



## Chapter-05 - teatbank

Intermediate Macroeconomic Theory and Policy I (The University of Western Ontario)

**Macroeconomics, 5e (Williamson)**

**Chapter 5 A Closed-Economy One-Period Macroeconomic Model**

1) An economy that has no interaction with the rest of the world is called

- A) an isolated economy.
- B) a closed economy.
- C) a parochial economy.
- D) a rogue nation.

Answer: B

Question Status: Previous Edition

2) An economy that engages in international trade is called

- A) a cooperative economy.
- B) a modern economy.
- C) an engaged economy.
- D) an open economy.

Answer: D

Question Status: Previous Edition

3) A closed economy is characterized by

- A) the absence of trade with other economies.
- B) the absence of use of money for transactions.
- C) no growth in population.
- D) a Cobb-Douglas production function.

Answer: A

Question Status: New

4) Goods and services provided by the government are called

- A) government goods.
- B) public goods.
- C) free goods.
- D) social goods.

Answer: B

Question Status: Previous Edition

5) In an economic model, an exogenous variable is

- A) a stand-in for more complicated variables.
- B) determined by the model itself.
- C) determined outside the model.
- D) a variable that has no effect on the workings of the model.

Answer: C

Question Status: Previous Edition

- 6) In an economic model, an endogenous variable is
- A) a stand-in for more complicated variables.
  - B) determined by the model itself.
  - C) determined outside the model.
  - D) a variable that has no effect on the workings of the model.

Answer: B

Question Status: Previous Edition

- 7) In a one-period model, government is likely to run
- A) a deficit but not a surplus.
  - B) a surplus but not a deficit.
  - C) either a surplus or a deficit.
  - D) neither a surplus nor a deficit.

Answer: D

Question Status: Previous Edition

- 8) In a one-period economic model, the government budget constraint requires that government spending
- A) = taxes + transfers.
  - B) = taxes + borrowing.
  - C)  $> 0$ .
  - D) = taxes.

Answer: D

Question Status: Previous Edition

- 9) Which of the following relationships does not hold in the one-period model?
- A)  $G=T$
  - B)  $Y=C+G$
  - C)  $Y=zF(K,N)$
  - D)  $\pi=Y-wN-C$

Answer: D

Question Status: Previous Edition

- 10) Fiscal policy refers to a government's choices over its
- A) expenditures, taxes, transfers, and borrowing.
  - B) expenditures, taxes, issuance of money, and borrowing.
  - C) expenditures, foreign affairs, issuance of money, and borrowing.
  - D) issuance of money, taxes, environmental regulations, and foreign affairs.

Answer: A

Question Status: Previous Edition

11) Fiscal policy encompasses all of the following **except**

- A) expenditures by the government.
- B) monetary injection by the government.
- C) taxation by the government.
- D) borrowing by the government.

Answer: B

Question Status: New

12) Making use of an economic model is a process of

- A) solving hundreds of simultaneous equations.
- B) running experiments to determine how changes in the endogenous variables will change the exogenous variables.
- C) running experiments to determine how changes in the exogenous variables will change the endogenous variables.
- D) resolving inconsistencies in the actions of economic agents.

Answer: C

Question Status: Previous Edition

13) A competitive equilibrium is a state of affairs in which

- A) markets clear, and output is maximized.
- B) output is maximized, and all agents are equally well-off.
- C) all agents are equally well-off and agents are price-takers.
- D) agents are price-takers, and markets clear.

Answer: D

Question Status: Previous Edition

14) For a competitive equilibrium to occur, all of the following has to happen **except**

- A) agents are price takers.
- B) the government sets taxes at zero.
- C) markets clear.
- D) the actions of all agents are consistent.

Answer: B

Question Status: New

15) In a general equilibrium model

- A) all markets but one clear.
- B) there are no fluctuations.
- C) all prices are exogenous.
- D) all prices are endogenous.

Answer: D

Question Status: Previous Edition

16) In a competitive equilibrium all these relationships hold but one. Which one?

- A)  $N^d = N^s$
- B)  $Y = G + C$
- C)  $G = T$
- D)  $w = z$

Answer: D

Question Status: Previous Edition

17) In the one-period competitive model we have been studying

- A) both consumption and total factor productivity are exogenous.
- B) consumption is exogenous and total factor productivity is endogenous.
- C) consumption is endogenous and total factor productivity is exogenous.
- D) both consumption and total factor productivity are endogenous.

Answer: C

Question Status: Previous Edition

18) A relationship that shows the technological possibilities for an economy as a whole is called a

- A) production function.
- B) utility possibilities frontier.
- C) production possibilities frontier.
- D) budget constraint.

Answer: C

Question Status: Previous Edition

19) The production possibilities frontier in the one-period model is a

- A) behavioral relationship between consumption and leisure.
- B) behavioral relationship between consumption and government spending.
- C) technological relationship between consumption and leisure.
- D) technological relationship between consumption and government spending.

Answer: C

Question Status: Previous Edition

20) The production possibilities frontier represents

- A) all combinations of consumption and leisure for fixed output.
- B) all equally affordable combinations of consumption and leisure for a given wage.
- C) all feasible combinations of consumption and leisure.
- D) all equally liked combinations of consumption and leisure.

Answer: C

Question Status: Previous Edition

21) Which of the following is not a reason for solving the model with a PPF?

- A) It merges the household and firm problems into one graph.
- B) It is simpler to solve the social planner problem.
- C) It highlights the fact that the marginal rate of substitution should equal the marginal rate of transformation.
- D) It highlights the fact that firms make no profit in equilibrium.

Answer: D

Question Status: Previous Edition

22) The PPF represents

- A) all possible outcomes for a given wage.
- B) the set of feasible outcomes.
- C) given leisure, how much consumption a household wants.
- D) the share of consumption in output.

Answer: B

Question Status: Previous Edition

23) PPF is the

- A) price parity formula.
- B) possible production function.
- C) producer's preferred frontier.
- D) production possibilities frontier.

Answer: D

Question Status: New

24) The rate at which one good can be converted technologically into another is called

- A) the marginal rate of transformation.
- B) the marginal rate of substitution.
- C) the marginal product of labor.
- D) the rate of conversion.

Answer: A

Question Status: Previous Edition

25) Points on the production possibilities frontier have the property that they

- A) are inherently unattainable.
- B) show the maximum amount of leisure that can be consumed for given amounts of goods consumed.
- C) show the maximum amount of goods that can be consumed for given amounts of government spending.
- D) show the maximum amount of leisure that can be consumed for given amounts of hours worked.

Answer: B

Question Status: Previous Edition

26) A competitive equilibrium has all of the following properties **except**

A)  $MP_N = \text{slope of } PPF$ .

B)  $MRS_{l,C} = MRT_{l,C}$ .

C)  $MRT_{l,C} = MP_N$ .

D)  $MP_N = w$ .

Answer: A

Question Status: Previous Edition

27) A competitive equilibrium is Pareto optimal if there is no way to rearrange or to reallocate goods so that

A) anyone can be made better off.

B) no one can be made worse off.

C) someone can be made better off without making someone else worse off.

D) someone can be made better off without making everyone else worse off.

Answer: C

Question Status: Previous Edition

28) Which of the following is not equal to the others in equilibrium?

A) the real wage

B) the marginal rate of substitution between leisure and consumption

C) the marginal product of labor

D) the price of consumption

Answer: D

Question Status: Previous Edition

29) A Pareto optimum is a point that

A) a malevolent dictator would choose.

B) a cooperative coalition of some altruistic consumers would choose.

C) a cooperative coalition of some socially responsible firms would choose.

D) a social planner would choose.

Answer: D

Question Status: Previous Edition

30) A Pareto optimum requires all of the following **except**

A)  $MP_N = \text{slope of } PPF$ .

B)  $MRS_{l,C} = MRT_{l,C}$ .

C)  $MRT_{l,C} = MP_N$ .

D)  $MP_N = w$ .

Answer: D

Question Status: Previous Edition

31) Much of the writings of Adam Smith are in close agreement with

- A) the necessity of trade restrictions.
- B) the first fundamental theorem of welfare economics.
- C) the second theorem of welfare economics.
- D) both B and C above.

Answer: B

Question Status: Previous Edition

32) The first fundamental theorem of welfare economics states that

- A) under certain conditions, a competitive equilibrium is Pareto optimal.
- B) a competitive equilibrium is always Pareto optimal.
- C) under certain conditions, a Pareto optimum is a competitive equilibrium.
- D) a Pareto optimum is always a competitive equilibrium.

Answer: A

Question Status: Previous Edition

33) The second fundamental theorem of welfare economics states that

- A) under certain conditions, a competitive equilibrium is Pareto optimal.
- B) a competitive equilibrium is always Pareto optimal.
- C) under certain conditions, a Pareto optimum is a competitive equilibrium.
- D) a Pareto optimum is always a competitive equilibrium.

Answer: C

Question Status: Previous Edition

34) Under certain conditions, the two welfare theorems state that

- A) capitalism leads to the same outcome as communism.
- B) it is always better tax less.
- C) profit maximization is not good for consumers.
- D) the government can do better than firms.

Answer: A

Question Status: New

35) The concept of Pareto optimality is a

- A) utopian concept.
- B) useful concept because it guarantees economic equality.
- C) useful concept because it guarantees economic efficiency.
- D) useful concept that carefully balances a society's desires for equality and efficiency.

Answer: C

Question Status: Previous Edition



36) Under a Pareto Optimum

- A) it is always possible to improve someone's outcome.
- B) it is never possible to improve someone's outcome.
- C) one can only hurt someone's outcome.
- D) it is impossible to hurt someone's outcome.

Answer: C

Question Status: New

37) A competitive equilibrium may fail to be Pareto optimal due to all of the following **except**

- A) inequality.
- B) externalities.
- C) distorting taxes.
- D) non-price-taking firms.

Answer: A

Question Status: Previous Edition

38) An externality is any activity for which an individual firm or consumer does not take into account all

- A) of the ramifications of its actions on others.
- B) associated costs.
- C) associated benefits.
- D) associated costs and benefits.

Answer: D

Question Status: Previous Edition

39) A competitive equilibrium fails to be a Pareto Optimum with a distorting tax because

- A) the consumer's budget constraint has an additional kink.
- B) the firm is no longer maximizing profits.
- C) the government wastes its revenue.
- D) the consumer faces a different wage than the firm.

Answer: D

Question Status: New

40) The presence of a distorting tax on wage income can result in

- A)  $MP_N < MRT_{l,C}$ .
- B)  $MRT_{l,C} < MRS_{l,C}$ .
- C)  $MP_N < w$ .
- D)  $MRS_{l,C} < MP_N$ .

Answer: D

Question Status: Previous Edition

41) Relative to the social optimum, monopoly power directly leads to

- A) underproduction.
- B) overproduction.
- C) too much leisure.
- D) too little leisure.

Answer: A

Question Status: Previous Edition

42) An increase in government spending shifts the PPF

- A) upward, but does not change its slope.
- B) upward, and also changes its slope.
- C) downward, but does not change its slope.
- D) downward, and also changes its slope.

Answer: C

Question Status: Previous Edition

43) The experience of the U.S. economy during World War II confirms the prediction that a dramatic increase in government spending is likely to

- A) increase both real GDP and consumption.
- B) increase real GDP and decrease consumption.
- C) decrease real GDP and increase consumption.
- D) decrease both real GDP and consumption.

Answer: B

Question Status: Previous Edition

44) An increase in government spending

- A) increases consumption, increases hours worked, and increases the real wage.
- B) reduces consumption, increases hours worked, and increases the real wage.
- C) reduces consumption, increases hours worked, and reduces the real wage.
- D) reduces consumption, reduces hours worked, and reduces the real wage.

Answer: C

Question Status: Previous Edition

45) An increase in government spending

- A) increases consumption and output.
- B) increases consumption, decreases output.
- C) decreases consumption, increases output.
- D) decreases consumption and output.

Answer: C

Question Status: Previous Edition

46) Changes in government spending are not likely causes of business cycles because government spending induced business cycles would counterfactually predict

- A) countercyclical real wages.
- B) procyclical real wages.
- C) countercyclical employment.
- D) procyclical employment.

Answer: A

Question Status: Previous Edition

47) Changes in government spending are not likely causes of business cycles because government spending induced business cycles would counterfactually predict

- A) countercyclical consumption.
- B) procyclical consumption.
- C) countercyclical employment.
- D) procyclical employment.

Answer: A

Question Status: Previous Edition

48) Which feature of the business cycle does the one-period model replicate with shocks to government expenditures?

- A) procyclical employment
- B) procyclical consumption
- C) procyclical real wages
- D) countercyclical prices

Answer: A

Question Status: Previous Edition

49) During World War II,

- A) consumption and government expenses increased.
- B) consumption and government expenses decreased.
- C) consumption increased and government expenses decreased.
- D) consumption decreased and government expenses increased.

Answer: D

Question Status: New

50) An increase in total factor productivity shifts the PPF

- A) upward, but does not change its slope.
- B) upward, and also changes its slope.
- C) downward, but does not change its slope.
- D) downward, and also changes its slope.

Answer: B

Question Status: Previous Edition

51) An increase in total factor productivity

- A) increases consumption, increases output, and increases the real wage.
- B) reduces consumption, increases output, and increases the real wage.
- C) reduces consumption, increases output and reduces the real wage.
- D) reduces consumption, reduces output, and reduces the real wage.

Answer: A

Question Status: Previous Edition

52) Which of the following is wrong with respect to an increase in total factor productivity?

- A) Households are better off.
- B) Consumption is up.
- C) The real wage is down.
- D) Output is up.

Answer: C

Question Status: Previous Edition

53) In response to an increase in total factor productivity

- A) both the substitution effect and the income effect suggest that hours worked should increase.
- B) the substitution effect suggests that hours worked should increase, while the income effect suggests that hours worked should decrease.
- C) the substitution effect suggests that hours worked should decrease, while the income effect suggests that hours worked should increase.
- D) both the substitution effect and the income effect suggest that hours worked should decrease.

Answer: B

Question Status: Previous Edition

54) Changes in total factor productivity are plausible causes of business cycles because productivity-induced business cycles correctly predict

- A) real wages and total hours must be procyclical.
- B) real wages and consumption must be procyclical.
- C) total hours worked and consumption must be procyclical.
- D) consumption and government spending must be procyclical.

Answer: B

Question Status: Previous Edition

55) Changes in total factor productivity are plausible causes of business cycles because

- A) of the welfare theorems.
- B) the U.S. government is following supply-side economic policy.
- C) the model matches many stylized facts.
- D) prices are countercyclical.

Answer: C

Question Status: Previous Edition

- 56) Real business cycle theory argues that the primary cause of business cycles is fluctuations in
- A) preferences.
  - B) government spending.
  - C) the importance of externalities.
  - D) total factor productivity.

Answer: D

Question Status: Previous Edition

- 57) Just prior to the four most recent U.S. recessions, there has been a
- A) significant contraction of the money supply.
  - B) large decrease in government spending.
  - C) large increase in the relative price of food.
  - D) significant increase in the relative price of energy.

Answer: D

Question Status: Previous Edition

- 58) World War II was not a typical business cycle because
- A) it cannot be explained by the current model.
  - B) it is not Pareto optimal.
  - C) it was driven by government expenses.
  - D) the economy was not fully efficient.

Answer: C

Question Status: New

- 59) The variable  $G$  considered in the model encompasses
- A) government expenses on goods.
  - B) government expenses on goods and services.
  - C) government expenses on goods and services as well as transfers.
  - D) government expenses on goods and services as well as transfers and public debt service.

Answer: B

Question Status: New

- 60) An increase in government expenditures corresponding to 2% of GDP should, according to the model, increase GDP by
- A) 0%.
  - B) between 0% and 2%.
  - C) 2%.
  - D) more than 2%.

Answer: B

Question Status: New

61) One drawback of the modeling of government expenses so far is that

- A) they are pure waste.
- B) they do not distinguish state and federal expenses.
- C) they include interest payments.
- D) they fail to account for defense spending.

Answer: A

Question Status: New

62) If the government replaces a lump sum tax with a proportional labor income tax, then

- A) employment and output increase.
- B) employment increases and output decreases.
- C) employment decreases and output increases.
- D) employment and output decrease.

Answer: D

Question Status: Previous Edition

63) Proportional income taxation is distorting because

- A) people do all they can to avoid paying taxes.
- B) the competitive equilibrium is not Pareto optimal.
- C) firms do all they can to avoid paying taxes.
- D) the government budget constraint does not hold.

Answer: B

Question Status: Previous Edition

64) With a linear production function in labor only, which of the following must be true?

- A) The representative household works as much as possible.
- B) The representative firm makes large profits.
- C) The real wage equals total factor productivity.
- D) The marginal product of labor exceeds the real wage.

Answer: C

Question Status: Previous Edition

65) How does an increase in the proportional labor income tax modify the budget constraint?

- A) a parallel move up
- B) a parallel move down
- C) a tilting up
- D) a tilting down

Answer: D

Question Status: Previous Edition

- 66) At the competitive equilibrium with a positive proportional labor income tax
- A) the real wage after tax exceeds the marginal product of labor.
  - B) the real wage after tax equals the marginal product of labor.
  - C) the real wage after tax is lower than the marginal product of labor.
  - D) We cannot say.

Answer: C

Question Status: Previous Edition

- 67) At the competitive equilibrium with a positive proportional labor income tax
- A) the real wage before tax exceeds the marginal product of labor.
  - B) the real wage before tax equals the marginal product of labor.
  - C) the real wage before tax is lower than the marginal product of labor.
  - D) We cannot say.

Answer: B

Question Status: Previous Edition

- 68) The tax base is
- A) the average tax rate.
  - B) the tax rate for the base year.
  - C) the object being taxed.
  - D) the lowest tax rate.

Answer: C

Question Status: Previous Edition

- 69) When the tax rate increases, the tax revenue
- A) always increases.
  - B) does not change.
  - C) always decreases.
  - D) may increase or decrease.

Answer: D

Question Status: Previous Edition

- 70) The Laffer curve is a curve showing
- A) output as a function of the tax rate.
  - B) tax revenue as a function of the tax rate.
  - C) government expenses as a function of how liberal the government is.
  - D) the tax rate as a function of government expenses.

Answer: B

Question Status: Previous Edition

- 71) Supply-side economists argue that
- A) one should get rid of all taxes.
  - B) tax rates should not be progressive.
  - C) increasing tax rates always hurts tax revenue.
  - D) one can increase tax revenue by decreasing the tax rate.

Answer: D

Question Status: Previous Edition

72) In a competitive equilibrium with a Laffer curve, there are two equilibria that differ in their

- A) tax revenue.
- B) total factor productivity.
- C) output.
- D) marginal tax rate.

Answer: C

Question Status: Previous Edition