

Macro Exam 2 Self Test -- T/F questions
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Fill in your answer (T/F) in the blank in front of the question. If false, provide a brief explanation of why it is false, and state what is true. Simple negation will not count as an explanation. See my answers for examples of satisfactory answers to these questions (but don't peek until you try them yourself).

Chapter 8 -- Aggregate Expenditure and Equilibrium Output

_____ 1. Firms react to unplanned inventory investment by increasing output.

_____ 2. If actual investment is greater than planned investment, inventories decrease more than planned.

_____ 3. Disposable income is the major determinant of consumption spending in classical thought (for example, in the economics of Jean-Baptiste Say).

_____ 4. The marginal propensity to consume is the change in consumption expenditure divided by the change in disposable income.

_____ 5. If the MPC is 0.8, the marginal propensity to save will be 0.4.

_____ 6. In a Keynesian macroeconomic model, private savings will equal the sum of private investment, the government budget deficit, and the international current account surplus.

_____ 7. When the economy is in Keynesian macroeconomic equilibrium, planned investment is equal to actual investment.

_____ 8. The larger the MPS, the smaller the Keynesian government spending multiplier.

_____ 9. If the MPC is 0.75, the Keynesian government spending multiplier will be $\frac{4}{3}$; that is, an increase of \$ 300 billion in government spending will lead to an increase in GDP of \$ 400 billion.

_____ 10. If the MPC is 0.75, the lump-sum tax multiplier will be -4, that is, an increase in taxes of \$ 100 billion will lead to a drop in GDP of \$ 400 billion.

Self-Test -- Chapter 8 - 2

_____11. If an economy shifts from lump-sum taxes to income taxes, an increase in government spending will result in a smaller increase in GDP.

_____12. If the marginal propensity to import increases, the multiplier will decrease.

_____13. If everyone increases their marginal propensity to save, the Keynesian model predicts that total saving will not increase, and may decline.

_____14. In the equation $C = C_o + C_y (Y - T)$, we label the term “ C_y ” as “induced consumption”

_____15. In the equation $C = C_o + C_y (Y - T)$ we label the C_o term as “autonomous consumption”

_____16. In a simple Keynesian economy with the above consumption equation, with $C_o = 0.5$ and $C_y = 0.8$ and no foreign trade, a rise in investment of 200 billion would lead to a rise in GDP of 400 billion.

_____17. In the simple Keynesian economy of the last question, a rise in investment of 200 billion and a simultaneous increase in taxes of 200 billion would lead to no change at all in GDP.

_____18. A “Keynesian cross” representation of the consumption function of question 16 would have the consumption function, and hence also the “planned aggregate expenditure” line more steeply sloped than the 45 degree line.

_____19. The “Keynesian cross” representation of the consumption function was not the work of John Maynard Keynes, but of his father, John Neville Keynes.

_____20. The phrase “Savings equals investment” is a bit misleading, since savings must also finance the government budget deficit and any trade deficit.

_____21. If consumers spend 80 cents out of each dollar of disposable income, we can conclude that the government spending multiplier in a simple Keynesian model is 20.

Chapter 9 -- The Government and Fiscal Policy

_____ 1. Disposable personal income is national income minus taxes plus transfer payments.

_____ 2. When actual investment is greater than planned investment, the economy is in danger of falling into a recession.

_____ 3. When $G - T$ is positive, the government budget is in deficit.

_____ 4. If investment increases, the planned aggregate expenditure line on the Keynesian cross diagram shifts upward

_____ 5. If the MPC increases, the planned aggregate expenditure line on the Keynesian cross diagram becomes flatter.

_____ 6. In a simple Keynesian model (with lump-sum taxes and a MPC of 0.8), if the government increases spending by \$400 billion and increases taxes by \$400 billion, output will increase by \$2000 billion.

_____ 7. In a simple Keynesian model (with lump-sum taxes and a MPC of 0.8), a tax cut of \$ 10 billion will have more of an impact on GDP than an increase in government spending of \$ 10 billion.

_____ 8. When taxes are given as a percentage of income, a higher tax rate implies a smaller government spending multiplier.

_____ 9. In an open economy, the government spending multiplier will be higher than in an economy without international trade.

_____ 10. If an economy has a marginal propensity to consume of 0.8 and an income tax of 50 percent of income, the multiplier will be only half of what it would be with lump-sum taxes.

_____ 11. Income taxes, unemployment insurance, and a lower marginal propensity to import will all reduce the multiplier, and hence insulate the economy against the shock of a drop in planned investment.

Self-Test -- Chapter 9 - 2

_____12. The “structural deficit” is the deficit that would remain even if the economy were at full employment.

_____13. All expenditures which are part of the Federal Budget are counted as “government expenditure” in the National Income and Product Accounts.

_____14. A government can increase GDP if it increases its spending and taxes by exactly the same amount.

_____15. The multiplier will be lower than the simple Keynesian model predicts if government borrowing raises interest rates and therefore “crowds out” private investment.

_____16. Fiscal policy is usually used during recessions because it takes less time to implement than monetary policy.

_____17. The last two consecutive years that the Federal government budget was in surplus for the entire year were 1999 and 2000.

_____18. Social Security, Medicare, and Defense are each about 20 percent of the Federal Budget, so that together they make up about 60 percent of the Federal Budget.

_____19. Only Medicare and Defense count as Government Expenditure in the National Income and Product Accounts.

_____20. The “paradox of thrift” implies that savings is good in the short run, but may harm economic growth in the long run.

_____21. Automatic stabilizers ensure that government revenues and expenditures both decrease in a recession, so that the government budget will automatically be balanced.

_____22. A lower income tax rate means a lower government spending multiplier.

Chapter 10. The Money Supply and the Federal Reserve System

_____ 1. The most important role of money is to serve as a store of value.

_____ 2. Only items defined by the government as legal tender count as M1.

_____ 3. The major problem of barter is the need for a double coincidence of wants.

_____ 4. When you take \$ 100 from your savings account and deposit it in your checking account, M1 increases.

_____ 5. When you take \$ 100 from your savings account and deposit it in your checking account, M2 stays the same

_____ 6. If a bank sells a \$ 10,000 Treasury bill to the Federal Reserve, and receives a credit in its account with the Fed, the money supply will increase by more than \$ 10,000.

_____ 7. If a bank sells a \$ 10,000 Treasury bill to the Federal Reserve, and receives a credit in its account with the Fed, the money supply will decrease by exactly \$ 10,000.

_____ 8. If a bank has liabilities of \$ 3 million and a net worth of \$ 1 million, its assets will be \$ 4 million.

_____ 9. A bank will list the mortgage loans it makes as assets.

_____ 10. A bank is said to have a "liquidity problem" when its capital is too low to cover likely losses on bad loans.

_____ 11. The Federal Reserve will act as a "lender of last resort" if a bank runs into liquidity problems.

Self-Test -- Chapter 10 - 2

_____12.The required reserve ratio is 0.25 (twenty-five percent) and a bank has \$ 800 in deposits. Its actual reserves are \$ 300, so it will have excess reserves of \$ 500.

_____13.The policy making body of the Federal Reserve System is known as the Board of Governors.

_____14.The one Federal Reserve Bank that is automatically a member of the policy making body of the Fed is the Washington, DC bank.

_____15.Most \$ 100 dollar bills issued in the US are issued by the Federal Reserve Bank of Chicago.

_____16.The Federal Reserve is headed by the Secretary of the Treasury.

_____17.A decrease in the required reserve ratio will normally increase the money supply.

_____18.The most commonly used tool of monetary policy by the Federal Reserve system is to change the required reserve ratio.

_____19.An open market purchase of government securities (such as Treasury Bills) by the Fed will increase the money supply and raise the interest rate.

_____20.The most commonly used tool of monetary policy by the Fed is open market operations..

_____21. M1 includes currency in circulation, currency in bank vaults, checking accounts, and credit card accounts.

_____22. M2 is an alternative measure of money which counts only bank money: it includes vault cash, checking and savings accounts, and bank certificates of deposit.

Chapter 11. The Demand for Money

- _____ 1. The rate of interest is the opportunity cost of holding money

- _____ 2. More frequent switching from bonds to money will result in a higher opportunity cost of holding money and lower money management costs.

- _____ 3. The optimal money balance desired will be lower if the CPI is higher.

- _____ 4. The optimal money balance desired will be lower if the inflation rate is higher.

- _____ 5. The optimal money balance desired will be lower if the interest rate is higher.

- _____ 6. The optimal money balance desired will be lower if the level of real income is higher.

- _____ 7. If people think that interest rates are above normal levels, they will want to hold bonds in anticipation of a rise in bond prices.

- _____ 8. Investors will probably wish to hold bonds when interest rates are low in the hope of selling them at higher prices when interest rates increase.

- _____ 9. If the money supply increases, and the price level is unchanged, interest rates will fall.

- _____ 10. If the money supply and the price level both increase by 10 percent, interest rates will not change.

- _____ 11. The Fed has more control over short-term interest rates than long-term interest rates.

- _____ 12. "Federal funds" are the interest rates charged by the Fed on its loans to commercial banks.

Self-Test -- Chapter 11 - 2

_____13. The demand for money will increase when the price level increases.

_____14. The demand for money will increase when inflation increases.

_____15. The demand for money will increase when the interest rate increases.

_____16. The simple quantity theory of money holds that the velocity of money often changes.

_____17. The simple quantity theory of money holds that the growth rate of the money supply will be the same as the inflation rate minus the growth rate of real GDP.

_____18. Monetarists such as Milton Friedman think that the Federal Reserve should actively use monetary policy to keep the economy from falling into recession.

_____19. Monetarists such as Milton Friedman favor a constant growth rate of the money supply.

_____20. Milton Friedman attributed the Great Depression to the excessively inflationary policy of the Federal Reserve.

_____21. Milton Friedman was a very conservative economist who advocated a return to the gold standard.

_____22. Milton Friedman is a very conservative economist who is opposed to the Federal Reserve policy of “quantitative easing” in response to the Great Recession of 2007-2009.