

NAME: _____ Student ID: _____



College of Business Administration
Department of Economics
Principles of Macroeconomics
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ECO 2013 - 0008
Spring 2004

QUIZ III – Version 1

- This closed book QUIZ is worth 100 points.
The exam totals 40 Multiple-Choice questions and 3 Short-Essay questions.
Each Multiple-Choice question is worth 2 points.
The Short-Essay questions are worth 20 points.
Allocate your time accordingly.
- Including the cover page, the exam totals 11 pages.
- DO NOT forget to write your name and your student id on the exam booklet.
- Non-Programmable calculators and language dictionaries are allowed.
- At the end of the exam, hand-in the exam booklet and the computer sheet to the examiner.

March 3, 2004

4:35 p.m. – 5:40 p.m.

BA 2-210

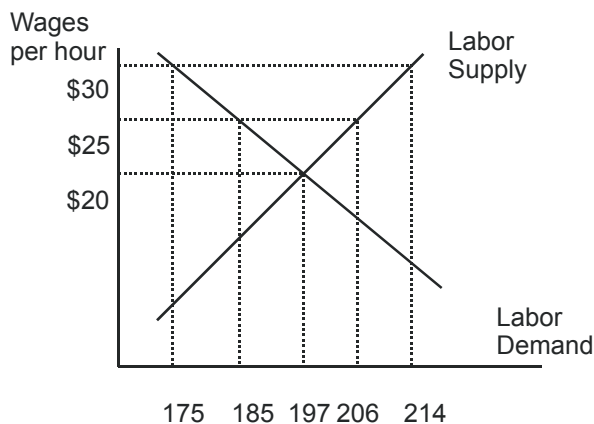
14. Mr. Long is considering the purchase of a corporate bond with a yield (interest rate) of 6% per year, and he expects the inflation rate will average 4% per year during the period that he would hold the bond. Mr. Long has decided to purchase the bond only if the real rate of return is positive on the investment. If the tax rate on the interest income is:
- a) less than 33.3%, he should not buy the bond.
 - b) less than 33.3%, he should buy the bond.
 - c) greater than 33.3%, he should buy the bond.
 - d) greater than 50%, he should buy the bond.
 - e) less than 50%, he should buy the bond.
15. Globalization _____ the wages of workers in the exporting industries and _____ the wages of workers in the import-competing industries.
- a) lowers; raises
 - b) raises; does not change
 - c) raises; raises
 - d) raises; lowers
 - e) lowers; lowers
16. Joy's Java Café needs \$3,000 cash per day for customer transactions. Joy has a choice between going to the bank first thing on Monday morning to withdraw \$15,000 - enough cash for the whole week - or going to the bank first thing every morning for \$3,000 each time. Joy puts the cost of going to the bank at \$2 per trip. Assume that funds left in the bank earn precisely enough interest to keep their purchasing power unaffected by inflation. Joy's Java Cafe is open 5 days a week for 50 weeks each year. When the inflation rate is 10% Joy goes to the bank everyday instead of once a week. Joy's annual shoe leather costs of inflation equal _____.
- a) \$100
 - b) \$3,000
 - c) \$500
 - d) \$ 2
 - e) \$400
17. In the United States between 1980 and 2000, the over-sixteen population:
- a) grew less rapidly than employment.
 - b) grew more rapidly than employment.
 - c) grew at approximately the same rate as employment.
 - d) was constant, while employment increased.
 - e) decreased while employment increased.
18. The marginal product of labor and the price of the output produced determine the:
- a) supply of labor.
 - b) the price of labor.
 - c) the quantity of labor employed.
 - d) demand for labor.
 - e) the amount of worker mobility.

- 19.** Large productivity gains explain:
- a) the slowdown in real wage growth in the 1970s.
 - b) high unemployment in Western Europe.
 - c) skill-based technological change.
 - d) the long-term increase in real wages.
 - e) increasing wage inequality.
- 20.** A political system that promotes the free and open exchange of ideas:
- a) slows the development of new technologies and products.
 - b) increases average labor productivity.
 - c) is detrimental to economic growth.
 - d) encourages unproductive economic activity.
 - e) will not have well-defined property rights.
- 21.** If the CPI equaled 1.00 in 1995 and 1.10 in 2000 and a typical household's income equaled \$35,000 in 1995 and \$38,500 in 2000, then between 1995 and 2000, real household income:
- a) may have increased or decreased.
 - b) was constant.
 - c) increased.
 - d) can not be determined.
 - e) decreased.
- 22.** Costs of structural unemployment:
- a) include substantial lost economic output.
 - b) may actually be negative.
 - c) are quite small because workers are usually only structurally unemployed for a short period of time.
 - d) are quite small since unemployed workers gain the opportunity to develop new job skills.
 - e) are quite small since unemployed workers gain time to gain psychological stability
- 23.** The population of Alpha totals one million people of whom 40 percent are employed. Average output per worker in Alpha is \$20,000. Real GDP per person in Alpha totals:
- a) \$20,000
 - b) \$28,000
 - c) \$8 billion
 - d) \$8,000
 - e) \$12,000
- 24.** If the market interest rate is 8% and the inflation rate is 3%, then the real interest rate equals:
- a) 8%
 - b) 24%
 - c) 11%
 - d) 5%
 - e) 3%

- 28.** An example of a government policy to provide a framework within which the private sector can operate productively is:
- a) government ownership of capital.
 - b) maintaining a well-functioning legal system.
 - c) the establishment of minimum wage laws.
 - d) the suppression of political dissent.
 - e) the taxation of savings.
- 29.** Increasing the capital available to the workforce, holding other factors constant, tends to _____ total output at a(n) _____ rate.
- a) decrease; decreasing
 - b) decrease; increasing
 - c) increase; decreasing
 - d) increase; increasing
 - e) increase; constant
- 30.** The introduction of an overnight delivery service that guarantees the delivery of packages anywhere in the world overnight will increase:
- a) the quantity of human capital.
 - b) the unemployment rate.
 - c) the share of population employed.
 - d) average labor productivity.
 - e) the labor force participation rate.
- 31.** A currency board was introduced in 1991 In Argentina mandating that the Argentine government exchange Argentine pesos for dollars at a one-to-one rate. The goal of introducing the currency board was to:
- a) overcome the hyperinflation of the 1980s and ensure a strong, stable domestic currency.
 - b) expand foreign trade between Argentina and the United States.
 - c) begin the change toward dollarization and eventually replace the Argentine peso with the U.S. dollar.
 - d) overcome the problem of the illegal use of dollars in the Argentine economy.
 - e) reduce the Argentine government's cost of printing pesos.
- 32.** If real GDP per person equaled \$2,000 in 1900 and grew at a 1 percent annual rate, what would real GDP per person equal 100 years later?
- a) \$5,410
 - b) \$22,000
 - c) \$2,200
 - d) \$13,780,612
 - e) \$2,020

- 33.** An example of a government policy to provide a framework within which the private sector can operate productively is:
- a) the establishment of minimum wage laws.
 - b) establishing well defined property rights.
 - c) government ownership of capital.
 - d) the taxation of savings.
 - e) the suppression of political dissent.
- 34.** In symbolic terms where Y equals real GDP, POP equals total population, and N equals the number of employed workers, Y/POP must equal:
- a) $N/Y \times N/POP$
 - b) $Y/POP \times N/POP$.
 - c) $Y/N \times N/POP$.
 - d) $Y/N \times POP/N$.
 - e) $N/Y \times POP/N$.
- 35.** Globalization can increase wage inequality in the United States, if international competition is primarily in industries requiring ____ workers.
- a) low-skilled
 - b) highly-skilled
 - c) highly paid
 - d) few
 - e) many
- 36.** Globalization and skill-biased technological change have contributed to:
- a) high rates of employment in Western Europe.
 - b) the long-term growth in real wages.
 - c) the slowdown in productivity since 1973.
 - d) diminishing returns to labor.
 - e) increasing wage inequality.

Use the following to answer question 37:



- 37.** Based on the figure, if a union contract requires that workers be paid \$25 per hour, there will be ____ unemployed workers.
a) 21 **b)** 22 **c)** 39 **d)** 10 **e)** 12
- 38.** Which of the following contributed to the worldwide slowdown in productivity since 1973?
a) The improvement in the measurement of productivity growth.
b) An increase in technological innovations during the 1970s.
c) The decline the quality of public education.
d) The increase in the price of oil that followed the Arab-Israeli war of 1973.
e) A dearth of technological innovations during the 1970s.
- 39.** Hyperinflations are:
a) inflations that are very high then very low.
b) extremely low rates of inflation.
c) frequently experienced in the United States.
d) extremely high rates of inflation.
e) very erratic inflations.
- 40.** Factors increasing the labor supply and thereby contributing to the slowdown in real-wage growth that began in the 1970s include ____ and _____.
a) skill-biased technological change; globalization
b) technological progress; diminishing returns to labor
c) increasing wage inequality; globalization
d) increased labor force participation by women; the coming-of-age of the baby-boom generation
e) increased worker mobility; increased transition aid

Answer Key

1. b
2. a
3. c
4. e
5. e
6. e
7. e
8. b
9. d
10. c
11. e
12. e
13. b
14. b
15. d
16. e
17. a
18. d
19. d
20. b
21. b
22. a
23. d
24. d
25. b
26. b
27. b
28. b
29. c
30. d
31. a
32. a
33. b
34. c
35. a
36. e
37. a
38. e
39. d
40. d

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Short-Essay Questions (20 points)

Answer in the given space below each question.

Question 1 (7 points)

Give two reasons why the official inflation rate may understate the “true” rate of inflation. Illustrate by example.

First, *quality adjustment bias* occurs when government statisticians underestimate quality improvements. For example, if candy bars weigh 10% more than last year and also cost 10% more, there is no true inflation in candy bar prices (the price per ounce is unchanged). But if the statisticians fail to note the increase in weight and simply record the 10% increase in price, they would mistakenly overstate inflation. Changes in the weight of candy bars are easy to measure, of course, so this particular problem would probably not occur in practice; but more subtle improvements in quality (for example, more effective medical procedures) are often very difficult to measure precisely, potentially leading to quality adjustment bias and overstatement of inflation. Explain.

Second, the fact that the CPI assumes a fixed “basket” of goods and services, and does not allow for the possibility of consumer substitution of less expensive for more expensive items, also tends to create an overstatement of inflation (*substitution bias*). For example, if Mars candy bars are included in the official basket, and the price of these candy bars rises, then an increase in the official cost of living will be recorded. But if people can switch to Snickers bars, which they like equally well and which have not had a price increase, then the “true” cost of living will not have risen, despite what the CPI shows.

Question 2 (7 points)

What is human capital? Why is it economically important? How is new human capital created? Explain.

Human capital is the talents, education, training, and skills of workers. Human capital is important because workers with more human capital are more productive, implying higher levels of output per worker and higher living standards. New human capital is created through “investment in people”, as when individuals spend time and money acquiring an education, or an employer devotes resources to training workers.

Question 3 (6 points)

List three types of unemployment and their causes. Which of these types is economically and socially least costly? Explain.

Frictional unemployment is the short-term unemployment associated with the process of matching workers with jobs in a dynamic, heterogeneous labor market. *Structural unemployment* is the long-term and chronic unemployment that exists even when the economy is producing at a normal rate. Structural unemployment results from factors such as language barriers, discrimination, structural features of the labor market, lack of skills, or long-term mismatches between the skills workers have and the available jobs. *Cyclical unemployment* is the extra unemployment that occurs during periods of recession. Frictional unemployment is probably the least costly type of unemployment, because it is both usually of short duration and often economically beneficial, being part of the process by which productive matches of workers and jobs are formed.