Problem Set 3

Due: Monday, July 21, 2008

Total Points 50 (1 point each question)

Please print out and turn in only this page. Make sure that you give an answer to a correct question number.

There are 50 multiple-choice questions, 12 pages. Identify the choice that best completes the statement or answers the question.

1. _____ 2. _____ 3. _____ 4. _____ 5. _____
26. _____ 27. _____ 28. _____ 29. _____ 30. _____
31. _____ 32. _____ 33. _____ 34. _____ 35. _____
36. _____ 37. _____ 38. _____ 39. _____ 40. _____
41. _____ 42. _____ 43. _____ 44. _____ 45. _____
46. _____ 47. _____ 48. _____ 49. _____ 50. _____

Name: ____________________________________
1. Essentially, gross domestic product measures
   a. the savings of all households in an economy.
   b. the profits earned by all firms in an economy.
   c. the wages that everyone in an economy earns.
   d. the total income that everyone in an economy earns.

2. When we refer to “intangible” items, we are referring to such things as
   a. illegal goods, and the value of such items is included in GDP.
   b. illegal goods, and the value of such items is excluded from GDP.
   c. consulting services and dental care, and the value of such items is included in GDP.
   d. consulting services and dental care, and the value of such items is excluded from GDP.

3. What word do we use to refer to the purchase of goods that will be used in the future to produce more goods and services?
   a. investment
   b. consumption
   c. expenditure on durable goods
   d. non-consumption expenditure

4. Gross domestic product includes all
   a. goods, but it excludes all services.
   b. goods, but it excludes the housing services provided by the economy’s stock of housing.
   c. legal goods, but it excludes illegal goods.
   d. goods, including those that are illegal.

5. Transfer payments
   a. are payments that flow from government to households.
   b. are not made in exchange for currently produced goods or services.
   c. alter household income, but they do not reflect the economy’s production.
   d. All of the above are correct.
6. Consider the following three items of spending by the government: (1) The federal government pays a $500 unemployment benefit to an unemployed person; (2) the federal government makes a $2,000 salary payment to a Navy lieutenant; (3) the city of Bozeman, Montana makes a $10,000 payment to ABC Lighting Company for street lights in Bozeman. Which of these payments contributes directly to government purchases in the national income accounts?
   a. only item (1)
   b. only item (2)
   c. only items (1) and (2)
   d. only items (2) and (3)

Table 23-1. The table applies to a hypothetical economy that produces only computers and DVD players.

<table>
<thead>
<tr>
<th>Year</th>
<th>Price of Computers</th>
<th>Quantity of Computers</th>
<th>Price of DVD Players</th>
<th>Quantity of DVD Players</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>$900</td>
<td>90</td>
<td>$200</td>
<td>300</td>
</tr>
<tr>
<td>2007</td>
<td>$875</td>
<td>120</td>
<td>$220</td>
<td>360</td>
</tr>
<tr>
<td>2008</td>
<td>$825</td>
<td>140</td>
<td>$250</td>
<td>x</td>
</tr>
</tbody>
</table>

7. Refer to Table 23-1. Using 2006 as the base year, the GDP deflator
   a. decreased by 4.67 percent between 2006 and 2007.
   b. decreased by 3.44 percent between 2006 and 2007.
   c. increased by 2.33 percent between 2006 and 2007.
   d. increased by 4.67 percent between 2006 and 2007.

8. Two alternative measures of the overall level of prices are
   a. the inflation rate and the consumer price index.
   b. the inflation rate and the GDP deflator.
   c. the GDP deflator and the consumer price index.
   d. the cost of living index and nominal GDP.

9. The consumer price index (CPI) is a measure of the overall cost of the goods and services bought by
   a. a typical consumer, and the CPI is computed and reported by the Department of the Treasury.
   b. typical consumers and typical business firms, and the CPI is computed and reported by the Department of the Treasury.
   c. a typical consumer, and the CPI is computed and reported by the Bureau of Labor Statistics.
   d. typical consumers and typical business firms, and the CPI is computed and reported by the Bureau of Labor Statistics.
10. Suppose a basket of goods and services has been selected to calculate the consumer price index (CPI), and 2002 has been selected as the base year. In 2002, the basket’s cost was $50; in 2004, the basket’s cost was $52; and in 2006, the basket’s cost was $54.60. The value of the CPI in 2006 was
a. 102.60.
b. 105.00.
c. 109.20.
d. 154.60.

11. For an imaginary economy, the consumer price index was 80 in 2004, 100 in 2005, and 110 in 2006. The base year must be
c. 2006.
d. The base year cannot be determined from the given information.

12. The price index that measures the cost of a basket of goods and services bought by firms is called the
a. industrial price index.
b. producer price index.
c. core price index.
d. GDP deflator.

13. The consumer price index (CPI) differs from the GDP deflator in that
a. the CPI is a price index, while the GDP deflator is an inflation index.
b. Substitution bias is not a problem with the CPI, but it is a problem with the GDP deflator.
c. increases in the prices of foreign-made goods that are sold to U.S. consumers show up in the CPI but not in the GDP deflator.
d. increases in the prices of domestically-produced goods that are sold to the U.S. government show up in the CPI but not in the GDP deflator.

14. David earned a salary of $75,000 in 2001 and $95,000 in 2006. The consumer price index was 177 for 2001 and 266 for 2006. David’s 2006 salary in 2001 dollars is about
a. $112,712.
b. $90,234.
c. $74,818.
d. $63,214.
15. You are told that Country A experienced growth of real GDP per person of 4 percent per year throughout the 1900s. In view of other countries’ experience, you would have to characterize Country A’s growth as
   a. exceptionally high.
   b. moderately high.
   c. moderately low.
   d. exceptionally low.

16. In determining living standards, productivity plays a key role
   a. for individuals, but not for nations.
   b. for nations, but not for individuals.
   c. for both nations and individuals.
   d. for neither nations nor individuals.

17. The quantity of goods and services produced from each unit of labor input is called
   a. standard of living.
   b. productivity.
   c. capitalized quantity.
   d. the knowledge base.

18. What term do economists use to describe the relationship between the quantity of inputs used and the quantity of output produced?
   a. production function
   b. input function
   c. capital function
   d. returns to scale

19. Which of the following terms is used to refer to the ability of people to exercise authority over the resources they own?
   a. natural rights
   b. property rights
   c. input control
   d. collective control
Figure 25-1. On the horizontal axis, $K/L$ represents capital ($K$) per worker ($L$). On the vertical axis, $Y/L$ represents output ($Y$) per worker ($L$).

20. Refer to Figure 25-1. The curve becomes flatter as the amount of capital per worker increases because of
   a. increasing returns to capital.
   b. increasing returns to labor.
   c. diminishing returns to capital.
   d. diminishing returns to labor.

21. In a particular production process, if the quantities of all inputs used are increased by 60 percent, then the quantity of output increases by 60 percent as well. This means that
   a. the production process cannot be enhanced by technological advances.
   b. no mathematical representation of the relevant production function can be formulated.
   c. the relevant production function has the limits-to-growth property.
   d. the relevant production function has the constant-returns-to-scale property.

22. Industrial machinery is an example of
   a. a factor of production that in the past was an output from the production process.
   b. technological knowledge.
   c. a production function.
   d. All of the above are correct.
23. Which of the following statements about inputs is correct?
   a. Inputs into the production of human capital include teachers and books.
   b. There is no distinction between human capital and technological knowledge.
   c. Oil is an example of a natural resource; it is also an example of a renewable resource.
   d. Physical capital is a non-produced factor of production.

24. Investment in
   a. physical capital, unlike investment in human capital, has an opportunity cost.
   b. physical capital, like investment in human capital, has an opportunity cost.
   c. human capital is particularly attractive because it involves no externalities.
   d. human capital has been shown to be relatively unimportant, relative to investment in physical capital, for a country’s long-run economic success.

25. Countries that pursued outward-oriented policies in the 20th century
   a. experienced lower rates of economic growth than did countries that pursued inward-oriented policies.
   b. experienced higher levels of political instability than did countries that pursued inward-oriented policies.
   c. include Singapore, South Korea, and Taiwan.
   d. All of the above are correct.

26. Rapid population growth
   a. was hailed by Thomas Robert Malthus as the key to future economic growth.
   b. tends to lead to higher levels of educational attainment.
   c. is the main reason that less developed nations are poor.
   d. may depress economic prosperity by reducing the amount of capital which each worker has to work with.

27. At the broadest level, the financial system moves the economy’s scarce resources from
   a. the rich to the poor.
   b. financial institutions to business firms and government.
   c. households to financial institutions.
   d. savers to borrowers.

28. If a firm sells a total of 100 shares of stock, then
   a. each share represents 1 percent of the firm’s indebtedness.
   b. each share represents ownership of 1 percent of the firm.
   c. the firm is engaging in debt finance.
   d. the firm is engaging in term finance.
29. In the market for loanable funds, the interaction of the demand for, and supply of, loanable funds determines the equilibrium level of
   a. the inflation rate.
   b. gross domestic product.
   c. the real interest rate.
   d. the nominal interest rate.

**Figure 26-1.** The figure depicts a demand-for-loanable-funds curve and two supply-of-loanable-funds curves.

30. Refer to Figure 26-1. What is measured along the vertical axis of the graph?
   a. the nominal interest rate
   b. the real interest rate
   c. the quantity of investment
   d. the quantity of saving

**Figure 26-2.** The figure depicts a supply-of-loanable-funds curve and two demand-for-loanable-funds curves.
31. Refer to Figure 26-2. What is measured along the horizontal axis of the graph?
   a. the quantity of loanable funds
   b. the size of the government budget deficit or surplus
   c. the real interest rate
   d. the nominal interest rate

32. Refer to Figure 26-2. Which of the following events would shift the demand curve from D1 to D2?
   a. The government goes from running a budget deficit to running a budget surplus.
   b. Firms become optimistic about the future and, as a result, they plan to increase their purchases of new equipment and construction of new factories.
   c. A change in the tax laws encourages people to consume less and save more.
   d. A change in the tax laws encourages people to consume more and save less.

33. Long-term bonds are
   a. riskier than short-term bonds, and so interest rates on long-term bonds are usually lower than interest rates on short-term bonds.
   b. riskier than short-term bonds, and so interest rates on long-term bonds are usually higher than interest rates on short-term bonds.
   c. less risky than short-term bonds, and so interest rates on long-term bonds are usually lower than interest rates on short-term bonds.
   d. less risky than short-term bonds, and so interest rates on long-term bonds are usually higher than interest rates on short-term bonds.

34. Potential buyers of ABC Corporation bonds are not concerned about ABC Corporation declaring bankruptcy. Potential buyers of XYZ Corporation bonds are concerned that XYZ Corporation may declare bankruptcy. Then which of the following statements is correct?
   a. Other things equal, the interest rate on XYZ Corporation bonds will be high relative to the interest rate on ABC Corporation bonds.
   b. An ABC Corporation bond is a perpetuity, whereas an XYZ Corporation bond is not a perpetuity.
   c. XYZ Corporation bonds carry more interest-rate risk than do ABC Corporation bonds.
   d. All of the above are correct.

35. Compared to stocks, bonds offer the holder
   a. lower risk and lower potential return.
   b. lower risk and higher potential return.
   c. higher risk and lower potential return.
   d. higher risk and higher potential return.
36. The bond market
   a. is a financial market, whereas the stock market is a financial intermediary.
   b. is a financial intermediary, whereas the stock market is a financial market.
   c. is a financial market, as is the stock market.
   d. is a financial intermediary, as is the stock market.

37. Which of the following statements about mutual funds is correct?
   a. A mutual fund is a financial intermediary.
   b. A mutual fund acquires its funds primarily by selling shares to the public.
   c. People who buy shares from a mutual fund accept all of the risk and return associated with the mutual fund’s portfolio.
   d. All of the above are correct.

Scenario 26-1. Assume the following information for an imaginary, closed economy.
   GDP = $110,000; consumption = $70,000; private saving = $8,000; national saving = $12,000.

38. Refer to Scenario 26-1. This economy’s government is running a
   a. budget surplus of $4,000.
   b. budget surplus of $8,000.
   c. budget deficit of $4,000.
   d. budget deficit of $8,000.

39. The Bureau of Labor Statistics classifies a person as employed if he or she
   a. has a job but is temporarily absent from the job.
   b. is self-employed.
   c. works without pay in a family member’s business.
   d. All of the above are correct.

40. The labor force consists of
   a. only those people who are classified as employed.
   b. only those people who are classified as employed or unemployed.
   c. only those people who are classified as employed or unemployed or are full-time students.
   d. the entire adult population.
41. In the United States since about 1950, the labor-force participation rate for women has
   a. increased slightly, and for men the labor-force participation rate has remained
      about constant.
   b. remained about constant, and for men the labor-force participation rate has
      decreased significantly.
   c. increased significantly, and for men the labor-force participation rate has decreased
      slightly.
   d. increased significantly, as has the labor-force participation rate for men.

42. Evidence provided by economists indicates that the typical person who becomes
   unemployed
   a. will soon find a job.
   b. will find a job, but not before a year or more has gone by.
   c. will leave the labor force and never return.
   d. does so due to retirement.

43. The Bureau of Labor Statistics classifies a person as employed if he or she
   a. is without a job, but is available for work, and has tried to find a job during the
      previous four weeks.
   b. works without pay in a family member’s business.
   c. has been laid off from a job and is waiting to be recalled to the job.
   d. All of the above are correct.

**Scenario 28-1.** In an imaginary economy there are 20,000 adults. Of these adults:
   8,000 are paid employees;
   1,600 work in their own business;
   1,000 work as unpaid workers in a family member’s business;
   1,400 do not have a job, are available for work, and have tried to
   find a job within the past four weeks;
   780 do not have a job, are available for work, but have not tried to
   find a job within the past four weeks;
   3,000 are full-time students;
   4,220 are homemakers or retirees.

44. Refer to Scenario 28-1. Using the U.S. Bureau of Labor Statistics definitions, how many
   people in this economy are employed?
   a. 9,600
   b. 10,600
   c. 11,820
   d. 13,600
45. Refer to Scenario 28-1. Using the U.S. Bureau of Labor Statistics definitions, how many people in this economy are in the labor force?
   a. 9,600
   b. 12,000
   c. 12,780
   d. 15,780

46. If the natural rate of unemployment is 5.2 percent and if the actual unemployment rate is 5.7 percent, then by definition there is
   a. cyclical unemployment amounting to 0.5 percent of the labor force.
   b. frictional unemployment amounting to 0.5 percent of the labor force.
   c. structural unemployment amounting to 0.5 percent of the labor force.
   d. search unemployment amounting to 0.5 percent of the labor force.

47. Frictional unemployment is
   a. not inevitable; rather, it can be reduced to zero if public policies are well-designed.
   b. not inevitable; rather, it could be reduced to zero if the Bureau of Labor Statistics updated its categorizations to reflect today’s job markets.
   c. inevitable, because at any given time jobs are being created in some firms and destroyed in other firms.
   d. inevitable, because in some industries, wages are always set above the level that brings supply and demand into equilibrium.

48. There is a clear consensus among economists that unions are
   a. good for the economy because they result in higher wages for most workers.
   b. good for the economy because they are a necessary antidote to the market power of employers.
   c. bad for the economy because they are cartels and therefore detrimental to an efficient allocation of resources.
   d. None of the above is correct; there is no clear consensus among economists about whether unions are good or bad for the economy.

49. The available evidence indicates that union workers
   a. are paid about 20 percent more than their nonunion counterparts, and their fringe benefits are substantially larger.
   b. are paid about 20 percent more than their nonunion counterparts, but their fringe benefits are roughly the same.
   c. receive about the same amount of pay as their nonunion counterparts, but their fringe benefits are substantially higher.
   d. receive about the same amount of pay as their nonunion counterparts, with about the same level of fringe benefits.
50. The theory of efficiency wages provides a possible explanation as to why
a. workers form unions.
b. high-paid workers support increases in the minimum wage.
c. firms may be inclined to keep their workers’ wages above the equilibrium level.
d. firms may be inclined to keep their workers’ wages below the equilibrium level.