c4

Student: ____

1. To understand how economy works, the economists could look at number of data including:
A. the number of new residential building permits.
B. the amount of new orders for capital goods.
C. the number of manufacturers' new orders for consumer goods.
D. all of these.

2. To look at the health of economy, economists would most probably look at indictors such as:
A. real GDP, unemployment rate and, the inflation rate.
B. level of saving, nominal GDP and, the inflation rate.
C. nominal GDP, level of investment and, the general price level.
D. the general price level, employment rate and, level of saving.

3. The concept of "real GDP" refers to:
A. the value of nominal GDP after adjustments have been made for changes in the price level.
B. the value of nominal GDP minus the environmental pollution and changes in the distribution of income.
C. the value of the current total output minus the value of intermediate goods.
D. GDP data which reflect changes in both physical output and the environmental damages.

4. If the current prices are used to calculate the value of total output produced by a country during a specific period of time, the result is called:
A. real GDP.
B. nominal GDP.
C. full employment GDP.
D. constant dollar GDP.

5. Real GDP and nominal GDP differ because the real GDP:
A. is adjusted for changes in the nation's distribution of income.
B. includes the economic effects of international trade.
C. is equal to the nominal GDP minus the total tax payments.
D. has been adjusted for changes in the price level.

6. The official unemployment rate:
A. reveals people over 21 years of age who are currently discouraged and are not looking for a job.
B. is the percentage of labour force which is unemployed.
C. is the percentage of the labour force which is working part-time.
D. is the percentage of the total population which is not working.

7. According to the researchers, there is a direct link between unemployment and:
A. major social problems like higher crime rates, higher rate of depression heart disease and other illnesses.
B. major social problems such as high level of education and, health services.
C. noneconomic costs of unemployment.
D. characteristics of structural unemployment.

8. Inflation means that:
A. an increase in the individuals' real income.
B. all prices are rising and at the same rate.
C. an increase in the overall price levels.
D. a decrease in the overall level of prices.

9. The term "inflation" describes the situation where:
A. general price levels are declining.
B. Stock market prices are increasing.
C. all prices are increasing at the same rate.
D. overall price levels are increasing.

10. Economic growth is defined as:
A. an increase in either real GDP or real GDP per capita.
B. an increase in the nominal GDP.
C. an increase in the overall general price level.
D. an increase in the level of consumption.

11. Economic growth is best defined as the:
A. increase in consumption level as a percentage of GDP over time.
B. percentage increase in real GDP over time.
C. percentage increase in nominal GDP over time.
D. percentage decrease in the overall price levels over time.

12. To keep track of long-run growth and short-run fluctuations, economists will look at statistics such as:
A. interest rate and, stock market prices.
B. stock market prices only.
C. inflation, expected rate of returns on investments.
D. real and nominal GDP, unemployment and inflation rates.

13. Between the 1998-2008, the Canadian economy has grown by:
A. an average rate of 4% per year.
B. an average rate of 3.1% per year.
C. an average rate of 1% per year.
D. a negative rate of 2% per year.

14. Modern economic growth refers to the idea of experiencing:
A. an increase in output per person as compared with increase in output.
B. an increase in output as compared with increase in output per person.
C. an increase in population at a faster rate than increase in output.
D. an increase in population at the same rate as the increase in output.

15. An improvement in productivity refers to:
A. an increase in the general price level.
B. an increase in output per person.
C. an increase in the output.
D. an increase in percentage of the population which participates in the labour force.

The following information about the relationship between input quantities and real domestic output in a hypothetical economy:

Input quantity	Real domestic output
100	300
150	450
200	600

16. Refer to the above information, the level of productivity is:
A. 2.
B. .5.
C. 4.
D. 3.

17. Productivity measures:
A. real output per unit of input.
B. the amount of capital goods used per worker.
C. the change in the cost of production per unit.
D. the number of labours which are working with a fixed number of capital goods.

18. Suppose that real domestic output in an economy is 30 units and, the quantity of inputs is 10. The level of productivity is:
A. 30.
B. 10.
C. 300.
D. 3.

19. If the economy's output and income double in 35 years, we can:
A. not say anything about the average annual rate of growth.
B. conclude that its average annual rate of growth is about 5.5 percent.
C. conclude that its average annual rate of growth is about 2 percent.
D. conclude that its average annual rate of growth is about 4 percent.

20. Today, the vast differences in the living standard between rich and poor countries are mainly the result of:
A. small differences in per capita GDP levels around the world.
B. rich countries experiencing the modern economic growth while poor countries do not.
C. small differences in nominal GDP levels around the world.
D. large differences in population levels around the world.

21. To facilitate the international comparisons of living standards around the world, adjustments are supposed to be made to each country's GDP. These adjustments require:
A. calculating each country's GDP in terms of U.S. dollar, dividing it by the general price level and, subtracting the previous year's value of the country's GDP from it.
B. converting each country's GDP to U.S. dollars, dividing it by the country's population and, to adjust the resulting figure for the purchasing power parity.
C. each country's GDP should be multiplied by its general price level.
D. there is no need for any adjustments since, each country's GDP is the representative of its standard of living.

22. Definition of investment in economics includes:
A. the purchase of a Microsoft stock.
B. the purchase of gold by a businessman.
C. the addition of cash to a savings account.
D. any increase in business inventories.

23. Which of the following is not an economic investment?
A. the purchase of a machinery by ABC Manufacturing Company
B. the purchase of 50 shares of Aliant by a retired business executive
C. construction of a housing project for the homeless
D. the increase in the inventory on a grocer's shelf

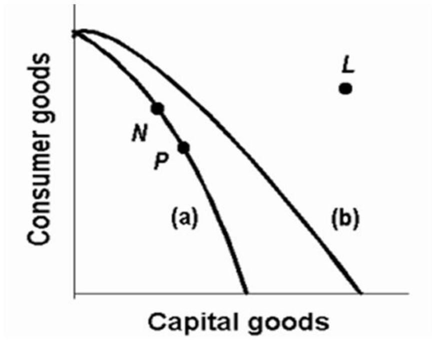
24. The Flamingo Corporation issued $30 million in new common stock in 2008. It used $22 million of the proceeds to replace obsolete equipment in its factory and $8 million to repay bank loans. As a result, investment:
A. of $8 million has occurred.
B. of $22 million has occurred.
C. of $30 million has occurred.
D. has not occurred.

25. Which would be considered an investment according to economists?
A. the buying of shares of Fidelity mutual funds
B. the purchase of a new machinery by McCain Food
C. the selling of Boeing stock by a businessman
D. the selling of GE corporate bonds

26. Which would be considered an investment according to economists?
A. the purchase of government bonds by the nation's central bank.
B. the purchase of a laptop by a university student to prepare her class projects.
C. the construction of a new factory by Intel.
D. the purchase of shares of stock by Manulife, a mutual fund company.

27. The higher is the current level of saving:
A. the higher is the current level of investment and higher the future level of consumption.
B. the lower is the current level of investment and lower the future level of consumption.
C. the higher is the current level of investment and lower the future level of consumption.
D. the lower is the current level of investment and higher the future level of consumption.

28. The inequality of saving and planned investment:
A. is attributable to a low level of consumption.
B. may be of considerable significance because of the subsequent changes in income, employment, and the price level.
C. is of no consequence because a compensating inequality of tax collections and government spending will always occur.
D. is of no consequence because saving and actual investment will always be equal.



29. Refer to the above diagram. Curve (a) is the current production possibilities frontier for the economy. Other things being equal, society's current choice of point P on curve (a) means:
A. a possible more rapid economic growth than would the choice of point N.
B. a slower rate of economic growth than would the choice of point N.
C. the same rate of growth as would the choice of point N.
D. it is unachievable because it exceeds the productive capacity of the economy.

30. The financial institutions play an important role in transferring the savings of the individuals to the investments by businesses. This transfer is done through:
A. banks collect the savings and invest it in the stock market.
B. banks collect the savings, rewarding the savings by interest and dividend payments and, lending the funds to the business who in turn buy equipments, factories and capital goods.
C. banks collect the savings and lend the funds to the government who in turn redistribute it through different kinds of subsidies.
D. The financial institutions do not have a major role in this process.

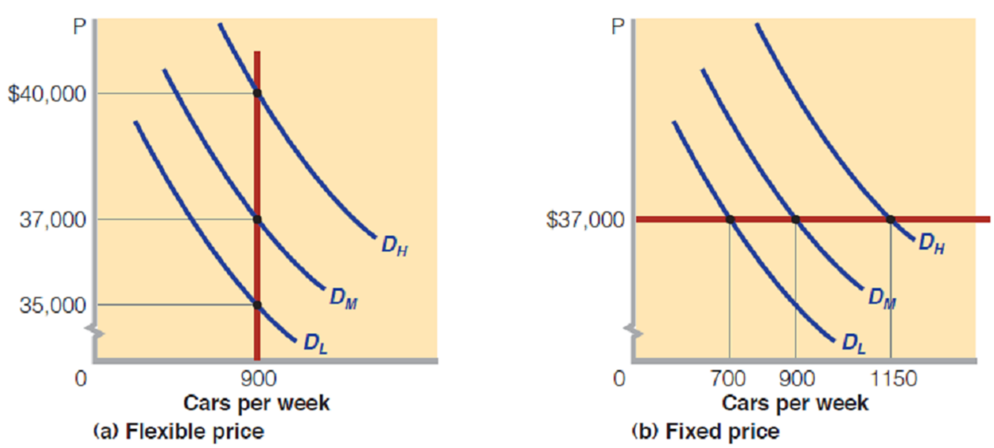
31. The decisions about savings and investments are complicated because:
A. it involves uncertainty about the future.
B. higher savings means higher levels of consumption for individuals.
C. the investment decisions are independent from the decisions about savings.
D. savings are taken by businesses while investments are done by households.

32. ________ shocks are unexpected changes in the demand for goods and services While, _________ shocks are unexpected changes in the supply of goods and services.
A. supply, demand.
B. investment, savings.
C. internal, external.
D. demand, supply.

33. Economists believe that most short-run fluctuations are the result of:
A. supply shocks.
B. demand shocks.
C. unexpected changes in the availability of imported resources.
D. negative supply shocks.

34. When we say "Prices of many goods and services are inflexible in the short-run" it means:
A. prices change too quickly in the short-run.
B. prices do not change in the long-run.
C. prices change too slowly in the short- run.
D. prices are not sticky in the short-run.

35. Because prices change too slowly in the short-run and as a result, they do not quickly equalize the quantity demanded and quantity supplied of goods and services, the short-run response of the economy to a demand shock is through:
A. changes in output and employment levels rather than through changes in prices.
B. changes in prices rather than through changes in employment.
C. changes in employment but not in output.
D. changes in output but not in the employment.



36. The above diagram (a) represents the demand for and supply of a brand of automobile (Turbo-car) for a car manufacturing company named Fancy Auto. Assume that D_L represents low demand for the Turbo-car, D_M represents the medium level of demand and, D_H represents the high level of demand for Turbo-car and, Fancy Auto's optimal output level is 900 cars per week. If the prices are flexible, the Fancy Auto:
A. can continue to sell its optimal output regardless of the demand level.
B. can continue producing its optimal output level only if demand is at D_L level.
C. can continue producing its optimal output level only if demand is at D_M level.
D. can continue producing its optimal output level only if demand is at D_H level.

37. Refer to the above diagram (b), assume that D_L represents low demand for the Turbo-car, D_M represents the medium level of demand and, D_H represents the high level of demand for Turbo-car and, Fancy Auto's optimal output level is 900 cars per week. If the Fancy Auto Company has a fixed price policy of $37,000 per vehicle:
A. the quantity demanded will be 900 cars per week if the demand is D_L.
B. the quantity demanded will be 700 cars per week if the demand is D_L.
C. the quantity demanded will be 1150 cars per week if the demand is D_L.
D. the quantity demanded will be 1150 cars per week if the demand is D_M.

38. Refer to the above diagrams, one can conclude that if expectations are always fulfilled, Fancy Auto Company:
A. will never have to adjust the optimal output and employment levels accordingly.
B. has to adjust the employment level but not the optimal output.
C. has to adjust the optimal output level but not the employment.
D. has to adjust both optimal output level and employment accordingly.

39. The short-run fluctuations in output and unemployment that we see in the real world are the result of:
A. shocks and events that are going according to the plans.
B. shocks and events that are not going according to the plans.
C. the actual demand to be exactly what the firms were expecting.
D. the actual supply to be exactly what the firms were planning.

40. In response to an unexpected change in demand, if the prices are free to adjust quickly:
A. a firm could always operate at its optimal output level.
B. a firm would experience a decline in its output and employment.
C. a firm would not be able to adjust its output according to the plan.
D. a firm would not be able to change its employment accordingly.

41. In response to some unexpected changes in demand:
A. the economy could always adjust its production level if the prices are inflexible.
B. the economy would always produce less than what was expected if the prices of goods and services are inflexible.
C. the economy could always produce at its optimal capacity if the prices of goods and services are inflexible.
D. the economy could always produce at its optimal capacity if the prices of goods and services are fully flexible.

42. Knowing that in real world, the demand for goods and services could change unexpectedly, the firms would attempt to deal with it by:
A. producing different levels of goods and services according to the changes in demand.
B. switching to the production of another product in the short-run.
C. maintaining an inventory.
D. closing down the production in the short-run with the hope that the situation would change in the future.

43. To explain the short-run fluctuations in the real-world economies, the economists refer to:
A. the combination of unexpected changes in demand and inflexible prices.
B. the combination of unexpected changes in demand and flexible prices.
C. the combination of fully expected changes in demand and inflexible prices.
D. the combination of flexible prices and changes in the inventories.

44. Assuming inflexible prices, if the demand for many goods and services falls across the the entire economy and for an extended period of time:
A. many firms will face a constant reduction in their inventories.
B. many firms will face with an inventory pile up and will be forced to cut production.
C. many firms will face with an inventory pile up and will be forced to hire more workers.
D. many firms will face a constant reduction in their inventories and will be forced to hire more workers.

45. Assume that the demand for goods and services falls across the entire economy and for an extended period of time. If the prices are inflexible, the unintended increase in business inventories would force:
A. businesses to keep the production at the existing level.
B. businesses to increase the level of production.
C. businesses to lower the level of production.
D. businesses to increase the level of employment.

46. Which of the following product categories have the most flexible prices?
A. corn, oil, gasoline and, natural gas.
B. hair cuts, newspapers and, taxi fares.
C. computer software and, veterinary services.
D. coin-operated laundry machines, restaurant menus and, magazines.

47. Several factors contribute to the short-run price stickiness. These include:
A. consumer preference for lower prices and the quality of the product.
B. durability and the quality of the product.
C. frequent sales and, inventory pile ups.
D. consumer preference for predictable prices and, the fear of price war.

48. If the unexpected short-run fluctuations in demand begin to look permanent:
A. the firms would allow their prices to change accordingly.
B. the firms would be hesitant to allow their prices to change accordingly.
C. the firms would not allow their prices to change.
D. the firms would change the quality of their products but not the prices.

49. To study macroeconomics, one need various models with different assumptions about the flexibility and/or stickiness of the price levels. This is because:
A. the economy behaves similarly to demand shocks regardless of the length of time.
B. the price flexibility is a short-run phenomenon while, the price stickiness is a long-run phenomenon.
C. the economy behaves so differently depending on how much time has passed after a demand shock.
D. various government policies are useless to eliminate the effects of an unexpected demand shock.

50. One major difference between the short-run and long-run macroeconomic analysis is that:
A. in short-run prices are fully flexible while in long-run they are not.
B. in short-run prices are sticky while in long-run they are fully flexible.
C. in short-run stickiness of prices would guaranty the long-run price inflexibility.
D. the price stickiness in long-run guaranties the flexibility of prices in the short-run.

51. Before the use of computer in tracking the inventories, the firms:
A. would hardly counting it because it was an impossible task to accomplish.
B. would hardly practicing it because they liked surprises.
C. would count the inventory only a few times per year due to the high cost.
D. would count the inventory too frequently.

52. Before the use of computerized inventory tracking, an unfortunate side effect of counting inventories infrequently was that:
A. unexpected shifts in demand could cause an undetected large change in inventory Levels.
B. unexpected increase in demand could cause a large undetected increase in inventory levels.
C. unexpected decrease in demand could cause a large undetected decrease in inventory levels.
D. unexpected increase or decrease in demand could cause a large undetected decrease in supply.

53. Infrequent inventory counting leads to strong fluctuations in output and employment, because:
A. by the time an unexpected change in demand is discovered, it will not have had enough time to create a large change in inventory.
B. by the time an unexpected change in demand is discovered, it will have had enough time to create a large change in inventory.
C. by the time an unexpected change in demand is discovered, it will have had enough time to create a reduction in employment.
D. by the time an unexpected change in demand is discovered, it will not have had any effect on inventory.

54. The Gross Domestic Product (GDP) measures the value of final goods and services produced by a nation during a given period of time.
True False

55. Unemployment occurs when a person cannot get a job despite being willing to work and actively seeking work.
True False

56. Modern economic growth in a country implies that output per person increases.
True False

57. Before the start of the Industrial Revolution in the late 1700s, living standards around the world were quite different.
True False

58. Savings are generated when current consumption is less than current output.
True False

59. A well functioning financial system helps to promote economic growth and stability.
True False

60. Demand shocks are the expected changes in the demand for goods and services.
True False

61. If prices are flexible, no matter what demand turns out to be, the firms within an economy can continue selling their optimal output.
True False

62. In reality, all the prices in the economy are inflexible and are not able to change rapidly when demand changes unexpectedly.
True False

63. Commodities such as corn, oil, natural gas and gasoline have sticky prices.
True False

64. Sticky prices imply that some firms are afraid to cut their prices because they are afraid of the price wars.
True False

65. Computerized inventory tracking has accelerated the speed which companies can respond to unexpected changes in demand.
True False

66. Define macroeconomics and provide two key concerns it studies.

67. What three key statistics do macroeconomists study to assess the health of the economy? Give a short explanation of each.

68. What is the difference between nominal and real GDP?

69. Why do economists measure growth in an economy using real GDP rather than nominal GDP?

70. Why do economists worry about unemployment?

71. List two concerns with inflation.

72. What is modern economic growth?

73. What is GDP per capita?

74. In order to compare GDP across nations, economists typically make 3 adjustments. What are these adjustments and why are they carried out?

75. Compare the adjusted GDP per capita for the richest and poorest countries listed in Global Perspective 4.1 (page 85). How does Canada compare to these two countries?

76. In order to grow, what must a country do?

77. What is the difference between financial investment and economic investment?

78. In this list, identify those investments which are financial (F) and those that are economic (E): Canada Savings Bonds, stock in Potash Corporation of Saskatchewan, an old house you plan on fixing and reselling, new machinery for a factory you own, land that you plan to develop, an old window factory, your university education.

79. If households are typically the source of savings and businesses the source of investments, how then are savings and investments coordinated?

80. What roles do expectations play in macroeconomics?

81. What are two broad categories of macroeconomic shocks?

82. Suppose that we are in a condition of "stuck" prices so that the price of nails will not go above or below \$2/kg. Further suppose that nail factories have been built on a business plan designed to deliver 6,000 kg/week. How many apples will be sold in a market in which demand (which includes a modest amount of inventory) is characterized by: (a) $P = 5-0.5Q$, (b) $P = 6-0.5Q$, and (c) $P = 4-0.5Q$, where P is in \$/kg and Q is in thousands of kg/week? In each case, what happens to inventory.

83. Suppose that we are in a condition of fully flexible prices, but production of nails will not go above 6,000 kg/week. What price will nails sell for if market demand is characterized by: (a) $P = 5-0.5Q$, (b) $P = 6-0.5Q$, and (c) $P = 4-0.5Q$, where P is in \$/kg and Q is in thousands of kg/week?

84. Suppose that we are in a condition of "stuck" prices so that the price of wooden chairs will not go above or below \$125/unit. Further suppose that chair factories have been built on a business plan designed to deliver 200/month. How many chairs will be sold in a market in which demand (which includes a modest amount of inventory) is characterized by: (a) $P = 425-1.5Q$, (b) $P = 530-1.5Q$, and (c) $P = 400-0.5Q$, where P is in \$/chair and Q is in chairs/month? In each case, what happens to planned inventory.

85. Suppose that we are in a condition of fully flexible prices, but production of nails will not go above 200 chairs/month. What price will chairs sell for if market demand is characterized by: (a) $P = 425-1.5Q$, (b) $P = 530-1.5Q$, and (c) $P = 400-0.5Q$, where P is in \$/chair and Q is in chairs/month?

86. What will happen to prices and output levels if there is an unexpected demand increase and prices are fully flexible?

87. What will happen to prices and output levels if there is an unexpected demand decrease and prices are fully flexible?

88. What are inventories and what role do they play in an economy with sticky prices?

89. If prices are "stuck" and there is an unexpected demand increase, describe what happens in the economy.

90. If prices are "stuck" and there is an unexpected demand decrease, describe what happens in the economy.

91. "Most prices are not that sticky." Evaluate this claim.

92. What are two reasons why prices might be sticky?

93. Why do economists use the term "sticky" prices rather than "stuck" prices?

94. How might recent changes in inventory management affect the business cycle?

c4 Key

1. *(p. 82)* To understand how economy works, the economists could look at number of data including:
A. the number of new residential building permits.
B. the amount of new orders for capital goods.
C. the number of manufacturers' new orders for consumer goods.
D. all of these.

Learning Objective: 4.1 Assessing the health of the economy: Performance and policy
Level: Easy
McConnell - Chapter 004 #1
Type: Application

2. *(p. 83)* To look at the health of economy, economists would most probably look at indictors such as:
A. real GDP, unemployment rate and, the inflation rate.
B. level of saving, nominal GDP and, the inflation rate.
C. nominal GDP, level of investment and, the general price level.
D. the general price level, employment rate and, level of saving.

Learning Objective: 4.1 Assessing the health of the economy: Performance and policy
Level: Easy
McConnell - Chapter 004 #2
Type: Definition

3. *(p. 83)* The concept of "real GDP" refers to:
A. the value of nominal GDP after adjustments have been made for changes in the price level.
B. the value of nominal GDP minus the environmental pollution and changes in the distribution of income.
C. the value of the current total output minus the value of intermediate goods.
D. GDP data which reflect changes in both physical output and the environmental damages.

Learning Objective: 4.1 Assessing the health of the economy: Performance and policy
Level: Easy
McConnell - Chapter 004 #3
Type: Definition

4. *(p. 83)* If the current prices are used to calculate the value of total output produced by a country during a specific period of time, the result is called:
A. real GDP.
B. nominal GDP.
C. full employment GDP.
D. constant dollar GDP.

Learning Objective: 4.1 Assessing the health of the economy: Performance and policy
Level: Easy
McConnell - Chapter 004 #4
Type: Definition

5. *(p. 83)* Real GDP and nominal GDP differ because the real GDP:
A. is adjusted for changes in the nation's distribution of income.
B. includes the economic effects of international trade.
C. is equal to the nominal GDP minus the total tax payments.
D. has been adjusted for changes in the price level.

Learning Objective: 4.1 Assessing the health of the economy: Performance and policy
Level: Easy
McConnell - Chapter 004 #5
Type: Definition

6. *(p. 83)* The official unemployment rate:
A. reveals people over 21 years of age who are currently discouraged and are not looking for a job.
B. is the percentage of labour force which is unemployed.
C. is the percentage of the labour force which is working part-time.
D. is the percentage of the total population which is not working.

Learning Objective: 4.1 Assessing the health of the economy: Performance and policy
Level: Easy
McConnell - Chapter 004 #6
Type: Definition

7. *(p. 83)* According to the researchers, there is a direct link between unemployment and:
A. major social problems like higher crime rates, higher rate of depression heart disease and other illnesses.
B. major social problems such as high level of education and, health services.
C. noneconomic costs of unemployment.
D. characteristics of structural unemployment.

Learning Objective: 4.1 Assessing the health of the economy: Performance and policy
Level: Moderate
McConnell - Chapter 004 #7
Type: Application

8. *(p. 83)* Inflation means that:
A. an increase in the individuals' real income.
B. all prices are rising and at the same rate.
C. an increase in the overall price levels.
D. a decrease in the overall level of prices.

Learning Objective: 4.1 Assessing the health of the economy: Performance and policy
Level: Easy
McConnell - Chapter 004 #8
Type: Definition

9. *(p. 83)* The term "inflation" describes the situation where:
A. general price levels are declining.
B. Stock market prices are increasing.
C. all prices are increasing at the same rate.
D. overall price levels are increasing.

Learning Objective: 4.1 Assessing the health of the economy: Performance and policy
Level: Easy
McConnell - Chapter 004 #9
Type: Definition

10. *(p. 83)* Economic growth is defined as:
A. an increase in either real GDP or real GDP per capita.
B. an increase in the nominal GDP.
C. an increase in the overall general price level.
D. an increase in the level of consumption.

Learning Objective: 4.1 Assessing the health of the economy: Performance and policy
Level: Easy
McConnell - Chapter 004 #10
Type: Definition

11. *(p. 83)* Economic growth is best defined as the:
A. increase in consumption level as a percentage of GDP over time.
B. percentage increase in real GDP over time.
C. percentage increase in nominal GDP over time.
D. percentage decrease in the overall price levels over time.

Learning Objective: 4.1 Assessing the health of the economy: Performance and policy
Level: Easy
McConnell - Chapter 004 #11
Type: Definition

12. *(p. 83)* To keep track of long-run growth and short-run fluctuations, economists will look at statistics such as:
A. interest rate and, stock market prices.
B. stock market prices only.
C. inflation, expected rate of returns on investments.
D. real and nominal GDP, unemployment and inflation rates.

Learning Objective: 4.1 Assessing the health of the economy: Performance and policy
Level: Easy
McConnell - Chapter 004 #12
Type: Application

13. *(p. 84)* Between the 1998-2008, the Canadian economy has grown by:
A. an average rate of 4% per year.
B. an average rate of 3.1% per year.
C. an average rate of 1% per year.
D. a negative rate of 2% per year.

Learning Objective: 4.1 Assessing the health of the economy: Performance and policy
Level: Easy
McConnell - Chapter 004 #13
Type: Application

14. *(p. 84)* Modern economic growth refers to the idea of experiencing:
A. an increase in output per person as compared with increase in output.
B. an increase in output as compared with increase in output per person.
C. an increase in population at a faster rate than increase in output.
D. an increase in population at the same rate as the increase in output.

Learning Objective: 4.2 The miracle of modern economic growth
Level: Easy
McConnell - Chapter 004 #14
Type: Application

15. *(p. 84)* An improvement in productivity refers to:
A. an increase in the general price level.
B. an increase in output per person.
C. an increase in the output.
D. an increase in percentage of the population which participates in the labour force.

Learning Objective: 4.2 The miracle of modern economic growth
Level: Easy
McConnell - Chapter 004 #15
Type: Application

The following information about the relationship between input quantities and real domestic output in a hypothetical economy:

Input quantity	Real domestic output
100	300
150	450
200	600

McConnell - Chapter 004

16. *(p. 84)* Refer to the above information, the level of productivity is:
A. 2.
B. .5.
C. 4.
D. 3.

Learning Objective: 4.2 The miracle of modern economic growth
Level: Easy
McConnell - Chapter 004 #16
Type: Calculation

17. *(p. 84)* Productivity measures:
A. real output per unit of input.
B. the amount of capital goods used per worker.
C. the change in the cost of production per unit.
D. the number of labours which are working with a fixed number of capital goods.

Learning Objective: 4.2 The miracle of modern economic growth
Level: Easy
McConnell - Chapter 004 #17
Type: Definition

18. *(p. 84)* Suppose that real domestic output in an economy is 30 units and, the quantity of inputs is 10. The level of productivity is:
A. 30.
B. 10.
C. 300.
D. 3.

Learning Objective: 4.2 The miracle of modern economic growth
Level: Easy
McConnell - Chapter 004 #18
Type: Calculation

19. *(p. 84)* If the economy's output and income double in 35 years, we can:
A. not say anything about the average annual rate of growth.
B. conclude that its average annual rate of growth is about 5.5 percent.
C. conclude that its average annual rate of growth is about 2 percent.
D. conclude that its average annual rate of growth is about 4 percent.

Learning Objective: 4.2 The miracle of modern economic growth
Level: Moderate
McConnell - Chapter 004 #19
Type: Calculation

20. *(p. 84)* Today, the vast differences in the living standard between rich and poor countries are mainly the result of:
A. small differences in per capita GDP levels around the world.
B. rich countries experiencing the modern economic growth while poor countries do not.
C. small differences in nominal GDP levels around the world.
D. large differences in population levels around the world.

Learning Objective: 4.2 The miracle of modern economic growth
Level: Easy
McConnell - Chapter 004 #20
Type: Application

21. *(p. 85)* To facilitate the international comparisons of living standards around the world, adjustments are supposed to be made to each country's GDP. These adjustments require:
A. calculating each country's GDP in terms of U.S. dollar, dividing it by the general price level and, subtracting the previous year's value of the country's GDP from it.
B. converting each country's GDP to U.S. dollars, dividing it by the country's population and, to adjust the resulting figure for the purchasing power parity.
C. each country's GDP should be multiplied by its general price level.
D. there is no need for any adjustments since, each country's GDP is the representative of its standard of living.

Learning Objective: 4.2 The miracle of modern economic growth
Level: Moderate
McConnell - Chapter 004 #21
Type: Application

22. *(p. 86)* Definition of investment in economics includes:
A. the purchase of a Microsoft stock.
B. the purchase of gold by a businessman.
C. the addition of cash to a savings account.
D. any increase in business inventories.

Learning Objective: 4.3 Savings, investment, and modern economic growth
Level: Easy
McConnell - Chapter 004 #22
Type: Definition

23. *(p. 86)* Which of the following is not an economic investment?
A. the purchase of a machinery by ABC Manufacturing Company
B. the purchase of 50 shares of Aliant by a retired business executive
C. construction of a housing project for the homeless
D. the increase in the inventory on a grocer's shelf

Learning Objective: 4.3 Savings, investment, and modern economic growth
Level: Easy
McConnell - Chapter 004 #23
Type: Application

24. *(p. 86)* The Flamingo Corporation issued $30 million in new common stock in 2008. It used $22 million of the proceeds to replace obsolete equipment in its factory and $8 million to repay bank loans. As a result, investment:
A. of $8 million has occurred.
B. of $22 million has occurred.
C. of $30 million has occurred.
D. has not occurred.

Learning Objective: 4.3 Savings, investment, and modern economic growth
Level: Easy
McConnell - Chapter 004 #24
Type: Application

25. *(p. 86)* Which would be considered an investment according to economists?
A. the buying of shares of Fidelity mutual funds
B. the purchase of a new machinery by McCain Food
C. the selling of Boeing stock by a businessman
D. the selling of GE corporate bonds

Learning Objective: 4.3 Savings, investment, and modern economic growth
Level: Easy
McConnell - Chapter 004 #25
Type: Application

26. *(p. 86)* Which would be considered an investment according to economists?
A. the purchase of government bonds by the nation's central bank.
B. the purchase of a laptop by a university student to prepare her class projects.
C. the construction of a new factory by Intel.
D. the purchase of shares of stock by Manulife, a mutual fund company.

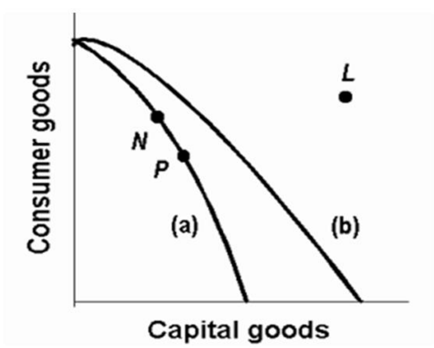
Learning Objective: 4.3 Savings, investment, and modern economic growth
Level: Moderate
McConnell - Chapter 004 #26
Type: Application

27. *(p. 86)* The higher is the current level of saving:
<u>A.</u> the higher is the current level of investment and higher the future level of consumption.
B. the lower is the current level of investment and lower the future level of consumption.
C. the higher is the current level of investment and lower the future level of consumption.
D. the lower is the current level of investment and higher the future level of consumption.

Learning Objective: 4.3 Savings, investment, and modern economic growth
Level: Moderate
McConnell - Chapter 004 #27
Type: Application

28. *(p. 86)* The inequality of saving and planned investment:
A. is attributable to a low level of consumption.
<u>B.</u> may be of considerable significance because of the subsequent changes in income, employment, and the price level.
C. is of no consequence because a compensating inequality of tax collections and government spending will always occur.
D. is of no consequence because saving and actual investment will always be equal.

Learning Objective: 4.3 Savings, investment, and modern economic growth
Level: Difficult
McConnell - Chapter 004 #28
Type: Application



McConnell - Chapter 004

29. *(p. 86)* Refer to the above diagram. Curve (a) is the current production possibilities frontier for the economy. Other things being equal, society's current choice of point P on curve (a) means:
A. a possible more rapid economic growth than would the choice of point N.
B. a slower rate of economic growth than would the choice of point N.
C. the same rate of growth as would the choice of point N.
D. it is unachievable because it exceeds the productive capacity of the economy.

Learning Objective: 4.3 Savings, investment, and modern economic growth
Level: Moderate
McConnell - Chapter 004 #29
Type: Application

30. *(p. 86)* The financial institutions play an important role in transferring the savings of the individuals to the investments by businesses. This transfer is done through:
A. banks collect the savings and invest it in the stock market.
B. banks collect the savings, rewarding the savings by interest and dividend payments and, lending the funds to the business who in turn buy equipments, factories and capital goods.
C. banks collect the savings and lend the funds to the government who in turn redistribute it through different kinds of subsidies.
D. The financial institutions do not have a major role in this process.

Learning Objective: 4.3 Savings, investment, and modern economic growth
Level: Moderate
McConnell - Chapter 004 #30
Type: Application

31. *(p. 87)* The decisions about savings and investments are complicated because:
A. it involves uncertainty about the future.
B. higher savings means higher levels of consumption for individuals.
C. the investment decisions are independent from the decisions about savings.
D. savings are taken by businesses while investments are done by households.

Learning Objective: 4.4 Uncertainty, expectations, shocks, and short-run fluctuations
Level: Easy
McConnell - Chapter 004 #31
Type: Application

32. *(p. 87)* ________ shocks are unexpected changes in the demand for goods and services While, _________ shocks are unexpected changes in the supply of goods and services.
A. supply, demand.
B. investment, savings.
C. internal, external.
D. demand, supply.

Learning Objective: 4.4 Uncertainty, expectations, shocks, and short-run fluctuations
Level: Easy
McConnell - Chapter 004 #32
Type: Definition

33. *(p. 87)* Economists believe that most short-run fluctuations are the result of:
A. supply shocks.
B. demand shocks.
C. unexpected changes in the availability of imported resources.
D. negative supply shocks.

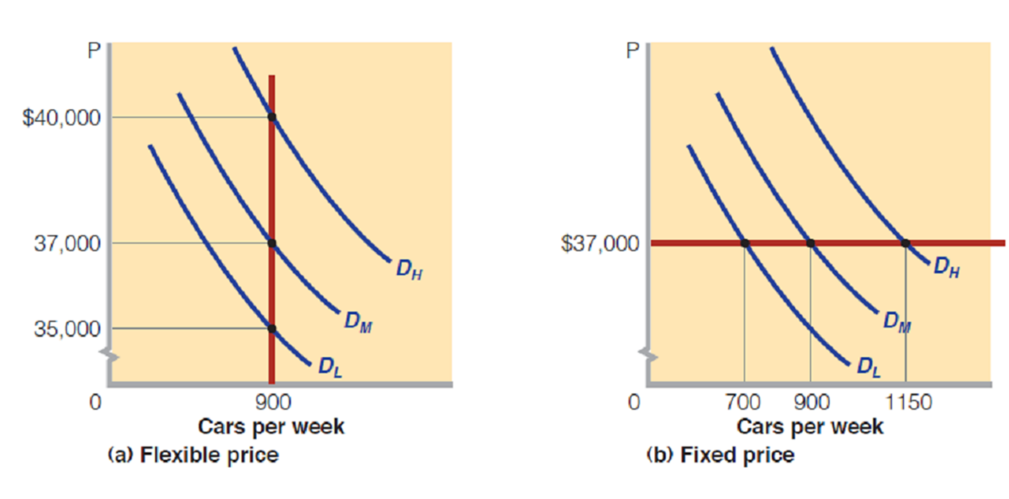
Learning Objective: 4.4 Uncertainty, expectations, shocks, and short-run fluctuations
Level: Easy
McConnell - Chapter 004 #33
Type: Definition

34. *(p. 87)* When we say "Prices of many goods and services are inflexible in the short-run" it means:
A. prices change too quickly in the short-run.
B. prices do not change in the long-run.
C. prices change too slowly in the short- run.
D. prices are not sticky in the short-run.

Learning Objective: 4.4 Uncertainty, expectations, shocks, and short-run fluctuations
Level: Easy
McConnell - Chapter 004 #34
Type: Definition

35. *(p. 87)* Because prices change too slowly in the short-run and as a result, they do not quickly equalize the quantity demanded and quantity supplied of goods and services, the short-run response of the economy to a demand shock is through:
A. changes in output and employment levels rather than through changes in prices.
B. changes in prices rather than through changes in employment.
C. changes in employment but not in output.
D. changes in output but not in the employment.

Learning Objective: 4.4 Uncertainty, expectations, shocks, and short-run fluctuations
Level: Easy
McConnell - Chapter 004 #35
Type: Application



McConnell - Chapter 004

36. *(p. 88)* The above diagram (a) represents the demand for and supply of a brand of automobile (Turbo-car) for a car manufacturing company named Fancy Auto. Assume that D_L represents low demand for the Turbo-car, D_M represents the medium level of demand and, D_H represents the high level of demand for Turbo-car and, Fancy Auto's optimal output level is 900 cars per week. If the prices are flexible, the Fancy Auto:
A. can continue to sell its optimal output regardless of the demand level.
B. can continue producing its optimal output level only if demand is at D_L level.
C. can continue producing its optimal output level only if demand is at D_M level.
D. can continue producing its optimal output level only if demand is at D_H level.

Learning Objective: 4.4 Uncertainty, expectations, shocks, and short-run fluctuations
Level: Easy
McConnell - Chapter 004 #36
Type: Graphic

37. *(p. 88)* Refer to the above diagram (b), assume that D_L represents low demand for the Turbo-car, D_M represents the medium level of demand and, D_H represents the high level of demand for Turbo-car and, Fancy Auto's optimal output level is 900 cars per week. If the Fancy Auto Company has a fixed price policy of $37,000 per vehicle:
A. the quantity demanded will be 900 cars per week if the demand is D_L.
B. the quantity demanded will be 700 cars per week if the demand is D_L.
C. the quantity demanded will be 1150 cars per week if the demand is D_L.
D. the quantity demanded will be 1150 cars per week if the demand is D_M.

Learning Objective: 4.4 Uncertainty, expectations, shocks, and short-run fluctuations
Level: Easy
McConnell - Chapter 004 #37
Type: Graphic

38. *(p. 88)* Refer to the above diagrams, one can conclude that if expectations are always fulfilled, Fancy Auto Company:
A. will never have to adjust the optimal output and employment levels accordingly.
B. has to adjust the employment level but not the optimal output.
C. has to adjust the optimal output level but not the employment.
D. has to adjust both optimal output level and employment accordingly.

Learning Objective: 4.4 Uncertainty, expectations, shocks, and short-run fluctuations
Level: Easy
McConnell - Chapter 004 #38
Type: Graphic

39. *(p. 89)* The short-run fluctuations in output and unemployment that we see in the real world are the result of:
A. shocks and events that are going according to the plans.
B. shocks and events that are not going according to the plans.
C. the actual demand to be exactly what the firms were expecting.
D. the actual supply to be exactly what the firms were planning.

Learning Objective: 4.4 Uncertainty, expectations, shocks, and short-run fluctuations
Level: Easy
McConnell - Chapter 004 #39
Type: Application

40. *(p. 89)* In response to an unexpected change in demand, if the prices are free to adjust quickly:
A. a firm could always operate at its optimal output level.
B. a firm would experience a decline in its output and employment.
C. a firm would not be able to adjust its output according to the plan.
D. a firm would not be able to change its employment accordingly.

Learning Objective: 4.4 Uncertainty, expectations, shocks, and short-run fluctuations
Level: Moderate
McConnell - Chapter 004 #40
Type: Application

41. *(p. 89)* In response to some unexpected changes in demand:
A. the economy could always adjust its production level if the prices are inflexible.
B. the economy would always produce less than what was expected if the prices of goods and services are inflexible.
C. the economy could always produce at its optimal capacity if the prices of goods and services are inflexible.
D. the economy could always produce at its optimal capacity if the prices of goods and services are fully flexible.

Learning Objective: 4.4 Uncertainty, expectations, shocks, and short-run fluctuations
Level: Moderate
McConnell - Chapter 004 #41
Type: Application

42. *(p. 89)* Knowing that in real world, the demand for goods and services could change unexpectedly, the firms would attempt to deal with it by:
A. producing different levels of goods and services according to the changes in demand.
B. switching to the production of another product in the short-run.
C. maintaining an inventory.
D. closing down the production in the short-run with the hope that the situation would change in the future.

Learning Objective: 4.4 Uncertainty, expectations, shocks, and short-run fluctuations
Level: Moderate
McConnell - Chapter 004 #42
Type: Application

43. *(p. 90)* To explain the short-run fluctuations in the real-world economies, the economists refer to:
A. the combination of unexpected changes in demand and inflexible prices.
B. the combination of unexpected changes in demand and flexible prices.
C. the combination of fully expected changes in demand and inflexible prices.
D. the combination of flexible prices and changes in the inventories.

Learning Objective: 4.4 Uncertainty, expectations, shocks, and short-run fluctuations
Level: Moderate
McConnell - Chapter 004 #43
Type: Application

44. *(p. 90)* Assuming inflexible prices, if the demand for many goods and services falls across the the entire economy and for an extended period of time:
A. many firms will face a constant reduction in their inventories.
B. many firms will face with an inventory pile up and will be forced to cut production.
C. many firms will face with an inventory pile up and will be forced to hire more workers.
D. many firms will face a constant reduction in their inventories and will be forced to hire more workers.

Learning Objective: 4.4 Uncertainty, expectations, shocks, and short-run fluctuations
Level: Moderate
McConnell - Chapter 004 #44
Type: Application

45. *(p. 90)* Assume that the demand for goods and services falls across the entire economy and for an extended period of time. If the prices are inflexible, the unintended increase in business inventories would force:
A. businesses to keep the production at the existing level.
B. businesses to increase the level of production.
C. businesses to lower the level of production.
D. businesses to increase the level of employment.

Learning Objective: 4.4 Uncertainty, expectations, shocks, and short-run fluctuations
Level: Moderate
McConnell - Chapter 004 #45
Type: Application

46. *(p. 90-91)* Which of the following product categories have the most flexible prices?
A. corn, oil, gasoline and, natural gas.
B. hair cuts, newspapers and, taxi fares.
C. computer software and, veterinary services.
D. coin-operated laundry machines, restaurant menus and, magazines.

Learning Objective: 4.4 Uncertainty, expectations, shocks, and short-run fluctuations
Level: Easy
McConnell - Chapter 004 #46
Type: Application

47. *(p. 91)* Several factors contribute to the short-run price stickiness. These include:
A. consumer preference for lower prices and the quality of the product.
B. durability and the quality of the product.
C. frequent sales and, inventory pile ups.
D. consumer preference for predictable prices and, the fear of price war.

Learning Objective: 4.4 Uncertainty, expectations, shocks, and short-run fluctuations
Level: Easy
McConnell - Chapter 004 #47
Type: Application

48. *(p. 92)* If the unexpected short-run fluctuations in demand begin to look permanent:
A. the firms would allow their prices to change accordingly.
B. the firms would be hesitant to allow their prices to change accordingly.
C. the firms would not allow their prices to change.
D. the firms would change the quality of their products but not the prices.

Learning Objective: 4.4 Uncertainty, expectations, shocks, and short-run fluctuations
Level: Easy
McConnell - Chapter 004 #48
Type: Application

49. *(p. 92)* To study macroeconomics, one need various models with different assumptions about the flexibility and/or stickiness of the price levels. This is because:
A. the economy behaves similarly to demand shocks regardless of the length of time.
B. the price flexibility is a short-run phenomenon while, the price stickiness is a long-run phenomenon.
C. the economy behaves so differently depending on how much time has passed after a demand shock.
D. various government policies are useless to eliminate the effects of an unexpected demand shock.

Learning Objective: 4.4 Uncertainty, expectations, shocks, and short-run fluctuations
Level: Easy
McConnell - Chapter 004 #49
Type: Application

50. *(p. 92)* One major difference between the short-run and long-run macroeconomic analysis is that:
A. in short-run prices are fully flexible while in long-run they are not.
B. in short-run prices are sticky while in long-run they are fully flexible.
C. in short-run stickiness of prices would guaranty the long-run price inflexibility.
D. the price stickiness in long-run guaranties the flexibility of prices in the short-run.

Learning Objective: 4.4 Uncertainty, expectations, shocks, and short-run fluctuations
Level: Easy
McConnell - Chapter 004 #50
Type: Application

51. *(p. 93)* Before the use of computer in tracking the inventories, the firms:
A. would hardly counting it because it was an impossible task to accomplish.
B. would hardly practicing it because they liked surprises.
C. would count the inventory only a few times per year due to the high cost.
D. would count the inventory too frequently.

Learning Objective: Last Word
Level: Easy
McConnell - Chapter 004 #51
Type: Application

52. *(p. 93)* Before the use of computerized inventory tracking, an unfortunate side effect of counting inventories infrequently was that:
A. unexpected shifts in demand could cause an undetected large change in inventory Levels.
B. unexpected increase in demand could cause a large undetected increase in inventory levels.
C. unexpected decrease in demand could cause a large undetected decrease in inventory levels.
D. unexpected increase or decrease in demand could cause a large undetected decrease in supply.

Learning Objective: Last Word
Level: Easy
McConnell - Chapter 004 #52
Type: Application

53. *(p. 93)* Infrequent inventory counting leads to strong fluctuations in output and employment, because:
A. by the time an unexpected change in demand is discovered, it will not have had enough time to create a large change in inventory.
B. by the time an unexpected change in demand is discovered, it will have had enough time to create a large change in inventory.
C. by the time an unexpected change in demand is discovered, it will have had enough time to create a reduction in employment.
D. by the time an unexpected change in demand is discovered, it will not have had any effect on inventory.

Learning Objective: Last Word
Level: Easy
McConnell - Chapter 004 #53
Type: Application

54. *(p. 83)* The Gross Domestic Product (GDP) measures the value of final goods and services produced by a nation during a given period of time.
FALSE

Learning Objective: 4.1 Assessing the health of the economy: Performance and policy
Level: Easy
McConnell - Chapter 004 #54
Type: Definition

55. *(p. 83)* Unemployment occurs when a person cannot get a job despite being willing to work and actively seeking work.
TRUE

Learning Objective: 4.1 Assessing the health of the economy: Performance and policy
Level: Easy
McConnell - Chapter 004 #55
Type: Definition

56. *(p. 84)* Modern economic growth in a country implies that output per person increases.
TRUE

Learning Objective: 4.2 The miracle of modern economic growth
Level: Easy
McConnell - Chapter 004 #56
Type: Definition

57. *(p. 84)* Before the start of the Industrial Revolution in the late 1700s, living standards around the world were quite different.
FALSE

Learning Objective: 4.2 The miracle of modern economic growth
Level: Easy
McConnell - Chapter 004 #57
Type: Application

58. *(p. 85)* Savings are generated when current consumption is less than current output.
TRUE

Learning Objective: 4.3 Savings, investment, and modern economic growth
Level: Easy
McConnell - Chapter 004 #58
Type: Application

59. *(p. 86)* A well functioning financial system helps to promote economic growth and stability.
TRUE

Learning Objective: 4.3 Savings, investment, and modern economic growth
Level: Easy
McConnell - Chapter 004 #59
Type: Application

60. *(p. 87)* Demand shocks are the expected changes in the demand for goods and services.
FALSE

Learning Objective: 4.4 Uncertainty, expectations, shocks, and short-run fluctuations
Level: Easy
McConnell - Chapter 004 #60
Type: Application

61. *(p. 88)* If prices are flexible, no matter what demand turns out to be, the firms within an economy can continue selling their optimal output.
TRUE

Learning Objective: 4.4 Uncertainty, expectations, shocks, and short-run fluctuations
Level: Moderate
McConnell - Chapter 004 #61
Type: Application

62. *(p. 89)* In reality, all the prices in the economy are inflexible and are not able to change rapidly when demand changes unexpectedly.
FALSE

Learning Objective: 4.4 Uncertainty, expectations, shocks, and short-run fluctuations
Level: Moderate
McConnell - Chapter 004 #62
Type: Application

63. *(p. 90)* Commodities such as corn, oil, natural gas and gasoline have sticky prices.
FALSE

Learning Objective: 4.4 Uncertainty, expectations, shocks, and short-run fluctuations
Level: Easy
McConnell - Chapter 004 #63
Type: Application

64. *(p. 91)* Sticky prices imply that some firms are afraid to cut their prices because they are afraid of the price wars.
TRUE

Learning Objective: 4.4 Uncertainty, expectations, shocks, and short-run fluctuations
Level: Easy
McConnell - Chapter 004 #64
Type: Application

65. *(p. 93)* Computerized inventory tracking has accelerated the speed which companies can respond to unexpected changes in demand.
TRUE

Learning Objective: Last Word
Level: Easy
McConnell - Chapter 004 #65
Type: Application

66. *(p. 82)* Define macroeconomics and provide two key concerns it studies.

Macroeconomics studies the behaviour of an economy as a whole. It focuses its studies upon two key concerns: (1) long-run economic growth, and (2) short-run fluctuations in output and employment (the business cycle).

Learning Objective: 4.1 Assessing the health of the economy: Performance and policy
McConnell - Chapter 004 #66

67. *(p. 83)* What three key statistics do macroeconomists study to assess the health of the economy? Give a short explanation of each.

Macroeconomists study real gross domestic product (GDP), unemployment, and inflation. Real GDP measures the annual output of final goods and services by an economy after adjusting for price changes. Unemployment is a measure of the number of people who are not able to find work despite actively looking for it. Inflation is the increase in the general (or overall) price level.

Learning Objective: 4.1 Assessing the health of the economy: Performance and policy
McConnell - Chapter 004 #67

68. *(p. 83)* What is the difference between nominal and real GDP?

The GDP measures all final goods and services produced in an economy in a year. The problem is, you cannot add apples to typing services and then to movies produced and come up with a meaningful value. As a solution economists add the dollar value of each final good and service. When final goods and services are measured in current prices, we call this the nominal GDP. Real GDP measures output after accounting for year-to-year price changes. This makes it possible to compare quantity changes between years.

Learning Objective: 4.1 Assessing the health of the economy: Performance and policy
McConnell - Chapter 004 #68

69. *(p. 83)* Why do economists measure growth in an economy using real GDP rather than nominal GDP?

Nominal GDP measures the final dollar value of all goods and services produced in an economy in a year. This measurement is made using current dollars. Growth in nominal GDP can occur for three reasons: (1) more goods and services are produced, (2) goods and services have higher prices, and (3) there is an increase in both goods and services produced and their associated prices. Real GDP is measured in constant dollars, so an increase in real GDP simply measures an increase in the production of goods and services.

Learning Objective: 4.1 Assessing the health of the economy: Performance and policy
McConnell - Chapter 004 #69

70. *(p. 83)* Why do economists worry about unemployment?

High unemployment rates mean that an economy is producing within its production possibilities curve – goods and services that could have been produced are not being produced. Economists have also linked a number of social issues that seem to be associated with unemployment rates including higher incidence of crime and social/political unrest. At the level of the individual, unemployment is often linked with depression, heart disease, and other illnesses.

Learning Objective: 4.1 Assessing the health of the economy: Performance and policy
McConnell - Chapter 004 #70

71. *(p. 83)* List two concerns with inflation.

First, if the rate of inflation exceeds the rate of income growth, then inflation means a decline in living standards. Inflation is especially problematic for people on fixed incomes. Second, an unexpected increase in inflation reduces the purchasing power of savings.

Learning Objective: 4.1 Assessing the health of the economy: Performance and policy
McConnell - Chapter 004 #71

72. *(p. 84)* What is modern economic growth?

Modern economic growth is the relatively recent phenomenon of steadily increasing real GDP per capita.

Learning Objective: 4.2 The miracle of modern economic growth
McConnell - Chapter 004 #72

73. *(p. 84-85)* What is GDP per capita?

It is GDP divided by population. It is sometimes referred to as GDP per person.

Learning Objective: 4.2 The miracle of modern economic growth
McConnell - Chapter 004 #73

74. *(p. 85)* In order to compare GDP across nations, economists typically make 3 adjustments. What are these adjustments and why are they carried out?

First, currencies are converted to a common currency, usually the U.S. dollar, so that prices are in a common unit. Second, GDP is adjusted for the population size by calculating GDP per capita (GDP divided by population). This gives some idea of the potential standard of living for all people in a society. Finally, prices are adjusted to ensure purchasing power parity. A men's haircut in Canada may cost $10 and $1 (even after the exchange rate is used) in India. The purchasing power parity adjustment corrects for this difference.

Learning Objective: 4.2 The miracle of modern economic growth
McConnell - Chapter 004 #74

75. *(p. 85)* Compare the adjusted GDP per capita for the richest and poorest countries listed in Global Perspective 4.1 (page 85). How does Canada compare to these two countries?

In 2008, the United States had a GDP per capita of $46,859 while Burundi had a GDP per capita of $389. Canada had a GDP per capita of $39,183. The U.S. had a GDP per capita about 120 times as large as Burundi and about 1.2 times as large as Canada. Canada`s GDP per capita was about 100 times as large as Burundi.

Learning Objective: 4.2 The miracle of modern economic growth
McConnell - Chapter 004 #75

76. *(p. 85-86)* In order to grow, what must a country do?

Economic growth requires that a country save and invest. That means the nation forgoes current consumption to enhance future productivity.

Learning Objective: 4.3 Savings, investment, and modern economic growth
McConnell - Chapter 004 #76

77. *(p. 86)* What is the difference between financial investment and economic investment?

Financial investment involves the purchase of financial assets (e.g., stocks, bonds, and mutual funds), or real assets (e.g. houses, land, or factories), or building real assets with the expectation that they will earn financial gain. Economic investment involves the purchase of newly created capital goods – goods that will be used in future production. Financial investment includes everything in economic investment and more.

Learning Objective: 4.3 Savings, investment, and modern economic growth
McConnell - Chapter 004 #77

78. *(p. 86)* In this list, identify those investments which are financial (F) and those that are economic (E): Canada Savings Bonds, stock in Potash Corporation of Saskatchewan, an old house you plan on fixing and reselling, new machinery for a factory you own, land that you plan to develop, an old window factory, your university education.

Canada Savings Bonds (F), stock in Potash Corporation of Saskatchewan (F), an old house you plan on fixing and reselling (F), new machinery for a factory you own (E and F as all economic investments are also financial investments), land that you plan to develop (F), an old window factory (F), your university education (E – your education is an investment in human capital – and of course F).

Learning Objective: 4.3 Savings, investment, and modern economic growth
McConnell - Chapter 004 #78

79. *(p. 86)* If households are typically the source of savings and businesses the source of investments, how then are savings and investments coordinated?

Banks and other financial institutions (mutual funds, pension plans, insurance companies) essentially accept savings and organize investments.

Learning Objective: 4.3 Savings, investment, and modern economic growth
McConnell - Chapter 004 #79

80. *(p. 87)* What roles do expectations play in macroeconomics?

There are two channels through which economists believe expectations play a role in the macroeconomy. First, changing expectations affect investment decisions. If people and businesses expect the economy is in a growth phase, they are more likely to invest which will expand future consumption opportunities. On the other hand, a pessimistic outlook will decrease current investment and slow growth.

Second, unmet expectations are shocks to an economy. People and companies are planning on one thing but realize a different outcome and then have to reorganize their plans.

Learning Objective: 4.4 Uncertainty, expectations, shocks, and short-run fluctuations
McConnell - Chapter 004 #80

81. *(p. 87)* What are two broad categories of macroeconomic shocks?

In macroeconomics, shocks are categorized as either demand shocks or supply shocks. Demand shocks are unexpected changes in the demand for goods and services while supply shocks are unexpected changes in the supply of goods and services (usually due to input price changes).

Learning Objective: 4.4 Uncertainty, expectations, shocks, and short-run fluctuations
McConnell - Chapter 004 #81

82. *(p. 87-90)* Suppose that we are in a condition of "stuck" prices so that the price of nails will not go above or below \$2/kg. Further suppose that nail factories have been built on a business plan designed to deliver 6,000 kg/week. How many apples will be sold in a market in which demand (which includes a modest amount of inventory) is characterized by: (a) P = 5-0.5Q, (b) P = 6-0.5Q, and (c) P = 4-0.5Q, where P is in \$/kg and Q is in thousands of kg/week? In each case, what happens to inventory.

(a) At \$2/kg we get 2 = 5-0.5Q, -3 = -0.5Q, Q = 3/0.5, Q = 6 thousand kg/week. This is exactly the same production as the business plan, so inventory does not change.

(b) At \$2/kg we get 2 = 6-0.5Q, -4 = -0.5Q, Q = 4/0.5, Q = 8 thousand kg/week. This is 2,000 kg/week (6,000-8,000) more demand than the business plan, so inventory unexpectedly falls by 2,000 kg/week.

(c) At \$2/kg we get 2 = 4-0.5Q, -2 = -0.5Q, Q = 2/0.5, Q = 4 thousand kg/week. This is 2,000 kg/week (6,000-4,000) less demand than the business plan, so inventory unexpectedly increases by 2,000 kg/week.

Learning Objective: 4.4 Uncertainty, expectations, shocks, and short-run fluctuations
McConnell - Chapter 004 #82

83. *(p. 87-89)* Suppose that we are in a condition of fully flexible prices, but production of nails will not go above 6,000 kg/week. What price will nails sell for if market demand is characterized by: (a) P = 5-0.5Q, (b) P = 6-0.5Q, and (c) P = 4-0.5Q, where P is in $/kg and Q is in thousands of kg/week?

(a) P = 5-0.5(6), P = 5-3, P = $2/kg; (b) P = 6-0.5(6), P = 6-3, P = $3/kg; (c) P = 4-0.5(6), P = 4-3, P = $1/kg.

Learning Objective: 4.4 Uncertainty, expectations, shocks, and short-run fluctuations
McConnell - Chapter 004 #83

84. *(p. 87-90)* Suppose that we are in a condition of "stuck" prices so that the price of wooden chairs will not go above or below $125/unit. Further suppose that chair factories have been built on a business plan designed to deliver 200/month. How many chairs will be sold in a market in which demand (which includes a modest amount of inventory) is characterized by: (a) P = 425-1.5Q, (b) P = 530-1.5Q, and (c) P = 400-0.5Q, where P is in $/chair and Q is in chairs/month? In each case, what happens to planned inventory.

(a) At $125/chair we get 125 = 425-1.5Q, -300 = -1.5Q, Q = 300/1.5, Q = 200/month. This is exactly the same production as the business plan, so inventory does not change.

(b) At $125/chair we get 125 = 530-1.5Q,-405 = -1.5Q, Q = 405/1.5, Q = 270 chairs/month. This is 70 chairs/month (200-270) more demand than the business plan, so inventory unexpectedly falls by 70 chairs/month.

(c) At $125/chair we get 125 = 395-1.5Q, -270 = -1.5Q, Q = 270/1.5, Q = 180 chairs/month. This is 20 chairs/month (200-180) less demand than the business plan, so inventory unexpectedly increases by 20 chairs/month.

Learning Objective: 4.4 Uncertainty, expectations, shocks, and short-run fluctuations
McConnell - Chapter 004 #84

85. *(p. 87-89)* Suppose that we are in a condition of fully flexible prices, but production of nails will not go above 200 chairs/month. What price will chairs sell for if market demand is characterized by: (a) P = 425-1.5Q, (b) P = 530-1.5Q, and (c) P = 400-0.5Q, where P is in $/chair and Q is in chairs/month?

(a) P = 425-1.5(200), P = 425-300, P = $125/chair; (b) P = 530-1.5(200), P = 530-300, P = $230/chair; (c) P = 400-1.5(200), P = 400-300, P = $100/chair.

Learning Objective: 4.4 Uncertainty, expectations, shocks, and short-run fluctuations
McConnell - Chapter 004 #85

86. *(p. 89)* What will happen to prices and output levels if there is an unexpected demand increase and prices are fully flexible?

In this instance, output is fixed and only prices change. With a demand increase and output fixed, the price will necessarily rise.

Learning Objective: 4.4 Uncertainty, expectations, shocks, and short-run fluctuations
McConnell - Chapter 004 #86

87. *(p. 89)* What will happen to prices and output levels if there is an unexpected demand decrease and prices are fully flexible?

In this instance, output is fixed and only prices change. With a demand increase and output fixed, prices will necessarily fall.

Learning Objective: 4.4 Uncertainty, expectations, shocks, and short-run fluctuations
McConnell - Chapter 004 #87

88. *(p. 89-90)* What are inventories and what role do they play in an economy with sticky prices?

Inventories are goods that have been produced but remain unsold. In a world of sticky prices, unexpected increases in inventories indicate an unexpected increase in demand. Similarly, unexpected decreases in inventories indicate an unexpected decrease in demand.

Learning Objective: 4.4 Uncertainty, expectations, shocks, and short-run fluctuations
McConnell - Chapter 004 #88

89. *(p. 88-90)* If prices are "stuck" and there is an unexpected demand increase, describe what happens in the economy.

An unexpected increase in demand would normally cause a price increase. However, with prices fixed, output will increase and inventories will be depleted faster than firms' expect.

Learning Objective: 4.4 Uncertainty, expectations, shocks, and short-run fluctuations
McConnell - Chapter 004 #89

90. *(p. 88-90)* If prices are "stuck" and there is an unexpected demand decrease, describe what happens in the economy.

An unexpected decrease in demand would normally cause a price decrease. However, with prices fixed, output will decrease and inventories will be build up beyond what firms expected to hold.

Learning Objective: 4.4 Uncertainty, expectations, shocks, and short-run fluctuations
McConnell - Chapter 004 #90

91. *(p. 90-91)* "Most prices are not that sticky." Evaluate this claim.

While some prices like retail gas change fairly quickly others like coin-operated machines take almost four years to change. Canadians will recall the rather long period of time it took for American-made goods to fall in price once the Canadian dollar appreciated rapidly in early 2008.

Learning Objective: 4.4 Uncertainty, expectations, shocks, and short-run fluctuations
McConnell - Chapter 004 #91

92. *(p. 91)* What are two reasons why prices might be sticky?

First, consumers prefer stable and predictable prices. Companies recognize this preference and can improve customer loyalty by keeping prices relatively constant. Second, firms might believe that price cuts will initiate costly price wars. Another reason may be that input prices are often fixed by longer-term contracts that take time to renegotiate.

Learning Objective: 4.4 Uncertainty, expectations, shocks, and short-run fluctuations
McConnell - Chapter 004 #92

93. *(p. 90-92)* Why do economists use the term "sticky" prices rather than "stuck" prices?

Prices do eventually adjust, so they are not stuck forever. If demand shocks come to look like permanent shifts, then prices will adjust. It might be best to think of prices in the immediate short-run as stuck, in the short-run as sticky or partially adjusting, and fully flexible in the long-run.

Learning Objective: 4.4 Uncertainty, expectations, shocks, and short-run fluctuations
McConnell - Chapter 004 #93

94. *(p. 93-94)* How might recent changes in inventory management affect the business cycle?

Past inventory management meant devoting potentially productive resources to the somewhat unfulfilling task of counting inventory. Companies and labourers viewed inventory counts as a costly chore so they only did it a few times a year. As a consequence, it took a few months for companies to realize if inventories were unexpectedly growing or shrinking. Today many firms use a just-in-time delivery model with small inventories. Moreover, computerized inventory management allows managers to know on a weekly if not daily basis if inventory is unexpectedly high or low. As such, firms become aware of, and can react to, demand shocks much more quickly and this is hypothesized to reduce the frequency and severity of the business cycle.

Learning Objective: Last Word
McConnell - Chapter 004 #94

c4 Summary

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