Do not forget to write your full name, student number and section on the top.

Turn off your cell phone and put it away. During the exam if you are seen with a cell phone, on or off, your exam will be taken away instantaneously.

Put away all your lecture notes, books, etc.

There are 60 multiple choice questions and 8 pages in the exam. Make sure you have them all.

Please put all your answers in your answer key. Do not forget to put your exam type on your answer key.

You have 80 minutes. GOOD LUCK!!

1. A typical society strives to get the most it can from its scarce resources. At the same time, the society attempts to distribute the benefits of those resources to the members of the society in a fair manner. In other words, the society faces a tradeoff between
   (a) guns and butter.
   (b) efficiency and equality.
   (c) inflation and unemployment.
   (d) work and leisure.

   ANSWER: b (easy)

2. Stephen is restoring a car and has already spent $4,000 on the restoration. He expects to be able to sell the car for $5,800. Stephen discovers that he needs to do an additional $2,400 of work to make the car worth $5,800 to potential buyers. He could also sell the car now, without completing the additional work, for $3,800. What should he do?
   (a) He should sell the car now for $3,800.
   (b) He should keep the car since it wouldn't be rational to spend $6,400 restoring a car and then sell it for only $5,800.
   (c) He should complete the additional work and sell the car for $5,800.
   (d) It does not matter which action he takes since the outcome will be the same either way.

   ANSWER: a (challenging)

3. In the simple circular-flow diagram, who buys the factors of production?
   (a) households only
   (b) firms only
   (c) both households and firms
   (d) neither households nor firms

   ANSWER: b (moderate)

4. When an economy is operating at a point on its production possibilities frontier, then
   (a) consumers are content with the mix of goods and services that is being produced.
   (b) there is no way to produce more of one good without producing less of the other.
5. Consider the production possibilities curve below for a country that can produce sweaters, apples (in bushels), or a combination of the two.

If this society moves from point U to point V,

(a) it gives up 40 bushels of apples to get 80 sweaters.
(b) it gives up 140 bushels of apples to get 80 sweaters.
(c) it gives up 80 sweaters to get 140 bushels of apples.
(d) it gives up 80 sweaters to get 40 bushels of apples.

ANSWER: d (moderate)

Assume that England and Spain can switch between producing cheese and producing bread at a constant rate. Answer questions from 6 to 10 considering the table below.

<table>
<thead>
<tr>
<th>Labor Hours Needed to Make 1 Unit of</th>
<th>Number of Units Produced in 40 Hours</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cheese</td>
<td>Bread</td>
</tr>
<tr>
<td>England</td>
<td>1</td>
</tr>
<tr>
<td>Spain</td>
<td>4</td>
</tr>
</tbody>
</table>

6. The opportunity cost of 1 unit of cheese for Spain is

(a) 1/2 unit of bread.
(b) 2 hours of labor.
(c) 2 units of bread.
(d) 4 hours of labor.

ANSWER: a (moderate)

7. England has an absolute advantage in the production of

(a) cheese and Spain has an absolute advantage in the production of bread.
(b) bread and Spain has an absolute advantage in the production of cheese.
(c) both goods and Spain has an absolute advantage in the production of neither good.
(d) neither good and Spain has an absolute advantage in the production of both goods.

ANSWER: c (moderate)

8. England has a comparative advantage in the production of

(a) cheese and Spain has a comparative advantage in the production of bread.
(b) bread and Spain has a comparative advantage in the production of cheese.
(c) both goods and Spain has a comparative advantage in the production of neither good.
(d) neither good and Spain has a comparative advantage in the production of both goods.

ANSWER: a (moderate)

9. If England and Spain each spends all its time producing the good in which it has a comparative advantage and the countries agree to trade 2 units of bread for 6 units of cheese, then England will consume

(a) 34 units of cheese and 2 units of bread and Spain will consume 6 units of cheese and 3 units of bread.
(b) 34 units of cheese and 2 units of bread and Spain will consume 16 units of cheese and 3 units of bread.
(c) 34 units of cheese and 12 units of bread and Spain will consume 6 units of cheese and 3 units of bread.
(d) 34 units of cheese and 12 units of bread and Spain will consume 16 units of cheese and 3 units of bread.

ANSWER: a (challenging)

10. Without trade, England produced and consumed 32 units of cheese and 2 units of bread and Spain produced and consumed 6 units of cheese and 2 units of bread. Then, each country agreed to specialize in the production of the good in which it has a comparative advantage and trade 7 units of cheese for 2.5 units of bread. As a result, England gained

(a) 0 units of cheese and 0.5 unit of bread and Spain gained 1 unit of cheese and 0.5 unit of bread.
(b) 1 unit of cheese and 0.5 unit of bread and Spain gained 1 unit of cheese and 0.5 unit of bread.
(c) 7 units of cheese and 2.5 units of bread and Spain gained 7 units of cheese and 2.5 units of bread.
(d) 33 units of cheese and 2.5 units of bread and Spain gained 7 units of cheese and 2.5 units of bread.

ANSWER: b (challenging)

11. An increase in the price of a good will
   (a) increase demand.
   (b) decrease demand.
   (c) increase quantity demanded.
   (d) decrease quantity demanded.

ANSWER: d (moderate)

12. Which of these statements best represents the law of demand?
   (a) When buyers’ tastes for a good increase, they purchase more of the good.
   (b) When income levels increase, buyers purchase more of most goods.
   (c) When the price of a good decreases, buyers purchase more of the good.
   (d) When buyers’ demands for a good increase, the price of the good increases.

ANSWER: c (moderate)

13. An increase in demand is represented by a
   (a) movement downward and to the right along a demand curve.
   (b) movement upward and to the left along a demand curve.
   (c) rightward shift of a demand curve.
   (d) leftward shift of a demand curve.

ANSWER: c (moderate)

14. Soup is an inferior good if the demand
   (a) for soup falls when the price of a substitute for soup rises.
   (b) for soup rises when the price of soup falls.
   (c) curve for soup slopes upward.
   (d) for soup falls when income rises.

ANSWER: d (easy)

15. Two goods are complements when a decrease in the price of one good
   (a) decreases the quantity demanded of the other good.
   (b) decreases the demand for the other good.
   (c) increases the quantity demanded of the other good.
   (d) increases the demand for the other good.

ANSWER: d (easy)

16. Suppose the number of buyers in a market increases and a technological advancement occurs also. What would we expect to happen in the market?
   (a) Equilibrium price would decrease, but the impact on equilibrium quantity would be ambiguous.
   (b) Equilibrium price would increase, but the impact on equilibrium quantity would be ambiguous.
   (c) Equilibrium quantity would decrease, but the impact on equilibrium price would be ambiguous.
   (d) Equilibrium quantity would increase, but the impact on equilibrium price would be ambiguous.

ANSWER: d (moderate)

17. Music compact discs are normal goods. What will happen to the equilibrium price and quantity of music compact discs if musicians accept lower royalties, compact disc players become cheaper, more firms start producing music compact discs, and music lovers experience an increase in income?
   (a) Price will fall, and the effect on quantity is ambiguous.
   (b) Price will rise, and the effect on quantity is ambiguous.
   (c) Quantity will fall, and the effect on price is ambiguous.
   (d) Quantity will rise, and the effect on price is ambiguous.

ANSWER: d (challenging)

18. What would happen to the equilibrium price and quantity of lattes if coffee shops began using a machine that reduced the amount of labor necessary to produce steamed milk, which is used to make lattes, and scientists discovered that coffee prevents heart attacks?
   (a) Both the equilibrium price and quantity would increase.

ANSWER: d (challenging)
(b) Both the equilibrium price and quantity would decrease.

(c) The equilibrium price would increase, and the effect on equilibrium quantity would be ambiguous.

(d) The equilibrium quantity would increase, and the effect on equilibrium price would be ambiguous.

ANSWER: d (challenging)

19. Which of the following observations would be consistent with the imposition of a binding price ceiling on a market? After the price ceiling becomes effective,

(a) a smaller quantity of the good is bought and sold.
(b) a smaller quantity of the good is demanded.
(c) a larger quantity of the good is supplied.
(d) the price rises above the previous equilibrium.

ANSWER: a (moderate)

20. A binding price floor (i) causes a surplus. (ii) causes a shortage. (iii) is set at a price above the equilibrium price. (iv) is set at a price below the equilibrium price.

(a) (i) only
(b) (iii) only
(c) (i) and (iii) only
(d) (ii) and (iv) only

ANSWER: c (moderate)

22. Which of the following price ceilings would be binding in this market?

(a) $4
(b) $5
(c) $6
(d) $7

ANSWER: a (moderate)

23. Which of the following price floors would be binding in this market?

(a) $3
(b) $4
(c) $5
(d) $6

ANSWER: d (moderate)

24. If the government imposes a price floor of $7 on this market, then there will be

(a) no surplus.
(b) a surplus of 10 units.
(c) a surplus of 15 units.
(d) a surplus of 20 units.

ANSWER: d (moderate)

25. A tax on sellers will shift the

(a) demand curve upward by the amount of the tax.
(b) demand curve downward by the amount of the tax.
(c) supply curve upward by the amount of the tax.
(d) supply curve downward by the amount of the tax.

ANSWER: c (moderate)
26. A tax imposed on the buyers of a good will lower the

(a) price paid by buyers and lower the equilibrium quantity.

(b) price paid by buyers and raise the equilibrium quantity.

(c) effective price received by sellers and lower the equilibrium quantity.

(d) effective price received by sellers and raise the equilibrium quantity.

ANSWER: c (moderate)

27. The price paid by buyers after the tax is imposed is

(a) $3.00.

(b) $3.50.

(c) $5.00.

(d) $6.00.

ANSWER: c (moderate)

28. The effective price sellers receive after the tax is imposed is

(a) $2.00.

(b) $3.50.

(c) $5.00.

(d) $3.00.

ANSWER: d (moderate)

29. Buyers pay how much of the tax per unit?

(a) $0.50.

(b) $1.50.

(c) $3.00.

(d) $5.00.

ANSWER: b (moderate)

30. Which of the following is included in GDP?

(a) the market value of rental housing services, but not the market value of owner-occupied housing services.

(b) the market value of owner-occupied housing services, but not the market value of rental housing services.

(c) both the market value of rental housing services and the market value of owner-occupied housing services.

(d) neither the market value of owner-occupied housing services nor the market value of rental housing services.

ANSWER: c (moderate)

31. James owns two houses. He rents one house to the Johnson family for $10,000 per year. He lives in the other house. If he were to rent the house in which he lives, he could earn $12,000 per year in rent. How much do the housing services provided by the two houses contribute to GDP?

(a) $0

(b) $10,000

(c) $12,000

(d) $22,000

ANSWER: d (moderate)

32. Joe and Jim purchase vegetables at a grocery store, but Jim also grows vegetables in his back yard. Regarding these two practices, which of the following statements is correct?

(a) Only Joe’s grocery store purchases are included in GDP.

(b) Only Joe’s and Jim’s grocery store purchases are included in GDP.

(c) Joes and Jim’s grocery store purchases are included in GDP. The vegetables from Jim’s backyard garden are included at the market value.

(d) Joe’s and Jim’s grocery store purchases are included in GDP. The vegetables from Jim’s backyard garden are included at their market value, if Jim provides this information.
33. A professional gambler moves from a state where gambling is illegal to a state where gambling is legal. Most of his income was, and continues to be, from gambling. His move

(a) raises GDP.
(b) decreases GDP.
(c) doesn’t change GDP because gambling is never included in GDP.
(d) doesn’t change GDP because in either case his income is included.

ANSWER: a (moderate)

34. Sam, an American citizen, prepares meals for his family at home. Ellen, a Canadian citizen, commutes to the U.S. to help prepare meals at a restaurant in Idaho. Whose value of services preparing meals is included in U.S. GDP?

(a) Sam’s and Ellen’s.
(b) Sam’s but not Ellen’s.
(c) Ellen’s but not Sam’s.
(d) Neither Sam’s nor Ellen’s.

ANSWER: c (moderate)

35. A tire manufacturer produces 400 tires valued at $20 each. Three hundred tires are sold to a tire shop, which then sells them to households for $50 each. The remaining tires are unsold and are added to the tire manufacturers’ inventory. How much is added to GDP?

(a) $8,000
(b) $15,000
(c) $17,000
(d) $13,000

ANSWER: c (moderate)

36. Jennifer lives in a home that was newly constructed in 2011 for which she paid $240,000. In 2014 she sold the house for $260,000. Which of the following statements is correct regarding the sale of the house?

(a) The 2014 sale increased 2014 GDP by $260,000 and had no effect on 2011 GDP.
(b) The 2014 sale increased 2014 GDP by $20,000 and had no effect on 2011 GDP.
(c) The 2014 sale increased 2014 GDP by $260,000; furthermore, the 2014 sale caused 2011 GDP to be revised upward by $20,000.
(d) The 2014 sale affected neither 2014 GDP nor 2011 GDP.

ANSWER: d (moderate)

37. Martin, a U.S. citizen, travels to Mexico and buys a newly manufactured motorcycle made there. His purchase is included in

(a) both Mexican GDP and U.S. GDP.
(b) Mexican GDP, but it is not included in U.S. GDP.
(c) U.S. GDP, but it is not included in Mexican GDP.
(d) neither Mexican GDP nor U.S. GDP.

ANSWER: b (moderate)

38. Michigan Cranberry Company sold $10 million worth of cranberries it produced. In producing cranberries, it purchased $1 million dollars worth of supplies from foreign countries and paid workers who reside in Canada but commute to the U.S. $1 million. How much did these transactions add to U.S. GDP?

(a) $12 million
(b) $11 million
(c) $10 million
(d) $9 million

ANSWER: d (challenging)

39. Which of the following is included in the consumption component of U.S. GDP?

(a) purchases of staplers, paper clips, and pens by U.S. business firms
(b) purchases of natural gas by U.S. households
(c) purchases of newly constructed homes by U.S. households
(d) All of the above are correct.

ANSWER: b (moderate)

40. The value of goods added to a firm’s inventory in a certain year is treated as

(a) consumption, since the goods will be sold to consumers in another period.
(b) intermediate goods, and so is not included in that years GDP.
(c) investment, since GDP aims to measure the value of the economy’s production that year.
45. If in some year nominal GDP was $18 billion and the GDP deflator was 120, what was real GDP?
   (a) $6.7 billion.
   (b) $15 billion.
   (c) $21.6 billion.
   (d) $38 billion.
   ANSWER: b (moderate)

46. Suppose an economy’s production consists only of corn and soybeans. In 2010, 20 bushels of corn are sold at $4 per bushel and 10 bushels of soybeans are sold at $2 per bushel. In 2009, the price of corn was $2 per bushel and the price of soybeans was $1 per bushel. Using 2009 as the base year, it follows that, for 2010,
   (a) nominal GDP is $50, real GDP is $100, and the GDP deflator is 50.
   (b) nominal GDP is $50, real GDP is $100, and the GDP deflator is 200.
   (c) nominal GDP is $100, real GDP is $50, and the GDP deflator is 50.
   (d) nominal GDP is $100, real GDP is $50, and the GDP deflator is 200.
   ANSWER: d (moderate)

47. Which of the following statements regarding GDP is correct?
   (a) GDP includes factory production, but not any harm that may be inflicted on the environment.
   (b) GDP accounts for all activities taking place outside markets.
   (c) GDP provides detailed information about the distribution of income.
   (d) GDP is a good measure of economic well-being for all purposes.
   ANSWER: a (moderate)

48. The steps involved in calculating the consumer price index and the inflation rate, in order, are as follows:
   (a) Choose a base year, update the basket, find the prices, estimate the basket’s cost, compute the index, and compute the inflation rate.
   (b) Choose a base year, fix the basket, find the prices, compute the inflation rate, compute the basket’s cost, and compute the index.
(c) Fix the basket, find the prices, compute the basket’s cost, choose a base year and compute the index, and compute the inflation rate.
(d) Fix the basket, find the prices, compute the inflation rate, compute the basket’s cost, and choose a base year and compute the index.

ANSWER: c (easy)

49. Suppose a basket of goods and services has been selected to calculate the CPI and 2012 has been chosen as the base year. In 2012, the baskets cost was $80.00. In 2013, the baskets cost was $84. And in 2014, the baskets cost was $87.60. The value of the CPI was

(a) 100 in 2012.
(b) 105 in 2013.
(c) 109.5 in 2014.
(d) All of the above are correct.

ANSWER: d (moderate)

50. If the consumer price index changes from 125 in September to 150 in October, what is the rate of inflation?

(a) 45.5%
(b) 20.0%
(c) 16.7%
(d) 9.1%

ANSWER: b (easy)

51. For an imaginary economy, the value of the consumer price index was 138.75 in 2016, and the inflation rate was 10 percent between 2015 and 2016. The consumer price index in 2015 was

(a) 126.1.
(b) 128.8.
(c) 148.8.
(d) 152.6.

ANSWER: a (moderate)

The table below pertains to Pieway, an economy in which the typical consumers basket consists of 15 bushels of peaches and 10 bushels of pecans. Refer to the table below for questions 52, 53, and 54.

<table>
<thead>
<tr>
<th>Year</th>
<th>Price of Peaches</th>
<th>Price of Pecans</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>$11 per bushel</td>
<td>$6 per bushel</td>
</tr>
<tr>
<td>2013</td>
<td>$9 per bushel</td>
<td>$10 per bushel</td>
</tr>
</tbody>
</table>

52. The cost of the basket in 2012 was

(a) $200.
(b) $225.
(c) $235.
(d) $212.50.

ANSWER: b (moderate)

53. If 2012 is the base year, then the CPI for 2013 was

(a) 95.7.
(b) 100.0.
(c) 104.4.
(d) 110.0.

ANSWER: c (moderate)

54. If 2012 is the base year, then the inflation rate in 2013 was

(a) 23.5 percent.
(b) 1.04 percent.
(c) 10 percent.
(d) 4.4 percent.

ANSWER: d (moderate)

55. The introduction of a new good

(a) increases the cost of maintaining the same level of economic well-being.
(b) decreases the cost of maintaining the same level of economic well-being.
(c) has no impact on the cost of maintaining the same level of economic well-being.
(d) may increase or decrease the cost of maintaining the same level of economic well-being, depending on how expensive the new good is.

ANSWER: b (moderate)

56. If the quality of a good deteriorates while its price remains the same, then the value of a dollar

(a) rises and the cost of living increases.
(b) rises and the cost of living decreases.
(c) falls and the cost of living increases.
(d) falls and the cost of living decreases.

ANSWER: c (moderate)
57. If the CPI was 108.00 in 1942 and is 336.96 today, then $10 in 1942 purchased the same amount of goods and services as

(a) $2.57 purchases today.
(b) $28.89 purchases today.
(c) $31.20 purchases today.
(d) $38.89 purchases today.

ANSWER: c (moderate)

58. Indexation refers to

(a) a process of adjusting the nominal interest rate so that it is equal to the real interest rate.
(b) using a law or contract to automatically correct a dollar amount for the effects of inflation.
(c) using a price index to deflate dollar values.
(d) an adjustment made by the Bureau of Labor Statistics to the CPI so that the index is in line with the GDP deflator.

ANSWER: b (easy)

59. Which of the following statements is correct about the relationship between the nominal interest rate and the real interest rate?

(a) The real interest rate is the nominal interest rate times the rate of inflation.
(b) The real interest rate is the nominal interest rate minus the rate of inflation.
(c) The real interest rate is the nominal interest rate plus the rate of inflation.
(d) The real interest rate is the nominal interest rate divided by the rate of inflation.

ANSWER: b (easy)

60. If the nominal interest rate is 4 percent and the real interest rate is -2.5 percent, then the inflation rate is

(a) -6.5 percent.
(b) -1.5 percent.
(c) 1.5 percent.
(d) 6.5 percent.

ANSWER: d (moderate)