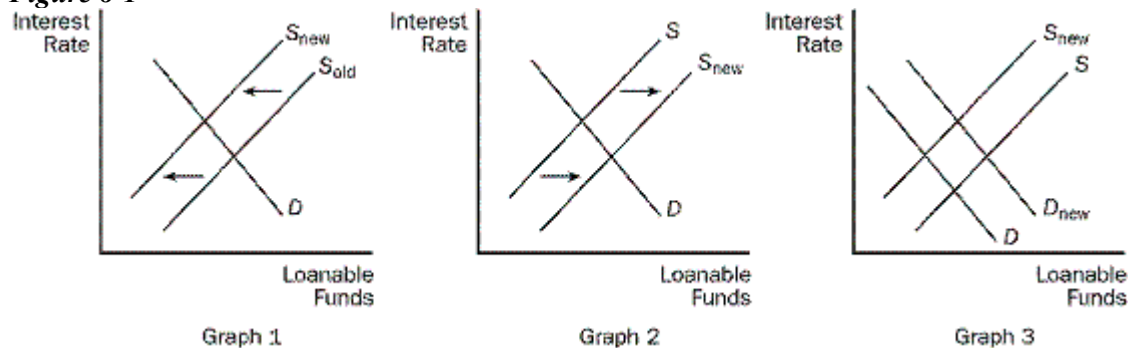
- a. If GDP is rising slower than debt, the government is, in some sense, living within its means.
- b. A declining debt-to-GDP ratio raises concerns about a country's financial difficulties.
- c. It is a better measure than the level of debt because it takes into account a country's net exports.
- d. It allows international comparisons of how indebted countries are.

ANS: D PTS: 1 DIF: Average REF: p.182-184
BLM: Higher Order NOT: Macro TB_8-162

163. Which of the following best describes the evolution of Canadian national debt between 1996 and 2008?
- It fell by 10 percent of GDP.
 - It fell, and then it rose.
 - It fell by \$60 billion.
 - It fell to 32 percent of GDP.

ANS: D PTS: 1 DIF: Easy REF: p.183
 BLM: Remember NOT: Macro TB_8-163

Figure 8-1



164. **Refer to Figure 8-1.** Which of the graphs in the figure shows the effects of an increase in the tax rate on saving?
- graph 1
 - graph 2
 - graph 3
 - none of the three graphs

ANS: A PTS: 1 DIF: Average REF: p.178-181
 BLM: Higher Order NOT: Macro TB_8-164

165. **Refer to Figure 8-1.** Which of the graphs in the figure shows the effects of instituting a national sales tax and simultaneously lowering the income tax rate?
- graph 1
 - graph 2
 - graph 3
 - none of the three graphs

ANS: B PTS: 1 DIF: Average REF: p.178-81
 BLM: Higher Order NOT: Macro TB_8-165

TRUE/FALSE

1. Most entrepreneurs finance their purchases of real capital using their past saving.

ANS: F PTS: 1 DIF: Easy REF: p.165
NOT: Macro TB_8-166

2. Other things the same, the higher the rate of saving and investment in a country, the higher will be the standard of living.

ANS: T PTS: 1 DIF: Easy REF: p.166
NOT: Macro TB_8-167

3. Lenders sell bonds and borrowers buy them.

ANS: F PTS: 1 DIF: Easy REF: p.166
NOT: Macro TB_8-168

4. Corporate bonds generally have higher interest rates than federal government bonds.

ANS: T PTS: 1 DIF: Easy REF: p.167
NOT: Macro TB_8-169

5. The sale of stocks or bonds to raise money is known as equity finance.

ANS: F PTS: 1 DIF: Easy REF: p.168
NOT: Macro TB_8-170

6. When a corporation experiences financial problems, bondholders are paid before shareholders.

ANS: T PTS: 1 DIF: Easy REF: p.168
NOT: Macro TB_8-171

7. Corporations receive no proceeds from the resale of their stock.

ANS: T PTS: 1 DIF: Easy REF: p.168
NOT: Macro TB_8-172

8. Generally, if people expect a company to have higher future profits, the price of the stock will be driven down.

ANS: F PTS: 1 DIF: Easy REF: p.168
NOT: Macro TB_8-173

9. If you know that Alberta Dreams Corporation, a travel equipment and clothing company, has revenues of \$30 million and accounting costs of \$10 million, you know that its earnings are \$20 million.

ANS: T PTS: 1 DIF: Easy REF: p.169
NOT: Macro TB_8-174

10. If a share of stock in Skylight Chili sells for \$75, the retained earnings per share are \$5, and the dividend per share is \$2, then the price-earnings ratio is 15.

ANS: F PTS: 1 DIF: Average REF: p.169
NOT: Macro TB_8-175

11. If people become less optimistic about the future earnings of Hyde Park Records, the price of stock in the company will fall.

ANS: T PTS: 1 DIF: Easy REF: p.168
NOT: Macro TB_8-176

12. Mutual funds are a type of financial intermediary.

ANS: T PTS: 1 DIF: Easy REF: p.170
NOT: Macro TB_8-177

13. Index funds are usually outperformed by mutual funds that are actively managed by professional money managers.

ANS: F PTS: 1 DIF: Easy REF: p.171
NOT: Macro TB_8-178

14. National saving is equal to $Y - T - C$.

ANS: F PTS: 1 DIF: Easy REF: p.173
NOT: Macro TB_8-179

15. Public saving is $T - G$, while private saving is $Y - T - C$.

ANS: T PTS: 1 DIF: Easy REF: p.174
NOT: Macro TB_8-180

16. Public saving is equal to national saving minus private saving.

ANS: T PTS: 1 DIF: Average REF: p.174
NOT: Macro TB_8-181

17. In a closed economy, investment must be equal to private saving.

ANS: F PTS: 1 DIF: Easy REF: p.175
NOT: Macro TB_8-182

18. Suppose a small closed economy has GDP of \$5 billion, consumption of \$3 billion, and government expenditures of \$1 billion. Then domestic investment and national saving are both \$1 billion.

ANS: T PTS: 1 DIF: Easy REF: p.173-175
NOT: Macro TB_8-183

19. Joan uses some of her income to buy mutual fund shares. A macroeconomist would refer to Joan's purchase as investment.

ANS: F PTS: 1 DIF: Easy REF: p.174
NOT: Macro TB_8-184

20. Alberta buys a paint sprayer and a lift for her car customizing shop. A macroeconomist would refer to these purchases as investment.

ANS: T PTS: 1 DIF: Easy REF: p.174-175
NOT: Macro TB_8-185

21. The demand for loanable funds comes from saving, and the supply of loanable funds comes from investment.

ANS: F PTS: 1 DIF: Easy REF: p.175-176
NOT: Macro TB_8-186

22. Many economists believe that if the current income tax were replaced with a consumption tax, then saving, investment, economic growth, and the standard of living of Canadians would increase.

ANS: T PTS: 1 DIF: Easy REF: p.178
NOT: Macro TB_8-187

23. A decrease in taxes on interest income would increase the interest rate.

ANS: F PTS: 1 DIF: Easy REF: p.177-178
NOT: Macro TB_8-188

24. If Parliament instituted an investment tax credit, the demand for loanable funds would shift right.

ANS: T PTS: 1 DIF: Easy REF: p.179-180
NOT: Macro TB_8-189

25. When the government runs a budget deficit, national saving is reduced, interest rates rise, and investment falls.

ANS: T PTS: 1 DIF: Easy REF: p.180
NOT: Macro TB_8-190

26. When the federal government is in debt, it follows that it has a deficit.

ANS: F PTS: 1 DIF: Easy REF: p.182-183
NOT: Macro TB_8-191

SHORT ANSWER

1. What are the basic differences between bonds and stocks?

ANS:

A bond is a certificate of indebtedness that specifies the obligations of the borrower to the holder of the bond, while stock represents ownership in a firm and is, therefore, a claim on the profits that the firm makes. The sale of bonds to raise money is called debt finance, while the sale of stock is called equity finance. Whereas the owner of shares of stock in a company shares in the profits of a company, the owner of bonds receives a fixed interest rate. Compared to bonds, stocks offer the holder both higher risk and higher return.

PTS: 1 DIF: Average REF: p.166-168 NOT: Macro TB_8-192

2. Which of the two bonds in each example would you expect to pay the higher interest rate? Explain why.
- a Canadian government bond or a Brazilian government bond
 - a government of Canada bond or a municipal bond of the same face value and term?
 - a 6-month Treasury bill or a 20-year bond
 - a Canadian National Railway Company bond or a bond issued by a new record company

ANS:

- The Brazilian government bond would likely pay a higher interest rate because the market perceives a higher level of risk for the Brazilian bond relative to the Canadian bond.
- Because of the higher perceived risk of municipal bonds, the Canada government bond would likely pay the lower interest rate.
- The 20-year bond would likely pay a higher interest rate than would the 6-month bill, because the future is uncertain; therefore, it is more risky for a 20-year bond than for a 6-month bill.
- Since the Canadian National Railway Company is less likely to default than is the issuer of a junk bond, the junk bond will likely pay a higher interest rate.

PTS: 1 DIF: Average REF: p.166-168 NOT: Macro TB_8-193

3. Suppose that you are a broker and people tell you the following about themselves. What sort of bond would you recommend to each? Defend your choices.
- "I am in a high federal income-tax bracket and I don't want to take very much risk."
 - "I want a high return and I am willing to take a lot of risk to get it."
 - "I want a decent return and I have enough deductions that I don't value tax breaks highly."

ANS:

- A federal bond, because generally they have low credit risk.
- A junk bond, because of their high risk, they have a high return.
- A corporate bond that isn't a junk bond. Because they have more risk than government bonds and have no special tax treatment, they pay moderate rates of return.

PTS: 1 DIF: Average REF: p.166-168 NOT: Macro TB_8-194

4. Your brother-in-law wants to buy either stock or bonds in Cedar Valley Furniture, but he isn't sure which to buy. Explain how each of his quotes below should affect his choice between the stock and the bond.
- "I have reason to believe that people are soon going to find rocking chairs have health benefits."
 - "I would like to tell people I am part owner of Cedar Valley Furniture."
 - "I do not want to take on much risk."

ANS:

- Presumably, when this happens, unless everyone else has anticipated it, dividends or the price of the stock, or both will increase. The interest rate on bonds will not change as profits increase, so this quote suggests buying stock would better suit your brother-in-law's purposes.
- Bondholders are simply creditors, while shareholders are part owners. So this quote indicates your brother-in-law would prefer to buy stock.
- In case of financial difficulties shareholders get paid after bondholders, so the stock is somewhat more risky. So, your brother-in-law may prefer the bond.

PTS: 1

DIF: Easy

REF: p.166-168

NOT: Macro TB_8-195

5. Suppose the GetUpOffofYourButt exercise chain has revenues of \$45 million, costs of \$15 million, and currently has issued 10 million shares selling at \$90 each. Compute the price-to-earnings ratio. Show your work. Is this ratio relatively high or low? What might an increase in the price-to-earnings ratio indicate?

ANS:

The earnings per share is $(\$45 \text{ million} - \$15 \text{ million}) / 10 \text{ million} = \$3$. So, the price-earnings ratio is $\$90 / \$3 = 30$. This is a high P/E ratio, as the historical average for the market is about 15. An increase in the P/E ratio often indicates that people think the corporation will have better future earnings.

PTS: 1

DIF: Average

REF: p.169

NOT: Macro TB_8-196

6. In the national income accounting identity showing the equality between national saving and investment, what is the representation of private saving and what is the representation of public saving?

ANS:

Starting with $Y = C + I + G$, subtract C and G from both sides, obtaining $Y - C - G = I$. The left-hand side represents national saving, the total income of the economy that remains after paying for consumption and government purchases. Hence, substituting S for $Y - C - G$, we obtain $S = I$. To separate private and public saving, add and subtract T in $S = Y - C - G$, obtaining $S = (Y - T - C) + (T - G)$. Here, $(Y - T - C)$ represents private saving, the part of disposable income $(Y - T)$ left after subtracting consumption, and $(T - G)$ represents the government budget surplus—i.e., public saving.

PTS: 1

DIF: Average

REF: p.173-175

NOT: Macro TB_8-197

7. Identify each of the following acts as representing either saving or investment.
- Fred uses some of his income to buy government bonds.
 - Julie takes some of her income and buys mutual funds.
 - Alex purchases a new truck for his delivery business using borrowed funds.
 - Elaine uses some of her income to buy stock in a major corporation,
 - Henrietta hires a builder to construct a new home using borrowed funds.

ANS:

- Fred is saving.
- Julie is saving.
- Alex is investing.
- Elaine is saving.
- Henrietta is investing.

PTS: 1

DIF: Easy

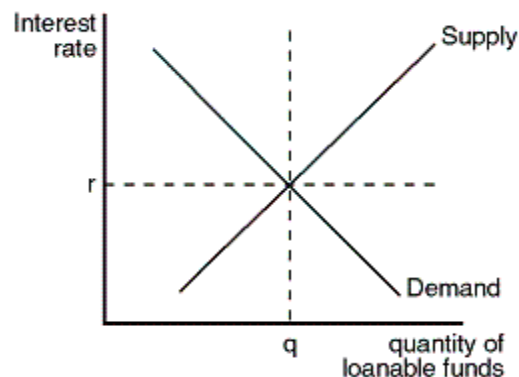
REF: p.174

NOT: Macro TB_8-198

8. Draw and label a graph showing equilibrium in the market for loanable funds.

ANS:

Market for Loanable Funds



PTS: 1

DIF: Easy

REF: p.176

NOT: Macro TB_8-199

9. Explain why the demand for loanable funds slopes downward and the supply of loanable funds slopes upward.

ANS:

When the interest rate rises, investment spending becomes more expensive, so people invest less. As the interest rate rises, saving becomes more rewarding, so people want to save more. The inverse relation between interest and borrowing is reflected in the downward slope of the demand for loanable funds curve. The positive relation between interest and saving is reflected in the upward slope of the supply of loanable funds curve.

PTS: 1

DIF: Average

REF: p.175-177

NOT: Macro TB_8-200

10. Australia has recently implemented a national sales tax. If that country uses the proceeds from this tax to reduce income tax rates, what happens in the loanable funds market?

ANS:

The supply of loanable funds shifts right. This causes the interest rate to fall. Both investment and saving rise.

PTS: 1

DIF: Average

REF: p.178

NOT: Macro TB_8-201

11. The model of the market for loanable funds shows that an investment tax credit will cause interest rates to rise and investment to rise. Yet we also suppose that higher interest rates lead to lower investment. How can these two conclusions be reconciled?

ANS:

The claim that an increase in the interest rate decreases investment supposes that only the interest rate changes and everything else is constant. The investment tax credit causes investment to rise at each interest rate. As firms want to borrow more, the interest rate will rise. The rise in interest rates does make investment less than it would otherwise be but does not offset the increase in investment created by the tax credit.

PTS: 1

DIF: Challenging

REF: p.179-180

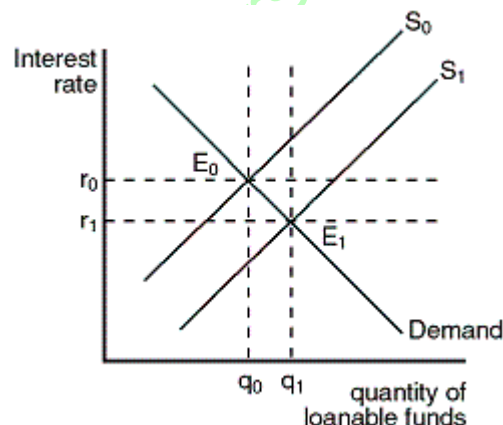
NOT: Macro TB_8-202

12. Using a graph representing the market for loanable funds, show and explain what happens to interest rates and investment if a government goes from a deficit to a surplus.

ANS:

As shown in the graph below, the economy starts in equilibrium at point E_0 with interest rate r_0 and equilibrium quantity of saving and investment at q_0 . If the government succeeds in obtaining a surplus, there will be more public saving in the economy at each interest rate, and the supply of loanable funds curve will shift from S_0 to S_1 . The new equilibrium will be at E_1 , with a lower interest rate, r_1 and a higher quantity of saving and investment, q_1 . Hence, if the federal government succeeds in having a surplus, interest rates will fall and investment will increase.

Market for Loanable Funds



PTS: 1

DIF: Challenging

REF: p.180-182

NOT: Macro TB_8-203

13. The following table shows information about bonds issued by governments and companies in Canada, sorted by increasing maturity. (Source: *Globe and Mail*, retrieved 12 August, 2010, <http://www.globeinvestor.com/servlet/Page/document/v5/data/bonds/>). Does this information support the theory that less risky bonds yield lower returns? Explain your answer.

No.	Issuer	Bond Type	Coupon	Maturity	Price	Yield
1	MANITOBA	PROV	4.3	01/03/2016	107.7	2.79
2	ONTARIO	PROV	4.4	08/03/2016	107.91	2.85
3	ONTARIO	PROV	4.4	08/03/2016	107.91	2.85
4	ROGERS COMM	CORP	5.8	26/05/2016	111.47	3.58
5	CANADIAN TIRE	CORP	5.65	01/06/2016	110.5	3.62
6	CANADA	FEDGOV	4	01/06/2016	108.87	2.35
7	CANADA COUPON	FEDGOV	0	01/06/2016	86.33	2.55
8	LOBLAWS	CORP	7.1	01/06/2016	118.24	3.58
9	NEW BRUNSWICK	PROV	4.7	21/07/2016	109.44	2.95
10	SASKATCHEWAN	PROV	4.5	23/08/2016	108.93	2.87
11	ALBERTA	PROV	5.93	16/09/2016	112.81	3.57
12	MANITOBA	PROV	4.06	01/10/2016	104.13	0

ANS:

According to the theory, the return on a bond depends of the perceived risk of the issuer, on the bond's interest rate (coupon), and the remaining time to maturity. Besides the coupon, the yield (return) is defined by the difference between the current market price and the face value of the bond: the higher the price, the lower the yield, for any given face value. One would expect federal bonds to produce lower yield than provincial bonds, which would produce lower yields than corporate bonds. To see if the data in the table support this theory, one should compare the yields for bonds having the same maturity date. For instance, if we compare entries 5 and 6, we see that they have the same maturity date but the federal government bond has lower yield. An interesting case provides entries 6 and 7, both federal government bonds, with the same maturity date, but the yields are different (they also have different coupons, but this should not matter if the market is efficient.)

PTS: 1 NOT: Macro TB_8-204

14. A company releases the following information:
 Number of shares (in thousands) = 7500
 Dividend = \$0.12
 Dividend yield = 0.7%
 Profit (in thousands) = \$1500
- Calculate the share price
 - Calculate the market value of the firm (the total value of the firm's stock)
 - Calculate Earnings per share and the P/E ratio
 - Is this company expensive relative to its earnings?

ANS:

- The dividend yield is the percentage of the dividend in the share price. In this case, it is equal to $(\$0.12/\text{Price}) \times 100 = 0.7\%$. Hence, the share price is $12/0.7 = \$17.1$
- The market value of the firm = $7\,500\,000 \times \$17.1 = \$128\,250\,000$
- Earnings per share = $\$1\,500\,000 / 7\,500\,000 = \$0.2$ per share; $P/E = 17.1/0.2 = 85.5$.
- Since P/E is much greater than 15, it shows that the company's stock is too expensive relative to earnings.

PTS: 1

NOT: Macro TB_8-205

15. In a closed economy, the fact that total income equals total expenditure is reflected by the GDP identity $Y = C + I + G$.
- Starting from the GDP identity, show that national saving (S) must be equal to investment. Show that an increase in government spending reduces national saving.
 - Rewrite the GDP identity by introducing taxes (T). In this new form of the GDP relationship, identify private saving and public saving. Show that an increase in taxes has no effect on national saving.
 - Is the equation $S = I$ true for an open economy? Could you explain why or why not?

ANS:

- We rewrite the GDP identity $Y = C + I + G$ under the form $Y - C - G = I$, and define national saving as $S = Y - C - G$. With this notation, the GDP identity becomes $S = I$. Since G , government spending enters the defining formula $S = Y - C - G$ with a negative sign, an increase in G must decrease S , national saving.
- First, subtract taxes from both sides of the equation: $Y - T = C + I + G - T$; then, identify private saving as being income minus consumption minus taxes, and public saving as tax revenue minus government spending and reorganize the previous equation identifying private and public saving: $(Y - C - T) + (T - G) = I$. An increase in taxes will reduce private savings ($Y - C - T$), but at the same time will increase public saving by the same amount, leaving their sum, which is national saving, unchanged.
- The GDP equation for an open economy is $Y = C + I + G + NX$. National saving is, as before, $S = Y - C - G$. Therefore, in an open economy, $S = I + NX$. In an open economy, national saving is equal to investment only if $NX = 0$. If $NX > 0$, national saving is greater than investment and the other way around. (This will be studied in great detail in another chapter.)

PTS: 1

NOT: Macro TB_8-206

16. In a closed economy $GDP = \$1300$, private saving = \$125, government budget deficit = \$5, and government spending = \$15 (all numbers are in billions). Calculate national saving, taxes, and consumption.

ANS:

National saving = private saving + public saving = $125 - 5 = \$120$ (public saving is equal to minus budget deficit.) Since public saving = $T - G = -5$, government spending $G = 15$, it follows that $T = G - 5 = 15 - 5 = \$10$.

PTS: 1

NOT: Macro TB_8-207

17. Consider a closed economy. Use the supply and demand for loanable funds model to predict the effects of the following events on interest rates and investment.
- The government introduces a tax credit for savings accounts of up to \$5000 per year.
 - The government introduces a tax credit for savings accounts of up to \$5000 per year, and at the same time it repeals an investment tax exemption provision.
 - The government raises the tax rates.
 - The government issues bonds worth \$10 billion.

ANS:

- Since saving is now less taxed, one would expect people to save more. In our supply and demand for loanable funds model. The supply curve shifts to the right, while the demand curve does not change.
- The supply of loanable funds shifts to the right, the demand to the left. The resulting interest rate is lower, but the change in investment is ambiguous.
- If government expenditure does not change, raising taxes lowers private saving but increases public saving by the same amount, thus the national saving curve remains unchanged. (A secondary effect may be that higher taxes induce deadweight losses, thus GDP may decrease, which makes savings to decrease as well.)
- In itself, this is just another possibility of saving, but it does not change the amount people want to save. National saving remains the same, unless the government wants to increase spending.

PTS: 1

NOT: Macro TB_8-208

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Chapter 9—Unemployment and Its Natural Rate

MULTIPLE CHOICE

1. Which of the following best defines the natural rate of unemployment?
- It is the unemployment rate that would prevail with zero inflation.
 - It is the rate associated with the highest possible level of GDP.
 - It is the difference between the long-run and short-run unemployment rates.
 - It is the amount of unemployment that the economy normally experiences.

ANS: D PTS: 1 DIF: Easy REF: p.191 | p.197-198
BLM: Remember NOT: MacroTB_9-1

2. What does cyclical unemployment refer to?
- the relation between the probability of unemployment and a worker's changing level of experience
 - how often a worker is likely to be employed during her lifetime
 - year-to-year fluctuations of unemployment around its natural rate
 - long-term trends in unemployment

ANS: C PTS: 1 DIF: Easy REF: p.192 | p.201
BLM: Remember NOT: MacroTB_9-2

3. Cyclical unemployment is closely associated with which of the following?
- long-term economic growth
 - short-run ups and downs of the economy
 - fluctuations in the natural rate of unemployment
 - seasonal fluctuations in spending

ANS: B PTS: 1 DIF: Easy REF: p.192 | p.201
BLM: Remember NOT: MacroTB_9-3

4. Which of the following is characteristic of the natural rate of unemployment?
- It is a constant.
 - It is the desirable rate of unemployment.
 - It is a variable that cannot be altered by economic policy.
 - It is the amount of unemployment that the economy normally experiences.

ANS: D PTS: 1 DIF: Easy REF: p.192 | p.201
BLM: Remember NOT: MacroTB_9-4

5. Which of the following best explains how unemployment relates to business cycles?
- Unemployment can be completely eliminated through economic policies when the economy grows at normal rates.
 - Unemployment only exists during periods of economic slowdown.
 - Cyclical unemployment is inversely related to short-run economic fluctuations.
 - Unemployment is unrelated to short-run economic fluctuations.

ANS: C PTS: 1 DIF: Easy REF: p.201
BLM: Higher Order NOT: MacroTB_9-5

6. How often is data on unemployment reported?

- a. weekly
- b. monthly
- c. quarterly
- d. yearly

ANS: B PTS: 1 DIF: Easy REF: p.190
BLM: Remember NOT: MacroTB_9-6

7. Which of the following data does Statistics Canada **NOT** produce?

- a. monthly data on unemployment
- b. data on types of employment
- c. data on length of the average workweek
- d. daily data on unemployment

ANS: D PTS: 1 DIF: Easy REF: p.192
BLM: Remember NOT: MacroTB_9-7

8. How is the unemployment rate computed?

- a. The unemployment rate is computed using the number of unemployment insurance claims filed.
- b. Each adult included in a survey is classified as employed, unemployed, or not in the labour force. Then, the unemployment rate is computed by dividing the number of unemployed persons to the number of persons in the labour force.
- c. The unemployment rate is computed by determining the number of unemployed in the population aged 18 and older.
- d. Every person who does not have a job is considered unemployed.

ANS: B PTS: 1 DIF: Easy REF: p.192-193
BLM: Remember NOT: MacroTB_9-8

9. How is unemployment data collected?

- a. from unemployment insurance claims
- b. through a regular survey of about 50 000 households
- c. through a regular survey of about 200 000 firms
- d. using Canada Revenue Agency tax files

ANS: B PTS: 1 DIF: Easy REF: p.192
BLM: Remember NOT: MacroTB_9-9

10. Which of the following lists includes all the categories into which Statistics Canada divides the adult population?

- a. employed or unemployed
- b. discouraged workers, employed, or unemployed
- c. employed, unemployed, or not in the labour force
- d. discouraged workers, employed, or not in the labour force

ANS: C PTS: 1 DIF: Easy REF: p.193
BLM: Remember NOT: MacroTB_9-10

11. Which of the following constitutes the labour force?

- a. the number of people who are employed
- b. the number of people who are unemployed
- c. the number of people employed plus the number of people unemployed
- d. the adult population

ANS: C PTS: 1 DIF: Easy REF: p.193
BLM: Remember NOT: MacroTB_9-11

12. Which one of the following people would be counted as unemployed according to official statistics?

- a. Shasta, who is currently not working and is waiting for her new job to start
- b. Mary, who worked only 35 hours last week
- c. Karen, who neither has a job nor is looking for one
- d. Kevin, who is a retiree

ANS: A PTS: 1 DIF: Easy REF: p.192-194
BLM: Higher Order NOT: MacroTB_9-12

13. Which one of the following people would be counted as unemployed according to official statistics?

- a. Brian, a full-time student who is not looking for work
- b. Kate, who is on temporary layoff
- c. Heath, who has retired and is not looking for work
- d. James, who has just graduated from university is taking a well-deserved long vacation

ANS: B PTS: 1 DIF: Easy REF: p.192
BLM: Higher Order NOT: MacroTB_9-13

14. Which of the following people would **NOT** be included in the labour force?

- a. Jay, who is on temporary layoff
- b. Mike, who has retired and is not looking for work
- c. Jane, who does not have a job, but has applied for several in the last week
- d. Joan, who has a job but is looking for a new one

ANS: B PTS: 1 DIF: Easy REF: p.192
BLM: Higher Order NOT: MacroTB_9-14

15. Which of the following people would be included in the labour force?

- a. Holly, an unpaid homemaker
- b. Tiffany, a full-time student not looking for work
- c. Cody, who does not have a job, but is looking for work
- d. Kara, who has interrupted her carrier to raise her two children

ANS: C PTS: 1 DIF: Easy REF: p.192
BLM: Higher Order NOT: MacroTB_9-15

16. Which of the following people would **NOT** be included in the labour force?

- a. Karen, who works most of the week in a steel factory
- b. Beth, who is waiting for her new job at the bank to start
- c. Dave, who does not have a job, but is looking for work
- d. Jeremiah, who does only voluntary work for charity organizations

ANS: D PTS: 1 DIF: Easy REF: p.192
BLM: Higher Order NOT: MacroTB_9-16

17. Which of the following people would be included in the labour force?

- a. Derrick, who is waiting for his new job to start
- b. Brett, who has become discouraged looking for a job and has quit looking for a while
- c. Homer, an unpaid homemaker
- d. A 20-year-old student who does not work and is not looking for work

ANS: A PTS: 1 DIF: Easy REF: p.192
BLM: Higher Order NOT: MacroTB_9-17

18. Sally is on a temporary layoff from the factory where she makes plastic tableware. If Sally participates in the Statistics Canada survey, how will she be classified?

- a. as unemployed and in the labour force
- b. as unemployed and out of the labour force
- c. as employed and in the labour force
- d. as employed and out of the labour force

ANS: A PTS: 1 DIF: Easy REF: p.192
BLM: Higher Order NOT: MacroTB_9-18

19. Which of the following correctly ranks categories from smallest to largest according to recent Canadian statistics?

- a. unemployed, employed, not in labour force
- b. unemployed, not in labour force, employed
- c. not in labour force, employed, unemployed
- d. not in labour force, unemployed, employed

ANS: B PTS: 1 DIF: Easy REF: p.192
BLM: Remember NOT: MacroTB_9-19

20. In which of the following situations would Statistics Canada count a person as unemployed?

- a. when that person is not in the labour force
- b. when that person is not looking for work
- c. when that person is under the age of 15
- d. when that person is age 15 or over and looking for work

ANS: D PTS: 1 DIF: Easy REF: p.192
BLM: Remember NOT: MacroTB_9-20

21. How is a college student who is not working or looking for a job counted?

- a. as neither employed nor part of the labour force
- b. as unemployed and in the labour force
- c. as unemployed, but not in the labour force
- d. as employed and in the labour force

ANS: A PTS: 1 DIF: Easy REF: p.192
BLM: Higher Order NOT: MacroTB_9-21

22. How is Latoya, a homemaker who works as a volunteer at the local Red Cross and is currently not looking for a job, counted?
- a. as employed and in the labour force
 - b. as unemployed and in the labour force
 - c. as unemployed and not in the labour force
 - d. as not in the labour force

ANS: D PTS: 1 DIF: Easy REF: p.192
BLM: Higher Order NOT: MacroTB_9-22

23. How does Statistics Canada define the unemployment rate?
- a. as the percentage of those unemployed relative to the percentage employed
 - b. as the percentage of the labour force that is unemployed
 - c. as the percentage of the adult population that is unemployed
 - d. as the percentage of the labour force without full-time employment

ANS: B PTS: 1 DIF: Easy REF: p.192
BLM: Remember NOT: MacroTB_9-23

24. How is the unemployment rate computed?
- a. as the number of unemployed divided by the labour force times 100
 - b. as the number of unemployed divided by the number of people employed times 100
 - c. as the number of unemployed divided by the adult population times 100
 - d. as the number of unemployed times the participation rate times 100

ANS: A PTS: 1 DIF: Easy REF: p.193
BLM: Remember NOT: MacroTB_9-24

25. Which of the following best defines the labour force?
- a. the number of employed
 - b. the population minus the number of unemployed
 - c. the population aged 15 or over
 - d. the number of unemployed plus the number of employed

ANS: D PTS: 1 DIF: Average REF: p.193
BLM: Higher Order NOT: MacroTB_9-25

26. What does the labour-force participation rate measure?
- a. the percentage of the total adult population that is in the labour force
 - b. the percentage of the total adult population that is employed
 - c. the percentage of the labour force that is employed
 - d. the percentage of the labour force that is either employed or unemployed

ANS: A PTS: 1 DIF: Average REF: p.193
BLM: Higher Order NOT: MacroTB_9-26

27. How is the labour-force participation rate defined?

- a. $(\text{Employed} \div \text{Adult population}) \times 100$
- b. $(\text{Employed} \div \text{Labour force}) \times 100$
- c. $(\text{Labour force} \div \text{Adult population}) \times 100$
- d. $(\text{Adult population} \div \text{Labour force}) \times 100$

ANS: C PTS: 1 DIF: Easy REF: p.193
BLM: Remember NOT: MacroTB_9-27

28. How is the labour-force participation rate computed?

- a. as the number of adults in the labour force divided by the adult population times 100
- b. as the number of adults in the labour force divided by the number of unemployed times 100
- c. as the number of adults in the labour force divided by the unemployment rate times 100
- d. as the number of adults in the labour force times the participation rate times 100

ANS: A PTS: 1 DIF: Average REF: p.191-192
BLM: Remember NOT: MacroTB_9-28

29. The U.S. Bureau of Labour Statistics recently reported that there were 48.6 million people over age 25 who had at least a bachelor's degree. Of this number, 38.0 million were in the labour force and 36.9 million were employed. What was the unemployment rate in this group?

- a. about 21.8 percent
- b. about 24.1 percent
- c. about 2.9 percent
- d. about 2.3 percent

ANS: C PTS: 1 DIF: Average REF: p.193
BLM: Higher Order NOT: MacroTB_9-29

30. In 2000 in Japan, based on concepts similar to those used to compute Canadian employment statistics, the unemployment rate was about 4.8 percent, the labour force participation rate was about 62 percent, and the adult population was about 108 million. How many people were employed?

- a. about 52 million
- b. about 64 million
- c. about 67 million
- d. about 103 million

ANS: B PTS: 1 DIF: Challenging REF: p.193
BLM: Higher Order NOT: MacroTB_9-30

31. In 2000 in the United Kingdom, the adult population was about 46.5 million, the labour force participation rate was 63.5 percent, and the unemployment rate was 5.8 percent. What was the number of people unemployed?

- a. 3.7 million
- b. 2.7 million
- c. 1.7 million
- d. 0.7 million

ANS: C PTS: 1 DIF: Challenging REF: p.192-194
BLM: Higher Order NOT: MacroTB_9-31

32. Rick loses his job and immediately begins looking for another. *Other things equal*, what happens to the unemployment rate?
- a. The unemployment rate decreases.
 - b. The unemployment rate increases.
 - c. The unemployment rate is unaffected.
 - d. There is insufficient information to answer the question.

ANS: B PTS: 1 DIF: Average REF: p.192-194
BLM: Higher Order NOT: MacroTB_9-32

33. Matt loses his job and decides to sit around at home for a few months. *Assuming that other things remain the same*, what happens to the unemployment rate?
- a. The unemployment rate decreases.
 - b. The unemployment rate increases.
 - c. The unemployment rate is unaffected.
 - d. There is insufficient information.

ANS: D PTS: 1 DIF: Average REF: p.192-194
BLM: Higher Order NOT: MacroTB_9-33

34. Anna has just finished school and started looking for a job, but has not yet found one. To which of the following pairs of categories does Anna now belong?
- a. unemployed and not in the labour force
 - b. unemployed and in the labour force
 - c. employed and not in the labour force
 - d. employed and in the labour force

ANS: B PTS: 1 DIF: Average REF: p.192-194
BLM: Higher Order NOT: MacroTB_9-34

35. Tara has just finished school, but she is going to roam around the country awhile before she starts looking for work. Which of the following best characterizes the changes that occur in labour statistics?
- a. The unemployment rate increases, and the labour-force participation rate increases.
 - b. The unemployment rate is unaffected, and the labour-force participation rate is unaffected.
 - c. The unemployment rate increases, and the labour-force participation rate decreases.
 - d. The unemployment rate increases, and the labour-force participation rate is unaffected.

ANS: B PTS: 1 DIF: Easy REF: p.192-194
BLM: Higher Order NOT: MacroTB_9-35

36. Between 2006 and 2007, the country of Aquilonia reported an increase in the number of people who were employed. It also reported an increase in the unemployment rate. Which of the following would best explain the two reports?
- a. There was an increase in the size of the labour force between 2006 and 2007.
 - b. There was a decrease in the size of the labour force between 2006 and 2007.
 - c. There was an increase in the size of the adult population between 2006 and 2007.
 - d. The two reports are contradictory and cannot be reconciled.

ANS: A PTS: 1 DIF: Challenging REF: p.192-194
BLM: Higher Order NOT: MacroTB_9-36

37. Prime Minister Bigego is running for re-election against Finance Minister Pander. Bigego proclaims that more people are working now than when he took office. Pander says that the unemployment rate is higher now than when Bigego took office. Which of the following can you conclude?
- One of them must be lying.
 - Both of them could be telling the truth if the labour force participation rate and the labour force both fell.
 - Both of them could be telling the truth if the labour force grew slower than employment.
 - Both of them could be telling the truth if the labour force grew faster than employment.

ANS: D

PTS: 1

DIF: Challenging REF: p.192-194

BLM: Higher Order

NOT: MacroTB_9-37

Table 28-1. This table shows the 2007 data for males and females aged 15 and over in the country of Dan.

Not in the Labour Force		Unemployed		Employed	
<i>Male</i>	<i>Female</i>	<i>Male</i>	<i>Female</i>	<i>Male</i>	<i>Female</i>
45 million	35 million	5 million	5 million	85 million	65 million

38. **Refer to Table 28-1.** What is the adult population in Dan?
- 90 million
 - 150 million
 - 160 million
 - 240 million

ANS: D

PTS: 1

DIF: Easy

REF: p.192-194

BLM: Higher Order

NOT: MacroTB_9-38

39. **Refer to Table 28-1.** What is the adult labour force in Dan?
- 90 million
 - 150 million
 - 160 million
 - 230 million

ANS: C

PTS: 1

DIF: Easy

REF: p.192-194

BLM: Higher Order

NOT: MacroTB_9-39

40. **Refer to Table 28-1.** What is the adult unemployment rate in Dan?
- 4.12 percent
 - 6.25 percent
 - 11.11 percent
 - 12.50 percent

ANS: B

PTS: 1

DIF: Average

REF: p.192-194

BLM: Higher Order

NOT: MacroTB_9-40

41. **Refer to Table 28-1.** What is the adult labour-force participation rate in Dan?

- a. 4.12 percent
- b. 12.50 percent
- c. 37.50 percent
- d. 66.67 percent

ANS: D PTS: 1 DIF: Average REF: p.192-194
BLM: Higher Order NOT: MacroTB_9-41

42. **Refer to Table 28-1.** What is the adult female population in Dan?

- a. 35 million
- b. 40 million
- c. 85 million
- d. 105 million

ANS: D PTS: 1 DIF: Easy REF: p.192-194
BLM: Higher Order NOT: MacroTB_9-42

43. **Refer to Table 28-1.** What is the adult male population in Dan?

- a. 85 million
- b. 105 million
- c. 120 million
- d. 135 million

ANS: C PTS: 1 DIF: Easy REF: p.192-194
BLM: Higher Order NOT: MacroTB_9-43

44. **Refer to Table 28-1.** What is the adult female labour force in Dan?

- a. 35 million
- b. 40 million
- c. 70 million
- d. 85 million

ANS: C PTS: 1 DIF: Average REF: p.192-194
BLM: Higher Order NOT: MacroTB_9-44

45. **Refer to Table 28-1.** What is the adult male labour force in Dan?

- a. 85 million
- b. 90 million
- c. 100 million
- d. 120 million

ANS: B PTS: 1 DIF: Average REF: p.192-194
BLM: Higher Order NOT: MacroTB_9-45

46. **Refer to Table 28-1.** What is the adult female unemployment rate in Dan?

- a. 4.76 percent
- b. 5.56 percent
- c. 7.14 percent
- d. 7.69 percent

ANS: C PTS: 1 DIF: Challenging REF: p.192-194
BLM: Higher Order NOT: MacroTB_9-46

47. **Refer to Table 28-1.** What is the adult male unemployment rate in Dan?

- a. 3.70 percent
- b. 4.00 percent
- c. 5.56 percent
- d. 5.88 percent

ANS: A PTS: 1
BLM: Higher Order

DIF: Challenging REF: p.192-194
NOT: MacroTB_9-47

48. **Refer to Table 28-1.** What is the adult female labour-force participation rate in Dan?

- a. 4.76 percent
- b. 37.03 percent
- c. 38.10 percent
- d. 66.67 percent

ANS: D PTS: 1
BLM: Higher Order

DIF: Challenging REF: p.192-194
NOT: MacroTB_9-48

49. **Refer to Table 28-1.** What is the adult male labour-force participation rate in Dan?

- a. 7.40 percent
- b. 33.33 percent
- c. 37.03 percent
- d. 66.67 percent

ANS: D PTS: 1
BLM: Higher Order

DIF: Challenging REF: p.192-194
NOT: MacroTB_9-49

50. Which of the following groups has the highest labour-force participation rate in Canada?

- a. Females
- b. Males
- c. It depends on when the individuals entered the labour force.
- d. There are no significant differences in participation rates across these groups.

ANS: B PTS: 1 DIF: Average REF: p.197
BLM: Remember NOT: MacroTB_9-50

51. How do male and female groups compare based on unemployment rates in Canada?

- a. Men have similar unemployment rates compared to women.
- b. Men have lower rates of unemployment than women.
- c. Men have higher rates of unemployment compared to women.
- d. It depends on the age group.

ANS: C PTS: 1 DIF: Easy REF: p.194
BLM: Remember NOT: MacroTB_9-51

52. What is the approximate labour-force participation rate of the Canadian adult population (aged 15 and over)?
- a. 47 percent
 - b. 55 percent
 - c. 67 percent
 - d. 75 percent

ANS: C PTS: 1 DIF: Easy REF: p.194
BLM: Remember NOT: MacroTB_9-52

53. In Canada in recent years, how does the unemployment rate among those aged 15 to 24 compare with that of older adults?
- a. less than that of older adults
 - b. about the same as that of older adults
 - c. much higher than that of older adults
 - d. approximately half that of older adults

ANS: C PTS: 1 DIF: Average REF: p.194
BLM: Higher Order NOT: MacroTB_9-53

54. What is a rough estimate of the natural rate of unemployment?
- a. 1 to 2.5 percent
 - b. 3 to 5.5 percent
 - c. 6 to 8 percent
 - d. 8.5 to 11 percent

ANS: C PTS: 1 DIF: Average REF: p.199
BLM: Remember NOT: MacroTB_9-54

55. Since World War II, which of the following has happened to the labour-force participation rate?
- a. It has increased for both men and women.
 - b. It increased for women and decreased for men.
 - c. It has decreased for both men and women.
 - d. It decreased for women and increased for men.

ANS: B PTS: 1 DIF: Easy REF: p.196
BLM: Remember NOT: MacroTB_9-55

56. How does the labour-force participation rate of women just after World War II compare to the same statistic today?
- a. Today, labour-force participation rate of women is about 2.1 times the one after World War II.
 - b. Today, labour-force participation rate of women is about 2.6 times the one after World War II.
 - c. Today, labour-force participation rate of women is about 3.2 times the one after World War II.
 - d. Today, labour-force participation rate of women is about 4.2 times the one after World War II.

ANS: B PTS: 1 DIF: Challenging REF: p.196-197
BLM: Remember NOT: MacroTB_9-56

57. What was the labour-force participation rate of men just after World War II?
- a. about 84% and about 73%
 - b. about 75%
 - c. about 70%
 - d. about 63%

ANS: A PTS: 1 DIF: Average REF: p.196
BLM: Remember NOT: MacroTB_9-57

58. Which of the following led to the decrease in labour-force participation rates among Canadian men since World War II?
- a. longer schooling, an increase in stay-at-home dads, earlier retirement, and longer lives
 - b. longer lives, laws that prevent mandatory retirement, and an increase in stay-at-home dads
 - c. better unemployment insurance and laws that prevent mandatory retirement and age discrimination in hiring
 - d. easier job searches, better training, and laws that prevent mandatory retirement and age discrimination in hiring

ANS: A PTS: 1 DIF: Average REF: p.197
BLM: Remember NOT: MacroTB_9-58

59. Since 1951, which of the following has happened to the labour-force participation rate of women?
- a. It is impossible to tell if the labour-force participation rate of women has increased or decreased.
 - b. It has increased, and they are now playing a more equal role in the economy.
 - c. It has decreased, because they stay in school longer.
 - d. It has decreased, because they now retire earlier.

ANS: B PTS: 1 DIF: Easy REF: p.196
BLM: Remember NOT: MacroTB_9-59

60. If an unemployed person quits looking for work, *ceteris paribus*, which of the following best describes the changes in the labour statistics?
- a. The unemployment rate decreases, and the labour-force participation rate increases.
 - b. The unemployment rate decreases, and the labour-force participation rate decreases.
 - c. The unemployment rate stays the same, and the labour-force participation rate decreases.
 - d. The unemployment rate and the labour-force participation rate stay the same.

ANS: B PTS: 1 DIF: Average REF: p.197
BLM: Higher Order NOT: MacroTB_9-60

61. In Canada, what fraction of the unemployed are recent entrants into the labour force?
- a. about 1/6 of those who are unemployed
 - b. about 1/5 of those who are unemployed
 - c. about 1/4 of those who are unemployed
 - d. about 1/3 of those who are unemployed

ANS: D PTS: 1 DIF: Average REF: p.197
BLM: Remember NOT: MacroTB_9-61

62. In Canada, about what fraction of the time do spells of unemployment end with the person leaving the labour force?
- a. 1/5 of the time
 - b. 1/4 of the time
 - c. 1/3 of the time
 - d. 1/2 of the time

ANS: D PTS: 1 DIF: Average REF: p.198
BLM: Remember NOT: MacroTB_9-62

63. How is the number of long-term unemployment spells compared to short-term spells in Canadian economy?
- a. about the same
 - b. much lower
 - c. much higher
 - d. it could be either higher or lower

ANS: B PTS: 1 DIF: Average REF: p.198
BLM: Remember NOT: MacroTB_9-63

64. In one year you meet 45 people who are each unemployed for one week, and five people who are each unemployed for the whole year. Which of the following statistics best describe this situation?
- a. 90 percent are short-term unemployed, and 85.3 percent are long-term unemployed
 - b. 10 percent are short-term unemployed, and 90 percent are long-term unemployed
 - c. 90 percent are short-term unemployed, and 10 percent are long-term unemployed
 - d. 88 percent are short-term unemployed, and 22 percent are long-term unemployed

ANS: C PTS: 1 DIF: Average REF: p.198
BLM: Higher Order NOT: MacroTB_9-64

65. Consider these facts: (1) Some people who are employed or who are not making a serious effort to find employment will report themselves as unemployed. (2) Some people who want to find work will be counted as out of the labour force. How do these facts affect the reported unemployment rate?
- a. Both the first and the second facts tend to make the reported unemployment rate lower than the actual unemployment rate.
 - b. Both the first and the second facts tend to make the reported unemployment rate higher than the actual unemployment rate.
 - c. The first fact tends to make the reported unemployment rate higher than the actual unemployment rate. The second fact tends to make the reported unemployment rate lower than the actual rate.
 - d. The first fact tends to make the reported unemployment rate lower than the actual unemployment rate. The second fact tends to make the reported unemployment rate higher than the actual rate.

ANS: C PTS: 1 DIF: Average REF: p.197-198
BLM: Higher Order NOT: MacroTB_9-65

66. Suppose that some people report themselves as unemployed when, in fact, they are working in the underground economy. If these persons were counted as employed, how would the labour statistics change?
- a. The unemployment rate and the labour-force participation rate would be higher.
 - b. The unemployment rate and the labour-force participation rate would be lower.
 - c. The unemployment rate would be higher and the labour-force participation rate would be lower.
 - d. The unemployment rate would be lower and the labour-force participation rate would be unaffected.

ANS: D PTS: 1 DIF: Average REF: p.197
BLM: Higher Order NOT: MacroTB_9-66

67. Suppose that some people are counted as unemployed when, to maintain unemployment compensation, they search for work only at places where they are unlikely to be hired. If these individuals were counted as out of the labour force instead of as unemployed, how would the labour statistics change?
- a. The unemployment rate and the labour-force participation rate would be higher.
 - b. The unemployment rate and the labour-force participation rate would be lower.
 - c. The unemployment rate would be lower and the labour-force participation rate would be higher.
 - d. The unemployment rate would be higher and the labour-force participation rate would be lower.

ANS: B PTS: 1 DIF: Challenging REF: p.197
BLM: Higher Order NOT: MacroTB_9-67

68. Some people are counted as out of the labour force because they have made no serious or recent effort to look for work. However, some of these people may want to work even though they are too discouraged to make a serious effort. If these persons were counted as unemployed instead of out of the labour force, how would the labour statistics change?
- a. The unemployment rate and the labour-force participation rate would be higher.
 - b. The unemployment rate would be higher and the labour-force participation rate would be lower.
 - c. The unemployment rate would be lower and the labour-force participation rate would be higher.
 - d. The unemployment rate and the labour-force participation rate would be lower.

ANS: A PTS: 1 DIF: Average REF: p.197-198
BLM: Higher Order NOT: MacroTB_9-68

69. How are discouraged workers counted in unemployment statistics?
- a. They are not counted either as part of the adult population or as part of the labour force.
 - b. They are counted as part of the adult population, but not as part of the labour force.
 - c. They are counted as part of the adult population and as unemployed.
 - d. They are counted as unemployed, but not part of labour force.

ANS: B PTS: 1 DIF: Easy REF: p.197
BLM: Remember NOT: MacroTB_9-69

70. Consider two people who are currently out of work. Deb is not currently looking for work but would like a job. Although she is not currently searching for work, she has done so at some time in the recent past. Ted is not looking for work, because he doesn't think there are jobs available for which he would qualify. Who does Statistics Canada consider to be a discouraged worker?
- a. both Deb and Ted
 - b. only Ted
 - c. only Deb
 - d. Neither Deb nor Ted

ANS: B PTS: 1 DIF: Average REF: p.197
BLM: Higher Order NOT: MacroTB_9-70

71. Consider two people who are currently out of work. Bernie is not looking for work because there have been many job cuts where he lives and he doesn't think it likely that he will find work. Bev is not currently looking for work, but she would like a job. While she hasn't looked for work for some time, she has looked for work in the past. How does Statistics Canada consider Bernie and Bev?
- a. Statistics Canada considers both Bernie and Bev to be marginally attached workers.
 - b. Statistics Canada considers neither Bernie nor Bev to be marginally attached workers.
 - c. Statistics Canada considers only Bernie to be a marginally attached worker.
 - d. Statistics Canada considers only Bev to be a marginally attached worker.

ANS: A PTS: 1 DIF: Average REF: p.197
BLM: Higher Order NOT: MacroTB_9-71

72. How is the unemployment rate reported by Statistics Canada likely to relate to the actual unemployment rate?
- a. It is somewhat higher than the actual unemployment rate.
 - b. It is somewhat lower than the actual unemployment rate.
 - c. It is fairly close to the actual unemployment rate.
 - d. It could be higher or lower than the actual unemployment rate. We cannot be certain.

ANS: D PTS: 1 DIF: Easy REF: p.197
BLM: Higher Order NOT: MacroTB_9-72

73. According to economists, how should the reported unemployment rate be viewed?
- a. as a useful but imperfect measure of joblessness
 - b. as clearly smaller than the true unemployment rate
 - c. as clearly larger than the true unemployment rate
 - d. as being very close to the true unemployment rate

ANS: A PTS: 1 DIF: Easy REF: p.197
BLM: Higher Order NOT: MacroTB_9-73

74. Is the reported unemployment rate statistic, as reported by Statistics Canada, reliable? If not, are there easy ways to improve it?
- a. No, but there is no easy way to improve it.
 - b. No, but there are several easy ways economists have identified to improve it.
 - c. No, but there is one easy way of improving it.
 - d. Yes, and there are several easy ways of improving it even more.

ANS: A PTS: 1 DIF: Easy REF: p.197
BLM: Higher Order NOT: MacroTB_9-74

75. According to Statistics Canada data, which of the following categories had the highest percentage of the labour force in 2009?
- a. unemployed 1 to 4 weeks
 - b. unemployed 5 to 13 weeks
 - c. unemployed 14 to 25 weeks
 - d. unemployed 26 to 52 weeks

ANS: A PTS: 1 DIF: Easy REF: p.198
BLM: Remember NOT: MacroTB_9-

76. What fraction of the unemployed persons have been unemployed for less than a month?
- a. $\frac{4}{5}$
 - b. $\frac{3}{4}$
 - c. $\frac{2}{3}$
 - d. $\frac{1}{3}$

ANS: D PTS: 1 DIF: Average REF: p.198
BLM: Remember NOT: MacroTB_9-76

77. Which of the following is most likely to happen when someone becomes unemployed?
- a. It is likely that the person will be unemployed a long time and that most of the unemployed he or she joins have been unemployed a long time.
 - b. It is likely that the person will be unemployed for a long time, even though most of the unemployed he or she joins have been unemployed for a short time.
 - c. It is likely that the person will be unemployed for a short time, even though most of the unemployed he or she joins have been unemployed for a long time.
 - d. It is likely that the person will be unemployed for a short time, and that most of the unemployed he or she joins have been unemployed for a short time.

ANS: C PTS: 1 DIF: Average REF: p.198
BLM: Remember NOT: MacroTB_9-77

78. According to your text, which of the following is not a reason that actual labour markets experience unemployment?
- a. unions
 - b. job search
 - c. flexible wages
 - d. minimum-wage legislation

ANS: C PTS: 1 DIF: Easy REF: p.199-201
BLM: Remember NOT: MacroTB_9-78

79. Curtis is a stockbroker. He has had several job offers, but he has turned them down because he thinks he can find a firm that better matches his tastes and skills. John is an accountant. He has looked for work for some time, but no accounting firms are hiring. Which of the following best describes the nature of their unemployment?
- a. John and Curtis are both frictionally unemployed.
 - b. John and Curtis are both structurally unemployed.
 - c. Curtis is frictionally unemployed, and John is structurally unemployed.
 - d. Curtis is structurally unemployed, and John is frictionally unemployed.

ANS: C PTS: 1 DIF: Easy REF: p.199-201
BLM: Higher Order NOT: MacroTB_9-79

80. Meredith is looking for work as a computer programmer. Although her prospects are good, she hasn't yet taken a job. Julie is looking for work in a steel mill, but there aren't many job ads for steel workers and every time she shows up for an interview, there are many more people than openings. Which of the following best describes the nature of these persons' unemployment?
- a. Meredith and Julie are both frictionally unemployed.
 - b. Meredith and Julie are both structurally unemployed.
 - c. Meredith is frictionally unemployed, and Julie is structurally unemployed.
 - d. Meredith is structurally unemployed, and Julie is frictionally unemployed.

ANS: C PTS: 1 DIF: Average REF: p.199-201
BLM: Higher Order NOT: MacroTB_9-80

81. Nancy is searching for a job that suits her tastes about where to live and the people she works with. Laura is looking for a job that makes best use of her skills. Contrast Nancy and Laura's natures of unemployment.
- a. Nancy and Laura are both frictionally unemployed.
 - b. Nancy and Laura are both structurally unemployed.
 - c. Nancy is frictionally unemployed, and Laura is structurally unemployed.
 - d. Nancy is structurally unemployed, and Laura is frictionally unemployed.

ANS: A PTS: 1 DIF: Average REF: p.199-201
BLM: Higher Order NOT: MacroTB_9-81

82. Tom is looking for work after school, but everywhere he fills out an application he is told that so have lots of others. Simon has a law degree. Several firms have made him offers, but he thinks he might be able to find a firm where his talents could be put to better use. To which categories of unemployment the two persons belong?
- a. Tom and Simon are both frictionally unemployed.
 - b. Tom and Simon are both structurally unemployed.
 - c. Tom is frictionally unemployed, and Simon is structurally unemployed.
 - d. Tom is structurally unemployed, and Simon is frictionally unemployed.

ANS: D PTS: 1 DIF: Average REF: p.199-201
BLM: Higher Order NOT: MacroTB_9-82

83. Which of the following does the natural unemployment rate include?
- a. both frictional and structural unemployment
 - b. neither frictional nor structural unemployment
 - c. structural unemployment, but not frictional unemployment
 - d. frictional unemployment, but not structural unemployment

ANS: A PTS: 1 DIF: Average REF: p.199-201
BLM: Remember NOT: MacroTB_9-83

84. Which of the following best defines job search?
- a. It is a process through which the firms determine the equilibrium wage.
 - b. It is an imbalance between labour supply and labour demand.
 - c. It is the process of matching workers with appropriate jobs.
 - d. It is the process through which firms hire new employees.

ANS: C PTS: 1 DIF: Easy REF: p.201
BLM: Remember NOT: MacroTB_9-84

85. Some people are unemployed because they are searching for a very specific job. How are these people best classified?
- a. as cyclically unemployed
 - b. as structurally unemployed
 - c. as frictionally unemployed
 - d. as discouraged workers

ANS: C PTS: 1 DIF: Easy REF: p.199-201
BLM: Higher Order NOT: MacroTB_9-85

86. How do sectoral shifts in the economy affect unemployment?
- a. They create structural unemployment.
 - b. They reduce unemployment.
 - c. They increase unemployment due to job search.
 - d. Overall, they leave unemployment unchanged.

ANS: C PTS: 1 DIF: Easy REF: p.202
BLM: Remember NOT: MacroTB_9-86

87. From time to time, the demand for workers has risen in one region of Canada and fallen in another. Which of the following types of unemployment does this occurrence illustrate?
- a. frictional unemployment created by efficiency wages
 - b. structural unemployment created by efficiency wages
 - c. frictional unemployment created by sectoral shifts
 - d. structural unemployment created by sectoral shifts

ANS: C PTS: 1 DIF: Easy REF: p.201
BLM: Higher Order NOT: MacroTB_9-87

88. Suppose that in 2007, the demand for construction workers increased and the demands for textile and steel workers diminished. Which of the following types of unemployment does this situation illustrate?
- a. frictional unemployment created by a sectoral shift
 - b. structural unemployment created by a sectoral shift
 - c. frictional unemployment created by efficiency wages
 - d. structural unemployment created by efficiency wages

ANS: A PTS: 1 DIF: Easy REF: p.201
BLM: Higher Order NOT: MacroTB_9-88

89. Which of the following is most likely to cause frictional unemployment?
- a. workers leaving the labour force
 - b. an economy in recession
 - c. an increase in population
 - d. changes in the composition of demand among industries or regions

ANS: D PTS: 1 DIF: Easy REF: p.201
BLM: Higher Order NOT: MacroTB_9-89

90. Which of the following is most likely to cause frictional unemployment?

- a. the minimum wage
- b. a worker leaving a job to find one with better benefits
- c. labour unions
- d. an increase in the income tax

ANS: B PTS: 1 DIF: Easy REF: p.201
BLM: Higher Order NOT: MacroTB_9-90

91. In Canada, approximately what percentage of the existing number of unemployed workers can be explained by the mismatch between available jobs and people seeking employment?

- a. 8 percent
- b. 12.5 percent
- c. 50 percent
- d. 87.5 percent

ANS: B PTS: 1 DIF: Average REF: p.202
BLM: Remember NOT: MacroTB_9-91

92. The government operates programs for job training and job information intended to reduce unemployment. Which of the following best describes how economists feel about such programs?

- a. Most economists agree that such programs are of no use.
- b. Most economists agree that such programs work very well.
- c. Some economists claim that the government can do these things no better than firms and individuals could do them for themselves.
- d. Some economists believe that the private sector has no role in the process of job search.

ANS: C PTS: 1 DIF: Easy REF: p.203
BLM: Higher Order NOT: MacroTB_9-92

93. Which of the following would we predict if a country increases its unemployment compensation?

- a. The country would have shorter durations of each spell of unemployment, and it would have a higher unemployment.
- b. The country would have shorter durations of each spell of unemployment, and it would have a lower unemployment rate
- c. The country would have longer durations of each spell of unemployment, and it would have a higher unemployment rate.
- d. The country would have longer durations of each spell of unemployment, and it would have a lower unemployment.

ANS: C PTS: 1 DIF: Easy REF: p.203-204
BLM: Higher Order NOT: MacroTB_9-93

94. In 2007, how much did the government budget for the EI program?

- a. about \$5 billion
- b. about \$10 billion
- c. about \$12 million
- d. about \$18 billion

ANS: C PTS: 1 DIF: Easy REF: p.203
BLM: Remember NOT: MacroTB_9-94

95. Based on evidence given in your text, which of the following is an effect of employment-insurance benefits on the job-search efforts of the unemployed?
- Unemployment-insurance benefits decrease the job-search effort of the unemployed.
 - Unemployment-insurance benefits have no effect on the job-search effort of the unemployed.
 - Unemployment-insurance benefits increase the job-search effort of the unemployed.
 - Unemployment-insurance benefits have an uncertain effect on the job-search effort of the unemployed.

ANS: A PTS: 1 DIF: Easy REF: p.203-205
BLM: Remember NOT: MacroTB_9-95

96. Which of the following impacts does employment insurance have on the labour market?
- It reduces search effort and raises unemployment.
 - It reduces search efforts and lowers unemployment.
 - It increases search effort and raises unemployment.
 - It increases search effort and decreases unemployment.

ANS: A PTS: 1 DIF: Easy REF: p.203-205
BLM: Higher Order NOT: MacroTB_9-96

97. According to most economists, which of the following would be an effect of eliminating unemployment insurance?
- It would cause an increase in unemployment because people would quit jobs they thought were not secure.
 - It would cause an increase in unemployment because if the government didn't provide unemployment insurance, private firms would offer superior insurance.
 - It would cause a decrease in unemployment and an improvement in economic well-being.
 - It would cause a decrease in unemployment, but economists disagree about whether economic well-being would be enhanced by such a change.

ANS: D PTS: 1 DIF: Average REF: p.203-205
BLM: Remember NOT: MacroTB_9-97

98. Which of the following would be the most likely effect of an increase in the world price of oil that would create a sectoral shift?
- There would be a decrease in unemployment, and the decrease would be greater in a country with unemployment insurance than in one without.
 - There would be a decrease in unemployment, but the decrease would be smaller in a country with unemployment insurance than in one without.
 - There would be an increase in unemployment, and the increase would be greater in a country with unemployment insurance than in one without.
 - There would be an increase in unemployment, but the increase would be smaller in a country with unemployment insurance than in one without.

ANS: C PTS: 1 DIF: Average REF: p.202
BLM: Higher Order NOT: MacroTB_9-98

99. Suppose that consumers decide to buy more computers and fewer typewriters. As a result, computer companies expand production while typewriter companies lay off workers. What is this an example of?
- a. structural unemployment created by efficiency wages
 - b. cyclical unemployment created by a recession
 - c. frictional unemployment created by a sectoral shift in demand
 - d. frictional unemployment created by a sectoral shift in supply

ANS: C PTS: 1 DIF: Average REF: p.202
BLM: Higher Order NOT: MacroTB_9-99

100. Which of the following is characteristic of the relationship between unemployment insurance and job-search effort?
- a. Unemployment insurance raises structural unemployment because it reduces the job search of the unemployed.
 - b. Most economists are sceptical of the value of unemployment insurance because they believe that it results in a poorer match between workers and jobs.
 - c. A typical unemployed worker near the end of the time in which he or she can receive benefits increases job-search efforts.
 - d. Unemployed people need to put less job-search effort now than they did in 1971 because in 1971 the conditions to receive unemployment benefits were stricter than today.

ANS: C PTS: 1 DIF: Average REF: p.203-205
BLM: Higher Order NOT: MacroTB_9-100

101. What impact would an increase in the minimum wage have on the quantity demanded and quantity supplied of labour?
- a. It would increase both the quantity demanded and the quantity supplied of labour.
 - b. It would decrease both the quantity demanded and the quantity supplied of labour.
 - c. It would increase the quantity of labour demanded while decreasing the quantity supplied.
 - d. It would decrease the quantity of labour demanded while increasing the quantity supplied.

ANS: D PTS: 1 DIF: Average REF: p.205-206
BLM: Higher Order NOT: MacroTB_9-101

102. If the minimum wage was currently above the equilibrium wage, what would a decrease in the minimum wage do to the quantity demanded and quantity supplied of labour?
- a. It would increase both the quantity demanded and the quantity supplied of labour.
 - b. It would decrease both the quantity demanded and the quantity supplied of labour.
 - c. It would increase the quantity of labour demanded and decrease the quantity supplied.
 - d. It would decrease the quantity of labour demanded and increase the quantity supplied.

ANS: C PTS: 1 DIF: Average REF: p.205-206
BLM: Higher Order NOT: MacroTB_9-102

103. Under which of the following conditions will there be structural unemployment?
- a. if some wages are kept above the equilibrium level
 - b. if some people choose not to work at the equilibrium wage
 - c. if some wages are below the equilibrium level
 - d. if conditions for unemployment insurance benefits are relaxed

ANS: A PTS: 1 DIF: Easy REF: p.205-206
BLM: Higher Order NOT: MacroTB_9-103

104. What is the effect of minimum wage laws on unemployment?
- Minimum wage laws are the major cause of natural unemployment.
 - Minimum wage laws probably increase teenage unemployment.
 - Minimum wage laws mainly affect skilled workers.
 - Minimum wage laws have no impact on unemployment.

ANS: B

PTS: 1

DIF: Easy

REF: p.205-206

BLM: Higher Order

NOT: MacroTB_9-104

105. Which of the following would be associated with the type of unemployment created by the minimum wage law?
- Greg quits his job as a grocery cashier because he would rather work at the library.
 - Fred decides to close his Thai restaurant because he cannot afford to pay workers the going wage.
 - In hopes of earning a higher income, Bruce goes back to trade school to get further training.
 - Liz pays the workers for her plumbing and heating company more than the equilibrium wage because she believes it will make them work harder.

ANS: B

PTS: 1

DIF: Average

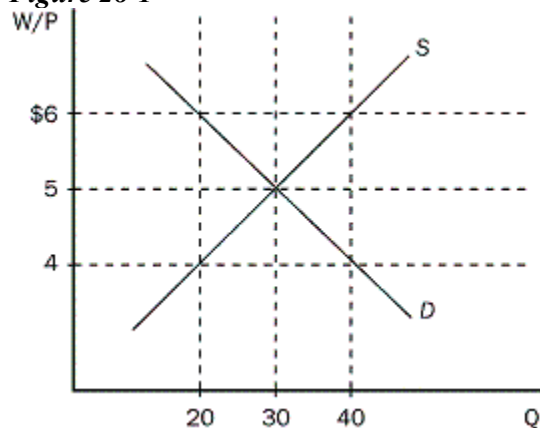
REF: p.205-206

BLM: Higher Order

NOT: MacroTB_9-105

The following questions are based on the figure below, which shows the effect of a minimum-wage law.

Figure 28-1



106. **Refer to Figure 28-1.** Which of the following describes the equilibrium point in the diagram in the absence of the minimum-wage law?
- \$6 and 20 workers
 - \$5 and 30 workers
 - \$4 and 40 workers
 - \$6 and 40 workers

ANS: B

PTS: 1

DIF: Easy

REF: p.206

BLM: Higher Order

NOT: MacroTB_9-106

107. **Refer to Figure 28-1.** If there was no minimum wage and then the government instituted a minimum wage of \$6, what would happen to employment in this market?
- Employment would rise by 10.
 - Employment would fall by 20.
 - Unemployment would increase by 10.
 - Unemployment would increase by 20.

ANS: D

PTS: 1

DIF: Average

REF: p.206

BLM: Higher Order

NOT: MacroTB_9-107

108. **Refer to Figure 28-1.** If there was a minimum wage of \$4 and then the government instituted a minimum wage of \$5, what would happen to employment in this market?
- Unemployment would be unchanged.
 - Unemployment would drop by 10.
 - Unemployment would rise by 10.
 - Unemployment would rise by 20.

ANS: A

PTS: 1

DIF: Average

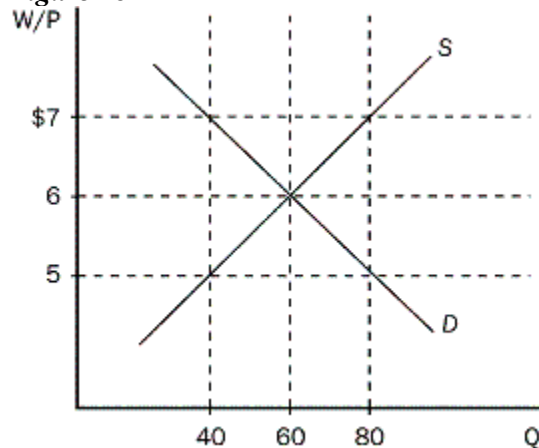
REF: p.206

BLM: Higher Order

NOT: MacroTB_9-108

Use the graph below to answer the following questions.

Figure 28-2



109. **Refer to Figure 28-2.** If the minimum wage is \$5 or \$6, what is the number of people unemployed, respectively?
- 40 and 0
 - 20 and 20
 - 40 and 20
 - 0 and 0

ANS: D

PTS: 1

DIF: Average

REF: p.206

BLM: Higher Order

NOT: MacroTB_9-109

110. **Refer to Figure 28-2.** If the minimum wage fell from \$7 to \$5, what would happen to unemployment?
- a. It would fall by 20.
 - b. It would fall by 40.
 - c. It would be unchanged.
 - d. It would rise by 20.

ANS: B PTS: 1 DIF: Average REF: p.206
BLM: Higher Order NOT: MacroTB_9-110

111. **Refer to Figure 28-2.** If the minimum wage rose from \$5 to \$7, what would happen to unemployment?
- a. It would rise by 40.
 - b. It would rise by 20.
 - c. It would fall by 20.
 - d. It would fall by 40.

ANS: A PTS: 1 DIF: Average REF: p.206
BLM: Higher Order NOT: MacroTB_9-111

112. **Refer to Figure 28-2.** If the minimum wage rose from \$6 to \$7, what would happen to unemployment?
- a. It would rise by 40.
 - b. It would rise by 20.
 - c. It would fall by 20.
 - d. It would fall by 40.

ANS: A PTS: 1 DIF: Average REF: p.206
BLM: Higher Order NOT: MacroTB_9-112

113. Which of the following best defines collective bargaining?
- a. It is the process by which the government sets exemptions from the minimum wage law.
 - b. It is setting the same wage for all employees to prevent jealousy among workers.
 - c. It is the situation when firms collude to set the wages of employees in order to keep them below equilibrium.
 - d. It is the process by which unions and firms agree on the terms of employment.

ANS: D PTS: 1 DIF: Easy REF: p.207
BLM: Remember NOT: MacroTB_9-113

114. In Sweden and Denmark, what percentage of the workers belong to unions?
- a. almost zero
 - b. about the same as in Canada
 - c. a bit greater than in Canada
 - d. much greater than in Canada

ANS: D PTS: 1 DIF: Average REF: p.207
BLM: Remember NOT: MacroTB_9-114

115. Approximately what percentage of all Canadian workers are union members?

- a. 95 percent
- b. 25 percent
- c. 50 percent
- d. 5 percent

ANS: B PTS: 1 DIF: Average REF: p.206-207
BLM: Remember NOT: MacroTB_9-115

116. Typically how much more do union members earn than similar workers who do not belong to a union?

- a. 0 to 5 percent
- b. 5 to 10 percent
- c. 10 to 20 percent
- d. 20 to 30 percent

ANS: C PTS: 1 DIF: Easy REF: p.208
BLM: Remember NOT: MacroTB_9-116

117. When a union bargains successfully with employers, what happens to quantity of labour supplied and demanded in that industry?

- a. Both the quantity of labour supplied and the quantity of labour demanded increase.
- b. Both the quantity of labour supplied and the quantity of labour demanded decrease.
- c. The quantity of labour supplied increases and the quantity of labour demanded decreases.
- d. The quantity of labour supplied increases the quantity of labour demanded decreases.

ANS: C PTS: 1 DIF: Average REF: p.207-208
BLM: Higher Order NOT: MacroTB_9-117

118. When a union bargains successfully with an employer, which of the following happens to unemployment and wages in that industry?

- a. unemployment and wages increase
- b. unemployment and wages decrease
- c. unemployment decreases and wages increase
- d. unemployment increases and wages decrease

ANS: A PTS: 1 DIF: Easy REF: p.207-208
BLM: Higher Order NOT: MacroTB_9-118

119. What impact do employment insurance and unions have on unemployment?

- a. Unemployment insurance and unions both create structural unemployment.
- b. Unemployment insurance and unions both create frictional unemployment.
- c. Unemployment insurance creates frictional unemployment and unions create structural unemployment.
- d. Unemployment insurance creates structural unemployment and unions create frictional unemployment.

ANS: C PTS: 1 DIF: Average REF: p.203-209
BLM: Higher Order NOT: MacroTB_9-119

120. When unions raise wages in some sectors of the economy, which of the following happens to the supply of labour in other sectors of the economy?
- a. It decreases, raising wages in industries that are not unionized.
 - b. It decreases, reducing wages in industries that are not unionized.
 - c. It increases, raising wages in industries that are not unionized.
 - d. It increases, reducing wages in industries that are not unionized.

ANS: D PTS: 1 DIF: Average REF: p.207-209
BLM: Higher Order NOT: MacroTB_9-120

121. Suppose that in some country, neither textile workers nor shoemakers are unionized. If textile workers unionize and so are able to raise their wages, which of the following will most likely happen to shoemakers?
- a. The demand for shoemakers will rise, and their wages will rise.
 - b. The demand for shoemakers will fall, and their wages will fall.
 - c. The supply of shoemakers will rise, and their wages will fall.
 - d. The supply of shoemakers will fall, and their wages will rise.

ANS: C PTS: 1 DIF: Average REF: p.207-209
BLM: Higher Order NOT: MacroTB_9-121

122. Which of the following do the laws governing the activity of labour unions achieve?
- a. They prevent unions from acting as cartels.
 - b. They allow workers joining a unionized firm to choose not to join the union.
 - c. They allow workers the right to representation and collective bargaining.
 - d. They limit the number of unionized organizations.

ANS: C PTS: 1 DIF: Easy REF: p.207-209
BLM: Higher Order NOT: MacroTB_9-122

123. Which of the following best explains the purpose of Canada's Public Service Staff Relations Act of 1967?
- a. to enforce antitrust laws against unions in federal institutions
 - b. to allow federal public service employees the right to representation and collective bargaining
 - c. to allow federal and provincial public service employees the right to representation and collective bargaining
 - d. to require that all collective bargaining agreements be approved by the federal government before they can be enforced

ANS: B PTS: 1 DIF: Easy REF: p.207-209
BLM: Remember NOT: MacroTB_9-123

124. Which of the following Canadian provinces has the highest percentage of unionized workers?
- a. Ontario
 - b. Quebec
 - c. British Columbia
 - d. Nova Scotia

ANS: B PTS: 1 DIF: Easy REF: p.207-209
BLM: Remember NOT: MacroTB_9-124

125. Which of the following industries in the Canadian economy have the highest percentage of unionized workers?

- a. agriculture
- b. the public sector industries
- c. oil and gas industries
- d. the food and accommodation industries

ANS: B PTS: 1 DIF: Easy REF: p.207-209
BLM: Remember NOT: MacroTB_9-125

126. Which of the following countries has the lowest percentage of unionized workers?

- a. the United States
- b. Canada
- c. Sweden
- d. Denmark

ANS: A PTS: 1 DIF: Average REF: p.207-209
BLM: Remember NOT: MacroTB_9-126

127. What is the effect of unions on wages and employment?

- a. Unions are unlikely to affect wages and employment.
- b. Unions raise wages above the competitive equilibrium level.
- c. Unions increase the level of employment in unionized firms.
- d. Unions decrease the level of employment in nonunionized firms.

ANS: B PTS: 1 DIF: Easy REF: p.207-209
BLM: Higher Order NOT: MacroTB_9-127

128. Which of the following is a possible effect of unions?

- a. Unions decrease the natural rate of unemployment.
- b. Unions decrease the wages of workers in the union.
- c. Unions raise the profits of firms they work for.
- d. Unions cause wages of nonunionized workers to fall.

ANS: D PTS: 1 DIF: Easy REF: p.207-209
BLM: Higher Order NOT: MacroTB_9-128

129. If competition laws were applied to unions, which of the following would most likely happen to the natural rate of unemployment?

- a. The natural rate of unemployment would increase, *other things being the same*.
- b. The natural rate of unemployment would decrease, *other things being the same*.
- c. The natural rate of unemployment would not change.
- d. The effect on the natural rate of unemployment is uncertain.

ANS: B PTS: 1 DIF: Average REF: p.208
BLM: Higher Order NOT: MacroTB_9-129

130. Which of the following is the consensus among economists with respect to unions?
- a. There is consensus among economists that unions are good for the economy.
 - b. There is consensus among economists that unions are bad for the economy.
 - c. There is consensus among economists that, on net, unions have almost no impact on macroeconomic variables.
 - d. There is no consensus among economists about whether unions are good or bad for the economy.

ANS: D PTS: 1 DIF: Easy REF: p.208-209
BLM: Remember NOT: MacroTB_9-130

131. Which of the following does the theory of efficiency wages explain?
- a. why setting wages at the equilibrium level may increase unemployment
 - b. why it may be in the best interest of firms to offer wages that are above the equilibrium level
 - c. why the most efficient way to pay workers is to pay them according to their skills
 - d. why it is efficient for firms to set wages at the equilibrium level

ANS: B PTS: 1 DIF: Easy REF: p.209-211
BLM: Remember NOT: MacroTB_9-131

132. Dawn is the CEO of a corporation that hires nonunion labour. According to the theory of efficiency wages, if she decides to pay her workers more than the competitive equilibrium wage, which of the following is most likely to happen?
- a. The profits of her firm may increase.
 - b. The higher wages will induce her workers to shirk.
 - c. The turnover of her workers may increase.
 - d. She will face a shortage of labour.

ANS: A PTS: 1 DIF: Easy REF: p.209-211
BLM: Higher Order NOT: MacroTB_9-132

133. Samantha, the CEO of a corporation operating in Uganda, decides to raise the wages of her workers, even though she faces an excess supply of labour. Which of the following is an expected result from her decision?
- a. It will increase productivity, according to the efficiency wage theory.
 - b. It will help eliminate the excess supply of labour if she raises it sufficiently.
 - c. It will cause unemployment to fall.
 - d. It will decrease profits, according to the efficiency wage theory.

ANS: A PTS: 1 DIF: Easy REF: p.209-211
BLM: Higher Order NOT: MacroTB_9-133

134. Arnie is the owner of a firm that produces bottled water in Alberta. There are many such firms in the area. Arnie decides that if he pays his workers a wage higher than the going market wage, his profits will increase. Which of the following is a likely explanation for his decision?
- a. The higher the wage, the less often his workers will choose to leave his firm.
 - b. The higher the wage, the lower will be the cost of obtaining needed supplies.
 - c. The higher the wage, the more he can charge for his water.
 - d. The higher the wage, the less competition will be in the industry.

ANS: A PTS: 1 DIF: Easy REF: p.209-211
BLM: Higher Order NOT: MacroTB_9-134

135. Mary Sue is the newly appointed CEO of a company that manufactures CD drives on an assembly line. Her staff has told her that the output the firm produces, given the number of workers employed, indicates that some workers may be shirking. According to efficiency wage theory, which of the following should she do?
- a. pay all workers more than the equilibrium wage rate
 - b. pay all workers below the equilibrium wage rate to make up for the loss from shirking
 - c. make sure that workers are getting paid exactly the equilibrium wage rate
 - d. reduce production

ANS: A PTS: 1 DIF: Average REF: p.209-211
BLM: Higher Order NOT: MacroTB_9-135

136. According to efficiency wage theory, which of the following is a way to increase employees' work effort?
- a. increase wages
 - b. increase the number of supervisors
 - c. decrease wages
 - d. reduce the number of supervisors

ANS: A PTS: 1 DIF: Easy REF: p.209-211
BLM: Higher Order NOT: MacroTB_9-136

137. Which of the following is the most likely result of efficiency wages?
- a. reduced labour-force participation rates
 - b. reduced natural rate of unemployment
 - c. reduced incentive to shirk
 - d. increased worker turnover

ANS: C PTS: 1 DIF: Easy REF: p.209-211
BLM: Higher Order NOT: MacroTB_9-137

138. Which of the following will an efficient wage most likely do?
- a. require increased turnover
 - b. increase profitability
 - c. help reduce the level of unemployment
 - d. make the union stronger

ANS: B PTS: 1 DIF: Easy REF: p.209-211
BLM: Higher Order NOT: MacroTB_9-138

139. Regarding the categories of unemployment, which of the following best describes how the effect of sectoral changes compares to the effect of firms paying higher-than-equilibrium wages?
- a. Sectoral changes create frictional unemployment, while firms paying wages above equilibrium create structural unemployment.
 - b. Sectoral changes create structural unemployment, while firms paying wages above equilibrium create frictional unemployment.
 - c. Sectoral changes and firms paying wages above equilibrium both create structural unemployment.
 - d. Sectoral changes and firms paying wages above equilibrium both create frictional unemployment.

ANS: A PTS: 1 DIF: Average REF: p.202 | p.209-211
BLM: Higher Order NOT: MacroTB_9-139

140. Regarding the categories of unemployment, how does a minimum wage law compare to firms paying higher-than-equilibrium wages?
- a. The minimum wage creates frictional unemployment, while firms paying wages above equilibrium create structural unemployment.
 - b. The minimum wage creates structural unemployment, while firms paying wages above equilibrium create frictional unemployment.
 - c. The minimum wage and firms paying wages above equilibrium both create structural unemployment.
 - d. The minimum wage and firms paying wages above equilibrium both create frictional unemployment.

ANS: C PTS: 1 DIF: Average REF: p.205-207 | p.209-211
BLM: Higher Order NOT: MacroTB_9-140

141. Dan decides to hire some additional workers for his golf-ball factory. The equilibrium wage is \$12 per hour. What does efficiency wage theory suggest that it is reasonable for Dan to offer?
- a. \$12 per hour
 - b. less than \$12 per hour, since some people would be willing to work for less
 - c. enough to attract the number of applicants necessary to fill the jobs available
 - d. more than \$12 per hour, so as to attract a better pool of applicants

ANS: D PTS: 1 DIF: Easy REF: p.209-211
BLM: Higher Order NOT: MacroTB_9-141

142. Four employers have justified their actions as follows. Whose logic is inconsistent with the logic of efficiency wage theory?
- a. Jay develops a new assembly line technology that limits the amount of shirking workers may do, so he reduces what he pays his employees so as to make it closer to the equilibrium wage.
 - b. Kay pays her workers less than the equilibrium wage so they won't have the time or money to look for work somewhere else.
 - c. Ray pays his workers in a developing country more than the going wage, hoping that they will get a better diet and so be more productive.
 - d. Ms. Fay pays her workers the market wages, but she hires more supervisors to make sure workers do not shirk.

ANS: B PTS: 1 DIF: Easy REF: p.209-211
BLM: Higher Order NOT: MacroTB_9-142

143. Which of the following is the effect of anything that makes the efficiency wage rise relative to the market-clearing wage on the quantities of labour demanded and supplied?
- a. It increases both the quantity demanded and the quantity supplied of labour.
 - b. It decreases both the quantity demanded and the quantity supplied of labour.
 - c. It increases the quantity demanded and decreases the quantity supplied of labour.
 - d. It decreases the quantity demanded and increases the quantity supplied of labour.

ANS: D PTS: 1 DIF: Average REF: p.209-211
BLM: Higher Order NOT: MacroTB_9-143

144. Why did Henry Ford decide to pay \$5.00 per day to his workers?
- a. He was forced by a union to pay \$5.00 per day.
 - b. He paid \$5.00 per day to improve worker nutrition.
 - c. He believed that \$5.00 a day would increase worker productivity.
 - d. He paid \$5.00 per day to illustrate that he was a humanitarian.

ANS: C PTS: 1 DIF: Easy REF: p.211-212
BLM: Remember NOT: MacroTB_9-144

145. Which of the following causes of unemployment is **NOT** associated with an excess supply of labour?
- a. minimum-wage laws
 - b. unions
 - c. job search
 - d. efficiency wages

ANS: C PTS: 1 DIF: Average REF: p.201-212
BLM: Higher Order NOT: MacroTB_9-145

146. Which of the following causes of unemployment is associated with a wage rate above the market equilibrium level?
- a. mismatch between skills and available jobs
 - b. economic recession
 - c. sectoral changes
 - d. unions

ANS: D PTS: 1 DIF: Easy REF: p.207-208
BLM: Higher Order NOT: MacroTB_9-146

147. Which of the following causes of unemployment is **NOT** associated with a wage rate above the equilibrium level?
- a. unions
 - b. efficiency wages
 - c. job search
 - d. minimum-wage laws

ANS: C PTS: 1 DIF: Easy REF: p.201-212
BLM: Higher Order NOT: MacroTB_9-147

148. Which of the following is most likely to reduce the natural rate of unemployment?
- the Internet providing more readily available information about available jobs
 - provincial legislators voting for increasing the minimum wage
 - passing laws that make it more difficult to monitor the efforts of workers
 - firms offering higher-than-equilibrium wages to attract better job candidates

ANS: A PTS: 1 DIF: Average REF: p.201
BLM: Higher Order NOT: MacroTB_9-148

149. Which of the following laws is most likely to reduce the natural rate of unemployment?
- a law that makes all provinces repeal right-to-work laws
 - a law that makes it harder to find out about job candidates' past job history
 - a law that abolishes the minimum wage
 - a law that increases the minimum wage

ANS: C PTS: 1 DIF: Average REF: p.201
BLM: Higher Order NOT: MacroTB_9-149

150. Which of the following explanations of the natural rate of unemployment is most important for the Canadian economy?
- job search
 - minimum-wage laws
 - unions
 - Economists have not determined the answer to this question.

ANS: D PTS: 1 DIF: Easy REF: p.212
BLM: Higher Order NOT: MacroTB_9-150

TRUE/FALSE

1. Government policy can do nothing about the natural rate of unemployment.

ANS: F PTS: 1 DIF: Easy REF: p.199 | p.203
NOT: MacroTB_9-151

2. Statistics Canada uses data from each province's unemployment insurance agency to compute unemployment statistics.

ANS: F PTS: 1 DIF: Easy REF: p.192
NOT: MacroTB_9-152

3. Someone who is without work but is not looking for work would be counted as unemployed.

ANS: F PTS: 1 DIF: Easy REF: p.193-195
NOT: MacroTB_9-153

4. The unemployment rate is defined as the percentage of the labour force that is unemployed. The labour-force participation rate is the percentage of the adult population that is either employed or unemployed.

ANS: T PTS: 1 DIF: Easy REF: p.193-195
NOT: MacroTB_9-154

5. Even though the difference in labour-force participation rates of males and females has narrowed, the participation rate of males remains higher.

ANS: T PTS: 1 DIF: Easy REF: p.196-197
NOT: MacroTB_9-155

6. Full-time students, retirees, and unpaid stay-at-home fathers are counted as unemployed.

ANS: F PTS: 1 DIF: Average REF: p.192-195
NOT: MacroTB_9-156

7. Over one-half of the unemployed are recent entrants into the labour force.

ANS: F PTS: 1 DIF: Easy REF: p.197
NOT: MacroTB_9-157

8. About one-half of all spells of unemployment end when the unemployed person leaves the labour force.

ANS: T PTS: 1 DIF: Easy REF: p.197-198
NOT: MacroTB_9-158

9. Cynthia is collecting unemployment insurance benefits. To continue to receive her benefits, she must be looking for work. However, she only applies at places where she is unlikely to be hired because she doesn't really want to work. People like Cynthia make the reported unemployment rate less than the true rate of unemployment.

ANS: F PTS: 1 DIF: Easy REF: p.197
NOT: MacroTB_9-159

10. The unemployment rate reported by Statistics Canada clearly understates the true unemployment rate.

ANS: F PTS: 1 DIF: Easy REF: p.197
NOT: MacroTB_9-160

11. Even though most spells of unemployment are short, most unemployment results from long-term unemployment.

ANS: T PTS: 1 DIF: Easy REF: p.198-199
NOT: MacroTB_9-161

12. Frictional unemployment exists because of the time it takes for workers to search for the jobs that best suit their tastes and skills.

ANS: T PTS: 1 DIF: Easy REF: p.201
NOT: MacroTB_9-162

13. Frictional unemployment is different from unemployment arising from minimum-wage laws, unions, and efficiency wages because in the former, workers are searching for the jobs that best suit them, while in the latter, workers are waiting for jobs to open up.

ANS: T PTS: 1 DIF: Easy REF: p.202-211
NOT: MacroTB_9-163

14. Unemployment due to job search is best classified as structural unemployment.

ANS: F PTS: 1 DIF: Easy REF: p.202
NOT: MacroTB_9-164

15. Employment insurance reduces hardships of unemployment but also increases the amount of structural unemployment.

ANS: F PTS: 1 DIF: Easy REF: p.203-205
NOT: MacroTB_9-165

16. A minimum wage above equilibrium creates a labour surplus.

ANS: T PTS: 1 DIF: Easy REF: p.203-205
NOT: MacroTB_9-166

17. If the wage is kept above the equilibrium wage for any reason, the result is structural unemployment.

ANS: T PTS: 1 DIF: Easy REF: p.205-207
NOT: MacroTB_9-167

18. Union workers earn about 10 percent to 20 percent more than similar workers who do not belong to unions.

ANS: T PTS: 1 DIF: Easy REF: p.208
NOT: MacroTB_9-168

19. Right-to-work laws allow striking union members to be permanently replaced.

ANS: F PTS: 1 DIF: Easy REF: p.207-209
NOT: MacroTB_9-169

20. According to the theory of efficiency wages, firms operate more efficiently if they can pay wages that are below the equilibrium level.

ANS: F PTS: 1 DIF: Easy REF: p.208-209
NOT: MacroTB_9-170

21. Efficiency wages create structural unemployment.

ANS: T PTS: 1 DIF: Easy REF: p.209-211
NOT: MacroTB_9-171

22. Firms might offer efficiency wages in order to attract a better pool of applicants.

ANS: T PTS: 1 DIF: Easy REF: p.209-211
NOT: MacroTB_9-172

23. In 1914, Henry Ford began paying his workers \$5 per day, about twice the going wage. As a result, turnover and absenteeism fell, and productivity and profits rose.

ANS: T PTS: 1 DIF: Easy REF: p.211-212
NOT: MacroTB_9-173

SHORT ANSWER

1. The table below uses data for the year 2000 provided by Statistics Canada and adjusted to be comparable to U.S. data. All values are in millions. Fill in the blank entries in the table. Show your work.

Country	Adult Population	Labour Force	Employed	Unemployed	Unemployment Rate	Labour-Force Participation Rate
Japan	108.12		63.79	3.20		
France		25.98		2.45		56.4 percent
Germany	69.17	39.75			8.08 percent	

ANS:

Country	Adult Population	Labour Force	Employed	Unemployed	Unemployment Rate	Labour-Force Participation Rate
Japan	108.12	66.99	63.79	3.20	4.78 percent	61.96 percent
France	46.06	25.98	23.53	2.45	9.43 percent	56.4 percent
Germany	69.17	39.75	36.54	3.21	8.08 percent	57.47 percent

PTS: 1 DIF: Average REF: p.192-194 NOT: MacroTB_9-174

2. Why have labour-force participation rates for women in Canada increased since World War II while labour-force participation rates for men have decreased?

ANS:

Labour-force participation rates for women have increased largely as a result of a change in the attitude of society toward women working outside the home and an increase in educational and vocational opportunities for women. Advances in birth control have made it possible for women to stay in the labour force longer. Labour-force participation rates for men have decreased because young men now stay in school longer than they used to, older men now retire earlier and live longer, and more fathers now stay at home to raise their children.

PTS: 1 DIF: Average REF: p.196-197 NOT: MacroTB_9-175

3. Most spells of unemployment are short, and most unemployment observed at any given time is long term. How can this be?

ANS:

Most unemployed people in the economy are unemployed for relatively short periods of time, while fewer people are unemployed for relatively long periods of time. If you were to track the labour hours lost due to unemployment, it is likely that most of them would be among those who are unemployed for long periods of time.

PTS: 1 DIF: Average REF: p.198-199 NOT: MacroTB_9-176

4. Why might a favourable change to the economy such as technological change or a decrease in the price of imported oil be associated with an increase in frictional unemployment?

ANS:

Even generally favourable changes will usually involve some sort of sectoral shock that changes the demand of labour among different firms. For example a decrease in the price of imported oil would likely reduce the demand for Canadian oil workers and increase the demand for automobile workers. Technological progress makes some industries decline and others advance, creating frictional unemployment.

PTS: 1 DIF: Challenging REF: p.202-203 NOT: MacroTB_9-177

5. Teenage unemployment is higher than unemployment of people ages 20 and over. Explain why economists would attribute at least part of this difference to minimum-wage laws. (Hint: who is likely to get paid more?)

ANS:

People who are experienced and educated are likely to find jobs where the equilibrium wage is above the minimum wage. In labour markets where the equilibrium wage is above the minimum wage, the minimum wage does not create unemployment. Since people aged 20 and over tend to have more experience and education than younger persons, the minimum wage matters less and so it creates less unemployment.

PTS: 1 DIF: Challenging REF: p.205-207 NOT: MacroTB_9-178

6. What is the theory of efficiency wages? Give a couple of explanations for how efficiency wages might work.

ANS:

According to the theory of efficiency wages, firms operate more efficiently if wages are above the equilibrium level. Therefore, it may be profitable for firms to keep wages high even in the presence of an excess supply of labour. If so, firms will keep wages above the equilibrium level, creating unemployment.

(1) Worker Health:

Better-paid workers eat a more nutritious diet, and workers who eat a better diet are healthier and more productive. A firm may find it profitable to pay higher wages in order to have healthier, more productive workers.

(2) Worker Turnover:

The more a firm pays its workers, the less often will its workers choose to leave employment. Since it is costly to hire and train new workers, it may be profitable for an employer to pay higher than equilibrium wages in order to reduce worker turnover rates.

(3) Worker Effort:

In jobs where workers have some discretion over how hard they work, workers may shirk. As a result, firms monitor the effort of their workers, and those caught shirking are fired. However, it is costly to monitor workers, and monitoring is often imperfect. By paying higher wages, firms make it more expensive for workers to shirk, since if they are caught they will not be able to find other employment at a wage as high as their current wage. It may be profitable for a firm to pay higher than market wages in order to reduce shirking.

(4) Worker Quality:

When a firm hires new workers, it cannot perfectly gauge the quality of the applicants. By paying a higher wage, the firm attracts a better pool of workers to apply for its jobs. It may be profitable for a firm to pay higher than market wages in order to increase the probability that it will hire good-quality workers.

PTS: 1

DIF: Average

REF: p.211

NOT: MacroTB_9-179

7. Suppose that there is an excess supply of economics professors. Should universities necessarily reduce salaries? What does standard economic theory suggest? What does efficiency-wage theory suggest?

ANS:

Standard economic theory suggests that if universities are interested in maximizing profits or minimizing costs, they should reduce salaries until the supply of workers is equal to the demand. This will reduce costs of production and raise profits. Efficiency-wage theory suggests that it might be profitable for universities to keep wages above the equilibrium level in order to reduce worker turnover, increase worker quality, increase worker effort (reduce shirking), and therefore worker productivity. (Fortunately salaries of economics professors are usually a bit above what is necessary to eat nutritious diets, so the worker-health variant of the efficiency wage is not likely to be important here.)

PTS: 1

DIF: Challenging

REF: p.211

NOT: MacroTB_9-180

8. Cyclical unemployment and the natural rate of unemployment are sometimes hard to distinguish from each other, so economists are not very confident about estimates of the natural rate of unemployment. Still, since unemployment rates are consistently higher in Canada and most Western European countries than in the United States, it appears that the natural rate of unemployment is lower in the United States. What might explain this difference?

ANS:

The text offers two explanations for the natural rate of unemployment. The first is frictional unemployment, which arises as people and employees take time to search for the best match. Frictional unemployment would be higher in countries that have frequent and large sectoral shifts and generous unemployment compensation. It seems unlikely that Canada and Western European countries would have greater sectoral shifts than the United States. So, some of the difference might be due to more generous unemployment compensation in Canada and Western Europe.

The second explanation for the natural rate of unemployment is that wages in some labour markets are above equilibrium. One rationale for setting wages above equilibrium is to attract and retain productive workers. There is no obvious reason why these efficiency wages should contribute to unemployment more in Canada and Western Europe than in the United States. Wages can also be above equilibrium in some markets because of minimum-wage laws. So, some unemployment in Canada and Western Europe might result from higher minimum wages.

PTS: 1

DIF: Challenging REF: p.207

NOT: MacroTB_9-181

PROBLEM

1. Statistics Canada provides labour data as presented in the table below. Based on this data, answer the following questions.

	June 2010 (Seasonally adjusted)
	thousands
Both sexes, 15 years and over	
Population	27 696.6
Labour force	?
Employment	17 189.8
Unemployment	1 475.2
Participation rate	?
Unemployment rate	?
Employment rate	?

- What was the labour force in June 2010?
- What was the participation rate?
- What was the unemployment rate?
- What was the employment rate?

ANS:

- Labour force = unemployed + employed (= employment + unemployment) = 17 189 800 + 1 475 200 = 18 665 000 workers
- Participation rate = labour force / population aged 15 or over $\times 100\%$ = $18\,665\,000 / 27\,696\,600 \times 100\% = 67.4\%$
- Unemployment rate = unemployed / labour force $\times 100\%$ = $1\,475\,200 / 18\,665\,000 \times 100\% = 7.9\%$
- Employment rate = employed / adult population = $17\,189\,800 / 27\,696\,600 \times 100\% = 62\%$

PTS: 1

NOT: MacroTB_9-182

2. Consider the following labour data compiled by Statistics Canada.

	June 2010	July 2010	June to July 2010	July 2009 to July 2010
	Seasonally adjusted			
	thousands		change in thousands	
Both sexes, 15 years and over				
Population	27 696.6	27 735.2	38.6	409.2
Labour force	18 665.0	18 673.6	8.6	309.1
Employment	17 189.8	17 180.5	-9.3	393.7
Unemployment	1 475.2	1 493.1	17.9	-84.6

- Between July 2009 and July 2010, employment has increased by 393 700 workers, but the labour force increased by only 309 100 workers. Explain the difference in these numbers. Is it possible that the increase in labour force be greater than the increase in employment?
- During the same period, employment increased by 393 700 workers, but unemployment decreased by only 84 600. Are these data plausible? How this difference could be explained?

ANS:

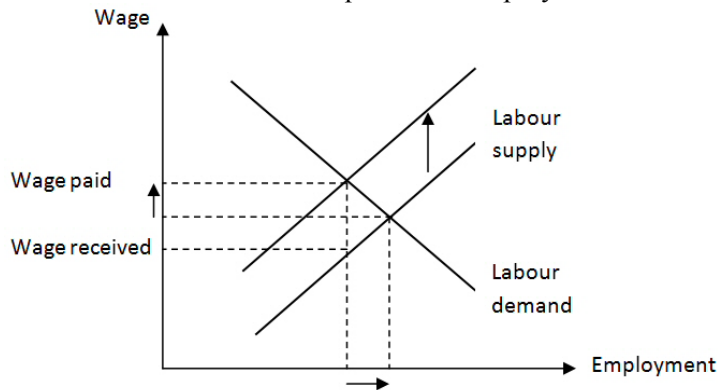
- Change in labour force = change in employment + change in unemployment. It is possible that both employment and unemployment either increase or decrease. When the increase in employment is higher than the decrease in unemployment, labour force increases. In our case, the change in labour force is $309.1 = 393.7 - 84.6$. When both employment and unemployment increase, the increase in labour force will be greater than the increase in employment. This situation may occur when, for instance, many young people enter the labour force but not all find jobs, other things being equal.
- The difference between the increase in employment and the decrease in unemployment is normal, since some people who were not in the labour force before started to look for, and found jobs during the year.

PTS: 1 NOT: MacroTB_9-183

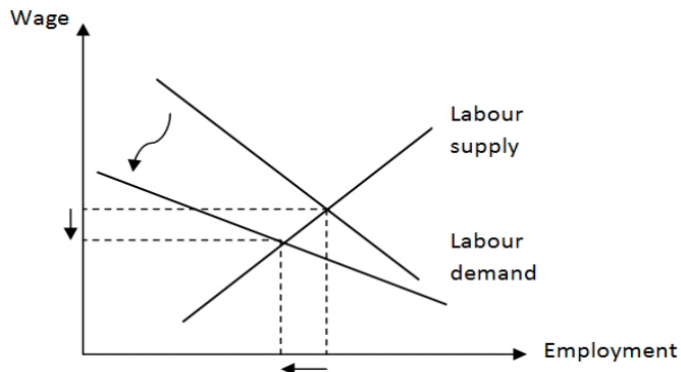
3. In a labour demand and supply diagram, show the effects of the following events. In each case, discuss the changes in the equilibrium wage and employment.
- An increase in the wage income tax.
 - A new trade agreement that allows for foreign competition in Canadian food sector. (Hint: consider how the elasticity of demand for food changes, then how does that affect the elasticity of demand for labour in the food sector.)

ANS:

- If the income tax increases, employment will remain the same as before only if the wage increases by the same amount as the tax. Thus, the labour supply curve shifts upward, as the figure below illustrates. The wage paid by employers increases, and the wage workers receive decreases. The equilibrium employment level decreases.



- Foreign competition brings about a larger diversity of products and brands, therefore the elasticity of demand in the food industry will increase. This allows producers lower profit margins and prices that are closer to marginal costs. Producers are more reluctant to increase wages. The labour demand curve becomes flatter. Depending on how the market for domestic products changes (exports may increase), employment and wages may increase or decrease. The situation in which both employment and wage decrease is presented in the next diagram.

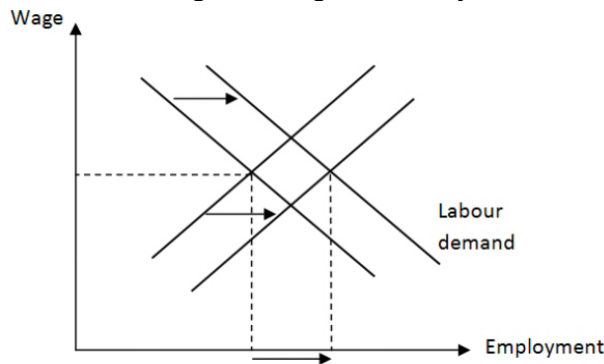


PTS: 1

4. Consider an economy where population increases, which in turn causes both the demand for goods and services and the supply of labour increase.
 - a. In a labour supply and demand diagram, analyze the effects of the increase in population on the equilibrium wage and employment
 - b. What happens to wage and unemployment if a minimum wage law exists?

ANS:

- a. The increase in demand for goods and services increases the demand for labour by the companies, thus the labour demand curve shifts upward (right). The labour supply curve will shift to the right, towards higher numbers of workers that would accept a job at any given wage level. The result is higher employment (measured in number of workers). The effect on wage is ambiguous; it may increase, decrease, or remain unchanged.



- b. Depending on how the equilibrium wage changes, a minimum wage provision may become more or less binding; therefore, unemployment may increase or decrease.

PTS: 1

NOT: MacroTB_9-184

5. (Challenging) Draw a firm's labour demand curve that intersects the vertical axis at \$20 per hour, and choose a point on the curve corresponding to an hourly wage of \$12 and employment of 50 workers.
 - a. Explain the significance of the labour demand curve and show why such a curve is downward sloping.
 - b. At the employment level of 50 workers, what is the total amount the employer pays in wages?
 - c. At the employment level of 50 workers, what is the firm's profit? (Hint: at each level of employment, the labour demand curve shows the maximum wage the firm is willing to pay an extra worker.).

ANS:

- a. When the market wage is high compared with the general price level, companies hire few workers, while at lower market wages companies hire many workers, hence, the downward sloping shape of the demand curve. Another interpretation of the demand curve is that it shows, at every level of employment, the maximum wage that an employer is willing to pay. A firm will increase employment up to the point where an extra worker's contribution to revenue just equals the worker's wage. Therefore, the demand curve can also be looked at as a marginal product of labour curve.
- b. The wage bill at 50 workers is equal to $50 \times \$12 = \$600$.
- c. The firm's profit is the area under the labour demand curve and the wage line, which is equal to $(1/2) \times (\$20 - 12) \times (50) = \$200$.

PTS: 1

NOT: MacroTB_9-185

Chapter 10—The Monetary System

MULTIPLE CHOICE

1. Which of the following is the role of money in an economy?
- a. Money serves as a person's wealth.
 - b. Money allows people to save
 - c. Money is an investment asset.
 - d. Money allows greater specialization.

ANS: D PTS: 1 DIF: Easy REF: p.220
BLM: Remember NOT: Macro TB_10-1

2. Which of the following is a characteristic of paper money?
- a. It has a high intrinsic value.
 - b. It is used in a barter economy.
 - c. It is valuable because it is generally accepted in trade.
 - d. It is valuable only because of the legal tender requirement.

ANS: C PTS: 1 DIF: Easy REF: p.219
BLM: Remember NOT: Macro TB_10-1

3. Which of the following best defines barter?
- a. It is an exchange of goods for money.
 - b. It is an exchange of money for foreign currency.
 - c. It is a generally accepted legal tender.
 - d. It is a transaction that requires a double coincidence of wants.

ANS: D PTS: 1 DIF: Easy REF: p.220
BLM: Remember NOT: Macro TB_10-2

4. When Arnold uses dollars to record his income and expenses, how is he using money?
- a. as a unit of account
 - b. as a means of payment
 - c. as a store of value
 - d. as a medium of exchange

ANS: A PTS: 1 DIF: Easy REF: p.221
BLM: Higher Order NOT: Macro TB_10-3

5. Which of the following is a generally accepted medium of exchange?
- a. a plane ticket
 - b. federal government bonds
 - c. fine art
 - d. currency

ANS: D PTS: 1 DIF: Easy REF: p.221
BLM: Remember NOT: Macro TB_10-4

6. Which of the following best illustrates the unit of account function of money?
- a. You list prices for candy sold on your Web site, www.sweettooth.com, in dollars.
 - b. You pay for your NHL tickets with dollars.
 - c. You keep \$10 in your backpack for emergencies.
 - d. You sell a used copy of your textbook for \$40.

ANS: A PTS: 1 DIF: Easy REF: p.221
BLM: Higher Order NOT: Macro TB_10-5

7. Mia puts money into a piggy bank so she can spend it later. Which of the following functions of money does this illustrate?
- a. store of value
 - b. medium of exchange
 - c. unit of account
 - d. wealth

ANS: A PTS: 1 DIF: Easy REF: p.221
BLM: Higher Order NOT: Macro TB_10-6

8. Which of the following best illustrates the medium of exchange function of money?
- a. You keep some money hidden in your shoe.
 - b. You keep track of the value of your assets in terms of currency.
 - c. You pay for your double latte using currency.
 - d. You lend \$25 to your friend.

ANS: C PTS: 1 DIF: Easy REF: p.221
BLM: Higher Order NOT: Macro TB_10-7

9. What do economists use the word "money" to refer to?
- a. income generated by the production of goods and services
 - b. those assets regularly used to buy goods and services
 - c. the value of a person's assets
 - d. the value of stocks and bonds

ANS: B PTS: 1 DIF: Easy REF: p.221
BLM: Remember NOT: Macro TB_10-8

10. Which of the following best defines liquidity?
- a. It is the ease with which an asset is converted to the medium of exchange.
 - b. It is a measurement of the intrinsic value of commodity money.
 - c. It is the suitability of an asset to serve as a store of value.
 - d. It refers to how many times a dollar changes hands in a given year.

ANS: A PTS: 1 DIF: Easy REF: p.221
BLM: Remember NOT: Macro TB_10-9

11. Which of the following lists ranks assets from most to least liquid?

- a. currency, fine art, stocks
- b. currency, stocks, fine art
- c. fine art, currency, stocks
- d. fine art, stocks, currency

ANS: B PTS: 1 DIF: Easy REF: p.221
BLM: Higher Order NOT: Macro TB_10-10

12. Which of the following is current Canadian currency?

- a. fiat money with intrinsic value
- b. fiat money with no intrinsic value
- c. commodity money with intrinsic value
- d. commodity money with no intrinsic value

ANS: B PTS: 1 DIF: Easy REF: p.222
BLM: Higher Order NOT: Macro TB_10-11

13. Which of the following characterizes fiat money?

- a. It has no intrinsic value.
- b. It is backed by gold.
- c. It has intrinsic value equal to its value in exchange.
- d. It is an illiquid asset.

ANS: A PTS: 1 DIF: Easy REF: p.222
BLM: Remember NOT: Macro TB_10-12

14. Which of the following characterizes commodity money?

- a. It is money that is backed by gold.
- b. It is the principal type of money in use today.
- c. It is money with intrinsic value.
- d. It is comprised of receipts created in international trade that are used as a medium of exchange.

ANS: C PTS: 1 DIF: Easy REF: p.221
BLM: Remember NOT: Macro TB_10-13

15. Which of the following characterizes currency?

- a. It has intrinsic value.
- b. It has no intrinsic value.
- c. It may be used as a medium of exchange but is not legal tender.
- d. It performs all the functions of money except providing a unit of account.

ANS: B PTS: 1 DIF: Easy REF: p.222
BLM: Remember NOT: Macro TB_10-14

16. Which of the following has intrinsic value?

- a. a golden coin
- b. a twenty-dollar bill
- c. a bank account
- d. a personal cheque

ANS: A PTS: 1 DIF: Easy REF: p.221-222
BLM: Remember NOT: Macro TB_10-15

17. What does the legal tender requirement imply?

- a. People are more likely to accept the dollar as a medium of exchange.
- b. The government must hold enough gold to redeem all currency.
- c. People may not make trades with anything else.
- d. It is illegal to hold foreign currencies.

ANS: A PTS: 1 DIF: Easy REF: p.222
BLM: Higher Order NOT: Macro TB_10-16

18. Which of the following does M1 include?

- a. currency
- b. savings deposits
- c. travellers' cheques
- d. foreign currency accounts

ANS: A PTS: 1 DIF: Easy REF: p.225
BLM: Remember NOT: Macro TB_10-17

19. Which of the following is included in M1?

- a. government bonds
- b. demand deposits
- c. savings deposits
- d. travellers' cheques

ANS: B PTS: 1 DIF: Easy REF: p.225
BLM: Remember NOT: Macro TB_10-18

20. Which of the following is included in M2 but not in M1?

- a. currency
- b. demand deposits
- c. savings deposits
- d. gold

ANS: C PTS: 1 DIF: Easy REF: p.225
BLM: Remember NOT: Macro TB_10-19

21. Which of the following is included in M2 but not in M1?

- a. demand deposits
- b. corporate bonds
- c. currency
- d. term deposits

ANS: D PTS: 1 DIF: Average REF: p.225
BLM: Remember NOT: Macro TB_10-20

22. Which of the following is included in the M2 definition of the money supply?
- a. credit cards
 - b. term deposits
 - c. corporate bonds
 - d. foreign currency accounts

ANS: B PTS: 1 DIF: Easy REF: p.225
BLM: Remember NOT: Macro TB_10-21

23. How are term deposits treated in M1 as compared to M2?
- a. They are included in M1 but not M2.
 - b. They are included in M1 and M2.
 - c. They are included in M2 but not M1.
 - d. They are included in neither M1 nor M2.

ANS: C PTS: 1 DIF: Easy REF: p.225
BLM: Remember NOT: Macro TB_10-22

24. How are demand deposits treated in M1 as compared to M2?
- a. They are included in M1 but not M2.
 - b. They are included in M2 but not M1.
 - c. They are included in M1 and M2.
 - d. They are included in neither M1 nor M2.

ANS: C PTS: 1 DIF: Easy REF: p.225
BLM: Remember NOT: Macro TB_10-23

25. How are credit card balances treated in M1 as compared to M2?
- a. They are included in M1 but not M2.
 - b. They are included in M2 but not M1.
 - c. They are included in M1 and M2.
 - d. They are included in neither M1 nor M2.

ANS: D PTS: 1 DIF: Easy REF: p.225
BLM: Higher Order NOT: Macro TB_10-24

26. How does M1 compare with M2?
- a. M1 is smaller and less liquid than M2.
 - b. M1 is smaller but more liquid than M2.
 - c. M1 is larger than and less liquid than M2.
 - d. M1 is larger than but more liquid than M2.

ANS: B PTS: 1 DIF: Average REF: p.225
BLM: Higher Order NOT: Macro TB_10-25

27. How are savings deposits treated in M1 as compared to M2?
- a. They are included in M1 but not M2.
 - b. They are included in M2 but not M1.
 - c. They are included in M1 and M2.
 - d. They are included in neither M1 nor M2.

ANS: B PTS: 1 DIF: Easy REF: p.225
BLM: Remember NOT: Macro TB_10-26

28. Which of the following best characterizes credit cards?

- a. They are a payment form of money.
- b. They are part of the M1 money supply.
- c. They are a method of deferring payment.
- d. They are a unit of account.

ANS: C PTS: 1 DIF: Easy REF: p.224
BLM: Higher Order NOT: Macro TB_10-27

29. Which of the following is the fundamental function of credit cards?

- a. Credit cards are used for deferring payments.
- b. Credit cards are used as store of value.
- c. Credit cards are used for increasing the money supply.
- d. Credit cards are used as investment assets.

ANS: A PTS: 1 DIF: Easy REF: p.224
BLM: Higher Order NOT: Macro TB_10-29

30. Which of the following is the function of debit cards?

- a. They defer payments.
- b. They are equivalent to credit cards.
- c. They are included in M2.
- d. They are used as a method of payment.

ANS: D PTS: 1 DIF: Easy REF: p.224
BLM: Remember NOT: Macro TB_10-30

Use the (hypothetical) information in the following table to answer the following questions.

Table 29-1

Type of Money	Amount
Large time deposits	\$80 billion
Small time deposits	\$75 billion
Demand deposits	\$75 billion
Foreign currency accounts	\$40 billion
Savings deposits	\$10 billion
Travellers' cheques	\$1 billion
Money market mutual funds	\$15 billion
Currency	\$100 billion
SDRs	\$10 billion
Term Deposits	\$25 billion

31. **Refer to Table 29-1.** What is the M1 money supply?

- a. \$175 billion
- b. \$215 billion
- c. \$216 billion
- d. \$226 billion

ANS: A PTS: 1 DIF: Average REF: p.225
BLM: Higher Order NOT: Macro TB_10-31

32. **Refer to Table 29-1.** What is the M2 money supply?

- a. \$125 billion
- b. \$210 billion
- c. \$341 billion
- d. \$421 billion

ANS: B PTS: 1 DIF: Average REF: p.225
BLM: Higher Order NOT: Macro TB_10-32

33. What is the approximate amount of currency per person in Canada?

- a. \$275
- b. \$858
- c. \$1025
- d. \$2052

ANS: D PTS: 1 DIF: Easy REF: p.225
BLM: Remember NOT: Macro TB_10-33

34. Which of the following might explain why Canada has so much currency per person?

- a. Canadian citizens are holding a lot of foreign currency.
- b. Currency may be a preferable store of wealth for criminals.
- c. People use credit and debit cards more frequently.
- d. Much of Canadian currency is held by foreigners.

ANS: B PTS: 1 DIF: Easy REF: p.225-226
BLM: Remember NOT: Macro TB_10-34

35. What is the average currency holding of Canadian dollars relative to Canadian population, and what could explain it?

- a. Average currency holdings are about \$800. One explanation for this relatively small amount is that people use credit and debit cards to make transactions.
- b. Average currency holdings are about \$800. One explanation for this relatively small amount is that Canadian citizens hold a lot of foreign currency.
- c. Average holdings of currency are about \$2052. One explanation for this relatively large amount is that criminals may prefer currency as a medium of exchange.
- d. Average holdings are about \$2052. One explanation for this relatively large average is that foreign citizens hold a lot of Canadian currency.

ANS: C PTS: 1 DIF: Easy REF: p.225-226
BLM: Remember NOT: Macro TB_10-35

36. Given the size of the Canadian money stock, is the amount of currency per person reasonable?

- a. Yes, the amount of currency per person is about right.
- b. There is no way of determining the amount of currency in circulation.
- c. No, there is too little currency per person.
- d. No, there is too much currency per person.

ANS: D PTS: 1 DIF: Easy REF: p.225-226
BLM: Remember NOT: Macro TB_10-36

37. Which of the following agencies is responsible for regulating the money supply in Canada?
- a. the Comptroller of the Currency
 - b. the Bank of Canada
 - c. the TD Bank
 - d. the Canadian Payments Association

ANS: B PTS: 1 DIF: Easy REF: p.226
BLM: Remember NOT: Macro TB_10-37

38. Which of the following does the Bank of Canada **NOT** do?
- a. control the supply of money
 - b. control the value of money
 - c. make loans to individuals
 - d. regulate the banking system

ANS: C PTS: 1 DIF: Easy REF: p.227
BLM: Remember NOT: Macro TB_10-38

39. Who appoints the members of the Board of Directors at the Bank of Canada?
- a. the Governor General
 - b. the Minister of Finance
 - c. the Director of the IMF
 - d. the Prime Minister

ANS: B PTS: 1 DIF: Easy REF: p.226
BLM: Remember NOT: Macro TB_10-39

40. For how long is the governor of the Bank of Canada appointed?
- a. life
 - b. a seven-year term
 - c. a five-year term
 - d. a two-year term

ANS: B PTS: 1 DIF: Easy REF: p.226
BLM: Remember NOT: Macro TB_10-40

41. Who owns the Bank of Canada?
- a. private individuals
 - b. the Queen
 - c. the commercial banks
 - d. the federal government of Canada

ANS: D PTS: 1 DIF: Easy REF: p.227
BLM: Remember NOT: Macro TB_10-41

42. When was the Bank of Canada Act first enacted?
- a. 1935
 - b. 1867
 - c. 1984
 - d. 1934

ANS: D PTS: 1 DIF: Easy REF: p.226
BLM: Remember NOT: Macro TB_10-42

43. Who chairs the Board of Directors of the Bank of Canada?

- a. the Governor of the Bank of Canada
- b. the Prime Minister
- c. the Minister of Finance
- d. the Governor General

ANS: A PTS: 1 DIF: Easy REF: p.226-227
BLM: Remember NOT: Macro TB_10-43

44. Which of the following plays the role of a central bank in Canada?

- a. TD Canada Trust
- b. the Bank of Montreal
- c. the Bank of Canada
- d. the Royal Bank of Canada

ANS: C PTS: 1 DIF: Easy REF: p.226
BLM: Remember NOT: Macro TB_10-44

45. What is the role of the Bank of Canada?

- a. to lend money to large companies
- b. to make monetary policy
- c. to raise taxes
- d. to oversee government spending

ANS: B PTS: 1 DIF: Easy REF: p.226-227
BLM: Remember NOT: Macro TB_10-45

46. What is the role of the Minister of Finance with respect to the Bank of Canada or the banking system?

- a. to control all activities of the Bank of Canada
- b. to issue the Governor of Bank of Canada a written directive to resign
- c. to issue currency
- d. to maintain the stability of the banking system

ANS: B PTS: 1 DIF: Easy REF: p.227
BLM: Remember NOT: Macro TB_10-46

47. Which of the following is one of the functions of the Bank of Canada?

- a. to maximize profits on behalf of its shareholders
- b. to act as a lender of last resort
- c. to convert currency into gold
- d. to bail out troubled commercial banks

ANS: B PTS: 1 DIF: Easy REF: p.227-228
BLM: Remember NOT: Macro TB_10-47

48. Which of the following is a characteristic of the Bank of Nova Scotia?

- a. It can issue currency. .
- b. It is part of the “big 5” commercial banks group.
- c. It acts as a central bank for Nova Scotia.
- d. It is owned by the Canadian government.

ANS: A PTS: 1 DIF: Average REF: p.227
BLM: Higher Order NOT: Macro TB_10-48

49. What is the reason behind the seven-year appointment for the governor of Bank of Canada?
- a. It makes the system compatible with the ones in other countries.
 - b. It confers stability to the financial system.
 - c. It allows the governor to become better in doing his or her job.
 - d. It insulates the governor from political pressure.

ANS: D PTS: 1 DIF: Easy REF: p.227
BLM: Remember NOT: Macro TB_10-49

50. Which of the following happens in a 100-percent-reserve banking system?
- a. Banks can create money by issuing currency.
 - b. Banks can create money by lending out reserves.
 - c. The Bank of Canada can increase the money supply with open market sales.
 - d. Banks hold as many reserves as they hold deposits.

ANS: D PTS: 1 DIF: Easy REF: p.229
BLM: Higher Order NOT: Macro TB_10-50

51. How do deposits and reserves appear on a bank's T-account?
- a. Both deposits and reserves are assets.
 - b. Both deposits and reserves are liabilities.
 - c. Deposits are assets and reserves are liabilities.
 - d. Reserves are assets and deposits are liabilities.

ANS: D PTS: 1 DIF: Easy REF: p.229
BLM: Higher Order NOT: Macro TB_10-51

52. Suppose that the reserve ratio is 7 percent and that a bank has \$2000 in deposits. What are its required reserves?
- a. \$100
 - b. \$120
 - c. \$140
 - d. \$160

ANS: C PTS: 1 DIF: Easy REF: p.230
BLM: Higher Order NOT: Macro TB_10-52

53. Suppose that the reserve ratio is 5 percent and that a bank has \$3000 in deposits. What are its required reserves?
- a. \$150
 - b. \$50
 - c. \$1500
 - d. \$500

ANS: A PTS: 1 DIF: Easy REF: p.230
BLM: Higher Order NOT: Macro TB_10-53

54. Suppose a bank has a 20 percent reserve ratio, \$2500 in deposits, and it loans out all it can, given the reserve ratio. Which of the following describes the bank's assets?
- a. It has \$50 in reserves and \$2500 in loans.
 - b. It has \$50 in reserves and \$2450 in loans.
 - c. It has \$500 in reserves and \$2000 in loans.
 - d. It has \$500 in reserves and \$2500 in loans.

ANS: C PTS: 1 DIF: Easy REF: p.230
BLM: Higher Order NOT: Macro TB_10-54

55. Suppose a bank has a 5 percent reserve ratio, \$4000 in deposits, and it loans out all it can, given the reserve ratio. Which of the following describes the bank's assets?
- a. It has \$20 in reserves and \$3980 in loans.
 - b. It has \$200 in reserves and \$3800 in loans.
 - c. It has \$200 in reserves and \$4000 in loans.
 - d. It has \$5 in reserves and \$3995 in loans.

ANS: B PTS: 1 DIF: Easy REF: p.230
BLM: Higher Order NOT: Macro TB_10-55

56. Suppose a bank has \$10 000 in deposits and \$7000 in loans. What is its reserve ratio?
- a. 3 percent
 - b. 7 percent
 - c. 30 percent
 - d. 70 percent

ANS: C PTS: 1 DIF: Easy REF: p.230
BLM: Higher Order NOT: Macro TB_10-56

57. Suppose a bank has \$200 000 in deposits and \$180 000 in loans. What is its reserve ratio?
- a. 1 percent
 - b. 5 percent
 - c. 10 percent
 - d. 18 percent

ANS: C PTS: 1 DIF: Easy REF: p.230
BLM: Higher Order NOT: Macro TB_10-57

58. If you deposit \$100 into a demand deposit at a bank, what does this action by itself do to the money supply?
- a. It does not change the money supply.
 - b. It increases the money supply.
 - c. It decreases the money supply.
 - d. It has an indeterminate effect on the money supply.

ANS: A PTS: 1 DIF: Average REF: p.230
BLM: Higher Order NOT: Macro TB_10-58

59. When a bank loans out \$1000, what happens to the money supply?
- a. It does not change.
 - b. It decreases.
 - c. It increases.
 - d. It has an indeterminate effect on the money supply.

ANS: C PTS: 1 DIF: Average REF: p.230
BLM: Higher Order NOT: Macro TB_10-59

60. Which of the following is most likely to happen under a fractional reserve banking system?
- a. Banks hold more reserves than deposits.
 - b. Banks generally lend out a majority of the funds deposited.
 - c. Banks cause the money supply to fall by lending out reserves.
 - d. Banks only accept savings deposits.

ANS: B PTS: 1 DIF: Easy REF: p.229-230
BLM: Higher Order NOT: Macro TB_10-60

61. If the reserve ratio is 10 percent and a bank receives a new deposit of \$800, which of the following will this bank most likely do?
- a. It will increase its required reserves by \$8000.
 - b. It will make new loans of \$8000.
 - c. It will be able to make new loans of \$800.
 - d. It will initially see its total reserves increase by \$800.

ANS: D PTS: 1 DIF: Average REF: p.230-231
BLM: Higher Order NOT: Macro TB_10-61

62. If the reserve ratio is 10 percent and a bank receives a new deposit of \$20, which of the following happens to this bank's reserves or deposits?
- a. Required reserves must increase by \$2.
 - b. Total reserves will increase by \$2.
 - c. New loans can be made up to a maximum of \$2.
 - d. Total reserves increase by \$200.

ANS: A PTS: 1 DIF: Average REF: p.230-231
BLM: Higher Order NOT: Macro TB_10-62

63. If the reserve ratio is 7 percent and a bank receives a new deposit of \$300, which of the following will this bank most likely do?
- a. It will increase required reserves by \$2100.
 - b. It will initially see reserves increase by \$279.
 - c. It will be able to make new loans up to a maximum of \$279.
 - d. It will be able to increase its required reserves by \$30.

ANS: C PTS: 1 DIF: Average REF: p.229-230
BLM: Higher Order NOT: Macro TB_10-63

64. If you deposit \$5000 into First Hawkeye Bank, what will the bank most likely do?
- It will eventually increase its required reserves by the reserve ratio times \$5000.
 - It will be able to lend out \$5,000 times the reserve ratio.
 - It will initially see reserves increase by \$5000 divided by the reserve ratio.
 - It will be able to lend out \$5000.

ANS: A PTS: 1 DIF: Average REF: p.229-230
 BLM: Higher Order NOT: Macro TB_10-64

65. A central bank raised the reserve requirement ratio from 10 percent to 12 percent. Other things the same, how does the money multiplier change?
- It increases by 1.67.
 - It decreases by 1.67.
 - It increases by about 2.
 - It decreases by 2.

ANS: B PTS: 1 DIF: Average REF: p.231
 BLM: Higher Order NOT: Macro TB_10-65

Use the balance sheet below for the following questions.

Table 29-2

<u>First Bank of Mason City</u>			
Assets		Liabilities	
Required Reserves	\$20.00	Deposits	\$100.00
Loans	\$80.00		

66. **Refer to Table 29-2.** What is the reserve ratio?
- 0 percent
 - 20 percent
 - 80 percent
 - 100 percent

ANS: B PTS: 1 DIF: Easy REF: p.229-231
 BLM: Higher Order NOT: Macro TB_10-66

67. **Refer to Table 29-2.** If \$1000 is deposited into the First Bank of Mason City, which of the following happens?
- Total reserves will initially increase by \$200.
 - Liabilities will decrease by \$1000.
 - Assets will increase by \$1000.
 - Required reserves will increase by \$800.

ANS: C PTS: 1 DIF: Easy REF: p.229-231
 BLM: Higher Order NOT: Macro TB_10-67

68. **Refer to Table 29-2.** If \$400 is deposited into the First Bank of Mason City, which of the following happens?
- The bank will be able to make additional loans totalling \$400.
 - Excess reserves initially increase by \$400.
 - Required reserves initially increase by \$8000.
 - Excess reserves initially increase by \$320.

ANS: D PTS: 1 DIF: Easy REF: p.229-231
 BLM: Higher Order NOT: Macro TB_10-68

Use the balance sheet for the following questions.

Table 29-3

<u>Last Bank of Cedar Bend</u>			
Assets		Liabilities	
Reserves	\$25 000	Deposits	\$180 000
Loans	\$155 000		

69. **Refer to Table 29-3.** If the reserve requirement is 10 percent, what is the state of this bank?
- It can make a new loan of \$18 000.
 - It has less reserves than required.
 - It has excess reserves of less than \$8000.
 - It has excess reserves of more than \$8000.

ANS: C PTS: 1 DIF: Easy REF: p.229-231
 BLM: Higher Order NOT: Macro TB_10-69

70. **Refer to Table 29-3.** If the reserve requirement is 10 percent and then someone deposits \$50 000 into the bank, what is the bank's reserve position?
- It will have \$57 000 in excess reserves.
 - It will have \$52 000 in excess reserves.
 - It will need to raise reserves by \$5000.
 - It will have excess reserves of \$2000.

ANS: B PTS: 1 DIF: Average REF: p.229-231
 BLM: Higher Order NOT: Macro TB_10-70

71. **Refer to Table 29-3.** If the reserve requirement is 30 percent, what is this bank's reserve position?
- It has \$29 000 of excess reserves.
 - It needs \$10 000 more in reserves to meet its reserve requirements.
 - It needs \$29 000 more in reserves to meet its reserve requirements.
 - It just meets its reserve requirement.

ANS: C PTS: 1 DIF: Easy REF: p.229-231
 BLM: Higher Order NOT: Macro TB_10-71

72. **Refer to Table 29-3.** If the Last Bank of Cedar Bend is holding \$5000 in excess reserves, what is the reserve requirement?
- 1/7
 - 1/8
 - 1/9
 - 1/10

ANS: C PTS: 1 DIF: Easy REF: p.229-231
 BLM: Higher Order NOT: Macro TB_10-72

Table 29-4 The following information pertains to the Bank of Edmonton.

Assets:		Liabilities:	
Reserves	\$100	Deposits	\$1000
Loans	\$900		

73. **Refer to Table 29-4.** If the Bank of Edmonton has loaned out all the money it wants, given its deposits, what is its reserve ratio?
- 1 percent
 - 5 percent
 - 10 percent
 - 15 percent

ANS: C PTS: 1 DIF: Easy REF: p.229-231
 BLM: Higher Order NOT: Macro TB_10-73

74. **Refer to Table 29-4.** Assume that the Bank of Edmonton is holding the required percent of deposits as reserves. Also, assume all other banks hold only the required percent of deposits as reserves, and that people hold only deposits and no currency. What is the money multiplier?
- 1
 - 5
 - 10
 - 15

ANS: C PTS: 1 DIF: Easy REF: p.229-231
 BLM: Higher Order NOT: Macro TB_10-74

75. **Refer to Table 29-4.** If the Bank of Canada requires banks to hold 5 percent of deposits as reserves, how much in excess reserves does the Bank of Edmonton now hold?
- \$5
 - \$25
 - \$50
 - \$55

ANS: C PTS: 1 DIF: Average REF: p.229-231
 BLM: Higher Order NOT: Macro TB_10-75

76. **Refer to Table 29-4.** Assume that all other banks hold only the required 5 percent of deposits as reserves and people hold only deposits and no currency. If the Bank of Edmonton decides to hold exactly 5 percent reserves, by how much would the economy's money supply increase?
- \$500
 - \$1000
 - \$1500
 - \$2000

ANS: B PTS: 1 DIF: Average REF: p.229-231
 BLM: Higher Order NOT: Macro TB_10-76

Table 29-5 The following information pertains to the Bank of Kingston.

Assets:		Liabilities:	
Reserves	\$12 000	Deposits	\$240 000
Loans	\$228 000		

77. **Refer to Table 29-5.** If the Bank of Kingston has lent out all the money it can given its deposits, then what is its reserve ratio?
- 1 percent
 - 5 percent
 - 10 percent
 - 15 percent

ANS: B PTS: 1 DIF: Easy REF: p.229-231
 BLM: Higher Order NOT: Macro TB_10-77

78. **Refer to Table 29-5.** Assume that the Bank of Kingston is holding the required percent of deposits as reserves. Also, assume all other banks hold only the required percent of deposits as reserves. What is the money multiplier?
- 12.5
 - 15
 - 17.5
 - 20

ANS: D PTS: 1 DIF: Easy REF: p.229-231
 BLM: Higher Order NOT: Macro TB_10-78

79. **Refer to Table 29-5.** If the Bank of Canada requires a reserve ratio of 4 percent, how much in excess reserves does the Bank of Kingston now hold?
- \$1200
 - \$2400
 - \$2880
 - \$3000

ANS: B PTS: 1 DIF: Average REF: p.229-231
 BLM: Higher Order NOT: Macro TB_10-79

80. **Refer to Table 29-5.** Assume that all other banks hold only the required 4 percent of deposits as reserves, and that people hold only deposits and no currency. If the Bank of Kingston decides to hold reserves of 4 percent, by how much would the economy's money supply increase?

- a. \$50 200
- b. \$60 000
- c. \$62 000
- d. \$65 400

ANS: B

PTS: 1

DIF: Average

REF: p.229-231

BLM: Higher Order

NOT: Macro TB_10-80

81. **Refer to Table 29-5.** If all banks hold only the required 4 percent of deposits as reserves, then what is the money multiplier?

- a. 5
- b. 10
- c. 15
- d. 25

ANS: D

PTS: 1

DIF: Easy

REF: p.229-231

BLM: Higher Order

NOT: Macro TB_10-81

82. If a bank uses \$80 of excess reserves to make a new loan when the reserve ratio is 25 percent, what happens to the money supply?

- a. The money supply initially decreases by \$80.
- b. The money supply initially increases by \$20.
- c. The money supply will eventually increase by more than \$20 but less than \$80.
- d. The money supply will eventually increase by \$320.

ANS: D

PTS: 1

DIF: Average

REF: p.229-231

BLM: Higher Order

NOT: Macro TB_10-82

83. Suppose a bank uses \$100 of its \$500 excess reserves to make a new loan when the reserve ratio is 20 percent. How does this action by itself initially change the money supply?

- a. The money supply increases by \$80.
- b. The money supply decreases by \$80.
- c. The money supply increases by \$100.
- d. The money supply decreases by \$100.

ANS: C

PTS: 1

DIF: Average

REF: p.229-231

BLM: Higher Order

NOT: Macro TB_10-83

84. As the reserve ratio increases, which of the following happens to the money multiplier?

- a. It increases.
- b. It does not change.
- c. It decreases.
- d. It cannot be determined without additional information.

ANS: C

PTS: 1

DIF: Easy

REF: p.229-231

BLM: Higher Order

NOT: Macro TB_10-84

85. If the central bank in some country lowered the reserve ratio, which of the following would happen to the money multiplier?
- a. It would increase.
 - b. It would not change.
 - c. It would decrease.
 - d. It cannot be determined without additional information.

ANS: A PTS: 1 DIF: Easy REF: p.229-231
BLM: Higher Order NOT: Macro TB_10-85

86. If the reserve ratio is 10 percent, what is the money multiplier?
- a. 100
 - b. 10
 - c. 9/10
 - d. 1/10

ANS: B PTS: 1 DIF: Easy REF: p.229-231
BLM: Higher Order NOT: Macro TB_10-86

87. If the reserve ratio is 20 percent, what is the money multiplier?
- a. 2
 - b. 4
 - c. 5
 - d. 8

ANS: C PTS: 1 DIF: Easy REF: p.229-231
BLM: Higher Order NOT: Macro TB_10-87

88. If the reserve ratio increased from 10 percent to 20 percent, which of the following would happen to the money multiplier?
- a. It would rise from 10 to 20.
 - b. It would rise from 5 to 10.
 - c. It would fall from 10 to 5.
 - d. It would not change.

ANS: C PTS: 1 DIF: Easy REF: p.229-231
BLM: Higher Order NOT: Macro TB_10-88

89. If the reserve ratio is 10 percent, how much new money can \$1000 of excess reserves create?
- a. \$100
 - b. \$1000
 - c. \$10 000
 - d. \$100 000

ANS: C PTS: 1 DIF: Easy REF: p.229-231
BLM: Higher Order NOT: Macro TB_10-89

90. If the reserve ratio is 15 percent, by how much will an additional \$1000 of reserves increase the money supply?
- a. \$1176
 - b. \$1275
 - c. \$5667
 - d. \$6667

ANS: D PTS: 1 DIF: Easy REF: p.229-231
BLM: Higher Order NOT: Macro TB_10-90

91. In Wellville, the money supply is \$80 000 and reserves are \$18 000. Assuming that people hold only deposits and no currency, and that banks hold only required reserves, what is the required reserve ratio?
- a. 29 percent
 - b. 22.5 percent
 - c. 16 percent
 - d. 4.44 percent

ANS: B PTS: 1 DIF: Average REF: p.229-231
BLM: Higher Order NOT: Macro TB_10-91

92. At one time, the country of Aquilonia had no banks, but had currency of \$10 million. Then a banking system was established with a reserve requirement of 20 percent. The people of Aquilonia deposited half of their currency into the banking system. If banks do not hold excess reserves, what is Aquilonia's money supply now?
- a. \$10 million
 - b. \$12 million
 - c. \$25 million
 - d. \$30 million

ANS: D PTS: 1 DIF: Average REF: p.229-231
BLM: Higher Order NOT: Macro TB_10-92

93. At one time, the country of Freedonia had no banks, but had currency of \$40 million. Then a banking system was established with a reserve requirement of one-third. The people of Freedonia now keep half their money in the form of currency and half in the form of bank deposits. If banks do not hold excess reserves, how much currency do the people of Freedonia now hold?
- a. \$13.33 million
 - b. \$20 million
 - c. \$30 million
 - d. \$36.36 million

ANS: C PTS: 1 DIF: Challenging REF: p.229-231
BLM: Higher Order NOT: Macro TB_10-93

94. At one time, the country of Sylvania had no banks, but had currency of \$10 million. Then a banking system was established with a reserve requirement of 20 percent. The people of Sylvania now keep half their money in the form of currency and half in the form of bank deposits. If banks do not hold excess reserves, how much currency do the people of Sylvania now hold?
- a. \$2 million
 - b. \$5 million
 - c. \$8.33 million
 - d. \$9.09 million

ANS: C PTS: 1
BLM: Higher Order

DIF: Challenging REF: p.229-231
NOT: Macro TB_10-94

95. Suppose the banking system has \$10 million in reserves, the reserve requirement is 20 percent, and there are no excess reserves. The public holds \$10 million in cash. Then bankers decide that it is prudent to hold some excess reserves, and so begin to hold 25 percent of deposits in the form of reserves. Other things the same, what will this action cause the money supply to do?
- a. to change forms, but not size
 - b. to fall by \$10 million
 - c. to fall by \$5 million
 - d. to fall by \$0.5 million

ANS: B PTS: 1
BLM: Higher Order

DIF: Challenging REF: p.229-231
NOT: Macro TB_10-95

96. Suppose the banking system has \$10 million in reserves, the reserve requirement is 20 percent, and there are no excess reserves. The public holds \$10 million in cash. Then bankers decide that it is prudent to hold some excess reserves, and so begin to hold 25 percent of deposits in the form of reserves. At the same time, the public decides to withdraw \$5 million in currency from the banking system. Other things the same, what will these actions cause the money supply to do?
- a. to change forms, but not size
 - b. to fall by \$10 million
 - c. to fall by \$25 million
 - d. to fall by \$35 million

ANS: C PTS: 1
BLM: Higher Order

DIF: Challenging REF: p.229-231
NOT: Macro TB_10-96

97. When the Bank of Canada wants to change the money supply, which of the following does it most frequently do?
- a. It changes the bank rate.
 - b. It changes the reserve requirement.
 - c. It conducts open market operations.
 - d. It changes the amount of transfers such as unemployment benefits, child allowances, or other social assistance payments.

ANS: C PTS: 1
BLM: Remember NOT: Macro TB_10-97

DIF: Easy REF: p.232-235

98. If the reserve ratio is 100 percent, how much will the money supply eventually increase if there is a deposit of \$500 of paper money in a bank?
- a. \$5000
 - b. \$1000
 - c. \$500
 - d. \$0

ANS: D PTS: 1 DIF: Average REF: p.229-231
BLM: Higher Order NOT: Macro TB_10-98

99. Which of the following lists contains only actions that increase the money supply?
- a. lower the bank rate; raise the reserve requirement ratio
 - b. lower the bank rate; lower the reserve requirement ratio
 - c. raise the bank rate; raise the reserve requirement ratio
 - d. raise the bank rate; lower the reserve requirement ratio

ANS: B PTS: 1 DIF: Average REF: p.232-235
BLM: Higher Order NOT: Macro TB_10-99

100. Which of the following lists contains only actions that increase the money supply?
- a. raise the bank rate; make open market purchases
 - b. raise the bank rate; make open market sales
 - c. lower the bank rate; make open market purchases
 - d. lower the bank rate; make open market sales

ANS: C PTS: 1 DIF: Average REF: p.232-235
BLM: Higher Order NOT: Macro TB_10-100

101. Which of the following lists contains only actions that increase the money supply?
- a. make open market purchases; raise the reserve requirement ratio
 - b. make open market purchases; lower the reserve requirement ratio
 - c. make open market sales; raise the reserve requirement ratio
 - d. make open market sales; lower the reserve requirement ratio

ANS: B PTS: 1 DIF: Average REF: p.232-235
BLM: Higher Order NOT: Macro TB_10-101

102. Which of the following lists contains only actions that decrease the money supply?
- a. lower the bank rate; raise the reserve requirement ratio
 - b. lower the bank rate; lower the reserve requirement ratio
 - c. raise the bank rate; raise the reserve requirement ratio
 - d. raise the bank rate; lower the reserve requirement ratio

ANS: C PTS: 1 DIF: Average REF: p.232-235
BLM: Higher Order NOT: Macro TB_10-102

103. Which of the following lists contains only actions that decrease the money supply?
- a. raise the bank rate; make open market purchases
 - b. raise the bank rate; make open market sales
 - c. lower the bank rate; make open market purchases
 - d. lower the bank rate; make open market sales

ANS: B PTS: 1 DIF: Average REF: p.232-235
BLM: Higher Order NOT: Macro TB_10-103

104. Which of the following lists contains only actions that decrease the money supply?
- a. make open market purchases; raise the reserve requirement ratio
 - b. make open market purchases; lower the reserve requirement ratio
 - c. make open market sales; raise the reserve requirement ratio
 - d. make open market sales; lower the reserve requirement ratio

ANS: C PTS: 1 DIF: Average REF: p.232-235
BLM: Higher Order NOT: Macro TB_10-104

105. Which of the following lists ranks the Bank of Canada's monetary policy tools from most to least frequently used?
- a. bank rate changes; reserve requirement changes; open market transactions
 - b. reserve requirement changes; open market transactions; bank rate changes
 - c. open market transactions; bank rate changes; reserve requirement changes
 - d. open market transactions; reserve requirement changes; bank rate changes

ANS: C PTS: 1 DIF: Easy REF: p.232-235
BLM: Remember NOT: Macro TB_10-105

106. If a central bank wanted to increase the money supply, which of the following would it most likely do?
- a. It would make open market purchases and lower the bank rate.
 - b. It would make open market sales and lower the bank rate.
 - c. It would make open market purchases and raise the bank rate.
 - d. It would make open market sales and raise the bank rate.

ANS: A PTS: 1 DIF: Average REF: p.232-235
BLM: Higher Order NOT: Macro TB_10-106

107. Which of the following best explains the role of the Bank of Canada?
- a. It maintains a target exchange rate.
 - b. It determines the bank rate.
 - c. It makes loans to large corporations.
 - d. It controls the government budget deficit.

ANS: B PTS: 1 DIF: Easy REF: p.232-235
BLM: Remember NOT: Macro TB_10-107

108. Which of the following is not a tool of monetary policy?

- a. open market operations
- b. reserve requirements
- c. changing the bank rate
- d. increasing the deficit

ANS: D PTS: 1 DIF: Easy REF: p.232-235
BLM: Remember NOT: Macro TB_10-108

109. On which of the following do the Bank of Canada's policy decisions have an important influence?

- a. both the rate of inflation and the level of employment in the short run
- b. the rate of inflation in the long run and the level of employment in the short run
- c. the rate of inflation in the short run and the level of employment in the long run
- d. both the rate of inflation and the level of employment in both the short run and the long run

ANS: B PTS: 1 DIF: Average REF: p.228
BLM: Higher Order NOT: Macro TB_10-109

110. To increase the money supply, which of the following could the Bank of Canada do?

- a. sell government bonds
- b. increase the bank rate
- c. decrease the reserve requirement
- d. decrease the money multiplier

ANS: C PTS: 1 DIF: Easy REF: p.232-235
BLM: Remember NOT: Macro TB_10-110

111. How does the Bank of Canada conduct open market transactions?

- a. It issues banknotes.
- b. It buys or sells government bonds from/to the public.
- c. It lowers the bank rate.
- d. It increases its lending to chartered banks.

ANS: B PTS: 1 DIF: Easy REF: p.232-233
BLM: Remember NOT: Macro TB_10-111

112. How could the Bank of Canada increase the money supply?

- a. sell government bonds
- b. decrease the bank rate
- c. increase the reserve requirement
- d. increase the bank rate

ANS: B PTS: 1 DIF: Easy REF: p.232-235
BLM: Remember NOT: Macro TB_10-112

113. How could the Bank of Canada decrease the money supply?

- a. buy government bonds
- b. decrease the bank rate
- c. decrease the reserve requirement
- d. increase the bank rate

ANS: D PTS: 1 DIF: Easy REF: p.232-235
BLM: Remember NOT: Macro TB_10-113

114. When the Bank of Canada conducts open market purchases, how do commercial banks' assets most likely change?

- a. Reserves increase and banks increase lending.
- b. Reserves increase and banks decrease lending.
- c. Reserves decrease and banks increase lending.
- d. Reserves decrease and banks decrease lending.

ANS: A PTS: 1 DIF: Average REF: p.232-233
BLM: Higher Order NOT: Macro TB_10-114

115. Which of the following best describes the process of open market sales conducted by the Bank of Canada?

- a. The Bank of Canada sells Treasury bills, which increases the money supply.
- b. The Bank of Canada sells Treasury bills, which decreases the money supply.
- c. The Bank of Canada borrows from member banks, which increases the money supply.
- d. The Bank of Canada lends money to member banks, which decreases the money supply.

ANS: B PTS: 1 DIF: Easy REF: p.232-233
BLM: Higher Order NOT: Macro TB_10-115

116. Which of the following best describes the consequences of open market sales conducted by the Bank of Canada?

- a. Bank reserves increase and the money supply increases.
- b. Bank reserves increase and the money supply decreases.
- c. Bank reserves decrease and the money supply increases.
- d. Bank reserves decrease and the money supply decreases.

ANS: D PTS: 1 DIF: Average REF: p.232-233
BLM: Higher Order NOT: Macro TB_10-116

117. Which of the following best describes the process of open market purchases conducted by the Bank of Canada?

- a. The Bank of Canada buys Treasury bills, which increases the money supply.
- b. The Bank of Canada buys Treasury bills, which decreases the money supply.
- c. The Bank of Canada borrows from member banks, which increases the money supply.
- d. The Bank of Canada lends money to member banks, which decreases the money supply.

ANS: A PTS: 1 DIF: Easy REF: p.232-233
BLM: Higher Order NOT: Macro TB_10-117

118. Which of the following best describes the consequences of open market purchases conducted by the Bank of Canada?

- a. Bank reserves increase and the money supply increases.
- b. Bank reserves increase and the money supply decreases.
- c. The Bank of Canada borrows from member banks, which increases the money supply.
- d. The Bank of Canada lends money to member banks, which decreases the money supply.

ANS: A PTS: 1 DIF: Easy REF: p.232-233
BLM: Higher Order NOT: Macro TB_10-118

119. How can the Bank of Canada increase the money supply?

- a. by conducting open market sales and raising the bank rate
- b. by conducting open market sales and lowering the bank rate
- c. by conducting open market purchases and raising the bank rate
- d. by conducting open market purchases and lowering the bank rate

ANS: D PTS: 1 DIF: Average REF: p.232-233
BLM: Remember NOT: Macro TB_10-119

120. How may the Bank of Canada influence the price level?

- a. by conducting open market sales and raising the bank rate
- b. by conducting open market sales and lowering the bank rate
- c. by conducting open market purchases and raising the bank rate
- d. by conducting open market purchases and lowering the bank rate

ANS: D PTS: 1 DIF: Challenging REF: p.232-233
BLM: Higher Order NOT: Macro TB_10-120

121. During what period can the Bank of Canada influence unemployment?

- a. in the short and long run
- b. in the short run, but not the long run
- c. in the long run, but not the short run
- d. in neither the short nor long run

ANS: B PTS: 1 DIF: Average REF: p.228
BLM: Higher Order NOT: Macro TB_10-121

122. Is there tradeoff between inflation and unemployment?

- a. There is a short-run tradeoff between inflation and unemployment.
- b. There is a long-run tradeoff between inflation and unemployment.
- c. There is a tradeoff between inflation and unemployment both in the short-run and long-run.
- d. There is no relationship between inflation and unemployment.

ANS: A PTS: 1 DIF: Easy REF: p.228
BLM: Higher Order NOT: Macro TB_10-122

123. When the Bank of Canada decreases the bank rate, banks will borrow more from the Bank of Canada. Which of the following best describes the consequences of this process?
- a. Banks lend more to the public, and so the money supply will decrease.
 - b. Banks lend less to the public, and so the money supply will decrease.
 - c. Banks lend more to the public, and so the money supply will increase.
 - d. Banks lend less to the public, and so the money supply will increase.

ANS: C PTS: 1 DIF: Average REF: p.234-235
BLM: Higher Order NOT: Macro TB_10-123

124. In a fractional reserve banking system, how does an increase in the reserve requirement change the money multiplier?
- a. The money multiplier increases by a higher percentage change than the increase in the reserve ratio.
 - b. The money multiplier decreases by a higher percentage change than the increase in the reserve ratio.
 - c. The money multiplier increases by a lower percentage change than the increase in the reserve ratio.
 - d. The money multiplier decreases by a lower percentage change than the increase in the reserve ratio.

ANS: A PTS: 1 DIF: Challenging REF: p.234
BLM: Higher Order NOT: Macro TB_10-124

125. Which of the following best describes the consequences of a decrease in the reserve requirements in a fractional reserve system?
- a. Both the money multiplier and the money supply increase.
 - b. Both the money multiplier and the money supply decrease.
 - c. The money multiplier increases, but the money supply decreases.
 - d. The money multiplier decreases, but the money supply increases.

ANS: A PTS: 1 DIF: Average REF: p.234
BLM: Higher Order NOT: Macro TB_10-125

126. Which of the following best defines reserve requirements?
- a. They are regulations concerning the amount banks are allowed to borrow from the central bank.
 - b. They are regulations concerning the amount of reserves banks must hold against deposits.
 - c. They are regulations concerning reserves banks must hold based on the number and type of loans they make.
 - d. They are regulations concerning the interest rate at which banks can borrow from the central bank.

ANS: B PTS: 1 DIF: Easy REF: p.234
BLM: Remember NOT: Macro TB_10-126

127. Which of the following best describes the consequences of an increase in reserve requirements?
- a. The reserve ratio increases, the money multiplier increases, and the money supply increases.
 - b. The reserve ratio increases, the money multiplier decreases, and the money supply decreases.
 - c. The reserve ratio decreases, the money multiplier increases, and the money supply increases.
 - d. The reserve ratio decreases, the money multiplier decreases, and the money supply increases.

ANS: B PTS: 1 DIF: Challenging REF: p.234
BLM: Higher Order NOT: Macro TB_10-127

128. Which of the following best describes the consequences of a decrease in reserve requirements?
- a. The reserve ratio decreases, the money multiplier decreases, and the money supply decreases.
 - b. The reserve ratio increases, the money multiplier increases, and the money supply increases.
 - c. The reserve ratio decreases, the money multiplier increases, and the money supply increases.
 - d. The reserve ratio increases, the money multiplier decreases, and the money supply decreases.

ANS: C PTS: 1 DIF: Challenging REF: p.234
BLM: Higher Order NOT: Macro TB_10-128

129. Which of the following best describes the consequences of a decrease in the bank rate?
- a. Banks will borrow less from Bank of Canada so reserves increase.
 - b. Banks will borrow less from Bank of Canada so reserves decrease.
 - c. Banks will borrow more from Bank of Canada so reserves increase.
 - d. Banks will borrow more from Bank of Canada so reserves decrease.

ANS: C PTS: 1 DIF: Easy REF: p.234-235
BLM: Higher Order NOT: Macro TB_10-129

130. Which of the following best describes the consequences of an increase in the bank rate?
- a. Banks will borrow more from Bank of Canada so reserves increase.
 - b. Banks will borrow more from Bank of Canada so reserves decrease.
 - c. Banks will borrow less from Bank of Canada so reserves increase.
 - d. Banks will borrow less from Bank of Canada so reserves decrease.

ANS: D PTS: 1 DIF: Easy REF: p.234-235
BLM: Remember NOT: Macro TB_10-130

131. Which of the following best defines the bank rate?
- a. It is the interest rate the Bank of Canada charges banks.
 - b. It is one divided by the difference between one and the reserve ratio.
 - c. It is the interest rate banks receive on reserve deposits with Bank of Canada.
 - d. It is the interest rate that banks charge on overnight loans to other banks.

ANS: A PTS: 1 DIF: Easy REF: p.234-235
BLM: Remember NOT: Macro TB_10-131

132. What is the interest rate the Bank of Canada charges on loans it makes to banks?
- a. the prime rate
 - b. the federal funds rate
 - c. the bank rate
 - d. the operating band

ANS: C PTS: 1 DIF: Average REF: p.234-235
BLM: Remember NOT: Macro TB_10-132

133. In a fractional reserve banking system with no excess reserves and no currency holdings, suppose the central bank buys \$100 million of bonds. Which of the following best describes the effects of this open market operation?
- a. Reserves and the money supply increase by less than \$100 million.
 - b. Reserves increase by \$100 million and the money supply increases by \$100 million.
 - c. Reserves increase by \$100 million and the money supply increases by more than \$100 million.
 - d. Both reserves and the money supply increase by more than \$100 million.

ANS: C PTS: 1 DIF: Average REF: p.231-233
BLM: Higher Order NOT: Macro TB_10-133

134. Suppose the reserve ratio is 10 percent, banks do not hold excess reserves, people do not hold currency, and the Bank of Canada purchases \$20 million of government bonds. Which of the following best describes the effects of Bank of Canada's purchase?
- a. Bank reserves increase by \$20 million, and the money supply eventually increases by \$200 million.
 - b. Bank reserves decrease by \$20 million, and the money supply eventually increases by \$200 million.
 - c. Bank reserves increase by \$20 million, and the money supply eventually decreases by \$200 million.
 - d. Bank reserves decrease by \$20 million, and the money supply eventually decreases by \$200 million.

ANS: A PTS: 1 DIF: Easy REF: p.231-233
BLM: Higher Order NOT: Macro TB_10-134

135. Suppose the reserve ratio is 20 percent, and banks do not hold excess reserves. Under these circumstances, suppose the Bank of Canada sells \$40 million of bonds to the public. Which of the following best describes the effects of this open market operation?
- a. Bank reserves increase by \$40 million, and the money supply eventually increases by \$200 million.
 - b. Bank reserves increase by \$40 million, and the money supply eventually increases by \$800 million.
 - c. Bank reserves decrease by \$40 million, and the money supply eventually decreases by \$200 million.
 - d. Bank reserves decrease by \$40 million, and the money supply eventually decreases by \$800 million.

ANS: C PTS: 1 DIF: Challenging REF: p.231-233
BLM: Higher Order NOT: Macro TB_10-135

136. Suppose the reserve ratio is 10 percent, and banks do not hold excess reserves. Suppose the Bank of Canada sells \$10 million of bonds to the public. Which of the following best describes the effects of this open market operation?
- a. Bank reserves increase by \$1 million, and the money supply eventually increases by \$10 million.
 - b. Bank reserves increase by \$10 million, and the money supply eventually increases by \$100 million.
 - c. Bank reserves decrease by \$1 million, and the money supply eventually increases by \$10 million.
 - d. Bank reserves decrease by \$10 million, and the money supply eventually decreases by \$100 million.

ANS: D PTS: 1 DIF: Challenging REF: p.231-233
BLM: Higher Order NOT: Macro TB_10-136

137. Suppose the public decides to hold more currency and fewer deposits in banks. Which of the following best describes the effects of this decision?
- a. Bank reserves decrease, and the money supply eventually decreases.
 - b. Bank reserves decrease, but the money supply does not change.
 - c. Bank reserves increase, and the money supply eventually increases.
 - d. Bank reserves increase, but the money supply does not change.

ANS: A PTS: 1 DIF: Average REF: p.235
BLM: Higher Order NOT: Macro TB_10-137

138. During recessions, banks typically choose to hold more excess reserves relative to their deposits. Which of the following best describes the effects of the increase in reserves?
- a. The money multiplier increases, and the money supply increases.
 - b. The money multiplier decreases, and the money supply decreases.
 - c. The money multiplier does not change, but the money supply increases.
 - d. The money multiplier does not change, but the money supply decreases.

ANS: B PTS: 1 DIF: Average REF: p.235-237
BLM: Higher Order NOT: Macro TB_10-138

139. During wars, the public tends to hold relatively more currency and relatively fewer deposits. Which of the following best describes the effects of this increase in currency holdings?
- a. Reserves would decrease, and the money supply would increase.
 - b. Reserves and the money supply would decrease.
 - c. Reserves would increase, but the money supply would be unchanged.
 - d. Reserves would decrease, but the money supply would be unchanged.

ANS: B PTS: 1 DIF: Easy REF: p.235-237
BLM: Higher Order NOT: Macro TB_10-139

140. Who determines the amount of money in the economy?
- a. The Bank of Canada controls the money supply precisely.
 - b. The amount of money in the economy does not depend on the behaviour of depositors.
 - c. The amount of money in the economy depends in part on the behaviour of banks.
 - d. The Minister of Finance determines the amount of money in the economy by law.

ANS: C PTS: 1 DIF: Easy REF: p.235
BLM: Remember NOT: Macro TB_10-140

141. How does currency contribute to the money supply?
- a. Currency held by the public and by banks is part of the money supply.
 - b. Currency held by the public is part of the money supply, but currency held by banks is not.
 - c. Currency held by the public is not part of the money supply, but currency held by banks is.
 - d. Currency held by the public or banks is not part of the money supply since it is not included in M1.

ANS: B PTS: 1 DIF: Easy REF: p.235
BLM: Higher Order NOT: Macro TB_10-141

142. Assume that banks do not hold excess reserves. The banking system has \$20 million in reserves and has a reserve requirement of 20 percent. The public holds \$10 million in currency. Then the public decides to withdraw \$5 million in currency from the banking system. If the Bank of Canada wants to keep the money supply stable by changing the reserve requirement, then what will the new reserve requirement be?
- a. 20 percent
 - b. 18.2 percent
 - c. 15.8 percent
 - d. 15 percent

ANS: C PTS: 1 DIF: Challenging REF: p.229-231 | p.235
BLM: Higher Order NOT: Macro TB_10-142

143. Assume that banks do not hold excess reserves. The banking system has \$50 million in reserves and has a reserve requirement of 10 percent. The public holds \$20 million in currency. Then the public decides to withdraw \$5 million in currency from the banking system. If the Bank of Canada wants to keep the money supply stable by changing the reserve requirement, then what will the new reserve requirement be?
- a. 10 percent
 - b. 9.1 percent
 - c. 9 percent
 - d. 8.1 percent

ANS: B PTS: 1 DIF: Challenging REF: p.229-231 | p.234
BLM: Higher Order NOT: Macro TB_10-143

144. The banking system has \$20 million in reserves and has a reserve requirement of 20 percent. Bankers previously did not hold any excess reserves, but difficult economic times make them decide that it is prudent to hold 25 percent of deposits as reserves. Other things equal, by how much must the Bank of Canada increase bank reserves to keep the money supply the same?
- a. \$4 million
 - b. \$5 million
 - c. \$20 million
 - d. No action by the Bank of Canada is necessary.

ANS: B PTS: 1 DIF: Challenging REF: p.229-231 | p.234
BLM: Higher Order NOT: Macro TB_10-144

145. The banking system has \$20 million in reserves and has a reserve requirement of 20 percent. The public holds \$10 million in currency. Bankers previously did not hold any excess reserves, but difficult economic times make them decide that it is prudent to hold 25 percent of deposits as reserves. At the same time, the public decides to withdraw \$10 million in currency from the banking system. Other things equal, by how much must the Bank of Canada increase bank reserves to keep the money supply the same?
- a. \$10 million
 - b. \$12.5 million
 - c. \$50 million
 - d. No action by the Bank of Canada is necessary.

ANS: B PTS: 1 DIF: Challenging REF: p.229-231 | p.234
BLM: Higher Order NOT: Macro TB_10-145

146. The banking system has \$20 million in reserves and has a reserve requirement of 20 percent. The public holds \$20 million in currency. Bankers previously did not hold any excess reserves, but difficult economic times make them decide that it is prudent to hold 25 percent of deposits as reserves. At the same time, the public decides to deposit \$6.7 million in currency into the banking system. Other things equal, what must the Bank of Canada do to bank reserves to keep the money supply the same?
- a. reduce reserves by \$6.7 million
 - b. reduce reserves by \$5 million
 - c. increase reserves by \$3 million
 - d. No action by the Bank of Canada is necessary.

ANS: D PTS: 1 DIF: Challenging REF: p.229-231 | p.234
BLM: Higher Order NOT: Macro TB_10-146

147. Which of the following best explains whether bank runs are a problem for the economy?
- a. They are not a problem, because bank runs will affect neither the money supply nor the money multiplier.
 - b. Bank runs are only a problem for insolvent banks.
 - c. They are a problem, but they can be neither prevented nor stopped by a central bank.
 - d. Bank runs are a problem because bank failures may spread to healthy banks.

ANS: D PTS: 1 DIF: Easy REF: p.236-237
BLM: Higher Order NOT: Macro TB_10-147

148. How can the Bank of Canada directly protect a bank during a bank run?
- a. by increasing reserve requirements
 - b. by selling government bonds to the bank
 - c. by lending reserves to the bank
 - d. by penalizing the bank in trouble

ANS: C PTS: 1 DIF: Easy REF: p.236-237
BLM: Higher Order NOT: Macro TB_10-149

149. Which of the following happened during the Great Depression in the early 1930s?
- a. The Great Depression was as bad in Canada as it was in the United States.
 - b. The Bank runs closed many banks in Canada. .
 - c. The money supply rose sharply.
 - d. The value of Canadian exports increased considerably.

ANS: A PTS: 1 DIF: Easy REF: p.236-237
BLM: Remember NOT: Macro TB_10-149

150. In the nineteenth century when there were often bank runs caused by crop failures, banks would make relatively fewer loans and hold relatively more excess reserves. By itself, which of the following actions should the banks have done?
- a. They should have increased both the money multiplier and the money supply.
 - b. They should have decreased the money multiplier and increased the money supply.
 - c. They should have increased the money multiplier and decreased the money supply.
 - d. They should have decreased both the money multiplier and the money supply.

ANS: D PTS: 1 DIF: Easy REF: p.235-237
BLM: Higher Order NOT: Macro TB_10-150

151. Which of the following best describes bank runs today?
- a. Bank runs are uncommon because of the high required reserve ratio.
 - b. Bank runs are uncommon because of CDIC deposit insurance.
 - c. Bank runs are common because of the low required reserve ratio.
 - d. Bank runs are common because the CDIC is inefficient.

ANS: B PTS: 1 DIF: Easy REF: p.236-237
BLM: Remember NOT: Macro TB_10-151

152. Which of the following explains the role of the Canadian Deposit Insurance Corporation (CDIC)?
- a. The CDIC protects depositors in the event of bank failures.
 - b. The CDIC routinely makes overnight loans to banks.
 - c. The CDIC determines the bank rate.
 - d. The CDIC determines the reserve requirement.

ANS: A PTS: 1 DIF: Easy REF: p.237
BLM: Remember NOT: Macro TB_10-152

TRUE/FALSE

1. In an economy that relies on barter, trade requires a double coincidence of wants.

ANS: T PTS: 1 DIF: Easy REF: p.220
NOT: Macro TB_10-153

2. The use of money allows trade to be roundabout.

ANS: T PTS: 1 DIF: Easy REF: p.220
NOT: Macro TB_10-154

3. Joe wants to trade eggs for sausage. Lashonda wants to trade eggs for orange juice. Joe and Lashonda have a double coincidence of wants.

ANS: F PTS: 1 DIF: Easy REF: p.220
NOT: Macro TB_10-155

4. Gary's wealth is \$1 million. Economists would say that Gary has \$1 million worth of money.

ANS: F PTS: 1 DIF: Easy REF: p.220
NOT: Macro TB_10-156

5. Marc puts prices on surfboards and skateboards at his sporting goods store. He is using money as a unit of account.

ANS: T PTS: 1 DIF: Easy REF: p.221
NOT: Macro TB_10-157

6. Ralph deposits half of his inheritance in a savings account at the bank. In doing so, Ralph is using money as a medium of exchange.

ANS: F PTS: 1 DIF: Easy REF: p.221
NOT: Macro TB_10-158

7. Bottles of very fine wine are less liquid than demand deposits.

ANS: T PTS: 1 DIF: Easy REF: p.221
NOT: Macro TB_10-159

8. When the Soviet Union began breaking up in the late 1980s, cigarettes began replacing the ruble as the medium of exchange, even though the ruble was legal tender. The cigarettes provide an example of fiat money.

ANS: F PTS: 1 DIF: Easy REF: p.222
NOT: Macro TB_10-160

9. In order for currency to be widely used as a medium of exchange, it is sufficient for the government to designate it as legal tender.

ANS: F PTS: 1 DIF: Easy REF: p.222
NOT: Macro TB_10-161

10. M1 includes savings deposits.

ANS: F PTS: 1 DIF: Easy REF: p.225
NOT: Macro TB_10-162

11. M2 is both larger and more liquid than M1.

ANS: F PTS: 1 DIF: Easy REF: p.225
NOT: Macro TB_10-163

12. Credit cards are not a medium of exchange and so are not important for analyzing the monetary system.

ANS: F PTS: 1 DIF: Easy REF: p.224
NOT: Macro TB_10-164

13. The Bank of Canada is a privately operated commercial bank.

ANS: F PTS: 1 DIF: Easy REF: p.226
NOT: Macro TB_10-165

14. The Bank of Canada was created in 1934 in the wake of the Great Depression.

ANS: T PTS: 1 DIF: Easy REF: p.226
NOT: Macro TB_10-166

15. The Bank of Canada is run by the Board of Directors, who are appointed by the minister of Finance.

ANS: T PTS: 1 DIF: Easy REF: p.226
NOT: Macro TB_10-167

16. Monetary policy is determined by the Bank of Canada's governor.

ANS: F PTS: 1 DIF: Easy REF: p.227
NOT: Macro TB_10-168

17. If the Bank of Canada buys bonds in the open market, the money supply decreases.

ANS: F PTS: 1 DIF: Easy REF: p.241
NOT: Macro TB_10-169

18. Banks could not change the money supply if they were required to hold all deposits in reserve.

ANS: T PTS: 1 DIF: Easy REF: p.229
NOT: Macro TB_10-170

19. The money multiplier equals 1 divided by $(1 - \text{the reserve ratio})$.

ANS: F PTS: 1 DIF: Easy REF: p.231
NOT: Macro TB_10-171

20. As banks create money, they create wealth.

ANS: F PTS: 1 DIF: Easy REF: p.228-230
NOT: Macro TB_10-172

21. The money supply of Hooba is \$10 000 under a 100 percent reserve banking system. If Hooba decreases the reserve requirement to 10 percent, the money supply could increase by no more than \$9000.

ANS: F PTS: 1 DIF: Average REF: p.229-230
NOT: Macro TB_10-173

22. If the Bank of Canada decreases reserve requirements, the money supply will increase.

ANS: T PTS: 1 DIF: Easy REF: p.234
NOT: Macro TB_10-174

23. An increase in reserve requirements raises the reserve ratio and decreases the money supply.

ANS: T PTS: 1 DIF: Average REF: p.234
NOT: Macro TB_10-175

24. If banks decide to hold a smaller part of their deposits as excess reserves, the money supply will fall, *ceteris paribus*.

ANS: F PTS: 1 DIF: Average REF: p.229-231
NOT: Macro TB_10-176

SHORT ANSWER

1. Economists argue that the move from barter to money increased trade and production. How is this possible?

ANS:

The use of money allows people to trade more easily. When it is easier to trade what one produces, people specialize. The specialization creates greater production.

PTS: 1 DIF: Average REF: p.220 NOT: Macro TB_10-177

2. What is the difference between money and wealth?

ANS:

Money is defined as the set of assets in the economy that people regularly use to buy goods and services from other people. Wealth includes all assets, both monetary and nonmonetary.

PTS: 1 DIF: Average REF: p.220 NOT: Macro TB_10-178

3. Which of the three functions of money are met by each of the following assets in the Canadian economy?
- paper dollar
 - precious metals
 - collectibles such as baseball cards, stamps, and antiques

ANS:

- medium of exchange, store of value, unit of account
- store of value
- store of value

PTS: 1 DIF: Easy REF: p.221 NOT: Macro TB_10-179

4. Are credit cards and debit cards money? What's the difference between credit and debit cards?

ANS:

Neither credit cards nor debit cards are money, but credit cards are very different from debit cards. Credit cards are not a medium of exchange, but are a means of deferring payment. Debit cards allow the user immediate access to deposits in a bank account, which are part of the money supply.

PTS: 1 DIF: Average REF: p.224 NOT: Macro TB_10-180

5. What is the difference between commodity money and fiat money? Why do people accept fiat currency in trade for goods and services?

ANS:

Commodity money has "intrinsic value," or value in uses other than as money. Fiat money is established as money by government. It has very little, if any, intrinsic value. Although fiat currency has no intrinsic value, people accept it in trade when they are confident that others will also accept it. The government's decree that fiat currency serves as legal tender increases this confidence.

PTS: 1 DIF: Average REF: p.221-222 NOT: Macro TB_10-180

6. What does the text mean by, and how does it answer the question, "Where Is All the Currency?"

ANS:

The amount of currency per person is over \$2052. Most people carry far less than this with them. The question is, "where is the rest of the currency?" Foreigners and criminals hold some. Criminals use currency because it makes it harder for the government to trace their activities than if they used bank accounts. So they may hold above average amounts of currency.

PTS: 1 DIF: Average REF: p.225-226 NOT: Macro TB_10-181

7. What is meant by the term "lender of last resort?" In what circumstances might the Bank of Canada be a lender of last resort?

ANS:

A "lender of last resort" is a lender to those who cannot borrow anywhere else. The Bank might loan funds to a solvent bank that is experiencing a bank run and so doesn't have enough cash on hand to meet depositors' demands.

PTS: 1 DIF: Easy REF: p.235 NOT: Macro TB_10-182

8. Which two of the *Ten Principles of Economics* imply that the Bank of Canada can profoundly affect the economy?

ANS:

1. Prices rise when the government prints too much money.
2. There is a short-run tradeoff between inflation and unemployment.

PTS: 1 DIF: Average REF: p.228 NOT: Macro TB_10-183

9. Explain why banks can influence the money supply if the required reserve ratio is less than 100 percent.

ANS:

When the reserve requirement is less than 100 percent, banks can lend out deposits. The money they lend out is redeposited. In this way, deposits can be greater than reserves. Since deposits are greater under fractional-reserve banking and since deposits are part of the money supply, the money supply will be greater under fractional-reserve banking.

PTS: 1 DIF: Average REF: p.229-231 NOT: Macro TB_10-184

10. If the reserve ratio is 20 percent, how much money can be created from \$100 of reserves? Show your work.

ANS:

$$(1/.20) \times \$100 = \$500.$$

PTS: 1 DIF: Easy REF: p.229-231 NOT: Macro TB_10-185

11. What is the difference between the reserve ratio and the reserve requirement? Which is generally larger?

ANS:

The reserve ratio is the percent of deposits that banks hold as reserves. The reserve requirement is the minimum percent of deposits that banks must hold in reserve by law. To maintain some liquidity, banks generally hold more reserves than required so that the reserve ratio is larger than the reserve requirement.

PTS: 1 DIF: Average REF: p.229-231 NOT: Macro TB_10-186

12. Draw a simple T-account for First National Bank of Me, which has \$5000 of deposits, a reserve ratio of 10 percent, and excess reserves of \$300.

ANS:

<u>First National Bank of Me</u>			
Assets		Liabilities	
Reserves	\$800	Deposits	\$5,000
Loans	\$4200		

PTS: 1 DIF: Average REF: p.229-231 NOT: Macro TB_10-187

13. Explain how each of the following changes the money supply.
- the Bank of Canada buys bonds
 - the Bank of Canada raises the bank rate
 - the Bank of Canada raises the reserve requirement

ANS:

- If the Bank of Canada buys bonds, it pays for them with money. So there is more money.
- If the Bank of Canada raises the bank rate, banks will borrow less from the Bank, and so have fewer reserves, which decreases the money supply.
- If the Bank of Canada raises the reserve requirement, banks will have to hold more of their deposits as reserves and so will have less to lend out. With less to lend out, deposits and the money supply decrease.

PTS: 1 DIF: Average REF: p.232-235 NOT: Macro TB_10-188

14. Describe the two things that limit the precision of the Bank of Canada's control of the money supply and explain how each limits that control.

ANS:

First, the Bank of Canada does not control the amount of currency that households choose to hold relative to deposits. If households decide to hold relatively more currency, banks have fewer reserves and the money supply decreases. Second, the Bank of Canada cannot control the amount banks choose to hold as excess reserves. If bankers decide to lend out less of their deposits, the money supply will decrease.

PTS: 1 DIF: Challenging REF: p.235-236 NOT: Macro TB_10-189

15. During the early 1930s, there were a number of bank failures in the United States. What did this do to the money supply? The New York Federal Reserve Bank advocated open market purchases. Would these purchases have reversed the change in the money supply and helped banks? Explain.

ANS:

Bank failures cause people to lose confidence in the banking system so that deposits fall and banks have less to lend. Further, under these circumstances, banks are probably more cautious about lending. Both of these reactions would tend to decrease the money supply. Open market purchases increase bank reserves and so may offset the decrease in the money supply. The increase in reserves would also have provided banks with greater liquidity to meet the demands of customers who wanted to make withdrawals.

PTS: 1

DIF: Challenging REF: p.236

NOT: Macro TB_10-190

PROBLEM

1. Suppose an economy has no money, and people use gold for all payments.
- Discuss the effects of economic growth (an increase in the amount of goods and services that the economy produces) on prices.
 - What happens to prices when more gold becomes available, say due to new openings of gold mines?
 - Who determines the economy's money supply?
 - Discuss the advantages and disadvantages of such a "gold standard" economy.

ANS:

- If the amount of goods and services available for purchase increases, but the amount of gold "money" remains the same, prices must decrease. In other words, the value of the unit of gold becomes higher in terms of the goods and services that it can buy.
- When the amount of gold in the economy increases, while the production of goods and services remains the same, prices must increase; the economy experiences inflation.
- Based on the answer to point (b), one can easily see that the money supply is determined by the amount of gold in the economy. Thus, the country's "monetary policy" is determined by geologists and gold mine owners, rather than governments.
- The advantage of a "gold standard" economy is that the tools of monetary policy cannot be abused by governments being in financial trouble. The disadvantage is that the amount of gold money is not related to the growth needs of the economy.

PTS: 1

NOT: Macro TB_10-191

2. Suppose the value of bank notes issued by the Bank of Canada as of 31 December, 2009, was \$56 billion, while the money supply (M2+) was about \$1.3 trillion.
 - a. Assuming that half of the bank note value is in the hands of the population and the other half in banks' reserves, what must have been the money multiplier?
 - b. What is the average bank reserve ratio corresponding to the money multiplier calculated at point (b)?
 - c. Now, let us assume that people hold one-tenth of their money (cash plus deposits) in cash and nine-tenths in bank deposits. With the reserve ratio calculated above, what is the value of the bank notes in the banks' reserves?
 - d. What is the value of the bank notes in circulation, if the bank reserves are equal to the number you calculated c?

ANS:

- a. Let M be the money multiplier. This number must satisfy the equation $56/2 + (56/2) \times M = 1300$. The solution is $M = (2 \times 1300 - 56)/56 = 45.4$.
- b. The reserve ratio corresponding to money multiplier determined above is $r = 1/M = 1/45.4 = 0.022$, or 2.2%.
- c. Let R be the value of the bank notes in the banks' reserves. This number must be such that $R/0.022 = (9/10)(56 - R + R/0.022)$. The solution to this equation is $R = \$9.3$ billion.
- d. The value of the bank notes in circulation is $\$56 \text{ billion} - \$9.3 \text{ billion} = \$46.7 \text{ billion}$.

PTS: 1

NOT: Macro TB_10-192

3. In order to support the Canadian dollar, suppose the Bank of Canada buys an amount of Euros from some major commercial Canadian banks (a type of operation the Bank of Canada rarely undertakes).
 - a. What is the immediate and the longer term impact of this operation on the money supply?
 - b. If the Bank of Canada does not wish that the currency swap influence the money supply, what does it have to do?

ANS:

- a. Since the purchase is from major commercial banks, which have their reserve funds in Bank of Canada's accounts, the payments go directly into these banks' reserves, with no cash involved. As long as the money stays in reserves (which may be for a very short time), the money supply is not affected because reserves are not part of either M1 or M2. Later, banks start making loans out of this excess reserve, and eventually the money supply will increase by the initial amount times the money multiplier.
- b. To sterilize the currency purchase, the Bank of Canada needs to sell other assets, such as Treasury bills. The value of this sell should be equal to the amount initially paid for the currency. Through the reversed action of the money multiplier, the money supply falls back to its initial level.

PTS: 1

NOT: Macro TB_10-193

4. Suppose Jeremiah deposits in a bank an amount of \$1000 that he had been holding at home in a jar for a long time.
 - a. If the banking system is 100 percent reserve, how does the money supply change?
 - b. If the reserve requirement is 10 percent and the bank holds no excess reserves, how does the money supply change?
 - c. If the reserve requirement is 10 percent and the bank holds an excess reserve of 2 percent, how does the money supply change?

ANS:

- a. By definition, the money supply is currency in circulation plus deposits (reserves are not part on the money supply.) If Jeremiah had been holding the \$1000 in a jar for a long time, in effect this money was not “in circulation,” and so it was not part of the money supply before being deposited in the bank. However, if the banking system is 100 percent reserve, then all “deposits” are reserves; therefore, the money supply does not change. If the money wasn’t held in a jar before, then the money supply would have decreased by \$1000.
- b. The money supply increases by $\$1000 \times 10 = \$10\,000$.
- c. The effective reserve ratio is 12 percent, hence the money supply increases by $\$1000 \times (1/0.12) = \$833$.

PTS: 1

NOT: Macro TB_10-194

5. Suppose Heather receives a payment in cash of \$400 and she deposits it in a bank.
 - a. If the banking system is 100 percent reserve, how does the money supply change?
 - b. If the reserve requirement is 10 percent and the bank holds no excess reserve, how does the money supply change?
 - c. If the reserve requirement is 10 percent and the bank holds an excess reserve of 2 percent, how does the money supply change?

ANS:

- a. Since the \$400 had been in circulation before being deposited in the bank, and after being deposited it remains in the bank’s reserve, the money supply decreases by \$400.
- b. The money supply decreases by \$400 because the currency is not in the hands of the public anymore, but increases by $\$400 \times 10 = \$4000$. Thus, the net effect on the money supply is $\$4000 - 400 = \$3600$.
- c. The money supply decreases by \$400 and increases by $\$400 \times 8.33 = \$3332$. The overall effect is an increase in the money supply of $\$3332 - 400 = \$2932$.

PTS: 1

NOT: Macro TB_10-195

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Chapter 11—Money Growth and Inflation

MULTIPLE CHOICE

1. How can inflation be measured?
 - a. by the change in the consumer price index
 - b. by the percentage change in the consumer price index
 - c. by the percentage change in the price of a specific commodity
 - d. by the change in the price of a specific commodity

ANS: B PTS: 1 DIF: Easy REF: p.241
BLM: Remember NOT: Macro TB_11-1

2. Over the past 70 years, what was the approximate average annual inflation rate?
 - a. 2 percent
 - b. 3 percent
 - c. 4 percent
 - d. 7 percent

ANS: C PTS: 1 DIF: Easy REF: p.241
BLM: Remember NOT: Macro TB_11-2

3. Over the past 70 years, what was the approximate average annual inflation rate?
 - a. 3 percent, implying that prices have increased 12-fold
 - b. 4 percent, implying that prices have increased 16-fold
 - c. 3 percent, implying that prices have increased 18-fold
 - d. 5 percent, implying that prices increased about 18-fold

ANS: B PTS: 1 DIF: Easy REF: p.241
BLM: Remember NOT: Macro TB_11-3

4. When prices are falling, which of the following terms do economists use?
 - a. disinflation
 - b. deflation
 - c. a contraction
 - d. an inverted inflation

ANS: B PTS: 1 DIF: Easy REF: p.241
BLM: Remember NOT: Macro TB_11-4

5. Which of the following best describes the evolution of inflation in Canada?
 - a. It has been relatively constant over the past 70 years.
 - b. The inflation rate was constant at 7 percent annually for most of the twentieth century.
 - c. During 1990s, prices rose at an average rate of about 2 percent per year.
 - d. There was deflation during the 1990s.

ANS: C PTS: 1 DIF: Easy REF: p.241
BLM: Remember NOT: Macro TB_11-5

6. Which of the following best describes the evolution of inflation in Canada?
- a. Prices rose at an average annual rate of about 2 percent over the last 60 years.
 - b. There was about a 12-fold increase in the price level over the last 60 years.
 - c. Inflation in the 1970s was above the average over the last 60 years.
 - d. Canada has never experienced periods of deflation.

ANS: C PTS: 1 DIF: Easy REF: p.241-242
BLM: Remember NOT: Macro TB_11-6

7. When and where did hyperinflation occur?
- a. during 1880–1896 in the United States
 - b. in post–World War I Germany
 - c. during the 1970s in Canada
 - d. during 1930–1933 in the United States

ANS: B PTS: 1 DIF: Easy REF: p.240
BLM: Remember NOT: Macro TB_11-7

8. Which of the following events took place in the early 1920s in Germany?
- a. deflation that proved detrimental to farmers
 - b. an aversion to inflation by policymakers that kept wages stagnant
 - c. an unexpected drop in inflation that hurt borrowers
 - d. an extraordinarily high rate of inflation

ANS: D PTS: 1 DIF: Easy REF: p.251
BLM: Remember NOT: Macro TB_11-8

9. Which of the following does the classical theory of inflation try to explain?
- a. changes in relative prices in the economy determined by factors other than inflation
 - b. the effect of inflation on economic growth
 - c. the short-run determinants of the price level and the inflation rate
 - d. the long-run determinants of the price level and the inflation rate

ANS: D PTS: 1 DIF: Easy REF: p.242
BLM: Remember NOT: Macro TB_11-9

10. Which of the following does the quantity theory of money try to explain?
- a. how inflation determines economic growth
 - b. the relationship between the quantity of money and the price level
 - c. the determinants of relative prices in the economy
 - d. the relationship between inflation and unemployment

ANS: B PTS: 1 DIF: Easy REF: p.242
BLM: Remember NOT: Macro TB_11-10

11. What do economists think about high and moderate inflation?
- They agree that neither high inflation nor moderate inflation is very costly.
 - They agree that both high and moderate inflation are quite costly
 - They agree that high inflation is costly, but they disagree about the costs of moderate inflation.
 - They agree that moderate inflation is as costly as high inflation, but they disagree about how to determine the costs of inflation.

ANS: C PTS: 1 DIF: Easy REF: p.242
BLM: Remember NOT: Macro TB_11-11

12. When the price level falls, what happens to the number of dollars needed to buy a representative basket of goods?
- It increases, so the value of money rises.
 - It increases, so the value of money falls.
 - It decreases, so the value of money rises.
 - It decreases, so the value of money falls.

ANS: C PTS: 1 DIF: Easy REF: p.242-243
BLM: Higher Order NOT: Macro TB_11-12

13. When the value of money rises, what happens to the number of dollars needed to buy a representative basket of goods?
- It increases, and so the price level rises.
 - It increases, and so the price level falls.
 - It decreases, and so the price level rises.
 - It decreases, and so the price level falls.

ANS: D PTS: 1 DIF: Average REF: p.242-243
BLM: Higher Order NOT: Macro TB_11-13

14. When the number of dollars needed to buy a representative basket of goods falls, what happens to the value of money?
- It rises, and so the price level rises.
 - It rises, and so the price level falls.
 - It falls, and so the price level rises.
 - It falls, and so the price level falls.

ANS: B PTS: 1 DIF: Average REF: p.242-243
BLM: Higher Order NOT: Macro TB_11-14

15. Why is the money supply curve vertical?
- because the quantity of money supplied increases when the value of money increases
 - because the quantity of money supplied increases when the value of money decreases
 - because the quantity of money supplied increases only if people desire to hold more money
 - because the quantity of money supplied increases only if the central bank increases the money supply

ANS: D PTS: 1 DIF: Easy REF: p.243
BLM: Higher Order NOT: Macro TB_11-15

16. How is the supply of money determined?

- a. by the price level
- b. by the Ministry of Finance
- c. by the Bank of Canada
- d. by the demand for money

ANS: C PTS: 1 DIF: Easy REF: p.243
BLM: Remember NOT: Macro TB_11-16

17. When does the supply of money increase?

- a. when the value of money increases
- b. when the price level decreases
- c. when the Bank of Canada makes open-market purchases
- d. when the Bank of Canada increases the bank rate

ANS: C PTS: 1 DIF: Average REF: p.243
BLM: Higher Order NOT: Macro TB_11-17

18. When the money market is depicted in a graph with the value of money on the vertical axis, what does an increase in the price level cause?

- a. a shift to the right of the money demand curve
- b. a shift to the left of the money demand curve
- c. a movement to the left along the money demand curve
- d. a movement to the right along the money demand curve

ANS: D PTS: 1 DIF: Easy REF: p.245
BLM: Higher Order NOT: Macro TB_11-18

19. When the money market is depicted in a graph with the value of money on the vertical axis, as the price level increases, how does the quantity of money demanded or supplied change?

- a. The quantity of money demanded increases.
- b. The quantity of money demanded decreases.
- c. The quantity of money supplied increases.
- d. The quantity of money supplied decreases.

ANS: A PTS: 1 DIF: Easy REF: p.245
BLM: Higher Order NOT: Macro TB_11-19

20. When the money market is depicted in a graph with the value of money on the vertical axis, as the price level increases, which of the following happens to the value of money?

- a. It increases, so the quantity of money demanded increases.
- b. It increases, so the quantity of money demanded decreases.
- c. It decreases, so the quantity of money demanded decreases.
- d. It decreases, so the quantity of money demanded increases.

ANS: D PTS: 1 DIF: Average REF: p.245
BLM: Higher Order NOT: Macro TB_11-20

21. As the price level decreases, which of the following happens to the value of money?
- a. It increases, so people want to hold more of it.
 - b. It increases, so people want to hold less of it.
 - c. It decreases, so people want to hold more of it.
 - d. It decreases, so people want to hold less of it.

ANS: B PTS: 1 DIF: Average REF: p.244-245
BLM: Higher Order NOT: Macro TB_11-21

22. When the money market is depicted in a diagram with the value of money on the vertical axis, which of the following best describes the money demand function?
- a. It slopes upward because at higher prices people want to hold more money.
 - b. It slopes downward because at higher prices people want to hold more money.
 - c. It slopes downward because at higher price people want to hold less money.
 - d. It slopes upward, because at higher prices people want to hold less money.

ANS: B PTS: 1 DIF: Easy REF: p.244-245
BLM: Higher Order NOT: Macro TB_11-22

23. Which of the following best describes the effects of an open market operation undertaken by the Bank of Canada?
- a. If the Bank of Canada purchases bonds in the open market, then the money supply shifts right and the price level increases.
 - b. If the Bank of Canada sells bonds in the open market, then money supply shifts right and the price level decreases.
 - c. If the Bank of Canada purchases bonds, then the money supply shifts left and the price level decreases.
 - d. If the Bank of Canada sells bonds, then the money supply shifts right and the price level decreases.

ANS: A PTS: 1 DIF: Average REF: p.244-245
BLM: Higher Order NOT: Macro TB_11-23

24. When the money market is represented in a diagram with the value of money on the vertical axis, how does the money supply curve shift from an increase in the money supply?
- a. It shifts to the right, lowering the price level.
 - b. It shifts to the right, raising the price level.
 - c. It shifts to the left, raising the price level.
 - d. It shifts to the left, lowering the price level.

ANS: B PTS: 1 DIF: Easy REF: p.244-245
BLM: Higher Order NOT: Macro TB_11-24

25. When the money market is represented in a diagram with the value of money on the vertical axis, which of the following best describes the effects of an increase in money supply?
- a. It increases the price level and the value of money.
 - b. It increases the price level and decreases the value of money.
 - c. It decreases the price level and increases the value of money.
 - d. It decreases the price level and the value of money.

ANS: B PTS: 1 DIF: Easy REF: p.244-245
BLM: Higher Order NOT: Macro TB_11-25

26. When the money market is depicted in a diagram with the value of money on the vertical axis, which of the following best describes the effects of an increase in money supply?
- The equilibrium value and equilibrium quantity of money both increase.
 - The equilibrium value and equilibrium quantity of money both decrease.
 - The equilibrium value increases, while the equilibrium quantity of money decreases.
 - The equilibrium value decreases, while the equilibrium quantity of money increases.

ANS: D PTS: 1 DIF: Easy REF: p.244-245
BLM: Higher Order NOT: Macro TB_11-26

27. When the money market is depicted in a diagram with the value of money on the vertical axis, in which of the following situations does the value of money increase?
- if either money demand or money supply shifts right
 - if either money demand or money supply shifts left
 - if money demand shifts right or money supply shifts left
 - if money demand shifts left or money supply shifts right

ANS: C PTS: 1 DIF: Easy REF: p.244-245
BLM: Higher Order NOT: Macro TB_11-27

28. When the money market is drawn with the value of money on the vertical axis, in which of the following situations does the price level increase?
- if either money demand or money supply shifts right
 - if either money demand or money supply shifts left
 - if money demand shifts right or money supply shifts left
 - if money demand shifts left or money supply shifts right

ANS: D PTS: 1 DIF: Easy REF: p.244-245
BLM: Higher Order NOT: Macro TB_11-28

29. When the money market is depicted in a diagram with the value of money on the vertical axis, in which situation does the price level decrease?
- if either money demand or money supply shifts right
 - if either money demand or money supply shifts left
 - if money demand shifts right or money supply shifts left
 - if money demand shifts left or money supply shifts right

ANS: C PTS: 1 DIF: Easy REF: p.244-245
BLM: Higher Order NOT: Macro TB_11-29

30. When the money market is depicted in a diagram with the value of money on the vertical axis, which of the following best describes the long run effects of an increase in money supply?
- The price level and the quantity of money demanded increases.
 - The price level increases, but the quantity of money demanded decreases.
 - The price level decreases, but the quantity of money demanded increases.
 - The price level and the quantity of money demanded decreases.

ANS: A PTS: 1 DIF: Easy REF: p.244-245
BLM: Higher Order NOT: Macro TB_11-30

31. Which of the following best describes the impact of open-market purchases by the Bank of Canada?
- a. The money supply and the value of money increase.
 - b. The money supply increases, which makes the value of money decrease.
 - c. The money supply and the value of money decrease.
 - d. The money supply decreases, which makes the value of money increase.

ANS: B PTS: 1 DIF: Easy REF: p.245-246
BLM: Higher Order NOT: Macro TB_11-31

32. In the 14th century, the Western African Emperor Kankan Musa travelled to Cairo where he gave away much gold, which was in use as a medium of exchange. Which of the following would we predict this increase in gold would do to the price level and value of gold in Cairo?
- a. raise both the price level and the value of gold in Cairo
 - b. raise the price level, but decrease the value of gold in Cairo
 - c. lower the price level, but increase the value of gold in Cairo
 - d. lower both the price level and the value of gold in Cairo

ANS: B PTS: 1 DIF: Easy REF: p.244-246
BLM: Higher Order NOT: Macro TB_11-32

33. In the 1970s in response to recessions caused by an increase in the price of oil, the central banks in many countries increased the money supply. How might the central banks have done this?
- a. by selling bonds on the open market, which would have raised the value of money
 - b. by purchasing bonds on the open market, which would have raised the value of money
 - c. by selling bonds on the open market, which would have raised the value of money
 - d. by purchasing bonds on the open market, which would have lowered the value of money

ANS: D PTS: 1 DIF: Average REF: p.244-246
BLM: Higher Order NOT: Macro TB_11-33

34. When the money market is depicted in a diagram with the value of money on the vertical axis, which of the following best describes the effects of an increase in money supply?
- a. It creates an excess supply of money, causing people to spend more.
 - b. It creates an excess supply of money, causing people to spend less.
 - c. It creates an excess demand for money, causing people to spend more.
 - d. It creates an excess demand for money, causing people to spend less.

ANS: A PTS: 1 DIF: Average REF: p.246-247
BLM: Higher Order NOT: Macro TB_11-34

35. Which of the following is the immediate and longer-term effect of a decrease in the money supply?
- a. A decrease in the money supply creates an excess supply of money that is eliminated by rising prices.
 - b. A decrease in the money supply creates an excess supply of money that is eliminated by falling prices.
 - c. A decrease in the money supply creates an excess demand for money that is eliminated by rising prices.
 - d. A decrease in the money supply creates an excess demand for money that is eliminated by falling prices.

ANS: D PTS: 1 DIF: Average REF: p.246-247
BLM: Higher Order NOT: Macro TB_11-35

36. When a graph of the money market is drawn with the value of money on the vertical axis, long-run equilibrium is obtained when the quantity demanded and quantity supplied of money are equal. This is due to adjustments in which of the following?
- the value of money
 - real interest rates
 - nominal interest rates
 - the money supply

ANS: A PTS: 1 DIF: Average REF: p.246-247
BLM: Higher Order NOT: Macro TB_11-36

37. When a graph of the money market is drawn with the value of money on the vertical axis, which of the following will happen if the value of money is below the equilibrium level?
- The price level will rise.
 - The value of money will rise.
 - Money demand will shift left.
 - Money demand will shift right.

ANS: B PTS: 1 DIF: Easy REF: p.246-247
BLM: Higher Order NOT: Macro TB_11-37

38. When the money market is depicted in a diagram with the value of money on the vertical axis, which of the following happens if the price level is above the equilibrium level?
- There is a shortage, so the price level will rise.
 - There is a shortage, so the price level will fall.
 - There is a surplus, so the price level will rise.
 - There is a surplus, so the price level will fall.

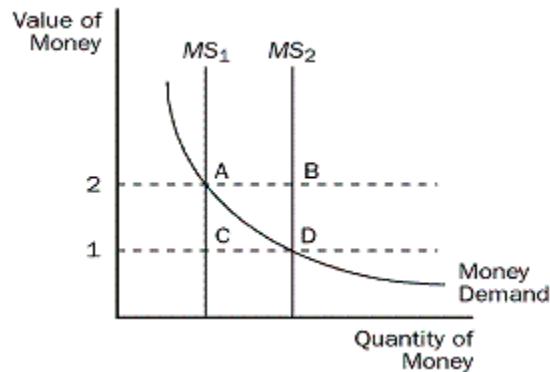
ANS: B PTS: 1 DIF: Challenging REF: p.246-247
BLM: Higher Order NOT: Macro TB_11-38

39. When the money market is depicted in a diagram with the value of money on the vertical axis, which of the following would shift money demand to the right?
- an increase in the price level
 - a decrease in the price level
 - a decrease in real GDP
 - an increase in real GDP

ANS: D PTS: 1 DIF: Average REF: p.246-247
BLM: Higher Order NOT: Macro TB_11-39

Use the figure below for the following questions.

Figure 30-1



40. **Refer to Figure 30-1.** If the money supply is MS_2 and the value of money is 2, which of the following relationships holds?
- The value of money is less than its equilibrium level.
 - The price level is higher than its equilibrium level.
 - Money demand is greater than the money supply.
 - The money supply is greater than money demand.

ANS: D PTS: 1 DIF: Average REF: p.246
BLM: Higher Order NOT: Macro TB_11-40

41. **Refer to Figure 30-1.** If the money supply is MS_2 and the value of money is 2, how much is the excess demand or supply?
- There is an excess demand equal to the distance between A and C.
 - There is an excess demand equal to the distance between A and B.
 - There is an excess supply equal to the distance between A and C.
 - There is an excess supply equal to the distance between A and B.

ANS: D PTS: 1 DIF: Average REF: p.246
BLM: Higher Order NOT: Macro TB_11-41

42. **Refer to Figure 30-1.** What happens when the money supply curve shifts from MS_1 to MS_2 ?
- The demand for goods and services decreases.
 - The economy's ability to produce goods and services increases.
 - The equilibrium price level increases.
 - The equilibrium value of money increases.

ANS: C PTS: 1 DIF: Easy REF: p.246
BLM: Higher Order NOT: Macro TB_11-42

43. **Refer to Figure 30-1.** What happens when the money supply curve shifts from MS_1 to MS_2 ?
- The equilibrium value of money decreases.
 - The equilibrium price level decreases.
 - The supply of money decreases.
 - The demand for goods and services decreases.

ANS: A PTS: 1 DIF: Easy REF: p.246
BLM: Higher Order NOT: Macro TB_11-43

44. **Refer to Figure 30-1.** If the current money supply is located at MS_1 and the value of money is 2, what is the excess demand or supply?
- a. There is no excess supply or excess demand.
 - b. There is an excess demand.
 - c. There is an excess supply.
 - d. There is both an excess demand and an excess supply.

ANS: A PTS: 1 DIF: Easy REF: p.246
BLM: Higher Order NOT: Macro TB_11-44

45. Which of the following terms refers to economic variables whose values are measured in monetary units?
- a. dichotomous variables
 - b. nominal variables
 - c. classical variables
 - d. real variables

ANS: B PTS: 1 DIF: Easy REF: p.247
BLM: Remember NOT: Macro TB_11-45

46. Randy pays \$120 for a bag of goods he purchases at the HyValu discount store. Which of the following accurately identifies the types of the variables involved?
- a. The \$120 is a real variable; the bag of groceries is a nominal variable.
 - b. The \$120 is a nominal variable; the bag of groceries is a real variable.
 - c. Both the \$120 and the bag of groceries are nominal variables.
 - d. Both the \$120 and the bag of groceries are real variables.

ANS: B PTS: 1 DIF: Easy REF: p.247
BLM: Higher Order NOT: Macro TB_11-44

47. Which of the following does nominal GDP measure?
- a. the total quantity of final goods and services produced
 - b. the dollar value of the economy's output of final goods and services
 - c. the total income received from producing final goods and services in constant dollars
 - d. the price level

ANS: B PTS: 1 DIF: Easy REF: p.247
BLM: Remember NOT: Macro TB_11-47

48. Which of the following does real GDP measure?
- a. the total quantity of final goods and services produced
 - b. the dollar value of the economy's output of final goods and services
 - c. the total income received from producing final goods and services at current prices
 - d. the change in prices from the base year to current year

ANS: A PTS: 1 DIF: Easy REF: p.247
BLM: Remember NOT: Macro TB_11-48

49. What type of variable is the price level?

- a. a relative variable
- b. an actual variable
- c. a real variable
- d. a nominal variable

ANS: D PTS: 1 DIF: Easy REF: p.247
BLM: Remember NOT: Macro TB_11-49

50. What is the price of a Honda Accord divided by the price of a Honda Civic called?

- a. a classical variable
- b. a dichotomous variable
- c. a nominal variable
- d. a real variable

ANS: D PTS: 1 DIF: Easy REF: p.247
BLM: Higher Order NOT: Macro TB_11-50

51. An assistant professor of economics gets a \$100-a-month raise, but then she figures that with her current monthly salary she can't buy as many goods as she could last year. Which of the following has happened to her real and nominal wage?

- a. Her real and nominal wages have risen.
- b. Her real and nominal wages have fallen.
- c. Her real wage has risen and her nominal wage has fallen.
- d. Her real wage has fallen and her nominal wage has risen.

ANS: D PTS: 1 DIF: Easy REF: p.247
BLM: Higher Order NOT: Macro TB_11-51

52. Your boss gives you an increase in the number of dollars you earn per hour. How does this change your nominal and real wages?

- a. This increase in pay makes your nominal wage increase. If your nominal wage rose by a greater percentage than the price level, then your real wage also increased.
- b. This increase in pay makes your nominal wage increase. If your nominal wage rose by a greater percentage than the price level, then your real wage decreased.
- c. This increase in pay makes your real wage increase. If your real wage rose by a greater percentage than the price level, then your nominal wage also increased.
- d. This increase in pay makes your real wage decrease. If your real wage rose by a greater percentage than the price level, then your nominal wage decreased.

ANS: A PTS: 1 DIF: Easy REF: p.247
BLM: Higher Order NOT: Macro TB_11-52

53. Which of the following kinds of variables are the interest rates stated in the *Wall Street Journal*?

- a. classical variables
- b. dichotomous variables
- c. nominal variables
- d. real variables

ANS: C PTS: 1 DIF: Easy REF: p.247
BLM: Higher Order NOT: Macro TB_11-53

54. Which of the following kinds of variables are interest rates adjusted for the effects of inflation?
- a. nominal variables
 - b. real variables
 - c. classical variables
 - d. dichotomous variables

ANS: B PTS: 1 DIF: Easy REF: p.247
BLM: Higher Order NOT: Macro TB_11-54

55. There is an idea that nominal variables are heavily influenced by the quantity of money and that money is largely irrelevant for understanding the determinants of real variables. What is this idea called?
- a. the velocity concept
 - b. the Fisher effect
 - c. the classical dichotomy
 - d. the classical theory of money

ANS: C PTS: 1 DIF: Easy REF: p.247
BLM: Remember NOT: Macro TB_11-55

56. Which of the following ideas does the classical dichotomy refers to?
- a. The supply of money is irrelevant for understanding the determinants of nominal and real variables.
 - b. The supply of money determines nominal variables, but not real variables.
 - c. The supply of money determines real variables, but not nominal variables.
 - d. The supply of money is a determinant of both real and nominal variables.

ANS: B PTS: 1 DIF: Easy REF: p.247
BLM: Remember NOT: Macro TB_11-56

57. According to the classical dichotomy, which of the following increases when the money supply increases?
- a. the real interest rate
 - b. real GDP
 - c. the real wage
 - d. the price level

ANS: D PTS: 1 DIF: Easy REF: p.247
BLM: Higher Order NOT: Macro TB_11-57

58. According to the classical dichotomy, which of the following is influenced by monetary factors?
- a. real GDP
 - b. unemployment
 - c. nominal interest rates
 - d. the real wage rate

ANS: C PTS: 1 DIF: Average REF: p.247
BLM: Higher Order NOT: Macro TB_11-58

59. According to the classical dichotomy, which of the following is influenced by monetary factors?
- a. the amount of goods and services that wages can buy
 - b. the interest rate adjusted for inflation
 - c. the current-dollar wage
 - d. the constant-dollar GDP

ANS: C PTS: 1 DIF: Easy REF: p.247
BLM: Higher Order NOT: Macro TB_11-59

60. According to the classical dichotomy, which of the following is **NOT** influenced by monetary factors?
- a. the price level
 - b. real GDP
 - c. nominal interest rates
 - d. nominal GDP

ANS: B PTS: 1 DIF: Easy REF: p.247
BLM: Remember NOT: Macro TB_11-60

61. According to the classical dichotomy, which of the following is **NOT** influenced by monetary factors?
- a. nominal GDP and nominal interest rates
 - b. real wages and real GDP
 - c. the price level and nominal GDP
 - d. the price level and nominal GDP

ANS: B PTS: 1 DIF: Easy REF: p.247
BLM: Remember NOT: Macro TB_11-61

62. According to which of the following theories are changes in nominal variables determined mostly by the quantity of money and the monetary system?
- a. both the classical dichotomy and the quantity theory of money
 - b. the classical dichotomy, but not the quantity theory of money
 - c. the quantity theory of money, but not the classical dichotomy
 - d. neither the classical dichotomy nor the quantity theory of money

ANS: A PTS: 1 DIF: Easy REF: p.247-250
BLM: Remember NOT: Macro TB_11-62

63. According to the classical dichotomy, when the money supply doubles, which of the following also double(s)?
- a. the price level and nominal wages
 - b. the price level, but not the nominal wage
 - c. the nominal wage, but not the price level
 - d. neither the nominal wage nor the price level

ANS: A PTS: 1 DIF: Easy REF: p.247-250
BLM: Higher Order NOT: Macro TB_11-63

64. According to the classical dichotomy, when the money supply doubles, which of the following also double(s)?
- a. the price level and nominal GDP
 - b. the price level and real GDP
 - c. only real GDP
 - d. only the price level

ANS: A PTS: 1 DIF: Average REF: p.247-250
BLM: Higher Order NOT: Macro TB_11-64

65. What does the principle of monetary neutrality imply?
- a. An increase in the money supply will increase real GDP and the price level.
 - b. An increase in the money supply will increase real GDP, but not the price level.
 - c. An increase in the money supply will increase the price level, but not real GDP.
 - d. An increase in the money supply will increase neither the price level nor real GDP.

ANS: C PTS: 1 DIF: Easy REF: p.248
BLM: Remember NOT: Macro TB_11-65

66. According to the principle of monetary neutrality, which of the following will a decrease in the money supply **NOT** change?
- a. nominal GDP
 - b. the price level
 - c. unemployment
 - d. the nominal wage rate

ANS: C PTS: 1 DIF: Easy REF: p.248
BLM: Remember NOT: Macro TB_11-66

67. Monetary neutrality implies that an increase in the quantity of money will increase which of the following?
- a. employment
 - b. the price level
 - c. the incentive to save
 - d. no other economic variable

ANS: B PTS: 1 DIF: Easy REF: p.248
BLM: Remember NOT: Macro TB_11-67

68. When do most economists believe the principle of monetary neutrality is relevant?
- a. relevant to both the short and long run
 - b. irrelevant to both the short and long run
 - c. mostly relevant to the short run
 - d. mostly relevant to the long run

ANS: D PTS: 1 DIF: Easy REF: p.248
BLM: Remember NOT: Macro TB_11-68

69. According to the classical dichotomy, when the money supply doubles, which of the following also double(s)?
- a. the value of the dollar
 - b. nominal interest rates
 - c. real interest rates
 - d. the price level

ANS: D PTS: 1 DIF: Easy REF: p.247-250
BLM: Higher Order NOT: Macro TB_11-69

70. Which of the following best defines the velocity of money?
- a. It is the rate at which the central bank puts money into the economy.
 - b. It is the same thing as the long-term growth rate of the money supply.
 - c. It is the money supply divided by nominal GDP.
 - d. It is the average number of times per year a dollar is spent.

ANS: D PTS: 1 DIF: Easy REF: p.249
BLM: Remember NOT: Macro TB_11-70

71. How is velocity computed?
- a. $(P \times Y)/M$
 - b. $(P \times M)/Y$
 - c. $(Y \times M)/P$
 - d. $(Y \times M)/V$

ANS: A PTS: 1 DIF: Easy REF: p.249
BLM: Higher Order NOT: Macro TB_11-71

72. Based on the quantity equation, if $M = 125$, $V = 4$, and $Y = 200$, what is P ?
- a. 0.5
 - b. 1
 - c. 1.5
 - d. 2.5

ANS: D PTS: 1 DIF: Easy REF: p.249
BLM: Higher Order NOT: Macro TB_11-72

73. According to the quantity equation, if $P = 15$, $Y = 10$, and $M = 20$, what is V ?
- a. 30
 - b. 15
 - c. 7.5
 - d. 7

ANS: C PTS: 1 DIF: Easy REF: p.249
BLM: Higher Order NOT: Macro TB_11-73

74. Last year, Tealandia produced 60 000 bags of green tea, which sold at 5 units each of Tealandia's currency—the Leaf. Tealandia's money supply was 10 000. What was the velocity of money in Tealandia?
- 40
 - 30
 - $5/6$
 - $1/30$

ANS: B PTS: 1 DIF: Easy REF: p.249
BLM: Higher Order NOT: Macro TB_11-74

75. According to the quantity equation, if $P = 4$ and $Y = 800$, which of the following pairs could M and V be?
- 800, 4
 - 600, 3
 - 400, 2
 - 200, 1

ANS: A PTS: 1 DIF: Average REF: p.249
BLM: Higher Order NOT: Macro TB_11-75

76. Assuming that V is constant, the quantity equation implies that an increase in M could result in which of the following?
- a decrease in the price level
 - an increase in real GDP
 - a decrease in nominal GDP
 - an increase in the price level

ANS: D PTS: 1 DIF: Average REF: p.249-250
BLM: Higher Order NOT: Macro TB_11-76

77. According to the quantity equation, if Y and V are constant, and M doubles, which of the following will happen to the price level?
- It will more than double.
 - It will less than double.
 - It will double.
 - It might double, less than double, or more than double; more information is needed.

ANS: C PTS: 1 DIF: Easy REF: p.249-250
BLM: Higher Order NOT: Macro TB_11-77

78. According to the quantity equation, if Y and M are constant, and V doubles, which of the following will happen to the price level?
- It will less than double.
 - It will double.
 - It will more than double.
 - It might double, more than double, or less than double; more information is needed.

ANS: B PTS: 1 DIF: Easy REF: p.249-250
BLM: Higher Order NOT: Macro TB_11-78

79. According to the quantity equation, if V and M are constant, and Y doubles, which of the following will happen to the price level?
- It will fall to half its original level.
 - It will not change.
 - It will double.
 - It will more than double.

ANS: A PTS: 1 DIF: Easy REF: p.249-250
BLM: Higher Order NOT: Macro TB_11-79

80. If velocity and output were nearly constant, how would the inflation rate compare with the money supply growth rate?
- The inflation rate would be much higher than the money supply growth rate.
 - The inflation rate would be about the same as the money supply growth rate.
 - The inflation rate would be much lower than the money supply growth rate.
 - The inflation rate cannot be compared with the money supply growth rate because they are independent of each other.

ANS: B PTS: 1 DIF: Easy REF: p.249-250
BLM: Higher Order NOT: Macro TB_11-80

81. The money supply in Freedonia is \$100 billion. Nominal GDP is \$800 billion, and real GDP is \$200 billion. What is the price level in Freedonia?
- 1
 - 2
 - 4
 - 8

ANS: C PTS: 1 DIF: Average REF: p.249-250
BLM: Higher Order NOT: Macro TB_11-81

82. The money supply in Freedonia is \$200 billion. Nominal GDP is \$800 billion and real GDP is \$400 billion. The central bank of Freedonia has instituted a policy of zero inflation. Assuming that velocity is stable, if real GDP grows by 10 percent this year, how will the central bank of Freedonia change the money supply this year?
- It will not change the money supply at all.
 - It will reduce the money supply by 10 percent.
 - It will increase the money supply by 10 percent.
 - It will increase the money supply by 2.5 percent.

ANS: C PTS: 1 DIF: Average REF: p.249-250
BLM: Higher Order NOT: Macro TB_11-82

83. Assuming that velocity is stable, if real GDP grows by 10 percent this year, and if the money supply does not change this year, how does the price level or nominal GDP change?
- The price level will not change.
 - Nominal GDP will grow by 10 percent.
 - Nominal GDP will stay the same.
 - The price level will increase by 10 percent.

ANS: C PTS: 1 DIF: Challenging REF: p.249-250
BLM: Higher Order NOT: Macro TB_11-83

84. Assuming that velocity is stable, if real GDP grows by 10 percent this year, and if the money supply does not change this year, how does the price level change?
- a. The inflation rate will be zero.
 - b. The price level will fall by 9.09 percent.
 - c. The price level will rise by 10 percent.
 - d. The price level will rise by 9.09 percent.

ANS: B

PTS: 1

DIF: Challenging REF: p.249-250

BLM: Higher Order

NOT: Macro TB_11-84

85. Velocity in the country of Nemedia is always stable. In 2009, the money supply was \$100 billion and real GDP was \$300 billion. In 2010, the money supply increased by 10 percent, real GDP increased by 5 percent, and nominal GDP equalled \$660 billion. By how much did the price level increase between 2009 and 2010?
- a. 10 percent
 - b. 9.5 percent
 - c. 4.76 percent
 - d. 2.38 percent

ANS: C

PTS: 1

DIF: Challenging REF: p.249-250

BLM: Higher Order

NOT: Macro TB_11-85

86. Velocity in the country of Shem is always stable. In 2009, the money supply was \$200 billion and the GDP price deflator was four times as high as it was in the base year. In 2010, the money supply increased to \$240 billion, the price level increased by 15 percent, and nominal GDP equalled \$1200 billion. By how much did real GDP increase between 2009 and 2010?
- a. 20 percent
 - b. 4.35 percent
 - c. 2.17 percent
 - d. There is not enough information to answer the question.

ANS: B

PTS: 1

DIF: Challenging REF: p.249-250

BLM: Higher Order

NOT: Macro TB_11-86

87. Velocity in the country of Aquilonia is always stable. In 2009, the money supply was \$100 billion, nominal GDP was \$500 billion, and the real interest rate was 3 percent. In 2010, the money supply was \$105 billion, and real GDP did not change from its level in 2009. What was the approximate nominal interest rate in 2010?
- a. 3 percent
 - b. 5 percent
 - c. 8 percent
 - d. 11 percent

ANS: C

PTS: 1

DIF: Challenging REF: p.249-250

BLM: Higher Order

NOT: Macro TB_11-87

88. According to the quantity equation, which of the following best describes the effects of an increase in the money supply?
- a. If velocity is stable, an increase in the money supply creates a proportional increase in nominal GDP but not in the price level.
 - b. If velocity is stable, an increase in the money supply creates a proportional increase in the price level and real GDP.
 - c. If velocity is stable, an increase in the money supply creates an increase in the real GDP but not in the price level.
 - d. With constant money supply and velocity, an increase in the money supply creates a proportional increase in the price level and nominal GDP

ANS: D PTS: 1 DIF: Challenging REF: p.249-250
BLM: Higher Order NOT: Macro TB_11-88

89. If money is neutral and velocity is stable, an increase in the money supply creates a proportional increase in which of the following?
- a. real output
 - b. both real and nominal interest rate
 - c. inflation rate
 - d. the price level

ANS: D PTS: 1 DIF: Average REF: p.249-250
BLM: Higher Order NOT: Macro TB_11-89

90. Which of the following does the evidence gained from studying hyperinflation indicate?
- a. The rate of inflation is not closely related to the rate at which the money supply changes.
 - b. Nominal interest rates are independent of the money supply.
 - c. Inflation rates parallel money supply growth rates.
 - d. Inflation rates move in the opposite direction as the growth rate in money supply.

ANS: C PTS: 1 DIF: Average REF: p.250-252
BLM: Higher Order NOT: Macro TB_11-90

91. What does the evidence from hyperinflations indicate with respect to the quantity theory of money?
- a. Evidence shows that money growth and inflation moved together, which supports the quantity theory.
 - b. Evidence shows that money growth and inflation moved together, which does not support the quantity theory.
 - c. Evidence shows that money growth and inflation did not move closely with each other, which supports the quantity theory.
 - d. Evidence shows that money growth and inflation did not move closely with each other, which does not support the quantity theory.

ANS: A PTS: 1 DIF: Easy REF: p.250-252
BLM: Remember NOT: Macro TB_11-91

92. Which of the following best describes the inflation tax?
- a. It is a property tax.
 - b. It is a sales tax.
 - c. It is the revenue created when the government prints money.
 - d. It is the revenue created when inflation is low.

ANS: D PTS: 1 DIF: Easy REF: p.252
BLM: Remember NOT: Macro TB_11-92

93. Which of the following best explains why governments may prefer an inflation tax to some other kind of tax?
- a. The inflation tax is easier to impose.
 - b. The inflation tax reduces inflation.
 - c. The inflation tax falls mainly on high-income individuals.
 - d. The inflation tax reduces the real cost of government expenditure.

ANS: A PTS: 1 DIF: Easy REF: p.252
BLM: Remember NOT: Macro TB_11-93

94. Which of the following best describes the effect of printing money to finance government expenditures on the economy?
- a. Printing money causes the value of money to rise.
 - b. Printing money imposes a tax on everyone who holds money.
 - c. Printing money increases the real interest rate.
 - d. Printing money lowers the velocity of money.

ANS: B PTS: 1 DIF: Easy REF: p.252
BLM: Higher Order NOT: Macro TB_11-94

95. Which of the following best describes the effect of printing money to finance government expenditures on the economy?
- a. Printing money causes the value of money to rise.
 - b. Printing money imposes a tax on everyone who holds money.
 - c. Printing money is the principle method by which the Canadian government finances its expenditures.
 - d. Printing money causes the nominal interest rate to decrease.

ANS: B PTS: 1 DIF: Average REF: p.252
BLM: Higher Order NOT: Macro TB_11-95

96. Suppose that the Government of Canada unexpectedly decided to pay off its debt by printing new money. Which of the following would happen?
- a. People who held money would feel richer.
 - b. Prices would fall.
 - c. People who lent money at a fixed interest rate would feel richer.
 - d. People who borrowed money at a fixed interest rate would feel richer.

ANS: D PTS: 1 DIF: Average REF: p.252
BLM: Higher Order NOT: Macro TB_11-96

97. Which of the following best characterizes the inflation tax?
- a. The inflation tax transfers wealth from the government to households.
 - b. The inflation tax is the increase in income taxes due to lack of indexation.
 - c. The inflation tax is a tax on everyone who holds money.
 - d. The inflation tax is illegal.

ANS: C PTS: 1 DIF: Easy REF: p.252
BLM: Remember NOT: Macro TB_11-97

98. How can people avoid the inflation tax?
- a. by reducing savings
 - b. by not filing a tax return
 - c. by reducing cash holdings
 - d. by spending less

ANS: C PTS: 1 DIF: Easy REF: p.252
BLM: Higher Order NOT: Macro TB_11-98

99. What is the name of the one-for-one adjustment of the nominal interest rate to the inflation rate?
- a. the Friedman Effect
 - b. the Hume Effect
 - c. the Fisher Effect
 - d. the Ricardian equivalence effect

ANS: C PTS: 1 DIF: Easy REF: p.252-254
BLM: Remember NOT: Macro TB_11-99

100. If the nominal interest rate is 5 percent and the inflation rate is 2 percent, what is the real interest rate?
- a. 7 percent
 - b. 6 percent
 - c. 5 percent
 - d. 3 percent

ANS: D PTS: 1 DIF: Easy REF: p.253
BLM: Higher Order NOT: Macro TB_11-100

101. If the nominal interest rate is 8 percent and the real interest rate is 3 percent, what is the inflation rate?
- a. 3 percent
 - b. 5 percent
 - c. 8 percent
 - d. 11 percent

ANS: B PTS: 1 DIF: Easy REF: p.253
BLM: Higher Order NOT: Macro TB_11-101

102. Greta puts money in a savings account at her bank earning 6.5 percent. One year later she takes her money out and notes that while her money was earning interest, prices rose 3.5 percent. Which of the following does Greta now have?
- a. 3.5 percent more money with which she can purchase 6.5 percent more goods
 - b. 6.5 percent more money with which she can purchase 3 percent more goods
 - c. 6.5 percent more money with which she can purchase 6.5 percent more goods
 - d. 10 percent more money with which she can purchase 3 percent more goods

ANS: B PTS: 1 DIF: Easy REF: p.252-254
BLM: Higher Order NOT: Macro TB_11-102

103. Arnold puts money into an account. One year later he sees that he has 7 percent more dollars and that his money will buy 3 percent more goods. Which of the following is consistent with these facts?
- a. The nominal interest rate was 7 percent and the inflation rate was 4 percent.
 - b. The nominal interest rate was 10 percent and the inflation rate was 3 percent.
 - c. The nominal interest rate was 3 percent and the inflation rate was -10 percent.
 - d. The nominal interest rate was 4 percent and the inflation rate was -3 percent.

ANS: A PTS: 1 DIF: Average REF: p.252-254
BLM: Higher Order NOT: Macro TB_11-103

104. If a country had deflation, how would the nominal interest rate compare to the real interest rate?
- a. The nominal interest rate would be greater than the real interest rate.
 - b. The real interest rate would be greater than the nominal interest rate.
 - c. The real interest rate would equal the nominal interest rate.
 - d. There is insufficient information to answer the question.

ANS: B PTS: 1 DIF: Average REF: p.252-254
BLM: Higher Order NOT: Macro TB_11-104

105. Which of the following does the Fisher effect imply?
- a. The nominal interest rate adjusts one for one with the inflation rate.
 - b. The growth rate of the money supply determines the inflation rate.
 - c. Real variables are heavily influenced by the monetary system.
 - d. The real interest rate adjusts one for one with the inflation rate.

ANS: A PTS: 1 DIF: Easy REF: p.252-254
BLM: Higher Order NOT: Macro TB_11-105

106. In the long run when money is neutral, which of the following increases when the money supply growth rate increases?
- a. real output growth
 - b. real interest rates
 - c. nominal interest rates
 - d. the money supply divided by the price level

ANS: C PTS: 1 DIF: Average REF: p.252-254
BLM: Higher Order NOT: Macro TB_11-106

107. Which of the following can a country increase in the long run by increasing its money growth rate?
- a. the nominal wage divided by the price level
 - b. real output
 - c. real interest rates
 - d. the price level

ANS: D PTS: 1 DIF: Easy REF: p.252-254
BLM: Higher Order NOT: Macro TB_11-107

108. If the money supply growth rate permanently increased from 5 percent to 30 percent, which of the following would we expect to happen to inflation?
- a. It would increase by more than 25 percentage points.
 - b. It would increase by 25 percentage points.
 - c. It would increase by less than 25 percentage points.
 - d. It would decrease by more than 25 percentage points.

ANS: B PTS: 1 DIF: Easy REF: p.252-254
BLM: Higher Order NOT: Macro TB_11-108

109. If the money supply growth rate permanently increased from 4 percent to 12 percent, which of the following would we expect to happen?
- a. The inflation rate would increase by 8 percent, and the nominal interest rate would increase by less than 10 percent.
 - b. The inflation rate would increase by less than 8 percent, and the nominal interest rate would increase by 8 percent.
 - c. Both the inflation rate and the nominal interest rate would increase by 8 percent.
 - d. Both the inflation rate and the nominal interest rate would increase by less than 8 percent.

ANS: C PTS: 1 DIF: Easy REF: p.252-254
BLM: Higher Order NOT: Macro TB_11-109

110. Suppose that velocity and output are constant and that the quantity theory and Fisher effect are both correct. If the nominal interest rate is 8 percent and inflation is 3 percent, what is the money supply growth rate or the real interest rate?
- a. The money supply growth rate is 3 percent.
 - b. The real interest rate is 11 percent.
 - c. The real interest rate is 8 percent.
 - d. The money supply growth rate is 11 percent.

ANS: A PTS: 1 DIF: Average REF: p.252-254
BLM: Higher Order NOT: Macro TB_11-110

111. Suppose that velocity and output are constant, the quantity theory and Fisher effect are correct, the nominal interest rate is 7 percent, and money growth is 2 percent. Which of the following is consistent with these facts?
- a. The real interest rate is 2 percent, and nominal wages are rising.
 - b. The real interest rate is 2 percent, and real wages are rising.
 - c. The real interest rate is 5 percent, and nominal wages are rising.
 - d. The real interest rate is 9 percent, and real wages are rising.

ANS: C PTS: 1 DIF: Easy REF: p.252-254
BLM: Higher Order NOT: Macro TB_11-111

112. Which of the following does an increase in the money supply growth rate increase?
- a. inflation, nominal interest rates, and real interest rates
 - b. inflation and nominal interest rates, but it does not change real interest rates
 - c. inflation and real interest rates, but it does not change nominal interest rates
 - d. nominal and real interest rates, but it does not change inflation

ANS: B PTS: 1 DIF: Average REF: p.252-254
BLM: Higher Order NOT: Macro TB_11-112

113. Inflation positively correlated with which of the following?
- a. nominal wage growth and nominal interest rates
 - b. neither nominal wage growth nor nominal interest rates
 - c. nominal wage growth, but not nominal interest rates
 - d. the nominal interest rate, but not nominal wage growth

ANS: A PTS: 1 DIF: Easy REF: p.252-254
BLM: Remember NOT: Macro TB_11-113

114. If your salary increased by 7 percent and prices increased by 4 percent, by how much did your real wage rise?
- a. 3 percent
 - b. 4 percent
 - c. 6 percent
 - d. 7 percent

ANS: A PTS: 1 DIF: Easy REF: p.252-254
BLM: Higher Order NOT: Macro TB_11-114

115. Which of the following does the shoeleather cost of inflation refer to?
- a. the fall in real income associated with inflation
 - b. the time spent searching for low prices when inflation rises
 - c. the waste of resources used to maintain lower money holdings
 - d. the increased cost to the government of printing more money

ANS: C PTS: 1 DIF: Easy REF: p.256-257
BLM: Remember NOT: Macro TB_11-115

116. Which of the following do shoeleather costs refer to?
- a. the cost of more frequent price changes induced by higher inflation
 - b. the distortion in resource allocation created by distortions in relative prices due to inflation
 - c. resources used to maintain lower money holdings when inflation is high
 - d. the distortion in incentives created by inflation by taxes that do not adjust for inflation

ANS: C PTS: 1 DIF: Easy REF: p.256-257
BLM: Remember NOT: Macro TB_11-116

117. When people use more resources to reduce their money holdings because of high inflation, this an example of which of the following?
- a. inflation-induced tax distortions
 - b. relative-price variability costs
 - c. shoeleather costs
 - d. menu costs

ANS: C PTS: 1 DIF: Easy REF: p.256-257
BLM: Higher Order NOT: Macro TB_11-117

118. Which of the following terms refers to the cost of changing price tags and price listings?
- a. inflation-induced tax distortions
 - b. relative-price variability costs
 - c. shoeleather costs
 - d. menu costs

ANS: D PTS: 1 DIF: Easy REF: p.257
BLM: Remember NOT: Macro TB_11-118

119. Which of the following best defines menu costs?
- a. resources used by people to maintain lower money holdings when inflation is high
 - b. the distortion in resource allocation created by uncertainty concerning relative price changes created by inflation
 - c. the distortion in incentives created by inflation when taxes do not adjust for inflation
 - d. the cost of more frequent price changes induced by higher inflation

ANS: D PTS: 1 DIF: Easy REF: p.257
BLM: Remember NOT: Macro TB_11-119

120. Which of the following inflation costs matter even if actual inflation and expected inflation are the same?
- a. production costs
 - b. losses in real income
 - c. losses in tax revenue
 - d. menu costs

ANS: D PTS: 1 DIF: Easy REF: p.252 | p.254-257
BLM: Remember NOT: Macro TB_11-120

121. Which of the following is an effect of expected inflation?
- a. It does not affect the purchasing power of most workers.
 - b. It increases the incentive to save.
 - c. It benefits lenders and borrowers.
 - d. It changes real interest rates because of the Fischer effect.

ANS: A PTS: 1 DIF: Average REF: p.250 | p.258-259
BLM: Higher Order NOT: Macro TB_11-121

122. Monica buys a bond for \$750 and then sells it later for \$950. Monica's gain is which of the following?
- a. a net gain
 - b. a Fisher gain
 - c. a capital gain
 - d. an inflation tax gain

ANS: C PTS: 1 DIF: Easy REF: p.258
BLM: Higher Order NOT: Macro TB_11-122

123. Which of the following are people required to report on income tax forms?
- a. nominal interest earnings
 - b. real interest earnings
 - c. real capital gains
 - d. expected inflation

ANS: A PTS: 1 DIF: Easy REF: p.258
BLM: Remember NOT: Macro TB_11-123

124. Assume you buy stock and its price rises just as much as the price level. Before taxes, which of the following have you made?
- a. a nominal and real gain, and you pay taxes on the nominal gain
 - b. a nominal and real gain, but you pay taxes only on the real gain
 - c. a nominal gain, but no real gain, yet you pay taxes on the nominal gain
 - d. a nominal gain, but no real gain, so you pay no taxes on the nominal gain

ANS: C PTS: 1 DIF: Average REF: p.258-259
BLM: Higher Order NOT: Macro TB_11-124

125. Assume you buy a stock and its price rises less than the price level. Before taxes, which of the following have you made?
- a. a nominal and real gain, and you pay taxes on the nominal gain
 - b. a nominal gain and a real loss, and you don't have to pay taxes since you gained less than the change in the price level
 - c. a nominal and a real gain, and you pay taxes on the real gain
 - d. a nominal gain and a real loss, and you pay taxes on the nominal gain

ANS: D PTS: 1 DIF: Average REF: p.258-259
BLM: Higher Order NOT: Macro TB_11-125

126. For a given real interest rate, which of the following best describes the effects of an increase in inflation?
- a. Inflation makes the real interest rate decrease, which encourages savings.
 - b. Inflation makes the real interest rate decrease, which discourages savings.
 - c. Inflation makes the real interest rate increase, which encourages savings.
 - d. Inflation makes the real interest rate increase, which discourages savings.

ANS: B PTS: 1 DIF: Average REF: p.258-259
BLM: Higher Order NOT: Macro TB_11-126

127. Given a nominal interest rate of 10 percent, in which of the following cases would you earn the highest after-tax real interest rate?
- a. Inflation is 6 percent, and the tax rate is 20 percent.
 - b. Inflation is 5 percent, and the tax rate is 30 percent.
 - c. Inflation is 4 percent, and the tax rate is 40 percent.
 - d. Inflation is 2 percent, and the tax rate is 50 percent.

ANS: D PTS: 1 DIF: Challenging REF: p.259
BLM: Higher Order NOT: Macro TB_11-127

128. Given a nominal interest rate of 7 percent, in which of the following cases would you earn the lowest after-tax real rate of interest?
- a. Inflation is 4 percent, and the tax rate is 25 percent.
 - b. Inflation is 3 percent, and the tax rate is 20 percent.
 - c. Inflation is 2 percent, and the tax rate is 15 percent.
 - d. Inflation is 1 percent, and the tax rate is 10 percent.

ANS: D PTS: 1 DIF: Average REF: p.259
BLM: Higher Order NOT: Macro TB_11-128

129. You put money in an account that earns 6 percent. The inflation rate is 4 percent, and your marginal tax rate is 10 percent. Which of the following is your after-tax real rate of interest?
- a. 3.4 percent
 - b. 1.6 percent
 - c. 1.4 percent
 - d. 1 percent

ANS: C PTS: 1 DIF: Average REF: p.258-259
BLM: Higher Order NOT: Macro TB_11-129

130. You put money in an account and earn a real interest rate of 8 percent. Inflation is 3 percent, and your marginal tax rate is 20 percent. Which of the following is your after-tax real rate of interest?
- a. 1.8 percent
 - b. 2.8 percent
 - c. 3.8 percent
 - d. 5.8 percent

ANS: D PTS: 1 DIF: Average REF: p.258-259
BLM: Higher Order NOT: Macro TB_11-130

131. You put money in an account and earn a real interest rate of 10 percent, inflation is 3 percent, and your marginal tax rate is 40 percent. Which of the following is your after-tax real rate of interest?
- a. 4.8 percent
 - b. 3.2 percent
 - c. 2.8 percent
 - d. 1.8 percent

ANS: A PTS: 1 DIF: Average REF: p.258-259
BLM: Higher Order NOT: Macro TB_11-131

132. Given a nominal interest rate of 12 percent, in which of the following cases would you earn the highest after-tax real rate of interest?

- a. Inflation is 5 percent, and the tax rate is 20 percent.
- b. Inflation is 4 percent, and the tax rate is 30 percent.
- c. Inflation is 3 percent, and the tax rate is 40 percent.
- d. Inflation is 2 percent, and the tax rate is 50 percent.

ANS: A

PTS: 1

DIF: Average

REF: p.258-259

BLM: Higher Order

NOT: Macro TB_11-132

133. The country of Aquilonia has a tax system identical to that of Canada. Suppose someone in Aquilonia bought a parcel of land for \$20 000 in 1960 when the price index equalled 100. In 2002, the person sold the land for \$100 000, and the price index equalled 600. If the person must pay 20 percent of any capital gain in taxes, which of the following is the after-tax real capital gain (in 2002 dollars) on the land?

- a. \$64 000
- b. -\$36 000
- c. -\$16 667
- d. -\$3333

ANS: B

PTS: 1

DIF: Challenging

REF: p.258-259

BLM: Higher Order

NOT: Macro TB_11-133

134. The country of Aquilonia has a tax system identical to that of Canada. Suppose someone in Aquilonia bought a parcel of land for \$10 000 in 1960 when the price index equalled 100. In 2002, the person sold the land for \$100 000, and the price index equalled 500. If the person must pay 20 percent of any capital gain in taxes, which of the following is the after-tax real capital gain (in 2002 dollars) on the land?

- a. \$72 000
- b. \$62 000
- c. \$32 000
- d. \$6400

ANS: C

PTS: 1

DIF: Challenging

REF: p.258-259

BLM: Higher Order

NOT: Macro TB_11-134

135. Norbert purchased 10 shares of Gentech stock for \$200 a share in year 1 and sold all the shares in year 2 for \$220 a share. Between year 1 and year 2, the price index increased by 5 percent. The tax on capital gains is 50 percent. If the capital gains tax is on nominal gains, how much tax does Norbert pay on his gain?

- a. \$90
- b. \$95
- c. \$100
- d. \$105

ANS: C

PTS: 1

DIF: Average

REF: p.258-259

BLM: Higher Order

NOT: Macro TB_11-135

136. Casimir purchased one share of Norcet stock for \$200 in year 1 and sold that share in year 2 for \$400. The inflation rate between year 1 and year 2 was 50 percent. If the capital gains tax is imposed at a rate of 50 percent, what is Casimir's after-tax real capital gain?

a. \$0
b. \$50
c. \$100
d. \$200

ANS: A PTS: 1
BLM: Higher Order

DIF: Challenging REF: p.258-259
NOT: Macro TB_11-136

137. When deciding how much to save, which of the following interest rates do people usually care most about?

a. after-tax nominal interest rates
b. after-tax real interest rates
c. before-tax real interest rates
d. before-tax nominal interest rates

ANS: B PTS: 1
BLM: Higher Order

DIF: Easy REF: p.258-259
NOT: Macro TB_11-137

138. Which of the following would be the effect of indexing the tax system to take into account the effects of inflation on taxing capital gains?

a. Only real interest earnings would be taxed.
b. Taxing capital gains would become irrelevant.
c. Average tax rates would increase.
d. Investors would be worse off.

ANS: A PTS: 1
BLM: Higher Order

DIF: Average REF: p.259
NOT: Macro TB_11-138

139. Which of the following best characterizes the effect of inflation?

a. It impedes financial markets in their role of allocating resources.
b. It reduces the purchasing power of the average consumer.
c. Generally, it increases after-tax real interest rates.
d. It is most costly when anticipated.

ANS: A PTS: 1
BLM: Higher Order

DIF: Average REF: p.257-258
NOT: Macro TB_11-139

140. Under which of the following conditions is wealth distributed from debtors to creditors?

a. When inflation is high, but expected.
b. When inflation is low, but expected.
c. When inflation is unexpectedly high.
d. When inflation is unexpectedly low.

ANS: D PTS: 1
BLM: Higher Order

DIF: Easy REF: p.260
NOT: Macro TB_11-140

141. Under which of the following conditions is wealth distributed from creditors to debtors?
- a. When inflation is high, whether it is expected or not.
 - b. When inflation is low, whether it is expected or not.
 - c. When inflation is unexpectedly high.
 - d. When inflation is unexpectedly low.

ANS: C PTS: 1 DIF: Easy REF: p.260
BLM: Higher Order NOT: Macro TB_11-141

142. How are debtors and creditors affected when the economy unexpectedly goes from inflation to deflation?
- a. Debtors and creditors would both have reduced real wealth.
 - b. Debtors and creditors would both have increased real wealth.
 - c. Debtors would gain at the expense of creditors.
 - d. Creditors would gain at the expense of debtors.

ANS: D PTS: 1 DIF: Average REF: p.260
BLM: Higher Order NOT: Macro TB_11-142

143. If inflation is more than expected, how are creditors or debtors affected?
- a. Creditors receive a lower real interest rate than they had anticipated.
 - b. Creditors pay a lower real interest rate than they had anticipated.
 - c. Debtors receive a higher real interest rate than they had anticipated.
 - d. Debtors pay a higher real interest rate than they had anticipated.

ANS: A PTS: 1 DIF: Easy REF: p.260
BLM: Higher Order NOT: Macro TB_11-143

144. Which of the following best describes how the cost of unexpected inflation is distributed?
- a. Unexpected inflation has a greater cost for those who borrow than those who save
 - b. Unexpected inflation has a greater cost for those who hold a little money than for those who hold a lot of money
 - c. Unexpected inflation has a greater cost for those whose wages increase by as much as inflation, than those who are paid a fixed nominal wage
 - d. Unexpected inflation has a greater cost for savers in high income tax brackets than for savers in low income tax brackets

ANS: D PTS: 1 DIF: Average REF: p.260
BLM: Higher Order NOT: Macro TB_11-144

145. In order to maintain stable prices, which of the following must the central bank do?
- a. maintain low interest rates
 - b. keep unemployment low
 - c. tightly control the money supply
 - d. sell indexed bonds

ANS: C PTS: 1 DIF: Easy REF: p.261-262
BLM: Remember NOT: Macro TB_11-145

146. Which of the following best characterizes the effects of monetary policy?
- Monetary policy is neutral in both the short run and the long run; therefore, it does not affect real variables.
 - Monetary policy is neutral in the long run, but it may have effects on real variables in the short run.
 - Monetary policy has profound effects on real variables in both the short run and the long run.
 - Monetary policy has profound effects on real variables in the long run, but is neutral in the short run.

ANS: B PTS: 1 DIF: Easy REF: p.261-262
BLM: Remember NOT: Macro TB_11-146

147. Since 1992, which of the following has the Bank of Canada done?
- It has announced that it was targeting the money supply growth of 2 percent.
 - It has announced a target rate of inflation of 2 percent.
 - It has announced an inflation target close to 4 percent.
 - It has announced its objective of maintaining a stable rate of economic growth of 2 percent.

ANS: B PTS: 1 DIF: Easy REF: p.261
BLM: Remember NOT: Macro TB_11-147

TRUE/FALSE

1. Canadian prices rose at an average annual rate of about 4 percent over the past 70 years.

ANS: T PTS: 1 DIF: Easy REF: p.241
NOT: Macro TB_11-148

2. Canada has never experienced deflation.

ANS: F PTS: 1 DIF: Easy REF: p.241
NOT: Macro TB_11-149

3. In the 1990s, Canadian prices rose at about the same rate as in the 1970s.

ANS: F PTS: 1 DIF: Easy REF: p.242
NOT: Macro TB_11-150

4. The quantity theory of money can explain hyperinflations but not moderate inflation.

ANS: F PTS: 1 DIF: Easy REF: p.242
NOT: Macro TB_11-151

5. If P represents the price of goods and services measured in money, then $1/P$ is the value of money measured in terms of goods and services.

ANS: T PTS: 1 DIF: Easy REF: p.242-243
NOT: Macro TB_11-152

6. When the value of money is on the vertical axis, an increase in the price level shifts money demand to the right.

ANS: F PTS: 1 DIF: Easy REF: p.242-245
NOT: Macro TB_11-153

7. The money supply curve shifts to the left when the Bank of Canada buys government bonds.

ANS: F PTS: 1 DIF: Easy REF: p.245-246
NOT: Macro TB_11-154

8. When the value of money is on the vertical axis, the money supply curve slopes upward because an increase in the value of money induces banks to create more money.

ANS: F PTS: 1 DIF: Easy REF: p.243-245
NOT: Macro TB_11-155

9. If the Bank of Canada increases the money supply, the equilibrium value of money decreases and the equilibrium price level must increase.

ANS: T PTS: 1 DIF: Easy REF: p.246
NOT: Macro TB_11-156

10. A rising price level eliminates an excess supply of money.

ANS: T PTS: 1 DIF: Easy REF: p.246-247
NOT: Macro TB_11-157

11. Nominal GDP measures output of final goods and services in physical terms.

ANS: F PTS: 1 DIF: Easy REF: p.247
NOT: Macro TB_11-158

12. According to Hume, the classical dichotomy is useful for analyzing the economy because nominal variables are heavily influenced by developments in the monetary system, and real variables are not.

ANS: T PTS: 1 DIF: Easy REF: p.247-248
NOT: Macro TB_11-159

13. The irrelevance of monetary changes for real variables is called monetary neutrality. Most economists accept monetary neutrality as a good description of the economy in the long run, but not the short run.

ANS: T PTS: 1 DIF: Average REF: p.247-248
NOT: Macro TB_11-160

14. The quantity theory implies that if output and velocity are constant, then a 50 percent increase in the money supply would lead to less than a 50 percent increase in the price level.

ANS: F PTS: 1 DIF: Easy REF: p.249
NOT: Macro TB_11-161

15. The source of all four classic hyperinflations was high rates of money growth.

ANS: T PTS: 1 DIF: Easy REF: p.250-252
NOT: Macro TB_11-162

16. In the long run, an increase in the growth rate of the money supply leads to an increase in the real interest rate, but no change in the nominal interest rate.

ANS: F PTS: 1 DIF: Easy REF: p.252-254
NOT: Macro TB_11-163

17. Inflation induces people to spend more resources maintaining lower money holdings. This is called shoeleather costs.

ANS: T PTS: 1 DIF: Easy REF: p.254-257
NOT: Macro TB_11-164

18. Inflation distorts savings because people pay taxes on their nominal rather than their real interest income.

ANS: T PTS: 1 DIF: Average REF: p.258-259
NOT: Macro TB_11-165

19. If the Bank of Canada were to unexpectedly increase the money supply, creditors would gain at the expense of debtors.

ANS: F PTS: 1 DIF: Easy REF: p.260
NOT: Macro TB_11-166

20. Even though monetary policy is neutral in the short run, it may have profound real effects in the long run.

ANS: F PTS: 1 DIF: Easy REF: p.263
NOT: Macro TB_11-167

SHORT ANSWER

1. Explain the adjustment process that creates a change in the price level when the money supply increases.

ANS:

When the money supply increases, there is an excess supply of money until the value of money falls and the price level rises. After the money supply increases, people have more money than they want to hold in their wallets and chequing accounts. They use this excess money to buy goods and services or lend it out to other people to buy goods and services. The increase in expenditures causes prices to rise and the value of money to fall. As the value of money falls, the quantity of money people want to hold increases so that the excess supply is eliminated.

PTS: 1

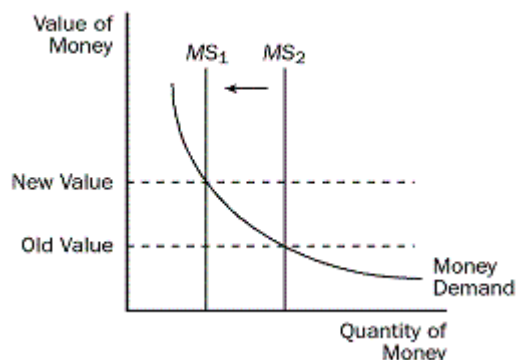
DIF: Average

REF: p.246-247

NOT: Macro TB_11-168

2. Suppose the Bank of Canada sells government bonds. Use a graph of the money market to show what this does to the value of money.

ANS:



When the Bank of Canada sells government bonds, the money supply decreases. This shifts the money supply curve from MS_1 to MS_2 and makes the value of money increase. Since money is worth more, it takes less to buy goods with it, which means the price level falls.

PTS: 1

DIF: Average

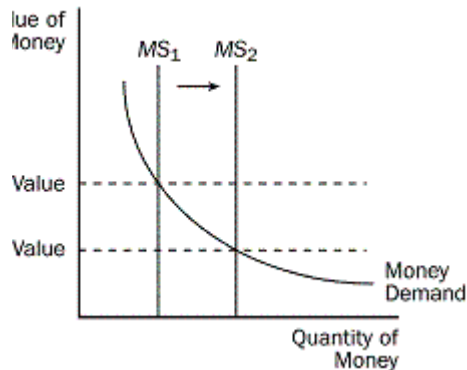
REF: p.246

NOT: Macro TB_11-169

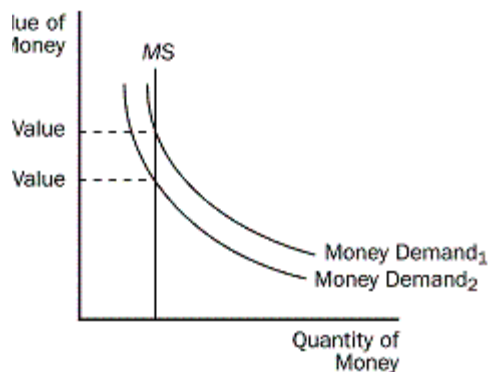
3. Using separate graphs, demonstrate what happens to the money supply, money demand, the value of money, and the price level if:
- the Bank of Canada increases the money supply.
 - people decide to demand less money at each value of money.

ANS:

- The Bank of Canada increases the money supply. When that happens, we find the consequences of their action by shifting the money supply curve to the right from MS_1 to MS_2 . This shift causes the value of money to fall, so the price level rises.



- People decide to demand less money at each value of money. Since people want to hold less at each value of money, it follows that the money demand curve will shift to the left from MD_1 to MD_2 . The decrease in money demand results in a lower value of money and so a higher price level.



PTS: 1

DIF: Average

REF: p.242-246

NOT: Macro TB_11-170

4. According to the classical dichotomy, what changes nominal variables? What changes real variables?

ANS:

The classical dichotomy argues that nominal variables are determined primarily by developments in the monetary system such as changes in money demand and supply. Real variables are largely independent of the monetary system and are determined by productivity and real changes in the factor and loanable funds markets.

PTS: 1 DIF: Average REF: p.247-248 NOT: Macro TB_11-171

5. Suppose that monetary neutrality holds. Of the following variables, which ones do not change when the money supply increases?
- real interest rates
 - inflation
 - the price level
 - real output
 - real wages
 - nominal wages

ANS:

- real interest rates
- real output
- real wages

PTS: 1 DIF: Easy REF: p.247-248 NOT: Macro TB_11-172

6. Prices are many times higher today than they were 30 years ago, yet people do not work a lot harder nor spend a lot less. How can this be?

ANS:

Inflation raised the general price level. An increase in the general price level has no effect on real variables in the long run. Prices may be three times higher, but so are wages and incomes. In the long run, people change their behaviour in response to changes in real variables, not nominal ones.

PTS: 1 DIF: Average REF: p.247-248 NOT: Macro TB_11-173

7. Identify each of the following as nominal or real variables.
- the physical output of goods and services
 - the overall price level
 - the dollar price of apples
 - the price of apples relative to the price of oranges
 - the unemployment rate
 - the amount that shows up on your paycheque after taxes
 - the amount of goods you can purchase with the wage you get each hour
 - the taxes that you pay the government

ANS:

- real variable
- nominal variable
- nominal variable
- real variable
- real variable
- nominal variable
- real variable
- nominal variable

PTS: 1 DIF: Easy REF: p.247-248 NOT: Macro TB_11-174

8. Define each of the symbols and explain the meaning of $M \times V = P \times Y$.

ANS:

M is the quantity of money, V is the velocity of money, P is the price level, and Y is the quantity of output. $P \times Y$ is nominal spending. The amount people spend should equal the amount of money in the economy times the average number of times each unit of currency is spent.

PTS: 1 DIF: Easy REF: p.249-250 NOT: Macro TB_11-175

9. What assumptions are necessary to argue that the quantity equation implies that increases in the money supply lead to proportional changes in the price level?

ANS:

We must suppose that V is relatively constant and that changes in the money supply have no effect on real output.

PTS: 1 DIF: Easy REF: p.249-250 NOT: Macro TB_11-176

10. What is the inflation tax, and how might it explain the creation of inflation by a central bank?

ANS:

The inflation tax refers to the fact that inflation is a tax on money. When prices rise, the value of your money is reduced. Hence, when a government raises revenue by printing money, it obtains resources from households by taxing their money holdings through inflation rather than by sending them a tax bill. In countries where governments are unable or unwilling to raise revenues by raising taxes explicitly, the inflation tax may be an attractive alternative source of revenue.

PTS: 1 DIF: Easy REF: p.252 NOT: Macro TB_11-177

11. Economists agree that increases in the money supply growth rate increases inflation and that inflation is undesirable. So why have there been hyperinflations and how have they been ended?

ANS:

Typically, the government in countries that had hyperinflation started with high spending, inadequate tax revenue, and limited ability to borrow. Therefore, they turned to the printing press to pay their bills. Massive and continued increases in the quantity of money led to hyperinflation, which ended when the governments instituted fiscal reforms eliminating the need for the inflation tax.

PTS: 1 DIF: Easy REF: p.250-251 NOT: Macro TB_11-178

12. Suppose that velocity and output are constant and that the quantity theory and the Fisher effect both hold. What happens to inflation, real interest rates, and nominal interest rates when the money supply growth rate increases from 5 percent to 10 percent?

ANS:

Inflation and nominal interest rates each increase by 5 percent points. There is no change in the real interest rate or any other real variable.

PTS: 1 DIF: Easy REF: p.252-254 NOT: Macro TB_11-179

13. In recent years Bolivia, Russia, and Turkey have had much higher nominal interest rates than Canada, while Japan has had lower nominal interest rates. What would you predict is true about money growth in these other countries? Why?

ANS:

The Fisher effect says that increases in the inflation rate lead to one-to-one increases in nominal interest rates. The quantity theory says that in the long run, inflation increases one-to-one with money supply growth. It follows that differences in nominal interest rates may be due to differences in inflation rates. There may be some difference in real interest rates, but if we suppose these are small, then we predict that Bolivia, Russia, and Turkey have higher inflation, and Japan has lower inflation than Canada.

PTS: 1 DIF: Easy REF: p.252-254 NOT: Macro TB_11-180

14. What are the costs of inflation?

ANS:

The costs of inflation include "shoeleather costs," the cost of reducing your money holdings to reduce your inflation tax; "menu costs," the costs of price adjustments; the costs of resource misallocation that result from the relative-price variability induced by inflation; the costs of inflation-induced tax distortions; the costs of confusion and inconvenience; and the costs associated with the arbitrary redistribution of wealth that accompanies unexpected inflation.

PTS: 1

DIF: Easy

REF: p.254-258

NOT: Macro TB_11-181

15. List and define any two of the costs of high inflation.

ANS:

The costs include:

Shoeleather costs: the resources wasted when inflation induces people to reduce their money holdings

Menu costs: the cost of more frequent price changes at higher inflation rates

Relative Price Variability: higher inflation causes relative prices to vary more since prices change infrequently. Decisions based on relative prices are then distorted

Inflation-Induced Tax Distortions: the income tax is not completely indexed for inflation; an increase in nominal income created by inflation results in higher real tax rates that discourage savings

Confusion and Inconvenience: inflation decreases the reliability of the unit of account making it more complicated to differentiate successful and unsuccessful firms thereby impeding the efficient allocation of funds to alternative investments

Unexpected Inflation: inflation decreases the real value of debt thereby transferring wealth from creditors to debtors

PTS: 1

DIF: Easy

REF: p.252-260

NOT: Macro TB_11-182

16. Inflation distorts relative prices. What does this mean and why does it impose a cost on society?

ANS:

Relative prices are the value of one good in terms of other goods. Relative prices ordinarily provide signals concerning the relative scarcity of goods so the goods may be allocated efficiently. Some prices change infrequently, so that when inflation rises, there is greater variation in relative prices. However, changes in relative prices created by inflation do not signal changes in the scarcity of goods and so lead to an inefficient allocation of goods and resources.

PTS: 1

DIF: Easy

REF: p.257-258

NOT: Macro TB_11-183

17. Explain how inflation affects savings.

ANS:

Inflation discourages savings. Income tax is collected on nominal rather than real interest rates. So an increase in inflation will increase nominal interest rates and taxes. The increase in taxes in turn lowers the real return on savings and so discourages savings.

PTS: 1

DIF: Easy

REF: p.259

NOT: Macro TB_11-184

Use a money supply and demand diagram to answer the following questions.

18. In a diagram having the value of money on the vertical axis and the quantity of money on the horizontal axis, draw a money demand curve and explain its shape. Do the same for the money supply curve.

ANS:

See Figure 11.1 on page 245 in the textbook. The money demand curve is downward sloping because lower values of money (higher price levels) induce higher quantity of money demanded. The money supply curve is vertical because money supply is discretionary determined by the Bank of Canada and it does not directly depend on the price level.

PTS: 1

NOT: Macro TB_11-185

19. "The introduction of the automated teller machines was equivalent to an increase in money supply." Discuss this assertion.

ANS:

The introduction of the automated teller machines made cash easily available when needed, thus people did not need to hold so much cash in their wallets as before. When the demand for liquidity is lowered, the money demand curve shifts leftward. The consequence is a higher price level, which is the same as if the money demand curve did not shift but the money supply shifted to the right. Thus, the quoted assertion is true.

PTS: 1

NOT: Macro TB_11-186

20. Everything else being the same, what is the effect of an increase in interest rates on the price level? Discuss the process of adjustment to the new equilibrium.

ANS:

An increase in interest rates makes the opportunity cost of holding cash higher. Therefore, people will reduce their demand for money, which shifts the money demand curve to the left. At the initial price level, the shift in the demand for money creates an excess supply of money, which people try to eliminate by buying goods and services or lending to others through banks. The increased demand for goods and services will increase the price level until a new equilibrium is reached.

PTS: 1

NOT: Macro TB_11-187

21. In 2009, Canadian economic activity was reduced by approximately 2.5 percent. What would our money demand–money supply model predict would happen to prices if money supply and velocity would have remained constant? Did this happen in reality? (Hint: to answer this question, you will need to look for information about the inflation level in 2009.) If you have found that your prediction was not supported by data, why do you think this happened?

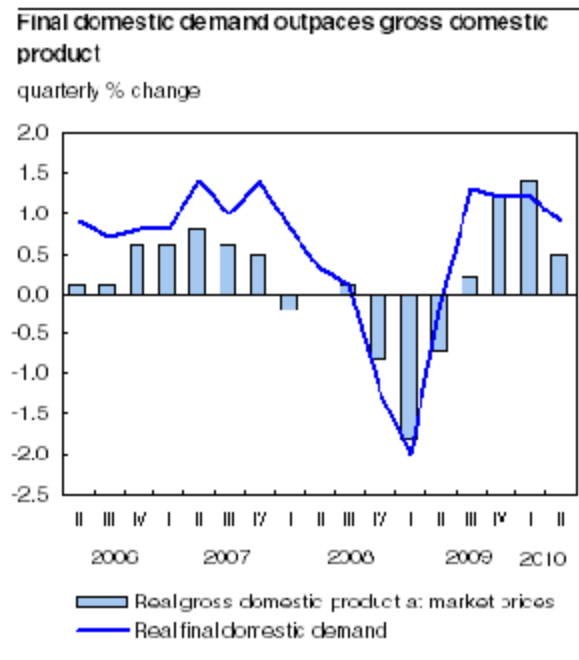
ANS:

Since the money demand curve is shifted by changes in GDP (higher GDP requires more money in circulation), a reduction in economic activity shifts our money demand curve to the left. If the vertical money supply curve does not change, the model predicts an increase in the overall price level.

Information about inflation can be found, for instance, at the Bank of Canada's website (<http://www.bankofcanada.ca/en/cpi.html>), from where the following table was compiled:

	Total inflation
Dec-09	1.3
Nov-09	1
Oct-09	0.1
Sep-09	-0.9
Aug-09	-0.8
Jul-09	-0.9
Jun-09	-0.3
May-09	0.1
Apr-09	0.4
Mar-09	1.2
Feb-09	1.4

To compare the periods of economic slowdown with the periods of inflation, one can use the information in the next chart, which is provided by Statistics Canada (<http://www.statcan.gc.ca/daily-quotidien/100831/dq100831a-eng.htm>):



During the first and second quarter of 2009, the GDP growth rate is negative, while the inflation rates are positive. When the economy starts increasing, in the third quarter, prices start decreasing (negative inflation rates.) During the last quarter, however, the negative relationship between GDP and inflation seems to break down. In conclusion, the data shows some support for our theory, but the correlation between changes in GDP and inflation is rather weak. An explanation could be that the money supply may have not remained constant during the period. In fact, the Bank of Canada's objective is to maintain inflation constant, which implies that it may have increased the money supply when a deflationary tendency was observed. Another explanation for the weak correlation could be that it takes time for prices to change when GDP changes.

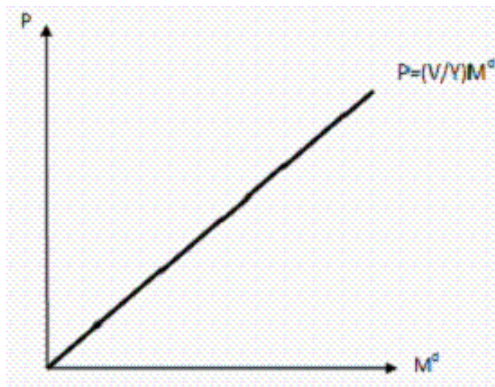
PTS: 1 NOT: Macro TB_11-188

In this problem we try to establish a link between the quantity equation, $M^d V = PY$, and the money demand–money supply diagram (M^d is the quantity of money demanded).

22. In a graph having the price level P on the vertical axis and the quantity of money M on the horizontal axis and considering V and Y independent on the price level or the quantity of money demanded, draw the $M^d - P$ curve that is implied by the quantity equation.

ANS:

The quantity equation can be written under the form $P = (V/Y) \times M$. Since (V/Y) is constant, this equation is a straight line passing through the origin in a P - M space. Since both V and M are positive, the line is upward sloping.



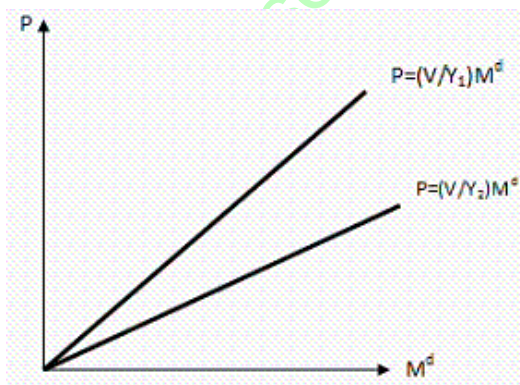
PTS: 1

NOT: Macro TB_11-189

23. Show in your graph how this curve changes when Y changes.

ANS:

When Y increases from Y_1 to Y_2 , the slope of our money demand curve decreases (at the same price level, more money is necessary to satisfy the quantity equation.) Thus, at higher Y s the money demand line becomes flatter.



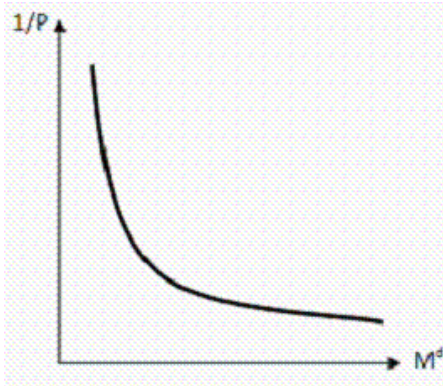
PTS: 1

NOT: Macro TB_11-190

24. Now, replace the price level in your graph with the value of money on the vertical axis and redraw the money demand curve. What do you observe?

ANS:

The graph having the value of money ($1/P$) on the vertical axis is similar to the one in the textbook. Since we defined “the value of money” as $1/P$, the money supply curve is not a straight line in the $1/P - M^d$ space, as it used to be in the $P - M^d$ space.



PTS: 1

NOT: Macro TB_11-191

25. Suppose Bob considers borrowing \$100 from Sheila at a 10 percent interest rate. They both think that a 4 percent real interest rate would be fair.
- What was the inflation rate they both expected?
 - If the inflation rate turned out to be 8 percent, how much was the real interest rate? Who gained and who lost from this transaction, and how much because of unexpected inflation?
 - If there was a capital gain tax of 30 percent, what is the after-tax real interest rate, with the inflation rate of 8 percent?

ANS:

- Let i be the nominal interest rate, r the real interest rate, and π the inflation rate. According to Fisher's principle, $i = r + \pi$. For the given numbers, $10\% = 4\% + \pi$, hence the expected inflation was $\pi = 10 - 4 = 6\%$.
- With the actual inflation of 8 percent, the real interest rate was $r = 10 - 8 = 2\%$, which is 2 percent less than expected. Sheila, the lender, lost \$2 worth of goods and services that she can buy for the \$110 she receives from Bob at the end of the year. Bob has gained the same amount, since the dollar is less valuable than expected.
- Sheila paid 30 percent of the \$10 she received for interest from Bob. Thus, the after-tax real interest rate was $10 \times (1 - 0.3) - 8 = -1\text{percent}$.

PTS: 1

NOT: Macro TB_11-192

26. Suppose Bob considers borrowing \$100 from Sheila. They both think that a 4 percent real interest rate would be fair, but they are aware of a 30 percent capital gain tax. Therefore, they think of the fair 4 percent real interest rate as an after-tax rate. How much should Bob pay to Sheila in interest, such that the after-tax real interest rate would be 4 percent, if they expect inflation to be 6 percent? What if the expected inflation was 8 percent? How does this affect Bob's incentive to borrow?

ANS:

The after-tax real interest rate can be calculated using Fischer's formula, where the nominal interest rate is the after-tax value: After-tax real interest rate = After-tax nominal interest rate minus Inflation rate. Let t be the tax rate, r the after-tax real interest rate, i the nominal interest rate, and π the inflation rate. Fisher's formula becomes $r = i(1 - t) - \pi$. When a target after-tax real interest rate is given, the corresponding nominal interest rate is $i = (r + \pi)/(1 - t)$. If Bob and Sheila are aware of the capital gain tax and they agree on a 4 percent after-tax real interest rate, the nominal interest rate should be equal to $(4\% + 6\%)/(1 - 0.3) = 14.28\%$. If they expect inflation to be 8 percent, then the corresponding nominal interest rate should be $(4\% + 8\%)/(1 - 0.3) = 17.14\%$. One can notice that, because of the tax, the increase in the nominal interest rate is higher than the increase in the inflation rate. This, of course, would make Bob think twice before borrowing. Like any other tax, a capital gain tax will induce an additional burden on both lender and borrower. (Sheila may also agree to lower her real after-tax real interest rate in order to persuade Bob to borrow.)

PTS: 1

NOT: Macro TB_11-193

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Chapter 12—Open-Economy Macroeconomics: Basic Concepts

MULTIPLE CHOICE

1. How does international trade affect the standard of living?
 - a. It raises the standard of living in all trading countries.
 - b. It lowers the standard of living in all trading countries.
 - c. It leaves the standard of living unchanged.
 - d. It raises the standard of living for importing countries and lowers it for exporting countries.

ANS: A PTS: 1 DIF: Easy REF: p.269
BLM: Remember NOT: Macro TB_12-1

2. What are foreign-produced goods and services that are sold domestically called?
 - a. imports
 - b. exports
 - c. net imports
 - d. net exports

ANS: A PTS: 1 DIF: Easy REF: p.270
BLM: Remember NOT: Macro TB_12-2

3. How are net exports of a country determined?
 - a. the value of goods and services imported minus the value of goods and services exported
 - b. the value of goods and services exported minus the value of goods and services imported
 - c. the value of goods exported minus the value of goods imported
 - d. the value of goods imported minus the value of goods exported

ANS: B PTS: 1 DIF: Easy REF: p.270
BLM: Remember NOT: Macro TB_12-3

4. Suppose that a country exports \$200 million of goods and services and imports \$80 million of goods and services. What is the value of that country's net exports?
 - a. \$280 million
 - b. \$200 million
 - c. \$120 million
 - d. -\$200 million

ANS: C PTS: 1 DIF: Easy REF: p.270
BLM: Higher Order NOT: Macro TB_12-4

5. Country A buys \$150 of wine from country B, and B buys \$30 of wool from A. Which of the following correctly indicates the two countries' net exports (in the order A, B)?
 - a. \$180 and \$0
 - b. \$150 and \$30
 - c. -\$120 and \$120
 - d. \$120 and -\$120

ANS: C PTS: 1 DIF: Average REF: p.270
BLM: Higher Order NOT: Macro TB_12-5

6. When Dee, a Canadian living in Canada, purchases a designer dress made in Milan, which of the following is this purchase?
- a. both a Canadian and an Italian import
 - b. a Canadian export and an Italian import
 - c. a Canadian import and an Italian export
 - d. neither an export nor an import for either country

ANS: C PTS: 1 DIF: Easy REF: p.270
BLM: Higher Order NOT: Macro TB_12-6

7. Roger lives in Iceland and purchases a snowmobile manufactured in Canada. Which of the following is this purchase?
- a. both a Canadian and an Icelandic export
 - b. both a Canadian and an Icelandic import
 - c. a Canadian import and an Icelandic export
 - d. a Canadian export and an Icelandic import

ANS: D PTS: 1 DIF: Easy REF: p.270
BLM: Higher Order NOT: Macro TB_12-7

8. What is the value of Peru's exports minus the value of Peru's imports called?
- a. Peru's net capital inflow
 - b. Peru's foreign direct investment
 - c. Peru's net exports
 - d. Peru's net imports

ANS: C PTS: 1 DIF: Easy REF: p.270
BLM: Remember NOT: Macro TB_12-8

9. Sonya, a citizen of Denmark, sells Danish boots and shoes in Canada. Which of the following correctly identifies the effects of these sales on net exports?
- a. They increase Canadian net exports and have no effect on Danish net exports.
 - b. They decrease Canadian net exports and have no effect on Danish net exports.
 - c. They increase Canadian net exports and decrease Danish net exports.
 - d. They decrease Canadian net exports and increase Danish net exports.

ANS: D PTS: 1 DIF: Easy REF: p.270
BLM: Higher Order NOT: Macro TB_12-9

10. A firm in India sells jackets to a Canadian department store chain. Which of the following correctly identifies the effects of this transaction?
- a. It increases Canadian and Indian net exports.
 - b. It decreases Canadian and Indian net exports.
 - c. It increases Canadian net exports and decreases Indian net exports.
 - d. It decreases Canadian net exports and increases Indian net exports.

ANS: D PTS: 1 DIF: Easy REF: p.270
BLM: Higher Order NOT: Macro TB_12-10

11. Ivan, a Russian citizen, sells several hundred cases of Russian caviar to a restaurant chain in Canada. Which of the following correctly identifies the effects of this transaction?
- a. It increases Canadian net exports and has no effect on Russian net exports.
 - b. It increases Canadian net exports and decreases Russian net exports.
 - c. It decreases Canadian net exports and has no effect on Russian net exports.
 - d. It decreases Canadian net exports and increases Russian net exports.

ANS: D PTS: 1 DIF: Easy REF: p.270
BLM: Higher Order NOT: Macro TB_12-11

12. In 2001, Cote d'Ivoire had \$3 billion of net exports and bought \$1 billion of goods from foreign countries. What were Cote d'Ivoire's changes in the components of net exports?
- a. an increase of \$4 billion in exports and \$1 billion in imports
 - b. an increase of \$3 billion in imports and \$2 billion in exports
 - c. an increase of \$2 billion in exports and \$3 billion in imports
 - d. an increase of \$1 billion in imports and \$4 billion in exports

ANS: A PTS: 1 DIF: Average REF: p.270
BLM: Higher Order NOT: Macro TB_12-12

13. In 2001, Denmark had net exports of \$10 billion and sold \$60 billion of goods and services abroad. What were Denmark's increases in the components of net exports?
- a. \$70 billion of exports and \$50 billion of imports
 - b. \$50 billion of exports and \$70 billion of imports
 - c. \$60 billion of exports and \$50 billion of imports
 - d. \$50 billion of exports and \$60 billion of imports

ANS: C PTS: 1 DIF: Average REF: p.270
BLM: Higher Order NOT: Macro TB_12-13

14. Mike, a Canadian citizen living in Canada, buys \$30 of cheese from France. Which of the following correctly identifies the effects of this transaction?
- a. It increases Canadian imports by \$30 and increases Canadian net exports by \$30.
 - b. It increases Canadian imports by \$30 and decreases Canadian net exports by \$30.
 - c. It increases Canadian exports by \$30 and increases Canadian net exports by \$30.
 - d. It increases Canadian exports by \$30 and decreases Canadian net exports by \$30.

ANS: B PTS: 1 DIF: Easy REF: p.270
BLM: Higher Order NOT: Macro TB_12-14

15. Clear Brook Farms, a Canadian manufacturer of frozen vegetarian entrées, sells cases of its product to stores overseas. Which of the following correctly identifies the effects of these transactions?
- a. They decrease Canadian exports but increase Canadian net exports.
 - b. They decrease both Canadian exports and Canadian net exports.
 - c. They increase both Canadian exports and Canadian net exports.
 - d. They increase Canadian exports but decrease Canadian net exports.

ANS: C PTS: 1 DIF: Easy REF: p.270
BLM: Higher Order NOT: Macro TB_12-15

16. A German company sells cameras to a retailer in Canada. Which of the following correctly identifies the effects of these transactions?
- a. They have no effect on Canadian net exports, and they increase German net exports.
 - b. They decrease Canadian net exports and increase German net exports.
 - c. They increase Canadian and German net exports.
 - d. They increase Canadian net exports and decrease German net exports.

ANS: B PTS: 1 DIF: Easy REF: p.270
BLM: Higher Order NOT: Macro TB_12-16

17. A country sells more to people overseas than it buys from them. Which of the following correctly identifies the effects of these transactions?
- a. The country will have a trade surplus and positive net exports.
 - b. The country will have a trade surplus and negative net exports.
 - c. The country will have a trade deficit and positive net exports.
 - d. The country will have a trade deficit and negative net exports.

ANS: A PTS: 1 DIF: Easy REF: p.270
BLM: Remember NOT: Macro TB_12-17

18. A country sells less to people overseas than it buys from them. Which of the following correctly reflects this situation?
- a. The country has a balanced trade.
 - b. The country has a trade surplus.
 - c. The country has a trade deficit.
 - d. There is not enough information to answer the question.

ANS: C PTS: 1 DIF: Easy REF: p.270
BLM: Remember NOT: Macro TB_12-18

19. In 2005, Canada had positive net exports. Which of the following does this fact imply?
- a. Canada sold more abroad than it purchased abroad and had a trade surplus.
 - b. Canada sold more abroad than it purchased abroad and had a trade deficit.
 - c. Canada bought more abroad than it sold abroad and had a trade surplus.
 - d. Canada bought more abroad than it sold abroad and had a trade deficit.

ANS: A PTS: 1 DIF: Easy REF: p.270
BLM: Higher Order NOT: Macro TB_12-19

20. Which of the following best describes how the Canadian economy has evolved over the past five decades?
- a. It has become more closed.
 - b. It has become more open.
 - c. It has become less trade-oriented.
 - d. It has become more self-sufficient.

ANS: B PTS: 1 DIF: Easy REF: p.271
BLM: Remember NOT: Macro TB_12-20

21. About what percentage of GDP are Canadian imports?

- a. less than 13 percent
- b. about 14 percent
- c. about 37 percent
- d. about 67 percent

ANS: C PTS: 1 DIF: Easy REF: p.271
BLM: Remember NOT: Macro TB_12-21

22. Over the past 50 years, which of the following has happened to Canadian imports as a percentage of GDP?

- a. They have approximately stayed constant.
- b. They have approximately doubled.
- c. They have approximately tripled.
- d. They have approximately quadrupled.

ANS: B PTS: 1 DIF: Easy REF: p.271
BLM: Remember NOT: Macro TB_12-22

23. Which of the following partly caused the increase in international trade in Canada since 1989?

- a. an increase in Canadian GDP
- b. an appreciation of the dollar
- c. better quality of Canadian products
- d. the free trade agreement between Canada and the United States

ANS: D PTS: 1 DIF: Easy REF: p.272
BLM: Remember NOT: Macro TB_12-23

24. Which of the following best defines net capital outflow?

- a. It is the purchase of foreign assets by domestic residents minus the purchase of domestic assets by foreign residents.
- b. It is the purchase of foreign assets by domestic residents minus the purchase of foreign goods and services by domestic residents.
- c. It is the purchase of domestic assets by foreign residents minus the purchase of domestic goods and services by foreign residents.
- d. It is the purchase of domestic assets by foreign residents minus the purchase of foreign assets by domestic residents.

ANS: A PTS: 1 DIF: Easy REF: p.274
BLM: Remember NOT: Macro TB_12-24

25. Which of the following does net capital outflow measure?

- a. foreign assets held by domestic residents minus domestic assets held by foreign residents
- b. the imbalance between the amount of domestic assets bought by domestic residents and the amount of foreign assets bought by foreigners
- c. the imbalance between the amount of foreign assets bought by domestic residents and the amount of domestic goods and services sold to foreigners
- d. domestic assets held by foreigners minus foreign assets held by domestic residents

ANS: B PTS: 1 DIF: Easy REF: p.275
BLM: Remember NOT: Macro TB_12-25

26. Which of the following would be Canadian foreign direct investment?
- a. A Swedish car manufacturer opens a plant in Sherbrooke, Quebec.
 - b. A Dutch citizen buys shares of stock in a Canadian company.
 - c. Tim Hortons, a Canadian company, opens a restaurant in Jamaica.
 - d. A Canadian citizen buys stock in companies located in Japan.

ANS: C PTS: 1 DIF: Easy REF: p.275
BLM: Higher Order NOT: Macro TB_12-26

27. Which of the following would be Canadian foreign direct investment?
- a. Your Canadian-based mutual fund buys stock in Eastern European companies.
 - b. A Canadian citizen opens a guitar store in Hong Kong.
 - c. A Swiss bank buys a Canadian government bond.
 - d. A German tractor factory opens a plant in Victoria, B.C.

ANS: B PTS: 1 DIF: Easy REF: p.275
BLM: Higher Order NOT: Macro TB_12-27

28. Which of the following would be Canadian foreign direct investment?
- a. A Polish company opens a shipbuilding plant in Canada.
 - b. A Bolivian bank buys Canadian corporate bonds.
 - c. A Canadian bank buys Bolivian corporate bonds.
 - d. A Canadian canning factory opens a plant in Ecuador.

ANS: D PTS: 1 DIF: Easy REF: p.275
BLM: Higher Order NOT: Macro TB_12-28

29. Which of the following would be a Canadian foreign portfolio investment?
- a. Nortel, a Canadian company, builds a new factory near Rome, Italy.
 - b. Your economics professor, a Canadian citizen, buys stock in companies located in Eastern European countries.
 - c. A Dutch hotel chain opens a new hotel in Canada.
 - d. A citizen of Singapore buys a bond issued by a Canadian corporation.

ANS: B PTS: 1 DIF: Easy REF: p.275
BLM: Higher Order NOT: Macro TB_12-29

30. Which of the following is an example of Canadian foreign portfolio investment?
- a. Crystal, a Canadian citizen, buys bonds issued by a corporation in Turkey.
 - b. Randall, a Canadian citizen, opens a cheesecake factory in Italy.
 - c. Abigail, a Canadian citizen, buys software produced by Microsoft Corporation, a U.S. company.
 - d. Fernando, a Spanish citizen, buys stock in Research In Motion, a Canadian company.

ANS: A PTS: 1 DIF: Easy REF: p.275
BLM: Higher Order NOT: Macro TB_12-30

31. Which of the following is an example of Canadian foreign portfolio investment?
- a. Albert, a German citizen, buys stock in a Canadian computer company.
 - b. Larry, a citizen of Ireland, opens a fish-and-chips restaurant in Canada.
 - c. Ruth, a Canadian citizen, buys bonds issued by a German corporation.
 - d. Dustin, a Canadian citizen, opens a tavern in New Zealand.

ANS: C PTS: 1 DIF: Easy REF: p.275
BLM: Higher Order NOT: Macro TB_12-31

32. John, a Canadian citizen, opens up a 70s style disco bar in Tokyo. This count as which of the following?
- a. Canadian exports
 - b. Canadian imports
 - c. Canadian foreign portfolio investment
 - d. Canadian foreign direct investment

ANS: D PTS: 1 DIF: Easy REF: p.275
BLM: Higher Order NOT: Macro TB_12-32

33. If a Swiss watchmaker opens a factory in Canada, this is an example of which of the following?
- a. Swiss exports
 - b. Swiss imports
 - c. Swiss foreign portfolio investment
 - d. Swiss foreign direct investment

ANS: D PTS: 1 DIF: Easy REF: p.275
BLM: Higher Order NOT: Macro TB_12-33

34. Sue, a Canadian citizen, buys stock in a French chain of boutiques. Her purchase counts as which of the following?
- a. investment for Sue and Canadian foreign direct investment
 - b. investment for Sue and Canadian foreign portfolio investment
 - c. saving for Sue and Canadian foreign direct investment
 - d. saving for Sue and Canadian foreign portfolio investment

ANS: D PTS: 1 DIF: Easy REF: p.275
BLM: Higher Order NOT: Macro TB_12-34

35. Larry, a Canadian citizen, opens and operates a bookstore in Spain. This counts as which of the following?
- a. investment for Larry and Canadian foreign direct investment
 - b. investment for Larry and Canadian foreign portfolio investment
 - c. Canadian foreign direct investment and Canadian domestic investment
 - d. Canadian foreign portfolio investment and Canadian domestic investment

ANS: A PTS: 1 DIF: Easy REF: p.275
BLM: Higher Order NOT: Macro TB_12-35

36. Tony, an Italian citizen, opens and operates a spaghetti factory in Canada. This counts as which of the following?
- Italian foreign direct investment that increases Italian net capital outflow
 - Italian foreign direct investment that decreases Italian net capital outflow
 - Italian foreign portfolio investment that increases Italian net capital outflow
 - Italian foreign portfolio investment that decreases Italian net capital outflow
- ANS: A PTS: 1 DIF: Easy REF: p.275
 BLM: Higher Order NOT: Macro TB_12-36
37. Suppose Judy, a Canadian citizen, opens an ice cream store in Bermuda. Which of the following would her expenditures be?
- Canadian foreign portfolio investment that would increase Canadian net capital outflow
 - Canadian foreign portfolio investment that would decrease Canadian net capital outflow
 - Canadian foreign direct investment that would increase Canadian net capital outflow
 - Canadian foreign direct investment that would decrease Canadian net capital outflow
- ANS: C PTS: 1 DIF: Easy REF: p.275
 BLM: Higher Order NOT: Macro TB_12-37
38. Suppose Connie, a Canadian citizen, buys bonds issued by an automobile manufacturer in Sweden. Which of the following would her expenditure be?
- Canadian foreign direct investment that would increase Canadian net capital outflow
 - Canadian foreign direct investment that would decrease Canadian net capital outflow
 - Canadian foreign portfolio investment that would increase Canadian net capital outflow
 - Canadian foreign portfolio investment that would decrease Canadian net capital outflow
- ANS: C PTS: 1 DIF: Easy REF: p.275
 BLM: Higher Order NOT: Macro TB_12-38
39. Suppose Paul, a Romanian citizen, builds a telescope factory in Israel. Which of the following correctly identifies the effects of these expenditures?
- They increase Romanian and Israeli net capital outflow.
 - They increase Romanian net capital outflow, but decrease Israeli net capital outflow.
 - They decrease Romanian net capital outflow, but increase Israeli net capital outflow.
 - They increase Romanian net capital outflow, but Israeli net capital outflow remain unchanged.
- ANS: B PTS: 1 DIF: Average REF: p.275
 BLM: Higher Order NOT: Macro TB_12-39
40. Suppose Bob, a Greek citizen, opens a restaurant in Vancouver. Which of the following correctly identifies the effects of this action?
- It increases Canadian net capital outflow and has no affect on Greek net capital outflow.
 - It increases both Canadian and Greek net capital outflows.
 - It increases Canadian net capital outflow, but decreases Greek net capital outflow.
 - It decreases Canadian net capital outflow, but increases Greek net capital outflow.
- ANS: D PTS: 1 DIF: Easy REF: p.275
 BLM: Higher Order NOT: Macro TB_12-40

41. When making investment decisions, which of the following are investors most likely to do?
- a. They compare the real interest rates offered on different bonds.
 - b. They compare the nominal, but not the real, interest rates offered on different bonds.
 - c. They purchase the highest-priced bond available.
 - d. They purchase the highest-interest bonds available.

ANS: A PTS: 1 DIF: Average REF: p.275
BLM: Higher Order NOT: Macro TB_12-41

42. Catherine, a citizen of Spain, decides to purchase bonds issued by Chile instead of Canadian bonds, even though the Chilean bonds have a higher risk of default. Which of the following might be an economic reason for her decision?
- a. Chile has a lower inflation rate.
 - b. The Chilean bonds pay a higher rate of interest.
 - c. The Canadian government is more stable than the Chilean government.
 - d. Chilean bonds have shorter maturity periods than Canadian bonds.

ANS: B PTS: 1 DIF: Easy REF: p.275
BLM: Higher Order NOT: Macro TB_12-42

43. Which of the following does net capital outflow measure?
- a. an imbalance between a country's income and expenditure
 - b. an imbalance between a country's investment and saving
 - c. an imbalance between a country's sale of goods and services abroad and buying of foreign goods and services
 - d. an imbalance between a country's sale of domestic assets abroad and domestic purchase of foreign assets

ANS: D PTS: 1 DIF: Easy REF: p.275
BLM: Remember NOT: Macro TB_12-43

44. Which of the following do net exports measure?
- a. an imbalance between a country's income and expenditures
 - b. an imbalance between a country's sale of goods and services abroad and purchase of foreign goods and services
 - c. an imbalance between a country's sale of domestic assets abroad and purchase of foreign assets
 - d. imports minus exports

ANS: B PTS: 1 DIF: Easy REF: p.276
BLM: Remember NOT: Macro TB_12-44

45. Which of the following shows that any trade transaction must have a financial counterpart?
- a. $NCO = NX$
 - b. $NCO + I = NX$
 - c. $NX + NCO = Y$
 - d. $Y = NCO - I$

ANS: A PTS: 1 DIF: Easy REF: p.276
BLM: Remember NOT: Macro TB_12-45

46. Which of the following is an identity that always holds in an open economy?

- a. $NCO + C = NX$
- b. $NCO = NX$
- c. $NX - NCO = C$
- d. $NX + NCO = C$

ANS: B PTS: 1 DIF: Easy REF: p.276
BLM: Remember NOT: Macro TB_12-46

47. Suppose Canada sells chocolate to the United States. Which of the following correctly identifies the effects of this transaction?

- a. U.S. net exports increase, and U.S. net capital outflow increases.
- b. U.S. net exports increase, and U.S. net capital outflow decreases.
- c. U.S. net exports decrease, and U.S. net capital outflow increases.
- d. U.S. net exports decrease, and U.S. net capital outflow decreases.

ANS: D PTS: 1 DIF: Average REF: p.276
BLM: Higher Order NOT: Macro TB_12-47

48. If a U.S. textbook publishing company sells texts to Canadian students, which of the following correctly identifies the effects of these sales?

- a. U.S. net exports increase, and U.S. net capital outflow increases.
- b. U.S. net exports increase, and U.S. net capital outflow decreases.
- c. U.S. net exports decrease, and U.S. net capital outflow increases.
- d. U.S. net exports decrease, and U.S. net capital outflow decreases.

ANS: A PTS: 1 DIF: Easy REF: p.276
BLM: Higher Order NOT: Macro TB_12-48

49. If a Canadian shirt-maker purchases cotton from Egypt, which of the following correctly identifies the effects of this transaction?

- a. Canadian net exports increase, and Canadian net capital outflow increases.
- b. Canadian net exports increase, and Canadian net capital outflow decreases.
- c. Canadian net exports decrease, and Canadian net capital outflow increases.
- d. Canadian net exports decrease, and Canadian net capital outflow decreases.

ANS: D PTS: 1 DIF: Average REF: p.276
BLM: Higher Order NOT: Macro TB_12-49

50. A Canadian firm buys sardines from Morocco and pays for them with Canadian dollars. Which of the following correctly identifies the effects of this transaction?

- a. Canadian net exports increase, and Canadian net capital outflow increases.
- b. Canadian net exports increase, and Canadian net capital outflow decreases.
- c. Canadian net exports decrease, and Canadian net capital outflow increases.
- d. Canadian net exports decrease, and Canadian net capital outflow decreases.

ANS: D PTS: 1 DIF: Average REF: p.276
BLM: Higher Order NOT: Macro TB_12-50

51. A Canadian firm opens a factory that produces camping equipment in Albania. Which of the following correctly identifies the effects of this transaction?
- a. Canadian net capital outflow increases, and Albanian net capital outflow decreases.
 - b. Canadian net capital outflow decreases, and Albanian net capital outflow increases.
 - c. Only Canadian net capital outflow increases.
 - d. Only Albanian net capital outflow increases.

ANS: A PTS: 1 DIF: Average REF: p.276
BLM: Higher Order NOT: Macro TB_12-51

52. A Japanese firm buys lumber from Canada and pays for it with yen. Which of the following correctly identifies the effects of this transaction?
- a. Japanese net exports increase, and Canadian net capital outflow increases.
 - b. Japanese net exports increase, and Canadian net capital outflow decreases.
 - c. Japanese net exports decrease, and Canadian net capital outflow increases.
 - d. Japanese net exports decrease, and Canadian net capital outflow decreases.

ANS: C PTS: 1 DIF: Challenging REF: p.276
BLM: Higher Order NOT: Macro TB_12-52

53. A Russian flour mill buys wheat from Canada and pays for it with rubles. Which of the following correctly identifies the effects of this transaction?
- a. Russian net exports increase, and Canadian net capital outflow increases.
 - b. Russian net exports increase, and Canadian net capital outflow decreases.
 - c. Russian net exports decrease, and Canadian net capital outflow increases.
 - d. Russian net exports decrease, and Canadian net capital outflow decreases.

ANS: C PTS: 1 DIF: Challenging REF: p.276
BLM: Higher Order NOT: Macro TB_12-53

54. Jill, a Canadian citizen, uses some previously obtained euros to purchase a bond issued by a French vineyard. How does this transaction affect Canadian net capital outflow?
- a. It increases Canadian net capital outflow by more than the value of the bond.
 - b. It increases Canadian net capital outflow by the value of the bond.
 - c. It does not change Canadian net capital outflow.
 - d. It decreases Canadian net capital outflow.

ANS: C PTS: 1 DIF: Challenging REF: p.276
BLM: Higher Order NOT: Macro TB_12-54

55. Tony, a Canadian citizen, uses some previously obtained Portuguese currency (escudo) to purchase a bond issued by a Portuguese company. How does this transaction affect Canadian net capital outflow?
- a. It increases Canadian net capital outflow by more than the value of the bond.
 - b. It increases Canadian net capital outflow by the value of the bond.
 - c. It does not change Canadian net capital outflow.
 - d. It decreases Canadian net capital outflow.

ANS: C PTS: 1 DIF: Challenging REF: p.276
BLM: Higher Order NOT: Macro TB_12-55

56. A citizen of Saudi Arabia uses previously obtained Canadian dollars to purchase apples from Canada. Which of the following correctly identifies the effects of this transaction?
- It increases Saudi net capital outflow and increases Canadian net exports.
 - It increases Saudi net capital outflow and decreases Canadian net exports.
 - It decreases Saudi net capital outflow and increases Canadian net exports.
 - It decreases Saudi net capital outflow and decreases Canadian net exports.

ANS: C PTS: 1 DIF: Average REF: p.276
BLM: Higher Order NOT: Macro TB_12-56

57. A British pharmacy buys drugs from a Canadian company and pays for them with British pounds. Which of the following correctly identifies the effects of this transaction?
- It increases British net exports and increases Canadian capital outflow.
 - It increases British net exports and decreases Canadian capital outflow.
 - It decreases British net exports and increases Canadian capital outflow.
 - It decreases British net exports and decreases Canadian capital outflow.

ANS: C PTS: 1 DIF: Average REF: p.276
BLM: Higher Order NOT: Macro TB_12-57

58. A Venezuelan firm purchases earth-moving equipment from a Canadian company and pays for it with domestic currency. Which of the following correctly identifies the effects of this transaction?
- It increases Canadian net exports and increases Venezuelan net capital outflow.
 - It increases Canadian net exports and decreases Venezuelan net capital outflow.
 - It decreases Canadian net exports and increases Venezuelan net capital outflow.
 - It decreases Canadian net exports and decreases Venezuelan net capital outflow.

ANS: B PTS: 1 DIF: Average REF: p.276
BLM: Higher Order NOT: Macro TB_12-58

59. A Canadian firm buys apples from New Zealand with Canadian currency. The Canadian firm then uses this money to buy packaging equipment from a Canadian firm. How do these transactions affect net exports or net capital outflow?
- They increase New Zealand net capital outflow and New Zealand net exports.
 - They increase New Zealand net exports but not New Zealand net capital outflow.
 - They increase New Zealand net capital outflow but not New Zealand net exports.
 - They increase neither New Zealand net exports nor New Zealand capital outflow.

ANS: D PTS: 1 DIF: Challenging REF: p.276
BLM: Higher Order NOT: Macro TB_12-59

60. Canada sells machinery to a South African company, which pays Canada with South African currency (the rand). Which of the following best describes the consequences of this transaction?
- It increases Canadian net capital outflow because Canada acquires foreign assets.
 - It decreases Canadian net capital outflow because Canada acquires foreign assets.
 - It increases Canadian net capital outflow because Canada sells capital goods.
 - It decreases Canadian net capital outflow because Canada sells capital goods.

ANS: A PTS: 1 DIF: Average REF: p.276
BLM: Higher Order NOT: Macro TB_12-60

61. Suppose that the real return from operating factories in Ghana rises relative to the real rate of return in Canada. Which of the following best describes the effects of this transaction?
- a. This will increase Canadian net capital outflow and decrease Ghanaian net capital outflow.
 - b. This will decrease Canadian net capital outflow and increase Ghanaian net capital outflow.
 - c. This will only increase Canadian net capital outflow.
 - d. This will only increase Ghanaian net capital outflow.

ANS: A PTS: 1 DIF: Average REF: p.276
BLM: Higher Order NOT: Macro TB_12-61

62. A Canadian computer maker sells computers to a German firm. This company uses all of the revenues from this sale to purchase automobiles from German firms. Which of the following best describes the effects of these transactions?
- a. They will increase both Canadian net exports and Canadian net foreign investment.
 - b. They will decrease both Canadian net exports and Canadian net foreign investment.
 - c. They will increase Canadian net exports and will not affect Canadian net foreign investment.
 - d. They will not affect Canadian net exports or Canadian net foreign investment.

ANS: A PTS: 1 DIF: Average REF: p.276
BLM: Higher Order NOT: Macro TB_12-62

63. Bolivia buys railroad engines from a Canadian firm and pays for them with Bolivianos (Bolivian currency). Which of the following best describes the effects of this transaction?
- a. It increases both Canadian net exports and Canadian net foreign investment.
 - b. It decreases both Canadian net exports and Canadian net foreign investment.
 - c. It increases Canadian net exports and does not affect Canadian net foreign investment.
 - d. It decreases Canadian net exports and net foreign investment.

ANS: A PTS: 1 DIF: Average REF: p.276
BLM: Higher Order NOT: Macro TB_12-63

64. Which of the following best defines the current account balance?
- a. net exports
 - b. net exports – net inflow of dividends and interest payments
 - c. net exports + net inflow of dividends and interest payments
 - d. net inflow of dividends and interest payments – net exports

ANS: C PTS: 1 DIF: Easy REF: p.277
BLM: Remember NOT: Macro TB_12-64

65. Which of the following best describes the net flow of dividends and interest payments?
- a. part of the current account balance
 - b. part of net capital outflow
 - c. part of net exports
 - d. part of foreign direct investment

ANS: A PTS: 1 DIF: Easy REF: p.277
BLM: Remember NOT: Macro TB_12-65

66. Which of the following is the formula for an open economy's GDP?

- a. $Y = C + I + G$
- b. $Y = C + I + G + T$
- c. $Y = C + I + G + S$
- d. $Y = C + I + G + NX$

ANS: D PTS: 1 DIF: Easy REF: p.278
BLM: Remember NOT: Macro TB_12-66

67. Which of the following is the formula for a closed economy's GDP?

- a. $Y = C + I + G$
- b. $Y = C + I + G + T$
- c. $Y = C + I + G + S$
- d. $Y = C + I + G + NX$

ANS: A PTS: 1 DIF: Easy REF: p.278
BLM: Remember NOT: Macro TB_12-67

68. Which of the following is the formula for national saving?

- a. $S = I + C$
- b. $S = I - NX$
- c. $S = I + NCO$
- d. $S = NX - NCO$

ANS: C PTS: 1 DIF: Easy REF: p.278
BLM: Remember NOT: Macro TB_12-68

69. Which of the following equations is the GDP identity in an open economy?

- a. $Y = C + I + G + NCO$
- b. $NX = -NCO$
- c. $NCO = S - I + NX$
- d. $Y = C + I + G - NX$

ANS: D PTS: 1 DIF: Easy REF: p.278
BLM: Remember NOT: Macro TB_12-69

70. Which of the following is the formula for investment in an open economy?

- a. $I = Y - C$
- b. $I = S$
- c. $I = S - NCO$
- d. $I = S + NX$

ANS: C PTS: 1 DIF: Easy REF: p.278
BLM: Remember NOT: Macro TB_12-70

71. Which of the following is the formula for saving in an open economy?

- a. Saving = Foreign saving + Net capital outflow
- b. Saving = Domestic investment – Net capital outflow
- c. Saving = Domestic saving + Net capital outflow
- d. Saving = Domestic investment + Net capital outflow

ANS: D PTS: 1 DIF: Easy REF: p.278
BLM: Remember NOT: Macro TB_12-71

72. In which of the following situations *must* national saving rise?
- a. Both domestic investment and net capital outflow increase.
 - b. Domestic investment increases and net capital outflow decreases.
 - c. Domestic investment decreases and net capital outflow increases.
 - d. Net exports decrease and domestic investment is unchanged.

ANS: A PTS: 1 DIF: Average REF: p.278-279
BLM: Higher Order NOT: Macro TB_12-72

73. A country has \$150 million of net exports and \$190 million of saving. What is net capital outflow?
- a. \$40 million
 - b. -\$40 million
 - c. \$150 million
 - d. \$190 million

ANS: C PTS: 1 DIF: Average REF: p.278
BLM: Higher Order NOT: Macro TB_12-73

74. A country has \$80 million of saving and domestic investment of \$30 million. What are net exports?
- a. -\$50 million
 - b. \$50 million
 - c. \$80 million
 - d. \$110 million

ANS: B PTS: 1 DIF: Average REF: p.278
BLM: Higher Order NOT: Macro TB_12-74

75. A country has \$60 million of domestic investment and net capital outflow of \$20 million. What is saving?
- a. -\$60 million
 - b. -\$40 million
 - c. \$40 million
 - d. \$60 million

ANS: B PTS: 1 DIF: Average REF: p.278
BLM: Higher Order NOT: Macro TB_12-75

76. A country has \$50 million of domestic investment and net capital outflow of -\$70 million. What is saving?
- a. -\$70 million
 - b. -\$20 million
 - c. \$50 million
 - d. \$120 million

ANS: B PTS: 1 DIF: Average REF: p.278
BLM: Higher Order NOT: Macro TB_12-76

77. The country of Freedonia has a GDP of \$4000, consumption of \$1800, and government purchases of \$500. Which of the following does this situation imply?
- a. Investment is equal to -\$1700.
 - b. Investment plus net capital outflow is equal to \$1700.
 - c. Investment plus net exports is equal to \$2300.
 - d. Saving is equal to \$2200.

ANS: B PTS: 1 DIF: Average REF: p.278
BLM: Higher Order NOT: Macro TB_12-77

78. The country of Sylvania has a GDP of \$4000, investment of \$500, government purchases of \$400, and net capital outflow of negative \$300. What is consumption?
- a. \$600
 - b. \$700
 - c. \$3400
 - d. \$3700

ANS: C PTS: 1 DIF: Challenging REF: p.278
BLM: Higher Order NOT: Macro TB_12-78

79. In which situation must domestic saving equal investment?
- a. in both closed and open economies
 - b. in closed economies, but not open economies
 - c. in open economies, but not closed economies
 - d. in neither closed nor open economies

ANS: B PTS: 1 DIF: Average REF: p.278
BLM: Remember NOT: Macro TB_12-79

80. Part of Canadian savings may be counted as which of the following?
- a. foreign direct investment
 - b. foreign portfolio investment
 - c. net capital outflow
 - d. net exports

ANS: C PTS: 1 DIF: Easy REF: p.278
BLM: Remember NOT: Macro TB_12-80

81. Other things the same, which of the following would induce a trade deficit?
- a. a decline in saving, but not a rise in investment
 - b. a rise in investment, but not a decline in saving
 - c. both a decline in saving and a rise in investment
 - d. neither a decline in saving nor a rise in investment

ANS: C PTS: 1 DIF: Average REF: p.279
BLM: Higher Order NOT: Macro TB_12-81

82. Which of the following does a trade deficit imply?

- a. saving is greater than domestic investment and $Y > C + I + G$
- b. saving is greater than domestic investment and $Y < C + I + G$
- c. saving is less than domestic investment and $Y > C + I + G$
- d. saving is less than domestic investment and $Y < C + I + G$

ANS: D PTS: 1 DIF: Average REF: p.279
BLM: Higher Order NOT: Macro TB_12-82

83. Which of the following does a trade surplus imply?

- a. saving is greater than domestic investment and $Y > C + I + G$
- b. saving is greater than domestic investment and $Y < C + I + G$
- c. saving is less than domestic investment and $Y > C + I + G$
- d. saving is less than domestic investment and $Y < C + I + G$

ANS: A PTS: 1 DIF: Average REF: p.279
BLM: Higher Order NOT: Macro TB_12-83

84. Which of the following was an important change in Canadian economy after 1999?

- a. National saving fell below investment, and net capital outflow was a large positive number.
- b. Net capital outflow turned positive.
- c. Investment equalled saving every year.
- d. Investment fell below saving, so net capital outflow was a large negative number.

ANS: B PTS: 1 DIF: Average REF: p.280
BLM: Remember NOT: Macro TB_12-84

85. Which of the following best describes net capital outflow in Canada from 1961 to about 1998?

- a. small but always positive
- b. small and sometimes negative and sometimes positive
- c. large and positive
- d. large and negative in all but three years

ANS: D PTS: 1 DIF: Average REF: p.281
BLM: Higher Order NOT: Macro TB_12-85

86. Which of the following best describes Canadian net capital outflow and net exports since 1999?

- a. Net capital outflow has been positive, and net exports have been negative.
- b. Net capital outflow has been positive, and net exports have been positive.
- c. Net capital outflow has been negative, and net exports have been negative.
- d. Net capital outflow has been negative and net exports have been positive.

ANS: B PTS: 1 DIF: Average REF: p.280
BLM: Remember NOT: Macro TB_12-86

87. Which of the following was of much concern about Canadian economy in the 1960s and 1970s?
- a. increasing budget deficits
 - b. the extent of foreign investment in Canada
 - c. the fact that net exports were positive
 - d. Canadians purchasing too many foreign assets

ANS: B PTS: 1 DIF: Average REF: p.280
BLM: Remember NOT: Macro TB_12-87

88. How has Canadian national saving changed in recent history?
- a. It remained positive from 1999 to 2008.
 - b. It decreased below 10 percent toward the end of the 1990s.
 - c. It had a historic high in early 1990s.
 - d. It has been decreasing since 1991.

ANS: A PTS: 1 DIF: Average REF: p.280-281
BLM: Remember NOT: Macro TB_12-88

89. Between 1981 and 1988, which of the following happened to Canadian net capital outflow as a percent of GDP?
- a. It became a larger, positive number.
 - b. It became a smaller, positive number.
 - c. It became a larger, negative number.
 - d. It became a smaller, negative number.

ANS: C PTS: 1 DIF: Average REF: p.280-281
BLM: Remember NOT: Macro TB_12-89

90. Between 1981 and 1988, which of the following caused most of the change in Canadian net capital outflow as a percent of GDP?
- a. decline in public saving
 - b. decline in private saving
 - c. increase in public saving
 - d. increase in private saving

ANS: A PTS: 1 DIF: Challenging REF: p.280-281
BLM: Remember NOT: Macro TB_12-90

91. Between 1981 and 1988, which of the following caused most of the change in Canadian net capital outflow as a percent of GDP?
- a. decrease in Canadian investment
 - b. decrease in Canadian national saving
 - c. increase in Canadian investment
 - d. decrease in Canadian national saving

ANS: B PTS: 1 DIF: Average REF: p.280-281
BLM: Higher Order NOT: Macro TB_12-91

92. Since 1999, which of the following caused most of the change of Canadian net capital outflow as a percent of GDP?
- a. decrease in private investment
 - b. increase in national saving
 - c. decrease in U.S. investment
 - d. decrease in national saving

ANS: B PTS: 1 DIF: Average REF: p.280-281
BLM: Higher Order NOT: Macro TB_12-92

93. If a country has business opportunities that become relatively attractive to other countries, which of the following best predicts the effects of this change?
- a. Both net exports and net capital outflow increase.
 - b. Both net exports and net capital outflow decrease.
 - c. Net exports increase, but net capital outflow decreases.
 - d. Net exports decrease, but net capital outflow increases.

ANS: B PTS: 1 DIF: Average REF: p.276
BLM: Higher Order NOT: Macro TB_12-93

94. In 2009, approximately what was Canadian net capital outflow as a percent of GDP?
- a. 4.5 percent
 - b. 2.5 percent
 - c. -2.5 percent
 - d. -4.5 percent

ANS: C PTS: 1 DIF: Average REF: p.280
BLM: Remember NOT: Macro TB_12-94

95. If citizens of a country are not saving much, which of the following is best for that country's government to do?
- a. force citizens to save
 - b. reduce investment
 - c. have foreigners invest in the domestic economy
 - d. prevent opportunities for citizens to buy capital assets abroad

ANS: C PTS: 1 DIF: Average REF: p.277-278
BLM: Higher Order NOT: Macro TB_12-95

96. Which of the following best defines the nominal exchange rate?
- a. It is the nominal interest rate in one country divided by the nominal interest rate in the other country.
 - b. It is the rate at which a person can trade the currency of one country for the currency of another.
 - c. It is the price of a good in one country divided by the price of the same good in another.
 - d. It is the number of goods a person can trade for a similar good in another country.

ANS: B PTS: 1 DIF: Easy REF: p.282
BLM: Remember NOT: Macro TB_12-96

97. If the exchange rate is 175 yen = \$1, what is the cost of a bottle of rice wine that costs 5250 yen?
- a. \$28
 - b. \$30
 - c. \$32
 - d. \$34

ANS: B PTS: 1 DIF: Easy REF: p.282
BLM: Higher Order NOT: Macro TB_12-97

98. Suppose the exchange rate is 5 units of Peruvian currency per dollar, and a hotel room in Lima, Peru, costs 350 units of Peruvian currency. How many dollars do you need to get a room in Lima?
- a. \$1750
 - b. \$355
 - c. \$70
 - d. \$35

ANS: B PTS: 1 DIF: Easy REF: p.282
BLM: Higher Order NOT: Macro TB_12-98

99. Exchange rates are 0.98 U.S. dollars per Canadian dollar, 150 yen per Canadian dollar, 0.8 euro per Canadian dollar, and 20 pesos per Canadian dollar. A bottle of beer in New York costs 6 U.S. dollars, 1200 yen in Tokyo, 7 euros in Munich, and 100 pesos in Cancun. Which of the following indicates the most expensive beer?
- a. Cancun
 - b. New York
 - c. Tokyo
 - d. Munich

ANS: D PTS: 1 DIF: Average REF: p.282
BLM: Higher Order NOT: Macro TB_12-99

100. If the exchange rate changes from 100 yen per dollar to 150 yen per dollar, what has happened to the dollar?
- a. It has appreciated and so buys more Japanese goods.
 - b. It has appreciated and so buys fewer Japanese goods.
 - c. It has depreciated and so buys more Japanese goods.
 - d. It has depreciated and so buys fewer Japanese goods.

ANS: A PTS: 1 DIF: Easy REF: p.282
BLM: Higher Order NOT: Macro TB_12-100

101. If the exchange rate changes from 40 Thai baht per dollar to 35 Thai baht per dollar, what has happened to the dollar?
- a. It has appreciated and so buys more Thai goods.
 - b. It has appreciated and so buys fewer Thai goods.
 - c. It has depreciated and so buys more Thai goods.
 - d. It has depreciated and so buys fewer Thai goods.

ANS: D PTS: 1 DIF: Easy REF: p.282
BLM: Higher Order NOT: Macro TB_12-101

102. If the exchange rate changes from 0.35 Kuwaiti dinar per dollar to 0.30 Kuwaiti dinar per dollar, what has happened to the dollar?
- a. It has appreciated and so buys more Kuwaiti goods.
 - b. It has appreciated and so buys fewer Kuwaiti goods.
 - c. It has depreciated and so buys more Kuwaiti goods.
 - d. It has depreciated and so buys fewer Kuwaiti goods.

ANS: D PTS: 1 DIF: Easy REF: p.282
BLM: Higher Order NOT: Macro TB_12-102

103. Suppose that in 1999 you could purchase about 400 Greek drachmas (the former Greek currency, replaced by the euro in 2002) for a dollar. In 2000, you could purchase about 350 drachmas for a dollar. Which of the following best explain the changes that could have taken place between 1999 and 2000?
- a. The dollar appreciated, increasing the trade balance.
 - b. The dollar depreciated, decreasing the trade balance.
 - c. The dollar appreciated, decreasing the trade balance.
 - d. The dollar depreciated, increasing the trade balance.

ANS: D PTS: 1 DIF: Average REF: p.282
BLM: Higher Order NOT: Macro TB_12-103

104. Suppose that a kilogram can of coffee costs about \$6 in Canada. Suppose the exchange rate is about 0.7 euro per dollar and that a kilogram can of coffee in Belgium costs about 2.1 euros. What is the real exchange rate?
- a. 2.45 cans of Belgian coffee per can of Canadian coffee
 - b. $\frac{3}{4}$ cans of Belgian coffee per can of Canadian coffee
 - c. $\frac{3}{5}$ cans of Belgian coffee per can of Canadian coffee
 - d. 2 cans of Belgian coffee per can of Canadian coffee

ANS: B PTS: 1 DIF: Average REF: p.283
BLM: Higher Order NOT: Macro TB_12-104

105. In Canada, a cup of hot chocolate costs \$6. In Australia, the same hot chocolate costs \$6 Australian dollars. If the exchange rate is \$3 Australian dollars per Canadian dollar, what is the real exchange rate?
- a. $\frac{1}{2}$ cup of Australian hot chocolate per cup of Canadian hot chocolate
 - b. 1 cup of Australian hot chocolate per cup of Canadian hot chocolate
 - c. 2 cups of Australian hot chocolate per cup of Canadian hot chocolate
 - d. 3 cups of Australian hot chocolate per cup of Canadian hot chocolate

ANS: C PTS: 1 DIF: Average REF: p.283
BLM: Higher Order NOT: Macro TB_12-105

106. In Ireland, a pint of beer costs 4 Irish punts. In Australia, a pint of beer costs 6 Australian dollars. If the exchange rate is 0.6 punts per Australian dollar, what is the real exchange rate?
- a. 0.8 pints of Irish beer per pint of Australian beer
 - b. 0.9 pints of Irish beer per pint of Australian beer
 - c. 1.11 pints of Irish beer per pint of Australian beer
 - d. 1.25 pints of Irish beer per pint of Australian beer

ANS: B PTS: 1 DIF: Challenging REF: p.283
BLM: Higher Order NOT: Macro TB_12-106

107. Suppose the real exchange rate is $\frac{3}{5}$ pounds of Chilean beef per pound of Canadian beef, a pound of Canadian beef costs \$3, and the nominal exchange rate is 400 Chilean pesos per dollar. What does Chilean beef cost?
- a. 960 pesos per pound
 - b. 1200 pesos per pound
 - c. 1500 pesos per pound
 - d. 2000 pesos per pound

ANS: D PTS: 1 DIF: Challenging REF: p.283
BLM: Higher Order NOT: Macro TB_12-107

108. Suppose the real exchange rate is $\frac{1}{2}$ gallon of Canadian gasoline per gallon of U.S. gasoline, a gallon of U.S. gasoline costs \$1.50 U.S., and a gallon of Canadian gas costs \$3.90 Canadian. What is the nominal exchange rate?
- a. 0.385 Canadian dollars per U.S. dollar
 - b. 0.65 Canadian dollars per U.S. dollar
 - c. 1.10 Canadian dollars per U.S. dollar
 - d. 1.30 Canadian dollars per U.S. dollar

ANS: D PTS: 1 DIF: Challenging REF: p.282830
BLM: Higher Order NOT: Macro TB_12-108

109. Which of the following units of measurement would be appropriate for a real exchange rate?
- a. 9 euros per dollar
 - b. 15 euros per basket of Canadian goods
 - c. $\frac{1}{2}$ case of German beer per case of Canadian beer
 - d. $\frac{1}{2}$ case of German beer per dollar of Canadian beer

ANS: C PTS: 1 DIF: Average REF: p.283
BLM: Higher Order NOT: Macro TB_12-109

110. Suppose that a bushel of wheat costs \$5 in Canada and costs 50 pesos in Mexico. If the nominal exchange rate is 30 pesos per dollar, what is the real exchange rate?
- a. $\frac{1}{3}$
 - b. 1
 - c. 3
 - d. 10

ANS: C PTS: 1 DIF: Average REF: p.283
BLM: Higher Order NOT: Macro TB_12-110

111. If goods in Canada cost the same number of dollars as German goods cost in euros, the real exchange rate would be computed as how many German goods per Canadian goods?
- a. one
 - b. the price of the Canadian goods
 - c. the amount of German currency that can be bought with one unit of Canadian currency
 - d. the amount of Canadian currency that can be bought with one unit of German currency

ANS: C PTS: 1 DIF: Average REF: p.283
BLM: Higher Order NOT: Macro TB_12-111

112. If it took as many dollars to buy goods in Canada as it did to buy enough currency to buy the same goods in India, the real exchange rate would be computed as how many Indian goods per Canadian goods?
- one
 - the number of dollars needed to buy Canadian goods divided by the number of rupees needed to buy Indian goods
 - the number of rupees needed to buy Indian goods divided by the number of dollars needed to buy Canadian goods
 - a number equal to the nominal exchange rate

ANS: A PTS: 1 DIF: Average REF: p.283
 BLM: Higher Order NOT: Macro TB_12-112

113. If the nominal exchange rate e is foreign currency per dollar, the domestic price is P , and the foreign price is P^* , which of the following is the definition of the real exchange rate?
- $e(P^*/P)$
 - $e(P/P^*)$
 - $e + P/P$
 - $e - P/P^*$

ANS: B PTS: 1 DIF: Easy REF: p.285
 BLM: Remember NOT: Macro TB_12-113

114. Suppose that the real exchange rate between Canada and Kenya is defined in terms of baskets of goods. Which of the following will increase the real exchange rate (that is, increase the number of baskets of Kenyan goods a basket of Canadian goods buys)?
- an increase in the number of Kenyan shillings that can be purchased with a dollar
 - an increase in the price in Canadian dollars of Kenyan goods
 - an increase in the price in Kenyan shillings of Kenyan goods
 - a decrease in the number of Kenyan shillings that can be purchased with a dollar

ANS: A PTS: 1 DIF: Average REF: p.285
 BLM: Higher Order NOT: Macro TB_12-114

115. Which of the following would a depreciation of the Canadian real exchange rate induce Canadian consumers to buy?
- fewer domestic goods and fewer foreign goods
 - more domestic goods and fewer foreign goods
 - fewer domestic goods and more foreign goods
 - more domestic goods and more foreign goods

ANS: B PTS: 1 DIF: Easy REF: p.285
 BLM: Higher Order NOT: Macro TB_12-115

116. Which of the following would an appreciation of the Canadian real exchange rate induce Canadian consumers to buy?
- fewer domestic goods and fewer foreign goods
 - more domestic goods and fewer foreign goods
 - fewer domestic goods and more foreign goods
 - more domestic goods and more foreign goods

ANS: C PTS: 1 DIF: Easy REF: p.285
 BLM: Higher Order NOT: Macro TB_12-116

117. Which of the following is the most likely effect of an appreciation of the Canadian real exchange rate on the quantity of Alberta beef demanded by French citizens?
- a. French citizens will buy less of Alberta beef.
 - b. French citizens will buy more of Alberta beef.
 - c. The quantity of Alberta beef demanded by French citizens will not change because the nominal exchange rate has not changed.
 - d. The quantity of Alberta beef demanded by French citizens will not change because it is the French real interest rate that matters for French citizens.

ANS: A PTS: 1 DIF: Average REF: p.285
BLM: Higher Order NOT: Macro TB_12-117

118. If the Canadian real exchange rate appreciates, which of the following most likely happen?
- a. Net exports increase, and net capital outflow decreases.
 - b. Net exports decrease, and net capital outflow increases.
 - c. Net exports and net capital outflow both increase.
 - d. Net exports and net capital outflow both decrease.

ANS: D PTS: 1 DIF: Average REF: p.285
BLM: Higher Order NOT: Macro TB_12-118

119. If the Canadian real exchange rate appreciates, which of the following most likely happen?
- a. Exports increase and imports decrease.
 - b. Exports decrease and imports increase.
 - c. Exports and imports both increase.
 - d. Exports and imports both decrease.

ANS: B PTS: 1 DIF: Easy REF: p.285
BLM: Higher Order NOT: Macro TB_12-119

120. When the yen gets "stronger" relative to the dollar, what happens to the Canadian trade deficit with Japan?
- a. The Canadian trade deficit with Japan will rise.
 - b. The Canadian trade deficit with Japan will fall.
 - c. The Canadian trade deficit with Japan will be unchanged.
 - d. There is insufficient information to answer this question.

ANS: B PTS: 1 DIF: Average REF: p.285
BLM: Higher Order NOT: Macro TB_12-120

121. If the Canadian real exchange rate appreciates relative to the euro, which of the following best describes the consequences?
- a. Canadian exports to Europe and European exports to Canada both rise.
 - b. Canadian exports to Europe and European exports to Canada both fall.
 - c. Canadian exports to Europe rise, and European exports to Canada fall.
 - d. Canadian exports to Europe fall, and European exports to Canada rise.

ANS: D PTS: 1 DIF: Average REF: p.285
BLM: Higher Order NOT: Macro TB_12-121

122. Which of the following is the most likely consequence of the introduction of the euro as the common currency of many European countries?
- a. It will lead to less international trade.
 - b. It will reduce the costs of trading within Europe.
 - c. It will lead to greater differences in monetary policy amongst participating countries.
 - d. It will reduce trade of some European countries with Canada.

ANS: B PTS: 1 DIF: Easy REF: p.285
BLM: Higher Order NOT: Macro TB_12-122

123. How has the introduction of the euro affected arbitrage?
- a. It has eliminated the possibility of arbitrage within Europe.
 - b. It has eliminated the possibility of arbitrage based on exchange-rate differences within Europe.
 - c. It has increased the possibilities for arbitrage within Europe.
 - d. It has not affected the possibilities for arbitrage within Europe.

ANS: B PTS: 1 DIF: Challenging REF: p.285
BLM: Higher Order NOT: Macro TB_12-123

124. Suppose the nominal exchange rate between the yen and the U.S. dollar is 220 yen per U.S. dollar, and that the nominal exchange rate between the Canadian dollar and the U.S. dollar is 1.10 Canadian dollars per U.S. dollar. How many yen would it take to buy a Canadian dollar?
- a. 200
 - b. 20
 - c. 0.5
 - d. 0.005

ANS: A PTS: 1 DIF: Average REF: p.285
BLM: Higher Order NOT: Macro TB_12-124

125. What does the law of one price state?
- a. A good cannot be sold at a black market price.
 - b. A good must sell at the price fixed by law.
 - c. A good must sell at the same price at all locations.
 - d. A good cannot sell for a price greater than the legal price ceiling.

ANS: C PTS: 1 DIF: Easy REF: p.286
BLM: Remember NOT: Macro TB_12-125

126. Which of the following terms refers to the process of taking advantage of different prices for a good in different markets?
- a. arbitrage
 - b. absolute advantage
 - c. capitalism
 - d. the law of one price

ANS: A PTS: 1 DIF: Easy REF: p.286
BLM: Remember NOT: Macro TB_12-126

127. What does purchasing-power parity explain?

- a. It explains prices in the short run.
- b. It explains prices in the long run.
- c. It explains exchange rates in the short run.
- d. It explains exchange rates in the long run.

ANS: D PTS: 1 DIF: Easy REF: p.286
BLM: Remember NOT: Macro TB_12-127

128. How do nominal exchange rates change over time?

- a. They vary little over time.
- b. They vary substantially over time.
- c. They appreciate over time for most countries.
- d. They depreciate over time for most countries.

ANS: B PTS: 1 DIF: Easy REF: p.284
BLM: Remember NOT: Macro TB_12-128

129. What does purchasing parity imply for the exchange rate?

- a. that the real exchange rate is equal to one
- b. that the nominal exchange rate is equal to one
- c. that the real exchange rate is equal to the nominal exchange rate
- d. that the real exchange rate is equal to the difference in inflation rates between the two countries

ANS: A PTS: 1 DIF: Easy REF: p.287
BLM: Remember NOT: Macro TB_12-129

130. If purchasing-power parity holds, which of the following is the implication for the Canadian dollar?

- a. The Canadian dollar will buy more goods in foreign countries than in Canada.
- b. The Canadian dollar will buy as many goods in foreign countries as it does in Canada.
- c. The Canadian dollar will buy fewer goods in foreign countries than it does in Canada.
- d. The amount of goods that the Canadian dollar buys is not determined by purchasing power parity.

ANS: B PTS: 1 DIF: Easy REF: p.287
BLM: Higher Order NOT: Macro TB_12-130

131. What does purchasing-power parity imply about the purchasing power of the dollar?

- a. It is the same in the Canada as in foreign countries.
- b. It depends on the nominal exchange rate.
- c. It is greater in the country with lower prices in local currency.
- d. It has no relevance for the purchasing power of the dollar in foreign countries.

ANS: A PTS: 1 DIF: Easy REF: p.287
BLM: Higher Order NOT: Macro TB_12-131

132. Suppose that a lobster in Nova Scotia costs \$10 and the same type of lobster in New Brunswick costs \$30. How could people make a profit in the situation?
- by buying lobsters in Nova Scotia and selling them in New Brunswick, which would increase the price of lobster in New Brunswick
 - by buying lobsters in Nova Scotia and selling them in New Brunswick, which would decrease the price of lobster in New Brunswick
 - by buying lobsters in New Brunswick and selling them in Nova Scotia, which would increase the price of lobster in New Brunswick
 - by buying lobsters in New Brunswick and selling them in Nova Scotia, which would decrease the price of lobster in New Brunswick

ANS: B PTS: 1 DIF: Easy REF: p.286-288
BLM: Higher Order NOT: Macro TB_12-132

133. Suppose that the dollar buys more bananas in Honduras than in Guatemala. How could traders make a profit?
- by buying bananas in Honduras and selling them in Guatemala, which would tend to raise the price of bananas in Honduras
 - by buying bananas in Honduras and selling them in Guatemala, which would tend to raise the price of bananas in Guatemala
 - by buying bananas in Guatemala and selling them in Honduras, which would tend to raise the price of bananas in Guatemala
 - by buying bananas in Guatemala and selling them in Honduras, which would tend to raise the price of bananas in Honduras

ANS: A PTS: 1 DIF: Average REF: p.286-288
BLM: Higher Order NOT: Macro TB_12-133

134. Suppose that the dollar buys less cotton in Canada than in Egypt. How could traders make a profit?
- by buying cotton in Canada and selling it in Egypt, which would tend to raise the price of cotton in Canada
 - by buying cotton in Canada and selling it in Egypt, which would tend to raise the price of cotton in Egypt
 - by buying cotton in Egypt and selling it in Canada, which would tend to raise the price of cotton in Egypt
 - by buying cotton in Egypt and selling it in Canada, which would tend to raise the price of cotton in Canada

ANS: C PTS: 1 DIF: Average REF: p.286-288
BLM: Higher Order NOT: Macro TB_12-134

135. The nominal exchange rate is about 2 Aruban florin per dollar. If a basket of goods in Canada costs \$40, how many florins must a basket of goods in Aruba cost for purchasing-power parity to hold?
- 20 florins
 - 40 florins
 - 80 florins
 - 100 florins

ANS: C PTS: 1 DIF: Easy REF: p.287
BLM: Higher Order NOT: Macro TB_12-135

136. Suppose that the exchange rate is 50 Bangladesh taka per dollar, and that a bushel of rice costs 200 taka in Bangladesh and \$3 in Canada. Which of the following is consistent with these facts?
- The real exchange rate is greater than one, and arbitrageurs could profit by buying rice in Canada and selling it in Bangladesh.
 - The real exchange rate is greater than one, and arbitrageurs could profit by buying rice in Bangladesh and selling it in Canada.
 - The real exchange rate is less than one, and arbitrageurs could profit by buying rice in Canada and selling it in Bangladesh.
 - The real exchange rate is less than one, and arbitrageurs could profit by buying rice in Bangladesh and selling it in Canada.

ANS: C

PTS: 1

DIF: Challenging REF: p.285-288

BLM: Higher Order

NOT: Macro TB_12-136

137. Suppose that the exchange rate is 10 Moroccan dirhams per Canadian dollar. Also suppose that you can buy a crate of oranges for 300 dirhams in the Moroccan capital of Rabat and can buy a similar crate of oranges in Ottawa for \$35. Which of the following is consistent with these facts?
- The real exchange rate is greater than one, and arbitrageurs could profit by buying oranges in the United States and selling them in Morocco.
 - The real exchange rate is greater than one, and arbitrageurs could profit by buying oranges in Morocco and selling them in the United States.
 - The real exchange rate is less than one, and arbitrageurs could profit by buying oranges in the United States and selling them in Morocco.
 - The real exchange rate is less than one, and arbitrageurs could profit by buying oranges in Morocco and selling them in the United States.

ANS: B

PTS: 1

DIF: Challenging REF: p.285-288

BLM: Higher Order

NOT: Macro TB_12-137

138. According to the theory of purchasing-power parity, what must the nominal exchange rate between two countries reflect?
- the different price levels in those countries
 - the different resource endowments in those countries
 - the different income levels in those countries
 - the different standards of living between those countries

ANS: A

PTS: 1

DIF: Easy

REF: p.286-288

BLM: Higher Order

NOT: Macro TB_12-138

139. If P = domestic prices, P^* = foreign prices, and e is the nominal exchange rate, which of the following is implied by purchasing-power parity?

a. $P = e/P^*$

b. $1 = e/P^*$

c. $e = P^*/P$

d. $P/P^* = 1$

ANS: C

PTS: 1

DIF: Easy

REF: p.287

BLM: Remember

NOT: Macro TB_12-139

Use the hypothetical information in the following table to answer the following questions.

Table 31-1

Country	Currency	Currency per Canadian Dollar	Canadian Price Index	Country Price Index
Bolivia	Boliviano	8.00	100	800
Japan	Yen	125.00	100	25 000
Morocco	Dinar	10.00	100	1 000
Norway	Kroner	6.5	100	750
Thailand	Baht	40.00	100	3 500

140. **Refer to Table 31-1.** For which countries in the table does purchasing-power parity hold?

- a. Bolivia and Japan
- b. Bolivia and Morocco
- c. Japan and Morocco
- d. Norway and Thailand

ANS: B PTS: 1
BLM: Higher Order

DIF: Challenging REF: p.287
NOT: Macro TB_12-140

141. **Refer to Table 31-1.** Which currency (ies) is (are) less valuable than predicted by the doctrine of purchasing-power parity?

- a. the boliviano
- b. the yen and kroner
- c. the baht and kroner
- d. the baht

ANS: D PTS: 1
BLM: Higher Order

DIF: Challenging REF: p.287
NOT: Macro TB_12-141

142. **Refer to Table 31-1.** Which currency (ies) is (are) more valuable than predicted by the doctrine of purchasing-power parity?

- a. the boliviano and dinar
- b. the yen, kroner, and baht
- c. the yen and kroner
- d. the baht

ANS: C PTS: 1
BLM: Higher Order

DIF: Challenging REF: p.287
NOT: Macro TB_12-142

143. **Refer to Table 31-1.** In real terms, Canadian goods are more expensive than goods in which of the following countries?

- a. Bolivia and Morocco
- b. Japan, Norway, and Thailand
- c. Japan and Norway
- d. Thailand

ANS: D PTS: 1
BLM: Higher Order

DIF: Challenging REF: p.287
NOT: Macro TB_12-143

144. **Refer to Table 31-1.** In real terms, Canadian goods are less expensive than goods in which of the following countries?
- a. Bolivia and Morocco
 - b. Japan, Norway, and Thailand
 - c. Japan and Norway
 - d. Thailand

ANS: C PTS: 1
BLM: Higher Order

DIF: Challenging REF: p.287
NOT: Macro TB_12-144

145. **Refer to Table 31-1.** Assume that there are no transportation costs or trade restrictions. With which of the following countries can arbitrageurs make a profit?
- a. Bolivia and Morocco
 - b. Japan, Norway, and Thailand
 - c. Japan and Norway
 - d. Thailand

ANS: B PTS: 1
BLM: Higher Order

DIF: Challenging REF: p.287
NOT: Macro TB_12-145

146. Purchasing-power parity implies that the nominal exchange rate given as foreign currency per unit of Canadian currency must rise if the price levels in which country rise?
- a. the foreign country
 - b. Canada
 - c. both Canada and the foreign country
 - d. neither the foreign country nor Canada

ANS: A PTS: 1
BLM: Higher Order

DIF: Easy REF: p.288
NOT: Macro TB_12-146

147. When a country's central bank increases the money supply, which of the following best predicts the consequences?
- a. Its price level rises, and its currency appreciates relative to other currencies in the world.
 - b. Its price level rises, and its currency depreciates relative to other currencies in the world.
 - c. Its price level falls, and its currency appreciates relative to other currencies in the world.
 - d. Its price level falls, and its currency depreciates relative to other currencies in the world.

ANS: B PTS: 1
BLM: Higher Order

DIF: Challenging REF: p.288
NOT: Macro TB_12-147

148. When a country's central bank decreases the money supply, which of the following best predicts the consequences?
- a. Its price level rises, and its currency appreciates relative to other currencies in the world.
 - b. Its price level falls, and its currency appreciates relative to other currencies in the world.
 - c. Its price level rises, and its currency depreciates relative to other currencies in the world.
 - d. Its price level falls, and its currency depreciates relative to other currencies in the world.

ANS: B PTS: 1
BLM: Higher Order

DIF: Challenging REF: p.288
NOT: Macro TB_12-148

149. When a country's central bank increases the money supply, which of the following happens to a unit of that country's money?
- It gains value both in terms of the domestic goods and services it can buy and in terms of the foreign currency it can buy.
 - It gains value in terms of the domestic goods and services it can buy, but loses value in terms of the foreign currency it can buy.
 - It loses value in terms of the domestic goods and services it can buy, but gains value in terms of the foreign currency it can buy.
 - It loses value both in terms of the domestic goods and services it can buy and in terms of the foreign currency it can buy.

ANS: D PTS: 1 DIF: Challenging REF: p.288
BLM: Higher Order NOT: Macro TB_12-149

150. According to purchasing-power parity, if prices in Canada increase by a smaller percentage than prices in Algeria, how does the exchange rate change?
- The real exchange rate, defined as Algerian goods per unit of Canadian goods, rises.
 - The real exchange rate, defined as Algerian goods per unit of Canadian goods, falls.
 - The nominal exchange rate, defined as Algerian currency per dollar, rises.
 - The nominal exchange rate, defined as Algerian currency per dollar, falls.

ANS: C PTS: 1 DIF: Average REF: p.288
BLM: Higher Order NOT: Macro TB_12-150

151. According to purchasing-power parity, if prices in Canada increase by a larger percentage than prices in Algeria, how does the exchange rate change?
- The real exchange rate, defined as Algerian goods per unit of Canadian goods, rises.
 - The real exchange rate, defined as Algerian goods per unit of Canadian goods, falls.
 - The nominal exchange rate, defined as Algerian currency per dollar, rises.
 - The nominal exchange rate, defined as Algerian currency per dollar, falls.

ANS: D PTS: 1 DIF: Average REF: p.288
BLM: Higher Order NOT: Macro TB_12-151

152. Assume the exchange rate is about 153 Kazakhstan tenge per dollar. According to purchasing-power parity, when would this exchange rate rise?
- if the price level in either Canada or Kazakhstan rose
 - if the price level in either Canada or Kazakhstan fell
 - if the price level in Canada rose or the price level in Kazakhstan fell
 - if the price level in Canada fell or the price level in Kazakhstan rose

ANS: D PTS: 1 DIF: Average REF: p.288
BLM: Higher Order NOT: Macro TB_12-152

153. Suppose inflation is higher in Canada over the next few months than in foreign countries, and exchange rates are given in terms of how much foreign currency a dollar buys or how many foreign goods Canadian goods buy. According to purchasing-power parity, which of the following should we expect to see?
- Only the nominal exchange rate depreciates.
 - Both the real and nominal exchange rates appreciate.
 - Both the real and nominal exchange rates depreciate.
 - Only the real exchange rate appreciates.

ANS: A PTS: 1 DIF: Average REF: p.288
BLM: Higher Order NOT: Macro TB_12-153

154. Which of the following best explains the relationship among price levels, nominal and real exchange rates, and money supply in Canada and Ireland when purchasing power parity holds?
- When the price level in Canada falls more rapidly than that in Ireland, the real exchange rate, defined as Irish goods per unit of Canadian goods, stays the same.
 - When the money supply in Canada rises more rapidly than in Ireland, the nominal exchange rate, defined as euros (the currency used in Ireland) per dollar, increases.
 - When prices for the same goods are the same in Canadian dollars in Canada and Ireland, the nominal exchange rate does not change.
 - When prices in both countries stay the same and the nominal exchange rate increases, the real exchange rate decreases.

ANS: D PTS: 1 DIF: Average REF: p.288
BLM: Higher Order NOT: Macro TB_12-154

155. On behalf of your firm, you make frequent trips to Hong Kong. You notice that you always have to pay more dollars to get enough local currency to get your hair styled than you have to pay to get your hair styled in Canada. Is this consistent with purchasing power parity?
- No, but it might be explained by limited opportunities for arbitrage across international borders.
 - Yes, if prices in Hong Kong are rising more rapidly than prices in Canada.
 - Yes, if prices in Hong Kong are rising less rapidly than prices in Canada.
 - No, but it can be explained by arbitrage across international borders.

ANS: A PTS: 1 DIF: Average REF: p.289-290
BLM: Higher Order NOT: Macro TB_12-155

156. Why does purchasing-power parity theory **NOT** hold at all times?
- because countries use different currencies
 - because wages are higher in some countries and lower in others
 - because some goods and services cannot be traded
 - because prices are different across countries

ANS: C PTS: 1 DIF: Easy REF: p.289-290
BLM: Higher Order NOT: Macro TB_12-156

157. According to purchasing-power parity theory, if a McDonald's Big Mac cost U.S. \$2.50 in the United States and 5 euros in France, what should the nominal exchange rate be?
- a. 2 euros per U.S. dollar
 - b. 1 euro per U.S. dollar
 - c. 1/2 euro per U.S. dollar
 - d. 1/4 euro per U.S. dollar

ANS: A PTS: 1 DIF: Easy REF: p.290-291
BLM: Higher Order NOT: Macro TB_12-157

158. According to purchasing-power parity theory, if a McDonald's Big Mac cost U.S. \$2.50 in the United States and 10 Tunisian dinars, what should the exchange rate be?
- a. 1/4 Tunisian dinars per U.S. dollar
 - b. 1 Tunisian dinar per U.S. dollar
 - c. 4 Tunisian dinars per U.S. dollar
 - d. 25 Tunisian dinars per U.S. dollar

ANS: C PTS: 1 DIF: Easy REF: p.290-291
BLM: Higher Order NOT: Macro TB_12-158

159. Which of the following best describes the type of economy Canada has?
- a. a large closed economy
 - b. a small closed economy
 - c. a large open economy
 - d. a small open economy

ANS: D PTS: 1 DIF: Easy REF: p.291
BLM: Remember NOT: Macro TB_12-159

160. What kind of country would most likely have a “small open economy”?
- a. a country that trades with other countries and has consistently a trade surplus.
 - b. a country that trades with other countries and has consistently a trade deficit.
 - c. a country that trades with other countries and has a significant effect on world prices
 - d. a country that trades with other countries, but has a negligible effect on world prices.

ANS: D PTS: 1 DIF: Easy REF: p.291
BLM: Remember NOT: Macro TB_12-160

161. Consider this statement: “Canada is characterized by perfect capital mobility.” Which of the following best explains what this statement means?
- a. that Canadians do not have access to world capital markets
 - b. that foreigners do not have full access to Canadian capital markets
 - c. that Canadians have full access to world financial markets and foreigners have access to Canadian financial markets
 - d. that physical capital can easily be freely transported across borders

ANS: C PTS: 1 DIF: Easy REF: p.291
BLM: Remember NOT: Macro TB_12-161

162. Consider this statement: “Canada is characterized by perfect capital mobility.” Which of the following best explains what this statement means?

- a. that labour can easily move across Canada’s borders
- b. that purchasing-power parity holds in Canada
- c. that Canada’s net foreign investment is zero
- d. that investors’ funds can easily move across Canada’s borders

ANS: D PTS: 1 DIF: Easy REF: p.291
BLM: Higher Order NOT: Macro TB_12-162

163. What is the implication of perfect capital mobility for a small open economy like Canada’s?

- a. The real interest rate in Canada should exceed the real interest rate prevailing in world financial markets.
- b. The real interest rate in Canada should equal the real interest rate prevailing in world financial markets.
- c. The real interest rate in Canada should be less than the real interest rate prevailing in world financial markets.
- d. The real interest rate is irrelevant for capital mobility.

ANS: B PTS: 1 DIF: Easy REF: p.291
BLM: Higher Order NOT: Macro TB_12-163

164. If the Canadian real interest rate exceeds the world real interest rate, what would Canadian savers most likely do?

- a. Canadian savers would prefer to buy foreign assets.
- b. Canadian savers would prefer to wait until the real interest rate falls to equal the world interest rate.
- c. Canadian savers would sell their Canadian assets and buy foreign assets instead.
- d. Canadian savers would sell their foreign assets and buy Canadian assets instead.

ANS: D PTS: 1 DIF: Average REF: p.291
BLM: Higher Order NOT: Macro TB_12-164

165. If the world real interest rate exceeds the Canadian real interest rate, what would Canadian savers most likely do?

- a. Canadian savers would prefer to buy foreign assets.
- b. Canadian savers would prefer to buy Canadian assets.
- c. Canadian savers will prefer to wait until the two real interest rates are again equal.
- d. Canadian savers will sell their foreign assets and buy Canadian assets instead.

ANS: A PTS: 1 DIF: Average REF: p.291
BLM: Higher Order NOT: Macro TB_12-165

166. Which of the following refers to the theory that the real interest rate in Canada should equal that in the rest of the world?

- a. the Fisher effect
- b. the theory of Ricardian equivalence
- c. the theory of purchasing power parity
- d. interest rate parity

ANS: D PTS: 1 DIF: Easy REF: p.291-293
BLM: Remember NOT: Macro TB_12-166

167. Why is interest rate parity **NOT** a perfect theory of real interest rate determination in a small open economy?

- a. because of differences in prices
- b. because of differences in tax treatments of returns earned on financial assets
- c. because of Ricardian non-equivalence
- d. because of perfect capital mobility

ANS: D PTS: 1 DIF: Average REF: p.293
BLM: Remember NOT: Macro TB_12-167

168. How did the real interest rates paid on long-term government debt in Canada and the United States compare with each other over the period from 1984 to 2009?

- a. The average real interest rate was 3.4 percent in Canada and 4.4 percent in the United States.
- b. The average real interest rate was 4.4 percent in Canada and 3.4 percent in the United States.
- c. The average real interest rate was 5.7 percent in Canada and 6.7 percent in the United States.
- d. The real interest rates paid on long-term government debt in Canada and the United States have tended to move in opposite directions.

ANS: B PTS: 1 DIF: Easy REF: p.293
BLM: Remember NOT: Macro TB_12-168

TRUE/FALSE

1. For many questions in macroeconomics, international issues are peripheral.

ANS: T PTS: 1 DIF: Easy REF: p.270
NOT: Macro TB_12-169

2. Negative net exports are the same as a trade surplus.

ANS: F PTS: 1 DIF: Easy REF: p.271
NOT: Macro TB_12-170

3. If a country sells more goods and services abroad than it purchases abroad, it has positive net exports and a trade surplus.

ANS: T PTS: 1 DIF: Easy REF: p.271
NOT: Macro TB_12-171

4. A country with no imports necessarily has zero net exports.

ANS: F PTS: 1 DIF: Easy REF: p.271
NOT: Macro TB_12-172

5. Perhaps the most dramatic change in the Canadian economy over the past four decades has been the increasing relative importance of international trade and finance.

ANS: T PTS: 1 DIF: Easy REF: p.271
NOT: Macro TB_12-173

6. Canadian exports make up less than 20 percent of GDP.

ANS: F PTS: 1 DIF: Easy REF: p.271
NOT: Macro TB_12-174

7. Net capital outflow is the purchase of domestic assets purchased by foreign residents minus the purchase of foreign assets by domestic residents.

ANS: F PTS: 1 DIF: Easy REF: p.274
NOT: Macro TB_12-175

8. When a company from Germany builds an automobile factory in Canada, the German firm has engaged in foreign direct investment.

ANS: T PTS: 1 DIF: Easy REF: p.274
NOT: Macro TB_12-176

9. A rational investor will always purchase the bond that pays the highest real interest rate.

ANS: F PTS: 1 DIF: Easy REF: p.274
NOT: Macro TB_12-177

10. For an economy as a whole, net exports must equal minus one times net capital outflow.

ANS: F PTS: 1 DIF: Easy REF: p.275
NOT: Macro TB_12-178

11. If Canada buys cameras from Japan, both Canadian net exports and Canadian net capital outflow decrease.

ANS: T PTS: 1 DIF: Easy REF: p.275
NOT: Macro TB_12-179

12. When Canada imports more than it exports, it must also buy domestic assets from foreigners.

ANS: F PTS: 1 DIF: Easy REF: p.275-276
NOT: Macro TB_12-180

13. In every economy, national saving equals domestic investment plus net capital outflow.

ANS: T PTS: 1 DIF: Easy REF: p.277
NOT: Macro TB_12-181

14. When Canada increases its net capital outflow, it causes Canadian national savings to increase.

ANS: F PTS: 1 DIF: Easy REF: p.277
NOT: Macro TB_12-182

15. The large, positive net capital outflow in Canada after 1999 is primarily the result of government budget surpluses.

ANS: T PTS: 1 DIF: Easy REF: p.279
NOT: Macro TB_12-183

16. In an open economy, Canadian national savings can be less than Canadian investment.

ANS: T PTS: 1 DIF: Easy REF: p.277-278
NOT: Macro TB_12-184

17. If the exchange rate is 10 pesos per U.S. dollar, it is also 0.10 U.S. dollars per peso.

ANS: T PTS: 1 DIF: Easy REF: p.281-282
NOT: Macro TB_12-185

18. If the real exchange rate of the Canadian dollar falls, Canadian net exports will fall.

ANS: F PTS: 1 DIF: Easy REF: p.281-283
NOT: Macro TB_12-186

19. The theory of purchasing-power parity states that a unit of any given currency should be able to buy the same quantity of goods in all countries.

ANS: T PTS: 1 DIF: Easy REF: p.286
NOT: Macro TB_12-187

20. Many economists believe that the theory of purchasing-power parity describes the forces that determine exchange rates in the long run.

ANS: T PTS: 1 DIF: Easy REF: p.286
NOT: Macro TB_12-188

21. According to purchasing-power parity theory, the real exchange rate should equal the nominal exchange rate.

ANS: F PTS: 1 DIF: Easy REF: p.286-287
NOT: Macro TB_12-189

22. If the purchasing power of the dollar is always the same at home and abroad, then the nominal exchange rate defined as foreign goods per unit of Canadian goods decreases if the Canadian price level rises more than the price level in foreign countries.

ANS: T PTS: 1 DIF: Easy REF: p.285-288
NOT: Macro TB_12-190

23. According to the theory of purchasing-power parity, the real exchange rate defined as foreign goods per unit of Canadian goods will equal the domestic price level divided by the foreign price level.

ANS: F PTS: 1 DIF: Easy REF: p.287
NOT: Macro TB_12-191

24. From 1970 to 1998, the Canadian dollar depreciated against the German mark and appreciated against the Italian lira because Canada experienced more inflation than Germany but less inflation than Italy.

ANS: T PTS: 1 DIF: Easy REF: p.288
NOT: Macro TB_12-192

25. When the central bank prints large quantities of money, that money loses value both in terms of the goods and services it buys and in terms of the amount of foreign currencies it can buy.

ANS: T PTS: 1 DIF: Easy REF: p.288-289
NOT: Macro TB_12-193

SHORT ANSWER

1. List the factors that might influence a country's exports, imports, and trade balance.

ANS:

- a. the tastes of consumers for domestic and foreign goods
- b. the prices of goods at home and abroad
- c. the exchange rates at which people can use domestic currency to buy foreign currencies
- d. the costs of importing goods from country to country
- e. the policies of the government toward international trade

PTS: 1 DIF: Average REF: p.271-272 NOT: Macro TB_12-194

2. Suppose that Bill, a resident of Canada, buys software from a company in Japan. Explain why and in what directions this changes Canadian net exports and Canadian net capital outflow.

ANS:

The purchase of a foreign good by a Canadian resident is a Canadian import. Since net exports = exports – imports, net exports decrease. Bill pays for the software with Canadian dollars so that the Japanese have obtained more Canadian assets. Since, net capital outflow = the amount of foreign assets acquired by domestic residents – domestic assets acquired by foreign residents, the increase in foreign holdings of dollars by Japanese residents decreases Canadian net capital outflow.

PTS: 1 DIF: Challenging REF: p.275-278 NOT: Macro TB_12-195

3. Why are net exports and net capital outflow always equal?

ANS:

Net exports and net capital outflow are always equal because every international transaction is an exchange. When a seller country transfers a good or service to a buyer country, the buyer country gives up some asset to pay for this good or service. The value of that asset equals the value of goods and services sold. Hence, the net value of goods and services sold by a country (NX) must equal the net value of assets acquired (NCO).

PTS: 1

DIF: Challenging REF: p.275

NOT: Macro TB_12-196

4. How can one derive the identity that saving equals the sum of domestic investment and net capital outflow from the national income accounting identity?

ANS:

Start from the national income accounting identity,

$$(1) Y = C + I + G + NX$$

Recall from Chapter 8 that national saving is the income that is left after paying for current consumption and government expenditure,

$$(2) S = Y - C - G$$

Rearranging (1), we obtain $Y - C - G = I + NX$, and substituting in (2)

$$(3) S = I + NX$$

Because net exports also equal net capital outflow, we can also write this equation as

$$(4) S = I + NCO$$

PTS: 1

DIF: Challenging REF: p.277

NOT: Macro TB_12-197

5. Suppose that a country has \$120 billion of national savings, and \$80 billion of domestic investment. Is this possible? Where did the other \$40 billion of national savings go?

ANS:

This is possible for an open economy. The remaining \$40 billion is for net capital outflow in the form of purchases of foreign assets by Canadian residents. Canadian citizens can save by buying Canadian assets or by buying foreign assets.

PTS: 1

DIF: Average REF: p.277

NOT: Macro TB_12-198

6. How do the nominal exchange rate and the real exchange rate differ?

ANS:

The nominal exchange rate is the rate at which a person can trade the currency of one country for the currency of another. The real exchange rate is the rate at which a person can trade the goods and services of one country for the goods and services of another.

PTS: 1

DIF: Average REF: p.279-284

NOT: Macro TB_12-199

7. How do we find the real exchange rate from the nominal exchange rate?

ANS:

Real Exchange Rate = Nominal Exchange Rate $\times$ Domestic Price Index / Foreign Price Index

PTS: 1 DIF: Average REF: p.283 NOT: Macro TB_12-200

8. Suppose a bottle of wine costs 25 euros in France and \$20 in Canada. If the exchange rate is 1.25 euros per dollar, what is the real exchange rate?

ANS:

The real exchange rate = Nominal Exchange Rate $\times$ Domestic Price / Foreign Price = 1.25 euros per dollar $\times$ 20 dollars/25 euro = 1.

PTS: 1 DIF: Average REF: p.283 NOT: Macro TB_12-201

9. What is the logic behind the theory of purchasing-power parity?

ANS:

The logic behind purchasing-power parity is the law of one price, which asserts that a good must sell for the same price in all locations. If the price for a good is higher in one market than in another, someone can make a profit by purchasing the good where it is relatively cheap, and selling the good where it is relatively expensive. This process of arbitrage leads to an equalization of prices for the good in all locations.

PTS: 1 DIF: Average REF: p.287-288 NOT: Macro TB_12-202

10. Suppose that a Canadian dollar buys more gold in Australia than it buys in Burkina Faso. What does purchasing-power parity imply should happen?

ANS:

People can make a profit by buying gold in Australia and selling it in Burkina Faso. Purchases in Australia drive down the amount of gold a dollar can buy there. Sales in Burkina Faso drive up the amount of gold a dollar can buy there. Purchasing-power parity theory claims that this should continue until the dollar can buy the same amount of gold anywhere.

PTS: 1 DIF: Average REF: p.287-288 NOT: Macro TB_12-203

11. What does purchasing-power parity imply about the real exchange rate?

ANS:

If purchasing-power parity holds, the real exchange rate is fixed and equal to one.

PTS: 1 DIF: Easy REF: p.287-288 NOT: Macro TB_12-204

12. According to purchasing-power parity, what is the relationship between changes in price levels between two countries and changes in nominal exchange rates?

ANS:

Purchasing-power parity asserts that the nominal exchange rate is equal to the foreign price level divided by the domestic price level. If the domestic price level rises more than the foreign price level, domestic currency depreciates. If the foreign price level rises more than the domestic price level, domestic currency appreciates.

PTS: 1 DIF: Average REF: p.287-288 NOT: Macro TB_12-205

13. Can purchasing-power parity be used to explain the fact that the Canadian dollar has depreciated by more than 50 percent against the German mark since 1970, but has appreciated by more than 100 percent against the Italian lira during the same period? Defend your answer.

ANS:

The theory of purchasing-power parity would suggest that Italy must have experienced much more inflation than has Canada since 1970, and that Germany must have experienced much less inflation than has Canada since 1970. In fact, that is exactly what has happened.

PTS: 1 DIF: Average REF: p.288 NOT: Macro TB_12-206

14. Suppose that money supply growth continues to be higher in Turkey than it is in Canada. What does purchasing-power parity imply will happen to the real and to the nominal exchange rate?

ANS:

Higher money growth leads to higher prices, so prices will rise more in Turkey than in Canada. Under purchasing-power parity, this has no effect on the real exchange rate. However, in order for a dollar to buy as many goods in Turkey as it buys in Canada when prices are rising faster in Turkey, the nominal exchange rate must be rising so that a dollar buys more Turkish lira.

PTS: 1 DIF: Average REF: p.288 NOT: Macro TB_12-207

15. Assuming all other things equal, what would happen to the Canadian dollar real exchange rate under each of the following circumstances?
- The Canadian nominal exchange rate depreciates.
 - Canadian domestic prices increase.
 - Prices in the rest of the world rise.

ANS:

- The Canadian real exchange rate depreciates.
- The Canadian dollar real exchange rate appreciates.
- The Canadian dollar real exchange rate depreciates.

PTS: 1 DIF: Average REF: p.285-288 NOT: Macro TB_12-208

16. Under what circumstances does purchasing-power parity explain how exchange rates are determined, and why is it not completely accurate?

ANS:

Purchasing-power parity works well in helping us explain long-term trends in exchange rates, and in explaining what happens to exchange rates during hyperinflation. It is not completely accurate because (1) not all goods are easily traded, and (2) even tradable goods are not always perfect substitutes when they are produced in different countries.

PTS: 1 DIF: Average REF: p.289-290 NOT: Macro TB_12-209

17. Suppose a lobster supper in Nova Scotia costs fewer dollars than a lobster supper in Moscow. Explain why this is inconsistent with purchasing-power parity and explain why the inconsistency may exist.

ANS:

According to purchasing-power parity, a dollar should buy the same amount of goods everywhere in the world. The inconsistency may exist because lobsters have to be transported to Moscow. Price differences can also persist because goods are not perfect substitutes. Presumably, people would rather eat lobster while looking out over the Nova Scotia coastline than while in downtown Moscow, but this would tend to make the price higher in Nova Scotia. Still, purchasing-power parity suggests any difference should not be large.

PTS: 1 DIF: Average REF: p.289-290 NOT: Macro TB_12-210

PROBLEM

1. Suppose Canadian wheat sells for \$100 per bushel and Russian wheat sells for 1600 rubles per bushel.
- If you believe that the purchasing-power parity theory holds, and if the current exchange rate is 12 rubles per dollar, would you expect the exchange rate to change? In what direction?
 - If the current exchange rate is 12 rubles per dollar, how much is the real exchange rate, based on the prices of wheat?
 - If the exchange rate is 12, how you could make profit in this situation? How much profit per bushel you could make?

ANS:

- The PPP exchange rate is $1600/100 = 16$ rubles per dollar.
- The real exchange rate is $12 \times 100 / 1600 = 3/4$ bushels of Russian wheat per bushel of Canadian wheat.
- Buy wheat in Canada for $12 \times \$100 = \$1200$ rubles per bushel and sell in Russia for 1600 rubles. Profit is $1600 - 1200 = 400$ rubles $= 400/12 = \$33.33$.

PTS: 1 NOT: Macro TB_12-211

2. Consider the following excerpt from the Big Mac Index table computed by *The Economist* magazine. (Source: <http://www.oanda.com/currency/big-mac-index> retrieved on September 17, 2010.) The table shows prices of a Big Mac in local currencies and the current nominal exchange rate between the local currency and the U.S. dollar.

Country	Big Mac Price		Implied PPP rate +	Today's Exchange Rate 1 USD =	Over(+) / Under(-) Valuation against the USD, % ++
	in Local Currency	in U.S. Dollars			
United States (US\$)	3.73		---	1.0000	---
Argentina (Peso)	14			3.9525	
Australia (A\$)	4.35			1.0684	
Brazil (Real)	8.71			1.7248	
Britain (£)	2.29			0.6406	
Canada (C\$)	4.17			1.0269	
Chile (Peso)	1750			499.348	
China (Yuan)	13.2			6.7356	

- Compute the Big Mac prices in US dollars for each country.
- Compute the PPP exchange rate.
- Compute the over- or undervaluation of each country's currency with respect to the U.S. dollar. (A currency is considered to be overvalued if the nominal exchange rate is less than the PPP exchange rate. Overvaluation is the percentage difference between the nominal and the PPP exchange rate, computed using the following formula: $[(\text{PPP exchange rate} - \text{nominal exchange rate}) / \text{nominal exchange rate}] * 100$.)

ANS:

Country	Big Mac Price		Implied PPP rate +	Today's Exchange Rate 1 USD =	Over(+) / Under(-) Valuation against the USD, % ++
	in Local Currency	in U.S. Dollars			
United States	\$ 3.73	3.7300	---	1.0000	---
Argentina	Peso 14	3.5421	3.75	3.9525	-5.1233
Australia	A\$ 4.35	4.0715	1.17	1.0684	9.5095
Brazil	Real 8.71	5.0499	2.33	1.7248	35.0881
Britain	£ 2.29	3.5748	0.61	0.6406	-4.7768
Canada	C\$ 4.17	4.0608	1.12	1.0269	9.0661
Chile	Peso 1750	3.5046	469	499.348	-6.0775
China	Yuan 13.2	1.9597	3.54	6.7356	-47.4434

PTS: 1

NOT: Macro TB_12-212

3. The next table shows PPP exchange rates (the price of 1 U.S. dollar in units of the foreign currency) for several countries, determined based on the Big Mac Index. According to this data, what are the predicted exchange rates between the following countries?
- Argentina and Australia
 - Brazil and Canada
 - Chile and China
 - China and Canada

	PPP exchange rate (1US\$=)
United States (US\$)	---
Argentina (Peso)	3.75
Australia (A\$)	1.17
Brazil (Real)	2.33
Britain (£)	0.61
Canada (C\$)	1.12
Chile (Peso)	469
China (Yuan)	3.54

ANS:

- $3.75 \text{ Peso} / 1.17 \text{ A\$} = 3.2 \text{ Peso/A\$}$
- $2.33 \text{ Real} / 1.12 \text{ C\$} = 2.08 \text{ Real/C\$}$
- $469 \text{ Peso} / 3.54 \text{ Yuan} = 132.48 \text{ Peso/Yuan}$
- $3.54 \text{ Yuan} / 1.12 \text{ C\$} = 3.16 \text{ Yuan/C\$}$

PTS: 1

NOT: Macro TB_12-213

4. Suppose the price level in Canada increases from P_1 to P_2 , while the price level abroad (P^*) and the nominal exchange rate (e) between the Canadian dollar and the foreign currency remain the same. Let the real exchange rate be X . What is the percentage change in the real exchange rate?

ANS:

By definition, the real exchange rate is $X = eP/P^*$. The percentage change in X due to the change in the domestic price from P_1 to P_2 is equal to $[(X_2 - X_1)/X_1] \times 100 = [(eP_2/P^* - eP_1/P^*)/eP_1/P^*] \times 100$. After simplifying this expression by e/P^* , we get $[(P_2 - P_1)/P_1] \times 100$, which is equal to the inflation rate in Canada. Thus, everything else being the same, inflation in the home country makes the real exchange rate increase by the same percentage as the inflation rate. Canadian goods become more expensive for foreigners.

PTS: 1

NOT: Macro TB_12-214

5. Suppose the price level in Canada (P) and the nominal exchange rate (e) between the Canadian dollar and the foreign currency remain the same, while the price level abroad increases from P_1^* to P_2^* . Let the real exchange rate be X . What is the percentage change in the real exchange rate?

ANS:

The percentage change in the real exchange rate is $[(X_2 - X_1)/X_1] \times 100 = [(eP/P_2^* - eP/P_1^*)/eP/P_1^*] \times 100 = [(1/P_2^* - 1/P_1^*)/(1/P_1^*)] \times 100 = [P_1^*/P_2^* - 1] \times 100 = -(P_2^* - P_1^*)/P_2^* \times 100$, which is approximately the negative of the inflation rate in the foreign country. The approximation is negligible when the change in price is relatively small. Thus, the real exchange rate decreases when prices abroad increase in terms of the local currency but the nominal exchange rate remains unchanged. Canadian goods become cheaper for foreigners.

PTS: 1

NOT: Macro TB_12-215

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Chapter 13—A Macroeconomic Theory of the Open Economy

MULTIPLE CHOICE

1. What does the market for loanable funds coordinate?
 - a. supply and demand for dollars in the foreign exchange market
 - b. people who want to import or export goods
 - c. sellers and buyers
 - d. lenders and borrowers

ANS: D PTS: 1 DIF: Easy REF: p.300-301
BLM: Remember NOT: Macro TB_13-1

2. What does the market for foreign-currency exchange coordinate?
 - a. foreign investment
 - b. foreign trade
 - c. people exchanging domestic currency for the currency of other countries
 - d. investment and saving

ANS: C PTS: 1 DIF: Easy REF: p.300-301
BLM: Remember NOT: Macro TB_13-2

3. If a country's imports are greater than its exports, what is the country said to have?
 - a. a trade surplus
 - b. a trade deficit
 - c. a comparative advantage
 - d. an absolute advantage

ANS: B PTS: 1 DIF: Easy REF: p.300
BLM: Remember NOT: Macro TB_13-3

4. Which of the following does the open-economy macroeconomic model include?
 - a. only the market for loanable funds
 - b. only the market for foreign-currency exchange
 - c. both the market for loanable funds and the market for foreign-currency exchange
 - d. neither the market for loanable funds or the market for foreign-currency exchange

ANS: C PTS: 1 DIF: Easy REF: p.300
BLM: Remember NOT: Macro TB_13-4

5. Which of the following does the open-economy macroeconomic model examine?
 - a. the determination of output growth rate and the real interest rate
 - b. the determination of unemployment and the exchange rate
 - c. the determination of output growth rate and the inflation rate
 - d. the determination of the trade balance and the exchange rate

ANS: D PTS: 1 DIF: Easy REF: p.300
BLM: Remember NOT: Macro TB_13-5

6. Which of the following does the open-economy macroeconomic model take as given?
- a. GDP, but not the price level
 - b. the price level, but not GDP
 - c. both the price level and GDP
 - d. the exchange rate

ANS: C PTS: 1 DIF: Easy REF: p.300
BLM: Remember NOT: Macro TB_13-6

7. In an open economy, what does the market for loanable funds equate national saving with?
- a. domestic investment
 - b. net capital outflow
 - c. the sum of national consumption and government spending
 - d. the sum of domestic investment and net capital outflow

ANS: D PTS: 1 DIF: Easy REF: p.301
BLM: Remember NOT: Macro TB_13-7

8. In an open economy, which of the following does the market for loanable funds take as given?
- a. saving
 - b. investment
 - c. exchange rate
 - d. real interest rate

ANS: D PTS: 1 DIF: Easy REF: p.301
BLM: Remember NOT: Macro TB_13-8

9. In the open-economy macroeconomic model, how can the market for loanable funds identity be written?
- a. $S = I$
 - b. $S = NCO$
 - c. $S = I + NCO$
 - d. $S + I = NCO$

ANS: C PTS: 1 DIF: Easy REF: p.301
BLM: Remember NOT: Macro TB_13-9

10. In the open-economy macroeconomic model, where does the supply of loanable funds come from?
- a. national saving
 - b. private saving
 - c. domestic investment
 - d. the sum of domestic investment and net capital outflow

ANS: A PTS: 1 DIF: Easy REF: p.301
BLM: Remember NOT: Macro TB_13-10

11. In the open-economy macroeconomic model, where does the demand for loanable funds come from?
- a. domestic investment
 - b. net exports
 - c. net capital outflow
 - d. the sum of net capital outflow and domestic investment

ANS: D PTS: 1 DIF: Easy REF: p.301
BLM: Remember NOT: Macro TB_13-11

12. When does the purchase of a capital asset add to the demand for loanable funds?
- a. only if the asset is located at home
 - b. only if the asset is located abroad
 - c. whether the asset is located at home or abroad
 - d. never

ANS: C PTS: 1 DIF: Average REF: p.301
BLM: Remember NOT: Macro TB_13-12

13. Jack and Jill are co-owners of the Canadian firm Wells Grey Petroleum. Jack borrows money to build an oil well in Alberta. Jill borrows money to build an oil well in Venezuela. Which of the following purchases of capital counts as demand for loanable funds in the Canadian market?
- a. both Jack's and Jill's purchase of capital
 - b. neither Jack's nor Jill's purchase of capital
 - c. Jack's purchase of capital, but not Jill's
 - d. Jill's purchase of capital, but not Jack's

ANS: A PTS: 1 DIF: Average REF: p.301
BLM: Higher Order NOT: Macro TB_13-13

14. What does a higher real interest rate lowers the quantity of?
- a. national saving
 - b. net capital outflow
 - c. loanable funds demanded
 - d. loanable funds supplied

ANS: C PTS: 1 DIF: Average REF: p.301-303
BLM: Higher Order NOT: Macro TB_13-14

15. What does a lower real interest rate decrease the quantity of?
- a. loanable funds demanded
 - b. loanable funds supplied
 - c. domestic investment
 - d. net capital outflow

ANS: B PTS: 1 DIF: Easy REF: p.301-303
BLM: Higher Order NOT: Macro TB_13-15

16. Which of the following best describes the effects of an increase in the real interest rate?
- It discourages people from saving and so increases the quantity of loanable funds demanded.
 - It discourages people from saving and so decreases the quantity of loanable funds demanded.
 - It encourages people to save and so increases the quantity of loanable funds supplied.
 - It encourages people to save and so decreases the quantity of loanable funds supplied.

ANS: C PTS: 1 DIF: Easy REF: p.301-303
BLM: Higher Order NOT: Macro TB_13-16

17. What effect does a fall in the real interest rate have on the quantity of loanable funds?
- It increases the quantity of loanable funds demanded.
 - It decreases the quantity of loanable funds demanded.
 - It increases the quantity of loanable funds supplied.
 - It does not affect the quantity of loanable funds supplied.

ANS: A PTS: 1 DIF: Easy REF: p.300
BLM: Higher Order NOT: Macro TB_13-17

18. Which of the following best describes the effects of an increase in real interest rates in Canada?
- It discourages both Canadian and foreign residents from buying Canadian assets.
 - It encourages both Canadian and foreign residents to buy Canadian assets.
 - It encourages Canadian residents to buy Canadian assets, but discourages foreign residents from buying Canadian assets.
 - It encourages foreign residents to buy Canadian assets, but discourages Canadian residents from buying Canadian assets.

ANS: B PTS: 1 DIF: Easy REF: p.300
BLM: Higher Order NOT: Macro TB_13-18

19. Which of the following would be consistent with an increase in the Canadian real interest rate?
- A Swiss bank purchases a Canadian bond instead of the German bond it had considered purchasing.
 - Canadian firms decide, since interest rates are higher, to do more investment spending.
 - Brad, a Canadian resident, decides to put less money in his savings account than he had planned to.
 - Canadian net exports increase.

ANS: A PTS: 1 DIF: Easy REF: p.300
BLM: Higher Order NOT: Macro TB_13-19

20. Which of the following is the effect of an increase in the Canadian real interest rate?
- Canadians buy more foreign assets, which increases Canadian net capital outflow.
 - Canadians buy more foreign assets, which reduces Canadian net capital outflow.
 - Foreigners buy more Canadian assets, which reduces Canadian net capital outflow.
 - Foreigners buy more Canadian assets, which increases Canadian net capital outflow.

ANS: C PTS: 1 DIF: Average REF: p.301-303
BLM: Higher Order NOT: Macro TB_13-20

21. In an open economy, where does the demand for loanable funds come from?
- a. only from those who want to borrow funds to buy domestic capital goods
 - b. only from those who want to borrow funds to buy foreign assets
 - c. from those who want to borrow funds to buy either domestic capital goods or foreign assets
 - d. from those who want to borrow funds to buy Canadian bonds or stock in Canadian companies

ANS: C PTS: 1 DIF: Easy REF: p.300
BLM: Remember NOT: Macro TB_13-21

22. In an open economy, which of the following best identifies the sources of loanable funds?
- a. Canadians who consume less than their income and government budget deficit
 - b. Canadians who consume less than their income and government budget surplus
 - c. foreigners who buy Canadian bonds and stock and Canadian government surplus
 - d. foreigners who invest in Canada and Canadian government surplus

ANS: B PTS: 1 DIF: Average REF: p.300
BLM: Higher Order NOT: Macro TB_13-22

23. If the quantity of loanable funds supplied is greater than the quantity demanded, which of the following best describes the consequences?
- a. There is a shortage of loanable funds, and the interest rate will fall.
 - b. There is a shortage of loanable funds, and the interest rate will rise.
 - c. There is a surplus of loanable funds, and the interest rate will fall.
 - d. There is a surplus of loanable funds, and the interest rate will rise.

ANS: C PTS: 1 DIF: Average REF: p.301-303
BLM: Higher Order NOT: Macro TB_13-23

24. If there is a surplus of loanable funds, which of the following best describes the consequences?
- a. The quantity demanded is greater than the quantity supplied, and the interest rate will rise.
 - b. The quantity demanded is greater than the quantity supplied, and the interest rate will fall.
 - c. The quantity demanded is less than the quantity supplied, and the interest rate will rise.
 - d. The quantity demanded is less than the quantity supplied, and the interest rate will fall.

ANS: D PTS: 1 DIF: Average REF: p.301-303
BLM: Higher Order NOT: Macro TB_13-24

25. What changes will a shortage of loanable funds induce in a Savings-Investment diagram in a closed economy?
- a. The demand for loanable funds curve will shift right, so the interest rate will rise.
 - b. The supply of loanable funds curve will shift left, so the interest rate will fall.
 - c. There will be no shifts of the curves, but the interest rate will rise.
 - d. There will be no shifts of the curves, but the interest rate will rise.

ANS: C PTS: 1 DIF: Easy REF: p.301-303
BLM: Higher Order NOT: Macro TB_13-25

26. Which of the following would make both the equilibrium interest rate and the equilibrium quantity of loanable funds increase?
- a. The demand for loanable funds shifts right.
 - b. The demand for loanable funds shifts left.
 - c. The supply of loanable funds shifts right.
 - d. The supply of loanable funds shifts left.

ANS: A PTS: 1 DIF: Average REF: p.301-303
BLM: Higher Order NOT: Macro TB_13-26

27. Which of the following would make the equilibrium interest rate increase and the equilibrium quantity of funds decrease?
- a. The supply of loanable funds shifts right.
 - b. The supply of loanable funds shifts left.
 - c. The demand for loanable funds shifts right.
 - d. The demand for loanable funds shifts left.

ANS: B PTS: 1 DIF: Average REF: p.301-303
BLM: Higher Order NOT: Macro TB_13-27

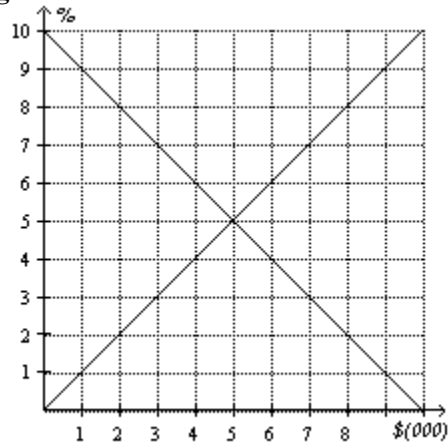
28. At the equilibrium interest rate in the open economy macroeconomic model, which of the following is the amount that people want to save?
- a. the desired quantity of net capital outflow
 - b. the desired quantity of domestic investment
 - c. the desired quantity of net capital outflow plus domestic investment
 - d. the desired quantity of net capital outflow minus domestic investment

ANS: C PTS: 1 DIF: Easy REF: p.301-303
BLM: Higher Order NOT: Macro TB_13-28

29. In an open economy, what does net capital outflow equal?
- a. imports
 - b. net exports
 - c. exports
 - d. net imports

ANS: B PTS: 1 DIF: Easy REF: p.301
BLM: Remember NOT: Macro TB_13-29

Figure 32-1



30. **Refer to Figure 32-1.** In the figure shown, if the real interest rate is 4 percent, what is the quantity of loanable funds demanded?
- \$7000
 - \$6000
 - \$5000
 - \$4000

ANS: B PTS: 1
BLM: Higher Order

DIF: Easy REF: p.301
NOT: Macro TB_13-30

31. **Refer to Figure 32-1.** In the figure shown, if the real interest rate is 6 percent, what is the result?
- a surplus of \$4000
 - surplus of \$2000
 - shortage of \$4000
 - shortage of \$2000

ANS: B PTS: 1
BLM: Higher Order

DIF: Easy REF: p.301
NOT: Macro TB_13-31

32. **Refer to Figure 32-1.** If the world interest rate equals 4 percent, what is the net capital outflow?
- \$4000
 - \$2000
 - \$2000
 - \$4000

ANS: C PTS: 1
BLM: Higher Order

DIF: Average REF: p.301
NOT: Macro TB_13-32

33. **Refer to Figure 32-1.** In the figure shown, if the real interest rate is 4 percent, there will be pressure for which of the following changes?
- a. for the real interest rate to rise
 - b. for the demand for loanable funds curve to shift right
 - c. for the supply for loanable funds curve to shift left
 - d. for the real interest rate to fall

ANS: A PTS: 1 DIF: Easy REF: p.301
BLM: Higher Order NOT: Macro TB_13-33

34. **Refer to Figure 32-1.** If the world interest rate equals 6 percent, what is the net capital outflow?
- a. positive
 - b. negative
 - c. either positive or negative
 - d. Net capital outflow is not determined by the world interest rate.

ANS: D PTS: 1 DIF: Average REF: p.301
BLM: Higher Order NOT: Macro TB_13-34

35. If the world real interest rate exceeds the interest rate that would occur if the Canadian economy were closed, then the Canadian net capital outflow will be which of the following?
- a. positive
 - b. negative
 - c. decreasing
 - d. increasing

ANS: D PTS: 1 DIF: Average REF: p.301
BLM: Higher Order NOT: Macro TB_13-35

36. If the world real interest rate is less than the real interest rate that would occur in Canada if there was no trade, then how does Canadian net capital outflow change?
- a. It decreases.
 - b. It increases.
 - c. It does not change.
 - d. There is not sufficient information to determine the change in capital outflow.

ANS: C PTS: 1 DIF: Average REF: p.301
BLM: Higher Order NOT: Macro TB_13-36

37. Which of the following is consistent with positive net exports?
- a. Exports are greater than imports.
 - b. Net capital outflow is negative.
 - c. Exports are less than imports.
 - d. Net capital outflow is zero.

ANS: A PTS: 1 DIF: Easy REF: p.301
BLM: Remember NOT: Macro TB_13-37

38. Which of the following is consistent with negative net exports?
- a. Net capital outflow is positive, so foreign assets bought by Canadians are greater than Canadian assets bought by foreigners.
 - b. Net capital outflow is positive, so Canadian assets bought by foreigners are greater than foreign assets bought by Canadians.
 - c. Net capital outflow is negative, so foreign assets bought by Canadians are greater than Canadian assets bought by foreigners.
 - d. Net capital outflow is negative, so Canadian assets bought by foreigners are greater than foreign assets bought by Canadians.

ANS: D PTS: 1 DIF: Average REF: p.301
BLM: Higher Order NOT: Macro TB_13-38

39. In the market for foreign currency exchange in the open economy macroeconomic model, which of the following does the amount of net capital outflow represent?
- a. the quantity of dollars supplied for the purpose of selling assets domestically
 - b. the quantity of dollars supplied for the purpose of buying assets abroad
 - c. the quantity of dollars demanded for the purpose of buying Canadian net exports of goods and services
 - d. the quantity of dollars demanded for the purpose of importing foreign goods and services

ANS: B PTS: 1 DIF: Average REF: p.302
BLM: Higher Order NOT: Macro TB_13-39

40. In the open economy macroeconomic model, what is net capital outflow equal to?
- a. the quantity of dollars supplied in the foreign exchange market
 - b. the quantity of dollars demand in the foreign exchange market
 - c. the quantity of funds supplied in the loanable funds market
 - d. the quantity of funds demanded in the loanable funds market

ANS: A PTS: 1 DIF: Easy REF: p.302
BLM: Remember NOT: Macro TB_13-40

41. What is net capital outflow equal to?
- a. national saving minus the trade balance
 - b. domestic investment plus national saving
 - c. national saving minus domestic investment
 - d. domestic investment minus national saving

ANS: C PTS: 1 DIF: Average REF: p.302-303
BLM: Remember NOT: Macro TB_13-41

42. What does the value of net exports equal?
- a. the value of national saving
 - b. the value of public saving
 - c. the value of national saving minus imports
 - d. the value of national saving minus domestic investment

ANS: D PTS: 1 DIF: Average REF: p.301-303
BLM: Remember NOT: Macro TB_13-42

43. Which of the following is included in the demand for dollars in the market for foreign-currency exchange in the open-market macroeconomic model?
- a. A firm in Kenya wants to buy wheat from a Canadian firm.
 - b. A Japanese bank desires to purchase Canadian government securities.
 - c. A Canadian citizen wants to buy a bond issued by a Mexican corporation.
 - d. A Canadian citizen exchanges dollars for Euros.

ANS: A PTS: 1 DIF: Challenging REF: p.302-304
BLM: Higher Order NOT: Macro TB_13-43

44. Which of the following is included in the supply of dollars in the market for foreign-currency exchange in the open-economy macroeconomic model?
- a. A retail outlet in Afghanistan wants to buy watches from a Canadian manufacturer.
 - b. A Canadian bank loans dollars to Blair, a Canadian resident, who wants to purchase a new car made in Canada.
 - c. A Canadian-based mutual fund wants to purchase stock issued by a Polish company.
 - d. A Canadian resident imports a car made in Japan.

ANS: C PTS: 1 DIF: Challenging REF: p.302-304
BLM: Higher Order NOT: Macro TB_13-44

45. Which of the following would tend to shift the supply of dollars in the foreign-currency exchange market model to the right?
- a. The exchange rate rises.
 - b. The exchange rate falls.
 - c. The expected rate of return on Canadian assets rises.
 - d. The expected rate of return on Canadian assets falls.

ANS: D PTS: 1 DIF: Average REF: p.302-304-
BLM: Higher Order NOT: Macro TB_13-45

46. Which of the following would tend to shift the supply of dollars in the foreign-currency exchange market model to the left?
- a. The exchange rate rises.
 - b. The exchange rate falls.
 - c. The expected rate of return on Canadian assets rises.
 - d. The expected rate of return on Canadian assets falls.

ANS: C PTS: 1 DIF: Average REF: p.302-304-
BLM: Higher Order NOT: Macro TB_13-46

47. What is the real exchange rate equal to?
- a. the relative price of domestic and foreign currency
 - b. the relative price of domestic and foreign goods
 - c. the ratio between the domestic and foreign interest rates
 - d. the nominal exchange rate minus the inflation rate

ANS: B PTS: 1 DIF: Easy REF: p.302-304
BLM: Remember NOT: Macro TB_13-47

48. What does the identity “net capital outflow = net exports” imply?
- a. The supply of dollars equals the demand for dollars in the foreign-currency exchange market.
 - b. National saving equals domestic investment.
 - c. The volume of exports equals the volume of imports.
 - d. National saving is greater than domestic investment.

ANS: A PTS: 1 DIF: Easy REF: p.302-304
BLM: Remember NOT: Macro TB_13-48

49. In the market for foreign-currency exchange in the open-economy macroeconomic model, which of the following results from a higher real exchange rate?
- a. It makes Canadian goods more expensive relative to foreign goods and reduces the quantity of dollars supplied.
 - b. It makes Canadian goods more expensive relative to foreign goods and reduces the quantity of dollars demanded.
 - c. It makes foreign goods more expensive relative to Canadian goods and reduces the quantity of dollars supplied.
 - d. It makes foreign goods more expensive relative to Canadian goods and reduces the quantity of dollars demanded.

ANS: B PTS: 1 DIF: Easy REF: p.302-304
BLM: Higher Order NOT: Macro TB_13-49

50. What is the price that balances supply and demand in the market for foreign-currency exchange in the open-economy macroeconomic model?
- a. the nominal exchange rate
 - b. the nominal interest rate
 - c. the real exchange rate
 - d. the real interest rate

ANS: C PTS: 1 DIF: Easy REF: p.302-304
BLM: Remember NOT: Macro TB_13-50

51. Where does the supply of dollars in the foreign currency exchange market come from?
- a. from Canadian national saving
 - b. from Canadian net capital outflow
 - c. from domestic investment
 - d. from foreign demand for Canadian goods

ANS: B PTS: 1 DIF: Average REF: p.302-304
BLM: Remember NOT: Macro TB_13-51

52. Which of the following is consistent with an appreciation of the dollar?
- a. Canadian goods become less expensive relative to foreign goods, which makes exports rise and imports fall.
 - b. Canadian goods become less expensive relative to foreign goods, which makes exports fall and imports rise.
 - c. Canadian goods become more expensive relative to foreign goods, which makes exports rise and imports fall.
 - d. Canadian goods become more expensive relative to foreign goods, which makes exports fall and imports rise.

ANS: D PTS: 1 DIF: Average REF: p.302-304
BLM: Higher Order NOT: Macro TB_13-52

53. Which of the following is consistent with a depreciation of the dollar?
- a. Canadian goods become less expensive relative to foreign goods, which makes exports rise and imports fall.
 - b. Canadian goods become less expensive relative to foreign goods, which makes exports fall and imports rise.
 - c. Canadian goods become more expensive relative to foreign goods, which makes exports rise and imports fall.
 - d. Canadian goods become more expensive relative to foreign goods, which makes exports fall and imports rise.

ANS: A PTS: 1 DIF: Average REF: p.302-304
BLM: Higher Order NOT: Macro TB_13-53

54. Which of the following is consistent with an above-the-equilibrium exchange rate of the dollar?
- a. The quantity of dollars supplied is greater than the quantity demanded, and the dollar will appreciate.
 - b. The quantity of dollars supplied is greater than the quantity demanded, and the dollar will depreciate.
 - c. The quantity of dollars supplied is less than the quantity demanded, and the dollar will appreciate.
 - d. The quantity of dollars supplied is less than the quantity demanded, and the dollar will depreciate.

ANS: B PTS: 1 DIF: Average REF: p.302-304
BLM: Higher Order NOT: Macro TB_13-54

55. Which of the following is consistent with a below-the-equilibrium exchange rate of the dollar?
- a. The quantity of dollars supplied is less than the quantity demanded, and the dollar will appreciate.
 - b. The quantity of dollars supplied is less than the quantity demanded, and the dollar will depreciate.
 - c. The quantity of dollars supplied is greater than the quantity demanded, and the dollar will appreciate.
 - d. The quantity of dollars supplied is greater than the quantity demanded, and the dollar will depreciate.

ANS: A PTS: 1 DIF: Average REF: p.302-304
BLM: Higher Order NOT: Macro TB_13-55

56. In the open-economy macroeconomic model, what does the quantity of dollars demanded in the foreign-currency exchange market depend on?
- a. the real exchange rate and import quotas
 - b. the real exchange rate and government deficit
 - c. the real interest rate and import quotas
 - d. import quotas and government deficit

ANS: A PTS: 1 DIF: Challenging REF: p.302-304
BLM: Higher Order NOT: Macro TB_13-56

57. According to the theory of purchasing-power parity, what is the shape of the demand curve for foreign-currency exchange?
- a. downward sloping
 - b. upward sloping
 - c. horizontal
 - d. vertical

ANS: C PTS: 1 DIF: Average REF: p.302-304
BLM: Remember NOT: Macro TB_13-57

58. What is the variable that links the market for loanable funds and the foreign-currency exchange market?
- a. net capital outflow
 - b. national saving
 - c. exports
 - d. imports

ANS: A PTS: 1 DIF: Average REF: p.302-304
BLM: Remember NOT: Macro TB_13-58

59. Which of the following is the supply and demand for loanable funds equation in an open economy?
- a. $S = I$
 - b. $S = NX + NCO$
 - c. $S = NCO$
 - d. $S = I + NCO$

ANS: D PTS: 1 DIF: Easy REF: p.305
BLM: Remember NOT: Macro TB_13-59

60. In the open-economy macroeconomic model, which of the following is the key determinant of net capital outflow?
- a. the nominal exchange rate
 - b. the nominal interest rate
 - c. the real exchange rate
 - d. the real interest rate

ANS: D PTS: 1 DIF: Easy REF: p.307
BLM: Remember NOT: Macro TB_13-60

61. Which of the following best predicts the effects of a fall in the Canadian real interest rate?
- a. Owning Canadian assets becomes less attractive, and net capital outflow rises.
 - b. Owning Canadian assets becomes less attractive, and net capital outflow falls.
 - c. Owning Canadian assets becomes more attractive, and net capital outflow rises.
 - d. Owning Canadian assets becomes more attractive, and net capital outflow falls.

ANS: A PTS: 1 DIF: Easy REF: p.307
BLM: Higher Order NOT: Macro TB_13-61

62. Which of the following best predicts the effects of an increase in the Canadian real interest rate?
- a. Canadian net capital outflow and net capital outflow of other countries would rise.
 - b. Canadian net capital outflow and net capital outflow of other countries would fall.
 - c. Canadian net capital outflow would rise, while net capital outflow of other countries would fall.
 - d. Canadian net capital outflow would fall, while net capital outflow of other countries would rise.

ANS: D PTS: 1 DIF: Easy REF: p.307
BLM: Higher Order NOT: Macro TB_13-62

63. In the open-economy macroeconomic model, which of the following would make Mexico's net capital outflow decrease?
- a. a decrease in Canadian interest rates
 - b. a decrease in Mexican interest rates
 - c. an appreciation of the Mexican peso
 - d. an increase in Mexico's net exports

ANS: A PTS: 1 DIF: Average REF: p.307-309
BLM: Higher Order NOT: Macro TB_13-63

64. Which of the following best predicts the effects of an increase in a country's real interest rate?
- a. Its net capital outflow and the real exchange rate increase.
 - b. Its net capital outflow and the real exchange rate decrease.
 - c. Its net capital outflow increases and the real exchange rate decreases.
 - d. Its net capital outflow decreases and the real exchange rate increases.

ANS: D PTS: 1 DIF: Average REF: p.307-309
BLM: Higher Order NOT: Macro TB_13-64

65. What are the effects of an increase in the supply of loanable funds?
- a. Net capital outflow and the real exchange rate both increase.
 - b. Net capital outflow and the real exchange rate both decrease.
 - c. Net capital outflow increases, and the real exchange rate decreases.
 - d. Net capital outflow decreases, and the real exchange rate increases.

ANS: C PTS: 1 DIF: Challenging REF: p.307-309
BLM: Higher Order NOT: Macro TB_13-65

66. Which of the following best predicts the effects of an increase in the supply of loanable funds?
- a. The interest rate and the real exchange rate both increase.
 - b. The interest rate and the real exchange rate both decrease.
 - c. The interest rate increases, and the real exchange rate decreases.
 - d. The interest rate decreases, and the real exchange rate increases.

ANS: B PTS: 1 DIF: Average REF: p.307-309
BLM: Higher Order NOT: Macro TB_13-66

67. If Canadian firms decide to invest more domestically at each interest rate, which of the following best describes the results?
- a. The real interest rate decreases, the real exchange rate of the dollar depreciates, and Canadian net capital outflow decreases.
 - b. The real interest rate decreases, the real exchange rate of the dollar appreciates, and Canadian net capital outflow increases.
 - c. The real interest rate increases, the real exchange rate of the dollar appreciates, and Canadian net capital outflow decreases.
 - d. The real interest rate increases, the real exchange rate of the dollar depreciates, and Canadian net capital outflow increases.

ANS: C PTS: 1 DIF: Challenging REF: p.307-309
BLM: Higher Order NOT: Macro TB_13-67

68. If Canadian citizens decide to save a larger fraction of their incomes, which of the following best identifies the effects?
- a. The real interest rate decreases, the real exchange rate of the dollar depreciates, and Canadian net capital outflow increases.
 - b. The real interest rate decreases, the real exchange rate of the dollar appreciates, and Canadian net capital outflow decreases.
 - c. The real interest rate increases, the real exchange rate of the dollar appreciates, and Canadian net capital outflow decreases.
 - d. The real interest rate increases, the real exchange rate of the dollar depreciates, and Canadian net capital outflow increases.

ANS: A PTS: 1 DIF: Average REF: p.307-309
BLM: Higher Order NOT: Macro TB_13-68

69. If Canadian citizens decide to save a smaller fraction of their incomes, which of the following best describes the effects?
- a. Canadian domestic investment increases, and Canadian net capital outflow increases.
 - b. Canadian domestic investment increases, and Canadian net capital outflow decreases.
 - c. Canadian domestic investment decreases, and Canadian net capital outflow increases.
 - d. Canadian domestic investment decreases, and Canadian net capital outflow decreases.

ANS: D PTS: 1 DIF: Average REF: p.307-309
BLM: Higher Order NOT: Macro TB_13-69

70. If Canadian citizens decide to purchase more foreign assets at each interest rate, which of the following best describes the effects?
- The real interest rate increases, the real exchange rate of the dollar appreciates, and Canadian net capital outflow decreases.
 - The real interest rate increases, the real exchange rate of the dollar depreciates, and Canadian net capital outflow increases.
 - The real interest rate decreases, the real exchange rate of the dollar depreciates, and Canadian net capital outflow decreases.
 - The real interest rate decreases, the real exchange rate of the dollar appreciates, and Canadian net capital outflow increases.

ANS: B PTS: 1 DIF: Challenging REF: p.307-309
BLM: Higher Order NOT: Macro TB_13-70

71. How does a change in government budget affect national saving?
- An increase in budget deficit increases national saving.
 - An increase in budget surplus increases national saving.
 - A decrease in budget surplus increases national saving.
 - A decrease in budget deficit does not affect national saving.

ANS: B PTS: 1 DIF: Easy REF: p.311
BLM: Higher Order NOT: Macro TB_13-71

72. The People's Republic of China has had a large trade surplus in recent years. Which of the following is the most likely explanation of this surplus?
- China has a high rate of inflation, which reduces the value of its currency.
 - China has a large supply of labour, so low wages give it a competitive edge.
 - China has many trade barriers, which restrict the ability of other countries to sell their products in China.
 - China has a large amount of saving relative to domestic investment.

ANS: D PTS: 1 DIF: Average REF: p.311
BLM: Higher Order NOT: Macro TB_13-72

73. How does the supply or demand for loanable funds shift when a country increases its budget deficit?
- The supply of loanable funds shifts right.
 - The supply of loanable funds shifts left.
 - The demand for loanable funds shifts right.
 - The demand for loanable funds shifts left.

ANS: B PTS: 1 DIF: Easy REF: p.311
BLM: Higher Order NOT: Macro TB_13-73

74. Suppose that Chile has a budget surplus, and then goes into deficit. Which of the following best predicts the consequences?
- a. National saving would increase, and Chile's supply of loanable funds would shift to the left.
 - b. National saving would increase, and Chile's demand for loanable funds would shift to the right.
 - c. National saving would decrease, and Chile's supply of loanable funds would shift to the left.
 - d. National saving would decrease, and Chile's demand for loanable funds would shift to the right.

ANS: C PTS: 1 DIF: Easy REF: p.311
BLM: Higher Order NOT: Macro TB_13-74

75. If a country went from a government budget deficit to a surplus, which of the following best predicts the consequences?
- a. National savings would increase, shifting the supply of loanable funds right.
 - b. National savings would increase, shifting the supply of loanable funds left.
 - c. National savings would decrease, shifting the demand for loanable funds right.
 - d. National savings would decrease, shifting the demand for loanable funds left.

ANS: A PTS: 1 DIF: Average REF: p.311-312
BLM: Higher Order NOT: Macro TB_13-75

76. If the government of Colombia implemented a policy that reduced national saving, which of the following best predicts the consequences?
- a. Its real exchange rate would depreciate, and Colombian net exports would rise.
 - b. Its real exchange rate would depreciate, and Colombian net exports would fall.
 - c. Its real exchange rate would appreciate, and Colombian net exports would rise.
 - d. Its real exchange rate would appreciate, and Colombian net exports would fall.

ANS: D PTS: 1 DIF: Average REF: p.311-313
BLM: Higher Order NOT: Macro TB_13-76

77. If the government of India made policy changes that increased national saving, which of the following best predicts the consequences?
- a. The real exchange rate of the rupee would depreciate, and Indian net exports would rise.
 - b. The real exchange rate of the rupee would depreciate, and Indian net exports would fall.
 - c. The real exchange rate of the rupee would appreciate, and Indian net exports would rise.
 - d. The real exchange rate of the rupee would appreciate, and Indian net exports would fall.

ANS: A PTS: 1 DIF: Average REF: p.311-313
BLM: Higher Order NOT: Macro TB_13-77

78. Suppose that the government of Jordan raises its budget deficit. Which of the following best predicts the effects of this action?
- The real exchange rate of the Jordanian dinar would depreciate, and Jordanian net exports would rise.
 - The real exchange rate of the Jordanian dinar would depreciate, and Jordanian net exports would fall.
 - The real exchange rate of the Jordanian dinar would appreciate, and Jordanian net exports rise.
 - The real exchange rate of the Jordanian dinar would appreciate, and Jordanian net exports fall.

ANS: D PTS: 1 DIF: Average REF: p.311-313
BLM: Higher Order NOT: Macro TB_13-78

79. If a government increases its budget deficit, which of the following best describes the consequences?
- Interest rates and domestic investment rise.
 - Interest rates and domestic investment fall.
 - Interest rates rise and domestic investment fall.
 - Interest rates fall and domestic investment rise.

ANS: C PTS: 1 DIF: Average REF: p.311-313
BLM: Higher Order NOT: Macro TB_13-79

80. If a government increases its budget deficit, which of the following best predicts the effects?
- Interest rates rise and the real exchange rate appreciates.
 - Interest rates fall and the real exchange rate depreciates.
 - Interest rates rise and the real exchange rate depreciates.
 - Interest rates fall and the real exchange rate appreciates.

ANS: A PTS: 1 DIF: Average REF: p.311-313
BLM: Higher Order NOT: Macro TB_13-80

81. If a government increases its budget deficit, which of the following best predicts the effects?
- Interest rates rise and the trade balance moves toward surplus.
 - Interest rates rise and the trade balance moves toward deficit.
 - Interest rates fall and the trade balance moves toward surplus.
 - Interest rates fall and the trade balance moves toward deficit.

ANS: B PTS: 1 DIF: Average REF: p.311-313
BLM: Higher Order NOT: Macro TB_13-81

82. If a government increases its budget deficit, which of the following best predicts the effects?
- The real exchange rate and domestic investment rise.
 - The real exchange rate and domestic investment fall.
 - The real exchange rate rises and domestic investment falls.
 - The real exchange rate falls and domestic investment rises.

ANS: C PTS: 1 DIF: Average REF: p.311-313
BLM: Higher Order NOT: Macro TB_13-82

83. If a government increases its budget deficit, which of the following best predicts the effects?
- a. The real exchange rate appreciates, and the trade balance moves toward surplus.
 - b. The real exchange rate appreciates, and the trade balance moves toward deficit.
 - c. The real exchange rate depreciates, and the trade balance moves toward surplus.
 - d. The real exchange rate depreciates, and the trade balance moves toward deficit.

ANS: B PTS: 1 DIF: Average REF: p.311-313
BLM: Higher Order NOT: Macro TB_13-83

84. If a government started with a deficit and moved to a surplus, which of the following best describes the effects of these changes?
- a. Domestic investment and the real exchange rate would rise.
 - b. Domestic investment and the real exchange rate would fall.
 - c. Domestic investment would rise, and the real exchange rate would fall.
 - d. Domestic investment would fall, and the real exchange rate would rise.

ANS: C PTS: 1 DIF: Average REF: p.311-313
BLM: Higher Order NOT: Macro TB_13-84

85. If the government started with a budget deficit and moved to a surplus, which of the following best describes the effects of these changes?
- a. Domestic investment would rise, and the trade balance would move towards surplus.
 - b. Domestic investment would rise, and the trade balance would move towards deficit.
 - c. Domestic investment would fall, and the trade balance would move towards surplus.
 - d. Domestic investment would fall, and the trade balance would move towards deficit.

ANS: A PTS: 1 DIF: Average REF: p.311-313
BLM: Higher Order NOT: Macro TB_13-85

86. Which of the following would **NOT** be a consequence of an increase in the Canadian government's budget deficit?
- a. Canadian interest rates rise.
 - b. Canadian net capital outflow falls.
 - c. The real exchange rate of the Canadian dollar depreciates.
 - d. The Canadian supply of loanable funds shifts left.

ANS: C PTS: 1 DIF: Average REF: p.311-313
BLM: Higher Order NOT: Macro TB_13-86

87. Suppose that from 1980 to 1987, Canadian net capital outflows decreased. According to the open-economy macroeconomic model, which of the following could have caused this?
- a. an increase in the demand for Canadian currency in the foreign-currency exchange
 - b. a decrease in the demand for Canadian currency in the foreign-currency exchange
 - c. an increase in the supply of loanable funds
 - d. a decrease in the supply of loanable funds

ANS: D PTS: 1 DIF: Average REF: p.311-313
BLM: Higher Order NOT: Macro TB_13-87

88. Suppose that in the 1990s, Canadian net capital outflow fell. Which of the following could explain this?

- a. an increase in the demand for Canadian currency in the foreign-currency exchange
- b. a decrease in the demand for Canadian currency in the foreign-currency exchange
- c. an increase in the demand for loanable funds
- d. a decrease in the demand for loanable funds

ANS: C PTS: 1 DIF: Average REF: p.311-313
BLM: Higher Order NOT: Macro TB_13-88

89. According to the open-economy macroeconomic model, which of the following would **NOT** be a consequence of an increase in the Canadian government budget deficit?

- a. Canadian trade balance rises.
- b. Canadian net capital outflow falls.
- c. Canadian investment abroad decreases.
- d. The real exchange rate of the Canadian dollar appreciates.

ANS: A PTS: 1 DIF: Average REF: p.311-313
BLM: Higher Order NOT: Macro TB_13-89

90. How does an increase in the Canadian government budget deficit shift the supply of Canadian loanable funds?

- a. The supply of loanable funds curve shifts to the right.
- b. The supply of loanable funds curve shifts to the left.
- c. The supply of loanable funds does not change.
- d. The change in the supply of loanable funds is ambiguous.

ANS: B PTS: 1 DIF: Average REF: p.311-313
BLM: Higher Order NOT: Macro TB_13-90

91. Which of the following is the most likely result from an increase in the government's budget surplus?

- a. higher interest rates
- b. lower imports
- c. lower net capital outflows
- d. lower domestic investment

ANS: B PTS: 1 DIF: Challenging REF: p.311-313
BLM: Higher Order NOT: Macro TB_13-91

92. Which of the following lists contains only things that increase when the budget deficit of the Canadian government increases?

- a. Canadian supply of loanable funds, Canadian domestic investment
- b. Canadian imports, the real exchange rate of the dollar
- c. The real exchange rate of the dollar, Canadian domestic investment
- d. the real exchange rate of the dollar, Canadian net exports

ANS: B PTS: 1 DIF: Challenging REF: p.311-313
BLM: Higher Order NOT: Macro TB_13-92

93. Which of the following lists contains only things that decrease when the budget deficit of the Canadian government increases?
- a. Canadian net exports, national saving, and net capital outflow
 - b. Canadian supply of loanable funds, the real exchange rate of the dollar, and domestic investment
 - c. Canadian imports, interest rates, and the real exchange rate of the dollar
 - d. National saving, net exports, and the quantity demanded for loanable funds for domestic investment

ANS: A PTS: 1 DIF: Challenging REF: p.311-313
BLM: Higher Order NOT: Macro TB_13-93

94. Suppose that the Canadian budget deficit rises. At the same time the Canadian trade deficit grows larger, the real exchange rate of the dollar appreciates, and Canadian net capital outflow decreases. Which of these events is contrary to what the open-economy macroeconomic model predicts concerning the effects of an increase in the budget deficit?
- a. The Canadian trade deficit grew.
 - b. The real exchange rate of the dollar appreciated.
 - c. Canadian net capital outflow fell.
 - d. The supply of dollars in the foreign exchange market increased.

ANS: D PTS: 1 DIF: Average REF: p.311-313
BLM: Higher Order NOT: Macro TB_13-94

95. Since the mid 1990s, Canadian governments have tried to eliminate budget deficits. Which of the following was expected to happen?
- a. This would decrease national savings, appreciate the real exchange rate, and decrease net exports.
 - b. This would increase national savings, depreciate the real exchange rate, and increase net exports.
 - c. This would increase national savings, depreciate the real exchange rate, and increase net exports.
 - d. This would decrease national savings, depreciate the real exchange rate, and decrease net exports.

ANS: C PTS: 1 DIF: Easy REF: p.311-313
BLM: Higher Order NOT: Macro TB_13-95

96. Which of the following best defines a trade policy?
- a. It is a government policy directed toward the goal of improving the tradeoff between equity and efficiency.
 - b. It is a government policy that directly influences the quantity of goods and services that a country imports or exports.
 - c. It is a government policy directed toward the goal of increasing domestic trade.
 - d. It is a government policy toward trade unions.

ANS: B PTS: 1 DIF: Easy REF: p.312
BLM: Remember NOT: Macro TB_13-96

97. Which of the following refers to a tax on imported goods?

- a. an excise tax
- b. a tariff
- c. an import quota
- d. import tax

ANS: B PTS: 1 DIF: Easy REF: p.312
BLM: Remember NOT: Macro TB_13-97

98. Which of the following refers to a limit on the quantity of an imported good?

- a. a tariff
- b. an excise tax
- c. an import quota
- d. net imports

ANS: C PTS: 1 DIF: Easy REF: p.312
BLM: Remember NOT: Macro TB_13-98

99. Which of the following increases if the Canadian government imposes an import quota on computer components?

- a. Canadian exports
- b. Canadian imports
- c. Canadian net exports
- d. the real exchange rate of the dollar

ANS: D PTS: 1 DIF: Average REF: p.312
BLM: Higher Order NOT: Macro TB_13-99

100. If Canada imposes an import quota on clothing, which of the following best predicts the consequences?

- a. Canadian exports increase, imports increase, and net exports are unchanged.
- b. Canadian exports increase, imports decrease, and net exports increase.
- c. Canadian exports decrease, imports increase, and Canadian net exports decrease.
- d. Canadian exports decrease, imports decrease, and net exports are unchanged.

ANS: D PTS: 1 DIF: Average REF: p.313-314
BLM: Higher Order NOT: Macro TB_13-100

101. Suppose that Canada imposes restrictions on the importation of steel into the Canada. According to the open-economy macroeconomic model, which of the following would be the most likely result?

- a. This policy would lower the real exchange rate and increase net exports.
- b. This policy would lower the real exchange rate and have no effect on net exports.
- c. This policy would raise the real exchange rate and decrease net exports.
- d. This policy would raise the real exchange rate and have no effect on net exports.

ANS: D PTS: 1 DIF: Average REF: p.313-314
BLM: Higher Order NOT: Macro TB_13-101

102. Suppose that Canada places higher tariffs on imports of steel. Which of the following would be the most likely result?
- a. The tariffs would reduce imports into Canada, which would cause Canadian net exports to rise.
 - b. The tariffs would reduce imports into Canada, which would cause the net supply of dollars in the foreign exchange market to rise.
 - c. The tariffs would reduce imports of steel into Canada, but would reduce Canadian exports of other goods by an equal amount.
 - d. The tariffs would reduce imports of steel into Canada, but would increase Canadian exports of other goods by an equal amount.

ANS: C PTS: 1 DIF: Average REF: p.313-314
BLM: Higher Order NOT: Macro TB_13-102

103. Suppose Canada imposes an import quota on steel. Which of the following describes the most likely effects of this quota?
- a. Canadian exports would increase, the real exchange rate of the Canadian dollar would appreciate, and Canadian net capital outflow would increase.
 - b. Canadian exports would increase, the real exchange rate of the Canadian dollar would depreciate, and Canadian net capital outflow would remain unchanged.
 - c. Canadian exports would decrease, the real exchange rate of the Canadian dollar would appreciate, and Canadian net capital outflow would remain unchanged.
 - d. Canadian exports would decrease, the real exchange rate of the Canadian dollar would depreciate, and Canadian net capital outflow would decrease.

ANS: C PTS: 1 DIF: Challenging REF: p.313-314
BLM: Higher Order NOT: Macro TB_13-103

104. Suppose that Canada imposes an import quota on automobiles. In the open-economy macroeconomic model, this quota would shift which of the following curves?
- a. supply of loanable funds left
 - b. demand for loanable funds left
 - c. demand for Canadian dollars right
 - d. supply of Canadian dollars left

ANS: C PTS: 1 DIF: Challenging REF: p.313-314
BLM: Higher Order NOT: Macro TB_13-104

105. Suppose that Canada imposes an import quota on automobiles. Which of the following describes the most likely effects of this quota?
- a. The quota would cause the real exchange rate of Canadian dollars to appreciate, but it would not change the real interest rate in Canada.
 - b. The quota would cause the real exchange rate of Canadian dollars to appreciate and the real interest rate in Canada to increase.
 - c. The quota would cause the real exchange rate of Canadian dollars to depreciate and the real interest rate in Canada to decrease.
 - d. The quota would cause the real exchange rate of Canadian dollars to depreciate, but it would not change the real interest rate in Canada.

ANS: A PTS: 1 DIF: Challenging REF: p.313-314
BLM: Higher Order NOT: Macro TB_13-105

106. Suppose the Canadian government imposed import quotas on agricultural products. According to the foreign currency exchange market diagram, which of the following outcomes would most likely result?
- a. Both the demand and supply curves would shift right.
 - b. Both the demand and supply curves would shift left.
 - c. Only the demand curve would shift right.
 - d. Only the supply curve would shift right.

ANS: C PTS: 1 DIF: Average REF: p.313-314
BLM: Higher Order NOT: Macro TB_13-106

107. Which of the following is the correct way to show the effects of a new import quota?
- a. shift the demand for loanable funds right, the supply of dollars for foreign exchange right, and the demand for dollars left
 - b. shift the demand for loanable funds right, and the supply of dollars for foreign exchange left
 - c. shift the demand for dollars for foreign currency exchange left
 - d. shift the demand for dollars for foreign currency exchange right

ANS: D PTS: 1 DIF: Average REF: p.313-314
BLM: Higher Order NOT: Macro TB_13-107

108. Which of the following best explains the effect of trade policies on the trade balance?
- a. Trade policies alter the trade balance because they alter imports of the country that implemented them.
 - b. Trade policies alter the trade balance because they alter net capital outflow of the country that implemented them.
 - c. Trade policies do not alter the trade balance because they cannot alter the national saving or domestic investment of the country that implements them.
 - d. Trade policies do not alter the trade balance because they cannot alter the real exchange rate of the currency of the country that implements them.

ANS: C PTS: 1 DIF: Average REF: p.313-314
BLM: Higher Order NOT: Macro TB_13-108

109. Which of the following best identifies the effects of trade policies? And on firms or industries?
- a. Trade policies affect the trade balance and all firms and industries the same.
 - b. Trade policies affect the trade balance and some firms or industries differently than others.
 - c. Trade policies do not affect the trade balance, but they affect some firms or industries differently than others.
 - d. Trade policies affect neither the trade balance nor specific firms or industries.

ANS: C PTS: 1 DIF: Average REF: p.313-314
BLM: Higher Order NOT: Macro TB_13-109

110. Suppose that Canada imposed an import quota on beef. Which of the following identifies the most likely results?
- a. Sales of Canadian beef would rise; exports of other industries would increase.
 - b. Sales of Canadian beef would rise; exports of other industries would decline.
 - c. Sales of Canadian beef would not change; exports of other industries would increase.
 - d. Sales of Canadian beef would not change; exports of other industries would decline.

ANS: B PTS: 1 DIF: Average REF: p.313-314
BLM: Higher Order NOT: Macro TB_13-110

111. If the Canadian government imposes an import quota on French wine, which of the following best predicts the consequences?
- Canadian net exports will increase, the real exchange rate will appreciate, and domestic sales of Canadian wine will increase.
 - Canadian net exports will not change, the real exchange rate will appreciate, and domestic sales of Canadian wine will increase.
 - Canadian net exports will not change, the real exchange rate will depreciate, and domestic sales of Canadian wine will not change.
 - Canadian net exports will not change, the real exchange rate will appreciate, and domestic sales of Canadian wine will decrease.

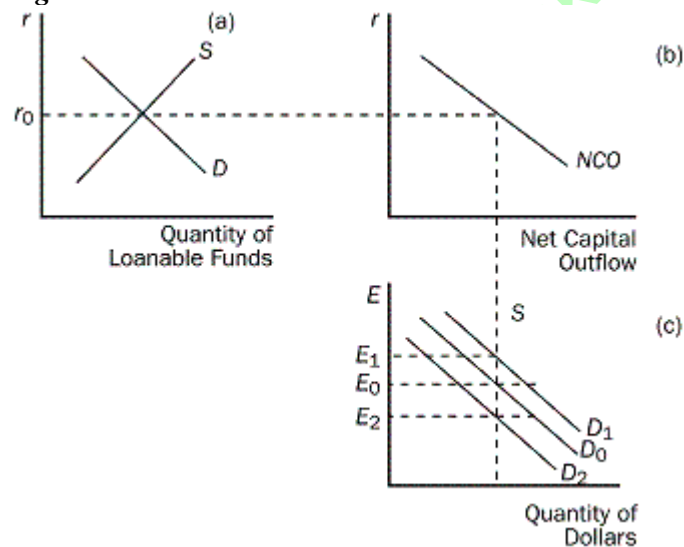
ANS: B PTS: 1 DIF: Average REF: p.313-314
 BLM: Higher Order NOT: Macro TB_13-111

112. Which of the following is the most accurate statement about trade policy?
- Trade policy has neither microeconomic nor macroeconomic effects.
 - Trade policy has similar microeconomic and macroeconomic effects.
 - The effects of trade policy are more macroeconomic than microeconomic.
 - The effects of trade policy are more microeconomic than macroeconomic.

ANS: D PTS: 1 DIF: Average REF: p.313-314
 BLM: Higher Order NOT: Macro TB_13-

Use the figure below to answer the following questions.

Figure 32-2



113. **Refer to Figure 32-2.** Which of the following shifts shows the effects of an import quota?
- a shift of NCO to the right in Panel B
 - a shift from D_0 to D_1 in Panel C
 - a shift from D_0 to D_2 in Panel C
 - a shift of D to the left in Panel A

ANS: B PTS: 1 DIF: Easy REF: p.313
 BLM: Higher Order NOT: Macro TB_13-113

114. **Refer to Figure 32-2.** If the interest rate were initially at r_0 and an import quota was imposed, what would happen to the interest rate?
- a. It would stay at r_0 .
 - b. It would decrease because supply would shift right.
 - c. It would increase because supply would shift left.
 - d. It would decrease because demand would shift left.

ANS: A PTS: 1 DIF: Easy REF: p.313
BLM: Higher Order NOT: Macro TB_13-114

115. **Refer to Figure 32-2.** If the economy were initially in equilibrium at r_0 and E_0 and the government removed import quotas, what would happen to the exchange rate?
- a. It would appreciate to E_1 .
 - b. It would appreciate to E_2 .
 - c. It would depreciate to E_1 .
 - d. It would depreciate to E_2 .

ANS: D PTS: 1 DIF: Easy REF: p.313
BLM: Higher Order NOT: Macro TB_13-115

116. **Refer to Figure 32-2.** Suppose that these diagrams refer to Canada. Which of the following shifts show the effect of a voluntary export restriction by the government of China?
- a. a shift of NCO to the right in Panel B
 - b. a shift from D_0 to D_1 in Panel C
 - c. a shift from D_0 to D_2 in Panel C
 - d. a shift from D_1 to D_0 in Panel C

ANS: B PTS: 1 DIF: Easy REF: p.313
BLM: Higher Order NOT: Macro TB_13-116

117. **Refer to Figure 32-2.** Suppose that these diagrams refer to Canada. If the interest rate were initially at r_0 and China voluntarily restricted its exports to Canada, what would happen to the interest rate?
- a. It would stay at r_0 .
 - b. It would decrease because supply would shift right.
 - c. It would increase because supply would shift left.
 - d. It would decrease because demand would shift left.

ANS: A PTS: 1 DIF: Easy REF: p.313
BLM: Higher Order NOT: Macro TB_13-117

118. Which of the following terms refers to a large and sudden movement of funds out of a country?
- a. arbitrage
 - b. capital flight
 - c. crowding out
 - d. capital mobility

ANS: B PTS: 1 DIF: Average REF: p.315
BLM: Higher Order NOT: Macro TB_13-118

119. Which of the following best defines capital flight?

- a. the movement of workers across international borders in response to exchange rate changes
- b. the movement of funds between financial intermediaries when interest rates change
- c. the ability of investment expenditures to lift a country out of poverty
- d. a large and sudden movement of funds out of a country

ANS: D PTS: 1 DIF: Average REF: p.315
BLM: Remember NOT: Macro TB_13-119

120. When Mexico suffered from capital flight in 1994, what happened to Mexico's net capital outflow and net exports?

- a. The net capital outflow and net exports decreased.
- b. The net capital outflow and net exports increased.
- c. The net capital outflow increased while net exports decreased.
- d. The net capital outflow decreased while net exports increased.

ANS: B PTS: 1 DIF: Average REF: p.315
BLM: Higher Order NOT: Macro TB_13-120

121. When Mexico suffered from capital flight in 1994, what happened to Mexico's real interest rate and the peso?

- a. The real interest rate fell and the peso appreciated.
- b. The real interest rate fell and the peso depreciated.
- c. The real interest rate rose and the peso appreciated.
- d. The real interest rate rose and the peso depreciated.

ANS: D PTS: 1 DIF: Average REF: p.315-317
BLM: Higher Order NOT: Macro TB_13-121

122. When Mexico suffered from capital flight in 1994, what happened to Mexico's net exports?

- a. They decreased.
- b. They did not change.
- c. They increased.
- d. They decreased until the peso appreciated; then they increased.

ANS: C PTS: 1 DIF: Average REF: p.315-317
BLM: Higher Order NOT: Macro TB_13-122

123. If there is capital flight from Canada, how does the open economy macroeconomic model change?

- a. Both the supply of loanable funds and the supply of dollars for foreign exchange curves shift right.
- b. Both the supply of loanable funds and the supply of dollars for foreign exchange curves shift left.
- c. The supply of loanable funds shifts left, while the supply of dollars shifts right.
- d. The supply of loanable funds shifts right, while the supply of dollars shifts left.

ANS: C PTS: 1 DIF: Average REF: p.315-317
BLM: Higher Order NOT: Macro TB_13-123

124. When a country suffers from capital flight, which of the following best explains the effects?
- a. The supply for loanable funds shifts right, and the interest rate increases.
 - b. The supply for loanable funds shifts right, and the interest rate decreases.
 - c. The supply for loanable funds shifts left, and the interest rate increases.
 - d. The supply for loanable funds shifts left, and the interest rate decreases.

ANS: C PTS: 1 DIF: Average REF: p.315-317
BLM: Higher Order NOT: Macro TB_13-124

125. When a country experiences capital flight, which of the following best explains the effects?
- a. The interest rate falls because the demand for loanable funds shifts left.
 - b. The interest rate falls because the supply for loanable funds shifts right.
 - c. The interest rate rises because the demand for loanable funds shifts right.
 - d. The interest rate rises because the supply for loanable funds shifts left.

ANS: D PTS: 1 DIF: Average REF: p.315-317
BLM: Higher Order NOT: Macro TB_13-125

126. If Kenya experienced capital flight, which of the following best explains the effects?
- a. The supply of Kenyan schillings curve would shift left, which would make the real exchange rate of the Kenyan schilling appreciate.
 - b. The supply of Kenyan schillings curve would shift left, which would make the real exchange rate of the Kenyan schilling depreciate.
 - c. The supply of Kenyan schillings curve would shift right, which would make the real exchange rate of the Kenyan schilling appreciate.
 - d. The supply of Kenyan schillings curve would shift right, which would make the real exchange rate of the Kenyan schilling depreciate.

ANS: D PTS: 1 DIF: Average REF: p.315-317
BLM: Higher Order NOT: Macro TB_13-126

127. When Mexico suffered from capital flight in 1994, which of the following best describes the effects of this event on Canadian economy?
- a. Canadian demand for loanable funds and Canadian net capital outflow rose.
 - b. Canadian demand for loanable funds and Canadian net capital outflow fell.
 - c. Canadian demand for loanable funds fell, and Canadian net capital outflow rose.
 - d. Canadian demand for loanable funds rose, and Canadian net capital outflow fell.

ANS: B PTS: 1 DIF: Challenging REF: p.315-317
BLM: Higher Order NOT: Macro TB_13-127

128. When Mexico suffered from capital flight in 1994, which of the following best describes the effects of this event on Canadian economy?
- a. The Canadian real interest rate rose, and the real exchange rate of the dollar appreciated.
 - b. The Canadian real interest rate rose, and the real exchange rate of the dollar depreciated.
 - c. The Canadian real interest rate fell, and the real exchange rate of the dollar appreciated.
 - d. The Canadian real interest rate fell, and the real exchange rate of the dollar depreciated.

ANS: C PTS: 1 DIF: Average REF: p.315-317
BLM: Higher Order NOT: Macro TB_13-128

129. The country of Aquilonia is politically very stable and has a long tradition of respecting property rights. If several other countries suddenly became politically unstable, which of the following would happen?
- a. Aquilonia's real interest rate would rise.
 - b. Aquilonia's real exchange rate would fall.
 - c. Aquilonia's net exports would fall.
 - d. Aquilonia's net exports would not change.

ANS: C PTS: 1 DIF: Challenging REF: p.315-317
BLM: Higher Order NOT: Macro TB_13-129

130. Which of the following is most likely to result if foreigners decide to withdraw the funds that they have loaned to Canada over the past two decades?
- a. Canadian net exports will rise.
 - b. Canadian saving will rise.
 - c. Canadian domestic investment will rise.
 - d. Canadian imports will rise.

ANS: A PTS: 1 DIF: Challenging REF: p.315-317
BLM: Higher Order NOT: Macro TB_13-130

131. In 1995, Newt Gingrich, the Speaker of the U.S. House of Representatives, threatened to send the United States into default on its debt. During the day of this announcement, U.S. interest rates rose and the real exchange rate of the U.S. dollar depreciated. Which of the following changes is consistent with the results of the open-economy macroeconomic model?
- a. a fall in U.S. interest rates and an increase in net capital outflow
 - b. an appreciation of the real exchange rate of the U.S. dollar
 - c. an increase in U.S. interest rates and a depreciation of the U.S. dollar
 - d. an appreciation of the U.S. dollar and an increase in U.S. net capital outflow

ANS: C PTS: 1 DIF: Challenging REF: p.315-317
BLM: Higher Order NOT: Macro TB_13-131

132. In 2002 it looked like the Argentinean government might default on its debt (which eventually it did). Which of the following is consistent with what the open-economy macroeconomic model predicts?
- a. This event should have raised Argentinean interest rates and caused the Argentinean currency to appreciate.
 - b. This event should have raised Argentinean interest rates and caused the Argentinean currency to depreciate.
 - c. This event should have lowered Argentinean interest rates and caused the Argentinean currency to appreciate.
 - d. This event should have lowered Argentinean interest rates and caused the Argentinean currency to depreciate.

ANS: B PTS: 1 DIF: Average REF: p.315-317
BLM: Higher Order NOT: Macro TB_13-132

133. The 1998 default by the Russian government had results that were predictable using the textbook model. Which of the following best describes what happened?
- The event increased Russian interest rates and net exports.
 - The event reduced Russian interest rates and net exports.
 - The event increased Russian interest rates and reduced Russian net exports.
 - The event reduced Russian interest rates and increased Russian net exports.

ANS: A

PTS: 1

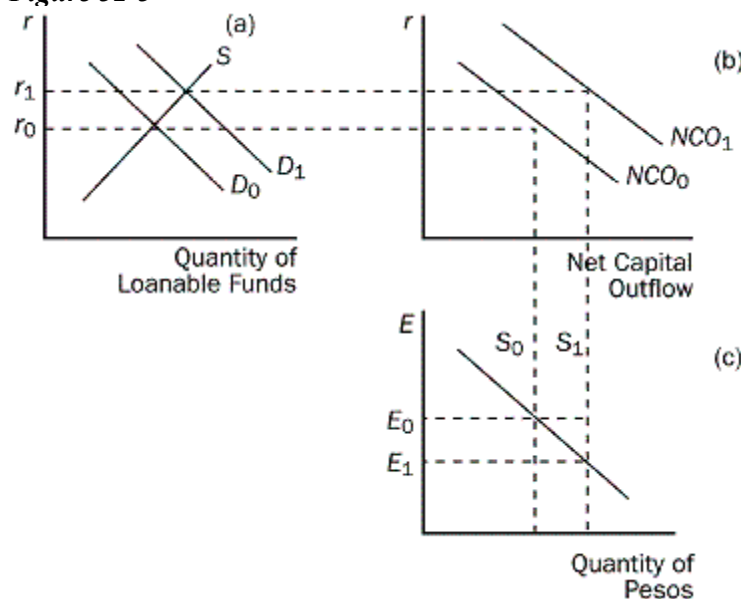
DIF: Challenging REF: p.315-317

BLM: Higher Order

NOT: Macro TB_13-133

The diagram below represents the market for loanable funds and the market for foreign-currency exchange in Mexico. Use the diagram to answer the following questions.

Figure 32-3



134. **Refer to Figure 32-3.** Suppose that the Mexican economy starts at r_0 and E_0 . Which of the following are consistent with the effects of capital flight?
- the shift from D_0 to D_1 in Panel A
 - the shift from NCO_0 to NCO_1 in Panel B
 - the shift from S_1 to S_0 in Panel C
 - the shift from r_1 to r_0 in Panel A

ANS: B

PTS: 1

DIF: Average REF: p.315-317

BLM: Higher Order

NOT: Macro TB_13-134

135. **Refer to Figure 32-3.** Which of the following is consistent with capital flight from Mexico?
- The real exchange rate of the peso appreciates from E_0 to E_1 .
 - The real exchange rate of the peso depreciates from E_0 to E_1 .
 - The real exchange rate of the peso appreciates from E_1 to E_0 .
 - The real exchange rate of the peso depreciates from E_1 to E_0 .

ANS: B

PTS: 1

DIF: Average REF: p.315-317

BLM: Higher Order

NOT: Macro TB_13-135

136. **Refer to Figure 32-3.** Suppose the Mexican economy starts at r_0 and E_0 . Which of the following new equilibriums is consistent with capital flight?

- a. r_0 and E_0
- b. r_1 and E_0
- c. r_1 and E_1
- d. r_0 and E_1

ANS: C

PTS: 1

DIF: Easy

REF: p.315-317

BLM: Higher Order

NOT: Macro TB_13-136

137. Which of the following would cause the real exchange rate of the Canadian dollar to depreciate?

- a. an increase in the Canadian government budget deficit
- b. capital flight from Canada
- c. the imposition of Canadian government import quotas
- d. a decrease in the world interest rate

ANS: B

PTS: 1

DIF: Challenging

REF: p.315-317

BLM: Higher Order

NOT: Macro TB_13-137

138. Which of the following will not change Canadian net exports?

- a. capital flight from Canada
- b. an increase in the government budget deficit
- c. the imposition of Canadian import quotas
- d. an increase in the world interest rate

ANS: C

PTS: 1

DIF: Average

REF: p.311-318

BLM: Higher Order

NOT: Macro TB_13-138

139. Which of the following will decrease Canadian net capital outflow?

- a. capital flight from Canada
- b. an increase in the government budget deficit
- c. the imposition of Canadian government import quotas
- d. a decrease in the tax on capital gains

ANS: B

PTS: 1

DIF: Average

REF: p.311-318

BLM: Higher Order

NOT: Macro TB_13-139

140. Which of the following is most likely to increase Canadian exports?

- a. The government increases its spending.
- b. The government reduces the size of the budget surplus.
- c. Canada reduces its restrictions on foreign imports.
- d. Taxes on domestic saving rise.

ANS: C

PTS: 1

DIF: Challenging

REF: p.311-318

BLM: Higher Order

NOT: Macro TB_13-140

141. Which of the following is most likely to increase exports in the country of Turania?
- a. The government of Turania introduces an investment tax credit.
 - b. The government of Turania reduces the size of the budget surplus.
 - c. Political instability in Turania increases modestly.
 - d. The government of Turania imposes an import quota.

ANS: C PTS: 1 DIF: Challenging REF: p.311-318
BLM: Higher Order NOT: Macro TB_13-141

142. Which of the following would do the most to reduce a trade deficit?
- a. increasing domestic saving
 - b. increasing political stability and respect for property rights
 - c. negotiating with other countries to get them to reduce their trade restrictions
 - d. imposing higher tariffs on imported goods

ANS: A PTS: 1 DIF: Challenging REF: p.311-318
BLM: Higher Order NOT: Macro TB_13-142

143. Which of the following is most likely to increase exports in the country of Aquilonia?
- a. a reduction in political instability
 - b. ending investment tax credits
 - c. a reduction in the size of the government's budget surplus
 - d. an import quota

ANS: B PTS: 1 DIF: Challenging REF: p.311-318
BLM: Higher Order NOT: Macro TB_13-143

TRUE/FALSE

1. In the open-economy macroeconomic model we focus on the determination of GDP and the price level.

ANS: F PTS: 1 DIF: Easy REF: p.298
NOT: Macro TB_13-144

2. In an open economy, the supply of loanable funds comes from national saving.

ANS: T PTS: 1 DIF: Easy REF: p.299
NOT: Macro TB_13-145

3. In an open economy, the demand for loanable funds comes from both domestic investment and net capital outflow.

ANS: T PTS: 1 DIF: Easy REF: p.299
NOT: Macro TB_13-146

4. A drop in the Peruvian real interest rate reduces Peruvian net capital outflow.

ANS: F PTS: 1 DIF: Average REF: p.301
NOT: Macro TB_13-147

5. In the open-economy macroeconomic model, at the equilibrium real interest rate, the amount that people (including government) want to save exactly balances desired domestic investment.

ANS: F PTS: 1 DIF: Easy REF: p.301
NOT: Macro TB_13-148

6. If the real interest rate were above the equilibrium rate, there would be a shortage of loanable funds.

ANS: F PTS: 1 DIF: Easy REF: p.301
NOT: Macro TB_13-149

7. Net capital outflow represents the quantity of dollars supplied in the foreign-currency exchange market.

ANS: T PTS: 1 DIF: Easy REF: p.301
NOT: Macro TB_13-150

8. In the open-economy macroeconomic model, net exports represent the quantity of dollars demanded in the foreign-currency exchange market.

ANS: T PTS: 1 DIF: Easy REF: p.301
NOT: Macro TB_13-151

9. Other things the same, when the real exchange rate of the dollar appreciates, Canadian goods become more attractive to Canadian residents, but less attractive to foreign residents.

ANS: F PTS: 1 DIF: Easy REF: p.301
NOT: Macro TB_13-152

10. In the open-economy macroeconomic model, the supply curve of currency is vertical because the quantity of currency supplied does not depend on the real exchange rate.

ANS: T PTS: 1 DIF: Easy REF: p.303
NOT: Macro TB_13-153

11. If the real exchange rate of the Canadian dollar were above its equilibrium level, the real exchange rate of the Canadian dollar would appreciate.

ANS: F PTS: 1 DIF: Easy REF: p.303
NOT: Macro TB_13-154

12. In the open-economy macroeconomic model, other things the same, when a Canadian resident imports a foreign good, our model treats this as a decrease in the demand for dollars in the foreign-currency exchange market.

ANS: T PTS: 1 DIF: Average REF: p.303
NOT: Macro TB_13-155

13. The key determinant of net capital outflow is the real exchange rate.

ANS: F PTS: 1 DIF: Average REF: p.303
NOT: Macro TB_13-156

14. Because depreciation of the real exchange rate of the dollar increases Canadian net exports, the demand curve for dollars in the foreign-currency exchange market is downward sloping.

ANS: T PTS: 1 DIF: Average REF: p.303
NOT: Macro TB_13-157

15. Other things the same, when a Canadian company imports wool from Australia, the open-economy macroeconomic model treats this transaction as a decrease in the quantity of dollars demanded in the Canadian foreign-currency exchange market.

ANS: T PTS: 1 DIF: Average REF: p.303
NOT: Macro TB_13-158

16. In the open-economy macroeconomic model, net capital outflow links the markets for loanable funds and foreign-currency exchange.

ANS: T PTS: 1 DIF: Easy REF: p.307
NOT: Macro TB_13-159

17. When the government increases the government budget deficit, national saving decreases.

ANS: T PTS: 1 DIF: Easy REF: p.308-311
NOT: Macro TB_13-160

18. According to the open-economy macroeconomic model, if the Canadian government decreased the government budget deficit, both Canadian domestic investment and Canadian net capital outflow would fall.

ANS: T PTS: 1 DIF: Average REF: p.308-311

19. According to the open-economy macroeconomic model, an increase in the Canadian government budget surplus increases Canadian net capital outflow, causes the real exchange rate of the dollar to depreciate, and increases Canadian net exports.

ANS: T PTS: 1 DIF: Average REF: p.311-313
NOT: Macro TB_13-162

20. According to the open-economy macroeconomic model, if Canada moved from a government budget deficit to a government budget surplus, Canadian real interest rates would increase and the real exchange rate of the Canadian dollar would appreciate.

ANS: F PTS: 1 DIF: Average REF: p.311-313
NOT: Macro TB_13-163

21. When a country imposes a trade restriction, the real exchange rate of that country's currency appreciates.

ANS: T PTS: 1 DIF: Easy REF: p.313-315
NOT: Macro TB_13-164

22. An import quota imposed by Egypt would reduce Egyptian imports, but have no impact on Egyptian exports.

ANS: F PTS: 1 DIF: Average REF: p.313-315
NOT: Macro TB_13-165

23. Although trade policies do not affect a country's overall trade balance, they do affect specific firms and industries.

ANS: T PTS: 1 DIF: Easy REF: p.313-315
NOT: Macro TB_13-166

24. If policymakers impose import restrictions on automobiles, the Canadian trade deficit would shrink.

ANS: F PTS: 1 DIF: Easy REF: p.313-315
NOT: Macro TB_13-167

25. If Argentina suffers from capital flight, Argentinean domestic investment will fall and Argentinean net exports will increase.

ANS: T PTS: 1 DIF: Easy REF: p.315-318
NOT: Macro TB_13-168

SHORT ANSWER

1. Explain why saving need not equal domestic investment in an open economy.

ANS:

Because saving equals domestic investment plus net capital outflow. If net capital outflow is not equal to zero, then domestic saving does not equal domestic investment.

PTS: 1 DIF: Average REF: p.299 NOT: Macro TB_13-169

2. Why do higher real interest rates lead to lower net capital outflow?

ANS:

Higher Canadian interest rates make Canadian assets look more attractive than foreign assets. Investors in Canada and other countries are likely to move funds into Canada, reducing Canadian net capital outflow.

PTS: 1 DIF: Average REF: p.301 NOT: Macro TB_13-170

3. State what, if anything, each of the following does to the supply or demand of loanable funds.
 - a. net capital outflow increases at each interest rate
 - b. domestic investment increases at each interest rate
 - c. the government deficit increases
 - d. private saving increases

ANS:

- a. The demand for loanable funds increases.
- b. The demand for loanable funds increases.
- c. The supply of loanable funds decreases.
- d. The supply of loanable funds increases.

PTS: 1

DIF: Average

REF: p.201

NOT: Macro TB_13-171

4. Suppose that Canadian investors decide that investment opportunities in African countries have improved. What happens to Canadian net capital outflow? What happens to the Canadian real interest rate?

ANS:

Canadian net capital outflow will increase. The increase in net capital outflow increases the Canadian demand for loanable funds, which increases Canadian interest rates.

PTS: 1

DIF: Average

REF: p.300-302

NOT: Macro TB_13-172

5. Suppose that Canadian citizens start saving more. What does this imply about the supply of loanable funds and the equilibrium real interest rate? What happens to the real exchange rate?

ANS:

The supply of loanable funds increases, and the equilibrium real interest rate falls. Because of the lower interest rate, Canadian net capital outflow rises. This increase makes the supply of dollars shift to the right, and the real exchange rate of the dollar depreciates.

PTS: 1

DIF: Average

REF: p.301

NOT: Macro TB_13-173

6. Explain how the relation between the real exchange rate and net exports explains the downward slope of the demand for foreign-currency exchange curve.

ANS:

When the Canadian real exchange rate appreciates, Canadian goods become more expensive relative to foreign goods. This induces Canadian citizens to buy more goods overseas, which increases Canadian imports. The appreciation also induces foreign citizens to buy fewer Canadian goods, so Canadian exports fall. The decline in exports and increase in imports decreases net exports, and so the demand for Canadian dollars declines. The inverse relation between the exchange rate and the quantity of Canadian dollars demanded in the foreign-currency exchange market is represented by the downward-sloping demand curve.

PTS: 1

DIF: Average

REF: p.303

NOT: Macro TB_13-174

7. How are the identities $S = NCO + I$ and $NCO = NX$ related to the foreign currency exchange market and the loanable funds market?

ANS:

S is national saving, which is the source of loanable funds supply. $NCO + I$ is net capital outflow plus domestic investment, which is the source of demand in the loanable funds market. NCO is the source of supply in the foreign-currency exchange market. NX is net exports, which is the source of demand in the foreign-currency exchange market.

PTS: 1 DIF: Average REF: p.305 NOT: Macro TB_13-175

8. Suppose that the Turkish government budget deficit increases. What curves in the open-economy macroeconomic model shift? Explain why each curve shifts the direction it does.

ANS:

The supply of Turkish loanable funds curve shifts left because the government deficit decreases national saving. As the supply of loanable funds shifts left, the Turkish interest rate rises. This increase in the interest rate causes the quantity of Turkish net capital outflow to fall, which means that people will be supplying fewer Turkish dinars in order to purchase foreign assets. So the supply of dinars in the foreign-currency exchange market shifts left.

PTS: 1 DIF: Average REF: p.311-313 NOT: Macro TB_13-176

9. Suppose a prime ministerial candidate promises to increase the government budget surplus and claims that doing so will stop Canadian citizens from investing in foreign companies and increase the value of the dollar. Evaluate this promise.

ANS:

An increase in the government budget surplus will cause Canadian interest rates to fall. The decline in interest rates will increase domestic investment, but it will also cause Canadians to look for higher returns abroad, which means that net capital outflow rises rather than falls as promised. To take advantage of these higher returns, Canadians will supply more dollars in the foreign-currency exchange market and the dollar will depreciate rather than appreciate as promised.

PTS: 1 DIF: Challenging REF: p.311-313 NOT: Macro TB_13-177

10. Suppose the Canadian government institutes a "Buy Canadian" campaign, in order to encourage spending on domestic goods. What effect will this have on the Canadian trade balance?

ANS:

Such a campaign will increase the demand for domestically produced goods and hence decrease the demand for imports. This increases the demand for dollars in the market for foreign currency. The real exchange rate of the Canadian dollar will appreciate, and the net effect will be no change in the trade balance. The level of net exports ultimately depends upon domestic saving and investment, neither of which is affected by the campaign.

PTS: 1 DIF: Average REF: p.311-313 NOT: Macro TB_13-178

11. Fill in the table below with the direction of the variables that change in response to the events in the first column.

	Canadian real interest rate	Canadian domestic investment	Canadian net capital outflow	Canadian real exchange rate of domestic currency	Canadian trade balance
Canadian government budget deficit increases					
Canada imposes import quotas					
Capital flight from Canada					

ANS:

	Canadian real interest rate	Canadian domestic investment	Canadian net capital outflow	Canadian real exchange rate of domestic currency	Canadian trade balance
Canadian government budget deficit increases	rises	falls	falls	appreciates	falls
Canada imposes import quotas	no change	no change	no change	appreciates	no change
Capital flight from Canada	rises	falls	rises	depreciates	rises

PTS: 1 DIF: Challenging REF: p.311-313 NOT: Macro TB_13-179

PROBLEM

1. Suppose we measure Canada's net capital outflow by what Statistics Canada calls "net international investment position," and we approximate the real exchange rate of the dollar by the price of Canadian dollar in terms of U.S. dollars. The following table gives data on these two variables, as provided by Statistics Canada.

	2005	2006	2007	2008	2009
Canada's net international investment position (\$millions)	-164,925	-90,884	-129,799	-30,787	-153,243
Exchange rate	0.825	0.882	0.931	0.937	0.876

- a. What does our open-economy macro model predict with regard to the relationship between net capital outflow and the real exchange rate?
- b. Do you find evidence in the data to support the theory?
- c. If you find discrepancies between the data and the theory, what could cause them?

ANS:

- a. Our macro model predicts an inverse relationship between net capital outflow and the real exchange rate: when net capital outflow increases, there is an excess supply of dollars in the market for foreign-currency exchange, which causes a fall in the real exchange rate. The model assumes fixed domestic and foreign prices, as well as fixed domestic and foreign GDPs. Because of the fixed price assumption, changes in the real exchange rate will mirror changes in the nominal exchange rate. Fixed prices also mean zero inflation, which implies that the real interest rate and the nominal interest rate are equal.
- b. Between years 2005 and 2006, both NCO and the exchange rate have increased; next year they moved in opposite directions; between 2007 and 2008 they both increased again, and finally between 2008 and 2009 they both decreased. The data seem to contradict our theory most of the time.
- c. The most likely causes of the discrepancy between our theory and this data is that prices and GDPs were not constant over the period investigated and that Canada trades with other countries as well, not only with the United States. To determine the real interest rate, one would need price indexes of the tradable goods both in Canada and abroad and GDP growth rates. Differences in interest rates may also play a role. Such differences may be determined by imperfect capital mobility between Canada and other countries.

PTS: 1

NOT: Macro TB_13-180

2. Using the macroeconomic model of a foreign-currency exchange market, (a) analyze the situation in which a government imposes a fixed exchange rate, and (b) determine what that government should do in order to maintain the fixed exchange.

ANS:

- a. According to our “exchange rate vs. quantity of dollars exchanged” model, the exchange rate moves up and down to balance the net demand for dollars for exports to the net capital outflow. When the exchange rate is fixed by non-economic forces such as the will of a government, the balancing role of the exchange rate is limited. When the fixed exchange rate is less than the equilibrium value (the home currency is undervalued), there is an excess demand for the domestic currency. Net exports exceed net capital outflow. Foreigners prefer to buy local currency at the official exchange offices for the official exchange rate, while home country’s citizens prefer to buy foreign currency in the black market where they can get better rates. Since net capital outflow is below its equilibrium level, home interest rates are lower than the world interest rates, and capital tends to move abroad.
- b. To prevent capital flight, the home government will have to impose restrictions on the movement of capital. If the imbalance persists, foreign countries may retaliate by restricting their imports.

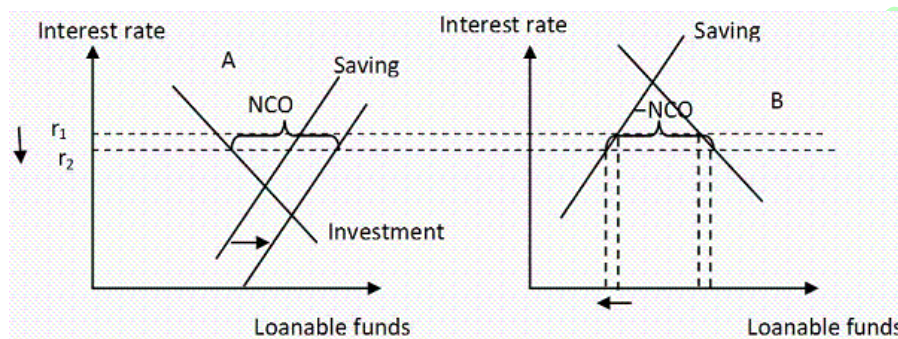
PTS: 1

NOT: Macro TB_13-181

3. Suppose that the world consists of only two countries, A and B, of relatively equal sizes. The world interest rate in such a model is some average of the autarkic (no trade) interest rates in each of the two countries.
 - a. Draw “parallel” loanable funds markets for the two countries and show the position of the world interest rate. (*Hint: What relationship must exist between the NCOs of the two countries?*)
 - b. Suppose country A enacts laws that induce people to save more. Show the effects of such laws on each country’s domestic amounts saved and invested.
 - c. In the currency-exchange diagrams for both countries, show the effect of country A’s savings policies on both countries’ exchange rates and net exports.

ANS:

- a. A country’s NCO must be equal to the negative of the other country’s NCO. This relationship determines the common (“world”) interest rate.



- b. When savings in country A increase, its NCO increases, which implies a decrease in country B’s NCO and a decrease in the world interest rate to balance the two NCOs. Investment and saving increase in A. Investment in B increases; saving in B decreases.
- c. The increase in NCO in A causes NX in A to increase and its real exchange rate to decrease. In country B, the opposite happens: lower net exports by the same amount as in A, and an appreciation of its real exchange rate that will have to match the depreciation of country A’s exchange rate.

PTS: 1

NOT: Macro TB_13-182

4. Using the macroeconomic model studied, analyze the impact of the following events on the Canadian economy.
- a voluntary export restraint (VER) by Japanese car producers
 - an export subsidy by Canadian government for Canadian lumber producers
 - an increase in U.S. GDP

ANS:

- This trade barrier is similar to an import quota. It shifts the NX curve up, increasing the exchange rate. NCO and net exports remain the same.
- The same as (a).
- This event may not be easily analyzed using our macroeconomic model, since we assumed that GDP was constant. An increase in a country's GDP increases proportionally all expenditures: consumption, investment, government spending, and net exports. Though net exports may increase, imports will likely increase as well. Thus, foreign demand for Canadian goods and services increases, which increases Canada's net exports. However, if U.S. savings increase more than U.S. domestic investment, world interest rates may fall, which negatively affects Canada's net exports and causes an appreciation of the Canadian dollar. Thus, our simple model cannot predict the full effects of this event.

PTS: 1

NOT: Macro TB_13-183

5. Suppose the Federal Reserve, which is the central bank in the United States, decided to lower the bank interest rate. Use the macroeconomic model studied in this chapter to analyze the possible effects of this event on Canada's net capital outflow, net exports, and exchange rate. (*Hint: Consider the United States a large economy, which is able to influence the world interest rate.*)

ANS:

Since the United States is a large economy, lower interest rates in the United States will lower the world interest rate. In our market for loanable funds model, a lower world interest rate will make Canadian net capital outflow decrease; hence, net exports will decrease. Corresponding to the lower NCO, Canadian exchange rate will appreciate.

PTS: 1

NOT: Macro TB_13-18

Chapter 14—Aggregate Demand and Aggregate Supply

MULTIPLE CHOICE

1. Which of the following explains why production rises in most years?
- increases in prices of goods and services
 - increases in stock prices
 - aging population
 - technological innovation

ANS: D PTS: 1 DIF: Easy REF: p.325
BLM: Remember NOT: Macro TB_14-1

2. On average over the past 130 years, at about what rate has the Canadian economy grown?
- 1 percent per year
 - 2 percent per year
 - 4 percent per year
 - 6 percent per year

ANS: B PTS: 1 DIF: Easy REF: p.325
BLM: Remember NOT: Macro TB_14-2

3. Which of the following terms refers to a short period of falling incomes and rising unemployment?
- depression
 - recession
 - expansion
 - business cycle

ANS: B PTS: 1 DIF: Easy REF: p.325
BLM: Remember NOT: Macro TB_14-3

4. Which of the following happens during recessions?
- Firms produce less but invest more.
 - Firms have to increase production because of falling prices.
 - Incomes increase because workers have to work overtime.
 - Many workers are laid off.

ANS: D PTS: 1 DIF: Easy REF: p.325
BLM: Remember NOT: Macro TB_14-4

5. Which of the following does the economy experience during a recession?
- rising employment and income
 - rising employment and falling income
 - rising income and falling employment
 - falling employment and income

ANS: D PTS: 1 DIF: Easy REF: p.325
BLM: Remember NOT: Macro TB_14-5

6. Which of the following best defines business cycles?
- a. long-term trends in economic activity
 - b. regular, predictable fluctuations in GDP
 - c. the rise and fall of multinational companies
 - d. fluctuations in the economy

ANS: D PTS: 1 DIF: Easy REF: p.325
BLM: Remember NOT: Macro TB_14-6

7. Which of the following characterizes business cycles?
- a. They are mainly fluctuations in consumption.
 - b. They are no longer very important due to government policy.
 - c. They are fluctuations in real GDP and related variables over time.
 - d. They are easily predicted by competent economists.

ANS: C PTS: 1 DIF: Easy REF: p.325
BLM: Remember NOT: Macro TB_14-7

8. What happens to sales and profit during recessions?
- a. sales and profits fall
 - b. sales and profits rise
 - c. sales rise and profits fall
 - d. profits fall and sales rise

ANS: A PTS: 1 DIF: Easy REF: p.325
BLM: Remember NOT: Macro TB_14-8

9. Which of the following expenditure items is responsible for the decrease in real GDP during a recession?
- a. mostly investment spending
 - b. mostly consumption spending
 - c. both consumption and investment spending, equally
 - d. sometimes mostly consumption and sometimes mostly investment

ANS: A PTS: 1 DIF: Easy REF: p.325
BLM: Remember NOT: Macro TB_14-9

10. Which of the following typically rises during a recession?
- a. garbage collection
 - b. unemployment
 - c. corporate profits
 - d. automobile sales

ANS: B PTS: 1 DIF: Easy REF: p.325
BLM: Remember NOT: Macro TB_14-10

11. Most economists use the aggregate demand and aggregate supply model primarily to analyze which of the following?
- a. short-run fluctuations in the economy
 - b. the effects of macroeconomic policy on the prices of individual goods
 - c. the long-run effects of international trade policies
 - d. productivity and economic growth

ANS: A PTS: 1 DIF: Easy REF: p.326
BLM: Remember NOT: Macro TB_14-11

12. Which of the following does real GDP measure?
- a. the dollar value of all goods
 - b. economic activity and income
 - c. primarily long-run trends
 - d. profitability of all companies in the economy

ANS: B PTS: 1 DIF: Average REF: p.326
BLM: Remember NOT: Macro TB_14-12

13. How does real GDP change over time?
- a. It moves in the same direction as unemployment
 - b. It moves in the same direction as inflation.
 - c. It has a long-term upward trend.
 - d. It is approximately constant because it is measured in constant dollars.

ANS: C PTS: 1 DIF: Easy REF: p.326
BLM: Remember NOT: Macro TB_14-13

14. In a recession, compared to the percentage decline in GDP, what happens to investment spending?
- a. Investment spending falls by a larger percentage than GDP.
 - b. Investment spending falls by about the same percentage as GDP.
 - c. Investment spending falls by a smaller percentage than GDP.
 - d. Investment spending falls, but the percentage change is sometimes much larger and sometimes much smaller.

ANS: A PTS: 1 DIF: Average REF: p.327
BLM: Remember NOT: Macro TB_14-14

15. Which of the following parts of real GDP fluctuates most over the course of the business cycle?
- a. consumption
 - b. government expenditures
 - c. investment
 - d. net exports

ANS: C PTS: 1 DIF: Easy REF: p.327
BLM: Remember NOT: Macro TB_14-15

16. In 1982, Canada was in recession. Which of the following things would you expect **NOT** to have happened?

- a. layoffs and firings
- b. a higher rate of bankruptcy
- c. increased claims for unemployment insurance
- d. increased investment spending

ANS: D PTS: 1 DIF: Easy REF: p.327
BLM: Higher Order NOT: Macro TB_14-16

17. How does the size of investment as a fraction of GDP compare to its importance in creating economic fluctuations?

- a. Investment is a small part of real GDP and it accounts for a small share of the fluctuation in real GDP.
- b. Investment is a small part of real GDP, yet it accounts for a large share of the fluctuation in real GDP.
- c. Investment is a large part of real GDP and it accounts for a large share of the fluctuation in real GDP.
- d. Investment is a large part of real GDP, yet it accounts for a small share of the fluctuation in real GDP.

ANS: B PTS: 1 DIF: Easy REF: p.327
BLM: Remember NOT: Macro TB_14-17

18. Below are pairs of GDP growth rates and unemployment rates. Economists would be shocked to see most of these pairs. Which of the following pairs of GDP growth rates and unemployment rates is most realistic?

- a. 6 percent, 0 percent
- b. 3 percent, 20 percent
- c. -1 percent, 6 percent
- d. -3 percent, 2 percent

ANS: C PTS: 1 DIF: Easy REF: p.326-328
BLM: Higher Order NOT: Macro TB_14-18

19. Which of the following best describes the beginning of a recession?

- a. Production and unemployment both rise.
- b. Production rises and unemployment falls.
- c. Production falls and unemployment rises.
- d. Production and unemployment both fall.

ANS: C PTS: 1 DIF: Easy REF: p.328-329
BLM: Remember NOT: Macro TB_14-19

20. Which of the following variables or policies can influence economic growth in the long run?

- a. an increase in capital stock
- b. an increase in money supply
- c. an increase in unemployment benefits
- d. a decrease in nominal interest rates

ANS: A PTS: 1 DIF: Average REF: p.329
BLM: Remember NOT: Macro TB_14-20

21. How controversial is the theory concerning long-run economic performance compared with short-run theories?
- a. It is less controversial than short-run theories.
 - b. It is equally controversial as short-run theories.
 - c. It is more controversial than short-run theories.
 - d. Neither the long-run theory nor the short-run theories are controversial.

ANS: A PTS: 1 DIF: Easy REF: p.329-330
BLM: Remember NOT: Macro TB_14-21

22. Which of the following best defines the classical dichotomy?
- a. It is the separation of variables that move with the business cycle and variables that do not.
 - b. It is the separation of changes in money and changes in government expenditures.
 - c. It is the separation of endogenous and exogenous variables.
 - d. It is the separation of real and nominal variables.

ANS: D PTS: 1 DIF: Easy REF: p.329
BLM: Remember NOT: Macro TB_14-22

23. According to classical economic theory, which of the following do changes in the money supply affect?
- a. nominal variables and real variables
 - b. nominal variables, but not real variables
 - c. real variables, but not nominal variables
 - d. neither nominal nor real variables

ANS: B PTS: 1 DIF: Easy REF: p.329-330
BLM: Remember NOT: Macro TB_14-23

24. According to classical economic theory, which of the following do changes in the money supply affect?
- a. real GDP
 - b. real interest rates
 - c. the price level
 - d. unemployment

ANS: C PTS: 1 DIF: Average REF: p.329-330
BLM: Remember NOT: Macro TB_14-24

25. Most economists believe that classical economic theory is a good description of the world over which of the following time periods?
- a. in neither the short nor long run
 - b. in the short run and in the long run
 - c. in the short run, but not in the long run
 - d. in the long run, but not in the short run

ANS: D PTS: 1 DIF: Easy REF: p.329-330
BLM: Remember NOT: Macro TB_14-25

26. In addition to the price level, which of the following does the aggregate demand and aggregate supply model focus on?
- a. real GDP
 - b. nominal GDP
 - c. the neutrality of money
 - d. stock prices

ANS: A PTS: 1 DIF: Easy REF: p.330
BLM: Remember NOT: Macro TB_14-26

27. Which of the following measures the overall price level?
- a. the price of some particular commodity or service
 - b. the rate of inflation
 - c. the consumer price index
 - d. the nominal GDP

ANS: C PTS: 1 DIF: Easy REF: p.330
BLM: Remember NOT: Macro TB_14-27

28. Which of the following relationships does the model of aggregate demand and aggregate supply explain?
- a. the relationship between the price and quantity of a particular good
 - b. the relationship between unemployment and output
 - c. the relationship between wages and employment
 - d. the relationship between real GDP and the price level

ANS: D PTS: 1 DIF: Easy REF: p.330-331
BLM: Remember NOT: Macro TB_14-28

29. What are the variables on the vertical and horizontal axes of the aggregate supply and demand curve?
- a. the price level and real output
 - b. real output and employment
 - c. employment and the inflation rate
 - d. the value of money and the price level

ANS: A PTS: 1 DIF: Easy REF: p.331
BLM: Remember NOT: Macro TB_14-29

30. Which of the following best describes the aggregate demand and aggregate supply model?
- a. Aggregate supply adjusts to satisfy aggregate demand at the prevailing market prices.
 - b. The price level adjusts to bring aggregate demand and supply into balance.
 - c. Aggregate demand adjusts to equate aggregate supply at the prevailing market prices.
 - d. Both aggregate demand and supply adjust to become equal at the prevailing market prices.

ANS: B PTS: 1 DIF: Easy REF: p.331
BLM: Remember NOT: Macro TB_14-30

31. Which of the following adjusts to bring aggregate supply and demand into balance?
- a. the price level
 - b. the real rate of interest
 - c. the money supply
 - d. technology

ANS: A PTS: 1 DIF: Easy REF: p.331
BLM: Remember NOT: Macro TB_14-31

32. Which of the following best explains the slope of the aggregate demand curve?
- a. The aggregate demand curve slopes downward for the same reasons that market demand curves slope downward.
 - b. The aggregate demand curve is vertical in the long run because people can only consume a certain maximum quantity.
 - c. The aggregate demand curve is downward sloping because it shows an inverse relation between the price level and the quantity of all goods and services demanded.
 - d. The aggregate demand curve is downward sloping because the more people wish to consume, the lower is the price.

ANS: C PTS: 1 DIF: Easy REF: p.331
BLM: Higher Order NOT: Macro TB_14-32

33. What does a fall in the economy's overall level of prices tend to do?
- a. It tends to raise both the quantity demanded and supplied of goods and services.
 - b. It tends to raise the quantity demanded of goods and services, but lower the quantity supplied.
 - c. It tends to lower the quantity demanded of goods and services, but raise the quantity supplied.
 - d. It tends to lower both the quantity demanded and the quantity supplied of goods and services.

ANS: B PTS: 1 DIF: Easy REF: p.331
BLM: Higher Order NOT: Macro TB_14-33

34. What does a rise in the economy's overall level of prices tend to do?
- a. It tends to raise both the quantity demanded and supplied of goods and services.
 - b. It tends to raise the quantity demanded of goods and services, but lower the quantity supplied.
 - c. It tends to lower the quantity demanded of goods and services, but raise the quantity supplied.
 - d. It tends to lower both the quantity demanded and the quantity supplied of goods and services.

ANS: C PTS: 1 DIF: Easy REF: p.331
BLM: Higher Order NOT: Macro TB_14-34

35. Which of the following is included in the aggregate demand for goods and services?
- a. intermediate goods
 - b. income taxes
 - c. net exports
 - d. government deficit

ANS: D PTS: 1 DIF: Easy REF: p.332
BLM: Remember NOT: Macro TB_14-35

36. Which of the following is **NOT** included in aggregate demand?
- a. purchases of stock and bonds
 - b. purchases of services such as visits to the doctor
 - c. purchases of capital goods such as equipment in a factory
 - d. purchases by foreigners of consumer goods produced in Canada

ANS: A PTS: 1 DIF: Easy REF: p.331
BLM: Higher Order NOT: Macro TB_14-36

37. How is the effect of an increase in the price level represented?
- a. by a shift to the right of the aggregate demand curve
 - b. by a shift to the left of the aggregate demand curve
 - c. by a movement to the left along a given aggregate demand curve
 - d. by a movement to the right along a given aggregate demand curve

ANS: C PTS: 1 DIF: Easy REF: p.332-334
BLM: Remember NOT: Macro TB_14-37

38. Which of the following does the downward slope of the aggregate demand curve show?
- a. that an increase in the money supply causes the aggregate quantity of goods and services demanded to increase
 - b. that an increase in the money supply causes the aggregate quantity of goods and services demanded to decrease
 - c. that an increase in the price level causes the aggregate quantity of goods and services demanded to increase
 - d. that an increase in the price level causes the aggregate quantity of goods and services demanded to decrease

ANS: D PTS: 1 DIF: Easy REF: p.332-334
BLM: Remember NOT: Macro TB_14-38

39. All else equal, which of the following happens as the price level falls?
- a. the money supply falls
 - b. interest rate rise
 - c. dollars become more valuable
 - d. dollars become less valuable

ANS: C PTS: 1 DIF: Average REF: p.332-334
BLM: Higher Order NOT: Macro TB_14-40

40. Which of the following is consistent with an increase in the price level?

- a. Dollars become more valuable, and interest rates rise.
- b. Dollars become more valuable, and interest rates fall.
- c. Dollars become less valuable, and interest rates rise.
- d. Dollars become less valuable, and interest rates fall.

ANS: C PTS: 1 DIF: Average REF: p.332-334
BLM: Higher Order NOT: Macro TB_14-40

41. Which of the following best describes the effects of a fall in the price level?

- a. Dollars become more valuable, and interest rates rise.
- b. Dollars become more valuable, and interest rates fall.
- c. Dollars become less valuable, and interest rates rise.
- d. Dollars become less valuable, and interest rates fall.

ANS: B PTS: 1 DIF: Average REF: p.332-334
BLM: Higher Order NOT: Macro TB_14-41

42. Which of the following best describes the effects of a fall in the price level?

- a. The real exchange rate and interest rates rise.
- b. The real exchange rate and interest rates fall.
- c. The real exchange rate falls, and interest rates rise.
- d. The real exchange rate rises, and interest rates fall.

ANS: B PTS: 1 DIF: Average REF: p.333
BLM: Higher Order NOT: Macro TB_14-42

43. Which of the following best describes the effects of an increase in the price level?

- a. Real exchange rates and interest rates rise.
- b. Real exchange rates and interest rates fall.
- c. Real exchange rates fall, and interest rates rise.
- d. Real exchange rates rise, and interest rates fall.

ANS: A PTS: 1 DIF: Average REF: p.333
BLM: Higher Order NOT: Macro TB_14-43

44. Which of the following best describes the effects of a fall in the price level?

- a. The real value of money and the real exchange rate rise.
- b. The real value of money and the real exchange rate fall.
- c. The real value of money rises, and the real exchange rate falls.
- d. The real value of money falls, and the real exchange rate rises.

ANS: D PTS: 1 DIF: Average REF: p.333
BLM: Higher Order NOT: Macro TB_14-44

45. An increase in the price level makes consumers feel less wealthy. How is this situation represented?

- a. Aggregate demand shifts right.
- b. Aggregate demand shifts left.
- c. There is a movement to right along a given aggregate demand curve.
- d. There is a movement to the left along a given aggregate demand curve.

ANS: D PTS: 1 DIF: Easy REF: p.333
BLM: Higher Order NOT: Macro TB_14-45

46. Which of the following best describes the effects of a fall in the price level?
- a. Dollars are worth more, so people spend more.
 - b. Dollars are worth more, so people spend less.
 - c. Dollars are worth less, so people spend more.
 - d. Dollars are worth less, so people spend less.

ANS: A PTS: 1 DIF: Easy REF: p.333
BLM: Higher Order NOT: Macro TB_14-46

47. Which of the following best describes the effects of an increase in the price level?
- a. Dollars are worth more, so people spend more.
 - b. Dollars are worth more, so people spend less.
 - c. Dollars are worth less, so people spend more.
 - d. Dollars are worth less, so people spend less.

ANS: D PTS: 1 DIF: Easy REF: p.333
BLM: Higher Order NOT: Macro TB_14-47

48. Which of the following best explains an increase in consumer spending?
- a. People spend more when the price level rises, because the dollars they hold worth more.
 - b. People spend more when the price level rises, because the dollars they hold worth less.
 - c. People spend more when the price level falls, because the dollars they hold worth more.
 - d. People spend more when the price level falls, because the dollars they hold worth less.

ANS: C PTS: 1 DIF: Easy REF: p.333
BLM: Higher Order NOT: Macro TB_14-48

49. In which of the following situations are people most likely to spend more?
- a. when their real wealth and interest rates rise
 - b. when their real wealth rises and interest rates fall
 - c. when their real wealth falls and interest rates rise
 - d. when their real wealth and interest rates fall

ANS: B PTS: 1 DIF: Easy REF: p.333
BLM: Higher Order NOT: Macro TB_14-49

50. What happens when the price level rises?
- a. The value of money rises, and exchange rates and interest rates also rise.
 - b. The value of money rises, while exchange rates and interest rates fall.
 - c. The value of money falls, while exchange rates and interest rates rise.
 - d. The value of money falls, and exchange rates and interest rates also fall.

ANS: C PTS: 1 DIF: Average REF: p.333
BLM: Higher Order NOT: Macro TB_14-50

51. Which of the following best describes what happens when the price level falls?
- a. Households increase foreign bond purchases, and the supply of dollars increases.
 - b. Households increase foreign bond purchases, and the supply of dollars decreases.
 - c. Households decrease foreign bond purchases, and the supply of dollars increases.
 - d. Households decrease foreign bond purchases, and the supply of dollars decreases.

ANS: A PTS: 1 DIF: Challenging REF: p.333
BLM: Higher Order NOT: Macro TB_14-51

52. Which of the following best describes what happens when the price level rises?
- a. Households increase foreign bond purchases, and the supply of dollars increases.
 - b. Households increase foreign bond purchases, and the supply of dollars decreases.
 - c. Households decrease foreign bond purchases, and the supply of dollars increases.
 - d. Households decrease foreign bond purchases, and the supply of dollars decreases.

ANS: D PTS: 1 DIF: Challenging REF: p.333
BLM: Higher Order NOT: Macro TB_14-52

53. In the aggregate demand and aggregate supply model, when does the aggregate quantity of goods demanded increase?
- a. when real wealth falls
 - b. when the interest rate rises
 - c. when the dollar depreciates
 - d. when stock prices decrease

ANS: C PTS: 1 DIF: Average REF: p.333
BLM: Higher Order NOT: Macro TB_14-53

54. In the aggregate demand and aggregate supply model, when does the aggregate quantity of goods demanded increase?
- a. when real wealth rises
 - b. when the interest rate rises
 - c. when the dollar appreciates
 - d. when the expected price level rises

ANS: A PTS: 1 DIF: Easy REF: p.333
BLM: Higher Order NOT: Macro TB_14-54

55. In the aggregate demand and aggregate supply model, when does the aggregate quantity of goods demanded decrease?
- a. when real wealth increases
 - b. when the interest rate falls
 - c. when the dollar depreciates
 - d. when stock prices fall

ANS: D PTS: 1 DIF: Average REF: p.333
BLM: Higher Order NOT: Macro TB_14-55

56. What are the effects of a decrease in the price level?
- a. People hold less money, so they lend less, and the interest rate rises.
 - b. People hold less money, so they lend more, and the interest rate falls.
 - c. People hold more money, so they lend more, and the interest rate rises.
 - d. People hold more money, so they lend less, and the interest rate falls.

ANS: B PTS: 1 DIF: Average REF: p.332-333
BLM: Higher Order NOT: Macro TB_14-56

57. What are the effects of an increase in the price level?

- a. People hold less money, so they lend less, and the interest rate rises.
- b. People hold less money, so they lend more, and the interest rate falls.
- c. People hold more money, so they lend more, and the interest rate falls.
- d. People hold more money, so they lend less, and the interest rate rises.

ANS: D PTS: 1 DIF: Average REF: p.332
BLM: Higher Order NOT: Macro TB_14-57

58. What happens when the price level rises?

- a. Interest rates rise, so firms increase investment.
- b. Interest rates rise, so firms decrease investment.
- c. Interest rates fall, so firms increase investment.
- d. Interest rates fall, so firms decrease investment.

ANS: B PTS: 1 DIF: Average REF: p.332
BLM: Higher Order NOT: Macro TB_14-58

59. What happens when the price level rises?

- a. Interest rates rise, so firms increase investment.
- b. Interest rates rise, so firms decrease investment.
- c. Interest rates fall, so firms increase investment.
- d. Interest rates fall, so firms decrease investment.

ANS: C PTS: 1 DIF: Average REF: p.332
BLM: Higher Order NOT: Macro TB_14-59

60. In which of the following situations does investment spending increase?

- a. when the price level rises, causing interest rates to rise
- b. when the price level rises, causing interest rates to fall
- c. when the price level falls, causing interest rates to rise
- d. when the price level falls, causing interest rates to fall

ANS: D PTS: 1 DIF: Average REF: p.332
BLM: Higher Order NOT: Macro TB_14-60

61. In which of the following situations does investment spending decrease?

- a. when the price level rises, causing interest rates to rise
- b. when the price level rises, causing interest rates to fall
- c. when the price level falls, causing interest rates to rise
- d. when the price level falls, causing interest rates to fall

ANS: A PTS: 1 DIF: Average REF: p.332
BLM: Higher Order NOT: Macro TB_14-61

62. What are the effects of a decrease in the price level?

- a. Wealth falls, people lend less, interest rates fall, and the dollar appreciates.
- b. Wealth falls, people lend less, interest rates rise, and the dollar depreciates.
- c. Wealth rises, people lend more, interest rates rise, and the dollar appreciates.
- d. Wealth rises, people lend more, interest rates fall, and the dollar depreciates.

ANS: D PTS: 1 DIF: Average REF: p.331
BLM: Higher Order NOT: Macro TB_14-62

63. What are the effects of a decrease in the price level?
- a. The real interest rate increases, the dollar appreciates, and net exports increase.
 - b. The real interest rate increases, the dollar depreciates, and net exports decrease.
 - c. The real interest rate decreases, the dollar depreciates, and net exports increase.
 - d. The real interest rate decreases, the dollar appreciates, and net exports decrease.

ANS: C PTS: 1 DIF: Average REF: p.333
BLM: Higher Order NOT: Macro TB_14-63

64. What are the effects of an increase in the price level?
- a. The interest rate increases, the dollar depreciates, and net exports increase.
 - b. The interest rate increases, the dollar appreciates, and net exports decrease.
 - c. The interest rate decreases, the dollar depreciates, and net exports increase.
 - d. The interest rate decreases, the dollar appreciates, and net exports decrease.

ANS: B PTS: 1 DIF: Average REF: p.333
BLM: Higher Order NOT: Macro TB_14-64

65. What happens when the dollar depreciates?
- a. Canadian exports and imports increase.
 - b. Canadian exports increase, while imports decrease.
 - c. Canadian exports decrease, while imports increase.
 - d. Canadian exports and imports decrease.

ANS: B PTS: 1 DIF: Average REF: p.333
BLM: Higher Order NOT: Macro TB_14-65

66. What happens when the dollar appreciates?
- a. Canadian exports decrease, while imports increase.
 - b. Canadian exports and imports decrease.
 - c. Canadian exports and imports increase.
 - d. Canadian exports increase, while imports decrease.

ANS: A PTS: 1 DIF: Average REF: p.333
BLM: Higher Order NOT: Macro TB_14-66

67. What are the implications of a depreciation of the dollar?
- a. The dollar buys more foreign currency, and so it buys more foreign goods.
 - b. The dollar buys more foreign currency, and so it buys fewer foreign goods.
 - c. The dollar buys less foreign currency, and so it buys more foreign goods.
 - d. The dollar buys less foreign currency, and so it buys fewer foreign goods.

ANS: D PTS: 1 DIF: Average REF: p.333
BLM: Higher Order NOT: Macro TB_14-67

68. What are the effects of a decrease in Canadian interest rates?
- a. a depreciation of the dollar and greater net exports
 - b. a depreciation of the dollar and smaller net exports
 - c. an appreciation of the dollar and greater net exports
 - d. an appreciation of the dollar and smaller net exports

ANS: A PTS: 1 DIF: Average REF: p.333
BLM: Higher Order NOT: Macro TB_14-68

69. What does an increase in the interest rate cause?

- a. It causes investment to rise and the exchange rate to appreciate.
- b. It causes investment to fall and the exchange rate to depreciate.
- c. It causes investment to rise and the exchange rate to depreciate.
- d. It causes investment to fall and the exchange rate to appreciate.

ANS: D PTS: 1 DIF: Challenging REF: p.333
BLM: Higher Order NOT: Macro TB_14-69

70. Which of the following best characterizes the aggregate demand curve?

- a. It slopes downward because higher prices cause the exchange rate to depreciate.
- b. It slopes downward because higher prices cause real wealth to decrease and interest rates to increase.
- c. It slopes upward because higher prices cause people to increase their production.
- d. It slopes upward because higher prices cause real wealth to increase and interest rates to decrease.

ANS: B PTS: 1 DIF: Average REF: p.333
BLM: Higher Order NOT: Macro TB_14-70

71. Which of the following explains the downward slope of the aggregate demand curve?

- a. As the Canadian price level increases, the dollar depreciates and people buy more imports.
- b. As the Canadian price level increases, the interest rate falls and firms invest less.
- c. As the Canadian price level increases, people feel less wealthy and buy less goods and services.
- d. As the Canadian price level increases, people buy more substitute goods.

ANS: C PTS: 1 DIF: Easy REF: p.333
BLM: Higher Order NOT: Macro TB_14-71

72. Why does a decrease in the price level induce an increase in the aggregate quantity of goods and services demanded?

- a. because as wealth falls, interest rates rise, and the dollar appreciates
- b. because as wealth falls, interest rates rise, and the dollar depreciates
- c. because as wealth rises, interest rates rise, and the dollar appreciates
- d. because as wealth rises, interest rates fall, and the dollar depreciates

ANS: D PTS: 1 DIF: Average REF: p.333-334
BLM: Higher Order NOT: Macro TB_14-72

73. Why does an increase in the price level cause a decrease in the aggregate quantity of goods and services demanded?

- a. because as wealth rises, interest rates rise, and the dollar appreciates
- b. because as wealth rises, interest rates fall, and the dollar depreciates
- c. because as wealth falls, interest rates rise, and the dollar appreciates
- d. because as wealth falls, interest rates fall, and the dollar depreciates

ANS: C PTS: 1 DIF: Average REF: p.333-334
BLM: Higher Order NOT: Macro TB_14-73

74. Changes in the price level affect which of the following components of aggregate demand?
- a. only consumption and investment
 - b. only consumption and net exports
 - c. only consumption
 - d. consumption, investment, and net exports

ANS: D PTS: 1 DIF: Average REF: p.333-334
BLM: Remember NOT: Macro TB_14-74

75. Suppose a stock market boom makes people feel wealthier. What are the effects of this increase in wealth?
- a. increased consumption, which shifts the aggregate demand curve right
 - b. increased consumption, which shifts the aggregate demand curve left
 - c. decreased consumption, which shifts the aggregate demand curve right
 - d. decreased consumption, which shifts the aggregate demand curve left

ANS: A PTS: 1 DIF: Easy REF: p.333-334
BLM: Higher Order NOT: Macro TB_14-75

76. Suppose a fall in stock prices makes people feel poorer. What are the effects of this decrease in wealth?
- a. a decrease in consumption, shown as a movement to the left along a given aggregate demand curve
 - b. an increase in consumption, shown as a movement to the right along a given aggregate demand curve
 - c. a decrease in consumption, which shifts the aggregate demand curve to the left
 - d. an increase in consumption, which shifts the aggregate demand curve to the right

ANS: C PTS: 1 DIF: Average REF: p.335-336
BLM: Higher Order NOT: Macro TB_14-76

77. Suppose a stock market crash makes people feel poorer. What are the effects of this decrease in wealth?
- a. a decrease in consumption, which shifts aggregate supply left
 - b. a decrease in consumption, which shifts aggregate demand left
 - c. a increase in consumption, which shifts aggregate supply right
 - d. a increase in consumption, which shifts aggregate demand right

ANS: B PTS: 1 DIF: Average REF: p.334-336
BLM: Higher Order NOT: Macro TB_14-77

78. When taxes decrease, consumption increases. How is this situation represented in the aggregate demand and aggregate supply model?
- a. by a movement to the right along a given aggregate demand curve
 - b. by shifting aggregate demand to the right
 - c. by shifting aggregate supply to the right
 - d. by a movement to the left along the aggregate demand curve

ANS: B PTS: 1 DIF: Average REF: p.334-336
BLM: Higher Order NOT: Macro TB_14-78

79. When taxes increase, consumption decreases. How is this situation represented in the aggregate demand and aggregate supply model?
- by a movement to the left along a given aggregate demand curve
 - by shifting aggregate demand to the left
 - by shifting aggregate supply the left
 - by a movement to the right along the aggregate demand curve

ANS: B PTS: 1 DIF: Average REF: p.334-336
BLM: Higher Order NOT: Macro TB_14-79

80. How does the aggregate demand and supply model reflect a decrease in taxes?
- Consumption increases, so aggregate demand shifts right.
 - Consumption increases, so aggregate supply shifts right.
 - Consumption decreases, so aggregate demand shifts left.
 - Consumption decreases, so aggregate supply shifts left.

ANS: A PTS: 1 DIF: Average REF: p.334-336
BLM: Higher Order NOT: Macro TB_14-80

81. What is the effect of a change in taxes on aggregate demand?
- Aggregate demand would shift right if taxes increased.
 - Aggregate demand would shift right if taxes decreased.
 - Aggregate demand would shift left if taxes increased.
 - Aggregate demand would shift left if taxes decreased.

ANS: C PTS: 1 DIF: Average REF: p.334-336
BLM: Higher Order NOT: Macro TB_14-81

82. Which of the following shifts aggregate demand to the right?
- a decrease in the money supply
 - a decrease in net exports at every exchange rate
 - an investment tax
 - a decrease in taxes

ANS: D PTS: 1 DIF: Easy REF: p.334-336
BLM: Higher Order NOT: Macro TB_14-82

83. Which of the following shifts aggregate demand to the right?
- a decrease in the money supply
 - technological progress that increases the profitability of capital goods
 - the repeal of an investment tax credit
 - a decrease in the price level

ANS: B PTS: 1 DIF: Average REF: p.334-336
BLM: Higher Order NOT: Macro TB_14-83

84. Which of the following shifts aggregate demand to the left?

- a. an increase in the price level
- b. a decrease in the money supply
- c. an increase in net exports
- d. an investment tax credit

ANS: B PTS: 1

DIF: Average REF: p.334-336

BLM: Higher Order

NOT: Macro TB_14-84

85. Which of the following shifts aggregate demand to the right?

- a. Federal government reduces purchases of new weapons.
- b. The Bank of Canada buys bonds in the open market.
- c. The price level falls.
- d. Net exports fall.

ANS: B PTS: 1

DIF: Average REF: p.334-336

BLM: Higher Order

NOT: Macro TB_14-85

86. Which of the following shifts aggregate demand to the left?

- a. The price level rises.
- b. The price level falls.
- c. The dollar depreciates.
- d. Stock prices fall.

ANS: D PTS: 1

DIF: Average REF: p.334-336

BLM: Higher Order

NOT: Macro TB_14-86

87. When the government spends more, what is the initial effect?

- a. Aggregate demand shifts right.
- b. Aggregate demand shifts left.
- c. Aggregate supply shifts right.
- d. Aggregate supply shifts left.

ANS: A PTS: 1

DIF: Easy REF: p.334-336

BLM: Higher Order

NOT: Macro TB_14-87

88. Which of the following government actions will shift the aggregate demand left?

- a. a decrease in taxes
- b. cuts in military expenditures
- c. signing a free trade agreement
- d. repealing an import tariff

ANS: B PTS: 1

DIF: Easy REF: p.334-336

BLM: Higher Order

NOT: Macro TB_14-88

89. Which of the following government actions will shift the aggregate demand right?
- a. a rise in personal income taxes
 - b. an increase in the money supply
 - c. a repeal of an investment tax credit
 - d. closing up a military facility to reduce costs

ANS: B PTS: 1 DIF: Average REF: p.334-336
BLM: Higher Order NOT: Macro TB_14-89

90. Which of the following situations would induce a shift of the aggregate demand to the right?
- a. The price level and government expenditures decreased.
 - b. The price level decreased, and the government instituted an investment tax credit.
 - c. Government expenditures and the money supply increased.
 - d. The bank rate increased, and the dollar appreciated.

ANS: C PTS: 1 DIF: Average REF: p.334-336
BLM: Higher Order NOT: Macro TB_14-90

91. Which of the following would happen to Canadian net exports and aggregate demand if countries that imported from Canada went into recession?
- a. Net exports would rise, and aggregate demand would shift right.
 - b. Net exports would rise, and aggregate demand would shift left.
 - c. Net exports would fall, and aggregate demand would shift right.
 - d. Net exports would fall, and aggregate demand would shift left.

ANS: D PTS: 1 DIF: Average REF: p.334-336
BLM: Higher Order NOT: Macro TB_14-91

92. Which of the following happens to aggregate demand if people want to save more for retirement and the government raises taxes?
- a. Aggregate demand shifts right.
 - b. Aggregate demand shifts left.
 - c. If people save more, aggregate demand shifts right; if the government raises taxes, aggregate demand shifts left.
 - d. If people save more, aggregate demand shifts left; if the government raises taxes, aggregate demand shifts right.

ANS: B PTS: 1 DIF: Average REF: p.334-336
BLM: Higher Order NOT: Macro TB_14-92

93. At the end of World War II, many European countries were rebuilding and so were eager to buy capital goods and had rising incomes. Where would we expect that the rebuilding increased aggregate demand?
- a. in both Canada and Europe
 - b. in Canada, but not in Europe
 - c. in Europe, but not in Canada
 - d. in neither Canada nor Europe

ANS: A PTS: 1 DIF: Average REF: p.334-336
BLM: Higher Order NOT: Macro TB_14-93

94. What happens when the dollar appreciates?

- a. Net exports increase, and aggregate demand shifts right.
- b. Net exports increase, and aggregate demand shifts left.
- c. Net exports decrease, and aggregate demand shifts right.
- d. Net exports decrease, and aggregate demand shifts left.

ANS: D

PTS: 1

DIF: Average

REF: p.334-336

BLM: Higher Order

NOT: Macro TB_14-94

95. How does Canadian aggregate demand change if the dollar appreciates or other countries experience recessions?

- a. Aggregate demand shifts right.
- b. Aggregate demand shifts left.
- c. If the dollar appreciates, aggregate demand shifts right; if other countries experience recessions aggregate demand shifts left.
- d. If the dollar appreciates, aggregate demand shifts left; if other countries experience recessions aggregate demand shifts right.

ANS: B

PTS: 1

DIF: Average

REF: p.334-336

BLM: Higher Order

NOT: Macro TB_14-95

96. An increase in which of the following (assuming the increase was not due to a price level change) shifts aggregate demand to the right?

- a. interest rates
- b. taxes
- c. government surplus
- d. net exports

ANS: D

PTS: 1

DIF: Easy

REF: p.334-336

BLM: Higher Order

NOT: Macro TB_14-96

97. When is the aggregate supply curve vertical?

- a. in the short and the long run
- b. in neither the short run nor the long run
- c. in the long run, but not in the short run
- d. in the short run, but not in the long run

ANS: C

PTS: 1

DIF: Easy

REF: p.337

BLM: Remember

NOT: Macro TB_14-97

98. When is the aggregate supply curve upward sloping rather than vertical?

- a. in the short and the long run
- b. in neither the short run nor long run
- c. in the long run, but not in the short run
- d. in the short run, but not in the long run

ANS: D

PTS: 1

DIF: Easy

REF: p.337

BLM: Remember

NOT: Macro TB_14-98

99. Which of the following does **NOT** determine the long-run level of real GDP?
- a. the price level
 - b. the supply of labour
 - c. available natural resources
 - d. available technology

ANS: A PTS: 1 DIF: Easy REF: p.337
BLM: Remember NOT: Macro TB_14-99

100. Which of the following characterizes the long-run aggregate supply curve?
- a. It is horizontal.
 - b. It shows a positive relationship between price level and output.
 - c. It demonstrates the importance of money in the economy.
 - d. It shows that money does not influence real GDP in the long run.

ANS: D PTS: 1 DIF: Easy REF: p.337
BLM: Remember NOT: Macro TB_14-100

101. Which of the following characterizes the long-run aggregate supply curve?
- a. It is determined by the things that determine output in the classical model.
 - b. It is located at the point where unemployment is zero.
 - c. It shifts to the right when the price level increases.
 - d. It is positioned at the point where the economy would cease to grow.

ANS: A PTS: 1 DIF: Easy REF: p.337
BLM: Remember NOT: Macro TB_14-101

102. When would the long-run aggregate supply curve shift right?
- a. When immigration increases or the government makes a substantial increase in the minimum wage.
 - b. When immigration decreases or the government abolishes the minimum wage.
 - c. When immigration increases or the government abolishes the minimum wage.
 - d. When immigration decreases or the government makes a substantial increase in the minimum wage.

ANS: C PTS: 1 DIF: Easy REF: p.338-339
BLM: Higher Order NOT: Macro TB_14-102

103. In which of the following situations would the long-run aggregate supply curve shift right?
- a. if immigration from abroad decreases
 - b. if the capital stock decreases
 - c. if the money supply increases
 - d. if technology advances

ANS: D PTS: 1 DIF: Easy REF: p.338-339
BLM: Remember NOT: Macro TB_14-103

104. In which of the following situations would the long-run aggregate supply curve shift left?
- a. if the capital stock increases
 - b. if there is a hurricane
 - c. if the government removes some environmental regulations that limit production methods
 - d. if trade barriers are removed

ANS: B PTS: 1 DIF: Easy REF: p.338-339
BLM: Higher Order NOT: Macro TB_14-104

105. In which of the following situations would the long-run aggregate supply curve shift right?
- a. if the government were to increase the minimum-wage law
 - b. if the government were to make unemployment benefits more generous
 - c. if the government were to raise taxes on investment spending
 - d. if immigration were to increase

ANS: D PTS: 1 DIF: Average REF: p.338-339
BLM: Higher Order NOT: Macro TB_14-105

106. In which of the following situations would the long-run aggregate supply curve shift right?
- a. if technology improves
 - b. if the price level decreases
 - c. if the price of oil increases
 - d. if the money supply increases

ANS: A PTS: 1 DIF: Average REF: p.338-339
BLM: Higher Order NOT: Macro TB_14-106

107. What is the effect of technological progress and increases in the money supply on prices in the long run?
- a. Both make the price level rise.
 - b. Both make the price level fall.
 - c. Technological progress makes the price level rise, while increases in the money supply make prices fall.
 - d. Technological progress makes the price level fall, while increases in the money supply make prices rise.

ANS: D PTS: 1 DIF: Average REF: p.340-341
BLM: Higher Order NOT: Macro TB_14-107

108. What happens to prices and output when the long-run aggregate supply curve shifts right?
- a. Prices and output both increase.
 - b. Prices and output both decrease.
 - c. Prices increase and output decreases.
 - d. Prices decrease and output increases.

ANS: D PTS: 1 DIF: Average REF: p.340-341
BLM: Higher Order NOT: Macro TB_14-108

109. What happens to prices and output when the long-run aggregate supply curve shifts left?
- Prices and output both increase.
 - Prices and output both decrease.
 - Prices increase and output decreases.
 - Prices decrease and output increases.

ANS: C PTS: 1 DIF: Average REF: p.340-341
BLM: Higher Order NOT: Macro TB_14-109

110. According to the aggregate demand and aggregate supply model, in the long run what is the impact of an increase in the money supply?
- It leads to increased price level and real GDP.
 - It leads to increased GDP, but there is no change in the price level.
 - It leads to increased price level, but there is no change in real GDP.
 - It does not cause a change in either the price level or real GDP.

ANS: C PTS: 1 DIF: Average REF: p.340-341
BLM: Higher Order NOT: Macro TB_14-110

111. Which of the following would make the price level decrease and real GDP increase?
- Long-run aggregate supply shifts right.
 - Long-run aggregate supply shifts left.
 - Aggregate demand shifts right.
 - Aggregate demand shifts left.

ANS: A PTS: 1 DIF: Average REF: p.340-341
BLM: Higher Order NOT: Macro TB_14-111

112. According to the misperceptions theory of the short-run aggregate supply curve, if the price level increases more than people expect, how do firms change their behaviour?
- They believe that the relative price has decreased, so they increase production.
 - They believe that the relative price has decreased, so they decrease production.
 - They believe that the relative price has increased, so they increase production.
 - They believe that the relative price has increased, so they decrease production.

ANS: C PTS: 1 DIF: Average REF: p.343-344
BLM: Remember NOT: Macro TB_14-112

113. According to misperceptions theory, if a firm thought that inflation was going to be 5 percent and actual inflation was 6 percent, how the firm may be affected?
- It may believe that the relative price has increased, so it would increase production.
 - It may believe that the relative price has increased, so it would decrease production.
 - It may believe that the relative price has decreased, so it would increase production.
 - It may believe that the relative price has increased, so it would decrease production.

ANS: A PTS: 1 DIF: Average REF: p.343-344
BLM: Higher Order NOT: Macro TB_14-113

114. Which of the following is consistent with an increase in the quantity of output supplied, according to the misperceptions theory?
- a. The price level increases less than expected so that firms believe the relative price of their output has increased.
 - b. The price level increases less than expected so that firms believe the relative price of their output has decreased.
 - c. The price level increases more than expected so that firms believe the relative price of their output has increased.
 - d. The price level increases more than expected so that firms believe the relative price of their output has decreased.

ANS: C PTS: 1 DIF: Average REF: p.343-344
BLM: Remember NOT: Macro TB_14-114

115. According to the sticky wage theory, which of the following is consistent with an unexpected increase in the price level?
- a. The real wage rises, and employment rises.
 - b. The real wage rises, and employment falls.
 - c. The real wage falls, and employment rises.
 - d. The real wage falls, and employment falls.

ANS: C PTS: 1 DIF: Average REF: p.342-343
BLM: Remember NOT: Macro TB_14-115

116. According to the sticky wage theory, which of the following is consistent with an unexpected fall in the price level?
- a. The real wage rises and employment rises.
 - b. The real wage rises and employment falls.
 - c. The real wage falls and employment rises.
 - d. The real wage falls and employment falls.

ANS: B PTS: 1 DIF: Average REF: p.342-343
BLM: Remember NOT: Macro TB_14-116

117. According to the sticky wage theory, which of the following is consistent with a more-than-expected increase in the price level?
- a. Real wages rise, so firms will hire more workers.
 - b. Real wages rise, so firms will hire fewer workers.
 - c. Real wages fall, so firms will hire more workers.
 - d. Real wages fall, so firms will hire fewer workers.

ANS: C PTS: 1 DIF: Average REF: p.342-343
BLM: Higher Order NOT: Macro TB_14-117

118. According to the sticky price theory, which of the following is consistent with a more-than-expected rise in the price level?
- a. Some firms' prices are higher than desired, which increases their sales.
 - b. Some firms' prices are higher than desired, which depresses their sales.
 - c. Some firms' prices are lower than desired, which increases their sales.
 - d. Some firms' prices are lower than desired, which depresses their sales.

ANS: C PTS: 1 DIF: Average REF: p.343
BLM: Higher Order NOT: Macro TB_14-118

119. According to the sticky price theory, which of the following is consistent with an unexpected fall in the price level?
- a. Some firms' prices are lower than desired, which increases their sales.
 - b. Some firms' prices are lower than desired, which depresses their sales.
 - c. Some firms' prices are higher than desired, which increases their sales.
 - d. Some firms' prices are higher than desired, which depresses their sales.

ANS: D PTS: 1 DIF: Average REF: p.343
BLM: Higher Order NOT: Macro TB_14-119

120. Assuming that a is positive, how are theories of short-run aggregate supply expressed mathematically?
- a. quantity of output supplied = natural rate of output + a (actual price level – expected price level)
 - b. quantity of output supplied = natural rate of output + a (expected price level – actual price level)
 - c. quantity of output supplied = a (actual price level – expected price level) – natural rate of output
 - d. quantity of output supplied = a (expected price level – actual price level) – natural rate of output

ANS: A PTS: 1 DIF: Average REF: p.344
BLM: Remember NOT: Macro TB_14-120

121. Consider the following equation, where a is a positive number: quantity of output supplied = natural rate of output + a (actual price level – expected price level). What does this equation represent?
- a. an upward-sloping short-run aggregate supply curve
 - b. a vertical long-run supply curve
 - c. a downward-sloping aggregate demand curve
 - d. an upward-sloping aggregate demand curve

ANS: A PTS: 1 DIF: Average REF: p.344
BLM: Remember NOT: Macro TB_14-121

122. How are the effects of an increase in the price level that is greater than expected shown in the aggregate demand and aggregate supply model?
- a. by shifting the short-run aggregate supply curve right
 - b. by shifting the short-run aggregate supply curve left
 - c. by moving to the right along a given aggregate supply curve
 - d. by moving to the left along a given aggregate supply curve

ANS: C PTS: 1 DIF: Average REF: p.344
BLM: Higher Order NOT: Macro TB_14-122

123. Which of the following is consistent with the theory of aggregate supply?
- a. An increase in the expected price level shifts the short-run aggregate supply curve to the right, and an increase in the actual price level shifts the short-run aggregate supply to the right.
 - b. An increase in the expected price level shifts the short-run aggregate supply curve to the right, and an increase in the actual price level does not shift the short-run aggregate supply.
 - c. An increase in the expected price level shifts the short-run aggregate supply curve to the left, and an increase in the actual price level shifts the short-run aggregate supply to the left.
 - d. An increase in the expected price level shifts the short-run aggregate supply curve to the left, and an increase in the actual price level does not shift the short-run aggregate supply.

ANS: D PTS: 1 DIF: Challenging REF: p.344
BLM: Higher Order NOT: Macro TB_14-123

124. Which of the following shifts both the short-run and the long-run aggregate supply right?
- a. an increase in the actual price level
 - b. an increase in the expected price level
 - c. an increase in the capital stock
 - d. an increase in money supply

ANS: C PTS: 1 DIF: Average REF: p.342-346
BLM: Higher Order NOT: Macro TB_14-124

125. Which of the following shifts the short-run, but not the long-run, aggregate supply right?
- a. a decrease in the price level
 - b. a decrease in the expected price level
 - c. a decrease in the capital stock
 - d. an increase in the money supply

ANS: B PTS: 1 DIF: Average REF: p.344-346
BLM: Higher Order NOT: Macro TB_14-125

126. Which of the following shifts the short-run aggregate supply right?
- a. an increase in the minimum wage
 - b. an increase in immigration from abroad
 - c. an increase in the price of oil
 - d. an increase in the actual price level

ANS: B PTS: 1 DIF: Average REF: p.346
BLM: Remember NOT: Macro TB_14-126

127. Which of the following shifts the short-run aggregate and the long-run aggregate supply left?
- a. a decrease in the price level
 - b. a decrease in the expected price level
 - c. a decrease in the capital stock
 - d. a decrease in the money supply

ANS: C PTS: 1 DIF: Average REF: p.346
BLM: Remember NOT: Macro TB_14-127

128. Which of the following shifts the short-run aggregate supply left?

- a. an increase in the price level
- b. an increase in the expected price level
- c. an increase in the capital stock
- d. a decrease in taxes

ANS: B PTS: 1 DIF: Average REF: p.346
BLM: Higher Order NOT: Macro TB_14-128

129. Which of the following shifts the short-run aggregate supply right?

- a. an increase in the price level
- b. an increase in the minimum wage
- c. a decrease in the price of oil
- d. a decrease in immigration from abroad

ANS: C PTS: 1 DIF: Average REF: p.346
BLM: Higher Order NOT: Macro TB_14-129

130. Which of the following shifts the short-run aggregate supply left?

- a. an increase in price expectations
- b. an increase in the price level
- c. a decrease in the money supply
- d. a decrease in the price of oil

ANS: A PTS: 1 DIF: Average REF: p.346
BLM: Higher Order NOT: Macro TB_14-130

131. Which of the following would cause prices and real GDP to rise in the short run?

- a. Short-run aggregate supply shifts right.
- b. Short-run aggregate supply shifts left.
- c. Aggregate demand shifts right.
- d. Aggregate demand shifts left.

ANS: C PTS: 1 DIF: Average REF: p.347-348
BLM: Higher Order NOT: Macro TB_14-131

132. Which of the following would cause prices to fall and output to rise in the short run?

- a. Short-run aggregate supply shifts right.
- b. Short-run aggregate supply shifts left.
- c. Aggregate demand shifts right.
- d. Aggregate demand shifts left.

ANS: A PTS: 1 DIF: Average REF: p.348
BLM: Higher Order NOT: Macro TB_14-132

133. Which of the following would cause prices and real GDP to rise in the short run?

- a. an increase in the expected price level
- b. an increase in the money supply
- c. a decrease in the capital stock
- d. an import tariff

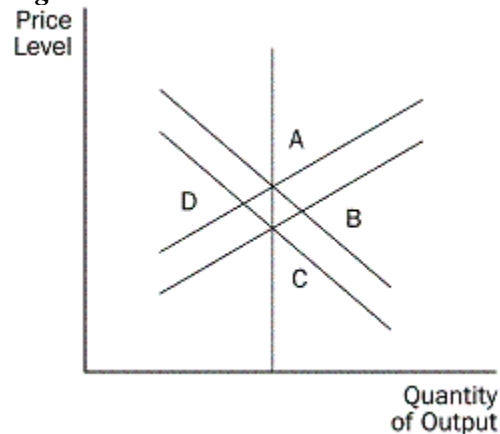
ANS: B PTS: 1 DIF: Average REF: p.348
BLM: Higher Order NOT: Macro TB_14-133

134. Which of the following would cause prices to rise and real GDP to fall in the short run?
- an increase in the expected price level
 - an increase in the capital stock
 - an increase in the quantity of labour available
 - an increase in money supply

ANS: A PTS: 1 DIF: Average REF: p.348
 BLM: Higher Order NOT: Macro TB_14-134

Consider the exhibit below for the following questions.

Figure 14-1



135. **Refer to Figure 14-1.** How would an increase in the money supply move the economy in the short and long run?
- From C to B in the short run and the long run.
 - From C to D in the short run and the long run.
 - From C to B in the short run and to A in the long run.
 - From C to D in the short run and to C in the long run.

ANS: C PTS: 1 DIF: Easy REF: p.348-349
 BLM: Higher Order NOT: Macro TB_14-135

136. **Refer to Figure 14-1.** How would an increase in the money supply move the economy in the long run?
- from C to A
 - from C to B
 - from C to A to C again
 - from C to D

ANS: A PTS: 1 DIF: Average REF: p.348-349
 BLM: Higher Order NOT: Macro TB_14-136

137. **Refer to Figure 14-1.** If the economy is at A and there is a fall in aggregate demand, what happens to the economy in the short run?
- a. It stays at A.
 - b. It moves to B.
 - c. It moves to C.
 - d. It moves to D.

ANS: D PTS: 1
BLM: Higher Order

DIF: Easy REF: p.348-349
NOT: Macro TB_14-137

138. **Refer to Figure 14-1.** If the economy starts at A and there is a fall in aggregate demand, what happens to the economy in the long run?
- a. It moves back to A.
 - b. It moves to B.
 - c. It moves to C.
 - d. It moves to D.

ANS: C PTS: 1
BLM: Higher Order

DIF: Easy REF: p.348-350
NOT: Macro TB_14-138

139. **Refer to Figure 14-1.** If the economy starts at A and moves to D, what happens to the economy in the long run?
- a. It moves to A.
 - b. It moves to B.
 - c. It moves to C.
 - d. It moves back to D.

ANS: C PTS: 1
BLM: Higher Order

DIF: Easy REF: p.348-350
NOT: Macro TB_14-139

140. **Refer to Figure 14-1.** Which of the following paths indicates how the economy would move to long run equilibrium?
- a. from A to B
 - b. from C to B
 - c. from D to C
 - d. From C to A

ANS: C PTS: 1
BLM: Higher Order

DIF: Easy REF: p.348-350
NOT: Macro TB_14-140

141. **Refer to Figure 14-1.** How would an adverse shift in aggregate supply move the economy?
- a. from A to B
 - b. from C to D
 - c. from B to A
 - d. from D to C

ANS: B PTS: 1
BLM: Higher Order

DIF: Easy REF: p.352-355
NOT: Macro TB_14-141

142. **Refer to Figure 14-1.** In the short run, which of the following would result from a favourable shift in aggregate supply?

- a. It would move the economy from A to B.
- b. It would move the economy from B to C.
- c. It would move the economy from C to D.
- d. It would move the economy from D to A.

ANS: A PTS: 1 DIF: Easy REF: p.353-355
BLM: Higher Order NOT: Macro TB_14-142

143. How does an economic contraction that is caused by a shift in aggregate demand remedy itself over time?

- a. The expected price level rises, shifting aggregate demand right.
- b. The expected price level rises, shifting aggregate demand left.
- c. The expected price level falls, shifting aggregate supply right.
- d. The expected price level falls, shifting aggregate supply left.

ANS: C PTS: 1 DIF: Easy REF: p.347-350
BLM: Higher Order NOT: Macro TB_14-143

144. How do prices change due to an economic contraction that is caused by a shift in aggregate demand?

- a. They rise in the short run, and rise even more in the long run.
- b. They rise in the short run, and fall back to their original level in the long run.
- c. They fall in the short run, and fall even more in the long run.
- d. They fall in the short run, and rise back to their original level in the long run.

ANS: C PTS: 1 DIF: Challenging REF: p.347-350
BLM: Higher order NOT: Macro TB_14-144

145. If the economy is initially in long-run equilibrium, which of the following best describes the effects of a shift in aggregate demand?

- a. Prices and output are affected in both the short and long run.
- b. Prices and output are affected only in the short run.
- c. Prices are affected in the long and short run, but output only in the short run.
- d. Prices are affected in the long and short run, but output only in the long run.

ANS: C PTS: 1 DIF: Average REF: p.347-350
BLM: Higher Order NOT: Macro TB_14-145

146. Suppose the economy is initially in long-run equilibrium. Which of the following best describes the state of the economy after an increase in aggregate demand?

- a. Prices and output are higher.
- b. Prices and output are lower.
- c. Prices are higher and output is the same.
- d. Prices are the same and output is lower.

ANS: C PTS: 1 DIF: Challenging REF: p.347-350
BLM: Higher Order NOT: Macro TB_14-146

147. Suppose a shift in aggregate demand creates an economic contraction. If policymakers can respond with sufficient speed and precision, how can they offset the initial shift?
- by shifting the aggregate supply right
 - by shifting the aggregate supply left
 - by shifting the aggregate demand right
 - by shifting the aggregate demand left

ANS: C

PTS: 1

DIF: Easy

REF: p.347-350

BLM: Higher Order

NOT: Macro TB_14-147

Scenario 14-1. The economy is in long-run equilibrium. Suddenly, due to improved international relations and the increased confidence of policymakers, citizens become more optimistic about the future and stay this way for a long time.

148. **Refer to Scenario 14-1.** Initially, which curve shifts in which direction?

- AD shifts right.
- AD shifts left.
- Short-run AS shifts right.
- Short-run AS shifts left.

ANS: A

PTS: 1

DIF: Easy

REF: p.347-350

BLM: Higher Order

NOT: Macro TB_14-148

149. **Refer to Scenario 14-1.** In the short run, which of the following describes the changes that take place in the economy?

- Both the price level and real GDP rise.
- Both the price level and real GDP fall.
- The price level rises and real GDP falls.
- The price level falls and real GDP rises.

ANS: A

PTS: 1

DIF: Easy

REF: p.347-350

BLM: Higher Order

NOT: Macro TB_14-149

150. **Refer to Scenario 14-1.** Which of the following are predicted by the aggregate demand and aggregate supply theory?

- The expected inflation falls. Workers bargain for higher increases in wages.
- The expected inflation falls. Workers bargain for lower increases in wages.
- The expected inflation rises. Workers bargain for higher increases in wages.
- The expected inflation rises. Workers bargain for lower increases in wages.

ANS: C

PTS: 1

DIF: Average

REF: p.347-350

BLM: Higher Order

NOT: Macro TB_14-150

151. **Refer to Scenario 14-1.** In the long-run, how does the change in price expectations created by optimism change the aggregate demand and aggregate supply diagram?

- The long-run aggregate supply curve shifts left.
- The long-run aggregate supply curve shifts right.
- The short-run aggregate supply curve shifts right.
- The short-run aggregate supply curve shifts left.

ANS: D

PTS: 1

DIF: Average

REF: p.347-350

BLM: Higher Order

NOT: Macro TB_14-151

152. **Refer to Scenario 14-1.** How does the new long-run equilibrium differ from the original one?
- a. Both the price level and real GDP are higher.
 - b. Both the price level and real GDP are lower.
 - c. The price level is the same and real GDP is higher.
 - d. The price level is higher and real GDP is the same.

ANS: D PTS: 1 DIF: Average REF: p.347-350
BLM: Higher Order NOT: Macro TB_14-152

Scenario 14-2. The economy is in long-run equilibrium. Suddenly, due to corporate scandals, international tensions, and the loss of confidence among policymakers, citizens become pessimistic concerning the future. They maintain this level of pessimism for a long time.

153. **Refer to Scenario 14-2.** Initially, which curve shifts in which direction?
- a. AD shifts right.
 - b. AD shifts left.
 - c. Short-run AS shifts left.
 - d. Short-run AS shifts right.

ANS: B PTS: 1 DIF: Easy REF: p.347-350
BLM: Higher Order NOT: Macro TB_14-153

154. **Refer to Scenario 14-2.** In the short-run, which of the following are consistent with the aggregate demand and aggregate supply theory?
- a. The price level and real GDP both increase.
 - b. The price level and real GDP both decrease.
 - c. The price level rises, and real GDP falls.
 - d. The price level falls, and real GDP rises.

ANS: B PTS: 1 DIF: Easy REF: p.347-350
BLM: Higher Order NOT: Macro TB_14-154

155. **Refer to Scenario 14-2.** Which of the following are consistent with the aggregate demand and aggregate supply theory?
- a. The expected price level rises. Bargains are struck for higher increases in wages.
 - b. The expected price level rises. Bargains are struck for lower increases in wages.
 - c. The expected price level falls. Bargains are struck for higher increases in wages.
 - d. The expected price level falls. Bargains are struck for lower increases in wages.

ANS: D PTS: 1 DIF: Average REF: p.347-350
BLM: Higher Order NOT: Macro TB_14-155

156. **Refer to Scenario 14-2.** In the long-run, the change in price expectations caused by pessimism leads to which of the following shifts?
- a. Long-run AS shifts left.
 - b. Long-run AS shifts right.
 - c. Short-run AS shifts right.
 - d. Short-run AS shifts left.

ANS: C PTS: 1 DIF: Average REF: p.347-350
BLM: Higher Order NOT: Macro TB_14-156

157. **Refer to Scenario 14-2.** How does the new long-run equilibrium differ from the original one?
- a. Both the price level and real GDP are higher.
 - b. Both the price level and real GDP are lower.
 - c. The price level is the same and real GDP is lower.
 - d. The price level is lower and real GDP is the same.

ANS: D PTS: 1 DIF: Average REF: p.347-350
BLM: Higher Order NOT: Macro TB_14-157

158. What were the changes in output in the early 1930s and early 1940s in Canada, respectively?
- a. a large increase and a large increase
 - b. a large increase and a large decrease
 - c. a large decrease and a large increase
 - d. a large decrease and a large decrease

ANS: C PTS: 1 DIF: Easy REF: p.351-353
BLM: Remember NOT: Macro TB_14-158

159. Which of the following has been suggested as a cause of the Great Depression?
- a. a decline in output
 - b. a decrease in prices
 - c. strong bank regulations
 - d. a decrease in the money supply

ANS: D PTS: 1 DIF: Easy REF: p.351-353
BLM: Remember NOT: Macro TB_14-159

160. Which of the following has **NOT** been suggested as a cause of the Great Depression?
- a. rapidly rising asset prices
 - b. a decline in the money supply
 - c. a decrease in stock prices
 - d. the collapse of the banking system

ANS: A PTS: 1 DIF: Easy REF: p.351-353
BLM: Remember NOT: Macro TB_14-160

161. Which of the following did **NOT** happen during the onset of the Great Depression?
- a. The money supply fell as households took money out of banks.
 - b. The Bank of Canada decreased the bank rate.
 - c. The real GDP per person fell about 30 percent.
 - d. Bankers began holding greater reserves.

ANS: B PTS: 1 DIF: Easy REF: p.351-353
BLM: Remember NOT: Macro TB_14-161

162. What happened in the first few years of the Great Depression?
- a. Unemployment rose by about 10 percent, and prices rose about 27 percent.
 - b. Unemployment rose by about 19 percent, and prices rose about 12 percent.
 - c. Unemployment rose by about 20 percent, and prices fell about 12 percent.
 - d. Unemployment rose by about 25 percent, and prices fell about 19 percent.

ANS: D PTS: 1 DIF: Easy REF: p.351-353
BLM: Remember NOT: Macro TB_14-162

163. Which of the following happened during World War II?

- a. Government purchases of goods and services increased.
- b. The real GDP per person decreased by 60 percent.
- c. The unemployment rate increased to 15 percent.
- d. The long-run aggregate supply shifted to the right.

ANS: A PTS: 1 DIF: Easy REF: p.352-353
BLM: Remember NOT: Macro TB_14-163

164. By how much did the real GDP per person increase during World War II?

- a. 25 percent
- b. 50 percent
- c. 60 percent
- d. 80 percent

ANS: C PTS: 1 DIF: Average REF: p.352-353
BLM: Remember NOT: Macro TB_14-164

165. What was the main reason for the economic boom of the early 1940s?

- a. increased government expenditures
- b. falling prices of oil and other natural resources
- c. an increase in the growth rate of the money supply
- d. rapid developments in transportation, electronics, and communication

ANS: A PTS: 1 DIF: Easy REF: p.352-353
BLM: Remember NOT: Macro TB_14-165

166. What is the effect of bad weather for farming or some other temporary decrease in the availability of raw materials?

- a. Aggregate supply shifts right.
- b. Output falls in the short run.
- c. Prices fall in the short run.
- d. Long-run aggregate supply shifts to the left.

ANS: B PTS: 1 DIF: Easy REF: p.352-353
BLM: Higher Order NOT: Macro TB_14-166

167. Which of the following could create an increase in the price level and a reduction in real GDP?

- a. a fall in stock prices
- b. natural disasters such as hurricanes and famines
- c. declining government expenditures
- d. tax rebates

ANS: B PTS: 1 DIF: Average REF: p.352-353
BLM: Higher Order NOT: Macro TB_14-167

168. Which of the following could create an increase in the price level and a decrease in real GDP in the short run?
- a. an increase in the money supply
 - b. an increase in government expenditures
 - c. a fall in stock prices
 - d. bad weather in farm provinces

ANS: D PTS: 1 DIF: Easy REF: p.352-353
BLM: Higher Order NOT: Macro TB_14-168

169. Suppose there is a decrease in the availability of an important major resource, such as oil. Which of the following shifts would most likely occur?
- a. The aggregate supply would shift right.
 - b. The aggregate supply would shift left.
 - c. The aggregate demand would shift right.
 - d. The aggregate demand would shift left.

ANS: B PTS: 1 DIF: Easy REF: p.352-353
BLM: Higher Order NOT: Macro TB_14-169

170. Suppose that there has been bad weather, a decrease in the availability of oil, or some other temporary increase in firms' costs and the economy has reached its new short-run equilibrium. What happens as the economy moves from this short-run equilibrium to long-run equilibrium?
- a. Prices and output rise.
 - b. Prices and output fall.
 - c. Prices rise and output falls.
 - d. Prices fall and output rises.

ANS: D PTS: 1 DIF: Average REF: p.352-353
BLM: Higher Order NOT: Macro TB_14-170

171. Suppose there was an economic contraction caused by a shift in aggregate supply; suppose the central bank changes the money supply to offset the effects of that contraction. How would the effects of the change in money supply be reflected in the aggregate demand and aggregate supply model?
- a. Aggregate supply would shift to the right
 - b. Aggregate supply would shift to the left
 - c. Aggregate demand would shift to the right.
 - d. Aggregate demand would shift to the left.

ANS: C PTS: 1 DIF: Average REF: p.353-354
BLM: Higher Order NOT: Macro TB_14-171

172. In which of the following situations would stagflation exist?
- a. when prices and output rise
 - b. when prices rise and output falls
 - c. when prices fall and output rises
 - d. when prices and output fall

ANS: B PTS: 1 DIF: Easy REF: p.353-355
BLM: Remember NOT: Macro TB_14-172

173. Which of the following would cause stagflation?

- a. aggregate demand shifts right
- b. aggregate demand shifts left
- c. aggregate supply shifts right
- d. aggregate supply shifts left

ANS: D PTS: 1 DIF: Easy REF: p.353-355
BLM: Remember NOT: Macro TB_14-173

174. How does the aggregate demand and aggregate supply model reflect a rise in production costs?

- a. The short-run aggregate supply curve shifts to the right.
- b. The short-run aggregate supply curve shifts to the left.
- c. The aggregate demand curve shifts to the right.
- d. The aggregate demand curve shifts to the left.

ANS: B PTS: 1 DIF: Easy REF: p.353-355
BLM: Higher Order NOT: Macro TB_14-174

175. What changes are likely to happen in an economy when production costs rise?

- a. Output and prices rise.
- b. Output rises and prices fall.
- c. Output falls and prices rise.
- d. Output and prices fall.

ANS: C PTS: 1 DIF: Easy REF: p.353-355
BLM: Higher Order NOT: Macro TB_14-175

176. Suppose the Canadian economy is in long-run equilibrium. Then suppose the value of the Canadian dollar increases. At the same time, people in Canada revise their expectations so that the expected price level falls. What would we expect will happen in the short-run?

- a. Real GDP will rise, and the price level might rise, fall, or stay the same.
- b. Real GDP will fall, and the price level might rise, fall, or stay the same.
- c. The price level will rise, and real GDP might rise, fall, or stay the same.
- d. The price level will fall, and real GDP might rise, fall, or stay the same.

ANS: D PTS: 1 DIF: Challenging REF: p.346-355
BLM: Higher Order NOT: Macro TB_14-176

177. Suppose the economy is in long-run equilibrium. If there is a sharp increase in the minimum wage as well as an increase in pessimism about future business conditions, what would we expect to happen in the short-run?

- a. Real GDP will rise, and the price level might rise, fall, or stay the same.
- b. Real GDP will fall, and the price level might rise, fall, or stay the same.
- c. The price level will rise, and real GDP might rise, fall, or stay the same.
- d. The price level will fall, and real GDP might rise, fall, or stay the same.

ANS: B PTS: 1 DIF: Challenging REF: p.346-355
BLM: Higher Order NOT: Macro TB_14-177

178. Suppose the economy is in long-run equilibrium. If there is a sharp decline in the stock market combined with a significant increase in immigration of skilled workers, what would we expect to happen in the short run?
- a. Real GDP will rise, and the price level might rise, fall, or stay the same.
 - b. Real GDP will fall, and the price level might rise, fall, or stay the same.
 - c. The price level will rise, and real GDP might rise, fall, or stay the same.
 - d. The price level will fall, and real GDP might rise, fall, or stay the same.

ANS: D PTS: 1 DIF: Challenging REF: p.346-355
BLM: Higher Order NOT: Macro TB_14-178

179. Suppose the economy is in long-run equilibrium. If there is a tax cut at the same time that major new sources of oil are discovered in the country, what would we expect will happen in the short run?
- a. Real GDP will rise, and the price level might rise, fall, or stay the same.
 - b. Real GDP will fall, and the price level might rise, fall, or stay the same.
 - c. The price level will rise, and real GDP might rise, fall, or stay the same.
 - d. The price level will fall, and real GDP might rise, fall, or stay the same.

ANS: A PTS: 1 DIF: Challenging REF: p.346-355
BLM: Higher Order NOT: Macro TB_14-179

180. Suppose the economy is in long-run equilibrium. Concerns about pollution cause the government to significantly restrict the production of electricity. At the same time, the value of the dollar falls. What would we expect to happen in the short run?
- a. Real GDP will rise, and the price level might rise, fall, or stay the same.
 - b. Real GDP will fall, and the price level might rise, fall, or stay the same.
 - c. The price level will rise, and real GDP might rise, fall, or stay the same.
 - d. The price level will fall, and real GDP might rise, fall, or stay the same.

ANS: C PTS: 1 DIF: Challenging REF: p.346-355
BLM: Higher Order NOT: Macro TB_14-180

181. Suppose the economy is in long-run equilibrium. Premier Aviary succeeds in getting a major new highway project for his province. At the same time, Premier Green succeeds in getting major new restrictions on logging enacted for her province. In the short run, what would we expect to happen?
- a. Real GDP will rise, and the price level might rise, fall, or stay the same.
 - b. Real GDP will fall, and the price level might rise, fall, or stay the same.
 - c. The price level will rise, and real GDP might rise, fall, or stay the same.
 - d. The price level will fall, and real GDP might rise, fall, or stay the same.

ANS: C PTS: 1 DIF: Challenging REF: p.346-355
BLM: Higher Order NOT: Macro TB_14-181

182. Suppose the economy is in long-run equilibrium. In a short span of time, there is a sharp decline in the stock market, a tax cut, an increase in the money supply, and a decline in the value of the dollar. In the short run, what would we expect to happen?
- a. the price level and real GDP both to rise
 - b. the price level and real GDP both to fall
 - c. the price level and real GDP both to stay the same
 - d. The price level and real GDP may rise, fall, or remain the same.

ANS: D PTS: 1 DIF: Challenging REF: p.346-355
BLM: Higher Order NOT: Macro TB_14-182

183. Suppose the economy is in long-run equilibrium. In a short span of time, there is a decline in the money supply, a tax increase, a pessimistic revision of expectations about future business conditions, and a rise in the value of the dollar. In the short run, what would we expect to happen?
- The price level and real GDP will both rise.
 - The price level and real GDP will both fall.
 - The price level and real GDP will both stay the same.
 - The price level will increase, and the real GDP will fall.

ANS: B PTS: 1 DIF: Challenging REF: p.346-355
BLM: Higher Order NOT: Macro TB_14-183

184. Suppose the economy is in long-run equilibrium. In a short span of time, there is a sharp increase in the minimum wage, a major new discovery of oil, a large influx of immigrants, and new environmental regulations that reduce electricity production. In the short run, what would we expect to happen?
- The price level to rise and real GDP will both fall.
 - The price level will fall, and real GDP will rise.
 - The price level and real GDP will both stay the same.
 - The price level will rise, fall, or stay the same, and the real GDP will rise, fall, or stay the same.

ANS: D PTS: 1 DIF: Challenging REF: p.346-355
BLM: Higher Order NOT: Macro TB_14-184

185. Suppose the economy is in long-run equilibrium. In a short span of time, there is a large influx of skilled immigrants, a major new discovery of oil, and a major new technological advance in electricity production. In the short run, what would we expect to happen?
- The price level will rise, and real GDP will fall.
 - The price level will fall, and real GDP to rise.
 - The price level and real GDP will both stay the same.
 - The price level and real GDP will both fall.

ANS: B PTS: 1 DIF: Challenging REF: p.346-355
BLM: Higher Order NOT: Macro TB_14-185

186. Suppose the economy is in long-run equilibrium. If there is a sharp increase in the minimum wage as well as an increase in pessimism about future business conditions, what would we expect to happen?
- In the short run, real GDP will rise and the price level might rise, fall, or stay the same. In the long run, the price level might rise, fall, or stay the same, but real GDP will be unaffected.
 - In the short run, real GDP will fall, and the price level might rise, fall, or stay the same. In the long run, the price level might rise, fall, or stay the same, but real GDP will be unaffected.
 - In the short run, real GDP will rise, and the price level might rise, fall, or stay the same. In the long run, the price level might rise, fall, or stay the same, but real GDP will be lower.
 - In the short run, real GDP will fall and the price level might rise, fall, or stay the same. In the long run, the price level might rise, fall, or stay the same, but real GDP will be lower.

ANS: D PTS: 1 DIF: Challenging REF: p.346-355
BLM: Higher Order NOT: Macro TB_14-186

187. Suppose the economy is in long-run equilibrium. If there is a sharp decline in the stock market combined with a significant increase in immigration of skilled workers, what would we expect to happen?
- a. In the short run, real GDP will rise, and the price level might rise, fall, or stay the same. In the long-run, real GDP will rise, and the price level might rise, fall, or stay the same.
 - b. In the short run, the price level will fall, and real GDP might rise, fall, or stay the same. In the long-run, real GDP and the price level will be unaffected.
 - c. In the short run, the price level will rise, and real GDP might rise, fall, or stay the same. In the long run, real GDP will rise, and the price level will fall.
 - d. In the short run, the price level will fall, and real GDP might rise, fall, or stay the same. In the long run, real GDP will rise, and the price level will fall.

ANS: D PTS: 1 DIF: Challenging REF: p.346-355
BLM: Higher Order NOT: Macro TB_14-187

188. In 1986, OPEC countries increased their production of oil. What was the result?
- a. The price level rose.
 - b. Aggregate supply shifted right.
 - c. Unemployment rose.
 - d. Stagflation.

ANS: B PTS: 1 DIF: Average REF: p.355-358
BLM: Higher Order NOT: Macro TB_14-188

189. In the mid-1970s the price of oil rose dramatically. What did this event cause?
- a. It shifted aggregate supply left.
 - b. It caused Canadian prices to fall.
 - c. The aggregate demand increased because of an increase in the demand for gasoline.
 - d. Nominal GDP increased.

ANS: A PTS: 1 DIF: Easy REF: p.355-358
BLM: Higher Order NOT: Macro TB_14-189

190. What are the recessions of the 1970s often most attributed to?
- a. declining inflation expectations
 - b. an increase in oil prices
 - c. declines in the price of stock
 - d. decreases in the money supply

ANS: B PTS: 1 DIF: Easy REF: p.355-358
BLM: Remember NOT: Macro TB_14-190

191. How do changes in the price of oil affect economies?
- a. They lead to recession and deflation
 - b. They do not contribute much to output fluctuations.
 - c. They change the economy principally by changing aggregate demand.
 - d. They may create both inflation and recession.

ANS: D PTS: 1 DIF: Easy REF: p.355-358
BLM: Higher Order NOT: Macro TB_14-191

192. What did *The General Theory*, a 1936 book by John Maynard Keynes, attempt to explain?
- stagflation
 - the classical dichotomy
 - short-run economic fluctuations
 - how changes in the money supply had created the Great Depression

ANS: C PTS: 1 DIF: Easy REF: p.357
BLM: Remember NOT: Macro TB_14-192

193. What did Keynes believe caused recessions and depressions?
- excess aggregate demand
 - inadequate aggregate demand
 - excess aggregate supply
 - inadequate aggregate supply

ANS: B PTS: 1 DIF: Easy REF: p.357
BLM: Remember NOT: Macro TB_14-193

194. What did Keynes believe that economies experiencing high unemployment should do?
- adopt policies to reduce the money supply
 - adopt policies to reduce government expenditures
 - adopt policies to increase aggregate demand
 - adopt policies to increase aggregate supply

ANS: C PTS: 1 DIF: Easy REF: p.357
BLM: Remember NOT: Macro TB_14-194

TRUE/FALSE

1. Because we understand what things change GDP, we can predict recessions with a fair amount of accuracy.

ANS: F PTS: 1 DIF: Easy REF: p.325
NOT: Macro TB_14-195

2. Like real GDP, investment fluctuates, but investment fluctuates by a larger percentage.

ANS: T PTS: 1 DIF: Easy REF: p.327
NOT: Macro TB_14-196

3. When output rises, unemployment falls.

ANS: T PTS: 1 DIF: Easy REF: p.328
NOT: Macro TB_14-197

4. An increase in the money supply raises output in the long run.

ANS: F PTS: 1 DIF: Easy REF: p.329-330
NOT: Macro TB_14-198

5. Most economists believe that classical theory explains the world in the short run, but not the long run.

ANS: F PTS: 1 DIF: Easy REF: p.330
NOT: Macro TB_14-199

6. A change in the money supply changes only nominal variables in the long run.

ANS: T PTS: 1 DIF: Easy REF: p.329
NOT: Macro TB_14-200

7. The explanations for the slopes of the aggregate demand and aggregate supply curves are the same as the explanations for the slope of demand and supply curves for specific goods and services.

ANS: F PTS: 1 DIF: Easy REF: p.333-334
NOT: Macro TB_14-201

8. A decrease in the price level makes consumers feel wealthier, so they purchase more. This logic helps explain why the aggregate demand curve slopes downward.

ANS: T PTS: 1 DIF: Easy REF: p.333
NOT: Macro TB_14-202

9. Other things the same, a decrease in the price level makes the interest rate increase, which leads to an appreciation of the dollar in the foreign-currency exchange.

ANS: F PTS: 1 DIF: Average REF: p.333
NOT: Macro TB_14-203

10. The explanations for the downward slope of the aggregate demand curve say that as the price level rises, consumption, investment, and net exports all fall.

ANS: T PTS: 1 DIF: Average REF: p.333-334
NOT: Macro TB_14-204

11. Aggregate demand shifts to the left if the money supply decreases.

ANS: T PTS: 1 DIF: Average REF: p.335
NOT: Macro TB_14-205

12. A decrease in the money supply causes the interest rate to rise so that investment rises.

ANS: F PTS: 1 DIF: Average REF: p.335
NOT: Macro TB_14-206

13. If speculators bid up the value of the dollar in the market for foreign-currency exchange, aggregate demand would shift to the left.

ANS: T PTS: 1 DIF: Average REF: p.335-336
NOT: Macro TB_14-207

14. An increase in the money supply shifts the long-run aggregate supply curve to the right.
- ANS: F PTS: 1 DIF: Easy REF: p.335
NOT: Macro TB_14-208
15. Technological progress shifts the long-run aggregate supply curve to the right.
- ANS: T PTS: 1 DIF: Easy REF: p.338-339
NOT: Macro TB_14-209
16. When all prices rise together, there is no change in the overall quantity of goods and services supplied.
- ANS: T PTS: 1 DIF: Easy REF: p.341-344
NOT: Macro TB_14-210
17. We could explain continued increases in both output and the price level by supposing that only long-run aggregate supply shifted right over time.
- ANS: F PTS: 1 DIF: Easy REF: p.347
NOT: Macro TB_14-211
18. Because not all prices adjust instantly to changing conditions, an unexpected fall in the price level leaves some firms with higher-than-desired prices, and these higher-than-desired prices depress sales and induce firms to reduce the quantity of goods and services they produce.
- ANS: T PTS: 1 DIF: Easy REF: p.343
NOT: Macro TB_14-212
19. All explanations for the upward slope of the short-run aggregate supply curve suppose that output supplied increases when the price level increases more than expected.
- ANS: T PTS: 1 DIF: Easy REF: p.344
NOT: Macro TB_14-213
20. An unexpected increase in the price level does not shift the aggregate supply curve, but an expected increase in the price level shifts the aggregate supply curve to the left.
- ANS: T PTS: 1 DIF: Average REF: p.344
NOT: Macro TB_14-214
21. Fluctuations in real GDP are caused only by changes in aggregate demand and not by changes in aggregate supply.
- ANS: F PTS: 1 DIF: Easy REF: p.350
NOT: Macro TB_14-215
22. Increased uncertainty and pessimism about the future of the economy decreases investment spending shifting aggregate demand to the left.
- ANS: T PTS: 1 DIF: Easy REF: p.347-350
NOT: Macro TB_14-216

23. Pessimism about the future leads to falling prices and rising unemployment.

ANS: T PTS: 1 DIF: Easy REF: p.347-350
NOT: Macro TB_14-217

24. In response to a decrease in output, the economy would revert to its original level of prices and output whether the decrease in output was caused by a decrease in aggregate demand or a decrease in aggregate supply.

ANS: F PTS: 1 DIF: Average REF: p.347-350 | p.353-355
NOT: Macro TB_14-218

25. Economists mostly agree that the Great Depression was the result of a very large adverse supply shock.

ANS: F PTS: 1 DIF: Easy REF: p.351-353
NOT: Macro TB_14-219

26. Increased output and prices in Canada in the early 1940s was mostly the result of increased government expenditures.

ANS: T PTS: 1 DIF: Easy REF: p.350-353
NOT: Macro TB_14-220

27. During World War II, output increased by a larger percentage than government expenditures.

ANS: F PTS: 1 DIF: Average REF: p.350-353
NOT: Macro TB_14-221

28. Stagflation would result from the aggregate supply curve shifting left.

ANS: T PTS: 1 DIF: Average REF: p.355
NOT: Macro TB_14-222

29. If the government increased the money supply in response to a decrease in aggregate supply, unemployment would return towards its natural rate, but prices would rise even more.

ANS: T PTS: 1 DIF: Average REF: p.355
NOT: Macro TB_14-223

30. John Maynard Keynes advocated policies that would increase aggregate demand as a way to decrease unemployment caused by recessions.

ANS: T PTS: 1 DIF: Easy REF: p.357
NOT: Macro TB_14-224

SHORT ANSWER

1. The long-run trend in real GDP is upward. How is this possible given business cycles? What explains the upward trend?

ANS:

There are occasional short-lived periods of negative real GDP growth. However, in most years real GDP increases. The years of increase are more frequent and the increases large enough that over long periods of time real GDP increases despite the occasional declines. The long-run upward trend in real GDP is due to increases in the labour force and capital stock, and advances in technological knowledge.

PTS: 1 DIF: Average REF: p.325-326 NOT: Macro TB_14-225

2. What variables besides real GDP tend to decline during recessions? Given the definition of real GDP, argue that declines in these variables are to be expected.

ANS:

Variables that fall along with real GDP include employment, incomes, investment, sales, and home purchases. GDP may be measured as either the production or expenditures of final goods and services. It follows that any other variable that could be used to measure production or expenditures, employment, or sales, for example, will generally move in the same direction as real GDP.

PTS: 1 DIF: Average REF: p.326-327 NOT: Macro TB_14-226

3. Discuss what economists believe is different about the long and short run.

ANS:

Most economists believe that in the long run, real variables are not affected by nominal variables. So, for example, changes in the money supply do not change real variables in the long run. However, most economists believe that nominal variables do change real variables in the short run.

PTS: 1 DIF: Average REF: p.329-330 NOT: Macro TB_14-227

4. Make a list of expenditures whose sum equals GDP.

ANS:

consumption, investment, government expenditures, and net exports.

PTS: 1 DIF: Easy REF: p.332 NOT: Macro TB_14-228

5. Explain how an increase in the price level changes interest rates. How does this change in interest rates lead to changes in investment and net exports?

ANS:

When the price level increases, the purchasing power of money held in purses and bank accounts declines. This decline makes people feel less wealthy so that they lend less. The reduction in lending causes the interest rate to rise. The rise in interest rates discourages spending on investment goods so that the aggregate quantity of goods and services demanded decreases. As the interest rate increases, the supply of dollars in the market for foreign-currency exchange falls, as people wish to purchase fewer foreign assets. This makes the dollar appreciate, thus decreasing net exports.

PTS: 1 DIF: Average REF: p.333 NOT: Macro TB_14-229

6. Make a list of things that would shift the aggregate demand curve to the right.

ANS:

Examples (and variations on examples) in the text include a stock market boom that increases consumption spending, a tax cut that increases consumption, improvements in the capital goods such as computers that increase investment, increased optimism about the future of the economy induces increased investment, an investment tax credit, an increase in the money supply, an increase in government defence expenditures, and economic expansions overseas that create increases in net exports.

PTS: 1 DIF: Average REF: p.334-336 NOT: Macro TB_14-230

7. Make a list of things that would shift the long-run aggregate supply curve to the right.

ANS:

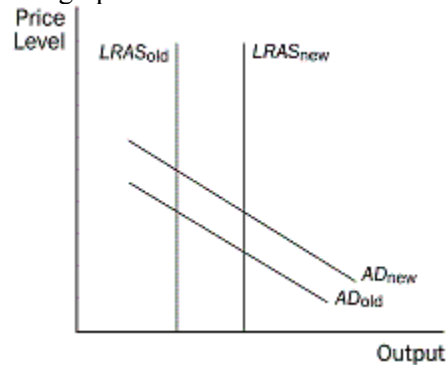
Examples in the text (or variations) include increased immigration, a decrease in the minimum wage, more generous unemployment insurance, an increase in the capital stock, an increase in the average level of education, a discovery of new mineral deposits, technology, and removal of barriers to international trade.

PTS: 1 DIF: Average REF: p.338-339 NOT: Macro TB_14-231

8. Illustrate the classical analysis of growth and inflation with aggregate demand and long-run aggregate supply curves.

ANS:

See graph.



Over time, technological advances cause the long-run aggregate supply curve to shift right. Increases in the money supply cause the aggregate demand curve to shift right. Output growth puts downward pressure on the price level, but money supply growth contributes to rising prices.

PTS: 1

DIF: Average

REF: p.340

NOT: Macro TB_14-232

9. In the 1970s people had become accustomed to high inflation. In 1979, the Bank of Canada decided to fight inflation and decreased the money supply growth rates. Many people thought that the Bank of Canada's action would cause a recession. Is this thinking consistent with the aggregate demand and aggregate supply model? Explain. According to monetary misperceptions theory, what should have happened to output if the inflation rate fell relative to what people expected? Explain.

ANS:

The decrease in the money supply would shift aggregate demand to the left causing prices to fall, but also causing output to fall. So, the aggregate demand and aggregate supply model does suggest the Bank of Canada's actions could have created a recession.

According to the price misperceptions theory, if prices fall more (or rise less) than people expect, they will think the price of what they sell has fallen relative to the price of other goods and decrease production. This provides one explanation for the upward sloping aggregate supply curve.

To the extent that people expected inflation to fall, the aggregate supply curve should have shifted right. This would have offset some of the recessionary impact of the money supply decrease.

PTS: 1

DIF: Challenging

REF: p.347-350

NOT: Macro TB_14-233

10. Suppose that a decrease in the demand for goods and services pushes the economy into recession. What happens to the price level? If the government does nothing, what ensures that the economy still eventually gets back to the natural rate of output?

ANS:

A decrease in aggregate demand causes the price level to fall. If the government does not respond, then the actual price level will be below the price level that people expected. Individuals will gradually correct their misperception of the price level, so expected prices will fall, causing the aggregate supply curve to shift to the right. The rightward shift in aggregate supply eventually restores the economy to the natural rate of output.

PTS: 1 DIF: Challenging REF: p.347-350 NOT: Macro TB_14-234

11. Use the sticky wage theory to explain why an increase in the expected price level shifts the aggregate supply curve.

ANS:

When people expect the price level to increase, they will ask for higher wages. The increase in wages raises the costs of production. So firms will supply less at any price level.

PTS: 1 DIF: Average REF: p.342-343 NOT: Macro TB_14-235

12. Keynes thought that the behaviour of the economy in the short run was influenced by what he called "animal spirits." By this he meant that businesspeople sometimes felt good about the economy, and carried out lots of investment, and at other times felt bad about the economy, and so cut back on their investment spending. Explain how such fluctuations in investment would lead to fluctuations in GDP and prices.

ANS:

Fluctuations in investment cause the aggregate demand curve to shift. If the aggregate demand curve shifts to the right, GDP and the price level rise. If the aggregate demand curve shifts to the left, GDP and the price level fall. Erratic movements in investment thus cause fluctuations in output and prices.

PTS: 1 DIF: Average REF: p.357 NOT: Macro TB_14-236

PROBLEM

1. An aggregate supply (AS) curve is described by the equation

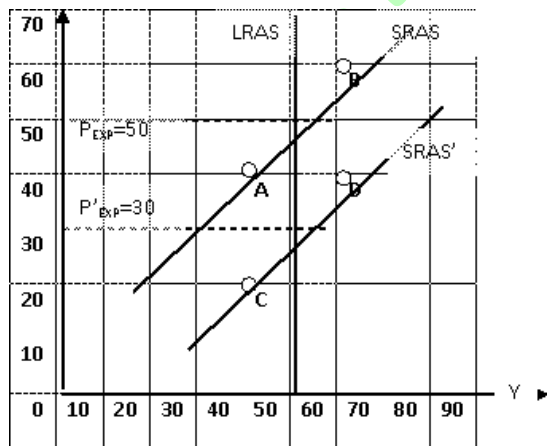
$$Y = Y_{LR} + a \times (P - P_{EXP}),$$

where Y is current output, Y_{LR} is the long run level of output, a is a positive constant, P is the current price level, and P_{EXP} is the expected price level. Suppose $Y_{LR} = 50$, $a = 1$, and $P_{EXP} = 40$.

- a. Draw the long run aggregate supply curve in an AD - AS (aggregate demand – aggregate supply) diagram.
- b. Using the AS equation, find the output corresponding to price levels $P = 40$ and $P = 80$ and place the 2 points on your diagram. Draw the short run AS curve that passes through the two points.
- c. Identify the expected price level on your graph.
- d. Suppose the expected price level decreases to $P'_{EXP} = 30$. For current price levels $P = 40$ and $P = 60$, recalculate the output levels using the AS formula. Draw the new AS curve and identify the new expected price level.

ANS:

- a. The long-run aggregate supply curve is a vertical line at $Y = 50$.
- b. From the AS equation, with $P = 40$ and the given values for the other parameters, we get $Y = 50 + 1 \times (40 - 50) = 40$. This point is represented by A in the graph. The second point is similarly determined and is represented by point B ($Y = 60$, $P = 60$). The short-run AS curve is marked SRAS.
- c. The expected price level corresponds to the intersection between the LRAS and the SRAS lines.
- d. The calculations for the new expected price level, $P'_{EXP} = 30$ give points C and D and the SRAS shifts downward by a vertical distance equal to the change in the expected price level.



PTS: 1

NOT: Macro TB_14-237

2. Use the misperceptions theory to discuss the economic forces that shift the aggregate supply curve when the expectations about the overall price level change.

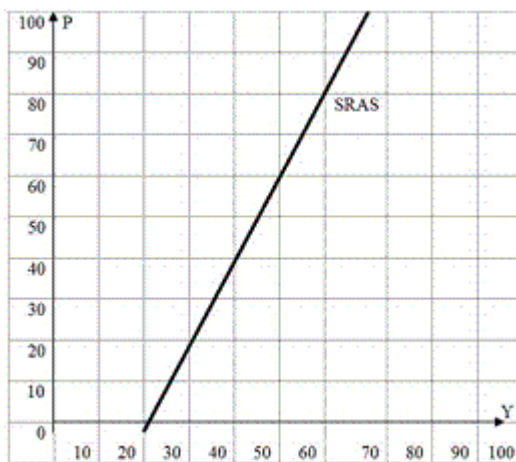
ANS:

According to the misperceptions theory, suppliers mistakenly lower their production when all prices decrease below expectations, thinking that only the price of their product has decreased. Now, suppose that suppliers increase their expectations about the overall price level. To decrease their production by the same amount as before, the difference in the new expected price and the actual price has to be the same as before. Thus, the new price must be higher than before. If we apply the same reasoning for every possible price – expected price difference, we get a new supply curve that is shifted upward.

PTS: 1

NOT: Macro TB_14-238

3. Consider the short-run aggregate supply curve in the following graph.



- a. Calculate approximately the elasticities of the curve at two price levels, $P = 20$ and $P = 100$. (*Hint: The price elasticity formula is $E_P = \text{percentage change in } Y / \text{percentage change in } P$.*)
- b. Explain the meaning of the elasticity in the context of the AS curve.
- c. Compare the two elasticities found in (a) and discuss the results. Does this comparison suggest certain policy implications?

ANS:

An easier way of calculating the elasticities is to notice that the AS curve is a straight line, thus its slope is constant. The elasticity formula can be written as $E_P = (\Delta Y / \Delta P) \times (P / Y)$, where $(\Delta Y / \Delta P)$ is the reciprocal of the slope of the AS line. The slope = $100 / (70 - 20) = 2$, thus $E_P = (1/2) \times (P / Y)$. At $P = 20$, $Y = 30$, thus $E_P(P = 20) = 0.5 \times 20 / 30 = 0.33$. At $P = 100$, $Y = 70$, and $E_P(P = 100) = 0.5 \times 100 / 70 = 0.71$. Elasticity shows what the percentage change in Y is when the price changes by 1 percent. Elasticity being higher at higher prices suggests that an increase in price of 1 percent is more effective in increasing the aggregate quantity supplied when prices are already high. This result sounds unrealistic. The reason for this unrealistic result may be that in reality AS curves may not be linear.

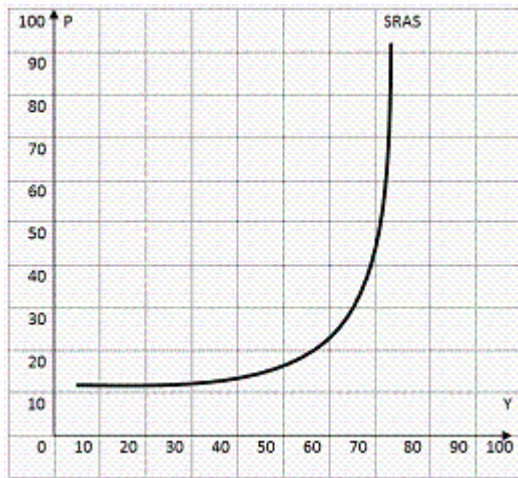
PTS: 1

NOT: Macro TB_14-239

4. Some economists argue that at low levels of GDP shifts in the aggregate demand curve increase output without significant increases in the price levels (without inflation), while at higher level of output a shift in the aggregate demand increases significantly the price level without much effect on output. How would an aggregate supply curve look like according to this theory?

ANS:

This theory describes an AS curve that has higher elasticity at lower levels of output than at higher levels. Such an AS curve might look like the one in the following graph.



PTS: 1

NOT: Macro TB_14-240

5. Compare the effects of an aggregate-demand-induced recession with an aggregate-supply-induced recession. How would you recognize that a recession is induced by demand or supply? What policies would be appropriate in the first case and what in the second?

ANS:

An AD-induced recession lowers prices and output, while an AS-induced recession lowers output and increases prices. Policies trying to reduce the effects of an AD-induced recession can need to stimulate demand for instance by increasing money supply with less danger of high inflation. When the recession is caused by an AS shift, stimulating demand is less of an option because prices would increase too much.

PTS: 1

NOT: Macro TB_14-241

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Chapter 15—The Influence of Monetary and Fiscal Policy on Aggregate Demand

MULTIPLE CHOICE

1. How long does fiscal policy affect the economy?
 - a. only in the short run
 - b. only in the long run
 - c. in both the short and long run
 - d. in neither the short nor long run

ANS: C PTS: 1 DIF: Easy REF: p.366
BLM: Remember NOT: Macro TB_15-1

2. Which of the following is **NOT** a reason the aggregate demand curve slopes downward?
 - a. As the price level increases, real wages decline.
 - b. As the price level increases, real wealth declines.
 - c. As the price level increases, the interest rate increases.
 - d. As the price level increases, the exchange rate increases.

ANS: A PTS: 1 DIF: Easy REF: p.362
BLM: Remember NOT: Macro TB_15-2

3. For the Canadian economy, which of the following is the **LEAST** important reason for the downward slope of the aggregate-demand curve?
 - a. the wealth effect
 - b. the interest-rate effect
 - c. the exchange-rate effect
 - d. the real-wage effect

ANS: A PTS: 1 DIF: Easy REF: p.363
BLM: Remember NOT: Macro TB_15-3

4. Which of the following reasons for the downward slope of the aggregate demand curve would likely be more important for a small closed economy?
 - a. the wealth effect
 - b. the interest-rate effect
 - c. the exchange-rate effect
 - d. the real-wage effect

ANS: B PTS: 1 DIF: Easy REF: p.363
BLM: Remember NOT: Macro TB_15-4

5. Which of the following is **NOT** a response that would result from a decrease in the price level and so help to explain the slope of the aggregate demand curve?
- a. When interest rates fall, Sleepwell Hotels decides to build some new hotels.
 - b. The exchange rate falls, so French restaurants in Paris buy more Canadian beef.
 - c. Janet feels wealthier because of the price drop, and so she decides to remodel her bathroom.
 - d. With prices down and wages fixed by contract, Gatekeeper Computers decides to lay off workers.

ANS: D PTS: 1 DIF: Easy REF: p.363
BLM: Higher Order NOT: Macro TB_15-5

6. The wealth effect helps explain the downward slope of the aggregate demand curve. How important is this effect and why?
- a. relatively important in Canada because expenditures on consumer durables is very responsive to changes in wealth
 - b. relatively important in Canada because consumption spending is a large part of GDP
 - c. relatively unimportant in Canada because money holdings are a small part of consumer wealth
 - d. relatively unimportant in Canada because it takes a large change in wealth to make a significant change in interest rates

ANS: C PTS: 1 DIF: Easy REF: p.363
BLM: Remember NOT: Macro TB_15-6

7. Which of the following is characteristic of aggregate demand in Canada?
- a. The exchange-rate effect is relatively small because exports and imports are a small part of real GDP.
 - b. The interest-rate effect is relatively small because investment spending is not very responsive to interest rate changes.
 - c. The wealth effect is relatively large because money holdings are a significant portion of most households' wealth.
 - d. The interest rate effect is relatively large.

ANS: D PTS: 1 DIF: Easy REF: p.363
BLM: Remember NOT: Macro TB_15-7

8. Which of Keynes's theories does liquidity preference refer to?
- a. the effects of changes in money demand and supply on interest rates
 - b. the effects of changes in money demand and supply on exchange rates
 - c. the effects of wealth on expenditures
 - d. the difference between temporary and permanent changes in income

ANS: A PTS: 1 DIF: Easy REF: p.363
BLM: Remember NOT: Macro TB_15-8

9. According to the liquidity preference theory, equilibrium in the money market is achieved by adjustments in which of the following?
- a. the price level
 - b. the interest rate
 - c. the exchange rate
 - d. real wealth

ANS: B PTS: 1 DIF: Easy REF: p.363
BLM: Remember NOT: Macro TB_15-9

10. Over what period of time is the liquidity preference theory most relevant, and what does it suppose?
- a. short run; it supposes that the price level adjusts to bring money supply and money demand into balance
 - b. short run; it supposes that the interest rate adjusts to bring money supply and money demand into balance
 - c. long run; it supposes that the price level adjusts to bring money supply and money demand into balance
 - d. long run; it supposes that the interest rate adjusts to bring money supply and money demand into balance

ANS: B PTS: 1 DIF: Average REF: p.363
BLM: Remember NOT: Macro TB_15-10

11. If expected inflation is constant and the nominal interest rate increases, how does the real interest rate change?
- a. It increases by more than the change in the nominal interest rate.
 - b. It increases by the change in the nominal interest rate.
 - c. It decreases by the change in the nominal interest rate.
 - d. It decreases by more than the change in the nominal interest rate.

ANS: B PTS: 1 DIF: Easy REF: p.363
BLM: Higher Order NOT: Macro TB_15-11

12. If expected inflation is constant and the nominal interest rate increased 5 percentage points, what would happen to the real interest rate?
- a. It would increase 5 percentage points.
 - b. It would increase, but by less than 5 percentage points.
 - c. It would decrease, but by less than 5 percentage points.
 - d. It would decrease by 5 percentage points.

ANS: A PTS: 1 DIF: Easy REF: p.363
BLM: Higher Order NOT: Macro TB_15-12

13. The theory of liquidity preference assumes that the nominal supply of money is determined by which of the following?
- a. the level of real GDP
 - b. the rate of inflation
 - c. the interest rate
 - d. the central bank

ANS: D PTS: 1 DIF: Easy REF: p.363
BLM: Remember NOT: Macro TB_15-13

14. According to the theory of liquidity preference, how is the money supply affected by the interest rate?
- a. positively
 - b. negatively
 - c. not affected
 - d. directly

ANS: C PTS: 1 DIF: Easy REF: p.363
BLM: Remember NOT: Macro TB_15-14

15. According to liquidity preference theory, what shape is the money supply curve?
- a. upward sloping
 - b. downward sloping
 - c. vertical
 - d. horizontal

ANS: C PTS: 1 DIF: Easy REF: p.364
BLM: Remember NOT: Macro TB_15-15

16. According to liquidity preference theory, when would the money supply curve shift right?
- a. if the money demand curve shifted right
 - b. only if the Bank of Canada chose to increase the money supply
 - c. if the interest rate increased
 - d. if the price level fell or the interest rate decreased

ANS: B PTS: 1 DIF: Easy REF: p.364
BLM: Remember NOT: Macro TB_15-16

17. According to liquidity preference theory, what action taken by the Bank of Canada would shift the money supply curve?
- a. if the Bank of Canada engaged in arbitrage
 - b. if the Bank of Canada changed the inflation rate
 - c. if the Bank of Canada changed the exchange rate
 - d. if the Bank of Canada engaged in open-market transactions

ANS: D PTS: 1 DIF: Easy REF: p.363-364
BLM: Remember NOT: Macro TB_15-17

18. When the Bank of Canada buys government bonds, how do the reserves of the banking system change and what happens to the money supply?
- a. The reserves increase, so the money supply increases.
 - b. The reserves increase, so the money supply decreases.
 - c. The reserves decrease, so the money supply increases.
 - d. The reserves decrease, so the money supply decreases.

ANS: A PTS: 1 DIF: Easy REF: p.363
BLM: Higher Order NOT: Macro TB_15-18

19. What does liquidity refer to?
- a. the relation between the price and interest rate of an asset
 - b. the risk of an asset relative to its selling price
 - c. the ease with which an asset is converted into a medium of exchange
 - d. the sensitivity of investment spending to changes in the interest rate

ANS: C PTS: 1 DIF: Easy REF: p.364
BLM: Remember NOT: Macro TB_15-19

20. Which of the following is the most liquid asset?
- a. capital goods
 - b. stocks and bonds with a low risk
 - c. stocks and bonds with a high risk
 - d. funds in a chequing account

ANS: D PTS: 1 DIF: Easy REF: p.364
BLM: Higher Order NOT: Macro TB_15-20

21. Why do people primarily own or hold money?
- a. because it has a guaranteed nominal return
 - b. because it has a guaranteed real return
 - c. because it can directly be used to buy goods and services
 - d. because it functions as a unit of account

ANS: C PTS: 1 DIF: Easy REF: p.364
BLM: Remember NOT: Macro TB_15-21

22. When the interest rate increases, how do the opportunity cost of holding money and the quantity of money demanded change?
- a. The opportunity cost of holding money increases, so the quantity of money demanded increases.
 - b. The opportunity cost of holding money increases, so the quantity of money demanded decreases.
 - c. The opportunity cost of holding money decreases, so the quantity of money demanded increases.
 - d. The opportunity cost of holding money decreases, so the quantity of money demanded decreases.

ANS: B PTS: 1 DIF: Easy REF: p.364
BLM: Higher Order NOT: Macro TB_15-22

23. When the interest rate decreases, what happens to the opportunity cost of holding money and the quantity of money demanded?
- a. The opportunity cost of holding money increases, so the quantity of money demanded increases.
 - b. The opportunity cost of holding money increases, so the quantity of money demanded decreases.
 - c. The opportunity cost of holding money decreases, so the quantity of money demanded increases.
 - d. The opportunity cost of holding money decreases, so the quantity of money demanded decreases.

ANS: D PTS: 1 DIF: Easy REF: p.364
BLM: Higher Order NOT: Macro TB_15-23

24. When does the opportunity cost of holding money decrease or increase, and how does people's desire to hold money change?
- a. The opportunity cost of holding money decreases when the interest rate increases, so people desire to hold more money.
 - b. The opportunity cost of holding money decreases when the interest rate increases, so people desire to hold less money.
 - c. The opportunity cost of holding money increases when the interest rate increases, so people desire to hold more money.
 - d. The opportunity cost of holding money increases when the interest rate increases, so people desire to hold less money.

ANS: D PTS: 1 DIF: Easy REF: p.364
BLM: Higher Order NOT: Macro TB_15-24

25. According to liquidity preference theory, what is the opportunity cost of holding money?
- a. the interest rate on bonds
 - b. the inflation rate
 - c. the cost of converting bonds to a medium of exchange
 - d. the difference between the inflation rate and the interest rate on bonds

ANS: A PTS: 1 DIF: Easy REF: p.364
BLM: Remember NOT: Macro TB_15-25

26. According to liquidity preference theory, why is the money demand curve downward sloping?
- a. because interest rates rise as the Bank of Canada reduces the quantity of money demanded
 - b. because interest rates fall as the Bank of Canada reduces the supply of money
 - c. because people will want to hold less money as the cost of doing so falls
 - d. because people will want to hold more money as the cost of doing so falls

ANS: D PTS: 1 DIF: Easy REF: p.364
BLM: Higher Order NOT: Macro TB_15-26

27. According to the theory of liquidity preference, which of the following variables adjusts to balance the supply and demand for money?
- interest rate
 - money supply
 - quantity of output
 - price level

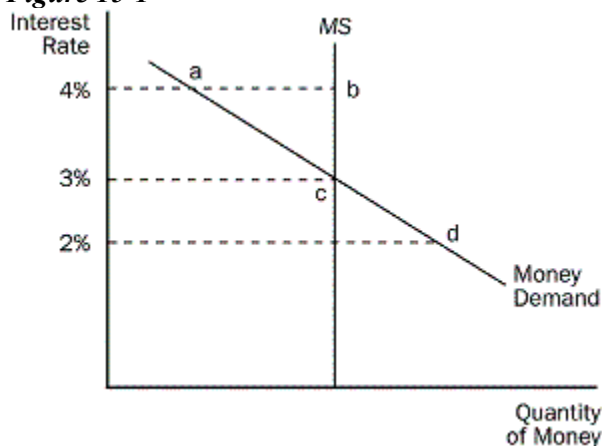
ANS: A PTS: 1 DIF: Easy REF: p.364
 BLM: Remember NOT: Macro TB_15-27

28. In recent years, the Bank of Canada has conducted policy by setting a target for which of the following?
- bank reserves
 - the monetary growth rate
 - the exchange rate
 - the bank rate

ANS: D PTS: 1 DIF: Easy REF: p.364
 BLM: Remember NOT: Macro TB_15-28

For the following questions, consult the diagram below.

Figure 15-1



29. **Refer to Figure 15-1.** Which of the following will happen if the current interest rate is 2 percent?
- There will be excess money supply.
 - People will sell more bonds, which drives interest rates up.
 - As the money market moves to equilibrium, people will buy more goods.
 - People will sell more bonds, which drives the interest rates down.

ANS: B PTS: 1 DIF: Average REF: p.365-368
 BLM: Higher Order NOT: Macro TB_15-29

30. **Refer to Figure 15-1.** At which of the following interest rates is there an excess money demand?
- a. 2 percent
 - b. 3 percent
 - c. 4 percent
 - d. 5 percent

ANS: A PTS: 1 DIF: Easy REF: p.365-368
BLM: Higher Order NOT: Macro TB_15-30

31. **Refer to Figure 15-1.** At an interest rate of 4 percent, how much is the excess money demand or supply?
- a. There is an excess money demand equal to the distance between *a* and *b*.
 - b. There is an excess money demand equal to the distance between *b* and *c*.
 - c. There is an excess money supply equal to the distance between *b* and *a*.
 - d. There is an excess money supply equal to the distance between *c* and *b*.

ANS: C PTS: 1 DIF: Average REF: p.365-368
BLM: Higher Order NOT: Macro TB_15-31

32. **Refer to Figure 15-1.** At the interest rate specified, which of the following is most likely to happen?
- a. If the interest rate is 4 percent, there is excess money demand, and the interest rate will fall.
 - b. If the interest rate is 3 percent, there is excess money supply, and the interest rate will rise.
 - c. If the interest rate is 4 percent, the demand for goods will rise when the money market is in its new equilibrium.
 - d. If the interest rate is 2 percent, there is an excess supply of money and the interest rates will rise.

ANS: C PTS: 1 DIF: Average REF: p.365-368
BLM: Higher Order NOT: Macro TB_15-32

33. According to liquidity preference theory, if the quantity of money demanded is greater than the quantity supplied, what will happen to the interest rate and the quantity of money demanded?
- a. The interest rate will increase, and the quantity of money demanded will decrease.
 - b. The interest rate will increase, and the quantity of money demanded will increase.
 - c. The interest rate will decrease, and the quantity of money demanded will decrease.
 - d. The interest rate will decrease, and the quantity of money demanded will increase.

ANS: A PTS: 1 DIF: Average REF: p.365-368
BLM: Higher Order NOT: Macro TB_15-33

34. According to liquidity preference theory, if the quantity of money supplied is greater than the quantity demanded, what will happen to the interest rate and the quantity of money demanded?
- a. The interest rate will increase, and the quantity of money demanded will decrease.
 - b. The interest rate will increase, and the quantity of money demanded will increase.
 - c. The interest rate will decrease, and the quantity of money demanded will decrease.
 - d. The interest rate will decrease, and the quantity of money demanded will increase.

ANS: D PTS: 1 DIF: Average REF: p.365-368
BLM: Higher Order NOT: Macro TB_15-34

35. If at some interest rate the quantity of money demanded is greater than the quantity of money supplied, what will people desire to do and what will happen to the interest rate?
- a. People will sell interest-bearing assets, causing the interest rate to decrease.
 - b. People will sell interest-bearing assets, causing the interest rate to increase.
 - c. People will buy interest-bearing assets, causing the interest rate to decrease.
 - d. People will buy interest-bearing assets, causing the interest rate to increase.

ANS: B PTS: 1 DIF: Average REF: p.365-366
BLM: Higher Order NOT: Macro TB_15-35

36. If at some interest rate the quantity of money supplied is greater than the quantity of money demanded, what will people desire to do and what happens to the interest rate?
- a. People will sell interest-bearing assets, causing the interest rate to decrease.
 - b. People will sell interest-bearing assets, causing the interest rate to increase.
 - c. People will buy interest-bearing assets, causing the interest rate to decrease.
 - d. People will buy interest-bearing assets, causing the interest rate to increase.

ANS: C PTS: 1 DIF: Average REF: p.365-366
BLM: Higher Order NOT: Macro TB_15-36

37. If there is excess money demand, what will people do and what happens to the interest rate?
- a. People will deposit more into interest-bearing accounts, and the interest rate will fall.
 - b. People will deposit more into interest-bearing accounts, and the interest rate will rise.
 - c. People will withdraw money from interest-bearing accounts, and the interest rate will fall.
 - d. People will withdraw money from interest-bearing accounts, and the interest rate will rise.

ANS: D PTS: 1 DIF: Average REF: p.365-366
BLM: Higher Order NOT: Macro TB_15-37

38. If there is excess money supply, what will people do and what happens to the interest rate?
- a. People will deposit more into interest-bearing accounts, and the interest rate will fall.
 - b. People will deposit more into interest-bearing accounts, and the interest rate will rise.
 - c. People will withdraw money from interest-bearing accounts, and the interest rate will fall.
 - d. People will withdraw money from interest-bearing accounts, and the interest rate will rise.

ANS: A PTS: 1 DIF: Average REF: p.365-366
BLM: Higher Order NOT: Macro TB_15-38

39. In which of the following situations do people want to hold more money?
- a. when the price level or the interest rate increases
 - b. when the price level or the interest rate decreases
 - c. when the price level increases or the interest rate decreases
 - d. when the price level decreases or the interest rate increases

ANS: C PTS: 1 DIF: Average REF: p.367
BLM: Higher Order NOT: Macro TB_15-39

40. In which of the following situations do people want to hold less money?
- a. when the price level or the interest rate increases
 - b. when the price level or the interest rate decreases
 - c. when the price level increases or the interest rate decreases
 - d. when the price level decreases or the interest rate increases

ANS: D PTS: 1 DIF: Average REF: p.367
BLM: Higher Order NOT: Macro TB_15-40

41. What is the variable that balances the money demand and supply in the liquidity preference and the classical theories?
- a. the interest rate in both theories
 - b. the price level in both theories
 - c. the interest rate in the liquidity preference theory and the price level in the classical theory
 - d. the price level in the liquidity preference theory and the interest rate in the classical theory

ANS: C PTS: 1 DIF: Average REF: p.366
BLM: Higher Order NOT: Macro TB_15-41

42. According to which theory do changes in the interest rate bring the money market into equilibrium?
- a. both liquidity preference theory and classical theory
 - b. neither liquidity preference theory nor classical theory
 - c. liquidity preference theory, but not classical theory
 - d. classical theory, but not liquidity preference theory

ANS: C PTS: 1 DIF: Average REF: p.366
BLM: Higher Order NOT: Macro TB_15-42

43. Which of the following lists of events is consistent with the long-run and short-run economic theories studied?
- a. In the long run, output is determined by the amount of capital, labour, and technology; the interest rate adjusts to balance the supply and demand for money; and the price level adjusts to balance the supply and demand for loanable funds.
 - b. In the long run, output is determined by the amount of capital, labour, and technology; the interest rate adjusts to balance the supply and demand for loanable funds; and the price level adjusts to balance the supply and demand for money.
 - c. In the long run, output is determined by the amount of capital, labour, and technology; the interest rate adjusts to balance the supply and demand for loanable funds; and the price level is stuck.
 - d. In the long run, output responds to the aggregate demand for goods and services; the interest rate adjusts to balance the supply and demand for loanable funds; and the price level adjusts to balance the supply and demand for money.

ANS: B PTS: 1 DIF: Average REF: p.365-366
BLM: Higher Order NOT: Macro TB_15-43

44. Which of the following lists of events is consistent with the long-run and short-run economic theories studied?
- a. In the short run, output is determined by the amount of capital, labour, and technology; the interest rate adjusts to balance the supply and demand for money; and the price level adjusts to balance the supply and demand for loanable funds.
 - b. In the short run, output is determined by the amount of capital, labour, and technology; the interest rate adjusts to balance the supply and demand for loanable funds; and the price level adjusts to balance the supply and demand for money.
 - c. In the short run, output responds to the aggregate demand for goods and services; the interest rate adjusts to balance the supply and demand for money; and the price level is stuck.
 - d. In the short run, output responds to the aggregate demand for goods and services; the interest rate adjusts to balance the supply and demand for loanable funds; and the price level adjusts to balance the supply and demand for money.

ANS: C PTS: 1 DIF: Average REF: p.365-366
BLM: Higher Order NOT: Macro TB_15-44

45. The effects of the interest rate in the short run are usually best shown using which theory?
- a. either liquidity preference theory or classical theory
 - b. neither liquidity preference theory or classical theory
 - c. only liquidity preference theory
 - d. only classical theory

ANS: C PTS: 1 DIF: Average REF: p.365-366
BLM: Higher Order NOT: Macro TB_15-45

46. Which of the following shifts money demand to the right?
- a. an increase in the price level
 - b. a decrease in the price level
 - c. an increase in the interest rate
 - d. a decrease in the interest rate

ANS: A PTS: 1 DIF: Average REF: p.366-368
BLM: Remember NOT: Macro TB_15-46

47. Which of the following shifts money demand to the left?
- a. an increase in the price level
 - b. a decrease in the price level
 - c. an increase in the interest rate
 - d. a decrease in the interest rate

ANS: B PTS: 1 DIF: Average REF: p.366-368
BLM: Higher Order NOT: Macro TB_15-47

48. Which of the following shifts money demand to the right?
- a. an increase in either the price level or the interest rate
 - b. an increase in the price level or a decrease in the interest rate
 - c. a decrease in the interest rate but not a change in the price level
 - d. an increase in the price level but not a change in the interest rate

ANS: D PTS: 1 DIF: Average REF: p.366-368
BLM: Remember NOT: Macro TB_15-48

49. Assume the money market is initially in equilibrium. If the price level increases, according to liquidity preference theory, what is in excess and for how long?
- The supply of money is in excess until the interest rate increases.
 - The supply of money is in excess until the interest rate decreases.
 - The demand for money is in excess until the interest rate increases.
 - The demand for money is in excess until the interest rate decreases.

ANS: C PTS: 1 DIF: Average REF: p.366-368
BLM: Higher Order NOT: Macro TB_15-49

50. Assume the money market is initially in equilibrium. If the price level decreases, according to liquidity preference theory, what is in excess and for how long?
- The supply of money is in excess until the interest rate increases.
 - The supply of money is in excess until the interest rate decreases.
 - The demand for money is in excess until the interest rate increases.
 - The demand for money is in excess until the interest rate decreases.

ANS: B PTS: 1 DIF: Average REF: p.366-368
BLM: Higher Order NOT: Macro TB_15-50

51. According to liquidity preference theory, if the price level increases, how do the equilibrium interest rate and the aggregate quantity of goods change?
- The interest rate and the quantity demanded rise.
 - The interest rate rises and the quantity demanded falls.
 - The interest rate falls and the quantity demanded rises.
 - The interest rate and the quantity demanded fall.

ANS: B PTS: 1 DIF: Average REF: p.366-368
BLM: Higher Order NOT: Macro TB_15-51

52. According to liquidity preference theory, if the price level increases, in which direction does the demand curve shift, and how does the interest rate change?
- The demand curve shifts right, so the interest rate increases.
 - The demand curve shifts right, so the interest rate decreases.
 - The demand curve shifts left, so the interest rate decreases.
 - The demand curve shifts left, so the interest rate increases.

ANS: A PTS: 1 DIF: Easy REF: p.366-368
BLM: Higher Order

53. Which of the following is an effect of an increase in the interest rate?
- It induces firms to invest more.
 - It induces households to increase consumption.
 - It shifts money demand to the right.
 - It leads to the appreciation of the exchange rate.

ANS: D PTS: 1 DIF: Average REF: p.367-369
BLM: Remember NOT: Macro TB_15-53

54. Which of the following is an effect of an increase in the interest rate?
- a. People put more money in their savings accounts.
 - b. Foreign citizens decide to buy fewer Canadian bonds.
 - c. Firms decide to purchase new machinery.
 - d. People decide to consume more.

ANS: A PTS: 1 DIF: Easy REF: p.368
BLM: Higher Order NOT: Macro TB_15-54

55. According to liquidity preference theory, how are the price level and the interest rate related?
- a. positively
 - b. inversely
 - c. negatively
 - d. unrelated

ANS: A PTS: 1 DIF: Average REF: p.368
BLM: Higher Order NOT: Macro TB_15-55

56. According to liquidity preference theory, other things equal, a higher price level leads households to do which of the following in the short run?
- a. increase consumption
 - b. decrease the amount of cash they want to hold
 - c. buy bonds
 - d. decrease consumption

ANS: D PTS: 1 DIF: Average REF: p.368
BLM: Higher Order NOT: Macro TB_15-46

57. According to liquidity preference theory, how does an increase in the price level affect the interest rate and output demanded, respectively?
- a. The interest rate increases, and output demanded increases.
 - b. The interest rate increases, and output demanded decreases.
 - c. The interest rate decreases, and output demanded increases.
 - d. The interest rate decreases, and output demanded decreases.

ANS: B PTS: 1 DIF: Average REF: p.368
BLM: Higher Order NOT: Macro TB_15-57

58. According to liquidity preference theory, how does a decrease in the price level affect the interest rate and output demanded, respectively?
- a. The interest rate increases, and output demanded increases.
 - b. The interest rate increases, and output demanded decreases.
 - c. The interest rate decreases, and output demanded increases.
 - d. The interest rate decreases, and output demanded decreases.

ANS: C PTS: 1 DIF: Average REF: p.368
BLM: Higher Order NOT: Macro TB_15-58

59. According to the theory of liquidity preference, what does an increase in the price level cause the interest rate and investment to do?
- a. It causes both the interest rate and investment to rise.
 - b. It causes both the interest rate and investment to fall.
 - c. It causes the interest rate to rise and investment to fall.
 - d. It causes the interest rate to fall and investment to rise.

ANS: C PTS: 1 DIF: Average REF: p.368
BLM: Higher Order NOT: Macro TB_15-59

60. According to the theory of liquidity preference, what does a decrease in the price level cause the interest rate and investment to do?
- a. It causes both the interest rate and investment to rise.
 - b. It causes both the interest rate and investment to fall.
 - c. It causes the interest rate to rise and investment to fall.
 - d. It causes the interest rate to fall and investment to rise.

ANS: D PTS: 1 DIF: Average REF: p.368
BLM: Higher Order NOT: Macro TB_15-60

61. According to liquidity preference theory, when do people demand fewer goods and services?
- a. when the price level or interest rate increase
 - b. when the price level or interest rate decrease
 - c. when the price level increases or the interest rate decreases
 - d. when the price level decreases or the interest rate increases

ANS: A PTS: 1 DIF: Average REF: p.368
BLM: Higher Order NOT: Macro TB_15-61

62. What is the main reason the aggregate demand curve slopes downward?
- a. As the price level increases, interest rates increase, and investment decreases.
 - b. As the price level increases, interest rates decrease, and investment increases.
 - c. As the price level decreases, interest rates increase, and investment increases.
 - d. As the price level decreases, interest rates decrease, and investment decreases.

ANS: A PTS: 1 DIF: Average REF: p.368
BLM: Remember NOT: Macro TB_15-62

63. Which of the following properly describes the interest rate effect?
- a. As the money supply increases, the interest rate falls, so spending rises.
 - b. As the money supply increases, the interest rate rises, so spending falls.
 - c. As the price level increases, the interest rate falls, so spending rises.
 - d. As the price level increases, the interest rate rises, so spending falls.

ANS: D PTS: 1 DIF: Average REF: p.369-370
BLM: Higher Order NOT: Macro TB_15-63

64. Which of the following properly describes the interest rate effect?
- a. A higher price level leads to higher money demand, higher money demand leads to higher interest rates, and a higher interest rate increases the quantity of goods and services demanded.
 - b. A higher price level leads to higher money demand, higher money demand leads to lower interest rates, and a higher interest rate reduces the quantity of goods and services demanded.
 - c. A lower price level leads to lower money demand, lower money demand leads to lower interest rates, and a lower interest rate reduces the quantity of goods and services demanded.
 - d. A lower price level leads to lower money demand, lower money demand leads to lower interest rates, and a lower interest rate increases the quantity of goods and services demanded.

ANS: D PTS: 1 DIF: Average REF: p.369-370
BLM: Higher Order NOT: Macro TB_15-64

65. In the short run, an increase in the money supply causes interest rates and aggregate demand to do what?
- a. It causes interest rates to increase and aggregate demand to shift right.
 - b. It causes interest rates to increase and aggregate demand to shift left.
 - c. It causes interest rates to decrease and aggregate demand to shift right.
 - d. It causes interest rates to decrease and aggregate demand to shift left.

ANS: C PTS: 1 DIF: Average REF: p.369-370
BLM: Higher Order NOT: Macro TB_15-65

66. In the short run, a decrease in the money supply causes interest rates and aggregate demand to do what?
- a. It causes interest rates to increase and aggregate demand to shift right.
 - b. It causes interest rates to increase and aggregate demand to shift left.
 - c. It causes interest rates to decrease and aggregate demand to shift right.
 - d. It causes interest rates to decrease and aggregate demand to shift left.

ANS: B PTS: 1 DIF: Average REF: p.369-370
BLM: Higher Order NOT: Macro TB_15-66

67. Which of the following shifts aggregate demand to the right?
- a. an increase in the price level
 - b. an increase in the money supply
 - c. a decrease in the price level
 - d. a decrease in the money supply

ANS: B PTS: 1 DIF: Easy REF: p.369-370
BLM: Higher Order NOT: Macro TB_15-67

68. Which of the following shifts aggregate demand to the left?

- a. an increase in the price level
- b. an increase in the money supply
- c. a decrease in the price level
- d. a decrease in the money supply

ANS: D

PTS: 1

DIF: Average

REF: p.369-370

BLM: Higher Order

NOT: Macro TB_15-68

69. Which of the following shifts aggregate demand right?

- a. an increase in interest rates
- b. a decrease in the price level
- c. a decrease in the money supply
- d. a decrease in the bank rate

ANS: D

PTS: 1

DIF: Easy

REF: p.369-370

BLM: Higher Order

NOT: Macro TB_15-69

70. If the Bank of Canada conducts open-market sales, how do the money supply and the aggregate demand change?

- a. The money supply increases, and aggregate demand shifts right.
- b. The money supply increases, and aggregate demand shifts left.
- c. The money supply decreases, and aggregate demand shifts right.
- d. The money supply decreases, and aggregate demand shifts left.

ANS: D

PTS: 1

DIF: Average

REF: p.370

BLM: Higher Order

NOT: Macro TB_15-70

71. If the Bank of Canada conducts open-market purchases, how do the money supply and the aggregate demand change?

- a. The money supply increases, and aggregate demand shifts right.
- b. The money supply increases, and aggregate demand shifts left.
- c. The money supply decreases, and aggregate demand shifts right.
- d. The money supply decreases, and aggregate demand shifts left.

ANS: A

PTS: 1

DIF: Average

REF: p.370

BLM: Higher Order

NOT: Macro TB_15-71

72. What does a monetary injection by the Bank of Canada do to interest rates and aggregate demand?

- a. It increases interest rates and increases aggregate demand.
- b. It increases interest rates and decreases aggregate demand.
- c. It decreases interest rates and decreases aggregate demand.
- d. It decreases interest rates and increases aggregate demand.

ANS: D

PTS: 1

DIF: Average

REF: p.370

BLM: Higher Order

NOT: Macro TB_15-72

73. What do open-market purchases do to the price level and real GDP?

- a. They increase the price level and real GDP.
- b. They decrease the price level and real GDP.
- c. They increase the price level and decrease real GDP.
- d. They decrease the price level and increase real GDP.

ANS: A PTS: 1 DIF: Average REF: p.370
BLM: Higher Order NOT: Macro TB_15-73

74. What do open-market sales do to the price level and real GDP?

- a. They increase the price level and real GDP.
- b. They decrease the price level and real GDP.
- c. They increase the price level and decrease real GDP.
- d. They decrease the price level and increase real GDP.

ANS: B PTS: 1 DIF: Average REF: p.370
BLM: Higher Order NOT: Macro TB_15-74

75. The economy is in long-run equilibrium. Suppose that automatic teller machines become cheaper and more convenient to use, and as a result the demand for money falls. Other things equal, what would we expect will happen to the price level and real GDP in the short and long run?

- a. In the short run, the price level and real GDP would rise, but in the long run they would both be unaffected.
- b. In the short run, the price level and real GDP would rise, but in the long run the price level would rise and real GDP would be unaffected.
- c. In the short run, the price level and real GDP would fall, but in the long run they would both be unaffected.
- d. In the short run, the price level and real GDP would fall, but in the long run the price level would fall and real GDP would be unaffected.

ANS: B PTS: 1 DIF: Challenging REF: p.370
BLM: Higher Order NOT: Macro TB_15-75

76. How does the interest rate change when the price level falls and when the money supply falls?

- a. The interest rate rises both when the price level falls and when the money supply falls.
- b. The interest rate rises when the price level falls and falls when the money supply falls.
- c. The interest rate falls when the price level falls and rises when the money supply falls.
- d. The interest rate falls both when the price level falls and when the money supply falls.

ANS: C PTS: 1 DIF: Average REF: p.370
BLM: Higher Order NOT: Macro TB_15-76

77. Which of the following principles does the theory of liquidity preference illustrate?

- a. Monetary policy can be described either in terms of the money supply or in terms of the interest rate.
- b. Monetary policy can be described either in terms of the exchange rate or the interest rate.
- c. Monetary policy must be described in terms of the money supply.
- d. Monetary policy must be described in terms of the interest rate.

ANS: A PTS: 1 DIF: Easy REF: p.370
BLM: Higher Order NOT: Macro TB_15-77

78. When a central bank sets a target for the interest rate, it commits itself to which of the following?
- a. revealing its target to the public
 - b. adjusting the demand for money in order to make the equilibrium in the money market hit that target
 - c. adjusting the money supply in order to meet the interest rate target
 - d. having to make open-market sales

ANS: C PTS: 1 DIF: Easy REF: p.370
BLM: Remember NOT: Macro TB_15-78

79. If a central bank targets the interest rate, what does this imply?
- a. The central bank can then set the money supply at whatever value it wants.
 - b. The central bank must increase the money supply if the interest rate is above its target.
 - c. The central bank must decrease the money supply if the interest rate is above its target.
 - d. The central bank must not change the money supply.

ANS: B PTS: 1 DIF: Easy REF: p.370
BLM: Higher Order NOT: Macro TB_15-79

80. If the interest rate is above a central bank's target, what should the central bank do?
- a. buy bonds to increase the money supply
 - b. buy bonds to decrease the money supply
 - c. sell bonds to increase the money supply
 - d. sell bonds to decrease the money supply

ANS: A PTS: 1 DIF: Average REF: p.370
BLM: Higher Order NOT: Macro TB_15-80

81. If the interest rate is below a central bank's target, what should the central bank do?
- a. buy bonds to increase the money supply
 - b. buy bonds to decrease the money supply
 - c. sell bonds to increase the money supply
 - d. sell bonds to decrease the money supply

ANS: D PTS: 1 DIF: Average REF: p.370
BLM: Higher Order NOT: Macro TB_15-81

82. Why are monetary authorities concerned about stock market booms?
- a. because the booms decrease consumption spending
 - b. because the booms decrease investment spending
 - c. because the booms increase consumption spending
 - d. because the booms increase government deficit

ANS: C PTS: 1 DIF: Average REF: p.374-376
BLM: Higher Order NOT: Macro TB_15-82

83. Which of the following actions might we logically expect to result from rising stock prices?
- a. Jim increases his consumption spending.
 - b. Firms sell fewer shares of new stock.
 - c. Firms spend less on investment.
 - d. People will save less.

ANS: A PTS: 1 DIF: Average REF: p.374-376
BLM: Higher Order NOT: Macro TB_15-83

84. What is the effect of a stock market boom, and how could the Bank of Canada offset that effect?
- a. Aggregate demand increases, which Bank of Canada could offset by increasing the money supply.
 - b. Aggregate supply increases, which Bank of Canada could offset by increasing the money supply.
 - c. Aggregate demand increases, which Bank of Canada could offset by decreasing the money supply.
 - d. Aggregate supply increases, which Bank of Canada could offset by decreasing the money supply.

ANS: C PTS: 1 DIF: Average REF: p.374-376
BLM: Higher Order NOT: Macro TB_15-84

85. How does a stock market boom affect household spending, and how would the Bank of Canada offset the effects on the price level and real GDP?
- a. Household spending increases; the Bank of Canada would increase the money supply.
 - b. Household spending increases; the Bank of Canada would decrease the money supply.
 - c. Household spending decreases; the Bank of Canada would increase the money supply.
 - d. Household spending decreases; the Bank of Canada would decrease the money supply.

ANS: B PTS: 1 DIF: Average REF: p.374-376
BLM: Higher Order NOT: Macro TB_15-85

86. If the stock market crashes, what would be the effect on aggregate demand and how could the Bank of Canada offset those effects?
- a. aggregate demand increases; by increasing the money supply
 - b. aggregate demand increases; by decreasing the money supply
 - c. aggregate demand decreases; by increasing the money supply
 - d. aggregate demand decreases; by decreasing the money supply

ANS: C PTS: 1 DIF: Average REF: p.374-376
BLM: Higher Order NOT: Macro TB_15-86

87. When the Bank of Canada decreases the money supply, what do we expect to happen to interest rates and stock prices?
- a. Interest rates and stock prices both rise.
 - b. Interest rates and stock prices both fall.
 - c. Interest rates rise and stock prices fall.
 - d. Interest rates fall and stock prices rise.

ANS: C PTS: 1 DIF: Average REF: p.374-376
BLM: Higher Order NOT: Macro TB_15-87

88. In a small open economy with a flexible exchange rate, a monetary injection causes which of the following?
- a. It causes the dollar to appreciate.
 - b. It causes net exports to decline.
 - c. It causes an additional decrease in demand for Canadian-produced goods that is not realized in a closed economy.
 - d. It causes a shift of the aggregate demand curve farther to the right than in a closed economy.

ANS: D PTS: 1 DIF: Average REF: p.373
BLM: Higher Order NOT: Macro TB_15-88

89. In a small open economy with a flexible exchange rate, a monetary injection by the Bank of Canada causes which of the following?
- a. It causes the dollar to appreciate.
 - b. It causes net exports to fall.
 - c. It causes an additional decrease in demand for Canadian-produced goods and services that is not realized in a closed economy.
 - d. It causes a shift of the aggregate demand curve farther to the right than it would in a closed economy.

ANS: D PTS: 1 DIF: Average REF: p.373
BLM: Higher Order NOT: Macro TB_15-89

90. What does fiscal policy primarily affect in the long run and the short run, respectively?
- a. aggregate demand in the long run; aggregate supply in the short run
 - b. aggregate supply in the long run; saving, investment, and growth in the short run
 - c. saving, investment, and growth in the long run; aggregate demand in the short run
 - d. saving, investment, and growth in the long run; aggregate supply in the short run

ANS: C PTS: 1 DIF: Easy REF: p.376
BLM: Higher Order NOT: Macro TB_15-90

91. Fiscal policy refers to the idea that aggregate demand is changed by changes in what?
- a. the money supply
 - b. government spending and taxes
 - c. trade policy
 - d. exchange rates

ANS: B PTS: 1 DIF: Easy REF: p.376
BLM: Remember NOT: Macro TB_15-91

92. An increase in government spending initially and primarily shifts which curve in what direction?
- a. aggregate demand right
 - b. aggregate demand left
 - c. aggregate supply right
 - d. neither aggregate demand nor aggregate supply

ANS: A PTS: 1 DIF: Easy REF: p.376
BLM: Higher Order NOT: Macro TB_15-92

93. A decrease in government spending initially and primarily shifts which curve in what direction?
- a. aggregate demand right
 - b. aggregate demand left
 - c. aggregate supply right
 - d. neither aggregate demand nor aggregate supply

ANS: B PTS: 1 DIF: Easy REF: p.376
BLM: Higher Order NOT: Macro TB_15-93

94. Which of the following shifts aggregate demand right?
- a. an increase in government expenditures or a decrease in the price level
 - b. a decrease in government expenditures or an increase in the price level
 - c. an increase in government expenditures, but not a change in the price level
 - d. a decrease in the price level, but not an increase in government expenditures

ANS: C PTS: 1 DIF: Easy REF: p.376
BLM: Higher Order NOT: Macro TB_15-94

95. Which of the following tends to make aggregate demand shift right farther than the amount government expenditures increase?
- a. the crowding-out effect
 - b. the multiplier effect
 - c. the wealth effect
 - d. the interest-rate effect

ANS: B PTS: 1 DIF: Easy REF: p.377
BLM: Higher Order NOT: Macro TB_15-95

96. Which of the following best defines the multiplier effect?
- a. the multiplied impact on the money supply of a given increase in government purchases
 - b. the multiplied impact on tax revenues of a given increase in government purchases
 - c. the multiplied impact on investment of a given increase in interest rates
 - d. the multiplied impact on aggregate demand of a given increase in government purchases

ANS: D PTS: 1 DIF: Easy REF: p.377
BLM: Remember NOT: Macro TB_15-96

97. The government buys a bridge. The owner of the company that builds the bridge pays her workers. The workers increase their spending. Firms that the workers buy goods from increase their output. Which of the following does this type of effect on spending illustrate?
- a. the multiplier effect
 - b. the crowding-out effect
 - c. the marginal propensity to consume effect
 - d. the catch-up effect

ANS: A PTS: 1 DIF: Easy REF: p.377
BLM: Higher Order NOT: Macro TB_15-97

98. Which of the following illustrates how the investment accelerator works?
- a. An increase in government expenditures increases the interest rate so that the Sleepwell Hotel chain decides to build fewer new hotels.
 - b. An increase in government expenditures increases aggregate spending so that the Sleepwell Hotel chain finds it profitable to build more new hotels.
 - c. An increase in government expenditures increases the interest rate so that the demand for stocks and bonds issued by the Sleepwell Hotel chain rises.
 - d. An increase in government expenditures decreases the interest rate so that the Sleepwell Hotel chain decides to build more new hotels.

ANS: B PTS: 1 DIF: Average REF: p.378
BLM: Higher Order NOT: Macro TB_15-98

99. Which of the following terms refers to the positive feedback from aggregate demand to investment?
- a. the investment multiplier
 - b. the stock-market effect
 - c. the investment accelerator
 - d. the crowding-in multiplier

ANS: C PTS: 1 DIF: Average REF: p.378
BLM: Remember NOT: Macro TB_15-99

100. Which of the following best defines the marginal propensity to consume (*MPC*)?
- a. the fraction of extra income that a household consumes rather than saves
 - b. the fraction of extra income that a household either consumes or saves
 - c. the fraction of total income that a household consumes rather than saves
 - d. the fraction of total income that a household either consumes or saves

ANS: A PTS: 1 DIF: Average REF: p.378
BLM: Remember NOT: Macro TB_15-100

101. Which of the following defines the government purchases multiplier?
- a. *MPC*
 - b. $1 - MPC$
 - c. $1/MPC$
 - d. $1/(1 - MPC)$

ANS: D PTS: 1 DIF: Average REF: p.379
BLM: Remember NOT: Macro TB_15-101

102. Which of the following defines the government purchases multiplier?
- a. $1/MPC$
 - b. $1/(1 - MPC)$
 - c. $MPC/(1 - MPC)$
 - d. $(1 - MPC)/MPC$

ANS: B PTS: 1 DIF: Average REF: p.379
BLM: Remember NOT: Macro TB_15-102

103. If the $MPC = 5/6$, what is the government purchases multiplier?

- a. $1/6$
- b. $5/6$
- c. $6/5$
- d. 6

ANS: D PTS: 1 DIF: Average REF: p.379
BLM: Higher Order NOT: Macro TB_15-103

104. If the $MPC = 0.9$, what is the government purchases multiplier?

- a. 0.10
- b. 1
- c. 1.11
- d. 10

ANS: D PTS: 1 DIF: Average REF: p.379
BLM: Higher Order NOT: Macro TB_15-104

105. Assume that the MPC is 0.80. What is the multiplier?

- a. .20
- b. .25
- c. 5
- d. 8

ANS: C PTS: 1 DIF: Average REF: p.381
BLM: Higher Order NOT: Macro TB_15-105

106. If the MPC is 0, what is the multiplier?

- a. 0
- b. 1
- c. 10
- d. 100

ANS: B PTS: 1 DIF: Average REF: p.383
BLM: Higher Order NOT: Macro TB_15-106

107. As the MPC gets close to 1, what does the value of the multiplier approach?

- a. 0
- b. 1
- c. 10
- d. infinity

ANS: D PTS: 1 DIF: Average REF: p.379
BLM: Higher Order NOT: Macro TB_15-107

108. How does the multiplier change when the *MPC* increases, and what is the effect on aggregate demand?
- a. Higher *MPC* increases the multiplier, so that changes in government expenditures have a larger effect on aggregate demand.
 - b. Higher *MPC* increases the multiplier, so that changes in government expenditures have a smaller effect on aggregate demand.
 - c. Higher *MPC* decreases the multiplier, so that changes in government expenditures have a larger effect on aggregate demand.
 - d. Higher *MPC* decreases the multiplier, so that changes in government expenditures have a smaller effect on aggregate demand.

ANS: A PTS: 1 DIF: Easy REF: p.379
BLM: Higher Order NOT: Macro TB_15-108

109. If the multiplier is 4, what is the *MPC*?
- a. 0.25
 - b. 0.5
 - c. 0.75
 - d. 1.00

ANS: C PTS: 1 DIF: Average REF: p.379
BLM: Higher Order NOT: Macro TB_15-109

110. If the multiplier is 6, what is the *MPC*?
- a. 1/6
 - b. 1/2
 - c. 4/5
 - d. 5/6

ANS: D PTS: 1 DIF: Average REF: p.379
BLM: Higher Order NOT: Macro TB_15-110

111. Which of the following terms refers to the reduction in demand that results when a fiscal expansion raises the interest rate?
- a. the multiplier effect
 - b. the crowding-out effect
 - c. the accelerator effect
 - d. the Ricardian equivalence effect

ANS: B PTS: 1 DIF: Average REF: p.380-381
BLM: Remember NOT: Macro TB_15-111

112. According to the crowding-out effect, how do the interest rate and investment spending change when government spending increases?
- a. The interest rate and investment spending both increase.
 - b. The interest rate increases and investment spending decreases.
 - c. The interest rate decreases and investment spending increases.
 - d. The interest rate and investment spending both decrease.

ANS: B PTS: 1 DIF: Average REF: p.381
BLM: Higher Order NOT: Macro TB_15-112

113. According to the crowding-out effect, how does a decrease in government spending affect the interest rate and investment spending?

- a. It increases the interest rate and so increases investment spending.
- b. It increases the interest rate and so decreases investment spending.
- c. It decreases the interest rate and so increases investment spending.
- d. It decreases the interest rate and so decreases investment spending.

ANS: C PTS: 1 DIF: Average REF: p.381
BLM: Higher Order NOT: Macro TB_15-113

114. Which of the following is an effect of an increase in government purchases?

- a. It decreases interest rates.
- b. It results in a net decrease in aggregate demand.
- c. It crowds out investment spending by business.
- d. It decreases money demand.

ANS: C PTS: 1 DIF: Average REF: p.381
BLM: Higher Order NOT: Macro TB_15-114

115. If there is crowding out, which of the following might decrease as government expenditures increase?

- a. the overall change in real GDP
- b. the demand for money curve
- c. interest rates
- d. demand for capital goods

ANS: D PTS: 1 DIF: Average REF: p.380-381
BLM: Higher Order NOT: Macro TB_15-115

116. Which of the following correctly explains the crowding-out effect?

- a. An increase in government expenditures decreases the interest rate and so increases investment spending.
- b. An increase in government expenditures increases the interest rate and so reduces investment spending.
- c. A decrease in government expenditures increases the interest rate and so increases investment spending.
- d. A decrease in government expenditures decreases the interest rate and so reduces investment spending.

ANS: B PTS: 1 DIF: Average REF: p.380-381
BLM: Higher Order NOT: Macro TB_15-116

117. Assuming no crowding-out, investment-accelerator, or multiplier effects, how will a \$200 billion increase in government expenditures shift aggregate demand?

- a. It will shift aggregate demand right by more than \$200 billion.
- b. It will shift aggregate demand right by \$200 billion.
- c. It will shift aggregate demand right by less than \$200 billion.
- d. It will shift aggregate demand left by more than \$200 billion.

ANS: B PTS: 1 DIF: Average REF: p.381
BLM: Higher Order NOT: Macro TB_15-117

118. Assuming the multiplier effect but no crowding-out or investment-accelerator effects, what is the effect of a \$300 billion increase in government expenditures on the aggregate demand or supply?
- a. It shifts the aggregate demand right by more than \$300 billion.
 - b. It shifts the aggregate demand right by less than \$300 billion.
 - c. It shifts the aggregate demand right by exactly \$300 billion
 - d. It shifts the aggregate supply left by more than \$300 billion.

ANS: A PTS: 1 DIF: Average REF: p.381
BLM: Higher Order NOT: Macro TB_15-118

119. Assuming the crowding-out effect but no multiplier or investment-accelerator effects, what is the effect of a \$500 billion increase in government expenditures on the aggregate demand or supply?
- a. It shifts the aggregate demand right by more than \$500 billion.
 - b. It shifts the aggregate demand right by less than \$500 billion.
 - c. It shifts the aggregate supply left by more than \$500 billion.
 - d. It shifts the aggregate supply left by less than \$500 billion.

ANS: B PTS: 1 DIF: Challenging REF: p.381
BLM: Higher Order NOT: Macro TB_15-119

120. If the MPC is 0.75 and there are no crowding-out or accelerator effects, an initial increase in AD of \$200 billion will eventually shift the AD curve to the right by how much?
- a. \$80 billion
 - b. \$133.33 billion
 - c. \$150 billion
 - d. \$800 billion

ANS: D PTS: 1 DIF: Average REF: p.381
BLM: Higher Order NOT: Macro TB_15-120

121. Suppose that the MPC is 0.50 and there is no investment accelerator or crowding-out effects. If government expenditures increase by \$20 billion, what happens to aggregate demand?
- a. It shifts right by \$20 billion.
 - b. It shifts right by \$25 billion.
 - c. It shifts right by \$40 billion.
 - d. It shifts left by \$40 billion.

ANS: C PTS: 1 DIF: Average REF: p.381
BLM: Higher Order NOT: Macro TB_15-121

122. Assume that the MPC is 0.75. Assuming only the multiplier effect matters, how will an increase in government purchases of \$400 billion shift the aggregate demand curve?
- a. It will shift the aggregate demand curve left by \$150 billion.
 - b. It will shift the aggregate demand curve left by \$250 billion.
 - c. It will shift the aggregate demand curve right by \$750 billion.
 - d. It will shift the aggregate demand curve right by \$1600 billion.

ANS: D PTS: 1 DIF: Average REF: p.381
BLM: Higher Order NOT: Macro TB_15-122

123. Assume that the MPC is 0.8. Assuming that only the multiplier effect matters, how will a decrease in government purchases of \$15 billion shift the aggregate demand curve?
- It will shift the aggregate demand curve left by \$12 billion.
 - It will shift the aggregate demand curve left by \$15 billion.
 - It will shift the aggregate demand curve right by \$15 billion.
 - It will shift the aggregate demand curve left by \$75 billion.

ANS: D PTS: 1 DIF: Average REF: p.381
BLM: Higher Order NOT: Macro TB_15-123

124. Assume that the MPC is 0.8. Assume that there is a multiplier effect and that the total crowding-out effect is \$7 billion. How will an increase in government purchases of \$8 billion shift aggregate demand?
- It will shift aggregate demand left by \$1 billion.
 - It will shift aggregate demand left by \$33 billion.
 - It will shift aggregate demand right by \$1 billion.
 - It will shift aggregate demand right by \$33 billion.

ANS: D PTS: 1 DIF: Average REF: p.381
BLM: Higher Order NOT: Macro TB_15-124

125. Assume that the MPC is 0.8. Assume that the total crowding-out effect is \$25 billion. How will an increase in government purchases of \$9 billion shift the AD curve?
- It will shift the AD curve right by \$25 billion.
 - It will shift the AD curve left by \$25 billion.
 - It will shift the AD curve right by \$20 billion.
 - It will shift the AD curve left by \$20 billion.

ANS: C PTS: 1 DIF: Average REF: p.381
BLM: Higher Order NOT: Macro TB_15-125

126. How do the multiplier effect and the crowding-out effect change the consequences of an increase in government spending?
- They both amplify the consequences.
 - They both diminish the consequences.
 - The multiplier effect diminishes the consequences, while the crowding-out effect amplifies the consequences.
 - The multiplier effect amplifies the consequences, while the crowding-out effect diminishes the consequences.

ANS: D PTS: 1 DIF: Easy REF: p.381
BLM: Higher Order NOT: Macro TB_15-126

127. In a small open economy with a flexible exchange rate, an expansionary fiscal policy will cause which of the following to happen?
- It will cause the dollar to depreciate.
 - It will cause the dollar to appreciate.
 - It will cause net exports to increase.
 - It will cause a lasting effect on aggregate demand.

ANS: B PTS: 1 DIF: Easy REF: p.384
BLM: Higher Order NOT: Macro TB_15-127

128. In a small open economy with a flexible exchange rate, an expansionary fiscal policy will cause which of the following to happen?
- It will cause the dollar to depreciate.
 - It will cause net exports to rise.
 - It will cause an additional investment accelerator effect.
 - It will cause a reduction in the demand for Canadian-produced goods.

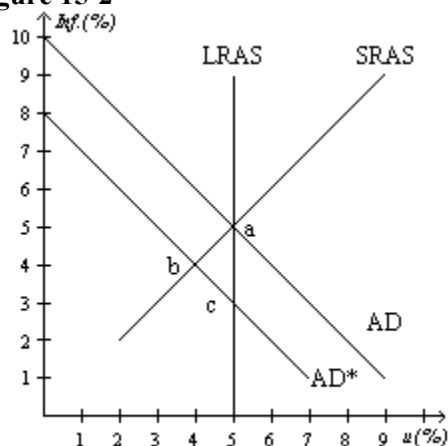
ANS: D PTS: 1 DIF: Easy REF: p.384
 BLM: Higher Order NOT: Macro TB_15-128

129. If the Bank of Canada chooses to prevent any change in the exchange rate when government spending increases, which of the following is most likely to happen?
- crowding out effects
 - no crowding out effects
 - no increase in the demand for goods and services
 - a decrease in aggregate demand

ANS: B PTS: 1 DIF: Average REF: p.386
 BLM: Higher Order NOT: Macro TB_15-129

For the following questions, consult the diagram below.

Figure 15-2



130. **Refer to Figure 15-2.** In a closed economy, which of the following would cause the aggregate demand curve to shift from AD to AD^* ?
- an increase in government purchases
 - a decrease in stock prices
 - consumers and firms becoming more optimistic about the future
 - an increase in the price level

ANS: B PTS: 1 DIF: Average REF: p.387
 BLM: Higher Order NOT: Macro TB_15-130

131. **Refer to Figure 15-2.** In a closed economy, which of the following could have caused the economy to move from *a* to *b*?
- a. a wave of optimism
 - b. a decrease in price
 - c. either fiscal or monetary contraction
 - d. an increase in the price of oil

ANS: C PTS: 1 DIF: Easy REF: p.387
BLM: Higher Order NOT: Macro TB_15-131

132. **Refer to Figure 15-2.** If the closed economy is at point *b*, which of the following is the best policy to restore full employment?
- a. increasing the money supply
 - b. decreasing government purchases
 - c. increasing taxes
 - d. selling Canadian dollars

ANS: A PTS: 1 DIF: Average REF: p.387
BLM: Higher Order

133. **Refer to Figure 15-2.** Which of the following can happen in a closed economy?
- a. Unemployment falls as the economy moves from *a* to *b*.
 - b. Fiscal policy is ineffective to move the economy from *b* to *a*.
 - c. If the economy is left alone, then as the economy moves from *b* to long-run equilibrium, the price level will increase.
 - d. An increase in money supply increases both output and prices.

ANS: D PTS: 1 DIF: Easy REF: p.387
BLM: Higher Order NOT: Macro TB_15-133

134. In a small open economy with perfect capital mobility, if exchange rates are fixed, how could aggregate demand be increased?
- a. by increasing government expenditures
 - b. by increasing tax rates
 - c. by increasing the money supply
 - d. by decreasing the money supply

ANS: A PTS: 1 DIF: Average REF: p.387
BLM: Higher Order NOT: Macro TB_15-134

135. In a small open economy with perfect capital mobility, if the exchange rate is flexible, which of the following would be the effect of an expansionary monetary policy?
- a. It would cause the domestic interest rate to remain above the world interest rate.
 - b. It would cause the domestic interest rate to remain below the world interest rate.
 - c. It would leave the domestic interest rate equal to the world interest rate.
 - d. It would cause the domestic currency to appreciate.

ANS: C PTS: 1 DIF: Average REF: p.387
BLM: Remember NOT: Macro TB_15-135

136. In a small open economy with perfect capital mobility, if the Bank of Canada chooses to fix the value of the Canadian dollar, what will a contractionary monetary policy do?
- a. It will have no effect.
 - b. It will shift the AD curve to the left.
 - c. It will shift the AD curve to the right.
 - d. It will shift both the AD curve and the short-run AS curve to the left.

ANS: A PTS: 1 DIF: Average REF: p.387
BLM: Remember NOT: Macro TB_15-136

137. If the Bank of Canada allows the exchange rate to vary freely, which of the following effects will an expansionary fiscal policy have?
- a. It will cause a large and permanent rightward shift of the AD curve.
 - b. It will cause a large and permanent leftward shift of the AD curve.
 - c. It will have no permanent effect on the position of the AD curve, but it will cause interest rates to permanently increase.
 - d. It will have no permanent effect on either the position of the AD curve or the interest rate.

ANS: D PTS: 1 DIF: Average REF: p.387
BLM: Higher Order NOT: Macro TB_15-137

138. If the Bank of Canada maintains a fixed exchange rate, which of the following effects will an expansionary fiscal policy have?
- a. It will cause a large and permanent rightward shift in the AD curve.
 - b. It will cause a large and permanent leftward shift in the AD curve.
 - c. It will have no permanent effect on the position of the AD curve, but it will cause interest rates to rise.
 - d. It will have no permanent effect on either the position of the AD curve or the interest rate.

ANS: A PTS: 1 DIF: Average REF: p.387
BLM: Higher Order NOT: Macro TB_15-138

139. In a small open economy with a flexible exchange rate, which of the following effects will a contractionary fiscal policy have?
- a. It will cause the Canadian interest rate to fall below the world interest rate for a short period of time, which in turn will cause the dollar to depreciate and net exports to increase.
 - b. It will cause the Canadian interest rate to rise above the world interest rate for a short period of time, which in turn will cause the dollar to appreciate and net exports to decrease.
 - c. It will cause the Canadian interest rate to fall below the world interest rate for a short period of time, which in turn will cause the dollar to appreciate and net exports to decrease.
 - d. It will cause the Canadian interest rate to rise above the world interest rate for a short period of time, which in turn will cause the dollar to depreciate and net exports to increase.

ANS: A PTS: 1 DIF: Challenging REF: p.387
BLM: Higher Order NOT: Macro TB_15-139

140. How do tax cuts and government expenditure affect aggregate demand?
- a. Both shift aggregate demand right.
 - b. Both shift aggregate demand left.
 - c. Tax cuts shift aggregate demand right; government expenditure shifts aggregate demand left.
 - d. Tax cuts shift aggregate demand left; government expenditure shifts aggregate demand right.

ANS: A PTS: 1 DIF: Easy REF: p.388-389
BLM: Higher Order NOT: Macro TB_15-140

141. What are the effects of a change in taxes on consumption and aggregate demand?
- a. If taxes increase, consumption increases and aggregate demand shifts right.
 - b. If taxes increase, consumption decreases and aggregate demand shifts left.
 - c. If taxes decrease, consumption increases and aggregate demand shifts left.
 - d. If taxes decrease, consumption decreases and aggregate demand shifts right.

ANS: B PTS: 1 DIF: Easy REF: p.388-389
BLM: Higher Order NOT: Macro TB_15-141

142. When the government reduces taxes, which of the following decrease, everything else being the same?
- a. consumption
 - b. take-home pay
 - c. household saving
 - d. government surplus

ANS: D PTS: 1 DIF: Easy REF: p.388-389
BLM: Higher Order NOT: Macro TB_15-142

143. Which of the following tends to make the size of a shift in aggregate demand resulting from a tax change smaller than otherwise?
- a. the multiplier effect
 - b. the crowding-out effect
 - c. the accelerator effect
 - d. the Fisher effect

ANS: B PTS: 1 DIF: Easy REF: p.388-389
BLM: Remember NOT: Macro TB_15-143

144. Suppose the closed economy is in long-run equilibrium. Technological change shifts the long-run aggregate supply curve \$80 billion to the right. At the same time, government purchases increase by \$40 billion. If the *MPC* equals 0.8 and the crowding-out effect is \$70 billion, what would we expect to happen in the long-run to real GDP and the price level?
- a. Both real GDP and the price level would be higher.
 - b. Both real GDP and the price level would be lower.
 - c. Real GDP would be higher but the price level would be lower.
 - d. Real GDP would be higher but the price level would be the same.

ANS: A PTS: 1 DIF: Challenging REF: p.381 | p.389
BLM: Higher Order NOT: Macro TB_15-144

145. Suppose the economy is in long-run equilibrium. Parliament passes regulations that make it more costly to conduct business, so the long-run aggregate supply curve shifts \$80 billion to the left. At the same time, government purchases increase by \$60 billion. If the MPC equals 0.75 and the crowding-out effect is \$70 billion, what would we expect to happen in the long run to real GDP and the price level?
- a. Both real GDP and the price level would be higher.
 - b. Both real GDP and the price level would be lower.
 - c. Real GDP would be lower, but the price level would be higher.
 - d. Real GDP would be lower, but the price level would be the same.

ANS: C PTS: 1 DIF: Challenging REF: p.386 | p.394
BLM: Higher Order NOT: Macro TB_15-145

146. Suppose the closed economy is in long-run equilibrium. Immigration of skilled workers shifts the long-run aggregate supply curve \$60 billion to the right. At the same time, government purchases increase by \$40 billion. If the MPC equals 0.75 and the crowding-out effect is \$160 billion, what would we expect to happen in the long-run to real GDP and the price level?
- a. Both real GDP and the price level would be higher.
 - b. Both real GDP and the price level would be lower.
 - c. Real GDP would be higher, but the price level would be lower.
 - d. Real GDP would be higher, but the price level would be the same.

ANS: C PTS: 1 DIF: Challenging REF: p.386 | p.394
BLM: Higher Order NOT: Macro TB_15-146

147. Suppose the closed economy is in long-run equilibrium. Immigration of skilled workers shifts the long-run aggregate supply curve \$120 billion to the right. At the same time, government purchases increase by \$50 billion. If the MPC equals 0.75 and the crowding-out effect is \$80 billion, what would we expect to happen in the long run to real GDP and the price level?
- a. Both real GDP and the price level would be higher.
 - b. Both real GDP and the price level would be lower.
 - c. Real GDP would be higher, but the price level would be lower.
 - d. Real GDP would be higher, but the price level would be the same.

ANS: D PTS: 1 DIF: Challenging REF: p.386 | p.394
BLM: Higher Order NOT: Macro TB_15-147

148. Suppose the closed economy is in long-run equilibrium. Pessimism on the part of investors then shifts the aggregate demand curve \$50 billion to the left. The government wants to increase spending in order to avoid a recession. If the crowding-out effect is always half as strong as the multiplier effect, and if the MPC equals 0.8, by how much do government purchases have to rise?
- a. \$10 billion
 - b. \$20 billion
 - c. \$50 billion
 - d. \$100 billion

ANS: B PTS: 1 DIF: Challenging REF: p.386 | p.394
BLM: Higher Order NOT: Macro TB_15-148

149. Suppose the closed economy is in long-run equilibrium. Advances in technology shift the long-run aggregate supply curve \$75 billion to the right. Optimistic investors have shifted the aggregate demand curve \$150 billion to the right. In order to stabilize the price level at its original value, the government wants to reduce its spending. If the crowding-out effect is always half of the multiplier effect, and if the MPC equals 0.8, by how much must the government cut its spending?
- a. \$4 billion
 - b. \$30 billion
 - c. \$75 billion
 - d. \$150 billion

ANS: B PTS: 1 DIF: Challenging REF: p.386 | p.394
BLM: Higher Order NOT: Macro TB_15-149

150. If households view a tax cut as being temporary, how does the tax cut affect aggregate demand?
- a. It has no effect on aggregate demand.
 - b. It has more of an effect on aggregate demand than if households view it as permanent.
 - c. It has the same effect on aggregate demand than if households view the cut as permanent.
 - d. It has less of an effect on aggregate demand than if households view the cut as permanent.

ANS: D PTS: 1 DIF: Average REF: p.389
BLM: Remember NOT: Macro TB_15-150

151. How do permanent tax cuts shift the AD curve compared with temporary tax results?
- a. Permanent tax cuts shift the AD curve farther to the right than temporary tax cuts do.
 - b. Permanent tax cuts shift the AD curve less to the right than temporary tax cuts do.
 - c. Permanent tax cuts shift the AD curve farther to the left than temporary tax cuts do.
 - d. Permanent tax cuts shift the AD curve less to the left than temporary tax cuts do.

ANS: A PTS: 1 DIF: Easy REF: p.394
BLM: Remember NOT: Macro TB_15-151

152. Most economists believe that fiscal policy affects which of the following?
- a. only aggregate demand and not aggregate supply
 - b. mostly aggregate demand
 - c. mostly aggregate supply
 - d. only aggregate supply and not aggregate demand

ANS: B PTS: 1 DIF: Easy REF: p.394
BLM: Remember NOT: Macro TB_15-152

153. What do supply-side economists focus more on than other economists?
- a. how fiscal policy affects consumption
 - b. the multiplier affect of fiscal policy
 - c. how fiscal policy affects aggregate supply
 - d. the accelerator and exchange-rate effects

ANS: C PTS: 1 DIF: Easy REF: p.394
BLM: Remember NOT: Macro TB_15-153

154. According to supply-side theories, which of the following happens if the government cuts the tax rate?
- Workers keep less of each additional dollar they earn, so work effort increases, and aggregate supply shifts right.
 - Workers keep less of each additional dollar they earn, so work effort decreases, and aggregate supply shifts left.
 - Workers keep more of each additional dollar they earn, so work effort increases, and aggregate supply shifts right.
 - Workers keep more of each additional dollar they earn, so work effort decreases, and aggregate supply shifts left.

ANS: C PTS: 1 DIF: Average REF: p.394
BLM: Remember NOT: Macro TB_15-154

155. Supply-side economists believe that a reduction in the tax rate will do which of the following?
- decrease government tax revenue
 - shift the aggregate supply curve to the right
 - provide no incentive for people to work more
 - decrease consumption

ANS: B PTS: 1 DIF: Average REF: p.394
BLM: Higher Order NOT: Macro TB_15-155

156. Most economists believe that a cut in tax rates will do which of the following?
- increase government tax revenue
 - decrease significantly the hours people work
 - have a relatively small effect on the aggregate supply curve
 - have a significant effect on the aggregate supply curve

ANS: C PTS: 1 DIF: Easy REF: p.394
BLM: Remember NOT: Macro TB_15-156

157. Supply-side economists believe that changes in government purchases affect which of the following?
- only aggregate demand
 - only aggregate supply
 - both aggregate demand and aggregate supply
 - neither aggregate demand nor aggregate supply

ANS: C PTS: 1 DIF: Easy REF: p.394
BLM: Remember NOT: Macro TB_15-157

158. Which of the following is the most likely effect of an increase in government spending on goods to build or repair infrastructure?
- It would shift the aggregate demand curve to the left.
 - It would have a crowding-out effect.
 - It would shift the short-run aggregate supply curve, but not the long-run aggregate supply curve.
 - It would shift the aggregate supply curve to the right in the long run.

ANS: D PTS: 1 DIF: Easy REF: p.394
BLM: Remember NOT: Macro TB_15-158

159. The economy is in long-run equilibrium when the government decides to significantly increase spending on transportation infrastructure, which will lower shipping costs for many businesses. What might we expect in the short run and the long run to happen to real GDP and the price level?
- Real GDP will increase and the price level will fall, but in the long run, there will be no effect.
 - Real GDP will increase and the price level will fall, but in the long run, real GDP will increase and the price level might rise, fall, or stay the same.
 - Real GDP will increase and the price level might rise, fall, or stay the same, and in the long run, real GDP will increase and the price level might rise, fall, or stay the same.
 - Real GDP will increase and the price level might rise, fall, or stay the same, but in the long run, the price level will increase and real GDP might rise, fall or stay the same.

ANS: C PTS: 1 DIF: Challenging REF: p.394
BLM: Higher Order NOT: Macro TB_15-159

160. If the federal government cuts spending to balance the federal budget, how can the Bank of Canada act to prevent unemployment and recession while maintaining the balanced budget?
- by increasing the money supply
 - by decreasing the money supply
 - by raising taxes
 - by cutting expenditures

ANS: A PTS: 1 DIF: Average REF: p.394-395
BLM: Higher Order NOT: Macro TB_15-160

161. Which of the following is consistent with the supply-side theories?
- The Bank of Canada should use monetary policy only to control the rate of inflation.
 - The government should promote full employment and production.
 - The government should periodically increase the minimum wage and unemployment insurance benefits.
 - Tax cuts influence the aggregate supply significantly.

ANS: D PTS: 1 DIF: Easy REF: p.394
BLM: Higher Order NOT: Macro TB_15-161

162. Which of the following is consistent with the supply-side theories?
- When there is a recession, the Bank of Canada should decrease the money supply.
 - A shift in aggregate supply leads to a permanent increase in the natural rate of output.
 - The government should periodically increase the minimum wage and unemployment insurance benefits.
 - Aggregate demand does not shift in the short run.

ANS: B PTS: 1 DIF: Easy REF: p.389
BLM: Remember NOT: Macro TB_15-162

163. What did Keynes argue about aggregate demand?
- Aggregate demand is stable, because the economy returns to long-run equilibrium.
 - Aggregate demand is stable, because changes in consumption are mostly offset by changes in investment and vice versa.
 - Aggregate demand is unstable, because waves of pessimism and optimism create fluctuations in aggregate demand.
 - Aggregate demand is unstable, because seasonal variations create fluctuations in aggregate demand.

ANS: C PTS: 1 DIF: Easy REF: p.395-396
BLM: Remember NOT: Macro TB_15-163

164. Which of the following is consistent with the Keynesian theory?
- Irrational waves of pessimism would cause a decrease in aggregate demand and increase unemployment.
 - Irrational waves of optimism would cause a reduction in aggregate demand and decrease unemployment.
 - Changes in business and consumer expectations generally stabilize the economy.
 - Changes in consumer confidence are irrelevant for the economy.

ANS: A PTS: 1 DIF: Easy REF: p.395-396
BLM: Remember NOT: Macro TB_15-164

165. What did Keynes use the term "animal spirits" to refer to?
- debates by politicians concerning fiscal policy
 - arbitrary changes in attitudes of households and firms
 - mean-spirited economists who believed in the classical dichotomy
 - firms' relentless efforts to maximize profits

ANS: B PTS: 1 DIF: Easy REF: p.395-396
BLM: Remember NOT: Macro TB_15-165

166. Which of the following policy alternatives would be an appropriate response to an increase in investment demand by a government that wants to stabilize output?
- increasing taxes
 - increasing the money supply
 - increasing government expenditures
 - increasing the government deficit

ANS: A PTS: 1 DIF: Easy REF: p.395-396
BLM: Higher Order NOT: Macro TB_15-166

167. Which of the following policies would someone who wants the government to follow an active stabilization policy recommend when the economy is experiencing unemployment above the natural rate?
- decreasing the money supply
 - increasing government expenditures
 - increasing taxes
 - reducing the government deficit

ANS: B PTS: 1 DIF: Easy REF: p.395-396
BLM: Higher Order NOT: Macro TB_15-167

168. Which of the following policies would Keynes's followers support when an increase in business optimism shifts the aggregate demand curve to the right away from long-run equilibrium?
- a. decreasing taxes
 - b. increasing government expenditures
 - c. increasing the money supply
 - d. increasing taxes

ANS: D PTS: 1 DIF: Average REF: p.395-396
BLM: Higher Order NOT: Macro TB_15-168

169. Which of the following policies would stabilization policy activists support when the economy is experiencing unemployment above the natural rate?
- a. a decrease in the money supply
 - b. a reduction in tax rates
 - c. a decrease in government purchases
 - d. an increase in taxes

ANS: B PTS: 1 DIF: Average REF: p.395-396
BLM: Higher Order NOT: Macro TB_15-169

170. When making a case against active stabilization policies, what do some economists argue?
- a. Monetary policy should not be used to stabilize the economy.
 - b. Policy instruments cannot be used to achieve long term goals.
 - c. Fiscal policies are theoretically invalid as instruments for stabilizing the economy.
 - d. Policies are effective immediately, with too short lags.

ANS: A PTS: 1 DIF: Easy REF: p.395-396
BLM: Remember NOT: Macro TB_15-170

171. Economists agree on all of the following statements **EXCEPT** which one?
- a. Increases in the money supply shift aggregate demand to the right.
 - b. In the long run, increases in the money supply increase prices, but not output.
 - c. Recessions are associated with decreases in consumption, investment, and employment.
 - d. Government should use fiscal policy to try and stabilize the economy.

ANS: D PTS: 1 DIF: Easy REF: p.395-396
BLM: Higher Order NOT: Macro TB_15-171

172. Which of the following do critics of stabilization policy argue?
- a. There is a too short lag between the time policy is passed and policy has an impact on the economy.
 - b. The impact of policy may not last enough such that the problem it was designed to offset is solved.
 - c. Policy cannot cause economic fluctuations.
 - d. Policy can be a source of, instead of a cure for, recessions.

ANS: D PTS: 1 DIF: Easy REF: p.395-396
BLM: Remember NOT: Macro TB_15-172

173. Which of the following factors mostly determines the lag problem associated with monetary policy?
- a. the fact that business firms make investment plans far in advance
 - b. the political system of checks and balances that slows down the process of determining monetary policy
 - c. the time it takes for changes in government spending to affect the interest rate
 - d. the time it takes to print money

ANS: A PTS: 1 DIF: Easy REF: p.395-396
BLM: Remember NOT: Macro TB_15-173

174. Which of the following statements do opponents of active stabilization policy believe?
- a. A monetary policy designed to offset changes in the unemployment rate is effective.
 - b. Fiscal policy is unable to change aggregate demand or aggregate supply.
 - c. The political process creates lags in the implementation of fiscal policy.
 - d. Fluctuations would not exist in the absence of fiscal policies.

ANS: C PTS: 1 DIF: Easy REF: p.395-396
BLM: Higher Order NOT: Macro TB_15-174

175. Which of the following statements do opponents of active stabilization policy believe?
- a. Fiscal policy cannot stabilize the economy even in theory.
 - b. Fiscal policy has no impact in the long run.
 - c. The effects of monetary policy may be long lived.
 - d. The Bank of Canada should try to fine-tune the economy.

ANS: C PTS: 1 DIF: Average REF: p.395-396
BLM: Higher Order NOT: Macro TB_15-175

176. Which of the following best defines automatic stabilizers?
- a. changes in taxes or government spending that increase the lags caused by fiscal policy
 - b. changes in taxes or government spending that shift aggregate demand without requiring active policies
 - c. changes in taxes or government spending that policymakers quickly agree to
 - d. any changes in taxes or government policies

ANS: B PTS: 1 DIF: Easy REF: p.395-396
BLM: Remember NOT: Macro TB_15-176

177. Which of the following is **NOT** an automatic stabilizer?
- a. the minimum wage
 - b. the unemployment compensation system
 - c. the federal income tax
 - d. the welfare system

ANS: A PTS: 1 DIF: Easy REF: p.395-396
BLM: Higher Order NOT: Macro TB_15-177

178. During recessions, what do taxes tend to do, and to what effect?

- a. They rise and so shift aggregate demand right.
- b. They rise and so shift aggregate demand right.
- c. They fall and so shift aggregate demand right.
- d. They fall and so shift aggregate demand right.

ANS: C PTS: 1 DIF: Average REF: p.395-396
BLM: Higher Order NOT: Macro TB_15-178

179. If there are automatic stabilizers but no deliberate action by policymakers, how would government expenditures change as output changes?

- a. They would rise as output rises.
- b. They would remain unchanged as output rises.
- c. They would rise as output falls.
- d. They would fall as output falls.

ANS: C PTS: 1 DIF: Average REF: p.395-396 | p.392
BLM: Higher Order NOT: Macro TB_15-179

180. During expansions, what do automatic stabilizers make government expenditures and taxes do?

- a. They make government expenditures and taxes fall.
- b. They make government expenditures and taxes rise.
- c. They make government expenditures rise and taxes fall.
- d. They make government expenditures fall and taxes rise.

ANS: D PTS: 1 DIF: Easy REF: p.395-396
BLM: Higher Order NOT: Macro TB_15-180

181. During recessions, how do automatic stabilizers tend to make the government's budget move?

- a. They make the budget move toward deficit.
- b. They make the budget move toward surplus.
- c. They make the budget move toward balance.
- d. They do not necessarily move the budget in any particular direction.

ANS: A PTS: 1 DIF: Average REF: p.395-396
BLM: Higher Order NOT: Macro TB_15-181

182. Which of the following is the most important automatic stabilizer?

- a. open-market transactions
- b. the tax system
- c. unemployment compensation
- d. welfare benefits

ANS: B PTS: 1 DIF: Easy REF: p.395-396
BLM: Remember NOT: Macro TB_15-182

183. Which of the following is most likely to happen in the short run?
- a. The price level alone adjusts to balance the supply and demand for money.
 - b. Output responds to changes in the aggregate demand for goods and services.
 - c. Changes in the money supply cause a proportional change in the price level.
 - d. Changes in the money supply shift the aggregate supply curve, causing output to rise.

ANS: B PTS: 1 DIF: Average REF: p.401
BLM: Higher Order NOT: Macro TB_15-183

184. In the long run, which of the following determines the level of output?
- a. the money supply
 - b. the price level
 - c. supply-side factors
 - d. policies aimed at stabilizing the economy

ANS: C PTS: 1 DIF: Average REF: p.401
BLM: Higher Order NOT: Macro TB_15-184

185. In the long run, which of the following do changes in the money supply affect?
- a. prices
 - b. output
 - c. unemployment rates
 - d. nothing

ANS: A PTS: 1 DIF: Easy REF: p.401
BLM: Higher Order NOT: Macro TB_15-185

186. When the Bank of Canada lowers the growth rate of the money supply, which of the following must it take into account?
- a. only the short-run effect on production
 - b. only the short-run effects on inflation and production
 - c. only the long-run effect on inflation
 - d. the long-run effect on inflation as well as the short-run effect on production

ANS: D PTS: 1 DIF: Easy REF: p.401
BLM: Higher Order NOT: Macro TB_15-186

187. When Parliament reduces spending in order to balance the budget, which of the following does it need to consider?
- a. both the short-run effects on aggregate demand and aggregate supply and the long-run effects on saving and growth
 - b. only the short-run effects on aggregate demand and aggregate supply
 - c. only the long-run effects on saving and growth
 - d. the long-run effects on aggregate demand and aggregate supply

ANS: A PTS: 1 DIF: Easy REF: p.401
BLM: Higher Order NOT: Macro TB_15-187

TRUE/FALSE

1. For the most part, fiscal policy affects the economy in the short run while monetary policy primarily matters in the long run.

ANS: F PTS: 1 DIF: Easy REF: p.366
NOT: Macro TB_15-188

2. For Canada, the most important reason for the downward slope of the aggregate demand curve is the real exchange-rate effect.

ANS: T PTS: 1 DIF: Easy REF: p.366-367
NOT: Macro TB_15-189

3. If inflation is zero, then the nominal and real interest rates are the same.

ANS: T PTS: 1 DIF: Easy REF: p.367
NOT: Macro TB_15-190

4. In liquidity preference theory, an increase in the interest rate decreases the quantity of money demanded, but does not shift the money demand curve.

ANS: T PTS: 1 DIF: Easy REF: p.368
NOT: Macro TB_15-191

5. An increase in the price level shifts the money demand curve to the left, making interest rates rise.

ANS: F PTS: 1 DIF: Easy REF: p.369
NOT: Macro TB_15-192

6. An increase in the money supply shifts the aggregate supply curve right.

ANS: F PTS: 1 DIF: Easy REF: p.373
NOT: Macro TB_15-193

7. When the Bank of Canada increases the money supply, the interest rate decreases. This decrease in the interest rate increases consumption and investment demand so the aggregate demand curve shifts to the right.

ANS: T PTS: 1 DIF: Easy REF: p.373
NOT: Macro TB_15-194

8. Stock prices often rise when the Bank of Canada raises interest rates.

ANS: F PTS: 1 DIF: Easy REF: p.378-381
NOT: Macro TB_15-195

9. Both the multiplier and the investment accelerator tend to make the aggregate demand curve shift farther than the increase in government expenditures.

ANS: T PTS: 1 DIF: Easy REF: p.382-383
NOT: Macro TB_15-196

10. The multiplier is equal to $MPC/(1 - MPC)$.

ANS: F PTS: 1 DIF: Easy REF: p.378
NOT: Macro TB_15-197

11. In principle, the government could increase the money supply or government expenditures to try to offset the effects of a wave of pessimism about the future of the economy.

ANS: T PTS: 1 DIF: Easy REF: p.394
NOT: Macro TB_15-198

12. Permanent tax cuts have a larger impact on consumption spending than temporary ones.

ANS: T PTS: 1 DIF: Easy REF: p.393-394
NOT: Macro TB_15-199

13. The main criticism of those who doubt the ability of the government to respond in a useful way to the business cycle is that the theory by which money and government expenditures change output is flawed.

ANS: F PTS: 1 DIF: Easy REF: p.395-396
NOT: Macro TB_15-200

14. The most important lag for monetary policy is the time it takes to formulate policy, while the most important lag for fiscal policy is the time it takes for the economy to respond to changes in government spending.

ANS: F PTS: 1 DIF: Easy REF: p.395-396
NOT: Macro TB_15-201

15. Unemployment insurance and welfare programs work as automatic stabilizers.

ANS: T PTS: 1 DIF: Easy REF: p.396-397
NOT: Macro TB_15-202

16. During recessions, the government tends to run a budget deficit.

ANS: T PTS: 1 DIF: Easy REF: p.396-397
NOT: Macro TB_15-203

SHORT ANSWER

1. What is the difference between monetary policy and fiscal policy?

ANS:

The Bank of Canada conducts monetary policy. It consists of policies to affect the financial side of the economy—most notably the supply of money in the economy. Fiscal policy is conducted by the executive and Parliament, and entails decisions about taxes and government spending.

PTS: 1 DIF: Average REF: p.366 NOT: Macro TB_15-204

2. Explain why the interest rate is the opportunity cost of holding currency. What is the benefit of holding currency?

ANS:

The nominal interest rate on currency is zero. The next best alternative is to buy a bond and earn the interest. Currency is used as a medium of exchange. Bonds are illiquid and so are costly to convert to a medium of exchange.

PTS: 1 DIF: Average REF: p.373 NOT: Macro TB_15-205

3. Describe the process in the money market by which the interest rate reaches its equilibrium value if it starts above equilibrium.

ANS:

If the interest rate is above equilibrium, there is an excess supply of money. People with more money than they want to hold, given the current interest rate, deposit the money in banks and buy bonds. The increase in funds to lend out causes the interest rate to fall. As the interest rate falls, the quantity of money demanded increases, which tends to diminish the excess supply of money.

PTS: 1 DIF: Average REF: p.368-372 NOT: Macro TB_15-206

4. Use the money market to explain why the aggregate demand curve slopes downward.

ANS:

When the price level falls, people need less money for their transactions. The decreased demand for money leads to a decrease in interest rates. Lower interest rates encourage consumption and investment spending. Thus, an increase in the price level lowers the quantity of goods and services demanded.

PTS: 1 DIF: Average REF: p.370-373 NOT: Macro TB_15-207

5. Explain the logic according to liquidity preference theory by which an increase in the money supply changes the aggregate demand curve.

ANS:

When the money supply increases, the interest rate falls. As the interest rate falls, people will want to spend more and firms will want to build more factories and buy more capital goods. This increase in aggregate demand happens for any given price level, so aggregate demand shifts right.

PTS: 1 DIF: Average REF: p.373 NOT: Macro TB_15-208

6. How does a reduction in the money supply by the Bank of Canada make owning stocks less attractive?

ANS:

The reduction in the money supply raises the interest rate. The return on bonds increases relative to the return on stocks. The increase in the interest rate also causes spending to fall so that revenues and profits fall, making shares of ownership in corporations less valuable.

PTS: 1 DIF: Average REF: p.378-380 NOT: Macro TB_15-209

7. Suppose that the government spends more on a missile defence program. What does this do to aggregate demand? How is your answer affected by the presence of the multiplier, crowding-out, and investment-accelerator effects?

ANS:

The increase in expenditures means that government spending rises. The aggregate demand curve shifts to the right. Aggregate demand shifts farther if there is a multiplier effect or an investment accelerator and shifts less if there is crowding out.

PTS: 1 DIF: Average REF: p.380-383 NOT: Macro TB_15-210

8. Suppose that there are no crowding-out effects and the *MPC* is 0.9. By how much must the government increase expenditures to shift the aggregate demand curve right by \$10 billion?

ANS:

An *MPC* of 0.9 means the multiplier = $1/(1 - 0.9) = 10$. The increase in aggregate demand equals the multiplier times the change in government expenditures. So to increase aggregate demand by \$10 billion, the government would have to increase expenditures by \$1 billion.

PTS: 1 DIF: Average REF: p.382-384 NOT: Macro TB_15-211

9. Suppose that consumers become pessimistic about the future health of the economy, and so cut back on their consumption spending. What will happen to aggregate demand and to output? What might the executive and the Parliament have to do to keep output stable?

ANS:

As consumers become pessimistic about the future of the economy, they cut their expenditures so that aggregate demand shifts left and output falls. The executive and the Parliament could adjust fiscal policy to increase aggregate demand. They could either increase government spending, or cut taxes, or both.

PTS: 1 DIF: Average REF: p.382 NOT: Macro TB_15-212

10. Why and in what way are fiscal policy lags different from monetary policy lags?

ANS:

The fiscal policy lags are mostly a matter of waiting to implement the policy. By the time the executive and the Parliament can agree to and pass legislation changing expenditures or taxes, the recession may have ended. The Bank of Canada can act to change the money supply quickly, but it may take some time before the effects of an increase in the money supply work their way through the economy.

PTS: 1 DIF: Average REF: p.395-396 NOT: Macro TB_15-213

11. Explain how unemployment insurance acts as an automatic stabilizer.

ANS:

As income falls, unemployment rises. More people will apply for unemployment compensation from the government and so government spending rises. An increase in government spending tends to increase aggregate demand, output, and income.

PTS: 1 DIF: Average REF: p.396-397 NOT: Macro TB_15-214

PROBLEM

1. Consider the income-expenditure identity in a closed economy, $Y = C + I + G$. Suppose consumption is always a fraction MPC of income, $C = MPC \times Y$.
- Show that income Y is equal to $(I + G)/(1 - MPC)$.
 - Show that an increase in G by an amount ΔG increases income by $\Delta G/(1 - MPC)$ when investment is considered constant with respect to Y . What is the ratio $1/(1 - MPC)$ called?

ANS:

- In the income-expenditure identity, replace C by $MPC \times Y$ to obtain $Y = MPC \times Y + I + G$, which can be written $Y - Y \times MPC = I + G$, or $Y(1 - MPC) = I + G$. From this, $Y = (I + G)/(1 - MPC)$.
- Let Y' be the value of income after the increase in G . If G increases to $G + \Delta G$, then $Y' = (I + G + \Delta G)/(1 - MPC)$. Calculate the difference $Y' - Y$ to find the increase in Y due to the increase in G : $Y' - Y = (I + G + \Delta G - I - G)/(1 - MPC) = \Delta G/(1 - MPC)$. This result shows that, when G increases by an amount ΔG , income increases by $\Delta G/(1 - MPC)$. The ratio $1/(1 - MPC)$ is the spending multiplier.

PTS: 1 NOT: Macro TB_15-215

2. Compare the classical model of money market with the liquidity preference model.
 - a. Are they consistent with each other?
 - b. Draw the classical money demand curve in a Price-Quantity-of-money diagram.
 - c. How does your money demand curve shift when income, Y , increases?
 - d. Use your classical money demand diagram to derive an aggregate demand curve.

ANS:

- a. Both models use a money demand and money supply curve; in both models money supply is fixed by the central bank. In the classical framework, the price level adjusts to balance money demand and money supply; in the liquidity preference model the price level is fixed and the interest rate adjusts such that the quantities of money demanded and supplied are balanced.
- b. The classical money market model implies a positive relationship between the price level and the quantity of money in the market. The quantity equation gives such a relationship: $PY = MV$, where M can be viewed as the quantity of money necessary to buy output Y , i.e. the quantity of money demanded. The next graph (curve A) shows this relationship; Q_M stands for quantity of money.

P				A			
			P_1, Y_1				
						B	
			$P_2, Y_2 > Y_1$				
				MS			Q_M

- c. The quantity equation can be written $P = Q_M V / Y$. According to this equation, for any given value of the quantity of money Q_M , when output Y increases, the price level must be lower. This shows that the $P - Q_M$ line shifts downward when Y increases (curve B).
- d. When $Q_M = \text{constant}$, say at a level MS determined by the money supply, at the price level P_1 corresponds the income level Y_1 , and at the price level $P_2 < P_1$ corresponds the income level $Y_2 > Y_1$. This inverse relationship between prices and output can be viewed as an aggregate demand curve.

PTS: 1

NOT: Macro TB_15-216

3. Suppose the federal government decides to stimulate the economy and increases government expenditure on new infrastructure projects worth \$40 billion. The marginal propensity to consume is $MPC = 2/3$ and the marginal propensity to import is $MPI = 1/5$. Suppose also that the crowding-out effect is twice the amount of government spending.
- In a closed economy, what is the increase in output caused by the stimulus package of \$40 billion?
 - What is the increase in output if the economy is open?

ANS:

- If the economy is closed, output increases $1/(1 - MPC)$ times the change in G , which is $1/(1 - 2/3) \times 40 = 120$ billion. However, because of the crowding out effect, investment and aggregate demand decrease by $2 \times 40 = 80$ billion. The overall effect is $120 - 80 = 40$ billion.
- In an open economy, the effect of the stimulus package depends on the exchange rate regime. If the exchange rate is fixed, the increase in government spending causes the appreciation of the dollar and the central bank would have to buy foreign currency in exchange for dollars. This open market operation will increase the money supply, strengthening even further the increase in output. However, in the open economy imports are also allowed and the change in output is reduced by the marginal propensity to import. The overall result under fixed exchange rate is that the increase in output is more than $1/(1 - MPC + MPI) \times 40 = 1/(1 - 2/3 + 1/5) \times 40 = (20/9) \times 40 = 88.9$ billion. The crowding-out effect in an open economy may be weakened because of the possibility of foreign investment. If the exchange rate is flexible, the effect of the stimulus package is substantially reduced or offset by the appreciation of the dollar, which reduces net exports. In a flexible exchange rate world, countries need to coordinate their fiscal policies to avoid the exchange rate effects that otherwise may render the fiscal policies ineffective.

PTS: 1

NOT: Macro TB_15-217

4. Let x be the marginal propensity to consume, MPC . The principle of spending multiplier involves calculating the infinite sum $1 + x + x^2 + x^3 + \dots$. Show that this sum is equal to $1/(1 - x)$.

ANS:

Let the sum be $m = 1 + x + x^2 + x^3 + \dots$. We can write the sum as $m = 1 + x(1 + x + x^2 + x^3 + \dots)$, or $m = 1 + x \cdot m$. Solving this last equation, one easily finds $m = 1/(1 - x)$, which is what was to be demonstrated.

PTS: 1

NOT: Macro TB_15-218

5. How does an automatic stabilizer interfere with fiscal policy? Discuss possible positive and negative effects.

ANS:

Automatic stabilizers are countercyclical; they tend to stimulate the economy in recessions and to slow it down in booms. If government actions were timely and well designed, automatic stabilizers should reduce the magnitude of changes in government spending or taxation. However, government actions tend to come later than necessary and their effects tend to last longer than necessary. In such a case, automatic stabilizers may undesirably enhance the effects of fiscal policies.

PTS: 1

NOT: Macro TB_15-219

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Chapter 16—The Short-Run Tradeoff between Inflation and Unemployment

MULTIPLE CHOICE

1. Who releases the closely watched indicators such as the inflation rate and unemployment each month?
 - a. the Bureau of the Budget
 - b. the Ministry of Finance
 - c. the Department of the Treasury
 - d. Statistics Canada

ANS: D PTS: 1 DIF: Easy REF: p.407
BLM: Remember NOT: Macro TB_16-1

2. How is the misery index calculated?
 - a. It is the inflation rate plus the unemployment rate.
 - b. It is the unemployment rate minus the inflation rate.
 - c. It is the actual inflation rate minus the expected inflation rate.
 - d. It is the natural unemployment rate plus the long-run inflation rate.

ANS: A PTS: 1 DIF: Easy REF: p.401
BLM: Remember NOT: Macro TB_16-2

3. Which of the following is the misery index supposed to measure?
 - a. the social cost of unemployment
 - b. the health of the economy
 - c. the lost output associated with a particular unemployment rate
 - d. the short-run tradeoff between inflation and unemployment

ANS: B PTS: 1 DIF: Easy REF: p.401
BLM: Remember NOT: Macro TB_16-3

4. Which of the following is one determinant of the natural rate of unemployment?
 - a. the rate of growth of the money supply
 - b. the minimum wage rate
 - c. the expected inflation rate
 - d. the exchange rate

ANS: B PTS: 1 DIF: Easy REF: p.401
BLM: Remember NOT: Macro TB_16-4

5. Among other things, which of the following determines the long-run average unemployment rate and inflation, respectively?
 - a. the market power of unions; government spending
 - b. the minimum wage; the money supply growth rate
 - c. the rate of growth of the money supply; the market power of unions
 - d. efficiency wages; the extent to which firms are competitive

ANS: B PTS: 1 DIF: Easy REF: p.401
BLM: Remember NOT: Macro TB_16-5

6. In the long run, which of the following does the inflation rate primarily depend on?
- a. the ability of unions to raise wages
 - b. government spending
 - c. the money supply growth rate
 - d. the monopoly power of firms

ANS: C PTS: 1 DIF: Average REF: p.401
BLM: Remember NOT: Macro TB_16-6

7. Which of the following is a long-run economic aspect on which most economists agree?
- a. The natural rate of unemployment depends primarily on the level of aggregate demand.
 - b. Inflation depends primarily upon the money supply growth rate.
 - c. There is a tradeoff between the inflation rate and the natural rate of unemployment.
 - d. The rate of economic growth depends primarily on the growth in money supply.

ANS: B PTS: 1 DIF: Average REF: p.401
BLM: Remember NOT: Macro TB_16-7

8. Is there a tradeoff between inflation and unemployment?
- a. yes, in the short-run only
 - b. no, neither in the short run nor in the long run
 - c. yes, in the long run only
 - d. yes, both in the short run and in the long run

ANS: A PTS: 1 DIF: Easy REF: p.401
BLM: Higher Order NOT: Macro TB_16-8

9. If policymakers reduce aggregate demand, what happens to inflation and unemployment?
- a. Inflation and unemployment rise.
 - b. Inflation rises, but unemployment falls.
 - c. Inflation falls, but unemployment rises.
 - d. Inflation and unemployment fall.

ANS: C PTS: 1 DIF: Easy REF: p.401
BLM: Higher Order NOT: Macro TB_16-9

10. If policymakers expand aggregate demand, what happens to inflation and unemployment?
- a. Inflation falls, but unemployment rises.
 - b. Inflation and unemployment fall.
 - c. Inflation and unemployment rise.
 - d. Inflation rises, but unemployment falls.

ANS: D PTS: 1 DIF: Easy REF: p.401
BLM: Higher Order NOT: Macro TB_16-10

11. If policymakers expand aggregate demand, what happens to inflation and unemployment in the long run?
- a. Inflation will be higher and unemployment will be lower.
 - b. Inflation will be higher and unemployment will be unchanged.
 - c. Inflation and unemployment will be unchanged.
 - d. Both inflation and unemployment will be higher.

ANS: B PTS: 1 DIF: Average REF: p.401
BLM: Higher Order NOT: Macro TB_16-11

12. If the government raises government expenditures, what happens to prices and unemployment in the short run?
- a. Prices rise and unemployment falls.
 - b. Prices fall and unemployment rises.
 - c. Prices and unemployment rise.
 - d. Prices and unemployment fall.

ANS: A PTS: 1 DIF: Easy REF: p.401
BLM: Higher Order NOT: Macro TB_16-12

13. In the long run, policy that changes aggregate demand also changes which of the following?
- a. both unemployment and the price level
 - b. neither unemployment nor the price level
 - c. only unemployment
 - d. only the price level

ANS: D PTS: 1 DIF: Easy REF: p.401
BLM: Higher Order NOT: Macro TB_16-13

14. In the short run, policy that changes aggregate demand also changes which of the following?
- a. both unemployment and the price level
 - b. neither unemployment nor the price level
 - c. only unemployment
 - d. only the price level

ANS: A PTS: 1 DIF: Easy REF: p.401
BLM: Higher Order NOT: Macro TB_16-14

15. Which of the following terms refers to the short-run relationship between inflation and unemployment?
- a. the classical dichotomy
 - b. money neutrality
 - c. the Phillips curve
 - d. the Keynesian cross

ANS: C PTS: 1 DIF: Easy REF: p.401-403
BLM: Remember NOT: Macro TB_16-15

16. Which of the following did Phillips discover?
- a. a positive relation between unemployment and inflation in the United Kingdom
 - b. a positive relation between unemployment and inflation in Canada
 - c. a negative relation between unemployment and inflation in Canada
 - d. a negative relation between unemployment and inflation in the United Kingdom

ANS: D PTS: 1 DIF: Average REF: p.402
BLM: Remember NOT: Macro TB_16-16

17. According to Phillips, which of the following sets of two items have a negative relation?
- a. output and unemployment
 - b. output and employment
 - c. wage inflation and output
 - d. wage inflation and unemployment

ANS: D PTS: 1 DIF: Easy REF: p.402
BLM: Remember NOT: Macro TB_16-17

18. Which of the following data supported A.W. Phillips' findings?
- a. data from 1861–1957 for the United Kingdom
 - b. data from 1861–1957 for the United States
 - c. data mostly from the post–World War II period in the United Kingdom
 - d. data mostly from the post–World War II period in the United States

ANS: A PTS: 1 DIF: Average REF: p.402
BLM: Remember NOT: Macro TB_16-18

19. If the short-run Phillips curve were stable, which of the following would be unusual?
- a. an increase in inflation and an increase in output
 - b. a decrease in inflation and an increase in unemployment
 - c. an increase in both inflation and unemployment
 - d. an increase in output and a decrease in unemployment

ANS: C PTS: 1 DIF: Average REF: p.401-403
BLM: Higher Order NOT: Macro TB_16-19

20. If the short-run Phillips curve were stable, which of the following would be unusual?
- a. an increase in government spending and a fall in unemployment
 - b. an increase in inflation and a decrease in output
 - c. a decrease in the inflation rate and a rise in the unemployment rate
 - d. a decrease in output and an increase in unemployment

ANS: B PTS: 1 DIF: Average REF: p.401-403
BLM: Higher Order NOT: Macro TB_16-20

21. According to Samuelson and Solow, when aggregate demand is high, how are unemployment, wages, and prices affected?
- a. Unemployment is low, so there is upward pressure on wages and prices.
 - b. Unemployment is low, so there is downward pressure on wages and prices.
 - c. Unemployment is high, so there is upward pressure on wages and prices.
 - d. Unemployment is high, so there is downward pressure on wages and prices.

ANS: A PTS: 1 DIF: Average REF: p.402-403
BLM: Higher Order NOT: Macro TB_16-21

22. According to Samuelson and Solow, when aggregate demand is low, how are unemployment, wages, and prices affected?
- a. Unemployment is high, so there is upward pressure on wages and prices.
 - b. Unemployment is high, so there is downward pressure on wages and prices.
 - c. Unemployment is low, so there is upward pressure on wages and prices.
 - d. Unemployment is low, so there is downward pressure on wages and prices.

ANS: B PTS: 1 DIF: Average REF: p.402-403
BLM: Higher Order NOT: Macro TB_16-22

23. What did Samuelson and Solow believe about the Phillips curve?
- a. It implied that low unemployment was associated with low inflation.
 - b. It indicated that the aggregate supply and aggregate demand model was incorrect.
 - c. It offered policymakers a menu of possible economic outcomes from which to choose.
 - d. It demonstrated that fiscal policies were ineffective in reducing unemployment.

ANS: C PTS: 1 DIF: Average REF: p.402
BLM: Remember NOT: Macro TB_16-23

24. When aggregate demand increases, what happens to prices and employment?
- a. Prices will fall and unemployment will rise.
 - b. Prices and unemployment fall.
 - c. Prices and unemployment rise.
 - d. Prices will rise and unemployment will fall.

ANS: D PTS: 1 DIF: Average REF: p.403-404
BLM: Higher Order NOT: Macro TB_16-24

25. Suppose that a central bank increases the money supply. According to the Phillips curve, what should happen to prices, output, and employment?
- a. Prices, output, and employment all rise.
 - b. Prices and output rise, and employment falls.
 - c. Prices rise, and output and employment fall.
 - d. Prices fall, and output and employment rise.

ANS: A PTS: 1 DIF: Easy REF: p.403-405
BLM: Higher Order NOT: Macro TB_16-25

26. Suppose that the money supply increases. In the short run, this increases employment according to what theory?
- a. both the short-run Phillips curve and the aggregate demand and aggregate supply model
 - b. neither the short-run Phillips curve nor the aggregate demand and aggregate supply model
 - c. only the short-run Phillips curve
 - d. only the aggregate demand and aggregate supply model

ANS: A PTS: 1 DIF: Average REF: p.403-405
BLM: Higher Order NOT: Macro TB_16-26

27. Suppose that the money supply increases. In the short run, this increases prices according to what theory?
- a. both the short-run Phillips curve and the aggregate demand and aggregate supply model
 - b. neither the short-run Phillips curve nor the aggregate demand and aggregate supply model
 - c. only the short-run Phillips curve
 - d. only the aggregate demand and aggregate supply model

ANS: A PTS: 1 DIF: Average REF: p.403-405
BLM: Higher Order NOT: Macro TB_16-27

28. In which of the following situations will the economy move to a point on the Phillips curve where unemployment is higher?
- a. if the inflation rate increases
 - b. if the government increases its expenditures
 - c. if the Bank of Canada decreases the money supply
 - d. if expected inflation increases

ANS: C PTS: 1 DIF: Average REF: p.403-405
BLM: Higher Order NOT: Macro TB_16-28

29. Which of the following changes will move the economy to a point on the Phillips curve where unemployment is lower?
- a. lower inflation
 - b. lower taxes
 - c. a decrease the money supply
 - d. higher expectations about inflation

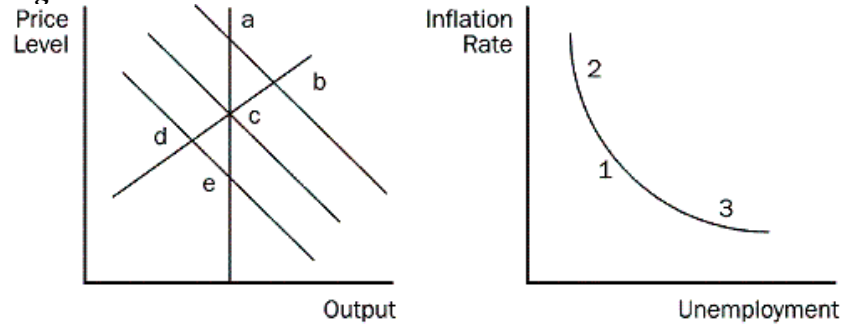
ANS: B PTS: 1 DIF: Average REF: p.403-405
BLM: Higher Order NOT: Macro TB_16-29

30. Which of the following would we **NOT** expect to happen if government policy moved the economy up along a given short-run Phillips curve?
- a. Ravi reads in the newspaper that the central bank raised the money supply.
 - b. Tony gets more job offers.
 - c. Louis makes smaller increases in the prices at his health food store.
 - d. Jessica's nominal wage increases at a faster rate.

ANS: C PTS: 1 DIF: Easy REF: p.403-405
BLM: Higher Order NOT: Macro TB_16-30

Use the pair of diagrams below to answer the following questions.

Figure 16-1



31. **Refer to Figure 16-1.** If the economy starts at *c* and 1, then in the short run, an increase in the money supply growth rate moves the economy to where?

a. *a* and 1
b. *b* and 2
c. *c* and 3
d. back to *c* and 1

ANS: B PTS: 1
BLM: Higher Order

DIF: Easy REF: p.403-405
NOT: Macro TB_16-31

32. **Refer to Figure 16-1.** If the economy starts at *c* and 1, then in the short run, an increase in government expenditures moves the economy to where?

a. *b* and 2
b. *b* and 3
c. *d* and 3
d. *c* and 2

ANS: A PTS: 1
BLM: Higher Order

DIF: Average REF: p.403-405
NOT: Macro TB_16-32

33. **Refer to Figure 16-1.** If the economy starts at *c* and 1, then in the short run, a decrease in taxes moves the economy to where?

a. *d* and 2
b. *d* and 3
c. back to *c* and 1
d. *c* and 2

ANS: D PTS: 1
BLM: Higher Order

DIF: Average REF: p.403-405
NOT: Macro TB_16-33

34. **Refer to Figure 16-1.** If the economy starts at *c* and 1, then in the short run, a decrease in aggregate demand moves the economy to where?

a. *a* and 2
b. *d* and 3
c. *e* and 3
d. *a* and 3

ANS: B PTS: 1
BLM: Higher Order

DIF: Easy REF: p.403-405
NOT: Macro TB_16-34

35. **Refer to Figure 16-1.** If the economy starts at *c* and 1, then in the short run, a decrease in the money supply growth rate moves the economy to where?
- a. *e* and 1
 - b. *d* and 2
 - c. *d* and 3
 - d. back to *c* and 1

ANS: C PTS: 1 DIF: Average REF: p.410
BLM: Higher Order NOT: Macro TB_16-35

36. **Refer to Figure 16-1.** If the economy starts at *c* and 1, then in the short run, a decrease in government expenditures moves the economy to where?
- a. *d* and 2
 - b. *d* and 3
 - c. *e* and 3
 - d. *e* and 2

ANS: B PTS: 1 DIF: Average REF: p.403-405
BLM: Higher Order NOT: Macro TB_16-36

37. **Refer to Figure 16-1.** If the economy starts at *c* and 1, then in the short run, an increase in taxes moves the economy to where?
- a. *b* and 2
 - b. *d* and 3
 - c. *e* and 2
 - d. *b* and 3

ANS: B PTS: 1 DIF: Average REF: p.403-405
BLM: Higher Order NOT: Macro TB_16-37

38. In 1968, economist Milton Friedman published a paper that was critical of the Phillips curve. On what grounds did Friedman criticize the Phillips curve?
- a. It seemed to work for wages but not for inflation.
 - b. Monetary policy was ineffective in combating inflation.
 - c. The Phillips curve did not apply in the long run.
 - d. Phillips had made errors in collecting his data.

ANS: C PTS: 1 DIF: Average REF: p.405
BLM: Remember NOT: Macro TB_16-38

39. In the late 1960s, which of the following was published by economist Edmund Phelps?
- a. a paper that argued that there was no long-run tradeoff between inflation and unemployment
 - b. a paper that disproved Friedman's claim that monetary policy was ineffective in controlling inflation
 - c. a paper that showed the optimal point on the Phillips curve was at an unemployment rate of 5 percent and an inflation rate of 2 percent
 - d. a paper that argued that the Phillips curve was stable and that it would not shift

ANS: A PTS: 1 DIF: Easy REF: p.405-406
BLM: Remember NOT: Macro TB_16-39

40. What did Friedman and Phelps argue about the relationship between inflation and unemployment?
- a. The rate of inflation is related to unemployment in the long run.
 - b. Policymakers face a short-run Phillips curve that is vertical.
 - c. The short-run unemployment rate is independent of the inflation rate.
 - d. Inflation and unemployment are unrelated in the long-run.

ANS: D PTS: 1 DIF: Easy REF: p.405-406
BLM: Higher Order NOT: Macro TB_16-40

41. What did Friedman and Phelps argue about inflation and unemployment?
- a. that in the long run, monetary growth did not influence those factors that determine the unemployment rate
 - b. the Phillips curve could be exploited in the long run by using monetary, but not fiscal policy
 - c. that the short-run Phillips curve was very steep
 - d. that there was neither a short-run nor long-run tradeoff between inflation and unemployment

ANS: A PTS: 1 DIF: Easy REF: p.405-406
BLM: Higher Order NOT: Macro TB_16-41

42. According to classical macroeconomic theory, which of the following does money growth influence in the long run?
- a. both real and nominal variables
 - b. the unemployment rate
 - c. factors that affect unemployment
 - d. only nominal variables

ANS: D PTS: 1 DIF: Easy REF: p.406
BLM: Higher Order NOT: Macro TB_16-42

43. Milton Friedman argued that a central bank's control over the money supply could be used to peg which of the following?
- a. the level or growth rate of a nominal variable, but not the level or growth rate of a real variable
 - b. the level of a nominal or real variable, but not the growth rate of a real or nominal variable
 - c. the level or growth rate of a real variable, but not the level or growth rate of a nominal variable
 - d. both levels and growth rates of both real and nominal variables

ANS: A PTS: 1 DIF: Easy REF: p.406
BLM: Remember NOT: Macro TB_16-43

44. Friedman argued that a central bank could use monetary policy to peg which of the following?
- a. the nominal exchange rate
 - b. real GDP growth rate
 - c. the unemployment rate
 - d. the interest rate

ANS: A PTS: 1 DIF: Easy REF: p.406
BLM: Remember NOT: Macro TB_16-44

45. In responding to the Phillips curve hypothesis, Friedman argued that a central bank can peg which of the following?
- a. the unemployment rate
 - b. the inflation rate
 - c. the growth rate of real GDP
 - d. the real exchange rate

ANS: B PTS: 1 DIF: Easy REF: p.406
BLM: Remember NOT: Macro TB_16-45

46. According to Friedman and Phelps, no matter what a central bank does to the money supply, which of the following will happen in the long run?
- a. The economy will have a zero inflation rate.
 - b. The unemployment rate will tend toward the natural rate of unemployment.
 - c. The inflation rate will tend to the natural rate of inflation.
 - d. The economy will have a zero unemployment rate.

ANS: B PTS: 1 DIF: Easy REF: p.406
BLM: Higher Order NOT: Macro TB_16-46

47. In the long run, if the Bank of Canada decreases the rate at which it increases the money supply, what will happen to inflation and unemployment?
- a. Inflation and unemployment will be higher.
 - b. Inflation will be higher and unemployment will be lower.
 - c. Inflation will be lower and unemployment will be higher.
 - d. Inflation will be lower and unemployment will stay the same.

ANS: D PTS: 1 DIF: Easy REF: p.406
BLM: Higher Order NOT: Macro TB_16-47

48. In the long run, which of the following will happen if the Bank of Canada increases the rate at which it increases the money supply?
- a. Inflation will be higher.
 - b. Unemployment will be lower.
 - c. Real GDP will be higher.
 - d. Unemployment will be higher.

ANS: A PTS: 1 DIF: Average REF: p.406
BLM: Higher Order NOT: Macro TB_16-48

49. In the long run, which of the following will shift the long-run Phillips curve to the right?
- a. an increase in the minimum wage
 - b. an increase in the money supply
 - c. a decrease in the money supply
 - d. tax cuts

ANS: A PTS: 1 DIF: Easy REF: p.406
BLM: Higher Order NOT: Macro TB_16-49

50. A vertical long-run Phillips curve is consistent with which of the following?
- the principle of monetary neutrality
 - real world data
 - a natural rate of unemployment that depends on the inflation rate
 - a downward-sloping aggregate demand curve

ANS: A PTS: 1 DIF: Easy REF: p.406-408
 BLM: Higher Order NOT: Macro TB_16-50

51. Which of the following best describes how the natural rate of unemployment changes?
- It cannot change; it is constant over time.
 - It does not change by any actions of the government.
 - It changes by changing the maximum legal number of work hours a week.
 - It changes by changing the rate at which the Bank of Canada increases the money supply.

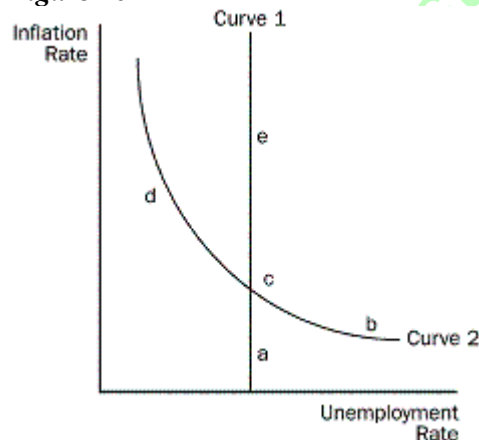
ANS: C PTS: 1 DIF: Easy REF: p.406
 BLM: Higher Order NOT: Macro TB_16-51

52. Which of the following characterizes the long-run Phillips curve?
- Its position is determined primarily by monetary factors.
 - If it shifts right, long-run aggregate supply shifts right.
 - It cannot be changed by any government policy.
 - Its position depends on the natural rate of unemployment.

ANS: D PTS: 1 DIF: Easy REF: p.407
 BLM: Remember NOT: Macro TB_16-52

Use the graph below to answer the following questions.

Figure 16-2



53. Refer to Figure 16-2. What is curve 1?
- the long-run aggregate supply curve
 - the short-run aggregate supply curve
 - the long-run Phillips curve
 - the short-run Phillips curve

ANS: C PTS: 1 DIF: Easy REF: p.407
 BLM: Higher Order NOT: Macro TB_16-53

54. **Refer to Figure 16-2.** What is curve 2?
- a. the long-run Phillips curve
 - b. the short-run Phillips curve
 - c. the long-run aggregate demand curve
 - d. the short-run aggregate demand curve

ANS: B PTS: 1
BLM: Higher Order

DIF: Easy REF: p.407
NOT: Macro TB_16-54

55. **Refer to Figure 16-2.** If the economy starts at *c* and the money supply growth rate increases, where does the economy move to in the short run?
- a. *b*
 - b. *d*
 - c. *e*
 - d. either *b* or *e*

ANS: B PTS: 1
BLM: Higher Order

DIF: Average REF: p.407
NOT: Macro TB_16-55

56. **Refer to Figure 16-2.** If the economy starts at *c* and the money supply growth rate decreases, where does the economy move to in the short run?
- a. *b*
 - b. *d*
 - c. *e*
 - d. either *b* or *e*

ANS: A PTS: 1
BLM: Higher Order

DIF: Average REF: p.407
NOT: Macro TB_16-56

57. **Refer to Figure 16-2.** If the economy starts at *c* and the money supply growth rate increases, where does the economy move to in the long run?
- a. *b*
 - b. *d*
 - c. *e*
 - d. either *b* or *e*

ANS: C PTS: 1
BLM: Higher Order

DIF: Average REF: p.407
NOT: Macro TB_16-57

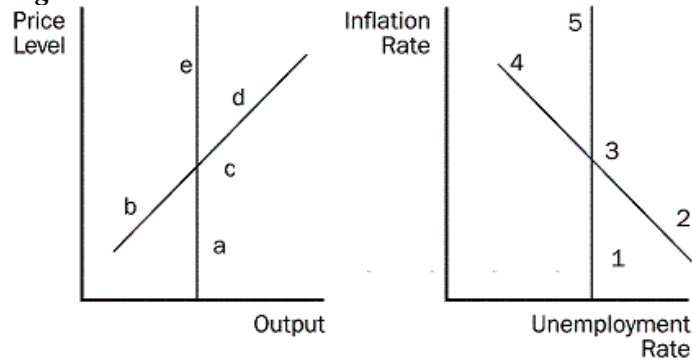
58. **Refer to Figure 16-2.** Where is the money supply growth rate the greatest?
- a. at *a*
 - b. at *b*
 - c. at *c*
 - d. at *e*

ANS: D PTS: 1
BLM: Higher Order

DIF: Average REF: p.407
NOT: Macro TB_16-58

Use the two graphs in the diagram to answer the following questions.

Figure 16-3



59. **Refer to Figure 16-3.** Starting from *c* and 3, in the short run, where does an unexpected increase in money supply growth move the economy to?

a. *a* and 1
b. *b* and 2
c. back to *c* and 3
d. *d* and 4

ANS: D PTS: 1

DIF: Average REF: p.407

BLM: Higher Order

NOT: Macro TB_16-59

60. **Refer to Figure 16-3.** Starting from *c* and 3, in the short run, where does an unexpected decrease in money supply growth move the economy to?

a. *a* and 1
b. *b* and 2
c. back to *c* and 3
d. *d* and 4

ANS: B PTS: 1

DIF: Average REF: p.407

BLM: Higher Order

NOT: Macro TB_16-60

61. **Refer to Figure 16-3.** Starting from *c* and 3, in the long run, where does an increase in money supply growth move the economy to?

a. *a* and 1
b. back to *c* and 3
c. *d* and 4
d. *e* and 5

ANS: D PTS: 1

DIF: Average REF: p.407

BLM: Higher Order

NOT: Macro TB_16-61

62. **Refer to Figure 16-3.** Starting from *c* and 3, in the long run, where does a decrease in money supply growth move the economy to?
- a. *a* and 1
 - b. back to *c* and 3
 - c. *d* and 4
 - d. *e* and 5

ANS: A PTS: 1 DIF: Average REF: p.407
BLM: Higher Order NOT: Macro TB_16-62

63. **Refer to Figure 16-3.** Where does an increase in aggregate demand move the economy from *c* and 3 to, in the short run and the long run?
- a. *a* and 1 in the short run, *b* and 2 in the long run
 - b. *b* and 2 in the short run, *a* and 1 in the long run
 - c. *d* and 4 in the short run, *e* and 5 in the long run
 - d. *d* and 2 in the short run, *a* and 5 in the long run

ANS: C PTS: 1 DIF: Average REF: p.407
BLM: Higher Order NOT: Macro TB_16-63

64. **Refer to Figure 16-3.** Where does a decrease in aggregate demand move the economy from *c* and 3 to, in the short run and the long run?
- a. *a* and 1 in the short run, *b* and 2 in the long run
 - b. *b* and 2 in the short run, *a* and 1 in the long run
 - c. *d* and 4 in the short run, *e* and 5 in the long run
 - d. *b* and 4 in the short run, *e* and 1 in the long run

ANS: B PTS: 1 DIF: Average REF: p.407
BLM: Higher Order NOT: Macro TB_16-64

65. **Refer to Figure 16-3.** When would the economy move from *c* and 3 to *e* and 5?
- a. in the short run if money supply growth increased unexpectedly
 - b. in the short run if money supply growth decreased unexpectedly
 - c. in the long run if money supply growth increases
 - d. in the long run if money supply growth decreases

ANS: C PTS: 1 DIF: Average REF: p.407
BLM: Higher Order NOT: Macro TB_16-65

66. **Refer to Figure 16-3.** When would the economy move from *c* and 3 to *b* and 2?
- a. in the short run if money supply growth increased unexpectedly
 - b. in the short run if money supply growth decreased unexpectedly
 - c. in the long run if money supply growth increased
 - d. in the long run if money supply growth decreased

ANS: B PTS: 1 DIF: Average REF: p.407
BLM: Higher Order NOT: Macro TB_16-66

67. If efficiency wages became more common, where would the long-run Phillips curve and the long-run aggregate supply curve shift?
- a. Both the long-run Phillips curve and the long-run aggregate supply curve would shift right.
 - b. Both the long-run Phillips curve and the long-run aggregate supply curve would shift left.
 - c. The long-run Phillips curve would shift right, and the long-run aggregate supply curve would shift left.
 - d. The long-run Phillips curve would shift left, and the long-run aggregate supply curve would shift right.

ANS: C PTS: 1 DIF: Average REF: p.409
BLM: Higher Order NOT: Macro TB_16-67

68. Which of the following would shift the long-run Phillips curve right?
- a. an increase in the money supply
 - b. an increase in the inflation rate
 - c. increases in unemployment compensation
 - d. an decrease in the unemployment rate

ANS: C PTS: 1 DIF: Average REF: p.409-410
BLM: Higher Order NOT: Macro TB_16-68

69. Suppose the long-run Phillips curve shifts to the right. For any given rate of money growth and inflation, how would unemployment and output change?
- a. Unemployment would be higher, and output would be lower.
 - b. Unemployment would be higher, and output would be higher.
 - c. Unemployment would be lower, and output would be lower.
 - d. Unemployment would be lower, and output would be higher.

ANS: A PTS: 1 DIF: Average REF: p.409-410
BLM: Higher Order NOT: Macro TB_16-69

70. Suppose the long-run Phillips curve shifts to the left. For any given rate of money growth and inflation, how would unemployment and output change?
- a. Unemployment would be higher, and output would be lower.
 - b. Unemployment would be higher, and output would be higher.
 - c. Unemployment would be lower, and output would be lower.
 - d. Unemployment would be lower, and output would be higher.

ANS: D PTS: 1 DIF: Average REF: p.409-410
BLM: Higher Order NOT: Macro TB_16-70

71. Suppose the minimum wage decreased. At any given rate of inflation, what would happen to output and employment?
- a. Both output and employment would be higher.
 - b. Neither output nor employment would be higher.
 - c. Output would be higher and unemployment would be lower.
 - d. Unemployment would be lower and output would be higher.

ANS: C PTS: 1 DIF: Average REF: p.409-410
BLM: Higher Order NOT: Macro TB_16-71

72. Which of the following curves is (are) upward sloping?
- a. both the long-run and the short-run Phillips curve
 - b. neither the long-run nor the short-run Phillips curve
 - c. only the long-run Phillips curve
 - d. only the short-run Phillips curve

ANS: B PTS: 1 DIF: Easy REF: p.410
BLM: Remember NOT: Macro TB_16-72

73. Which of the following curves is (are) downward sloping?
- a. both the long-run and the short-run Phillips curve
 - b. neither the long-run nor the short-run Phillips curve
 - c. only the long-run Phillips curve
 - d. only the short-run Phillips curve

ANS: D PTS: 1 DIF: Easy REF: p.410
BLM: Remember NOT: Macro TB_16-73

74. Which of the following curves is (are) upward sloping?
- a. both the long-run Phillips curve and the long-run aggregate supply curve
 - b. neither the long-run Phillips curve nor the long-run aggregate supply curve
 - c. only the long-run Phillips curve
 - d. only the long-run aggregate supply curve

ANS: B PTS: 1 DIF: Easy REF: p.410
BLM: Remember NOT: Macro TB_16-74

75. Suppose that the money supply increases. In the long run, employment increases according to which of the following theories?
- a. both the long-run Phillips curve and the aggregate demand and aggregate supply model
 - b. neither the long-run Phillips curve nor the aggregate demand and aggregate supply model
 - c. only the long-run Phillips curve
 - d. only the aggregate demand and aggregate supply model

ANS: B PTS: 1 DIF: Average REF: p.410
BLM: Higher Order NOT: Macro TB_16-75

76. Suppose a policy affects the natural rate of unemployment. Which of the following does such a policy change?
- a. neither the long-run Phillips curve nor the long-run aggregate supply curve
 - b. both the long-run Phillips curve and the long-run aggregate supply curve
 - c. the long-run Phillips curve, but not the long-run aggregate supply curve
 - d. the long-run aggregate supply curve, but not the long-run Phillips curve

ANS: B PTS: 1 DIF: Average REF: p.410
BLM: Higher Order NOT: Macro TB_16-76

77. The position of the long-run Phillips curve and the long-run aggregate supply curve both depend on which of the following?
- the natural rate of unemployment and monetary growth
 - the natural rate of unemployment, but not monetary growth
 - monetary growth, but not the natural rate of unemployment
 - neither monetary growth nor the natural rate of unemployment

ANS: B

PTS: 1

DIF: Average

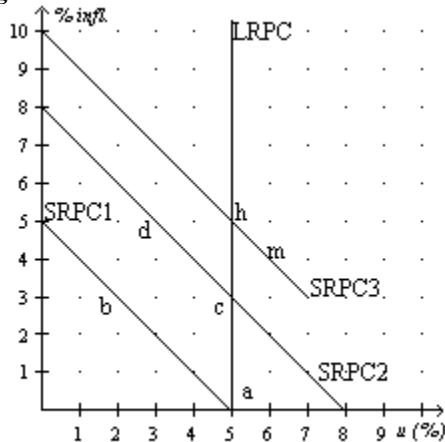
REF: p.410

BLM: Higher Order

NOT: Macro TB_16-77

Use the graph below to answer the following questions.

Figure 16-4



78. **Refer to Figure 16-4.** Along SRPC1, what is the expected rate of inflation?
- 0 percent
 - 2 percent
 - 5 percent
 - 8 percent

ANS: A

PTS: 1

DIF: Average

REF: p.410

BLM: Higher Order

NOT: Macro TB_16-78

79. **Refer to Figure 16-4.** Along SRPC2, what is the expected rate of inflation?
- 0 percent
 - 1 percent
 - 2 percent
 - 3 percent

ANS: D

PTS: 1

DIF: Average

REF: p.410

BLM: Higher Order

NOT: Macro TB_16-79

80. **Refer to Figure 16-4.** Along SRPC3, what is the expected rate of inflation?

- a. 0 percent
- b. 2 percent
- c. 3 percent
- d. 5 percent

ANS: D PTS: 1

DIF: Average REF: p.410

BLM: Higher Order

NOT: Macro TB_16-80

81. **Refer to Figure 16-4.** Along LRPC, what is the expected rate of inflation?

- a. 0 percent
- b. the actual rate of inflation
- c. 3 percent
- d. the natural rate of inflation

ANS: B PTS: 1

DIF: Average REF: p.410

BLM: Higher Order

NOT: Macro TB_16-81

82. **Refer to Figure 16-4.** What is the natural rate of unemployment?

- a. 0 percent
- b. 2 percent
- c. 5 percent
- d. 8 percent

ANS: C PTS: 1

DIF: Average REF: p.410

BLM: Higher Order

NOT: Macro TB_16-82

83. **Refer to Figure 16-4.** If the economy is at point *a* and the Bank of Canada pursues an expansionary monetary policy, then the economy will move to which of the following points in the short run?

- a. point *a*
- b. point *b*
- c. point *c*
- d. point *d*

ANS: B PTS: 1

DIF: Average REF: p.410

BLM: Higher Order

NOT: Macro TB_16-83

84. **Refer to Figure 16-4.** If the economy is at point *a* and the Bank of Canada pursues an expansionary monetary policy, then the economy will move to which of the following points in the short and long run?

- a. point *a* in the short run and point *b* in the long run
- b. point *b* in the short run and point *a* in the long run
- c. point *b* in the short run and point *c* in the long run
- d. point *m* in the short run and point *h* in the long run

ANS: A PTS: 1

DIF: Average REF: p.410

BLM: Higher Order

NOT: Macro TB_16-84

85. **Refer to Figure 16-4.** If the economy is at point *c* and the Bank of Canada pursues an expansionary monetary policy, then the economy will move to which of the following points in the short run?
- a. point *b*
 - b. point *c*
 - c. point *d*
 - d. point *h*

ANS: C PTS: 1 DIF: Average REF: p.410
BLM: Higher Order NOT: Macro TB_16-85

86. **Refer to Figure 16-4.** If the economy is at point *c* and the Bank of Canada pursues an expansionary monetary policy, then the economy will move to which of the following points in the short and long run?
- a. point *b* in the short run and point *c* in the long run
 - b. point *m* in the short run and point *c* in the long run
 - c. point *d* in the short run and point *h* in the long run
 - d. point *h* in the short run and point *d* in the long run

ANS: C PTS: 1 DIF: Average REF: p.410
BLM: Higher Order NOT: Macro TB_16-86

87. **Refer to Figure 16-4.** If the economy is at point *h* and the Bank of Canada pursues a contractionary monetary policy, then the economy will move to which of the following points in the short run?
- a. point *a*
 - b. point *b*
 - c. point *c*
 - d. point *m*

ANS: D PTS: 1 DIF: Average REF: p.410
BLM: Higher Order NOT: Macro TB_16-87

88. **Refer to Figure 16-4.** If the economy is at point *h* and the Bank of Canada pursues a contractionary monetary policy, then the economy will move to which of the following points in the short and long run?
- a. point *d* in the short run and point *c* in the long run
 - b. point *b* in the short run and point *c* in the long run
 - c. point *c* in the short run and point *a* in the long run
 - d. point *m* in the short run and point *c* in the long run

ANS: D PTS: 1 DIF: Average REF: p.410
BLM: Higher Order NOT: Macro TB_16-88

89. **Refer to Figure 16-4.** At point *b*, how do actual and expected inflation rates and unemployment rates compare?

- a. The actual inflation rate is less than the expected inflation rate, and the actual rate of unemployment exceeds the natural rate of unemployment.
- b. The actual inflation rate is greater than the expected inflation rate, and the actual rate of unemployment exceeds the natural rate of unemployment.
- c. The actual inflation rate is less than the expected inflation rate, and the actual rate of unemployment is less than the natural rate of unemployment.
- d. The actual inflation rate is greater than the expected inflation rate, and the actual rate of unemployment is less than the natural rate of unemployment.

ANS: D PTS: 1 DIF: Average REF: p.410
BLM: Higher Order NOT: Macro TB_16-89

90. **Refer to Figure 16-4.** At point *m*, how do actual and expected inflation rates and unemployment rates compare?

- a. The actual inflation rate exceeds the expected inflation rate and the actual unemployment rate exceeds the natural rate of unemployment.
- b. The actual inflation rate exceeds the expected inflation rate and the actual unemployment rate is less than the natural rate of unemployment.
- c. The actual inflation rate is less than the expected inflation rate and the actual unemployment rate exceeds the natural rate of unemployment.
- d. The actual inflation rate is less than the expected inflation rate and the actual unemployment rate is less than the natural rate of unemployment.

ANS: C PTS: 1 DIF: Average REF: p.410
BLM: Higher Order NOT: Macro TB_16-90

91. Which curve does an increase in expected inflation shift?

- a. only the long-run Phillips curve
- b. only the short-run Phillips curve
- c. neither the short-run nor long-run Phillips curve
- d. both the short-run and long-run Phillips curve

ANS: B PTS: 1 DIF: Easy REF: p.410
BLM: Higher Order NOT: Macro TB_16-91

92. A decrease in expected inflation shifts which of the following curves, and in what direction?

- a. It shifts the short-run Phillips curve right.
- b. It shifts the short-run Phillips curve left.
- c. It shifts the long-run Phillips curve right.
- d. It shifts the long-run Phillips curve left.

ANS: B PTS: 1 DIF: Easy REF: p.410
BLM: Higher Order NOT: Macro TB_16-92

93. According to Phelps and Friedman, in the short run, what effect does an increase in the money supply have on prices and unemployment?
- a. It raises prices and unemployment.
 - b. It raises prices and reduces unemployment.
 - c. It reduces prices and raises unemployment.
 - d. It reduces prices and unemployment.

ANS: B PTS: 1 DIF: Easy REF: p.410-411
BLM: Higher Order NOT: Macro TB_16-93

94. In the long run, what effect does an increase in the money supply have on prices and unemployment?
- a. It leaves prices and unemployment unchanged.
 - b. It raises prices and unemployment.
 - c. It raises prices and leaves unemployment unchanged.
 - d. It leaves prices unchanged and reduces unemployment.

ANS: C PTS: 1 DIF: Easy REF: p.410-411
BLM: Higher Order NOT: Macro TB_16-94

95. Where does the short-run Phillips curve intersect the long-run Phillips curve?
- a. where expected inflation is greater than actual inflation
 - b. where expected inflation equals actual inflation
 - c. where the quantity of goods and services demanded equals the quantity supplied
 - d. where the quantity of labour demanded equals the quantity supplied

ANS: B PTS: 1 DIF: Easy REF: p.410
BLM: Remember NOT: Macro TB_16-95

96. If the economy is at the point where the short-run Phillips curve intersects the long-run Phillips curve, what are the values of unemployment and inflation?
- a. Unemployment equals the natural rate, and expected inflation equals actual inflation.
 - b. Unemployment is above the natural rate, and expected inflation equals actual inflation.
 - c. Unemployment equals the natural rate, and expected inflation is greater than actual inflation.
 - d. Unemployment is below the natural rate, and inflation is lower than the expected rate.

ANS: A PTS: 1 DIF: Easy REF: p.409-411
BLM: Higher Order NOT: Macro TB_16-96

97. In the long run, what are the effects of a decrease in the rate of growth of the money supply?
- a. It will increase inflation and shift the short-run Phillips curve right.
 - b. It will increase inflation and shift the short-run Phillips curve left.
 - c. It will decrease inflation and shift the short-run Phillips curve right.
 - d. It will decrease inflation and shift the short-run Phillips curve left.

ANS: D PTS: 1 DIF: Average REF: p.410
BLM: Higher Order NOT: Macro TB_16-97

98. In the long run, what are the effects of a decrease in the rate of growth of the money supply on the Phillips curves?
- a. It shifts both the long-run and the short-run Phillips curves right.
 - b. It shifts the long-run Phillips curve left and the short-run Phillips curve right.
 - c. It shifts the long-run Phillips curve right and the short-run Phillips curve left.
 - d. It leaves the long-run Phillips curve unchanged and shifts the short-run Phillips curve left.

ANS: D PTS: 1 DIF: Easy REF: p.410
BLM: Higher Order NOT: Macro TB_16-98

99. In the long run, how does an increase in the rate of growth of the money supply shift the Phillips curves?
- a. It shifts both the short-run and long-run Phillips curves to the right.
 - b. It shifts both the short-run and long-run Phillips curves to the left.
 - c. It shifts only the short-run Phillips curve to the right.
 - d. It shifts only the short-run Phillips curve to the left.

ANS: C PTS: 1 DIF: Easy REF: p.410
BLM: Higher Order NOT: Macro TB_16-99

100. How does an increase in the expected rate of inflation shift the Phillips curves?
- a. It shifts only the short-run Phillips curve to the right.
 - b. It shifts only the short-run Phillips curve to the left.
 - c. It shifts both the short-run and long-run Phillips curves to the right.
 - d. It shifts both the short-run and long-run Phillips curves to the left.

ANS: A PTS: 1 DIF: Easy REF: p.409-411
BLM: Higher Order NOT: Macro TB_16-100

101. How does a decrease in the expected rate of inflation shift the Phillips curves?
- a. It shifts both the short-run and long-run Phillips curves to the right.
 - b. It shifts both the short-run and long-run Phillips curves to the left.
 - c. It shifts only the short-run Phillips curve to the right.
 - d. It shifts only the short-run Phillips curve to the left.

ANS: D PTS: 1 DIF: Easy REF: p.409-411
BLM: Higher Order NOT: Macro TB_16-101

102. More flexible labour markets will shift the long-run Phillips curve and the long-run aggregate supply curve in which direction?
- a. They will shift both the long-run Phillips curve and the long-run aggregate supply curve to the right.
 - b. They will shift both the long-run Phillips curve and the long-run aggregate supply curve to the left.
 - c. They will shift the long-run Phillips curve to the right and the long-run aggregate supply curve to the left.
 - d. They will shift the long-run Phillips curve to the left and the long-run aggregate supply curve to the right.

ANS: D PTS: 1 DIF: Average REF: p.409-411
BLM: Higher Order NOT: Macro TB_16-102

103. If technological change shifts the long-run aggregate supply curve to the right, it will also do which of the following?
- a. It will shift the short-run Phillips curve and the long-run Phillips curve to the right.
 - b. It will shift the short-run Phillips curve and the long-run Phillips curve to the left.
 - c. It will shift the short-run aggregate supply curve to the right and the long-run Phillips curve to the left.
 - d. It will shift the short-run aggregate supply curve to the right and leave the long-run Phillips curve unaffected.

ANS: D

PTS: 1

DIF: Challenging REF: p.409-411

BLM: Higher Order

NOT: Macro TB_16-103

104. The economy is in long-run equilibrium when an MP argues that the Bank of Canada should do more to fight unemployment. He argues that if the Bank of Canada increased the money supply faster, more workers would find jobs. How correct is the MP's argument?
- a. true for both the long run and the short run
 - b. wrong for both the long run and the short run
 - c. true for the short run but not the long run
 - d. true for the long run but not the short run

ANS: C

PTS: 1

DIF: Average REF: p.410

BLM: Higher Order

NOT: Macro TB_16-104

105. What did Friedman and Phelps argue about the effectiveness of monetary policies?
- a. As long as people's inflation expectations were fixed, an increase in the money supply growth rate could not change output in the short or long run.
 - b. If people's inflation expectations were fixed, in the short run, a decrease in the money supply growth rate could raise output and unemployment.
 - c. When the money supply growth rate changed, people would eventually revise their inflation expectations so that any change in unemployment created by an increase in the money supply growth rate would be temporary.
 - d. When the money supply growth rate changes, people slowly adjust their inflation expectations; therefore, the unemployment rate changes only in the long run but not in the short run.

ANS: C

PTS: 1

DIF: Average REF: p.409-411

BLM: Higher Order

NOT: Macro TB_16-105

106. Which of the following equations summarize the analysis of Friedman and Phelps (where a is positive number)?
- a. $\text{unemployment rate} = \text{natural rate of unemployment} - a(\text{actual inflation} - \text{expected inflation})$
 - b. $\text{unemployment rate} = \text{natural rate of unemployment} - a(\text{expected inflation} - \text{actual inflation})$
 - c. $\text{unemployment rate} = \text{expected rate of inflation} - a(\text{actual inflation} - \text{expected inflation})$
 - d. $\text{unemployment rate} = \text{actual rate of inflation} - a(\text{actual unemployment} - \text{expected unemployment})$

ANS: A

PTS: 1

DIF: Average REF: p.409-410

BLM: Remember

NOT: Macro TB_16-106

107. According to Friedman and Phelps, when is the unemployment rate below the natural rate?
- a. when actual inflation is greater than expected inflation
 - b. when actual inflation is less than expected inflation
 - c. when actual inflation equals expected inflation
 - d. when actual inflation is low

ANS: A PTS: 1 DIF: Easy REF: p.409-411
BLM: Higher Order NOT: Macro TB_16-107

108. According to Friedman and Phelps, when is the unemployment rate above the natural rate?
- a. when actual inflation is greater than expected inflation
 - b. when actual inflation is less than expected inflation
 - c. when actual inflation equals expected inflation
 - d. when actual inflation is high

ANS: B PTS: 1 DIF: Average REF: p.409-411
BLM: Higher Order NOT: Macro TB_16-108

109. According to Friedman and Phelps, when do policymakers face a tradeoff between inflation and unemployment?
- a. only in the long run
 - b. only in the short run
 - c. in neither the long run nor short run
 - d. in both the short run and long run

ANS: B PTS: 1 DIF: Average REF: p.415
BLM: Higher Order NOT: Macro TB_16-109

110. In the nineteenth century, some countries were on gold standards so that on average the money supply growth rate was close to zero and expected inflation was more or less constant. For these countries during this time period, we find that increases in inflation were generally associated with falling unemployment. Are these findings consistent with Friedman and Phelps's theories, and why?
- a. Yes, because they argued that when inflation was higher than expected, unemployment would fall.
 - b. Yes, because they argued that when prices rose unemployment would fall, whether actual inflation was higher than expected or not.
 - c. No, because they argued that higher inflation would increase unemployment.
 - d. No, because they argued that inflation and unemployment were unrelated.

ANS: A PTS: 1 DIF: Challenging REF: p.409-411
BLM: Higher Order NOT: Macro TB_16-110

111. In the late 1960s and early 1970s, how did the short-run Phillips curve shift?
- a. It shifted right as inflation expectations rose.
 - b. It shifted right as inflation expectations fell.
 - c. It shifted left as inflation expectations rose.
 - d. It shifted left as inflation expectations fell.

ANS: A PTS: 1 DIF: Average REF: p.412
BLM: Remember NOT: Macro TB_16-111

112. If inflation expectations rise, how do the short-run Phillips curve and unemployment change?
- a. The short-run Phillips curve shifts right, so that at any inflation rate unemployment is higher.
 - b. The short-run Phillips curve shifts left, so that at any inflation rate unemployment is higher.
 - c. The short-run Phillips curve shifts right, so that at any inflation rate unemployment is lower.
 - d. The short-run Phillips curve shifts left, so that at any inflation rate unemployment is lower.

ANS: A PTS: 1 DIF: Easy REF: p.412
BLM: Higher Order NOT: Macro TB_16-112

113. Which of the following hypotheses is supported by the economic experience of Canada during the late 1960s and early 1970s?
- a. Actual inflation and unemployment are negatively correlated.
 - b. Inflation and unemployment are related only in the short run.
 - c. Policymakers can permanently reduce unemployment below the natural level.
 - d. Inflation and unemployment are related both in the short run and long run.

ANS: B PTS: 1 DIF: Challenging REF: p.412
BLM: Higher Order NOT: Macro TB_16-113

114. In recent years, inflation expectations have fallen. How did this shift the short-run Phillips curve, and what are the implications for unemployment?
- a. This shifted the short-run Phillips curve left, meaning that at any given inflation rate unemployment will be lower in the short run than before.
 - b. This shifted the short-run Phillips curve right, meaning that at any given inflation rate unemployment will be lower in the short run than before.
 - c. This shifted the short-run Phillips curve right, meaning that at any given inflation rate unemployment will be higher in the short run than before.
 - d. This shifted the short-run Phillips curve left, meaning that at any given inflation rate unemployment will be higher in the short run than before.

ANS: A PTS: 1 DIF: Challenging REF: p.412
BLM: Higher Order NOT: Macro TB_16-114

115. Compared to the 1970s, how did the Canadian short-run Phillips curve move in recent years and why?
- a. It has moved further right, as inflation expectations have risen.
 - b. It has further right, as inflation expectations have fallen.
 - c. It has further left, as inflation expectations have risen.
 - d. It has further left, as inflation expectations have fallen.

ANS: D PTS: 1 DIF: Average REF: p.412
BLM: Higher Order NOT: Macro TB_16-115

116. Which of the following would **NOT** be associated with an adverse supply shock?
- a. The short-run Phillips curve shifts left.
 - b. Unemployment rises.
 - c. The price level rises.
 - d. Output falls.

ANS: A PTS: 1 DIF: Easy REF: p.413
BLM: Higher Order NOT: Macro TB_16-116

117. Which of the following would **NOT** be associated with a favourable supply shock?
- a. The short-run Phillips curve shifts left.
 - b. Unemployment falls.
 - c. The price level rises.
 - d. Output rises.

ANS: C PTS: 1 DIF: Easy REF: p.413
BLM: Higher Order NOT: Macro TB_16-117

118. Which of the following is an adverse supply shock?
- a. a decrease in the money supply
 - b. a tax cut
 - c. a worldwide drought
 - d. decreased government spending

ANS: C PTS: 1 DIF: Easy REF: p.413
BLM: Higher Order NOT: Macro TB_16-118

119. Faced with an adverse supply shock, what can policymakers increase, and how will prices and output be affected?
- a. They can increase aggregate demand, which increases prices and output.
 - b. They can increase aggregate demand, which decreases prices and increases output.
 - c. They can increase aggregate supply, which increases prices and output.
 - d. They can increase aggregate supply, which decreases prices and increases output.

ANS: A PTS: 1 DIF: Easy REF: p.413-414
BLM: Higher Order NOT: Macro TB_16-119

120. Suppose that in response to an adverse aggregate supply shock, the Bank of Canada increased the money supply. What would happen to unemployment and inflation?
- a. Unemployment and inflation would both be rise.
 - b. Unemployment and inflation would both fall.
 - c. Unemployment would rise and inflation would fall.
 - d. Unemployment would fall and inflation would rise.

ANS: D PTS: 1 DIF: Easy REF: p.414
BLM: Higher Order NOT: Macro TB_16-120

121. If policymakers accommodate an adverse supply shock, what will happen to the unemployment rate and inflation?
- a. The unemployment rate and the inflation rate will rise.
 - b. The unemployment rate and the inflation rate will fall.
 - c. The unemployment rate will rise and the inflation rate will fall.
 - d. The unemployment rate will fall and the inflation rate will rise.

ANS: D PTS: 1 DIF: Easy REF: p.414
BLM: Higher Order NOT: Macro TB_16-121

122. How will a favourable supply shock shift short-run aggregate supply, and how will output change?
- a. It will shift short-run aggregate supply left, making output rise.
 - b. It will shift short-run aggregate supply left, making output fall.
 - c. It will shift short-run aggregate supply right, making output rise.
 - d. It will shift short-run aggregate supply right, making output fall.

ANS: C PTS: 1 DIF: Easy REF: p.414
BLM: Higher Order NOT: Macro TB_16-122

123. How will an adverse supply shock shift the short-run aggregate supply curve, and what will be the effect on prices?
- a. It will shift the short-run aggregate supply curve right, making prices rise.
 - b. It will shift the short-run aggregate supply curve left, making prices rise.
 - c. It will shift the short-run aggregate supply curve right, making prices fall.
 - d. It will shift the short-run aggregate supply curve left, making prices fall.

ANS: B PTS: 1 DIF: Easy REF: p.414
BLM: Higher Order NOT: Macro TB_16-123

124. What will a favourable supply shock cause the price level and output to do?
- a. It will cause the price level and output to rise.
 - b. It will cause the price level and output to fall.
 - c. It will cause the price level to rise and output to fall.
 - d. It will cause the price level to fall and output to rise.

ANS: D PTS: 1 DIF: Easy REF: p.414
BLM: Higher Order NOT: Macro TB_16-124

125. What will an adverse supply shock cause output and prices to do?
- a. It will cause output and prices to rise.
 - b. It will cause output and prices to fall.
 - c. It will cause output to rise and prices to fall.
 - d. It will cause output to fall and prices to rise.

ANS: D PTS: 1 DIF: Easy REF: p.414
BLM: Higher Order NOT: Macro TB_16-125

126. How will a favourable supply shock shift the short-run Phillips curve, and how does unemployment change?
- a. It will shift the short-run Phillips curve right, and unemployment will rise.
 - b. It will shift the short-run Phillips curve right, and unemployment will fall.
 - c. It will shift the short-run Phillips curve left, and unemployment will rise.
 - d. It will shift the short-run Phillips curve left, and unemployment will fall.

ANS: D PTS: 1 DIF: Easy REF: p.414
BLM: Higher Order NOT: Macro TB_16-126

127. How will an adverse supply shock shift the short-run Phillips curve, and how will it change unemployment?

- a. It will shift the short-run Phillips curve right and raise unemployment.
- b. It will shift the short-run Phillips curve right and lower unemployment.
- c. It will shift the short-run Phillips curve left and raise unemployment.
- d. It will shift the short-run Phillips curve left and lower unemployment.

ANS: A PTS: 1 DIF: Easy REF: p.414
BLM: Higher Order NOT: Macro TB_16-127

128. How will a favourable supply shock shift the short-run Phillips curve and how does it change inflation?

- a. It will shift the short-run Phillips curve right and raise inflation.
- b. It will shift the short-run Phillips curve right and lower inflation.
- c. It will shift the short-run Phillips curve left and raise inflation.
- d. It will shift the short-run Phillips curve left and lower inflation.

ANS: D PTS: 1 DIF: Easy REF: p.414
BLM: Higher Order NOT: Macro TB_16-128

129. How will an adverse supply shock shift the short-run Phillips curve, and how does inflation change?

- a. It will shift the short-run Phillips curve right, and inflation will rise.
- b. It will shift the short-run Phillips curve right, and inflation will fall.
- c. It will shift the short-run Phillips curve left, and inflation will rise.
- d. It will shift the short-run Phillips curve left, and inflation will fall.

ANS: A PTS: 1 DIF: Easy REF: p.414
BLM: Higher Order NOT: Macro TB_16-129

130. Which of the following would cause the price level to rise and output to fall in the short run?

- a. an increase in the money supply
- b. a decrease in the money supply
- c. an adverse supply shock
- d. a favourable supply shock

ANS: C PTS: 1 DIF: Easy REF: p.414
BLM: Higher Order NOT: Macro TB_16-130

131. Suppose that there is an adverse supply shock. Which of the following curves will shift left?

- a. both the aggregate supply curve and the Phillips curve
- b. only the aggregate supply curve
- c. only the Phillips curve
- d. neither the aggregate supply curve nor the Phillips curve

ANS: B PTS: 1 DIF: Average REF: p.414
BLM: Higher Order NOT: Macro TB_16-131

132. If there is an adverse supply shock, which of the following will most likely happen?
- a. The aggregate supply curve and the short-run Phillips curve will both shift right.
 - b. The aggregate supply curve and the short-run Phillips curve will both shift left.
 - c. The aggregate supply curve will shift right, and the short-run Phillips curve will shift left.
 - d. The aggregate supply curve will shift left, and the short-run Phillips curve will shift right.

ANS: D PTS: 1 DIF: Average REF: p.414
BLM: Higher Order NOT: Macro TB_16-132

133. If there is a favourable supply shock, which of the following will most likely happen?
- a. The aggregate supply curve and the short-run Phillips curve will both shift right.
 - b. The aggregate supply curve and the short-run Phillips curve will both shift left.
 - c. The aggregate supply curve will shift right, and the short-run Phillips curve will shift left.
 - d. The aggregate supply curve will shift left, and the short-run Phillips curve will shift right.

ANS: C PTS: 1 DIF: Average REF: p.414
BLM: Higher Order NOT: Macro TB_16-133

134. Suppose that a small economy that depends mostly on agriculture experiences a year with exceptionally good conditions for growing crops. What would the good weather do to the short-run aggregate supply curve and the short-run Phillips curve?
- a. It would shift both the short-run aggregate supply curve and the short-run Phillips curve right.
 - b. It would shift both the short-run aggregate supply curve and the short-run Phillips curve left.
 - c. It would shift the short-run aggregate supply curve to the right, and the short-run Phillips curve to the left.
 - d. It would shift the short-run aggregate supply curve to the left, and the short-run Phillips curve to the right.

ANS: C PTS: 1 DIF: Average REF: p.414
BLM: Higher Order NOT: Macro TB_16-134

135. Suppose that weather around the world is especially good next year, so farmers have unusually good crops. What might we expect that this will do to the short-run and long-run Phillips curves?
- a. This will shift both the short-run and long-run Phillips curves to the right.
 - b. This will shift both the short-run and long-run Phillips curves to the left.
 - c. This will shift the short-run Phillips curve to the left, but not affect the long-run Phillips curve.
 - d. This will shift the long-run Phillips curve to the left, but not affect the short-run Phillips curve.

ANS: C PTS: 1 DIF: Average REF: p.414
BLM: Higher Order NOT: Macro TB_16-135

136. Suppose a war disrupts the supply of oil to the country. What would we expect to happen to the short-run aggregate supply curve, the short-run Phillips curve, and the long-run Phillips curve?
- We would expect the short-run aggregate supply curve, short-run Phillips curve, and long-run Phillips curve to shift left.
 - We would expect the short-run aggregate supply curve, short-run Phillips curve, and long-run Phillips curve to shift right.
 - We would expect the short-run aggregate supply curve to shift left, and the short-run Phillips curve and long-run Phillips curve to shift right.
 - We would expect the short-run aggregate supply curve to shift left, the short-run Phillips curve to shift right, and the long-run Phillips curve to be unaffected.

ANS: D PTS: 1 DIF: Challenging REF: p.414
BLM: Higher Order NOT: Macro TB_16-136

137. Which of the following was the primary cause of the large increase in oil prices in the 1970s?
- an increase in demand for oil
 - a decrease in demand for oil
 - a decrease in the supply of oil
 - an increase in the supply of oil

ANS: C PTS: 1 DIF: Easy REF: p.415
BLM: Remember NOT: Macro TB_16-137

138. What happened to expected inflation in Canada during the 1970s?
- It rose substantially.
 - It rose slightly.
 - It fell slightly.
 - It fell substantially.

ANS: A PTS: 1 DIF: Easy REF: p.415
BLM: Remember NOT: Macro TB_16-138

139. In 1980, what was the Canadian inflation rate and unemployment rate?
- The inflation rate was about 1 percent, and the unemployment rate was about 7 percent.
 - The inflation rate was less than 4 percent, and the unemployment rate was less than 6 percent.
 - The inflation rate was about 7 percent, and the unemployment rate was about 9 percent.
 - The inflation rate was about 10 percent, and the unemployment rate was about 7 percent.

ANS: D PTS: 1 DIF: Easy REF: p.415
BLM: Remember NOT: Macro TB_16-139

140. In 1980, how did the Canadian misery index compare to the average?
- It was much higher than average.
 - It was slightly higher than average.
 - It was about average.
 - It was below average.

ANS: A PTS: 1 DIF: Easy REF: p.415
BLM: Remember NOT: Macro TB_16-140

141. The long-run response to a decrease in the growth rate of the money supply is shown by shifting which of the Phillips curves and in what direction?
- by shifting the short-run and long-run Phillips curves left
 - by shifting the short-run and long-run Phillips curves right
 - by shifting only the short-run Phillips curve left
 - by shifting only the short-run Phillips curve right

ANS: C PTS: 1 DIF: Easy REF: p.415
BLM: Higher Order NOT: Macro TB_16-141

142. Suppose an economy with high inflation decides to decrease the money supply growth rate. Which of the following best describes the results?
- Initially unemployment rises. Eventually the short-run Phillips curve shifts right.
 - Initially unemployment rises. Eventually the short-run Phillips curve shifts left.
 - Initially unemployment falls. Eventually the short-run Phillips curve shifts right.
 - Initially unemployment falls. Eventually the short-run Phillips curve shifts left.

ANS: B PTS: 1 DIF: Average REF: p.415
BLM: Higher Order NOT: Macro TB_16-142

143. Suppose the Bank of Canada decreased the growth rate of the money supply. Which of the following would permanently decrease?
- both the natural rate of unemployment and the inflation rate
 - the natural rate of unemployment, but not the inflation rate
 - the inflation rate, but not the natural rate of unemployment
 - neither the natural unemployment rate nor the inflation rate

ANS: C PTS: 1 DIF: Average REF: p.417
BLM: Higher Order NOT: Macro TB_16-143

144. Which of the following best defines the sacrifice ratio?
- the sum of the inflation and unemployment rates
 - the inflation rate divided by the unemployment rate
 - the number of percentage points annual output falls for each percentage point reduction in inflation
 - the number of percentage points unemployment rises for each percentage point reduction in inflation

ANS: C PTS: 1 DIF: Easy REF: p.417
BLM: Remember NOT: Macro TB_16-144

145. Which of the following best describes the sacrifice ratio for Canada?
- It falls over a range of 2 to 5.
 - It is about 8.
 - It cannot be determined.
 - It is between 2 and 4.

ANS: A PTS: 1 DIF: Easy REF: p.417-418
BLM: Remember NOT: Macro TB_16-145

146. Which of the following best defines disinflation?

- a. It is a zero rate of inflation.
- b. It is a constant rate of inflation.
- c. It is a reduction in the rate of inflation.
- d. It is a negative rate of inflation.

ANS: C PTS: 1 DIF: Average REF: p.422
BLM: Remember NOT: Macro TB_16-146

147. Suppose the Bank of Canada reduces inflation 2 percentage points, and this makes output fall 12 percentage points and unemployment rises 4 percentage points. What is the sacrifice ratio?

- a. 1/6
- b. 2
- c. 6
- d. 8

ANS: C PTS: 1 DIF: Average REF: p.417-418
BLM: Higher Order NOT: Macro TB_16-147

148. Suppose a central bank reduced inflation by 4 percentage points and that made output fall by 6 percentage points for three years, and it made the unemployment rate rise from 3 percent to 9 percent for three years. What is the sacrifice ratio?

- a. 1
- b. 3
- c. 4
- d. 4.5

ANS: D PTS: 1 DIF: Average REF: p.417-418
BLM: Higher Order NOT: Macro TB_16-148

149. Suppose that reducing inflation 3 percentage points would cost a country 12 percent of annual output. What is this country's sacrifice ratio?

- a. 3
- b. 3.5
- c. 4
- d. 12

ANS: C PTS: 1 DIF: Average REF: p.417-418
BLM: Higher Order NOT: Macro TB_16-149

150. If the sacrifice ratio is 3, reducing the inflation rate from 10 percent to 8 percent would require sacrificing how much annual output?

- a. 2 percent of annual output
- b. 6 percent of annual output
- c. 8 percent of annual output
- d. 10 percent of annual output

ANS: B PTS: 1 DIF: Average REF: p.417-418
BLM: Higher Order NOT: Macro TB_16-150

151. If the sacrifice ratio is 3, reducing the inflation rate from 10 percent to 6 percent would require sacrificing what percent of annual output?
- a. 2 percent of annual output
 - b. 5 percent of annual output
 - c. 6 percent of annual output
 - d. 12 percent of annual output

ANS: D PTS: 1 DIF: Average REF: p.417-418
BLM: Higher Order NOT: Macro TB_16-151

152. Suppose the natural rate of unemployment is 4 percent. Then suppose that Parliament passes laws that make the labour market less flexible, so the natural rate of unemployment rises to 5 percent. If the sacrifice ratio is 3, how much higher must the inflation rate go in order to keep the unemployment rate at 4 percent in the long run?
- a. 3 percent
 - b. 12 percent
 - c. 15 percent
 - d. There is no inflation rate that will keep unemployment at 4 percent in the long run.

ANS: D PTS: 1 DIF: Challenging REF: p.417-418
BLM: Higher Order NOT: Macro TB_16-152

153. Ultimately, what causes the short-run reduction in unemployment associated with an increase in inflation?
- a. the shape of the long-run aggregate supply curve
 - b. unanticipated inflation, not inflation per se
 - c. rational expectations
 - d. anticipated changes in the price level

ANS: B PTS: 1 DIF: Average REF: p.418
BLM: Higher Order NOT: Macro TB_16-153

154. Suppose that monetary policymakers announced that they were going to make a serious effort to fight inflation. A few years later the inflation rate has been reduced, but there had also been a serious recession. Which of the following could we conclude with certainty?
- a. We could conclude that the rational expectations hypothesis is false.
 - b. We could conclude that the rational expectations hypothesis is true.
 - c. We could conclude that the policymakers lacked credibility.
 - d. No conclusion about the rational expectations theory or the policymakers' credibility can be drawn with certainty.

ANS: D PTS: 1 DIF: Challenging REF: p.419
BLM: Higher Order NOT: Macro TB_16-154

155. Which of the following best characterizes the theory of rational expectations?
- a. It describes how policymakers react to supply shocks.
 - b. It concerns how people use information to predict the future.
 - c. It explains why the long run Phillips curve is vertical.
 - d. It explains how people act when there is unemployment and workers must be rationed.

ANS: B PTS: 1 DIF: Easy REF: p.419
BLM: Remember NOT: Macro TB_16-155

156. Which of the following refers to the theory that people optimally use all available information when forecasting the future?
- a. rational expectations theory
 - b. perfect expectations theory
 - c. momentum expectations theory
 - d. accommodating expectations theory

ANS: A PTS: 1 DIF: Easy REF: p.419
BLM: Remember NOT: Macro TB_16-156

157. If the Bank of Canada announced a policy to reduce inflation and people found it credible, what would happen to the short-run Phillips curve and the sacrifice ratio?
- a. The short-run Phillips curve would shift right, and the sacrifice ratio would fall.
 - b. The short-run Phillips curve would shift right, and the sacrifice ratio would rise.
 - c. The short-run Phillips curve would shift left, and the sacrifice ratio would fall.
 - d. The short-run Phillips curve would shift left, and the sacrifice ratio would rise.

ANS: C PTS: 1 DIF: Easy REF: p.419-420
BLM: Higher Order NOT: Macro TB_16-157

158. Proponents of rational expectations theory have argued that, in the most extreme case, if policymakers are credibly committed to reducing inflation, and rational people understand that commitment and quickly lower their inflation expectation, the sacrifice ratio could be as small as what?
- a. 0
 - b. 1
 - c. 4
 - d. 5

ANS: A PTS: 1 DIF: Easy REF: p.419-420
BLM: Higher Order NOT: Macro TB_16-158

159. Proponents of rational expectations theory have argued that the sacrifice ratio could be as small as what?
- a. 0
 - b. 2
 - c. 3
 - d. 4

ANS: A PTS: 1 DIF: Easy REF: p.419-420
BLM: Higher Order NOT: Macro TB_16-159

160. What did proponents of rational expectations argue about the sacrifice ratio and why?
- a. The sacrifice ratio would be high because it was rational for people not to immediately change their expectations.
 - b. The sacrifice ratio would be high because people might adjust their expectations quickly if they found anti-inflation policy credible.
 - c. The sacrifice ratio could be low because it was rational for people not to immediately change their expectations.
 - d. The sacrifice ratio could be low because people might adjust their expectations quickly if they found anti-inflation policy credible.

ANS: B PTS: 1 DIF: Easy REF: p.419-420
BLM: Remember NOT: Macro TB_16-160

161. What did proponents of rational expectations argue about the sacrifice ratio and why?
- a. The sacrifice ratio would be high because it was rational for people not to immediately change their expectations.
 - b. The sacrifice ratio would be high because people might adjust their expectations quickly if they found anti-inflation policy credible.
 - c. The sacrifice ratio could be low because it was rational for people not to immediately change their expectations.
 - d. The sacrifice ratio could be low because people might adjust their expectations quickly if they found anti-inflation policy credible.

ANS: D PTS: 1 DIF: Average REF: p.419-420
BLM: Higher Order NOT: Macro TB_16-161

162. How were inflation and unemployment from 1980 to 1989 in Canada?
- a. Inflation was relatively low, and there were no fluctuations in unemployment.
 - b. Inflation was relatively low, and unemployment was high.
 - c. Unemployment was relatively low, but there were large fluctuations in inflation.
 - d. There were relatively large fluctuations in both unemployment and inflation.

ANS: B PTS: 1 DIF: Average REF: p.420
BLM: Remember NOT: Macro TB_16-162

163. How was the Phillips curve for most of the 1990s and why?
- a. It was fairly far to the right partly because of lower inflation expectations.
 - b. It was fairly far to the left partly because of lower inflation expectations.
 - c. It was fairly far to the right partly because of adverse supply shocks.
 - d. It was fairly far to the left partly because of adverse supply shocks.

ANS: B PTS: 1 DIF: Easy REF: p.423
BLM: Remember NOT: Macro TB_16-163

164. What happened to aggregate supply and the Phillips curve in the mid- and late 1990s?
- a. Aggregate supply and the Phillips curve shifted right.
 - b. Aggregate supply and the Phillips curve shifted left.
 - c. Aggregate supply shifted right and the Phillips curve shifted left.
 - d. Aggregates supply shifted left and the Phillips curve shifted right.

ANS: C PTS: 1 DIF: Easy REF: p.423
BLM: Remember NOT: Macro TB_16-164

165. Which of the following would shift aggregate supply to the right?
- a. increasing commodity prices
 - b. an increase in money supply
 - c. an increase in wages
 - d. the discovery of a new, cheaper form of energy

ANS: D PTS: 1 DIF: Easy REF: p.424
BLM: Higher Order NOT: Macro TB_16-165

TRUE/FALSE

1. In the long run, the natural rate of unemployment depends primarily on the growth rate of the money supply.

ANS: F PTS: 1 DIF: Easy REF: p.401
NOT: Macro TB_16-167

2. In the long run, the inflation rate depends primarily on money supply growth.

ANS: T PTS: 1 DIF: Easy REF: p.407
NOT: Macro TB_16-168

3. If macroeconomic policy expands aggregate demand, unemployment will fall and inflation will rise in the short run.

ANS: T PTS: 1 DIF: Easy REF: p.401
NOT: Macro TB_16-169

4. The logic behind the tradeoff between inflation and unemployment is that high aggregate demand puts upward pressure on wages and prices while raising output.

ANS: T PTS: 1 DIF: Easy REF: p.403-404
NOT: Macro TB_16-170

5. Short-run outcomes in the economy can be expressed in terms of output and the price level, or in terms of unemployment and inflation.

ANS: T PTS: 1 DIF: Easy REF: p.403-404
NOT: Macro TB_16-171

6. Fiscal policy cannot be used to move the economy along the short-run Phillips curve.

ANS: F PTS: 1 DIF: Easy REF: p.403-404
NOT: Macro TB_16-172

7. The vertical long-run Phillips curve is an exception to monetary neutrality implied by the classical dichotomy.

ANS: F PTS: 1 DIF: Easy REF: p.405-407
NOT: Macro TB_16-173

8. Friedman and Phelps believed that the natural rate of unemployment was constant.

ANS: F PTS: 1 DIF: Average REF: p.405-407
NOT: Macro TB_16-174

9. A decrease in the growth rate of the money supply eventually causes the short-run Phillips curve to shift right.

ANS: F PTS: 1 DIF: Easy REF: p.409
NOT: Macro TB_16-175

10. In the long run, people come to expect whatever inflation rate the Bank of Canada chooses to produce, so unemployment returns to its natural rate.

ANS: T PTS: 1 DIF: Easy REF: p.410
NOT: Macro TB_16-176

11. The analysis of Friedman and Phelps argues that any change in inflation that is expected has no impact on the unemployment rate.

ANS: T PTS: 1 DIF: Average REF: p.410
NOT: Macro TB_16-177

12. In the Friedman-Phelps analysis, when inflation is less than expected, unemployment is greater than the natural rate.

ANS: T PTS: 1 DIF: Easy REF: p.410
NOT: Macro TB_16-178

13. According to the Friedman-Phelps analysis, in the long run, actual inflation equals expected inflation, and unemployment is at its natural rate.

ANS: T PTS: 1 DIF: Easy REF: p.410
NOT: Macro TB_16-179

14. An increase in inflation expectations shifts the short-run Phillips curve right and has no effect on the long-run Phillips curve.

ANS: T PTS: 1 DIF: Easy REF: p.410
NOT: Macro TB_16-180

15. An adverse supply shock shifts the short-run Phillips curve right and the short-run aggregate-supply curve left.

ANS: T PTS: 1 DIF: Easy REF: p.412-413
NOT: Macro TB_16-181

16. Although monetary policy cannot reduce the natural rate of unemployment, other types of policies can.

ANS: T PTS: 1 DIF: Easy REF: p.414
NOT: Macro TB_16-182

17. A policy change that reduced the natural rate of unemployment would shift both the long-run aggregate-supply curve and the long-run Phillips curve left.

ANS: F PTS: 1 DIF: Easy REF: p.414
NOT: Macro TB_16-183

18. The sacrifice ratio is the percentage point increase in the unemployment rate created in the process of reducing inflation by one percentage point.

ANS: F PTS: 1 DIF: Easy REF: p.417
NOT: Macro TB_16-184

19. Proponents of rational expectations argue that failing to account for people's revised expectations led to estimates of the sacrifice ratio that were too high.

ANS: T PTS: 1 DIF: Easy REF: p.419
NOT: Macro TB_16-185

SHORT ANSWER

1. Are the effects of an increase in aggregate demand in the AD-AS model consistent with the Phillips curve? Explain.

ANS:

Consider what happens when the aggregate-demand curve shifts. For example, suppose there is an increase in aggregate demand. The aggregate demand and supply model shows that prices and output will rise. Rising prices mean that there is inflation. Rising output means falling unemployment. Thus, a shift in the aggregate-demand curve along the aggregate-supply curve corresponds to a movement along the Phillips curve.

PTS: 1 DIF: Average REF: p.404 NOT: Macro TB_16-186

2. The Phillips curve and the short-run aggregate supply curve are closely related, yet one slopes downward and the other slopes upward. Discuss.

ANS:

The Phillips curve shows the relation between inflation and unemployment. The short-run aggregate-supply curve shows the relation between the price level and output. When aggregate demand increases, the price level and output rise. The rising price level means that inflation has increased. The rising level of output means that firms will hire more workers so that the unemployment rate falls. Thus, the model implies that inflation and unemployment are inversely related as the Phillips curve indicates.

PTS: 1 DIF: Average REF: p.404 NOT: Macro TB_16-187

3. Explain the connection between the vertical long-run aggregate supply curve and the vertical long-run Phillips curve.

ANS:

Both reflect the classical dichotomy. The vertical long-run aggregate supply curve says that, in the long run, the economy will be at its natural rate of output, and that this is the same no matter what the price level. The natural rate of output depends on the natural rate of unemployment. The vertical Phillips curve says that, in the long run, the economy will be at the natural rate of unemployment (corresponding with the natural rate of output), and that this is the same no matter what the inflation rate.

PTS: 1

DIF: Average

REF: p.407

NOT: Macro TB_16-188

4. Suppose that the Bank of Canada unexpectedly decreases the money supply. What will happen to unemployment in the short run? What will happen to unemployment in the long run?

ANS:

In the short run, unemployment will rise, because, in the short run, a decrease in the money supply moves the economy along the Phillips curve. In the long run, the economy will return to its natural rate of unemployment as the short-run Philip curve shifts down as inflation expectations fall.

PTS: 1

DIF: Average

REF: p.407

NOT: Macro TB_16-189

5. What did Friedman and Phelps predict would happen if policymakers tried to move the economy upward along the Phillips curve (that is, to increase inflation and reduce unemployment)? Were they right or wrong?

ANS:

Friedman and Phelps predicted that, over time, people would come to expect the higher inflation, so the Phillips curve would shift up. When this happened, unemployment would go back to its natural rate, but inflation would be higher. They turned out to be right.

PTS: 1

DIF: Average

REF: p.410

NOT: Macro TB_16-190

6. Suppose that the economy is at an inflation rate such that unemployment is above the natural rate. How does the economy return to the natural rate of unemployment if this lower inflation rate persists?

ANS:

If inflation remains low, eventually the short-run Phillips curve will shift to the left until it intersects the long-run Phillips curve at the point where actual inflation equals expected inflation.

PTS: 1

DIF: Average

REF: p.410

NOT: Macro TB_16-191

7. Some economists argue that simply and suddenly reducing money supply growth is a costly way to reduce inflation and that it may not work. For example, if a government cuts money growth but makes no real reform so that people expect that the government will soon start printing more money again to pay for its expenditures, the promise to fight inflation will not be credible. Explain the importance of an inflation reduction policy that is announced ahead of time and is credible.

ANS:

In a country where expected inflation has been and continues to be high, a reduction in the money supply will decrease inflation some, but it will also increase unemployment and decrease output. The more certain people are of a decrease in inflation, the lower their inflation expectations are. When inflation expectations fall, the Phillips curve shifts left and each unemployment rate is associated with a lower inflation rate.

PTS: 1

DIF: Average

REF: p.410

NOT: Macro TB_16-192

8. Economists generally agree that there is a short-run Phillips curve. However, some economists believe that the short-run Phillips curve is steep and that inflation expectations adjust quickly so that the long run is short-lived. What do such beliefs imply about the benefits of using policy to reduce unemployment? What do such beliefs imply about the costs of using policy to reduce inflation?

ANS:

If the Phillips curve is steep, then an increase in the money supply or government expenditures to reduce unemployment will mostly increase inflation and reduce unemployment by little. Further, if the short run is very short, the decrease in unemployment is short-lived. So inflation rises a lot to increase unemployment a little for a short time.

Under the same conditions, a small decrease in the money supply would decrease inflation by a lot, without increasing unemployment very much for very long. So the costs of inflation reduction would be small.

PTS: 1

DIF: Challenging

REF: p.410

NOT: Macro TB_16-193

9. Some countries have had high inflation rates for a long time and other countries have had low inflation rates for a long time. Yet in some of the high-inflation countries, the unemployment rate is not much different or even higher than in the low-inflation countries. Explain how these observations can be consistent with the Phillips curve.

ANS:

It is reasonable to guess that in countries with chronically high inflation, expected inflation would also be high. In the long run, countries are on their long-run Phillips curve whose position is determined by labour laws, unemployment compensation, the nature of job searches, and other real factors. These can differ across countries and so the natural rate of unemployment can differ across countries. Different rates of inflation are possible along any given long-run Phillips curve, so countries can have similar unemployment rates with different inflation rates. Also, countries with higher expected inflation have short-run Phillips curves that are farther to the right. So a country with high expected inflation is on a Phillips curve to the right of one with low expected inflation. On a higher Phillips curve, inflation and the unemployment rate can be higher than on a lower Phillips curve.

PTS: 1

DIF: Challenging

REF: p.410

NOT: Macro TB_16-194

10. Some countries have inflation in excess of 20 percent. Suppose that the sacrifice ratio is 2.5. What is the cost of reducing inflation from 20 percent to 4 percent?

ANS:

The sacrifice ratio gives the annual percentage decline in output required to reduce the inflation rate 1 percentage point. The sacrifice ratio is 2.5, so if a country with 20 percent inflation wants to reduce it to 4 percent it will face a reduction in output equal to 2.5 (16 percent = 40 percent of annual output).

PTS: 1 DIF: Average REF: p.417-418 NOT: Macro TB_16-195

11. Why does a downward-sloping Phillips curve imply a positive sacrifice ratio?

ANS:

A downward-sloping Phillips curve implies that as a government acts to decrease inflation, unemployment increases. Increased unemployment leads to lower output. So the Phillips curve implies that inflation reduction requires a decrease in output, as does a positive sacrifice ratio.

PTS: 1 DIF: Average REF: p.417-418 NOT: Macro TB_16-196

PROBLEM

Scenario 1

The aggregate demand (AD) and aggregate supply (AS) model can be constructed having inflation rate on the vertical axis instead of the price level and the rate of economic growth instead of output.

1. **Referring to Scenario 1**, draw the AD-AS model in terms of inflation (π) and rate of growth (g).

ANS:

One can start from the AD-AS model in the Price level – Quantity of output space. Each price level can be replaced with a change in price with respect to some base year price, and each level of output can be replaced with the change in output with respect to a base year. Thus, the AD-AS diagram remains unchanged, but the coordinates are now inflation and growth.

PTS: 1 NOT: Macro TB_16-197

2. **Referring to Scenario 1**, discuss the advantages and disadvantages of this representation of the AD-AS model.

ANS:

The AD-AS model in terms of π and g is more accurate, since it incorporates an economic fact: that prices and output have a long-term increasing trend. In these terms, the AD-AS model is more appropriate when deriving the Phillips curve. The disadvantage of such a model is that it is more difficult to understand.

PTS: 1 NOT: Macro TB_16-198

3. Using the quantity theory of money, derive an aggregate demand curve. Show that this curve shifts when the money supply changes.

ANS:

The quantity equation is $PY = MV$. With V being constant, the relationship $P = MV/Y$ describes a negative relationship between the price level and the amount of output for any given amount of money supply. As opposed to the money demand function we derived in one of the previous chapters, we consider here M as being exogenous (determined externally by a discretionary central bank) and Y as endogenous (determined by the variable price level). For any given price level, when M increases Y should increase as well in order to maintain the equality in the quantity equation. Therefore, an increase in M will shift the aggregate demand to the right in a Price-Output space. The next diagram shows the shape of the AD curve implied by the quantity equation.



PTS: 1

NOT: Macro TB_16-199

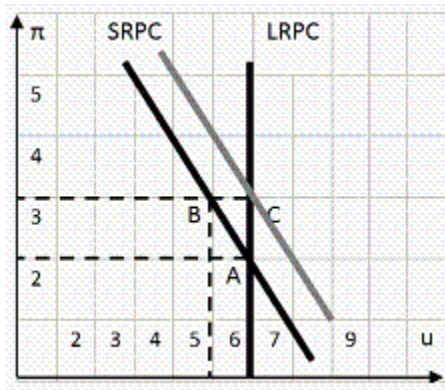
Scenario 2

Suppose the natural rate of unemployment is 6 percent, the expected inflation is 2 percent, and the constant a in the short-run Phillips curve equation is 0.8.

4. Referring to Scenario 2, draw the long-run and short-run Phillips curves. What is the inflation rate corresponding to the intersection of the two curves?

ANS:

The short-run Phillips curve is described by the equation $u = u_n - a(\pi - \pi^e)$. Replacing the given values into this equation, we get $u = 6 - 0.8(\pi - 2)$. If we rearrange this, we can write it as $u = 7.6 - 0.8\pi$. To draw this curve, we notice first that it is a straight line. It crosses the u -axis where $\pi = 0$ and the corresponding $u = 7.6 - 0.8 \cdot 0 = 7.6$. For a second point on the curve, let us take $\pi = 5$; the corresponding value for u is $u = 7.6 - 0.8 \cdot 5 = 3.6$. Having determined the two points, we can now draw the short-run Phillips curve. The long-run Phillips curve is a vertical line at $u = 6\%$. The following graph shows the long run and short run Phillips curves (LRPC and SRPC, respectively). They cross each other at $\pi = 2\%$, which is the expected rate of inflation.



PTS: 1

NOT: Macro TB_16-200

5. Referring to Scenario 2, change the expected inflation to 3 percent and draw the new Phillips curves. How did they change?

ANS:

The 3 percent expected inflation SRPC is parallel to the 2 percent one, but shifted upwards by a vertical distance of 1 percent inflation rate. It crosses the LRPC at $\pi = 3\%$. The LRPC remains the same after the change in expected inflation.

PTS: 1

NOT: Macro TB_16-201

6. **Referring to Scenario 2**, describe the process of adjustment from the old to the new inflation-unemployment point when the expected inflation has changed.

ANS:

First, the actual inflation rate increases to 3 percent while the expected inflation stays at 2 percent. Unemployment decreases to 5 percent and the economy moves up the SRPC from *A* to *B*. Then, people adjust their expectations about inflation and the SRPC shifts upward to point *C*.

PTS: 1

NOT: Macro TB_16-202

7. Discuss the factors determining the slope of the short-run Phillips curve. Is the linear shape appropriate? Why, or why not?

ANS:

The short-run Phillips curve (SRPC) was derived starting from the short-run aggregate supply (SRAS) curve, assuming that there is an inverse relationship between unemployment and output: high output implies low unemployment and vice-versa. Thus, the slope of the SRPC is determined partly by the same factors that determine the slope of the SRAS curve: how sticky prices and wages are, and for how long suppliers confuse relative prices with the overall price level. The more informed people are, and the more flexible suppliers and employers are in changing prices and wages, the steeper the SRAS and the SRPC are. Another category of factors influencing the slope of the SRPC refers to the relationship between unemployment (or employment) and output.

The linear shape of the SRPC may not be appropriate because it is much more difficult to increase output (or to decrease unemployment) when output is already higher than the full-employment output. Thus, a more plausible shape for the SRPC would be a curve that would be steeper at lower unemployment and flatter at higher unemployment.

PTS: 1

NOT: Macro TB_16-203

8. Use the AD-AS model and the Phillips curve to analyze the short run and long run effects of devaluating the home currency under a fixed exchange rate regime.

ANS:

With perfect capital mobility, the central bank will have to buy foreign currency (or to sell less) in order to reduce the exchange rate to the desired level. There are two effects. First, there is an increase in the money supply caused by this open market operation. Aggregate demand increases in the short run, output and the price level increase, and unemployment decreases. In the long run, only higher prices persist. Second, there is the net exports effect, which shifts the AD curve even further right. If the devaluation was necessary to restore equilibrium in the market for foreign currency exchange, the economy will eventually stabilize at the higher prices and at the long-run levels of output and unemployment. If the devaluation moves the exchange rate away from equilibrium, the rate of growth in the money supply will have to increase continuously in order to sustain an artificially low exchange rate.

PTS: 1

NOT: Macro TB_16-204

Chapter 17—Five Debates over Macroeconomic Policy

MULTIPLE CHOICE

1. Which of the following causes fluctuations in employment and output?
- changes in aggregate demand only
 - changes in aggregate supply only
 - changes in aggregate demand and aggregate supply
 - changes in neither aggregate demand nor aggregate supply

ANS: C PTS: 1 DIF: Easy REF: p.440
BLM: Higher Order NOT: Macro TB_17-1

2. How is "leaning against the wind" exemplified?
- by a tax cut when there is an expansion
 - by a decrease in the money supply when there is a recession
 - by an increase in government expenditures when there is a recession
 - by an increase in government spending when there is an expansion

ANS: C PTS: 1 DIF: Easy REF: p.440
BLM: Higher Order NOT: Macro TB_17-2

3. If firms were faced with greater uncertainty because of concern that oil prices might rise, they might decrease expenditures on capital. In response to this change, someone who advocated "lean against the wind" policies might advocate decreasing which of the following?
- the money supply
 - taxes
 - government expenditures
 - inflation

ANS: B PTS: 1 DIF: Average REF: p.440
BLM: Higher Order NOT: Macro TB_17-3

4. Those who desire that policymakers stabilize the economy would advocate which of the following when aggregate demand is insufficient to ensure full employment?
- decreasing the money supply
 - decreasing taxes
 - decreasing government expenditures
 - increasing taxes

ANS: B PTS: 1 DIF: Easy REF: p.440
BLM: Higher Order NOT: Macro TB_17-4

5. Suppose aggregate demand fell. In order to stabilize the economy, which of the following might the government do?
- a. decrease the money supply
 - b. decrease government expenditures
 - c. increase taxes
 - d. decrease taxes

ANS: D PTS: 1 DIF: Easy REF: p.440
BLM: Higher Order NOT: Macro TB_17-5

6. Which of the following are both policies that are consistent with trying to stabilize output when prices and output rise?
- a. decrease the money supply and decrease taxes
 - b. increase the money supply and decrease taxes
 - c. decrease the money supply and decrease government expenditures
 - d. increase the money supply and decrease government expenditures

ANS: C PTS: 1 DIF: Easy REF: p.440
BLM: Higher Order NOT: Macro TB_17-6

7. In general, what is the longest lag for fiscal and monetary policy?
- a. For both fiscal and monetary policy, it is the time it takes to change policy.
 - b. For both fiscal and monetary policy, it is the time it takes for policy to affect aggregate demand.
 - c. For monetary policy it is the time it takes to change policy, while for fiscal policy the longest lag is the time it takes for policy to affect aggregate demand.
 - d. For fiscal policy it is the time it takes to change policy, while for monetary policy the longest lag is the time it takes for policy to affect aggregate demand.

ANS: D PTS: 1 DIF: Easy REF: p.440-441
BLM: Remember NOT: Macro TB_17-7

8. What is the principal reason that monetary policy has lags?
- a. It takes a long time for changes in the interest rate to change aggregate demand.
 - b. It takes a long time for changes in the money supply to change interest rates.
 - c. It takes a long time for the Bank of Canada to make changes in policy.
 - d. It takes a long time for the government to pass the necessary laws.

ANS: A PTS: 1 DIF: Easy REF: p.440-441
BLM: Remember NOT: Macro TB_17-8

9. Which of the following do opponents of using policy to stabilize the economy generally believe?
- a. that neither fiscal nor monetary policy have much impact on aggregate demand
 - b. that attempts to stabilize the economy can increase the magnitude of economic fluctuations
 - c. that unemployment and inflation are not cause for much concern
 - d. that unemployment is a cause for concern, but inflation is not.

ANS: B PTS: 1 DIF: Easy REF: p.440-441
BLM: Higher Order NOT: Macro TB_17-9

10. Which of the following might offset the effects of a decline in the value of financial assets, such as stocks, on consumption and the economy?
- a. increasing government spending
 - b. decreasing the money supply
 - c. increasing taxes
 - d. increasing both taxes and money supply

ANS: A PTS: 1 DIF: Easy REF: p.440-441
BLM: Higher Order NOT: Macro TB_17-10

11. Suppose the economy goes into recession. Which of the following lists contains things policymakers could do to try to end the recession?
- a. increase the money supply, increase taxes, and increase government spending
 - b. increase the money supply, increase taxes, and decrease government spending
 - c. increase the money supply, decrease taxes, and increase government spending
 - d. decrease the money supply, increase taxes, and decrease government spending

ANS: C PTS: 1 DIF: Easy REF: p.440-441
BLM: Higher Order NOT: Macro TB_17-11

12. The Bank of Canada raised interest rates in 1999 and 2000. By doing this, what did the Bank of Canada do to the money supply and why?
- a. It increased the money supply because it was concerned about unemployment.
 - b. It increased the money supply because it was concerned about inflation.
 - c. It decreased the money supply because it was concerned about unemployment.
 - d. It decreased the money supply because it was concerned about inflation.

ANS: D PTS: 1 DIF: Average REF: p.440-441
BLM: Remember NOT: Macro TB_17-12

13. Why should policymakers **NOT** try to stabilize the economy?
- a. because recessions represent a waste of resources
 - b. because pessimism on the part of households and firms may become a self-fulfilling prophecy
 - c. because "leaning against the wind" requires policymakers to increase aggregate demand in recessions and reduce aggregate demand in booms
 - d. because macroeconomic theory is not developed sufficiently to show policymakers how to change aggregate demand

ANS: D PTS: 1 DIF: Average REF: p.440-441
BLM: Remember NOT: Macro TB_17-13

14. Why should policymakers try to stabilize the economy?
- a. because economic forecasting is highly imprecise
 - b. because long lags may cause stabilization policies to have an opposite effect
 - c. because monetary policy affects aggregate demand by changing interest rates
 - d. because fiscal policy must go through a long political process

ANS: C PTS: 1 DIF: Average REF: p.440-441
BLM: Remember NOT: Macro TB_17-14

15. Which of the following is one reason for the existence of policy lags?
- a. Government experts are slow in figuring out what is going on.
 - b. Households and firms plan their spending in advance and therefore are slow in responding to changes in interest rates.
 - c. It is impossible to build an accurate model of the economy.
 - d. It is difficult for the Bank of Canada to change the bank rate.

ANS: B PTS: 1 DIF: Easy REF: p.440-441
BLM: Remember NOT: Macro TB_17-15

16. Which of the following best defines the political business cycle?
- a. the fact that about every four years some politician advocates greater government control of the Bank of Canada
 - b. the potential for a central bank to increase the money supply and so output to help the incumbent get re-elected
 - c. the part of the business cycle caused by the reluctance of politicians to smooth the business cycle
 - d. the changes in output created by the monetary rule the Bank of Canada must follow

ANS: B PTS: 1 DIF: Easy REF: p.442
BLM: Remember NOT: Macro TB_17-16

17. What does the time inconsistency of policy imply?
- a. It implies that what policymakers say they will do is generally what they will do, but people don't believe them because of current policy.
 - b. It implies that when people expect that inflation will be low, it is harder for the Bank of Canada to increase output by increasing the money supply.
 - c. It implies that people will believe the Bank of Canada policy will be more inflationary than the Bank of Canada claims.
 - d. It implies that the Bank of Canada coordinates its actions with elected officials.

ANS: C PTS: 1 DIF: Easy REF: p.442
BLM: Remember NOT: Macro TB_17-17

18. What does the time inconsistency of monetary policy mean?
- a. It means that once people have formed expectations of low inflation based on a promise by the central bank, the central bank is tempted to raise inflation to lower unemployment.
 - b. It means that at some times central banks think it is more important to keep unemployment low; at other times, they think it is more important to keep inflation low.
 - c. It means that monetary policy is not consistent across time because it is influenced by politics.
 - d. It means that monetary policy cannot be consistent across time because the rate of inflation is fluctuating.

ANS: A PTS: 1 DIF: Easy REF: p.442
BLM: Remember NOT: Macro TB_17-18

19. Which of the following will time inconsistency cause?
- a. It will cause the short-run Phillips curve to be higher than it otherwise would.
 - b. It will cause the short-run Phillips curve to be lower than it otherwise would.
 - c. It will cause the long-run Phillips curve to be farther to the right than it otherwise would.
 - d. It will cause the long-run Phillips curve to be farther to the left than it otherwise would.

ANS: A PTS: 1 DIF: Average REF: p.442
BLM: Remember NOT: Macro TB_17-19

20. Suppose people in countries that have had persistently high inflation are sceptical about efforts to reduce inflation. What will happen to the short-run Phillips curve and the sacrifice ratio?
- a. The short-run Phillips curve remains to the left, and the sacrifice ratio will be low.
 - b. The short-run Phillips curve remains to the left, and the sacrifice ratio will be high.
 - c. The short-run Phillips curve remains to the right, and the sacrifice ratio will be low.
 - d. The short-run Phillips curve remains to the right, and the sacrifice ratio will be high.

ANS: D PTS: 1 DIF: Average REF: p.442-443
BLM: Higher Order NOT: Macro TB_17-20

21. If a central bank had to give up its discretion and had to follow a rule that required it to keep inflation low, how would the Phillips curve shift?
- a. The short-run Phillips curve would shift up.
 - b. The short-run Phillips curve would shift down.
 - c. The long-run Phillips curve would shift right.
 - d. The long-run Phillips curve would shift left.

ANS: B PTS: 1 DIF: Challenging REF: p.442-443
BLM: Higher Order NOT: Macro TB_17-21

22. A law that requires the money supply to grow by a fixed percentage each year would eliminate which of the following?
- a. the time inconsistency problem, but not political business cycles
 - b. the political business cycle, but not the time inconsistency problem
 - c. both the time inconsistency problem and political business cycles
 - d. neither the time inconsistency problem nor political business cycles

ANS: C PTS: 1 DIF: Average REF: p.442-443
BLM: Remember NOT: Macro TB_17-22

23. Suppose that the central bank must follow a rule that requires it to increase the money supply when the price level falls and decrease the money supply when the price level rises. If the economy starts from long-run equilibrium and aggregate demand shifts right, what must the central bank do, and what will happen to output?
- The central bank must decrease the money supply, which will move output back towards its long-run level.
 - The central bank must decrease the money supply, which will move output farther from its long-run level.
 - The central bank must increase the money supply, which will move output back towards its long-run level.
 - The central bank must increase the money supply, which will move output farther from its long-run level.

ANS: A

PTS: 1

DIF: Average

REF: p.442-443

BLM: Higher Order

NOT: Macro TB_17-23

24. Suppose that the central bank must follow a rule that requires it to increase the money supply when the price level falls and decrease the money supply when the price level rises. If the economy starts from long-run equilibrium and aggregate supply shifts left, what must the central bank do, and what will happen to output?
- The central bank must decrease the money supply, which will move output back towards its long-run level.
 - The central bank must decrease the money supply, which will move output farther from its long-run level.
 - The central bank must increase the money supply, which will move output back towards its long-run level.
 - The central bank must increase the money supply, which will move output farther from its long-run level.

ANS: D

PTS: 1

DIF: Average

REF: p.442-443

BLM: Higher Order

NOT: Macro TB_17-24

25. Suppose that a central bank is required to follow a monetary policy rule to stabilize prices. If the economy starts at long-run equilibrium and then aggregate demand shifts right, what should the central bank do, and what will happen to output?
- The central bank should increase the money supply, which causes output to move closer to its long-run equilibrium.
 - The central bank should increase the money supply, which causes output to move farther from its long-run equilibrium.
 - The central bank should decrease the money supply, which causes output to move closer to its long-run equilibrium.
 - The central bank should decrease the money supply, which causes output to move farther from its long-run equilibrium.

ANS: C

PTS: 1

DIF: Challenging

REF: p.442-443

BLM: Higher Order

NOT: Macro TB_17-25

26. Suppose that the central bank is required to follow a monetary policy rule to stabilize prices. If the economy starts at long-run equilibrium and then aggregate supply shifts right, what should the central bank do, and what will happen to output?
- The central bank should increase the money supply, which causes output to move closer to its long-run equilibrium.
 - The central bank should increase the money supply, which causes output to move farther from its long-run equilibrium.
 - The central bank should decrease the money supply, which causes output to move closer to its long-run equilibrium.
 - The central bank should decrease the money supply, which causes output to move farther from its long-run equilibrium.

ANS: B

PTS: 1

DIF: Challenging REF: p.442-443

BLM: Higher Order

NOT: Macro TB_17-26

27. Consider the following rule for monetary policy: $r = 2 \text{ percent} + \pi + 1/2(y - y^*)/y^* + 1/2(\pi - \pi^*)$, where r is the nominal interest rate, y is real GDP, y^* is an estimate of the natural rate of output, π is the inflation rate, and π^* is the inflation target. What is the implication of this rule?
- If aggregate demand shifts right from long-run equilibrium, this rule unambiguously implies that the Bank of Canada decreases the nominal interest rate.
 - If aggregate supply shifts right from long-run equilibrium, we cannot tell without more information whether the Bank of Canada should increase or decrease the nominal interest rate.
 - If output is at its natural level, but inflation is above its target, the Bank of Canada must decrease the nominal interest rate.
 - If inflation is at its targeted level, but output is above its natural rate, the Bank of Canada must decrease the federal funds rate.

ANS: B

PTS: 1

DIF: Challenging REF: p.442-443

BLM: Higher Order

NOT: Macro TB_17-27

28. Why should monetary policy be made by rule rather than discretion?
- because there is a clear consensus among economists about what a good monetary policy rule would be
 - because rules would eliminate the political business cycle
 - because rules respond to any random shocks in the economy
 - because rules create time inconsistency

ANS: B

PTS: 1

DIF: Average

REF: p.442-443

BLM: Remember NOT: Macro TB_17-28

29. Why should monetary policy be made by rule rather than discretion?
- because the economy is subject to a variety of random shocks
 - because monetary policymakers are now allowed undisciplined discretion
 - because it is not clear how important political business cycles have been in the past
 - because central banks can achieve credibility over time by backing up their words with deeds

ANS: B

PTS: 1

DIF: Average

REF: p.442-443

BLM: Remember NOT: Macro TB_17-29

30. Which of the following is a significant cost of inflation?

- a. printing more money
- b. lower nominal interest rates
- c. relative price variability
- d. higher unemployment

ANS: C PTS: 1 DIF: Easy REF: p.444
BLM: Higher Order NOT: Macro TB_17-30

31. Proponents of zero inflation argue that reducing inflation implies which of the following?

- a. that reducing inflation eventually reduces inflation expectations
- b. that reducing inflation eventually raises real interest rates
- c. that reducing inflation permanently decreases output
- d. that reducing inflation permanently raises unemployment

ANS: A PTS: 1 DIF: Easy REF: p.445
BLM: Remember NOT: Macro TB_17-31

32. Proponents of zero inflation argue that reducing inflation involves which of the following?

- a. permanent costs and temporary benefits
- b. temporary costs and permanent benefits
- c. permanent costs and benefits
- d. temporary costs and benefits

ANS: B PTS: 1 DIF: Easy REF: p.445
BLM: Remember NOT: Macro TB_17-32

33. How would a permanent reduction in inflation impact menu costs and unemployment?

- a. It would permanently reduce menu costs and permanently lower unemployment.
- b. It would permanently reduce menu costs and temporarily raise unemployment.
- c. It would temporarily reduce menu costs and temporarily lower unemployment.
- d. It would temporarily reduce menu costs and temporarily raise unemployment.

ANS: B PTS: 1 DIF: Average REF: p.445
BLM: Higher Order NOT: Macro TB_17-33

34. How would a permanent reduction in inflation impact shoeleather costs and unemployment?

- a. It would permanently reduce shoeleather costs and permanently lower unemployment
- b. It would permanently reduce shoeleather costs and temporarily raise unemployment
- c. It would temporarily reduce shoeleather costs and temporarily lower unemployment
- d. It would temporarily reduce shoeleather costs and temporarily raise unemployment

ANS: B PTS: 1 DIF: Average REF: p.445
BLM: Higher Order NOT: Macro TB_17-34

35. In which of the following situations does inflation reduction have the lowest cost?

- a. when the efforts are credible, so that the sacrifice ratio is low
- b. when the efforts are credible, so that the sacrifice ratio is high
- c. when the efforts are unexpected, so that the sacrifice ratio is high
- d. when the efforts are unexpected, so that the sacrifice ratio is low

ANS: A PTS: 1 DIF: Average REF: p.445
BLM: Higher Order NOT: Macro TB_17-35

36. Which of the following could the government do to decrease the costs of inflation without lowering the inflation rate?

- a. avoid unexpected changes in the inflation rate
- b. rewrite the tax laws so that nominal gains were taxed instead of real gains
- c. make policy that would discourage firms from issuing indexed bonds
- d. pass legislation to discourage inflation-adjusted work contracts

ANS: A PTS: 1 DIF: Average REF: p.445
BLM: Higher Order NOT: Macro TB_17-36

37. Some countries have had high inflation for a long time. Others have had low or moderate inflation for a long time. Which of the following, at least in theory, could explain why some countries would continue to have high inflation?

- a. High-inflation countries have relatively small sacrifice ratios and so see no need to reduce inflation.
- b. Inflation reduction works best when it is unexpected, and people in high-inflation countries would quickly anticipate any change in monetary policy.
- c. In a country where inflation has been high for a long time, people are likely to have found ways to limit the costs.
- d. Persistently low inflation has costs in terms of high unemployment.

ANS: C PTS: 1 DIF: Easy REF: p.446
BLM: Remember NOT: Macro TB_17-37

38. In which of the following situations is a program to reduce inflation likely to have the lowest costs?

- a. if the sacrifice ratio high and the reduction is unexpected
- b. if the sacrifice ratio high and the reduction is expected
- c. if the sacrifice ratio low and the reduction is unexpected
- d. if the sacrifice ratio low and the reduction is expected

ANS: D PTS: 1 DIF: Average REF: p.446
BLM: Higher Order NOT: Macro TB_17-38

39. In which of the following situations is a program to reduce inflation likely to have the highest costs?

- a. if the sacrifice ratio high and the reduction is unexpected
- b. if the sacrifice ratio high and the reduction is expected
- c. if the sacrifice ratio low and the reduction is unexpected
- d. if the sacrifice ratio low and the reduction is expected

ANS: A PTS: 1 DIF: Average REF: p.446
BLM: Higher Order NOT: Macro TB_17-39

40. Why should the central bank aim for zero inflation?

- a. because reducing inflation imposes temporary costs but provides permanent benefits
- b. because reducing inflation from 2 percent to zero is virtually costless
- c. because the government has indexed tax brackets to prevent the adverse effects of inflation
- d. because the costs of inflation are very high

ANS: C PTS: 1 DIF: Average REF: p.446
BLM: Higher Order NOT: Macro TB_17-40

41. Why should the central bank aim for a moderate rate, instead of a zero rate, of inflation?
- a. to keep the natural rate of unemployment low
 - b. because the social costs of moderate inflation are high
 - c. because it is very difficult to maintain a zero rate of inflation in the long run
 - d. to avoid the presumably high costs of lowering inflation to zero

ANS: D PTS: 1 DIF: Average REF: p.446
BLM: Remember NOT: Macro TB_17-41

42. Which of the following is a part of the argument against deficits?
- a. They increase interest rates and investment.
 - b. They increase interest rates and decrease investment.
 - c. They decrease interest rates and investment.
 - d. They decrease interest rates and increase investment.

ANS: B PTS: 1 DIF: Easy REF: p.448
BLM: Higher Order NOT: Macro TB_17-42

43. Suppose that a country has an inflation rate of about 4 percent per year and a real GDP growth rate of about 3 percent per year. What is the highest deficit the government can afford without raising the debt-to-income ratio?
- a. about 12 percent of GDP
 - b. about 7 percent of GDP
 - c. about 1 percent of GDP
 - d. 0

ANS: B PTS: 1 DIF: Easy REF: p.448
BLM: Higher Order NOT: Macro TB_17-43

44. If the Canadian government went from a budget deficit to a budget surplus, what would we expect to happen to interest rates and investment?
- a. an increase in interest rates and investment
 - b. an increase in interest rates and a decrease in investment
 - c. a decrease in interest rates and a decrease in investment
 - d. a decrease in interest rates and an increase in investment

ANS: D PTS: 1 DIF: Easy REF: p.448
BLM: Higher Order NOT: Macro TB_17-44

45. Why are deficits undesirable?
- a. They reduce private savings.
 - b. If deficits accumulate, people consume at the expense of their children.
 - c. They lead to high inflation.
 - d. They increase unemployment.

ANS: B PTS: 1 DIF: Average REF: p.448-449
BLM: Remember NOT: Macro TB_17-45

46. What is the relationship between deficit and debt?
- a. Deficits require people to consume at the expense of their children.
 - b. If the government uses funds to pay for useful programs, on net the debt need not burden future generations.
 - c. If the government runs a deficit, it is necessarily in debt.
 - d. High deficit implies high debt. n.

ANS: B PTS: 1 DIF: Average REF: p.448-449
BLM: Remember NOT: Macro TB_17-46

47. Which of the following would transfer wealth from the young to the old?
- a. Taxes are raised to provide better education.
 - b. Taxes are raised to improve government infrastructure such as roads and bridges.
 - c. Taxes are raised to provide more generous pensions.
 - d. Taxes are raised to pay back part of the government debt.

ANS: C PTS: 1 DIF: Easy REF: p.449-450
BLM: Higher Order NOT: Macro TB_17-47

48. Which of the following would transfer wealth from the old to the young?
- a. increases in the budget deficit
 - b. decreased building of highways and bridges
 - c. more generous education subsidies
 - d. indexation of pensions to inflation

ANS: C PTS: 1 DIF: Easy REF: p.449-450
BLM: Higher Order NOT: Macro TB_17-48

49. Suppose the budget deficit is rising 3 percent per year and nominal GDP is rising 5 percent per year. How are the debt and the burden on future generations created by these continuing deficits?
- a. The debt is sustainable, but the future burden on your children cannot be offset.
 - b. The debt is sustainable, and the future burden on your children can be offset if you save for them.
 - c. The debt is not sustainable, and the future burden on your children cannot be offset.
 - d. The debt is not sustainable, but the future burden on your children can be offset if you save for them.

ANS: B PTS: 1 DIF: Average REF: p.450
BLM: Higher Order NOT: Macro TB_17-49

50. Suppose the budget deficit is rising 4 percent per year and nominal GDP is rising 7 percent per year. How are the debt and the burden on future generations created by these continuing deficits?
- a. The debt is sustainable, but the future burden on your children cannot be offset.
 - b. The debt is not sustainable, and the future burden on your children cannot be offset.
 - c. The debt is sustainable, and the future burden on your children can be offset if you save for them.
 - d. The debt is not sustainable, but the future burden on your children can be offset if you save for them.

ANS: C PTS: 1 DIF: Average REF: p.450
BLM: Higher Order NOT: Macro TB_17-50

51. Suppose the budget deficit is rising 6 percent per year and nominal GDP is rising 10 percent per year. Which of the following best describes the debt created by these deficits?
- a. sustainable, but the future burden on your children cannot be offset
 - b. not sustainable, and the future burden on your children cannot be offset
 - c. not sustainable, but the future burden on your children can be offset if you save for them
 - d. sustainable, and the future burden on your children can be offset if you save for them

ANS: D PTS: 1 DIF: Average REF: p.450
BLM: Higher Order NOT: Macro TB_17-51

52. Suppose the budget deficit is rising 2 percent per year and nominal GDP is rising 7 percent per year. Which of the following best describes the debt created by these continuing deficits?
- a. sustainable, but the future burden on your children cannot be offset
 - b. not sustainable, and the future burden on your children cannot be offset
 - c. not sustainable, but the future burden on your children can be offset if you save for them
 - d. sustainable, and the future burden on your children can be offset if you save for them

ANS: D PTS: 1 DIF: Average REF: p.450
BLM: Higher Order NOT: Macro TB_17-52

53. Suppose that a country has an inflation rate of about 2 percent per year and a real growth rate of about 3 percent per year. Suppose also that it has nominal GDP of about 100 billion units of currency. What is the highest deficit it can have without raising the debt-to-income ratio?
- a. just under 2 billion units
 - b. just under 3 billion units
 - c. just under 5 billion units
 - d. just under 6 billion units

ANS: C PTS: 1 DIF: Average REF: p.450
BLM: Higher Order NOT: Macro TB_17-53

54. Suppose that a country has an inflation rate of about 3 percent per year and a real growth rate of about 6 percent per year. Suppose also that it has nominal GDP of about 100 billion units of currency. What is the highest deficit it can have without raising the debt-to-income ratio?
- a. just under 1 billion units
 - b. just under 3 billion units
 - c. just under 6 billion units
 - d. just under 9 billion units

ANS: D PTS: 1 DIF: Average REF: p.450
BLM: Higher Order NOT: Macro TB_17-54

55. Suppose that a country has an inflation rate of about 3 percent per year and a real growth rate of about 6 percent per year. Suppose also that it has nominal GDP of about 200 billion units of currency. What is the highest possible deficit it can have without raising the debt-to-income ratio?
- a. just under 18 billion units
 - b. just under 12 billion units
 - c. just under 9 billion units
 - d. just under 1 billion units

ANS: A PTS: 1 DIF: Average REF: p.450
BLM: Higher Order NOT: Macro TB_17-55

56. Suppose that in fiscal year 2010 the government ran a deficit of about \$160 billion. The debt at the start of this period was about \$6126 billion. Which of the following combinations of inflation and real GDP would have allowed the government to run a deficit this large without raising the debt-to-income ratio?
- a. inflation = 2 percent; real GDP growth = 0 percent
 - b. inflation = 3 percent; real GDP growth = -1 percent
 - c. inflation = 2 percent; real GDP growth = 1 percent
 - d. inflation = 1.5 percent; real GDP growth = 1 percent

ANS: C PTS: 1 DIF: Average REF: p.450
BLM: Higher Order NOT: Macro TB_17-56

57. Suppose that at the start of fiscal year 2010 the government had a debt of \$6126.5 billion. Suppose that during the same fiscal year real GDP grew by about 3 percent and inflation was about 1 percent. What is the largest deficit the government could have run without raising the debt-to-GDP ratio?
- a. about \$122 billion
 - b. about \$184 billion
 - c. about \$245 billion
 - d. about \$375 billion

ANS: C PTS: 1 DIF: Challenging REF: p.450-451
BLM: Higher Order NOT: Macro TB_17-57

58. Suppose that at the start of fiscal year 2010 the government had a debt of \$6250 billion. Suppose that during the same fiscal year real GDP grew by about 4 percent and inflation was about 2 percent. What is the largest deficit the government could have run without raising the debt-to-GDP ratio?
- a. about \$122 billion
 - b. about \$184 billion
 - c. about \$245 billion
 - d. about \$375 billion

ANS: D PTS: 1 DIF: Challenging REF: p.450-451
BLM: Higher Order NOT: Macro TB_17-58

59. Suppose that at the start of fiscal year 2006 the government had a debt of \$6800 billion. Suppose that during fiscal year 2006, real GDP grew by about 5 percent and inflation was about 3 percent. What is the largest deficit the government could have run without raising the debt-to-GDP ratio?
- a. about \$544 billion
 - b. about \$375 billion
 - c. about \$245 billion
 - d. about \$184 billion

ANS: A PTS: 1 DIF: Challenging REF: p.450-451
BLM: Higher Order NOT: Macro TB_17-59

60. Why should the government balance its budget?
- a. because government debt imposes higher taxes or more borrowing on future generations
 - b. because a balanced budget will smooth the business cycle
 - c. because deficits increase national saving
 - d. because recent history shows that the government will not run deficits unless they are justified by war or recession

ANS: B PTS: 1 DIF: Average REF: p.450-451
BLM: Remember NOT: Macro TB_17-60

61. In which of the following situations does the government **NOT** need to balance its budget?
- a. if nominal GDP grows faster than the growth in debt
 - b. if nominal GDP grows slower than the growth in debt
 - c. if inflation is zero
 - d. if inflation is higher than the growth in debt

ANS: A PTS: 1 DIF: Average REF: p.450-451
BLM: Higher Order NOT: Macro TB_17-61

62. Would economists say that, in general, Canadian tax system encourages saving?
- a. Yes, because the taxes on capital gain are low.
 - b. No, because income taxes are generally high.
 - c. Yes, because some forms of capital gain are not taxed.
 - d. No, because the taxes on capital gain are high.

ANS: D PTS: 1 DIF: Easy REF: p.452
BLM: Higher Order NOT: Macro TB_17-62

63. Why does Canadian public policy discourage saving?
- a. because, other things the same, taxes increase the return from savings
 - b. because means-tested programs such as Old Age Security provide greater benefits to those who saved
 - c. because some forms of capital income are not taxed
 - d. because capital gains are taxed heavily

ANS: D PTS: 1 DIF: Easy REF: p.452
BLM: Remember NOT: Macro TB_17-63

64. What does double taxation mean?
- a. Both wage income and interest income are taxed, which is currently the case in Canada.
 - b. Both wage income and interest income are taxed, which is not currently the case in Canada.
 - c. Both the profits of corporations and the dividends shareholders receive are taxed, which is not currently the case in Canada.
 - d. Both the profits of corporations and the dividends shareholders receive are taxed, which is currently the case in Canada.

ANS: D PTS: 1 DIF: Easy REF: p.452
BLM: Remember NOT: Macro TB_17-64

65. Which of the following would proponents of tax-law changes to encourage saving most likely do?
- a. They would argue that corporate tax rates should be increased.
 - b. They would argue in favour of eliminating or reducing the means tests for government benefits.
 - c. They would argue that provincial sales tax should be replaced with provincial income tax.
 - d. They would favour the idea of taxing more the rich and less the poor.

ANS: B PTS: 1 DIF: Easy REF: p.452
BLM: Remember NOT: Macro TB_17-65

66. Which of the following best describes RRSP plans?
- a. They impose added taxes on those who save.
 - b. They are taxed twice.
 - c. They impose penalties for withdrawals except under certain circumstances.
 - d. They are taxed more than other forms of savings.

ANS: C PTS: 1 DIF: Easy REF: p.452
BLM: Remember NOT: Macro TB_17-66

67. Assume that the substitution effect is large relative to the income effect. If a tax reform is designed to increase saving, what does it do to the interest rate and spending on capital goods?
- a. It increases the interest rate and decreases spending on capital goods.
 - b. It increases the interest rate and increases spending on capital goods.
 - c. It decreases the interest rate and increases spending on capital goods.
 - d. It decreases the interest rate and decreases spending on capital goods.

ANS: C PTS: 1 DIF: Easy REF: p.451-453
BLM: Higher Order NOT: Macro TB_17-67

68. What would those who oppose tax-law changes to encourage saving **NOT** say?
- a. that saving is not very responsive to changes in the tax rate
 - b. that saving is not an important determinant of a nation's ability to produce output
 - c. that reducing the budget deficit instead of changing the tax laws could raise saving
 - d. that changes in the tax laws to induce saving would distribute the tax burden less fairly

ANS: B PTS: 1 DIF: Easy REF: p.451-453
BLM: Remember NOT: Macro TB_17-68

69. What effects does a higher rate of return have on saving?
- a. A higher rate of return has an income effect that discourages saving and a substitution effect that encourages saving.
 - b. A higher rate of return has an income effect that encourages saving and a substitution effect that discourages saving.
 - c. A higher rate of return has income and substitution effects that both decrease saving.
 - d. A higher rate of return has income and substitution effects that both increase saving.

ANS: A PTS: 1 DIF: Average REF: p.451-453
BLM: Higher Order NOT: Macro TB_17-69

70. A reduction in the tax rate on income from saving would do which of the following?
- a. It would most directly benefit the poor in the short run.
 - b. It would increase real wages over time.
 - c. It would decrease the capital stock over time.
 - d. It would decrease productivity over time.

ANS: B PTS: 1 DIF: Easy REF: p.451-453
BLM: Higher Order NOT: Macro TB_17-70

71. Why should the tax laws to encourage saving be reformed?
- a. because saving is a key determinant of long-run prosperity
 - b. to increase taxes on capital gain
 - c. because higher-income households are taxed too much
 - d. because economic theory clearly predicts that higher rate of return encourages saving

ANS: A PTS: 1 DIF: Average REF: p.451-453
BLM: Higher Order NOT: Macro TB_17-71

72. Why should the tax laws to encourage saving remain as they are?
- a. because a decrease in capital gain taxes would be more beneficial to the wealthy, leading to an increase in income inequality
 - b. because tax rates on savings are relatively low
 - c. because people would probably save more than if taxes were lowered
 - d. because tax cuts might cause a budget deficit

ANS: A PTS: 1 DIF: Average REF: p.451-453
BLM: Higher Order NOT: Macro TB_17-72

73. Why do the five debates over macroeconomic policy exist?
- a. mostly because economists disagree over basic issues such as the importance of saving for economic growth
 - b. mostly because there are tradeoffs and people disagree about the best way to deal with them
 - c. mostly because economic policies have conflicting effects on various groups of people
 - d. mostly because people fail to clearly see the benefits or the costs of most changes

ANS: B PTS: 1 DIF: Easy REF: p.451
BLM: Remember NOT: Macro TB_17-73

TRUE/FALSE

1. A recession has no benefit to society—it represents a sheer waste of resources.

ANS: T PTS: 1 DIF: Easy REF: p.440
NOT: Macro TB_17-74

2. A "lean against the wind" policy says the government should not use stabilization policy and simply let the economy "weather the storm."

ANS: F PTS: 1 DIF: Easy REF: p.440
NOT: Macro TB_17-75

3. Advocates of stabilization policy argue that when there is a recession, the government should increase the money supply and increase government expenditures.

ANS: T PTS: 1 DIF: Easy REF: p.440
NOT: Macro TB_17-76

4. Economists predict the business cycle well enough that stabilization policy is likely to work despite lags in the effects of policy.

ANS: F PTS: 1 DIF: Average REF: p.440-441
NOT: Macro TB_17-77

5. The laws governing the activity of the Bank of Canada give some specific recommendations about what goals it should pursue, so it has little discretion in making policy.

ANS: F PTS: 1 DIF: Average REF: p.441-442
NOT: Macro TB_17-78

6. If the central bank has discretion to make policy, it may create economic fluctuations that reflect the electoral calendar. This is called the political business cycle.

ANS: T PTS: 1 DIF: Easy REF: p.442
NOT: Macro TB_17-79

7. If a central bank followed a rule for monetary policy, the time inconsistency problem would be eliminated.

ANS: T PTS: 1 DIF: Easy REF: p.442
NOT: Macro TB_17-80

8. In practice, the problems created by time inconsistency and the political business cycle appear to be quite serious.

ANS: F PTS: 1 DIF: Easy REF: p.442-443
NOT: Macro TB_17-81

9. Economists agree that if a monetary policy rule is to be used, the best one is one that makes the growth rate of the money supply constant.

ANS: F PTS: 1 DIF: Easy REF: p.443
NOT: Macro TB_17-82

10. The cost of inflation reduction is a small but permanent increase in unemployment.

ANS: F PTS: 1 DIF: Easy REF: p.445
NOT: Macro TB_17-83

11. The cost of inflation reduction is less if people believe that the central bank will really reduce inflation.

ANS: T PTS: 1 DIF: Easy REF: p.445
NOT: Macro TB_17-84

12. It is possible that the cost of inflation reduction might be quite large compared to the annual costs of moderate inflation.

ANS: T PTS: 1 DIF: Easy REF: p.446
NOT: Macro TB_17-85

13. There are ways that policymakers could reduce the costs of inflation without reducing inflation.

ANS: T PTS: 1 DIF: Easy REF: p.446
NOT: Macro TB_17-86

14. When the government has a deficit, it necessarily imposes a burden on future generations of taxpayers.

ANS: F PTS: 1 DIF: Easy REF: p.447
NOT: Macro TB_17-87

15. Some social programs transfer wealth from younger generations to older generations.

ANS: T PTS: 1 DIF: Easy REF: p.4453
NOT: Macro TB_17-88

16. A nation's saving rate is not a primary determinant of its long-run economic prosperity.

ANS: F PTS: 1 DIF: Easy REF: p.451-452
NOT: Macro TB_17-89

17. Tax laws do not give preferential treatment to some kinds of retirement saving.

ANS: F PTS: 1 DIF: Easy REF: p.451-452
NOT: Macro TB_17-90

18. Some studies have found that saving is not very sensitive to the rate of return on saving.

ANS: T PTS: 1 DIF: Easy REF: p.451-453
NOT: Macro TB_17-91

19. A reduction in the marginal tax rate includes a substitution effect that tends to increase savings.

ANS: T PTS: 1 DIF: Easy REF: p.451-4453
NOT: Macro TB_17-92

20. In essence, a consumption tax puts all saving into tax-advantaged savings accounts.

ANS: T PTS: 1 DIF: Easy REF: p.451-453
NOT: Macro TB_17-93

SHORT ANSWER

1. Explain the main argument in favour of economic stabilization.

ANS:

Fluctuations in the economy—recessions and booms—are costly. Recessions in particular are a waste of resources, since people and machines are idle when they could be producing goods and services. Stabilization policies can help to eliminate this waste of resources.

PTS: 1 DIF: Easy REF: p.440 NOT: Macro TB_17-94

2. Explain why policy lags could make stabilization policies counterproductive.

ANS:

As the textbook explains, it takes time to recognize an economic problem, to take action, and for that action to have its effect on the economy. By the time a policy is enacted and takes effect, the economy may have already recovered. So policy will end up being destabilizing; it may actually result in larger economic fluctuations.

PTS: 1 DIF: Easy REF: p.441 NOT: Macro TB_17-95

3. Which kind of lag is important for monetary policy? Which kind of lag is important for fiscal policy?

ANS:

Both are prone to lags, but the lags are different for the two types of policy. Monetary policy can be enacted quickly, but since it works through changes in interest rates and investment, it may take a long time to have an impact. Fiscal policy has an immediate impact, but takes a long time to enact.

PTS: 1 DIF: Easy REF: p.440-441 NOT: Macro TB_17-96

4. Suppose that changes in aggregate demand tended to be infrequent and that it took a long time for the economy to return to long-run output. How would this affect the arguments of those who oppose using policy to stabilize output?

ANS:

Those who oppose stabilization policy mostly argue that by the time policy can be put into action and affect aggregate demand, economic conditions may have changed so that the policy is no longer appropriate. If the economy tended to stay on one side of the natural rate of output for a long time, policymakers could worry less about lags.

PTS: 1 DIF: Easy REF: p.440-441 NOT: Macro TB_17-97

5. What is the political business cycle and how does it relate to whether the central bank should have discretion or use a rule?

ANS:

The political business cycle describes the idea that politicians may manipulate the economy to serve their own political ends. For example, the political party in power might want to generate an economic boom prior to an election, even if this policy is ultimately not in the best interest of the country. If the central bank had to follow a policy rule they would be unable to manipulate monetary policy for political gain.

PTS: 1 DIF: Easy REF: p.440 NOT: Macro TB_17-98

6. Explain the time inconsistency of monetary policy.

ANS:

Time inconsistency refers to the idea that policymakers may have an incentive to say one thing but do something different. For example, the Bank of Canada may wish to announce a tight monetary policy, in a bid to reduce expectations of inflation, but if inflation expectations fall, it may want to enact a loose monetary policy, in order to stimulate the economy. The result is likely to be a loss of the Bank of Canada's credibility and a higher expected inflation rate.

PTS: 1 DIF: Average REF: p.440 NOT: Macro TB_17-99

7. Identify three of the five costs of inflation.

ANS:

There are several costs of inflation, including the following: shoeleather costs, because people spend resources to economize on their holdings of money; menu costs created by having to change prices; increased relative price variability, which distorts signals provided by relative price changes; distortions in the tax laws that discourage saving; arbitrary redistribution of wealth from unexpected inflation; and the general inconvenience created by the lack of a fixed unit of account.

PTS: 1 DIF: Easy REF: p.444-445 NOT: Macro TB_17-100

8. Suppose a country has had a high and relatively stable inflation rate for a long time. How might this affect the costs and benefits of inflation reduction?

ANS:

If inflation is usually about what people expect, the arbitrary redistribution of wealth associated with dollar-denominated debts may be small. High and continuing inflation may lead people to develop ways to lessen the costs of inflation. Indexed bonds and chequing accounts or government policy to reduce tax distortions created by the tax laws are examples. The costs of inflation reduction may be high if people have become accustomed to inflation. When expected inflation is high, the tradeoff between inflation and unemployment is poor and even small reductions in inflation may require large decreases in unemployment. Further, a country that has experienced high inflation for a long time is likely to be sceptical of the central bank's commitment to reduce inflation.

PTS: 1 DIF: Easy REF: p.445 NOT: Macro TB_17-101

9. Explain why a government deficit is likely to lead to lower living standards in the future.

ANS:

A government deficit means that the government is dissaving. Unless the government's failure to save is offset by increased private saving, then a government deficit is likely to be associated with lower national saving. Lower national saving means a lower capital stock, and hence lower living standards in the future.

PTS: 1 DIF: Easy REF: p.448 NOT: Macro TB_17-102

10. Suppose that the government goes into deficit in order to help local school districts build better schools. Does this burden future generations?

ANS:

The benefits of the project accrue not just to the current generation, but also to future generations. By running a deficit, the government spreads some of the cost to future generations as well.

PTS: 1 DIF: Easy REF: p.448 NOT: Macro TB_17-103

11. Explain how it is possible for the government debt to grow forever.

ANS:

The debt can grow because the economy grows. If, for example, nominal GDP grows at 3 percent per year, and the debt also grows at 3 percent per year, then the debt will be a constant fraction of GDP. This is perfectly sustainable. Problems arise only if the debt grows faster than GDP. Such a situation cannot prevail forever, because that would imply that the debt would eventually be many times larger than GDP, and the government would no longer be able to pay the interest payments on its debt.

PTS: 1 DIF: Easy REF: p.448 NOT: Macro TB_17-104

12. Deficits do not necessarily burden future generations. Discuss and provide some examples.

ANS:

Some programs tax younger generations to provide benefits for older generations. Some programs, such as education, have benefits primarily for younger generations.

These programs may have greater benefits than costs for younger generations. The older generation can increase their saving when the government increases the deficit and gives these savings to younger generations to offset the delayed tax burden.

PTS: 1 DIF: Easy REF: p.449-450 NOT: Macro TB_17-105

13. Identify three government policies that discourage saving.

ANS:

First, the returns to saving are heavily taxed (which is why some economists advocate a consumption tax). Second, there is double taxation of some forms of capital income. Third, bequests above some level are taxed, which limits parents' incentives to save for their children. Fourth, some government benefits are means-tested, so a household that saves is less likely to receive such benefits.

PTS: 1 DIF: Average REF: p.450 NOT: Macro TB_17-106

14. Why do many economists advocate a consumption tax rather than an income tax?

ANS:

The current income tax means that income is taxed at the same rate if it is used for current consumption or if it is saved. A consumption tax would encourage saving, because individuals would be taxed only when they spend. Income saved would be exempt from tax until it was ultimately used for consumption. Thus a consumption tax would encourage saving.

PTS: 1 DIF: Average REF: p.450-453 NOT: Macro TB_17-107

15. Explain how a higher rate of return on saving could, at least in theory, lead to lower saving.

ANS:

A higher rate of return on saving means that savers obtain higher income. The associated income effect means that individuals have an incentive to consume more today, as well as in the future. If this is strong enough to outweigh the substitution effect (a higher rate of return on saving encourages more saving and less consumption), then the saving rate could go down. (Another way to say this is that, with a higher return on saving, you can enjoy the same level of consumption tomorrow even if you save less today.)

PTS: 1 DIF: Average REF: p.453 NOT: Macro TB_17-108

PROBLEM

1. Let d be the percentage change in government debt, g the rate of growth in real GDP, $RGDP$ the real GDP, $NGDP$ the nominal GDP, P the price level, and π the inflation rate. Let $G[X]$ denote the growth rate in variable X , which is the same thing as the percentage change in X ; thus, $G[X] = (X_2 - X_1)/X_1 \times 100\%$ for small changes in X . Here are two properties of the growth rate operator G : (i) $G[X*Y] = G[X] + G[Y]$, and (ii) $G[X/Y] = G[X] - G[Y]$.
 - a. Show that the growth rate in $NGDP$ is equal to $g + \pi$.
 - b. Show that d is equal to $(\text{Deficit}/\text{Debt}) \times 100\%$.
 - c. Show that the percentage change in the Debt/ $NGDP$ ratio is equal to $d - (g + \pi)$.
 - d. Show that the condition for the Debt to $NGDP$ ratio not to increase is $d = g + \pi$.

ANS:

- a. Using the growth rate operator G , the growth rate in nominal GDP is $G[NGDP]$; since $NGDP = RGDP * P$, the rate of growth in $NGDP$ is $G[NGDP] = G[RGDP * P] = G[RGDP] + G[P]$. But the growth rate in $RGDP$ is g and growth rate in the price level is the inflation rate, π . Thus, $G[NGDP] = g + \pi$, which is what we wanted to prove.
- b. The annual increase in Debt is equal to the Deficit. Thus, the growth rate in Debt is $d = G[\text{Debt}] = [(\text{Debt} + \text{Deficit} - \text{Debt}) / \text{Debt}] * 100\% = (\text{Deficit}/\text{Debt}) * 100\%$.
- c. $G[\text{Debt}/NGDP] = G[\text{Debt}] - G[NGDP] = d - (g + \pi)$.
- d. The condition that the Debt to $NGDP$ not to increase is that the growth rate in this ratio be less or equal to zero, $G[\text{Debt}/NGDP] = 0$, or $d - (g + \pi) = 0$, or $d = g + \pi$.

PTS: 1

NOT: Macro TB_17-109

2. The rate of growth in the Debt to nominal GDP ratio depends on the growth rate in Debt, real GDP, and the price level. Why would one say that inflation is similar to a tax when the government runs a positive public debt?

ANS:

The higher the inflation rate, the lower the debt to GDP ratio. Inflation effectively lowers the government's debt burden. Like always, the debtor is favoured by high inflation, while the creditor is hurt. If the debtor is the government and the creditor is the public, then inflation is similar to a tax.

PTS: 1

NOT: Macro TB_17-110

3. During the financial year 2008-2009, the government of Canada ran a deficit of \$5.8 billion, bringing the government's public debt to \$463.7 billion. (The debt-to-GDP ratio was 29 percent, still down from the preceding year. Source: Government of Canada, Annual Financial report, <http://www.fin.gc.ca/afr-rfa/2009/afr-rfa09-eng.pdf>). Assuming an inflation rate of 2 percent, what real GDP growth rate would have allowed the government to run a deficit this large without raising the debt-to-income ratio?

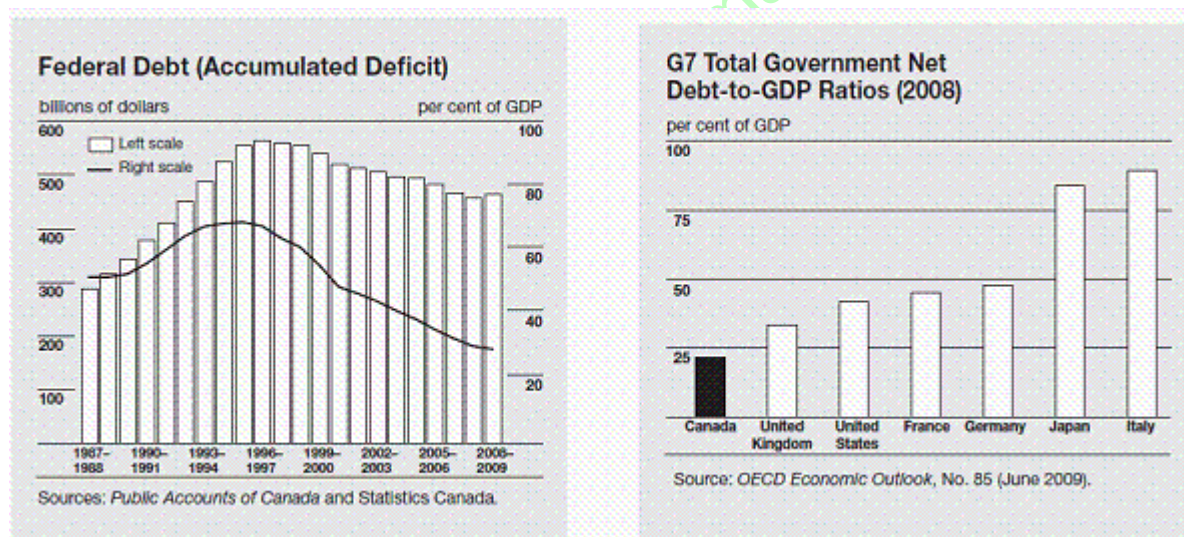
ANS:

The percentage change in the Debt to (nominal) GDP ratio is equal to the percentage change in Debt (d) minus the nominal GDP growth rate. In turn, the nominal GDP growth rate is the real GDP growth rate (g) plus the inflation rate (π). It follows that the percentage change in the Debt/GDP ratio = $d - (g + \pi)$. One needs $d = (g + \pi)$ in order to have the Debt/GDP ratio non-increasing. In our case, $d = 5.8/463.7 \times 100\% = 1.25\%$, g is unknown, and $\pi = 2\%$. Thus, g can be determined using the inequality $1.25 = g + 2$, which yields $g = -0.75$.

PTS: 1

NOT: Macro TB_17-111

The following charts are published by the Government of Canada in its Annual Financial Report 2008-2009. Based on the charts, answer the following questions.



4. What was the evolution of Canada's federal debt over the period 1967-2009?

ANS:

Canada's federal debt increased between 1967 and 1997, and then it decreased until 2008, when it increased again. The debt-to-GDP ratio has been continuously decreasing since 1997.

PTS: 1

NOT: Macro TB_17-112

5. What was Canada's debt-to-GDP ratio in the fiscal year 1995-1996? What was the debt-to-GDP ratio in 2008-2009?

ANS:

More than 60 percent of GDP; about 25 percent.

PTS: 1

NOT: Macro TB_17-113

6. How does Canada compare to other countries as far as public debt is concerned?

ANS:

Canada was the lowest in the G7 group.

PTS: 1

NOT: Macro TB_17-114

If you deposit \$100 now with interest rate of 3 percent, after the first period you will have an amount equal to $(100 + 100 \times 0.03) = 100(1 + 0.03)$; after the second period the amount will be $100(1 + 0.03) + [100(1 + 0.03)] \times 0.03 = 100(1 + 0.03)(1 + 0.03) = 100(1 + 0.03)^2$. If we continue this reasoning, we find out that the amount in the account after n periods is equal to $\$100(1 + 0.03)^n$. In general, if the interest rate is i percent, the formula for compound interest rate becomes $(1 + i\%/100)^n$.

7. Suppose there is a tax rate of t percent on capital gain. How does our formula change?

ANS:

Typically, if the tax is paid annually, the formula changes to $[1 + i(1 - t)/100]^n$.

PTS: 1

NOT: Macro TB_17-115

8. Consider a 25-year-old worker who saves \$1000 for retirement. She plans to retire at the age of 70. If the interest rate is 10 percent, how much will she accumulate until the retirement age?

ANS:

In this case, $n = 70 - 25 = 45$ years. The amount at the end of the period is $\$1000(1 + 0.1)^{45} = \$72\,890$

PTS: 1

NOT: Macro TB_17-116

9. Under the same circumstances as in (b), if there is a tax of 40 percent on interest income, how much will her savings be worth at the age of 70?

ANS:

With a tax rate of 40 percent, the effective interest rate is $i(1 - t) = 0.06$, or 6% instead of 10%. The accumulated amount with the tax is $\$1000(1 + 0.06)^{45} = \$13\,765$.

PTS: 1

NOT: Macro TB_17-117

10. To stimulate savings in retirement plans, suppose the capital gain is not taxed until it is realized (the money is effectively withdrawn from the account.) To simplify, suppose that when she is 70, our worker withdraws the entire amount in her account. How much will she receive if the capital gain tax is 40 percent?

ANS:

If interest is not taxed until realized, at the end of the period there will be \$72 890, of which \$1000 is the initial amount deposited. The worker will only take home 60% of the capital gain plus the principal, that is $(\$72\,890 - 1000) \times 0.6 + 1000 = \$44\,134$.

PTS: 1

NOT: Macro TB_17-118

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