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CLEP[®]

OFFICIAL STUDY GUIDE



Principles of Macroeconomics

Description of the Examination

The Subject Examination in Principles of Macroeconomics covers material that is usually taught in a one-semester undergraduate course in the principles of macroeconomics. This aspect of economics deals with principles of economics that apply to a total economic system, particularly the general levels of output and income and interrelations among sectors of the economy. The test places particular emphasis on the determinants of aggregate demand and on the monetary and fiscal policies that are appropriate to achieve particular policy objectives. Within this context, candidates are expected to understand concepts such as the multiplier, the accelerator, and balance-of-payments equilibrium; terms such as inflation, deflationary gap, and depreciation; and institutional arrangements such as open-market operations, deficit spending, and flexible exchange rates.

The exam consists of approximately 80 multiple-choice questions to be answered in two separately timed 45-minute sections.

Knowledge and Skills Required

Questions on the Principles of Macroeconomics exam require candidates to demonstrate one or more of the following abilities.

- Understanding of important economic terms and concepts
- Interpretation and manipulation of economic graphs
- Interpretation and evaluation of economic data
- Application of simple economic models

The outline below indicates the material covered by the exam and the approximate percentage of questions in each category.

➤ *Approximate Percent of Examination*

- 8-12% Basic economic concepts
 - Scarcity: the nature of the economic system
 - Opportunity costs and production possibilities curves
 - Demand, supply, and price determination
- 10-18% Measurement of economic performance
 - Gross domestic and national products and national income concepts
 - Inflation and price indices
 - Unemployment
- 60-70% National income and price determination
 - Aggregate supply and demand: Keynesian and classical analysis (25-30%)
 - Circular flow
 - Components of aggregate supply and demand
 - Multiplier
 - Fiscal policy
 - Long vs. short run
 - Money and banking (15-20%)
 - Definition of money and its creation
 - Tools of central bank policy and monetary policy
 - Fiscal and monetary policy combination (20-25%)
 - Interaction of fiscal and monetary policy
 - Debts and deficits
 - Stabilization policies for aggregate demand and supply shocks
 - Monetarist, supply-siders, and Keynesian controversies
- 10-15% International economics and growth
 - Comparative advantage, trade policy, international finance, and exchange rates
 - Economic growth

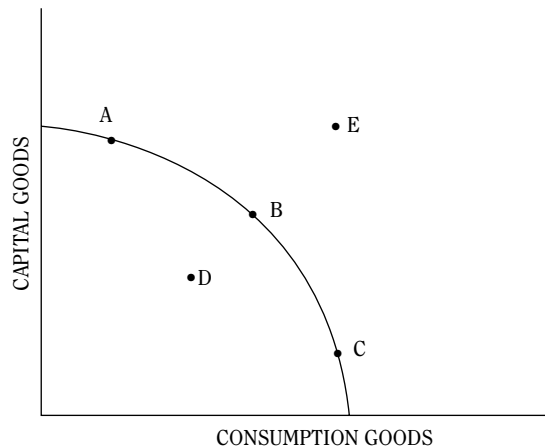
Sample Questions

The 38 sample questions that follow are similar to questions on the Principles of Macroeconomics exam, but they do not appear on the actual exam. CLEP exams are designed so that average students completing a course in the subject can usually answer about half the questions correctly.

Before attempting to answer the sample questions, read all the information about the Principles of Macroeconomics exam given above. Additional suggestions for preparing for CLEP exams are provided in Chapter 1.

Try to answer correctly as many questions as possible. Then compare your answers with the correct answers, given at the end of this examination guide.

Directions: Each of the questions or incomplete statements below is followed by five suggested answers or completions. Select the one that is best in each case.



1. An economy that is fully employing all its productive resources but allocating less to investment than to consumption will be at which of the following positions on the production possibilities curve shown above?

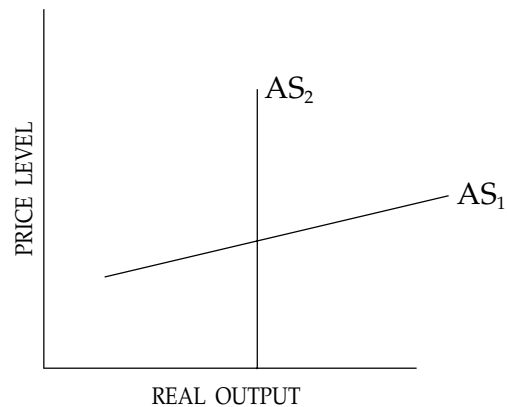
- (A) A
- (B) B
- (C) C
- (D) D
- (E) E

- (A) (B) (C) (D) (E)

2. Assume that land in an agricultural economy can be used either for producing grain or for grazing cattle to produce beef. The opportunity cost of converting an acre from cattle grazing to grain production is the
- (A) market value of the extra grain that is produced
 - (B) total amount of beef produced
 - (C) number of extra bushels of grain that are produced
 - (D) amount by which beef production decreases
 - (E) profits generated by the extra production of grain
- (A) (B) (C) (D) (E)
3. Which of the following is a possible cause of stagflation (simultaneous high unemployment and high inflation)?
- (A) Increase in labor productivity
 - (B) Increase in price for raw materials
 - (C) The rapid growth and development of the computer industry
 - (D) A decline in labor union membership
 - (E) A low growth rate of the money supply
- (A) (B) (C) (D) (E)
4. Which of the following will occur as a result of an improvement in technology?
- (A) The aggregate demand curve will shift to the right.
 - (B) The aggregate demand curve will shift to the left.
 - (C) The aggregate supply curve will shift to the right.
 - (D) The aggregate supply curve will shift to the left.
 - (E) The production possibilities curve will shift inward.
- (A) (B) (C) (D) (E)
5. Increases in real income per capita are made possible by
- (A) improved productivity
 - (B) a high labor/capital ratio
 - (C) large trade surpluses
 - (D) stable interest rates
 - (E) high protective tariffs
- (A) (B) (C) (D) (E)

6. Which of the following is an example of “investment” as the term is used by economists?
- (A) A schoolteacher purchases 10,000 shares of stock in an automobile company.
 - (B) Newlyweds purchase a previously owned home.
 - (C) One large automobile firm purchases another large automobile firm.
 - (D) A farmer purchases \$10,000 worth of government securities.
 - (E) An apparel company purchases 15 new sewing machines.
- (A) (B) (C) (D) (E)
7. The United States government defines an individual as unemployed if the person
- (A) does not hold a paying job
 - (B) has been recently fired
 - (C) works part-time but needs full-time work
 - (D) is without a job but is looking for work
 - (E) wants a job but is not searching because he or she thinks none is available
- (A) (B) (C) (D) (E)
8. If businesses are experiencing an unplanned increase in inventories, which of the following is most likely to be true?
- (A) Aggregate demand is greater than output, and the level of spending will increase.
 - (B) Aggregate demand is less than output, and the level of spending will decrease.
 - (C) The economy is growing and will continue to grow until a new equilibrium level of spending is reached.
 - (D) Planned investment is greater than planned saving, and the level of spending will decrease.
 - (E) Planned investment is less than planned saving, and the level of spending will increase.
- (A) (B) (C) (D) (E)

9. Which of the following workers is most likely to be classified as structurally unemployed?
- (A) A high school teacher who is unemployed during the summer months
 - (B) A recent college graduate who is looking for her first job
 - (C) A teenager who is seeking part-time employment at a fast-food restaurant
 - (D) A worker who is unemployed because his skills are obsolete
 - (E) A woman who reenters the job market after her child begins elementary school
- (A) (B) (C) (D) (E)
10. According to the classical model, an increase in the money supply causes an increase in which of the following?
- I. The price level
 - II. Nominal gross domestic product
 - III. Nominal wages
- (A) I only
 - (B) II only
 - (C) III only
 - (D) II and III only
 - (E) I, II, and III
- (A) (B) (C) (D) (E)



11. The diagram above shows two aggregate supply curves, AS_1 and AS_2 . Which of the following statements most accurately characterizes the AS_1 curve relative to the AS_2 curve?
- (A) AS_1 is Keynesian because it reflects greater wage and price flexibility.
 - (B) AS_1 is classical because it reflects greater wage and price flexibility.
 - (C) AS_1 is Keynesian because it reflects less wage and price flexibility.
 - (D) AS_1 is classical because it reflects less wage and price flexibility.
 - (E) AS_1 could be either classical or Keynesian because it reflects greater wage flexibility but less price flexibility.
- (A) (B) (C) (D) (E)
12. An increase in which of the following would cause the long-run aggregate supply curve to shift to the right?
- (A) Corporate income tax rates
 - (B) Aggregate demand
 - (C) Potential output
 - (D) The average wage rate
 - (E) The price level
- (A) (B) (C) (D) (E)
13. According to the classical economists, which of the following is most sensitive to interest rates?
- (A) Consumption
 - (B) Investment
 - (C) Government spending
 - (D) Transfer payments
 - (E) Intermediate goods
- (A) (B) (C) (D) (E)

14. In the circular flow diagram, which of the following is true?
- (A) Businesses pay wages, rent, interest, and profits to households in return for use of factors of production.
 - (B) Businesses purchase goods and services from households in return for money payments.
 - (C) Households pay wages, rent, interest, and profits to businesses in return for use of factors of production.
 - (D) The relationship between households and businesses exists only in a traditional society.
 - (E) The relationship between households and businesses exists only in a command economy.
- (A) (B) (C) (D) (E)
15. Which of the following would most likely lead to a decrease in aggregate demand, that is, shift the aggregate demand curve leftward?
- (A) A decrease in taxes
 - (B) A decrease in interest rates
 - (C) An increase in household savings
 - (D) An increase in household consumption
 - (E) An increase in business firms' purchases of capital equipment from retained earnings
- (A) (B) (C) (D) (E)
16. According to the Keynesian model, equilibrium output of an economy may be less than the full-employment level of output because at full employment
- (A) sufficient income may not be generated to keep workers above the subsistence level
 - (B) there might not be enough demand by firms and consumers to buy that output
 - (C) workers may not be willing to work the hours necessary to produce the output
 - (D) interest rates might not be high enough to provide the incentive to finance the production
 - (E) banks may not be willing to lend enough money to support the output
- (A) (B) (C) (D) (E)

17. If the Federal Reserve lowers reserve requirements, which of the following is most likely to happen to interest rates and gross domestic product?

- | <u>Interest Rates</u> | <u>Gross Domestic Product</u> |
|-----------------------|-------------------------------|
| (A) Increase | Decrease |
| (B) Increase | Increase |
| (C) Decrease | Decrease |
| (D) Decrease | Increase |
| (E) No change | No change |
- (A) (B) (C) (D) (E)

18. If the marginal propensity to consume is 0.9, what is the maximum amount that the equilibrium gross domestic product could change if government expenditures increase by \$1 billion?

- (A) It could decrease by up to \$9 billion.
 (B) It could increase by up to \$0.9 billion.
 (C) It could increase by up to \$1 billion.
 (D) It could increase by up to \$9 billion.
 (E) It could increase by up to \$10 billion.
- (A) (B) (C) (D) (E)

19. Expansionary fiscal policy will be most effective in increasing gross domestic product when

- (A) the aggregate supply curve is horizontal
 (B) the economy is at or above full-employment output
 (C) transfer payments are decreased, while taxes remain unchanged
 (D) wages and prices are very flexible
 (E) the Federal Reserve simultaneously increases the reserve requirement
- (A) (B) (C) (D) (E)

20. Which of the following would increase the value of the multiplier?

- (A) An increase in government expenditure
 (B) An increase in exports
 (C) A decrease in government unemployment benefits
 (D) A decrease in the marginal propensity to consume
 (E) A decrease in the marginal propensity to save
- (A) (B) (C) (D) (E)

21. Assume that the reserve requirement is 25 percent. If banks have excess reserves of \$10,000, which of the following is the maximum amount of additional money that can be created by the banking system through the lending process?
- (A) \$2,500
 - (B) \$10,000
 - (C) \$40,000
 - (D) \$50,000
 - (E) \$250,000
- (A) (B) (C) (D) (E)
22. The principal reason for requiring commercial banks to maintain reserve balances with the Federal Reserve is that these balances
- (A) provide the maximum amount of reserves a bank would ever need
 - (B) give the Federal Reserve more control over the money-creating operations of banks
 - (C) ensure that banks do not make excessive profits
 - (D) assist the Treasury in refinancing government debt
 - (E) enable the government to borrow cheaply from the Federal Reserve's discount window
- (A) (B) (C) (D) (E)
23. The purchase of securities on the open market by the Federal Reserve will
- (A) increase the supply of money
 - (B) increase the interest rate
 - (C) increase the discount rate
 - (D) decrease the number of Federal Reserve notes in circulation
 - (E) decrease the reserve requirement
- (A) (B) (C) (D) (E)
24. To counteract a recession, the Federal Reserve should
- (A) buy securities on the open market and raise the reserve requirement
 - (B) buy securities on the open market and lower the reserve requirement
 - (C) buy securities on the open market and raise the discount rate
 - (D) sell securities on the open market and raise the discount rate
 - (E) raise the reserve requirement and lower the discount rate
- (A) (B) (C) (D) (E)

25. Total spending in the economy is most likely to increase by the largest amount if which of the following occur to government spending and taxes?

<u>Government Spending</u>	<u>Taxes</u>
(A) Decrease	Increase
(B) Decrease	No change
(C) Increase	Increase
(D) Increase	Decrease
(E) No change	Increase

(A) (B) (C) (D) (E)

26. According to the Keynesian model, an increase in the money supply affects output more if

- (A) investment is sensitive to interest rates
- (B) money demand is sensitive to interest rates
- (C) the unemployment rate is low
- (D) consumption is sensitive to the Phillips curve
- (E) government spending is sensitive to public opinion

(A) (B) (C) (D) (E)

27. Supply-side economists argue that

- (A) a cut in high tax rates results in an increased deficit and thus increases aggregate supply
- (B) lower tax rates provide positive work incentives and thus shift the aggregate supply curve to the right
- (C) the aggregate supply of goods can only be increased if the price level falls
- (D) increased government spending should be used to stimulate the economy
- (E) the government should regulate the supply of imports

(A) (B) (C) (D) (E)

28. Which of the following policies would most likely be recommended in an economy with an annual inflation rate of 3 percent and an unemployment rate of 11 percent?

- (A) An increase in transfer payments and an increase in the reserve requirement
- (B) An increase in defense spending and an increase in the discount rate
- (C) An increase in income tax rates and a decrease in the reserve requirement
- (D) A decrease in government spending and the open-market sale of government securities
- (E) A decrease in the tax rate on corporate profits and a decrease in the discount rate

(A) (B) (C) (D) (E)

29. According to the monetarists, inflation is most often the result of

- (A) high federal tax rates
- (B) increased production of capital goods
- (C) decreased production of capital goods
- (D) an excessive growth of the money supply
- (E) upward shifts in the consumption function

(A) (B) (C) (D) (E)

30. According to the Keynesian model, an expansionary fiscal policy would tend to cause which of the following changes in output and interest rates?

- | <u>Output</u> | <u>Interest Rates</u> |
|---------------|-----------------------|
| (A) Increase | Increase |
| (B) Increase | Decrease |
| (C) Decrease | Increase |
| (D) Decrease | Decrease |
| (E) No change | Decrease |

(A) (B) (C) (D) (E)

31. Which of the following would result in the largest increase in aggregate demand?
- (A) A \$30 billion increase in military expenditure and a \$30 billion open-market purchase of government securities
 - (B) A \$30 billion increase in military expenditure and a \$30 billion open-market sale of government securities
 - (C) A \$30 billion tax decrease and a \$30 billion open-market sale of government securities
 - (D) A \$30 billion tax increase and a \$30 billion open-market purchase of government securities
 - (E) A \$30 billion increase in social security payments and a \$30 billion open-market sale of government securities
- (A) (B) (C) (D) (E)
32. Which of the following would most likely be the immediate result if the United States increased tariffs on most foreign goods?
- (A) The United States standard of living would be higher.
 - (B) More foreign goods would be purchased by Americans.
 - (C) Prices of domestic goods would increase.
 - (D) Large numbers of United States workers would be laid off.
 - (E) The value of the United States dollar would decrease against foreign currencies.
- (A) (B) (C) (D) (E)
33. Which of the following policies is most likely to encourage long-run economic growth in a country?
- (A) An embargo on high-technology imports
 - (B) A decrease in the number of immigrants to the country
 - (C) An increase in government transfer payments
 - (D) An increase in the per capita savings rate
 - (E) An increase in defense spending
- (A) (B) (C) (D) (E)

34. Which of the following would occur if the international value of the United States dollar decreased?
- (A) United States exports would rise.
 - (B) More gold would flow into the United States.
 - (C) United States demand for foreign currencies would increase.
 - (D) The United States trade deficit would increase.
 - (E) Americans would pay less for foreign goods. (A) (B) (C) (D) (E)
35. If exchange rates are allowed to fluctuate freely and the United States demand for German marks increases, which of the following will most likely occur?
- (A) Americans will have to pay more for goods made in Germany.
 - (B) Germans will find that American goods are getting more expensive.
 - (C) The United States balance-of-payments deficit will increase.
 - (D) The dollar price of marks will fall.
 - (E) The dollar price of German goods will fall. (A) (B) (C) (D) (E)
36. The replacement of some portion of the federal personal income tax with a general sales tax would most likely result in
- (A) greater overall progressivity in the tax structure
 - (B) lesser overall progressivity in the tax structure
 - (C) stronger automatic stabilization through the business cycle
 - (D) increased consumption of liquor, cigarettes, and gasoline
 - (E) a smaller federal budget deficit
- (A) (B) (C) (D) (E)
37. A deficit in the United States trade balance can be described as
- (A) an excess of the value of commodity imports over the value of commodity exports
 - (B) an excess of the value of commodity exports over the value of commodity imports
 - (C) an excess of payments to foreigners over receipts from foreigners
 - (D) an almost complete depletion of the gold stock
 - (E) the consequence of an undervalued dollar
- (A) (B) (C) (D) (E)

38. Problems faced by all economic systems include which of the following?
- I. How to allocate scarce resources among unlimited wants
 - II. How to decentralize markets
 - III. How to decide what to produce, how to produce, and for whom to produce
 - IV. How to set government production quotas
- (A) I only
(B) I and III only
(C) II and III only
(D) I, II, and III only
(E) I, II, III, and IV
- (A) (B) (C) (D) (E)

Study Resources

There are many introductory economics textbooks that vary greatly in difficulty. Most books are published in one-volume editions, which cover both microeconomics and macroeconomics; some are also published in two-volume editions, with one volume covering macroeconomics and the other microeconomics. A companion study guide/workbook is available for most textbooks. The study guides typically include brief reviews, definitions of key concepts, problem sets, and multiple-choice test questions with answers. Many publishers also make available computer-assisted learning packages. To prepare for the Principles of Macroeconomics and Microeconomics exams, you should study the contents of at least one college level introductory economics textbook. These textbooks can be found in most college bookstores. You would do well to consult two or three textbooks because they vary in content, approach, and emphasis. When selecting a textbook, check the table of contents against the “Knowledge and Skills Required” section at the beginning of this examination guide.

To broaden your knowledge of economic issues, you may read relevant articles published in the economics periodicals that are available in most college libraries — for example, *The Economist*, *The Margin*, and *The American Economic Review*. *The Wall Street Journal* and the *New York Times*, along with local papers, may also enhance your understanding of economic issues. The Internet is another resource you could explore.

Additional suggestions for preparing for CLEP exams are provided in Chapter 1.

Answers to Sample Questions

Principles of Macroeconomics

- | | |
|-------|-------|
| 1. C | 26. A |
| 2. D | 27. B |
| 3. B | 28. E |
| 4. C | 29. D |
| 5. A | 30. A |
| 6. E | 31. A |
| 7. D | 32. C |
| 8. B | 33. D |
| 9. D | 34. A |
| 10. E | 35. A |
| 11. C | 36. B |
| 12. C | 37. A |
| 13. B | 38. B |
| 14. A | |
| 15. C | |
| 16. B | |
| 17. D | |
| 18. E | |
| 19. A | |
| 20. E | |
| 21. C | |
| 22. B | |
| 23. A | |
| 24. B | |
| 25. D | |
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