Quiz # 3

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

C  1. The inflation rate is calculated
   a. by determining the change in the price index from the preceding period.
   b. by determining the change in the price index from the base year.
   c. by determining the percentage change in the price index from the preceding period.
   d. by determining the percentage change in the price index from the base year.

C  2. If the quality of a good deteriorates while its price remains the same, then the value of a dollar
   a. rises and the cost of living increases.
   b. rises and the cost of living decreases.
   c. falls and the cost of living increases.
   d. falls and the cost of living decreases.

A  3. Which of the following is the most accurate statement about the effects of quality change on the CPI?
   a. Even though the BLS adjusts the prices of products in the CPI basket when the quality of the products change, changes in quality are still a problem because quality is so hard to measure.
   b. Because the BLS adjusts the prices of products in the CPI basket when the quality of the products change, changes in quality are no longer a problem for the CPI.
   c. The BLS does not adjust the CPI for quality changes.
   d. Most economists believe that changes in the quality of goods included in the CPI basket do not bias the CPI as a measure of the cost of living.

B  4. Indexation refers to
   a. a process of adjusting the nominal interest rate so that it is equal to the real interest rate.
   b. using a law or contract to automatically correct a dollar amount for the effects of inflation.
   c. using a price index to deflate dollar values.
   d. an adjustment made by the Bureau of Labor Statistics to the CPI so that the index is in line with the GDP deflator.

B  5. Which of the following statements is correct about the relationship between the nominal interest rate and the real interest rate?
   a. The real interest rate is the nominal interest rate times the rate of inflation.
   b. The real interest rate is the nominal interest rate minus the rate of inflation.
   c. The real interest rate is the nominal interest rate plus the rate of inflation.
   d. The real interest rate is the nominal interest rate divided by the rate of inflation.

A  6. If the nominal interest rate is 6 percent and the rate of inflation is 9 percent, then the real interest rate is
   a. -3 percent.
   b. -0.33 percent.
   c. 3 percent.
   d. 15 percent.
7. When the relative price of a good decreases, consumers respond by buying
   a. a larger quantity of that good and a larger quantity of substitutes for that good.
   b. a larger quantity of that good and a smaller quantity of substitutes for that good.
   c. a smaller quantity of that good and a larger quantity of substitutes for that good.
   d. a smaller quantity of that good and a smaller quantity of substitutes for that good.

8. To which of the problems in the construction of the CPI is the invention of pocket-sized computers most relevant?
   a. substitution bias
   b. introduction of new goods
   c. unmeasured quality change
   d. income bias

9. The GDP Deflator reflects
   a. the prices of all final goods and services currently produced domestically, as does the CPI.
   b. the price of a fixed basket of goods and services purchased by a typical consumer, as does the CPI.
   c. the prices of all final goods and services currently produced domestically, while the CPI reflects the price of a fixed basket of goods and services purchased by a typical consumer.
   d. the price of a fixed basket of goods and services purchased by a typical consumer, while the CPI reflects the prices of all final goods and services produced domestically.

10. Which of the following is not a widely acknowledged problem with using the CPI as a measure of the cost of living?
    a. substitution bias
    b. introduction of new goods
    c. unmeasured quality change
    d. unmeasured price change