Quiz # 2  
Dr. Nath

Multiple Choice  
Identify the choice that best completes the statement or answers the question.

____ 1. Suppose the price of gasoline increases rapidly and consumers respond by buying a smaller quantity of gasoline. The consumer price index  
a. reflects this price increase accurately.  
b. understates this price increase due to the substitution bias.  
c. overstates this price increase due to the income bias.  
d. overstates this price increase due to the substitution bias.

____ 2. Laura bought word-processing software in 2005 for $50. Laura's twin brother, Laurence, bought an upgrade of the same software in 2006 for $50. To which problem in the construction of the CPI is this situation most relevant?  
a. substitution bias  
b. unmeasured quality change  
c. introduction of new goods  
d. income bias

____ 3. Suppose OPEC succeeds in raising world oil prices by 300 percent. This price increase causes inventors to look at alternative sources of fuel for internal-combustion engines. A hydrogen-powered engine is developed which is cheaper to operate than gasoline engines. Which problems in the construction of the CPI does this situation represent?  
a. substitution bias and introduction of new goods  
b. introduction of new goods and unmeasured quality change  
c. substitution bias and unmeasured quality change  
d. income bias and substitution bias

____ 4. The consumer price index is used to  
a. monitor changes in the level of wholesale prices in the economy.  
b. monitor changes in the cost of living over time.  
c. monitor changes in the level of real GDP over time.  
d. monitor changes in the stock market.

____ 5. When the consumer price index falls, the typical family  
a. has to spend more dollars to maintain the same standard of living.  
b. can spend fewer dollars to maintain the same standard of living.  
c. finds that its standard of living is not affected.  
d. can save less because they do not need to offset the effects of rising prices.

____ 6. The term inflation is used to describe a situation in which  
a. the overall level of prices in the economy is increasing.  
b. incomes in the economy are increasing.  
c. stock-market prices are rising.  
d. the economy is growing rapidly.
7. The CPI is calculated
   a. monthly by the Department of Commerce.
   b. monthly by the Bureau of Labor Statistics.
   c. quarterly by the Department of Commerce.
   d. quarterly by the Bureau of Labor Statistics.

8. In calculating the CPI, a fixed basket of goods and services is used. The quantities of the goods and services in the fixed basket are determined by
   a. surveying consumers.
   b. surveying sellers of the goods and services.
   c. working backward from the rate of inflation to arrive at imputed values for those quantities.
   d. arbitrary choices made by federal government employees.

9. In computing the consumer price index, a base year is chosen. Which of the following statements about the base year is correct?
   a. The base year is always the first year among the years for which computations are being made.
   b. It is necessary to designate a base year only in the simplest case of two goods; in more realistic cases, it is not necessary to designate a base year.
   c. The value of the consumer price index is always 100 in the base year.
   d. The base year is always the year in which the cost of the basket was highest among the years for which computations are being made.

10. The price index was 120 in 2006 and 127.2 in 2007. What was the inflation rate?
    a. 5.7 percent
    b. 6.0 percent
    c. 7.2 percent
    d. 27.2 percent
Quiz #2  

Dr. Nath [Answer Strip]

_____ 1. D

_____ 2. B

_____ 3. A

_____ 4. B

_____ 5. B

_____ 6. A

_____ 7. B

_____ 8. A

_____ 9. C

_____ 10. B

A

B

D

C

B

A

B

A

B

A