

Chapter 23

Measuring the Cost of Living

Test A

1. When the consumer price index rises, a typical family
 - a. can spend fewer dollars to maintain the same standard of living.
 - b. finds that its standard of living is not affected.
 - c. has to spend more dollars to maintain the same standard of living.
 - d. None of the above answers is necessarily correct.

ANSWER: c. has to spend more dollars to maintain the same standard of living.
TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 1 RANDOM: Y

2. The inflation rate is defined as the
 - a. cost of inflation.
 - b. cost of borrowing.
 - c. percentage change in real GDP from the previous period.
 - d. percentage change in the price level from the previous period.

ANSWER: d. percentage change in the price level from the previous period.
TYPE: M KEY1: D SECTION: INT OBJECTIVE: RANDOM: Y

3. The CPI is a measure of the overall cost of
 - a. producer inputs.
 - b. personal imports.
 - c. goods and services bought by a typical consumer.
 - d. goods and services produced in the economy.

ANSWER: c. goods and services bought by a typical consumer.
TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 1 RANDOM: Y

4. The CPI is computed using all goods and services
 - a. produced in the economy.
 - b. used to produce other goods.
 - c. that typical producers buy.
 - d. that typical consumers buy.

ANSWER: d. that typical consumers buy.
TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 1 RANDOM: Y

5. In computing the CPI, the base year is the
 - a. year against which this years price index is compared to find the inflation rate during the year.
 - b. benchmark against which other years are compared.
 - c. current year.
 - d. year with the lowest prices.

ANSWER: b. benchmark against which other years are compared.
TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 1 RANDOM: Y

6. For any given year, the CPI is the price of the basket of goods and services in the
 - a. given year divided by the price of the basket in the base year, then multiplied by 100.
 - b. base year divided by the price of the basket in the base year, then divided by 100.
 - c. base year divided by the price of the basket in the given year, then divided by 100.
 - d. base year divided by the price of the basket in the given year, then multiplied by 100.

ANSWER: a. given year divided by the price of the basket in the base year, then multiplied by 100.
TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 1 RANDOM: Y

7. Categories of U.S. consumer spending used in the CPI, ranked from largest to smallest are:
- food and beverages, housing, and medical care.
 - food and beverages, medical care, and housing.
 - housing, food and beverages, and medical care.
 - housing, medical care, and food and beverages.

ANSWER: c. housing, food and beverages, and medical care.

TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 1 RANDOM: Y

8. Substitution causes the increase in the cost of living from one year to the next to be
- neither overstated or understated by the CPI because the CPI is based on the price of all goods.
 - overstated by the CPI because the basket of goods used to compute the CPI changes from year to year and so does not take into account the fact that as prices rise people purchase more of the goods they like less.
 - understated by the CPI because the CPI changes from year to year and so does not take into account the fact that people substitute higher quality goods for lower quality ones as income increases.
 - overstated by the CPI because the CPI is based on a fixed basket of goods that does not reflect increases in the purchases of goods that become relatively cheap.

ANSWER: d. overstated by the CPI because the CPI is based on a fixed basket of goods that does not reflect increases in the purchases of goods that become relatively cheap.

TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 2 RANDOM: Y

9. Unmeasured quality change is a problem in the CPI because
- if the quality of a good deteriorates, the purchasing power of a dollar increases even if the price of the good remains the same.
 - the Bureau of Labor Statistics does not attempt to account for any quality changes that affect the standard of living.
 - if the quality of a good improves, the purchasing power of a dollar increases even if the price of the good remains the same.
 - Both a and b are correct.

ANSWER: c. if the quality of a good improves, the purchasing power of a dollar increases even if the price of the good remains the same.

TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 2 RANDOM: Y

10. Which of the following statements best represents economists' beliefs about the bias in the CPI as a measure of the cost of living?
- Economists agree on the severity of the CPI bias, but there is still debate on what to do about it.
 - Economists debate both the severity of the CPI bias and what to do about it.
 - Economists agree that the bias in the CPI is a very serious problem.
 - Economists agree that the bias in the CPI is not a serious problem.

ANSWER: b. Economists debate both the severity of the CPI bias and what to do about it.

TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 2 RANDOM: Y

11. Most, but not all, soccer balls used in the United States are imported from other nations. If the price of soccer balls increases, the GDP deflator will
- increase, but the consumer price index will not increase.
 - increase less than will the consumer price index.
 - increase more than will the consumer price index.
 - not increase, but the consumer price index will increase.

ANSWER: b. increase less than will the consumer price index.

TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 3 RANDOM: Y

12. An Egyptian company produces sweaters in the United States and exports all of them to Lithuania. Other things the same, if the price of these sweaters increases, the GDP deflator
- increases and the CPI is unchanged.
 - and the CPI are unchanged.
 - and the CPI both increase.
 - is unchanged and the CPI increases.

ANSWER: a. increases and the CPI is unchanged.

TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 3 RANDOM: Y

13. The basket of goods in the consumer price index changes
- occasionally, while the basket of goods in the GDP deflator changes each time it is computed.
 - each time it is computed, while the basket of goods in the GDP deflator changes occasionally.
 - occasionally, as does the basket of goods in the GDP deflator.
 - each time it is computed, as does the basket of goods in the GDP deflator.

ANSWER: a. occasionally, while the basket of goods in the GDP deflator changes each time it is computed.

TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 3 RANDOM: Y

14. What is the purpose of measuring the overall level of prices in the economy?
- to allow consumers to know what kinds of prices to expect in the future
 - to allow the measurement of GDP
 - to allow comparison between dollar figures from different points in time
 - All of the above are correct.

ANSWER: c. to allow comparison between dollar figures from different points in time

TYPE: M KEY1: D SECTION: 2 OBJECTIVE: 4 RANDOM: Y

15. Babe Ruth's 1931 salary was \$80,000. The price index for 1931 is 15.2 and the price index for 1999 is 166. Ruth's 1931 salary was equivalent to a 1999 salary of about
- \$8,700.
 - \$87,000.
 - \$870,000.
 - \$8,700,000.

ANSWER: c. \$870,000.

TYPE: M KEY1: D SECTION: 2 OBJECTIVE: 4 RANDOM: Y

16. Craig is offered a \$120,000 per year job in Los Angeles, and a \$90,000 per year job in Akron. The CPI for Los Angeles is 160 and the CPI for Akron is 120. What is the Los Angeles job's purchasing power in "Akron dollars"?
- \$160,000
 - \$120,000
 - \$90,000
 - \$65,000

ANSWER: c. \$90,000

TYPE: M KEY1: D SECTION: 2 OBJECTIVE: 4 RANDOM: Y

17. A COLA automatically raises the wage rate when
- real GDP increases.
 - the labor force increases.
 - taxes increase.
 - the consumer price index increases.

ANSWER: d. the consumer price index increases.

TYPE: M KEY1: D SECTION: 2 OBJECTIVE: 4 RANDOM: Y

18. The nominal interest rate is
- the interest rate paid or charged by a bank.
 - the interest rate as usually reported without a correction for the effects of inflation.
 - both a and b above.
 - None of the above is correct.

ANSWER: c. both a and b above.

TYPE: M KEY1: D SECTION: 2 OBJECTIVE: 5 RANDOM: Y

19. Which of the following is the most accurate statement about the relationship between the nominal interest rate and the real interest rate?
- The real interest rate is the nominal interest rate minus the rate of inflation.
 - The real interest rate is the nominal interest rate divided by the price level.
 - The real interest rate is the nominal interest rate times the price level.
 - The real interest rate is the nominal interest rate times the expected price level divided by the current price level.

ANSWER: a. The real interest rate is the nominal interest rate minus the rate of inflation.

TYPE: M KEY1: D SECTION: 2 OBJECTIVE: 5 RANDOM: Y

20. If the nominal interest rate is 8% and rate of inflation is 2%, the real interest rate is
- 16%.
 - 10%.
 - 6%.
 - 4%.

ANSWER: c. 6%.

TYPE: M KEY1: D SECTION: 2 OBJECTIVE: 5 RANDOM: Y

21. The nominal interest rate tells you
- how fast the purchasing power of your bank account rises over time.
 - how fast the number of dollars in your bank account rises over time.
 - the number of dollars in your bank account.
 - the purchasing power of your bank account.

ANSWER: b. how fast the number of dollars in your bank account rises over time.

TYPE: M KEY1: D SECTION: 2 OBJECTIVE: 5 RANDOM: Y

22. The real interest rate tells you
- the number of dollars in your bank account.
 - the purchasing power of your bank account.
 - how fast the number of dollars in your bank account rises over time.
 - how fast the purchasing power of your bank account rises over time.

ANSWER: d. how fast the purchasing power of your bank account rises over time.

TYPE: M KEY1: D SECTION: 2 OBJECTIVE: 5 RANDOM: Y

23. Which of the following is the most accurate statement about nominal and real interest rates?
- Nominal and real interest rates often do not move together.
 - Nominal and real interest rates always move together.
 - Nominal and real interest rates never move together.
 - Nominal and real interest rates are identical.

ANSWER: a. Nominal and real interest rates often do not move together.

TYPE: M KEY1: D SECTION: 2 OBJECTIVE: 5 RANDOM: Y

24. Samantha deposits \$1,000 in a saving account that pays an annual interest rate of 4%. Over the course of a year the inflation rate is 1%. At the end of the year Samantha has
- \$40 more in her account, and her purchasing power has increased \$30.
 - \$30 more in her account and her purchasing power has increased \$50.
 - \$50 more in her account, and her purchasing power has increased \$30.
 - \$40 more in her account, and her purchasing power has increased \$40.

ANSWER: a. \$40 more in her account, and her purchasing power has increased \$30.

TYPE: M KEY1: D SECTION: 2 OBJECTIVE: 5 RANDOM: Y

25. In the late 1970s, nominal interest rates were high and inflation rates were very high. As a result, real interest rates were
- very high.
 - moderately high.
 - low, but never negative.
 - low, and in some years they were negative.

ANSWER: d. low, and in some years they were negative.

TYPE: M KEY1: D SECTION: 2 OBJECTIVE: 5 RANDOM: Y

- 1 ANSWER: c. has to spend more dollars to maintain the same standard of living.

TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 1 RANDOM: Y

- 2 ANSWER: d. percentage change in the price level from the previous period.

TYPE: M KEY1: D SECTION: INT OBJECTIVE: RANDOM: Y

- 3 ANSWER: c. goods and services bought by a typical consumer.

TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 1 RANDOM: Y

- 4 ANSWER: d. that typical consumers buy.

TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 1 RANDOM: Y

- 5 ANSWER: b. benchmark against which other years are compared.

TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 1 RANDOM: Y

- 6 ANSWER: a. given year divided by the price of the basket in the base year, then multiplied by 100.

TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 1 RANDOM: Y

- 7 ANSWER: c. housing, food and beverages, and medical care.

TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 1 RANDOM: Y

- 8 ANSWER: d. overstated by the CPI because the CPI is based on a fixed basket of goods that does not reflect increases in the purchases of goods that become relatively cheap.

TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 2 RANDOM: Y

- 9 ANSWER: c. if the quality of a good improves, the purchasing power of a dollar increases even if the price of the good remains the same.

TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 2 RANDOM: Y

- 10 ANSWER: b. Economists debate both the severity of the CPI bias and what to do about it.

TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 2 RANDOM: Y

- 11 ANSWER: b. increase less than will the consumer price index.

TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 3 RANDOM: Y

- 12 ANSWER: a. increases and the CPI is unchanged.
TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 3 RANDOM: Y
- 13 ANSWER: a. occasionally, while the basket of goods in the GDP deflator changes each time it is computed.
TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 3 RANDOM: Y
- 14 ANSWER: c. to allow comparison between dollar figures from different points in time
TYPE: M KEY1: D SECTION: 2 OBJECTIVE: 4 RANDOM: Y
- 15 ANSWER: c. \$870,000.
TYPE: M KEY1: D SECTION: 2 OBJECTIVE: 4 RANDOM: Y
- 16 ANSWER: c. \$90,000
TYPE: M KEY1: D SECTION: 2 OBJECTIVE: 4 RANDOM: Y
- 17 ANSWER: d. the consumer price index increases.
TYPE: M KEY1: D SECTION: 2 OBJECTIVE: 4 RANDOM: Y
- 18 ANSWER: c. both a and b above.
TYPE: M KEY1: D SECTION: 2 OBJECTIVE: 5 RANDOM: Y
- 19 ANSWER: a. The real interest rate is the nominal interest rate minus the rate of inflation. TYPE: M
KEY1: D SECTION: 2 OBJECTIVE: 5 RANDOM: Y
- 20 ANSWER: c. 6%.
TYPE: M KEY1: D SECTION: 2 OBJECTIVE: 5 RANDOM: Y
- 21 ANSWER: b. how fast the number of dollars in your bank account rises over time.
TYPE: M KEY1: D SECTION: 2 OBJECTIVE: 5 RANDOM: Y
- 22 ANSWER: d. how fast the purchasing power of your bank account rises over time.
TYPE: M KEY1: D SECTION: 2 OBJECTIVE: 5 RANDOM: Y
- 23 ANSWER: a. Nominal and real interest rates often do not move together.
TYPE: M KEY1: D SECTION: 2 OBJECTIVE: 5 RANDOM: Y
- 24 ANSWER: a. \$40 more in her account, and her purchasing power has increased \$30.
TYPE: M KEY1: D SECTION: 2 OBJECTIVE: 5 RANDOM: Y

25 ANSWER: d. low, and in some years they were negative.
TYPE: M KEY1: D SECTION: 2 OBJECTIVE: 5 RANDOM: Y