Econ 375
Sample Exam 3 Questions

1. Some firms do not instantly adjust the prices they charge in response to changes in demand for *all* of the following reasons *except*:
   A) it is costly to alter prices.
   B) they do not want to annoy their frequent customers.
   C) prices do not adjust when there is perfect competition.
   D) some prices are set by long-term contracts between firms and customers.

2. According to the sticky-price model, output will be at the natural level if:
   A) firms expect a high price level and the demand for goods is high.
   B) the proportion of firms with flexible prices equals the proportion of firms with sticky prices.
   C) the price level equals the expected price level.
   D) expectations are formed adaptively, but not if expectations are formed rationally.

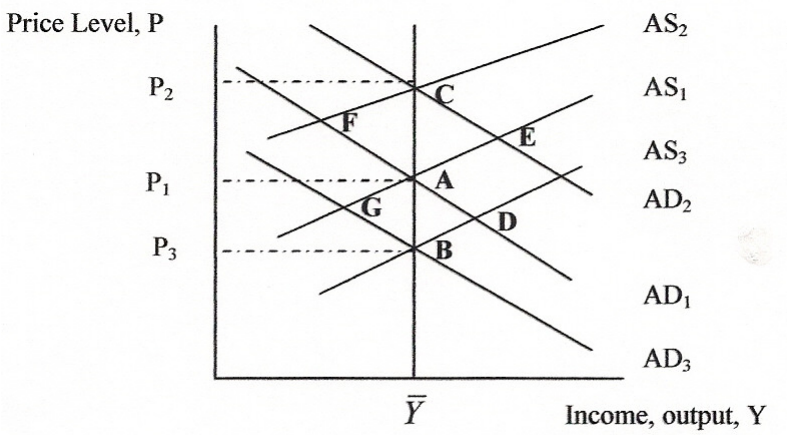
3. The imperfect-information model assumes that producers find it difficult to distinguish between changes in:
   A) real wages and nominal wages.
   B) the overall level of prices and relative prices.
   C) nominal wages and average wages.
   D) cost-push inflation and demand-pull inflation.

4. Starting from the natural level of output, an unexpected monetary contraction will cause output and the price level to _____ in the short run, and in the long run the expected price level will _____, causing the level of output to return to the natural level.
   A) increase; increase
   B) increase; decrease
   C) decrease; decrease
   D) decrease; increase

5. Along any aggregate supply curve, there is only one:
   A) unemployment level.
   B) expected price level.
   C) inflation level.
   D) output level.

6. According to the Phillips curve, other things being equal, inflation depends <u>positively</u> on *all* of the following *except*:
   A) expected inflation.
   B) the unemployment rate.
   C) the natural unemployment rate.
   D) a supply shock, if one occurs.

7. If the equation for a country's Phillips curve is $\pi = .02 - .8(u - .05)$, where π is the rate of inflation and u is the unemployment rate, what is the short-run inflation rate when unemployment is 4 percent (.04)?
   A) above 2 percent (.02)
   B) below 2 percent (.02)
   C) 2 percent (.02)
   D) –2 percent (–.02)



8. Starting from long-run equilibrium at A with output equal to $\bar{Y}$ and the price level equal to P_1, if there is an unexpected monetary contraction that shifts aggregate demand from AD_1 to AD_3, then the short-run non-neutrality of money is represented by the movement from:
   A) A to B
   B) A to G
   C) A to C
   D) A to D

9. Starting from long-run equilibrium at A with output equal to $\bar{Y}$ and the price level equal to P_1, if there is an unexpected monetary contraction that shifts aggregate demand from AD_1 to AD_3, then the long-run neutrality of money is represented by the movement from:
   A) A to B
   B) A to G
   C) A to C
   D) A to D

10. The most prominent feature of the U.S. economy in the 1970s was:
   A) demand deflation.
   B) demand inflation.
   C) cost-push deflation.
   D) cost-push inflation.

11. Assume that the sacrifice ratio for an economy is 4. If the central bank wishes to reduce inflation from 10 percent to 5 percent, this will cost the economy _____ percent of one year's GDP.
   A) 4
   B) 5
   C) 20
   D) 40

12. The idea that the natural rate of unemployment is increased following extended periods of unemployment is called:
   A) Okun's law.
   B) the cold-turkey approach.
   C) the natural-rate hypothesis.
   D) hysteresis.

13. Economists who view the economy as inherently unstable generally argue that:
   A) stabilization policy is too dangerous to be used.
   B) the economy should be stimulated when it is depressed and slowed when it is overheated.
   C) the economy should be slowed when it is depressed and stimulated when it is overheated.
   D) monetary and fiscal policies should follow rigid rules of constant growth.

14. Arguments in favor of active economic policy include *all* of the following *except*:
    A) failing to use monetary and fiscal policy leads to inefficient fluctuations in output and employment.
    B) the Great Depression could have been avoided if the Federal Reserve had pursued a policy of steady money growth.
    C) fluctuations in real GDP have been less severe following World War II than prior to World War I.
    D) failure of policymakers to respond to large contractionary shocks to private spending caused the Great Depression.

15. The outside lag is the time:
    A) before automatic stabilizers respond to economic activity.
    B) when automatic stabilizers are not effective.
    C) between a shock to the economy and the policy action responding to the shock.
    D) between a policy action and its influence on the economy.

16. Which of the following is an example of a fiscal policy that has no inside lag?
    A) a decrease in income tax rates
    B) an ongoing unemployment insurance program
    C) an increase in government spending for job training
    D) a reduction in the age at which people become eligible for retirement benefits

17. The Lucas critique argues that because the way people form expectations is based _____ on government policies, economists _____ predict the effect of a change in policy without taking changing expectations into account.
    A) partly; cannot
    B) only partly; can
    C) in no way; can
    D) in no way; cannot

18. Conducting fiscal policy so that $G = T + \beta\ (u - u_n)$, where G is government expenditures, T is tax revenue, u is the unemployment rate, u_n is the natural rate of unemployment, and β is a positive number, is an example of a(n):
    A) active rule.
    B) passive rule.
    C) discretionary policy.
    D) automatic stabilizer.

19. The manipulation of the economy to win elections is called:
    A) discretionary monetary policy.
    B) discretionary fiscal policy.
    C) the political business cycle.
    D) an automatic stabilizer.

20. Economic research finds that greater central-bank independence is _____ correlated with lower and more stable inflation as well as _____ correlated with the average growth and variability of real GDP.
    A) strongly; strongly
    B) strongly; not
    C) not; strongly
    D) not; not

21. Historically, the primary cause of increases in government debt is:
    A) printing too much money.
    B) cutting taxes.
    C) increasing interest rates.
    D) financing wars.

22. If government debt is not changing, then:
    A) the economy is at long-run equilibrium.
    B) the government's budget must be balanced.
    C) GDP must equal the natural rate of output.
    D) capital per worker is constant.

23. In a time of inflation when the real (i.e., deflated) value of the government debt is constant, then the conventionally:
    A) reported government budget will show a deficit equal to the inflation rate times the outstanding debt.
    B) reported government budget will show a deficit equal to less than the inflation rate times the outstanding debt.
    C) reported government budget will be balanced.
    D) measured government budget will show a surplus equal to the inflation rate times the outstanding debt.

24. If the preferred bank stock acquired by the U.S. government through the TARP program is valued using a capital budgeting approach, then the government budget deficit in the year in which the stocks is acquired will be _____ than if a current expenditure approach were employed.
    A) Larger
    B) Smaller
    C) No different
    D) More cyclical

25. According to the traditional view, if taxes are cut without cutting government spending, then the short-run effects will be:
    A) higher output and lower unemployment.
    B) higher output and higher unemployment.
    C) no change in output or unemployment.
    D) no change in output and higher unemployment.

26. Ricardian equivalence refers to the same impact of financing government:
    A) whether by printing money or raising taxes.
    B) in the long run as in the short run.
    C) whether by debt or taxes.
    D) in an open economy as in a closed economy.

27. In response to a tax cut, the consumption of a consumer who is borrowing-constrained _____, whereas the consumption of a forward-looking unconstrained consumer acting in accord with Ricardian equivalence _____.
    A) increases; increases
    B) increases; remains unchanged
    C) remains unchanged; remains unchanged
    D) remains unchanged; increases

28. If the government levies a one-time temporary tax on the young and gives the proceeds to the elderly, and both generations follow the life-cycle consumption pattern and are altruistically linked:
    A) both the young and the old will consume more.
    B) there will be a net increase in overall consumption.
    C) there will be a net decrease in overall consumption.
    D) there will be no change in overall consumption.

29. If the government levies a one-time temporary tax on the young and gives the proceeds to the elderly, and both generations follow the life-cycle consumption pattern but are *not* altruistically linked:
    A) both the young and the old will consume more.
    B) there will be a net increase in overall consumption.
    C) there will be a net decrease in overall consumption.
    D) there will be no change in overall consumption.