Lecture 13
Questions & Answers

Principles of Macroeconomics
KOF, ETH Zurich, Prof. Dr. Jan-Egbert Sturm
Fall Term 2008
Exam

- Tuesday, January 13
- 15:15-16:45h
- Room HG F1
- Closed book
  (allowed: non-programmable calculator, dictionary)
Multiple Choice Questions

Question 1
If markets are competitive, international trade...
A reduces welfare of the whole economy
B reduces welfare of consumers of the imported good
C raises welfare of consumers of the imported good
D raises welfare of producers of the imported good
Multiple Choice Questions

Question 2
Real GDP rises if...
A Land prices rise
B Stock prices rise
C the price level rises
D both production and the price level rise
Multiple Choice Questions

Question 3
The GDP deflator...
A rises if prices rise
B rises if production rises
C decreases in case of inflation
D indicates deflation
Multiple Choice Questions

Question 4
What happens if the central bank sells bonds to commercial banks?
A Money supply rises
B Money supply goes down
C The money multiplier gets larger
D The money multiplier gets smaller
Multiple Choice Questions

Question 5
In the long run, output does not depend on...
A the capital stock
B the amount of labour available
C the price level
D technological progress
Multiple Choice Questions

Question 6
The real exchange rate...
A Is the nominal exchange rate net of the interest rate
B Is the exchange rate at which trade takes place in reality
C Depends positively on domestic inflation
D Is the rate at which goods and services of one country can be traded for goods and services of another country
Question 7

A customer pays CHF 100 in his bank account. How much money can be created from this deposit, if the reserve ratio is 5 percent?

A  CHF 2100  
B  CHF 2000  
C  CHF 500  
D  CHF 600
Multiple Choice Questions

Question 8
An increase in the price level...
A shifts the long run aggregate supply curve to the right
B shifts the short run aggregate supply curve to the left
C decreases the natural rate of output
D does not affect the natural rate of output
Multiple Choice Questions

Question 9
If a country has a comparative advantage in the production of a good,...
A the domestic price will be below the world price, and the country will be an importer of the good
B the domestic price will be below the world price, and the country will be an exporter of the good
C the domestic price will be above the world price, and the country will be an importer of the good
D the domestic price will be above the world price, and the country will be an exporter of the good
Multiple Choice Questions

**Question 10**
Free markets in general ...
A maximize producer surplus
B maximize consumer surplus
C maximize the sum of producer surplus and consumer surplus
D minimize welfare
Question 10
Give a definition of the following terms:

a) inflation rate
   • percentage change in the price level from the previous period.

b) real interest rate
   • Nominal interest rate net of inflation

c) consumer price index
   • measure of the overall cost of the goods and services bought by a typical consumer.

d) substitution bias
   • Measurement error in the CPI. If prices increase, consumers substitute toward goods that have become relatively less expensive.
Multiple Choice Questions

Question 11
Give a definition of the term “efficiency wages”. Discuss the reasons for the introduction of efficiency wages from an employers’ viewpoint.

• Efficiency wages: above-equilibrium wages paid by firms in order to increase worker productivity.

• Reasons for introduction:
  • Worker health: Better paid workers eat a better diet and thus are more productive.
  • Worker turnover: A higher paid worker is less likely to look for another job.
  • Worker quality: Higher wages attract a better pool of workers to apply for jobs.
  • Worker effort: Higher wages motivate workers to put forward their best effort.
Multiple Choice Questions

Question 12
Consumers fear a recession and reduce consumption. How can the government counteract (assume that the Central Bank is independent)? What are the shortcomings of such a policy? Use a graph to illustrate your arguments.

• The government can counteract by raising government spending or by lowering taxes
• Due to the multiplier effect, aggregate demand potentially rises by more than the amount spent by the government
• Increased government spending causes an increase in the interest rate, which in turn lowers investment spending
• The overall effect can be larger or smaller than the increase in government spending.
The Crowding-Out Effect

(a) The Money Market

1. When an increase in government purchases increases aggregate demand...

2. . . . the increase in spending increases money demand . . .

3. . . . which increases the equilibrium interest rate . . .

Interest Rate

Money supply

Interest Rate

Money demand, \( MD_1 \)

Quantity of Money

0

Quantity fixed by the CB

(b) The Shift in Aggregate Demand

1. When an increase in government purchases increases aggregate demand . . .

4. . . . which in turn partly offsets the initial increase in aggregate demand.

Price Level

Aggregate demand, \( AD_1 \)

Aggregate demand, \( AD_2 \)

Quantity of Output