

Due In Class: Wednesday, January 23

Name (Print Clearly!) _____

Please select a five-digit number that will be your personal course ID number this semester. You will use this ID number to access your course scores and final course grade from the class web site. Please make a record of the number you write below so that it will be available to you later in the semester

Five-Digit Course ID Number: _____

This pretest exercise is designed to assess students' knowledge of the content of Econ 1021 *prior* to their completion of the course. The comparison of scores for the whole class on the pretest and the actual multiple choice questions on the course exams gives a measure of the amount of learning that takes place over the semester.

Please provide an answer to all of the questions on the following pages. Write the letter of the alternative that *best* answers the question in the blank. Recognize that you are not expected to know the answers to these questions at this time. You will likely be guessing. Do not refer to other materials, especially the online course notes, to answer these questions. Such an effort to learn is admirable, but it would defeat the purpose of this assignment. Nonetheless, to make this a useful tool, you should make a good attempt to choose the correct answer, *based on what you know prior to the class*.

To make the exercise replicate an actual exam setting as well as possible, answer all questions in one sitting, not to exceed 45 minutes in length.

(Note: questions marked with ** are based on material largely covered in the first two classes. There is no need to look up answers for these questions, but you may find them familiar.)

Thanks for taking the time to help the Economics Department assessment effort. All students who turn in this assignment in class Wednesday, January 23 will receive 5 extra points toward their course score.

- ___ 1**. Which of the following alternatives describes a transaction that adds directly to U.S. GDP
- (A) A U.S. auto company decides to buy tires to put on its new cars from a U.S. supplier rather than a foreign supplier.
 - (B) A homeowner decides to remodel her own basement and purchases materials from a local building supply store.
 - (C) A Mexican company located just south of the Texas border buys electric power from a U.S. utility.
 - (D) All of the above.
- ___ 2**. Which statement below is normative?
- (A) The Great Recession is the deepest U.S. economic crisis since the Great Depression
 - (B) If job growth does not accelerate soon, the recovery from the Great Recession will likely be labeled as “jobless.”
 - (C) The drop in employment at the beginning of the Great Recession was similar to the drop at the beginning of the Great Depression.
 - (D) It was necessary for the government to stimulate the U.S. economy in 2009 because of the unusual severity of the Great Recession.
- ___ 3**. Which alternative below best explains why the value of intermediate goods is excluded from GDP?
- (A) Intermediate goods do not add directly to the social welfare created by production.
 - (B) If the value of intermediate were included, some production would be counted multiple times.
 - (C) Intermediate goods go into inventories and therefore are part of investment already.
 - (D) Intermediate goods are primarily imports and therefore are not produced within a country’s borders.
- ___ 4. Suppose the government undertakes a wasteful “pork barrel” project that no citizen would be willing to pay for based on the true social value of the project. Which alternative below best describes the effect of the project on measured GDP?
- (A) Because the project ultimately creates inflation, it raises nominal GDP, but not real GDP.
 - (B) GDP rises by an amount equal to the cost of the project.
 - (C) The project has no effect on GDP because it does not add to social welfare.
 - (D) The project has no effect on GDP because it is not a final good or service.
- ___ 5. Which of the following statements best describes a widely held concern about the recovery from the deep recession that took place between late 2007 and the summer of 2009?
- (A) Although the economy has recovered for over a year, a “double dip” recession has already begun.
 - (B) The economy may grow so quickly in 2011 that inflation will accelerate sharply.
 - (C) Unemployment will remain unacceptably high for several years.
 - (D) Although nominal GDP is growing, the more measure of social welfare, real GDP, is falling.
- ___ 6. Which of the following scenarios, by itself, leads to a decline in the measured unemployment rate?
- (A) An individual who had not looked for a job for 6 months is encouraged by good economic news to start applying for jobs again.
 - (B) A worker retires from firm X and leaves the labor force. The next day, a replacement worker is hired who had applied to firm X for a job two weeks earlier.
 - (C) Unusually severe winter weather prevents construction workers from working as many hours as they would in a typical year.
 - (D) A college graduate starts looking for work (but does not find a job) in the same month as a long-term unemployed worker becomes discouraged and stops applying for jobs.

- ____ 7. Suppose people work more hours outside the home than they would normally choose because their country is at war. In this case,
- (A) GDP growth overstates social welfare because it does not account for the sacrifice of leisure time.
 - (B) GDP grows faster as long as it remains below the level of potential output.
 - (C) Because of lost home production, GDP rises less than the increase of production for market sales.
 - (D) GDP increases if the increase in the cost of pollution from higher production is not greater than the money value of higher output.
- ____ 8. Suppose you were told that the real GDP of the national economy of Fazzaland took 40 years to double in magnitude. Which of the following statements about Fazzaland's long-term annualized growth rate is most accurate?
- (A) Annualized growth rate was 2.5%.
 - (B) Annualized growth was more than 2.5%.
 - (C) Annualized growth was less than 2.5%.
 - (D) Without more information, you cannot be sure how annualized growth compares to 2.5%.
- ____ 9. Which of the following alternatives is necessarily correct if a country is running a trade deficit?
- (A) Foreigners will sell the country's currency because they do not want assets in another country.
 - (B) The country's central bank will raise interest rates to strengthen the currency and reduce the chances of a speculative attack.
 - (C) The economic factors that created the trade deficits will reduce future welfare of the country's citizens.
 - (D) The country absorbs more output, in various activities, than it produces.
- ____ 10. Which of the following alternatives best describes the supply-side prediction about the effect of saving on the economy?
- (A) Workers that save a greater share of their income will supply more labor resources.
 - (B) Higher saving requires the central bank to lower interest rates which stimulates spending.
 - (C) Higher saving means lower consumption, reduced sales by business, and therefore lower employment.
 - (D) Higher saving lowers the cost of capital and encourages business investment.
- ____ 11. Abstraction is a key feature of good economic theory because:
- (A) Abstraction allows focus on important features of reality by ignoring less relevant details.
 - (B) Abstraction assures that economic models describe economic reality as well as possible.
 - (C) Abstraction allows normative conclusions to be drawn from realistic positive theory.
 - (D) Abstraction helps distinguish causation from misleading correlations.
- ____ 12. Which of the following statements best represents demand-side (Keynesian) macroeconomics?
- (A) A trade deficit can raise standards of living if it arises from the import of productive capital.
 - (B) Greater business investment encourages growth by raising sales for firms that produce capital goods.
 - (C) Higher business investment adds to the productive capital of the economy.
 - (D) Investment in education raises the economy's human capital and therefore enhances labor resources.

- ____ 13. Suppose that a laptop computer costs \$1,200 in the U.S. and €1,000 in Germany (€ is the symbol for the euro currency). Also suppose that the exchange rate is \$1.40 per euro. What can you conclude about the values of the dollar and the euro from this information alone?
- (A) The euro is overvalued relative to purchasing power parity.
 - (B) Germans should raise interest rates to restore purchasing power parity.
 - (C) The euro and dollar are in purchasing power parity.
 - (D) The euro is undervalued relative to purchasing power parity.
- ____ 14. Which statement below correctly reflects the link between interest rates and investment if a firm uses its own funds (cash flow) to finance their capital spending?
- (A) Higher interest rates do not discourage investment for this firm, because it has no need for a loan when it finances its spending from cash flow.
 - (B) Higher interest rates reduce any investment tax credit the firm receives, so it discourages investment regardless of whether its spending is paid for by cash flow or a bank loan.
 - (C) The firm's opportunity cost of cash flow is likely about the same as the cost of a loan, so higher interest rates discourage investment.
 - (D) Although the cost to the firm of cash flow is likely less than the cost of a loan, a higher interest rate still raises the opportunity cost of cash flow and discourages investment.
- ____ 15. Which of the following alternatives best describes a main reason why the U.S. government has encouraged the Chinese government to allow the Chinese currency to appreciate?
- (A) The U.S. wants to reduce the cost of imported Chinese goods bought by American consumers.
 - (B) The U.S. wants to give Chinese citizens a greater incentive to hold dollar assets.
 - (C) The U.S. wants to raise its aggregate demand.
 - (D) The U.S. wants to raise the demand for Chinese labor so that Chinese wages increase.
- ____ 16. Which of the following statements best describes the expansion or “boom” phase of the “Minsky Cycle?”
- (A) More aggressive lending leads to higher spending that stimulates income growth, validates financial practices, and encourages even more extensive lending.
 - (B) Low interest rates raise consumption, investment, and international trade which all contribute to higher demand, stronger sales, and more employment.
 - (C) Good economic results encourage government spending stimulates the demand side of the economy.
 - (D) Improved access to credit stimulates business investment that leads to more capital resources and higher potential output.
- ____ 17. In late 2010, Congress and the President agreed to cut taxes American workers pay for Social Security (retirement benefits) during calendar year 2011. Which of the of the following alternatives best describes a demand-side reason that these tax cuts are likely to have a relatively small effect on output and employment?
- (A) These tax cuts go to people with a relatively low marginal propensity to consume.
 - (B) Most workers save very little, so this tax cut will do little to provide future resources for the economy.
 - (C) Because the tax cuts expire at the end of December 2011, they will not do much to boost consumption.
 - (D) These tax cuts are too small to encourage more people to search for jobs.
- ____ 18. There is a good argument to be made that small economies that sell much of their GDP abroad and import a high share of consumption goods have a lower multiplier than large economies like the U.S. Which of the following factors is most likely to explain this result?
- (A) Lower investment accelerator in the small economy.
 - (B) Higher share of imports in GDP for the small economy.
 - (C) Higher share of exports in GDP for the small economy.
 - (D) Lower marginal propensity to consume in the small economy.

- ___ 19. Which of the following alternatives is not a practical challenge of using monetary policy to respond to insufficient aggregate demand?
- (A) Uncertainty about what the target level of output should be.
 - (B) A long lag between identifying an AD problem and implementing stimulative policy.
 - (C) Estimating how much interest rates must fall to reach target output.
 - (D) Lags between policy implementation and the convergence of output to the new equilibrium level.
- ___ 20. Which of the following statements about U.S. federal government spending and taxation is most likely to be false?
- (A) Major percentage reductions in U.S. spending on foreign aid and business regulation will lead to a substantial percentage reduction in total federal spending.
 - (B) The federal deficit increased dramatically in the Great Recession of 2008 and 2009 in large part because a slow economy reduced income growth.
 - (C) Transfer payments constitute a large and growing share of federal spending.
 - (D) Federal spending on goods and services fell as a share of output in recent decades.
- ___ 21. Which of the following aspects of modern monetary policy can be explicitly attributed to inflation targeting rather than more general monetary policy pursued for macroeconomic stabilization?
- (A) Monetary policy stimulates demand by reducing the federal funds interest rate.
 - (B) Monetary policy transparency helps anchor inflation expectations
 - (C) Stimulative monetary policy causes higher inflation in the long run.
 - (D) An increase in bank reserves through Fed open market purchases drives up inflation immediately.
- ___ 22. Which of the following statements accurately describes the dilemma for the “new consensus” macroeconomic model if the federal funds interest rate hits the “zero bound?”
- (A) Monetary policy, as described by the Taylor Rule, can no longer effectively boost aggregate demand.
 - (B) Further easing of monetary policy will produce inflation only, with no effect on output and employment.
 - (C) Inflation will quickly fall to zero and the economy may fall into a damaging deflation.
 - (D) Banks will no longer accept reserve payments from the Fed in return for valuable assets like U.S. Treasury bonds.
- ___ 23. For a developed country operating with modern technology, which of the following alternatives most likely describes the long-run source of rising labor productivity and improving living standards?
- (A) Higher investment that raises the capital stock.
 - (B) Improvements in technology.
 - (C) Effective monetary policy following the Taylor rule.
 - (D) Long-term increases in consumer spending that encourage firms to raise production.
- ___ 24. Suppose the Fed wants to reduce the threat of inflation. Which of the following statements best describes the policy action the Fed would take?
- (A) Open market purchase of government bonds to raise the federal funds interest rate.
 - (B) Open market purchase of government bonds to lower the federal funds interest rate.
 - (C) Open market sale of government bonds to raise the federal funds interest rate.
 - (D) Open market sale of government bonds to lower the federal funds interest rate.

- ___ 25. Which statement below best describes the historical link between inflation and the state of the overall U.S. economy?
- (A) When the economy weakens inflation usually rises creating “stagflation” as in the 1970s.
 - (B) Inflation usually declines when the economy weakens, but there has been little acceleration of inflation in strong economic conditions over recent decades.
 - (C) Inflation has been more or less constant regardless of the state of the U.S. economy for the past 30 years.
 - (D) Inflation accelerates when the Fed attempts to stimulate a weak overall economy.
- ___ 26. Which of the following alternatives occur when a crazy fraternity boy dressed like a cow runs into a large macroeconomics lecture?
- (A) Students encourage the silliness by nudging the instructors to go along with the joke.
 - (B) A somewhat flustered professor consumes a drink he doesn’t really like.
 - (C) The class breaks into the most rousing applause in the professor’s multi-decade teaching career.
 - (D) All of the above.

Yes, folks, this really happened in the spring of 2011 and the question appeared on the third exam!)