

## Chapter 5 Introduction to Macroeconomics

1) Which of the following is NOT a topic studied in Macroeconomics?

- A) gross domestic product
- B) the unemployment rate
- C) the price of IBM computers
- D) the inflation rate

Answer: C

2) Which of the following is a topic studied in Macroeconomics?

- A) gross domestic product
- B) the wage of auto workers
- C) the price of IBM computers
- D) the amount of pizza produced

Answer: A

3) Which of the following is a topic studied in Macroeconomics?

- A) the functioning of individual industries
- B) aggregate behavior of households and industries
- C) the behavior of individual households
- D) the decision- making behavior of individual business firms

Answer: B

4) Prices that do not always adjust rapidly to maintain equality between quantity supplied and quantity demanded are

- A) administered prices.
- B) sticky prices.
- C) regulatory prices.
- D) market prices.

Answer: B

5) The demand for corn has increased in May without any change in supply. Eight months later there still has been no change in corn prices. This is an example of a

- A) price floor.
- B) price control.
- C) sticky price.
- D) macroeconomic price.

Answer: C

6) The demand for massage therapists declined in the spring of 2007, but the starting wages paid to massage therapists was still the same at the end of 2007. This is an example of a

- A) sticky price.
- B) flexible price.
- C) highly regulated market.
- D) price control.

Answer: A

7) An increase in the overall price level is known as

- A) deflation.
- B) recession.
- C) inflation.
- D) stagflation.

Answer: C

8) Aggregate behavior is

- A) the behavior of each household and firm.
- B) the behavior of each individual.
- C) the behavior of all households and firms together.
- D) none of the above.

Answer: C

9) Inflation is a(n)

- A) decrease in the overall price level.
- B) decrease in the overall level of economic activity.
- C) increase in the overall price level.
- D) increase in the overall level of economic activity.

Answer: C

10) Deflation occurs when

- A) the average price level declines.
- B) economic activity declines.
- C) the economic growth rate declines.
- D) the unemployment rate declines.

Answer: A

11) A period of very rapid increase in the overall price level is known as

- A) stagnation.
- B) hyperinflation.
- C) stagflation.
- D) depression.

Answer: B

12) The trend of the economy is

- A) the long run growth path of the economy.
- B) the long run inflation rate.
- C) the long run unemployment rate.
- D) the short run production capacity of an economy.

Answer: A

13) The term business cycle refers to the

- A) short- term ups and downs in the price level.
- B) long- term trends in the price level.
- C) short- term ups and downs in the level of economic activity.
- D) long- term trends in the level of economic activity.

Answer: C

14) A period during which aggregate output rises is known as a(n)

- A) recession.
- B) inflation.
- C) hyperinflation.
- D) expansion.

Answer: D

15) A period when the economy shrinks is known as

- A) a recession.
- B) a contraction.
- C) a slump.
- D) all of the above.

Answer: D

16) In a business cycle, a peak represents the end of \_\_\_\_\_ and a trough represents the end of \_\_\_\_\_.

- A) an expansion; a recession
- B) a depression; an expansion
- C) a trough; a peak
- D) a recession; an expansion

Answer: A

17) In a business cycle, a peak represents the end of

- A) an expansion.
- B) a depression.
- C) trough.
- D) a recession

Answer: A

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18) In a business cycle, a trough represents the end of

- A) an expansion.
- B) an inflation.
- C) a peak
- D) a recession.

Answer: D

19) It has become conventional to classify an economic downturn as a recession when aggregate output declines for

- A) three consecutive quarters.
- B) two consecutive quarters.
- C) a year.
- D) six consecutive quarters.

Answer: B

20) If the labor force is 500 and employment is 450, then the unemployment rate is

- A) 100%.
- B) 90%.
- C) 10%.
- D) 0%.

Answer: C

21) A prolonged and deep recession is called

- A) a business cycle.
- B) a depression.
- C) a stagflation.
- D) hyperinflation.

Answer: B

22) Between a trough and a peak, the economy goes through a(n)

- A) recession.
- B) bust.
- C) expansion.
- D) hyperinflation.

Answer: C

23) Between a peak and a trough, the economy goes through a(n)

- A) expansion.
- B) inflation.
- C) recession.
- D) boom.

Answer: C

24) Unemployment means that

- A) at the going wage rate, there are people who want to work but cannot find work.
- B) people are not willing to work at the going wage rate.
- C) there are some people who will not work at the going wage rate.
- D) there is excess demand in the labor market.

Answer: A

25) Unemployment implies that in the labor market

- A) there is an excess supply of labor.
- B) there is an excess demand for labor.
- C) there are too few workers for the jobs available.
- D) quantity demanded of labor exceeds quantity supplied.

Answer: A

26) The unemployment rate equals

- A) labor force/population.
- B) unemployed/employed.
- C) (employed- unemployed)/labor force.
- D) (labor force - employed) / labor force.

Answer: D

27) The unemployment rate equals

- A) labor force/population.
- B) unemployed/employed.
- C) (employed - unemployed) / labor force.
- D) unemployed / labor force.

Answer: D

28) If the labor force is 50 million and 48 million are employed then the unemployment rate is:

- A) 2%.
- B) 4%.
- C) 5%.
- D) 52%.

Answer: B

29) If 20 million workers are unemployed and 180 million workers are employed, then the unemployment rate is

- A) 10%.
- B) 11.1%.
- C) 18%.
- D) 80%.

Answer: A

30) The period in the business cycle from a trough to peak is called a(n)

- A) recession.
- B) expansion.
- C) slump.
- D) depression.

Answer: B

31) If output is rising and unemployment is falling, the economy MUST be in a(n)

- A) contraction.
- B) expansion.
- C) depression.
- D) hyperinflationary period.

Answer: B

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32) The period in the business cycle from a peak to a trough is a(n)

- A) recession.
- B) boom.
- C) expansion.
- D) inflation.

Answer: A

33) Unemployment generally \_\_\_\_\_ during recessions and \_\_\_\_\_ during expansions.

- A) falls; rises.
- B) falls; falls.
- C) rises; falls.
- D) rises; rises.

Answer: C

34) Which of the following statements is FALSE?

- A) The rate of change in economic activity is used to assess whether an economy is expanding or contracting.
- B) Short- term ups and downs in the economy are known as business cycles.
- C) During a recession, output and employment are falling.
- D) Business cycles are always symmetric the length of an expansion is the same as the length of a contraction.

Answer: D

2 True/False

- 1) Macroeconomics is concerned with inflation or deflation, output growth and unemployment.  
Answer: TRUE
- 2) Macroeconomics is concerned with the market price and equilibrium quantity of each good or service.  
Answer: FALSE
- 3) The employment rate is the number of people employed divided by number of people in the labor force.  
Answer: TRUE
- 4) Hyperinflation and stagflation are two different names which refer to identical economic conditions.  
Answer: FALSE
- 5) Macroeconomic behavior is the sum of all the microeconomic decisions made by individual households and firms.  
Answer: TRUE
- 6) All business cycles are symmetric the length of an expansion is the same as the length of a recession.  
Answer: FALSE
- 7) A recession is usually associated with increasing unemployment.  
Answer: TRUE
- 9) An expansion is usually associated with rising price levels.  
Answer: TRUE
- 10) A recession is associated with a negative rate of growth of the economy.  
Answer: TRUE

## 5.2 The Components of the Macroeconomy

### 1 Multiple Choice

1) If the central bank decreases the money supply, it is conducting

- A) monetary policy.
- B) supply- side policy.
- C) fiscal policy.
- D) incomes policy.

Answer: A

2) If Congress increases government spending, it is using

- A) monetary policy.
- B) supply- side policy.
- C) fiscal policy.
- D) incomes policy.

Answer: C

3) Government policies regarding taxes and expenditures are called

- A) fiscal policy.
- B) income policies.
- C) supply- side policy.
- D) monetary policy.

Answer: A

4) The government implements fiscal policy when it changes

- A) spending and/or interest rate.
- B) money supply and/or taxes.
- C) taxes and/or spending.
- D) taxes and/or interest rate.

Answer: C

5) The government wants to encourage consumer spending through cutting income taxes. This is an example of

- A) an incomes policy.
- B) a fiscal policy.
- C) a supply- side policy.
- D) a monetary policy.

Answer: B

6) The \_\_\_\_\_ can change the quantity of money in the economy.

- A) Treasury Department
- B) Federal Reserve
- C) Congress
- D) Office of the Comptroller of the Currency

Answer: B

7) The Federal Reserve affecting the supply of money is known as

- A) fiscal policy.
- B) monetary policy.
- C) growth policy.
- D) supply side policy.

Answer: B

8) Policies designed to affect the quantity of money are

- A) fiscal policies.
- B) supply side or growth policies.
- C) government spending policies.
- D) monetary policies.

Answer: D

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9) The diagram that shows the income received and payments made by each sector of the economy is the

- A) aggregate demand- aggregate supply diagram.
- B) circular flow diagram.
- C) income flow diagram.
- D) income- production diagram.

Answer: B

10) In the circular flow diagram, the different payments made by firms to households include

- A) wages and profits.
- B) interest and taxes.
- C) transfer payments and dividends.
- D) taxes and transfer payments.

Answer: A

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11) An example of a transfer payment is

- A) an interest payment on a General Motors' bond.
- B) the added value of stock from the time it was bought to the time it was sold.
- C) a Social Security retirement benefit.
- D) the salary paid to a member of the armed forces.

Answer: C

- 12) A transfer payment is
- A) a bonus to get a worker to accept a transfer.
  - B) a cash payment made by the government to people who do not supply goods, services or labor in exchange for the payment.
  - C) a cash payment for transferring a good from one person to another.
  - D) an in kind payment for working" off the books."

Answer: B

- 13) A household that spends less than it receives in income during a given period is
- A) saving.
  - B) dissaving.
  - C) running a deficit.
  - D) receiving transfer payments.

Answer: A

- 14) The major lesson of the circular flow diagram is that
- A) saving must always be less than investment.
  - B) taxes must always be greater than government expenditures.
  - C) total income in the economy must always equal total spending.
  - D) tax receipts must be equal to transfer payments

Answer: C

- 15) In which of the following markets are funds demanded and supplied?

- A) the labor market
- B) the goods and services market
- C) the money market
- D) the factor market

Answer: C

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- 16) In the goods- and- services market, households

- A) only supply.
- B) only demand.
- C)both supply and demand.
- D) neither supply nor demand.

Answer: B

- 17) The demanders in the goods- and- services market are

- A) households and business firms.
- B) households, the government, and the rest of the world.
- C) the government and business firms.
- D) households, the government, business firms, and the rest of the world.

Answer: D

- 18) In which basic market would DVDs be traded?

- A) the goods and services market
- B) the money market
- C) the labor market
- D) the factor market

Answer: A

19) In the circular flow diagram, firms \_\_\_\_\_ labor and households \_\_\_\_\_ goods and services.

- A) demand; supply.
- B) demand; demand.
- C) supply; demand.
- D) supply; supply.

Answer: B

20) In the circular flow diagram, households demand \_\_\_\_\_ and supply \_\_\_\_\_.

- A) labor; labor.
- B) goods; services.
- C) goods and services; labor.
- D) labor; goods and services.

Answer: C

21) Promissory notes issued by the federal government when it borrows money are known as

- A) Treasury shares.
- B) Treasury stocks.
- C) Treasury bonds.
- D) none of the above

Answer: C

22) A promissory note issued by a corporation when it borrows money is a

- A) share.
- B) corporate bond.
- C) corporate dividend.
- D) stock.

Answer: B

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23) Dividends are

- A) government profits distributed among bondholders.
- B) corporate profits distributed among shareholders.
- C) capital gains realized by stockholders.
- D) promissory notes issued by corporations.

Answer: B

24) Which of the following is a CORRECT statement?

- A) Companies issue shares but don't issue bonds.
- B) The government issues both bonds and shares.
- C) Bondholders earn dividends but shareholders don't.
- D) Shareholders earn dividends but bondholders don't.

Answer: D

25) A capital gain is

- A) a financial instrument that gives the holder a share in the ownership of a firm and therefore the right to share in the profits of the firm.
- B) the portion of a corporation's profits that the firm pays out each period to its shareholders.
- C) an increase in the value of an asset over the price initially paid for it.
- D) the difference between an individual's economic income and money income.

Answer: C

26) An increase in the value of an asset over the price initially paid for it is a

- A) dividend.
- B) share of stock.
- C) promissory note.
- D) capital gain.

Answer: D

27) A dividend is

- A) a promissory note issued by corporations when they borrow money.
- B) an increase in the value of an asset over the purchase price initially paid for it.
- C) the difference between the interest rate a bank pays on deposits and the interest rate it charges for loans.
- D) the portion of a corporation's profits that the firm pays out each period to its shareholders.

Answer: D

28) The portion of a corporation's profits that a firm pays out each period to its shareholders is a

- A) dividend.
- B) promissory note.
- C) capital gain.
- D) corporate bond.

Answer: A

2 True/False

1) Fiscal policy generally takes the form of regulations specifying the maximum amount by which the money supply can be changed.

Answer: FALSE

2) Contractionary fiscal policy includes raising taxes.

Answer: TRUE

3) Monetary policy includes changing the level of household taxes.

Answer: FALSE

4) A corporate bond is a promissory note issued by a firm when it borrows money.

Answer: TRUE

5) In the circular flow diagram everyone's expenditure is someone else's receipt.

Answer: TRUE

6) A dividend is is paid by shareholders to firms.

Answer: FALSE

7) A transfer payment is the tax one pays when transferring real estate.

Answer: FALSE

8) A capital gain is the increase in value of an asset above its initial cost.

Answer: TRUE

### 5.3 A Brief History of Macroeconomics

#### 1 Multiple Choice

1) To get the economy out of a slump, Keynes believed that the government should

- A) cut both taxes and government spending.
- B) increase both taxes and government spending.
- C) increase taxes and/or decrease government spending.
- D) decrease taxes and/or increase government spending.

Answer: D

2) To bring the economy out of an inflationary period, Keynes argued that the government should

- A) cut both taxes and government spending.
- B) increase both taxes and government spending.
- C) increase taxes and/or decrease government spending.
- D) decrease taxes and/or increase government spending.

Answer: C

3) Which of the following is an assumption used by Classical economists?

- A) Wages adjust downward but not upward.
- B) Wages adjust upward but not downward.
- C) Wages are inflexible.
- D) Wages adjust both upward and downward.

Answer: D

4) According to the Classical model, unemployment

- A) could not persist because wages would rise to eliminate the excess supply of labor.
- B) could not persist because wages would fall to eliminate the excess supply of labor.
- C) could be eliminated through fiscal and monetary policies.
- D) could be eliminated only through government intervention.

Answer: B

5) According to Classical economists, if the quantity of labor demanded exceeds the quantity supplied, there is a

- A) surplus of labor and wages will rise.
- B) shortage of labor and wages will fall.
- C) shortage of labor and wages will rise.
- D) surplus of labor and wages will fall.

Answer: C

6) According to the Classical economists, the economy

- A) requires fine-tuning to reach full employment.
- B) has sticky prices in many industries.
- C) is self-correcting.
- D) will never be at full employment.

Answer: C

7) Macroeconomic policies became more influenced by Keynes' theories starting with,

- A) the period of high unemployment and high inflation in the 1970s.
- B) the Great Depression.
- C) the period of high inflation in the early 1980s.
- D) the OPEC recession.

Answer: B

8) According to Classical models, the level of employment is determined primarily by

- A) the level of aggregate demand for goods and services.
- B) prices and wages.
- C) government taxation.
- D) government spending.

Answer: B

9) According to Keynes, the level of employment is determined by

- A) flexible wages and prices.
- B) interest rates.
- C) price and wages.
- D) the level of aggregate demand for goods and services.

Answer: D

10) The concept of "market clearing" is adopted and defended by

- A) Keynesian economists.
- B) Classical economists.
- C) fine-tuning economists.
- D) demand-side economists.

Answer: B

11) Suppose the economy suffers a high rate of unemployment. According to Keynesian economists, the government should increase employment by

- A) decreasing money supply.
- B) balancing the budget.
- C) not doing anything.
- D) increasing government spending.

Answer: D

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12) Which of the following would be an example of fine tuning?

- A) Firms increase wages to attract high-quality workers.
- B) Firms increase employment benefits to increase workers' productivity.
- C) The federal government enacts legislation to increase spending to try to stimulate the economy.
- D) The federal government passes legislation that would require that the government's budget always be balanced.

Answer: C

13) Rapid increases in the price level during periods of recession or high unemployment are known as

- A) stagflation.
- B) stagnation.
- C) depression.
- D) inflation.

Answer: A

14) Stagflation occurs when the economy's inflation rate is high and

- A) employment is high.
- B) the unemployment rate is high.
- C) the unemployment rate is low.
- D) the rate of change in economic activities is positive.

Answer: B

15) Related to the Economics in Practice on p. 97 [409]: F. Scott Fitzgerald's *The Great Gatsby* is set in the "Roaring '20s". This decade in U.S. history was characterized by

- A) economic expansion and high unemployment.
- B) recession and high unemployment.
- C) economic expansion and low unemployment.
- D) the Great Depression and stagflation.

Answer: C

16) Related to the Economics in Practice on p. 97 [409]: John Steinbeck's *The Grapes of Wrath* is set in the early 1930s. During this time, the U.S. economy was primarily in the \_\_\_\_\_ phase of the business cycle, culminating in the Great Depression.

- A) peak
- B) recession
- C) trough
- D) expansion

Answer: B

17) Related to the Economics in Practice on p. 99 [411]: John Maynard Keynes' most notable published work is entitled

- A) *Capitalism Doomed*.
- B) *The General Theory of Employment, Interest, and Money*.
- C) *The Communist Manifesto*.
- D) *Freakonomics*.

Answer: B

18) Related to the Economics in Practice on p. 99 [411]: John Maynard Keynes sought to solve the economic paradox of the Great Depression, which was the coexistence of

- A) low production and low unemployment.
- B) high production and low inflation.
- C) high production and high inflation.
- D) low production and high unemployment.

Answer: D

2 True/False

1) Keynes believed that expansionary fiscal policy could help get an economy out of an inflation.

Answer: FALSE

2) According to the Classical model, an excess supply of labor would drive up wages to a new equilibrium level and therefore unemployment would not persist.

Answer: FALSE

3) According to Keynes, aggregate supply determines the level of economic activities in the economy.

Answer: FALSE

4) According to Keynes, the government's role during periods when private demand is low is to stimulate aggregate demand and, by so doing, lift the economy out of recession.

Answer: TRUE

5) In the Classical model, the level of employment is determined by the level of aggregate demand.

Answer: FALSE

6) "Fine tuning" is any government attempt to regulate inflation or unemployment.

Answer: TRUE

7) Classical economists believed that economic slowdowns are self-correcting.

Answer: TRUE

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