

Principles of Macroeconomics

Exam IIa

Mark the best answer on the scantron. *Be sure to show your calculations on the scantron.*

1. Consumption that does not vary with income is called _____.
 - a. Induced consumption
 - b. autonomous consumption
 - c. fixed consumption
 - d. variable consumption
 - e. None of the above

2. The largest category of consumption expenditures is _____.
 - a. services
 - b. nondurable goods
 - c. durable goods
 - d. capital goods
 - e. None of the above

3. Permanent income hypothesis posits that _____.
 - a. income follows consumption patterns
 - b. consumption follows income patterns
 - c. consumption does not vary with income
 - d. income varies directly with consumption
 - e. None of the above

4. National Savings is the combination of _____.
 - I. Personal Savings
 - II. Business Savings
 - III. Government Savings
 - IV. Foreign Savings
 - a. I
 - b. I + III + II
 - c. I + III - IV
 - d. I + III + IV
 - e. None of the above

5. Given an expenditure multiplier of 4 and an external leakage of \$100 in expenditures, the economic impact would be _____.
 - a. positive \$25
 - b. negative \$25
 - c. positive \$400
 - d. negative \$400
 - e. None of the above

6. In the long run, investment spending affects _____.
- a. aggregate demand
 - b. investment expenditures
 - c. savings expenditures
 - d. aggregate supply
 - e. None of the above
7. Which function of investment is primarily concerned with its cost?
- a. savings
 - b. interest rates
 - c. income
 - d. wealth
 - e. None of the above
8. Residential housing is included in which category of investment expenditures?
- a. inventory
 - b. equipment
 - c. structures
 - d. derived demand
 - e. None of the above
9. What is Gross Investment?
- a. Investment that replaces worn out assets.
 - b. Net growth in investment.
 - c. Aggregate investment at the beginning of the year.
 - d. Aggregate investment at the end of the year.
 - e. None of the above
10. Demand for capital increases as _____.
- a. supply increases
 - b. savings increases
 - c. income falls
 - d. income rises
 - e. None of the above

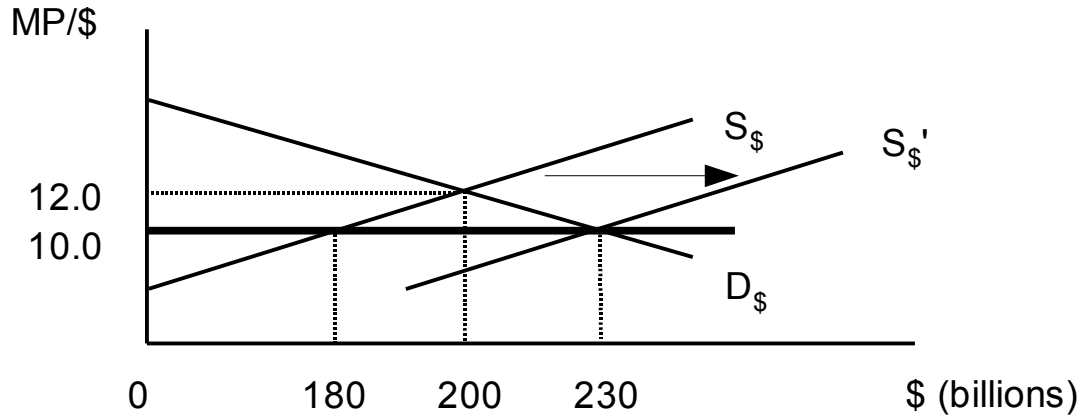
11. The _____ function is concerned with the proportion of income among the population.
- stabilization
 - allocation
 - distribution
 - political
 - None of the above
12. The characteristic known as _____ for public goods means that more than one person can enjoy the consumption of that item without diminishing the enjoyment by another.
- Nonallocativity
 - Nonexclusibility
 - Tragedy of the Commons
 - Nonrival consumption
 - None of the above
13. _____ is the additional cost imposed on those who indirectly and directly participate in the consumption of that product.
- Marginal social cost
 - Marginal social benefit
 - Marginal external cost
 - Marginal external benefit
 - None of the above
14. When drivers fail to exercise caution upon obtaining insurance, then a _____ problem exists.
- moral hazard
 - free rider problem
 - adverse selection
 - agency problem
 - None of the above
15. Social Security invests its funds in _____.
- stocks
 - mutual funds
 - US Treasury securities
 - corporate bonds
 - None of the above

16. _____ occur(s) as public expenditures reduce funds available for private investment.
- Fiscal drag
 - Crowding out
 - Lags
 - Automatic stabilizers
 - None of the above
17. Fiscal Policy is the use of _____ to achieve macroeconomic goals.
- Investment expenditures
 - taxes and government expenditures
 - personal savings
 - interest rates
 - None of the above
18. _____ suggests that tax policy is fair when taxpayers are assessed according to their income level.
- Vertical equity
 - Horizontal equity
 - Ability to pay principle
 - Benefits received principle
 - None of the above
19. If George's tax increases from 200 to 300 as his income increases from 1,000 to 1,200, then his marginal tax rate is _____.
- 20%
 - 25%
 - 30%
 - 50%
 - None of the above
20. Government failure is _____.
- costs of government intervention exceed their benefit
 - benefits of government intervention exceed their costs
 - persistent large deficits
 - persistent large surpluses
 - None of the above

21. The current account deficit exists when _____ are greater than _____.
- exports , imports
 - imports , exports
 - domestic purchases of foreign assets, foreign purchases
 - foreign purchases of domestic assets , domestic purchases
 - None of the above
22. An appreciating domestic currency causes _____.
- imports to be more expensive
 - exports to be more expensive
 - government deficits to greatly increase
 - government deficits to greatly decrease
 - None of the above
23. Demand for domestic assets by domestic residents will cause domestic currency to _____.
- depreciate
 - appreciate
 - remain constant
 - float
 - None of the above
24. _____ are a tax on imported goods.
- Domestic content rules
 - Subsidies
 - Quotas
 - Tariffs
 - None of the above
25. The principle of _____ says that trade occurs when countries export goods at which they are most efficient at producing.
- Absolute advantage
 - Comparative advantage
 - Product differentiation
 - Economies of scale
 - None of the above

26. The European Central Bank has increased their interest rates 3%. Predictably,

- a. the dollar is appreciating and Euro is appreciating
- b. the dollar is depreciating and Euro is appreciating
- c. the dollar is appreciating and Euro is depreciating
- d. the dollar is depreciating and Euro is depreciating
- e. None of the above



27. Given the shift in the supply curve, what will be the effects?

- a. Imports of Mexican goods to America will increase.
- b. Exports of American goods to Mexico will increase.
- c. Mexican goods will be cheaper in America.
- d. American goods will be cheaper in Mexico.
- e. None of the above

28. At an exchange rate of 10 Mexican Pesos to \$1, there will be a _____ of _____ \$ Billion at S'.

- a. shortage, 50
- b. surplus, 50
- c. shortage, 20
- d. surplus, 30
- e. None of the above

29. Which of the following are assumptions of PPP?

- a. All goods are tradeable.
- b. No goods are tradeable.
- c. Exchange rates are fixed.
- d. Exchange rates are floating.
- e. None of the above

30. _____ require(s) central banks to intervene in exchange markets to keep rates within a range of values.

- a. Fixed exchange rates
- b. Floating exchange rates
- c. Managed exchange rates
- d. Bond exchange
- e. None of the above

Macroeconomics Exam Ila Key

- 1 B Consumption that does vary with income is called induced consumption.
- 2 A The three categories of consumption are durable goods, nondurable goods, and services.
- 3 B The other theory studied, life cycle, posits a life time pattern of income and expenditures.
- 4 B National Savings is aggregate domestic savings. Adding foreign savings becomes Total Savings.
- 5 D $4 * -100 = -\$400$
- 6 D Investment spending creates more factories, structures, and equipment that allows the economy to expand output.
- 7 B Financing costs often exceed acquisition costs by a factor of 2 to 3. Savings, income, and wealth provides funds, they are not a cost in themselves.
- 8 C Structures includes both commercial and residential structures.
- 9 E Gross Investment is total new investment some of which replaces old capital.
- 10 D Firm's acquire capital to generate income. Savings finance investment.
- 11 C The stabilization function is concerned with maintaining growth and avoiding unemployment and inflation. The allocation function is concerned with
- 12 D Public goods have the characteristics of nonrival consumption & nonexclusion
- 13 A Remember, additional = marginal and social = everyone. External = everyone except you, and private = you, therefore, social = private + external.
- 14 A Moral hazard indicates a hidden action. Adverse selection indicates hidden information. Free rider is someone who does not pay for a service. An agency problem exists when a principal hires an agent to do something in which moral hazard and/or adverse selection may exist.
- 15 C By law, Social Security can buy only US Treasury securities
- 16 B Fiscal drag occurs when tax rates keep an economic expansion from reaching a full employment level of aggregate demand. Lags are the time period between action and result. Automatic stabilizers do not require policymaker action to take effect.
- 17 B Interest rate controls would be a subject of monetary policy. Investment expenditures and savings are what fiscal policies seek to influence.
- 18 C Horizontal equity refers to tax rates among equal incomes. All concepts of equity shed some light on the ability to pay which is one of the concerns of equity. Benefits received by those paying those taxes is commensurate with another principle of tax fairness.
- 19 D Marginal Tax Rate = $\Delta \text{tax} / \Delta \text{income} = 100 / 200 = 50\%$
- 20 A Budgetary deficits and/or surpluses often are the result of economic policies not a generic failure of government.
- 21 B Purchases of foreign or domestic assets fall under the capital account (now known

as the financial account).

- 22 B Foreign currency changes do not directly affect government deficits or surpluses
- 23 E Without any foreign transaction, there is no direct affect on exchange rates.
- 24 D Quotas are a numeric restriction. Subsidies are government payments/tax credits for domestic producers. Domestic content rules prescribe how much of an item must be originate domestically.
- 25 A Under comparative advantage production of the product with the lowest opportunity cost and import of goods with higher opportunity cost. Clue: in terms of opportunity cost think in terms of how much labor is used per unit of output.
- 26 B European assets are more desirable with higher returns so Americans buy more thus causing the American dollar to depreciate and the euro to appreciate
- 27 B & D The peso depreciates, dollar appreciates. Therefore, Mexican goods are cheaper and American goods are more expensive. America will import more, and export less.
- 28 E at S' it equals demand, there is no shortage or surplus
- 29 A Assumptions of PPP are: all goods are tradable.
- 30 C Floating exchange rates assume exchange rates are set by market forces of supply and demand. Fixed exchange rates are set by mutual consent of trading partner's governments. Bond exchanges do not set exchange rates.