

Name: _____
Honor Pledge Signature: _____
Section: _____

Multiple Choice Questions

1: Multiple Choice

If you invest \$10,000 in a bond that earns 8% interest per year, how many years will it take to double your money?

- (a) 1 year and 3 months
- (b) 2 years and 6 months
- (c) 8 years
- (d) 8 years and 9 months

2: Multiple Choice

Under which of the following circumstances would the government be running a deficit?

- (a) $G = \$5 \text{ trillion}$, $T = \$5 \text{ trillion}$, $TR = \$1 \text{ trillion}$
- (b) $G = \$5 \text{ trillion}$, $T = \$7 \text{ trillion}$, $TR = \$1 \text{ trillion}$
- (c) $G = \$7 \text{ trillion}$, $T = \$7 \text{ trillion}$, $TR = \$0$
- (d) $G = \$7 \text{ trillion}$, $T = \$10 \text{ trillion}$, $TR = \$3 \text{ trillion}$

3: Multiple Choice

The response of investment spending to an increase in the government budget deficit is called

- (a) expansionary investment.
- (b) private dissaving.
- (c) crowding out.
- (d) income minus net taxes.

4: Multiple Choice

A financial intermediary's main function is to match _____ with excess funds to _____ with a shortage of funds.

- (a) **savers; borrower**
- (b) borrower; savers
- (c) governments; households
- (d) firms; insurance companies

5: Multiple Choice

Which of the following correctly describes the automatic mechanism through which the economy adjusts to long-run equilibrium?

- (a) the leftward shift of the short-run aggregate supply curve that occurs after a recession.
- (b) **the rightward shift of the short-run aggregate supply curve that occurs after a recession**
- (c) the leftward shift of the aggregate demand curve that occurs after a recession.
- (d) the rightward shift of the aggregate demand curve that occurs after a recession.

6: Multiple Choice

Suppose the economy is at full employment and firms become more pessimistic about the future profitability of new investment. Which of the following will happen in the short run?

- (a) Output will rise.
- (b) Prices will rise.
- (c) **Unemployment will rise.**
- (d) The aggregate demand curve will shift to the right.

7: Multiple Choice

_____ of unemployment during _____ make it easier for workers to _____ wages.

- (a) High levels; a recession; negotiate higher.
- (b) **Low levels; an expansion; negotiate higher.**
- (c) Low levels; a recession; accept lower.
- (d) High levels; an expansion; accept lower.

8: Multiple Choice

Hurricane Katrina destroyed oil and natural gas refining capacity in the Gulf of Mexico. This subsequently drove up natural gas, gasoline, and heating oil prices. As a result, this should

- (a) **shift the short-run aggregate supply curve to the left.**
- (b) shift the short-run aggregate supply curve to the right.
- (c) move the economy up along a stationary short-run aggregate supply curve.
- (d) move the economy down along a stationary short-run aggregate supply curve.

9: Multiple Choice

If real GDP grows by 3% in 2011, 3.2% in 2012, and 2.5% in 2013, what is the average annual growth rate of real GDP?

- (a) 2.6%
- (b) **2.9%**
- (c) 3.1%
- (d) 4.2%

10: Multiple Choice

The demand for loanable funds is downward sloping because the _____ the interest rate, the _____ the number of profitable investment projects a firm can undertake, and the _____ the quantity demanded of loanable funds.

- (a) lower; greater; greater
- (b) lower; smaller; greater
- (c) greater; greater; greater
- (d) greater; smaller; greater

11: Multiple Choice

In comparison to a government that runs a balanced budget, when the government runs a budget deficit

- (a) the equilibrium interest rate will fall.
- (b) business investment will fall.
- (c) household savings will fall.
- (d) none of the above

12: Multiple Choice

Purchases of baby diapers should

- (a) remain fairly constant over the business cycle.
- (b) increase in recessions and decrease in expansions.
- (c) decrease in recessions and increase in expansions.
- (d) increase in recessions and remain constant in expansions.

13: Multiple Choice

Inflation tends to _____ during the expansion phase of the business cycle and _____ during the recession phase of the business cycle.

- (a) increase; decrease
- (b) decrease; increase
- (c) decrease; decrease further
- (d) increase; increase further

14: Multiple Choice

When the price level in the United States falls relative to the price level of other countries, _____ will fall, _____ will rise, and _____ will rise.

- (a) imports; exports; net exports
- (b) exports; imports; net exports
- (c) net exports; exports; imports
- (d) net exports; imports; exports

15: Multiple Choice

German luxury car exports were hurt in 2009 as a result of the recession. How would this decrease in exports have affected Germany's aggregate demand curve?

- (a) The aggregate demand curve would have shifted to the right.
- (b) The aggregate demand curve would not have shifted, but there would have been a movement up the aggregate demand curve.
- (c) The aggregate demand curve would not have shifted, but there would have been a movement down the aggregate demand curve.
- (d) The aggregate demand curve would have shifted to the left.

Short Answer Question

1: Short Answer (40 points)

Answer the following two subquestions. **State any assumptions that you make.**

- (a) Using equations for public and private saving, show that saving must equal investment in a closed economy. Hint: begin with the expression for total saving in the economy. (20 points)

See class notes or textbook pages 448-449.

- (b) Explain how unemployment changes over the business cycle. Why do these changes occur? (20 points)

Unemployment will fall during an expansion and rise during a recession. When the economy begins slowing down during a recession, firms cut back on production and workers get laid off. But it doesn't stop there. The unemployment rate typically rises even after the end of the recession. This happens for a couple of different reasons. First, it reflects the behavior of discouraged workers. When the economy goes into recession, the number of discouraged workers rises. When a discouraged worker drops out of the labor force, this actually lowers the unemployment rate. During the recession, the unemployment rate does not rise as much as it would if we counted discouraged workers as unemployed. When the recovery begins, these former discouraged workers enter back into the labor force and start searching for work again. This influx of people without jobs into the labor force raises the unemployment rate. Second, firms are reluctant to start adding back workers when the recovery begins to take hold. They are cautious and want to be sure that the recession is over. They work their workers overtime rather than add new workers. Both these effects, discouraged workers re-entering the labor market and firm's reluctance to hire in the early part of a recovery, contribute to keeping the unemployment rate high.

Extra Credit Question

Extra Credit: (5 points)

In the aggregate demand framework, what is the wealth effect?

See textbook page 473.