Name: ___________________________ Date: _____________

1. The most frequently used tool of monetary policy is:
   A) open-market operations.
   B) changes in the discount rate.
   C) changes in reserve requirements.
   D) changes in the money multiplier.

2. a. Suppose there is a technological breakthrough that increases the productivity of all capital and, consequently, increases the demand for investment. Using the long-run model of the economy developed in Chapter 3, graphically illustrate the impact of the increased investment demand. Be sure to label: i. the axes; ii. the curves; iii. the initial equilibrium values; iv. the direction curves shift; and v. the terminal equilibrium values.
   b. State in words what happens to: i. the real interest rate; ii. national saving; iii. investment; iv. consumption; and v. output.

3. According to the classical theory of money, inflation does not make workers poorer because wages increase:
   A) faster than the overall price level.
   B) more slowly than the overall price level.
   C) in proportion to the increase in the overall price level.
   D) in real terms during periods of inflation.

4. In a small open economy, if consumer confidence falls and consumers decide to save more, then the real exchange rate:
   A) rises and net exports fall.
   B) and net exports both rise.
   C) falls and net exports rise.
   D) and net exports both fall.

5. The only tax that those in the underground economy probably cannot evade is the:
   A) personal income tax.
   B) sales tax.
   C) inflation tax.
   D) corporate income tax.

6. An “open” economy is one in which:
   A) the level of output is fixed.
   B) government spending exceeds revenues.
   C) the national interest rate equals the world interest rate.
   D) there is trade in goods and services with the rest of the world.

7. *All* of the following actions are investments in the sense of the term used by macroeconomists *except*:
   A) IBM's building a new factory.
   B) corner candy store's buying a new computer.
   C) John Smith's buying a newly constructed home.
   D) Sandra Santiago's buying 100 shares of IBM stock.

8. In a large open economy, the exchange rate adjusts so that net exports equal:
   A) domestic saving.
   B) domestic investment.
   C) net capital outflow.
   D) domestic investment plus net capital outflow.

9. The real wage is the return to labor measured in:
   A) dollars.
   B) units of output.
   C) units of labor.
   D) units of capital.

10. In examining the impact of fiscal policy, it is assumed that:
   A) consumption, investment, and the interest rate are endogenous variables.
   B) consumption, investment, and the interest rate are exogenous variables.
   C) government purchases, taxes, and interest rates are endogenous variables.
   D) government purchases, taxes, and interest rates are exogenous variables.

11. Unlike the GDP deflator, the CPI includes the prices of:
   A) goods purchased by firms.
   B) goods purchased by governments.
   C) exported goods.
   D) imported goods.

12. The *ex post* real interest rate will be greater than the *ex ante* real interest rate when the:
    A) rate of inflation is increasing.
    B) rate of inflation is decreasing.
    C) actual rate of inflation is greater than the expected rate of inflation.
    D) actual rate of inflation is less than the expected rate of inflation.

13. In a small open economy, starting from a position of balanced trade, if the government increases the income tax, this produces a tendency toward a trade ______ and ______ net capital outflow.
    A) deficit; negative
    B) surplus; positive
    C) deficit; positive
    D) surplus; negative

14. The quantity of money in the United States is essentially controlled by the:
    A) president of the United States.
    B) Department of the Treasury.
    C) Federal Reserve.
    D) system of commercial banks.

15. In a small open economy, when foreign governments reduce national saving in their countries, the equilibrium real exchange rate:
    A) rises and net exports fall.
    B) rises and net exports rise.
    C) falls and net exports fall.
    D) falls and net exports rise.

16. Portfolio theories of money demand emphasize the role of money as a:
    A) medium of exchange.
    B) store of value.
    C) unit of account.
    D) standard for making deferred payments.

17. When the Fed increases the discount rate, it:
    A) increases the reserve to deposit ratio (rr).
    B) decreases the reserve to deposit ratio (rr).
    C) is likely to increase the monetary base (B).
    D) is likely to decrease the monetary base (B).

18. The factor that makes national saving equal investment, in equilibrium, is:
    A) the interest rate.
    B) private saving.
    C) public saving.
    D) fiscal policy.

19. Economists use the term *money* to
    A) income.
    B) profits.
    C) assets used for transactions.
    D) earnings from labor.

20. If 5 French francs trade for $1, the U.S. price level equals $1 per good, and the French price level equals 2 francs per good, then the real exchange rate between French goods and U.S. goods is ______ French goods per U.S. good.
    A) 0.5
    B) 2.5
    C) 5
    D) 10

21. If a U.S. corporation purchases a product made in Europe and the European producer uses the proceeds to purchase a U.S. government bond, then U.S. net exports ______ and net capital outflows ______.
    A) increase; increase
    B) increase; decrease
    C) decrease; increase
    D) decrease; decrease

22. In a large open economy, the real interest rate is determined by:
    A) national saving, the domestic investment function, and the net capital outflow function.
    B) national saving, the domestic investment function, and the net-exports function.
    C) the domestic investment function, the net capital outflow function, and the net-exports function.
    D) national saving, the domestic investment function, the net capital outflow function, and the net-exports function.

23. When factor supply is fixed and quantity of the factor is graphed on the horizontal axis while factor price is graphed on the vertical axis, the factor:
    A) supply curve is horizontal.
    B) supply curve is vertical.
    C) supply curve slopes up to the right.
    D) demand curve slopes up to the right.

24. Assume that in a small open economy where full employment always prevails, national saving is 300.
    a. If domestic investment is given by $I = 400 - 20r$, where r is the real interest rate in percent, what would the equilibrium interest rate be if the economy were closed?
    b. If the economy is open and the world interest rate is 10 percent, what will investment be?
    c. What will the current account surplus or deficit be? What will net capital outflow be?

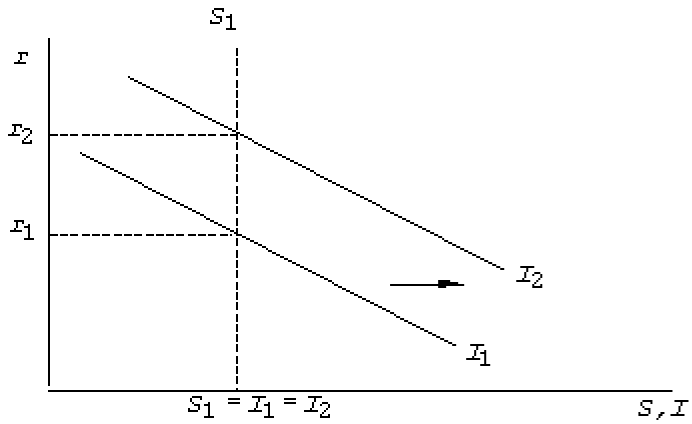
25. The real exchange rate:
    A) measures how many Japanese yen one really gets for a U.S. dollar.
    B) is equal to the nominal exchange rate multiplied by the domestic price level divided by the foreign price level.
    C) is equal to the nominal exchange rate multiplied by the foreign price level divided by the domestic price level.
    D) the price of a domestic car divided by the price of a foreign car.

26. To end a hyperinflation, a government trying to reduce its reliance on seigniorage would:
    A) print more money.
    B) raise taxes and cut spending.
    C) lower taxes and increase spending.
    D) lower interest rates.

27. If you spend $3,000 per year in cash, each trip to the bank costs you $5 in lost time, and the yearly interest rate on your bank account, expressed as a fraction, is 0.03, how many times a year does the Baumol-Tobin model suggest you should go to the bank?
    A) one
    B) two
    C) three
    D) four

Answer Key

1. A
2. a.



   b. i. real interest rate increases
   ii. national saving is unchanged
   iii. amount of investment is unchanged
   iv. consumption is unchanged
   v. output is unchanged, fixed because it is determined by the factors of production
3. C
4. C
5. C
6. D
7. D
8. C
9. B
10. A
11. D
12. D
13. B
14. C
15. D
16. B
17. D
18. A
19. C
20. B
21. D
22. A
23. B
24. a. 5 percent b. 200 c. The trade surplus will be 100. Net capital outflow will be 100.
25. B
26. B
27. C