

## Chapter 24 Measuring the Cost of Living Practice Test

### Multiple Choice

Identify the letter of the choice that best completes the statement or answers the question.

- \_\_\_\_\_ 1. What is the basket of goods used to construct the CPI?
- A random sample of all goods and services produced in the economy.
  - The goods and services determined by the American Medical Association to be most healthy.
  - The goods and services typically bought by consumers, according to Bureau of Labor Statistics surveys.
  - the least expensive goods and services in each major category of consumer expenditures.
- \_\_\_\_\_ 2. When constructing the CPI, the Bureau of Labor Statistics tries to include
- all goods and services produced in the economy.
  - all goods and services purchased in the economy.
  - all goods and services that typical consumers buy.
  - The Bureau of Labor Statistics does not construct the CPI.
- \_\_\_\_\_ 3. The steps involved in calculating the consumer price index include, in order:
- fix the basket, find the prices, compute the basket's cost, choose a base year and compute the index, compute the inflation rate
  - choose a base year, find the prices, fix the basket, compute the basket's cost, compute the index and the inflation rate
  - fix the basket, find the prices, compute the inflation rate, choose a base year and compute the index
  - choose a base year, fix the basket, compute the inflation rate, compute the basket's cost and compute the index
- \_\_\_\_\_ 4. The price index in the first year is 125, in the second year is 150, and in the third year is 200. What is the inflation rate between the first and second year and between the second and third year?
- 20 percent between the first and second year, 33 percent between the second and third year
  - 50 percent between the first and second year, 100 percent between the second and third year
  - 25 percent between the first and second year, 75 percent between the second and third year
  - 25 percent between the first and second year, 50 percent between the second and third year
- \_\_\_\_\_ 5. Which change in the price index shows the greatest rate of inflation: 80 to 96, 100 to 125, or 150 to 180?
- 80 to 96
  - 100 to 125
  - 150 to 180
  - All changes show the same rate of inflation.
- \_\_\_\_\_ 6. When prices change by differing amounts, consumers substitute \_\_\_\_\_ the goods that have become relatively \_\_\_\_\_ expensive.

- a. toward, more
- b. away from, more
- c. toward, less
- d. Both b and c are correct.

**Table 23-1**

The following questions are based on the information below:

Wally Plowman earns \$3,000 from his farm operation in 1945. In 2005, Wally's grandson Vern earns \$30,000 from the same farm. The price index for 1945 is 10, and the price index for 2005 is 150.

- \_\_\_\_\_ 7. Refer to Table 23-1. What is Wally's income in 2005 dollars?
  - a. \$3,000
  - b. \$30,000
  - c. \$45,000
  - d. \$130,000

**Table 23-2**

The following questions are based on the information below:

Ingrid takes a university teaching job as an assistant professor in 1972 at a salary of \$10,000. By 2002, she has been promoted to full professor, with a salary of \$50,000. The price index in 1972 is 50, and the price index in 2002 is 125.

- \_\_\_\_\_ 8. Refer to Table 23-2. What is Ingrid's 1972 salary in 2002 dollars?
  - a. \$125,000
  - b. \$50,000
  - c. \$25,000
  - d. \$10,000

**Table 23-3**

The following questions are based on the information below:

Marie is offered a job in Boston at a salary of \$60,000 per year. She is also offered a job in Austin at a salary of \$50,000 per year. The CPI for Boston is 120, and the CPI for Austin is 80.

- \_\_\_\_\_ 9. Refer to Table 23-3. What is the purchasing power of the Boston salary in Austin dollars?
  - a. \$40,000
  - b. \$84,000
  - c. \$50,000
  - d. \$72,000
- \_\_\_\_\_ 10. Refer to Table 23-3. If all Marie cares about is the purchasing power of her income, which job should she take?
  - a. the Austin job
  - b. the Boston job

- c. either job
  - d. It is impossible to make a comparison of purchasing power with the information given.
- \_\_\_ 11. Refer to Table 23-3. What is the purchasing power of the Austin salary in Boston dollars?
- a. \$40,000
  - b. \$50,000
  - c. \$60,000
  - d. \$75,000
- \_\_\_ 12. When box office receipts are corrected for inflation, the No. 1 movie of all time is
- a. Titanic.
  - b. Star Wars.
  - c. ET.
  - d. Gone With the Wind.
  - e. The Sound of Music.
- \_\_\_ 13. When some dollar amount is automatically corrected for inflation by law or contract, the amount is said to be
- a. indexed for inflation.
  - b. deflated.
  - c. corrected for inflation.
  - d. inflated.
- \_\_\_ 14. The nominal interest rate tells you
- a. how fast the number of dollars in your bank account rises over time.
  - b. how fast the purchasing power of your bank account rises over time.
  - c. the number of dollars in your bank account.
  - d. the purchasing power in your bank account.
- \_\_\_ 15. Babe Ruth, the famous baseball player, earned \$80,000 in 1931. Today, the best baseball players can earn 100 times as much as did Babe Ruth in 1931. However, prices have also risen since 1931. We can conclude that
- a. the best baseball players today are about 100 times better off than Babe Ruth was in 1931.
  - b. because prices have also risen, the standard of living of baseball stars hasn't changed since 1931.
  - c. one cannot make judgements about changes in the standard of living based on changes in prices and changes in incomes.
  - d. one cannot determine whether baseball stars today enjoy a higher standard of living than Babe Ruth did in 1931 without additional information regarding increases in prices since 1931.
- \_\_\_ 16. For any given year, the CPI is
- a. the price of the basket of goods and services in the base year divided by the price of the basket in the given year, then divided by 100.
  - b. higher than the previous year.
  - c. the price of the basket of goods and services in the base year divided by the price of the basket in the given year, then multiplied by 100.
  - d. the price of the basket of goods and services in the given year divided by the price of the basket in the base year, then multiplied by 100.

- \_\_\_\_\_ 17. Laura buys word processing software in 2001 for \$50. Laura's twin brother Laurence buys an upgrade of the same software in 2002 for \$50. What problem in the construction of the CPI does this situation best represent?
- substitution bias
  - unmeasured quality change
  - introduction of new goods
  - all of the above
  - none of the above
- \_\_\_\_\_ 18. Most studies conclude that the consumer price index
- overstates inflation by about 1 percentage point per year.
  - understates inflation by about 1 percentage point per year.
  - overstates inflation by about 3 percentage points per year.
  - understates inflation by about 3 percentage points per year.
- \_\_\_\_\_ 19. 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 \$87,000.
  - about \$870,000.
  - about \$1,870,000.
  - about \$8,700,000.