

Macroeconomics, Cdn. 9e (Abel et al.)
Chapter 1 Introduction to Macroeconomics

1.1 Multiple-Choice Questions

1) Which of the following is a topic of macroeconomics?

- A) why nations have different rates of growth
- B) what causes inflation and what can be done about it
- C) why unemployment periodically reaches very high levels
- D) all of the above

Answer: D

Diff: 1 Type: MC Page Ref: 1

2) The two major reasons for the tremendous growth in output in the Canadian economy over the last 125 years are

- A) population growth and budget deficit.
- B) population growth and increased productivity.
- C) low unemployment and budget surplus.
- D) low budget deficit and low trade deficits.

Answer: B

Diff: 1 Type: MC Page Ref: 2

3) The main reason Canada has such a high standard of living is

- A) low unemployment.
- B) high average labour productivity.
- C) low inflation.
- D) low government budget deficits.

Answer: B

Diff: 1 Type: MC Page Ref: 2

4) Average labour productivity is

- A) the amount of workers per machine.
- B) the amount of machines per worker.
- C) the ratio of employed to unemployed workers.
- D) the amount of output per worker.

Answer: D

Diff: 1 Type: MC Page Ref: 2

5) In analyzing macroeconomic data during the past year, you have discovered that average labour productivity fell, but total output increased. What was most likely to have caused this?

- A) Government deficit was reduced.
- B) The capital/output ratio probably rose.
- C) There was an increase in labour input.
- D) Unemployment probably increased.

Answer: C

Diff: 3 Type: MC Page Ref: 2

- 6) The business cycle describes the
- A) progression of an industry's structure from monopoly to perfect competition.
 - B) progression of an industry's structure from perfect competition to monopoly.
 - C) expansion and contraction of an individual industry within the economy.
 - D) expansion and contraction of economic activity in the economy as a whole.

Answer: D

Diff: 1 Type: MC Page Ref: 3

- 7) The short-run, but sometimes sharp, contractions and expansions in economic activity are called

- A) recession.
- B) stagnation.
- C) inflation.
- D) business cycles.

Answer: D

Diff: 1 Type: MC Page Ref: 3

- 8) When national output declines, the economy is said to be in

- A) an expansion.
- B) a deflation.
- C) a recovery.
- D) a recession.

Answer: D

Diff: 1 Type: MC Page Ref: 3

- 9) During recessions, the unemployment rate _____ and output _____.

- A) rises; falls
- B) rises; rises
- C) falls; rises
- D) falls; falls

Answer: A

Diff: 1 Type: MC Page Ref: 3

- 10) The unemployment rate is the

- A) number of unemployed divided by the number of employed.
- B) number of employed divided by the number of unemployed.
- C) number of unemployed divided by the labour force.
- D) labour force divided by the number of unemployed.

Answer: C

Diff: 1 Type: MC Page Ref: 4

- 11) The highest and prolonged period of unemployment in Canada occurred during
- A) the Great Depression of the 1930s.
 - B) the 1981-1982 recession.
 - C) the 1990-1991 recession.
 - D) the 2001 recession in the U.S.

Answer: A

Diff: 1 Type: MC Page Ref: 5

- 12) A country is said to be experiencing inflation when
- A) prices of most goods and services are rising over time.
 - B) prices of most goods and services are falling over time.
 - C) total output is rising over time.
 - D) total output is falling over time.

Answer: A

Diff: 1 Type: MC Page Ref: 4

- 13) A country is said to be experiencing deflation when
- A) prices of most goods and services are rising over time.
 - B) prices of most goods and services are falling over time.
 - C) total output is rising over time.
 - D) total output is falling over time.

Answer: B

Diff: 1 Type: MC Page Ref: 4

- 14) An open economy is a national economy that
- A) has good relations with its neighbouring countries.
 - B) has a stock market that is open to traders from anywhere in the world.
 - C) has extensive trading and financial relationships with other national economies.
 - D) has established diplomatic relations with most other nations.

Answer: C

Diff: 1 Type: MC Page Ref: 4

- 15) A closed economy is a national economy that
- A) doesn't interact economically with the rest of the world.
 - B) has a stock market that is not open to traders from outside the country.
 - C) has extensive trading and financial relationships with other national economies.
 - D) has not established diplomatic relations with other national economies.

Answer: A

Diff: 1 Type: MC Page Ref: 4

- 16) Canadian exports are goods and services
- A) produced abroad and sold to Canadians.
 - B) produced in Canada and sold to Canadians.
 - C) produced abroad and sold to foreigners.
 - D) produced in Canada and sold to foreigners.

Answer: D

Diff: 1 Type: MC Page Ref: 4

- 17) Canadian imports are goods and services
A) produced abroad and sold to Canadians.
B) produced in Canada and sold to Canadians.
C) produced abroad and sold to foreigners.
D) produced in Canada and sold to foreigners.

Answer: A

Diff: 1 Type: MC Page Ref: 4

- 18) A country has a trade surplus when
A) imports exceed exports.
B) imports equal exports.
C) exports exceed imports.
D) imports are zero.

Answer: C

Diff: 1 Type: MC Page Ref: 4

- 19) A country has a trade deficit when
A) imports exceed exports.
B) imports equal exports.
C) exports exceed imports.
D) exports are zero.

Answer: A

Diff: 1 Type: MC Page Ref: 4

20) In 2001 Anchovy had imports of \$50 billion, exports of \$60 billion, and Anchovy's GDP was equal to \$300 billion. The trade surplus was what percent of GDP in 2001?

- A) 3.3%
B) 10.0%
C) 16.7%
D) 20.0%

Answer: A

Diff: 2 Type: MC Page Ref: 4

21) In 2005, DAMA's exports were \$30 billion, imports \$40 billion, and real GDP \$200 billion. DAMA had a trade _____ equal to _____ of GDP in 2005.

- A) surplus; 5 percent
B) deficit; 5 percent
C) surplus; 10 percent
D) deficit; 10 percent

Answer: B

Diff: 2 Type: MC Page Ref: 4

22) The exchange rate is

- A) the rate of return in the stock market.
- B) the price index for goods and services.
- C) the price of Canadian dollar in terms of foreign currencies.
- D) the rate of return on investment in foreign countries.

Answer: C

Diff: 1 Type: MC Page Ref: 4

23) Fiscal policy determines _____ while monetary policy determines _____.

- A) government spending and taxation; the growth of the money supply
- B) government's capital; government's investment
- C) the rate of growth of the economy; the rate of growth of prices
- D) the inflation rate; the rate of growth of prices

Answer: A

Diff: 1 Type: MC Page Ref: 5

24) In Canada, monetary policy is determined by

- A) the Bank of Canada.
- B) the prime minister.
- C) private citizens.
- D) the Department of Finance.

Answer: A

Diff: 1 Type: MC Page Ref: 5

25) The difference between microeconomics and macroeconomics is that

- A) microeconomics looks at supply and demand for goods, while macroeconomics looks at supply and demand for services.
- B) microeconomics looks at prices, while macroeconomics looks at inflation.
- C) microeconomics looks at individual consumers and firms, while macroeconomics looks at national totals.
- D) microeconomics looks at national issues, while macroeconomics looks at global issues.

Answer: C

Diff: 1 Type: MC Page Ref: 6

26) The process of adding together individual economic variables to obtain economywide totals is called

- A) macroeconomics.
- B) aggregation.
- C) agglomeration.
- D) data development.

Answer: B

Diff: 1 Type: MC Page Ref: 6

27) A country that has many well-trained macroeconomic analysts will not necessarily have more beneficial macroeconomic policies because

- A) economists' understanding of the economy remains poor.
- B) there are few ways in which economists' complex models can be applied to the real world.
- C) economists agree on so few government policies.
- D) economic policy is usually made by politicians, not economists.

Answer: D

Diff: 1 Type: MC Page Ref: 7

28) The main goal of macroeconomic research is to

- A) predict how the macroeconomy will perform in the future.
- B) analyze current macroeconomic data.
- C) develop new data that can be used to better understand the operation of the economy.
- D) make general statements about how the economy works.

Answer: D

Diff: 1 Type: MC Page Ref: 8

29) Assumptions for economic theories and models should be

- A) rejected if they are not totally realistic.
- B) logical rather than empirically testable.
- C) simple and reasonable rather than complex.
- D) maintained until overwhelming evidence to the contrary occurs.

Answer: C

Diff: 1 Type: MC Page Ref: 8

30) If the theory behind an economic model fits the data only moderately well, you would probably want to

- A) use the theory to predict what would happen if the economic setting or economic policies change.
- B) start from scratch with a new model.
- C) enrich the model with additional assumptions.
- D) restate the research question.

Answer: C

Diff: 2 Type: MC Page Ref: 9

31) A useful macroeconomic theory

- A) is based on reasonable and realistic assumptions.
- B) is easy to use.
- C) has implications that can be tested in the real world.
- D) is consistent with the data and observed behaviour of the real-world economy.
- E) all of the above.

Answer: E

Diff: 2 Type: MC Page Ref: 9

32) Macroeconomists disagree on normative analysis of economic issues because

- A) they use different tools to study economics.
- B) they have different political agenda.
- C) they have different values.
- D) they have different objectives.

Answer: C

Diff: 2 Type: MC Page Ref: 11

33) Positive analysis of economic policy

- A) examines the economic consequences of policies but does not address the question of whether those consequences are desirable.
- B) examines the economic consequences of policies and addresses the question of whether those consequences are desirable.
- C) generates less agreement among economists than normative analysis.
- D) is rare in questions of economic policy.

Answer: A

Diff: 1 Type: MC Page Ref: 10

34) Which of the statements below is primarily normative in nature?

- A) There is an unequal distribution of income in Canada.
- B) The distribution of income is more unequal in Canada than it is in Japan.
- C) The inequality of income that exists in Canada is partly caused by an unequal distribution of wealth.
- D) The distribution of income in Canada should be more equal than it is.

Answer: D

Diff: 1 Type: MC Page Ref: 10

35) Adam Smith's idea of the "invisible hand" tries to convey the idea that while there are free markets and people conduct their economic affairs in their own best interests

- A) any country can become an advanced, industrialized nation.
- B) markets will eliminate problems of hunger and dissatisfaction.
- C) most inequalities between the rich and the poor will be eliminated.
- D) the overall economy will work well.

Answer: D

Diff: 1 Type: MC Page Ref: 11

36) Equilibrium in the economy means

- A) unemployment is zero.
- B) quantities demanded and supplied are equal in all markets.
- C) prices aren't changing over time.
- D) tax revenues equal government spending, so the government has no budget deficit.

Answer: B

Diff: 1 Type: MC Page Ref: 11

37) Classical economists who assume the "invisible hand" works reasonably well do NOT argue that

- A) the government should have a limited role in the economy.
- B) government policies will be ineffective and counterproductive.
- C) the government should actively intervene in the economy to eliminate business cycles.
- D) wages and prices adjust quickly to bring the economy back to equilibrium.

Answer: C

Diff: 2 Type: MC Page Ref: 12

38) The classical approach to macroeconomics assumes that

- A) wages, but not prices, adjust quickly to balance quantities supplied and demanded in markets.
- B) wages and prices adjust quickly to balance quantities supplied and demanded in markets.
- C) prices, but not wages, adjust quickly to balance quantities supplied and demanded in markets.
- D) neither wages nor prices adjust quickly to balance quantities supplied and demanded in markets.

Answer: B

Diff: 1 Type: MC Page Ref: 11

39) The Keynesian approach to macroeconomics assumes that

- A) wages, but not prices, adjust quickly to balance quantities supplied and demanded in markets.
- B) wages and prices adjust quickly to balance quantities supplied and demanded in markets.
- C) prices, but not wages, adjust quickly to balance quantities supplied and demanded in markets.
- D) neither wages nor prices adjust quickly to balance quantities supplied and demanded in markets.

Answer: D

Diff: 1 Type: MC Page Ref: 12

40) John Maynard Keynes disagreed with the classical economists because he assumed that

- A) wages and prices adjusted slowly.
- B) international trade played a major role in the macroeconomy.
- C) government intervention in the economy could not reduce business cycles.
- D) unemployment would be eliminated quickly by the invisible hand of the market.

Answer: A

Diff: 1 Type: MC Page Ref: 12

41) The critical assumptions behind the idea of Adam Smith's invisible hand are

- A) wage-price flexibility and individuals pursuing their own self-interests.
- B) balanced budget and balance trade.
- C) zero unemployment and high economic growth.
- D) high economic growth and low inflation.

Answer: A

Diff: 1 Type: MC Page Ref: 12

42) How did Keynes propose to solve the problem of high unemployment?

- A) increase the growth rate of the money supply
- B) allow wages to decline so that firms will want to hire more workers
- C) put on wage and price controls so that wages won't rise and firms won't have to lay people off to cut costs
- D) have the government increase its demand for goods and services

Answer: D

Diff: 2 Type: MC Page Ref: 13

43) Economists evaluate an economic model based on

- A) the results of the model.
- B) the testability of the implications of the model by empirical analysis.
- C) data availability.
- D) the consistency of the assumptions with the Classical model.

Answer: B

Diff: 1 Type: MC Page Ref: 8

44) When an economist wants to develop a theory to explain the effect of the price of oil on economic growth

- A) the first step is to state the research question.
- B) the first step is to examine the data.
- C) the first step is to work out the implications of the theory.
- D) he/she should start with microeconomic analysis.

Answer: A

Diff: 1 Type: MC Page Ref: 9

45) Comparative static experiments

- A) are conducted in social sciences labs.
- B) assume the model is in equilibrium.
- C) use data to compare empirical results.
- D) use economic surveys to analyze economic behaviour.

Answer: B

Diff: 2 Type: MC Page Ref: 10

46) Analyzing the effect of a shock on a macroeconomic model is called

- A) forecasting.
- B) disequilibrium analysis.
- C) comparative static experiments.
- D) shock analysis.

Answer: C

Diff: 2 Type: MC Page Ref: 10

47) A theoretical analysis of the effect of an oil shock on inflation is an example of

- A) the Classical model.
- B) the Keynesian model.
- C) why economists disagree.
- D) a comparative static experiment.

Answer: D

Diff: 3 Type: MC Page Ref: 10

48) Which of the following is NOT an issue addressed by macroeconomists?

- A) What determines the price of gasoline
- B) What causes prices to rise
- C) What causes the unemployment rate to rise
- D) Why a nation's economic activity fluctuates

Answer: A

Diff: 1 Type: MC Page Ref: 1

49) Which of the following is NOT true?

- A) The average labour productivity in Canada has risen by a factor of six since 1921.
- B) Canadian workers are working fewer hours but their real wages are higher, on average, than in the past.
- C) Canadian workers are, on average, much more productive than 60 years ago.
- D) Today, a typical Canadian is working longer and getting paid less in real terms.

Answer: D

Diff: 2 Type: MC Page Ref: 2

50) Which of the following is considered as a fiscal policy?

- A) Fixing the exchange rate.
- B) Lowering interest rates.
- C) Removing energy subsidies.
- D) Increasing mortgage rates.

Answer: C

Diff: 2 Type: MC Page Ref: 5

51) Macroeconomists cannot conduct experiments in the manner of physicists or chemists, because

- A) macroeconomic subjects such as business cycles are very complex.
- B) macroeconomists are not allowed to run experiments on human and firm subjects.
- C) macroeconomists do not have access to the labs used in physics and chemistry.
- D) results of macroeconomic experiments are not reliable.

Answer: B

Diff: 2 Type: MC Page Ref: 9

52) Which of the following event is NOT considered as a shock?

- A) Hurricane Harvey in Texas and the Caribbean Islands.
- B) An anticipated change in the interest rate.
- C) A fall in the price of oil.
- D) A fall in stock prices.

Answer: B

Diff: 2 Type: MC Page Ref: 10

1.2 Essay Questions

1) Macroeconomic information for the economy of Anchovy is given below:

	2000	2001
Output (pizzas)	8000	9000
Employment (workers)	700	800
Unemployed (workers)	70	100
Labour force (workers)	770	900
Price per pizza	\$8.00	\$9.00

- a. What was the growth rate of average labour productivity in Anchovy between 2000 and 2001?
- b. What was the inflation rate in Anchovy between 2000 and 2001?
- c. What was the unemployment rate in 2000? In 2001?

Answer:

a. Average labour productivity: 2000: $8000/700 = 80/7$; 2001: $9000/800 = 90/8$;
growth rate = $[(90/8)/(80/7)] - 1 = -.016 = -1.6\%$

b. Inflation rate: $(9/8) - 1 = .125 = 12.5\%$

c. Unemployment rates: 2000: $70/770 = .091 = 9.1\%$; 2001: $100/900 = .111 = 11.1\%$

Diff: 3 Type: ES Page Ref: Sec. 1.1

2) What are the four major areas in which macroeconomists work? Give an example of a job in each.

Answer: Forecasting, analysis, research, and data development.

Forecasting: forecasting the stock market on Bay Street

Analysis: analyzing the economy for the Bank of Canada

Research: investigating the link between the trade deficit and the government budget deficit as a university professor

Data development: working at Statistics Canada to develop better ways to measure unemployment.

Diff: 2 Type: ES Page Ref: Sec. 1.2

3) Match each of the following jobs to its major area: forecasting, analysis, research, or data development. Explain your answers.

- a. economist at university, testing theories about the efficient allocation of resources in the foreign exchange market
- b. economist at Bay Street firm trying to predict the rate of inflation next year using past data
- c. economist at auto firm looking at demand for new automobiles
- d. economist at the Department of Finance trying to determine whether foreign firms are dumping goods in Canada
- e. economist at Statistics Canada developing new methods for calculating price indexes
- f. economist consulting in Eastern Europe about how to set up free-market financial systems

Answer:

- a. research
- b. forecasting
- c. analysis
- d. analysis
- e. data development
- f. analysis

Diff: 2 Type: ES Page Ref: Sec. 1.2

4) Determine whether each of the following is a positive or normative statement.

- a. The Bank of Canada should lower interest rates to increase economic growth, because we're in a recession.
- b. Higher government budget deficits cause higher interest rates.
- c. The trade deficit should decline because of the fall in the value of the dollar.
- d. Because of our high inflation rate, we must reduce the rate of money growth.
- e. A generous unemployment insurance system is a primary cause of high unemployment in Europe.
- f. Increased average labour productivity in a country should lead to faster growth.
- g. Government budget deficits are too high in Canada and should be reduced.

Answer:

- a. normative
- b. positive
- c. positive
- d. normative
- e. positive
- f. positive
- g. normative

Diff: 2 Type: ES Page Ref: Sec. 1.3

5) Discuss the major difference between classical and Keynesian economists. Be sure to explain how they differ with regard to how quickly equilibrium is restored in the economy as well as what role they see for government action in restoring equilibrium.

Answer: Classical and Keynesian economists differ most with regard to how quickly they see wages and prices adjusting to restore equilibrium in the economy. Classical economists think that when the economy is out of equilibrium, wages and prices adjust quickly to restore equilibrium. As a result, there shouldn't be long periods of abnormally high unemployment. The quick return to equilibrium means there is no reason for government action. Keynesians, on the other hand, think wages and prices are slow to adjust. As a result, the economy may be out of equilibrium for some time, perhaps with high unemployment. To restore equilibrium quickly may necessitate some government action, such as increasing the government's demand for goods and services.

Diff: 2 Type: ES Page Ref: Sec. 1.3

6) Describe what the two key assumptions are in the "invisible hand" idea.

Answer: The first assumption in the invisible hand idea is that people pursue their own economic self-interests. The second key assumption is that the various markets in the economy must function smoothly and without impediment. In particular, it is assumed that wages and prices are fully flexible and must adjust rapidly enough to maintain equilibrium in all markets. If there is a disequilibrium, the prices and wages would adjust quickly to restore the equilibrium.

Diff: 2 Type: ES Page Ref: Sec. 1.3

7) You are asked to analyze the effect of the Bank of Canada's new interest rate policy on housing prices. Using a comparative static experiment, describe the steps you need to follow to produce a sound theoretical macroeconomic analysis.

Answer: First, we need to set up a macroeconomic model that includes all relevant variables and is assumed to be in equilibrium. Second, we change the interest rate, keeping all other variables constant, and examine the change in housing prices. Third, we observe how our macroeconomic model responds to the interest rate changes.

Diff: 2 Type: ES Page Ref: Sec. 1.2

8) Explain what Keynes meant by the phrase "in the long-run we are all dead."

Answer: Keynes argued that wages and prices will eventually adjust to equate demand and supply, but this adjustment might be slow to occur. Therefore, the phrase makes the point that it might not be good government policy to wait for that eventual adjustment in wages and prices. He therefore proposed that governments take actions to alleviate the unemployment resulting from the slow adjustment of wages and prices.

Diff: 2 Type: ES Page Ref: 12

9) Explain the main assumptions in a balanced and unified approach to macroeconomics.

Answer: The balanced and unified approach to macroeconomics has the following characteristics:

1. Individuals, firms, and the government interact in goods markets, asset markets, and labour markets.
2. The model's macroeconomic analysis is based on the analysis of individual behaviour.
3. In the long term, prices and wages fully adjust to achieve equilibrium in the markets for goods, assets, and labour.
4. The basic model may be used with either the classical assumption that wages and prices are flexible or the Keynesian assumption that wages and prices are slow to adjust.

Diff: 2 Type: ES Page Ref: 13