Macroeconomics, 11e (Abel/Bernanke/Croushore)
Chapter 1 Introduction to Macroeconomics

1.1 What Macroeconomics Is About

1) Which of the following is *not* a topic of macroeconomics?
A) Why nations have different rates of growth.
B) What causes inflation and what can be done about it?
C) What factors contribute to the presence of monopolies in the economy?
D) Why unemployment periodically reaches very high levels.
Answer: C
Diff: 1
Topic: Section: 1.1
Question Status: Previous Edition

2) The two major reasons for the tremendous growth in output in the U.S. economy over the last 125 years are
A) population growth and low inflation.
B) population growth and increased productivity.
C) low unemployment and low inflation.
D) low inflation and low trade deficits.
Answer: B
Diff: 1
Topic: Section: 1.1
Question Status: Previous Edition

3) The amount of output produced per unit of labor input is called
A) the marginal revenue product of labor.
B) average labor productivity.
C) a util.
D) unit labor cost.
Answer: B
Diff: 1
Topic: Section: 1.1
Question Status: New

4) The main reason that the United States has such a high standard of living is
A) low unemployment.
B) high average labor productivity.
C) low inflation.
D) high government budget deficits.
Answer: B
Diff: 1
Topic: Section: 1.1
Question Status: Previous Edition

5) Which of the following factors are most important for determining the economic growth of a country?
A) The country's level of resources
B) The independence of the country's central bank
C) The country's rates of saving and investment
D) The level of sophistication of a country's financial markets
Answer: C
Diff: 1
Topic: Section: 1.1
Question Status: Previous Edition

6) Average labor productivity is the
A) amount of workers per machine.
B) amount of machines per worker.
C) ratio of employed to unemployed workers.
D) amount of output per worker.
Answer: D
Diff: 1
Topic: Section: 1.1
Question Status: Previous Edition

7) In analyzing macroeconomic data during the past year, you have discovered that average labor productivity fell, but total output increased. What was most likely to have caused this?
A) There is nothing unusual in this outcome because this is what normally occurs.
B) The capital—output ratio probably rose.
C) There was an increase in labor input.
D) Unemployment probably increased.
Answer: C
Diff: 2
Topic: Section: 1.1
Question Status: Previous Edition

8) In which of the following periods did average labor productivity in the United States grow the fastest?
A) 1929 to 1935
B) 1949 to 1973
C) 1973 to 1995
D) 1995 to 2007
Answer: B
Diff: 1
Topic: Section: 1.1
Question Status: Revised

9) The most direct effect of an increase in the growth rate of average labor productivity would be an increase in
A) the inflation rate.
B) the unemployment rate.
C) the long-run economic growth rate.
D) imported goods.
Answer: C
Diff: 1
Topic: Section: 1.1
Question Status: Previous Edition

10) Short-run contractions and expansions in economic activity are called
A) recessions.
B) expansions.
C) deficits.
D) the business cycle.
Answer: D
Diff: 1
Topic: Section: 1.1
Question Status: Previous Edition

11) 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
Topic: Section: 1.1
Question Status: New

12) When national output rises, the economy is said to be in
A) an expansion.
B) a deflation.
C) an inflation.
D) a recession.
Answer: A
Diff: 1
Topic: Section: 1.1
Question Status: Previous Edition

13) When national output declines, the economy is said to be in
A) an expansion.
B) a deflation.
C) an inflation.
D) a recession.
Answer: D
Diff: 1
Topic: Section: 1.1
Question Status: Previous Edition

14) Which of the following best describes a typical business cycle?
A) Economic expansions are followed by economic contractions.
B) Inflation is followed by unemployment.
C) Trade surpluses are followed by trade deficits.
D) Stagflation is followed by inflationary economic growth.
Answer: A
Diff: 1
Topic: Section: 1.1
Question Status: Previous Edition

15) Recessions
A) are always followed by long periods of high rates of real economic growth.
B) almost never last more than two consecutive quarters.
C) cause the unemployment rate to increase.
D) do not occur in developed countries, including the United States.
Answer: C
Diff: 1
Topic: Section: 1.1
Question Status: Previous Edition

16) During recessions, the unemployment rate ________ and output ________.
A) rises; falls
B) rises; rises
C) falls; rises
D) falls; falls
Answer: A
Diff: 1
Topic: Section: 1.1
Question Status: Previous Edition

17) The number of unemployed divided by the labor force equals
A) the inflation rate.
B) the labor force participation rate.
C) the unemployment rate.
D) the misery index.
Answer: C
Diff: 1
Topic: Section: 1.1
Question Status: Previous Edition

18) 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 labor force.
D) labor force divided by the number of unemployed.
Answer: C
Diff: 1
Topic: Section: 1.1
Question Status: Previous Edition

19) The highest and most prolonged period of unemployment in the United States over the last 125 years occurred during
A) World War II.
B) the 1890s Depression.
C) the 1990-1991 recession.
D) the Great Depression of the 1930s.
Answer: D
Diff: 1
Topic: Section: 1.1
Question Status: Previous Edition

20) During the Great Depression, the unemployment rate for the United States peaked at approximately
A) 10%.
B) 70%.
C) 45%.
D) 25%.
Answer: D
Diff: 2
Topic: Section: 1.1
Question Status: Previous Edition

21) If a city has 3293 unemployed people and 73,177 in its labor force, then the city's unemployment rate equals
A) 45.0%.
B) 4.5%.
C) 4.3%.
D) 0.45%.
Answer: B
Diff: 2
Topic: Section: 1.1
Question Status: Previous Edition

22) If a city has 3293 unemployed people and 69,884 employed people, then the city's unemployment rate equals
A) 45.0%.
B) 4.5%.
C) 4.3%.
D) 0.45%.
Answer: B
Diff: 2
Topic: Section: 1.1
Question Status: Previous Edition

23) 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
Topic: Section: 1.1
Question Status: Previous Edition

24) From 1800 to 1940, the price level in the United States
A) trended neither upward nor downward.
B) fluctuated wildly.
C) declined slowly.
D) increased slowly.
Answer: A
Diff: 2
Topic: Section: 1.1
Question Status: Previous Edition

25) The average price of goods in the United States
A) was relatively constant over the 1800-1945 period.
B) was relatively constant over the decade of the 1980s.
C) declined over the decade of the 1970s.
D) is always constant in the long run.
Answer: A
Diff: 2
Topic: Section: 1.1
Question Status: New

26) Before World War II, the average level of prices in the United States usually
A) fell during wartime and rose during peacetime.
B) fell during wartime and fell during peacetime.
C) rose during wartime and fell during peacetime.
D) rose during wartime and rose during peacetime.
Answer: C
Diff: 1
Topic: Section: 1.1
Question Status: Previous Edition

27) Historical evidence shows that consumer prices in the United States
A) declined between the 1920s and World War II, but increased afterward.
B) increased between the 1920s and World War II, but declined afterward.
C) have shown a continuous inflationary pattern since the 1920s.
D) have displayed no clear-cut trend since the 1970s.
Answer: A
Diff: 2
Topic: Section: 1.1
Question Status: New

28) 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
Topic: Section: 1.1
Question Status: Previous Edition

29) 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
Topic: Section: 1.1
Question Status: Previous Edition

30) The inflation rate is the
A) percent increase in the average level of prices over a year.
B) percent increase in output over a year.
C) percent increase in the unemployment rate over a year.
D) price level divided by the level of output.
Answer: A
Diff: 1
Topic: Section: 1.1
Question Status: Previous Edition

31) The inflation rate is the
A) real interest rate minus the nominal interest rate.
B) percentage increase in the average level of prices over a year.
C) number of unemployed divided by the labor force.
D) labor force divided by the number of unemployed.
Answer: B
Diff: 1
Topic: Section: 1.1
Question Status: New

32) If the price level was 100 in 2021 and 102 in 2022, the inflation rate was
A) 102%.
B) 20%.
C) 2%.
D) 0.2%.
Answer: C
Diff: 2
Topic: Section: 1.1
Question Status: Revised

33) 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
Topic: Section: 1.1
Question Status: Previous Edition

34) An open economy is a national economy that
A) doesn't interact economically with the rest of the world.
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 national economies.
Answer: C
Diff: 1
Topic: Section: 1.1
Question Status: Previous Edition

35) An economy that doesn't interact economically with the rest of the world is called ________ economy.
A) a closed
B) an open
C) a surplus
D) an authoritarian
Answer: A
Diff: 1
Topic: Section: 1.1
Question Status: Previous Edition

36) U.S. exports are goods and services
A) produced abroad and sold to Americans.
B) produced in the United States and sold to Americans.
C) produced abroad and sold to foreigners.
D) produced in the United States and sold to foreigners.
Answer: D
Diff: 1
Topic: Section: 1.1
Question Status: Previous Edition

37) U.S. imports are goods and services
A) produced abroad and sold to Americans.
B) produced in the United States and sold to Americans.
C) produced abroad and sold to foreigners.
D) produced in the United States and sold to foreigners.
Answer: A
Diff: 1
Topic: Section: 1.1
Question Status: Previous Edition

38) Following World War I and World War II, the United States had a
A) small trade surplus.
B) small trade deficit.
C) large trade deficit.
D) large trade surplus.
Answer: D
Diff: 1
Topic: Section: 1.1
Question Status: Previous Edition

39) In the 1980s, 1990s, and 2000s, the United States has had a
A) small trade surplus.
B) small trade deficit.
C) large trade deficit.
D) large trade surplus.
Answer: C
Diff: 1
Topic: Section: 1.1
Question Status: Previous Edition

40) A country has a trade surplus when
A) imports exceed exports.
B) imports equal exports.
C) exports exceed imports.
D) imports equal zero.
Answer: C
Diff: 1
Topic: Section: 1.1
Question Status: Previous Edition

41) 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
Topic: Section: 1.1
Question Status: Previous Edition

42) A country had imports of $50 billion, exports of $60 billion, and GDP of $300 billion. The trade surplus was what percent of GDP?
A) 3.3%.
B) 10.0%.
C) 16.7%.
D) 20.0%.
Answer: A
Diff: 2
Topic: Section: 1.1
Question Status: New

43) A country had imports of $20 billion, exports of $5 billion, and GDP of $300 billion. The trade deficit was what percent of GDP?
A) -3.3%.
B) 3.3%.
C) 5.0%.
D) 50.0%.
Answer: C
Diff: 2
Topic: Section: 1.1
Question Status: New

44) Data on exports and imports for the United States over the period from 1890 to 2021 show that
A) the United States had large trade deficits throughout this entire period.
B) the United States had large trade surpluses throughout this entire period.
C) the percentage of total output exported by U.S. firms fell dramatically during World War I and World War II.
D) a higher percentage of U.S. goods was exported in recent years than in years before 2000.
Answer: D
Diff: 2
Topic: Section: 1.1
Question Status: Revised

45) A central bank is an institution that
A) pays for government expenditures.
B) controls a nation's monetary policy.
C) runs a country's stock market.
D) determines a nation's fiscal policy.
Answer: B
Diff: 1
Topic: Section: 1.1
Question Status: Previous Edition

46) A country's monetary policy is controlled by
A) private citizens.
B) the central bank.
C) large banks.
D) the legislature.
Answer: B
Diff: 1
Topic: Section: 1.1
Question Status: New

47) In the United States, monetary policy is determined by
A) the Federal Reserve.
B) the president.
C) private citizens.
D) the Treasury Department.
Answer: A
Diff: 1
Topic: Section: 1.1
Question Status: Previous Edition

48) The peak in U.S. government spending as a percent of GDP occurred during
A) World War II.
B) the 1960s war on poverty.
C) the Great Depression.
D) the pandemic recession in 2020.
Answer: A
Diff: 1
Topic: Section: 1.1
Question Status: Revised

49) Why were the U.S. government budget deficits of the 1980s and early 1990s so unusual from a historical point of view?
A) It was the first time the U.S. government had ever run deficits.
B) In the past, deficits were usually that large only in wartime.
C) It was the first time that deficits were accompanied by very high rates of inflation.
D) It was the first time that deficits diverted funds from other productive uses, such as investment in modern equipment.
Answer: B
Diff: 1
Topic: Section: 1.1
Question Status: Previous Edition

50) Critics of the government's fiscal policies argued that government deficits
A) prevented capital from flowing into the United States.
B) were linked to the excess of imports over exports that occurred in the 1980s.
C) caused the level of unemployment in the United States to increase during the 1980s.
D) had directly contributed to a decline in the level of demand in the American economy.
Answer: B
Diff: 2
Topic: Section: 1.1
Question Status: Previous Edition

51) The government collected receipts of $100 billion and had expenditures of $125 billion. Its GDP was $400 billion. The government's deficit was what percent of GDP?
A) 6.25%.
B) 12.5%.
C) 25.0%.
D) 100.0%.
Answer: A
Diff: 2
Topic: Section: 1.1
Question Status: New

52) The difference between microeconomics and macroeconomics is that
A) microeconomics looks at supply and demand for goods, macroeconomics looks at supply and demand for services.
B) microeconomics looks at prices, macroeconomics looks at inflation.
C) microeconomics looks at individual consumers, macroeconomics looks at national totals.
D) microeconomics looks at national issues, macroeconomics looks at global issues.
Answer: C
Diff: 1
Topic: Section: 1.1
Question Status: Previous Edition

53) Aggregation is the process of
A) calculating real GDP based on nominal GDP and the price index.
B) summing individual economic variables to obtain economywide totals.
C) forecasting the components of GDP.
D) predicting when recessions will occur.
Answer: B
Diff: 1
Topic: Section: 1.1
Question Status: Previous Edition

54) 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
Topic: Section: 1.1
Question Status: New

55) Starting from a year in which gross domestic product for the economy is $8,000 billion, calculate how much output the national economy would produce in each of the next five years if it continued to grow at its potential real growth rate of 3%.
How much output would the economy produce in each year if it grew by 4% the first year, 2% the second year, 1% the third year, -1% the fourth year, and -3% the fifth year? (Note: A negative growth rate means output is declining.)
By the fifth year, how far is output below its potential level?
Answer:

Potential Output (billions)	Actual Output (billions)
Year 1: $8,000 × 1.03 = $8,240	$8,000 × 1.04 = $8,320
Year 2: $8,240 × 1.03 = $8,487	$8,320 × 1.02 = $8,486
Year 3: $8,487 × 1.03 = $8,742	$8,486 × 1.01 = $8,571
Year 4: $8,742 × 1.03 = $9,004	$8,571 × 0.99 = $8,486
Year 5: $9,004 × 1.03 = $9,274	$8,486 × 0.97 = $8,231

[Note: Don't worry about rounding differences that arise in problems like this, because such differences depend on how many digits you carry over from one calculation to the next.]
Output is below potential output by [(9,274 - 8,231)/9,274] × 100% = 11.2%.
Diff: 2
Topic: Section: 1.1
Question Status: Previous Edition

56) What are the major factors affecting the long-term growth of the economy's output?
Answer: The major factors are population growth and average labor productivity.
Diff: 1
Topic: Section: 1.1
Question Status: Previous Edition

57) Macroeconomic information for the economy of Anchovy is given below.

	Year 1	Year 2
Output (pizzas)	8000	9000
Employment (workers)	700	800
Unemployed (workers)	70	100
Labor force (workers)	770	900
Price per pizza	$8.00	$9

(a) What was the growth rate of average labor productivity in Anchovy between Year 1 and Year 2?
(b) What was the inflation rate in Anchovy between Year 1 and Year 2?
(c) What was the unemployment rate in Year 1? In Year 2?
Answer:
(a) Average labor productivity: Year 1: 8000/700 = 80/7; Year 2: 9000/800 = 90/8; growth rate = [(90/8)/(80/7)] - 1 = -0.016 = -1.6%
(b) Inflation rate: (9/8) - 1 = 0.125 = 12.5%
(c) Unemployment rates: Year 1: 70/770 = 0.091 = 9.1%; Year 2: 100/900 = 0.111 = 11.1%
Diff: 2
Topic: Section: 1.1
Question Status: Previous Edition

58) Using the CPI measure of the price level, which is 100 in the base year of 2019, calculate the annual inflation rates for
(a) 2020, when the index is 103.7.
(b) 2021, when the index is 105.5.
(c) 2022, when the index is 107.7.
Answer:
(a) Inflation in 2020 = (103.7 - 100.0)/100 × 100% = 3.7%.
(b) Inflation in 2021 = (105.5 - 103.7)/103.7 × 100% = 1.7%.
(c) Inflation in 2022 = (107.7 - 105.5)/105.5 × 100% = 2.1%.
Diff: 2
Topic: Section: 1.1
Question Status: Revised

59) What is meant by *aggregation*? Why is aggregation important for macroeconomic analysis?
Answer: Aggregation refers to the process of adding together individual economic variables to obtain economywide totals. Aggregation distinguishes microeconomics from macroeconomics. It allows us to study the economy as a whole, rather than looking at its individual parts.
Diff: 1
Topic: Section: 1.1
Question Status: Previous Edition

1.2 What Macroeconomists Do

1) Many people perceive erroneously that most macroeconomists spend a lot of time engaged in
A) forecasting.
B) macroeconomic research.
C) macroeconomic analysis.
D) data development.
Answer: A
Diff: 1
Topic: Section: 1.2
Question Status: Previous Edition

2) Of these areas of macroeconomics, which employs the fewest economists?
A) Macroeconomic forecasting
B) Macroeconomic analysis
C) Macroeconomic research
Answer: A
Diff: 1
Topic: Section: 1.2
Question Status: Previous Edition

3) The most difficult part of forecasting is
A) lack of computing power.
B) not enough theoretical models.
C) insufficient data on the economy.
D) the complexity of the economy.
Answer: D
Diff: 1
Topic: Section: 1.2
Question Status: Previous Edition

4) A macroeconomist who is employed at a university is most likely to be primarily engaged in which of these tasks?
A) Macroeconomic forecasting
B) Macroeconomic analysis
C) Macroeconomic research
D) Macroeconomic data development
Answer: C
Diff: 1
Topic: Section: 1.2
Question Status: Previous Edition

5) The main function of public-sector macroeconomic analysts is to
A) assist in policymaking.
B) find ways to increase corporate profits.
C) engage in theoretical research.
D) forecast the developments in industries.
Answer: A
Diff: 1
Topic: Section: 1.2
Question Status: Previous Edition

6) 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 understand better the operation of the economy.
D) make general statements about how the economy works.
Answer: D
Diff: 1
Topic: Section: 1.2
Question Status: Previous Edition

7) A set of ideas about the economy that have been organized in a logical framework is called
A) empirical analysis.
B) a methodology.
C) economic theory.
D) data development.
Answer: C
Diff: 1
Topic: Section: 1.2
Question Status: Previous Edition

8) A simplified description of some aspect of the economy is called
A) empirical analysis.
B) a methodology.
C) an economic model.
D) data development.
Answer: C
Diff: 1
Topic: Section: 1.2
Question Status: Previous Edition

9) 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
Topic: Section: 1.2
Question Status: Previous Edition

10) Testing a theory by comparing the theory's implications with data obtained in the real world is called
A) empirical analysis.
B) descriptive calibration.
C) historical variance analysis.
D) univariate analysis.
Answer: A
Diff: 1
Topic: Section: 1.2
Question Status: Previous Edition

11) If the theory behind an economic model fits the data poorly, 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: B
Diff: 2
Topic: Section: 1.2
Question Status: Previous Edition

12) Why is macroeconomic forecasting so difficult? Does this difficulty mean economics is a worthless field of study?
Answer: Forecasting is difficult because our understanding of how the economy works is imperfect and because it's impossible to take into account all the factors that might affect future economic trends. This just means the field of economics is difficult and complex, not that it's worthless.
Diff: 1
Topic: Section: 1.2
Question Status: Previous Edition

13) What are the four major areas in which macroeconomists work? Give an example of a job in each.
Answer: The four areas are forecasting, analysis, research, and data development. Forecasting: forecasting the stock market on Wall Street; analysis: analyzing the economy for the Federal Reserve; research: investigating the link between the trade deficit and the government budget deficit as a university professor; data development: working at the Bureau of Labor Statistics to develop better ways to measure unemployment.
Diff: 1
Topic: Section: 1.2
Question Status: Previous Edition

14) 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 Wall 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 International Trade Commission trying to determine whether foreign firms are dumping goods in the United States
(e) Economist at the Commerce Department 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
Topic: Section: 1.2
Question Status: Previous Edition

15) Briefly describe the following tasks of macroeconomists: forecasting; analysis; research; and data development.
Answer:
(a) Forecasting. Macroeconomists develop models to predict the future values of macroeconomic variables in one or more markets. These models are usually based on economic theory but are statistical in form and estimated using macroeconomic data.
(b) Analysis. Macroeconomists analyze changes in macroeconomic policies as well as other changes in macroeconomic market conditions. This analysis is based on economic theory, uses analytic reasoning techniques, and may rely on forecasting models.
(c) Research. The goal of macroeconomic research is to make general statements about how the economy works. Research economists formulate and test theories.
(d) Data development. Macroeconomic data development provides the data needed in macroeconomic research, analysis, and forecasting. Most macroeconomic data are collected and published by the government.
Diff: 1
Topic: Section: 1.2
Question Status: Previous Edition

1.3 Why Macroeconomists Disagree

1) 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
Topic: Section: 1.3
Question Status: Previous Edition

2) Which of the statements below is primarily normative in nature?
A) There is an unequal distribution of income in the United States.
B) The distribution of income is more unequal in the United States than it is in Japan.
C) The inequality of income that exists in the United States is partly caused by an unequal distribution of wealth.
D) The distribution of income in the United States should be more equal than it is.
Answer: D
Diff: 2
Topic: Section: 1.3
Question Status: Previous Edition

3) The principal distinction between positive analysis and normative analysis is that
A) positive analysis is useful and normative analysis is not useful.
B) positive analysis is optimistic and normative analysis is neutral.
C) economists always agree on the conclusions of positive analysis but could disagree on the conclusions of normative analysis.
D) positive analysis tells us "what is," but normative analysis tells us "what ought to be."
Answer: D
Diff: 1
Topic: Section: 1.3
Question Status: Previous Edition

4) Equilibrium in the economy means
A) unemployment is zero.
B) quantities demanded and supplied are equal in all markets.
C) prices are not changing over time.
D) tax revenues equal government spending, so the government has no budget deficit.
Answer: B
Diff: 1
Topic: Section: 1.3
Question Status: Previous Edition

5) In equilibrium
A) there is no pressure for wages or prices to change.
B) inflation is zero.
C) GDP growth is zero.
D) the unemployment rate is zero.
Answer: A
Diff: 1
Topic: Section: 1.3
Question Status: Previous Edition

6) Adam Smith's idea of the "invisible hand" says that given a country's resources and its initial distribution of wealth, the use of markets will
A) insulate a nation from the effects of political instability.
B) eliminate problems of hunger and dissatisfaction.
C) eliminate inequalities between the rich and the poor.
D) make people as economically well off as possible.
Answer: D
Diff: 1
Topic: Section: 1.3
Question Status: Previous Edition

7) The two most comprehensive, widely accepted macroeconomic models are
A) the classical model and the supply-side model.
B) the supply-side model and the real business cycle model.
C) the classical model and the Keynesian model.
D) the Austrian model and the Keynesian model.
Answer: C
Diff: 1
Topic: Section: 1.3
Question Status: Previous Edition

8) Classical economists argue that
A) the government should have an active role in the economy.
B) government policies will be ineffective or counterproductive.
C) the government should actively intervene in the economy to eliminate business cycles.
D) wages and prices don't adjust quickly, so the economy is slow to return to equilibrium.
Answer: B
Diff: 2
Topic: Section: 1.3
Question Status: Revised

9) 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
Topic: Section: 1.3
Question Status: Previous Edition

10) Classical economists who assume the "invisible hand" works reasonably well do *not* argue that
A) wages and prices adjust quickly to bring the economy back to equilibrium.
B) the government should actively intervene in the economy to eliminate business cycles.
C) government policies will be ineffective and counterproductive.
D) the government should have a limited role in the economy.
Answer: B
Diff: 1
Topic: Section: 1.3
Question Status: Previous Edition

11) John Maynard Keynes disagreed with the classical economists because he believed that
A) wages and prices adjust slowly.
B) international trade plays a major role in the macroeconomy.
C) government intervention in the economy cannot reduce business cycles.
D) unemployment will be eliminated quickly by the invisible hand of the market.
Answer: A
Diff: 1
Topic: Section: 1.3
Question Status: Previous Edition

12) Keynes was motivated to create a macroeconomic theory different from classical theory because
A) he believed in government intervention in the economy.
B) he believed in the idea of the invisible hand.
C) monetary policy was more important than the classicals acknowledged.
D) classical theory was inconsistent with the data in the Great Depression.
Answer: D
Diff: 1
Topic: Section: 1.3
Question Status: Previous Edition

13) Keynes assumed that wages and prices were slow to adjust in order to explain
A) persistently high unemployment.
B) high inflation.
C) the high level of interest rates.
D) why inflation fell in recessions.
Answer: A
Diff: 2
Topic: Section: 1.3
Question Status: Previous Edition

14) 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 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
Topic: Section: 1.3
Question Status: Previous Edition

15) The primary factor that caused most economists to lose their faith in the classical approach to macroeconomic policy was
A) the high levels of unemployment that occurred during the Great Depression.
B) the presence of both high unemployment and high inflation during the 1970s.
C) the theoretical proof that classical ideas were invalid.
D) the evidence that classical ideas were useful during economic booms, but not during economic recessions.
Answer: A
Diff: 2
Topic: Section: 1.3
Question Status: Previous Edition

16) The primary factor that caused some economists to lose their faith in the Keynesian approach to macroeconomic policy was
A) the high levels of unemployment that occurred during the Great Depression.
B) the presence of both high unemployment and high inflation during the 1970s.
C) theoretical proof that Keynes's ideas were invalid.
D) evidence that Keynes's ideas were useful during economic recessions, but not during economic booms.
Answer: B
Diff: 2
Topic: Section: 1.3
Question Status: Previous Edition

17) Stagflation is a situation of
A) high unemployment and high inflation.
B) high unemployment and low inflation.
C) low unemployment and high inflation.
D) low unemployment and low inflation.
Answer: A
Diff: 2
Topic: Section: 1.3
Question Status: Previous Edition

18) Determine whether each of the following is a positive or normative statement.
(a) The Fed 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 labor productivity in a country should lead to faster growth.
(g) Government budget deficits are too high in the United States and should be reduced.
Answer:
(a) Normative
(b) Positive
(c) Positive
(d) Normative
(e) Positive
(f) Positive
(g) Normative
Diff: 2
Topic: Section: 1.3
Question Status: Previous Edition

19) Why is wage and price flexibility crucial to the idea of the "invisible hand"?
Answer: Wage and price flexibility is crucial because in a free-market system, changes in wages and prices are the signals that coordinate the actions of people and businesses in the economy.
Diff: 1
Topic: Section: 1.3
Question Status: Previous Edition

20) Discuss the major differences 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
Topic: Section: 1.3
Question Status: Previous Edition

21) Compare and contrast the classical and Keynesian schools of thought for the following economic issues.
(a) The flexibility of wages and prices.
(b) The importance of macroeconomic policies.
Answer:
(a) The flexibility of wages and prices is a principal point of disagreement between classical economists and Keynesians. Classical economists believe that wages and prices are quite flexible; in response to a change in market conditions, wages and prices adjust quickly to their new market-clearing levels. Keynesians believe that wages and prices are rigid or sticky; in response to changes in the economy, wages and prices adjust slowly to their new market-clearing levels.
(b) Classicals and Keynesians also disagree about the use of macroeconomic policies. Given wage-price flexibility, classical economists believe that the market economy normally provides for full employment. They believe that government intervention in the form of macroeconomic fiscal and monetary policies is not needed to prevent recessions. Given slow adjustments in wages and prices, Keynesians believe that recessions could plague the economy for several years. They believe that efficient use of macroeconomic policies could return the economy to equilibrium more quickly.
Diff: 2
Topic: Section: 1.3
Question Status: Previous Edition

22) In 1993, the debate heated up in the United States about the North American Free Trade Agreement (NAFTA), which proposed to reduce barriers to trade (such as taxes on or limits to imports) among Canada, the United States, and Mexico. Some people opposed strongly the agreement, arguing that an influx of foreign goods under NAFTA would disrupt the U.S. economy, harm domestic industries, and throw American workers out of work. How might a classical economist respond to these concerns? Would you expect a Keynesian economist to be more or less sympathetic to these concerns than the classical economist? Why?
Answer: A classical economist might argue that the economy would work more efficiently with NAFTA because it reduces trade barriers, making the invisible hand work even better. Workers could specialize even more than before so that total output produced by all three countries would be more. Though the industrial mix might change in each country, wages and prices across industries would adjust quickly, and people in industries that closed down in a particular country would quickly find new jobs.
A Keynesian economist might be more sympathetic to concerns about NAFTA because of the belief that adjustment to the changes will not occur quickly. As a result, people in particular industries in a country may become unemployed. Wages won't adjust quickly to restore full employment, so some government action (like retraining programs to give displaced workers new skills) may be desirable.
Diff: 2
Topic: Section: 1.3
Question Status: Previous Edition