

Texas A&M University (TAMU)

ECON410 Macroeconomic Theory

Practice Exam 1 (Sample)

Study Guide



Everything you need from our exam experts!

Copyright © 2025 by Examzify - A Kaluba Technologies Inc. product.

ALL RIGHTS RESERVED.

No part of this book may be reproduced or transferred in any form or by any means, graphic, electronic, or mechanical, including photocopying, recording, web distribution, taping, or by any information storage retrieval system, without the written permission of the author.

Notice: Examzify makes every reasonable effort to obtain from reliable sources accurate, complete, and timely information about this product.

SAMPLE

Questions

SAMPLE

1. Which of the following best describes the difference between fiscal policy and monetary policy?
 - A. Fiscal policy involves regulation of banking, while monetary policy involves government spending.
 - B. Fiscal policy pertains to taxation and spending, while monetary policy involves managing the money supply.
 - C. Fiscal policy focuses on interest rates, while monetary policy focuses on public debts.
 - D. Fiscal policy is concerned with trade, while monetary policy handles investment.
2. What does the long-run aggregate supply curve represent?
 - A. The economy's level of potential output
 - B. The relationship between price levels and real output
 - C. The impact of inflation on employment
 - D. The trade-offs between spending and saving
3. What is a characteristic of contractionary monetary policy?
 - A. Increasing money supply to stimulate growth
 - B. Decreasing money supply to control inflation
 - C. Increasing government expenditure on infrastructure
 - D. Lowering taxes to boost consumer spending
4. What are the phases of the business cycle?
 - A. Industry, economy, growth, and recession
 - B. Expansion, peak, contraction, and trough
 - C. Investment, profit, loss, and return
 - D. Growth, decline, stability, and crisis

5. What happens when wages are high in relation to labor supply and demand?
- A. The demand for labor increases
 - B. The supply of labor decreases
 - C. The supply of labor is higher than the demand for labor
 - D. The demand for labor and supply of labor reach equilibrium
6. Why are real wages important?
- A. They determine employment rates
 - B. They reflect the purchasing power of income
 - C. They are used to set minimum wage laws
 - D. They are a measure of productivity
7. What defines discouraged workers?
- A. Individuals actively searching for part-time work
 - B. People who have given up looking for a job
 - C. Workers who are employed but seeking better opportunities
 - D. Unemployed individuals who are continuously retraining
8. What occurs when a government's total expenditures exceed its total revenues?
- A. Budget surplus
 - B. Fiscal deficit
 - C. Trade surplus
 - D. Current account deficit
9. What does "full employment" refer to in macroeconomics?
- A. A situation with no unemployment at all
 - B. The efficient use of labor resources excluding cyclical unemployment
 - C. High unemployment rates with high economic growth
 - D. Only including structural unemployment rates

10. What calculation is used to derive the steady-state output per worker?

- A. Average income divided by population
- B. Investment minus depreciation
- C. Sum of consumption and investment
- D. The production function evaluated at k^*

SAMPLE

Answers

SAMPLE

1. B
2. A
3. B
4. B
5. C
6. B
7. B
8. B
9. B
10. D

SAMPLE

Explanations

SAMPLE

1. Which of the following best describes the difference between fiscal policy and monetary policy?
- A. Fiscal policy involves regulation of banking, while monetary policy involves government spending.
 - B. Fiscal policy pertains to taxation and spending, while monetary policy involves managing the money supply.
 - C. Fiscal policy focuses on interest rates, while monetary policy focuses on public debts.
 - D. Fiscal policy is concerned with trade, while monetary policy handles investment.

The distinction between fiscal policy and monetary policy is foundational in macroeconomic theory. Fiscal policy pertains specifically to government actions regarding taxation and spending. This includes decisions about how much revenue the government collects (through taxes) and how much it spends on public services and programs. These fiscal decisions directly influence economic activity by impacting consumer demand and can stimulate or contract the economy based on the level of government spending and taxation. Monetary policy, on the other hand, is centered around managing the money supply and interest rates to influence economic conditions. This is typically conducted by a nation's central bank, which can adjust interest rates to either encourage borrowing and spending (by lowering rates) or curb inflation (by raising rates). Through these actions, monetary policy affects liquidity in the economy, which is critical for maintaining economic stability. The other options misrepresent elements of fiscal and monetary policy by conflating their functions or misattributing their areas of focus. For instance, fiscal policy does not primarily involve banking regulation, nor does monetary policy solely focus on government spending or public debts. Understanding this distinction is vital for analyzing economic strategies and their implications for overall economic health.

2. What does the long-run aggregate supply curve represent?

- A. The economy's level of potential output
- B. The relationship between price levels and real output
- C. The impact of inflation on employment
- D. The trade-offs between spending and saving

The long-run aggregate supply curve represents the economy's level of potential output, also known as full employment output or natural level of output. This concept is crucial in macroeconomics, as it reflects the maximum sustainable production capacity of an economy when all resources are utilized efficiently, without leading to inflationary pressures. In the long run, the aggregate supply is considered to be price inelastic, implying that it is unaffected by changes in price levels. Instead, it is determined primarily by factors such as technology, labor, capital, and resources available in the economy. In contrast, the relationship between price levels and real output is captured by the short-run aggregate supply curve, which reacts to various economic shocks and price level changes. The impact of inflation on employment is more related to discussions on the Phillips curve, which addresses the trade-off between inflation and unemployment in the short run. Lastly, the trade-offs between spending and saving are part of other economic discussions, particularly relating to consumer behavior and the broader context of aggregate demand, rather than the long-run supply perspectives. Thus, the correct choice encapsulates the essence of the long-run aggregate supply curve as a representation of potential output.

3. What is a characteristic of contractionary monetary policy?

- A. Increasing money supply to stimulate growth
- B. Decreasing money supply to control inflation
- C. Increasing government expenditure on infrastructure
- D. Lowering taxes to boost consumer spending

Contractionary monetary policy is primarily employed to control inflation and stabilize an economy experiencing rapid growth or rising prices. By decreasing the money supply, central banks aim to reduce the amount of money available in the economy, which in turn can help constrain consumer spending and investment. When the money supply is decreased, interest rates generally increase, making borrowing more expensive. Higher interest rates can dampen consumer and business spending, which helps to slow down economic activity and reduce inflationary pressures. This approach is used to maintain price stability and ensure that inflation does not erode the purchasing power of consumers. The other options describe expansionary measures or fiscal policies rather than contractionary monetary policy. Increasing money supply or government expenditure and lowering taxes are strategies aimed at stimulating economic growth, which goes against the principle of contractionary monetary policy that focuses on restraining growth to control inflation.

4. What are the phases of the business cycle?

- A. Industry, economy, growth, and recession
- B. Expansion, peak, contraction, and trough
- C. Investment, profit, loss, and return
- D. Growth, decline, stability, and crisis

The phases of the business cycle refer to the fluctuations in economic activity that an economy experiences over time. The correct answer outlines these phases as expansion, peak, contraction, and trough. Expansion is the phase where the economy is growing, characterized by increases in production, employment, and consumer spending. This upward trend continues until it reaches a peak, which is the highest point of economic activity in the cycle. After the peak, the economy enters the contraction phase, marked by a decline in economic activity, leading to decreased spending and higher unemployment rates. The trough is the lowest point of the cycle, indicating the end of the contraction period before the economy begins to recover and enter another expansion phase. These phases are critical for understanding macroeconomic dynamics and for policymakers who aim to manage economic fluctuations. They provide a framework for analyzing economic data and forecasting future economic activity. The other choices do not correctly represent the widely accepted phases of the business cycle, as they focus on different concepts or aspects of economics that are not directly related to the cyclical nature of economic activity.

5. What happens when wages are high in relation to labor supply and demand?

A. The demand for labor increases

B. The supply of labor decreases

C. The supply of labor is higher than the demand for labor

D. The demand for labor and supply of labor reach equilibrium

When wages are high relative to labor supply and demand, it typically results in an oversupply of labor compared to the demand for it, leading to the scenario where the supply of labor exceeds the demand for labor. High wages can attract more individuals to the labor market because the incentive to work increases; however, employers may not be willing or able to hire as many workers at these elevated wage levels. Consequently, while more workers may be looking for jobs, the demand from employers does not match this increase, resulting in a situation where the number of laborers seeking work outstrips the number of jobs available. This imbalance is reflected in the excess supply of labor relative to demand in the market, which underscores why the correct answer aligns with this idea.

6. Why are real wages important?

A. They determine employment rates

B. They reflect the purchasing power of income

C. They are used to set minimum wage laws

D. They are a measure of productivity

Real wages are indeed significant because they reflect the purchasing power of income. When evaluating the economic well-being of individuals and households, real wages take into account the inflation rate and enable a more accurate measure of how much goods and services a worker can actually afford. If real wages are rising, it indicates that employees are able to buy more with their earnings, enhancing their standard of living and overall economic health. Conversely, if real wages are stagnant or falling, even if nominal wages increase, individuals may struggle to make ends meet due to higher prices for essentials. While employment rates are influenced by various factors including economic conditions and policies, they are not exclusively determined by real wages. Minimum wage laws can relate to nominal wages rather than real wages directly, and productivity measures are typically assessed through outputs relative to inputs without a direct connection to the purchasing power aspect of wages. Thus, the essence of real wages lies in their role as a direct indicator of economic well-being through purchasing power.

7. What defines discouraged workers?

- A. Individuals actively searching for part-time work
- B. People who have given up looking for a job
- C. Workers who are employed but seeking better opportunities
- D. Unemployed individuals who are continuously retraining

Discouraged workers are specifically defined as individuals who have stopped searching for a job because they believe there are no employment opportunities available for them. This status typically results from repeated unsuccessful job searches, leading them to feel disillusioned about their chances of finding work. This definition is crucial in understanding labor market dynamics because discouraged workers are not counted in the traditional unemployment statistics, which can make the unemployment rate appear lower than it actually is. Recognizing discouraged workers helps to provide a fuller picture of labor market health and can inform policy decisions aimed at improving employment chances. The other options focus on different types of workers or job-seeking behavior. For example, individuals actively searching for part-time work or those who are employed but seeking better opportunities do not fall under the category of discouraged workers, as they are still engaged in the job market. Similarly, unemployed individuals who are continuously retraining are actively preparing for employment rather than feeling discouraged about their job prospects. Therefore, the defining characteristic of discouraged workers is their cessation of job search activities due to feelings of hopelessness regarding employment opportunities.

8. What occurs when a government's total expenditures exceed its total revenues?

- A. Budget surplus
- B. Fiscal deficit
- C. Trade surplus
- D. Current account deficit

When a government's total expenditures exceed its total revenues, it results in a fiscal deficit. This situation means that the government is spending more money than it is receiving, which often leads to borrowing to cover the shortfall. A fiscal deficit can be indicative of the government's financial health and its ability to fund public services and projects. In general, a persistent fiscal deficit can raise concerns about sustainability, as excessive borrowing may lead to higher interest rates or inflation. It can also lead to diminished confidence among investors regarding the government's fiscal management, potentially impacting the overall economy. The other concepts mentioned, such as a budget surplus, trade surplus, and current account deficit, pertain to different economic scenarios. A budget surplus occurs when revenues exceed expenditures, while trade and current account surpluses or deficits refer to international trade balances, which do not directly relate to a government's fiscal status.

9. What does "full employment" refer to in macroeconomics?

- A. A situation with no unemployment at all
- B. The efficient use of labor resources excluding cyclical unemployment
- C. High unemployment rates with high economic growth
- D. Only including structural unemployment rates

In macroeconomics, "full employment" refers to a situation where all available labor resources are being utilized efficiently, but it does not imply the absence of all forms of unemployment. Rather, it recognizes that there will always be a certain level of unemployment due to factors such as frictional and structural unemployment. Frictional unemployment occurs as individuals transition between jobs, while structural unemployment arises from mismatches between workers' skills and job requirements. While cyclic unemployment, which is associated with economic downturns, is minimized or eliminated in full employment, it is essential to understand that full employment reflects an optimal allocation of labor resources without the presence of cyclical unemployment. Thus, option B encapsulates this concept accurately by highlighting the efficient use of labor while excluding cyclical unemployment from the calculation of full employment.

10. What calculation is used to derive the steady-state output per worker?

- A. Average income divided by population
- B. Investment minus depreciation
- C. Sum of consumption and investment
- D. The production function evaluated at k^*

The steady-state output per worker is derived by evaluating the production function at the level of capital per worker, often denoted as k^* . In macroeconomic theory, specifically in the Solow growth model, the production function relates the amount of capital available per worker to the overall output produced by those workers. At the steady-state, the economy reaches a condition where capital per worker remains constant over time. This occurs when the amount of investment in new capital equals the amount of capital that wears out or depreciates. The steady-state output per worker, therefore, is fundamentally tied to the production function evaluated at this steady-state level of capital (k^*). Evaluating the production function at k^* captures how much output can be generated per worker when the capital is neither increasing nor decreasing—essentially the long-run output level that an economy can sustain without external shocks impacting its capital stock. By focusing on this level, we can gain insights into the efficiency and productivity of the economy under conditions where growth stops, leading to a clearer understanding of output stability in the long term.