

**Macroeconomics, 6e, Global Edition (Blanchard/Johnson)**  
**Chapter 1: A Tour of the World**

1.1 Multiple Choice Questions

1) In 2010, output per capita in the United States was approximately equal to

- A) \$15,500.
- B) \$25,800.
- C) \$43,800.
- D) \$47,300.

Answer: D

Diff: 2

2) The most recent financial crisis started in

- A) stock market.
- B) bond market.
- C) foreign exchange market.
- D) housing market.

Answer: D

Diff: 2

3) The standard of living typically refers to

- A) the rate of unemployment.
- B) output per capita.
- C) wealth per capita.
- D) all of the above

Answer: B

Diff: 1

4) In 2010, the U.S. budget deficit as a percentage of U.S. output was approximately equal to

- A) 1.7%.
- B) 9%.
- C) 6%.
- D) 16.2%.

Answer: B

Diff: 1

5) In 2010, the unemployment in the U.S. was

- A) 5%.
- B) 11%.
- C) 9.6%.
- D) 4.6%.

Answer: C

Diff: 2

6) Economists have suggested that the relatively higher unemployment in Europe has been caused by which of the following?

- A) relatively high unemployment benefits
- B) relatively high level of worker protection
- C) inadequate macroeconomic policies
- D) increased labor costs
- E) all of the above

Answer: E

Diff: 2

7) Which of the following countries had the lowest level of output per capita in 2010?

- A) Spain
- B) France
- C) Italy
- D) German

Answer: A

Diff: 2

8) At what point could the Euro be used as currency?

- A) January 1, 1998
- B) January 1, 1999
- C) January 1, 2000
- D) January 1, 2002

Answer: D

Diff: 2

9) In 2010, output per capita in China was approximately equal to

- A) \$2,100.
- B) \$4,300.
- C) \$22,100.
- D) \$32,100.

Answer: B

Diff: 2

10) Inflation represents

- A) an increase in output.
- B) an increase in the aggregate price level.
- C) an increase in the unemployment rate.
- D) a recession.

Answer: B

Diff: 1

11) Between 2000 and 2010, the annual rate of output growth in China was approximately equal to

- A) 2%.
- B) 5%.
- C) 10%.
- D) 20%.

Answer: C

Diff: 2

12) Which of the following explains the relatively high growth rate of output in China since 1980?

- A) accumulation of capital
- B) technological progress
- C) a transition from central planning to a market economy
- D) all of the above

Answer: C

Diff: 2

13) How many countries are in the European Union?

- A) 27
- B) 6
- C) 21
- D) 17

Answer: A

Diff: 2

14) How many countries are in the Euro area?

- A) 17
- B) 27
- C) 21
- D) 11

Answer: A

Diff: 2

15) Most economists believe that the source of European high unemployment in the past two decades is

- A) labor market institutions.
- B) tight monetary policy.
- C) tight fiscal policy.
- D) financial crisis.

Answer: A

Diff: 2

## 1.2 Essay Questions

1) Briefly explain the disagreement among economists about how and when to reduce U.S. budget deficit.

Answer: Some economists argue that deficit reduction should start now and proceed rapidly. Other economists argue that too fast a reduction in deficit would be dangerous. The disagreement on how deficit reduction should be achieved is along political lines. Republicans believe that it should be done primarily through decreases in spending. Democrats are more inclined to do the adjustment through an increase in taxes.

2) Briefly explain why the decline in housing prices led to a major financial crisis.

Answer: Many of the mortgage loans that had been given out during earlier expansion were of poor quality. Many of the borrowers had taken too large a loan and were increasingly unable to make mortgage payments. mortgage backed securities were so complex that their value was nearly impossible to assess. Not knowing the quality of the assets that other banks had on their balance sheet, banks became very reluctant to lend to each other for fear that the bank to which they lent might not be able to repay. The credit market froze up. Unable to borrow, and with assets of uncertain value, many banks found themselves in trouble. The bankruptcy of Lehman Brothers put other banks at risk of going bankrupt as well. The whole financial system was in trouble.

3) Explain how the financial crisis turned into a major economic crisis.

Answer: Hit by the decrease in housing prices and the collapse in stock prices, and worried that this might be the beginning of another Great Depression, people sharply cut back consumption. Worried about sales and uncertain about the future, firms sharply cut back investment. Decreases in consumption and investment led to a decrease in demand, which in turn, led to a decrease in output.

4) Discuss the types of policies that could be implemented to reduce European unemployment.

Answer: There are basically two sets of policies. First, policy makers could reduce labor market rigidities that some economists believe have contributed to the high unemployment. Some examples of labor market rigidities are high unemployment benefits, high minimum wages, and excessive job protection regulations. The second set of policies includes bad labor relations and inadequate macroeconomic policies.

5) Discuss what is meant by labor market rigidities and explain how they might cause the relatively high unemployment in Europe.

Answer: Examples of labor market rigidities are: relatively high minimum wage, relatively high unemployment benefits, and relatively high level of worker protection. All three of these are hypothesized to cause a reduction in employment and, therefore, an increase in the unemployment rate.

6) Discuss some of the potential benefits and costs of the adoption of the Euro.

Answer: One of the benefits of the Euro is largely symbolic. Countries that have in the past century been in wars against each other are now using the same currency. There are economic benefits as well. The use of the same currency will eliminate the need to convert currencies when, for example, buying foreign goods from a country that has also adopted the Euro. One of the possible costs of the Euro is that it will force countries to pursue the same monetary policy. No longer will policy makers in these countries pursue independent monetary policy.

7) What are the two primary sources of economic growth in China since 1980?

Answer: The relatively high output growth in China has occurred as a result of capital accumulation and technological progress.

8) In addition to capital accumulation and technological progress, what are some of the other possible explanations for recent output growth in China?

Answer: There are several additional potential causes of economic growth in China. These are: (1) the transition from central planning to a market economy; (2) the encouragement of joint ventures with foreign firms; and (3) protection of property rights.

9) Explain why the U.S. crisis became a world crisis.

Answer: Other countries were affected through two channels. The first channel was trade. As U.S. consumers and firms cut spending, part of the decrease fell on imports of foreign goods. The second channel was financial. U.S. banks, badly needing funds in the United States, repatriated from other countries, creating problems for banks in those countries. The result was not just a U.S., but a world recession.

10) What problems remain in advanced countries after the crisis?

Answer: Both in the United States and the Euro area, unemployment remains very high. What is behind this persistently high unemployment is low output growth, and behind this low growth are many factors like declining housing prices and low housing investment. Banks are still not in good shape, and bank lending is still tight. Consumers are cutting consumption. And the crisis has led to a large increase in budget deficits, which have in turn led to a large increase in public debt over time. Countries must now reduce their deficits, and this is proving difficult. In some European countries, governments may not be able to adjust and may default on their debt.