Part 1. Multiple choice. 60 questions, @ 1.25 points, 75 points total. On your Accuscan 100AS answer form, mark the letter corresponding to the best answer. Use pencil only.

On your scan form, write
1. Your name
2. Today’s date
3. Exam 3
4. ECO231 and your CORRECT section number

1) When the economy is at its full employment Real GDP, the unemployment rate is equal to
A) zero.
B) the natural unemployment rate.
C) the frictional unemployment rate.
D) the structural unemployment rate.

2) If Real GDP is less than Natural Real GDP, the economy is in
A) an inflationary gap.
B) a recessionary gap.
C) an unemployment gap.
D) a real gap.

3) If the natural unemployment rate is 5 percent and the current unemployment rate is 6 percent, then the economy is
A) producing more Real GDP than it does at full employment.
B) in an inflationary gap.
C) an unemployment gap.
D) a real gap.

4) DELETE The long-run aggregate supply (LRAS) curve is
A) horizontal.
B) vertical.
C) positively sloped.
D) negatively sloped.

Exhibit 9-3

5) Refer to Exhibit 9-3. The economy is in short-run equilibrium and has an inflationary gap at point
A) A.
B) B.
C) C.
D) D.
E) E.

6) Refer to Exhibit 9-3. The economy is in short-run equilibrium and has a recessionary gap at point
A) A.
B) B.
C) C.
D) D.
E) E.

7) Refer to Exhibit 9-3. If the economy is in short-run equilibrium at point C, the (actual) unemployment rate is
A) less than the natural unemployment rate.
B) equal to the natural unemployment rate.
C) greater than the natural unemployment rate.
D) the relationship between the (actual) unemployment rate and the natural unemployment rate cannot be determined from the available information.

8) In a "self-regulating" economy, inflationary and recessionary gaps
A) never occur.
B) are eliminated by forces internal to the economy, without government intervention.
C) are eliminated by timely actions of economic policymakers.
D) are the desirable results of microeconomic price adjustments.

9) The institutional production possibilities frontier illustrates the different combinations of goods that society can obtain given
A) the constraints of finite resources and the current state of technology.
B) the price level.
C) its institutional constraints.
D) the natural rate of unemployment.
E) the constraints of finite resources and the current state of technology and institutional constraints.

10) An increase in a country's exchange rate will tend to _____ its net exports.
a. reduce
b. keep about unchanged
c. increase
11) The classical economists felt that saving would be equal to investment because
a. wages are flexible.
b. prices of domestic goods are flexible.
c. interest rates are flexible.
d. prices of imports are flexible.

12. Say’s law says
a. demand creates its own supply.
b. the more supply there is, the lower prices are.
c. supply creates supply.
d. supply creates its own demand.
e. none of the above

13) Refer to Exhibit 9-7. Which point is representative of the economy experiencing labor market shortages?
A) A  
B) B  
C) C  
D) E

14. Which of the following is consistent with the classical position on wages and prices?
a. Wages and prices are sticky in the downward direction.
b. Wages are sticky in the downward direction, but prices are flexible.
c. Wages and prices are flexible.
d. Prices are sticky in the downward direction, but wages are flexible.

15. Which of the following is an example of crowding out?
a. A decrease in the rate of growth of the money supply which causes a decrease in Real GDP.
b. A deficit causes an increase in interest rates, which causes a decrease in investment spending.
c. An increase in tariffs which causes a decrease in imports.
d. A decrease in government housing subsidies which causes an increase in private spending on housing.

16. With complete crowding out, an increase in government spending
a. is completely offset by a reduction in private spending.
b. is matched by an increase in private spending.
c. results in an increase in aggregate supply.
d. results in an increase in aggregate demand.

17. Say that the government of Atlantica runs a large government budget deficit this year. If international crowding out occurs, Atlantica’s currency exchange rate will ____ and net export spending will ____.
a. rise; rise  
b. rise; fall  
c. fall; rise  
d. fall; fall

18. Refer to Exhibit 11-2. At point B, if we reduce tax rates slightly, tax revenues
a. increase.  
b. decrease.  
c. will not change.  
d. drop to zero.
19. All other things held constant, lower marginal (income) tax rates
   a. necessarily increase tax revenues.
   b. necessarily decrease tax revenues.
   c. decrease the attractiveness of productive activities relative to leisure and
tax-avoidance activities, and shift the SRAS curve rightward.
   d. do not affect the attractiveness of productive activities relative to leisure and
tax-avoidance activities and therefore the SRAS does not shift rightward or leftward.
   e. increase the attractiveness of productive activities relative to leisure and
tax-avoidance activities and shift the SRAS curve rightward.

For the next three questions: Say that the Pacific island nation of Kiribati (pronounced,
inexplicably, kirbäss) is in a recessionary gap. Say further that the government takes no
action to remedy the situation, relying on the self-regulating nature of the market economy
to do the job.

20. In the labor market, we would find cyclical unemployment, which would lead to
   a _____ in wage rates, which would shift the _____ curve to the _____.
   a. decrease; SRAS; right
   b. decrease; AD; right
   c. increase; SRAS; left
   d. increase; AD; left

21. In the loanable funds market, we would find a _____, which would lead to a
   _____ in the real interest rate and a shift of the _____ curve to the _____.
   a. shortage; decrease; SRAS; left
   b. shortage; increase; SRAS; right
   c. surplus; decrease; AD; right
   d. surplus; increase; AD; left

22. In the foreign exchange market for the Kiribati dollar, we would find a _____,
   which would lead to a _____ in the exchange rate and a shift of the _____ curve to the _____.
   a. shortage; decrease; SRAS; left
   b. shortage; increase; SRAS; right
   c. surplus; decrease; AD; right
   d. surplus; increase; AD; left

23. Which of the following is the largest spending component of the federal budget?
   a. discretionary domestic spending
   b. discretionary defense spending
   c. entitlements and mandatory spending
   d. net interest payments on the debt

24. Say that countries A and B begin the year 2011 with balanced government
   budgets and real GDPs of $10 billion each. No changes in resources or technology
   take place during the year. Then, each increases government spending by $1 billion. A
   increases taxes by $1 billion. B does not raise taxes, but instead issues $1 billion of
   new government bonds. According to the Ricardian Equivalence Theorem, 2011 real
   GDP in A will be _____ $10 billion and in B, _____ $10 billion.
   A. less than; less than
   B. less than; equal to
   C. equal to; equal to
   D. equal to; greater than
   E. greater than; greater than

\begin{tabular}{|c|c|}
\hline
\textbf{Taxable Income} & \textbf{Taxes} \\
\hline
$0 - $23,000 & 15\% of taxable income \\
$23,001 - $42,000 & $3,450 + 20\% of everything over $23,000 \\
$42,001 - $100,000 & $7,250 + 25\% of everything over $42,000 \\
Greater than $100,000 & $21,750 + 30\% of everything over $100,000 \\
\hline
\end{tabular}

25. Refer to Exhibit 11-4. If a Bob's taxable income is $75,000, how much does he
   pay in taxes?
   a. $5,260
   b. $11,150
   c. $15,500
   d. $18,750

26. Use the information provided in Exhibit 11-4. What is the marginal tax rate on
   the 42,001st dollar of taxable income earned?
   a. 15\%
   b. 20\%
   c. 25\%
   d. 30\%
e. There is not enough information provided to answer this question.

27. Say that the government of Siluria conducts an expansionary Keynesian-style
   fiscal policy, increasing government spending by $90 billion, funded entirely by
   borrowing. If the government spending multiplier is 3, and it really works, then
   aggregate demand will
   a. fall by $270 billion.
   b. fall by $30 billion.
   c. rise by $30 billion.
   d. rise by $270 billion.
28. Each of the following is a reason why a fiscal policy action might not work as planned except
A. crowding out.
B. the political business cycle
C. permanent income.
D. inside and outside lags.

29. The national debt is equal to
a. federal debt owed to the public minus debt owed to the federal government foreign governments.
b. the total of federal, state, and local debts.
c. the total value of debt owed to Americans by foreigners.
d. the total value of all US government bonds outstanding.

30. The top 1 percent of US households, by income, in 2009 earned about ______ percent of total before-tax household income and paid about ______ percent of all federal taxes.
a. 55; 17
b. 24; 28
c. 74; 2
d. 13; 29
e. 46; 32

31. The most meaningful measure of a government’s debt is
a. the total indebtedness, in dollars
b. the indebtedness to foreign creditors only
c. the net national (public) debt as a percent of GDP.
d. the total national debt as a percent of GDP.

32. Refer to Figure 2. Which fiscal policy action might be appropriate in this case?
A. G↑ → AD↑
B. G↓ → AD↓
C. T↑ → AD↑
D. T↑ → AD↓

33. The approximate current value of the NET national debt (i.e., the debt held by the public) is
a. $4.5 trillion.
b. $12.9 trillion.
c. $19.2 trillion.
d. $22.7 trillion.

For the next two questions: Say that the King of Pomerania puts a standard, Keynesian-style expansionary fiscal policy in to effect to deal with his country’s recession. Specifically, he borrows $50 billion and spends it on public works projects, such as a new summer palace for him and his family. Refer also to Figure 4.

34. If the policy works as planned, ______ will rise, leading real GDP to rise as well.
a. LRAS (long run aggregate supply)
b. T (tax revenues)
c. AS (short run aggregate supply)
d. AD (aggregate demand)

35. Refer to Figure 4. Which shift correctly depicts the change described above?
A. AD1 to AD2
B. AD2 to AD3
C. AD2 to AD1
D. AD3 to AD2

36. The actual net value of the Social Security Trust Fund is approximately
a. zero.
b. $500 billion.
c. $2.7 trillion.
d. $15 trillion.

For the next three questions: Say that the government of Iceland has previously been balancing its budget. This year it chooses to increase government spending by kr200 billion without raising taxes, causing a kr200 billion budget deficit. (kr = króna, the Icelandic currency. It’s worth about ¼ cents.) The government finances this by borrowing kr200 billion from the loanable funds market. Consider the following three questions in the context of crowding out.

37. As a result, the real interest rate in Iceland will
a. rise.
b. stay the same.
c. fall.
38. The level of borrowing, i.e., the quantity of loanable funds loaned and borrowed, will
   a. rise by more than kr200 billion.
   b. rise by approximately kr200 billion.
   c. rise by less than kr200 billion.
   d. remain the same.

39. The level of investment spending in Iceland will
   a. rise.
   b. stay the same.
   c. fall.

40. A problem with eliminating the one-cent piece from our coinage is that
   a. the federal government employee’s union would resist the move.
   b. since they cost much less than one cent to produce, government revenues would fall.
   c. since they are made of 95% copper, the price of copper would plummet.
   d. unless we also eliminate nickels and quarters, we would have to round to the nearest 5 cents.

41. US half-dollars, or fifty-cent pieces
   a. have depicted Miss Liberty, Paul Revere, and Franklin Roosevelt.
   b. were made of 90% silver in the early 20th century.
   c. are no longer being minted by the US Mint.
   d. were withdrawn from circulation largely because of political opposition to their depiction of John F. Kennedy.

42. When money is accepted as payment for a good or service, it is being used as a
   a. unit of account.
   b. a mechanism for transforming current purchases into future purchases.
   c. store of value.
   d. medium of exchange.

43. In order for a barter transaction to be successful, there must be a
   a. high demand for a certain item.
   b. market for the goods.
   c. double coincidence of wants.
   d. federal tax law in effect.

44. A group of tribesmen living in the Kalahari desert use a barter system. They trade a set of only 8 different goods. What is the total number of prices their system requires?
   A. 16
   B. 28
   C. 56
   D. 64

45) Liquidity refers to
   A) the purchasing power of a dollar over time.
   B) the ability of an asset to hold its value over time.
   C) the ease with which an asset can be exchanged without loss of value.
   D) none of the above

46. What gives money value under a fiat money system?
   a. The supply of fiat money is controlled by the government.
   b. Fiat money is the same as Treasury bonds.
   c. Fiat money is backed by gold.
   d. Fiat money is also a valuable commodity.

47. Say that the price level in the US is 225 and that in India, 9500. The nominal exchange rate is 1 Indian rupee = $.0161. What is the real exchange rate of the dollar?
   a. 0.68
   b. 1.47
   c. 163
   d. 2,618

48. Which of the following serves as the central bank for the United States?
   a. the Federal Reserve System
   b. the Federal Deposit Insurance Corporation
   c. the Congress
   d. the Treasury Department

49) M1 is comprised of currency held outside banks + traveler’s checks +
   A) credit cards
   B) savings deposits
   C) gold
   D) checkable deposits
   E) money market mutual funds

50) The deficit that exists when the economy operates at full employment is called the
    a. net deficit
    b. gross deficit
    c. cyclical deficit
    d. structural deficit
51) According to the text, *The Wonderful Wizard of Oz* is alleged to be a story about
A) the California gold strikes of 1849.
B) the end of the gold standard in 1934.
C) the presidential election of 1896.
D) the financial panic of 1907.

52) Fractional reserve banking is a term used to describe a banking system whereby
A) individual banks share a fraction of the total funds deposited in the whole banking system.
B) banks are required to quote interest rates in fractions.
C) banks hold reserves equal to only a fraction of their deposit liabilities.
D) banks hold reserves equal to a multiple of their deposit liabilities; that is, fractional in this case really means multiple.
E) banks are required to maintain a certain fraction of their deposits in the form of checkable deposits, a certain fraction of their deposits in the form of savings deposits, etc.

53) Required reserves are the amount of
A) reserves a bank must hold against its deposits as mandated by the Federal Reserve.
B) cash a bank must hold against its deposits as mandated by the Federal Reserve.
C) checkable deposits a bank must hold against all other deposits as mandated by the U.S. Treasury.
D) reserves a bank must hold against all its assets as mandated by the Federal Reserve.

54) The Board of Governors of the Federal Reserve is comprised of
A) seven persons, each appointed to a seven-year term.
B) seven persons, each appointed to a fourteen-year term.
C) fourteen persons, each appointed to a seven-year term.
D) twelve persons, each appointed to a seven-year term.
E) twelve persons, each appointed to a fourteen-year term.

55) Which of the following is not a major responsibility of the Fed?
A) controlling the money supply
B) serving as the federal government’s banker
C) determining tax rates
D) acting as a lender of last resort

56) The Fed has been called “the lender of last resort” because it
A) is the biggest bank in the country.
B) is the only lender to the federal government.
C) serves as the last place to acquire loans for banks suffering cash management, or liquidity, problems.
D) a and b

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57. Bank X is required to hold ____ pounds in reserves.
   a. 5
   b. 15
   c. 50
   d. 85

58. If Clement borrows 50 pounds from Bank X and deposits it in his account at Bank Y, the M1 money supply will be equal to ____ pounds.
   a. 50
   b. 150
   c. 200
   d. 250

59. What is the amount of excess reserves held by Bank X at this point?
   a. 15 pounds
   b. 25 pounds
   c. 30 pounds
   d. 35 pounds

60. Say that the banks fully lend out all the deposits throughout the system. What is the maximum amount of money that can be created from Hassan’s 100 pound deposit (including the initial 100 pounds)?
   a. 100 pounds
   b. 555 pounds
   c. 667 pounds
   d. 1024 pounds

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The reserve requirement set by the Bank of South Sudan is currently 15 percent. Say that in the town of North Gudele there are 3 banks, Banks X, Y, and Z. Hassan deposits 100 South Sudanese pounds (about $33 US currency) in his checking account at Bank X. In the next four questions, ignore all other sources of funds except Hassan’s original 100 pounds.
Part 2. Essay. 2 questions @ 10 points, 20 points total. Answer the
following two questions on separate lined paper. Do not answer on the
back of your scan form.

USE COMPLETE PARAGRAPHS!

1. Say that the emperor of Kurdistan has been issuing coins containing 1
ounce of gold, in the denomination of 50 kuros. (The kuro is a real—well,
imaginary—currency that Kurdish nationalists in Turkey dream of actually using
in their own independent country one day.) Having borrowed heavily to
finance a war with Kazakhstan, the emperor decides to pay off his debts by
issuing new 50-kuro coins, each containing only one-half ounce of gold.

According to Gresham’s Law:
--What will happen to the old 50 kuro coins?
--What will happen to the new 50 kuro coins?
--What will happen to the price level in Kurdistan?

Explain your answer fully.

2. Answer part A and any two of the remaining parts.
A. Jana says to her friends, “This government debt is a crushing burden.
Our grandkids will never be able to pay it off.” Melanie responds, “It’s not a
problem. For one thing, they don’t have to pay it off, and for another, if they
do, they just owe it to themselves.” To which Annemarie replies, “Maybe so,
but you are both ignoring the true burdens of the debt.” Comment on this
conversation. Be certain to list and explain the three true burdens of
the debt.

Choose two of:
B. There are five ways a government can manage its debt. List and
describe these five ways.
C. Bob says he can sleep better at night knowing that the Social Security
Trust Fund amounts to $2.7 trillion, which is approximately 15% of GDP.
What might you tell Bob about the Trust Fund that might give him some
sleepless nights?
D. Why is the debt-to-GDP ratio the preferred method of measuring a
nation’s debt?
E. “The reason the government runs such big deficits is all this wasteful
military spending. Spending on the military is the single biggest item in the
federal budget, and the most out-of-control. If we cut spending on defense
only 5 percent, we could balance the budget year after year.” Comment.

END OF PART 2

Part 3. Reserve reading article summaries. 8 articles @3 points, 24
points total.

END OF EXAM 3