CHAPTER 8 Introduction to Economic Growth and Instability

Торіс		Question numbers	
1.	Economic growth	1-14	
2.	Business cycle	15-26	
3.	Unemployment	27-66	
4.	GDP gap; Okun's law	67-79	
5.	Inflation: measurement, rule of 70	80-89	
6.	Demand-pull and cost-push inflation	90-102	
7.	Nominal versus real income	103-109	
8.	Inflation effects	110-120	
	Last Word	121-124	
	True-False	125-139	

Multiple Choice Questions

Economic growth

- 1. Economic growth is best defined as an increase in:
 - A) either real GDP or real GDP per capita.
 - B) nominal GDP.
 - C) total consumption expenditures.
 - D) wealth in the economy.
- 2. Real GDP per capita is found by:
 - A) adding real GDP and population.
 - B) subtracting population from real GDP.
 - C) dividing real GDP by population.
 - D) dividing population by real GDP.
- 3. Growth is advantageous to a nation because it:
 - A) promotes faster population growth.
 - B) lessens the burden of scarcity.
 - C) eliminates the economizing problem.
 - D) slows the growth of wants.
- 4. For comparing changes in potential military strength and political preeminence, the most meaningful measure of economic growth would be:
 - A) changes in total nominal output.
 - B) changes in total real output.
 - C) changes in per capita output.
 - D) changes in per family output.

Use the following to answer questions 5-8:

	Alta	Zorn	Alta	Zorn
<u>Year</u>	(real GDP)	(real GDP)	(population)	(population)
1	\$ 2,000	\$ 150,000	200	500
2	2,100	152,000	202	505
3	2,200	154,000	210	508

5. Refer to the above table. Between years 1 and 2, real GdP grew by _____ percent in Alta:

- A) 3 percent.
- B) 4 percent.
- C) 5 percent.
- D) 10 percent.
- 6. Refer to the above table. Between years 1 and 2, real GDP per capita grew by _____ percent in Alta:A) 3
 - B) 4
 - C) 5
 - D) 10
- 7. Refer to the above table. Between years 2 and 3:
 - A) Alta's real GDP grew more rapidly than Zorn's real GDP.
 - B) real GDP fell in Zorn.
 - C) population growth reduced Alta's real GDP growth to zero.
 - D) population fell in Alta's.
- 8. Refer to the above table. Per capita GDP was about:
 - A) \$105 in year 3 in Alta.
 - B) \$303 in year 3 in Zorn.
 - C) \$200 in year 1 in Zorn.
 - D) \$5 in year 2 in Alta.

9. If a nation's real GDP is growing by 5 percent per year, its real GDP will double in approximately:

- A) 22 years.
- B) 20 years.
- C) 14 years.
- D) 8 years.
- 10. If the economy's real GDP doubles in 18 years, we can:
 - A) not say anything about the average annual rate of growth.
 - B) conclude that its average annual rate of growth is about 5.5 percent.
 - C) conclude that its average annual rate of growth is about 2 percent.
 - D) conclude that its average annual rate of growth is about 4 percent.
- 11. About ______ of U.S. economic growth comes from improved productivity (as opposed to added inputs).
 - A) one-fourth.
 - B) one-third.
 - C) one-half.
 - D) two-thirds.

- 12. Between 1950 and 2000, U.S. real GDP grew at an average annual rate of about:
 - A) 1.3 percent.
 - B) 3.5 percent.
 - C) 5.1 percent.
 - D) 8.6 percent.

13. Between 1950 and 2000, U.S. real GDP per capita grew at an average annual rate of about:

- A) 5.5 percent.
- B) 4.2 percent.
- C) 3.5 percent.
- D) 2.3 percent.
- 14. The United States experienced a:
 - A) higher economic growth rate than Japan between 1950 and 2000, but a lower rate between 1992 and 2000.
 - B) lower economic growth rate than Japan between 1950 and 2000, but a higher rate between 1992 and 2000.
 - C) higher rate of growth of real GDP than of real GDP per capita between 1950 and 2000.
 - D) higher rate of growth of real GDP than of real GDP per capita between 1990 and 2000.

Business cycle

- 15. Recurring upswings and downswings in an economy's real GDP over time are called:
 - A) recessions.
 - B) business cycles.
 - C) output yo-yos.
 - D) total product oscillations.
- 16. In the United States, business cycles have occurred against a backdrop of a long-run trend of:
 - A) declining unemployment.
 - B) stagnant productivity growth.
 - C) rising real GDP.
 - D) rising inflation.
- 17. The immediate determinant of the volume of output and employment is the:
 - A) composition of consumer spending.
 - B) ratio of public goods to private goods production.
 - C) level of total spending.
 - D) size of the labor force.
- 18. As it relates to economic growth, the term long-run trend refers to:
 - A) the long-run increase in the relative importance of durable goods in the U.S. economy.
 - B) the long-term expansion or contraction of business activity that occurs over 50 or 100 years.
 - C) fluctuations in business activity that average 40 months in duration.
 - D) fluctuations in business activity that occur around Christmas, Easter, and so forth.
- 19. In which of the following industries or sectors of the economy is *output* likely to be most strongly affected by the business cycle?
 - A) military goods

- B) producer's durables (machinery, equipment, etc.)
- C) textile products (clothing)
- D) agricultural commodities (wheat, corn, etc.)
- 20. In which of the following industries or sectors of the economy is *price* likely to be most strongly affected by the business cycle?
 - A) military goods
 - B) producer's durables (machinery, equipment, etc.)
 - C) textile products (clothing)
 - D) agricultural commodities (wheat, corn, etc.)
- 21. During a serious recession, we would expect output to fall the most in:
 - A) the health-care industry.
 - B) the clothing industry.
 - C) agriculture.
 - D) the construction industry.

22. The phase of the business cycle in which real GDP declines is called:

- A) the peak.
- B) a recovery.
- C) a recession.
- D) the trough.

23. The phase of the business cycle in which real GDP is at a minimum is called:

- A) the peak.
- B) a recession.
- C) the trough.
- D) the pits.

24. Market economies have been characterized by:

- A) occassional instability of employment and price levels.
- B) uninterrupted economic growth.
- C) persistent full employment.
- D) declining populations.
- 25. The production of durable goods varies more than the production of nondurable goods because:
 - A) durables purchases are nonpostponable.
 - B) durables purchases are postponable.
 - C) the producers of nondurables have monopoly power.
 - D) producers of durables are highly competitive.
- 26. A recession is a period in which:
 - A) cost-push inflation is present.
 - B) nominal domestic output falls.
 - C) demand-pull inflation is present.
 - D) real domestic output falls.

Unemployment

- 27. The United States' economy is considered to be at "full employment" when:
 - A) 90 percent of the total population is employed.
 - B) 90 percent of the labor force is employed.
 - C) about 5 percent of the labor force is unemployed.
 - D) 100 percent of the labor force is employed.
- 28. In the United States, the rate of unemployment is highest for:
 - A) white teenagers.
 - B) black teenagers.
 - C) married women.
 - D) unmarried women.
- 29. Kimberly voluntarily quit her job as an insurance agent to return to school full-time to earn an MBA degree. With degree in hand she is now searching for a position in management. Kimberly presently is:
 - A) cyclically unemployed.
 - B) structurally unemployed.
 - C) frictionally unemployed.
 - D) not a member of the labor force.
- 30. To be officially unemployed a person must:
 - A) be in the labor force.
 - B) be 21 years of age or older.
 - C) have just lost a job.
 - D) be waiting to be called back from a layoff.
- 31. The natural rate of unemployment is:
 - A) higher than the full-employment rate of unemployment.
 - B) lower than the full-employment rate of unemployment.
 - C) that rate of unemployment occurring when the economy is at its potential output.
 - D) found by dividing total unemployment by the size of the labor force.
- 32. The labor force includes:
 - A) employed workers and persons who are officially unemployed.
 - B) employed workers, but excludes persons who are officially unemployed.
 - C) full-time workers, but excludes part-time workers.
 - D) permanent employees, but excludes temporary employees.
- 33. The unemployment rate of:
 - A) women greatly exceeds that of men.
 - B) whites is roughly equal to that of blacks.
 - C) white-collar workers exceeds that of blue-collar workers.
 - D) teenagers is much higher than that of adults.
- 34. Anne Kasperson works in her own home as a full-time caretaker and homemaker. Officially, she is:
 - A) unemployed.
 - B) employed.
 - C) not in the labor force.

- D) in the labor force.
- 35. If the unemployment rate is 9 percent and the natural rate of unemployment is 5 percent, then the:
 - A) frictional unemployment rate is 5 percent.
 - B) cyclical unemployment rate and the frictional unemployment rate together are 5 percent.
 - C) cyclical unemployment rate is 4 percent.
 - D) natural rate of unemployment will eventually increase.
- 36. Official unemployment statistics:
 - A) understate unemployment because individuals receiving unemployment compensation are counted as employed.
 - B) understate unemployment because "discouraged workers" are not counted as unemployed.
 - C) include cyclical and structural unemployment, but not frictional unemployment.
 - D) overstate unemployment because workers who are involuntarily working part time are counted as being employed.
- 37. The presence of discouraged workers:
 - A) increases the size of the labor force, but does not affect the unemployment rate.
 - B) reduces the size of the labor force, but does not affect the unemployment rate.
 - C) may cause the official unemployment rate to understate the amount of unemployment.
 - D) may cause the official unemployment rate to overstate the amount of unemployment.
- 38. Part-time workers are counted as:
 - A) unemployed and therefore the official unemployment rate may overstate the level of unemployment.
 - B) unemployed and therefore the official unemployment rate may understate the level of unemployment.
 - C) fully employed and therefore the official unemployment rate may overstate the level of unemployment.
 - D) fully employed and therefore the official unemployment rate may understate the level of unemployment.
- 39. The natural rate of unemployment:
 - A) is fixed over time.
 - B) is found by adding the cyclical and structural unemployment rates.
 - C) may change from one decade to another.
 - D) cannot be changed through public policy.
- 40. Assuming the total population is 100 million, the civilian labor force is 50 million, and 47 million workers are unemployed, the unemployment rate is:
 - A) 3 percent.
 - B) 6 percent.
 - C) 7 percent.
 - D) 9 percent.
- 41. The natural rate of unemployment is the:
 - A) unemployment rate experienced at the depth of a depression.
 - B) full-employment unemployment rate.
 - C) unemployment rate experienced by the least-skilled workers in the economy.
 - D) unemployment rate experienced by the most-skilled workers in the economy.
- 42. Assume that Hernandez is temporarily unemployed because he has voluntarily quit his job with company A and will begin a better job next week with company B. Hernandez will be considered as:
 - A) cyclically unemployed.

- B) frictionally unemployed.
- C) secularly unemployed.
- D) employed.
- 43. During periods of "full employment" the:
 - A) burden of unemployment is quite evenly distributed among males and females, blacks and whites, and young and old workers.
 - B) unemployment rate for teenagers is below the rate for the labor force as a whole.
 - C) unemployment rate for women is considerably lower than that for men.
 - D) unemployment rate for blacks is about twice the rate for whites.
- 44. The unemployment rate is the:
 - A) ratio of unemployed to employed workers.
 - B) number of employed workers *minus* the number of workers who are not in the labor force.
 - C) percentage of the labor force which is out of work.
 - D) percentage of the total population which is out of work.

45. The full-employment unemployment rate means an unemployment rate of about:

- A) 15 percent.
- B) 10 percent.
- C) 5 percent.
- D) 2 percent.
- E) 1 percent.
- 46. The official unemployment rate:
 - A) involves people over 16 years of age who are not currently seeking employment.
 - B) is the ratio of unemployed to employed workers.
 - C) is the percentage of the labor force that is unemployed.
 - D) is the percentage of the total population that is not working.
- 47. Suppose there are 5 million unemployed workers seeking jobs. After a period of time, 1 million of them become discouraged over their job prospects and cease to look for work. As a result of this, the official unemployment rate would:
 - A) increase in the short run but eventually decline.
 - B) increase.
 - C) decline.
 - D) be unchanged.
- 48. Eckstein has lost her job in a Massachusetts textile plant because of import competition. She intends to take a short course in electronics and move to California where she anticipates that a new job will be available. We can say that Eckstein is faced with:
 - A) secular unemployment.
 - B) cyclical unemployment.
 - C) structural unemployment.
 - D) frictional unemployment.
- 49. Cyclical unemployment results from:
 - A) a deficiency of aggregate spending.
 - B) the decreasing relative importance of goods and the increasing relative importance of services in the U.S. economy.
 - C) the everyday dynamics of a free labor market.

- D) technological change.
- 50. Which of the following is *correct*?
 - A) The unemployment rates of men and women workers are roughly the same.
 - B) Unemployment rates for black and white workers are approximately the same.
 - C) Teenagers experience approximately the same unemployment rates as do adults.
 - D) Laborers are less vulnerable to unemployment than are professional workers.
- 51. A college graduate using the summer following graduation to search for a job would best be classified as:
 - A) not officially a member of the labor force.
 - B) a part of structural unemployment.
 - C) a part of cyclical unemployment.
 - D) a part of frictional unemployment.
- 52. Unemployment involving a mismatch of the skills of unemployed workers and the skills required for available jobs is called:
 - A) frictional unemployment.
 - B) structural unemployment.C) cyclical unemployment.
 - D) compositional unemployment.
- 53. Structural unemployment:
 - A) is also known as frictional unemployment.
 - B) is the main component of cyclical unemployment.
 - C) is said to occur when people are waiting to be called back to previous jobs.
 - D) may involve a locational mismatch between unemployed workers and job openings.
- 54. Dr. Homer Simpson, an economics professor, decided to take a year off from teaching to run a commercial fishing boat in Alaska. That year, Professor Simpson would be officially counted as:
 - A) structurally unemployed.
 - B) frictionally unemployed.
 - C) not in the labor force.
 - D) employed.
- 55. When the U.S. economy has achieved "full employment," the unemployment rate is at or below:
 - A) 5 percent.
 - B) 4 percent.
 - C) 3 percent.
 - D) 2 percent.
- 56. Which of the following constitute the unemployment occurring at the natural rate of unemployment?
 - A) frictional and cyclical unemployment
 - B) structural and frictional unemployment
 - C) cyclical and structural unemployment
 - D) frictional, structural, and cyclical unemployment.
- 57. "Wait unemployment" and "search unemployment" are both types of:
 - A) cyclical unemployment.
 - B) hidden unemployment.

- C) frictional unemployment.
- D) structural unemployment.
- 58. The type of unemployment associated with recessions is called:
 - A) frictional unemployment.
 - B) structural unemployment.
 - C) cyclical unemployment.
 - D) seasonal unemployment.
- 59. Suppose there are 10 million part-time workers and 90 million full-time workers in an economy. Five million of the part-time workers switch to full-time work. As a result:
 - A) the official unemployment rate will fall.
 - B) the official unemployment rate will rise.
 - C) the official unemployment rate will remain unchanged.
 - D) the size of the labor force will increase.
- 60. Cyclical unemployment is also called:
 - A) wait unemployment.
 - B) search unemployment.
 - C) seasonal unemployment.
 - D) deficient-demand unemployment.
- 61. At the economy's natural rate of unemployment:
 - A) the economy achieves its potential output.
 - B) there is only a relatively small amount of cyclical unemployment.
 - C) only frictional unemployment exists.
 - D) only structural unemployment exists.
- 62. Search unemployment and wait unemployment are types of:
 - A) frictional unemployment.
 - B) structural unemployment.
 - C) deficient-demand unemployment.
 - D) cyclical unemployment.
- 63. In the depth of the Great Depression, the unemployment rate in the United States was about:
 - A) 15 percent.
 - B) 33 percent.
 - C) 25 percent.
 - D) 40 percent.

Use the following to answer questions 64-66:

Answer the next question(s) on the basis of the following information about a hypothetical economy:

Full-time employed = 80 Part-time employed = 25 Unemployed = 15 Discouraged workers = 5 Members of underground economy = 6 Consumer Price Index = 110

- 64. Refer to the above information. The unemployment rate is:
 - A) 18.8 percent.
 - B) 12.5 percent.
 - C) 16.7 percent.
 - D) 25 percent.
- 65. Refer to the above information. If the members of the underground economy are presently counted as part of the unemployed when in fact they are employed, the official unemployment rate is overstated by:
 - A) 0 percentage points.
 - B) 2 percentage points.
 - C) 5 percentage points.
 - D) 6 percentage points.
- 66. Refer to the above information. The rate of inflation:
 - A) is 110 percent.
 - B) is 10 percent.
 - C) is 0 percent.
 - D) cannot be determined from the data.

GDP gap; Okun's law

- 67. The GDP gap measures the:
 - A) difference between NDP and GDP.
 - B) amount by which potential GDP exceeds actual GDP.
 - C) amount by which actual GDP exceeds potential GDP.
 - D) amount by which nominal GDP exceeds real GDP.
- 68. A large GDP gap implies:
 - A) an excess of imports over exports.
 - B) a low rate of unemployment.
 - C) a high rate of unemployment.
 - D) a sharply rising price level.
- 69. The aggregate cost of unemployment can be measured by the:
 - A) amount by which actual GDP exceeds potential GDP.
 - B) amount by which potential GDP exceeds actual GDP.
 - C) excess of real GDP over nominal GDP.
 - D) excess of nominal GDP over real GDP.
- 70. If the U.S. unemployment rate is 9 percent, we can infer that:
 - A) the economy is in the expansion phase of the business cycle.
 - B) potential GDP is in excess of actual GDP.
 - C) actual GDP is in excess of potential GDP.
 - D) actual GDP is equal to potential GDP.
- 71. Assume the natural rate of unemployment in the U.S. economy is 5 percent and the actual rate of unemployment is 9 percent.

According to Okun's law, the GDP gap is:

- A) 4 percent.
- B) 8 percent.
- C) 10 percent.
- D) 2 percent.
- 72. The relationship between the size of the GDP gap and the unemployment rate is:
 - A) direct.
 - B) inverse.
 - C) undefined.
 - D) direct during recession, but inverse during expansion.
- 73. If actual GDP is less than potential GDP:
 - A) potential GDP will fall.
 - B) the price level will rise.
 - C) investment spending will fall.
 - D) the actual unemployment rate will be higher than the natural unemployment rate.
- 74. Full-employment output is also called:
 - A) zero-unemployment output.
 - B) equilibrium output.
 - C) potential output.
 - D) zero-savings output.

Use the following to answer questions 75-77:

Answer the next question(s) on the basis of the following information for a specific year in a hypothetical economy for which Okun's law is applicable:

Potential Real GDP = \$200 billion Natural rate of unemployment = 6 percent Actual rate of unemployment = 12 percent

- 75. The amount of output being forgone by the above economy is:
 - A) \$12 billion.
 - B) \$15 billion.
 - C) \$18 billion.
 - D) \$24 billion.
- 76. The size of the GDP gap in percentage terms for the above economy is:
 - A) 9 percent.
 - B) 12 percent.
 - C) 15 percent.
 - D) 18 percent.
- 77. If the unemployment rate in the above economy declined to 6 percent, we could conclude that:
 - A) only structural unemployment remained.
 - B) the economy's production possibilities curve shifted outward.
 - C) the economy had moved from a point inside its production possibilities curve to a point on or near the curve.
 - D) nominal GDP would rise but real GDP would fall.

78. Okun's law:

- A) measures the tradeoff between the rate of inflation and the rate of unemployment.
- B) indicates the number of years it will take for a constant rate of inflation to cause the price level to double.
- C) quantifies the relationship between nominal and real incomes.
- D) shows the relationship between the unemployment rate and the size of the GDP gap.
- 79. "For every 1 percentage point that the actual unemployment rate exceeds the natural rate, a 2 percentage point GDP gap occurs." This is a statement of:
 - A) Taylor's rule.
 - B) Okun's law.
 - C) Say's law.
 - D) the Coase theorem.

Inflation: measurement, rule of 70

- 80. Inflation means that:
 - A) all prices are rising, but at different rates.
 - B) all prices are rising and at the same rate.
 - C) prices in the aggregate are rising, although some particular prices may be falling.
 - D) real incomes are rising.
- 81. If the consumer price index falls from 120 to 116 in a particular year, the economy has experienced:
 - A) inflation of 4 percent.
 - B) inflation of 3.33 percent.
 - C) deflation of 3.33 percent.
 - D) deflation of 4 percent.
- 82. The consumer price index was 166.6 in 1999 and 172.2 in 2000. Therefore, the rate of inflation in 2000 was about:A) 6.7 percent.
 - B) 3.4 percent.
 - C) 1.2 percent.
 - D) 4.1 percent.
- 83. The *rate* of inflation can be found by subtracting:
 - A) the real income from the nominal income.
 - B) last year's price index from this year's price index.
 - C) this year's price index from last year's price index and dividing the difference by this year's price index.
 - D) last year's price index from this year's price index and dividing the difference by last year's price index.
- 84. If the Consumer Price index rises from 300 to 333 in a particular year, the rate of inflation in that year is:
 - A) 11 percent.
 - B) 33 percent.
 - C) 91 percent.
 - D) 10 percent.

^{85.} As applied to the price level, the "rule of 70" indicates that the number of years required for the price to double can be found

by:

- A) dividing "70" into the annual rate of inflation.
- B) dividing the annual rate of inflation into "70."
- C) subtracting the annual change in nominal incomes from "70."
- D) multiplying the annual rate of inflation by "70."
- 86. Between 1980 and 2000 the price level approximately doubled. The average annual rate of inflation over this 20-year period was about:
 - A) 5.5 percent.
 - B) 4.7 percent.
 - C) 3.5 percent.
 - D) 2.8 percent.
- 87. Given the annual rate of inflation, the "rule of 70" allows one to:
 - A) determine whether the inflation is demand-pull or cost-push.
 - B) calculate the accompanying rate of unemployment.
 - C) determine when the value of a real asset will approach zero.
 - D) calculate the number of years required for the price level to double.
- 88. If Ernie's annual real income rises by 8 percent each year, his annual real income will double in about:
 - A) 8-9 years.
 - B) 10-11 years.
 - C) 5-6 years.
 - D) 19-20 years.

89. If the rate of inflation is 12 percent per year, the price level will double in about:

- A) 4 years.
- B) 6 years.
- C) 10 years.
- D) 12 years.

Demand-pull and cost-push inflation

- 90. Demand-pull inflation:
 - A) occurs when prices of resources rise, pushing up costs and the price level.
 - B) occurs when total spending exceeds the economy's ability to provide output at the existing price level.
 - C) occurs only when the economy has reached its absolute production capacity.
 - D) is also called cost-push inflation.

91. Demand-pull inflation:

- A) can occur before the economy has reached its full-employment output.
- B) can occur only after the economy has reached its full-employment output.
- C) can be present even during an economic depression.
- D) is self limiting.
- 92. "Too much money chasing too few goods" best describes:
 - A) the GDP gap.
 - B) demand-pull inflation.

- C) the inflation premium.
- D) cost-push inflation.

Use the following to answer questions 93-98:



- 93. Refer to the above diagram. An increase in total demand in Range l will:
 - A) cause unemployment and deflation.
 - B) increase employment, output, and the price level.
 - C) increase employment and output, but not the price level.
 - D) increase the price level, but not employment and output.
- 94. Refer to the above diagram. In Range 2 an increase in total demand will:
 - A) cause unemployment and deflation.
 - B) cause employment to fall, but the price level to rise.
 - C) increase employment, output, and the price level.
 - D) increase employment and output, but not the price level.
- 95. Refer to the above diagram. In Range 3 an increase in total demand will:
 - A) cause unemployment and deflation.
 - B) increase employment, but reduce output and the price level.
 - C) increase employment and output, but not the price level.
 - D) increase the price level, but not employment and output.
- 96. Refer to the above diagram. If an increase in total demand occurs in Range 1:
 - A) one cannot predict what will happen to either nominal or real GDP.
 - B) real GDP will increase faster than nominal GDP.
 - C) nominal GDP will increase faster than real GDP.
 - D) the resulting increases in nominal GDP and real GDP will be equal.
- 97. Refer to the above diagram. If an increase in total demand occurs in Range 2:
 - A) the resulting increases in nominal GDP and real GDP will be equal.
 - B) nominal GDP will increase faster than real GDP.

- C) real GDP will increase faster than nominal GDP.
- D) one cannot predict what will happen to either nominal or real GDP.
- 98. Refer to the above diagram. If an increase in total demand occurs in Range 3:
 - A) the resulting increases in nominal and real GDP will be equal.
 - B) nominal GDP will increase, but real GDP will be constant.
 - C) real GDP will increase, but nominal GDP will be constant.
 - D) one cannot predict what will happen to either nominal or real GDP.
- 99. Unlike demand-pull inflation, cost-push inflation:
 - A) is self-limiting.
 - B) drives up the price level.
 - C) increases nominal income.
 - D) increases real income.
- 100. Inflation initiated by increases in wages or other resource prices is labeled:
 - A) demand-pull inflation.
 - B) demand-push inflation.
 - C) cost-push inflation.
 - D) cost-pull inflation.
- 101. Cost-push inflation:
 - A) is caused by excessive total spending.
 - B) shifts the nation's production possibilities curve leftward.
 - C) moves the economy inward from its production possibilities curve.
 - D) is a mixed blessing because it has positive effects on real output and employment.
- 102. Cost-push inflation may be caused by:
 - A) a decline in per unit production costs.
 - B) a decrease in wage rates.
 - C) a negative supply shock.
 - D) an increase in resource availability.

Nominal versus real income

- 103. Which of the following formulas is correct? Percentage change in:
 - A) price level approximates percentage change in real income minus percentage change in nominal income.
 - B) real income *approximates* percentage change in nominal income *minus* percentage change in price level.
 - C) nominal income *approximates* percentage change in price level *minus* percentage change in real income.
 - D) real income approximates percentage change in price level minus percentage change in nominal income.
- 104. Real income can be determined by:
 - A) dividing the price level by nominal income.
 - B) inflating nominal income for inflation.
 - C) dividing the annual rate of inflation into the number "70."
 - D) deflating nominal income for inflation.

- 105. Suppose that a person's nominal income rises from \$10,000 to \$12,000 and the consumer price index rises from 100 to 105. The person's real income will:
 - A) fall by about 20 percent.
 - B) fall by about 2 percent.
 - C) rise by about 15 percent.
 - D) rise by about 25 percent.
- 106. Recently a labor union argued that the standard of living of its members was falling. A critic of the union argued that this could not possibly be true because the union had been acquiring significant increases in the nominal incomes of its members through collective bargaining. Is the critic correct?
 - A) Yes, because when you have a large nominal income your standard of living automatically increases.
 - B) No, because real income may fall if price increases are more proportionately than the increase in nominal income.
 - C) No, because real income may fall if price increases are less proportionately than the increases in nominal income.
 - D) Yes, because real income may fall if price increases are less proportionately than the increases in nominal income.
- 107. Suppose that a person's nominal income rises by 5 percent and the price level rises from 125 to 130. The person's real income will:
 - A) fall by about 1 percent.
 - B) remain constant.
 - C) rise by about 4 percent.
 - D) rise by about 1 percent.
- 108. In 2000 Ortega's nominal income rose by 6.5 percent and the price level rose by 3.5 percent. We can conclude that Ortega's real income:
 - A) may have either increased or decreased.
 - B) rose by 13 percent.
 - C) rose by 3 percent.
 - D) fell by 13 percent.
- 109. Which of the following is *correct*?
 - A) Real and nominal incomes always move in the same direction.
 - B) Inflation increases the purchasing power of the dollar and necessarily reduces one's nominal income.
 - C) Inflation reduces the purchasing power of the dollar and necessarily reduces one's real income.
 - D) Inflation reduces the purchasing power of the dollar, but does not necessarily reduce one's real income.

Inflation effects

- 110. Cost-of-living adjustment clauses (COLAs):
 - A) invalidate the "rule of 70."
 - B) apply only to demand-pull inflation.
 - C) increase the gap between nominal and real income.
 - D) tie wage increases to changes in the price level.
- 111. During a period of hyperinflation:
 - A) creditors gain because their loans are repaid with dollars of higher value.
 - B) people tend to hold goods rather than money.
 - C) income is redistributed away from borrowers.
 - D) the real value of the national currency rises.

- 112. Inflation is undesirable because it:
 - A) arbitrarily redistributes real income and wealth.
 - B) invariably leads to hyperinflation.
 - C) usually is accompanied by declining real GDP.
 - D) reduces everyone's standard of living.
- 113. Who is *least* likely to be hurt by unanticipated inflation?
 - A) a disabled laborer who is living off accumulated savings
 - B) an owner of a small business
 - C) a secretary
 - D) a pensioned steelworker
- 114. Which of the following statements is *correct?* Unanticipated inflation:
 - A) arbitrarily "taxes" fixed-income groups.
 - B) increases the real value of savings.
 - C) increases the purchasing power of the dollar.
 - D) benefits creditors at the expense of debtors.
- 115. A lender need not be penalized by inflation if the:
 - A) long-term rate of inflation is less than the short-term rate of inflation.
 - B) short-term rate of inflation is less than the long-term rate of inflation.
 - C) lender correctly anticipates inflation and increases the nominal interest rate accordingly.
 - D) inflation is unanticipated by both borrower and lender.
- 116. Unanticipated inflation:
 - A) reduces the real burden of the public debt to the Federal government.
 - B) hurts borrowers and helps lenders.
 - C) hurts people whose sole source of income is from social security benefits.
 - D) helps savers.
- 117. Inflation affects:
 - A) both the level and the distribution of income.
 - B) neither the level nor the distribution of income.
 - C) the distribution, but not the level, of income.
 - D) the level, but not the distribution, of income.
- 118. If the nominal interest rate is 12 percent and the real interest rate is 8 percent, then the inflation premium is:
 - A) 8 percent.
 - B) 12 percent.
 - C) 4 percent.
 - D) 20 percent.
- 119. If both the real interest rate and the nominal interest rate are 3 percent, then the:
 - A) inflation premium is zero.
 - B) real GDP must exceed the nominal GDP.
 - C) nominal GDP must exceed real GDP.
 - D) inflation premium also is 3 percent.

- 120. Suppose the *nominal* annual interest rate on a two year loan is 16 percent and lenders expect inflation to be 10 percent in each of the two years. The annual *real* rate of interest is:
 - A) 12 percent.
 - B) 16 percent.
 - C) 4 percent.
 - D) 6 percent.

Last Word Questions

- 121. (Last Word) Which of the following statements is *false*?
 - A) Stock prices are one clue as to the future direction of the economy.
 - B) Research has shown that changes in stock prices have a relatively modest impact on the economy.
 - C) Black Monday (1987) was followed immediately by a severe recession.
 - D) A rise in stock prices increases consumer wealth and therefore boosts consumption spending slightly.
- 122. (Last Word) Declines in stock prices measured by the Dow Jones average:
 - A) are a major cause of recessions.
 - B) usually reduce saving and increase consumption spending.
 - C) usually increase investment and reduce net exports.
 - D) sometimes precede recessions; sometimes do not.
- 123. (Last Word) Changes in stock market prices:
 - A) do not greatly impact the macroeconomy and alone are not reliable predictors of the future health of the economy.
 - B) greatly impact the macroeconomy but alone are not reliable predictors of the future health of the economy.
 - C) greatly impact the macroeconomy and alone are reliable predictors of the future health of the economy.
 - D) do not greatly impact the macroeconomy but alone are reliable predictors of the future health of the economy.
- 124. (Last Word) A burst stock market bubble might adversely affect the economy by:
 - A) causing rapid inflation.
 - B) greatly reducing net exports.
 - C) causing a negative wealth effect and engendering pessimism about the economy's future.
 - D) raising interest rates.

True/False Questions

- 125. If real GDP is \$300 billion in year 1 and \$312 billion in year 2, the growth rate between the two years is 4 percent.
- 126. Between 1992 and 2000, real GDP per capita increased more rapidly than real GDP in the United States.
- 127. About two-thirds of U.S. economic growth derives from more inputs and one-third derives from greater productivity of inputs.
- 128. The production of durable goods is more stable than the production of nondurables over the business cycle.

- 129. Unanticipated inflation benefits debtors at the expense of creditors.
- 130. If the price level doubles in a 23-year period, we can conclude that the average annual rate of inflation over that period was about 3 percent.
- 131. The business cycle is so named because upswings and downswings in business activity are equal in terms of duration and intensity.
- 132. People who work part time, but desire to work full time, are considered to be officially unemployed.
- 133. The natural rate of unemployment in the United States is about 5 percent.
- 134. An annual rate of inflation of 7 percent will double the price level in about 15 years.
- 135. Unanticipated inflation benefits some groups in the economy.
- 136. If the nominal interest rate is 8 percent and the real interest rate is 5 percent, then the inflation premium is 13 percent.
- 137. During the past ten years the U.S. economy has experience three recessions.
- 138. During the past ten years the annual rate of inflation in the United States has averaged less than 1 percent.
- 139. During recent years the U.S. unemployment rate has been higher than the rate in most of the other major industrial nations.