

Sample Midterm #3

SECTION I: MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question (60 points total; 4 pts. each)

- 1) An increase in the expected rate of inflation would
 - A) shift the Phillips curve downward.
 - B) shift the long-run Phillips curve to the right.
 - C) shift the Phillips curve upward.
 - D) shift the long-run Phillips curve to the left.

- 2) In the expectations-augmented Phillips curve $\pi_t = \pi_t^e + \beta(u_t - u^*)$, when $\pi_t = .09$ and $\pi_t^e = .03$, the unemployment rate is
 - A) .05. B) .03. C) .06. D) .04.

- 3) One cost of an unanticipated inflation is that it
 - A) transfers wealth from borrowers to lenders.
 - B) decreases menu costs.
 - C) transfers wealth from lenders to borrowers.
 - D) increases the purchasing power of money.

- 4) Keynesians prefer a disinflation policy of
 - A) cold turkey. B) aggregate demand management.
 - C) gradualism. D) stabilization.

- 5) The monetary base is defined as
 - A) all deposits at the Fed.
 - B) deposits at the Fed plus vault cash.
 - C) bank reserves minus vault cash.
 - D) bank reserves plus currency in circulation.

- 6) Assume that the currency-deposit ratio is 0.2 and the reserve-deposit ratio is 0.1. The Federal Reserve carries out open-market operations, purchasing \$1 million worth of bonds from banks. This action will increase the money supply by
 - A) \$3 million. B) \$4 million. C) \$1 million. D) \$2 million.

- 7) The primary purpose of the discount window is to
 - A) influence the nation's money supply.
 - B) influence the amount of loans that banks provide to the public.
 - C) control banks' excess reserves.
 - D) fulfill the bank's lender of last resort role.

- 8) Monetarists suggest doing which of the following?
- A) use fiscal policy to combat unemployment in the short run
 - B) use monetary policy to combat unemployment in the long run
 - C) maintain a steady growth rate of the money supply
 - D) use fiscal policy to combat inflation in the long run
- 9) The Fed can reduce the money supply by reducing
- A) the monetary base.
 - B) reserve requirements.
 - C) the discount rate.
 - D) the currency-deposit ratio.
- 10) The primary deficit is equal to
- A) government purchases + transfers + net interest - tax revenues.
 - B) outlays + net interest - tax revenues.
 - C) government purchases + transfers - tax revenues.
 - D) outlays - tax revenues.
- 11) Because of automatic stabilizers, in recessions the government budget deficit _____, while in expansion the deficit _____.
- A) falls; rises
 - B) rises; rises
 - C) rises; falls
 - D) falls; falls
- 12) The total amount of taxes paid divided by before-tax income is the
- A) median taxpayer rate.
 - B) rate of hysteresis.
 - C) marginal tax rate.
 - D) average tax rate.
- 13) The total value of government bonds outstanding at any particular time is called the
- A) yield curve.
 - B) government deficit.
 - C) primary deficit.
 - D) government debt.
- 14) Taxes distort economic behavior because
- A) they change the composition of consumption, investment, government spending, and net exports.
 - B) they change the balance between private and public expenditures.
 - C) they change the composition of income and spending.
 - D) they cause deviations in economic behavior from the efficient, free-market outcome.
- 15) According to the Ricardian equivalence proposition, current deficits
- A) will affect national saving but not consumption.
 - B) will not affect consumption or national saving.
 - C) will affect both consumption and national saving.
 - D) will affect consumption but not national saving.

TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false. (20 points total; 4 points each)

16) When the economy goes into a recession, there's an increase in cyclical unemployment

17) Hyperinflation occurs when the inflation rate is extremely high.

18) The fact that the long-run Phillips curve is vertical implies that money can't affect inflation in the long run.

19) When the effects of monetary policy on the economy work through changes in real interest rates, the effect is called the interest rate channel.

20) Increases in the debt-GDP ratio are primarily caused by a high growth rate of GDP

ESSAY. Write your answer in the space provided. (20 points total points)

21) The money supply is \$30 million, currency held by the public is \$5 million, and the reserve-deposit ratio is 0.2.

- a. What is the quantity of bank deposits?
- b. What is the currency-deposit ratio?
- c. What is the quantity of bank reserves?
- d. What is the quantity of the monetary base?