

Macroeconomics: Policy and Practice, 2e, Global Edition (Mishkin)

Chapter 1 The Policy and Practice of Macroeconomics

1.1 The Practice of Macroeconomics

- 1) Macroeconomics is the study of _____ while microeconomics studies _____.
A) large biological systems; political implications of nanotechnology
B) the overall economic activity and prices; an individual firm, household, or market
C) an individual firm; the overall economic performance of a nation
D) the overall economic performance of the world; the economy of a single country
E) firm behavior; market behavior

Answer: B

Topic: 1.1 The Practice of Macroeconomics

AACSB: Analytical Thinking

- 2) Macroeconomics is the study of _____ while microeconomics studies _____.
A) large business enterprises; small business ventures
B) the overall household economic activity; market behavior
C) an individual firm; the overall economic performance of a nation
D) the overall economic performance of the world; the economy of a single country
E) none of the above

Answer: E

Topic: 1.1 The Practice of Macroeconomics

AACSB: Analytical Thinking

- 3) Macroeconomics is the study of _____ while microeconomics studies _____.
A) an individual firm; the overall economic performance of a nation
B) the overall economic performance of the world; the economy of a single country
C) the overall economic activity and prices; an individual firm, household, or market
D) firm choices; market behavior
E) consumer choices; government behavior

Answer: C

Topic: 1.1 The Practice of Macroeconomics

AACSB: Analytical Thinking

- 4) An endogenous variable is typically _____.
A) taken as given
B) strictly explained *outside* the model
C) strictly explained *inside* the model
D) strictly explained by data
E) strictly explained by graphical analysis

Answer: C

Topic: 1.1 The Practice of Macroeconomics

AACSB: Analytical Thinking

- 5) An endogenous variable is typically _____.
A) strictly explained *inside* the model
B) taken as given
C) strictly explained *outside* the model
D) constant inside the model
E) explained by unemployment

Answer: A

Topic: 1.1 The Practice of Macroeconomics

AACSB: Analytical Thinking

- 6) An exogenous variable is typically _____.
A) not considered in an economic model
B) only used to conduct policy analysis
C) taken as given
D) explained *inside* the model
E) explained by interest rates

Answer: C

Topic: 1.1 The Practice of Macroeconomics

AACSB: Analytical Thinking

- 7) Which statement is true of an exogenous variable in an economic model?
A) It has no direct relation to the endogenous variables.
B) Its value within the model cannot be changed.
C) It is often a policy variable.
D) It is explained *inside* the model.
E) All of the above.

Answer: C

Topic: 1.1 The Practice of Macroeconomics

AACSB: Analytical Thinking

- 8) An exogenous variable is typically _____.
A) calculated by the model
B) only used to conduct policy analysis
C) explained *inside* the model
D) disregarded in economic models
E) none of the above

Answer: E

Topic: 1.1 The Practice of Macroeconomics

AACSB: Analytical Thinking

9) A(n) _____ variable is calculated from within the model. A(n) _____ variable can never be taken as given.

- A) endogenous; endogenous
- B) exogenous; endogenous
- C) endogenous; exogenous
- D) exogenous; exogenous
- E) none of the above

Answer: A

Topic: 1.1 The Practice of Macroeconomics

AACSB: Analytical Thinking

10) To compare the conclusions of a model with what actually happens, historical data are entered into the model as _____.

- A) endogenous variables
- B) exogenous variables
- C) equations
- D) predictions
- E) policies

Answer: B

Topic: 1.1 The Practice of Macroeconomics

AACSB: Analytical Thinking

11) A simple macroeconomic model might explain how an increase in the demand for new housing would lead to a decrease in the rate of unemployment. In such a model, which of these variables is likely to be *exogenous*?

- A) the quantity sold of home furnishings
- B) the degree of unionization of the construction industry
- C) the wage rate for unskilled workers
- D) the level of tax revenues
- E) the demand for concrete

Answer: B

Topic: 1.1 The Practice of Macroeconomics

AACSB: Reflective Thinking

12) In a macroeconomic model designed to explain why some countries grow faster than others, which of these variables is likely to be *endogenous*?

- A) investment
- B) economic policies
- C) geographic size
- D) population
- E) none of the above

Answer: A

Topic: 1.1 The Practice of Macroeconomics

AACSB: Reflective Thinking

13) In a model of the saving rate, which of these relationships is most crucial?

- A) the effect of the saving rate on government spending
- B) the effect of government spending on the saving rate
- C) the effect of the saving rate on taxes
- D) the effect of taxes on the saving rate
- E) the effect of the saving rate on the real wage

Answer: D

Topic: 1.1 The Practice of Macroeconomics

AACSB: Reflective Thinking

14) Which of the following sequences best describes the five necessary steps to develop an economic model in the correct order?

- A) (1): Identify the endogenous variables; (2): identify the exogenous variables; (3): develop a model; (4): compare the model with the data; (5): conduct prediction and policy analysis.
- B) (1): Develop a model; (2): identify the exogenous variables; (3): identify the endogenous variables; (4): compare the model with the data; (5): conduct prediction and policy analysis.
- C) (1): Conduct prediction and policy analysis; (2): develop a model; (3): identify the endogenous variables; (4): identify the exogenous variables; (5): compare the model with the data.
- D) (1): Conduct prediction and policy analysis; (2): compare the model with the data; (3): identify the endogenous variables; (4): identify the exogenous variables; (5): develop a model.
- E) none of the above

Answer: A

Topic: 1.1 The Practice of Macroeconomics

AACSB: Analytical Thinking

15) If a macroeconomist studying the causes of unemployment suspects that changes in technology might play a role, then this macroeconomist is at which step in the process of developing an economic model?

- A) Identify the exogenous variables.
- B) Identify the endogenous variables.
- C) Compare the model with the data.
- D) Conduct prediction and policy analysis.
- E) Develop a model.

Answer: A

Topic: 1.1 The Practice of Macroeconomics

AACSB: Reflective Thinking

16) If a macroeconomist studying the causes of unemployment finds that, historically, changes in technology seem to have caused between five and 15 percent of changes in unemployment, then this macroeconomist is at which step in the process of developing an economic model?

- A) Identify the exogenous variables.
- B) Identify the endogenous variables.
- C) Develop a model.
- D) Compare the model with the data.
- E) Conduct prediction and policy analysis.

Answer: D

Topic: 1.1 The Practice of Macroeconomics

AACSB: Reflective Thinking

17) If a macroeconomist studying the causes of unemployment asserts that a particular change in technology will cause the rate of unemployment to decrease by ten percent, then this macroeconomist is at which step in the process of developing an economic model?

- A) Identify the endogenous variables.
- B) Develop a model.
- C) Compare the model with the data.
- D) Identify the exogenous variables.
- E) Conduct prediction and policy analysis.

Answer: E

Topic: 1.1 The Practice of Macroeconomics

AACSB: Reflective Thinking

18) Macroeconomic models *particularly* focus on the following three economic data series.

- A) real GDP, the unemployment rate, and inflation
- B) endogenous variables, exogenous variables, and GDP per person
- C) inflation, recessions, and business cycles
- D) real GDP, the employment rate, and interest rates
- E) real GDP, the unemployment rate, and depressions

Answer: A

Topic: 1.1 The Practice of Macroeconomics

AACSB: Analytical Thinking

19) Macroeconomic models *particularly* focus on the following three economic data series.

- A) endogenous variables, exogenous variables, and taxes
- B) inflation, unemployment, and business cycles
- C) nominal GDP, the employment rate, and budget deficits
- D) bankruptcies, the unemployment rate, and depressions
- E) none of the above

Answer: E

Topic: 1.1 The Practice of Macroeconomics

AACSB: Analytical Thinking

20) Real GDP measures _____.

- A) the total hours the average U.S. citizen works a year
- B) the percentage of income produced by workers and firms
- C) how slowly interest rates grow
- D) the total market value of actual goods and services produced in an economy over a year
- E) how rapidly the overall level of prices is rising

Answer: D

Topic: 1.1 The Practice of Macroeconomics

AACSB: Analytical Thinking

21) Real GDP measures _____.

- A) the total amount of income of every person and firm in the economy
- B) the percentage of income produced by workers and firms
- C) how rapidly the overall level of prices is rising
- D) how many hours the average U.S. citizen works a year
- E) how many automobiles are produced in a month

Answer: A

Topic: 1.1 The Practice of Macroeconomics

AACSB: Analytical Thinking

22) From 1900 to 2013, real GDP per person has had two important attributes.

- A) It has grown substantially over time and there are small differences from country to country.
- B) It has grown unevenly over time in the U.S. but it has grown substantially.
- C) It has grown evenly over time in the U.S. and there are huge differences from country to country.
- D) It has fluctuated around a trend in the U.S. but it has not grown much for all the Southeast Asian countries.
- E) It has doubled in the U.S. but there have been many recession periods.

Answer: B

Topic: 1.1 The Practice of Macroeconomics

AACSB: Analytical Thinking

23) From 1900 to 2013 real GDP per person in the U.S. has _____.

- A) doubled
- B) grown by a factor of four
- C) grown by a factor of nine
- D) grown by a factor of twenty
- E) declined

Answer: C

Topic: 1.1 The Practice of Macroeconomics

AACSB: Analytical Thinking

- 24) The term "business cycle" refers to _____.
- A) the opening and eventual closing down of businesses
 - B) the rising and later declining of the purchasing power of the dollar
 - C) the acquiring of raw materials and ultimate selling of a finished product
 - D) the tendency for rich economies to be inevitably out-paced by other economies
 - E) the slowing and eventual accelerating of economic growth

Answer: E

Topic: 1.1 The Practice of Macroeconomics

- 25) What explains the rise in income in the U.S. between 1900 and 2013?

- A) business cycles
- B) economic growth
- C) recessions
- D) depressions
- E) the purchasing power of the dollar

Answer: B

Topic: 1.1 The Practice of Macroeconomics

AACSB: Reflective Thinking

- 26) What explains the rise in income in the U.S. between 1900 and 2013?

- A) business cycles
- B) inflation
- C) recessions
- D) depressions
- E) none of the above

Answer: E

Topic: 1.1 The Practice of Macroeconomics

AACSB: Reflective Thinking

- 27) In the Great Depression of the 1930s, the unemployment rate in the U.S. climbed to what percentage?

- A) 5
- B) 10
- C) 15
- D) 20
- E) 25

Answer: E

Topic: 1.1 The Practice of Macroeconomics

AACSB: Analytical Thinking

28) The unemployment rate measures, at a point in time, the _____.

- A) percentage of workers who do not have a job
- B) percentage of workers who do not have a job but are looking for work
- C) percentage of workers who stop working
- D) percentage of workers who are looking for work
- E) none of the above

Answer: B

Topic: 1.1 The Practice of Macroeconomics

AACSB: Analytical Thinking

29) Apart from the Great Depression of the 1930s, which decade saw the largest rise in unemployment in the U.S.?

- A) 1950s
- B) 1970s
- C) 1980s
- D) 1990s
- E) 2000s

Answer: E

Topic: 1.1 The Practice of Macroeconomics

30) From 1929 to 2013, the unemployment rate in the U.S. _____.

- A) has continued to grow but has always remained well above zero
- B) has fluctuated around zero
- C) has gone up and down but has always remained well above zero
- D) has decreased in most recessions
- E) has grown by a factor of four

Answer: C

Topic: 1.1 The Practice of Macroeconomics

AACSB: Analytical Thinking

31) Compared to other economies, the unemployment rate in the United States _____.

- A) is relatively high
- B) is relatively low
- C) is remarkably stable
- D) is neither particularly high nor low
- E) varies too much for a reasonable comparison

Answer: D

Topic: 1.1 The Practice of Macroeconomics

AACSB: Analytical Thinking

32) A business manager who observes that prices in general keep rising might infer, correctly, that now is a good time to _____.

- A) invest to expand the business
- B) raise the price of her product
- C) expect an increase in business profits
- D) expect a higher return on personal savings
- E) all of the above

Answer: B

Topic: 1.1 The Practice of Macroeconomics

AACSB: Reflective Thinking

33) Up until World War II inflation in the U.S. _____.

- A) remained around zero on average
- B) rose and remained quite high for an extended period of time
- C) has gone up and down but has always remained well above zero
- D) increased by a factor of four every year
- E) decreased by 30% every year

Answer: A

Topic: 1.1 The Practice of Macroeconomics

AACSB: Analytical Thinking

34) Economists apply the term "Great Inflation" to which decade?

- A) 1930s
- B) 1940s
- C) 1950s
- D) 1960s
- E) 1970s

Answer: E

Topic: 1.1 The Practice of Macroeconomics

35) Since World War II the U.S. _____.

- A) has seen a substantial decrease in the inflation rate
- B) has seen frequent periods of deflation
- C) has seen significant variations in unemployment
- D) has seen real GDP grow slower, on average, than in the pre-war period
- E) none of the above

Answer: C

Topic: 1.1 The Practice of Macroeconomics

AACSB: Analytical Thinking

- 36) Since World War II the U.S. _____.
A) has seen a substantial decrease in the inflation rate
B) has seen frequent periods of deflation
C) has seen a significant upward trend in unemployment
D) has seen a significant upward trend in real GDP
E) none of the above

Answer: D

Topic: 1.1 The Practice of Macroeconomics

AACSB: Analytical Thinking

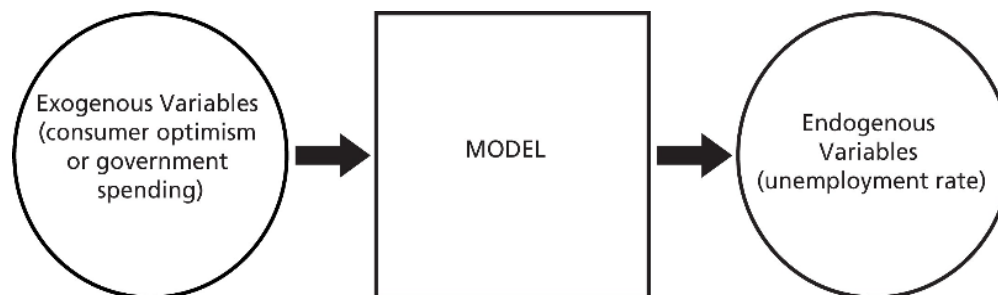
- 37) Since World War II the U.S. _____.
A) has seen a substantial increase in the inflation rate
B) has seen less frequent periods of deflation
C) has seen a significant upward trend in real GDP
D) all of the above
E) none of the above

Answer: D

Topic: 1.1 The Practice of Macroeconomics

AACSB: Analytical Thinking

Figure 1.1



- 38) Figure 1.1 displays exogenous variables entering a model from which emerge endogenous variables. Yet, in the five-step process to develop an economic model, the macroeconomist specifies the endogenous variables first, then the exogenous variables. Which is the correct sequence? Explain.

Answer: Both are correct. The figure displays a model in use. The five steps describe how to develop and use a model. To develop a model, one begins with an interesting economic question. That question, that which is to be explained, is (are) the endogenous variable(s). The attempted explanation includes the suspected causes, which are the exogenous variables. The next step is to connect the exogenous causes to the endogenous effects. The model is the set of such connections. Now, to test or use the model, as displayed in Figure 1.1, the exogenous variables are set to specific values which the model uses to produce predicted values for the endogenous variables.

Topic: 1.1 The Practice of Macroeconomics

AACSB: Reflective Thinking

39) Assume that a high proportion of recent college graduates decides to stay in school seeking advanced degrees, rather than confront the challenge of landing a good job in the midst of generally high unemployment. What is the direct impact of this behavior on the unemployment rate? In the longer term, what indirect impacts might there be on the unemployment rate?

Answer: Staying in school means that these graduates will not be counted as looking for work, so the unemployment rate will be lower than it would be otherwise. As students, these individuals will probably have lower income and spend less than if they had landed good jobs, so the level of output might be lower, thus unemployment higher than it might otherwise have been. Eventually, as these individuals bring their advanced skills to the economy as workers or employers, and increase their spending, they will contribute to economic growth and to lower unemployment.

Topic: 1.1 The Practice of Macroeconomics

AACSB: Reflective Thinking

40) Develop a simple model of inflation by identifying at least two exogenous variables and describing, briefly, how the value of these exogenous variables will impact the rate of increase in the overall level of prices in the economy.

Answer: Answers will vary. The most appropriate exogenous variables to identify are the (growth rate of) the quantity of money and the (growth rate of) output. The former is positively related to inflation; the latter is negatively related.

Topic: 1.1 The Practice of Macroeconomics

AACSB: Reflective Thinking

41) Common sense suggests (and macroeconomists agree!) that sustained economic growth over extended time periods is more important than the economy's short-term fluctuations. Why, then, do macroeconomists (and policymakers, and the general public) care so much about the business cycle?

Answer: One reason is impatience. Periods of high unemployment are costly in terms of lost output and personal distress. A portion of lost output is investment that would have contributed to long-run growth. The business cycle involves inflation, also, which causes uncertainty and distorts incentives in ways that lower investment and reduce long-run growth. If inflation is allowed to rise, corrective measures are likely to reduce economic activity, reducing or delaying the desired long-run growth.

Topic: 1.1 The Practice of Macroeconomics

AACSB: Reflective Thinking

42) By 2010, the U.S. economy had emerged from the recession that had begun in 2007. Despite an economic growth rate well above zero, unemployment showed little sign of declining much below ten percent. Focusing on the definition of the unemployment rate, explain how it is possible to have positive economic growth without declining unemployment.

Answer: To lower the unemployment rate, the number of people who are out of work and looking for a job must decline faster than the number of people in the labor force. As growth accelerates at the end of a recession, many people who had left the labor force return as job seekers, which raises the unemployment rate (the effect on the numerator is larger than the effect on the denominator).

Topic: 1.1 The Practice of Macroeconomics

AACSB: Reflective Thinking

1.2 Macroeconomic Policy

1) The percentage of income that Americans save each year _____.

- A) is much higher than the percentage the Chinese citizens save
- B) is higher than the saving rate of most industrialized countries
- C) is lower than the saving rate of most industrialized countries
- D) increased by a factor of five every year since the 1970s
- E) none of the above

Answer: C

Topic: 1.2 Macroeconomic Policy

2) Which of these is among the principal determinants of economic growth?

- A) inflation
- B) the financial system
- C) the central bank
- D) the government budget deficit
- E) stabilization policy

Answer: B

Topic: 1.2 Macroeconomic Policy

AACSB: Reflective Thinking

3) Which of these is **not** among the principal determinants of economic growth?

- A) institutions
- B) education
- C) research and development
- D) balanced trade
- E) saving and investment

Answer: D

Topic: 1.2 Macroeconomic Policy

AACSB: Reflective Thinking

4) A good example of a policy to increase an economy's saving rate is _____.

- A) to reduce poverty
- B) to increase the economic growth rate
- C) to increase government spending
- D) to reduce interest rates
- E) to increase sales taxes

Answer: E

Topic: 1.2 Macroeconomic Policy

AACSB: Reflective Thinking

- 5) The U.S. personal saving rate _____.
A) is much higher than the percentage the Chinese citizens save
B) is higher than the saving rate of most countries
C) cannot fall below zero
D) increased by a factor of five every year since the 1970s
E) none of the above

Answer: E

Topic: 1.2 Macroeconomic Policy

AACSB: Analytical Thinking

- 6) Looking at the U.S. personal saving rate over the last sixty years, we can say that _____.
A) it has always been low
B) Americans used to spend a lot more than they have in recent years
C) Americans used to save a lot more than they have in recent years
D) it has always been fairly high
E) Americans spend more when concerned about their future earnings

Answer: C

Topic: 1.2 Macroeconomic Policy

AACSB: Analytical Thinking

- 7) Which of these economies has the highest saving rate?
A) Greece
B) China
C) United States
D) Brazil
E) Japan

Answer: B

Topic: 1.2 Macroeconomic Policy

- 8) When households have very low savings _____.
A) investment decreases
B) they are less able to cope with severe economic downturns
C) bankruptcies increase
D) all of the above
E) none of the above

Answer: D

Topic: 1.2 Macroeconomic Policy

AACSB: Analytical Thinking

9) When households increase their personal savings _____.

- A) investment decreases
- B) they are better able to cope with severe economic downturns
- C) interest rates are likely to rise, as well
- D) all of the above
- E) none of the above

Answer: B

Topic: 1.2 Macroeconomic Policy

AACSB: Analytical Thinking

10) Raising household savings could be beneficial because _____.

- A) it translates into higher investment
- B) severe economic downturns can be "better-weathered"
- C) it provides a cushion to avoid bankruptcies
- D) all of the above
- E) none of the above

Answer: D

Topic: 1.2 Macroeconomic Policy

AACSB: Reflective Thinking

11) Policies to encourage higher personal saving rates include _____.

- A) raising income taxes
- B) raising sales taxes
- C) lowering taxes on pension plans
- D) A and B but not C
- E) B and C but not A

Answer: E

Topic: 1.2 Macroeconomic Policy

AACSB: Reflective Thinking

12) Policies to encourage higher personal saving rates include _____.

- A) lowering income taxes
- B) lowering sales taxes
- C) increasing the quantity of money
- D) raising asset prices
- E) reducing interest rates

Answer: A

Topic: 1.2 Macroeconomic Policy

AACSB: Reflective Thinking

13) Policies to encourage higher personal saving rates include _____.

- A) raising income taxes
- B) lowering sales taxes
- C) raising taxes on pension plans
- D) all of the above
- E) none of the above

Answer: E

Topic: 1.2 Macroeconomic Policy

AACSB: Reflective Thinking

14) Raising taxes and cutting spending are examples of _____.

- A) fiscal policy tightening
- B) fiscal policy expansion
- C) monetary policy tightening
- D) monetary policy expansion
- E) none of the above

Answer: A

Topic: 1.2 Macroeconomic Policy

15) An increase in government spending might be an example of a _____ policy for the purpose of _____.

- A) monetary; lowering unemployment
- B) monetary; reducing inflation
- C) monetary; increasing saving
- D) fiscal; reducing inflation
- E) fiscal; lowering unemployment

Answer: E

Topic: 1.2 Macroeconomic Policy

AACSB: Reflective Thinking

16) An increase in interest rates might be an example of a _____ policy for the purpose of _____.

- A) monetary; reducing inflation
- B) monetary; lowering unemployment
- C) monetary; increasing the quantity of money
- D) fiscal; reducing inflation
- E) fiscal; lowering unemployment

Answer: A

Topic: 1.2 Macroeconomic Policy

AACSB: Reflective Thinking

- 17) Policies to keep inflation in check _____.
A) are, typically, fiscal policies
B) are a potential cause of high unemployment
C) are unlikely to be needed, so long as government spending remains high
D) include increasing the quantities of money and saving
E) are desirable in the short run, but may produce bad long-run outcomes

Answer: B

Topic: 1.2 Macroeconomic Policy

AACSB: Reflective Thinking

- 18) Fiscal policy involves _____.
A) taxes and government spending
B) setting interest rates
C) controlling the amount of money in the economy
D) all of the above
E) none of the above

Answer: A

Topic: 1.2 Macroeconomic Policy

- 19) Since 1930 the period of highest government budget deficits for the U.S. took place in _____.

- A) the 1930s
B) the 1940s
C) the 1950s
D) the 1980s
E) the 1990s

Answer: B

Topic: 1.2 Macroeconomic Policy

- 20) Historically, the U.S. government seems to have _____.
A) run budget surpluses as often as budget deficits
B) generally spent less than what it collected in taxes each year
C) had difficulty running budget surpluses
D) not needed to borrow to finance wars
E) none of the above

Answer: C

Topic: 1.2 Macroeconomic Policy

- 21) Policies to reduce the likelihood of financial crises might include _____.
A) enlarging government budget deficits
B) reducing imbalances in global trade and capital flows
C) keeping the inflation rate near or below zero
D) more aggressive use of stabilization policy
E) all of the above

Answer: B

Topic: 1.2 Macroeconomic Policy

AACSB: Reflective Thinking

- 22) The Federal Reserve _____.
A) is the U.S. central bank
B) controls the amount of money in the economy
C) sets interest rates
D) all of the above
E) none of the above

Answer: D

Topic: 1.2 Macroeconomic Policy

- 23) The U.S. central bank _____.
A) usually raises taxes to stabilize a slowing economy
B) encourages higher savings rates by raising the national sales tax
C) is known as the Federal Reserve
D) all of the above
E) none of the above

Answer: C

Topic: 1.2 Macroeconomic Policy

- 24) The Federal Reserve _____.
A) engages in stabilization policy by setting interest rates
B) engages in fiscal policy by setting interest rates
C) addresses financial crises by raising taxes
D) all of the above
E) none of the above

Answer: A

Topic: 1.2 Macroeconomic Policy

- 25) Financial crises are typically _____.
A) characterized by sharp declines in asset prices
B) associated with increases in business failures
C) accompanied by sharp economic downturns
D) all of the above
E) none of the above

Answer: D

Topic: 1.2 Macroeconomic Policy

- 26) *Nonactivists* propose doing nothing in the face of economic hardship because _____.
A) activist policies can kick in at the wrong time and be counterproductive
B) "markets self-correct pretty rapidly anyway"
C) in the face of high unemployment, activist policies would likely lead to surges in inflation
D) all of the above
E) none of the above

Answer: D

Topic: 1.2 Macroeconomic Policy

AACSB: Reflective Thinking

- 27) *Nonactivists* propose doing nothing in the face of economic hardship because _____.
A) activist policies can kick in at the wrong time and be counterproductive
B) markets can take quite a bit of time to self-correct
C) while households feel the hardship, firms typically benefit
D) all of the above
E) none of the above

Answer: A

Topic: 1.2 Macroeconomic Policy

AACSB: Reflective Thinking

- 28) *Nonactivists* propose doing nothing in the face of economic hardship because _____.
A) markets can take quite a bit of time to self-correct
B) excessive unemployment tends to disappear on its own accord
C) while households feel the hardship, firms typically benefit
D) all of the above
E) none of the above

Answer: B

Topic: 1.2 Macroeconomic Policy

AACSB: Reflective Thinking

- 29) *Activists* believe _____.
A) the self-correcting mechanism in the economy is very slow
B) in the adoption of policies to eliminate excessive unemployment
C) doing nothing will leave too many people out of work for too long
D) all of the above
E) none of the above

Answer: D

Topic: 1.2 Macroeconomic Policy

AACSB: Reflective Thinking

- 30) The long-standing debate over rules versus discretion in macroeconomics centers on the following statement _____.
A) "discretionary policy can lead to bad long-run outcomes but rules lack flexibility in the short-run"
B) "the speed with which the self-correcting mechanism in the economy acts is in question"
C) "the speed with which unemployment tends to disappear is debatable"
D) all of the above
E) none of the above

Answer: A

Topic: 1.2 Macroeconomic Policy

AACSB: Reflective Thinking

31) The old adage "rules are made to be broken" would typically be associated with economists who might advocate _____.

- A) stabilization policy
- B) monetary policy
- C) rule-determined policy
- D) discretionary policy
- E) fiscal policy

Answer: D

Topic: 1.2 Macroeconomic Policy

AACSB: Reflective Thinking

32) Consider an economic policy regime in which rules are well-known but frequently ignored. Which of these statements is true?

- A) This regime might work in the long-run, but is unlikely to produce good outcomes in the short run.
- B) Policymakers in this regime might find that rules are being broken with increasing frequency.
- C) This regime is more likely to be supported by *nonactivist*, than by activist policymakers.
- D) This regime is more likely to result in high unemployment than in high inflation.
- E) This regime is unlikely to produce large government budget deficits.

Answer: B

Topic: 1.2 Macroeconomic Policy

AACSB: Reflective Thinking

33) Opponents of rule-determined policies might point out that _____.

- A) markets self-correct quickly so rules become obsolete
- B) unforeseen changes in the structure of the economy may make a rule obsolete
- C) policies that kick in at the wrong time may lead to undesirable results
- D) all of the above
- E) none of the above

Answer: B

Topic: 1.2 Macroeconomic Policy

AACSB: Reflective Thinking

34) An advantage of discretionary policy might be that _____.

- A) it has been shown to be more efficient than rules
- B) it is more flexible than rules
- C) it requires a binding plan in advance to deal with economic problems
- D) all of the above
- E) none of the above

Answer: B

Topic: 1.2 Macroeconomic Policy

AACSB: Reflective Thinking

35) An advantage of macroeconomic policy based on pre-specified rules might be that _____.

- A) it is easier to stick to long-run considerations and avoid bad long-run outcomes
- B) it is more flexible than discretionary policy
- C) it is easier to adapt to short-run changes and avoid a bad short-run outcome
- D) all of the above
- E) none of the above

Answer: A

Topic: 1.2 Macroeconomic Policy

AACSB: Reflective Thinking

36) Activist policymakers, compared to nonactivists, are more likely to emphasize _____ considerations and to prefer _____.

- A) short-run; rule-determined
- B) long-run; discretionary policy
- C) short-run; discretionary policy
- D) long-run; rule determined
- E) business; flexible plans

Answer: C

Topic: 1.2 Macroeconomic Policy

AACSB: Reflective Thinking

37) In the 2000s, the U.S. economy had both a _____ and a _____.

- A) large trade deficit; large capital inflow
- B) large trade surplus; large capital inflow
- C) large trade deficit; high saving rate
- D) large capital inflow; high saving rate
- E) large capital inflow; small government budget deficit

Answer: A

Topic: 1.2 Macroeconomic Policy

38) The low saving rate in the United States is no cause for concern, so long as people in other countries are saving and are willing to send their savings into the U.S. economy by buying our assets. Comment.

Answer: Capital inflow does help to sustain investment in the U.S. above what it would be otherwise. But having savers in other countries finance our investment means that they own a portion of the resulting economic growth, leaving less for U.S. citizens to enjoy. Because capital inflow is an increase in the supply of savings, it can lower the return and thus incentive to save, discouraging U.S. citizens from ever consuming less and saving more. Capital inflow, also, may reflect a global imbalance in which the combination of high consumer demand and low return on saving fuels speculative activities (e.g., housing boom). As long as U.S. citizens consume so much and save so little, our trade deficit and corresponding indebtedness to other economies will persist.

Topic: 1.2 Macroeconomic Policy

AACSB: Reflective Thinking

39) All governments face a budget constraint: none can spend more than the sum of current government revenues plus the amount that creditors are willing to lend. Why, then, do government budget deficits matter?

Answer: Deficits matter because they are costly, and because they can become unsustainably large. The interest cost of the debt must be paid by spending less on other worthy goods and services, and repayment of principal has the same opportunity cost. Credit extended to the government might have been borrowed and spent in the private sector. While it might be reasonable for a government to borrow to meet crisis needs, it might be reluctant later to raise taxes and/or reduce spending in order to pay down the debt. The next crisis won't wait for repayment of the preceding crisis's debt. The debt makes the economy more vulnerable to crisis and the government less able to respond appropriately. If creditors become reluctant to lend more at a reasonable rate of interest, the government might feel compelled to borrow from the central bank, fueling inflation.

Topic: 1.2 Macroeconomic Policy

AACSB: Reflective Thinking

40) Why might most people, as in the United States, save less than is good for themselves and for the economy as a whole? How might policymakers encourage more saving?

Answer: The saving rate is determined by incentives. If the return on saving is too low, people will choose to consume, instead, even though they are vulnerable to economic misfortune and downturns. Individual vulnerability aggregates to macroeconomic vulnerability, while a low saving rate constrains investment and, thus, economic growth. Policies to increase the saving rate include reducing income tax rates, reducing the tax liability of income that is saved, raising sales tax rates, reducing taxes on the income from savings, and reducing the tax liability of business income that is contributed to employee pensions. It is important, also, to create confidence that inflation will not erode the purchasing power of savings, and that financial crises will not destroy the value of assets.

Topic: 1.2 Macroeconomic Policy

AACSB: Reflective Thinking

41) The necessary ingredients for economic growth and poverty reduction are no mystery, really: education, favorable and efficient institutions, research and development, etc. Macroeconomists are unlikely to have anything useful to say. Comment.

Answer: The ingredients are familiar, but implementation is difficult. Citizens, politicians, and policymakers face tough decisions, because each ingredient has costs; resources devoted to education, for example, must mean sacrificing other worthy expenditures, such as health care. Macroeconomists can help to quantify the relative effectiveness of particular expenditures and policy packages, so that scarce resources are utilized efficiently. Analysis and clarification of the details can help in the design of and to generate public support for the most effective policies.

Topic: 1.2 Macroeconomic Policy

AACSB: Reflective Thinking

1.3 How We Will Study Macroeconomics

1) There are no questions for this section.