

**PRINCIPLES OF MACROECONOMICS
ECONOMICS 1022B-001/003**

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REVIEW TEST

March 2015

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

- 1) Dissaving occurs when a household
 - A) saves more than it spends.
 - B) consumes more than it receives in disposable income.
 - C) borrows.
 - D) spends less than it receives in disposable income.
 - E) spends more than it saves.

- 2) If consumption expenditure for a household increases from \$300 to \$500 when disposable income increases from \$200 to \$500, the marginal propensity to consume is
 - A) equal to 0.67.
 - B) equal to 1.33.
 - C) negative.
 - D) equal to 1.
 - E) equal to 0.75.

- 3) The vertical distance between the consumption function and the 45° line measures
 - A) consumption.
 - B) disposable income.
 - C) the marginal propensity to save.
 - D) saving or dissaving.
 - E) the marginal propensity to consume.

- 4) Which of the following events would shift the consumption function upward?
 - A) a decrease in disposable income
 - B) an increase in disposable income
 - C) a decrease in wealth
 - D) a decrease in expected future disposable income
 - E) an increase in wealth

- 5) If there is an unplanned increase in inventories, aggregate planned expenditure is
- A) greater than real GDP and firms increase production.
 - B) less than real GDP and firms decrease production.
 - C) less than real GDP and firms increase production.
 - D) greater than real GDP and firms decrease production.
 - E) less than real GDP and firms decrease investment.
- 6) If $AE = 50 + 0.6Y$ and $Y = 200$, then unplanned inventories
- A) decrease by 30.
 - B) increase by 30.
 - C) decrease by 75.
 - D) increase by 75.
 - E) do not change and equilibrium exists.

Refer to the table below to answer the following question.

Table 1

Y (trillions of dollars)	C (trillions of dollars)	I (trillions of dollars)	G (trillions of dollars)	X (trillions of dollars)	M (trillions of dollars)
1.0	1.00	0.5	0.7	0.45	1.15
2.0	1.65	0.5	0.7	0.45	0.30
3.0	2.30	0.5	0.7	0.45	0.45
4.0	2.95	0.5	0.7	0.45	0.60
5.0	3.60	0.5	0.7	0.45	0.75
6.0	4.25	0.5	0.7	0.45	0.90

- 7) Table 1 gives the aggregate expenditure schedule. Equilibrium expenditure is equal to _____.
- A) \$2 trillion
 - B) \$4 trillion
 - C) \$3 trillion
 - D) zero
 - E) \$5 trillion

Use the figure below to answer the following question.

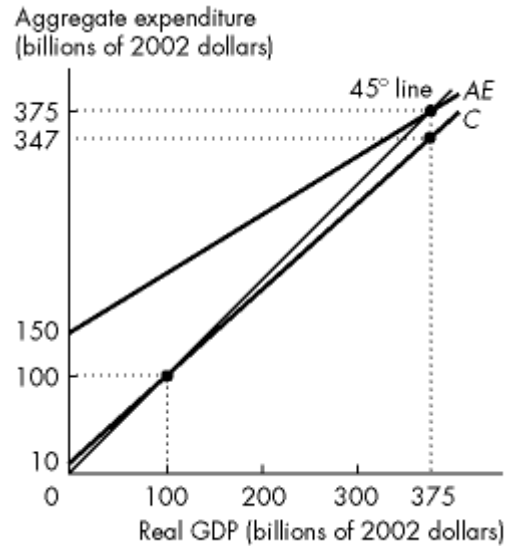


Figure 1

- 8) In Figure 1, the multiplier is
 A) 10. B) 1.00. C) 0.25. D) 1.60. E) 2.50.
- 9) Which of the following quotations illustrates the idea of the multiplier?
 A) "The projected cuts in government jobs will hurt the local retail industry."
 B) "The new stadium will generate \$200 million in spinoff spending."
 C) "Higher expected profits are leading to higher investment spending by business, and will lead to higher consumer spending."
 D) "Taking the grain elevator out of our small town will destroy 300 jobs."
 E) all of the above
- 10) As the aggregate expenditure curve becomes steeper, the value of the multiplier becomes
 A) greater than 1.
 B) equal to the marginal propensity to save.
 C) negative.
 D) larger.
 E) smaller.

- 11) The aggregate expenditure curve and the aggregate demand curve are
- A) the same curve, just with different names.
 - B) linked because if the price level rises, the aggregate expenditure curve shifts downward, and there is a movement up along the aggregate demand curve.
 - C) linked because if the price level rises, the aggregate expenditure curve shifts downward, and there is a movement down along the aggregate demand curve.
 - D) linked because if the price level rises, the aggregate expenditure curve shifts downward, and the aggregate demand curve shifts leftward.
 - E) not related at all.
- 12) Suppose that investment increases by \$10 billion. If the multiplier is 2, the *AD* curve
- A) shifts rightward by the horizontal distance \$20 billion.
 - B) is not affected.
 - C) shifts rightward by a horizontal distance greater than \$20 billion.
 - D) shifts upward by a vertical distance equal to \$20 billion.
 - E) shifts rightward by a horizontal distance less than \$20 billion.

Use the information below to answer the following questions.

Fact 1

The marginal propensity to consume is 0.75, the marginal tax rate is 0.25, and the marginal propensity to import 0.1.

- 13) Refer to Fact 1. What is the autonomous tax multiplier?
- A) -1.39 B) -1.63 C) -3 D) 1.85 E) 2.17
- 14) Refer to Fact 1. How much should the government increase spending by if they want to raise GDP by \$100 million?
- A) \$71.9 million
 - B) \$61.3 million
 - C) \$53.8 million
 - D) \$46.1 million
 - E) \$33.3 million
- 15) Suppose the government starts with a debt of \$0. Then in year 1, there is a deficit of \$100 billion, in year 2 there is a deficit of \$60 billion, in year 3 there is a surplus of \$40 billion, and in year 4 there is a deficit of \$20 billion. What is government debt at the end of year 4?
- A) Somewhat greater than \$140 billion, depending on the interest rate.
 - B) Somewhat greater than \$220 billion, depending on the interest rate.
 - C) \$140 billion.
 - D) \$20 billion.
 - E) \$180 billion.

- 16) What are the main categories of the federal government outlays?
- A) personal income taxes, expenditures on goods and services, and debt interest
 - B) indirect taxes, farmers' subsidies, and debt interest
 - C) transfer payments, expenditures on goods and services, and debt interest
 - D) investment income, debt interest and transfer payments
 - E) none of the above
- 17) Norland has the budget deficit of \$15 billion. According to the government economists, Norland has a structural deficit of \$3 billion. What is a cyclical deficit in Norland?
- A) \$12 billion B) \$15 billion C) zero D) \$10 billion E) \$18 billion
- 18) If the economy is in an expansion, and the federal government is running a deficit, then a recession would automatically
- A) increase taxes.
 - B) decrease the deficit.
 - C) increase government outlays.
 - D) increase the deficit.
 - E) C and D.

Use the figure below to answer the following questions.

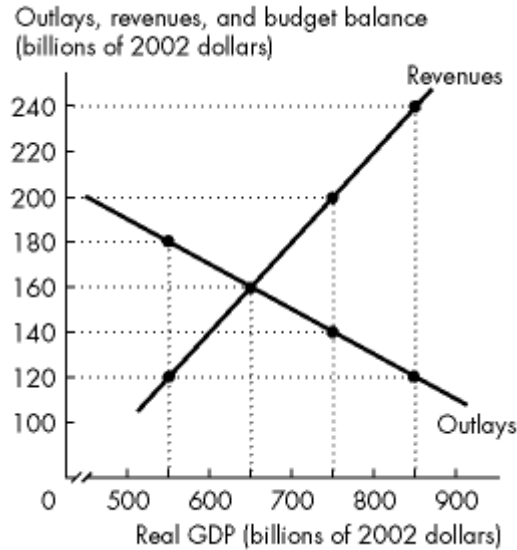


Figure 2

- 19) Refer to Figure 2, which shows the outlays and revenues for the government of Pianoland. The budget is balanced when real GDP equals _____.
- A) \$700 billion
 - B) \$600 billion
 - C) \$750 billion
 - D) \$550 billion
 - E) \$650 billion
- 20) Refer to Figure 2, which shows the outlays and revenues for the government of Pianoland. An automatic increase in tax revenues would be shown as a
- A) shift upwards in the the outlays curve.
 - B) shift upwards in the revenues curve.
 - C) movement from left to right along the outlays curve.
 - D) movement from left to right along the revenues curve.
 - E) both A and C.
- 21) Which one of the following happens automatically if the economy goes into a recession?
- A) Government outlays increase and revenues do not change.
 - B) The government budget deficit increases or the government budget surplus decreases.
 - C) Revenues decrease and government outlays do not change.
 - D) Both government outlays and revenues increase, and the deficit stays the same.
 - E) The government budget deficit decreases.

- 22) During a recession, revenues
- A) remain constant and government outlays increase.
 - B) increase and government outlays decrease.
 - C) and government outlays increase.
 - D) and government outlays decrease.
 - E) decrease and government outlays increase.
- 23) When real GDP equals potential GDP of \$12 trillion, the budget deficit is \$1 trillion. Real GDP actually equals \$14 trillion and the budget surplus is \$3 trillion. The economy has a structural _____ and a cyclical _____.
- A) surplus of \$3 trillion; surplus of \$2 trillion
 - B) deficit of \$4 trillion; surplus of \$1 trillion
 - C) deficit of \$1 trillion; surplus of \$4 trillion
 - D) surplus of \$4 trillion; deficit of \$1 trillion
 - E) deficit of \$1 trillion; surplus of \$2 trillion
- 24) Which of the following policies shifts the *AD* curve the farthest leftward?
- A) an increase in taxes of \$10 billion
 - B) a decrease in government expenditure of \$10 billion
 - C) a decrease in taxes of \$10 billion
 - D) an increase in government expenditure of \$10 billion
 - E) a simultaneous increase in government expenditure of \$10 billion and taxes of \$10 billion
- 25) Which of the following best fits the definition of money?
- A) any medium of exchange
 - B) any commodity or token that is generally acceptable as a means of payment
 - C) gold
 - D) an obligation between the parties to a transaction
 - E) any unit of account
- 26) Which of the following is *not* considered money in Canada today?
- A) bank of Canada notes
 - B) deposits at credit unions
 - C) debit cards
 - D) coins
 - E) deposits at banks

- 27) The Monetary Base consists of the sum of
- A) Bank of Canada notes held within the Bank of Canada, bank deposits at the Bank of Canada, and coins held by banks.
 - B) Bank of Canada notes held outside the Bank of Canada, bank deposits at the Bank of Canada, and coins held by banks and the public.
 - C) Bank of Canada notes held outside the Bank of Canada, the desired reserves of chartered banks, and coins held by banks.
 - D) Bank of Canada notes held within the Bank of Canada, bank deposits at the Bank of Canada, and coins held by banks and the public.
 - E) Bank of Canada notes held outside the Bank of Canada, bank deposits at the Bank of Canada, and notes and coins held by banks.
- 28) Suppose that a country has \$50 billion in bank reserves, \$100 billion in currency held by the public, and \$500 billion in bank deposits. The currency drain ratio is
- A) 50%.
 - B) 30%.
 - C) 20%.
 - D) 18%.
 - E) 10%.
- 29) Suppose that the interest rate is greater than the equilibrium interest rate. Which of the following statements is true?
- I. There is an excess quantity of money.
 - II. The quantity of money automatically increases.
 - III. The interest rate falls.
- A) II only
 - B) I only
 - C) III only
 - D) I and III only
 - E) None of the above statements are true.
- 30) Choose the correct statement.
- A) The quantity of money measured in dollars is nominal money.
 - B) The quantity of nominal money demanded is inversely related to the price level.
 - C) The quantity of money measured in constant dollars is nominal money.
 - D) As real GDP increase the quantity of nominal money demanded decreases.
 - E) As the interest rate rises, the quantity of real money demanded increases.
- 31) Everything else remaining the same, an increase in real GDP
- A) decreases the demand for real money up to a point, and then demand will automatically rise.
 - B) increases the demand for real money up to a point, and then demand will automatically fall.
 - C) decreases the demand for real money.
 - D) increases the demand for real money.
 - E) does not change the demand for real money.

Use the figure below to answer the following question.

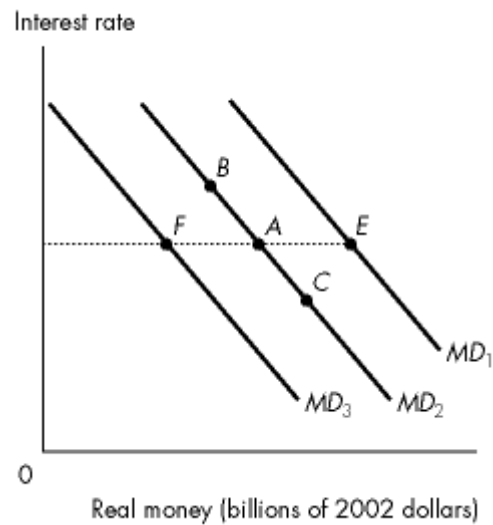


Figure 3

- 32) Refer to Figure 3. Which one of the following best describes the response to a rise in the price level?
- A) A movement from *A* to *F*
 - B) A movement from *A* to *B*
 - C) A movement from *A* to *C*
 - D) A movement from *A* to *E*
 - E) none of the above
- 33) The amount of real money people want to hold will increase if either the amount they are spending increases or the
- A) interest rate increases.
 - B) price level increases.
 - C) price of bond falls.
 - D) price level decreases.
 - E) interest rate decreases.
- 34) The opportunity cost of holding currency is
- A) the nominal interest rate.
 - B) the real interest rate.
 - C) the price level.
 - D) the inflation rate.
 - E) consumption given up.

- 35) The amount of real money people want to hold will decrease if either _____ or the interest rate _____.
- A) the price level increases; rises
 - B) real GDP decreases; rises
 - C) the price level decreases; falls
 - D) the price of bonds increase; rises
 - E) real GDP increases; falls
- 36) The quantity theory of money begins with the equation of exchange, $MV = PY$, and then adds the assumptions that
- A) velocity varies inversely with the interest rate, and the price level is independent of the quantity of money.
 - B) velocity and potential GDP are independent of the quantity of money.
 - C) velocity and the price level are independent of the quantity of money.
 - D) potential GDP and the quantity of money are independent of the price level.
 - E) potential GDP and the price level are independent of the quantity of money.
- 37) Quantecon is a country in which the quantity theory of money operates. The country has a constant population, capital stock, and technology. In year 1, real GDP was \$400 million, the price level was 200, and the velocity of circulation was 20.
- In year 2 the quantity of money was 20 percent higher than in year 1.
- The quantity of money in year 1 was _____.
- The quantity of money in year 2 was _____.
- The price level in year 2 is _____.
- A) \$20 million; \$24 million; 220
 - B) \$40 million; \$48 million; 220
 - C) \$20 million; 24 million; 240
 - D) \$80 million; \$88 million; 200
 - E) \$40 million; \$48 million; 240
- 38) In the United Kingdom, the currency drain ratio is 0.38 and the desired reserve ratio is 0.002. The U.K. money multiplier is
- A) 3.61.
 - B) 2.62.
 - C) 2.77.
 - D) 0.28.
 - E) 0.38.

- 39) You are given the following information about the economy of Nocoin:
 The banks have deposits of \$300 billion. Their reserves are \$15 billion, two thirds of which is in deposits with the central bank. Households and firms hold \$30 billion in bank notes. There are no coins!
 The banks have no excess reserves.
 The Bank of Nocoin, the central bank, increases bank reserves by \$0.5 billion.
 The quantity of money _____.
 The change in the quantity of money is not equal to the change in the monetary base because _____.
 The money multiplier is _____.
- A) increases; the components of the monetary base are not the components of the quantity of money; 7.0
 - B) increases; when bank reserves increase, banks loan out their excess reserves and a multiplier process ensues; 7.33
 - C) decreases; money includes currency but the monetary base does not include currency; 7.0
 - D) increases; the monetary base includes bank deposits; 7.0
 - E) decreases; an increase in monetary base brings about a decrease in the quantity of money; 7.33
- 40) How can the Bank of Canada use the bank rate to regulate the overnight loans rate?
- A) The overnight loans rate is set at a quarter percentage point above the bank rate, which in turn is set by the Bank of Canada.
 - B) The bank rate is set at the target overnight rate plus 0.25 percentage points.
 - C) The bank rate is set at 0.25 percentage points below the settlement balances rate, which is used to determine the overnight loans rate.
 - D) The overnight loans rate is set at 25 basis points above the bank rate.
 - E) The bank rate is set at the settlement balances rate plus 0.25 percentage points.
- 41) The Bank of Canada can lower the overnight loans rate by
- A) raising the settlement balances rate.
 - B) lowering the bank rate.
 - C) raising the bank rate.
 - D) lowering the settlement balances rate.
 - E) both B and D.

- 42) In an open market operation aimed at increasing expenditure, the Bank of Canada
- A) buys government bonds, increasing bank reserves, increasing lending, decreasing the overnight rate.
 - B) buys government bonds, increasing bank reserves, increasing lending, increasing the overnight rate.
 - C) sells government bonds, decreasing bank reserves, decreasing lending, decreasing the overnight rate.
 - D) sells government bonds, decreasing bank reserves, increasing lending, increasing the overnight rate.
 - E) sells government bonds, decreasing bank reserves, decreasing lending, increasing the overnight rate.
- 43) The purchase of government bonds by the Bank of Canada
- A) increases bank loans.
 - B) decreases the price of bonds.
 - C) fights inflation.
 - D) tightens credit conditions.
 - E) decreases bank reserves.
- 44) If the Bank of Canada buys government securities in the open market, the supply curve of real money shifts
- A) leftward and the overnight rate falls.
 - B) rightward and the overnight rate remains constant because the demand for money increases at the same time.
 - C) leftward and the overnight rate rises.
 - D) rightward and the overnight rate rises.
 - E) none of the above.
- 45) When the Bank of Canada lowers the overnight loans rate, the Canadian dollar _____ on the foreign exchange market and _____.
- A) rises; aggregate demand decreases
 - B) rises; U.S. aggregate demand decreases
 - C) falls; the increase in imports is greater than the increase in exports
 - D) falls; aggregate demand decreases
 - E) falls; aggregate demand increases
- 46) The purchase of government bonds by the Bank of Canada
- A) raises the overnight loans rate.
 - B) decreases the quantity of money.
 - C) decreases bank reserves.
 - D) decreases the supply of loanable funds.
 - E) increases aggregate demand.

- 47) To decrease aggregate demand, the Bank of Canada can
- A) raise the overnight loans rate, which decreases the quantity of money.
 - B) lower the overnight loans rate, which decreases the quantity of money.
 - C) lower the overnight loans rate, which increases the quantity of money.
 - D) raise the overnight loans rate, which decreases the government budget deficit.
 - E) raise the overnight loans rate, which increases the quantity of money.

Use the figure below to answer the following question.

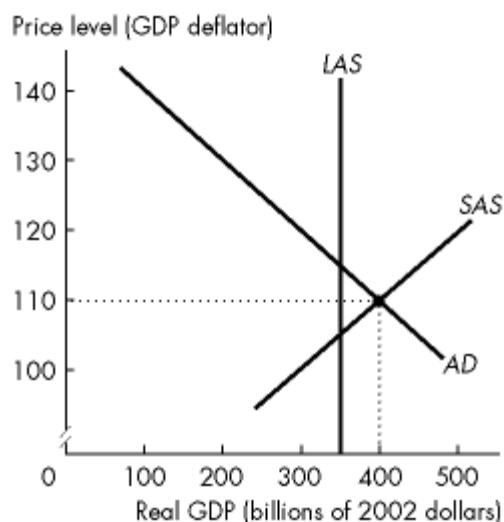


Figure 4

- 48) Refer to Figure 4. The figure shows the economy of Freezone. Potential GDP is \$350 billion. To return the economy to full employment, the central bank can _____ the overnight rate and _____ securities.
- A) raise; buy
 - B) lower; sell
 - C) lower; not change its holdings of
 - D) lower; buy
 - E) raise; sell
- 49) When the Bank of Canada fights recession by lowering the overnight loans rate, the supply of reserves curve shifts _____ and the supply of money curve shifts _____.
- A) leftward; rightward
 - B) rightward; leftward
 - C) leftward; leftward
 - D) rightward; rightward
 - E) rightward; rightward, and the demand for loanable funds increases

50) A decrease in the overnight loans rate

- A) decreases the demand for loanable funds, lowers the real interest rate, and decreases aggregate demand.
- B) increases other short-term interest rates, decreases investment, and decreases aggregate demand.
- C) lowers the exchange rate, increases the demand for loanable funds, and increases aggregate demand.
- D) lowers the exchange rate, increases the supply of loanable funds, and increases aggregate demand.
- E) lowers other short-term interest rates, raises the real interest rate, and increases aggregate demand.

Answer Key

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- | | |
|-------|-------|
| 1) B | 43) A |
| 2) A | 44) E |
| 3) D | 45) E |
| 4) E | 46) E |
| 5) B | 47) A |
| 6) B | 48) E |
| 7) B | 49) D |
| 8) E | 50) D |
| 9) E | |
| 10) D | |
| 11) B | |
| 12) A | |
| 13) A | |
| 14) C | |
| 15) C | |
| 16) C | |
| 17) A | |
| 18) E | |
| 19) E | |
| 20) D | |
| 21) B | |
| 22) E | |
| 23) C | |
| 24) B | |
| 25) B | |
| 26) C | |
| 27) B | |
| 28) C | |
| 29) D | |
| 30) A | |
| 31) D | |
| 32) E | |
| 33) E | |
| 34) A | |
| 35) B | |
| 36) B | |
| 37) E | |
| 38) A | |
| 39) B | |
| 40) B | |
| 41) E | |
| 42) A | |