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for

Macroeconomics

Twelfth Edition

Mihajlo Balic

Palm Beach Community College

Executive Editor: David Alexander
Editorial Project Manager: Lindsey Sloan
Associate Production Project Manager: Alison Eusden

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***Macroeconomics, 12e* (Gordon)**
Chapter 1 What Is Macroeconomics?

1.1 How Macroeconomics Affects Our Everyday Lives

1) Macroeconomics is the study of
A) the economic issues which affect individual well-being and individual firms' profit levels.
B) the economic issues which affect foreign and domestic prices of related goods and services.
C) inflation and poverty at the level of the household.
D) the economic issues which affect the nation's total income, employment, and output.
Answer: D
Question Status: New

2) Political incumbents often gain or lose re-election because of a strong or weak economy. Which of the following is an exception to that rule?
A) Al Gore
B) George H.W. Bush
C) Jimmy Carter
D) Herbert Hoover
Answer: A
Question Status: Previous Edition

3) The "Big Three" concepts of Macroeconomics are
A) profits, liquidity, and sustainability.
B) unemployment rate, inflation, and economic growth.
C) asset rebalancing, markups, and profitability.
D) federal budget, foreign trade, and quantitative easing.
Answer: B
Question Status: New

4) Economy with no productivity growth is called the
A) zero-sum society.
B) zero-growth society.
C) export-led society.
D) doomed-to-fail society.
Answer: A
Question Status: New

5) The inflation rate is the
A) measure used to calculate the price level.

B) measure used to calculate the cost of borrowing money.
C) percentage increase in the average level of prices.
D) percentage increase in the average level of wages.
Answer: C
Question Status: Previous Edition

6) A rising inflation rate tends to help the following types of people:
A) retirees and students with savings accounts.
B) borrowers and homeowners without mortgages.
C) homeowners with mortgages and students with loans.
D) landowners and borrowers.
Answer: C
Question Status: Previous Edition

7) A rising inflation rate tends to injure the following types of people:
A) retirees and students with savings accounts.
B) borrowers and homeowners.
C) homeowners with mortgages and students with student loans.
D) landowners and borrowers.
Answer: A
Question Status: Previous Edition

8) Inflation tends to redistribute income from
A) savers to borrowers.
B) borrowers to savers.
C) homeowners to landowners.
D) parents to students.
Answer: A
Question Status: Previous Edition

9) A high inflation rate will
A) harm those who have saved while helping those who have borrowed.
B) harm those who have borrowed while helping those who have saved.
C) harm those who have saved and those who have borrowed.
D) benefit those who have saved and those who have borrowed.
Answer: A
Question Status: Previous Edition

10) Which of the three central concepts in macroeconomics is cited in the textbook as being linked to crime, mental illness, and suicide?
A) the inflation rate
B) the unemployment rate
C) productivity growth
D) None of the above is cited as being linked to these events.
Answer: B
Question Status: Previous Edition

11) A high current rate of inflation ________ those who have saved and ________ those who have borrowed.
A) harms, helps
B) harms, has no effect on
C) helps, helps
D) helps, has no effect on
E) helps, harms
Answer: A
Question Status: Previous Edition

12) The average output produced per worker is one way of measuring
A) inflation.
B) the interest rate.
C) employment.
D) productivity.
Answer: D
Question Status: Previous Edition

13) To avoid the conflicts and suffering of a "zero-sum society," an economy must maintain a
A) positive rate of productivity growth.
B) positive rate of inflation.
C) foreign trade surplus
D) government budget deficit.
Answer: A
Question Status: Previous Edition

14) The branch of macroeconomics concerned with changes in the natural real GDP is the theory of
A) business cycles.
B) economic growth.
C) GDP gaps.
D) unemployment.
Answer: B
Question Status: Previous Edition

15) The central macroeconomic concept that is most clearly related to changes in the well-being of the *average* member of the economy is the
A) unemployment rate.
B) inflation rate.
C) productivity growth rate.
D) None of the above is closely related.
Answer: C
Question Status: Previous Edition

1.2 Defining Macroeconomics

1) Among the subjects covered in macroeconomics are the
A) unemployment rate for the entire labor force, and the causes of the increase in the overall price level.
B) causes of the increase in the price of oil relative to other commodities.
C) effects of low wages on the laborers' moral.
D) causes of the change in the individual firms' profits.
Answer: A
Question Status: Previous Edition

2) Which of the following does Gordon believe people consider the single most important macroeconomic issue today?
A) inflation
B) poverty
C) unemployment
D) low productivity
Answer: C
Question Status: Previous Edition

3) The unemployment rate is the number of
A) people looking for work divided by the population.
B) jobless individuals divided by the total labor force.
C) jobless people looking for work divided by the population.
D) jobless individuals looking for work divided by those employed and unemployed but actively looking.
Answer: D
Question Status: Previous Edition

4) Generally, the higher the level of output in an economy is the ________ will be.
A) lower the unemployment rate and inflation rate
B) higher the unemployment rate and inflation rate
C) higher the unemployment rate and the lower inflation rate
D) lower the unemployment rate and the higher inflation rate
Answer: D
Question Status: Previous Edition

5) A low unemployment rate implies that
A) job offers are scarce and inflation is high.
B) job offers are plentiful and wages are high.
C) jobs are permanent and job offers are plentiful.
D) jobs are difficult to find, and wages are low.
Answer: B
Question Status: Previous Edition

6) Microeconomics focuses on
A) the relationships among the different parts of the economy.
B) the totals, or aggregates, of the economy.
C) unemployment.
D) business cycles.
Answer: A
Question Status: New

7) Macroeconomics is the study of
A) the role of the individual in an economy.
B) The overall performance of an economy.
C) how a private economy would function in the absence of government involvement.
D) how one economy trades with other economies.
E) the role of government in an economy.
Answer: B
Question Status: Previous Edition

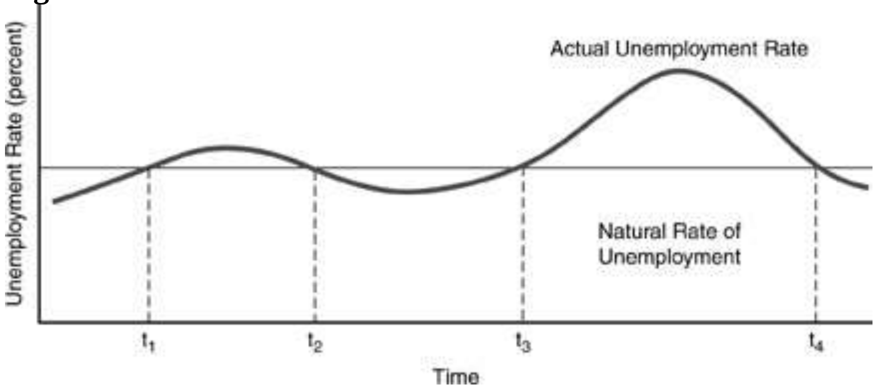
8) Do macroeconomic issues concern the well-being of the typical individual member of an economy?
A) No, since we are focusing on the behavior of aggregate quantities.
B) No, since most individuals have little contact with other economies in the world.
C) Yes, since macroeconomic events have widespread effects on everyday lives.
D) Yes, since macroeconomics focuses on the decisions constantly being made by the average individual.
Answer: C
Question Status: Previous Edition

9) Macroeconomics focuses on a certain set of variables called
A) micros.
B) marginals.
C) partials.
D) balances.
E) aggregates.
Answer: E
Question Status: Previous Edition

10) As an example of the simplifications that make economic theorizing possible, the major economic "totals" are assumed to be constant in the study of
A) government budget deficits.
B) macroeconomics.
C) economic aggregates.
D) microeconomics.
E) unemployment and inflation.
Answer: D
Question Status: Previous Edition

1.3 Actual and Natural Real GDP

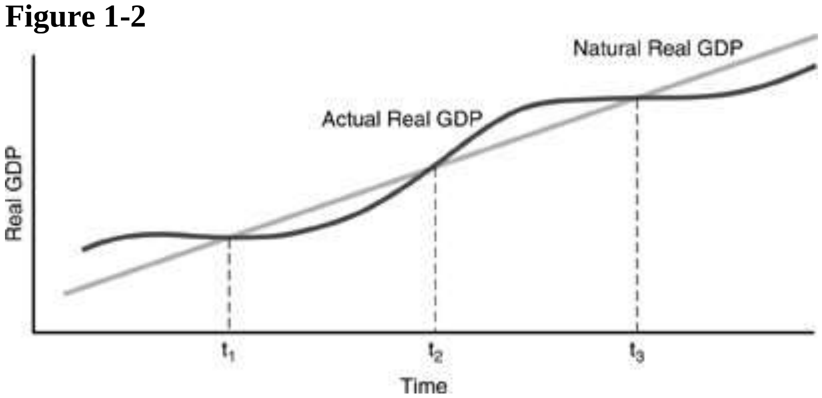
Figure 1-1



1) When the actual unemployment rate is likely to exceed the natural rate of unemployment, as in the time intervals between t_1 and t_2 and t_3 and t_4 in Figure 1-1 above, we can expect that

A) inflation is speeding up and real GDP is likely to exceed natural GDP.
B) inflation is slowing down and real GDP is likely to fall below natural GDP.
C) inflation is speeding up and natural GDP is likely to exceed real GDP.
D) inflation is slowing down and real GDP is likely to exceed natural GDP.
Answer: B
Question Status: Previous Edition

Figure 1-2



2) When the actual real GDP exceeds the natural real GDP as in Figure 1-2 above, we expect to find that unemployment is

A) high and inflation is high.
B) low and inflation is high.
C) low and inflation is low.
D) high and inflation is low.
Answer: B
Question Status: Previous Edition

3) The natural level of real GDP is that level of
A) real GDP at which the price level will continue increasing.
B) nominal GDP at which the price level will remain constant.
C) real GDP at which there is no tendency for inflation to accelerate or decelerate.
D) Nominal real GDP at which the price level will continue to decrease.
Answer: C
Question Status: New

4) Which of the following is a criterion by which Gordon judges the desirability of any given level of actual real GDP?
A) Actual real GDP is too low if it causes the unemployment rate to be higher than necessary.
B) Actual real GDP is too high if it strains a nation's ability to produce and puts upward pressure on the inflation rate.
C) Actual real GDP is at a desirable level if there is no tendency for inflation to accelerate or decelerate.
D) All of the above.
Answer: D
Question Status: Previous Edition

5) The *output gap* is zero when
A) Actual real GDP > Natural real GDP.
B) Actual real GDP = Natural real GDP.
C) Actual real GDP < Natural real GDP.
D) Natural real GDP = 0.
Answer: B
Question Status: Previous Edition

6) The "zero sum" society is
A) a society that has reached its limit in population growth and has placed quotas on its birth rate.
B) a society where the rate of growth of GDP minus the inflation rate equals zero.
C) a society in which the fluctuations of GDP around the natural level of output sum to zero.
D) a society with no productivity growth in which any additional good enjoyed by one person requires that something be taken away from someone else.
Answer: D
Question Status: Previous Edition

7) Business cycles in the United States
A) tend to occur at regular intervals and are periodic.
B) tend to recur at irregular intervals, but are usually of the same length.
C) were quite common before World War II but have not occurred in the postwar period.
D) tend to have expansions that last longer than the recessions.
Answer: D
Question Status: Previous Edition

8) "Natural" real GDP is defined as the total output
A) at business cycle peaks.
B) at business cycle troughs.
C) that causes an inflation rate of zero.
D) that causes the inflation rate to remain constant.
E) produced when all of our resources are being used to their maximum capacity.
Answer: D
Question Status: Previous Edition

9) When actual real GDP is equal to the natural real GDP, the unemployment rate is
A) zero.
B) at its "natural" rate.
C) accelerating.
D) decelerating.
Answer: B
Question Status: Previous Edition

10) Suppose that the natural rate of unemployment is 5.7 percent. If unemployment has for some time been varying between 5.1 and 5.3 percent, we should be at an actual real GDP ________ the natural real GDP, and should expect inflation to be ________.
A) below, slowing down
B) below, speeding up
C) above, slowing down
D) above, constant
E) above, speeding up
Answer: E
Question Status: Previous Edition

11) We are told that over the past year actual real GDP has risen by three percent. This fact alone is enough to tell us that
A) the unemployment rate has fallen.
B) the inflation rate has risen.
C) the actual real GDP is above natural real GDP.
D) productivity has grown.
E) none of the above.
Answer: E
Question Status: Previous Edition

1.4 Macroeconomics in the Short Run and Long Run

1) The period of the business cycle between the peak and the trough is the
A) recession.
B) expansion.
C) recovery.
D) All of the above may fall between the peak and the trough.
Answer: A
Question Status: Previous Edition

2) The period of the business cycle which follows the trough is the
A) recession.

B) expansion.
C) peak.
D) All of the above may follow the trough.
Answer: B
Question Status: Previous Edition

3) Immediately following a business cycle "peak" comes a
A) "trough."
B) "recession."
C) "expansion."
D) "recurrence."
Answer: B
Question Status: Previous Edition

4) At a business cycle peak, we usually have ________ real Gross Domestic Product.
A) an all-time high level of
B) an all-time low level of
C) an historically average level of
D) accelerating growth of
E) the maximum growth rate of
Answer: A
Question Status: Previous Edition

5) Approaching a business cycle trough we find actual real GDP ________ natural real GDP, so inflation is ________.
A) below, slowing down
B) below, speeding up
C) above, slowing down
D) above, speeding up
Answer: A
Question Status: Previous Edition

6) Approaching a business cycle peak, actual real GDP ________ natural real GDP, which causes inflation to ________.
A) exceeds, remain constant
B) exceeds, accelerate
C) is less than, decelerate
D) equals, accelerate
E) equals, remain constant
Answer: B
Question Status: Previous Edition

7) Given the path of natural real GDP growth, economists prefer an economy such as ________, in which the real GDP gaps are ________.
A) Stabilia's, minimized
B) Stabilia's, maximized
C) Volatilia's, minimized
D) Volatilia's, maximized
Answer: A
Question Status: Previous Edition

8) In an economy where actual real GDP is always equal to the natural real GDP, inflation
A) settles down to zero percent.
B) is at the same rate as GDP growth.
C) is constant at a rate that can be low or high.
D) fluctuates around an average of zero percent.
Answer: C
Question Status: Previous Edition

1.5 Case Study: How Does the Global Economic Crisis Compare to Previous Business Cycles?

1) Between 1900 and 2007, the ratio of actual to natural real GDP hit its low point in
A) 1933.
B) 1904.
C) 1944.
D) 1982.
Answer: A
Question Status: Previous Edition

2) In 1991 the unemployment rate in the United States rose to 7.1 percent. This is ________ the unemployment rate reached in the depths of the Great Depression.
A) about two percentage points more than
B) roughly equal to
C) about three percentage points less than
D) about half of
E) less than one-third of
Answer: E
Question Status: Previous Edition

3) In the United States, the most recent period in which the unemployment rate stayed below the natural unemployment rate for several consecutive years was
A) the early 1930s.
B) the late 1940s.
C) the late 1960s.
D) the mid 1980s.
E) the late 1990s.
Answer: E
Question Status: Previous Edition

4) International influences have become relatively ________ important for the U.S. economy in recent decades, as we become a more ________ economy.

A) less, "open"
B) less, "closed"
C) more, "open"
D) more, "closed"
Answer: C
Question Status: Previous Edition

5) By participating in international financial markets, a nation can finance its government budget deficit in part by ________, which ________ the link between the nation's deficit and its internal private investment.
A) buying foreign assets, strengthens
B) buying foreign assets, weakens
C) selling assets to foreigners, strengthens
D) selling assets to foreigners, weakens
Answer: D
Question Status: Previous Edition

6) Going from a closed to an open economy ________ macroeconomic policymaking, especially now that exchange rates are ________.
A) complicates, flexible
B) complicates, fixed
C) simplifies, flexible
D) simplifies, fixed
Answer: A
Question Status: Previous Edition

7) Prior to 1995 productivity growth in Europe was ________ in the United States.
A) higher than
B) lower than
C) same as
D) None of the above
Answer: A
Question Status: New

8) Compared to the US, the unemployment rate in Europe was ________ throughout the 1960s and 1970s and ________ after 1980.
A) higher; lower
B) lower; higher
C) lower; remained lower
D) higher, remained higher
Answer: B
Question Status: Previous Edition

9) After 1995 U.S. growth rate ________ and the European Rate ________
A) slowed down; speeded up
B) speeded up; slowed down
C) slowed down; slowed down
D) speeded up, speeded up
Answer: B
Question Status: New

1.6 Macroeconomics at the Extremes

1) *Hyperinflation* can be defined as an inflation rate of
A) 50% or more per month.
B) 50% or more per year.
C) 50% or more decade.
D) All of the above are appropriately defined as hyperinflation.
Answer: A
Question Status: Previous Edition

2) The U.S. business cycle record, in common with most, has
A) peaks lasting longer than troughs.
B) troughs lasting longer than peaks.
C) recessions lasting longer than expansions.
D) expansions lasting longer than recessions.
Answer: D
Question Status: Previous Edition

3) Over the period between 1960 and 2010, the increase in unemployment rate was the greatest in
A) early 1960s.
B) late 2000s.
C) mid 1970s.
D) early 1980s.
E) early 1990s.
Answer: B
Question Status: New

4) The recession of 1990-1992 ________ the trend set over 1965-1990 of ________ unemployment rates at each successive cyclical trough.
A) continued, lower
B) continued, higher
C) broke, lower
D) broke, higher
Answer: D
Question Status: Previous Edition

5) Which of the following contributed to the emergence of hyperinflation in Germany in the early 1920s?
A) payment of massive war reparations required by the Versailles Peace Treaty
B) huge budget deficits financed by printing paper money
C) decreased desire to hold money on the part of the German people
D) All of the above
Answer: D
Question Status: Previous Edition

6) Gordon states that ________ caused the substantial increase in the standard of living in South Korea relative to that of the Philippines during the period 1960-2010.
A) lower unemployment rates
B) higher inflation rates
C) higher rate of growth in per capita real GDP.
D) All of the above
Answer: C
Question Status: New

7) In 1999 the European unemployment rate was ________ that in the United States.
A) double
B) triple
C) equal to
D) lower compared to
Answer: A
Question Status: New

1.7 Taming Business Cycles: Stabilization Policy

1) Are government activities of any concern to macroeconomists?
A) Yes, since government actions and policies can affect an economy's overall performance.
B) Yes, since macroeconomics is defined as the study of the role that government plays in the economy.
C) No, since the government cannot affect the functioning of the private economy.
D) No, since macroeconomists study hypothetical economies that have no government involvement at all.
Answer: A
Question Status: Previous Edition

2) In policy discussions macroeconomic aggregates (inflation, unemployment, and productivity) are called
A) monetary variables.
B) fiscal variables.
C) target variables.
D) interest variables.
Answer: C
Question Status: New

3) Much of macroeconomics is concerned with advising governments on ways to ________ business cycles, since it is desirable to ________.
A) amplify, create the greatest cyclical peaks possible

B) amplify, create deep recessions to cool down the economy
C) dampen, avoid both very low troughs and very high peaks
D) dampen, keep the economy at its maximum productive capacity
Answer: C
Question Status: Previous Edition

4) Our business cycle experiences suggest that a macroeconomic policy designed to lower the average rate of inflation will require ________ in actual real GDP and an accompanying ________ in the unemployment rate.
A) an increase, increase
B) an increase, decrease
C) a reduction, increase
D) a reduction, decrease
Answer: C
Question Status: Previous Edition

5) Why would macroeconomists rate economic performance in Speed-Nation superior to that in Stag-Nation? Speed-Nation has
A) milder business cycles.
B) more volatile business cycles.
C) faster economic growth.
D) larger real GDP gaps.
E) smaller real GDP gaps.
Answer: C
Question Status: Previous Edition

6) The proper short-run goal of macroeconomic policymakers is to
A) amplify the business cycle.
B) dampen the business cycle.
C) promote high economic growth.
D) maintain low economic growth.
Answer: B
Question Status: Previous Edition

7) Any policy that seeks to influence the level of aggregate demand is called
A) productivity policy.
B) stabilization policy.
C) aggregate policy.
D) employment policy.
Answer: B
Question Status: New

8) Policy that tries to influence target variables by changing the interest rate is called
A) fiscal policy.
B) interest rate policy.
C) recession policy.
D) monetary policy.
Answer: D
Question Status: New

9) Fiscal policy tries to influence target variables by manipulating
A) money supply.
B) interest rates.
C) government expenditures.
D) All of the above.
Answer: C
Question Status: Previous Edition

10) Policy that tries to influence target variables by changing the tax rates is called
A) fiscal policy.
B) tax rate policy.
C) recession policy.
D) monetary policy.
Answer: A
Question Status: New

11) According to Gordon, for which of the following should policymakers set a target rate of zero?
A) productivity growth
B) inflation rate
C) unemployment rate
D) None of the above
Answer: D
Question Status: Previous Edition

1.8 The "Internationalization" of Macroeconomics

1) There are no questions for this section.
Answer:

***Macroeconomics, 12e* (Gordon)**
Chapter 2 The Measurement of Income, Prices, and Unemployment

2.1 Why We Care About Income

1) Job openings are plentiful when the
A) actual real GDP is above the natural real GDP.
B) natural real GDP is above the actual real GDP.
C) natural real GDP is increasing rapidly.
D) None of the above.
Answer: A
Question Status: Previous Edition

2) The real income per capita is a measure of the
A) well-being of every individual in the nation.
B) well-being of the average individual in the nation.
C) well-being of the average employed person in the nation.
D) total well-being of the nation.
Answer: B
Question Status: Previous Edition

2.2 The Circular Flow of Income and Expenditure

1) GDP can be measured by the
A) total value of all sales in the economy.
B) total market value of final goods and services produced in the economy.
C) total value of all intermediate goods produced in the economy.
D) net national product plus investment.
Answer: B
Question Status: Previous Edition

2) Assume a simple economy without a government and that saving and borrowing behavior is never observed. Then the value of
A) production is equal to income.
B) expenditures is less than the value of production.
C) production is less than the value of expenditures.
D) production is less than income.
Answer: A
Question Status: Previous Edition

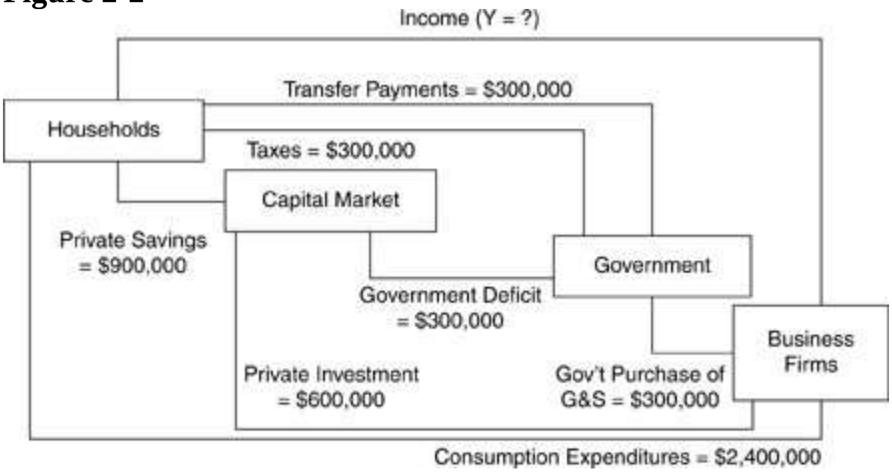
3) From the last five recessions, the mildest two were
A) 1975 and 2008-09 recessions.
B) 1981-82 and 2008-09 recessions.
C) 1990-91 and 2001 recessions.
D) 1975 and 2001 recessions.
Answer: C
Question Status: New

4) The circular flow of income describes the
A) flow of income from domestic firms to the nonproduction sector and back again.
B) amount of money in the economy.
C) sum of all injections into the economy.
D) sum of all withdrawals from the economy.
Answer: A
Question Status: Previous Edition

5) Changes in business inventories
A) are included in gross but not in net investment.
B) can either be positive or negative.
C) are not included in GDP because they are not sold to anyone.
D) are only partly included in GDP because part of these are holdings of intermediate goods.
Answer: B

Question Status: Previous Edition

Figure 2-2



6) Employing the data from Figure 2-2, income Y is equal to
A) $3,000,000.
B) $3,300,000.
C) $3,600,000.
D) $5,100,000.
Answer: B
Question Status: Previous Edition

7) Negative net exports represent reduced investment because
A) payments for imports will be used by foreigners to buy domestic goods in the future.
B) payments for exports will be used by foreigners to buy domestic goods in the future.
C) payments for imports will be used by U.S. citizens to buy domestic goods in the future.
D) None of the above.
Answer: A
Question Status: Previous Edition

8) When the dollar strengthens,
A) exports will increase and U.S. consumers benefit.
B) imports will increase and U.S. consumers benefit.
C) exports will decrease and U.S. exporters benefit.
D) exports will increase and U.S. exporters gain.
Answer: B
Question Status: Previous Edition

9) When the dollar depreciates,
A) exports will increase and U.S. consumers benefit.
B) imports will increase and U.S. consumers benefit.
C) exports will decrease and U.S. exporters benefit.
D) exports will increase and U.S. exporters gain.
Answer: D
Question Status: Previous Edition

10) In the simple circular flow model containing just households and business firms, all income is received by households in exchange for
A) consumer expenditures.
B) wages.
C) labor services.
D) product.
Answer: C
Question Status: Previous Edition

11) In the simple circular flow model containing just households and business firms, the entire product flows to ________ in exchange for ________.
A) business firms, labor services
B) business firms, wages
C) households, consumer expenditures
D) households, labor services
Answer: C
Question Status: Previous Edition

12) Which of the following is NOT a "flow" variable?
A) government debt
B) consumption expenditure
C) labor services
D) income
Answer: A
Question Status: Previous Edition

13) In the second circular-flow model of Chapter 2, households have two uses for their total income:
A) consumption and investment.
B) consumption and saving.
C) saving and investment.
D) saving and payment of taxes.
E) consumption and payment of taxes.
Answer: B
Question Status: Previous Edition

14) The condition in circular-flow models whereby firms purchase all the goods not purchased by households is that
A) inventory investment is zero.
B) saving is zero.
C) fixed investment is zero.
D) consumption equals investment.
E) investment equals saving.
Answer: E
Question Status: Previous Edition

15) An individual buys shares in a mutual fund, which uses the proceeds to buy corporate stocks and bonds. This is part of the process by which
A) total product becomes unequal to total expenditures.
B) firms release goods to make them available to consumers.
C) firms obtain investment goods that consumers relinquish claims to.
D) consumers make an "inventory investment" in goods to be purchased in the future.
Answer: C
Question Status: Previous Edition

16) "Net exports" is defined as
A) GDP minus imports.
B) exports plus imports.
C) GDP minus exports.
D) exports minus imports.
Answer: D
Question Status: Previous Edition

17) With positive net exports, a nation is a net ________, and thus has a ________ "net foreign investment."
A) seller of assets to foreigners, positive
B) seller of assets to foreigners, negative
C) buyer of foreign assets, positive
D) buyer of foreign assets, negative
Answer: C
Question Status: Previous Edition

18) The cars produced by Toyota in its factory in Kentucky ________ in U.S. GDP and ________ in U.S. GNP.
A) count, count
B) count, do not count
C) do not count, count
D) do not count, do not count
Answer: B
Question Status: New

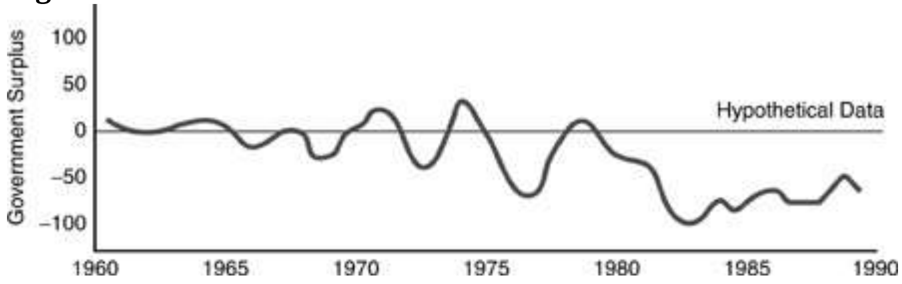
19) In a circular-flow diagram, the saving and taxation "pipes" are carrying
A) injections to firms.
B) injections to households.
C) leakages from firms.
D) leakages from households.
Answer: D
Question Status: Previous Edition

2.3 What GDP Is, and What GDP Is Not

1) The value of steel sold to an automobile producer is ________ directly included in the GDP because ________.
A) always; it was produced during the current period
B) never; to do so is to double count the value of the steel
C) sometimes; the automobile may not be sold in the current period
D) sometimes; the steel is sometimes not resold in the current period
Answer: D
Question Status: Previous Edition

2) Which of the following is NOT an injection?
A) The state of Illinois builds a new courthouse.
B) Kansas farmers sell 1 million bushels of wheat to Russia
C) The Smithsonian Institute purchases Chris Evert Lloyd's tennis racket.
D) An accountant purchases a new personal computer for use in his office.
Answer: C
Question Status: Previous Edition

Figure 2-1



3) Assuming a closed economy (i.e., NX = O) the data in Figure 2-1 suggest that for each year after 1980
A) private saving could have been either positive or negative.
B) private saving was negative.
C) private saving was positive.
D) private saving equaled zero.
Answer: C
Question Status: Previous Edition

4) Which of the following government outlays would be classified as a transfer payment?
A) payments of veterans benefits under the GI bill
B) interest on the federal debt
C) subsidies to gold-mining firms
D) all of these
Answer: D
Question Status: Previous Edition

5) Suppose that steel produced this year is used to produce a car sold next year. The value of the steel ________ included in GDP this year as ________.
A) is; an intermediate good
B) is not; an intermediate good
C) is; an adjustment to inventories
D) is not; an adjustment to inventories
Answer: C
Question Status: Previous Edition

6) An intermediate good is
A) always counted when measuring GDP because it doesn't represent time spent in production of a final good or service.
B) a good whose value is of neither a high grade nor a low grade.
C) a good that is sold to the government and then redistributed to the poor.
D) any good that is resold by its purchaser rather than used as is.
Answer: D
Question Status: Previous Edition

7) Which of the following would be included in total final product (GDP)?
A) Social Security
B) unemployment benefits.
C) U.S. semiconductors that are bought by a firm in Hong Kong
D) product produced in Canada that is bought by a firm in the U.S.
Answer: C
Question Status: New

8) Which of the following components of the current account are included in GDP?
A) net exports
B) net foreign investment income
C) net transfer payments sent to foreigners
D) all of the above
Answer: A
Question Status: Previous Edition

9) In calculating GDP, "transfer payments" are
A) included because they are re-valuations of existing wealth.
B) excluded because no goods or services were produced in exchange for them.
C) included because they are payments for labor services.
D) excluded because used goods already counted the year they were produced.
Answer: B
Question Status: Previous Edition

10) A restaurant purchases a package of sandwich buns for 50 cents. The buns are ________ good in this case, and thus its purchase ________ a transaction that is included in GDP.
A) a final, is
B) a final, is not
C) an intermediate, is
D) an intermediate, is not
Answer: D
Question Status: Previous Edition

11) A family purchases a package of sandwich buns at a supermarket. Are those buns considered a "final" good?
A) No, because they are an intermediate ingredient in the actual final good: sandwiches.
B) Yes, if the family eats them and does not sell the sandwiches made from them.
C) No, because the supermarket bought the finished buns, so they are "used" goods by the time the family buys them.
D) Yes, for so long as it is sold on the market it is a final good.
Answer: B
Question Status: Previous Edition

12) A farmer sells raw milk for 50 cents to a dairy, who sells cheese made from it for $1.50 to a grocery wholesaler, who sells it for $1.90 to a supermarket, who sells it to the final consumer for $2.19. These transactions increase the GDP by
A) $0.50 + $1.00 + $0.40 + $0.29 = $2.19.
B) $0.50 + $1.00 + $1.90 + $2.19 = $5.59.
C) $0.50 + $1.00 = $1.50.
D) $2.19 - $1.50 = $0.69.
E) $2.19 - $0.50 = $1.69.
Answer: A
Question Status: Previous Edition

13) Adding up all transactions in the economy ________ "double counting" and thus produces ________ measure of GDP.
A) avoids, a proper
B) avoids, an improper
C) results in, a proper
D) results in, an improper
Answer: D
Question Status: Previous Edition

2.4 Components of Expenditure

1) It is important to distinguish investment expenditures from consumption expenditures because
A) households invest and business firms consume.
B) foreign firms invest and domestic firms consume
C) investment, not consumption, increases the natural real GDP.
D) consumption, not investment, increases natural real GDP.
Answer: C
Question Status: New

2) By definition, when the economy is in equilibrium it must be true that
A) leakages equal injections.
B) saving equals investment.
C) government spending equals taxes.
D) exports equal imports.
Answer: A
Question Status: Previous Edition

3) The difference between gross investment and net investment is
A) equal to the difference between GDP and disposable income.
B) equal to the government deficit.
C) equal to capital consumption allowances.
D) equal to the difference between gross and net exports.
Answer: C
Question Status: Previous Edition

4) Which of the following is NOT a leakage?
A) import of a Toyota
B) export of a Cadillac
C) personal saving
D) indirect business taxes
Answer: B
Question Status: Previous Edition

Table 2-1

Item	Billions of Dollars
a. Personal Consumption	1970
b. Capital Consumption Allowance	360
c. Personal Interest Payments	60
d. Indirect Business Taxes	260
e. Corporate Dividends	80
f. Federal Purchases of Goods and Services	300
g. Inventory Change	40
h. Social Security Contributions	220
i. Nonresidential Fixed Investment	240
j. Exports	300
k. Personal Taxes	400
l. After-tax Corporate Profits	180
m. Government Transfer and Interest Payments	440
n. Corporate Income Taxes	90
o. Import	280
p. State and Local Purchases of Goods and Services	340
q. Residential Fixed Investment	140

5) Refer to above Table 2-1. What is the level of Gross Domestic Product?
A) 2690
B) 3050
C) 2430
D) 3010
Answer: B
Question Status: Previous Edition

6) Refer to above Table 2-1. What is the level of National Income?
A) 2630
B) 2420
C) 2660
D) 2430
Answer: D
Question Status: Previous Edition

7) Refer to above Table 2-1. What is the level of Net Private Domestic Investment?
A) 420
B) 780
C) 380
D) 340
Answer: A
Question Status: Previous Edition

8) Refer to above Table 2-1. What is the level of Corporate Profits?
A) 260
B) 180
C) 270
D) 170
Answer: C
Question Status: Previous Edition

9) Refer to above Table 2-1. What is the level of Disposable Personal Income?
A) 2520
B) 1900
C) 2200
D) 2120
Answer: D
Question Status: Previous Edition

10) Refer to above Table 2-1. What is the level of Personal Saving?
A) 100
B) 90
C) 80
D) 130
Answer: B
Question Status: Previous Edition

11) Refer to above Table 2-1. What is the total amount of leakages?
A) 530
B) 1080
C) 970
D) 550
Answer: B
Question Status: Previous Edition

12) Positive net exports are treated like domestic investment in the national income accounts because they are
A) always part of inventories.
B) fixed assets not intended for resale.
C) they represent future flows of real income.
D) not intended for resale.
Answer: B
Question Status: Previous Edition

13) Total expenditures as discussed by Gordon are
A) C + I + G + M.
B) C + S + T + X.
C) C + I + S + X.
D) C + I + G + X - M.
Answer: D
Question Status: Previous Edition

14) The final goods businesses keep for themselves are called
A) assets.
B) savings.
C) investment.
D) sunk costs.
E) intermediate goods.
Answer: C
Question Status: Previous Edition

15) Cans of soup purchased by supermarkets but not sold to individuals in the current period
A) are considered intermediate goods, yet still count in the GDP.
B) are considered intermediate goods, thus do not count in the GDP.
C) are considered investment goods and do count in the GDP.
D) are considered investment goods and thus do not count in the GDP.
E) are considered consumption goods but do not yet count in the GDP.
Answer: C
Question Status: Previous Edition

16) This national income accounting rule guarantees that total product exactly equals total expenditure on that product:
A) changes in inventories count as expenditures.
B) changes in inventories do not count as expenditures.
C) depreciation of capital is subtracted from investment.
D) total product is the sum of values added.
Answer: A
Question Status: Previous Edition

17) Which of the following is included in the GDP?
A) the current services flowing from the housing stock
B) the estimated value of drugs sold illegally
C) the estimated value of leisure time
D) transfer payments such as Social Security and veterans' benefits
E) private purchases of used assets
Answer: A
Question Status: Previous Edition

2.5 The "Magic" Equation and the Twin Deficits

1) Which of the following is NOT one of the ways a budget surplus can be used?
A) to allow private saving to fall without any need for a decline in total investment
B) to stimulate domestic investment
C) to reduce foreign investment
D) to increase the amount of borrowing from foreigners
Answer: D
Question Status: Previous Edition

2) Which of the following is a way to finance a budget deficit?
A) increased private saving
B) decreased domestic investment
C) decreased foreign investment
D) all of the above
Answer: D
Question Status: Previous Edition

3) In the national income accounting identity Q = C + S + T, T stands for
A) taxes.
B) transfers.
C) taxes minus transfers.
D) taxes plus transfers.
Answer: C
Question Status: Previous Edition

4) A crucial national income accounting identity has (S + T) equal to
A) I + G - NX.
B) I + G + F.
C) I + NX.
D) G + F.
E) I + G + NX.
Answer: E
Question Status: Previous Edition

5) In national income accounting, (S + T) is
A) the portion of total income not consumed.
B) net national product.
C) the methods of financing the government deficit.
D) the final output firms absorb as investment.
Answer: A
Question Status: Previous Edition

6) The government budget deficit, ________, is ________ when saving exceeds domestic investment.
A) (T - G), created
B) (T - G), partially financed
C) (G - T), created
D) (G - T), partially financed
Answer: B
Question Status: Previous Edition

7) Suppose that in our economy: G = 1100, T = 900, S = 140, and NX = -90. How much of our final product is left for domestic firms to purchase for themselves?
A) 110
B) 200
C) 230
D) 50
E) 30
Answer: E
Question Status: Previous Edition

8) Help in financing our federal budget deficit comes from a ________ amount of net exports, which is called ________.
A) negative, net foreign investment
B) negative, foreign borrowing
C) positive, net foreign investment
D) positive, foreign borrowing
Answer: B
Question Status: Previous Edition

9) If a the government of Country Z is running a budget deficit and net exports are zero, then
A) investment is greater than saving.
B) investment and saving are equal.
C) saving is greater than investment.
D) none of the above.
Answer: C
Question Status: Previous Edition

10) The term "twin deficits" refers to
A) government budget and trade deficits.
B) saving and investment deficits.
C) exports and imports deficits.
D) production and expenditure deficit.
Answer: A
Question Status: Previous Edition

2.6 Where Does Household Income Come From?

1) Which of the following sets of categories correctly describes the categories of nonconsumption injections?
A) foreign imports, private domestic investment, government transfer payments
B) capital consumption allowances, government transfer payments, net exports
C) net exports, inventory accumulation, government transfer payments
D) government purchases of goods and services, net exports, private domestic investment
Answer: D
Question Status: Previous Edition

2) In order to determine personal income, what adjustments have to be made to national income?
A) subtract undistributed corporate profits, corporate income tax, social security taxes, and then add government transfers and private interest payments
B) subtract undistributed corporate profits, social security taxes, government transfers, and then add private interest payments
C) subtract undistributed corporate profits, corporate consumption allowance, corporate income tax, social security tax and then add government transfers and private interest payments
D) subtract corporate income tax and social security taxes and then add corporate dividends, government transfers, and private interest payments
Answer: A
Question Status: Previous Edition

3) From the perspective of households the uses of income are
A) taxes, saving, consumption of domestically produced and imported goods.
B) taxes, investment, consumption of domestically produced and imported goods.
C) taxes, saving, consumption, exports, and imports.
D) None of the above.
Answer: A
Question Status: Previous Edition

4) The leakage and injections approach implies that deficit spending by the government must be financed by
A) private investment less private savings plus net exports.
B) private saving less private investment plus net exports.
C) the trade deficit must always offset the government deficit.
D) B and C.
Answer: A
Question Status: Previous Edition
5) The leakage and injections approach implies that a government deficit is financed by

A) private saving less private investment plus net exports.
B) private investment less private saving plus net exports.
C) the trade deficit must always offset the government deficit.
D) None of the above.
Answer: B
Question Status: Previous Edition

6) Actual real GDP this year is expected to exceed last year's by two percent, while the annual growth rate of natural real GDP is three percent. This is enough to lead us to expect that this year's unemployment rate will be
A) below last year's and below the natural rate of unemployment.
B) below last year's but still above the natural rate of unemployment.
C) below last year's.
D) above last year's.
E) above last year's and above the natural rate of unemployment.
Answer: D
Question Status: Previous Edition

7) Suppose exports and imports both rise by $1. GDP
A) rises by $2.
B) rises by $1.
C) remains unchanged.
D) falls by $1.
E) falls by $2.
Answer: C
Question Status: Previous Edition

8) (C + S + T) most closely approximates
A) personal income.
B) personal disposable income.
C) national income.
D) net national product.
E) gross national product.
Answer: A
Question Status: Previous Edition

9) Economic magnitudes measured at the prices actually paid are referred to as ________ magnitudes.
A) "real"
B) "actual"
C) "nominal"
D) "unadjusted"
E) "gross"
Answer: C
Question Status: Previous Edition

2.7 Nominal GDP, Real GDP, and the GDP Deflator

1) If nominal GDP increases, which of the following will always take place?
A) Output will have increased but prices will have fallen or remained the same.

B) Prices will have increased but output will have fallen or remained the same.
C) Both output and prices will have increased.
D) none of the above
Answer: D
Question Status: Previous Edition

2) If real GDP has increased, which of the following statements is always true?
A) Nominal GDP has increased.
B) Output has increased.
C) Prices have remained the same.
D) Output might have decreased if prices have risen enough.
Answer: B
Question Status: Previous Edition

3) Suppose that nominal GDP were $1200 billion in 1990 and $2000 billion in 1995. The implicit GDP deflator was 1.00 in 1990 and 1.50 in 1995. From this we can infer that, between 1990 and 1995
A) nominal GDP rose by 33%.
B) prices rose by 66%.
C) real GDP remained constant.
D) real GDP rose by about 11%.
Answer: D
Question Status: Previous Edition

4) If real GDP for a given year is $2400 billion and nominal GDP is $2400,
A) this year is the base year for the GDP deflator.
B) the GDP deflator for this year is 1.25.
C) the GDP deflator for this year is 0.8.
D) the GDP deflator for this year is 1.10.
Answer: A
Question Status: Previous Edition

5) To measure productivity in an economy, we compute the actual real GDP and then divide it by
A) the number of years over which it was produced.
B) the amount of labor that went into producing it.
C) the capital stock in existence at the time.
D) the value of the capital stock that was used up in the process of production.
E) the natural real GDP in the same period.
Answer: B
Question Status: Previous Edition

6) We go from Gross to Net Domestic Product by
A) adding depreciation to GDP.
B) subtracting depreciation from GDP.
C) adding indirect business taxes to GDP.
D) subtracting indirect business taxes from GDP.
Answer: B
Question Status: Previous Edition

7) We go from personal income to personal disposable income by
A) subtracting undistributed profits.
B) adding transfer payments.
C) subtracting personal income taxes.
D) subtracting depreciation.
E) subtracting personal saving.
Answer: C
Question Status: Previous Edition

8) A change in nominal GDP sums up changes in
A) prices alone.
B) physical production alone.
C) physical production and hours of production time.
D) physical production and prices.
Answer: D
Question Status: Previous Edition

9) A change in real GDP sums up changes in
A) prices alone.
B) physical production alone.
C) physical production minus changes in price.
D) physical production and prices.
Answer: B
Question Status: Previous Edition

10) The current official "base year" is
A) 2000.
B) 1992.
C) 1980.
D) 1972.
Answer: A
Question Status: Previous Edition

Table 2-2

	Year 1		Year 2	
	Quantity	Price	Quantity	Price
Apples	100	$0.05	130	$0.06
Peaches	300	$0.03	270	$0.04

11) Refer to above Table 2-2. What is the nominal GDP in year 2?
A) $18.60
B) $14.60
C) $18.00
D) 400 units
Answer: A
Question Status: Previous Edition

12) Refer to above Table 2-2. What are the constant-dollar expenditures in years 1 and 2 at fixed year 1 prices?
A) $5.00, $7.80
B) $14.00, $14.60
C) $18.00, $18.60
D) $9.00, $10.80
Answer: B
Question Status: Previous Edition

13) Refer to above Table 2-2. What are the constant-dollar expenditures in years 1 and 2 at fixed year 2 prices?
A) $14.00, $14.60
B) $7.90, $13.50
C) $18.00, $18.60
D) $12.80, $19.80
Answer: C
Question Status: Previous Edition

14) Refer to above Table 2-2. What is the increase in real GDP between years 1 and 2 at fixed year 1 prices?
A) 4.3%
B) 3.3%
C) 2.5%
D) 1.9%
Answer: A
Question Status: Previous Edition

15) Refer to above Table 2-2. What is the increase in real GDP between years 1 and 2 at fixed year 2 prices?
A) 2.1%
B) 5.1%
C) 4.4%
D) 3.3%
Answer: D
Question Status: Previous Edition

16) Refer to above Table 2-2. Choosing the prices of year 2 gives a ________ increase in real GDP because year 2 prices place a ________ valuation on quantities that have increased ________ rapidly.
A) lower, higher, least
B) higher, lower, most
C) higher, higher, least
D) lower, lower, most
Answer: D
Question Status: Previous Edition

17) Refer to above Table 2-2. The geometric average of the increase in real GDP between year 1 and year 2 is
A) 3.1%.
B) 3.2%.
C) 3.3%.
D) 3.8%.
Answer: D
Question Status: Previous Edition

18) Refer to above Table 2-2. The chain-weighted real GDP for year 2 is
A) $14.53.
B) $14.49.
C) $14.44.
D) $16.61.
Answer: A
Question Status: Previous Edition

19) Refer to above Table 2-2. The implicit GDP deflator for year 2 is
A) 1.284.
B) 1.432.
C) 1.101.
D) 1.334.
Answer: A
Question Status: Previous Edition

20) Refer to above Table 2-2. The chain-weighted GDP deflator for year 2 is
A) 1.313.
B) 1.211.
C) 1.324.
D) 1.280.
Answer: D
Question Status: Previous Edition

21) If chain-weighted increases in real GDP for 2002-03, 2003-04, 2004-05, 2005-06, and 2006-07 are 5%, 4%, 2%, 1%, and 3% respectively, and nominal GDP in the 2002 base year is $6244.4 billion, then chain-weighted real GDP for 2007 is
A) $6987.02 billion.
B) $7,181.06 billion.
C) $7235.6 billion.
D) $7239.0 billion.
Answer: C
Question Status: Previous Edition

22) When real GDP is below natural real GDP, the unemployment rate is
A) rising.
B) above the average unemployment rate.
C) falling.
D) below the average unemployment rate.
Answer: A
Question Status: Previous Edition

2.8 Measuring Unemployment

1) The unemployment rate is a good measure of the social welfare or social distress because
A) it includes discouraged workers.
B) it distinguishes between part-time and full-time job seekers.
C) it measures the "importance" of a job to each worker.
D) None of the above.
Answer: D
Question Status: Previous Edition

2) The measured unemployment rate will be understated when
A) unemployed workers become discouraged and drop out of the labor market.
B) unemployed people that are not actively looking for a job are not counted as part of the labor force
C) people pretend to be looking for a job
D) All of these.
Answer: A
Question Status: New

3) Indicate which of the following individuals would be included in the labor force as defined by the Census Bureau.
A) a teenager looking for a part-time job
B) a man waiting for recall from a layoff
C) a woman who has accepted a new job but has not yet begun working
D) All of the above would be included in the labor force.
Answer: D
Question Status: Previous Edition

4) Unemployment is referred to as a lagging indicator because
A) it tends to stay high for many months after output stops declining during a recession.
B) reports on unemployment statistics tend to lag behind reports on inflation statistics.
C) it takes time to collect information regarding unemployed individuals..
D) it indicates economic activities from the year before.
Answer: A
Question Status: New

5) A survey of 200,000 people finds 76,300 "employed," 6,640 "unemployed," and the remaining 117,060 "not in the labor force." What is the unemployment rate derived from these numbers?
A) 8.7 percent
B) 3.3 percent
C) 8.0 percent
D) 5.7 percent
Answer: C
Question Status: Previous Edition

6) Official unemployment statistics in the United States are derived from a monthly government survey of approximately ________ households.
A) 300
B) 2000
C) 60,000
D) 420,000
Answer: C
Question Status: Previous Edition

7) Ann is waiting to be recalled after a layoff. Bill also has no job at the moment and is not searching for one. Who is officially "unemployed"?
A) Ann
B) Bill
C) Ann and Bill
D) neither Ann nor Bill
Answer: A
Question Status: Previous Edition

8) Claire works fifteen hours a week at a dry cleaning shop. Dustin is retired and living in a retirement home. Who is officially "unemployed"?
A) Claire
B) Dustin
C) Claire and Dustin
D) neither Claire nor Dustin
Answer: D
Question Status: Previous Edition

9) Suppose the Bureau of Labor Statistics interviews 194,000 people in its monthly survey: 91,300 are not in the labor force, 94,000 are employed, 6650 are unemployed, and 1,150 are in the armed forces. What is the unemployment rate the BLS announces?
A) 4.95 percent
B) 3.94 percent
C) 7.0 percent
D) 6.55 percent
E) 6.48 percent
Answer: D
Question Status: Previous Edition

10) Suppose the Bureau of Labor Statistics interviews 196,700 people in its monthly survey; 94,500 are not in the labor force, 91,150 are employed, 8,870 are unemployed, and 2,180 are in the armed forces. What is the unemployment rate the BLS announces?
A) 8.87 percent
B) 9.73 percent
C) 9.39 percent
D) 4.51 percent
E) 10.81 percent
Answer: A
Question Status: Previous Edition

11) One of the shortcomings of the government's method of measuring unemployment tends to make the official unemployment rate an overestimate of the unemployment problem:
A) people working less than twenty hours a week are counted as unemployed.
B) people seeking part-time jobs are counted as fully unemployed.
C) people who have given up looking for work are counted as fully unemployed.
D) "discouraged workers" aren't counted as unemployed.
Answer: B
Question Status: Previous Edition

12) "Discouraged workers" are officially considered ________ the labor force and ________.
A) in, unemployed
B) in, not unemployed
C) not in, unemployed
D) not in, not unemployed
Answer: D
Question Status: Previous Edition
Appendix to Chapter 2: How We Measure Real GDP and the Inflation Rate

1) There are no questions for this section.

Answer:

***Macroeconomics, 12e* (Gordon)**
Chapter 3   Income and Interest Rates: The Keynesian Cross Model and the IS Curve

3.1 Business Cycles and the Theory of Income Determination

1) During the worst of the Great Depression, in 1932 and 1933, disposable income was so low that it actually ________ aggregate consumption, so that aggregate saving became ________.
A) rose above, positive
B) rose above, negative
C) fell below, positive
D) fell below, negative
Answer: D
Question Status: Previous Edition

2) From 1950 till 2009 the four-quarter growth rate of real GDP has been as high as ________ percent and as low as ________ percent.
A) 8.1; -2.8
B) 12.6; -3.9
C) 3.2; 2.5
D) 5; -10
Answer: B
Question Status: New

3) During recent Global Economic Crises, U.S. household liabilities have
A) increased
B) decreased
C) remained the same
D) quadrupled
Answer: B
Question Status: New

4) Which of the following is a possible reason for the improved economic performance between 1985 and 2007?
A) Demand Shocks have become smaller and less important.
B) Monetary and fiscal policy have become more effective.
C) Change in conditions that make monetary and/or fiscal policy more powerful.
D) All of the above
Answer: D
Question Status: New

5) Stability of the U.S. economy between 1985 and 2007 referred to as
A) Great Moderation.
B) the Great Depression.
C) Automatic Stabilizer.
D) Fiscal Discretion.
Answer: A
Question Status: Previous Edition

6) During the 20th century, the highest savings rates in the U.S. were observed during
A) the Great Depression.
B) World War II.
C) the late 1980s and 1990s.
D) none of the above.
Answer: B
Question Status: Previous Edition

7) In the 2000s, low savings rates are attributed to
A) rapid economic growth.
B) stock market boom.
C) declining interest rates and increased refinancing of the mortgages.
D) inefficient monetary policy.
Answer: C
Question Status: Previous Edition

3.2 Income Determination, Unemployment, and the Price Level

1) In the simplest Keynesian model of the determination of income, interest rates are assumed to be
A) exogenous and to gradually change.
B) endogenous and to gradually change.
C) exogenous and to remain constant.
D) endogenous and to remain constant.
Answer: C
Question Status: Previous Edition

2) In the simplest Keynesian model of the determination of income, interest rates are assumed
A) to be exogenous and to influence desired spending.
B) to be endogenous and not to influence desired spending.
C) to be endogenous and to influence desired spending.
D) to be exogenous and not to influence spending.
Answer: A
Question Status: Previous Edition

3) In the simple Keynesian model of the determination of income, the price level is assumed to be
A) exogenous and to gradually change.
B) endogenous and to gradually change.
C) exogenous and to remain constant.
D) endogenous and to remain constant.
Answer: C
Question Status: Previous Edition

4) A fixed or rigid price level implies
A) that income is fixed.
B) real GDP is greater than nominal GDP.
C) nominal GDP is less than real GDP.
D) real GDP equals nominal GDP.
Answer: D
Question Status: Previous Edition

5) What type of variables have their movements explained by theory?
A) endogenous
B) exogenous
C) autonomous
D) Both B and C
Answer: A
Question Status: Previous Edition

6) In the simple Keynesian model of the determination of income, planned investment is
A) an endogenous parameter.
B) autonomous and thus an exogenous parameter.
C) explained by the model of income determination.
D) None of the above.
Answer: B
Question Status: Previous Edition

7) Which of these variables remains exogenous throughout Chapter 3?
A) the interest rate
B) investment
C) price level
D) all of the above
Answer: D
Question Status: Previous Edition

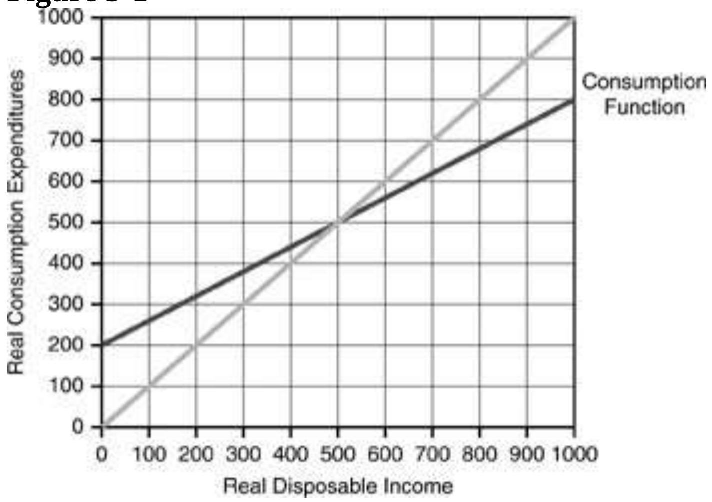
8) Suppose that in producing a GDP of 3000, goods worth 200 go unsold and are unintentionally added to business inventories. These goods
A) are not counted in total expenditure.
B) are part of the investment component of expenditure.
C) are nonetheless part of the consumption component of expenditure.
D) are classified as net exports and are subtracted from total expenditures.
Answer: B
Question Status: Previous Edition

9) A variable which is independent of the level of income is
A) endogenous.
B) exogenous.
C) autonomous.
D) irrelevant to any theory of income determination.
Answer: C
Question Status: Previous Edition

3.3 Planned Expenditure

1) If total planned spending (E(p)) exceeds GDP, we expect that
A) inventories will be falling.
B) inventories will be rising.
C) GDP will be falling.
D) government expenditures must be rising.
Answer: A
Question Status: Previous Edition

Figure 3-1



2) Employing Figure 3-1 above, autonomous consumption expenditures are ________, and the marginal propensity to consume is ________.
A) 200; 0.75
B) 500; 1
C) 200; 0.60
D) 0; 1
Answer: C
Question Status: Previous Edition

3) As used in this text, "autonomous" variables are
A) spontaneous variables that are completely unpredictable.
B) completely independent of income, although they can be explained by movements in other variables.
C) determined only by income levels.
D) the same as endogenous variables.
Answer: B
Question Status: Previous Edition

4) The multiplier measures the
A) number of steps it takes to move from one equilibrium to another.
B) rise in saving resulting from a rise in income.
C) marginal propensity to invest.
D) rise in equilibrium GDP resulting from a one dollar rise in planned autonomous expenditures.
Answer: D
Question Status: Previous Edition

5) Assuming that there are NO income taxes, if both autonomous taxes, and government expenditures were to rise by $100 million, we would expect equilibrium GDP to
A) rise by $100 million.
B) rise, but by a multiple of $100 million.
C) rise by less than $100 million.
D) remain unaffected because leakages have changed by the same amount.
Answer: A
Question Status: Previous Edition

6) The size of the multiplier depends in part on the
A) level of autonomous expenditures.
B) change in autonomous consumption.
C) level of consumption.
D) marginal propensity to consume.
Answer: D
Question Status: Previous Edition

7) If disposable income increases by $100 and consumption increased by $85, ceteris paribus, we may conclude that
A) the marginal propensity to consume is 0.85.
B) the marginal propensity to consume is 0.15.
C) $15 is autonomous consumption.
D) a change in disposable income is induced by a change in consumption.
Answer: A
Question Status: Previous Edition

8) If disposable income increases by $100 and saving increased by $25, ceteris paribus, we may conclude that
A) the marginal propensity to consume is 0.25.
B) the marginal propensity to save is 0.25.
C) $15 is autonomous consumption.
D) a change in disposable income is induced by a change in consumption.
Answer: B
Question Status: Previous Edition

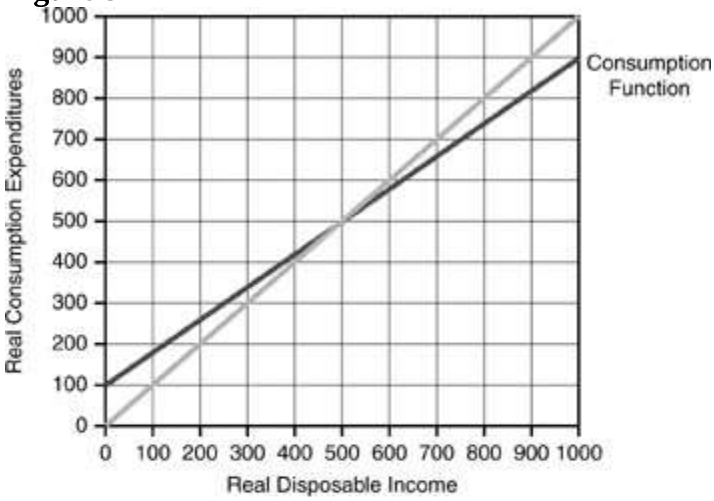
9) In equilibrium, with exports equal to imports it must be the case that
A) leakages equal injections.
B) saving plus taxes equal government expenditures plus investment.
C) total expenditures equal GDP.
D) All of these.
Answer: D
Question Status: Previous Edition

10) An increase in autonomous taxes
A) increases autonomous planned spending by an equal amount.
B) decreases autonomous planned spending by an equal amount.
C) increases consumption by that amount times the marginal propensity to consume.
D) decreases saving by that amount times the marginal propensity to save.
Answer: D
Question Status: Previous Edition

11) An exogenous rise in government expenditures will have the same effect on GDP as an equal rise in either autonomous ________ or autonomous ________.
A) consumption; investment
B) taxes; consumption
C) savings; investment
D) taxes; investment
Answer: A
Question Status: Previous Edition

12) A fall in the government's budget deficit will lower
A) equilibrium GDP and consumption.
B) consumption and saving.
C) saving and GDP.
D) All of the above are correct.
Answer: D
Question Status: Previous Edition

Figure 3-2



13) Employing the information in Figure 3-2 above, when real disposable income is 1000, savings from households would be ________ and the marginal propensity to save would be ________.
A) 300; 0.1
B) 100; 0.2
C) 100; 0.1
D) 500; 0.2
Answer: B
Question Status: Previous Edition

Assume that the level of autonomous consumption in an economy equals 400, the level of planned investment = 200, G = 0, T = 0, NX = 0, and the marginal propensity to consume is 0.6.

14) Refer to the information above. What is the level of consumption when the level of income equals 2000?
A) 600
B) 1000
C) 1600
D) 2000
Answer: C
Question Status: Previous Edition

15) Refer to the information above. What is the equilibrium level of GDP?
A) 600
B) 1000
C) 1500
D) 1800
Answer: D
Question Status: Previous Edition

16) Refer to the information above. If the level of production in the economy equals 3000, the amount of saving equals ________ and the level of unintended inventory investment equals ________.
A) 200; 200
B) 200; -200
C) 1200; 600
D) 1200; -600
Answer: C
Question Status: Previous Edition

Assume that all taxes in the economy are autonomous and the values for planned investment, government expenditures, and autonomous taxes are given:

p = 100 G = 100 T = 50

The consumption function is: C = 50 + 0.5 YD

17) Refer to the information above. What is the level of consumption when the level of income is 850?
A) 375
B) 425
C) 450
D) 475
Answer: C
Question Status: Previous Edition

18) Refer to the information above. What is the level of unintended inventory investment when income is 850?
A) -175
B) 175
C) -200
D) 200
Answer: C
Question Status: Previous Edition

19) Refer to the information above. What is the equilibrium level of GDP?
A) 300
B) 400
C) 450
D) 525
Answer: C
Question Status: Previous Edition

20) Refer to the information above. What will be the equilibrium level of GDP if taxes are reduced by 10?
A) 460
B) 470
C) 510
D) 520
Answer: A
Question Status: Previous Edition

21) Assume that the economy is initially at its equilibrium level of GDP. What will happen to the equilibrium level of GDP if planned investment decreases by 20, government spending increases by 30, and taxes increase by 10?
A) GDP will decrease by 60
B) GDP will decrease by 10
C) there will be no change in GDP
D) GDP will increase by 10
Answer: D
Question Status: Previous Edition

22) An increase in the marginal propensity to import will
A) raise imports and raise equilibrium income.
B) lower imports and raise equilibrium income.
C) lower the multiplier and reduce equilibrium income.
D) raise the multiplier and reduce equilibrium income.
Answer: C
Question Status: Previous Edition

23) Let the marginal leakage rate be 0.5 while the marginal propensity to consume is 0.8. Then a $50 million reduction in autonomous taxes will cause autonomous consumption to ________ and equilibrium income to ________.
A) fall by $50 billion; fall by $100 billion
B) rise by $50 billion; rise by $100 billion
C) fall by $40 billion; fall by $200 billion
D) rise by $40 billion; rise by $80 billion
Answer: D
Question Status: Previous Edition

24) Suppose the only leakages are savings and taxes. The tax rate is 0.2 and the multiplier is 1.92. These values imply that the marginal propensity to consume is
A) 0.32.
B) 0.60.
C) 0.68.
D) 0.8.
Answer: B
Question Status: Previous Edition

25) Assume that the marginal propensity to consume equals 0.8, the income tax rate equals 0.3, and the marginal propensity to import equals 0.2. The marginal leakage rate is ________ and the size of the multiplier is ________.
A) 0.70; 3.33
B) 0.60; 2.5
C) 0.64; 1.56
D) 0.50; 2.0
Answer: C
Question Status: Previous Edition

26) In the consumption function, suppose a = 60, c = 0.75, Y = 3000, and T = 800. Consumption expenditure is
A) 2910.
B) 2245.
C) 1710.
D) 1590.
E) 1510.
Answer: C
Question Status: Previous Edition

27) In the consumption function C = a + c(Y - T), "autonomous consumption" appears as
A) a.
B) c.
C) cY.
D) -cT.
E) c(Y - T).
Answer: A
Question Status: Previous Edition

28) When stock prices fall significantly, people may feel less wealthy and thus decide to consume less of their current flow of disposable income. In our consumption function, this can be represented by a
A) fall in (Y - T).
B) rise in T.
C) rise in c.
D) fall in a.
Answer: D
Question Status: Previous Edition

29) In our consumption function, when disposable income is zero, consumption is
A) a.
B) -cT.
C) cT.
D) -a.
Answer: A
Question Status: Previous Edition

30) On a diagram of the consumption function and the 45-degree line, saving at each level of disposable income is the vertical distance
A) from the horizontal axis to the intersection point of the consumption line and the 45-

degree line.
B) from the horizontal axis to the 45-degree line.
C) between the consumption and the 45-degree lines.
D) from the horizontal axis to where the consumption line intersects the vertical axis.
Answer: C
Question Status: Previous Edition

31) Suppose a = 50, c = 0.8, and T = 410. How much is saved out of a total income of 1230?
A) 706
B) 606
C) 278
D) 196
E) 114
Answer: E
Question Status: Previous Edition

32) Saving is positive for all levels of disposable income
A) above zero.
B) above where the consumption line intersects the 45-degree line.
C) below where the consumption line intersects the 45-degree line.
D) above where the consumption function intersects the vertical axis.
E) above autonomous consumption.
Answer: B
Question Status: Previous Edition

33) Which element of total planned expenditure is NOT included in "autonomous planned spending"?
A) cY
B) -cT
C) NX
D) Ip
E) a
Answer: A
Question Status: Previous Edition

34) The slope of the planned expenditure line is
A) autonomous consumption.
B) the marginal propensity to save.
C) autonomous planned spending.
D) the marginal propensity to consume.
Answer: D
Question Status: Previous Edition

35) Total income is always equal to ________ expenditures; but only in equilibrium is it equal to ________ expenditures, producing in equilibrium ________ on income to change.
A) actual, planned, pressure
B) actual, planned, no pressure
C) planned, actual, pressure
D) planned, actual, no pressure
Answer: B
Question Status: Previous Edition

36) Where the planned expenditure and the 45-degree lines intersect, the economy is ________ equilibrium, with unplanned inventory investment equal to ________.
A) in, zero
B) out of, zero
C) in, planned inventory investment
D) in, autonomous planned expenditure
E) out of, autonomous planned expenditure
Answer: A
Question Status: Previous Edition

37) In the consumption function $C = a + c(Y - T)$, induced consumption is
A) $a + c(Y - T)$.
B) $a + cY$.
C) cY.
D) $c(Y - T)$.
Answer: D
Question Status: Previous Edition

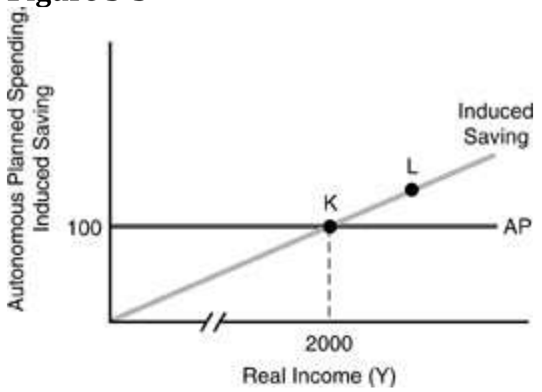
38) If Y = $200 billion, c = 0.75, autonomous consumption = $10 billion, and T = $20 billion, induced consumption expenditure is
A) $135 billion.
B) $200 billion.
C) $180 billion.
D) $150 billion.
Answer: A
Question Status: Previous Edition

39) If Y = $200 billion, c = 0.75, autonomous consumption = $10 billion, and T = $20 billion, induced saving is
A) $25 billion.
B) $50 billion.
C) $75 billion.
D) $150 billion.
Answer: B
Question Status: Previous Edition

40) The saving function is
A) cY.
B) Y - T.
C) (1 - c)(Y - T).
D) -a + (1 - c)(Y - T).
Answer: D
Question Status: Previous Edition

41) In the saving function, autonomous saving is
A) -a + (1 - c)(Y - T).
B) (1 - c)Y.
C) -a.
D) -Y - T.
Answer: C
Question Status: Previous Edition

Figure 3-5



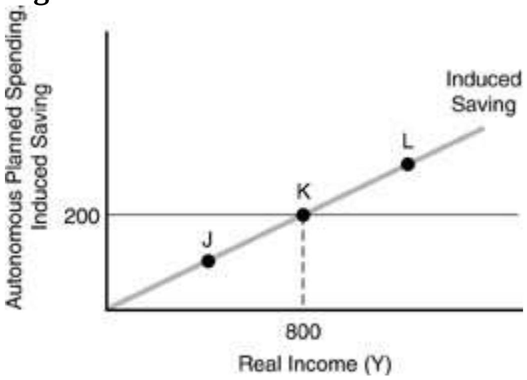
42) In Figure 3-5 above, the marginal propensity to save is
A) 0.20.
B) 0.80.
C) 0.05.
D) 0.02.
Answer: C
Question Status: Previous Edition

43) In Figure 3-5 above, the saving function is
A) 100 + 0.8(Y - T).
B) -100 + 0.05(Y - T).
C) 0.2Y - 100.
D) 100 + Y - T.
Answer: B
Question Status: Previous Edition

44) In Figure 3-5 above, saving is zero at
A) point J.
B) point K.
C) point L.
D) none of the above because saving is never equal to zero under the conditions described in the graph.
Answer: B
Question Status: Previous Edition

45) In Figure 3-5 above, saving is positive at
A) point J.
B) point K.
C) point L.
D) all of the above.
Answer: C
Question Status: Previous Edition

Figure 3-6



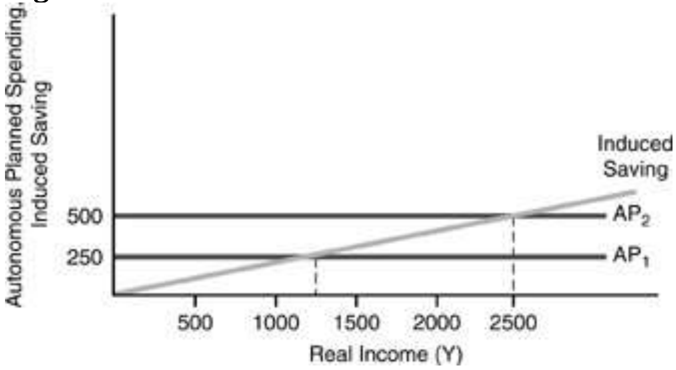
46) In Figure 3-6 above, income and planned expenditure are equal at
A) point J.
B) point K.
C) point L.
D) all of the above.
Answer: B
Question Status: Previous Edition

47) In Figure 3-6 above, income and actual expenditures are equal at
A) point J.
B) point K.
C) point L.
D) all of the above.
Answer: D
Question Status: Previous Edition

48) In Figure 3-6 above, at point J
A) there is unplanned inventory investment.
B) there is unplanned inventory disinvestment.
C) there is no change in inventory levels.
D) intended and unintended inventory investment are equal.
Answer: A
Question Status: Previous Edition

49) In Figure 3-6 above, unplanned inventory decreases occur at
A) point J.
B) point K.
C) point L.
D) all income levels.
Answer: A
Question Status: Previous Edition

Figure 3-7



50) In Figure 3-7 above, when autonomous planned spending is $250, the equilibrium income level is
A) $1000.
B) $1250.
C) $1500.
D) $2500.
Answer: B
Question Status: Previous Edition

51) In Figure 3-7 above, the marginal propensity to save is
A) 1.
B) 5.
C) 0.5.
D) 0.2.
Answer: D
Question Status: Previous Edition

52) In equilibrium,
A) income = planned expenditures.
B) unplanned inventory investment is zero.
C) Ep (planned expenditures) crosses the 45-degree income line.
D) all of the above.
Answer: D
Question Status: Previous Edition

53) In 2005 real personal saving has decreased to ________ of personal disposable income.
A) 3.5
B) 4.8
C) 11.2
D) 1.4
Answer: D
Question Status: New

3.4 The Economy In and Out of Equilibrium

1) Total planned expenditures are
A) C + Ip.
B) Ep + C.
C) Ep - Ip.
D) None of the above.
Answer: A
Question Status: Previous Edition

2) When an economy is in equilibrium,
A) planned expenditures exceed production and income.
B) there is no savings nor investment.
C) government tax revenues equal planned government expenditures.
D) production and income equal planned expenditures.
Answer: D
Question Status: Previous Edition

3) When an economy is not in equilibrium,
A) planned expenditures exceed production and income.
B) there is no savings nor investment.
C) government tax revenues equal planned government expenditures.
D) production and income equal planned expenditures.
Answer: A
Question Status: Previous Edition

4) A 45-degree line on a graph with expenditures, E, on the vertical axis and production, Y, on the horizontal axis, represents
A) the line of disequilibrium levels of income.
B) all possible equilibrium levels of production and expenditures.
C) some of the equilibrium levels of production and expenditures.
D) None of the above.
Answer: B
Question Status: Previous Edition

5) If planned autonomous investment is 500, autonomous consumption 300, induced consumption 2500, savings 500, and government spending and taxes zero, then
A) Ep is 3300 and the economy is in equilibrium.
B) Ep is 3300 and the economy is out of equilibrium.
C) Ep is 3500 and the economy is in equilibrium.
D) Ep is 3500 and the economy is out of equilibrium.
Answer: C
Question Status: Previous Edition

6) If Ep is 3500 and Y is 3000, then
A) planned inventory accumulation is 500.
B) planned inventory depletion is 500.
C) unplanned inventory accumulation is 500.
D) unplanned inventory depletion is 500.
Answer: D
Question Status: Previous Edition

7) If Ep is 3500 and Y is 3000, then companies will
A) reduce orders and production by 500.
B) increase orders and production by 500.
C) wait for final sales to increase but continue to produce at existing level in the future.
D) wait for final sales to decrease but reduce the level of production in the future.
Answer: B
Question Status: Previous Edition

8) If Ep is 2500 and Y is 3000, then
A) planned inventory accumulation is 500.
B) planned inventory depletion is 500.
C) unplanned inventory accumulation is 500.
D) unplanned inventory decumulation is 500.
Answer: D
Question Status: Previous Edition

9) If Ep is 2500 and Y is 3000, then companies will
A) reduce orders and production by 500.
B) increase orders and production by 500.
C) wait for final sales to increase.
D) wait for final sales to decrease.
Answer: A
Question Status: Previous Edition

10) The "equilibrating mechanism," the reason the economy tends toward equilibrium in the simple Keynesian model, is primarily
A) autonomous but flexible prices.
B) production responses to unplanned inventory changes.
C) exogenous inventory changes.
D) endogenous price changes.
Answer: B
Question Status: Previous Edition

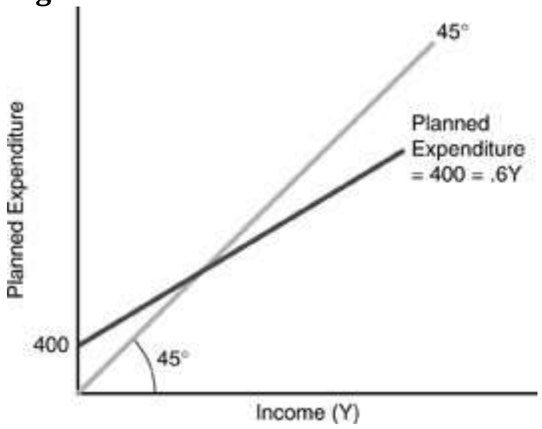
11) One way to view equilibrium in the simple Keynesian model without government spending and taxes is that:
A) saving equals planned investment.
B) saving equals planned expenditures.
C) saving equals planned autonomous spending.
D) None of the above.
Answer: A
Question Status: Previous Edition

12) On a diagram of the planned expenditure function Ep and the 45-degree line, we find autonomous planned spending
A) where the 45-degree line hits the vertical axis.
B) at each level of output by the vertical distance between the Ep and 45-degree lines.
C) where Ep intersects the vertical axis.
D) at each level of income by the vertical distance from the horizontal axis up to Ep.
Answer: C
Question Status: Previous Edition

13) Income on the horizontal axis at which the vertical distance to the 45-degree line is less than the vertical distance to the Ep line gives rise to ________-than-equal planned expenditures, and so we must be ________ the equilibrium level of income.
A) less, below
B) less, above
C) greater, below
D) greater, above
Answer: C
Question Status: Previous Edition

14) Income on the horizontal axis at which the vertical distance to the 45-degree line is greater than the vertical distance to the Ep line gives rise to ________-than-equal planned expenditures, and so we must be ________ the equilibrium level of income.
A) less, below
B) less, above
C) greater, below
D) greater, above
Answer: B
Question Status: Previous Edition

Figure 3-3



15) In Figure 3-3 above, autonomous planned spending is
A) 400.
B) 400 + 0.6Y.
C) 0.8Y.
D) 400 - 0.6Y.
E) 0.
Answer: A
Question Status: Previous Edition

16) In Figure 3-3 above, equilibrium income is
A) 400.
B) 640.
C) 666.67.
D) 1,000.
E) 2,400.
Answer: D
Question Status: Previous Edition

17) In Figure 3-3 above, when income is 1,500, unplanned inventory investment is
A) 200.
B) 300.
C) 500.
D) -200.
E) -500.
Answer: A
Question Status: Previous Edition

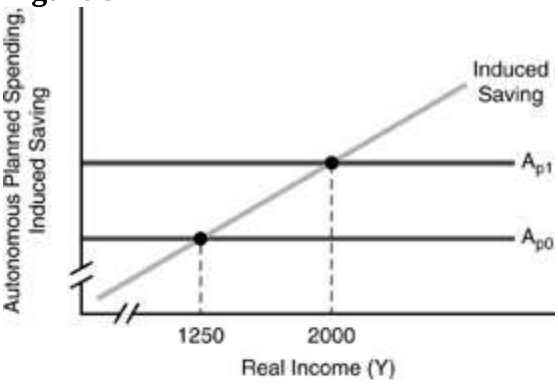
18) In Figure 3-3 above, when income is 700, unplanned inventory investment is
A) -180.
B) 180.
C) 300.
D) -300.
E) -120.
Answer: E
Question Status: Previous Edition

19) Income on the horizontal axis at which the vertical distance to the 45-degree line is less than the vertical distance to the Ep line gives rise to a ________ amount of unplanned inventory investment, and thus ________ pressure on output.
A) positive, upward
B) positive, downward
C) negative, upward
D) negative, downward
Answer: C
Question Status: Previous Edition

20) Income on the horizontal axis at which the vertical distance to the 45-degree line is greater than the vertical distance to the Ep line gives rise to a ________ amount of unplanned inventory investment, and thus ________ pressure on output.
A) positive, upward
B) positive, downward
C) negative, upward
D) negative, downward
Answer: B
Question Status: Previous Edition

21) Equilibrium income equals planned autonomous spending
A) times the marginal propensity to consume.
B) divided by the marginal propensity to consume.
C) times the marginal propensity to save.
D) divided by the marginal propensity to save.
Answer: D
Question Status: Previous Edition

Figure 3-4



22) In Figure 3-4 above, the marginal propensity to consume is
A) 500.
B) 2.5.
C) 0.6.
D) 0.4.
E) 1.5.
Answer: C
Question Status: Previous Edition

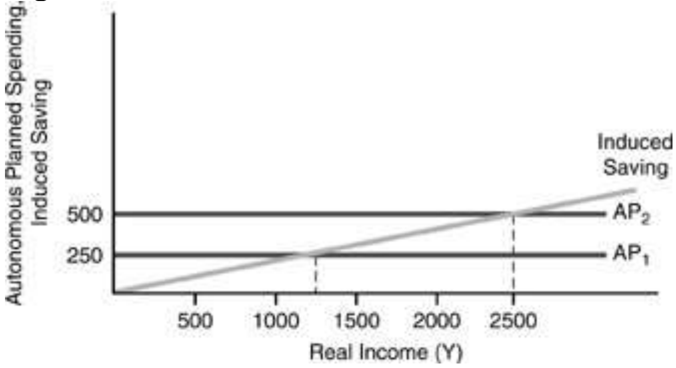
23) In Figure 3-4 above, the multiplier is
A) 2.5.
B) 0.6.
C) 0.4.
D) 1.67.
E) 1.5.
Answer: A
Question Status: Previous Edition

24) In Figure 3-4 above, an equilibrium income of 2000 occurs when planned autonomous spending is
A) 750.
B) 800.
C) 1250.
D) 250.
Answer: B
Question Status: Previous Edition

25) In Figure 3-4 above, the shift from A_{p0} to A_{p1} could have been caused by a rise in net exports of
A) 180.
B) 750.
C) 120.
D) 300.
Answer: D
Question Status: Previous Edition
26) In Figure 3-4 above, the shift from A_{p0} to A_{p1} could have been caused by a ________ in T of ________.

A) fall, 300
B) fall, 180
C) fall, 500
D) rise, 300
E) rise, 500
Answer: C
Question Status: Previous Edition

Figure 3-7



27) In Figure 3-7 above, a $250 increase in AP causes
A) Y to increase by $1250.
B) induced saving to increase by $250.
C) consumption to increase by $1000.
D) all of the above.
Answer: D
Question Status: Previous Edition

28) In Figure 3-7 above, if the natural real GDP is $2500, AP = $250, and the change in "a" = change in I = change in NX = 0, then the natural real GDP could be attained with a
A) $250 decrease in T.
B) $250 increase in G.
C) $1250 increase in G.
D) $500 decrease in T.
Answer: B
Question Status: Previous Edition

29) In Figure 3-7 above, if natural real GDP = $2500, AP = $250, and the change in "a" = change in I = change in NX = 0, the tax cut required to achieve then natural real GDP is
A) $312.50.
B) $250.00.
C) $500.00.
D) none of the above.
Answer: A
Question Status: Previous Edition
30) If Ap is total autonomous planned spending, c is the marginal propensity to consume, s is the marginal propensity to save, and Y is the equilibrium income level, then
A) Ap/Y.
B) Y = Ap/s.
C) sY.

D) cAp.
Answer: B
Question Status: Previous Edition

31) If Ap is total autonomous planned spending, c is the marginal propensity to consume, s is the marginal propensity to save, and Y is the equilibrium income level, then induced saving is
A) Ap/Y.
B) Y = Ap/s.
C) sY.
D) cAp.
Answer: C
Question Status: Previous Edition

32) If Y is income, E is actual expenditure, Ep is planned expenditure, and Iu is unintended inventory investment, then
A) Y = E + Iu.
B) Iu = Y - E.
C) Y = Ep + Iu.
D) none of the above.
Answer: C
Question Status: Previous Edition

3.5 The Multiplier Effect

1) Assuming a simple Keynesian multiplier, and given an increase in planned investment of $100 billion, the effect on total output will be greater than $100 billion only if the
A) MPS is greater than zero.
B) MPC is zero.
C) MPS is less than zero.
D) MPC is greater than one.
Answer: A
Question Status: Previous Edition

2) A $1 increase in autonomous spending has a multiplier effect greater than one on total expenditures and output because
A) each expenditure is respent in the same amount continuously.
B) overtime expenditures tend to increase.
C) total expenditures include autonomous expenditures.
D) each time an expenditure occurs the recipient respends a proportion of the funds.
Answer: D
Question Status: Previous Edition

3) If the gap between the actual level of output and the "natural real GDP" is 1000 and the marginal leakage rate is 0.5 then the simple Keynesian model suggests that the government could close the gap by
A) increasing autonomous expenditures by 1000.
B) increasing autonomous expenditures by 250.
C) increasing autonomous expenditures by 500.
D) decreasing taxes by 500.
Answer: C

Question Status: Previous Edition

4) In an economy described by the assumptions of the simple Keynesian Model, the impact of fluctuations in autonomous investment on consumption spending could be
A) caused by government tax and spending policies.
B) explained by changes in output, Y.
C) endogenous.
D) offset by government tax and spending policies.
Answer: D
Question Status: Previous Edition

5) In a country without foreign trade and no income taxes, if the government increases autonomous taxes by 1000 and the MPS is 0.1, then the initial or first round change in expenditures by all tax payers will be
A) a reduction equal to 1000.
B) an increase equal to 1000.
C) a reduction equal to 900.
D) an increase equal to 900.
Answer: C
Question Status: Previous Edition

6) In a country without foreign trade and income taxes, if the government decreases autonomous spending and autonomous taxes by 50 then total expenditures and output will
A) increase by 50 if the MPC is 1.
B) decrease by 50 for any value of the MPS greater than zero.
C) decrease by 100 if the MPS is 0.5.
D) increase by 200 if the MPS is 0.25.
Answer: B
Question Status: Previous Edition

7) If the MPS is 0.1 and the income tax rate is 0.33 the multiplier, k, is approximately
A) 2.5.
B) 2.0.
C) 10.
D) 3.
Answer: A
Question Status: Previous Edition

8) If the MPS is 0.1 and the income tax rate is 0.33 the marginal leakage rate for a closed economy is
A) 0.033.
B) 0.23.
C) 0.43.
D) 0.397.
Answer: D
Question Status: Previous Edition

9) The establishment of an income tax, ceteris paribus, will result in
A) a lower expenditure multiplier.
B) a higher expenditure multiplier.
C) no change in the size of the multiplier.
D) None of the above.
Answer: A
Question Status: Previous Edition

10) Since income tax revenues will rise (fall) as expenditures and output increase (decrease) the income tax results in
A) a reduction in the multiplier effect on GDP of autonomous expenditures.
B) automatic stabilization of GDP.
C) A and B.
D) None of the above.
Answer: C
Question Status: Previous Edition

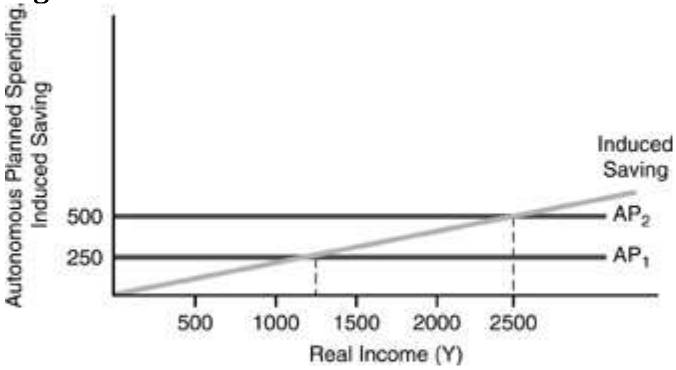
11) The one type of expenditure that we assume can differ from what spenders have planned is
A) consumption.
B) investment.
C) government expenditure.
D) net exports.
Answer: B
Question Status: Previous Edition

12) In the consumption function C = a + c(Y - T), the "marginal propensity to consume" appears as
A) a.
B) c.
C) cY.
D) -cT.
E) c(Y - T).
Answer: B
Question Status: Previous Edition

13) Which of the components of total planned autonomous spending has a negative multiplier, and one which is lower in absolute value than the multiplier of the others?
A) autonomous consumption
B) net taxes
C) planned investment
D) government expenditure
E) net exports
Answer: B
Question Status: Previous Edition

14) Should autonomous consumption fall by one dollar, the effect of this on equilibrium income can be offset if government expenditure
A) falls by one dollar.
B) rises by one dollar.
C) falls by 1/(1 - c) dollars.
D) rises by 1/(1 - c) dollars.
E) rises by c/(1 - c) dollars.
Answer: B
Question Status: Previous Edition

Figure 3-7



15) In Figure 3-7 above, the multiplier is
A) 2.
B) 0.2.
C) 5.
D) 2.5.
Answer: C
Question Status: Previous Edition

16) In Figure 3-7 above, the multiplier effect does NOT explain
A) the increase in equilibrium income.
B) the increase in induced saving.
C) the increase in AP.
D) all of the above.
Answer: C
Question Status: Previous Edition

17) In Figure 3-7 above, the multiplier for a change in autonomous taxes is
A) 5.

B) 4.
C) 2.50.
D) 1.
Answer: B
Question Status: Previous Edition

18) A marginal propensity to save of 0.20 results in a multiplier of
A) 2.
B) 5.
C) 1.25.
D) 8.
E) 1.
Answer: B
Question Status: Previous Edition

19) Which of the following defines the multiplier for a change in autonomous taxes?
A) -s/c
B) 1/s
C) 1/c
D) -c/s
Answer: D
Question Status: Previous Edition

3.6 Sources of Shifts in Planned Spending

1) A rise in the income tax rate will
A) raise the multiplier and raise equilibrium income.
B) lower the multiplier and raise equilibrium income.
C) raise the multiplier and lower equilibrium income.
D) lower the multiplier and lower equilibrium income.
Answer: D
Question Status: Previous Edition

2) Assume that all taxes are lump-sum, net exports = 0, and the marginal propensity to consume is 0.8. Then, if investment and taxes were each to fall by $100 million, the equilibrium level of income would
A) rise by $100 million.
B) fall by $100 million.
C) rise by $500 million.
D) fall by $500 million.
Answer: B
Question Status: Previous Edition

3) If the MPS is 0.1 and the income tax rate is 0.33, and the fraction of income spent on imports is 0.25, then the multiplier is
A) 2.5.
B) 1.47.
C) 1.51.
D) 1.55.
Answer: D
Question Status: Previous Edition

4) If both autonomous imports and autonomous taxes decrease by $100B we expect that equilibrium income will
A) increase by more than $200B.
B) decrease by more than $200B.
C) increase by $200B.
D) remain unchanged.
Answer: A
Question Status: Previous Edition

5) Fluctuations in total output are the reverse image of fluctuations in
A) the inflation rate.
B) the unemployment rate.
C) gross domestic product.
D) the GDP deflator.
Answer: B
Question Status: Previous Edition

6) In economic models, variables taken as given and not explained by the model are called ________ variables.
A) exogenous
B) endogenous.
C) short-run.
D) long-run.
E) nominal.
Answer: A
Question Status: Previous Edition

7) Economic model building begins with the construction of greatly oversimplified "benchmark" models, which are brought closer to reality by gradually removing the simplifying assumptions. In this process, more and more ________ variables become ________.
A) short-run, long-run
B) exogenous, endogenous
C) long-run, short-run
D) endogenous, exogenous
E) nominal, real
Answer: B
Question Status: Previous Edition

8) The multiplier is defined as the ratio of a change in income to the
A) marginal propensity to save.

B) marginal propensity to consume.
C) change in the marginal propensity to consume causing it.
D) change in the marginal propensity to save causing it.
E) change in planned autonomous spending causing it.
Answer: E
Question Status: Previous Edition

9) A marginal propensity to consume of 0.84 results in a multiplier of
A) 6.25.
B) 1.19.
C) 0.16.
D) 0.84.
E) 1.84.
Answer: A
Question Status: Previous Edition

10) When planned autonomous spending rises, the planned expenditure line
A) makes a parallel shift downward.
B) makes a parallel shift upward.
C) pivots upward from the vertical intercept.
D) pivots downward from the vertical intercept.
Answer: B
Question Status: Previous Edition

11) Should autonomous consumption rise by one dollar, the effect of this on equilibrium income can be offset if net taxes are
A) raised by one dollar.
B) lowered by one dollar.
C) raised by c dollars.
D) lowered by c dollars.
E) raised by (1/c) dollars.
Answer: E
Question Status: Previous Edition

12) Suppose that equilibrium income is 3200 and the multiplier is 2.38. Equilibrium income would rise to 3400 if planned investment
A) rises by 84.03.
B) rises by 476.
C) falls by 84.03.
D) falls by 476.
Answer: A
Question Status: Previous Edition

13) If s = MPS, and t = income tax rate, the marginal leakage rate is
A) s(1 - t) + t.
B) s -t.
C) s(1 - t).
D) t(1 - s) + t.
Answer: A
Question Status: Previous Edition

14) If autonomous planned spending increases by $1 million and s = 0.2 and t = 0.1, then equilibrium income increases by
A) $5 million.
B) $3.33 million.
C) $3.57 million.
D) $2.90 million.
Answer: C
Question Status: Previous Edition

15) Automatic stabilization refers to
A) the policy of lowering tax rates during a recession.
B) the policy of increasing autonomous G during a recession.
C) the effect of income taxes in lowering the multiplier effect of changes in autonomous planned spending.
D) all of the above.
Answer: C
Question Status: Previous Edition

16) If Y = income, G = government spending, T = autonomous taxes, and t = income tax rate, then the government budget deficit can be expressed as
A) G - T/Y(t).
B) G - T.
C) Y + G - T - ty.
D) G - T - ty.
Answer: D
Question Status: Previous Edition

17) During a recession, automatic stabilization causes the government budget deficit to
A) fall.
B) increase.
C) remain stable.
D) move in the same direction as Y.
Answer: B
Question Status: Previous Edition

18) Higher real GDP growth usually causes
A) a drop in net exports.
B) a rise in net exports.
C) a drop in the trade deficit.
D) A and C.
Answer: A
Question Status: Previous Edition

19) The portion of net exports determined by income in foreign countries is
A) induced net exports.
B) autonomous net exports.
C) total net exports.
D) always equal to zero.
Answer: B
Question Status: Previous Edition

20) Net exports ________ the autonomous expenditure multiplier.
A) reduce
B) increase
C) A or B
D) have no effect on
Answer: A
Question Status: Previous Edition

21) Changes in consumer confidence, business optimism, government spending, and foreign events that cause economic volatility are known as
A) Supply Shocks.
B) Demand Shocks.
C) Aggregate Demands.
D) Real Business Cycles.
Answer: B
Question Status: Previous Edition

3.7 How Can Monetary Policy Affect Planned Spending?

1) There are no questions for this section.
Answer:

3.8 The Relation of Autonomous Planned Spending to the Interest Rate

1) If the interest rate were to fall, we expect that
A) the supply of money will fall.
B) the supply of money will rise.
C) autonomous expenditures will rise.
D) the demand for money will fall.
Answer: C
Question Status: Previous Edition
2) If planned investment changes as interest rates change, then
A) autonomous consumption changes.
B) autonomous investment changes.

C) total expenditures and output changes.
D) the marginal leakage rate changes.
Answer: C
Question Status: Previous Edition

3) When interest rate rise consumers will
A) compare loan payments with the desirability of goods in the future and increase consumption.
B) compare loan payments with the desirability of goods today and increase consumption.
C) wait to borrow funds when interest rates fall.
D) none of above.
Answer: C
Question Status: Previous Edition

4) If the expected earnings of an investment project exceed all expenses except interest payments,
A) business firms will not undertake the project.
B) business firms will undertake the project and raise prices later.
C) business firms will not undertake the project but will borrow the funds.
D) consumers will get lower prices.
Answer: A
Question Status: Previous Edition

5) Since business firms will undertake a project whose rate of return exceeds the present level of interest rates, when interest rates
A) rise planned investment rises, ceteris paribus.
B) fall planned investment falls, ceteris paribus.
C) rise planned investment does not change.
D) rise planned investment falls, ceteris paribus.
Answer: D
Question Status: Previous Edition

6) If business firms are more optimistic during the expansion phase of the business cycle, they
A) raise their expected rates of return on projects and investment increases.
B) lower their expected rates of return on projects and investment increases.
C) raise their expected rates of return on projects and investment decreases.
D) lower their prices and increase investment.
Answer: A
Question Status: Previous Edition

7) Autonomous planned spending is a function of the
A) marginal propensity to consume.
B) marginal propensity to save.
C) interest rate.
D) tax rate.
Answer: C
Question Status: Previous Edition

8) The owner of Speedee Copy Center calculates that purchasing a new $13,000 color copier would return $1800 a year after payment of all expenses besides interest payments on borrowing $13,000. What is the maximum interest rate that makes purchasing the copier profitable?
A) 13.84 percent.
B) 7.22 percent.
C) 8.62 percent.
D) 12.16 percent.
Answer: A
Question Status: Previous Edition

9) A mass-production bagel factory is considering the purchase of a flash freezer to improve the quality of the raw dough it provides supermarket bakeries. The freezer costs $750,000 and would increase business revenues by $48,000 a year after all expenses besides interest are paid. If the interest rate is 7.8 percent, what is the freezer's annual profit rate?
A) 7.8 percent.
B) 1.4 percent.
C) -1.4 percent.
D) 5.9 percent.
E) -5.9 percent.
Answer: C
Question Status: Previous Edition

10) A falling interest rate ________ the number of investment projects having a positive profit rate, and thus ________ the amount of output that firms demand for themselves.
A) increases, raises
B) increases, lowers
C) decreases, raises
D) decreases, lower
Answer: A
Question Status: Previous Edition

11) The rate-of-return line ________ when the interest rate rises.
A) shifts to the right
B) shifts to the left
C) pivots to become steeper
D) pivots to become flatter
E) is not affected
Answer: E
Question Status: Previous Edition
12) Suppose that along the economy-wide rate-of-return line, the current interest rate of 8 percent causes planned investment of $300 billion. The $250-billionth dollar of investment

spending has a rate of return ________ 8 percent and thus a ________ profit rate.
A) below, positive
B) below, negative
C) above, positive
D) above, negative
Answer: C
Question Status: Previous Edition

13) Suppose that along the economy-wide rate-of-return line, the current interest rate of 8 percent causes a planned investment of $300 billion. Should the interest rate fall to 7 percent, the $300 billionth dollar of investment spending now generates a ________ rate of profit, which puts ________ pressure on investment.
A) positive, downward
B) positive, upward
C) negative, downward
D) negative, upward
Answer: B
Question Status: Previous Edition

3.9 The IS Curve

1) The IS curve represents
A) investment and saving when the commodity markets are in disequilibrium.
B) equilibrium in the commodity markets for every combination of interest rates and output level.
C) the determination of the level of interest rate.
D) the determination of the level of income and output.
Answer: B
Question Status: Previous Edition

2) The inauguration of a new President often increases the degree of optimism in business firms and households, causing Ap to
A) rise and IS to shift leftward.
B) fall and IS to shift leftward.
C) fall and IS to increase.
D) rise and IS to shift rightward.
Answer: D
Question Status: Previous Edition

3) The inauguration of a new President often increases the degree of optimism in foreign business firms and foreign households, causing net exports to
A) decrease and IS to shift right.
B) decrease and IS to shift left.
C) increase and IS to shift right.
D) increase and IS to shift left.
Answer: C
Question Status: Previous Edition

4) In the development of the IS curve, one variable that turns from exogenous to endogenous is
A) the interest rate.
B) the price level.
C) consumption.
D) saving.
E) investment.
Answer: E
Question Status: Previous Edition

5) In the four-part diagram used to construct the IS curve, a lower interest rate
A) has no effect on Y.
B) has no effect on the position of the demand for autonomous planned spending curve.
C) has no effect on the position of the IS curve.
D) none of the above.
Answer: C
Question Status: Previous Edition

6) In the four-part diagram used to construct the IS curve, a decrease in the interest rate causes
A) an increase in Ap and induced saving but does not shift the IS curve.
B) an increase in Ap and induced saving and shifts the IS curve to the right.
C) a decrease in Ap, an increase in induced saving, and shifts the IS curve to the right.
D) a decrease in Ap and a decrease in induced saving, but does not shift the IS curve.
Answer: A
Question Status: Previous Edition

7) In the four-part diagram used to construct the IS curve, the upper right-hand graph depicts
A) the IS curve.
B) the relationship between the interest rate and autonomous planned spending.
C) determination of real income by the saving function and the demand for autonomous planned spending function.
D) none of the above.
Answer: C
Question Status: Previous Edition

8) The IS curve plots for each level of income the ________ that causes income to equal ________.
A) interest rate, planned expenditures
B) interest rate, planned autonomous spending
C) planned autonomous spending, planned expenditures
D) planned autonomous spending, planned autonomous spending
Answer: A
Question Status: Previous Edition

9) The IS curve shows that higher income levels require ________ interest rates to ensure that income equals ________.
A) higher, planned autonomous spending
B) higher, planned expenditures
C) lower, planned autonomous spending
D) lower, planned expenditures
Answer: D
Question Status: Previous Edition

10) At every point on the IS curve, the level of income on the horizontal axis equals
A) planned autonomous spending.
B) planned autonomous spending times the multiplier.
C) planned autonomous spending divided by the multiplier.
D) planned expenditures times the multiplier.
Answer: B
Question Status: Previous Edition

11) A lower interest rate ________ Ap and thus causes ________ the IS curve.
A) raises, movement downward along
B) lowers, movement upward along
C) raises, a parallel rightward shift of
D) lowers, a parallel leftward shift of
Answer: A
Question Status: Previous Edition

12) Events that shift the Ap demand schedule to the left also cause ________ the IS curve.
A) movements downward along
B) movements upward along
C) parallel rightward shifts of
D) parallel leftward shifts of
Answer: D
Question Status: Previous Edition

13) Following housing market collapse, U.S. personal saving rates have
A) increased.
B) decreased.
C) remained the same.
D) data not yet available.
Answer: A
Question Status: New

3.10 Conclusion: The Missing Relation

1) There are no questions for this section.
Answer:

Appendix to Chapter 3: Allowing for Income Taxes and Income-Dependent Net Exports

1) There are no questions for this section.
Answer:

Macroeconomics, 12e **(Gordon)**
Chapter 4 Strong and Weak Policy Effects in the IS-LM Model

4.1 Introduction: The Power of Monetary and Fiscal Policy

1) Autonomous planned spending includes five components of which two are dependent on the interest rates. These are
A) government spending and autonomous tax revenue.
B) the demand for exports and the demand for imports.
C) autonomous consumption and planned investment.
D) government spending and investment.
Answer: C
Question Status: Previous Edition

2) In the IS-LM model, equilibrium income can be affected by
A) fiscal policy alone.
B) monetary policy alone.
C) both fiscal and monetary policy.
D) neither monetary nor fiscal policy.
Answer: C
Question Status: Previous Edition

3) Which variable is assumed to remain exogenous in all the models constructed in Chapters 3 and 4?
A) the money supply
B) the interest rate
C) the price level
D) the equilibrium GDP
E) autonomous consumption
Answer: C
Question Status: Previous Edition

4.2 Income, the Interest Rate, and the Demand for Money

1) If the interest rate were to rise, we expect that
A) autonomous expenditures will rise.
B) the supply of money will fall.
C) the amount of money people want to hold will rise.
D) the amount of money people want to hold will fall.
Answer: D
Question Status: Previous Edition

2) Factors that shift the demand schedule for money include all of the following EXCEPT
A) interest rate paid on money.
B) payment technology.
C) interest rate paid on non-money assets.
D) wealth.
Answer: C
Question Status: New

3) The economy is in short-run equilibrium
A) at any point on the IS curve.
B) only at the natural level of GDP.
C) at any point on the LM curve.
D) only at a point that is on both the IS and LM curves.
Answer: D
Question Status: Previous Edition

4) A change in the interest rate will generally affect the
A) level of investment.
B) level of consumption.
C) the amount of money people want to hold.
D) All of these.
Answer: D
Question Status: Previous Edition

5) Which of the following statements would be true of an economy that can be characterized as being to the left of the IS curve?
A) There is an excess demand for commodities at the existing interest rate.
B) There will be a tendency for the level of output to decrease.
C) There is an excess supply of commodities at the existing interest rate.
D) There will be a tendency for interest rates to fall.
Answer: A
Question Status: Previous Edition

6) If there is unplanned inventory accumulation there is excess
A) demand for bonds.
B) supply of bonds.
C) demand for commodities.
D) supply of commodities.
Answer: D
Question Status: Previous Edition

7) If there is unplanned inventory decumulation there is excess
A) demand for bonds.
B) supply of bonds.
C) demand for commodities.
D) supply of commodities.
Answer: C
Question Status: Previous Edition

8) As income and production rise, the demand for real money balances will ________ and interest rates will ________.
A) fall; fall
B) rise; rise
C) rise; fall
D) fall; rise
Answer: B
Question Status: Previous Edition

9) If the level of interest rates paid on time deposits rise relative to that paid by money market accounts, ceteris paribus, individual will
A) reduce their real money balances.
B) first reduce then increase their real money balances.
C) increase their real money balances.
D) hold the same amount of money.
Answer: A
Question Status: Previous Edition

10) The three functions of money are
A) store of value, medium of exchange, payment specie.
B) store of value, unit of account, bank settlement.
C) store of value, unit of account, to regulate the economy.
D) store of value, unit of account, medium of exchange.
Answer: D
Question Status: Previous Edition

11) The money supply consists of
A) currency alone.
B) currency and checking accounts.
C) checking and savings accounts.
D) currency and checking and savings accounts.
E) checking accounts alone.
Answer: B
Question Status: Previous Edition

12) In the early stages of macroeconomic model building, the money supply is regarded as a policy ________ that is under ________ control by the Federal Reserve.
A) goal, perfect
B) goal, imperfect
C) instrument, perfect
D) instrument, imperfect
Answer: C
Question Status: Previous Edition

13) "Real money balances" refers to
A) the currency part of the total money supply.
B) the money supply divided by the price level.
C) the money supply times one minus the interest rate.
D) the non-interest-earning part of the money supply.
Answer: B
Question Status: Previous Edition

14) An increase in real GDP causes the demand for real money balances to
A) rise.
B) fall.
C) remain unaffected.
D) rise, fall, or remain unaffected depending on the interest rate at the time.
Answer: A
Question Status: Previous Edition

15) On a money demand diagram with the interest rate on the vertical axis, the real money balance demand schedule would be a vertical line under the assumption that
A) a lower interest rate raises the demand for real money.
B) a lower interest rate lowers the demand for real money balances.
C) the interest rate has no effect on the demand for real money balances.
D) balances.
E) a higher real GDP raises the demand for real money balances.
Answer: C
Question Status: Previous Edition

16) Money is assumed to earn
A) no interest at all, being just currency in hand.
B) in checkable deposit form a rate below "the interest rate."
C) in checkable deposit form a rate equal to "the interest rate."
D) in checkable deposit form a rate above "the interest rate."
Answer: B
Question Status: Previous Edition

17) Holding nonmonetary assets and converting them to money when necessary is justifiable so long as
A) nonmonetary assets pay an interest rate above that available on money.
B) nonmonetary assets pay an interest rate below that available on money.
C) money, and not nonmonetary assets, are generally used in transactions.
D) money and nonmonetary assets are both used as bartering items.
Answer: A
Question Status: Previous Edition

18) Suppose that banks pay 4 percent interest on checking accounts while U.S. Savings Bonds pay 6 percent interest. Under these conditions
A) no nonmonetary assets are willingly held.
B) a combination of money and nonmonetary assets are willingly held.
C) no money balances are willingly held.
D) we do not have sufficient information to tell whether or not any money balances are willingly held.
Answer: B
Question Status: Previous Edition

19) Along a downward-sloping money demand schedule, as the interest rate falls
A) the quantity of money demanded falls.
B) the quantity of money demanded rises.
C) real income rises.
D) real income falls.
Answer: B
Question Status: Previous Edition

20) A decrease in real GDP causes
A) movement downward along a money demand schedule.
B) movement upward along a money demand schedule.
C) a rightward shift of the money demand schedule.
D) a leftward shift of the money demand schedule.
Answer: D
Question Status: Previous Edition

21) Suppose that Y = 4,000 and we are at a point on the money demand schedule where (M/P) = 600. Should Y rise to 4,200, the same quantity of real money balances
A) will not be demanded under any conditions.
B) will be demanded again provided the interest rate does not change.
C) will be demanded again provided the interest rate rises by a certain amount.
D) will be demanded again provided the interest rate falls by a certain amount.
Answer: C
Question Status: Previous Edition

22) Suppose that Y = 4,000 and we are at a point on the money demand schedule where (M/P) = 600. Should Y fall to 3,900, the same quantity of real money balances
A) will not be demanded under any conditions.
B) will be demanded again provided the interest rate does not change.
C) will be demanded again provided the interest rate rises by a certain amount.
D) will be demanded again provided the interest rate falls by a certain amount.
Answer: D
Question Status: Previous Edition

23) Suppose that we are at a point on the money demand schedule where (M/P) = 500. At a constant interest rate, the quantity of money demanded increases when real income ________ so that ________.
A) rises, the money demand schedule shifts to the right
B) rises, the money demand schedule shifts to the left
C) rises, we move downward along the money demand schedule
D) falls, the money demand schedule shifts to the left
E) falls, we move upward along the money demand schedule
Answer: A
Question Status: Previous Edition

24) The LM curve is the set of combinations of ________ such that ________.
A) interest rates and real money balances, real income equals real money balances times (1/r)
B) interest rates and real money balances, the money supply is equally demanded
C) real income and real money balances, the production of output is equally demanded
D) real income and interest rates, the production of output is equally demanded
E) real income and interest rates, the money supply is equally demanded
Answer: E
Question Status: Previous Edition

25) The "velocity" of money is
A) the ratio of real GDP to the real money supply.
B) the real money supply divided by the real GDP.
C) the money supply divided by the price level.
D) the money supply multiplied by the price level.
Answer: A
Question Status: Previous Edition

26) Among all assets, only money can be a
A) unit of account.
B) store of value.
C) medium of exchange.
D) a way of amassing wealth.
Answer: C
Question Status: Previous Edition

27) The use of money ________ barter, and ________ economic specialization.
A) eliminates the need for, increases
B) eliminates the need for, decreases
C) enhances the efficiency of, increases
D) enhances the efficiency of, decreases
Answer: A
Question Status: Previous Edition

4.3 The LM Curve

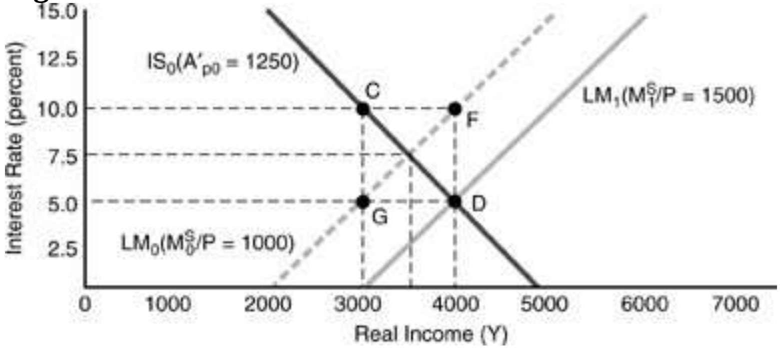
1) If the proportion of GDP that people choose to hold in the form of money balances is 0.25, then a $100 increase in the money supply will lead to a rightward shift in the LM curve in the amount of
A) $400.
B) $ 25.
C) $ 75.
D) $100.
Answer: A
Question Status: Previous Edition

2) Suppose the government increases its expenditures by $100 million and finances the resulting deficit by selling bonds. Then the LM curve will
A) shift rightward.
B) shift leftward.
C) become steeper.
D) None of these.
Answer: D
Question Status: Previous Edition

3) A change in the multiplier (k) will change the
A) slope of the IS curve.
B) slope and the position of the IS curve.
C) slope of the LM curve.
D) position of the LM curve.
Answer: B
Question Status: Previous Edition

4) The money supply is controlled by the
A) New York Stock Exchange.
B) Federal Reserve System.
C) stock of gold in the economy.
D) President of the United States.
Answer: B
Question Status: Previous Edition

Figure 4-2

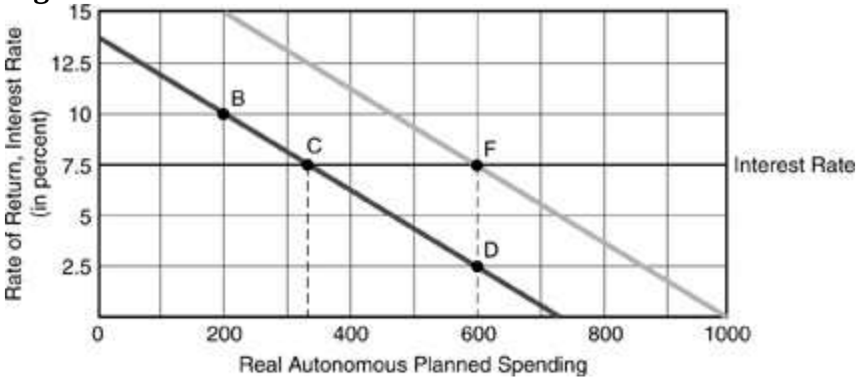


5) Employing Figure 4-2 above, the money market is initially in equilibrium at point G and after the economy moves to equilibrium, the Federal Reserve increases the money supply by 500. We would observe
A) the interest rate first rises to 7.5% and Y to 3500.
B) the interest rate first rises to 7.5% then falls to 5%.
C) Y rises to 4000 as interest rates remain stable.
D) the economy moves from point G to C, to F then D.
Answer: B
Question Status: Previous Edition

6) Since the velocity of money increases as interest rates rise the
A) LM curve is negatively sloped.
B) IS curve is negatively sloped.
C) LM curve is positively sloped.
D) IS curve is positively sloped.
Answer: C
Question Status: Previous Edition

7) An increase in the money supply will
A) decrease the quantity of money held at every interest rate.
B) increase the quantity of money held at every interest rate.
C) shift the LM curve leftward.
D) None of the above.
Answer: B
Question Status: Previous Edition

Figure 4-4



8) In Figure 4-4 above, if the interest rate falls from 10% to 7.5% and this causes businesses to become more optimistic about future investment conditions, we would observe that planned investment would
A) decrease from B to C to D.
B) increase from B to C to D.
C) increase from B to C to F.
D) decrease from B to C to F.
Answer: C
Question Status: Previous Edition

9) Moving upward along an LM curve, ________ quantity of real money balances is equally demanded as higher real incomes are accompanied by ________ interest rates.
A) an increasing, rising
B) an increasing, falling
C) a decreasing, falling
D) a constant, rising
E) a constant, falling
Answer: D
Question Status: Previous Edition

10) In deriving an LM curve, higher incomes shift the money demand schedule to the ________, yet the unchanged real money supply continues to be equally demanded so long as the interest rate ________.
A) right, rises
B) right, falls
C) left, rises
D) left, falls
Answer: A
Question Status: Previous Edition

11) In deriving LM curves, holding the real money supply constant while raising real GDP causes us to
A) trace up along an LM curve.
B) trace down along an LM curve.
C) shift the LM curve to the right.
D) shift the LM curve to the left.
Answer: A
Question Status: Previous Edition

12) At all points below the current LM curve,
A) the supply of output exceeds output demand.
B) the supply of output falls short of output demand.
C) the supply of money falls short of money demand.
D) the supply of money exceeds money demand.
Answer: C
Question Status: Previous Edition

13) From any point above the current LM curve, money market equilibrium can be restored by some combination of a ________ income and a ________ interest rate.
A) higher, higher
B) higher, lower
C) lower, higher
D) lower, lower
Answer: B
Question Status: Previous Edition

14) From any point below the current LM curve, money market equilibrium can be restored by some combination of a ________ income and a ________ interest rate that ________ the demand for money.
A) higher, higher, increases
B) higher, lower, increases
C) higher, lower, reduces
D) lower, higher, increases
E) lower, higher, reduces
Answer: E
Question Status: Previous Edition

15) On a diagram with "calories consumed per day" on the horizontal axis and "exercise per day" on the vertical axis, we can draw a line along which your body weight at this moment will remain constant. This line is analogous to how ________ for changing values of the variables on the two axes.
A) the IS curve holds income constant
B) the IS curve holds the demand for money constant
C) the LM curve holds the demand for money constant
D) the LM curve holds income constant
Answer: C
Question Status: Previous Edition

16) Moving upward along an LM curve, velocity ________ because ________ remains constant while ________ rises.

A) rises, real balances, real income
B) rises, the interest rate, the price level
C) rises, the interest rate, real balances
D) falls, real balances, real income
E) falls, real income, real balances
Answer: A
Question Status: Previous Edition

17) A higher nominal money supply is equally demanded, given each level of income, at a ________ interest rate, meaning that the LM curve has shifted to the ________.
A) higher, left
B) higher, right
C) lower, left
D) lower, right
Answer: D
Question Status: Previous Edition

18) A lower nominal money supply is equally demanded, given each interest rate, at a ________ level of income, meaning that the LM curve has shifted to the ________.
A) higher, left
B) higher, right
C) lower, left
D) lower, right
Answer: C
Question Status: Previous Edition

19) Suppose the demand for money becomes less sensitive to changes in the interest rate. In moving along an LM curve, an increase in income must be accompanied by a ________ change in the interest rate than before, meaning that the LM curve has become ________.
A) greater, steeper
B) greater, flatter
C) smaller, steeper
D) smaller, flatter
Answer: A
Question Status: Previous Edition

20) When the demand for money becomes less responsive to changes in income, the LM curve becomes ________ and it also shifts to the ________.
A) flatter, left
B) flatter, right
C) steeper, left
D) steeper, right
Answer: B
Question Status: Previous Edition

4.4 The IS Curve Meets the LM Curve

1) There are no questions for this section.
Answer:

4.5 Monetary Policy in Action

1) An increase in the money supply will raise equilibrium GDP if the
A) IS curve is not vertical.
B) IS curve is negatively sloped.
C) position of the IS curve depends on the level of real money balances.
D) position of the LM curve depends on the level of real money balances.
Answer: B
Question Status: Previous Edition

2) Which of the following would shift the LM curve?
A) an increase in the tax rate
B) an increase in the real money supply
C) a reduction in business confidence
D) All of these.
Answer: B
Question Status: Previous Edition

3) A change in the public's desire to hold money will
A) shift the IS curve.
B) change the slope of the IS curve.
C) shift the LM curve.
D) change the slope and position of the LM curve.
Answer: D
Question Status: Previous Edition

4) Which of the following statements would be true for an economy that can be characterized as being to the right of its LM curve?
A) There is excess supply of money.
B) There is excess demand for money.
C) There will be a tendency for the level of output to increase.
D) There will be a tendency for the interest rate to decrease.
Answer: B
Question Status: Previous Edition

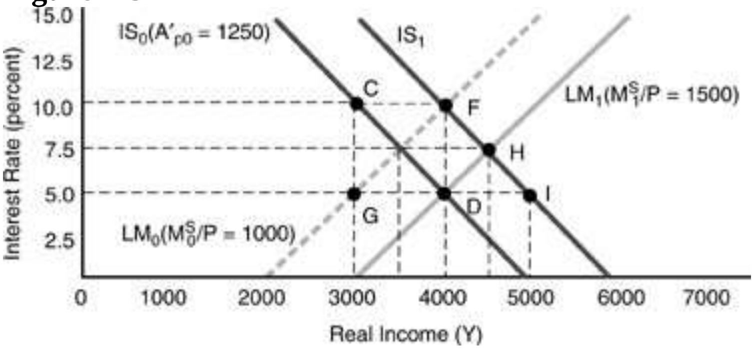
5) Which of the following statements are true?
A) The smaller the responsiveness of money demand to a change in the interest rate, the steeper the LM curve.
B) The larger the responsiveness of money demand to a change in the interest rate, the flatter the LM curve.
C) If money demand is not responsive to a change in the interest rate, the LM curve will be horizontal.
D) Both A and B.
Answer: D
Question Status: Previous Edition

6) During the recession phase of the business cycle, households become pessimistic about their future earning capacity as do banks. Nominal interest rates fall during recessions. Mortgage lending could be expected to
A) rise if the change in future earnings is thought to be greater than the change in interest payments.
B) stay the same.
C) fall.
D) fall if the change in future earnings is thought to be greater than the change in interest payments.
Answer: D
Question Status: Previous Edition

7) A change in interest rates ________, while a change in income ________ the real money demand schedule.
A) decreases; increases
B) has a large effect on; has no effect on
C) moves the economy along; shifts
D) shifts; moves along
Answer: C
Question Status: Previous Edition

8) "Since checking accounts now pay interest they should not be included in the money supply." Given that checks are the major medium of exchange, this statement is false because
A) checking accounts are primarily used for savings in the current year.
B) the interest rate on checking accounts is lower than on other accounts.
C) the demand for real balances is negatively related to interest rates.
D) money is money.
Answer: B
Question Status: Previous Edition

Figure 4-3



9) Employing Figure 4-3 above, the initial equilibrium is point D and government expenditures increase by ________ shifting the IS curve from IS_0 to IS_1 and crowding out is approximately ________.
A) 500, 500
B) 250, 500
C) 1000, 1000
D) 1000, 250
Answer: B
Question Status: Previous Edition

10) If spending is NOT responsive to changes in the interest rate, then the
A) LM curve is vertical.
B) IS and LM curves are vertical.
C) IS curve is vertical.
D) IS curve is vertical and the LM curve is horizontal.
Answer: C
Question Status: Previous Edition

11) When the marginal propensity to save declines, the
A) multiplier becomes larger and the IS curve becomes flatter.
B) marginal propensity to consume increases and there is no effect on the IS curve.
C) multiplier becomes larger and the IS curve becomes steeper.
D) multiplier declines and the IS curve becomes steeper.
Answer: A
Question Status: Previous Edition

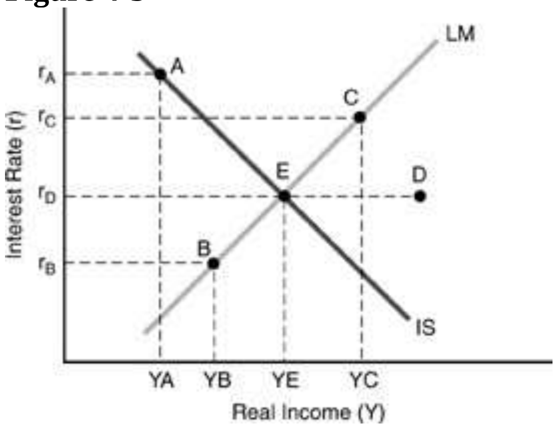
12) If the marginal leakage rate is 0.2, then a $300 fall in autonomous planned expenditures will shift the IS curve leftward by the amount of
A) $300.
B) $1500.
C) $75.
D) $600.
Answer: B
Question Status: Previous Edition

13) Which of the following would cause the IS curve to shift?
A) a change in the multiplier
B) a change in business or consumer confidence
C) an increase in autonomous tax revenue
D) All of these would shift the IS curve.
Answer: D
Question Status: Previous Edition

14) The IS curve would be vertical if
A) the government's budget was balanced.
B) autonomous expenditures were insensitive to the interest rate.
C) the demand for money was insensitive to the interest rate.
D) the government increased the money supply.
Answer: B
Question Status: Previous Edition

15) In the IS-LM diagram, we are in "general equilibrium"
A) at all points.
B) at all points on the LM curve.
C) at all points on the IS curve.
D) only at the intersection of the IS and LM curves.
Answer: D
Question Status: Previous Edition

Figure 4-5



16) In Figure 4-5, the commodity market is in equilibrium
A) at points B, C, and E.
B) at points A and E.
C) only at point E.
D) at points E and D.
E) at points A, B, E, and C.
Answer: B
Question Status: Previous Edition

17) In Figure 4-5 above, the money market is in equilibrium
A) at points B, C, and E.
B) at points A and E.
C) only at point E.
D) at points E and D.
E) at points A, B, E, and C.
Answer: A
Question Status: Previous Edition

18) In Figure 4-5 above, suppose that real income is YB and the money market is in equilibrium. The interest rate at this point is ________ to support commodity market equilibrium, so that involuntary inventory changes are ________.
A) too low, positive
B) too low, negative
C) just right, zero
D) too high, positive
E) too high, negative
Answer: B
Question Status: Previous Edition

19) In Figure 4-5 above, at what point do we find the commodity market in equilibrium while the money market is not?
A) A
B) B
C) C
D) D
E) E
Answer: A
Question Status: Previous Edition

20) In Figure 4-5 above, people would be trying to increase their holdings of money at
A) points A and E.
B) points B, E, and C.
C) point A.
D) points A and B.
E) point D.
Answer: E
Question Status: Previous Edition

21) In Figure 4-5 above, at what income would the interest rate that brings about money market equilibrium cause unwanted inventories of commodities to accumulate?
A) YA
B) YB
C) YE
D) YC
Answer: D
Question Status: Previous Edition
22) From an initial IS-LM equilibrium with normally-sloped IS and LM curves, the money supply falls. At the new IS-LM equilibrium we have some combination of a ________ income and a ________ interest rate.

A) higher, higher
B) higher, lower
C) lower, higher
D) lower, lower
Answer: C
Question Status: Previous Edition

23) Suppose we have normally-sloped IS and LM curves intersecting at point A. Then a monetary policy change shifts the LM curve to the right. Directly below point A we find a point on the new LM curve that shows us
A) where the new IS-LM equilibrium occurs.
B) how much the interest rate must fall to raise planned expenditures to the new equilibrium income.
C) how much the interest rate must fall to by itself raise the demand for money by as much as the money supply has decreased.
D) how much income must rise to by itself raise the demand for money by as much as the money supply has increased.
E) how much the interest rate must fall to by itself lower the demand for money by as much as the money supply has decreased.
Answer: C
Question Status: Previous Edition

24) Consider an initial IS-LM equilibrium with normally-sloped curves. An increase in government spending takes us to a new equilibrium with ________ income and ________ interest rate.
A) higher, a higher
B) higher, a lower
C) an unchanged, a higher
D) an unchanged, a lower
E) lower, an unchanged
Answer: A
Question Status: Previous Edition

25) Consider an initial IS-LM equilibrium with normally-sloped curves. An increase in government spending shifts the ________ by a horizontal distance equal to the change in government spending ________.
A) IS curve to the right, divided by the Chapter 3 multiplier
B) IS curve to the right, times the Chapter 3 multiplier
C) IS curve to the left, times the interest rate at the initial equilibrium
D) LM curve to the right, divided by the Chapter 3 multiplier
E) LM curve to the right, divided by the interest rate at the initial equilibrium
Answer: B
Question Status: Previous Edition

26) The Chapter 3 multiplier, because it assumes an ________ interest rate, is usually an ________ of the fiscal policy multiplier in the IS-LM model.
A) endogenous, underestimate
B) endogenous, overestimate
C) exogenous, underestimate
D) exogenous, overestimate

Answer: D
Question Status: Previous Edition

27) The September 11 attacks had the effect of shifting the
A) IS curve to the right.
B) IS curve to the left.
C) LM curve to the right.
D) LM curve to the left.
Answer: B
Question Status: Previous Edition

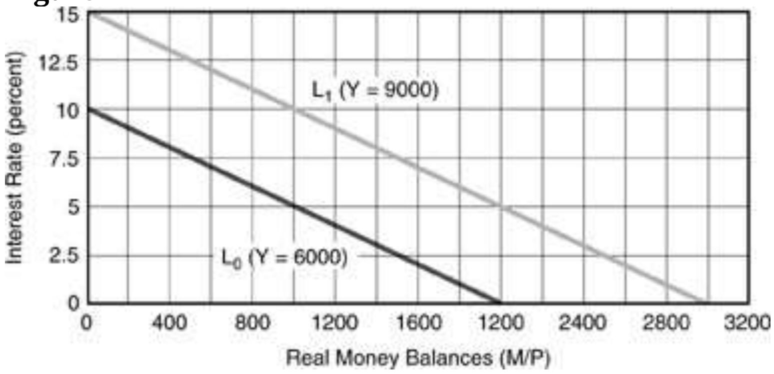
4.6 How Fiscal Expansion Can "Crowd Out" Private Investment

1) During the recession phase of the business cycle, business firms become pessimistic about their future earning capacity as do banks. Nominal interest rates fall during recessions. Investment lending could be expected to
A) rise if the change in future earnings is thought to be greater than the change in interest payments.
B) stay the same.
C) fall.
D) fall if the change in future earnings is thought to be greater than the change in interest payments.
Answer: D
Question Status: Previous Edition

2) During the expansion phase of the business cycle, households become optimistic about their future earning capacity as do banks. Nominal interest rates rise during expansions. Mortgage lending could be expected to
A) rise if the change in future earnings is thought to be greater than the change in interest rates.
B) stay the same.
C) fall.
D) fall if the change in future earnings is thought to be greater than the change in interest rates.
Answer: B
Question Status: Previous Edition

3) During the expansion phase of the business cycle, business firms become optimistic about their future earning capacity as do banks. Nominal interest rates rise during expansions. Investment lending could be expected to
A) rise if the change in future earnings is thought to be greater than the change in interest rates.
B) stay the same.
C) fall.
D) fall if the change in future earnings is thought to be greater than the change in interest rates.
Answer: A
Question Status: Previous Edition

Figure 4-1



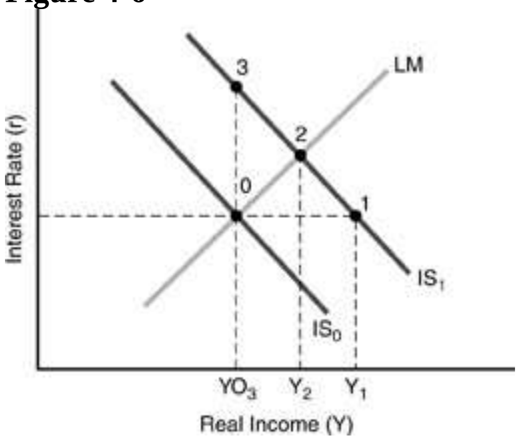
4) Employing Figure 4-1 above, if Y increases by 3000 and the interest rate is fixed at 5% then the sensitivity of real money balances to changes in real income is
A) 0.67.
B) 0.33.
C) -0.67.
D) -0.33.
Answer: B
Question Status: Previous Edition

4.7 Strong and Weak Effects of Monetary Policy

1) With normally-sloped IS and LM curves, an increase in government spending ________ the interest rate, which ________ autonomous planned expenditure, resulting in a final increase in income ________ than what the government spending increase would have produced in the Chapter 3 model.
A) lowers, raises, greater
B) lowers, lowers, greater
C) raises, lowers, less
D) raises, raises, less
E) raises, raises, greater
Answer: C
Question Status: Previous Edition

2) "Crowding-out" occurs in the IS-LM model as rising government spending requires a ________ in the interest rate in order to ________ the demand for money at the new equilibrium, thus ________ planned private investment.
A) rise, keep constant, lowering
B) rise, raise, lowering
C) rise, lower, raising
D) fall, keep constant, raising
E) fall, raise, lowering
Answer: A
Question Status: Previous Edition

Figure 4-6



3) In Figure 4-6 above, with IS_0 shifting to IS_1 against the upward-sloping LM curve, crowding-out is the result that
A) income stays at YO_3.
B) income rises to Y_1 instead of to Y_2.
C) income rises to Y_1 instead of staying at YO_3.
D) income rises to Y_2 instead of to Y_1.
Answer: D
Question Status: Previous Edition

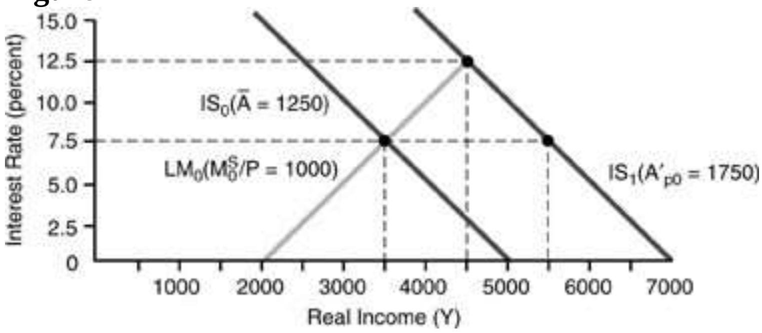
4) In Figure 4-6 above, with IS_0 shifting to IS_1 against the upward-sloping LM curve, at point 1
A) there is an excess demand for money.
B) there is an excess supply of money.
C) the demand for output exceeds Y_1.
D) the demand for output is below Y_1.
Answer: A
Question Status: Previous Edition

5) In Figure 4-6 above, with IS_0 shifting to IS_1, movement from points 0 to 2 requires the real money supply to ________.
A) rise by the same percentage as income
B) fall by the same percentage as income
C) remain constant
D) none of the above
Answer: C
Question Status: Previous Edition

6) In Figure 4-6 above, suppose we are initially at point 2. A reduction in government spending causes income to change by ________ and the interest rate to change by ________ than would be the case in the Chapter 3 model.
A) more, more
B) more, less
C) less, more
D) less, less
Answer: C
Question Status: Previous Edition

7) In constructing the planned autonomous demand schedule, which two components are assumed to depend on the interest rate?
A) government expenditures and net exports
B) government expenditures and net taxes
C) autonomous consumption and autonomous planned investment
D) autonomous consumption and net exports
E) government expenditure and autonomous planned investment
Answer: C
Question Status: Previous Edition

Figure 4-7



8) Using the information contained in Figure 4-7 above, the initial equilibrium Y is 3500. If there is 500 of new fiscal stimulus and a constant money supply, Y will increase to ________ and the interest rate will ________.
A) 4000; remain constant
B) 4000; rise to 10%
C) 4500; rise to 12.5%
D) 5500; remain constant
Answer: C
Question Status: Previous Edition

9) The "crowding-out" effect refers to the fact that
A) fiscal policy cannot be used to shift the IS curve.
B) rising interest rates tend to accompany an expansionary fiscal policy.
C) there may be a liquidity trap.
D) All of these.
Answer: B
Question Status: Previous Edition

10) Suppose the government increases its expenditures by $100 billion and simultaneously reduces the money supply by $100 billion. We definitely know that
A) equilibrium GDP will fall.
B) equilibrium GDP will rise.
C) the interest rate will rise.
D) the interest rate will fall.
Answer: C
Question Status: Previous Edition

11) When (if at all) can the crowding-out effect be prevented?
A) when the Fed decreases the money supply to accommodate the expansionary fiscal policy
B) when the real money supply is held constant
C) when the real balance effect is working
D) when the Fed allows the real money supply to increase sufficiently to keep the interest rate from rising
Answer: D
Question Status: Previous Edition

12) Complete "crowding-out" describes the situation in the economy when
A) fiscal policy is effective in changing output.
B) the shift in the LM curve by monetary policy is "impotent."
C) the shift in the IS curve by fiscal policy is "impotent."
D) fiscal policy crowds out monetary policy.
Answer: C
Question Status: Previous Edition

13) Crowding-out is eliminated when the LM curve is ________, so that expansionary fiscal policy ________ the interest rate.
A) vertical, does not affect
B) vertical, raises
C) horizontal, does not affect
D) horizontal, raises
Answer: C
Question Status: Previous Edition

4.8 Strong and Weak Effects of Fiscal Policy

1) One of the major chains of causation in macroeconomic policymaking is government manipulation of ________ in order to affect ________, and thus ultimately ________.
A) the money supply, the interest rate, equilibrium income
B) the money supply, equilibrium income, the interest rate
C) the interest rate, equilibrium income, the money supply
D) equilibrium income, the interest rate, the money supply
E) equilibrium income, the money supply, the interest rate
Answer: A
Question Status: Previous Edition

2) Suppose the Federal Reserve desires to raise the level of planned investment in the economy. It either has to hope that an improvement in business confidence shifts the rate-of-return line to the ________ , or it has to take direct action by ________ the interest rate.
A) right, raising
B) right, lowering
C) left, raising
D) left, lowering
Answer: B
Question Status: Previous Edition

3) Suppose the Fed changes the interest rate in an attempt to raise planned investment. But in spite of this, planned investment remains unchanged. The most likely explanation is that
A) we have moved downward along an unchanged rate-of-return line.
B) we have moved upward along an unchanged rate-of-return line.
C) the rate-of-return line has shifted to the left.
D) the rate-of-return line has shifted to the right.
Answer: C
Question Status: Previous Edition
4) A daily auction at the Chicago Board of Trade sets
A) Federal funds rate.
B) 10-year bond rate.

C) Discount rate.
D) Prime rate.
E) Credit cards rate.
Answer: B
Question Status: New

5) Monetary policy will have a large income effect provided the
A) IS curve is flat.
B) LM curve is steep.
C) IS curve is steep.
D) LM curve is flat.
Answer: A
Question Status: Previous Edition

6) Monetary policy will have a large income effect provided the
A) sensitivity of autonomous spending to interest rates is high.
B) sensitivity of autonomous spending to interest rates is low.
C) sensitivity of output changes to interest rates is small.
D) None of the above.
Answer: A
Question Status: Previous Edition

4.9 Using Fiscal and Monetary Policy Together

1) Fiscal policy makers may indirectly control the money supply if
A) they vote to "print" more dollars
B) the Fed targets interest rates
C) the Fed "prints" money as cyclical deficits increase
D) the budget deficit is a structural deficit
Answer: B
Question Status: Previous Edition

2) With normally-sloped IS and LM curves, an increase in government expenditure ________ consumption expenditure since autonomous consumption ________ while induced consumption ________.
A) can raise or lower, falls, rises
B) can raise or lower, rises, falls
C) must decrease, falls, also falls
D) must decrease, rises, falls
E) must increase, rises, also rises
Answer: A
Question Status: Previous Edition

3) The effect on the IS curve of a reduction in taxes will be less the
A) flatter is the LM curve.
B) steeper is the LM curve.
C) greater the extent of "crowding out."
D) greater is the marginal propensity to save.
Answer: D
Question Status: Previous Edition

4) A steep IS curve implies that
A) an increase in money supply will change output by a relatively small amount.
B) a decrease in taxes will change output by a relatively small amount.
C) changes in money supply will have large multiplier effects on output.
D) A and B.
Answer: A
Question Status: Previous Edition

5) A flat IS curve implies that
A) an increase in money supply will change output by a relatively small amount.
B) a decrease in taxes will change output by a relatively large amount.
C) changes in money supply will have large multiplier effects on output.
D) A and B.
Answer: C
Question Status: Previous Edition

6) The simple fiscal policy multiplier occurs in the IS-LM model when ________ interest responsiveness of money demand produces a ________ LM curve.
A) zero, vertical
B) zero, horizontal
C) infinite, vertical
D) infinite, horizontal
Answer: D
Question Status: Previous Edition

Appendix to Chapter 4: The Elementary Algebra of the IS-LM Model

1) During Global Financial Crises, housing starts in the US fell by
A) 76%.
B) 25%.
C) 30%.
D) 95%.
Answer: A
Question Status: New

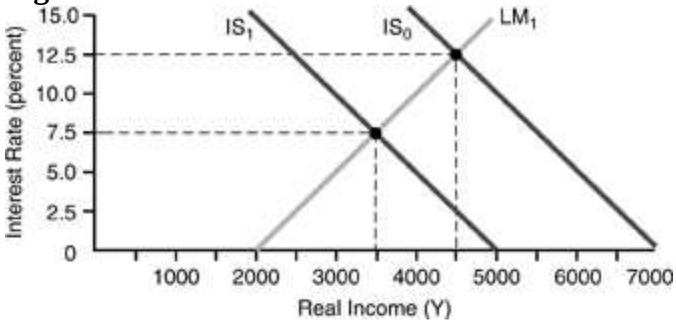
2) Monetary policy loses its effectiveness in all of the following situations EXCEPT
A) when the IS curve is vertical.
B) when the LM curve is nearly horizontal.
C) when interest rate controlled by the Fed reaches zero.
D) when the IS curve is horizontal.
Answer: D
Question Status: New

3) Monetary policy showed to be impotent in which of the following historical episodes.
A) Japan since 1992
B) U.S. since 1941
C) China between 1980 and 1987
D) U.S. between 1975 and 1982
Answer: A
Question Status: New

4) An increase in the marginal propensity to consume would cause the IS curve to
A) make a parallel shift to the right.
B) make a parallel shift to the left.
C) rotate to become steeper from its vertical intercept.
D) rotate to become flatter from its vertical intercept.
E) rotate to become flatter from its horizontal intercept.
Answer: D
Question Status: Previous Edition

5) Fully accommodating monetary policy results in
A) a constant interest rate.
B) the simple fiscal-policy multiplier of Chapter 3.
C) an increase in the money supply when there is a rise in government spending.
D) All of these.
Answer: D
Question Status: Previous Edition

Figure 4-8



6) If Figure 4-8 above is to show the result of a "fully accommodating" monetary policy following a shift of the IS curve from IS_0 to IS_1, what is the initial level of real income and interest rate before these changes?
A) 3500; 7.5%.
B) 4500; 12.5%.
C) 5500; 7.5%.
D) 4500; 2.5%.
Answer: C
Question Status: Previous Edition

7) Given the level of real GDP, the equilibrium level of the interest rate depends on the
A) demand for money.
B) monetary-fiscal policy mix.
C) size of the multiplier.
D) extent of crowding out.
Answer: B
Question Status: Previous Edition

8) The fiscal-policy multiplier will be greater
A) the greater is the interest responsiveness of the demand for money.
B) the smaller is the interest responsiveness of autonomous expenditures.
C) the smaller is the income responsiveness of the demand for money.
D) All of the above tend to make the fiscal-policy multiplier greater.
Answer: D
Question Status: Previous Edition

9) For a given level of equilibrium GDP, a tight-money/easy-fiscal policy mix compared with easy-money/tight-fiscal policy mix implies a
A) lower interest rate.
B) lower level of investment.
C) higher level of taxation.
D) lower level of government expenditures.
Answer: B
Question Status: Previous Edition

10) If a given fiscal policy is fully accommodated by monetary policy, then
A) GDP will remain constant.
B) the interest rate will remain constant.
C) GDP and the interest rate will move in the same direction.
D) GDP and the interest rate will move in the opposite direction.
Answer: B
Question Status: Previous Edition

11) If the IS curve is negatively sloped and the LM curve is positively sloped
A) an increase in government expenditures will raise real GDP and lower interest rates.
B) a fall in the real money supply will raise real GDP and lower the interest rate.
C) an increase in taxes and an increase in money supply will lower the interest rate and give little or no change in real GDP.
D) an increase in taxes and a fall in the money supply will raise the interest rate and give little or no change in real GDP.
Answer: C
Question Status: Previous Edition

12) An increase in transfer payments would have the same short run effect on the government deficit as an equal
A) increase in government expenditures.
B) reduction in taxes.
C) increase in taxes.
D) Both A and B.
Answer: D
Question Status: Previous Edition

13) We can infer that the government is following a restrictive fiscal policy when
A) the actual deficit falls.
B) the natural employment deficit falls.
C) the actual deficit rises.
D) the natural employment deficit rises.
Answer: B
Question Status: Previous Edition

14) We can infer that the government is following a restrictive fiscal policy when
A) the actual surplus falls.
B) the natural employment surplus falls.
C) the actual surplus rises.
D) the natural employment surplus rises.
Answer: D
Question Status: Previous Edition

15) Monetary restraint and fiscal stimulus will
A) both lower the real rate of interest.
B) both raise the real rate of interest.
C) have differing effects on the real rate of interest.
D) Both raise the level of output.
Answer: B
Question Status: Previous Edition

16) Which of the following events occur when fiscal expansion is used without accommodating monetary policy?
A) Total government spending increases (or net taxes decrease).
B) Total private induced spending increases.
C) Private induced spending decreases.
D) A and B are both correct.
Answer: D
Question Status: Previous Edition

17) If the demand for money was totally independent of the interest rate, the LM curve would ________ and monetary policy would ________.
A) have a positive slope, quite powerful
B) have a positive slope, impotent
C) be vertical, quite powerful
D) be vertical, impotent
Answer: C
Question Status: Previous Edition

18) An increase in the real money supply will have its maximum effect on the equilibrium level of GDP when the
A) LM curve is vertical.
B) LM curve is horizontal.
C) IS curve is vertical.
D) IS curve is negatively sloped.
Answer: A
Question Status: Previous Edition

19) A steep LM curve implies that
A) an increase in government spending will change output by a relatively small amount.
B) a decrease in taxes will change output by a relatively small amount.
C) changes in government spending and taxes will have a large multiple effect on output.
D) A and B.
Answer: D
Question Status: Previous Edition

20) A flat LM curve implies that
A) an increase in government spending will change output by a relatively small amount.
B) a decrease in taxes will change output by a relatively small amount.
C) changes in government spending and taxes will have a large multiple effect on output.
D) A and B.
Answer: C
Question Status: Previous Edition

21) If spending is NOT responsive to changes in the interest rate, then
A) the Fed is "impotent."
B) tax policy is "impotent."
C) fiscal policy is "impotent."
D) the Fed is "potent."
Answer: A
Question Status: Previous Edition

22) If a 200 billion dollar increase in government spending occurs when the Fed seeks to maintain a fixed interest rate then
A) there is no crowding out, the LM curve shifts to offset the shift in the IS curve.
B) there is no crowding out, the monetary policy is fixes as is the LM curve fixed.
C) crowding out is assured since monetary policy is fixed.
D) crowding out is assured since the Fed will accommodate the spending increases.
Answer: A
Question Status: Previous Edition

23) A "tight" money, easy "fiscal" policy combination will be preferred by society which values
A) low growth rates, but more goods and services in the future.
B) public goods today greater than private goods in the future.
C) private goods today more than public goods in the future.
D) public and private goods in the future more than public and private goods today.
Answer: B
Question Status: Previous Edition

24) A "easy" money, tight "fiscal" policy combination will be preferred by society which values
A) low growth rates, but more goods and services in the future.
B) public goods today greater than private goods in the future.
C) private goods today more than public goods in the future.
D) public and private goods in the future more than public and private goods today.
Answer: D
Question Status: Previous Edition

25) During the 1990s, Japan's economy experienced
A) a tripling of values in the stock market.
B) negligible inflation and unemployment rates.
C) falling short-term interest rates.
D) All of the above.
Answer: C
Question Status: Previous Edition

26) In a "liquidity trap,"
A) the demand for money is infinite.
B) the LM curve is a vertical line.
C) the nominal interest rate on short-term assets is relatively high.
D) money supply changes have a strong impact on interest rates.
Answer: A
Question Status: Previous Edition

27) In a liquidity trap, the
A) IS curve is vertical.
B) IS curve is horizontal.
C) LM curve is vertical.
D) LM curve is horizontal.
Answer: D
Question Status: Previous Edition

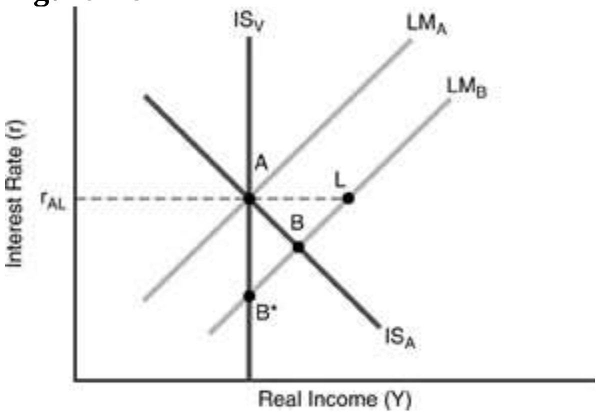
28) According to Paul Krugman, during the past decade Japan's macroeconomic policy should have incorporated which of the following?
A) stimulatory monetary policy
B) stimulatory fiscal policy
C) monetization of the debt by the central bank
D) All of the above
Answer: D
Question Status: Previous Edition

29) The practice of "monetizing the debt" is traditionally feared because it is thought to cause
A) unemployment.
B) inflation.
C) a falling price level.
D) a liquidity trap.
Answer: B
Question Status: Previous Edition

30) From an initial IS-LM equilibrium with a normally-sloped IS curve and a vertical LM curve, the money supply increases. A the new IS-LM equilibrium we have
A) higher income and a lower interest rate.
B) higher income and an unchanged interest rate.
C) an unchanged income and a lower interest rate.
D) lower income and an unchanged interest rate.
E) an unchanged income and a higher interest rate.
Answer: A
Question Status: Previous Edition

31) Suppose that changes in the interest rate have absolutely no effect on the demand for money. The resulting ________ LM curve causes monetary policy to have ________ effect in changing income.
A) horizontal, no
B) horizontal, an unusually strong
C) vertical, no
D) vertical, an unusually strong
Answer: D
Question Status: Previous Edition

Figure 4-9



32) In Figure 4-9 above, suppose LMA shifts to LMB. The distance from points A to L tells us
A) the change in income given zero interest responsiveness of Ap.
B) the change in income resulting from the interest rate falling to its value at point B□.
C) how much the money supply increased in producing the LM shift.
D) the change in income that by itself raises the demand for money by as much as the money supply rose.
Answer: D
Question Status: Previous Edition

33) A vertical IS curve comes from the assumption that changes in the interest rate do NOT affect
A) money demand.
B) the money supply.
C) autonomous planned spending.
D) the LM curve.
Answer: C
Question Status: Previous Edition

34) When the demand for money depends only on real income, the resulting ________ LM curve causes fiscal policy to have a ________ effect on income.
A) vertical, very strong
B) vertical, zero
C) horizontal, very strong
D) horizontal, zero
Answer: B
Question Status: Previous Edition

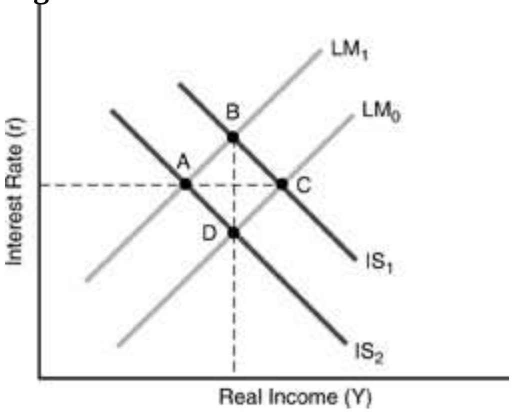
35) In the IS-LM model, the fiscal multiplier effect can be increased by
A) larger increases in government expenditure.
B) expansions of the money supply.
C) contractions of the money supply.
D) raising the income tax rate.
Answer: B
Question Status: Previous Edition

36) If the Fed's goal is to keep the interest rate fixed, a contractionary fiscal policy must be accompanied by ________ monetary policy that shifts the LM curve to the ________.
A) an expansionary, right
B) an expansionary, left
C) a contractionary, right
D) a contractionary, left
Answer: D
Question Status: Previous Edition

37) To "accommodate" an expansionary fiscal policy, the Fed ________ the money supply in order to hold ________ constant.
A) expands, the interest rate
B) expands, real income
C) contracts, the interest rate
D) contracts, real income
Answer: A
Question Status: Previous Edition

38) If the Fed's goal is to hold income constant, an expansionary fiscal policy must be accompanied by ________ monetary policy, and the Fed must allow the interest rate to ________ significantly.
A) an expansionary, rise
B) an expansionary, fall
C) a contractionary, rise
D) a contractionary, fall
Answer: C
Question Status: Previous Edition

Figure 4-10



39) In Figure 4-10 above, expansionary fiscal policy accommodated by the Fed can be pictured as a movement from points
A) A to D.
B) A to C.
C) D to B.
D) B to D.
E) A to B.
Answer: B
Question Status: Previous Edition

40) In Figure 4-10 above, if the Fed's goal is to hold income constant, contractionary fiscal policy combined with the Fed's response takes us from points
A) B to D.
B) D to B.
C) A to C.
D) C to A.
Answer: A
Question Status: Previous Edition

41) In Figure 4-10 above, preferring the "easy fiscal, tight money" policy mix at a certain income is why we are at
A) point A rather than point C.
B) point C rather than point A.
C) point D rather than point B.
D) point B rather than point D.
Answer: D
Question Status: Previous Edition

42) In Figure 4-10 above, preferring the "easy money, tight fiscal" policy mix at a certain income is why we are at
A) point A rather than point C.
B) point C rather than point A.
C) point D rather than point B.
D) point B rather than point D.
Answer: C
Question Status: Previous Edition

Macroeconomics, 12e **(Gordon)**
Chapter 5 Financial Markets, Financial Regulation, and Economic Instability

5.1 Introduction: Financial Markets and Macroeconomics

1) The impact of financial markets on the economy comes partly through
A) the substitution effect.
B) the wealth effect.
C) the international trade effect.
D) the travel effect.
Answer: B
Question Status: New

2) The wealth effect refers to
A) the impact of household real wealth on consumption, savings, and the IS curve.
B) the impact of household real wealth on money, prices, and the LM curve.
C) the impact of household real wealth on short term and long term interest rates.
D) the impact of household real wealth on aggregate supply curve.
Answer: A
Question Status: New

3) During recent Global Economic Crises, consumers' real wealth in the U.S. declined as a result of
A) the stock market crash, pricking of the housing bubble, and the increased household borrowing.
B) the expansionary fiscal policy, and the expansionary monetary policy.
C) the lack of fiscal and monetary policy coordination.
D) the banks' decision not to issue additional loans.
Answer: A
Question Status: New

4) During recent Global Economic Crises, consumers' wealth in the U.S. declined as a result

of all of the following EXCEPT
A) the stock market crash.
B) pricking of the housing bubble.
C) increased household borrowing.
D) aggressive fiscal policy.
Answer: D
Question Status: New

5) Ceteris paribus, if bond prices rise, then
A) there is no effect on bond yields.
B) bond yields will increase as well.
C) bond yields will fall
D) the Federal reserve must be pursuing contractionary monetary policy.
Answer: C
Question Status: New

6) Ceteris paribus, bond price and bond yields are
A) inversely related.
B) positively related.
C) not related.
D) associated but not correlated.
Answer: A
Question Status: New

7) Subprime mortgages refer to the mortgages issued
A) by low rating financial institutions.
B) at an interest rate below prime rate.
C) to borrowers with low incomes and poor credit histories.
D) by government
Answer: C
Question Status: New

8) Mortgages issued to individuals with low incomes and poor credit history are called
A) credit mortgages.
B) teaser mortgages.
C) subprime mortgages.
D) income mortgages.
Answer: C
Question Status: New

9) Teaser interest rates refer to
A) the initial rates that are typically below market rate and are offered by lenders to entice the clients to borrow.
B) mortgage rates.
C) rates charged on all subprime mortgages.
D) none of the above.
Answer: A
Question Status: New

5.2 Case Study: Dimensions of the Global Economic Crisis

1) The output gap of zero indicates that
A) nominal GDP is equal to Real GDP.
B) GDP is equal to GNP.
C) the balance between unemployment and inflation has been reached.
D) actual real GDP is equal to natural real GDP.
Answer: D
Question Status: New

2) When actual real GDP is above natural real GDP, we say that
A) the output gap is positive.
B) the output gap is negative.
C) the output gap has been eliminated.
D) the output gap cannot be calculated.
Answer: A
Question Status: New

3) When actual real GDP is below natural real GDP, we say that
A) the output gap is positive.
B) the output gap is negative.
C) the output gap has been eliminated.
D) the output gap cannot be calculated.
Answer: B
Question Status: New

4) Positive output gap indicates that
A) the actual real GDP is above natural real GDP.
B) the actual real GDP is below natural real GDP.
C) nominal GDP is above real GDP.
D) nominal GDP is below real GDP.
Answer: A
Question Status: New

5) Negative output gap indicates that
A) the actual real GDP is above natural real GDP.
B) the actual real GDP is below natural real GDP.
C) nominal GDP is above real GDP.
D) nominal GDP is below real GDP.
Answer: B
Question Status: New

5.3 Financial Institutions, Balance Sheets, and Leverage

1) Organized exchanges where securities and financial instruments are bought and sold are called
A) financial intermediaries.
B) financial markets.
C) banks.
D) financial branches.
Answer: B
Question Status: New

2) Financial markets are
A) institutions that make loans to borrowers and obtain funds from savers.
B) organized exchanges where securities and financial instruments are bought and sold.
C) organized exchanges where currencies are traded.
D) institutions that regulate financial instruments.
Answer: B
Question Status: New

3) Institutions that make loans to borrowers and obtain funds from savers are called
A) financial markets.
B) financial intermediaries.
C) financial conglomerates.
D) financial branches.
Answer: B
Question Status: New

4) Financial intermediaries are
A) institutions that regulate financial instruments.
B) organized exchanges where currencies are traded.
C) organized exchanges where securities and financial instruments are bought and sold
D) institutions that make loans to borrowers and obtain funds from savers.
Answer: D
Question Status: New

5) Funds are channeled from savers to borrowers directly through ________ and indirectly through ________.
A) financial markets; financial intermediaries
B) financial intermediaries; financial markets
C) main banks; branches
D) brokers;' agents
Answer: A
Question Status: New

6) Funds are channeled from savers to borrowers indirectly through ________ and directly through ________.
A) financial intermediaries; financial markets
B) financial markets; financial intermediaries
C) main banks; branches
D) broker; agents
Answer: A
Question Status: New

7) Referring to a bank's t-account, equity refers to
A) the difference between total assets and total liabilities.
B) the sum of total assets and total liabilities.
C) the ratio of the total assets and total liabilities.
D) none of the above.
Answer: A
Question Status: New

8) Bank equity is also referred to as
A) bank deposits.
B) bank reserves.
C) bank capital.
D) bank assets.
Answer: C
Question Status: New

9) In addition to being subject to the Fed's reserve requirements, the banks are also required to maintain a capital requirement, which is
A) the ratio of its deposits to its reserves.
B) the ratio of its loans to its reserves.
C) the ratio of its total assets to its total liabilities.
D) the ratio of its equity to its total assets.
Answer: D
Question Status: New

10) The ratio of bank's equity to its total assets is called
A) capital requirements.
B) leverage.
C) assets requirement.
D) risk.
Answer: A
Question Status: New

5.4 A Hardy Perennial: Bubbles and Crashes

1) Price bubble occurs when
A) price of an asset soars far above "fundamentals" like corporate earning or household income.
B) people can no longer afford to purchase an asset.
C) economy enters recessionary period.
D) economy experiences prolonged and slow recovery.
Answer: A
Question Status: New

2) Past centuries witnessed two important stock price bubbles. The first one occurred between ________, and the second one occurred between ________.
A) 1927-29; 2006-08
B) 1973-76; 2006-08
C) 1965-73; 1996-2000
D) 1927-29; 1996-2000
Answer: D
Question Status: New

3) According to Gordon, the three main ingredients in the recent U.S. housing bubble are
A) low interest rates, saving glut, and financial innovation.
B) high interest rates, lack of savings, and financial innovation.
C) financial innovation, expansionary fiscal policy, and capital outflow.
D) capital outflow, budget deficit, and trade deficit.
Answer: A
Question Status: New

4) According to Gordon, all of the following are important ingredients in the recent U.S. housing bubble EXCEPT
A) low interest rates.
B) saving glut.
C) financial innovation.
D) trade deficit.
Answer: D
Question Status: New

5) The process of combining many different debt instruments like home mortgages into a pool of hundreds of thousands of individual contracts and then selling new financial instruments is called
A) Securitization.
B) Leveraging.
C) Sub-priming.
D) NINJA loaning.
Answer: A
Question Status: New

5.5 Financial Innovation and the Subprime Mortgage Market

1) The securities, such as stocks or bonds, constitutes a(n) ________ for the borrowers and a (n) ________ for the saver.
A) asset; liability
B) asset; debt
C) liability; asset
D) debt or an asset; liability or an asset
Answer: C
Question Status: New

2) The securities, such as stocks or bonds, constitute a(n) ________ for the savers and a(m) ________ for the borrowers.
A) asset; liability
B) debt; assets
C) liability; asset
D) debt or an asset; liability or an asset
Answer: A
Question Status: New

3) Referring to a bank's t-account, the difference between total assets and total liabilities is called
A) leverage.
B) reserves.
C) deposits.
D) equity.
Answer: D
Question Status: New

5.6 The IS-LM Model, Financial Markets, and the Monetary Policy Dilemma

1) The ratio of the liabilities of a financial institution to equity capital is called
A) leverage.
B) assets.
C) liabilities.
D) equity.
Answer: A
Question Status: New

2) Leverage refers to
A) the ratio of total assets of a financial institution to total liabilities.
B) the ratio of the liabilities of a financial institution to equity capital..
C) the ratio of equity capital of a financial institution to the liabilities.
D) the ratio of the debt of a financial institution to liabilities.
Answer: B
Question Status: New

3) The main differences between the bank and the nonbank institutions include all of the following EXCEPT
A) banks are regulated by the Fed while nonbank institutions are not.
B) banks obtain the funds to buy investment by attracting deposits while nonbank institutions borrow funds.
C) banks hold more equity then nonbank institutions.
D) banks' balance sheets include assets and liabilities while nonbank institutions' balance sheets include only liabilities.
Answer: D
Question Status: New

4) The common feature of the Great Depression and the Global Economic Crisis is
A) that they were preceded by an asset price bubble.
B) the active role of the Government before the crises.
C) the active role of the FED before the crises.
D) the immediate and the aggressive response by both government and the FED.
Answer: A
Question Status: New

5) Securitization is
A) the process of combining many different debt instruments like home mortgages into a pool of hundreds of thousands of individual contracts and then selling new financial instruments.
B) the process of securing loans at the bank.
C) the process of combining assets and debt into a pool of individual contracts and then selling new financial instruments.
D) the process that FDIC uses to insure.
Answer: A
Question Status: New

6) In the IS-LM model, assuming downward sloping IS curve and upward sloping LM curve, reduction in consumers' wealth is going to
A) cause a movement along the IS curve.
B) cause a leftward shift of the IS curve.
C) cause a leftward shift in the LM curve.
D) cause a rightward shift of the LM curve.
Answer: B
Question Status: New

7) In the IS-LM Model, assuming downward sloping IS curve and upward sloping LM curve; increase in consumers' wealth is going to
A) cause a movement along the IS curve.
B) cause a rightward shift of the IS curve.
C) cause a leftward shift of the LM curve.
D) cause a rightward shift of the LM curve.
Answer: B
Question Status: New

8) The average difference over a long period of the interest rate on long-term bonds and the interest rate on the short-term federal funds rate is called
A) risk premium.
B) term premium.
C) FED's premium.
D) monetary premium.
Answer: B
Question Status: New

9) Term premium refers to
A) the average difference over a long period of the interest rate on long-term bonds and the interest rate on the short-term federal funds rate.
B) the average difference over a long period of the interest rate on short-term financial instruments and the interest rate on the discount rate.
C) the difference between the corporate bond rate and the risk-free rate of Treasury bonds.
D) the difference between prime rate and the discount rate.
Answer: C
Question Status: New

10) Risk Premium refers to
A) the average difference over a long period of the interest rate on long-term bonds and the interest rate on the short-term federal funds rate.
B) the average difference over a long period of the interest rate on short-term financial instruments and the interest rate on the discount rates.
C) the difference between the corporate bond rate and the risk-free rate of Treasury bonds.
D) the difference between prime rate and the discount rate.
Answer: C
Question Status: New

11) The difference between the corporate bond rate and the risk-free rate of Treasury bonds is called
A) risk premium.
B) term premium.
C) Fed's premium.
D) monetary premium.
Answer: A
Question Status: New

12) As shown by the IS-LM model, there are two reasons that the Fed can lose control of the economy. One of these reasons is
A) federal funds rate can never reach zero percent.
B) zero federal funds rate is not sustainable.
C) household and business borrowers do not base their decision to borrow on interest rates.
D) that the zero federal funds rate achieved by the Fed is irrelevant to household and business borrowers.
Answer: D
Question Status: New

13) If the intersection of the IS curve with the horizontal axis comes at a level of output below the natural level of output, the Fed
A) can easily bring the economy back to the full-employment level of output.
B) loses control of the economy.
C) must use contractionary model policy to correct economic problem.
D) must decrease money supply and ignore interest rates.
Answer: B
Question Status: New
14) If the intersection of the IS curve with the horizontal axis comes at a level of output below the natural level of output, lowering interest rate to zero will
A) bring economy back to natural output.

B) not bring the economy back to natural output.
C) will have inflationary effects on the economy.
D) will cause saving rates to increase.
Answer: D
Question Status: New

15) In the recent Global Economic Crisis, all of the following are causes that pushed the IS curve to the left EXCEPT
A) the negative wealth effect from the collapse of the housing bubble.
B) the end of cash-out mortgage refinancing.
C) growing unwillingness of banks and nonbank financial institutions to grant loan.
D) slow and minimal response of the U.S. government.
Answer: D
Question Status: New

16) In the recent Global Economic Crisis, the end of cash-out mortgage refinancing caused
A) LM curve to shift to the right.
B) LM curve to shift to the left.
C) IS curve to shift to the left.
D) LM curve to shift to the right.
Answer: C
Question Status: New

17) In the recent Global Economic Crisis, the negative wealth effect caused
A) LM curve to shift to the right.
B) LM curve to shift to the left.
C) IS curve to shift to the left.
D) LM curve to shift to the right.
Answer: C
Question Status: New

18) In the recent Global Economic Crisis, the negative wealth effect from a 50 percent decline in the stock market caused
A) LM curve to shift to the right.
B) LM curve to shift to the left.
C) IS curve to shift to the left.
D) LM curve to shift to the right.
Answer: C
Question Status: New

19) In the recent Global Economic Crisis, the growing unwillingness of banks and non bank financial institutions to grant loans caused
A) LM curve to shift to the right.
B) LM curve to shift to the left.
C) IS curve to shift to the left.
D) LM curve to shift to the right.
Answer: C
Question Status: New

5.7 The Fed's New Instrument: Quantitative Easing

1) ________ occurs when a central bank purchases assets with the intention not of lowering the short-term interest rate, which is already at zero, but with the purpose of increasing bank reserves.
A) Quantitative easing
B) Fiscal incrementing
C) Loan originating
D) Fiscal easing
Answer: A
Question Status: New

5.8 How the Crisis Became Worldwide and the Dilemma for Policymakers

1) There are no questions for this section.
Answer:

***Macroeconomics, 12e* (Gordon)**
Chapter 6 The Government Budget, the Government Debt, and the Limitations of Fiscal Policy

6.1 Introduction: Can Fiscal Policy Rescue Monetary Policy from Ineffectiveness?

1) If an economy uses monetary policy as its stabilization tool, the real interest rate and thus ________-run economic welfare depend on that economy's ________ policy.
A) short, monetary
B) short, fiscal
C) long, monetary
D) long, fiscal
Answer: D
Question Status: Previous Edition

2) If monetary policy is used to control GDP, there is greater sacrifice of long-run economic growth in pursuing short-run stabilization the ________ is fiscal policy and thus the ________ is the real interest rate.
A) tighter, higher
B) tighter, lower
C) easier, higher
D) easier, lower
Answer: C
Question Status: Previous Edition

3) If monetary policy is used to control real GDP then fiscal policy is a major determinant of
A) interest rates and economic growth.
B) interest rates and the foreign trade deficit.
C) unemployment and the foreign exchange rate.
D) None of the above.
Answer: A
Question Status: Previous Edition

4) Once monetary policy is dedicated to controlling the level of nominal GDP, then fiscal policy can be used to
A) choose the overall level of interest rates, with a high budget surplus implying a high level of interest rates.
B) choose the overall level of interest rates, with a high budget deficit implying a high level of interest rates.
C) control the level of inflation, with a high budget surplus implying a faster rate of inflation.
D) control the level of inflation, with a high budget deficit implying a faster rate of inflation.
Answer: B
Question Status: Previous Edition

6.2 The Pervasive Effects of the Government Budget

1) The three ways of reducing a government budget deficit are to
A) decrease government spending, reduce consumption, increase the tax rate.
B) increase government spending, decrease real income, reduce the tax rate.
C) decrease government spending, increase real income, reduce the tax rate.
D) decrease government spending, increase real income, increase the tax rate.
Answer: D
Question Status: Previous Edition

2) Suppose we are modeling a "closed" economy. The only way its government can obtain more goods and services than it can claim with net tax revenues is for
A) exports to exceed imports.
B) imports to exceed exports.
C) investment to exceed saving.
D) saving to exceed investment.
Answer: D
Question Status: Previous Edition

3) Suppose we have an economy for which G = 300, T = 240, S = 80, I = 45, and imports = 40. Exports must be
A) 25.
B) 40.
C) 15.
D) 65.
E) -25.
Answer: C
Question Status: Previous Edition

4) Suppose we have an economy for which G = 1100, T = 800, S = 230, and I = 230. If I falls to 150, the economy's trade deficit
A) increases from 0 to 80.
B) decreases from 300 to 220.
C) decreases from 0 to -80.
D) decreases from 70 to -10.
E) increases from 0 to 70.
Answer: B
Question Status: Previous Edition

5) In a small open economy, an increase in government spending, while taxes remain the same, will be accompanied by
A) a decrease in private investment and an increase in privates saving.
B) an increase in private investment and a decrease in private savings.
C) a decrease in national savings and an increase in foreign borrowing.
D) an increase in national savings and a decrease in foreign borrowing.
Answer: C
Question Status: Previous Edition

6) In a small open economy, when exports exceed imports, all of the following are true EXCEPT

A) net capital outflows are positive.
B) net exports are positive.
C) domestic investment exceeds domestic saving.
D) domestic output exceeds spending.
Answer: C
Question Status: Previous Edition

7) In a small open economy, the real interest rate will always be
A) above the world real interest rate.
B) below the world real interest rate.
C) equal to the world real interest rate.
D) independent of the world real interest rate.
Answer: C
Question Status: Previous Edition

6.3 Case Study: The Government Budget in Historical Perspective

1) During the fiscal expansion associated with the Vietnam war, what type of expenditures was initially "crowded out?"
A) autonomous consumption
B) nonresidential fixed investment
C) residential construction
D) nonresidential construction
Answer: C
Question Status: Previous Edition

2) In the 1980s, expansionary fiscal policy is believed to have crowded out
A) domestic investment as interest rates rose.
B) exports and imports as interest rates rose.
C) exports but not domestic investment as interest rates rose.
D) domestic investment as interest rates fell.
Answer: C
Question Status: Previous Edition

3) In the 1980s national savings declined as a percentage of GDP. Assuming that domestic private investment's percentage share has not declined, this situation requires, ceteris paribus,
A) net foreign investment (NX) to decrease.
B) net foreign investment (NX) to increase.
C) U.S. exports to decrease.
D) A and C are both necessary outcomes.
Answer: B
Question Status: Previous Edition

4) Historical data suggests that a trend toward ________ natural employment ________.
A) larger, deficits from the early 1960s to the mid-1980s.
B) larger, surpluses form the early 1960s to the mid-1980s.
C) smaller, surpluses form the mid-1980s to 1995.
D) larger, surpluses from the mid-1980s to 1995.
Answer: A
Question Status: Previous Edition

5) The 2001 recession was caused principally by
A) a slowing in the growth of the money supply.
B) a drop in autonomous consumption spending.
C) a decrease in government spending.
D) a drop in real business investment.
Answer: D
Question Status: Previous Edition

6) The economic policy response to the 2001 recession consisted of
A) a rapid change in fiscal policy and monetary policy.
B) a sluggish change in fiscal policy and monetary policy.
C) a rapid change in fiscal policy and a sluggish change in monetary policy.
D) a sluggish change in fiscal policy and a rapid change in monetary policy.
Answer: A
Question Status: Previous Edition

7) In the period 1980-92, United States net national saving fell due to
A) large budget deficits and an increase in private saving.
B) small budget deficits and a decrease in private saving.
C) small budget deficits and an increase in private saving.
D) large budget deficits and a decrease in private saving.
Answer: D
Question Status: Previous Edition

8) In the late 1980s the U.S. government ran a succession of large budget ________ which resulted mainly in ________ crowding-out.
A) deficits, domestic
B) deficits, international
C) surpluses, domestic
D) surpluses, international
Answer: B
Question Status: Previous Edition

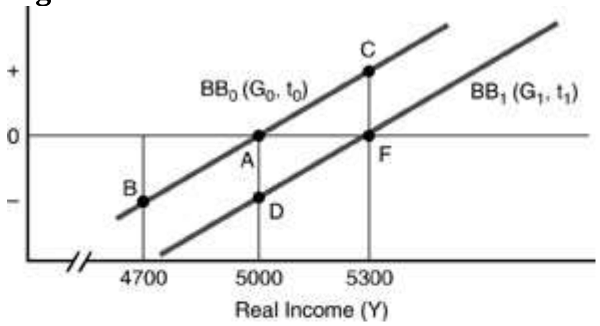
9) By far the largest real government budget deficits measured as a percentage of natural real GDP occurred during
A) World War I.
B) the Great Depression.
C) World War II.
D) the late 1960s.
E) the late 1980s and early 1990s.
Answer: C
Question Status: Previous Edition

10) In 1990-1991, the government budget deficit ________ mainly due to the ________.
A) rose, recession's effect on tax collection
B) rose, expenditures of the Persian Gulf War
C) fell, recession's effect on government expenditures
D) fell, economic stimulus provided by the Persian Gulf War
Answer: A
Question Status: Previous Edition

11) A prominent postwar pattern of U.S. government budget deficits was broken in 1983-1990 as
A) recession was accompanied by a shrinking deficit.
B) recession was accompanied by a growing deficit.
C) recovery from recession was accompanied by a shrinking deficit.
D) recovery from recession was accompanied by a growing deficit.
Answer: D
Question Status: Previous Edition

6.4 Automatic Stabilization and Discretionary Fiscal Policy

Figure 5-1



1) Employing the government budget diagram shown in Figure 5-1 above, assume that the economy is initially in equilibrium at point A. The movement A to D represents
A) an increase in government spending and/or a decrease in taxes.
B) a decrease in government spending and/or an increase in taxes.
C) a decrease in government spending and a decrease in taxes.
D) an increase in government spending and an increase in taxes.
Answer: B
Question Status: Previous Edition

2) In Figure 5-1 above, the impact of automatic stabilization is depicted by the movement

from
A) A to F.
B) A to B.
C) A to C.
D) D to A.
Answer: B
Question Status: Previous Edition

3) In Figure 5-1 above, if the budget line is BB_0 and the natural real GDP is $5300, the structural surplus or deficit is
A) FC.
B) AD.
C) FA.
D) none of the above.
Answer: A
Question Status: Previous Edition

4) In Figure 5-1 above, if the budget line BB_0, the natural real GDP is $5300, and actual real GDP is $5000, then the cyclical budget surplus or deficit is the
A) horizontal distance between A and F.
B) vertical distance between F and D.
C) vertical distance A and F.
D) horizontal distance between B and D.
Answer: B
Question Status: Previous Edition

5) An increase in the tax rate (t)
A) will rotate the budget line upward.
B) will increase the slope of the budget line.
C) will shift the budget line downward.
D) A and B.
Answer: D
Question Status: Previous Edition

6) The natural employment surplus is
A) G + T.
B) Y - tYN.
C) tYN - G.
D) YN + G + tYN.
Answer: C
Question Status: Previous Edition

7) The structural deficit is
A) the difference between the actual deficit and the natural employment deficit and it increases whenever income rises.
B) identical to the natural employment deficit and it decreases whenever tax rates are cut.
C) identical to the natural employment deficit and it increases whenever the natural level of output increases.
D) identical to the natural employment deficit and it decreases whenever the natural level of output increases.
Answer: D
Question Status: Previous Edition

8) The structural surplus is
A) the difference between the actual surplus and the natural employment surplus and it increases whenever income rises.
B) identical to the natural employment surplus and it increases whenever tax rates are cut.
C) identical to the natural employment surplus and it decreases whenever the natural level of output increases.
D) identical to the natural employment surplus and it increases whenever the natural level of output increases.
Answer: D
Question Status: Previous Edition

9) Which of the following effects takes place as a result of automatic stabilization?
A) extra tax revenues are generated in a boom
B) tax revenues remain constant during a recession
C) leakages increase during a recession, helping to stimulate the economy
D) Both A and C are correct.
Answer: A
Question Status: Previous Edition

10) A deliberate change in the government's deficit
A) constitutes discretionary fiscal policy.
B) leads to automatic stabilization.
C) acts as a drag on the economy.
D) is implemented by the Fed.
Answer: A
Question Status: Previous Edition

11) The actual government budget deficit ________ be used to determine the effectiveness of discretionary fiscal policy actions because ________.
A) cannot; it excludes non-discretionary spending changes
B) can; it includes non-discretionary spending changes
C) cannot; it includes non-discretionary spending changes
D) can; it excludes automatic stabilization expenditures
Answer: C
Question Status: Previous Edition

12) The actual government budget surplus ________ be used to determine the effectiveness of discretionary fiscal policy actions because ________.
A) cannot; it excludes non-discretionary spending changes

B) can; it includes non-discretionary spending changes
C) cannot; it includes non-discretionary spending changes
D) can; it excludes automatic stabilization expenditures
Answer: C
Question Status: Previous Edition

13) The natural employment deficit ________ be used to determine the effectiveness of discretionary fiscal policy actions because ________.
A) cannot; it excludes non-discretionary spending changes
B) can; it includes non-discretionary spending changes
C) cannot; it includes non-discretionary spending changes
D) can; it excludes automatic stabilization expenditures
Answer: D
Question Status: Previous Edition

14) The natural employment surplus ________ be used to determine the effectiveness of discretionary fiscal policy actions because ________.
A) cannot; it excludes non-discretionary spending changes
B) can; it includes non-discretionary spending changes
C) cannot; it includes non-discretionary spending changes
D) can; it excludes automatic stabilization expenditures
Answer: D
Question Status: Previous Edition

15) The progressive income tax is an automatic stabilizer with respect to the Federal government's budget surplus or deficit because
A) individuals must "automatically" pay taxes even when they have a deficit.
B) during periods of output growth, a greater percentage of real income "leaks" from the expenditure stream.
C) during periods of output growth, the marginal leakage rate increases as taxes decrease.
D) None of the above.
Answer: B
Question Status: Previous Edition

16) The relation S + (T - G) = I + NX describing the equilibrium of an economy explicitly demonstrates
A) deficit spending by the government reduces either investment and/or net foreign investment.
B) deficit spending reduces private saving (assuming net foreign investment remains unchanged).
C) as private saving increases net foreign investment must decrease, exports decline.
D) as private saving increases the deficit must decline if investment decreases.
Answer: A
Question Status: Previous Edition

17) Persistent government budget deficit result in ________ taxes and a ________ stock of capital in the future.
A) higher, larger
B) lower, larger
C) higher, smaller

D) lower, smaller
Answer: C
Question Status: Previous Edition

18) The cyclical deficit is
A) the amount by which the actual government budget deficit exceeds the structural deficit.
B) the amount by which structural deficit exceeds the actual budget deficit.
C) the same as the structural deficit.
D) what the budget deficit would be if the economy were operating at the natural real GDP level.
Answer: A
Question Status: Previous Edition

19) A structural budget deficit
A) appeared during the Vietnam War era from 1966-68.
B) appeared after 1982 due to tax cuts and spending increases.
C) peaked at 5 percent of GDP in mid-1986 and had become a structural surplus by 1997.
D) all of the above.
Answer: D
Question Status: Previous Edition

20) A government budget surplus
A) decreases a country's ability to finance domestic and foreign investment.
B) increases a country's ability to finance domestic and foreign investment.
C) increases a country's ability to finance domestic investment and decreases its ability to finance foreign investment.
D) decreases a country's ability to finance domestic investment and increases its ability to finance foreign investment.
Answer: B
Question Status: Previous Edition

21) A crucial national income accounting identity sets the government budget deficit equal to
A) S - I - NX.
B) S + I - NX.
C) S - I + NX.
D) S + I + NX.
Answer: A
Question Status: Previous Edition

22) A government budget deficit is financed by a combination of
A) saving rising relative to domestic investment and imports rising relative to exports.
B) saving rising relative to domestic investments and exports rising relative to imports.
C) domestic investment rising relative to saving and imports rising relative to exports.
D) domestic investment rising relative to saving and exports rising relative to imports.
Answer: A
Question Status: Previous Edition

23) Given the average tax rate t, a general expression for the budget deficit is
A) tG - Y.
B) Y - tG.
C) G - tY.
D) Y - (G/t).
Answer: C
Question Status: Previous Edition

24) A recession normally causes ________ in government net tax revenues, ________ the budget deficit is an example of ________ automatic stabilization.
A) an increase, increasing, the working of
B) an increase, decreasing, a failure of
C) a decrease, decreasing, the working of
D) a decrease, increasing, a failure of
E) a decrease, increasing, the working of
Answer: E
Question Status: Previous Edition

25) An increase in government expenditures that ________ the budget deficit in an example of ________.
A) raises, automatic stabilization
B) raises, discretionary fiscal policy
C) lowers, automatic stabilization
D) lowers, discretionary fiscal policy
Answer: B
Question Status: Previous Edition

26) An increase in the average tax rate that ________ the budget deficit in an example of ________.
A) raises, automatic stabilization
B) raises, discretionary fiscal policy
C) lowers, automatic stabilization
D) lowers, discretionary fiscal policy
Answer: D
Question Status: Previous Edition

27) Suppose we have an economy in which G = 1100, t = 0.26, Y = 3800, and YN = 4000. At Y, the actual deficit is
A) 60.
B) 200.
C) 112.
D) 286.
E) -60.
Answer: C
Question Status: Previous Edition

28) Suppose we have an economy in which G = 1100, t = 0.26, Y = 3800, and YN = 4000. The natural employment deficit is
A) 60.
B) 200.
C) 840.
D) 286.
E) -112.
Answer: A
Question Status: Previous Edition

29) Suppose we have an economy in which G = 1100, t = 0.26, Y = 3800, and YN = 4000. At Y the cyclical deficit is
A) 60.
B) 112.
C) -172.
D) -52.
E) 52.
Answer: E
Question Status: Previous Edition

30) In the diagram of the budget line BB, a rise in government expenditure shifts BB ________, so that an unchanged GDP the budget deficit ________.
A) downward, rises
B) downward, falls
C) downward, remains unchanged
D) upward, rises
E) upward, falls
Answer: A
Question Status: Previous Edition

31) In a closed economy, an increase in government spending, while taxes remain the same, will be accompanied by
A) a decrease in private investment and an increase in privates saving.
B) an increase in private investment and a decrease in private savings.
C) a decrease in private investment only.
D) an increase in private savings only.
Answer: A
Question Status: Previous Edition

32) In a closed economy, a decrease in government spending while taxes remain the same will be accompanied by
A) a decrease in private investment and an increase in privates saving.
B) an increase in private investment and a decrease in private savings.
C) a decrease in private investment only.
D) an increase in private savings only.
Answer: B
Question Status: Previous Edition

33) With a vertical LM curve, an increase in the money supply can be matched by an equal increase in money demand only through ________, which causes monetary policy to be particularly ________.
A) a rise in income, strong
B) a rise in income, weak
C) a fall in the interest rate, strong
D) a fall in the interest rate, weak
Answer: A
Question Status: Previous Edition

34) An increase in tax revenues ________ government saving and ________ national saving.
A) raises, raises
B) raises, lowers
C) lowers, raises
D) lowers, lowers
Answer: A
Question Status: Previous Edition

35) A large government budget deficit ________ government saving and ________ national saving.
A) raises, raises
B) raises, lowers
C) lowers, raises
D) lowers, lowers
Answer: D
Question Status: Previous Edition

36) If S = 300, T = 800, G = 1100, and I = 150, this makes net foreign investment
A) 150.
B) -150.
C) 450.
D) 750.
E) -450.
Answer: B
Question Status: Previous Edition

37) If S = 200, T = 700, G = 950, and NX = -200, this makes net domestic investment
A) 150.
B) -150.
C) 50.
D) -50.
E) 650.
Answer: A
Question Status: Previous Edition

38) If S = 250, T = 170, NX = -20, this makes government saving
A) -50.
B) -70.
C) 70.
D) 50.
E) -100.
Answer: E
Question Status: Previous Edition

39) When a nation's national saving falls short of its domestic investment, it must be
A) experiencing a government budget surplus.
B) experiencing a government deficit.
C) a net lender to foreign nations.
D) a net borrower from foreign nations.
Answer: D
Question Status: Previous Edition

40) If a country's private saving is 100 and government saving is -100, domestic private investment
A) must be 200.
B) must be zero.
C) is equal to the net amount the economy borrows from other countries.
D) is equal to the net amount the economy lends to other countries.
Answer: C
Question Status: Previous Edition

41) If a nation's budget deficit rises, domestic private investment can remain unchanged through some combination of ________ private saving and ________ importing relative to exporting.
A) increased, less
B) increased, more
C) decreased, less
D) decreased, more
Answer: A
Question Status: Previous Edition

42) Switching to a faster economic growth path comes at the cost of lower
A) present investment.
B) present consumption.
C) future investment.
D) present saving.
E) future saving.
Answer: B
Question Status: Previous Edition

43) In the current debate over fiscal policy, advocates of returning to significant budget surpluses
A) contended that the economic miracle of the late 1990s caused the budget surpluses.
B) think that tax cuts will benefit the wealthy.
C) believe that tax cuts will continue the dependence of the United States on borrowing from foreigners.
D) All of the above.
Answer: D
Question Status: Previous Edition

44) Which of the following policies would NOT affect the natural unemployment rate?
A) a reduction in minimum wages
B) an increase in public-service employment
C) an increase in subsidized private employment
D) a reduction sales taxes
Answer: D
Question Status: Previous Edition

45) A falling natural-employment deficit indicates that
A) the growth rate in the economy has increased.
B) the government is following a restrictive fiscal policy.
C) the government is following an expansionary fiscal policy.
D) the actual surplus is rising.
Answer: B
Question Status: Previous Edition

46) Private savings and thus investment could be increased by which of the following government policies, ceteris paribus?
A) elimination of the corporate income tax
B) allowing corporations to use "replacement cost accounting"
C) exemption of interest earnings from income taxation
D) all of the above.
Answer: D
Question Status: Previous Edition

47) A major side-effect of a stimulative fiscal policy is that it will
A) discriminate in favor of housing.
B) crowd out private expenditures.
C) increase the natural rate of unemployment.
D) permanently raise the rate of inflation.
Answer: B
Question Status: Previous Edition

48) The conditions for joining the "Euro" single-currency block led a number of European countries to ________ and consequently reduce their debt-GDP ratios.
A) tighten monetary policy
B) loosen monetary policy
C) loosen fiscal policy
D) tighten fiscal policy
Answer: D
Question Status: Previous Edition

49) If the economy is growing 5% a year and GDP is $1000 billion, the additional revenues available to meet interest payments on the government deficit would be, ceteris paribus,
A) 50.
B) 500.
C) It depends upon the amount of new debt issued.
D) There would be no additional revenues.
Answer: A
Question Status: Previous Edition

50) If the economy is growing 3% a year and the government increases the ratio of interest on the national debt to GDP, we may conclude that
A) the output ratio will fall.
B) additional interest payments exceed 3% of GDP.
C) tax revenues will fall.
D) the Laffer curve will be inoperable.
Answer: B
Question Status: Previous Edition

51) National saving is
A) the sum of private saving and government saving.
B) reduced by government budget deficits.
C) the sum of private saving and the government budget deficit or surplus.
D) all of the above.
Answer: D
Question Status: Previous Edition

52) Which of the following policies is likely to generate the smallest increase in national saving?
A) an increase in income taxes
B) an increase in consumption taxes
C) a cut in government transfer payments
D) None of the above policies will increase national saving.
Answer: A
Question Status: Previous Edition

53) Which of the following is least likely to increase the ratio of investment to real GDP? A reduction in ________.
A) transfer payments
B) subsidies to farms and corporations
C) defense outlays
D) spending on highways
Answer: D
Question Status: Previous Edition

6.5 Government Debt Basic Concepts

1) An example of "automatic stabilizers" is a rise in ________ causing the budget deficit to ________.
A) real GDP, fall
B) real GDP, rise
C) government expenditures, fall
D) government expenditures, rise
E) the average tax rate, fall
Answer: A
Question Status: Previous Edition

2) The clearest indicator of a switch to a less expansionary fiscal policy is a
A) rise in the actual deficit.
B) fall in the actual deficit.
C) rise in the natural employment deficit.
D) fall in the natural employment deficit.
Answer: D
Question Status: Previous Edition

3) The clearest indicator of a switch to a less expansionary fiscal policy is a
A) rise in the actual surplus.
B) fall in the actual surplus.
C) rise in the natural employment surplus.
D) fall in the natural employment surplus.
Answer: C
Question Status: Previous Edition

4) Suppose we have an economy in which G = 100, t = 0.26, Y = 3800, and YN = 4000. Then t rises to 0.28 as the same time as G rises to 1150. The overall impact of this resettling of the fiscal variables is ________ because ________.
A) expansionary, the actual deficit rises
B) expansionary, the natural employment deficit falls
C) contractionary, the natural employment deficit falls
D) contractionary, the natural employment deficit rises
E) contractionary, the actual deficit rises
Answer: C
Question Status: Previous Edition

5) Actual output exceeds the natural output when
A) the actual budget deficit is above the structural deficit.
B) the actual budget deficit is below the structural deficit.
C) the structural deficit is positive.
D) the structural deficit is negative.
Answer: B
Question Status: Previous Edition

6) Actual output exceeds the natural output when
A) the actual budget surplus is above the structural surplus.
B) the actual budget surplus is below the structural surplus.
C) the structural surplus is positive.
D) the structural surplus is negative.
Answer: A
Question Status: Previous Edition

7) Government debt places a burden on future generations if
A) the debt is used to fund the current consumption of its citizens.
B) the debt is used to fund the production of investment goods.
C) the debt is used to fund schools and highways.
D) All of the above are correct.
Answer: A
Question Status: Previous Edition

8) A true and unambiguous burden on future generations will be created whenever government deficit spending
A) increases the ratio of government expenditure to GDP.
B) pays for goods that yield no future benefits.
C) is used as part of a countercyclical fiscal expansion.
D) pays for capital expenditures.
Answer: B
Question Status: Previous Edition

6.6 Will the Government Remain Solvent?

1) The "solvency condition" states that the debt-GDP ratio will rise continuously so long as
A) the real GDP growth rate exceeds the real interest rate.
B) the real interest rate exceeds the real GDP growth rate.
C) the real interest rate exceeds the nominal interest rate.
D) the nominal interest rate exceeds the cost of borrowing.
Answer: B
Question Status: Previous Edition

2) The government can continuously issue new bonds to pay the interest on its outstanding bonds so long as
A) the real GDP growth rate exceeds the real interest rate.
B) the real interest rate exceeds the real GDP growth rate.
C) the real interest rate exceeds the nominal interest rate.
D) the nominal interest rate exceeds the cost of borrowing.
Answer: A
Question Status: Previous Edition

6.7 Case Study: Historical Behavior of the Debt-GDP Ratio Since 1790

1) From 1980 to 1992 net national saving in the United States averaged approximately ________ percent of national income.
A) 32
B) 18
C) 12
D) 4.7
E) 2.2
Answer: D
Question Status: Previous Edition

2) Compared to 1960-79, U.S. net national saving form 1980-92 as a proportion of national income
A) rose tremendously.
B) rose slightly.
C) fell slightly.
D) fell precipitously.
Answer: D
Question Status: Previous Edition

3) In the 1980s, the United States on net ________ foreign nations so that its private firms could absorb through domestic investment ________ goods than what was being left for them by national saving.
A) borrowed from, more
B) borrowed from, fewer
C) lent to, more
D) lent to, fewer
Answer: A
Question Status: Previous Edition

4) In the late 1980s, ________ domestic private investment led to ________ in net foreign borrowing.
A) higher, an increase
B) higher, a decrease
C) lower, an increase
D) lower, a decrease
Answer: D
Question Status: Previous Edition

5) In 1980, the U.S. budget was ________, private saving was ________ domestic investment, and foreign borrowing was ________.
A) in deficit, higher than, not needed to finance deficit
B) balanced, roughly equal to, not needed to finance deficit
C) balanced, less than, substantial.
D) surplus, greater, negligible
Answer: A
Question Status: Previous Edition

6) From 1988 to 1990, the U.S. budget was ________, private saving was ________ domestic investment, and foreign borrowing was ________.
A) in deficit, higher than, still needed to finance deficit
B) balanced, roughly equal to, not needed to finance deficit
C) balanced, less than, substantial.
D) surplus, less than, negligible
Answer: A
Question Status: Previous Edition

7) From 2004 to 2006, the U.S. budget was ________, private saving was ________ domestic investment, and foreign borrowing was ________.
A) in deficit, less than, needed to finance deficit
B) balanced, roughly equal to, not needed to finance deficit
C) balanced, less than, substantial.
D) surplus, greater than, negligible
Answer: A
Question Status: Previous Edition

8) From 2004 to 2006, the Japanese budget was ________, private saving was ________ domestic investment, and foreign lending ________.
A) in deficit, greater than, moderate
B) balanced, roughly equal to, negligible
C) balanced, less than, moderate.
D) surplus, greater than, negligible
Answer: A
Question Status: Previous Edition

9) From 2004 to 2006, the European Union budget was ________, private saving was ________ domestic investment, and foreign lending ________.
A) balanced, roughly equal to, negligible
B) balanced, less than, substantial.
C) surplus, greater than, negligible
D) in deficit, greater than, negligible
Answer: D
Question Status: Previous Edition

10) "Economists have generally come to agree that monetary policy is better suited than fiscal policy for controlling GDP" because
A) money is neutral and therefore changes affect real income but not prices.
B) fiscal spending and tax changes affect the economy less than changes in the money supply.
C) the Fed can make decisions quickly, Congress and the President more slowly.
D) Congress can make decisions quickly, the Fed more slowly.
Answer: C
Question Status: Previous Edition

11) The return to government deficit after 2001 was due to
A) drop in the government revenues.
B) both revenue drop and expenditure rise.
C) rise in the government expenditure.
D) After 2001, U.S. government did not experience budget deficit.
Answer: A
Question Status: New

12) The tax cuts in 1981 and 1982 did not lead to growth in GDP as did the tax cuts in 1964. One reason for this difference was that
A) the 1981-82 tax cuts concentrated on personal tax cuts, but the 1964 cuts were for both personal and corporate taxpayers.
B) the saving rate increased in 1981-82, but it decreased in 1964.
C) expansionary monetary policy accompanied the 1964 tax cuts, but the 1981-82 cuts were accompanied by restrictive monetary policy.
D) tax indexation was built into the 1981-82 tax-cut program, but in 1964 there was no indexation.
Answer: C
Question Status: Previous Edition

13) "In the 1980s the pain which results from a large government deficit was deferred, placed on future taxpayers since foreigners loaned money to the government to pay the debt." Gordon suggests that this "pain" maybe deferred forever if
A) the government uses the "deficit funds" to provide taxpayers increased future benefits from which to pay the interest to foreigners.
B) monetary policy is tighter in the future.
C) fiscal policy is tighter in the future.
D) B and C are correct.
Answer: A
Question Status: Previous Edition

14) Over a decade or longer, a government budget deficit
A) reduces national saving and stimulates economic growth.
B) reduces national saving and economic growth.
C) increases national saving and economic growth.
D) increases national saving and decreases economic growth.
Answer: B
Question Status: Previous Edition

15) Government debt which pays for ________ is a burden in that it yields no ________ benefits.
A) hospitals, future
B) ammunition for military target practice, current
C) Social Security benefits, future
D) public universities, current
Answer: C
Question Status: Previous Edition

16) If the inflation rate is 7 percent, real GDP growth is 2 percent, and the current budget deficit is $100 billion, what must the current national debt be if the debt-GDP ratio is to remain the same?
A) $1,111 billion
B) $2,000 billion
C) $1,429 billion
D) $5,000 billion
Answer: A
Question Status: Previous Edition

17) In the period from 1990 to 1994, which of the following countries experienced a drop in national debt as percentage of GDP?
A) Italy
B) United States
C) Germany
D) none of the above
Answer: D
Question Status: Previous Edition

18) The debt-GDP ratio
A) fell sharply after 1997 due to a high output ratio and higher income tax rates.
B) rose from 1981-1992 due to large budget deficits.
C) began to decline in 1993.
D) all of the above.
Answer: D
Question Status: Previous Edition

19) The debt-GDP ratio was lower in 1997 than it was during
A) the Civil War.
B) World War I.
C) World War II.
D) all of the above.
Answer: C
Question Status: Previous Edition

20) Which of the following is NOT an expected consequence of balancing the federal government's budget?
A) increased private investment
B) increased borrowing from foreigners
C) reduced interest payment to foreigners
D) B and C.
Answer: B
Question Status: Previous Edition

21) During 1998-2001 the government budget
A) moved deeper into deficit and caused a substantial increase in borrowing from foreign investors.
B) moved into surplus but the beneficial effect was largely offset by a drop in household saving.
C) was balanced and the inflow of capital from foreign lenders was finally stopped.
D) moved into surplus and resulted in large capital outflows from the United States.
Answer: B
Question Status: Previous Edition

22) A sharp reduction in the U.S. debt-GDP ratio occurred
A) between 1998 and 2001 .
B) between 1996 and 1997.
C) between 1994 and 1995.
D) between 1993 and 1995.
Answer: A
Question Status: Previous Edition

23) Persistent deficit after 1980 was almost entirely due to
A) higher share of expenditures in GDP.
B) lower tax revenue.
C) lower share of expenditures in GDP.
D) Higher tax revenue.
Answer: A
Question Status: Previous Edition

24) From 1981 till 1995, the ratio of revenue to GDP was around
A) 19.8%.
B) 21.5%.
C) 18%.
D) 3.5%.
Answer: C
Question Status: Previous Edition

25) From 1968 till 1980, budget deficit was on average around ________ percent of natural GDP; and from 1981 till 1995, it was ________ percent of natural GDP.
A) 19.8; 21.5
B) 21.5; 19.8
C) 1.5; 3.5
D) 3.5; 1.5
Answer: C
Question Status: Previous Edition

26) Return to deficit after 2001 was due to
A) a drop in the revenue share.
B) an increase in the expenditure share.
C) both a drop in the revenue share and an increase in the expenditure share.
D) recession.
Answer: A
Question Status: Previous Edition

27) The gap between Federal expenditures and Federal revenues after 1980 was caused primarily by
A) the recessions which occurred in the 1980s.
B) a substantial decrease in Federal revenues.
C) a substantial increase in Federal expenditures.
D) rising interest rates which made caused investment and growth to collapse.
Answer: C
Question Status: Previous Edition

28) Changes in tax laws in 1993
A) reduced Federal revenues by making the tax code more regressive.
B) reduced Federal revenues by making the tax code more progressive.
C) increased Federal revenues by making the tax code more regressive.
D) increased Federal revenues by making the tax code more progressive.
Answer: D
Question Status: Previous Edition

29) Between 1995 and 1998, Federal tax revenues from ________ increased sharply.
A) the personal income tax
B) the corporate profits tax
C) social insurance taxes
D) all of the above
Answer: A
Question Status: Previous Edition

30) Which of the following contributed to the sharp increase in Federal tax revenues between 1995 and 2001?
A) an increase in income tax rates
B) a sustained economic expansion
C) increased income inequality
D) all of the above
Answer: D
Question Status: Previous Edition

31) The "allowable deficit" that causes no change in the debt-GDP ratio is equal to the ________ times ________.
A) interest rate, outstanding national debt
B) interest rate, nominal GDP
C) rate of nominal GDP growth, outstanding national debt
D) rate of nominal GDP growth, nominal GDP
Answer: C
Question Status: Previous Edition

32) With inflation of 5 percent, real GDP growth of 3 percent, and an outstanding national debt of $3400 billion, the "allowable deficit" that holds the debt-GDP ratio constant is
A) $272 billion.
B) $68 billion.
C) $170 billion.
D) $175.1 billion.
E) $510 billion.
Answer: A
Question Status: Previous Edition

33) Throughout U.S. history, the debt-GDP ratio has jumped sharply higher during
A) cyclical expansions.
B) stock market crashes.
C) wars.
D) Presidential election years.
Answer: C
Question Status: Previous Edition

34) From the end of the World War II, the debt-GDP ratio in the United States fell almost without interruption to a low point in ________, which marked the beginning of a long-run climb.
A) 1955
B) 1962
C) 1974
D) 1984
E) 1990
Answer: C
Question Status: Previous Edition

35) The rise in the U.S. debt-GDP ratio after 1980 must be blamed primarily on a ________ ratio of ________ to GDP.
A) rising, government expenditures
B) rising, tax revenues
C) falling, government expenditures
D) falling, tax revenues
Answer: A
Question Status: Previous Edition

36) A central cause of the rising debt-GDP ratio in the United States during the 1980s and 1990s was
A) the tax cuts of the early 1980s.

B) continuous increases in the military portion of the federal budget.
C) overly-generous indexation of Social Security benefits.
D) deficit-reduction targets.
Answer: C
Question Status: Previous Edition

6.8 Factors Influencing the Multiplier Effect of a Fiscal Policy Stimulus

1) The government deficit does NOT place a burden on future generations when
A) taxes are eventually raised to pay interest on the additional debt.
B) the borrowed funds are used for productive government investment.
C) borrowing from foreigners offsets the deficit, so that private investment is not crowded-out.
D) the borrowed funds are transferred to the purchase of nondurable consumer goods.
Answer: B
Question Status: Previous Edition

2) Borrowing to fund investment projects until the marginal rate of return falls to ________ is optimizing investment strategy for ________.
A) the borrowing rate, businesses and governments
B) the borrowing rate, businesses but not governments
C) the borrowing rate, governments but not businesses
D) zero, businesses and governments
E) zero, governments but not businesses
Answer: A
Question Status: Previous Edition

3) Suppose the government borrows to purchase military ammunition which is immediately used up in target practice. The rate of return on this investment is ________, and in this case the government debt ________ a burden on future taxpayers.
A) r, is not
B) r, is
C) 0, is not
D) -r, is not
E) -r, is
Answer: E
Question Status: Previous Edition

4) If the federal government borrows to build a new dam in North Dakota with a rate of return above the borrowing rate, and later raises federal income taxes to pay the interest, future welfare in the United States is
A) redistributed and lowered overall.
B) redistributed but not lowered overall.
C) not redistributed but lowered overall.
D) not redistributed and not lowered overall.
Answer: B
Question Status: Previous Edition

5) If the U.S. government sells bonds to fund improvements in infrastructure, and the bonds are bought by foreigners, the burden on future U.S. taxpayers
A) is not increased so long as the return on the improvements is at or above the borrowing cost.
B) is not increased so long as the return on the improvements is below the borrowing cost.
C) is not increased so long as the return on the improvements is above zero.
D) is increased regardless of the borrowing cost and the return on the improvements.
Answer: A
Question Status: Previous Edition

6) In a recession, automatic stabilization ________ tax revenues and ________ the debt-GDP ratio.
A) lowers, raises
B) lowers, lowers
C) raises, raises
D) raises, lowers
Answer: A
Question Status: Previous Edition

6.9 Case Study: The Fiscal Policy Stimulus of 2008-11

1) The government can meet its interest bill without having to levy taxes if it issues more bonds and if the
A) economy's real growth rate of output is greater than the real interest rate.
B) economy's real growth rate of output is equal to the nominal interest rate.
C) economy's real growth rate of output equals or exceeds its real interest rate.
D) economy's nominal growth rate of output equals or exceeds its real interest rate.
Answer: C
Question Status: Previous Edition

2) Society's rate of time preference is
A) the extra amount people would be willing to pay to have consumption goods in the future instead of now.
B) the value that people place on the time saved by purchasing capital goods rather than consumer goods.
C) the extra amount people would be willing to pay to have consumption goods now instead of the future.
D) is negative if people prefer present consumption to future consumption.
Answer: C
Question Status: Previous Edition

6.10 Government Spending and Transfers to States/Localities

1) There are no questions for this section.
Answer:

6.11 Conclusion: Strengths and Limitations of Fiscal Policy

1) In the IS-LM model, we can be at natural real GDP with a low interest rate given the combination of ________ fiscal policy and ________ monetary policy.
A) tight, tight
B) tight, easy
C) easy, tight
D) easy, easy
Answer: B
Question Status: Previous Edition

2) Suppose the economy is at the natural real GDP. Changing macroeconomic policy to lower the interest rate while not affecting output means shifting the IS curve to the ________ and the LM curve to the ________.
A) right, right
B) right, left
C) left, right
D) left, left
Answer: C
Question Status: Previous Edition

3) The IS-LM model tells us that output remains constant when a tax cut is combined with ________ in the money supply, with the interest rate ________ its initial level.
A) an increase, rising above
B) an increase, falling below
C) a decrease, rising above
D) a decrease, falling below
Answer: C
Question Status: Previous Edition

4) A growing consensus among economists is that ________ policy is better suited for controlling GDP because of the promptness of ________ in making policy decisions.
A) monetary, the Federal Reserve
B) monetary, Congress
C) fiscal, the Federal Reserve
D) fiscal, Congress
Answer: A
Question Status: Previous Edition

5) Government spending and taxation determine the position of the ________ curve and, where that curve intersects the vertical line at YN, the ________ target of monetary policy.
A) IS, inflation rate
B) IS, real interest rate
C) LM, inflation rate
D) LM, real interest rate
Answer: B
Question Status: Previous Edition

6) In the United States it is clear that if a dollar were diverted from present consumption to present investment, the return on that investment would be ________ to reward the deferral of consumption, meaning that overall economic welfare would rise with ________ in national saving.
A) insufficient, an increase
B) insufficient, a decrease
C) more than sufficient, an increase
D) more than sufficient, a decrease
Answer: C
Question Status: Previous Edition

7) To raise economic growth, a tighter fiscal policy should be accompanied by a ________ money supply in order to keep the ________ from falling.
A) larger, output ratio
B) larger, real interest rate
C) smaller, output ratio
D) smaller, real interest rate
Answer: A
Question Status: Previous Edition

8) Suppose that a change in the fiscal/monetary policy mix shifts the IS and LM curves downward by exactly the same amount. The ________ in national saving is accompanied by ________ domestic investment due to the ________ in the interest rate.
A) fall, equally lower, lower
B) fall, unchanged, unchanged
C) rise, unchanged, unchanged
D) rise, equally higher, lower
E) rise, equally lower, higher
Answer: D
Question Status: Previous Edition

9) A fiscal policy designed for maximum stimulus of economic growth must discourage current ________ and thus makes for, at least in the short run, a ________ even income distribution.
A) consumption, less
B) consumption, more
C) private saving, less
D) private saving, more
Answer: A
Question Status: Previous Edition

10) Elimination of the corporate income tax would ________ government saving and probably ________ private business saving.
A) increase, increase
B) increase, decrease
C) decrease, increase
D) decrease, decrease
Answer: C
Question Status: Previous Edition

11) Suppose that interest income is exempted from taxation, which costs the Treasury $100 billion in tax revenues, while at the same time transfer payments are reduced by $100 billion. Together, these two changes in fiscal policy ________ national saving while moving the distribution of income toward greater ________ .
A) reduce, equality
B) reduce, inequality
C) increase, equality
D) increase, inequality
E) do not affect, equality
Answer: D
Question Status: Previous Edition

12) An annually balanced federal budget ________ macro- stabilization policy by requiring ________ fiscal policy during recessions.
A) inhibits, tighter
B) inhibits, easier
C) assists, tighter
D) assists, easier
Answer: A
Question Status: Previous Edition

13) Most economists would consider it sensible for the federal government to ________ its current operating and capital expenditure budgets and then ________.
A) consolidate, never borrow to fund it
B) consolidate, borrow what is necessary to fund it
C) separate, borrow what is necessary to fund the current operating budget.
D) separate, borrow what is necessary to fund the capital expenditure budget.
Answer: D
Question Status: Previous Edition

14) The one uncontroversial statement at the foundation of "supply-side" theory is that
A) cutting income tax rates raises the tax base by enough to increase tax revenues.
B) income taxes reduce the after-tax reward to work and saving.
C) reducing income taxes would significantly increase work effort.
D) reducing income taxes would significantly increase personal saving.
Answer: B
Question Status: Previous Edition

15) In the wake of the Reagan "supply-side" tax cuts of the early 1980s, growth in the labor-force participation rate ________ and the personal saving rate ________.
A) increased, rose
B) increased, fell
C) decreased, rose
D) decreased, fell
Answer: D
Question Status: Previous Edition

16) The Social Security System
A) pays benefits to people which are directly related to how much they contributed during working years.
B) collects money from an individual and uses the accrued interest on those funds to pay the person's retirement benefits.
C) is based on a "pay-as-you-go" principle.
D) All of the above.
Answer: C
Question Status: Previous Edition

17) Under the current Social Security System,
A) only tax rates are changed yearly to help cover changes increases in benefits.
B) only benefits are changed to balance the budget of the Social Security System.
C) benefits are changed only to reflect the preceding year's inflation.
D) tax rates and benefits are changed yearly to balance the budget of the Social Security System.
Answer: C
Question Status: Previous Edition

18) At present, the Social Security System
A) takes in more revenue than it spends on benefits.
B) takes in less revenue than it spends on benefits.
C) equates the revenue that it receives and the amount it spends on benefits.
D) has no idea of just how much revenue it taking in.
Answer: A
Question Status: Previous Edition

19) Which of the following will cause the date that the Social Security trust fund runs out of money to be pushed further into the future?
A) a decrease in the rate of real GDP growth
B) an increase in the population growth rate
C) a decrease in the growth of the real wage
D) all of the above
Answer: B
Question Status: Previous Edition

20) Direct investment in the stock market by the Social Security trust fund
A) does not require that new money be brought into the system.
B) would be more cost-effective than creating private accounts for each person in the Social Security system.
C) would cause the government indirectly to own substantial parts of American companies.
D) All of the above.
Answer: D
Question Status: Previous Edition

***Macroeconomics, 12e* (Gordon)**
Chapter 7 International Trade, Exchange Rates, and Macroeconomic Policy

7.1 Introduction

1) In the last years of the 1980s exports increased dramatically. The effects on the U.S. economy include, ceteris paribus,
A) higher unemployment, lower prices, higher interest rates.
B) lower unemployment, higher prices, higher interest rates.
C) lower unemployment, higher prices, lower interest rates.
D) higher unemployment, higher prices, lower interest rates.
Answer: B
Question Status: Previous Edition

2) International crowding out in the U.S. economy occurs when

A) relatively high U.S. interest rates weaken the dollar, ceteris paribus.
B) relatively high U.S. interest rates strengthen the yen, ceteris paribus.
C) relatively high U.S. interest rates strengthen the dollar, ceteris paribus.
D) None of the above.
Answer: C
Question Status: Previous Edition

3) The "trilemma problem" implies that countries that opt for
A) fixed exchange rates may lose control of domestic monetary policy.
B) flexible exchange rates may lose control of domestic monetary policy.
C) fixed exchange rates may experience exchange rates that "overshoot" when there are large capital inflows.
D) flexible exchange rates may experience exchange rates that "overshoot" when there are large capital inflows.
Answer: A
Question Status: Previous Edition

4) The foreign exchange rate refers to
A) the rate of change in a nation's international investment position.
B) the amount of one nation's money that can be obtained in exchange for a unit of another nation's currency.
C) the rate of change in a nation's exports and imports.
D) the rate at which foreign exports are flowing into a nation's output market.
Answer: B
Question Status: Previous Edition

5) Foreign borrowing is
A) S + (T - G).
B) -NX.
C) I + NX.
D) (T - G).
Answer: B
Question Status: Previous Edition

7.2 The Current Account and Balance of Payments

1) Which of the following would give rise to a credit in the balance of payments?
A) loans to foreigners
B) increase in foreign bank loans to U.S. companies
C) reductions in foreign holdings of U.S. assets
D) U.S hoarding of foreign currencies
Answer: B
Question Status: Previous Edition

2) Which of the following would give rise to a debit in the balance of payments?
A) foreign purchases of U.S. assets
B) dividends earned from foreign companies
C) dividends paid to foreigners
D) direct investment by foreign firms in the United States
Answer: C
Question Status: Previous Edition

3) The ballooning of the U.S. foreign debt to 500 billion dollars by 1988 implied that
A) a foreign trade surplus is required to reduce the interest payment burden.
B) a foreign trade deficit is required to reduce the interest payment burden.
C) the ratio of foreign debt to the U.S. GNP was increasing.
D) the ratio of foreign debt to the U.S. GNP was decreasing.
Answer: A
Question Status: Previous Edition

4) The payment of veterans benefits to U.S. servicemen retired in the Philippines would be included in ________ section in the calculation of the U.S. balance of payments.
A) only the capital account
B) both the capital account and the transfer account
C) both the current account and the transfer account
D) both the capital and the current accounts
Answer: C
Question Status: Previous Edition

5) During the second quarter of 1989 it is believed that Japanese investors bought a significant proportion of U.S. corporate stocks and bonds sold during this period. The required purchase of dollars
A) reduced the trade deficit of that year.
B) provided yen to purchase imported goods by U.S. citizens.
C) led to a trade surplus for that year.
D) led to a trade deficit for that year.
Answer: B
Question Status: Previous Edition

6) The "official reserve transactions balance" will be positive when
A) the current account is in surplus.
B) exports exceed imports.
C) U.S. official holdings of foreign exchange are falling.
D) the current account and capital account taken together are in surplus.
Answer: D
Question Status: Previous Edition

7) In 1988, the United States had a large current account deficit but an ORT surplus because
A) new production technology for gold increased the ORT.
B) the capital account surplus exceeded the current account deficit.
C) transfers of international reserves from foreign countries increased.
D) A and C are both correct.
Answer: B
Question Status: Previous Edition

8) A nation's net international investment position is
A) the difference between all foreign assets owned by a nation's citizens and domestic assets owned by foreign citizens.
B) the difference between its exports of goods and services and its import of goods and services.
C) identical to its current account balance.
D) unaffected by policy driven interest rate changes.
Answer: A
Question Status: Previous Edition

9) A nation's net international investment position moves toward surplus when
A) that nation runs a current account deficit.
B) that nation runs a current account surplus.
C) that nation runs a capital account surplus.
D) none of the above.
Answer: B
Question Status: Previous Edition

10) Exports are recorded in the balance of payments table of the exporting nation as
A) current account credits.
B) current account debits.
C) capital account credits.
D) capital account debits.
Answer: A
Question Status: Previous Edition

11) If U.S. firms sell some of their holdings of Treasury bills to other nations, this is recorded in the U.S. balance of payments table as a
A) current account credit.
B) current account debit.
C) capital account credit.
D) capital account debit.
Answer: C
Question Status: Previous Edition

12) Can a nation have in its balance of payments a current account deficit at the same time as a less-than-equal capital account surplus?
A) No, because current and capital accounts must both balance, by accounting convention.
B) No, because a current account deficit must be offset by an equal capital account surplus so the balance of payments balances overall.
C) Yes, and the nation would have an overall deficit in its balance of payments.
D) Yes, and the nation would have an overall surplus in its balance of payments.
Answer: C
Question Status: Previous Edition

13) If the United States imports another good in exchange for assets transferred from an American bank to a foreign bank, in the U.S. balance of payments table
A) the current account deficit rises and so the balance of payments deficit rises.
B) the current and capital account deficits both rise and so the balance of payments deficit rises.
C) the current and capital account deficits both rise and so the balance of payments is unaffected.
D) the current account deficit rises by as much as the capital account surplus rises and the balance of payments is unaffected.
E) the current and capital account deficits both fall and so the balance of payments deficit falls.
Answer: D
Question Status: Previous Edition

14) A U.S. balance of payments deficit puts ________ pressure on the foreign price of the dollar, which, under a flexible exchange rate system, tends to ________ that deficit.
A) upward, worsen
B) upward, eliminate
C) downward, worsen
D) downward, eliminate
Answer: D
Question Status: Previous Edition

15) When nations can run sizable balance of payments deficits, this indicates that the flexible exchange rate system ________ subject to government intervention, which describes exchange rates ________.
A) is, before 1973
B) is, at the present time
C) is not, before 1973
D) is not, at the present time
Answer: B
Question Status: Previous Edition

16) Since the early 1980s, the U.S. has run persistent capital account ________ that have ________ offset the opposite position of the current account.
A) deficits, largely
B) deficits, failed to
C) surpluses, largely
D) surpluses, failed to
Answer: C
Question Status: Previous Edition

17) When a nation's current account deficit exceeds its capital account surplus, the overall ________ in the "balance of payments outcome" means that the nation's central bank is ________ foreign central banks.
A) surplus, lending to
B) surplus, borrowing from
C) deficit, lending to
D) deficit, borrowing from
Answer: D
Question Status: Previous Edition

18) A nation running a current account deficit must either be ________ its indebtedness to foreigners in the private sector or ________ its indebtedness to foreign governments.
A) increasing, increasing
B) increasing, decreasing
C) decreasing, increasing
D) decreasing, decreasing
Answer: A
Question Status: Previous Edition

19) The three policies which cannot be maintained simultaneously by a nation (sometimes referred to as the "trilemma") do NOT include
A) independent control of the money supply.
B) independent control of fiscal policy.
C) fixed exchange rates.
D) free flow of capital.
Answer: B
Question Status: Previous Edition

20) The experiences of countries with fixed exchange rates and unrestricted capital flows did NOT include
A) withdrawal of foreign capital.

B) appreciation of the nominal exchange rate.
C) a stock market crash.
D) rising interest rates.
Answer: B
Question Status: Previous Edition

7.3 Exchange Rates

1) The exchange rate affects a nation's imports, essentially, because
A) it gives the price of foreign goods.
B) it gives the price of domestic goods to foreigners.
C) it is one element of the domestic price of foreign goods.
D) it is one element of the foreign price of domestic goods.
Answer: C
Question Status: Previous Edition

2) Which of the following does NOT create a demand for Swiss francs?
A) the repayment of a loan from a Swiss company to an Italian bank
B) the desire of a British company to purchase a Swiss factory
C) the declaration of a dividend by a Swedish company that has Swiss shareholders
D) the rise of the interest rate in Switzerland while other foreign interest rates remain constant
Answer: A
Question Status: Previous Edition

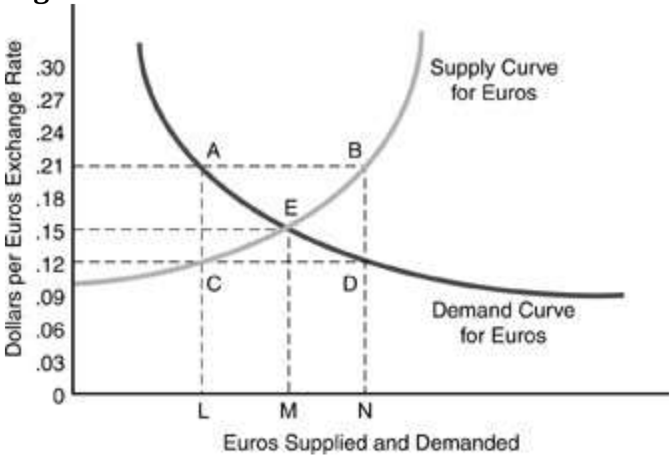
3) If the Federal Reserve intervenes in the foreign-exchange markets and buys foreign currencies
A) the U.S. money supply rises and foreign currencies depreciate.
B) the U.S. money supply falls and foreign currencies depreciate.
C) the U.S. money supply rises and foreign currencies appreciate.
D) the U.S. money supply falls and foreign currencies appreciate.
Answer: C
Question Status: Previous Edition

4) If the Federal Reserve intervenes in the foreign-exchange markets by selling foreign currencies
A) the U.S. money supply rises and foreign currencies depreciate.
B) the U.S. money supply falls and foreign currencies depreciate.
C) the U.S. money supply rises and foreign currencies appreciate.
D) the U.S. money supply falls and foreign currencies appreciate.
Answer: B
Question Status: Previous Edition

5) Suppose the United States and Canada were the only two countries in the world. There is an excess supply of U.S. dollars on the foreign-exchange market. This implies that
A) there is also an excess supply of Canadian dollars.
B) the Canadian balance of payments is in deficit.
C) the U.S. balance of payments is in surplus.
D) the U.S. dollar is overvalued.
Answer: D
Question Status: Previous Edition

7.4 The Market for Foreign Exchange

Figure 6-2



1) Suppose that the supply of euros is at point B in Figure 6-2 above and Europe only trades with the United States. We would conclude that ________ in the United States prefer ________ goods at ________ $ per euro.
A) U.S. citizens; European; 0.21
B) U.S. citizens; American; 0.21
C) European citizens; European; 0.15
D) European citizens; American; 0.15
Answer: B
Question Status: Previous Edition

2) Suppose that the supply of euros is at point C in Figure 6-2 above and Europe only trades with the United States. We would conclude that ________ in the United States prefer ________ goods at ________ $ per euros.
A) U.S. citizens; Europe; 0.12
B) U.S. citizens; American; 0.12
C) European citizens; European; 0.15
D) European citizens; American; 0.15
Answer: A
Question Status: Previous Edition

3) Suppose that the U.S. government devalues the dollar by 10% and maintains the new rate by intervening in the foreign exchange market. The ________ of ________ will ________, ceteris paribus.
A) supply; $; increase
B) demand; $; decrease
C) supply; foreign currencies; increase
D) demand; foreign currencies; decrease
Answer: A
Question Status: Previous Edition

4) The failure of U.S. net exports to improve dramatically in the mid-1980s despite the weakening of the dollar suggests that
A) U.S. industries supply of competitive goods was inelastic over the period.
B) LDC debt repayment schedules and lack of financing kept U.S. exports low.
C) NCIs maintained fixed exchange rates vis a vis the dollar and U.S. exports low.
D) All of the above.
Answer: D
Question Status: Previous Edition

5) Suppose that the Japanese television manufacturers offer a high definition television set to the U.S. market compatible with current transmission signals, i.e. it works immediately. In the foreign exchange market,
A) this would increase demand for dollars.
B) this would decrease demand for dollars.
C) this would decrease the supply of dollars.
D) this is a fundamental factor which causes the dollar to appreciate.
Answer: B
Question Status: Previous Edition

6) Consider a foreign exchange market diagram with dollars on the horizontal axis, the yen price of the dollar on the vertical axis, an upward-sloping supply curve and downward-sloping demand curve. At an exchange rate below the equilibrium rate there is an excess ________ dollars causing market pressure for ________ of the dollar.
A) demand for, appreciation
B) demand for, depreciation
C) supply of, appreciation
D) supply of, depreciation
Answer: A
Question Status: Previous Edition

7) Suppose the price of the dollar falls from 150 to 120 yen. As a result, Japanese purchases of $35,000 Cadillacs rise from 2,000 to 2,100 per year. This is the kind of event underlying the reason for drawing
A) a downward-sloping demand curve for dollars.
B) a downward-sloping supply curve of dollars.
C) an upward-sloping demand curve for dollars.
D) an upward-sloping supply curve of dollars.
Answer: A
Question Status: Previous Edition

8) Suppose the price of the dollar falls from 150 to 120 yen. As a result, Japanese purchases of $35,000 Cadillacs rise from 2,000 to 2,100 per year. This is the kind of event underlying the reason for drawing
A) a downward-sloping demand curve for yen.
B) a downward-sloping supply curve of yen.
C) an upward-sloping demand curve for yen.
D) an upward-sloping supply curve of yen.
Answer: B
Question Status: Previous Edition

9) Suppose the price of the dollar falls from 150 to 120 yen. As a result, U.S. purchases of Japanese VCRs, at a price of 25,000 yen apiece, fall from 3,000,000 to 2,700,000 per year. This is the kind of event underlying the reasoning for drawing
A) a downward-sloping demand curve for dollars.
B) a downward-sloping supply curve of dollars.
C) an upward-sloping demand curve for dollars.
D) an upward-sloping supply curve of dollars.
Answer: B
Question Status: Previous Edition

10) Suppose that "fundamentals" have determined an exchange rate of 130 yen to the dollar. If the Federal Reserve wishes to maintain an exchange rate of 140 yen to the dollar, it must meet the private excess ________ dollars in the dollar-yen market by ________.
A) supply of, selling yen for dollars
B) supply of, buying yen with dollars
C) demand for, selling yen for dollars
D) demand for, buying yen with dollars
Answer: A
Question Status: Previous Edition

7.5 Real Exchange Rates and Purchasing Power Parity

1) The purchasing power parity theory predicts that
A) a nation's exchange rate will decline at a rate equal to the difference between the domestic and the foreign rates of inflation.
B) a nation's exchange rate will differ from another nation's exchange rate by an amount depending upon the difference between the domestic and foreign rates of inflation.
C) a nation's exchange rate is determined by the extent of speculation in the foreign-exchange market.
D) a nation's exchange rate will decline when there is a balance-of-payments deficit.
Answer: A
Question Status: Previous Edition

2) Which of the following is likely to upset the prediction of the purchasing power parity theorem?
A) differing rates of technical change in the two nations
B) discovery of new natural resources in one of the nations
C) differing government policies in the two nations
D) All of these.
Answer: D
Question Status: Previous Edition

3) The purchasing power parity theory "predicts" that if the price of semiconductors in the United States is $3 and the price in Japan is 210 yen for a comparable semiconductor, the exchange rate would be (assume only 1 good is traded, there is no government intervention, and transportation costs are negligible)
A) 180 yen/$.
B) 140 yen/$.
C) 70 yen/$.
D) $/yen 1.45.
Answer: C
Question Status: Previous Edition

4) Suppose that a computer memory chip costs 600 yen in Japan and $3 in the United States and that the exchange rate was 250 yen/$. In this situation traders would ________ increasing the ________ and causing the dollar to ________.
A) buy chips in Japan; supply of $; weaken
B) buy chips in Japan; demand for yen; strengthen
C) buy chips in United States; demand for $; strengthen
D) buy chips in United States; demand for yen; weaken
Answer: A
Question Status: Previous Edition

5) If inflation is greater in Mexico by 10% than it is in the rest of the world then the purchasing power parity theory predicts that the
A) Mexican peso would appreciate.
B) Mexican peso would depreciate.
C) Mexican peso would remain stable.
D) U.S. dollar would weaken.
Answer: B
Question Status: Previous Edition

6) In the first half of 1989 the inflation rate in the United States exceeded that of Japan yet the dollar appreciated relative to the yen. Which of the following facts would explain the failure of the PPP theory to explain the strength of the $ during this period?
A) the Japanese produced a number of new electronic gadgets much in demand by U.S. consumers
B) the Exxon oil spill
C) the Japanese purchased an increasingly large percentage of U.S. government and corporate securities
D) U.S. citizens participated heavily in the Japanese stock market
Answer: C
Question Status: Previous Edition

7) If the purchasing power parity theory was valid at all times,
A) the nominal exchange rate would be very volatile.
B) the real exchange rate would be the stable.
C) aggregate demand would be relatively stable.
D) All of the above.
Answer: D
Question Status: Previous Edition

8) If e is the real exchange rate, e' is the nominal exchange rate, P is the domestic price level, and Pf is the foreign price level, then
A) e'(= e(P/Pf).
B) e = e'(P/Pf).
C) e = e'(Pf/P).
D) e = Pf/e'(P.
Answer: B
Question Status: Previous Edition

9) Assume that the price level in the United States and in Mexico is 100 and that the nominal and real exchange rate is 10 pesos per dollar. If the price level in Mexico increases relative to the price level in the United States, then at the same nominal exchange rate
A) the dollar has experienced a real depreciation.
B) the peso has experienced a real depreciation.
C) the real exchange rate between the dollar and the peso is unchanged.
D) the dollar and the peso have experienced a real appreciation relative to each other.
Answer: A
Question Status: Previous Edition
10) Assume that the price level in both the United States and Europe is 200, and that the real and nominal exchange rate is 6 euros per dollar. If the price level in the United States

increases by 20 percent and the nominal exchange rate remains unchanged, then the real exchange rate is
A) 6 euros per dollar.
B) 5 euros per dollar.
C) 7.2 euros per dollar.
D) 6.6 euros per dollar.
Answer: C
Question Status: Previous Edition

11) Assume that the price level in both the United States and Europe is 200, and that the real and nominal exchange rate is 6 euros per dollar. If the price level in the United States increases by 20 percent, what must the nominal exchange rate be if the real exchange rate is to remain the same?
A) 6 euros per dollar.
B) 5 euros per dollar.
C) 8 euros per dollar.
D) 7 euros per dollar.
Answer: B
Question Status: Previous Edition

12) The purchasing power parity theory (PPP) of the exchange rate implies that the real exchange rate between two countries
A) should be constant.
B) should rise when the foreign price level increases relative to the domestic price level.
C) should fall when the foreign price level decreases relative to the domestic price level.
D) B and C.
Answer: A
Question Status: Previous Edition

13) The purchasing power parity theory (PPP) of the exchange rate holds that if e is the nominal exchange rate, P is the domestic price level and Pf is the foreign price level, then
A) if Pf grows faster than P the nominal exchange rate appreciates.
B) e = Pf/P.
C) the real exchange rate is constant.
D) all of the above.
Answer: D
Question Status: Previous Edition

14) The purchasing power parity (PPP) theory of the exchange rate breaks down if
A) one country invents new products that other countries want to import.
B) one country discovers new deposits of raw materials that it can sell to other countries.
C) governments make large foreign transfers or subsidize exports and tax imports.
D) all of the above.
Answer: D
Question Status: Previous Edition

15) Suppose that "fundamentals" have determined an exchange rate of 130 yen to the dollar. If the Federal Reserve wishes to maintain an exchange rate of 120 yen to the dollar, it must meet the private excess ________ dollars in the dollar-yen market by ________.
A) supply of, selling yen for dollars
B) supply of, buying yen with dollars
C) demand for, selling yen for dollars
D) demand for, buying yen with dollars
Answer: D
Question Status: Previous Edition

16) The "purchasing-power-parity" theory states that the most important determinant of exchange rates is their role in equating ________ between trading nations.
A) nominal interest rates
B) inflation rates
C) prices of identical goods
D) nominal GDP growth rates
Answer: C
Question Status: Previous Edition

17) If a premium-grade blank videocassette sells for 12 euros in Germany and the exchange rate is 2 euros = $1, the price of that identical videocassette in the United States is predicted by PPP theory to be
A) $12.
B) $2.
C) $6.
D) $1.
Answer: C
Question Status: Previous Edition

18) If a premium-grade blank videocassette sells for 14 euros in Germany and that identical videocassette sells for $6 in the United States, exchange rate implied by PPP theory is ________ dollars per euro.
A) 2.333
B) 0.429
C) 8.000
D) 0.125
Answer: B
Question Status: Previous Edition

19) Suppose that U.S. and British inflation rates are equal, and $2 exchanges for 1 British pound. Then if U.S. inflation slows down relative to British inflation, the PPP theory predicts ________ of the dollar, so that the pound will cost ________ than $2.
A) an appreciation, more
B) an appreciation, less
C) a depreciation, more
D) a depreciation, less
Answer: B
Question Status: Previous Edition

20) Suppose that U.S. and British inflation rates are equal, and $2 exchanges for 1 British pound. Then if U.S. inflation speeds up relative to British inflation, the PPP theory predicts ________ of the dollar, so that the pound will cost ________ than $2.
A) an appreciation, more
B) an appreciation, less
C) a depreciation, more
D) a depreciation, less
Answer: C
Question Status: Previous Edition

21) According to PPP theory, the rate which the U.S. dollar appreciates against the British pound is equal to
A) the British nominal interest rate minus the U.S. nominal interest rate.
B) the British real interest rate minus the U.S. real interest rate.
C) the British inflation rate minus the U.S. inflation rate.
D) the U.S. nominal GDP growth rate minus the British nominal GDP growth rate.
E) the U.S. current account surplus with Britain as a percentage of the U.S. overall balance of payments.
Answer: C
Question Status: Previous Edition

22) According to PPP theory, the yen price of the dollar would rise in a year from 130 to 135 yen if along with a U.S. inflation rate of 6 percent, the Japanese inflation rate is ________ percent.
A) 11.00
B) 1.00
C) 23.08
D) 2.15
E) 9.85
Answer: E
Question Status: Previous Edition

23) According to PPP theory, the yen price of the dollar would fall in a year from 140 to 132 yen if along with a Japanese inflation rate of 2 percent, the U.S. inflation rate is ________ percent.
A) 7.71
B) -3.71
C) 6.00
D) 10.00
E) 2.11
Answer: A
Question Status: Previous Edition

24) The United States no longer manufactures television sets. This situation is ________ the workings of the PPP theory of exchange rates, since inflation in Pacific Rim nations, which raises the price of the TVs they build, ________ necessarily lead to a large drop in U.S. demand for their TVs and thus a depreciation of their currencies.
A) consistent with, does
B) consistent with, does not
C) opposed to, does
D) opposed to, does not
E) appreciate, predicted
Answer: D
Question Status: Previous Edition

25) If the U.S. interest rate falls relative to European interest rates, the dollar tends to ________ in a way ________ by the PPP theory of exchange rates.
A) appreciate, predicted
B) appreciate, not predicted
C) depreciate, predicted
D) depreciate, not predicted
Answer: A
Question Status: Previous Edition

26) If new sources of nickel are unexpectedly found in the United States, the dollar tends to ________ in a way ________ by the PPP theory of exchange rates.
A) appreciate, predicted
B) appreciate, not predicted
C) depreciate, predicted
D) depreciate, not predicted
Answer: B
Question Status: Previous Edition

27) If the United States tightens its fiscal policy and eases up on monetary policy, the dollar tends to ________ in a way ________ by the PPP theory of exchange rates.
A) appreciate, predicted
B) appreciate, not predicted
C) depreciate, predicted
D) depreciate, not predicted
Answer: B
Question Status: Previous Edition

28) If PPP theory were perfectly valid, movements in nominal exchange rates
A) would never occur, so that inflation differentials would cause fluctuating real exchange rates.
B) would be amplified by inflation differentials into wider movements of real exchange rates.
C) would counteract inflation differentials and create equal movements in the real exchange rates.
D) would be matched by inflation differentials in such a way that real exchange rates never change.
Answer: D
Question Status: Previous Edition

29) In the 1970s and 1980s, the real exchange rate of the dollar ________, which is ________ PPP theory.
A) fluctuated widely, consistent
B) fluctuated widely, inconsistent
C) was nearly constant, consistent
D) was nearly constant, inconsistent
Answer: B
Question Status: Previous Edition

30) Drastic fluctuations in exchange rates are possible in the plausible situation of very ________ short-run elasticities of demand for imports and exports, in which a nation's supply curve of its currency to the foreign exchange market can temporarily be ________.
A) high, downward-sloping
B) high, upward-sloping
C) low, downward-sloping
D) low, upward-sloping
Answer: C
Question Status: Previous Edition

7.6 Exchange Rate Systems

1) Under a fixed exchange rate system, if the British pound is undervalued, the British monetary authorities must
A) buy pounds or sell dollars.
B) sell pounds or buy dollars.
C) sell foreign exchange or gold and buy pounds.
D) devalue their currency.
Answer: B
Question Status: Previous Edition

2) Under a fixed exchange system with a flexible price level, balance of payments equilibrium will occur
A) only through a devaluation.
B) automatically, in the long-run.
C) only with an activist monetary policy.
D) only with a revaluation.
Answer: B
Question Status: Previous Edition

3) A fixed exchange rate is preferable to a flexible exchange rate because
A) aggregate economic policies will be more effective.
B) it is less costly to finance balance-of-payments disequilibria.
C) periodic devaluations or revaluations will be unnecessary.
D) None of these.
Answer: D
Question Status: Previous Edition

4) In theory with flexible exchange rates should allow countries to conduct ________ monetary and fiscal policies, exchange rates, but paradoxically the experience of the relatively flexible exchange rates of the 1970s suggests that such policies caused exchange rate ________.
A) coordinated; stable; instability
B) independent; stable; instability
C) managed; unstable; stability
D) targeted; unstable; stability
Answer: B
Question Status: Previous Edition

5) The impact of U.S. expansionary fiscal policy in the 1980s included which of the following?
A) higher interest and foreign exchange rates and lower exports
B) higher interest and foreign exchange rates and higher exports
C) lower net exports and lower interest rates
D) lower interest rates, higher exchange rates but lower net exports
Answer: A
Question Status: Previous Edition

6) A stronger dollar implies that foreigners will find U.S. exports ________ and U.S. citizens will find imports ________.
A) less expensive; more expensive
B) less expensive; less expensive
C) more expensive; more expensive
D) more expensive; less expensive
Answer: D
Question Status: Previous Edition

7) Suppose that the nominal exchange rate between the dollar and the English pound was 1 pound per $2 and that the English price level was twice that of the United States, then the real exchange rate is
A) 1 pound/$1.
B) 2 pounds/$1.
C) 1 pound/$2.
D) 1 pound/$4.
Answer: D
Question Status: Previous Edition

8) A fixed exchange rate system in which most central banks in the world agree to buy or sell dollars as needed to maintain the foreign price of their currency
A) has never existed in the real world.
B) existed before World War I.
C) existed between World Wars I and II.
D) existed between World War II and the early 1970s.
E) has existed since the early 1970s.
Answer: D
Question Status: Previous Edition

9) In a fixed exchange rate system such as the Bretton Woods system, a country would be forced to "devalue" its currency if persistent balance of payments ________ cause it to ________ foreign exchange reserves.
A) deficits, amass dangerous amounts of
B) deficits, run dangerously short of
C) surpluses, amass dangerous amounts of
D) surpluses, run dangerously short of
Answer: B
Question Status: Previous Edition

10) In the dollar-yen market, a movement of the exchange rate from 130 to 125 yen per dollar is good news for Japanese ________ and good news for U.S. ________.
A) exporters to the U.S., exporters to Japan
B) exporters to the U.S., importers of Japanese goods
C) importers of U.S. goods, exporters to Japan
D) importers of U.S. goods, importers of Japanese goods
Answer: C
Question Status: Previous Edition
11) From 1995 to 1998, the ________ of the dollar led to ________.
A) appreciation, a substantial increase in net exports
B) appreciation, collapse of net exports

C) depreciation, a substantial increase in net exports
D) depreciation, collapse of net exports
Answer: B
Question Status: Previous Edition

12) From 1980 to 1985, the effective exchange rate of the dollar against other major currencies ________, and then from 1985 to 1987 the rate ________.
A) remained rather constant, rose slowly
B) rose dramatically, remained rather constant
C) rose dramatically, fell back to its 1980 level
D) fell dramatically, remained rather constant
E) fell dramatically, rose back to near its 1980 level
Answer: C
Question Status: Previous Edition

13) From 1985 to 1987, there was a huge ________ of the dollar, meaning that it became on average ________ expensive to foreigners.
A) depreciation, less
B) depreciation, more
C) appreciation, less
D) appreciation, more
Answer: A
Question Status: Previous Edition

7.7 Case Study: Asia Intervenes with Buckets to Buy Dollars and Finance the U.S. Current Accounts Deficit—How Long Can This Continue?

1) During the Vietnam War years the U.S. official reserves transaction balance was negative and U.S. reserve assets declined. With the fixed exchange rate system during those years, the United States was able to run a deficit on current account because
A) foreign countries central banks accepted the U.S. currency as an international reserve.
B) it had an inexhaustible supply of gold reserves having discovered gold in California.
C) the capital account deficit compensated the current account deficit.
D) U.S. exports were expected to grow.
Answer: A
Question Status: Previous Edition

2) In 1985 the United States was in a "net debtor" position. This description means that
A) U.S. assets abroad were greater than foreign assets in the United States.
B) U.S. assets abroad were less than foreign assets in the United States.
C) the exports from the United States were greater than the imports into the United States.
D) the exports from the United States were less than the imports into the United States.
Answer: B
Question Status: Previous Edition
3) As a result of the United States suspending gold sales to foreign countries in 1968,
A) the United States had to make sure it ran an ORT surplus.
B) countries with balance-of-payments surpluses against the United States had to depreciate their exchange rates.
C) countries with balance-of-payment surpluses against the United States had to allow their economies to expand.

D) A and B.
Answer: C
Question Status: Previous Edition

4) The emergence of the United States as a net debtor country implies that
A) the United States will have to generate sufficient export sales to pay for these extra payments of investment income.
B) the dollar will have to depreciate more than otherwise.
C) the real income of Americans will decline because the dollar will have to appreciate.
D) A and B.
Answer: D
Question Status: Previous Edition

5) An increase in the net debtor status of the United States will serve to reduce the well-being of U.S. citizens because
A) the rate of importation must fall to pay the debt.
B) gold must be exported to pay the debt.
C) the rate of exportation must increase to pay the debt.
D) A and C.
Answer: D
Question Status: Previous Edition

6) Which of the following took place during the period 1980-85?
A) The United States employed a tight fiscal, easy money policy.
B) Major European countries generally followed easy fiscal policy.
C) Major European countries generally followed tight fiscal policy.
D) Both A and C.
Answer: D
Question Status: Previous Edition

7) What is the major reason for the increased volatility of both exchange rates and net exports after 1973?
A) a move toward fixed exchange rates in the world economy
B) a move toward flexible exchange rates in the world economy
C) the increased use of the dollar as an "international" currency
D) the movement toward the gold standard
Answer: B
Question Status: Previous Edition

8) Suppose that you travel from the United States to Japan this summer and the dollar has appreciated relative to the yen. Your total trip costs, assuming you buy the exact same goods and services, will
A) rise in dollar terms.
B) stay the same in terms of dollars.
C) fall in dollar terms.
D) stay the same in terms of yen and dollars expended.
Answer: C
Question Status: Previous Edition

9) Suppose that you are the representative of IBM selling computers manufactured in the United States to German companies. If the dollar appreciates, your prices in euros
A) rise.
B) fall.
C) stay the same.
D) None of the above since contracts are in fixed dollar terms.
Answer: B
Question Status: Previous Edition

10) The Vietnam War required the U.S. government to spend large amounts of dollars overseas. This effort
A) raised the demand and supply of dollars by private companies.
B) caused excess demand for dollars, and the exchange rate fell.
C) caused excess supply of dollars, and the exchange rate fell.
D) caused the dollar to appreciate.
Answer: C
Question Status: Previous Edition

11) From 1981 to 1998, the U.S. net international investment position
A) has improved significantly.
B) has deteriorated sufficiently to cost U.S. residents a flow of income equal to 1.2 percent of GDP each year.
C) has improved, and with it, so has the net foreign investment income of U.S. citizens.
D) none of the above.
Answer: D
Question Status: Previous Edition

12) Suppose that initially we have an exchange rate of 130 yen to the dollar. Suddenly trouble develops in the Japanese stock market, making American stocks more attractive than before. We expect that the dollar will ________ against the yen, meaning that it will cost ________ than 130 yen.
A) depreciate, more
B) depreciate, less
C) appreciate, more
D) appreciate, less
Answer: C
Question Status: Previous Edition
13) If the dollar depreciates against the yen, this tends to ________ our imports of Japanese goods and ________ our exports of goods to Japan, so that our net exports ________.
A) increase, increase, increase

B) increase, decrease, are unchanged
C) decrease, decrease, decrease
D) decrease, increase, increase
E) decrease, increase, are unchanged
Answer: D
Question Status: Previous Edition

14) In the late 1980s, foreign central banks ________ billions of dollars in order to ________ of the dollar.
A) bought, slow down the depreciation
B) bought, speed up the depreciation
C) sold, speed up the depreciation
D) sold, slow down the appreciation
E) sold, speed up the appreciation
Answer: A
Question Status: Previous Edition

15) If the European Central Bank buys dollars with euros, this causes the euro to ________ against the dollar, assisting European ________.
A) appreciate, importers of American goods
B) appreciate, exporters of goods to America
C) depreciate, importers of American goods
D) depreciate, exporters of goods to America
Answer: D
Question Status: Previous Edition

16) The difference between the value of the foreign assets owned by a nation's citizens and the nation's assets owned by foreign citizens is called the
A) current account balance.
B) capital account balance.
C) net international investment position.
D) balance of payments outcome.
Answer: C
Question Status: Previous Edition

17) Over the 1981-1991 decade, had the U.S. current account been in zero balance, the total income of Americans from their net investment position would have been about
A) 10 percent higher.
B) 1 percent higher.
C) 1 percent lower.
D) 10 percent lower.
Answer: B
Question Status: Previous Edition

18) On a foreign exchange market diagram with dollars on the horizontal axis and the yen price of the dollar on the vertical axis, a rise in the U.S. interest rate relative to the Japanese interest rate shifts the ________ curve of dollars to the ________.
A) supply, right
B) supply, left
C) demand, right

D) demand, left
Answer: C
Question Status: Previous Edition

19) On a foreign exchange market diagram with dollars on the horizontal axis and the yen price of the dollar on the vertical axis, the shape of the supply curve depends on the ________ and capital ________.
A) Japanese demand for U.S. goods, inflows to the United States
B) Japanese demand for U.S. goods, outflows to Japan
C) U.S. demand for Japanese goods, inflows to the United States
D) U.S. demand for Japanese goods, outflows to Japan
Answer: D
Question Status: Previous Edition

20) On a foreign exchange market diagram with dollars on the horizontal axis and the yen price of the dollar on the vertical axis, the shape of the demand curve depends on the ________ and capital ________.
A) Japanese demand for U.S. goods, inflows to the United States
B) Japanese demand for U.S. goods, outflows to Japan
C) U.S. demand for Japanese goods, inflows to the United States
D) U.S. demand for Japanese goods, outflows to Japan
Answer: A
Question Status: Previous Edition

21) Consider a foreign exchange market diagram with dollars on the horizontal axis, the yen price of the dollar on the vertical axis, an upward-sloping supply curve and downward-sloping demand curve. At an exchange rate above the equilibrium rate there is an excess ________ dollars causing market pressure for ________ of the dollar.
A) demand for, appreciation
B) demand for, depreciation
C) supply of, appreciation
D) supply of, depreciation
Answer: D
Question Status: Previous Edition

22) The bursting of the asset-price "bubble" in countries with fixed exchange rates and unrestricted capital flows caused
A) large capital outflows and a falling exchange rate.
B) large capital outflows and a rising exchange rate.
C) large capital inflows and a falling exchange rate.
D) large capital inflows and a rising exchange rate.
Answer: A
Question Status: Previous Edition

23) In response to the impact of large capital inflows, Asian countries
A) ran large government budget deficits.
B) increased their public debt.
C) tightened fiscal policy.
D) all of the above.
Answer: C
Question Status: Previous Edition

24) Which of the following are differences between the Fed and the European Central Bank which explain the slow response of the ECB to the economic slowdown in Europe?
A) The ECB is unable to compromise between the needs of high and low unemployment nations like France and Ireland.
B) The ECB has many policy targets.
C) The ECB inflation target includes energy costs which cause it to be more likely to raise interest rates when energy costs rise.
D) All of the above.
Answer: C
Question Status: Previous Edition

25) From 1996 till 2001, dollar was ________, causing net exports to ________.
A) depreciating; increase
B) depreciating; decrease
C) appreciating; increase
D) appreciating; decrease
Answer: D
Question Status: Previous Edition

26) In the past decade, the United States has been running extraordinary large foreign trade deficits. This is possible by the
A) desire of China, Japan and other countries to keep their currencies from strengthening against the dollar.
B) desire of China, Japan, and other countries to keep their currencies from weakening against the dollar.
C) desire of the U.S. population to save large amounts of their income.
D) desire of the U.S. government to maintain budget surplus.
Answer: A
Question Status: New

27) U.S. maintained a large current account deficit in all of the following years EXCEPT
A) 1970.
B) 1990.

C) 2000.
D) 2010.
Answer: A
Question Status: New

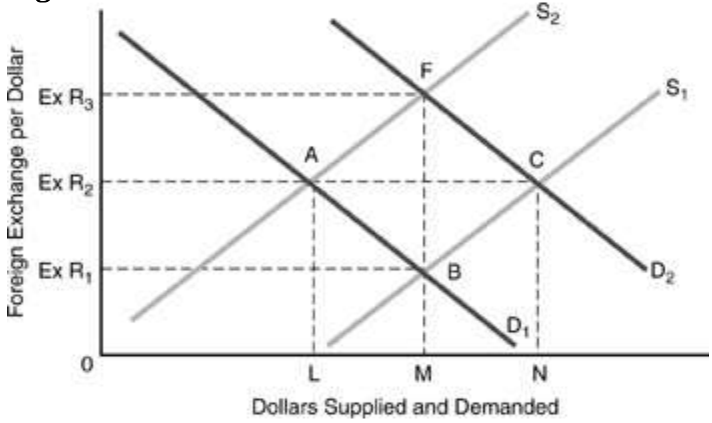
28) U.S. maintained a current account surplus in which of the following years?
A) 1970
B) 1990
C) 2000
D) 2010
Answer: A
Question Status: New

29) During the worst months of the 2008-2009 crisis, the U.S. dollar has
A) depreciated.
B) appreciated.
C) remained constant.
D) It is impossible to determined given the magnitude of the monetary policy.
Answer: B
Question Status: New

30) Between 2002 and 2010, foreign official holdings of dollars as a percent of U.S. GDP have increased to almost
A) 10 percent.
B) 5 percent.
C) 30 percent.
D) 20 percent.
Answer: C
Question Status: New

7.8 Determinants of Net Exports

Figure 6-1

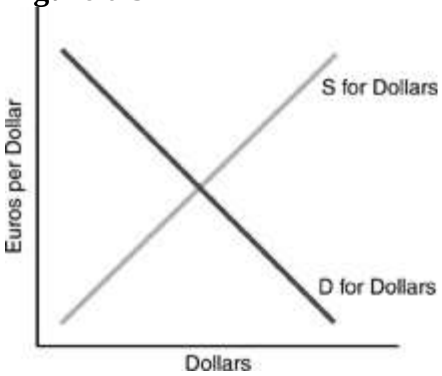


1) In Figure 6-1 above, an increase in autonomous exports will cause the ________ dollars to ________ and the exchange rate to ________, ceteris paribus.
A) supply of; shift to S_1; rise
B) supply of; shift to S_1; fall
C) demand for; shift to D_1; fall
D) demand for; shift to D_2; fall
Answer: D
Question Status: Previous Edition

2) In Figure 6-1 above, an increase in autonomous imports will cause the ________ dollars to ________ and the exchange rate to ________, ceteris paribus.
A) supply of; shift to S_1; rise
B) supply of; shift to S_1; fall
C) demand for; shift to D_1; fall
D) demand for; shift to D_2; fall
Answer: B
Question Status: Previous Edition

3) Long-term trends in the exchange rate are caused by ________ factors, while day-to-day volatility is more likely to be the result of ________.
A) interest rate differentials; technical factors
B) technical; new products and other fundamental factors
C) fundamental; changing interest rate differentials
D) volatile; fundamental factors
Answer: C
Question Status: Previous Edition

Figure 6-3



4) In Figure 6-3 above, the demand curve is generated by
A) U.S. exports.
B) U.S. imports.
C) the need to finance the budget deficits of the European government.
D) A and B.
Answer: A
Question Status: Previous Edition

5) In Figure 6-3 above, the supply curve is generated by
A) U.S. exports.
B) European imports.
C) U.S. imports.
D) foreign investors' desire to purchase U.S. factories.
Answer: C
Question Status: Previous Edition

6) In Figure 6-3 above, the demand for dollars will be vertical if
A) the price elasticity of European demand for U.S. imports is negative.
B) the price elasticity of European demand for U.S. imports is zero.
C) the price elasticity of demand for European imports is -1.0.
D) the price elasticity of U.S. demand for European imports is zero.
Answer: B
Question Status: Previous Edition

7) In Figure 6-3 above, if the demand for dollars shifts to the right
A) the dollar appreciates.
B) the euro depreciates.
C) A and B.
D) None of the above.
Answer: C
Question Status: Previous Edition

8) In the figure above, if the supply of dollars increases
A) the dollar and the euro appreciate.
B) the dollar and the euro depreciate.
C) the dollar appreciates and the euro depreciates.
D) the dollar depreciates and the euro appreciates.
Answer: D
Question Status: Previous Edition

9) Between 1992 and 1998 U.S. net exports fell substantially. The drop was attributable to
A) an appreciation of the dollar on foreign exchange markets.
B) an economic expansion in the United States.
C) slow economic growth in Japan and several European countries.
D) B and C.
E) all of the above.
Answer: D
Question Status: Previous Edition

10) A domestic economic expansion tends to ________ imports and thus ________ net exports.
A) increase, decrease
B) increase, increase
C) decrease, decrease
D) decrease, increase
Answer: A
Question Status: Previous Edition

11) Switching the U.S. policy mix to a tighter fiscal and easier monetary policy ________ the U.S. interest rate, leading to ________ of the dollar, which puts ________ long-run pressure on the U.S. foreign trade surplus.
A) raises, depreciation, upward
B) raises, depreciation, downward
C) raises, appreciation, upward
D) lowers, depreciation, upward
E) lowers, appreciation, downward
Answer: D
Question Status: Previous Edition

12) The relation between foreign borrowing and the domestic economy is given by
A) S - (T - G) + NX = I.
B) NX = S + T - G.
C) I = S + (T - G).
D) S + (T - G) - NX.
Answer: D
Question Status: Previous Edition

7.9 The Real Exchange Rate and Interest Rate

1) The relatively high interest rates in the United States in 1982-85 were associated with
A) a capital outflow from the United States and an appreciation of foreign currencies.
B) a surplus in the U.S. current account and a deficit in the capital account.
C) a deficit in the U.S. current account and an appreciation of the dollar.
D) a capital inflow and an appreciation of the dollar.
Answer: D
Question Status: Previous Edition

2) The mechanism of "international crowding-out" is that a government budget deficit ________ the domestic interest rate, which makes the dollar ________ expensive for foreigners, which then ________ net exports.
A) raises, less, lowers
B) raises, less, raises
C) raises, more, lowers
D) lowers, less, lowers
E) lowers, more, raises
Answer: C
Question Status: Previous Edition

3) The "real exchange rate" is the nominal exchange rate
A) inverted, so it expresses the home currency price of foreign currencies.
B) adjusted for interest rate differentials between nations.
C) adjusted for inflation rate differentials between nations.
D) that would exist in the absence of central bank intervention in foreign exchange markets.
Answer: C
Question Status: Previous Edition

4) In the early 1980s, there was a massive ________ of the dollar while at the same time U.S. net exports ________, which is ________ the modeling of net exports presented in the textbook.
A) appreciation, rose, in accord with
B) appreciation, rose, in violation of
C) appreciation, fell, in accord with
D) depreciation, rose, in violation of
E) depreciation, fell, in accord with
Answer: C
Question Status: Previous Edition

5) In 1985, the real exchange rate of the dollar began a long ________, while U.S. net exports ________.
A) rise, started rising before 1985
B) rise, started falling only in the late 1980s
C) rise, promptly started falling in 1985
D) decline, promptly started rising
E) decline, started rising only in the late 1980s
Answer: E
Question Status: Previous Edition

6) For the United States, a rise in e (the real exchange rate) means ________ of the dollar, thus ________ net exports.
A) an appreciation, rising
B) an appreciation, falling
C) a depreciation, rising
D) a depreciation, falling
Answer: B
Question Status: Previous Edition

7.10 Effects of Monetary and Fiscal Policy with Fixed and Flexible Exchange Rates

1) When a fiscal policy stimulus raises both real income and the interest,
A) the dollar appreciates.
B) the dollar depreciates.
C) imports decrease and exports increase.
D) both A and C.
Answer: A
Question Status: Previous Edition

2) When foreign securities become more attractive to U.S. investors,
A) there is an outflow of dollars from the United States and the dollar appreciates.
B) there is an outflow of dollars from the United States and the dollar depreciates.
C) the foreign currencies depreciate relative to the dollar.
D) imports into the United States will increase.
Answer: B
Question Status: Previous Edition

3) Following the use of expansionary fiscal policy in the United States, which of the following events will NOT take place?
A) increase in U.S. interest rate
B) appreciation of the dollar
C) increase in U.S. net exports
D) increase in exports of foreign countries to the United States
Answer: C
Question Status: Previous Edition

4) Which of the following events will tend to increase net exports of the United States?
A) an appreciation of the dollar
B) an increase in the U.S. real interest rate
C) a fall in the real interest rate in several western European countries
D) none of the above
Answer: D
Question Status: Previous Edition

5) With flexible exchange rates the fiscal policy multiplier becomes
A) larger because exports leak out of the economy.
B) smaller because the increase in interest rate lowers the exchange rate.
C) smaller because the increase in interest rate raises the exchange rate.
D) larger because the increase in interest rate raises the exchange rate.
Answer: C
Question Status: Previous Edition

6) A rise in U.S. interest rates, all else constant, would cause a dollar ________; in fact, this relationship ________ found in the actual data from the last two decades.
A) depreciation, is not
B) depreciation, is
C) appreciation, is not
D) appreciation, is
Answer: D
Question Status: Previous Edition

7) A change in Fed policy from "tight money" to "easy money" puts ________ pressure on the interest rate and thus tends to cause ________ of the dollar.
A) downward, depreciation
B) downward, appreciation
C) upward, depreciation
D) upward, appreciation
Answer: A
Question Status: Previous Edition

8) A tax decrease shifts the IS curve, causing a ________ domestic interest rate, leading to ________ of the dollar.
A) lower, depreciation
B) lower, appreciation
C) higher, depreciation
D) higher, appreciation
Answer: D
Question Status: Previous Edition

9) With the extreme assumption of "perfect capital mobility," a nation's interest rate is
A) completely independent of the other interest rates in the world.
B) tightly linked to all other interest rates in the world.
C) zero.
D) infinite.
Answer: B
Question Status: Previous Edition

10) With perfect capital mobility, a Fed policy that lowers the U.S. interest rate below the foreign rate causes a huge capital ________ that puts pressure on the dollar to ________.
A) inflow, appreciate
B) inflow, depreciate
C) outflow, appreciate
D) outflow, depreciate
Answer: D
Question Status: Previous Edition

11) Under the assumption of perfect capital mobility, a nation
A) can control its interest rate through either fiscal or monetary policy.
B) can control its interest rate only through fiscal policy.
C) can control its interest rate only through monetary policy.
D) cannot control its interest rate through either fiscal or monetary policy.
Answer: D
Question Status: Previous Edition

12) The assumption of perfect capital mobility is best suited to the modeling of ________ economies.
A) small open
B) small closed
C) large open
D) large closed
Answer: A
Question Status: Previous Edition

13) In a small open economy in a flexible exchange rate system with perfect capital mobility, there is complete ________ crowding-out of ________ policy.
A) domestic, monetary
B) domestic, fiscal
C) international, monetary
D) international, fiscal
Answer: D
Question Status: Previous Edition

14) The central bank is forced to accommodate fiscal policy under ________ exchange rates, which makes fiscal policy a ________ influence on equilibrium income.
A) fixed, powerful
B) fixed, powerless
C) flexible, powerful
D) flexible, powerless
Answer: A
Question Status: Previous Edition

15) In moving from a small open to a large open economy model, one policy has its effectiveness in changing equilibrium income enhanced:
A) monetary policy under fixed exchange rates.
B) fiscal policy under fixed exchange rates.
C) monetary policy under flexible exchange rates.
D) fiscal policy under flexible exchange rates.
Answer: C
Question Status: Previous Edition

16) Monetary policy is more powerful than fiscal policy under ________ exchange rates due to the amplifying effect from changes in interest rates to exchange rates to ________.
A) fixed, monetary accommodation
B) fixed, net exports
C) flexible, monetary accommodation
D) flexible, net exports
Answer: D
Question Status: Previous Edition

17) A large open economy can maintain a domestic interest rate below the foreign interest rate so long as the resulting capital account ________ is offset by an income level that produces an equal current account ________.
A) surplus, surplus
B) surplus, deficit
C) deficit, surplus
D) deficit, deficit
Answer: C
Question Status: Previous Edition

18) In moving from a small to a large open economy model under fixed exchange rates, fiscal policy
A) remains totally ineffective.
B) loses some of its effectiveness.
C) maintains the same degree of effectiveness.
D) gains extra effectiveness.
Answer: B
Question Status: Previous Edition

19) In moving from a small to a large open economy model under flexible exchange rates, fiscal policy
A) remains totally ineffective.
B) loses some of its effectiveness.
C) maintains the same degree of effectiveness.
D) gains extra effectiveness.
Answer: A
Question Status: Previous Edition

20) Switching the U.S. policy mix to an easier fiscal and tighter monetary policy ________ the U.S. interest rate, leading to ________ of the dollar, which puts ________ long-run pressure on the U.S. foreign trade surplus.
A) raises, depreciation, upward
B) raises, depreciation, downward
C) raises, appreciation, downward
D) lowers, depreciation, upward
E) lowers, appreciation, upward
Answer: C
Question Status: Previous Edition

21) Suppose the U.S. policy mix remains constant while major European nations switch to an easier fiscal and tighter monetary policy. With ________ European interest rates, the resulting ________ of the dollar eventually tends to ________ the U.S. foreign trade deficit.
A) higher, depreciation, decrease
B) higher, appreciation, increase
C) higher, appreciation, decrease
D) lower, depreciation, increase
E) lower, appreciation, decrease
Answer: A
Question Status: Previous Edition

22) U.S. macroeconomic policies of the early 1980s included a very ________ monetary policy that was largely responsible for the huge ________ of the dollar in 1980-1985.
A) tight, appreciation
B) tight, depreciation
C) easy, appreciation
D) easy, depreciation
Answer: A
Question Status: Previous Edition

23) A nation's foreign trade deficit implies a buildup of what ________ in allowing its imports to ________ its exports.
A) it owes to foreigners, fall short of
B) it owes to foreigners, exceed
C) foreigners owe to it, fall short of
D) foreigners owe to it, exceed
Answer: B
Question Status: Previous Edition

24) After a period of building up debt to foreigners, the associated interest payments mean that ending the foreign debt increase will require
A) a capital account surplus.
B) a current account surplus.
C) a current account deficit.
D) a zero balance in the capital account.
E) a zero balance in the current account.
Answer: B
Question Status: Previous Edition

25) Since the early 1980s, the U.S. current account has
A) been in near-balance in every year.
B) alternated between sizable deficits and surpluses.
C) been in surplus every year.
D) been in deficit every year.
Answer: D
Question Status: Previous Edition

7.11 Conclusion: Economic Policy in the Open Economy

1) There are no questions for this section.
Answer:

Macroeconomics, 12e **(Gordon)**
Chapter 8 Aggregate Demand, Aggregate Supply, and the Great Depression

8.1 Combining Aggregate Demand with Aggregate Supply

1) The aggregate demand curve may be derived from the IS-LM analysis by shifting
A) the IS curve as the price changes.
B) the real money supply and thus LM curve for each new price level.
C) both the LM and IS curves since the real money supply and real expenditures change when P changes.
D) the LM rightward when P increases to define Y.
Answer: B
Question Status: Previous Edition

2) If the interest responsiveness of business firms investment is great then the
A) IS curve is flatter and the AD curve is flatter.
B) IS curve is steeper and the AD curve is steeper.
C) IS curve is horizontal and the AD curve is perfectly vertical.

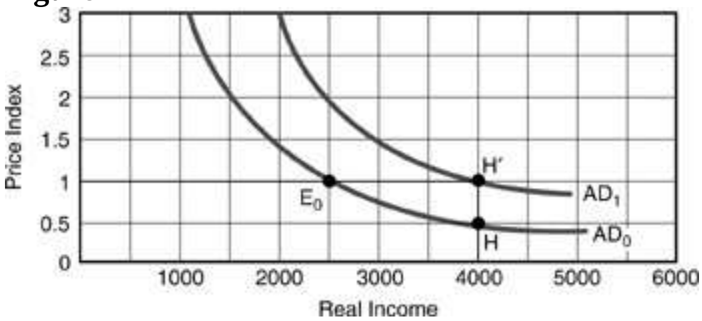
D) IS curve is horizontal and the AD curve is perfectly horizontal.
Answer: A
Question Status: Previous Edition

3) Let the government increase lump-sum taxes. The aggregate demand curve will
A) shift leftward and the IS curve will shift leftward.
B) shift rightward and the IS curve will shift rightward.
C) remain unaffected but the IS curve will shift leftward.
D) become positively sloped but the IS curve will remain negatively sloped.
Answer: A
Question Status: Previous Edition

8.2 Flexible Prices and the AD Curve

1) An increase in the price level will
A) increase the real money supply and shift the aggregate demand curve.
B) decrease the real money supply and shift the aggregate demand curve.
C) change the slope of the aggregate demand curve at each income level.
D) None of the above is correct.
Answer: D
Question Status: Previous Edition

Figure 7-1



2) Employing Figure 7-1 above, assume that the initial equilibrium Y was 2500 at E_0 prior to a change in the nominal money supply. The movement from E_0 to H' represents
A) an increase in the nominal money supply with a constant interest rate.
B) an increase in the nominal money supply with a constant price level.
C) a decrease in the nominal money supply with a constant price level.
D) a decrease in the nominal money supply with a rising interest rate.
Answer: B
Question Status: Previous Edition

3) A doubling of the nominal money supply would create a new AD curve at double the vertical position of the original AD curve because
A) at each price level there is a decrease in autonomous spending.
B) each output level requires the same real money supply as in the original situation.
C) the rise in money supply causes increased expectation of further price increases and investment declines.
D) the rise in the money supply causes an excess supply of money and generates rising interest rates.
Answer: B
Question Status: Previous Edition

4) A steeper LM curve implies that the aggregate demand curve will be
A) steeper and the k_1 multiplier becomes smaller.
B) flatter and the k_1 multiplier becomes larger.
C) unaffected and the k_1 multiplier becomes smaller.
D) horizontal and k_1 multiplier becomes larger.
Answer: B
Question Status: Previous Edition

5) A rise in the nominal money supply will
A) shift the IS curve and shift the AD curve.
B) shift the AD curve and raise the equilibrium price level.
C) shift the AD curve and raise the equilibrium level of nominal GDP.
D) All of the above are correct.
Answer: D
Question Status: Previous Edition

6) The fixed price level that was assumed in Chapters 3 through 7 implied that
A) there is always full employment.

B) there is always less than full employment.
C) the aggregate supply curve is upward sloping to the left.
D) the aggregate supply curve is horizontal.
Answer: D
Question Status: New

7) A fall in the price level causes changes in the IS-LM diagram that can also be recorded as a
A) rightward shift of the AD curve.
B) leftward shift of the AD curve.
C) movement downward along an AD curve.
D) movement upward along an AD curve.
Answer: C
Question Status: Previous Edition

8) Consider an initial IS-LM equilibrium in which the nominal money supply is 1000 and the price level is 1.0. As the price level falls to 0.5, then to 0.333, and then to 0.25, the effect on real balances means that AD
A) becomes flatter.
B) shifts upward by less and less.
C) shifts downward by less and less.
D) shifts downward by the same amount.
E) becomes upward-sloping at price levels below 1.0.
Answer: A
Question Status: Previous Edition

9) At every point to the right of the AD curve there is
A) an excess demand for real balances.
B) an excess supply of real balances.
C) an excess demand for commodities.
D) an excess supply of commodities.
Answer: D
Question Status: Previous Edition

8.3 Shifting the Aggregate Demand Curve with Monetary and Fiscal Policy

1) A flatter IS curve implies that the aggregate demand curve will be
A) steeper and the k_1 multiplier becomes larger.
B) flatter and the k_1 multiplier becomes smaller.
C) unaffected and the k_1 multiplier becomes smaller.
D) vertical and the k_1 multiplier becomes smaller.
Answer: B
Question Status: Previous Edition

2) The LM curve will shift to the
A) left if the price level falls and the quantity of money is held constant.
B) right if the price level rises and the quantity of money is held constant.
C) left if the price level is held constant and the quantity of money rises.
D) right if the price level falls and/or the quantity of money rises.
Answer: D
Question Status: Previous Edition

3) The AD curve will shift to the
A) right if the price level falls and the quantity of money is held constant.
B) right if the price level rises and the quantity of money is held constant.
C) right if the price level is held constant and the quantity of money rises.
D) right if the price level is held constant and the quantity of money falls.
Answer: C
Question Status: Previous Edition

4) If money demand relative to the level of real output is constant then, the slope of the AD curve is
A) steeper the steeper the slope of the LM curve.
B) flatter the flatter the slope of the LM curve.
C) steeper the flatter the slope of the LM curve.
D) horizontal if the LM curve is vertical.
Answer: C
Question Status: Previous Edition

5) If the marginal leakage rate is small, then the AD is
A) flatter.
B) steeper.
C) perfectly vertical.
D) perfectly horizontal.
Answer: A
Question Status: Previous Edition

6) The slope of the AD curve is important because it explains the
A) responsiveness of consumers to changes in the price level.
B) impact on Y and P for a given change in the SAS curve.
C) responsiveness of money demand to price changes.
D) responsiveness of business firms to price changes.
Answer: B
Question Status: Previous Edition

7) The slope of the SAS curve is important because it
A) explains the impact of supply side policies on the economy.
B) explains the impact of both supply and demand side policies on Y and P.
C) partially explains the impact of AD stabilization policies on Y and P.
D) None of the above.
Answer: C
Question Status: Previous Edition

8) Suppose that the administration proposes to follow a contractionary fiscal policy. This would cause the
A) AD to shift rightward and raise the price level.
B) SAS to shift rightward and lower the price level.
C) AD to shift leftward and lower the price level.
D) SAS to shift leftward and raise the price level.
Answer: C
Question Status: Previous Edition

Consider an initial IS-LM equilibrium point which corresponds to a point labeled "A" on the current AD curve.

9) Refer to the information above. If the nominal money supply falls by 4 percent with no change in the price level, the resulting IS-LM equilibrium corresponds to a point in the AD diagram
A) which has moved upward along the same AD curve.
B) 4 percent straight above A on a new AD curve.
C) 4 percent straight below A on a new AD curve.
D) directly to the right of A on a new AD curve.
E) directly to the left of A on a new AD curve.
Answer: E
Question Status: Previous Edition

10) Refer to the information above. If the nominal money supply falls by 4 percent, accompanied by a 4 percent fall in the price level, the resulting IS-LM equilibrium corresponds to a point in the AD diagram
A) which is exactly point A again.
B) 4 percent straight above A on a new AD curve.
C) 4 percent straight below A on a new AD curve.
D) directly to the right of A on a new AD curve.
E) directly to the left of A on a new AD curve.
Answer: C
Question Status: Previous Edition

11) Refer to the information above. If government spending increases with no change in the price level, the resulting IS-LM equilibrium corresponds to a point in the AD diagram
A) which has moved downward along the same AD curve.
B) straight above A on a new AD curve.
C) straight below A on a new AD curve.
D) directly to the right of A on a new AD curve.
E) directly to the left of A on a new AD curve.
Answer: D
Question Status: Previous Edition

12) Refer to the information above. If business confidence improves with no change in the price level, the resulting IS-LM equilibrium corresponds to a point in the AD diagram
A) which has moved downward along the same AD curve.
B) straight above A on a new AD curve.
C) straight below A on a new AD curve.
D) directly to the right of A on a new AD curve.
E) directly to the left of A on a new AD curve.
Answer: D
Question Status: Previous Edition

13) Refer to the information above. If the overall tax rate increases with no change in the price level, the resulting IS-LM equilibrium corresponds to a point in the AD diagram
A) which has moved upward along the same AD curve.
B) straight above A on a new AD curve.
C) straight below A on a new AD curve.
D) directly to the right of A on a new AD curve.
E) directly to the left of A on a new AD curve.
Answer: E
Question Status: Previous Edition

14) If firms are willing to produce and sell more output when prices rise, this implies
A) an upward-sloping short-run aggregate supply curve.
B) a vertical short-run aggregate supply curve.
C) an upward-sloping aggregate demand curve.
D) a horizontal aggregate supply curve.
Answer: A
Question Status: Previous Edition

15) Suppose the aggregate demand curve shifts rightward against a horizontal short-run aggregate supply curve. Real GDP would ________ while the price level ________.
A) remain unchanged, rises
B) rise, rises
C) remain unchanged, falls
D) rise, remain unchanged
E) fall, rises
Answer: D
Question Status: Previous Edition
16) Suppose the aggregate demand curve shifts rightward against an upward-sloping short-run aggregate supply curve. Real GDP would ________ while the price level ________.
A) remain unchanged, rises

B) rise, rises
C) remain unchanged, falls
D) rise, remain unchanged
E) fall, rises
Answer: B
Question Status: Previous Edition

17) From one period to the next, the change in real GDP depends on the shift in aggregate demand
A) but not on how SAS might shift.
B) and on SAS, but only if it also shifts.
C) and on SAS, but only if it is horizontal.
D) and on the slope and shifting of SAS.
Answer: D
Question Status: Previous Edition

8.4 Alternative Shapes of the Short-Run Aggregate Supply Curve

1) An increase in the nominal money supply will shift
A) AD up and raise the price level.
B) AD down and lower the price level.
C) SAS up and raise the price level.
D) SAS down and lower the price level.
Answer: A
Question Status: Previous Edition

2) If the price level were to rise, the short-run aggregate supply curve in the next period will
A) shift upward.
B) shift downward.
C) become steeper.
D) None of the above is correct.
Answer: D
Question Status: Previous Edition

3) The short-run aggregate supply curve slopes upward because, with a given equilibrium wage rate, a higher actual price level will
A) reduce the actual real wage and induce firms to hire more labor.
B) shift the labor supply curve.
C) increase the aggregate demand for goods, so that output will rise.
D) All of these.
Answer: A
Question Status: Previous Edition

4) The position of the short-run aggregate supply curve depends on
A) the price level.
B) workers' expectations.
C) aggregate demand.
D) the actions of the monetary authority.
Answer: B
Question Status: Previous Edition

5) In the short-run with fixed wages, the SAS curve is positively sloped because
A) the marginal product of labor declines, marginal costs rise.
B) the marginal product of labor increases, marginal costs rise.
C) marginal cost equals price and marginal costs decline.
D) None of the above.
Answer: A
Question Status: Previous Edition

6) The SAS curve will be steeper the
A) greater is the marginal product of each additional worker.
B) greater is MC.
C) greater is the nominal wage.
D) the faster the MPN falls for each additional worker.
Answer: D
Question Status: Previous Edition

7) If labor unions negotiate an increase in the nominal wage rate the SAS curve will shift
A) upward to the right and output will increase.
B) downward to the right and output will increase.
C) downward to the left and output will decrease.
D) upward to the left and output will decrease.
Answer: D
Question Status: Previous Edition

8) The labor supply curve may be shifted if
A) jobs are scarce.
B) jobs are plentiful.
C) real wages change.
D) immigration increases.
Answer: D
Question Status: Previous Edition

9) The SAS curve is positively sloped because workers, in the short-run, will supply the labor required by
A) households at the fixed real wage.
B) business firms at the fixed real wage.
C) business firms at the fixed nominal wage.
D) A and B.
Answer: C
Question Status: Previous Edition

10) Should the nominal money supply rise by six percent, real balances would remain unaffected if at the same time the price level ________ by six percent, which translates into the aggregate demand diagram as ________.
A) rises, a movement upward along AD by six percent
B) rises, an upward shift of AD by six percent
C) rises, a movement downward along AD by six percent
D) falls, a movement downward along AD by six percent
E) falls, a downward shift of AD by six percent
Answer: B
Question Status: Previous Edition

8.5 The Short-Run Aggregate Supply (SAS) Curve When the Nominal Wage Rate Is Constant

1) Assuming constant wages implies that
A) an increase in the price of goods raises profits and SAS is vertical.
B) a decrease in the price of goods lowers profits and SAS is horizontal.
C) an increase in the price of goods lowers profits and SAS is vertical.
D) an increase in the price of goods raises profits and SAS is positively sloped.
Answer: D
Question Status: Previous Edition

2) With a fixed nominal wage the SAS curve is positively sloped because
A) an increase in P decreases the real wage and raises profits if output is increased.
B) A decrease in P decreases the real wage and raises profits if output is increased.
C) business firms are responsive to interest rates.
D) the marginal leakage rate is small.
Answer: A
Question Status: Previous Edition

3) With the nominal wage rate given, an increase in the price level leads to
A) movement downward along a short-run aggregate supply curve (SAS).
B) movement upward along a short-run aggregate supply curve(SAS).
C) a rightward shift of the short-run aggregate supply curve(SAS).
D) a leftward shift of the short-run aggregate supply curve(SAS).
Answer: B
Question Status: Previous Edition

4) We derive the aggregate labor demand curve by horizontally adding all firms'
A) marginal product of labor curves.
B) production function curves.
C) supply curves.
D) horizontal lines at the real wage.
Answer: A
Question Status: Previous Edition

5) What is held constant at all points along a single SAS curve?
A) the nominal wage rate
B) the amount of labor employed
C) the price level
D) the real wage rate
E) real GDP
Answer: A
Question Status: Previous Edition

6) Along a short-run aggregate supply curve firms are willing to produce more output if a ________ causes the real wage to ________.
A) higher nominal wage, rise
B) lower nominal wage, fall
C) higher price level, rise
D) lower nominal wage, rise
E) higher price level, fall
Answer: E
Question Status: Previous Edition

7) When the nominal wage rate rises by x percent we
A) move upward along the SAS curve by x percent.
B) move downward along the SAS curve by x percent.
C) shift SAS upward by x percent.
D) shift SAS downward by x percent.
Answer: C
Question Status: Previous Edition

8) Suppose that the nominal wage falls by x percent, and a certain change in the price level maintains the same real wage as before. In the SAS diagram these events cause
A) no change at all, as they offset each other.
B) a downward movement along the SAS curve.
C) an upward movement along the SAS curve.
D) a downward shift of the SAS curve.
E) an upward shift of the SAS curve.
Answer: D
Question Status: Previous Edition

9) The long-run buildup of an economy's capital stock ________ the marginal product of labor thus shifting the labor demand curve to the ________, which then causes ________.
A) increases, right, SAS to shift to the right
B) increases, right, movement up the SAS curve
C) increases, left, SAS to shift to the left
D) decreases, right, SAS to shift to the left
E) decreases, left, movement down the SAS curve
Answer: A
Question Status: Previous Edition

8.6 Fiscal and Monetary Expansion in the Short and Long Run

1) An "easy money, easy fiscal" policy combination would shift AD
A) upward to the left and raise the price level.
B) downward to the left and raise the price level.
C) upward to the right and raise the price level.
D) downward to the left and lower the price level.
Answer: D
Question Status: Previous Edition

2) Which of the following factors will NOT cause the AD curve to shift?
A) tax rates
B) autonomous exports
C) changes in the marginal product of labor
D) consumer confidence
Answer: C
Question Status: Previous Edition

3) If there are perfectly flexible prices and the economy is operating at Y(N), then an increase in government expenditures
A) will increase real GDP and the price level.
B) will increase nominal GDP and the raise price level.
C) will not lead to complete real crowding out.
D) will lead to complete nominal crowding out and have the price level unchanged.
Answer: B
Question Status: Previous Edition

4) When the real wage falls, as a result of a rise in the price level
A) the demand for labor will fall.
B) the supply of labor will rise.
C) firms will hire more labor as they move down the demand curve for labor.
D) the nominal wage will fall.
Answer: C
Question Status: Previous Edition

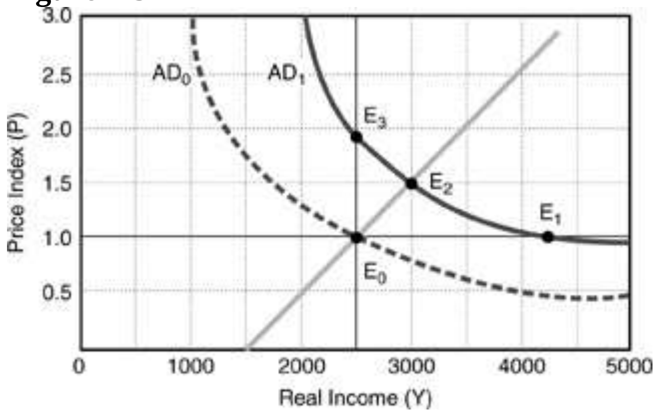
5) If, other things constant, the actual real wage is below the equilibrium real wage, the short-run aggregate supply curve in the next period would
A) be unaffected and the price level would remain constant.
B) shift upward and the price level would increase.
C) shift downward and the price level would fall.
D) be vertical and the price level would increase.
Answer: B
Question Status: Previous Edition

6) The long-run aggregate supply curve is
A) vertical at the natural level of income.
B) horizontal at the natural price level.
C) upward-sloping for all income levels below the natural level of income.
D) downward-sloping for all income levels above the natural level of income.
Answer: A
Question Status: Previous Edition

7) A fiscal expansion will
A) raise both the price level and real income in the long run.
B) reduce both the price level and the real income in the short run.
C) raise real income but leave the price level unaffected in the long run.
D) raise both the price level and real income in the short run.
Answer: D
Question Status: Previous Edition

8) Which of the following will NOT shift the aggregate demand curve?
A) an increase in the money supply
B) a change in the price level
C) a reduction in the marginal propensity to save
D) an increase in government spending
Answer: B
Question Status: Previous Edition

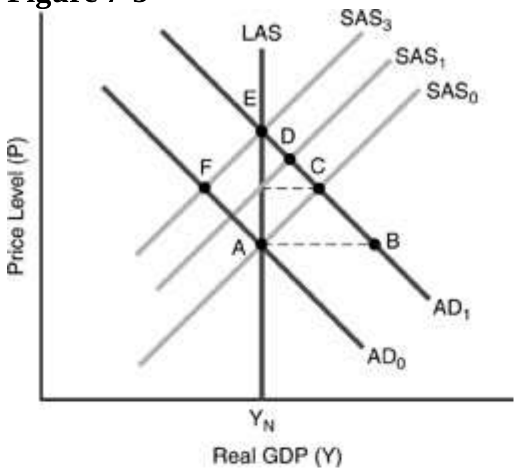
Figure 7-3



9) Employing Figure 7-3 above with equilibrium initially at E_0, assume the nominal money supply eased. If prices are flexible, in the short run ________ and in the long run ________.
A) prices and output rise as in E_2; output remains at 3000
B) prices and output remain at E_0; output changes to 2500
C) prices and output rise, E_0 to E_2; output returns to E_3
D) None of the above.
Answer: C
Question Status: Previous Edition

10) Suppose that the discovery of cold fusion implies that the productivity of each worker in the economy doubles. This would cause the
A) AD curve to shift up and the SAS curve to remain stationary.
B) SAS curve to shift rightward.
C) SAS curve to shift leftward.
D) AD curve to shift down and the SAS curve to shift upward.
Answer: B
Question Status: Previous Edition

Figure 7-5



11) In Figure 7-5, a fiscal expansion from point A with no initial change in the nominal wage causes a movement to point
A) B.
B) C.
C) D.
D) E.
E) F.
Answer: B
Question Status: Previous Edition

12) In Figure 7-5 above, we begin with the expansion of aggregate demand in the IS-LM model, with a result transferred into this model as a movement from points A to
A) B.
B) C.
C) D.
D) E.
E) F.
Answer: A
Question Status: Previous Edition

13) In Figure 7-5 above, from point A suppose the shift in aggregate demand is due to a 6 percent rise in the money supply. Suppose that at the same time the nominal wage also rises by 6 percent. We would move from points A to
A) B.
B) C.
C) D.
D) E.
E) F.
Answer: D
Question Status: Previous Edition

14) In Figure 7-5 above, from an initial long-run equilibrium the net tax rate rises with no initial change in the nominal wage. We would show this as a movement from points
A) A to B.
B) A to F.
C) B to E.
D) E to B.
E) E to F.
Answer: E
Question Status: Previous Edition

15) In Figure 7-5 above, from point A sudden increases in the price of crude oil would move us to point
A) B.
B) C.
C) D.
D) E.
E) F.
Answer: E
Question Status: Previous Edition

16) In Figure 7-5 above, at point C, the real wage is ________ its equilibrium value, leading to changes in the nominal wage that ________.
A) above, shift AD_1 back to AD_0
B) below, shift AD_1 further to the right
C) below, shift SAS_0 upward
D) above, shift SAS_0 downward
Answer: C
Question Status: Previous Edition

17) In Figure 7-5 above, at point F, the real wage is ________ its equilibrium value, leading to changes in the nominal wage that ________.
A) above, shift AD_0 back to AD_1
B) below, shift AD_0 further to the left
C) below, shift SAS_3 upward
D) above, shift SAS_3 downward
Answer: D
Question Status: Previous Edition

18) In Figure 7-5 above, from initial point A, suppose AD_0 shifts to AD_1. Under the assumptions of classical macroeconomics, we would
A) stay at point A.
B) almost immediately move to and then stay at point B.
C) almost immediately move to and then stay at point C.
D) almost immediately move to and then stay at point E.
Answer: D
Question Status: Previous Edition

19) In Figure 7-5 above, from initial point E, suppose AD_1 shifts to AD_0. Under the

assumptions of classical macroeconomics, we would
A) stay at point E.
B) almost immediately move to and then stay at point A.
C) almost immediately move to and then stay at point F.
D) almost immediately move to and then stay at point B.
Answer: B
Question Status: Previous Edition

20) That the LAS curve is vertical means that
A) firms are willing to produce any amount of output demanded at the fixed price level.
B) actual real GDP does not depend on the value of natural real GDP.
C) natural real GDP does not depend on the price level.
D) output never deviates from the natural real GDP.
Answer: C
Question Status: Previous Edition

8.7 Classical Macroeconomics: The Quantity Theory of Money and the Self-Correcting Economy

1) The classical economists believed that shifts in the AD and SAS curves offset each other such that the
A) price level rose and output fell unidirectionally given any change in aggregate demand.
B) unemployment level is constant.
C) price level is constant.
D) price level is cyclical.
Answer: B
Question Status: Previous Edition

2) In the classical model, flexible prices and wages serve to
A) self-correct the economy guaranteeing a constant price level and a constant level of output.
B) self-correct the economy above to the natural rate of unemployment, and constant price level.
C) ensure that stabilization policy is not required on the part of fiscal authorities.
D) none of the above
Answer: C
Question Status: Previous Edition

3) When AD curve is curved line, this indicates
A) a given decline in the price level will boost real GDP more when the price level is low than when the price level is high.
B) a given decline in the price level will boost real GDP less when the price level is low then when the price level is high.
C) a given change in the price level will have no effect on real GDP.
D) that SAS and LAS curves are horizontal
Answer: A
Question Status: New

4) Which of the following factors will NOT shift AD to the right?
A) an increase in foreign income

B) an increase in consumer optimism
C) a decrease in housing wealth
D) an increase in government spending
Answer: C
Question Status: New

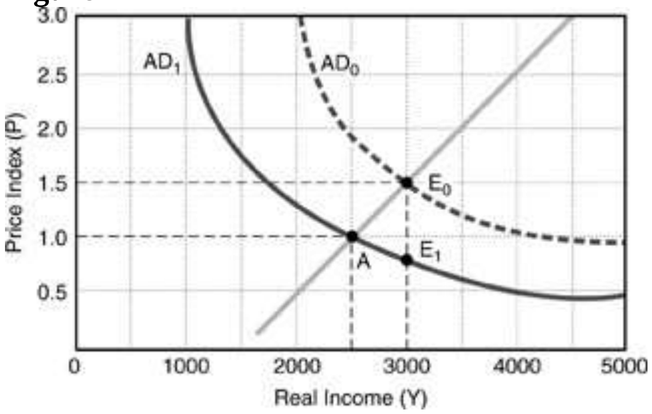
5) Classical economists believed that
A) government intervention was necessary to stabilize the economy.
B) movements away from the natural rate of output were only temporary.
C) monetary policy was ineffective.
D) monetary impotence would make fiscal policy necessary to bring the economy out of a depression.
Answer: B
Question Status: Previous Edition

6) In a self-correcting economy, an increase in government expenditures in the long-run will
A) raise equilibrium real GDP and raise the price level.
B) lower the price level but leave real GDP unaffected.
C) raise nominal GDP but leave real GDP unaffected.
D) leave the price level and real GDP unaffected.
Answer: C
Question Status: Previous Edition

7) To the classical economists it was ________ not ________ which adjust when unemployment differs from the natural rate.
A) wages; prices
B) prices; wages
C) output; prices
D) prices; output
Answer: D
Question Status: Previous Edition

8) The Classical Economists believed that
A) the cure for wage sickness was the passage of labor laws requiring the indexing of wages to changes in normal GDP.
B) the cure for unemployment was the passage of labor laws requiring the indexing of wages to changes in nominal GDP.
C) the cure for wage stickiness was to remedy market inefficiencies.
D) unemployment required active government intervention to manipulate AD.
Answer: C
Question Status: Previous Edition

Figure 7-4



9) According to the classical economists when aggregate demand declines, AD_0 to AD_1 in the figure above, and output, falls below the natural rate of unemployment at 3000, wages and prices would
A) fall to E_1 causing output to rise and unemployment would be temporary.
B) rise to E_0 causing output to rise and unemployment would be temporary.
C) rise to A causing output to fall and unemployment would be temporary.
D) fall to A causing output to fall and unemployment would be permanently increased.
Answer: A
Question Status: Previous Edition

10) According to the classical economists when output Y rises above the natural rate of employment, wages and prices would
A) fall causing output to rise; unemployment would be permanent.
B) rise causing output to rise; increased employment would be temporary.
C) rise causing output to fall; increased employment would be temporary.
D) fall causing output to fall; unemployment would be temporary.
Answer: C
Question Status: Previous Edition

11) What key assumption changed the quantity equation into the quantity theory of money?
A) Wage rates were flexible.
B) Only cash, currency, and demand deposits were considered money.
C) The velocity of money was relatively stable.
D) The money supply grew at a steady rate over the long run.
Answer: C
Question Status: Previous Edition

12) The term monetary impotence refers to the
A) failure of firms to lower prices even when wages are falling.
B) problems that an economy faces when industries are not perfectly competitive and prices do not fluctuate.
C) failure of fiscal policy to drive down prices in a depression.
D) inability of an increase in real balances to raise the level of output.
Answer: D
Question Status: Previous Edition

13) Classical macroeconomists believed that a market-based economy has ________ self-correcting forces and thus ________ business cycles.
A) strong, mild and fleeting
B) strong, violent and prolonged
C) weak, mild and fleeting
D) weak, violent and prolonged
Answer: A
Question Status: Previous Edition

14) Most classical macroeconomists considered unemployment
A) a minor problem due to the rapidity of downward price level changes.
B) a minor problem due to the sluggishness of downward price level changes.
C) a major problem due to the sluggishness of downward price level changes.
D) a major problem due to the rapidity of downward price level changes.
Answer: A
Question Status: Previous Edition

15) The "quantity theory of money" was employed by Classical macroeconomists to predict changes in the price level. Changes in P were forecast to be
A) proportional to changes in the money supply.
B) inversely proportional to changes in velocity.
C) proportional to changes in natural real GDP.
D) inversely proportional to changes in real GDP.
Answer: A
Question Status: Previous Edition

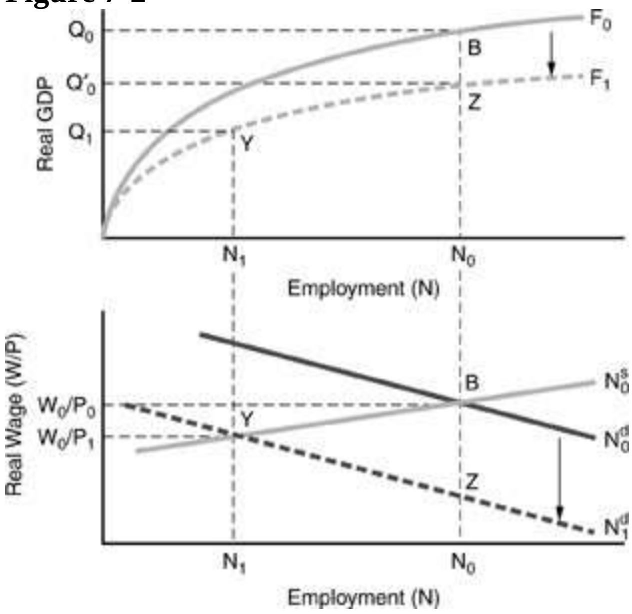
16) The result of raising government spending in the IS-LM model can be translated to the "quantity equation" as equal-proportional changes in
A) M and V.
B) M and P.
C) V and P.
D) V and Y.
E) P and Y.
Answer: D
Question Status: Previous Edition

17) Suppose we are at the natural real GDP when the aggregate demand curve suddenly shifts downward. In Classical macroeconomics, the price level would ________, and real output would ________.
A) remain unchanged, also remain unchanged
B) remain unchanged, fall below natural real GDP until the aggregate demand curve shifts back up
C) fall, fall briefly then return to natural real GDP
D) fall, fall below natural real GDP until the aggregate demand curve shifts back up
Answer: C
Question Status: Previous Edition

8.8 The Keynesian Revolution: The Failure of Self-Correction

1) If the productivity of labor were suddenly to increase, we would expect to observe
A) a short-run rise in output and fall in prices.
B) an increase in the natural level of real GDP.
C) a downward shift in the aggregate supply curve.
D) All of the above are correct.
Answer: D
Question Status: Previous Edition

Figure 7-2



2) In Figure 7-2 above, the shifts F_0 to F_1 and N_0^d to N_1^d may have occurred in an economy subjected to a
A) permanent fiscal deficit.
B) temporary fiscal deficit.
C) permanent increase in the relative price of energy.
D) permanent increase in the rate of growth of the money supply.
Answer: C
Question Status: Previous Edition

3) As firms hire more labor
A) the supply of labor increases.
B) each additional worker hired produces an additional amount of output but at a diminishing rate.
C) each additional worker hired produces an additional amount of output but at an increasing rate.
D) the marginal labor cost of output decreases.
Answer: B
Question Status: Previous Edition

4) Given the technology and the amount of other resources available, the position of the demand for labor depends on the
A) supply of labor.
B) other firms' demand for labor.
C) rate of population growth.
D) price level.
Answer: D
Question Status: Previous Edition

5) The equilibrium real wage rate
A) is equal to the nominal wage rate.
B) equals the actual real wage rate in short-run equilibrium.
C) equals the actual real wage rate at every point on the SS curve.
D) is determined by the intersection of the labor supply and demand curves.
Answer: D
Question Status: Previous Edition

6) If the actual real wage rate is above the equilibrium real wage rate there will be
A) pressure for the actual real wage rate to rise.
B) pressure for the actual real wage rate to decline.
C) a tendency for prices to rise and output to fall.
D) None of the above.
Answer: B
Question Status: Previous Edition

7) The demand for labor is determined by
A) the marginal product of labor, and technology.
B) the marginal product of labor, the price of goods, and nominal wages.
C) MPN and the CPI.
D) None of the above.
Answer: B
Question Status: Previous Edition

8) If firms hire workers until the real wage, W/P, is equal to the marginal product of labor, MPN, then the firm
A) maximizes employment.
B) maximizes employment and profits.
C) maximizes profits.
D) minimizes "waste," such as pollution.
Answer: C
Question Status: Previous Edition

9) The Pigou effect refers to the fact that autonomous expenditures may depend on
A) interest rates and variations in the perceived value of money balances.
B) the real money supply and variations in the perceived value of money balances.
C) income and variations in the perceived value of money balances.
D) taxes and variations in the perceived value of money balances.
Answer: B
Question Status: Previous Edition

10) The Pigou effect is
A) the stimulus to aggregate demand from a fall in the interest rate.
B) the effect of a cut in taxes on the aggregate demand curve.
C) the effect of a fall in prices on aggregate demand curve.
D) the direct stimulus to consumption because of an increase in the real value of the money supply.
Answer: D
Question Status: Previous Edition

11) Pigou's explanation of the existence of unemployment required
A) wage "stickiness" or slowness of wages to adjust to changes in market conditions.
B) fixed goods price or slowness of prices to adjust to changes in market conditions.
C) Churchill's introduction of unemployment compensation.
D) all of the above.
Answer: A
Question Status: Previous Edition

12) If the Pigou effect characterizes the economy then the slope
A) of the aggregate demand curve is zero; the aggregate supply curve is vertical.
B) of the aggregate supply curve is zero; the aggregate demand curve is vertical.
C) of both the AD and SAS curves are vertical.
D) of the AD cannot be vertical; the aggregate supply curve is unaffected.
Answer: D
Question Status: Previous Edition

13) According to Pigou, the Keynesian dilemma of a vertical AD curve is not a dilemma at all because the demand for commodities depends directly on the level of real balances. Thus, the
A) IS curve would shift to the left whenever the price level falls.
B) AD curve would shift to the left whenever the price level falls.
C) AD curve would shift to the right whenever the price level falls.
D) AD curve would always have a negative slope.
Answer: D
Question Status: Previous Edition

14) The Pigou effect might be ineffective in correcting a recession if
A) prices are falling.
B) people expect the implied deflation to continue.
C) there is a liquidity trap.
D) the government does not expand the money supply.
Answer: B
Question Status: Previous Edition

15) During the Great Depression
A) there is good evidence that the LM curve was horizontal.
B) there was almost perfect price flexibility.
C) wages fell continuously.
D) there was a major shift in aggregate demand.
Answer: D
Question Status: Previous Edition

16) The redistribution effect refers to the situation in which
A) a redistribution policy might raise consumption because poorer people spend a greater percentage of their income than the rich.
B) rising prices might make creditors feel wealthier and encourage them to increase their spending.
C) rising prices might make debtors feel less wealthy and encourage them to cut back on their spending.
D) falling prices might make debtors feel less wealthy and encourage them to cut back on their spending.
Answer: D
Question Status: Previous Edition

17) Which of the following groups was NOT affected by the redistribution effect?
A) farmers in the 1930s
B) oil producers in the 1980s
C) home owners in the 1970s
D) social security recipients in the 1970s
Answer: D
Question Status: Previous Edition

18) What explanation for monetary impotence was supported by the events of the Great Depression?
A) vertical IS curve and a horizontal LM curve
B) shifting IS curve and a vertical LM curve
C) horizontal IS curve and a vertical LM curve
D) a vertical IS curve and shifting IS curve
Answer: D
Question Status: Previous Edition

19) Keynes argued that monetary policy would be impotent during the Great Depression because
A) both the IS and the LM curve were vertical.
B) IS curve was continuously shifting, while the LM curve was stable.
C) IS curve was vertical and stuck at a low level of Y.
D) none of the above
Answer: C
Question Status: Previous Edition

20) Keynes argued that monetary policy would be impotent during the Great Depression because a
A) fall in interest rates would stimulate investment.
B) fall in interest rates would not stimulate investment.
C) rise in interest rates should not stimulate investment.
D) rise in interest rates would stimulate investment.
Answer: B
Question Status: Previous Edition

21) Keynes argued that monetary policy would be impotent during the Great Depression because
A) the LM curve was horizontal and the IS curve was vertical.
B) the LM curve was continuously shifting and the IS curve was vertical.
C) the LM curve was vertical and the IS curve was nearly flat.
D) both the LM curve and the IS curve were shifting rightward at the same time.
Answer: D
Question Status: Previous Edition

22) Evidence that a horizontal LM curve occurred during the middle depression years would require showing that individuals
A) refused to spend excess money.
B) increased the spending of excess money.
C) sold bonds and bought goods.
D) sold assets and bought bonds.
Answer: D
Question Status: Previous Edition

23) Even in the event of a horizontal LM curve, classicists argued that government intervention would NOT be required if the IS curve shifts in response to changes in
A) the price level (the Pigou effect).
B) the unemployment level (the real balance effect).
C) interest rate (the Keynes effect).
D) exchange rate (the expectations effect).
Answer: B
Question Status: Previous Edition

24) We have inflation
A) only when the price of every good is rising.
B) when the prices of most goods are rising.
C) when the prices of most goods are falling.
D) only when the price of every good is falling.
Answer: B
Question Status: Previous Edition

25) A rise in the price level causes
A) the LM curve to shift downward.
B) the LM curve to shift upward.
C) movement up along an LM curve.
D) movement down along an LM curve.
Answer: B
Question Status: Previous Edition

26) Suppose we have an initial equilibrium with curves IS_0 and LM_0. The price level then rises. At every point on LM_0 there is now an excess ________ real balances, which is eliminated at each income level by a ________ in the interest rate, meaning that the new LM curve is ________ LM_0.
A) demand for, fall, above
B) demand for, fall, below
C) demand for, rise, above
D) supply of, rise, above
E) supply of, fall, below
Answer: C
Question Status: Previous Edition

27) Suppose we have an initial equilibrium with curves IS_0 and LM_0. The price level then falls. At every point on LM_0 there is now an excess ________ real balances, which is eliminated at each income level by a ________ in the interest rate, meaning that the new LM curve is ________ LM_0.
A) demand for, fall, above
B) demand for, fall, below
C) demand for, rise, above
D) supply of, rise, above
E) supply of, fall, below
Answer: E
Question Status: Previous Edition

28) A fall in the price level causes
A) the LM curve to shift downward.
B) the LM curve to shift upward.
C) movement up along an LM curve.
D) movement down along an LM curve.
Answer: A
Question Status: Previous Edition

29) Suppose we have an initial IS-LM equilibrium at a certain price level. A rise in the price level puts ________ pressure on the interest rate as the money market re-equilibrates, which in turn causes commodity market equilibrium to occur at an output level ________ the initial one.
A) upward, above
B) upward, below
C) downward, above
D) downward, below
Answer: B
Question Status: Previous Edition

30) A single aggregate demand curve records how IS-LM equilibrium output changes as ________ changes.
A) the IS curve
B) the nominal money supply
C) government expenditure
D) the price level
Answer: D
Question Status: Previous Edition

31) Because of ________ marginal product of labor, the labor demand curve slopes ________.
A) rising, upward
B) rising, downward
C) diminishing, downward
D) diminishing, upward
Answer: C
Question Status: Previous Edition

32) The "marginal product of labor" curve describes
A) how much more labor is hired when the price of output rises by $1.
B) how much more labor is hired when the nominal wage falls by $1.
C) how much more output is produced by hiring one more unit of labor.
D) how much more revenue is earned by producing one more unit of output.
Answer: C
Question Status: Previous Edition

33) Which of the following is the basic rule by which firms find the number of workers to hire?
A) real wage = output price
B) real wage = marginal product of labor
C) marginal product of labor = output price
D) none of the above
Answer: B
Question Status: Previous Edition

34) Suppose that firms are operating at a point where marginal product of labor = 20, the nominal wage is $60, and the price level is $4. Because the real wage is ________ than the marginal product of labor, firms are hiring ________ workers.
A) less, too few
B) less, too many
C) greater, too few
D) greater, too many
Answer: A
Question Status: Previous Edition

35) When the price firms receive for their output rises, the resulting ________ in the real wage rate leads firms to profitably employ ________ labor than before, thus ________ the amount of output willingly supplied.
A) fall, more, raising
B) fall, less, raising
C) rise, less, lower
D) rise, more, raising
Answer: A
Question Status: Previous Edition

36) With a falling price level, we move ________ along the demand for labor curve and thus trace ________ along the short-run aggregate supply curve.
A) upward, upward
B) upward, downward
C) downward, upward
D) downward, downward
Answer: B
Question Status: Previous Edition

37) If the labor supply curve shifts to the left, the equilibrium real wage ________ and the equilibrium level of employment ________.
A) rises, rises
B) rises, falls
C) falls, rises
D) falls, falls
Answer: B
Question Status: Previous Edition

38) With unchanging labor supply and demand curves, employment greater than equilibrium employment requires a real wage ________ the equilibrium real wage, at a point that is off of the labor ________ curve.
A) below, supply
B) below, demand
C) above, supply
D) above, demand
Answer: A
Question Status: Previous Edition

39) Suppose that from an initial labor market equilibrium the price level suddenly falls. The resulting movement ________ the labor demand curve results in an excess ________ labor, which then puts ________ pressure on the nominal wage to restore labor market equilibrium.

A) up, demand for, upward
B) down, supply of, upward
C) up, supply of, downward
D) down, demand for, upward
E) up, demand for, downward
Answer: C
Question Status: Previous Edition

40) From an initial AD/SAS/LAS intersection, a fiscal stimulus with no initial change in the nominal wage causes output to ________ while the price level ________.
A) rise, remains constant
B) rise, rises
C) remains constant, rises
D) remains constant, falls
E) fall, rises
Answer: B
Question Status: Previous Edition

41) At any AD/SAS intersection to the right of LAS, excess ________ in the labor market is putting ________ pressure on the nominal wage.
A) supply, upward
B) supply, downward
C) demand, upward
D) demand, downward
Answer: C
Question Status: Previous Edition

42) At any AD/SAS intersection to the left of LAS, excess ________ in the labor market is putting ________ pressure on the nominal wage.
A) supply, upward
B) supply, downward
C) demand, upward
D) demand, downward
Answer: B
Question Status: Previous Edition

43) Suppose that from an initial AD/SAS/LAS intersection, the money supply grows by ten percent. At the same time, the nominal wage rises by six percent. As a result, output will be ________ the natural GDP, with a price level ________.
A) below, 10 percent lower
B) below, 10 percent higher
C) below, between 6 and 10 percent lower
D) above, that is unchanged
E) above, between 6 and 10 percent higher
Answer: E
Question Status: Previous Edition

44) Suppose that from an initial AD/SAS/LAS intersection, the money supply grows by six percent. At the same time, the nominal wage rises by ten percent. As a result, output will be ________ the natural GDP, with a price level ________.
A) below, 10 percent lower
B) below, 10 percent higher
C) below, between 6 and 10 percent higher
D) above, that is unchanged
E) above, between 6 and 10 percent higher
Answer: C
Question Status: Previous Edition

45) John Maynard Keynes revolutionized macroeconomics with the 1936 publication of his book
A) Macro-Economics.
B) The Wealth of Nations.
C) The General Theory of Employment, Interest, and Money.
D) Aggregate Economic Analysis.
Answer: C
Question Status: Previous Edition

46) Keynes held out the possibility of "monetary impotence" causing the aggregate demand curve to be ________ below the natural real GDP, which results in an economy with ________ self-correction.
A) vertical, instant
B) vertical, no
C) horizontal, instant
D) horizontal, no
Answer: B
Question Status: Previous Edition

47) If autonomous spending does NOT respond to changes in the interest rate, the resulting ________ IS curve implies that an economy ________ self-correct.
A) horizontal, will instantly
B) horizontal, can fail to
C) vertical, will instantly
D) vertical, can fail to
Answer: D
Question Status: Previous Edition

48) Keynes discussed the possibility of a horizontal LM curve, which causes a ________, thus the possibility of ________.
A) vertical AD curve, monetary impotence
B) vertical AD curve, an escape from monetary impotence
C) horizontal AD curve, monetary impotence
D) horizontal AD curve, an escape from monetary impotence
Answer: A
Question Status: Previous Edition

49) The "Pigou effect" is the stimulus to aggregate demand when a lower price level causes
A) a lower interest rate to increase fixed investment.
B) a lower interest rate to increase inventory investment.
C) a lower interest rate to increase the demand for consumer durables.
D) holdings of money to increase in purchasing power, thus raising consumption demand.
Answer: D
Question Status: Previous Edition

50) In the case of "unresponsive expenditures," the operation of the Pigou effect
A) shifts the LM curve downward, raising output.
B) shifts the LM curve downward, but fails to affect output.
C) shifts the IS curve rightward, but since that curve is vertical this has no effect on output.
D) shifts the IS curve rightward, raising output.
Answer: A
Question Status: Previous Edition

51) If falling prices cause an expectation of even lower prices in the future, this argues for a relatively ________ AD curve, thus ________ the Pigou effect.
A) steep, weakening
B) steep, intensifying
C) flat, weakening
D) flat, intensifying
Answer: A
Question Status: Previous Edition

52) Falling prices tend to redistribute income from ________, which plausibly ________ the Pigou effect.
A) debtors to creditors, reinforces
B) debtors to creditors, weakens
C) creditors to debtors, reinforces
D) creditors to debtors, weakens
Answer: B
Question Status: Previous Edition

53) Regarding the theoretical operation of the Pigou, expectations, and redistribution effects, does the U.S. experience between 1929 and 1933 provide any evidence?
A) Since the price level did not fall, no evidence is provided.
B) Only the Pigou effect appears to have operated.
C) The Pigou effect appears to have overwhelmed the other effects.
D) All three effects appear to have helped cushion the fall in output.
E) The expectations and redistribution effects appear to have overwhelmed the Pigou effect.
Answer: E
Question Status: Previous Edition

54) The combination of the Keynes, Pigou, expectations, and redistribution effects results in an economy that self-corrects given a sufficiently low price level, when the four effects give rise to an AD curve that is
A) vertical.
B) downward-sloping and that stays to the left of LAS.
C) downward-sloping and that intersects LAS.
D) downward-sloping and that stays to the right of LAS.
Answer: C
Question Status: Previous Edition

55) Keynes said that even should monetary impotence not occur, full self-correction could be short-circuited by
A) the price level failing to fall sufficiently due to downwardly-rigid wages.
B) the price level failing to fall sufficiently due to continuously falling wages.
C) the price level falling too much due to downwardly-rigid wages.
D) the price level falling too much due to continuously falling wages.
Answer: A
Question Status: Previous Edition

56) The 1933 real GDP per person had fallen to ________ of the 1929 value in the United States, to ________ in Germany, and to ________ in the U.K. and Japan.
A) 70; 86; 94
B) 94; 86; 70
C) 86; 94; 70
D) 94; 70; 86
Answer: A
Question Status: Previous Edition

57) What three factors explain the fact that the Great Depression was worse in the United States than in Europe?
A) exchange-rate policy, fiscal policy, and policy toward wages and prices

B) fiscal policy, monetary policy, and consumer confidence.
C) inflation, exchange-rate policy, and policy toward wages and prices
D) consumer confidence, monetary policy, and exchange-rate policy
Answer: A
Question Status: Previous Edition

58) Keynes stressed that a downwardly-rigid nominal wage
A) causes monetary impotence.
B) eliminates monetary impotence.
C) allows an economy to self-correct despite monetary impotence.
D) allows self-correction to fail without monetary impotence.
Answer: D
Question Status: Previous Edition

59) If the current AD curve intersects the LAS curve at a positive price level, can self-correction be thwarted?
A) No: it is inevitable.
B) Yes: via the Pigou effect.
C) Yes: via downwardly-rigid wages.
D) Yes: via monetary impotence.
Answer: C
Question Status: Previous Edition

60) The ________ effect is a destabilizing effect associated with a falling price level.
A) Pigou
B) Keynes
C) expectations
D) real balance
Answer: C
Question Status: Previous Edition

8.9 Case Study: What Caused the Great Depression?

1) Suppose an economy falls into a recession. The central bank responds by rapidly increasing the money supply. Best for the central bank is the case where
A) a vertical IS curve produces the largest possible reduction in the interest rate as LM shifts to the right.
B) a vertical IS curve allows the interest rate to remain constant while real output rises back to the natural real GDP.
C) a vertical IS curve allows real GDP to remain constant while the interest rate falls.
D) a downward-sloping IS curve causes both the interest rate and real GDP to fall.
E) a downward-sloping IS curve causes a falling interest rate to stimulate consumption and investment demand.
Answer: E
Question Status: Previous Edition

2) The possibility that an economy in recession may be afflicted by monetary impotence led Keynes and his followers to recommend
A) raising real balances by letting the price level fall rather than increasing the nominal money supply.
B) raising real balances by increasing the nominal money supply rather than waiting for the price level to fall.
C) an active fiscal policy to shift the IS and AD curves.
D) waiting for a falling price level to activate the real balance effect on the IS and AD curves.
Answer: C
Question Status: Previous Edition

3) In the case of monetary impotence without a horizontal LM curve, a rise in government expenditures
A) just causes us to move further down the vertical IS curve and so is of no help in raising output.
B) shifts the LM curve downward against a horizontal IS curve and so is of no help in raising output.
C) shifts the vertical IS curve to the right and thus increases output.
D) causes the IS curve to go from vertical to downward-sloping, thus raising output.
Answer: C
Question Status: Previous Edition

4) The first two years of the Great Depression were dominated by
A) leftward shifts of the IS curve.
B) rightward shifts of the IS curve.
C) leftward shifts of the LM curve.
D) rightward shifts of the LM curve.
E) upward shifts of the SAS curve.
Answer: A
Question Status: Previous Edition

5) The most accurate capsule summary of the Great Depression in terms of the AD/SAS/LAS model is that
A) we slid down an AD curve from 1929 to 1933, then down 1933's SAS curve for the rest of the decade.
B) we slid down an AD curve from 1929 to 1933, then back up the same curve for the rest of the decade.
C) we went up an AD curve from 1929 to 1933, then came back down it for the rest of the decade.
D) AD and SAS shifts in unison took us straight to the left from 1929 to 1933, then back straight to the right for the rest of the decade.
Answer: B
Question Status: Previous Edition

6) What was the behavior of nominal wages in the 1930s?
A) They remained virtually constant, justifying the assumption of nominal wage rigidity.
B) They fell tremendously, just as Classical macroeconomics predicts.
C) They fell a bit at first, but then rose even as output remained far below natural real GDP.
D) They rose throughout the decade, just as Keynesian macroeconomics predicts.
Answer: C
Question Status: Previous Edition

7) Which of the following statements regarding the Japanese deflation which began in 1992 is *incorrect*?
A) The growth rate of nominal GDP has fallen dramatically.
B) The growth rate of real GDP has remained fairly stable.
C) The GDP deflator has fallen significantly.
D) All of the above.
Answer: B
Question Status: Previous Edition

8) Gordon suggests that the Japanese deflation is bad because it is caused by
A) too high a rate of technological progress.
B) a downward shift in the short-run aggregates supply schedule.
C) a contraction in aggregate demand.
D) B and C
Answer: C
Question Status: Previous Edition

9) A bad deflation such as that experienced by Japan over the past decade poses problems
A) for monetary policy because it lowers the real interest rate below the nominal interest rate.
B) for fiscal policy because it raises the ratio of public debt to nominal GDP even if public debt is fixed.
C) for monetary and fiscal policy because it makes it impossible to use these together to shift the IS and LM curves rightward at the same time.
D) for monetary and fiscal policy because it makes it impossible to use these together to shift the IS and LM curves leftward at the same time.
Answer: B
Question Status: Previous Edition

10) During the Great Depression
A) there is good evidence that the LM curve was horizontal.
B) there was almost perfect price flexibility.
C) wages fell continuously.
D) there is good evidence that the IS curve was vertical.
Answer: D
Question Status: New

***Macroeconomics, 12e* (Gordon)**
Chapter 9 Inflation: Its Causes and Cures

9.1 Introduction

1) Continuous inflation in the long run requires repeated ________ shifts of the AD curve caused by a continuous increase in the ________.
A) leftward; government expenditures
B) rightward; nominal money supply
C) inward; nominal money supply
D) None of the above, inflation is primarily a supply side phenomenon.
Answer: B
Question Status: Previous Edition

2) Continuous inflation requires repeated ________ shifts of the SAS curve, accompanied by continuous ________ of price expectations.
A) leftward; upward adjustments
B) rightward; downward adjustments
C) inward; downward adjustments
D) None of the above, inflation is primarily a demand side phenomenon.
Answer: A
Question Status: Previous Edition

3) After a period of sustained unexpected inflation, it is likely that the renegotiation of nominal wages will
A) shift the SAS curve downward thereby increasing output.
B) shift the SAS curve upward thereby increasing output.
C) shift the SAS curve upward thereby decreasing output.
D) shift the AD curve downward thereby increasing output.
Answer: C
Question Status: Previous Edition

4) Suppose that members of Congress and the President believe that the natural rate of unemployment is 2% but in fact it is 6%, and employing fiscal policy they increase AD each time unemployment rises above 2%. The underestimation of the natural rate combined with adaptive expectations will
A) lead to continuous inflation by shifts in both AD and SAS.
B) lead to a continuous inflation by a shift in only AD.
C) lead to a continuous inflation by a shift in only SAS.
D) lead to continuous increases in output and unemployment.
Answer: A
Question Status: Previous Edition

5) Productivity growth shocks in 2009 and early 2010 were
A) highly beneficial.
B) highly adverse.
C) moderately beneficial.
D) moderately adverse.
Answer: A
Question Status: New

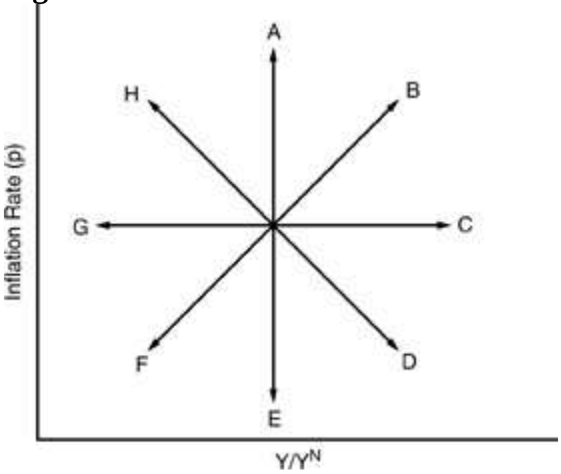
6) Low inflation rate in the late 1990 is caused by all of the following EXCEPT
A) fall in oil prices.
B) dollar appreciation.
C) productivity growth.
D) pricking of the asset bubble.
Answer: D
Question Status: New

7) Low inflation rate between 2007 and 2009 was the result of
A) weak aggregate demand and declining oil prices.
B) weak aggregate supply and rising oil prices.
C) rising oil prices and increasing exports.
D) increasing exports and strong dollar.
Answer: A
Question Status: New

8) Supply inflation is triggered by changes in
A) the prices of imported goods.
B) wages as expected inflation catches up with actual inflation.
C) wages due to the current value of (Y/YN).
D) business costs unrelated to prior changes in nominal GDP growth.
Answer: D
Question Status: Previous Edition

9) The natural unemployment rate fell in the 1990s in part because of
A) a drop in the fraction of labor force made up of teenagers.
B) an increase in the fraction of the male labor force in prison.
C) the growth in temporary help agencies.
D) All of the above.
Answer: D
Question Status: Previous Edition

Figure 8-6



10) In Figure 8-6 above, the one year since 1970 that the U.S. economy managed to travel along path E was
A) 1971.
B) 1970.
C) 1979.
D) 1986.
Answer: D
Question Status: Previous Edition

11) 1974-75 and 1980-81 saw the U.S. economy traveling along path ________ in Figure 8-6.
A) D
B) H
C) B
D) F
Answer: B
Question Status: Previous Edition

12) The late 1990s saw the U.S. economy traveling along path ________ in Figure 8-6.
A) D
B) H
C) B
D) F
Answer: D
Question Status: Previous Edition

13) In 1996, the growth rate of real GDP was 2.46 percent and the inflation rate was 1.94 percent. The growth of nominal GDP was
A) 4.4 percent.
B) 0.52 percent.
C) 3.88 percent.
D) 4.92 percent.
Answer: A
Question Status: Previous Edition

14) In 1991, the growth rate of nominal GDP was 2.97 percent and the growth rate of real GDP was -0.98 percent. The inflation rate was
A) 1.99 percent.
B) 2.91 percent.
C) 2.97 percent.
D) 3.95 percent.
Answer: D
Question Status: Previous Edition

15) The inflation rate, actual employment rate and natural rate of unemployment from 1980 to 1996 indicate that
A) the inflation rate fell when the actual unemployment rate exceeded the natural unemployment rate.
B) the inflation rate increased when the natural rate of unemployment exceeded the actual unemployment rate.
C) during most of this period the inflation rate was falling and the actual unemployment rate exceeded the natural rate of unemployment.
D) All of the above.
Answer: D
Question Status: Previous Edition

16) Supply shocks in the 1990s
A) reduced the natural rate of unemployment.
B) helped hold down inflation.
C) had the opposite effect on the economy from the supply shocks of the 1970s.
D) All of the above.
Answer: D
Question Status: Previous Edition

17) Which of the following was NOT a beneficial supply shock occurring in the 1990s?
A) falling computer prices
B) the transition to managed health care organizations, i.e. HMOs.
C) a stronger bargaining position for labor
D) increased global competition
Answer: C
Question Status: Previous Edition

18) Which of the following countries had the lowest inflation rate from 1980 to the early 1990s?
A) Italy
B) Germany
C) France
D) United Kingdom
Answer: B
Question Status: Previous Edition

19) The European Monetary System
A) led to resurgent inflation in the 1980s.
B) gave a competitive trade advantage to countries with high inflation rates.
C) required members to keep their exchange rates within a narrow band around the German currency.
D) All of the above.
Answer: C
Question Status: Previous Edition

20) Under the European Monetary System, a country's export prices
A) decreased if the inflation rate in that country increased.
B) could be controlled by loosening domestic monetary policy.
C) became more competitive as long as that country accelerated its domestic inflation and kept its foreign exchange rate with the deutsche mark stable.
D) none of the above.
Answer: D
Question Status: Previous Edition

21) For countries with high inflation rates, joining the European Monetary System meant
A) higher unemployment until they could lower their inflation rates sufficiently.
B) facing periodic upward adjustments in their exchange rate with the deutsche mark.
C) having to pursue loose monetary policy until they lowered the unemployment rate to the European average.
D) abandoning the fixed exchange rates they had preserved since the 1960s.
Answer: A
Question Status: Previous Edition

22) The European Monetary System
A) broke down in 1990 and resulted in a resurgence of inflation in many European countries.
B) was still in place in 1996 but was permitting frequent exchange rate adjustments.
C) came to an end in 1992 and was followed by devaluations in Italy, the U.K. and several other countries.
D) has been a successful experiment in fixed exchange rates and was still in place as of 1996.
Answer: C
Question Status: Previous Edition

23) A policy to slow the growth of nominal GDP
A) can result in a higher inflation rate and an increase in the output ratio.
B) can result in a lower inflation rate and a drop in the output ratio.
C) can be combined with cost-cutting supply policies to lower the inflation rate while maintaining the output ratio.
D) A and C.
E) B and C.
Answer: E
Question Status: Previous Edition

24) In ________ there were beneficial supply shocks to the U.S. economy.
A) 1974-1975
B) 1980-1981
C) 1995-1999
D) All of the above
Answer: C
Question Status: Previous Edition

25) In ________ there were adverse supply shocks to the U.S. economy.
A) 1973-1981
B) 1981-1986
C) 1995-1999
D) All of the above
Answer: A
Question Status: New

26) A negative relationship between inflation and unemployment emerged in
A) 1963-70.
B) 1974-75.
C) 1979-81.
D) All of the above
Answer: A
Question Status: Previous Edition

27) A positive relationship between inflation and unemployment emerged in
A) 1963-70.
B) 1974-75.
C) 1986-90.
D) All of the above
Answer: A
Question Status: Previous Edition

28) The natural unemployment rate fell in the 1990s in part because of ________.
A) a drop in the fraction of labor force made up of teenagers
B) an increase in the fraction of the male labor force in prison
C) the growth in temporary help agencies
D) All of the above
Answer: D
Question Status: Previous Edition

29) The introduction of a single currency or "Euro" in 1999 ________ the likelihood that inflation rates will converge in countries that join the Euro.
A) increases
B) decreases
C) has no effect on
D) may increase or decrease
Answer: A
Question Status: Previous Edition

9.2 Real GDP, the Inflation Rate, and the Short-Run Phillips Curve

1) The short-run SAS curve is positively sloped because as
A) AD increases, mark-ups are increased, indicating variable mark-up pricing.
B) SAS increases, mark-ups are increased, indicating variable mark-up pricing.
C) AD increases, raw materials prices set by auction tend to rise.
D) A and C are both correct.
Answer: D
Question Status: Previous Edition

2) When the expected rate of inflation falls, the short-run Phillips Curve
A) shifts upward.
B) shifts downward.
C) remains unaffected.
D) becomes vertical.
Answer: B
Question Status: Previous Edition

3) In constructing the short-run Phillips Curve, SP,
A) real wages are fixed.
B) nominal wages are renegotiated.
C) nominal wages are fixed.
D) raw materials prices are fixed.
Answer: C
Question Status: Previous Edition

4) Each SP curve is drawn assuming
A) Pe as embodied in wage contracts is "fixed."
B) Pe and prices are rigid.
C) Pe and real wages are rigid.
D) None of the above.
Answer: A
Question Status: Previous Edition

5) The slope of the SP curve is determined in large part by the
A) rate of increase in mark-ups.
B) the slope of the LP curve.
C) the level of Pe.
D) the level of fixed real wage.
Answer: A
Question Status: Previous Edition

6) The flatter the SP curve
A) the greater will be the shift in the SP.
B) the greater will be the change in inflation and the smaller will be the change in real GDP for any given change in nominal GDP growth.
C) the greater will be the change in real GDP and the smaller will be the change in inflation for any given change in nominal GDP growth.
D) the greater will be the growth of nominal GDP.
Answer: C
Question Status: Previous Edition

7) Which of the following will shift the short-run Phillips Curve?
A) supply shocks
B) price controls
C) removal of price controls
D) All of the above are correct.
Answer: D
Question Status: Previous Edition

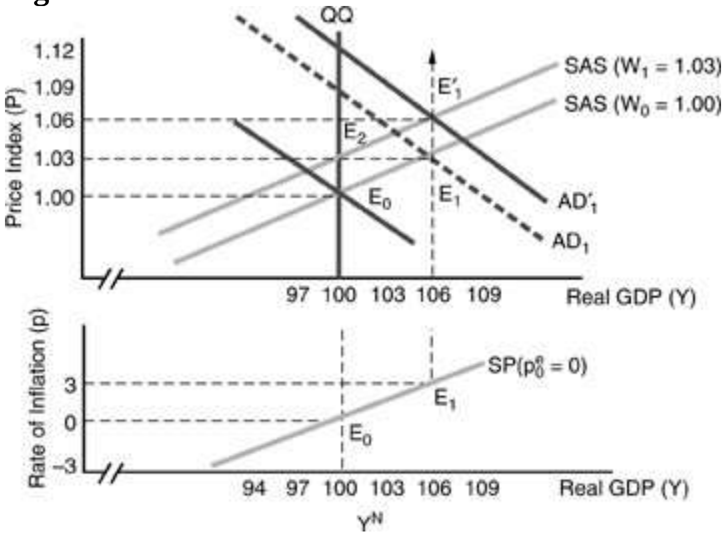
8) Compared to an economy with staggered overlapping wage contracts, an economy in which wage contracts are renegotiated simultaneously will tend to have
A) steeper SP curves.
B) flatter SP curves.
C) faster shifting of its SP curves.
D) slower shifting of its SP curves.
Answer: C
Question Status: Previous Edition

9.3 The Adjustment of Expectations

1) When the actual inflation rate is equal to the expected inflation rate the economy will be ________ and the SP curve will ________.
A) in long-run equilibrium; shift upward
B) in disequilibrium, at an output level less than the natural rate of output; shift upward
C) in short-run equilibrium; shift upward
D) in short- and long-run equilibrium; be stable
Answer: D
Question Status: Previous Edition

2) Suppose that the government enforced a law which required employers to adjust nominal wages monthly by the previous month's CPI. The short-run SAS curve would shift ________ and the SP curve would be ________.
A) gradually; stable
B) rapidly; unstable
C) continuously; flat
D) slowly; steep
Answer: B
Question Status: Previous Edition

Figure 8-1



3) Everywhere to the left of the long-run Phillips Curve as in Figure 8-1 above
A) actual inflation is less than expected inflation and the expected inflation rate will be reduced.
B) actual inflation is less than expected inflation and the expected inflation rate will be raised.
C) actual inflation is greater than expected inflation and the expected inflation rate will be raised.
D) actual inflation is greater than expected inflation and the expected inflation rate will be reduced.
Answer: A
Question Status: Previous Edition

4) In Figure 8-1 above, suppose that the economy traces the path E_0 to E_1 to E_1'. We might conclude that ________ fiscal or monetary policy shifted the AD curve with price expectation first ________ then ________.
A) expansionary; constant; revised upward
B) expansionary; revised upward; constant
C) contractionary; revised upward; constant
D) contractionary; constant; revised downward
Answer: A
Question Status: Previous Edition

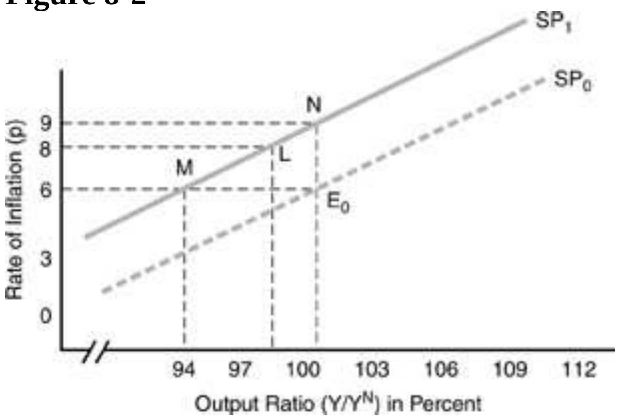
5) Everywhere to the right of the long-run Phillips Curve
A) actual inflation is less than expected inflation and the expected inflation rate will be reduced.
B) actual inflation is less than expected inflation and the expected inflation rate will be raised.
C) actual inflation is greater than expected inflation and the expected inflation rate will be raised.
D) actual inflation is greater than expected inflation and the expected inflation rate will be reduced.
Answer: A
Question Status: Previous Edition

6) In response to a rapid deceleration in the growth rate of nominal GDP in the early 1980s,
A) inflation declined slowly, thus giving empirical support to the proponents of the adaptive expectations approach.
B) inflation declined slower than the deceleration in nominal GDP and real output actually declined.
C) inflation declined slower than the deceleration in nominal GDP and the output ratio actually declined.
D) All of the above are correct.
Answer: D
Question Status: Previous Edition

7) Stagflation may be explained by
A) an upward shift in the SP curve.
B) a downward shift in the SP curve.
C) a stagnating level of AD.
D) a stagnating level of SAS.
Answer: A
Question Status: Previous Edition

8) The success or failure of economic policy with regard to the twin goals may be measured by the
A) stagflation rate.
B) unemployment rate.
C) change in the output ratio.
D) inflation rate.
Answer: C
Question Status: Previous Edition

Figure 8-2

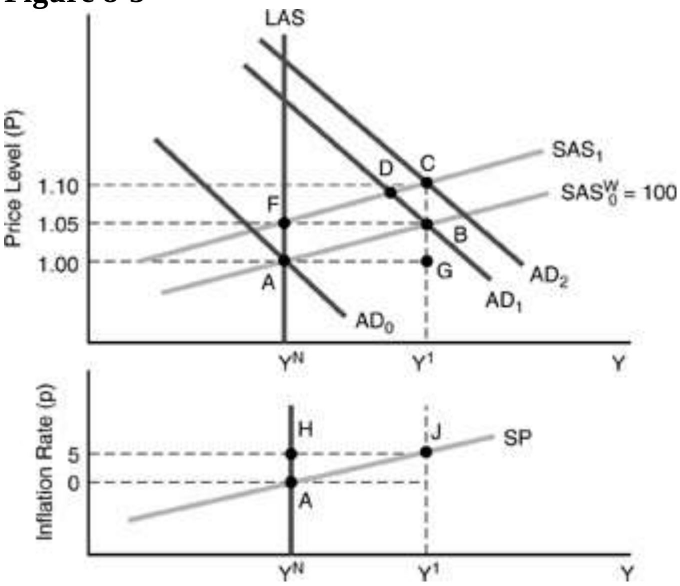


9) In Figure 8-2 above, a policy that maintains the level of real GDP in the advent of an adverse supply shock is a(n)
A) extinguishing policy; M.
B) neutral policy; L.
C) price-control policy; N.
D) accommodating policy; N.
Answer: D
Question Status: Previous Edition

10) If there is a permanent adverse supply shock,
A) the rate of inflation can be held constant if real wages are kept from falling.
B) an extinguishing policy will produce an acceleration of inflation.
C) the level of employment at the natural level of real GDP will remain constant only if the labor supply curve is vertical.
D) the natural level of real GDP will remain the same if the supply curve of labor is vertical.
Answer: C
Question Status: Previous Edition

11) Suppose that an adverse supply shock causes downward pressure on nominal wages and unemployment to increase. If the Fed increases the money supply to stimulate AD and restore output to its previous level (assuming no change in the labor supply) a(n)
A) one time increase in prices will result.
B) inflationary spiral will begin if the real GDP has been reduced.
C) increase in the real GDP will follow.
D) All of the above
Answer: B
Question Status: Previous Edition

Figure 8-5



12) In Figure 8-5 above, from initial point A in the top diagram AD_0 shifts to AD_1, while the nominal wage remains constant. Short-run equilibrium occurs at point
A) G.
B) B.
C) C.
D) D.
E) F.
Answer: B
Question Status: Previous Edition

13) In Figure 8-5 above, from initial point A in the top diagram AD_0 shifts to AD_1, while at the same time the nominal wage rises by 5 percent. Short-run equilibrium occurs at point
A) G.
B) B.
C) C.
D) D.
E) F.
Answer: D
Question Status: Previous Edition

14) In Figure 8-5 above, the wage rate attached to SAS_1 is
A) 1.10.
B) between 1.05 and 1.10.
C) 1.05.
D) 1.00.
Answer: C
Question Status: Previous Edition

15) In Figure 8-5 above, if we move from points A to B to C in the top diagram, this is translated to the bottom diagram as a move from points
A) A to J and back to A.
B) A to J.
C) A to H.
D) A to J to H.
E) A to H and back to A.
Answer: B
Question Status: Previous Edition

16) In Figure 8-5 above, from point B suppose the nominal wage rises by 5 percent while aggregate demand remains constant. As a result we
A) move to point C.
B) move to point D.
C) move to point F.
D) move to point A.
E) remain at point B.
Answer: B
Question Status: Previous Edition

17) In Figure 8-5 above, in going from points A to B the real wage ________, and then from point B to point C (where the exact price level is 1.1025, rounded to 1.10 in the diagram) the real wage ________.
A) rose, remained constant
B) rose, rose again
C) fell, remained constant
D) fell, fell again
E) remained constant, remained constant
Answer: C
Question Status: Previous Edition

18) In Figure 8-5 above, a crucial assumption that goes into positioning the SP curve in the bottom diagram is that
A) the wage rate is 1.00.
B) expected inflation is zero.
C) expected inflation is 5 percent.
D) the AD curve is AD_1.
E) the shift of AD_1 to AD_2 will be repeated continuously.
Answer: B
Question Status: Previous Edition

19) At every current AD/SAS equilibrium point to the right of the LAS curve, the price level is ________ than that expected on average and figured into the wage contracts in force, and thus there is pressure on the SAS curve to shift ________ with wage renegotiations.
A) greater, upward
B) greater, downward
C) less, upward
D) less, downward
Answer: A
Question Status: Previous Edition

20) At every current AD/SAS equilibrium point to the left of the LAS curve, the price level is ________ than that expected on average and figured into the wage contracts in force, and thus there is pressure on the SAS curve to shift ________ with wage renegotiations.
A) greater, upward
B) greater, downward
C) less, upward
D) less, downward
Answer: D
Question Status: Previous Edition

21) Suppose than successive AD/SAS equilibrium points run up a vertical line to the right of the LAS curve. It must be the case that inflation is ________ the average expected inflation figured into the wage contracts in force, which allows output to ________ the natural GDP.
A) greater than, remain below
B) greater than, remain above
C) less than, remain below
D) less than, remain above
E) equal to, be maintained at
Answer: B
Question Status: Previous Edition

22) When the expected inflation rate is 5 percent, we know to draw the short-run Phillips Curve through the
A) horizontal axis at Y = 105.
B) horizontal axis at P = 1.05.
C) long-run Phillips Curve at P = 1.05.
D) long-run Phillips Curve at p = 5.
Answer: D
Question Status: Previous Edition

23) Along the SP curve with expected inflation of 4 percent, we are below the natural GDP when
A) inflation falls below 4 percent.
B) inflation rises above 4 percent.
C) expected inflation falls below 4 percent.
D) expected inflation rises above 4 percent.
Answer: A
Question Status: Previous Edition
24) Along the SP curve with expected inflation of 6 percent, we are above the natural GDP when

A) inflation falls below 6 percent.
B) inflation rises above 6 percent.
C) expected inflation falls below 6 percent.
D) expected inflation rises above 6 percent.
Answer: B
Question Status: Previous Edition

25) A rise in expected inflation causes
A) the SP curve to shift upward.
B) the SP curve to shift downward.
C) a movement upward along the SP curve.
D) a movement downward along the SP curve.
Answer: A
Question Status: Previous Edition

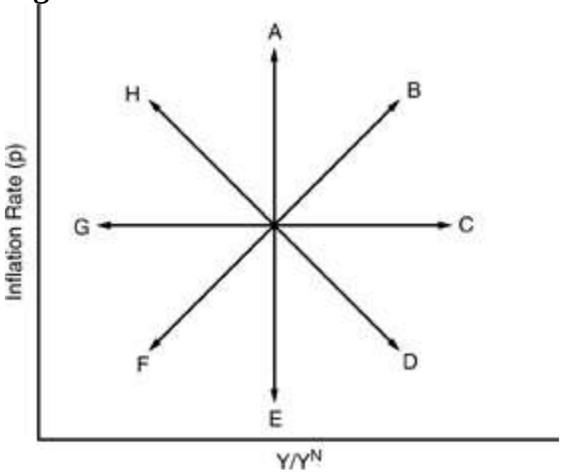
26) The SP curve shifts downward when
A) the average wage rate falls.
B) the average wage rate rises.
C) expected inflation falls.
D) expected inflation rises.
Answer: C
Question Status: Previous Edition

27) The economy is in long-run equilibrium
A) at any point along the current SP curve.
B) where the current SP curve intersects the LP line.
C) at any point along the SP curve for zero expected inflation.
D) only where the SP curve for zero expected inflation intersects the LP line.
Answer: B
Question Status: Previous Edition

28) At any point on the current SP curve that is to the right of the LP line, actual inflation is ________ than expected, which leads to wage renegotiations that shift SP ________.
A) lower, upward
B) lower, downward
C) higher, upward
D) higher, downward
Answer: C
Question Status: Previous Edition

29) The "long-run Phillips Curve" is the set of points for which
A) expected inflation is zero.
B) expected inflation is equal to actual inflation.
C) actual inflation is zero.
D) actual inflation is equal to expected inflation plus the growth rate of nominal wages.
E) actual inflation is equal to expected inflation minus the growth rate of nominal wages.
Answer: B
Question Status: Previous Edition

Figure 8-6



30) In Figure 8-6 above, positive nominal GDP growth accompanied by higher inflationary expectations take us along path
A) A.
B) C.
C) E.
D) G.
Answer: A
Question Status: Previous Edition

31) In Figure 8-6 above, an adverse supply shock accompanied by a neutral policy take us along path
A) F.
B) G.
C) H.
D) A.
Answer: C
Question Status: Previous Edition

32) In Figure 8-6 above, a beneficial supply shock accompanied by an accommodating policy takes us along path
A) A.
B) C.
C) D.
D) E.
Answer: D
Question Status: Previous Edition

33) If x is the growth rate of nominal GDP, p is the inflation rate, and y is the growth rate of real output, then
A) y = x + p.
B) p = x + y.
C) x = p + y.
D) none of the above.
Answer: C
Question Status: Previous Edition

9.4 Nominal GDP Growth and Inflation

1) All points on the SP curve (but not on the LP line) share the characteristic that the economy is not in the long-run equilibrium because
A) price level is constantly increasing faster than nominal wage rate.
B) wage contracts failed to anticipate inflation correctly.
C) wage contracts failed to specify in advance the wage increases necessary to keep up with inflation.
D) All of the above.
Answer: D
Question Status: Previous Edition

2) The slope of the SP curve depends on
A) how business changes its markups when output varies.
B) whether the expansionary force in the economy is coming through monetary policy or fiscal policy.
C) the percentage of GDP that is sold on auction markets.
D) both A and C.
Answer: D
Question Status: Previous Edition

3) The short-run equilibrium of inflation and real GDP
A) depends only on the rate of growth of the money supply.
B) occurs where expected inflation equals actual inflation.
C) depends only on the rate of growth of nominal GDP.
D) None of these.
Answer: D
Question Status: Previous Edition

4) An increase in the rate of growth of nominal GNP
A) will cause a greater increase in real GNP the lower the rate of inflation.
B) will cause a smaller increase in real GNP the lower the rate of inflation.

C) will shift the SP curve upward.
D) will shift the SP curve downward.
Answer: A
Question Status: Previous Edition

5) The growth of nominal GDP
A) can be broken down into the growth of the price level times the growth of real GDP.
B) is equal to the index of prices times the level of real GDP.
C) can be broken down into the growth of money supply plus the growth of velocity.
D) is the same as the growth of aggregate supply.
Answer: C
Question Status: Previous Edition

6) If the inflation rate is 10% and nominal GDP growth is 8% then real GDP must have
A) increased by 2%.
B) decreased by 18%.
C) decreased by 2%.
D) increased by 18%.
Answer: C
Question Status: Previous Edition

7) Which of the following does NOT affect nominal GDP?
A) tax rate
B) foreign exchange rate
C) nominal money supply
D) expected inflation rate
Answer: D
Question Status: Previous Edition

8) If nominal GDP growth has accelerated permanently (assuming Y(N), is constant),
A) real GDP must keep growing until the growth rate of nominal GDP equals the inflation rate.
B) real GDP will increase by the same percentage that nominal GDP increased.
C) real GDP must keep growing until the rate of growth of real GDP equals the inflation rate.
D) the level of real GDP will be permanently increased.
Answer: A
Question Status: Previous Edition

9) As the output rises above 100%, unemployment
A) falls and inflation rises.
B) rises and inflation falls.
C) and inflation rise.
D) and inflation fall.
Answer: B
Question Status: Previous Edition
10) As the output ratio falls below 100%, unemployment
A) falls and inflation rises.
B) rises and inflation falls.
C) and inflation rise.
D) and inflation fall.

Answer: B
Question Status: Previous Edition

11) If the government raises the growth of nominal GDP in response to a supply shock,
A) inflation will decelerate and unemployment will fall.
B) inflation will accelerate and unemployment will worsen.
C) employment can be maintained so long as expectations are unaffected by the supply shock.
D) None of these results follow an increase in the growth of nominal GDP.
Answer: C
Question Status: Previous Edition

12) From an initial situation where P = 1.00 and Y = 100, 6 percent nominal GDP growth that causes P to go to 1.02 also causes Y to go to
A) 98.
B) 112.
C) 103.
D) 104.
Answer: D
Question Status: Previous Edition

13) From an initial situation where P = 1.00 and Y = 100, 6 percent nominal GDP growth that causes P to go to 1.10 also causes Y to go to
A) 116.
B) 104.
C) 96.
D) 94.
Answer: C
Question Status: Previous Edition

14) Whenever x exceeds p,
A) y must be positive.
B) y must be negative.
C) Y must be above YN.
D) Y must be below YN.
Answer: A
Question Status: Previous Edition

15) For real output to remain constant
A) x must be zero.
B) p must be zero.
C) x and p must both be zero.
D) p must equal x.
E) x must equal -p.
Answer: D
Question Status: Previous Edition

16) From a long-run equilibrium with p = pe = 0, suppose x rises to 6. If initially pe remains at zero and p rises to 4, Y becomes
A) 110.
B) 102.
C) 98.
D) 96.
Answer: B
Question Status: Previous Edition

17) Suppose expected inflation is fixed at zero and we are on the SP curve with p = 2 and Y = 104. If nominal GDP rises (again) by 6 percent
A) the SP curve must now shift up.
B) we must move off the SP curve to where p = 6 and Y = 104.
C) we must slide northeast further up the SP curve.
D) we must move off the SP curve to where p = 2 and Y = 110.
Answer: C
Question Status: Previous Edition

18) From a long-run equilibrium with p = pe = 0, suppose x rises permanently to 8 and pe never rises from zero. The economy will come to rest
A) on its LP curve with p = 8.
B) at p = 0 and Y = 108.
C) back at p = 0 and Y = 100.
D) on its SP curve at p = 8.
E) on its SP curve at p = 4 and Y = 104.
Answer: D
Question Status: Previous Edition

19) Suppose we are on the economy's SP curve for pe = 0. Currently x = p = 7. We cannot be in long-run equilibrium because this long-run equilibrium conditions is being violated:
A) p must equal zero.
B) y must equal zero.
C) x must equal zero.
D) p must equal pe.
Answer: D
Question Status: Previous Edition

20) If nominal GDP growth in an economy is a constant 7 percent, the economy's long-run equilibrium is at Y equal to ________ with inflation of ________.
A) 100, zero
B) 100, 7 percent
C) 107, zero
D) 107, 7 percent
E) 103.5, 3.5 percent
Answer: B
Question Status: Previous Edition

9.5 Effects of an Acceleration in Nominal GDP Growth

1) An acceleration of nominal GDP growth from, say 4% to 6% will
A) permanently raise the rate of inflation.
B) temporarily lower the rate of inflation.
C) leave real GDP unaffected in the long run.
D) Both A and C.
Answer: D
Question Status: Previous Edition

2) The short-run Phillips Curve gives
A) the actual short-run level of real GDP and inflation.
B) all possible combinations of real GDP and inflation, for a given set of expectations.
C) all possible combinations of real GDP and inflation, for fully adjusted expectations.
D) the response of real GDP and inflation to supply shocks.
Answer: B
Question Status: Previous Edition

3) If actual real GDP (Q) is permanently greater than natural real GDP (YN),
A) the economy is off its short-run Phillips Curve.
B) the actual rate of inflation must be less than the expected rate.
C) the economy is on its long-run Phillips Curve.
D) there must be a continuous acceleration of inflation.
Answer: D
Question Status: Previous Edition

4) Natural real GDP is the rate of output produced by the amount of labor hired when
A) inflation is zero.
B) inflation is expected to be zero.
C) inflation is both zero and is expected to be zero.
D) being correctly anticipated.
Answer: D
Question Status: Previous Edition

5) The LP curve shifts when
A) the natural real GDP changes.
B) expected inflation changes.
C) output deviates from the natural real GDP.
D) actual inflation changes.
Answer: A
Question Status: Previous Edition

6) With a permanent acceleration in nominal GDP growth, an "adjustment loop" leaves us in the end with ________ output and ________ inflation.
A) higher, unchanged
B) higher, higher
C) unchanged, unchanged
D) unchanged, higher
Answer: D
Question Status: Previous Edition

7) "Overshooting" refers to a temporary period in the adjustment loop during which
A) the percentage deviation of real GDP from natural real GDP exceeds the growth rate of nominal GDP.
B) inflation exceeds the growth rate of nominal GDP.
C) nominal GDP growth exceeds its permanent value.
D) we move from one long-run equilibrium to another.
Answer: B
Question Status: Previous Edition

8) The segment of an adjustment loop in which movement is to the northwest is sometimes called
A) inflation.
B) expansion.
C) stagflation.
D) undershooting.
Answer: C
Question Status: Previous Edition

9) Can "stagflation" occur as part of a business cycle triggered by a change in nominal GDP growth?
A) It is the first thing that happens after GDP growth accelerates, before expected inflation has changed much.
B) It happens after the cyclical peak in output from a GDP growth acceleration, and expected inflation is catching up to actual inflation.
C) It is the first thing that happens after GDP growth decelerates, before expected inflation has changed much.
D) It is part of the business cycle triggered by supply shocks, but not by demand shocks.
Answer: B
Question Status: Previous Edition

10) With a "cold turkey" disinflationary policy of reducing GDP growth, the assumption of adaptive expectations causes
A) inflation to not decrease in the long-run.

B) an immediate full reduction in inflation with no temporary recession.
C) a temporary recession en route to the final long-run equilibrium.
D) a permanently lower level of output at the long-run rate of inflation.
Answer: C
Question Status: Previous Edition

11) A counterclockwise loop spiraling downward in the SP/LP diagram is the dynamic process typical of ________ policy with inflationary expectations that ________ adjust.
A) inflationary, are slow to
B) inflationary, instantly
C) disinflationary, are slow to
D) disinflationary, instantly
Answer: C
Question Status: Previous Edition

12) From a long-run equilibrium with x = p = pe = 10, a reduction in nominal GDP growth to 4 percent results in the long run in output of ________ and inflation of ________.
A) 100, 10 percent
B) 100, 4 percent
C) 94, 4 percent
D) 94, 10 percent
E) 96, 4 percent
Answer: B
Question Status: Previous Edition

13) Assume adaptive expectations. Compared to a simple one-period lag, if the last five periods' inflation rates are averaged to arrive at currently expected inflation, we have ________ disinflationary loops and ________ recessions accompanying disinflationary policy
A) skinnier, milder
B) skinnier, deeper
C) fatter, milder
D) fatter, deeper
Answer: D
Question Status: Previous Edition

9.6 Expectations and the Inflation Cycle

1) If expectations are adaptive it means that the expected rate of inflation
A) depends on the observed rate of inflation.
B) depends on one's previously expected rate of inflation.
C) will be rising when inflation is rising.
D) All of the above are accurate statements about adaptive expectations.
Answer: D
Question Status: Previous Edition
2) The variable p(e) represents
A) the inflation rate that workers expect during the current period.
B) the price level that workers believe will exist during the next year.
C) the inflation rate that both workers and firms expected at the time of the last contract negotiation.

D) the difference between the inflation rate expected this year and the actual rate of inflation.
Answer: C
Question Status: Previous Edition

3) The rate of inflation will be permanently reduced provided
A) the rate of monetary growth is permanently reduced.
B) the government balances the budget.
C) people behave rationally.
D) there is a Pigou effect.
Answer: A
Question Status: Previous Edition

4) Which of the following are reasons why rational workers and firms may form their expectations by looking backward rather than forward?
A) The existence of long-term wage and price agreements would prevent actual inflation from responding immediately to an acceleration in nominal GDP.
B) If in the past acceleration in nominal GDP has caused inflation, then a current acceleration might be expected to increase inflation.
C) People may have no reason to believe that the acceleration in GDP growth will be permanent.
D) Both A and B.
Answer: D
Question Status: Previous Edition

5) If people completely adjust for any error in their estimation of this period's inflation rate,
A) the expected rate of inflation must be higher next period.
B) the expected rate of inflation must be lower next period.
C) the actual rate of inflation will be higher next period.
D) next period's expected inflation will be the same as this period's actual inflation.
Answer: D
Question Status: Previous Edition

6) Which of the following "theories" of the formation of expectations are discussed by Gordon?
A) menu costs, markup, and wage efficiency theories
B) forward and backward-looking theories
C) economic, sociological, and political science theories
D) None of the above.
Answer: B
Question Status: Previous Edition

7) Lucas's idea of information barriers as applied to the formation of inflation expectations is an example of
A) forward-looking expectations.
B) backward-looking expectations.
C) adaptive expectations.
D) irrational expectations.
Answer: A
Question Status: Previous Edition

8) Backward-looking expectations could be classified as a ________ theory.
A) proactive
B) reactive
C) first proactive then a reactive
D) None of the above.
Answer: B
Question Status: Previous Edition

9) Backward-looking expectations may reasonably describe actual behavior because
A) changes in inflation rates or price levels are often temporary.
B) changes in inflation rates or price levels are often permanent.
C) the speed of adjustment of prices and wages is difficult to estimate since contract negotiators have perfect information about negotiations in other industries.
D) Both A and C.
Answer: A
Question Status: Previous Edition

10) If firms have only a weak tendency to raise markups during cyclical expansions, or if there are only a few auction markets in raw materials, then
A) the SP curve will be relatively flat and a "cold-turkey" cure for inflation will be relatively quick.
B) the SP curve will be relatively flat and a "cold-turkey" cure for inflation will be long lasting.
C) the SP curve will be relatively steep and a "cold-turkey" cure for inflation will be relatively quick.
D) the SP curve will be relatively steep and a "cold-turkey" cure for inflation will be long lasting.
Answer: B
Question Status: Previous Edition

11) The long-run Phillips Curve is
A) horizontal at the level of expected inflation p(e).
B) vertical at the natural level of Y/Y(n) = 100.
C) dependent on price expectations.
D) dependent on the rate of inflation.
Answer: B
Question Status: Previous Edition

12) In order for the economy to be in long-run equilibrium,
A) price expectations must be accurate.
B) the economy is on an SP curve.
C) y = p.
D) All of the above.
Answer: D
Question Status: Previous Edition

13) According to Gordon, an upward shift in the SAS curve caused by a renegotiation of nominal wages is
A) supply inflation since the SAS curve shifted.
B) not supply inflation since the required change in nominal wages is the result of past change in AD and pe.
C) natural since the SAS curve shifted.
D) a permanent acceleration of inflation.
Answer: B
Question Status: Previous Edition

14) In the SP/LP model it is possible to have all short-run equilibrium points run along the LP line if we employ the assumption of ________ expectations.
A) backward-looking
B) forward-looking
C) adaptive
D) extrapolative
Answer: B
Question Status: Previous Edition

15) Using a model of the economy's structure to estimate the future behavior of a variable is the procedure we assume is being followed under ________ expectations.
A) backward-looking
B) forward-looking
C) adaptive
D) extrapolative
Answer: B
Question Status: Previous Edition

16) The existence of staggered overlapping wage contracts makes the assumption of backward-looking expectations ________ reasonable since wages and prices tend to adjust ________ to changes in nominal GDP.
A) less, quickly
B) less, gradually
C) more, quickly
D) more, gradually
Answer: D
Question Status: Previous Edition

17) "pe = p - 1" is an expression of
A) the forward-looking expectations assumption.
B) the adaptive expectations assumption.
C) one of the conditions for short-run equilibrium.
D) one of the conditions for long-run equilibrium.
Answer: B
Question Status: Previous Edition

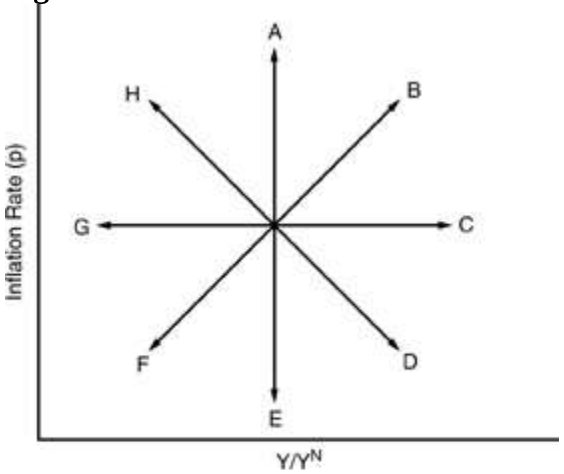
18) From an initial long-run equilibrium with zero nominal demand growth, nominal GDP growth rises to a permanent 9 percent. If we assume adaptive expectations with a one-period lag, the dynamic process in response to the demand growth is
A) a loop that eventually terminates at Y = 100 with 9 percent inflation.
B) a loop that eventually terminates at Y = 100 with zero percent inflation.
C) a straight path to the northeast until we reach Y = 109 with 9 percent inflation.
D) in the first period Y = 109 with zero inflation, and every period thereafter Y =100 with 9 percent inflation.
Answer: A
Question Status: Previous Edition

9.7 Recession as a Cure for Inflation

1) Assuming adaptive expectations, a "cold turkey" reduction in AD by policymakers will initially reduce
A) output but not inflation.
B) inflation but not output.
C) output less than inflation.
D) both output and inflation.
Answer: D
Question Status: Previous Edition

2) If the SP curve is steep then monetary and fiscal policy will have a ________ effect on inflation and a ________ effect on unemployment.
A) large; large
B) large; small
C) small; large
D) small; small
Answer: B
Question Status: Previous Edition

Figure 8-6



3) In Figure 8-6 above, a contractionary monetary policy with no change in inflationary expectations takes us along path
A) A.
B) H.
C) G.
D) F.
E) E.
Answer: D
Question Status: Previous Edition

4) In Figure 8-6 above, an expansionary monetary policy with no change in inflationary expectations takes us along path
A) A.
B) H.
C) G.
D) F.
E) B.
Answer: E
Question Status: Previous Edition

9.8 The Importance of Supply Shocks

1) "Supply inflation" is caused by
A) exogenous disturbances such as fiscal policy.
B) changes in business costs unrelated to prior changes in nominal GDP.
C) changes in business costs related to prior changes in nominal GDP.
D) shocks such as labor negotiations.
Answer: B
Question Status: Previous Edition

2) An adverse supply shock will shift the short-run Phillips Curve
A) outward to the right.
B) downward to the right.
C) upward to the left.
D) upward to the right.
Answer: C
Question Status: Previous Edition

3) A beneficial supply shock will shift the short-run Phillips Curve
A) inward to the left.
B) downward to the right.
C) upward to the left.
D) downward to the left.
Answer: B
Question Status: Previous Edition

4) A once-and-for-all increase in the price of a raw material, such as crude oil, will
A) not be inflationary, because this is, simply, "high prices."
B) have a short-run inflationary effect and reduces employment.
C) have no effect on inflation because this is the price of a raw material, not a final good.
D) both A and C are correct
Answer: B
Question Status: Previous Edition

5) The effect of a supply shock on inflation and real GDP
A) depends on the initial expected rate of inflation.
B) depends on the response in the growth of nominal GDP.
C) depends on the level of natural real GDP.
D) both A and B are correct
Answer: B
Question Status: Previous Edition

6) In the short-run, the impact of an adverse supply shock is to
A) reduce real GDP and increase the inflation rate if the growth of nominal GDP remains the same.
B) reduce real GDP and leave the inflation rate unchanged if the growth of nominal GDP is reduced enough.
C) maintain the same level of real GDP and increase the inflation rate if the growth of nominal GDP is increase enough.
D) All of the above
Answer: D
Question Status: Previous Edition

7) In the short-run, the impact of an adverse supply shock is to
A) reduce real GDP and leave the inflation rate unchanged if the growth of nominal GDP remains the same.
B) reduce real GDP and leave the inflation rate unchanged if the growth of nominal GDP is reduced enough.
C) maintain the same level of real GDP and reduce the inflation rate if the growth of nominal GDP is increase enough.
D) All of the above
Answer: B
Question Status: Previous Edition

8) Confronted with an adverse supply shock, an economy with rigid wages and prices would suffer
A) an increase in output and inflation.
B) a decrease in output and increase in inflation.
C) an increase in output and decrease in inflation.
D) a decrease in output only.
Answer: D
Question Status: Previous Edition

9) Confronted with an adverse supply shock, an economy with rigid wages but flexible prices would suffer
A) an increase in output and inflation.
B) a decrease in output and increase in inflation.
C) an increase in output and decrease in inflation.
D) a decrease in output only.
Answer: B
Question Status: Previous Edition

10) If price controls are initiated, we would expect that
A) unemployment will rise in the short-run.
B) the short-run rate of inflation will be unchanged.
C) the rate of inflation will accelerate in the short-run.
D) the rate of inflation will fall in the short-run.
Answer: D
Question Status: Previous Edition

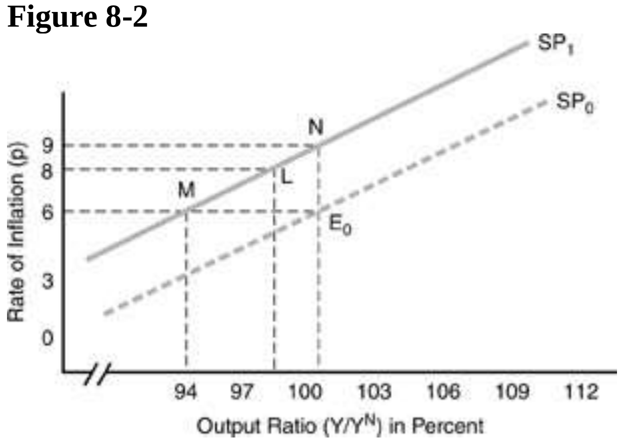
11) The effects of a supply shock on employment can be moderated in the short-run by
A) an appropriate acceleration in nominal GDP growth.
B) an appropriate deceleration of nominal GDP growth.
C) price controls.
D) Both A and C would moderate the effects of a supply shock.
Answer: D
Question Status: Previous Edition

12) An accommodating policy response to a supply shock
A) reduces the expected inflation rate.
B) maintains a fixed growth rate of nominal GDP.
C) eliminates the additional inflation caused by the supply shock.
D) none of these
Answer: D
Question Status: Previous Edition

13) An extinguishing policy response to a supply shock
A) attempts to keep real GDP from changing.
B) is one that maintains a fixed growth of real GDP.
C) changes the expected inflation rate.
D) causes a downward shift in the SP curve.
Answer: D
Question Status: Previous Edition

14) Given an adverse supply shock, an "extinguishing policy response" will
A) maintain the inflation rate and the output ratio.
B) lower the inflation rate and the output ratio.
C) raise the inflation rate and the output ratio.
D) maintain the inflation rate but lower the output ratio.
Answer: D
Question Status: Previous Edition

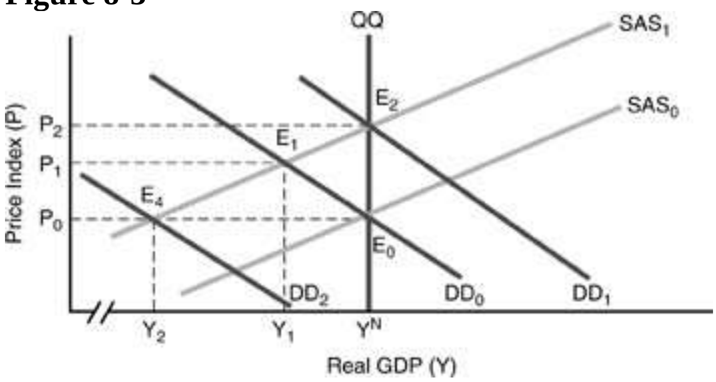
Figure 8-2



15) In Figure 8-2 above, a policy that maintains nominal GDP growth in the advent of an adverse supply shock is a(n)
A) extinguishing policy; M.
B) neutral policy; L.
C) accommodating policy; N.
D) incomes policy; N.
Answer: B
Question Status: Previous Edition

16) If there is a permanent adverse supply shock
A) the rate of inflation can be held constant if real wages are kept from falling.
B) an extinguishing policy will produce an acceleration of inflation.
C) the level of employment at the natural level of real GDP will remain constant only if the labor supply curve is upward sloping to the right.
D) a policy of accommodation at the original natural level of real GDP is not possible without an acceleration of inflation.
Answer: D
Question Status: Previous Edition

Figure 8-3



17) Employing Figure 8-3 above and assuming the nominal money supply is not altered, a permanent adverse supply side shock puts ________ pressure on nominal wages during renegotiation provided ________.
A) no; the reduction in the natural real GDP Y^N to Y_1 is exactly offset by the fall in goods demanded due to the rise in the price level
B) downward; the reduction in the real GDP Y^N to Y_2 is exactly offset by the fall in goods demanded due to the rise in the price level
C) upward; the reduction in the natural real GDP is exactly offset by the fall in goods demanded due to the rise in the price level
D) no; since the natural real GDP does not change
Answer: A
Question Status: Previous Edition

18) Suppose that a country's workers are universally protected by COLAs and an adverse SAS shock, occurs. After wage and price adjustments, ceteris paribus, we find
A) output falls dramatically and unemployment rises.
B) real wages decline and unemployment rises.
C) real wages rise and unemployment falls.
D) none of the above
Answer: A
Question Status: Previous Edition

19) Can monetary policy maintain a constant price level when confronted with the effects of an adverse supply shock?
A) Yes, if the economy is characterized by real and/or nominal wage rigidity.
B) No, if the economy is characterized by real and/or nominal wage rigidity.
C) Yes, if the economy is characterized by continuous renegotiation.
D) No, if the economy is characterized by overlapping contracts.
Answer: B
Question Status: Previous Edition

20) Given an adverse supply shock, a "neutral policy" will
A) maintain the inflation rate and the output ratio.
B) lower the inflation rate and the output ratio.
C) raise the inflation rate and the output ratio.
D) maintain the inflation rate but lower the output ratio.
Answer: C
Question Status: Previous Edition

21) The existence of COLAs in an economy will introduce
A) real wage rigidity and shift the LP curve.
B) real wage rigidity and shift the SP curve.
C) nominal wage rigidity and shift the SP curves.
D) nominal wage rigidity and shift the LP curve.
Answer: B
Question Status: Previous Edition

22) The statement, "With a permanent adverse supply shock, the government should engage in extinguishing policy changes," is true only if
A) the social costs of higher inflation are small and less than the social cost of less output.
B) the social costs of lost output are less than the social cost of permanently.
C) accommodating policy is impossible to conduct.
D) neutral policy is impossible to conduct.
Answer: B
Question Status: Previous Edition

23) If there is a supply shock and there are full protection COLAs
A) the Fed must reduce the money supply and follow an extinguishing policy to prevent an inflationary spiral.
B) the Fed must increase the money supply and follow an extinguishing policy to prevent an inflationary spiral.
C) the Fed must reduce the money supply and follow an accommodating policy to prevent an inflationary spiral.
D) the Fed must increase the money supply and follow an accommodating policy to prevent an inflationary spiral.
Answer: A
Question Status: Previous Edition

24) The aggravation of inflation and unemployment as a result of a supply shock
A) is unavoidable and is referred to as the direct effect of an adverse supply shock.
B) is called the indirect effect of an adverse supply shock.
C) is a subsequent result of following an accommodating policy.
D) can be avoided if expansionary fiscal policy is initiated when the shock occurs.
Answer: B
Question Status: Previous Edition

25) Preeminent among the causes of supply inflation in recent decades is
A) general strikes.
B) large changes in the price of oil.
C) unusually good or bad harvests.
D) unusually rapid adjustment of expected inflation to actual inflation.
Answer: B
Question Status: Previous Edition

26) The "direct effect" of an adverse supply shock in the SP/LP model is
A) a rightward shift of LP.
B) a leftward shift of LP.
C) an upward shift of SP.
D) a downward shift of SP.
Answer: B
Question Status: Previous Edition

27) The "indirect effect" of an adverse supply shock in the SP/LP model is
A) a rightward shift of LP.
B) a leftward shift of LP.
C) an upward shift of SP.
D) a downward shift of SP.
Answer: C
Question Status: Previous Edition

28) The "indirect effect" of a beneficial supply shock in the SP/LP model is
A) a rightward shift of LP.
B) a leftward shift of LP.
C) an upward shift of SP.
D) a downward shift of SP.
Answer: D
Question Status: Previous Edition

29) Crop failures generally produce ________ supply shocks in which the price level rises and then ________.
A) temporary, holds at its new higher level
B) temporary, returns to its previous level
C) permanent, holds at its new higher level
D) permanent, returns to its previous level
Answer: B
Question Status: Previous Edition

30) Oil price increases generally produce ________ supply shocks in which the price level rises and then ________.
A) temporary, holds at its new higher level
B) temporary, returns to its previous level
C) permanent, holds at its new higher level
D) permanent, returns to its previous level
Answer: C
Question Status: Previous Edition

31) Suppose we are initially at a long-run SP/LP equilibrium with x = p = pe = 4. Then an adverse supply shock adds 3 percentage points to the inflation necessary to produce each level of output. An "accommodating" policy response ________ the level of nominal GDP growth so that inflation is ________ percent while (Y/YN) ________.
A) lowers, 4, falls
B) lowers, 7, remains at 100
C) holds constant, 4, falls
D) raises, 4, remains at 100
E) raises, 7, remains at 100
Answer: E
Question Status: Previous Edition

32) Suppose we are initially at a long-run SP/LP equilibrium with x = p = pe = 4. Then an adverse supply shock adds 3 percentage points to the inflation necessary to produce each level of output. A "neutral" policy response ________ the level of nominal GDP growth so that inflation is ________ percent while (Y/YN) ________.
A) lowers, 4, falls
B) lowers, between 4 and 7, remains at 100
C) holds constant, between 4 and 7, falls
D) raises, 4, remains at 100
E) raises, 7, remains at 100
Answer: C
Question Status: Previous Edition

33) Suppose we are initially at a long-run SP/LP equilibrium with x = p = pe = 4. Then an adverse supply shock adds 3 percentage points to the inflation necessary to produce each level of output. An "extinguishing" policy response ________ the level of nominal GDP growth so that inflation is ________ percent while (Y/YN) ________.
A) lowers, 4, falls
B) lowers, between 4 and 7, remains at 100
C) holds constant, between 4 and 7, falls
D) raises, 4, remains at 100
E) raises, 7, remains at 100
Answer: A
Question Status: Previous Edition

34) Will a supply shock that shifts the SP curve upward leave it permanently at its new higher position?
A) A permanent shock will; a temporary shock cannot.
B) A permanent shock may if inflationary expectations are raised; a temporary shock cannot in any case.
C) Permanent or temporary shocks may if inflationary expectations are raised.
D) In no case will SP stay at its higher position.
Answer: C
Question Status: Previous Edition

35) COLAs ________ the probability that a permanent adverse supply shock will permanently increase an economy's ________.
A) increase, inflation rate
B) increase, price level
C) decrease, inflation rate
D) decrease, price level
Answer: A
Question Status: Previous Edition

36) With COLAs in effect, if the Fed wishes to avoid a permanent acceleration of inflation after a permanent adverse supply shock, it
A) must respond with an accommodating monetary policy.
B) must respond with a neutral monetary policy.
C) must respond with an extinguishing monetary policy.
D) can choose from accommodating, neutral, or extinguishing monetary policies.
Answer: C
Question Status: Previous Edition

37) Government price controls act as ________ supply shock, shifting SP ________.
A) an adverse, downward
B) an adverse, upward
C) a beneficial, downward
D) a beneficial, upward
Answer: C
Question Status: Previous Edition
38) With a beneficial supply shock, an extinguishing policy prevents ________, and allows ________.
A) output from rising, inflation to fall

B) output from falling, inflation to rise
C) inflation from rising, output to fall
D) inflation from falling, output to rise
Answer: C
Question Status: Previous Edition

39) Beneficial supply shocks ________ the rate of inflation and ________ the natural rate of unemployment.
A) reduce, reduce
B) reduce, increase
C) increase, reduce
D) increase, increase
Answer: A
Question Status: Previous Edition

40) A policy response to a beneficial supply shock which allows the full impact of the shock to increase the output ratio is
A) a neutral policy.
B) an extinguishing policy.
C) an accommodating policy.
D) an aggravating policy.
Answer: B
Question Status: Previous Edition

41) A policy response to a beneficial supply shock which focuses the full impact of the shock to lower the inflation rate is
A) a neutral policy.
B) an extinguishing policy.
C) an accommodating policy.
D) an aggravating policy.
Answer: C
Question Status: Previous Edition

42) Which of the following represent supply shocks?
A) oil, farm prices, import prices, productivity growth
B) oil, export prices, unemployment, real GDP
C) farm prices, export prices, money supply, productivity growth
D) all of the above
Answer: A
Question Status: New

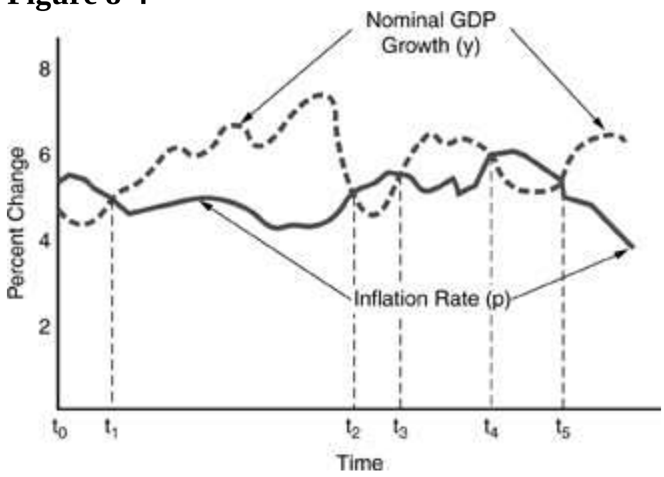
43) Which of the following was a beneficial supply shock in the United States in the late 1990s?
A) higher energy prices
B) lower import prices
C) stable real prices of computers
D) None of the above. Supply shocks in the late 1990s were detrimental to the economy.
Answer: B
Question Status: Previous Edition

9.9 The Response of Inflation and the Output Ratio to a Supply Shock

1) The imposition of price controls can be expected to
A) raise the natural rate of output and reduce unemployment.
B) raise unemployment in the short-run but decrease it in the long-run.
C) raise employment in the long-run, but reduce unemployment in the short-run.
D) raise employment in the short-run, but create market dislocations in other sectors.
Answer: D
Question Status: Previous Edition

2) Given an adverse supply shock, an "accommodating policy" will
A) maintain the inflation rate and the output ratio.
B) lower the inflation rate and the output ratio.
C) raise the inflation rate and the output ratio.
D) maintain the output ratio but allow inflation to increase.
Answer: D
Question Status: Previous Edition

Figure 8-4



3) Employing Figure 8-4 above in the time periods t_0 to t_1, and t_4 to t_5 real GNP is ________; from t_1 to t_2, t_3 to t_4, and beyond t_5 real GNP is ________.
A) decreasing; decreasing
B) increasing; decreasing
C) increasing; increasing
D) decreasing; increasing
Answer: D
Question Status: Previous Edition

4) Inflation is a ________ increase in the price level and it can be produced if the AD curve shifts up ________.
A) continuous, continuously
B) continuous, either once or continuously
C) one-shot, once but only once
D) one-shot, either once or continuously
Answer: A
Question Status: Previous Edition

5) In Chapter 8, the SAS curve is upward-sloping. One assumption that justifies this is that
A) that natural real GDP never exceeds actual real GDP.
B) that wage rates adjust instantaneously.
C) the use of long-term wage agreements.
D) All of the above.
Answer: C
Question Status: Previous Edition

6) A rising nominal wage causes
A) upward movement along the SAS curve.
B) downward movement along the SAS curve.
C) a downward shift of the SAS curve.
D) an upward shift of the SAS curve.
Answer: D
Question Status: Previous Edition

7) From an initial AD/SAS/LAS equilibrium with price and wage index numbers of 1.00 and

an output index number of 100, suppose a new SAS curve must be drawn for a wage level of 1.03. Applying a general rule for drawing SAS curves, it goes through the
A) current AD curve at Y = 103.
B) current AD curve at P = 1.03.
C) LAS curve at Y = 103.
D) LAS curve at P = 1.03.
Answer: D
Question Status: Previous Edition

9.10 Inflation and Output Fluctuations: Recapitulation of Causes and Curses

1) There are no questions for this section.
Answer:

9.11 How Is the Unemployment Rate Related to the Inflation Rate?

1) The sacrifice ratio for disinflations is the cumulative
A) loss of real GDP/increase in unemployment rate.
B) loss of real GDP/cumulative loss of nominal GDP.
C) loss of real GDP/permanent decrease in inflation rate.
D) gain in real GDP/total population.
Answer: C
Question Status: Previous Edition

2) The disinflation carried out with a cold turkey policy from 1980 to 1985 had a sacrifice ratio of
A) 35.5.
B) 5.9.
C) 450 billion.
D) 4.4
Answer: D
Question Status: Previous Edition

3) The recession of the early 1990s produced a sacrifice ratio ________ that of the much larger recession of the 1980s.
A) greater than
B) slightly smaller than
C) much smaller than
D) equal to
Answer: C
Question Status: Previous Edition

4) According to "Okun's Law," if expansionary monetary policy were to increase Y/Y(N) by 3 percent, we could expect the unemployment rate to decrease by ________ percentage points.
A) 0.4
B) 1.0
C) 1.5
D) 1.6
Answer: C
Question Status: Previous Edition

5) "Okun's Law" refers to
A) the trade-off between inflation and unemployment.
B) the relationship between real and nominal output growth.
C) minimum wage laws and the impact of price controls.
D) the relationship between the unemployment rate and the ratio of actual to natural output.
Answer: D
Question Status: Previous Edition

6) "Okun's Law" is the ________ relation between the ________ and the difference between the actual unemployment rate and the average rate of unemployment.
A) direct; output ratio
B) observed positive; price ratio
C) implicit positive; output ratio
D) negative; output ratio
Answer: D
Question Status: Previous Edition

7) "Okun's Law" is the close relationship observed between a period's ________ unemployment rate and ________.
A) actual unemployment rate, (Y/YN)
B) actual unemployment rate, YN
C) inflation rate, (Y/YN)
D) inflation rate, Y
Answer: A
Question Status: Previous Edition

8) The actual unemployment rate is most likely to rise when
A) Y is rising.
B) YN is rising.
C) (YN/Y) is falling.
D) (Y/YN) is falling.
Answer: D
Question Status: Previous Edition

9) In the general linear formulation of Okun's law, the value of the coefficient "h" given in the textbook as fairly summarizing U.S. data is
A) 200.
B) 4.
C) 1.75.
D) 0.5.
E) 0.025
Answer: D
Question Status: Previous Edition

10) If the average unemployment rate = 6.0, Y = 5200, and YN = 5030, Okun's law, using the textbook's value for "h," predicts that the unemployment rate is approximately ________ percent.
A) 7.4
B) 6.4
C) 4.3
D) 5.6
E) 5.0
Answer: C
Question Status: Previous Edition

11) If the average unemployment rate = 6.0, Y = 4850, and YN = 5030, Okun's law, using the textbook's value for "h," predicts that the unemployment rate is approximately ________ percent.
A) 20.3
B) 7.0
C) 4.6
D) 7.8
E) 6.0
Answer: D
Question Status: Previous Edition

12) Suppose the average unemployment rate = 6.0, and YN = 5000. According to Okun's law and the textbook's value for "h," what value of Y would bring about an actual unemployment rate of exactly 5.5 percent?
A) 6250
B) 6000
C) 5050
D) 4937.5
E) 4000
Answer: C
Question Status: Previous Edition

13) Suppose the average unemployment rate = 6.0 and YN = 5000. According to Okun's law and the textbook's value for "h," what value of Y would bring about an actual unemployment rate of exactly 7.2 percent?
A) 4880
B) 4940
C) 5060
D) 5150
E) 4760
Answer: A
Question Status: Previous Edition

14) From 1989 to 1992, the output ratio fell by 4 percent while the unemployment rate rose by 1.44 percentage points. This implies an Okun's law coefficient of
A) 2.60
B) 0.36
C) 2.40
D) 5.40
E) 0.059
Answer: B
Question Status: Previous Edition

15) From 1991 to 1996, the output ratio rose by 2.2 percent while the unemployment rate fell by 1.35 percentage points. This implies an Okun's law coefficient of
A) 5.0.
B) 2.136.
C) 13.8.
D) 41.36.
E) 0.614.
Answer: E
Question Status: Previous Edition

16) In the diagram displaying Okun's law, the data points loop around the summarizing "Okun's law line" in a ________ direction because the unemployment rate reacts to changes in production ________.
A) clockwise, in advance
B) clockwise, with a lag
C) counterclockwise, in advance
D) counterclockwise, with a lag
Answer: B
Question Status: Previous Edition

Appendix to Chapter 9: The Elementary Algebra of the SP-DG Model

1) There are no questions for this section.
Answer:

***Macroeconomics, 12e* (Gordon)**
Chapter 10 The Goals of Stabilization Policy: Low Inflation and Low Unemployment

10.1 The Costs and Causes of Inflation

1) Inflation has no effect on an economy's well-being if
A) it is universally and accurately anticipated.
B) relative prices are unaffected.
C) the nominal rate of interest for both savers and borrowers rises by an amount just equal to the rate of inflation.
D) all of these
Answer: D
Question Status: Previous Edition

2) According to Gordon, the main losers due to the redistributive effect of the postwar inflation in the United States were
A) households.
B) corporations.
C) government.
D) foreigners.
Answer: A
Question Status: Previous Edition

3) The costs of inflation depend upon
A) whether it is anticipated or unanticipated.
B) who pays it and who receives it.
C) the future savings rate.
D) none of the above.
Answer: C
Question Status: Previous Edition

4) The costs imposed by inflation should be lessened in the future because of the following reform that took place during the early 1980s
A) airline deregulation.
B) issuance of indexed government bonds.
C) changing tax laws to ensure that savers are taxed only on real, rather than nominal capital gains.
D) lifting of limits on interest paid on checking and savings accounts.
Answer: D
Question Status: Previous Edition

10.2 Money and Inflation

1) The real rate of interest
A) is equal to the nominal rate when Y equals YN.
B) is equal to the nominal rate minus the rate of inflation.
C) is equal to the nominal rate plus the rate of inflation.
D) is never negative.
Answer: B
Question Status: Previous Edition

2) If the nominal interest rate is 10% and expected inflation is 5%, the real expected interest rate is
A) 15%.
B) -5%.
C) 5%.
D) 10%.
Answer: C
Question Status: Previous Edition

3) The actual real interest rate and the expected real interest rate will be identical if
A) pe = p.
B) pe > p.
C) pe < p.
D) none of the above
Answer: A
Question Status: Previous Edition

4) If the market rate of interest is 13%, the growth of nominal GDP 9%, and the growth of real GDP 2%, then
A) the rate of inflation is 11%.
B) the rate of inflation is 4%.
C) the rate of inflation cannot be determined.
D) none of the above
Answer: D
Question Status: Previous Edition

5) The "quantity equation" states that nominal GDP is equal by the definition of velocity to the money supply ________ velocity.
A) plus
B) minus
C) multiplied by
D) divided by
Answer: C
Question Status: Previous Edition

6) From the quantity equation we find that the rate of inflation is equal by definition to the growth rate of the money supply ________ the growth rate of velocity ________ the growth rate of real GDP.
A) plus, plus
B) plus, minus
C) minus, plus
D) minus, minus
Answer: B
Question Status: Previous Edition

7) From the quantity equation we find that the rate of inflation is equal by definition to the growth rate of nominal GDP ________ the growth rate of real GDP.
A) minus
B) plus
C) multiplied by
D) divided by
Answer: A
Question Status: Previous Edition

8) Over a year, the money supply in a nation grew by 6 percent, while velocity fell by 1 percent and real GDP rose by 2 percent. This results in an inflation over the year of ________ percent.
A) 9
B) 7
C) 5
D) 3
Answer: D
Question Status: Previous Edition

9) Over a year, the money supply in a nation grew by 8 percent, while velocity rose by 2 percent and real GDP rose by 3 percent. This results in an inflation over the year of ________ percent.
A) 7
B) 9
C) 13
D) 3
Answer: A
Question Status: Previous Edition

10) Rising velocity means that people want to hold ________ nominal money per dollar of nominal GDP, which ________ the inflationary tendency of an increase in the money supply as one way of re-equating the demand and supply of money.
A) more, strengthens
B) more, weakens
C) less, strengthens
D) less, weakens
Answer: C
Question Status: Previous Edition

11) In the quantity equation framework for understanding the determinants of long-run

inflation, a rise in government spending ________ velocity, putting ________ pressure on inflation.
A) raises, upward
B) raises, downward
C) lowers, upward
D) lowers, downward
Answer: A
Question Status: Previous Edition

12) In the quantity equation framework for understanding the determinants of long-run inflation, a drop in consumer confidence ________ velocity, putting ________ pressure on inflation.
A) raises, upward
B) raises, downward
C) lowers, upward
D) lowers, downward
Answer: D
Question Status: Previous Edition

13) In the quantity equation framework for understanding the determinants of long-run inflation, a depreciation of the exchange rate ________ velocity, putting ________ pressure on inflation.
A) raises, upward
B) raises, downward
C) lowers, upward
D) lowers, downward
Answer: A
Question Status: Previous Edition

14) In the United States, the long-run average growth rate of velocity in recent decades has been
A) about 2 percent per year.
B) about 1 percent per year.
C) virtually zero.
D) about -1 percent per year.
E) about -2 percent per year.
Answer: C
Question Status: Previous Edition

15) In the United States, the long-run inflation rate can be expressed simply as the growth rate of money
A) plus the long-run growth rate of velocity.
B) minus the long-run growth rate of velocity.
C) plus the long-run growth rate of real GDP.
D) minus the long-run growth rate of real GDP.
Answer: D
Question Status: Previous Edition

16) The "excess" growth rate of the money supply is the growth rate of money
A) plus the long-run growth rate of velocity.
B) minus the long-run growth rate of velocity.
C) plus the long-run growth rate of real GDP.
D) minus the long-run growth rate of real GDP.
Answer: D
Question Status: Previous Edition

17) When the Federal Reserve raises the growth rate of the money supply to a permanently higher level, this produces ________ in real GDP and ________ in the inflation rate.
A) a permanent increase, a permanent increase
B) a permanent increase, a temporary increase
C) no change, a temporary increase
D) a temporary increase, a temporary increase
E) a temporary increase, a permanent increase
Answer: E
Question Status: Previous Edition

10.3 Why Inflation Is Not Harmless

1) Unanticipated inflation will hurt ________ and help ________.
A) pensioners; borrowers
B) borrowers; pensioners
C) the government; tax payers
D) homeowners; banks
Answer: A
Question Status: Previous Edition

2) Unanticipated inflation will insure that
A) homeowners with outstanding mortgage balances are hurt.
B) homeowners with outstanding mortgage balances are benefited.
C) creditors gain, debtors lose.
D) none of the above
Answer: B
Question Status: Previous Edition

3) "Shoe-leather costs" refer to
A) a cobbler's payment for leather.
B) "rubber costs" on today's shoes.
C) the inconvenience imposed by higher interest rates.
D) financial deregulation of retail business firms.
Answer: C
Question Status: Previous Edition

4) Which of the following anti-inflation policies imposes costs on society?
A) price controls
B) indexation
C) reduced growth in nominal demand
D) all of these
Answer: D
Question Status: Previous Edition

5) The U.S. macroeconomic experience of the early to mid-1980s is an example of how
A) reducing inflation comes at the cost of a permanent reduction in real GDP.
B) reducing inflation comes at the cost of a temporary reduction in real GDP.
C) reducing inflation can be done costless by simply increasing the money growth rate.
D) increasing the money growth rate affects inflation alone, and not real GDP.
Answer: B
Question Status: Previous Edition

6) In the late 1980s, Canada embarked on an ambitious policy of reducing inflation to zero. Inflation did come down, while the unemployment rate ________, which ________ the U.S. disinflation experience of the 1980s.
A) rose, runs counter to
B) rose, duplicates
C) remained nearly constant, runs counter to
D) remained nearly constant, duplicates
Answer: B
Question Status: Previous Edition

7) The textbook uses as its precise definition of hyperinflation an inflation rate
A) below zero.
B) of less than one percent per year.
C) of more than one hundred percent per year.
D) of more than one thousand percent per year.
E) of more than fifty percent per month.
Answer: D
Question Status: Previous Edition

8) For inflation to have no real effect on the economy, leaving all decisions and their real outcomes unchanged, five conditions must be met. Which of the following incorrectly states one of those conditions?
A) Inflation is universally and accurately anticipated.
B) All savings earn the nominal interest rate, while money earns zero interest.
C) Inflation of p0 percent raises the nominal interest rate by p0 above the no-inflation nominal rate.
D) Only real interest income is taxable and only the real cost of borrowing is tax-deductible.
E) Inflation raises the prices of all goods by the same percentage.
Answer: B
Question Status: Previous Edition

9) The classic loser from an unanticipated inflation is
A) the borrower who pays less nominal interest than expected.
B) the borrower who pays more nominal interest than expected.

C) the saver who earns less real interest than expected.
D) the saver who earns more real interest than expected, and so should have saved more.
Answer: C
Question Status: Previous Edition

10) Real income is redistributed from ________ in the case of ________ inflation.
A) creditors to debtors, anticipated
B) creditors to debtors, unanticipated
C) debtors to creditors, anticipated
D) debtors to creditors, unanticipated
Answer: B
Question Status: Previous Edition

11) Real income is redistributed from ________ in the case of ________ deflation.
A) creditors to debtors, anticipated
B) creditors to debtors, unanticipated
C) debtors to creditors, anticipated
D) debtors to creditors, unanticipated
Answer: D
Question Status: Previous Edition

12) Periods of low or negative inflation are generally ________ to farmers, who are ________ as a group.
A) advantageous, creditors
B) advantageous, debtors
C) harmful, creditors
D) harmful, debtors
Answer: D
Question Status: Previous Edition

13) A person who purchased a house with a small down payment just before an unanticipated inflation hits has ________ from the decision to be in debt, and has ________ by having an asset in the form of a house.
A) benefited, benefited again
B) benefited, been hurt
C) been hurt, benefited
D) been hurt, been hurt again
Answer: A
Question Status: Previous Edition

14) The "Fisher Effect" occurs when a one-percentage-point rise in expected inflation ________ interest rate by one percentage point
A) raises the expected real
B) lowers the expected real
C) raises the nominal
D) lowers the nominal
Answer: C
Question Status: Previous Edition

15) When the Fisher Effect holds, a one-percentage-point increase in the long-run money growth rate, because it ________ expected inflation, causes ________ in the nominal interest rate in the long run.
A) equally lowers, a one-percentage-point decrease
B) does not change, a one-percentage point decrease
C) does not change, no change
D) equally raises, no change
E) equally raises, a one-percentage-point increase
Answer: E
Question Status: Previous Edition

16) The expected real interest rate is equal to
A) the nominal interest rate minus the expected rate of inflation.
B) the nominal interest rate plus the expected rate of inflation.
C) the nominal interest rate minus the actual rate of inflation.
D) the nominal interest rate plus the actual rate of inflation.
Answer: A
Question Status: Previous Edition

10.4 Indexation and Other Reforms to Reduce the Costs of Inflation

1) Indexation is designed to
A) moderate the costs of inflation, not inflation itself.
B) rapidly reduce inflation.
C) reduce the natural rate of unemployment.
D) rapidly reduce inflationary expectations.
Answer: A
Question Status: Previous Edition

2) A program of complete indexation would
A) eliminate most of the costs of inflation.
B) increase the sensitivity of the economy to supply shocks.
C) make the role of expectations negligible.
D) all of these
Answer: D
Question Status: Previous Edition

3) If short-term government bond rates were indexed
A) such bonds would be a poor hedge against inflation.
B) banks and saving and loan institutions would likely lose deposits.
C) the government would gain from the implied inflation tax.
D) the government would gain from the implied inflation subsidy.
Answer: B
Question Status: Previous Edition

4) In the early 1980s the government's primary method of combating inflation was
A) price and wage controls.
B) undoing the "self-inflicted" wounds.
C) restrictive monetary policy.
D) indexing bonds to protect savers.
Answer: C
Question Status: Previous Edition

5) A legitimate objection to the government issuance of "indexed" bonds is that they
A) are more of a drain on the Treasury than conventional bonds.
B) can encourage inflation and weaken policy resistance to it.
C) discourage saving when inflation is reduced.
D) further discourage the use of money and thus increase shoe-leather costs.
Answer: B
Question Status: Previous Edition

6) A needed reform in the U.S. income tax system that would reduce the costs of inflation is to
A) go back to taxing nominal wage and salary income.
B) start taxing real wage and salary income.
C) go back to taxing nominal interest income.
D) tax real interest income.
Answer: D
Question Status: Previous Edition

10.5 The Government Budget Constraint and the Inflation Tax

1) When Okun's "misery index" is used to judge macroeconomic conditions, inflation is being considered
A) not to be a macroeconomic problem at all.
B) a less serious macroeconomic problem than unemployment.
C) just as serious a macroeconomic problem as unemployment.
D) a more serious macroeconomic problem than unemployment.
Answer: C
Question Status: Previous Edition

2) When the misery index is used to judge macroeconomic conditions, reducing inflation by one percentage point
A) has no effect at all on how we judge the economy's performance.
B) is of less benefit to the economy than reducing the unemployment rate by one percentage point.
C) gives the same benefit to the economy as reducing the unemployment rate by one percentage point.
D) is of greater benefit to the economy than reducing the unemployment rate by one percentage point.
Answer: C
Question Status: Previous Edition

3) Presidents running for re-election are tempted to urge the Federal Reserve to ________ the rate of money growth in order to reap the political benefits of ________.
A) reduce, permanently lower inflation
B) reduce, temporarily lower inflation
C) increase, temporarily lower inflation
D) increase, temporarily higher real GDP
E) increase, permanently higher real GDP
Answer: D
Question Status: Previous Edition

4) The government budget constraint tells us that to the extent that government expenditures are NOT financed by tax collection, the public ends up holding ________ government bonds and ________ money.
A) more, more
B) more, less
C) fewer, more
D) fewer, less
Answer: A
Question Status: Previous Edition

5) The three sources of government revenue are taxes, the ________ of government bonds, and the ________ of high-powered money.
A) issuance, collection
B) issuance, issuance
C) buying back, collection
D) buying back, issuance
Answer: B
Question Status: Previous Edition

6) Governments promote long-run inflation when they depend on ________ to finance their expenditures.
A) issuing bonds
B) taxation
C) raising the national debt
D) money creation
E) selling off assets
Answer: D
Question Status: Previous Edition

7) In the United States, who determines the combination of bond and money creation that finances the federal budget deficit?
A) the federal government itself
B) the Federal Reserve
C) the private banking system
D) private bond- and money-holders
Answer: B
Question Status: Previous Edition

8) The short-run simulative effect of a government budget deficit on real GDP is stronger with ________ financing, since this ________ the crowding out effect of the deficit.
A) bond, enhances
B) bond, eliminates
C) money, enhances
D) money, eliminates
Answer: A
Question Status: Previous Edition

9) Less-developed nations may have trouble with ________ financing of their deficits, and the only alternative creates the problem of ________.
A) money, high inflation
B) money, indebtedness to foreign nations
C) bond, high inflation
D) bond, indebtedness to foreign nations
Answer: C
Question Status: Previous Edition

10) Suppose the private sector wishes to hold a constant level of real high-powered money. This means that with an ongoing inflation of p percent, each year the government treasury can obtain goods from the private sector in exchange for ________ p times the existing high-powered money, a government revenue source called ________.
A) creating, seignorage
B) creating, transfer payments
C) collecting, seignorage
D) collecting, transfer payments
Answer: A
Question Status: Previous Edition
11) What is the "inflation tax"?
A) the difference between nominal and real interest rates received on financial assets, due to inflation

B) the fact that our tax system is based on nominal incomes and not real incomes, so that the government collects more taxes due to inflation alone
C) the government obtaining goods in exchange for newly created high-powered money that does not add to the real value of private assets due to the resulting inflation
D) the fact that greater government spending leaves fewer goods available to the private sector, thus lowering their prices.
Answer: C
Question Status: Previous Edition

12) If the private sector wishes to hold a constant quantity of real government bonds, inflation requires that the private sector continuously ________ those bonds, so that the government ends up having to pay out interest on net equal to the ________ interest rate times the bonds outstanding.
A) sell, nominal
B) sell, real
C) buy, nominal
D) buy, real
Answer: D
Question Status: Previous Edition

13) Government deficit financing is made easier by a p-percentage-point rise in inflation if it raises the nominal interest rate by ________ than p percentage points, and the private sector wishes to hold ________ quantity of real government bonds.
A) less, a lower
B) less, the same
C) more, a lower
D) more, the same
Answer: B
Question Status: Previous Edition

14) Government deficit financing is made easier by a rise in inflation when inflation ________ the private sector's demand for high-powered money, which the government can ________.
A) lowers, create and spend
B) lowers, obtain through taxation
C) raises, create and spend
D) raises, obtain through taxation
Answer: C
Question Status: Previous Edition

15) Suppose the U.S. public holds $1 trillion in government bonds, all with an 8 percent nominal interest rate. If the Federal Reserve can hold that nominal rate constant, what inflation rate would make the government's net interest expense exactly zero?
A) 16 percent
B) 8 percent
C) 0 percent
D) -8 percent
Answer: B
Question Status: Previous Edition

16) In nations where conventional taxes are difficult to collect, the inflation tax is ________, which tends to ________ the inflation rates of those nations.
A) also difficult to collect, aggravate
B) also difficult to collect, hold down
C) a realistic alternative, aggravate
D) a realistic alternative, hold down
Answer: C
Question Status: Previous Edition

10.6 Starting and Stopping a Hyperinflation

1) The textbook cites an estimate of the "sacrifice ratio" in the United States of approximately
A) one-third.
B) one-half.
C) one.
D) three.
E) six.
Answer: D
Question Status: Previous Edition

2) Supply shocks are a potential source of higher inflation, unless the government counters with ________ policy that ________ the money growth rate.
A) extinguishing, reduces
B) extinguishing, increases
C) neutral, leaves unchanged
D) accommodative, reduces
E) accommodative, increases
Answer: A
Question Status: Previous Edition

3) Higher inflation is particularly damaging to the real value of
A) wages.
B) financial assets.
C) physical assets.
D) government tax revenues.
Answer: B
Question Status: Previous Edition
4) If a worker receives 6 percent higher nominal wages over a year in which inflation is 2 percent, the worker's real wages have
A) risen by 8 percent.

B) risen by 4 percent.
C) risen by 3 percent.
D) fallen by 3 percent.
E) fallen by 4 percent.
Answer: B
Question Status: Previous Edition

5) The "nominal" interest rate is the
A) rate actually quoted in financial markets.
B) rate actually quoted in financial markets minus the expected inflation rate.
C) rate actually quoted in financial markets plus the expected inflation rate.
D) rate actually quoted in financial markets divided by the expected inflation rate.
Answer: A
Question Status: Previous Edition

6) The "expected real" interest rate is the
A) rate actually quoted in financial markets.
B) rate actually quoted in financial markets minus the expected inflation rate.
C) rate actually quoted in financial markets plus the expected inflation rate.
D) rate actually quoted in financial markets divided by the expected inflation rate.
Answer: B
Question Status: Previous Edition

7) Investment and saving decisions are assumed by economists to depend on the ________ interest rate.
A) expected nominal
B) nominal
C) expected real
D) real
Answer: C
Question Status: Previous Edition

8) If an increase in expected inflation equally raises the nominal interest rate, the expected real interest rate ________ and thus investment demand ________.
A) rises, increases
B) rises, decreases
C) is unchanged, is unchanged
D) falls, increases
E) falls, decreases
Answer: C
Question Status: Previous Edition

9) For inflation to have no real effect on the economy, leaving all decisions and their real outcomes unchanged, five conditions must be met. Which of the following incorrectly states one of those conditions?
A) Inflation is universally and accurately anticipated.
B) All savings and money earn the nominal interest rate.
C) Inflation of p0 percent lowers the nominal interest rate by p0 below the no-inflation nominal rate.
D) Only real interest income is taxable and only the real cost of borrowing is tax-deductible.
E) Inflation raises the prices of all goods by the same percentage.
Answer: C
Question Status: Previous Edition

10) For inflation to have no real effect on the economy, leaving all decisions and their real outcomes unchanged, five conditions must be met. Which of the following incorrectly states one of those conditions?
A) Inflation is universally and accurately anticipated.
B) All savings and money earn the nominal interest rate.
C) Inflation of p0 percent raises the nominal interest rate by p0 above the no-inflation nominal rate.
D) Only nominal interest income is taxable and only the nominal cost of borrowing is tax-deductible.
E) Inflation raises the prices of all goods by the same percentage.
Answer: D
Question Status: Previous Edition

11) Which of the following is NOT one of the "unholy trinity" of events that interact to fuel an explosive hyperinflation?
A) supply shocks
B) monetary accommodation
C) exchange rate appreciation
D) frequent wage indexation
Answer: C
Question Status: Previous Edition

12) The "key ingredient" in ending a hyperinflation is to
A) allow the money supply to grow more rapidly.
B) reduce the enormous budget deficit.
C) require wage contracts to be indexed more frequently.
D) devalue the nation's currency in the foreign exchange market.
Answer: B
Question Status: Previous Edition

13) The "shoe-leather" cost of a fully anticipated inflation is
A) the inconvenience of holding less cash.
B) the higher prices of imported raw materials due to currency depreciation.
C) the extra time spent on shopping in order to beat price increases.
D) the effort of changing posted prices on price tags and producing new price lists and catalogs.
Answer: A
Question Status: Previous Edition

14) It is estimated that a 10 percent inflation in the United States would bear a shoe-leather cost of approximately ________ percent of GDP.
A) 15
B) 6
C) 2
D) 0.25
Answer: D
Question Status: Previous Edition

15) If a rise in anticipated inflation produces for some reason a less-than-equal rise in the nominal interest rate, this ________ the costs of anticipated inflation by ________ saving.
A) reduces, encouraging
B) reduces, discouraging
C) increases, encouraging
D) increases, discouraging
Answer: D
Question Status: Previous Edition

16) In the 1980s, the federal government gradually ________ interest-rate ceiling on deposits at commercial banks and thrift institutions, which has ________ the costs of inflation.
A) imposed, lowered
B) imposed, reduced
C) lifted, lowered
D) lifted, reduced
Answer: C
Question Status: Previous Edition

10.7 Why the Unemployment Rate Cannot Be Reduced to Zero

1) The turnover view of unemployment stresses that
A) most job vacancies have skill requirements not possessed by the unemployed.
B) many job vacancies are located in different areas of the country than are the unemployed.
C) there exist incentives for workers to refuse to accept jobs.
D) there exists racial/and or sex discrimination against some workers.
Answer: C
Question Status: Previous Edition

2) Which of the following would NOT reduce the natural rate of unemployment?
A) a tax cut
B) an increase in government expenditures
C) wage or price controls
D) all of the above
Answer: D
Question Status: Previous Edition

3) The most basic cause of unemployment in the United States is that
A) the natural rate of unemployment is much higher than zero.
B) we are most of the time producing a real GDP below the natural real GDP.
C) we are suffering from low productivity growth.
D) we are converting from a predominantly industrial to a predominantly service-based economy.
E) policymakers are constantly trying to hold down inflation.
Answer: A
Question Status: Previous Edition

4) The natural unemployment rate is ________ unemployment rates.
A) the sum of the turnover and cyclical
B) the sum of the turnover and mismatch
C) the sum of the structural and cyclical
D) the sum of the structural, cyclical, and frictional
E) the cyclical minus the mismatch
Answer: B
Question Status: Previous Edition

5) Unemployment due to the normal processes of quitting and searching for jobs is called ________ unemployment.
A) turnover
B) mismatch
C) cyclical
D) natural
Answer: A
Question Status: Previous Edition

10.8 Sources of Mismatch Unemployment

1) The natural rate of unemployment is that rate
A) below which the economy can never be.
B) corresponding to full-employment.
C) corresponding to a constant rate of inflation.
D) which is zero.
Answer: C
Question Status: Previous Edition

2) "Natural unemployment" includes those out of work because of
A) expected or normal turnover which will always characterize a part of the labor force.
B) structural unemployment caused by normal technological change in production.
C) a recession.
D) A and B.
Answer: D
Question Status: Previous Edition

3) Suppose that the number of jobs for engineers expands by 10 percent per year, the number of new engineers by 5 percent per year while the number of automobile mechanics grows by 8 percent and the number of new automobile mechanics jobs grows by 3 percent. We conclude that
A) frictional unemployment will increase.
B) frictional unemployment will decrease.
C) structural unemployment will increase.
D) structural unemployment will increase 4 times.
Answer: C
Question Status: Previous Edition

4) Many extended periods of high actual unemployment above the natural rate have been the result of
A) deliberate government anti-inflationary policy.
B) high job turnover.
C) mismatches in the labor market.
D) unemployment compensation.
Answer: A
Question Status: Previous Edition

5) The payment of unemployment compensation tends to induce business firms to
A) lay off workers as opposed to lowering sales.
B) search for new workers for shorter periods of time.
C) lay off workers as opposed to increasing inventories and/or reducing hours worked for all employees.
D) recall previously laid off workers more rapidly.
Answer: C
Question Status: Previous Edition

6) The "benefits" from government programs to reduce mismatch unemployment include reduction in
A) private costs such as lost income and erosion of job skills.
B) private costs such as lost leisure and lower alcohol consumption.
C) social costs such as lower unemployment compensation and welfare payments.
D) A and C.
Answer: D
Question Status: Previous Edition

7) Which of the following statements is true?
A) Adult males, adult females, and teenagers all have similar rates of unemployment due to job losses.
B) Almost half of the total teenage unemployment rate appears to be due to the search for the first job.
C) Relative to adult males, adult females and teenagers have more frequent unemployment due to reentry and higher quit rates.
D) All of the above.
Answer: D
Question Status: Previous Edition

8) Unemployment due to the location or skill requirements of job vacancies not matching the location or skills of the unemployed is called ________ unemployment.
A) turnover
B) mismatch
C) cyclical
D) natural
Answer: B
Question Status: Previous Edition

9) The difference between actual and natural unemployment rates is called ________ unemployment.
A) turnover
B) mismatch
C) cyclical
D) measured
Answer: C
Question Status: Previous Edition

10) When the actual exceeds the natural unemployment rate, this means that we have ________ unemployment.
A) positive structural
B) negative structural
C) positive cyclical
D) negative cyclical
Answer: C
Question Status: Previous Edition

11) When the actual unemployment rate equals the natural unemployment rate, inflation is
A) zero.
B) constant.
C) rising.
D) falling.
Answer: B
Question Status: Previous Edition

10.9 Turnover Unemployment and Job Search

1) "Disgruntled" workers who quit their jobs to find "a more reasonable boss" are experiencing
A) involuntarily unemployment.
B) mismatch unemployment.
C) cyclically unemployment.
D) turnover unemployment.
Answer: D
Question Status: Previous Edition

2) The elimination of hourly rate assembly line jobs for unskilled workers by robots is an example of
A) involuntary unemployment.
B) mismatch unemployment.
C) cyclical unemployment.
D) turnover unemployment.
Answer: B
Question Status: Previous Edition

3) Unemployment that results when individuals who have voluntarily quite their jobs are seeking jobs is called
A) cyclical unemployment.
B) turnover unemployment.
C) mismatch unemployment.
D) natural unemployment.
Answer: B
Question Status: Previous Edition

4) An increase in the amount and time period for which unemployment compensation is paid will most likely
A) increase the structural rate of unemployment.
B) leave the natural rate of unemployment unchanged.
C) decrease the natural rate of unemployment.
D) increase turnover unemployment.
Answer: D
Question Status: Previous Edition

5) Which of the following will NOT affect the natural rate of unemployment?
A) minimum wage legislation
B) restrictive monetary policy
C) employer discrimination
D) geographic immobility
Answer: B
Question Status: Previous Edition

6) The layoff of workers in virtually all industries during the 1982 recession is an example of the classification of workers as
A) voluntarily unemployed.
B) structurally unemployed.
C) cyclically unemployed.
D) frictionally unemployed.
Answer: C
Question Status: Previous Edition

7) "Turnover" unemployment is another name for ________ unemployment.
A) frictional
B) structural
C) cyclical
D) natural
Answer: A
Question Status: Previous Edition

8) "Mismatch" unemployment is another name for ________ unemployment.
A) frictional
B) structural
C) cyclical
D) natural
Answer: B
Question Status: Previous Edition

9) The best guess has turnover unemployment about ________ as mismatch unemployment.
A) three times as large
B) twice as large
C) the same size
D) two-thirds as large
E) half as large
Answer: C
Question Status: Previous Edition

10) Suppose there is a shortage of computer programmers, but firms refuse to hire unemployed typists and train them. This is one reason for ________ unemployment.
A) turnover
B) seasonal
C) mismatch
D) cyclical
Answer: C
Question Status: Previous Edition

11) We have drawn the SAS and SP curves as straight lines for convenience. More realistically, rising output ________ the structural unemployment problem and the effect of this on wages causes those curves to ________ in slope.
A) aggravates, increase
B) aggravates, decrease
C) alleviates, increase
D) alleviates, decrease
Answer: A
Question Status: Previous Edition

12) Applying elementary economics, mismatch unemployment should fall when relative wages
A) rise.
B) fall.
C) are more flexible.
D) are less flexible.
Answer: C
Question Status: Previous Edition

13) Better public education serves to ________ unemployment.
A) raise mismatch
B) lower mismatch
C) raise turnover
D) lower turnover
Answer: B
Question Status: Previous Edition

14) With regional specialization, a nation is bound to suffer some mismatch unemployment. For example, in the early 1990s the highest regional unemployment rate was in
A) California.
B) the South.
C) the Midwest.
D) none of the above because the unemployment rate as essentially equal in all regions.
Answer: A
Question Status: Previous Edition

15) Lengthening of the average unemployment spell suggests that ________ unemployment is growing in importance.
A) frictional
B) structural
C) cyclical
D) turnover
Answer: B
Question Status: Previous Edition

16) Who among the following is NOT frictionally unemployed?
A) Andrew, a teenager who has just entered the labor market looking for his first part-time job
B) Barbara, who is re-entering the labor market after a divorce
C) Charles, who was laid off from his factory job but expects to be recalled in a few weeks
D) Diana, who has quit her job and is now looking for another
Answer: C
Question Status: Previous Edition

17) The typical cyclically unemployed person includes
A) Andrew, a teenager who has just entered the labor market looking for his first part-time job.
B) Barbara, who is re-entering the labor market after a divorce.
C) Charles, who was laid off from his factory job but expects to be recalled in a few weeks.
D) Diana, who has quit her job and is now looking for another.
Answer: C
Question Status: Previous Edition

10.10 The Costs of Persistently High Unemployment

1) If other things are constant, the longer the average unemployed worker searches before accepting a job
A) the lower will be the measured unemployment rate.
B) the higher will be the measured unemployment rate.
C) the lower will be the natural unemployment rate.
D) none of the above.
Answer: B
Question Status: Previous Edition

2) Mismatch and turnover unemployment, while conceptually easy to distinguish, are often difficult to identify. Ceteris paribus, a person out of work for two months would be classified by Gordon as
A) experiencing turnover unemployment.
B) experiencing mismatch unemployment.
C) impossible to distinguish the type.
D) first frictionally unemployed (the first month) and then structurally unemployed.
Answer: A
Question Status: Previous Edition

3) Mismatch and turnover unemployment, while conceptually easy to distinguish, are often difficult to identify. Ceteris paribus, a person out of work for six months or an extended period would be classified by Gordon as
A) experiencing turnover unemployment.
B) experiencing mismatch unemployment.
C) impossible to distinguish the type.
D) first frictionally unemployed (the first month) and then structurally unemployed.
Answer: B
Question Status: Previous Edition

4) In recent years new automobile factories have opened in California and Ohio and closed in

Detroit where the unemployment of automobile workers has increased. This unemployment could be decreased if
A) "moving costs" from Detroit to California and Ohio were reduced.
B) information about the new jobs was made available to the unemployed workers at reduced cost.
C) workers with the appropriate skills were relatively scarce in Ohio and California.
D) all of the above.
Answer: D
Question Status: Previous Edition

5) When mismatch unemployment characterizes an economy
A) monetary and fiscal policies to raise AD are the appropriate government action.
B) only monetary policy will be effective.
C) monetary and fiscal policies to raise AD are not the appropriate government action.
D) only general (not specific) fiscal policy will be effective.
Answer: C
Question Status: Previous Edition

6) It appears that many business firms discriminate against hiring young women of child bearing age in the United States and that this type of discrimination has been reduced in Europe. This may be an example of successful government intervention because
A) many European governments have laws against this type of discrimination.
B) many European governments subsidize maternity leave and child care, lowering the cost of hiring these women.
C) Europeans are less likely to discriminate on the basis of gender.
D) Europeans are more likely to discriminate on the basis of gender.
Answer: B
Question Status: Previous Edition

7) The payment of subsidies to firms who locate in high unemployment, depressed regions
A) is an example of a program to cure job discrimination.
B) is an example of a program to cure "mismatch unemployment."
C) has been universally successful in curing unemployment.
D) is "bribery" and against the law.
Answer: B
Question Status: Previous Edition

8) When the economy is near the natural unemployment rate, most adult males looking for work are experiencing ________ unemployment.
A) turnover
B) mismatch
C) cyclically
D) seasonally
Answer: B
Question Status: Previous Edition

9) Job search theory regards ________ unemployment as a socially valuable, productive investment undertaken by the job searcher.
A) structural
B) cyclical

C) mismatch
D) frictional
Answer: D
Question Status: Previous Edition

10) Frictional unemployment is reduced by ________ in the number of weeks one is eligible for unemployment compensation, and ________ in the price of gasoline.
A) an increase, an increase
B) an increase, a decrease
C) a decrease, an increase
D) a decrease, a decrease
Answer: C
Question Status: Previous Edition

11) Unemployment compensation, by ________ layoffs at firms whose sales have declined, ________ the natural rate of unemployment.
A) encouraging, raises
B) encouraging, lowers
C) discouraging, raises
D) discouraging, lowers
Answer: A
Question Status: Previous Edition

12) A one percent increase in the unemployment rate is statistically associated with ________ more deaths.
A) 37
B) 370
C) 3,700
D) 37,000
Answer: D
Question Status: Previous Edition

10.11 Conclusion: Solutions to the Inflation and Unemployment Dilemma

1) A major difference between the costs of unemployment and the costs of inflation is that
A) the former is structural the latter frictional.
B) the government pays the latter, the population pays the former.
C) unemployment costs are concentrated among a few people, while inflation costs are distributed more broadly across the entire population.
D) unemployment costs are distributed among people, while inflation costs are distributed more narrowly across the entire population.
Answer: C
Question Status: Previous Edition

2) A worker that quits her job
A) is always counted among the unemployed.
B) is never counted among the unemployed.
C) will be counted among the structurally unemployed.
D) may or may not be counted among the unemployed.
Answer: D

Question Status: Previous Edition

3) Holding the actual unemployment rate below the natural unemployment rate eventually causes the natural rate to fall toward the actual, according to the ________ hypothesis, implying that an aggressive stimulative demand policy causes a ________ acceleration of inflation.
A) hysteresis, temporary
B) hysteresis, permanent
C) structuralist, temporary
D) structuralist, permanent
Answer: A
Question Status: Previous Edition

4) Excessive unemployment benefits and government overregulation are part of the ________ hypothesis of why a nation's ________ unemployment rate can be high.
A) hysteresis, cyclical
B) hysteresis, natural
C) structuralist, cyclical
D) structuralist, natural
Answer: D
Question Status: Previous Edition

5) If there is a basic surplus but a positive total deficit, then
A) interest cost > basic surplus.
B) interest cost < basic surplus.
C) interest cost > positive total deficit.
D) interest cost < positive total deficit.
Answer: A
Question Status: Previous Edition

6) If there is a basic surplus and a negative total deficit, then
A) interest cost > basic surplus.
B) interest cost < basic surplus.
C) interest cost > positive total deficit.
D) interest cost < positive total deficit.
Answer: B
Question Status: Previous Edition

7) Which of the following countries successfully combated hyperinflation only to lapse back in to hyperinflation in 2002?
A) Brazil
B) Canada
C) Mexico
D) Argentina
Answer: D
Question Status: Previous Edition

8) In the famous allegorical work *The Wonderful Wizard of Oz*, the symbol for William Jennings Bryant (one-time leader of the free-silver movement) was the
A) Yellow brick road.
B) Scarecrow.
C) Lion.
D) dog named Toto.
Answer: C
Question Status: Previous Edition

9) According to Gordon, there is no pressing need for policies to reduce ________ unemployment.
A) cyclical
B) structural
C) turnover
D) mismatch
Answer: C
Question Status: Previous Edition

10) Gordon recommends that government macroeconomic policymakers focus on
A) reducing inflation to zero.
B) creating a national job finding service to reduce frictional unemployment to near zero.
C) creating "enterprise zones" to move jobs to areas of concentrated unemployment.
D) programs to match more closely the job skills of the unemployed to those of job vacancies.
Answer: D
Question Status: Previous Edition

11) During the Global Economic Crisis, the increase in the unemployment rate in Europe was
A) equal to that in the United States.
B) less than that in the United States.
C) greater than that in the United States.
D) impossible to compare given that Europe did not experience crises.
Answer: B
Question Status: New

12) During the Global Economic Crisis, low unemployment rate in Germany is attributed to the policy of
A) "work-sharing."
B) "money creation."
C) "99-ers."
D) "money powering."
Answer: A
Question Status: New

***Macroeconomics, 12e* (Gordon)**
Chapter 11 The Theory of Economic Growth

11.1 The Importance of Economic Growth

1) A growing government budget deficit and national debt reduces economic growth because
A) it insures that future generations will have to pay the debt.
B) it reduces public investment.
C) it reduces household saving.
D) it diverts private savings from the financing of private investment.
Answer: D
Question Status: Previous Edition

2) The principle of compound interest insures that
A) a small difference in the per capita GDP between countries in one year will grow to a large difference in the long run.
B) a small difference in the per capita GDP growth rate between countries in one year will grow to a large difference in the long run.
C) U.S. interests are compounded by the interests of Great Britain and Germany.
D) U.S. interests are compounded by the interests of all other countries.
Answer: A
Question Status: Previous Edition

3) Probably the best measure of a country's economic growth is the growth of
A) real domestic investment.
B) real GDP.
C) real GDP per person.
D) real consumption expenditures.
Answer: C
Question Status: Previous Edition

4) The one determinant of the growth of capital per person that can be affected by policy is the
A) depreciation rate.
B) saving rate.
C) money supply growth.
D) rate of technological change.
Answer: B
Question Status: Previous Edition

5) The theory of economic growth divides the causes of growth into

A) elements affecting the output ratio and factors affecting population growth.
B) elements affecting the output ratio and factors affecting inflation.
C) elements affecting the amount of factor inputs available and the productivity of those inputs.
D) None of the above.
Answer: C
Question Status: Previous Edition

6) Which of the following countries has had the fastest rate of economic growth since 1955?
A) United States
B) United Kingdom
C) Germany
D) Japan
Answer: D
Question Status: Previous Edition

11.2 Standards of Living as the Consequence of Economic Growth

1) When we study economic growth, we are most concerned about changes in
A) the output ratio.
B) the level of natural real output.
C) the absolute difference between natural and actual real output.
D) None of these.
Answer: B
Question Status: Previous Edition

2) When an equal percentage increase in the factors of production raises real GDP by the same percentage, the production function has the characteristic known as
A) constant returns to scale.
B) constant marginal productivity.
C) diminishing marginal productivity.
D) increasing returns to scale.
Answer: A
Question Status: Previous Edition

3) The level of capital per person would increase if
A) the average saving rate were higher.
B) the output-to-capital ratio increased.
C) the depreciation rate increased.
D) Both A and B.
Answer: D
Question Status: Previous Edition

11.3 The Production Function and Economic Growth

1) Economic growth is the result of two major or general "determinants":
A) capital and autonomous planned spending.
B) capital per capita and autonomous planned spending.
C) capital per capita and autonomous growth factors.
D) saving and autonomous growth factors.

Answer: C
Question Status: Previous Edition

2) The output-capital ratio (Y/K) depends on the following four determinants. Which determinant of these four is most likely to be affected by government growth policy?
A) the nature of the production function
B) the depreciation rate
C) the growth rate of labor input
D) the growth of capital per person
Answer: D
Question Status: Previous Edition

3) One of the main determinants of real GDP per person is the growth of capital per person. Which of the following variables does NOT determine the growth of capital per person in the long run?
A) average saving rate
B) output-to-capital ratio
C) marginal tax rate on investment
D) depreciation rate
Answer: A
Question Status: Previous Edition

4) The growth rate in the autonomous factor (a) in the production function can be directly influenced by all of the following EXCEPT
A) environmental legislation.
B) support for research and development.
C) subsidies for education.
D) initiation of tax indexation.
Answer: D
Question Status: Previous Edition

5) Net investment is
A) savings less replacement savings.
B) replacement investment.
C) investment net of savings.
D) total investment less replacement investment.
Answer: D
Question Status: Previous Edition

6) In equilibrium, rate of growth of capital in a simple closed economy (i.e., x = 0) is determined primarily by
A) the growth rate of savings.
B) the level of saving less expenditures for replacement capital.
C) per capita well-being.
D) the growth rate of replacement capital.
Answer: B
Question Status: Previous Edition

7) The general form of the production function used in Chapter 10 is
A) Y = A + F(K, N).
B) Y = A - F(K, N).
C) Y = AF(K, N).
D) Y = A/F(K, N).
Answer: C
Question Status: Previous Edition

8) The general form of the per-person production function used in Chapter 10 is
A) (Y/N) = A - f(N/K).
B) (Y/N) = A + f(N/K).
C) (Y/N) = A/f(K/N).
D) (Y/N) = Af(K/N).
Answer: D
Question Status: Previous Edition

9) The per-person production function in Chapter 10 assumes that a one percent rise in (K/N) causes a ________ rise in (Y/N), and so it is diagrammed as a ________ line.
A) less-than-one-percent, downward-curling
B) less-than-one-percent, upward-curling
C) one percent, upward-curling
D) one percent, downward-curling
E) more-than-one-percent, straight
Answer: A
Question Status: Previous Edition

10) Using the textbook's production function, an increase in A requires that one percent more labor working with ________ capital produces more ________.
A) an unchanged amount of, real GDP
B) an unchanged amount of, real GDP per labor input
C) one percent more, real GDP
D) one percent more, real GDP per labor input
Answer: D
Question Status: Previous Edition

11) Using the textbook's production function, if two percent more labor working with two percent more capital produces two percent more real GDP, then "multifactor productivity" has
A) risen by four percent.
B) risen by two percent.
C) remained unchanged.
D) fallen by one percent.
E) fallen by two percent.
Answer: C
Question Status: Previous Edition

12) An increase in government expenditures ________ "national saving" and thus tends to ________ private investment.
A) increases, increase
B) increases, decrease
C) decreases, increase
D) decreases, decrease
Answer: D
Question Status: Previous Edition

13) Private investment is equal to the net addition to the capital stock ________ the depreciation of that capital stock.
A) plus
B) minus
C) times
D) divided by
Answer: A
Question Status: Previous Edition

11.4 Solow's Theory of Economic Growth

1) Steady state growth will occur according to Robert Solow when
A) y = k.
B) y = n.
C) kn = y.
D) k = n.
Answer: D
Question Status: Previous Edition

2) Steady state growth will occur according to Robert Solow when
A) the growth rate of output equals the growth rate of capital.
B) the growth rate of output equals the growth rate of population.
C) the growth rate of output times the population growth rate equals the growth rate of capital.
D) the growth rate of capital equals the growth rate of the population.
Answer: D
Question Status: Previous Edition

3) Solow's theory of economic growth concludes, "the possibility of steady growth would be a miraculous stroke of luck" because
A) the three "determinants," s, (Y/K) and n are caused by different unrelated behavior.
B) s reflects temporal consumption preferences.
C) d reflects unrelated depreciation.
D) n reflects birth control decisions.
Answer: A
Question Status: Previous Edition

4) According to the Solow model of economic growth, if per capita savings, s (Y/N)0, exceeds required steady state investment, (n + d) K/N, then
A) per capita output declines.
B) capital per capita increases.
C) capital per capita decreases.
D) steady state growth characterizes the economy.
Answer: B
Question Status: Previous Edition

5) The application of Solow's growth theory to the explanation of the slowdown in productivity growth in the United States suggests that the slowdown is primarily caused by
A) reduced growth in the capital stock per hour of work.
B) reduced growth in the technical change or total factor productivity.
C) slow residual growth of the capital stock.
D) ignorance since people save and invest less.
Answer: B
Question Status: Previous Edition

6) "Given the long run implication of Solow's growth model with respect to the rate of savings, the low savings rate in the United States is not a problem." This statement overlooks that over time it appears that
A) total factor productivity and the growth rate of capital per person are positively related.
B) total factor productivity and the growth rate of capital per person are inversely related.
C) total factor productivity and the difference between the growth rates of capital per capita and population are not related a and k - n are not related.
D) savings rates and per capita growth rates are inversely related.
Answer: A
Question Status: Previous Edition

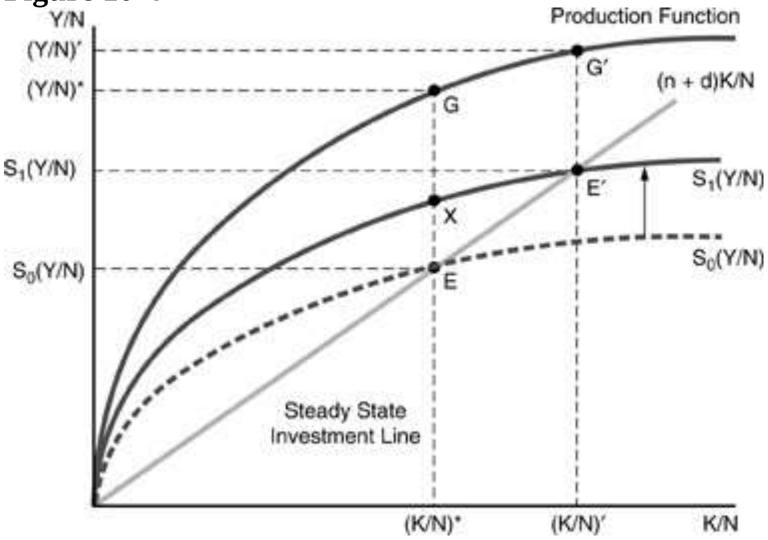
7) The investment required to maintain steady state growth
A) is impossible to achieve since capital for new workers requires continuous increases in s, the per capita savings ratio.
B) must equip new workers with capital equal to that employed by existing workers.
C) must replace "worn out" capital.
D) B and C.
Answer: D
Question Status: Previous Edition

8) Suppose that the government passes a law requiring households to increase savings 10% above previous levels. According to Solow's growth theory, in the short run
A) output per capita grows more rapidly.
B) output per capita grows at the constant steady state rate, n.
C) output per capita stays constant.
D) None of the above.
Answer: A
Question Status: Previous Edition

9) Suppose that the government passes a law requiring households to increase savings 10% above previous levels. According to Solow's growth theory, in the long run
A) output per capita grows more rapidly.

B) output per capita grows at the constant steady state rate, n.
C) output per capita stays constant.
D) None of the above.
Answer: B
Question Status: Previous Edition

Figure 10-4



10) Initially, the economy is at point G in Figure 10-4 above. An increase in per capita savings from s(0) to s(1) will in the short run result in ________ and in the long run result in ________.
A) excess per capita saving; more rapid growth in per capita output
B) excess per capita saving; less rapid growth in per capita output
C) more rapid growth in per capita output; more rapid growth in per capita output
D) more rapid growth in per capita output; no change in the long run rate of growth in per capita output
Answer: D
Question Status: Previous Edition

11) Initially, the economy is at point G in Figure 10-4 above. A change in per capita savings ________ will after complete adjustment ________.
A) point X to point E; lower the growth rate of output per capita
B) point X to point E; raise the growth rate of output per capita
C) point E to point X; raise output and saving but not the growth rate of output per capita
D) point E to point X; raise output and saving and the growth rate of output per capita
Answer: B
Question Status: Previous Edition

12) If the economy is characterized by constant returns to scale, then a
A) doubling of inputs will lead to a more than two-fold increase in output.
B) doubling of inputs will lead to a constant output.
C) doubling of inputs will lead to a two-fold increase in output.
D) doubling of inputs will lead to a less than two-fold increase in output.
Answer: C
Question Status: Previous Edition

13) Which of the following is NOT a real world factual conflict with the neoclassical growth model?
A) Income per capita varies greatly across countries.
B) Poor countries do not have a higher rate of return on capital.
C) Immigrant labor from poor countries experiences very small increases in income when it moves to rich countries.
D) Poor countries' income levels have not converged to the income levels of rich countries.
Answer: C
Question Status: Previous Edition

Use *b* as the exponent for physical capital, and *c* as the exponent for human capital. Assume that $b = 0.25$ and $c = 0.60$. Further assume that per person income of a rich country is 10 times that of a poor country.

14) Refer to the information above. What is the value of the exponent for uneducated labor (L)?
A) 0.75
B) 0.40
C) 0.35
D) 0.15
Answer: D
Question Status: Previous Edition

15) Refer to the information above. What is the approximate value of the multiple of combined physical and human capital that the rich country must have in order to produce 10 times the output per person of the poor country?
A) 1000
B) 100
C) 25
D) 15
Answer: D
Question Status: Previous Edition

Use *b* as the exponent for physical capital, and *c* as the exponent for human capital. Assume that $b = 0.25$ and $c = 0.65$. Further assume that per person income of a rich country is 10 times that of a poor country.

16) Refer to the information above. What is the value of the exponent for uneducated labor (L)?
A) 0.75
B) 0.35
C) 0.20
D) 0.10
Answer: D
Question Status: Previous Edition

17) Refer to the information above. What is the approximate value of the multiple of combined physical and human capital that the rich country must have in order to produce 10 times the output per person of the poor country?
A) 12
B) 25
C) 100
D) 1000
Answer: A
Question Status: Previous Edition

18) The introduction of human capital to the Solow neoclassical growth model reduces the significance of the contribution of ________ to increases in per capita income.
A) K
B) L
C) K and L
D) None of the above.
Answer: B
Question Status: Previous Edition

19) The introduction of human capital to the Solow neoclassical growth model ________ the predicted rate of return on investment in rich countries relative to poor countries.
A) increases
B) reduces
C) may either increase or reduce
D) has no effect on
Answer: B
Question Status: Previous Edition

20) Extensive growth is driven by
A) very high savings rates.
B) rapid capital accumulation.
C) improved multifactor productivity.
D) A and B.
E) all of the above.
Answer: D
Question Status: Previous Edition

21) In the graph of the Solow growth model, at any point to the right of the steady-state intersection we have national saving per person ________ than steady-state investment per person, causing (K/N) to ________.
A) greater, increase
B) greater, decrease
C) less, increase
D) less, decrease
Answer: D
Question Status: Previous Edition

22) In the Solow growth model, from an initial steady state with fixed values of A, d, and n, an increase in the national saving rate causes the standard of living to
A) rise temporarily, and then fall back to its initial level.
B) rise and then hold constant at a new higher level.
C) grow at a slower rate temporarily, and then return to the initial growth rate.
D) grow at a permanently faster rate.
E) not change at all in the short run or the long run.
Answer: B
Question Status: Previous Edition

23) From an initial steady state, suppose a government policy increases the national saving rate, causing the capital stock to start growing faster than the population. With (K/N) now rising, the Solow growth model goes on to say that (Y/N)
A) will rise only so far, to where the increased requirement for new capital matches the increased saving.
B) will rise only temporarily, so long as the population growth rate remains constant.
C) will rise and keep on rising, so long as the national saving rate exceeds the population growth rate.
D) never does rise, since the government's policy does not affect either the population growth rate or the depreciation rate.
Answer: A
Question Status: Previous Edition

24) In the Solow growth model, an increase in the marginal propensity to consume shifts the ________, with the implied change in the capital stock resulting in a ________ standard of living in the long run.
A) steady-state investment line upward, higher
B) steady-state investment line downward, higher
C) national saving line upward, lower
D) national saving line upward, higher
E) national saving line downward, lower
Answer: E
Question Status: Previous Edition

25) One of the shortcomings of the Solow growth model is that in it the rate of technological change is
A) assumed to be zero.
B) assumed to be equal to the population growth rate.
C) left unexplained.
D) zero unless the saving rate exceeds the depreciation rate.
Answer: C
Question Status: Previous Edition

26) The "nonconvergence" problem with the Solow growth model is that
A) a higher return to capital in poor countries should essentially cause all nations to have roughly the same standard of living, yet they clearly do not.
B) if a disturbance dislodges an economy from the steady-state point, it continues moving further from that point indefinitely.
C) technological change is assumed to just "drop from the sky."
D) a rise in the rate of national saving does not raise the growth rate of real GDP per person.
Answer: A
Question Status: Previous Edition

27) The new growth theory that arose in the late 1980s has been described as ________ because it treats technological change as ________.
A) exogenous, random unpredictable shocks
B) exogenous, generated by market incentives
C) endogenous, random unpredictable shocks
D) endogenous, generated by market incentives
Answer: D
Question Status: Previous Edition

28) Less-developed countries that nonetheless have access to the latest technologies must be suffering from a relative shortage of ________ according to the Solow growth model, implying a very ________ rate of return available on additions to capital in those countries.
A) capital, low
B) capital, high
C) labor, low
D) labor, high
Answer: B
Question Status: Previous Edition

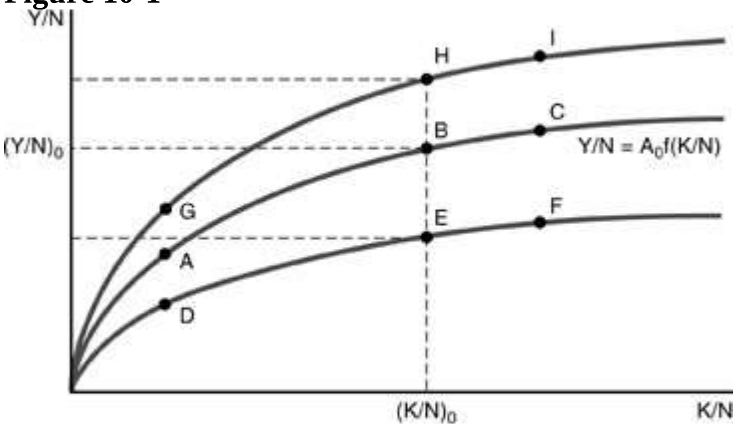
11.5 Technology in Theory and Practice

1) If technological change is "labor augmenting," then
A) output per worker declines, output per unit of capital increases.
B) "effective labor input" increases, output per unit of capital declines.
C) output per worker increases, output per unit of capital is constant.
D) Both output per worker and output per unit of capital change.
Answer: C
Question Status: Previous Edition
2) If technological change is "neutral," then
A) output per worker declines, output per unit of capital increases.
B) "effective labor input" increases, output per unit of capital declines.

C) output per worker increases, output per unit of capital is constant.
D) Both output per worker and output per unit of capital change.
Answer: D
Question Status: Previous Edition

3) Change in "total factor productivity" may be explained by
A) the relative rates of growth of crime and pollution control measures.
B) changes in the quality and composition of the labor force.
C) changes in the scale of production.
D) All of the above.
Answer: B
Question Status: Previous Edition

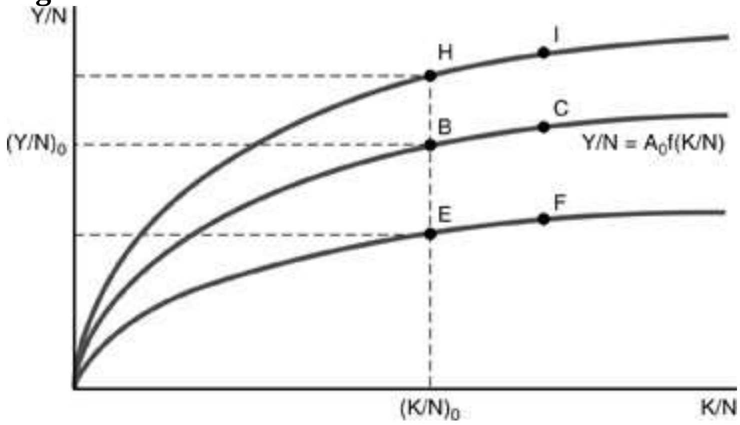
Figure 10-1



4) Initially, the economy is at point B on Figure 10-1 above. According to the Solow growth model, an increase in the output per capita without an increase in capital per worker is represented by ________ and could be the result of ________.
A) the movement B to E; new technology discoveries
B) the movement B to H; improved health and education per worker
C) the movement B to C; an increase in the savings rate
D) the movement B to F; a decrease in the savings rate
Answer: B
Question Status: Previous Edition

5) Initially, the economy is at point B on Figure 10-1 above. According to the Solow model of growth, in the short run, the discovery of a cold fusion process which reduces the cost of energy by 50%, ceteris paribus, will shift the economy from ________.
A) B to H, increasing per capita output without increasing capital per capita
B) B to C, increasing per capita output with increasing capital per capita
C) B to C, increasing per capita output without increasing savings
D) B to I, increasing output, saving and capital per capita
Answer: A
Question Status: Previous Edition

Figure 10-2

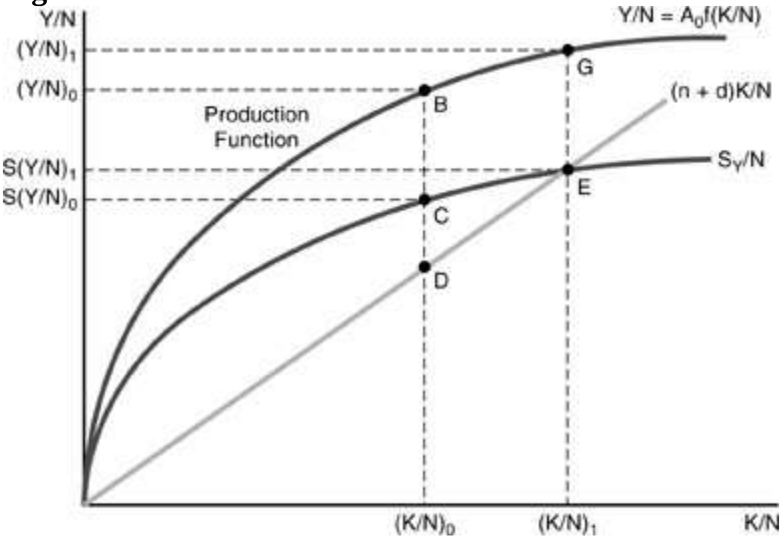


6) Initially, the economy is at point B on Figure 10-2 above. According to the Solow growth model, a dramatic decrease in the rate of saving after complete adjustment shifts the economy from ________.
A) B to H, increasing output per capita
B) B to C, increasing output and capital per capita
C) B to D, decreasing the output and capital per capita in the long run
D) B to E, decreasing output per capita but holding per capita capital constant
Answer: C
Question Status: Previous Edition

7) If the economy is characterized by diminishing or decreasing returns to scale, then a
A) doubling of inputs will lead to a constant output.
B) doubling of inputs will lead to a constant output.
C) doubling of inputs will lead to a two-fold increase in output.
D) doubling of inputs will lead to a less than two-fold increase in output.
Answer: D
Question Status: Previous Edition

8) If the economy is characterized by increasing returns to scale, then a
A) doubling of inputs will lead to a more than two-fold increase in output.
B) doubling of inputs will lead to a constant output.
C) doubling of inputs will lead to a two-fold increase in output.
D) doubling of inputs will lead to a less than two-fold increase in output.
Answer: A
Question Status: Previous Edition

Figure 10-3



9) Initially, the economy is at point B on Figure 10-3 above. We conclude that before adjustment,
A) per person savings is at point D and the level of steady state investment is at point C.
B) per person savings is at point E and the level of steady state investment is at point E.
C) per person savings is at point G and the level of steady state investment is at point E.
D) per person savings is at point C and steady state investment is at point D.
Answer: D
Question Status: Previous Edition

10) Initially, the economy is at point B in Figure 10-3 above. We may conclude that over time,
A) per person saving and steady state investment will remain stable at points C and D respectively.
B) per person capital will grow, point D to E since per capita savings exceed steady state investment, point C is greater than point D.
C) per person capital will grow, point D to E since per capita savings is less than steady state investment, point C is greater than point D.
D) per person saving and steady state investment will remain stable at points D and C respectively.
Answer: B
Question Status: Previous Edition

11) The economy will grow from points B to G in Figure 10-3 above over time because
A) per person saving and steady state investment will remain stable at points C and D respectively.
B) per person capital will grow, point D to E since per capita savings exceed steady state investment, point C is greater than point D.
C) per person capital will grow, point D to E since per capita savings is less than steady state investment, point C is greater than point D.
D) per person saving and steady state investment will remain stable at points D and C respectively.
Answer: B
Question Status: Previous Edition

12) Suppose that the capital stock initially is 1000, the depreciation rate is 0.08, and investment is 220. This makes the net growth of the capital stock
A) 300.
B) 237.6.
C) 202.4.
D) 140.
Answer: D
Question Status: Previous Edition

13) Suppose that the capital stock initially is 1000, the depreciation rate is 0.06, and net growth of the capital stock is 120. This makes investment equal to
A) 180.
B) 60.
C) 127.2.
D) 112.8
Answer: A
Question Status: Previous Edition

14) If K = 3000, n = 0.02, and d = 0.07, then investment of ________ will hold (K/N) constant.
A) 105
B) 150
C) 270
D) 420
Answer: C
Question Status: Previous Edition

15) If K = 3000, n = 0.015, and d = 0.082, then investment of ________ will hold (Y/N) constant.
A) 291
B) 201
C) 164
D) 549
Answer: A
Question Status: Previous Edition

16) Suppose s = 0.18, Y = 4000, K = 6200, n = 0.02, and d = 0.08. This makes national saving ________ than steady-state investment, so that the amount of capital per worker is

________.
A) greater, rising
B) greater, falling
C) less, rising
D) less, falling
Answer: A
Question Status: Previous Edition

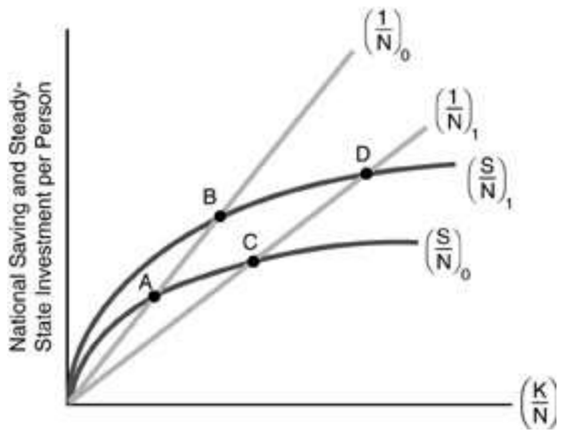
17) Suppose s = 0.14, Y = 4000, K = 6200, n = 0.02, and d = 0.08. In this case, national saving is ________ than steady-state investment, so that the amount of capital per worker is ________.
A) greater, rising
B) greater, falling
C) less, rising
D) less, falling
Answer: D
Question Status: Previous Edition

18) In the Solow growth model, given the values of A, s, n, and d, the economy has an equilibrium growth rate of real GDP per capita, (Y/N), equal to
A) n.
B) n - d.
C) s - n.
D) (s - d)/n.
E) zero.
Answer: E
Question Status: Previous Edition

19) In graphing the Solow growth model, the per-person production function is used to derive the ________ per-person line, with the vertical distance between them being ________ per person.
A) national saving, investment
B) national saving, consumption
C) steady-state investment, capital
D) steady-state investment, depreciation
E) steady-state investment, national saving
Answer: B
Question Status: Previous Edition

20) In the graph of the Solow growth model, at any point to the left of the steady-state intersection we have national saving per person ________ than steady-state investment per person, causing (K/N) to ________.
A) greater, increase
B) greater, decrease
C) less, increase
D) less, decrease
Answer: A
Question Status: Previous Edition

Figure 10-5



21) In Figure 10-5 above, suppose that the economy's steady-state point is C. At points to the left of this, steady-state investment ________ national saving, moving the economy ________ point C.
A) exceeds, further away from
B) exceeds, closer to
C) falls short of, further away from
D) falls short of, closer to
Answer: D
Question Status: Previous Edition

22) In Figure 10-5 above, suppose that the economy's initial steady-state point is A. An increase in the rate of national saving changes the steady-state point to
A) point B.
B) point C.
C) point D.
D) a point to the left of point A.
Answer: B
Question Status: Previous Edition

23) In Figure 10-5 above, suppose that new tougher environmental regulations require certain industries to accelerate their phase-out of some of their existing equipment and install new types that produce less pollution. Translating this into an effect on d causes a movement of the steady-state point such as from points
A) A to B.
B) D to B.
C) D to C.
D) A to C.
E) D to A.
Answer: B
Question Status: Previous Edition

24) In Figure 10-5 above, suppose that the population growth rate declines. This causes a movement of the steady-state point such as from points
A) A to B.
B) D to B.
C) D to C.
D) A to C.
E) A to D.
Answer: D
Question Status: Previous Edition

25) In Figure 10-5 above, suppose that the level of government expenditures increases. This causes a movement of the steady-state point such as from points
A) A to B.
B) D to B.
C) D to C.
D) A to C.
E) A to D.
Answer: C
Question Status: Previous Edition

26) In Figure 10-5 above, suppose that a "neutral" technological improvement occurs. This causes a movement of the steady-state point such as from points
A) A to B.
B) D to B.
C) D to C.
D) A to C.
E) A to D.
Answer: A
Question Status: Previous Edition

27) The most plausible way to produce a continuous increase in the standard of living within the Solow growth model is to assume
A) continuous technological improvement.
B) a positive rate of population growth.
C) a zero rate of depreciation.
D) continuous increases in the national saving rate.
E) continuous growth in the capital stock.
Answer: A
Question Status: Previous Edition

28) Suppose that we interpret N as the "effective" labor supply. A "labor-augmenting" technological improvement, when graphed in the Solow growth model, causes (Y/N) to ________ and real GDP per person to ________.
A) rise, rise
B) rise, fall
C) fall, rise
D) fall, fall
E) fall, remain unchanged
Answer: C
Question Status: Previous Edition

29) A rise in the multifactor productivity index means that at each (K/N) we have (Y/N) ________, which shifts the (S/N) curve ________, resulting in a movement of the steady-state intersection to the ________.
A) rising, downward, left
B) rising, upward, right
C) rising, downward, right
D) falling, upward, left
E) falling, downward, left
Answer: B
Question Status: Previous Edition

30) Studying the growth of (Y/N) in the United States over the period 1909-1957, Robert Solow found that growth in multifactor productivity accounted for ________ of it.
A) ten percent
B) twenty-five percent
C) one-third
D) roughly half
E) seven-eighths
Answer: E
Question Status: Previous Edition

11.6 Puzzles That Solow's Theory Cannot Explain

1) In the context of growth, the goal of stabilization policy once per capita output is equal to potential per capita output is to
A) insure that the percentage change in per capita output and potential per capita output over time are equal.
B) raise the growth rate of potential per capita output above that of per capita output.
C) raise the growth rate of per capita output above that of potential per capita output.
D) None of the above is correct.
Answer: A
Question Status: Previous Edition

2) Which of the following is NOT a reason for differences in per capita income in neoclassical growth theory?
A) All countries have the same production function.
B) Countries have different savings rates.
C) The slope of the steady-state investment line is different for different countries.
D) All of the above.
Answer: A
Question Status: Previous Edition

3) In the neoclassical growth theory
A) small differences in the saving rate or population growth cause large variations in per capita income.
B) large differences in the saving rate or population growth rate cause small variations in per capita income.
C) large differences in the saving rate or small differences in population growth cause large variations in per capita income.
D) small differences in the saving rate or large differences in population growth cause large variations in per capita income.
Answer: B
Question Status: Previous Edition

4) Given that all countries have the same Cobb-Douglas production function, i.e. $Y/N = (K/N)^b$, a ten-fold difference in per capita income requires a difference in capital per capita by a factor of
A) 10.
B) 10b.
C) $10^{1/b}$.
D) b.
Answer: C
Question Status: Previous Edition

5) Given that all countries have the same Cobb-Douglas production function, i.e. $Y/N = (K/N)^b$, where b = 0.5, then a ten-fold difference in per capita income requires a difference in capital per capita by a factor of
A) 10.
B) 100.
C) 1000.
D) 10,000.
Answer: B
Question Status: Previous Edition

6) In the real world, the K/Y ratio
A) is much higher in rich countries than in poor countries.
B) is much lower in rich countries than in poor countries.
C) is roughly equal across rich and poor countries.
D) cannot be properly compared except between countries of similar income levels.
Answer: C
Question Status: Previous Edition
7) In the neoclassical growth theory, differences in per capita income are determined by

differences in the
A) saving rate.
B) population growth rate.
C) depreciation rate.
D) all of the above.
Answer: D
Question Status: Previous Edition

8) The slope of the per person production function is
A) the marginal product of labor.
B) the marginal product of capital.
C) lower for a poor country than for a rich country.
D) higher for a rich country than for a poor country.
Answer: B
Question Status: Previous Edition

9) The neoclassical growth theory implies that
A) the marginal product of capital is low in poor countries.
B) the rate of return on capital is low in poor countries.
C) there should be large flows of capital from rich countries to poor countries.
D) all of the above.
Answer: C
Question Status: Previous Edition

10) Using a Cobb-Douglas production function, $Y/N = (K/N)^{b}$, the marginal product of capital is
A) $b(K/N)^{b-1}$.
B) b(K/N).
C) $(K/N)^{b-1}$.
D) (K/Y)b.
Answer: A
Question Status: Previous Edition

11) The rate of return on capital is
A) much higher in rich countries than in poor countries.
B) much lower in rich countries than in poor countries.
C) not substantially higher in poor countries than in rich countries.
D) not substantially higher in rich countries that in poor countries.
Answer: C
Question Status: Previous Edition

12) Which of the following "factors of production" is included in the neoclassical growth theory?
A) skills and education of the workforce
B) cultural attitudes toward work
C) effectiveness of the legal system in protecting property rights
D) labor measured in units of effective labor
E) all of the above
Answer: D
Question Status: Previous Edition

13) The neoclassical model predicts that nations that are initially poor should have
A) slower growth rates than nations that are rich.
B) faster growth rates than nations that are rich.
C) growth rates equal to those of nations that are rich.
D) negative growth rates.
Answer: B
Question Status: Previous Edition

14) Which of the following are NOT examples of "convergence"?
A) Japan and Europe
B) Individual states within the United States
C) regions within western Europe
D) major nations in Latin America and Western Europe
Answer: D
Question Status: Previous Edition

15) In the context of the neoclassical growth model, which of the following does NOT explain the growth rates of countries which are initially poor?
A) nations which are below their steady-state growth paths will grow more slowly until they reach the steady state
B) the rate of return is higher in poor countries
C) capital flows from rich countries to poor countries
D) the passage of time allows poor countries to adopt the productive techniques of rich countries.
Answer: A
Question Status: Previous Edition

16) The per person production function representing both physical capital per person (K/N) and human capital per person (H/N) is
A) $Y/N = (K/N)^b(H/N)^c$.
B) $Y/N = (K/N)^b + (H/N)^c$.
C) $Y/N = (K/N)^b - (H/N)^c$.
D) $Y/N = (K/N)^b/(H/N)^c$.
Answer: A
Question Status: Previous Edition

17) The most surprising outcome of the Solow growth model is that
A) the population growth rate has no effect on the standard of living.
B) the capital-labor ratio has no effect on the output-labor ratio.
C) a higher rate of national saving does not lead to a permanently higher rate of output growth.
D) a higher rate of depreciation lowers the capital-labor ratio, but not the output-labor ratio.
Answer: C
Question Status: Previous Edition

18) In the Solow growth model, given the values of A, s, n, and d, the economy has an equilibrium growth rate of real GDP equal to
A) s.
B) n.
C) n + d.
D) n - d.
E) s - d.
Answer: B
Question Status: Previous Edition

11.7 Human Capital, Immigration, and the Solow Puzzles

1) According to Robert E. Hall and Charles Jones, successful economic performance requires
A) a favorable infrastructure of rules and institutions.
B) minimizing corruption and criminality.
C) the use of one of the eight major international languages.
D) A and B.
E) all of the above.
Answer: E
Question Status: Previous Edition

2) The current slowdown in productivity growth afflicting most of the industrialized countries is commonly thought to have begun around
A) 1897.
B) 1929.
C) 1948.
D) 1973.
E) 1984.
Answer: D
Question Status: Previous Edition

3) Since 1973, the average annual growth rate of real GDP per person in the United States has been slower than the average annual growth rate in
A) Germany and Canada.
B) France and Italy.
C) Japan and United Kingdom.
D) France and Canada.
Answer: C
Question Status: New
4) The variable used by economists as the best broad indicator of a nation's standard of living is

A) real GDP per person.
B) real GDP.
C) the capital-labor ratio.
D) the capital-output ratio.
E) multifactor productivity.
Answer: A
Question Status: Previous Edition

5) In Chapter 10, the variable N can be regarded as total population, workers, work-hours, or "effective" work-hours, all proxies for each other if they are assumed to grow at the same rate. To define (Y/N) as the standard of living, N is particularly regarded as
A) total population.
B) workers.
C) work-hours.
D) "effective" work-hours.
Answer: A
Question Status: Previous Edition

A convenient rule of thumb called the "rule of 72" states that a quantity growing at x percent per year doubles in size approximately every (72/x) years.

6) Refer to the information above. An economy's real GDP per person doubles every 18 years when it maintains a growth rate of ________ per year.
A) 5.6 percent
B) 4.0 percent
C) 0.25 percent
D) 0.9 percent
Answer: B
Question Status: Previous Edition

7) Refer to the information above. If an economy has a real GDP doubling-time of 48 years, this can be reduced to 30 years if annual GDP growth is raised by ________ percentage points.
A) 4
B) 2.4
C) 1.6
D) 0.9
Answer: D
Question Status: Previous Edition

8) Refer to the information above. If an economy can raise its annual real GDP growth rate from 1.8 percent to 2.4 percent, its real GDP doubling time is reduced by ________ years.
A) 30
B) 24
C) 10
D) 43.2
Answer: C
Question Status: Previous Edition

11.8 Endogenous Growth Theory: How Is Technological Change Produced?

1) Economic growth theory studies how real GDP changes ________, in other words the growth of ________ real GDP.
A) on average over long periods, natural
B) on average over long periods, actual
C) from one year to the next, natural
D) from one year to the next, actual
Answer: A
Question Status: Previous Edition

2) If it is assumed that capital is alike and freely mobile between economies, the Solow growth model
A) has no need of the recent attempts at improving it.
B) suffers from the "exogeneity" problem.
C) suffers from the "non-convergence" problem.
D) suffers from the "incentives" problem.
Answer: C
Question Status: Previous Edition

3) The new endogenous growth theory concludes that sustained economic growth in a country comes from the interaction of labor, investments in physical and human capital, and what is perhaps the key ingredient:
A) natural resources.
B) the production of ideas.
C) post-secondary education within that country.
D) immigration into that country.
Answer: B
Question Status: Previous Edition

4) The crucial incentive to produce new ideas comes from
A) patents and copyrights.
B) international trade.
C) rising population growth.
D) shortages of physical and human capital.
E) government economic guidance.
Answer: A
Question Status: Previous Edition
5) Which of the following is NOT statistically correlated with higher economic growth rates?
A) higher rates of private investment spending
B) higher rates of government investment spending

C) greater political stability
D) higher fertility rates
E) higher school enrollment rates
Answer: D
Question Status: Previous Edition

11.9 Conclusion: Are There Secrets of Growth?

1) In Chapter 11, the production function variable A has been given several different names. Which of the following is NOT one of them?
A) autonomous growth factor
B) infrastructure
C) multifactor productivity
D) residual
Answer: B
Question Status: Previous Edition

2) In Chapter 11, depreciation is assumed to be
A) a fixed proportion of real GDP.
B) a fixed proportion of the capital stock.
C) a fixed absolute amount.
D) zero.
E) a fixed proportion of the capital-labor ratio.
Answer: B
Question Status: Previous Edition

Appendix to Chapter 11: General Functional Forms and the Production Function

1) There are no questions for this section.
Answer:

***Macroeconomics, 12e* (Gordon)**
Chapter 12 The Big Questions of Economic Growth

12.1 Answering the Big Questions

1) The so-called "Four Tigers" do NOT include
A) Japan.
B) Hong Kong.
C) Taiwan.
D) Singapore.
Answer: A
Question Status: Previous Edition

12.2 The Standard of Living and Concepts of Productivity

1) For the past 30 years, labor's share of national income ________ while labor productivity ________.
A) fell dramatically, increased
B) remained roughly constant, dropped

C) remained roughly constant, increased
D) increased modestly, dropped
Answer: B
Question Status: Previous Edition

2) The formula for the growth rate of multifactor productivity is
A) a = y + bk + (1 - b)n.
B) y = a + bk + bn.
C) a = y - bk - (1 - b)n.
D) y = a - b/k(1 - b)n.
Answer: C
Question Status: Previous Edition

3) In the formula used to measure the growth rate of multifactor productivity, the contribution of labor is represented by
A) bn.
B) bk - bn.
C) y - bk.
D) (1 - b)n.
Answer: D
Question Status: Previous Edition

4) In the formula for calculating the growth rate of multifactor productivity, the growth rate of labor productivity is represented by
A) y - n.
B) b(k - n).
C) bk/n.
D) b - n.
Answer: A
Question Status: Previous Edition

5) What is the growth rate of multifactor productivity if b = 0.20, k = 3, n = 1, and y = 4?
A) 1.0
B) 0.4
C) 2.4
D) 2.8
Answer: D
Question Status: Previous Edition

6) If the growth rate of multifactor productivity is 2.5, and b = 0.25, k = 4, n = 2, and y = 5, then the growth rate of labor productivity is
A) 3.0.
B) 8.0.
C) 2.0.
D) 2.5.
Answer: A
Question Status: Previous Edition

7) If the growth rate of multifactor productivity is 1.775, b = 0.15, n = 1, and y = 3, then the growth rate of capital is
A) 1.225.
B) 1.45.
C) 4.0.
D) 2.5.
Answer: D
Question Status: Previous Edition

8) If W is the nominal wage rate, N is the quantity of labor, P is the price level, and Y is real income, then labor's share in national income is
A) WN - PY.
B) WP/YN.
C) WN/PY.
D) PY - WN.
Answer: C
Question Status: Previous Edition

9) What ratio defines the standard of living?
A) (Y/N)
B) (Y/K)
C) (Y/A)
D) (Y/Q)
Answer: D
Question Status: Previous Edition

10) Which of the following is the growth rate of the standard of living?
A) y - q
B) y - n
C) y - a
D) y - b
Answer: A
Question Status: Previous Edition

11) The standard of living rises at a slower pace than labor productivity if
A) n = q.
B) n < q.
C) n > q.
D) The standard of living is not affected by the relative size of n and q.
Answer: B
Question Status: Previous Edition

12) The standard of living rises at a faster pace than labor productivity if
A) n = q.
B) n < q.
C) n > q.
D) The standard of living is not affected by the relative size of n and q.
Answer: C
Question Status: Previous Edition

13) The production function $Y = AK^{b}N^{1-b}$ written in terms of growth rates is
A) y = a - bk - (1 - b)n.
B) y = a + bk + (1 - b)n.
C) y = a - bk + (1 - b)n.
D) y = a + bk - (1 +b)n.
Answer: B
Question Status: Previous Edition

14) Which of the following is the formula for the growth rate of multifactor productivity written so that the first term in the equation represents the growth rate of labor productivity?
A) y + bk + (1 - b)n
B) y = a + bk + (1 - b)n
C) a = y - bk - (1 - b)n
D) a = (y - n) - b(k - n)
Answer: D
Question Status: Previous Edition

15) In the production function Y = A(G,P,T) F(K,R,H,N), the exogenous factors are
A) G,R,H.
B) G,P,T.
C) P,T,K.
D) P,R,G.
Answer: C
Question Status: Previous Edition

16) In the production function Y = A(G,P,T) F(K,R,H,N), the factors that affect the entire production process are
A) G,R,H.
B) G,P,T.
C) P,T,K.
D) KRHN.
Answer: B
Question Status: Previous Edition

17) Gordon notes that along with slow labor productivity growth in the period 1973-1995, real wages also grew slowly. What sort of productivity shocks are consistent with this explanation of the link between real wage growth and the growth of labor productivity?
A) productivity shocks which decrease supply of labor given the demand for labor
B) productivity shocks which increase supply of labor given the demand for labor
C) productivity shocks which increase demand for labor given the supply of labor
D) productivity shocks which decrease demand for labor given the supply of labor
Answer: D
Question Status: Previous Edition

18) What sort of productivity shocks would cause lower real wage growth and result in lower growth in labor productivity?
A) productivity shocks which decrease supply of labor given the demand for labor
B) productivity shocks which increase supply of labor given the demand for labor
C) productivity shocks which increase demand for labor given the supply of labor
D) productivity shocks which decrease demand for labor given the supply of labor
Answer: B
Question Status: Previous Edition

19) To what phenomenon does "Solow's Paradox" refer?
A) the failure of the Solow growth model to incorporate endogenous growth variables
B) the absence of any measured effect of new computer technology on productivity statistics.
C) the absence of any long term effect of saving on economic growth rates in the Solow growth model
D) the failure of the Solow growth model to predict non-convergence of poor countries
Answer: B
Question Status: Previous Edition

12.3 The Failure of Convergence

1) Which of the following countries had an economic growth rate equal to zero between 1960 and 2004?
A) South Africa
B) Philippines
C) South Korea
D) Kenya
Answer: D
Question Status: New

2) If labor's share of national income is to remain constant, then ________.
A) the real wage must grow faster than labor productivity
B) the real wage must grow at the same rate as labor productivity
C) labor productivity must grow faster than the real wage
D) the combined growth rates of labor productivity and the real wage must equal the growth rate of national income
Answer: B
Question Status: Previous Edition

3) Which of the following are NOT examples of "convergence"?
A) Japan and Europe
B) individual states within the United States
C) regions within western Europe
D) major nations in Latin America and Western Europe
Answer: D
Question Status: Previous Edition

4) Which of the following is a method by which a poor country might import technological change without having to incur the heavy expense of research and development (not to mention human and physical capital formation) out of its own saving?
A) Copy modern products made in rich countries.
B) Purchase imported machinery that embodies the latest technology.
C) Obtain investment by foreign firms.
D) All of the above.
Answer: D
Question Status: Previous Edition

5) Which of the following methods of importing technological change is available to a poor country which Gordon describes as being caught in the "poverty trap"?
A) Copy modern products made in rich countries.

B) Purchase imported machinery that embodies the latest technology.
C) Obtain investment by foreign firms.
D) None of the above.
Answer: D
Question Status: Previous Edition

12.4 Human Capital and Technology

1) Labor's share of national income is equal to ________.
A) 1 - b
B) WN/PY
C) (W/P)/(Y/N)
D) All of the above
Answer: D
Question Status: Previous Edition

2) If w is the growth rate of the nominal wage rate, p is the inflation rate as measured by the price deflator for total GDP, y is the growth rate for total domestic product, and n is the growth rate of labor, then the growth of real wage is ________.
A) wp/n
B) y - p
C) w - p
D) wn/p
Answer: C
Question Status: Previous Edition

3) A decrease in labor productivity and the real wage could be caused by
A) a decrease in demand for labor or an increase in the supply of labor.
B) a decrease in the demand for labor or a decrease in the supply of labor.
C) an increase in the demand for or supply of labor.
D) an increase in the demand for labor or a decrease in the supply of labor.
Answer: A
Question Status: Previous Edition

4) Which of the following is NOT the cause of an adverse productivity shock to the labor market?
A) a decline in the quantity of non-labor factors of production
B) a drop in multifactor productivity
C) a decrease in the labor force
D) none of the above
Answer: C
Question Status: Previous Edition

5) A feedback from low real wages to low productivity could be caused by
A) an increase in the labor force caused by more immigration.
B) a reduction in the power of labor unions.
C) a reduction in the real minimum wage.
D) increased worker anxiety about job security.
E) all of the above.
Answer: E
Question Status: Previous Edition

6) If the supply of labor increases while demand for labor is unchanged,
A) the real wage and labor productivity will increase.
B) the real wage will decrease and labor productivity will increase.
C) the real wage will increase and labor productivity will decrease.
D) the real wage and labor productivity will decrease.
Answer: D
Question Status: Previous Edition

7) Which of the following will cause slower growth in labor productivity?
A) decreased growth in physical capital
B) decreased growth in human capital such as education and training
C) decreased growth in government-financed infrastructure such as highways and airports
D) A and C
E) all of the above
Answer: E
Question Status: Previous Edition

8) Which of the following is NOT one of the potential sources of lower growth in productivity cited by Gordon?
A) falling productivity in the public utilities industry
B) wasted resources in the construction of unnecessary infrastructure
C) increases in energy prices
D) a decrease in growth of the capital stock
Answer: B
Question Status: Previous Edition

9) Gordon notes that the average growth rate of labor productivity between 1996 and 2004 was ________ percent, and the average reached ________ percent in 2003-04.
A) 3; 3.5
B) 2; 205
C) 1.7; 3.2
D) 2; 1.5
Answer: A
Question Status: Previous Edition

10) The period between ________ is commonly regarded by economists as a "golden age" of rapid productivity growth in the United States.
A) 1898 and 1929
B) 1920 and 1940
C) 1933 and 1965
D) 1948 and 1973
Answer: D
Question Status: Previous Edition

11) After 1979 there was an upsurge in labor productivity growth in the U.S. ________ sector, mainly coming from the ________ industry.
A) manufacturing, computer
B) manufacturing, machine tool
C) nonmanufacturing, edible oil
D) nonmanufacturing, financial services
E) nonmanufacturing, book publishing
Answer: A
Question Status: Previous Edition

12) What is the ratio that defines labor productivity?
A) (Y/N)
B) (Y/Q)
C) (Y/A)
D) (Y/K)
Answer: A
Question Status: Previous Edition

13) Which the following is NOT an *exogenous* factor affecting economic growth that countries caught in a "poverty trap" might utilize to encourage economic growth?
A) human capital
B) political capital
C) infrastructure
D) geographical location
Answer: A
Question Status: Previous Edition

14) How does Gordon integrate the exogenous factors affecting economic growth into the production function for an economy?
A) Y = A(G,R,H) F(K,P,T,N)
B) Y = A(G,P,T) F(K,R,H,N)
C) Y = A(G,P,T,R) F(K,H,N)
D) Y = A(P,T,K) F(G,R,H,N)
Answer: B
Question Status: Previous Edition

12.5 Political Capital, Infrastructure, and Geography

1) The simplest calculation of the growth rate of multifactor productivity starts with the growth rate of real GDP and then
A) subtracts the growth rate of labor.
B) subtracts the growth rate of capital.
C) subtracts the growth rate of labor and some fraction of the growth rate of the capital-labor ratio.
D) adds the growth rate of labor and then subtracts the depreciation and population growth rates.
Answer: C
Question Status: Previous Edition

2) In calculating multifactor productivity growth, the elasticity of output to changes in capital (given as "b" in the textbook) is assumed to be
A) one minus the population growth rate.
B) the depreciation rate.
C) the share of capital income in GDP.
Answer: C
Question Status: Previous Edition

3) What type of economic conditions are summarized by the variable a?
A) conditions other than changes in capital and labor that change productivity
B) urbanization
C) governmental regulations
D) All of the above
Answer: D
Question Status: Previous Edition

4) What type of economic conditions are summarized by the variable a?
A) changes in labor productivity
B) changes in capital productivity
C) technological change
D) All of the above
Answer: C
Question Status: Previous Edition

5) MFP growth represented by a will be lower than the growth of labor productivity if
A) $k > n$.
B) $k < n$.
C) $k = n$.
D) None of the above. The relative size of k and n do not affect MFP growth.
Answer: A
Question Status: Previous Edition

6) MFP growth represented by a will be higher than the growth of labor productivity if
A) k > n.
B) k < n.
C) k = n.
D) None of the above. The relative size of k and n do not affect MFP growth.
Answer: B
Question Status: Previous Edition

7) If 1 - b = WN/PY where W is the nominal wage rate, N is the quantity of labor input, and PY is total income in nominal terms, then labor's share of national income grows if
A) (w - p) > (y - n).
B) (w - p) < (y - n).
C) (w - n) > (y - p).
D) (w - n) < (y - p).
Answer: A
Question Status: Previous Edition

8) If 1 - b = WN/PY where W is the nominal wage rate, N is the quantity of labor input, and PY is total income in nominal terms, then labor's share of national income shrinks if
A) (w - p) > (y - n).
B) (w - p) < (y - n).
C) (w - n) > (y - p).
D) (w - n) < (y - p).
Answer: B
Question Status: Previous Edition

9) Which of the following would cause labor's share of national income to increase?
A) Labor productivity increases *less rapidly than* the real wage rate.
B) Labor productivity increases *more rapidly than* the real wage rate.
C) Labor productivity has increased *at the same rate as* the real wage rate.
D) Labor's share of national income is not affected by the relative growth rates of labor productivity and the real wage rate.
Answer: B
Question Status: Previous Edition

10) Which of the following would cause labor's share of national income to decrease?
A) labor productivity increases *less rapidly than* the real wage rate.
B) labor productivity increases *more rapidly than* the real wage rate.
C) labor productivity has increased *at the same rate as* the real wage rate.
D) labor's share of national income is not affected by the relative growth rates of labor productivity and the real wage rate.
Answer: A
Question Status: Previous Edition

12.6 Case Study: Uneven U.S. Productivity Growth Across Eras

1) According to Gordon, which of the following is NOT a plausible explanation for a decrease in the measured growth of capital per worker in the United States after 1973?
A) higher inflation causes overtaxation and discourages saving
B) increased labor force participation by women
C) slower growth in the capital stock
D) lower real wages in response to supply shocks in the 1970s
Answer: A
Question Status: Previous Edition

2) William Nordhaus' depletion hypothesis
A) is an attempt to explain the drop in the multifactor productivity growth rate between 1913 and 1964.
B) suggests that depletion of natural resources may explain part of the drop in multifactor productivity growth.
C) suggests that a drop in the rate at which new inventions are made may explain part of the drop in multifactor productivity.
D) B and C
E) all of the above
Answer: D
Question Status: Previous Edition

3) Productivity growth slowed rapidly after 1973. Bruno and Sachs argue that the slowdown is partially explained by
A) reduced growth in capital per capita since increasing numbers of women entered the labor force.
B) the reduction in savings rates caused by inflation and the U.S. tax system.
C) the "residual" nature of technological change.
D) the rapid increase in the relative price of energy.
Answer: D
Question Status: Previous Edition

4) The slowdown in labor productivity growth from 1973 to 1995 ________ matched by a similar slowdown in MFP growth, suggesting that the growth rate of capital had ________ to do with the productivity problem.
A) was, much
B) was, little
C) was not, much
D) was not, little
Answer: B
Question Status: Previous Edition

5) Dating the start of falling labor productivity growth in 1973 is very suggestive of this explanation for it: ________ energy prices and ________ use of energy per worker.
A) higher, decreased
B) higher, increased
C) lower, decreased
D) lower, increased
Answer: A
Question Status: Previous Edition

6) There is some evidence that demographic changes in the composition of the workforce are ________ the growth rate of labor quality, and thus ________ the growth rate of output per labor hour.
A) raising, decreasing
B) raising, increasing
C) lowering, decreasing
D) lowering, increasing
Answer: C
Question Status: Previous Edition

7) Between 1973 and 1995, what changes occurred in the labor force and the capital stock that caused a productivity slowdown?
A) The growth of the capital stock and the growth of labor hours increased.
B) The growth of the capital stock and the growth of labor hours slowed.
C) The growth of the capital increased slowed and the growth of labor hours slowed.
D) The growth of the capital stock slowed and the growth of labor hours increased.
Answer: D
Question Status: Previous Edition

12.7 Case Study: The Productivity Growth Contrast Between Europe and the United States

1) Some economists believe that the behavior of unemployment in Europe and in the United States during the 1980s and 1990s
A) was the same because both markets experienced adverse labor market shocks.
B) differed because the real wage in Europe was rigid.
C) was the same because the real wage in Europe and the United States moved together.
D) differed because the United States experienced adverse labor market shocks but Europe did not.
Answer: B
Question Status: Previous Edition

2) Relative to the United States, Europe has
A) caught up in output per capita.
B) caught up in growth of labor productivity.
C) faster job growth.
D) all of the above.
Answer: B
Question Status: Previous Edition
3) Relative to the United States, Europe has
A) higher unemployment.
B) slower job growth.

C) higher real wage growth.
D) A and B.
E) all of the above.
Answer: E
Question Status: Previous Edition

4) Relative growth rates of the standard of living in the United States and Europe indicate that workers in ________ have chosen to "spend" ________ of their higher productivity on leisure rather than on consumption of market goods and services.
A) Europe, a significant part
B) the United States, a significant part
C) Europe, almost none
D) the United States, almost all
Answer: A
Question Status: Previous Edition

5) Comparison of the European and U.S. labor markets suggests that
A) it is relatively cheap to hire workers in the United States.
B) the U.S. labor market is more "flexible" than the European labor market.
C) job security and income equality are greater in the European labor market.
D) A and B.
E) all of the above.
Answer: E
Question Status: Previous Edition

6) By comparison to U.S. labor market policies, European labor market policies promote
A) greater unemployment and job security.
B) slower real wage growth and greater income inequality.
C) greater job opportunities for low-skill workers and greater bargaining power for workers.
D) higher real minimum wages and slower real wage growth.
Answer: A
Question Status: Previous Edition

7) The labor supply shock hypothesis suggests that
A) the United States and Europe are following similar labor market policies.
B) there is a one-way causation from labor productivity to real wage growth.
C) slow real wage growth and slow productivity growth are simultaneously determined by the labor market system.
D) B and C.
E) none of the above.
Answer: C
Question Status: Previous Edition

8) The U.S. record is superior to that of Europe in ________.
A) growth in real productivity.
B) real wage growth
C) growth in employment
D) All of the above
Answer: C
Question Status: Previous Edition

9) The relative flexibility of the United States labor market explains why ________ in the United States than in Europe.
A) income inequality is greater
B) real wages grow more slowly
C) unemployment is lower
D) all of the above
Answer: D
Question Status: Previous Edition

10) Which of the following did NOT contribute to the European experience of the past few decades where the stand of living rose more slowly than labor productivity?
A) longer vacations
B) higher unemployment
C) higher participation rates
D) All of the above
Answer: C
Question Status: Previous Edition

12.8 Conclusion on the Great Questions of Growth

1) Which of the following policies have been suggested as ways to boost the growth of productivity?
A) tax cuts to boost saving and investment
B) reducing the budget deficit by raising taxes and cutting expenditures
C) increasing public investment in education
D) redesigning and scaling back the regulatory apparatus of the federal government
E) all of the above
Answer: E
Question Status: Previous Edition

2) The Solow model predicts that the standard of living in poorer nations will converge on that of richer nations through rapid capital formation that raises output per person. The introduction of technological change to the model ________ change this prediction because technology ________ assumed to be freely available to all countries.
A) does, is
B) does, is not
C) does not, is not
D) does not, is
Answer: D
Question Status: Previous Edition

3) The key prediction of the Solow model adapted to include technological change ________ been born out, i.e. with a few exceptions convergence ________ a reality.
A) has not, is not
B) has not, is
C) has, is not
D) has, is
Answer: A
Question Status: Previous Edition

4) One of the shortcomings of the Solow model is that it
A) treats technological change as freely available to all countries.
B) does not treat technological change as freely available to all countries.
C) treats technological change as an endogenous variable.
D) treats technological change as the only source of economic growth.
Answer: A
Question Status: Previous Edition

5) The idea of a "New Economy" driven by hi-tech equipment such as computers, cell phones, and the World Wide Web was rooted in part in the apparent simultaneous reversal of which of the following economic problems?
A) inflation
B) slow growth in productivity
C) the budget deficit
D) All of the above
Answer: D
Question Status: Previous Edition

6) Which of the following is NOT one of the economic problems that the "New Economy" is alleged to have solved?
A) deflation
B) slow growth in productivity
C) the budget deficit
D) business cycle
Answer: A
Question Status: Previous Edition

7) Which of the following was given as a reason to doubt the idea of "New Economy"?
A) High growth in computer investment could not be sustained.
B) Actual real GDP could not continue to grow slower than natural real GDP growth.

C) Inflation could not be reduced by a higher productivity growth rate.
D) All of the above.
Answer: A
Question Status: Previous Edition

8) Which of the following supports the skeptics doubts about the idea that a "New Economy" had emerged in the late 1990s?
A) In early 2000, investment in computer equipment turned to negative growth.
B) A drop in productivity growth in 2001 was followed by a bounce-back of productivity growth in early 2002.
C) The opinion of Alan Greenspan, Chairman of the Federal Reserve System, concerning the pace at which technological innovations are being applied
D) None of the above.
Answer: A
Question Status: Previous Edition

***Macroeconomics, 12e* (Gordon)**
Chapter 13 Money, Banks, and the Federal Reserve

13.1 Money as a Tool of Stabilization Policy

1) The issuance of new stocks or bonds are examples of
A) indirect finance.
B) direct finance.
C) financial intermediation.
D) All of the above.
Answer: B
Question Status: Previous Edition

2) As an individual, you cannot participate in the financial markets to issue new stock or sell new bonds because
A) it is too costly for individual savers to research your credit worthiness.
B) you have a bad reputation.
C) your good reputation is insufficient to convince savers.
D) your bank has foreclosed on your automobile loan.
Answer: A
Question Status: Previous Edition

3) A policy of maintaining a fixed interest rate will have the greatest stabilizing effect on output when money demand is
A) stable.
B) unstable and commodity demand is unstable.
C) stable and commodity demand is unstable.
D) unstable and commodity demand is stable.
Answer: D
Question Status: Previous Edition

4) A fixed money-supply rule will have the greatest stabilizing effect on output when
A) money demand is unstable and commodity demand is stable.
B) both money and commodity demand are unstable.

C) both money demand and commodity demand are stable.
D) the velocity of money is unstable.
Answer: C
Question Status: Previous Edition

5) Which of the following was NOT part of the financial deregulation of the 1970s and 1980s?
A) Banks could pay interest on checking accounts.
B) Banks could issue checkbooks for savings accounts.
C) Institutions other than banks could offer money-market mutual funds, from which checks could be written.
D) All of the above were part of the deregulation.
Answer: D
Question Status: Previous Edition

6) The quantity equation makes the demand for money depend on
A) the unemployment rate and the level of interest rates.
B) the inflation rate and the unemployment rate.
C) interest rates and the unemployment rate.
D) None of these.
Answer: D
Question Status: Previous Edition

13.2 Definitions of Money

1) A negotiable large-denomination certificate of deposit is an example of a
A) capital market instrument to finance capital acquisitions.
B) money market instrument to finance inventories and short-term receivables.
C) type of stock held by financial institutions.
D) type of stock held by individuals.
Answer: B
Question Status: Previous Edition

2) The ________ measure of money contains items that are not direct media of exchange, such as ________.
A) M1, checkable deposits
B) M1, savings certificates
C) M2, checkable deposits
D) M2, savings certificates
Answer: D
Question Status: Previous Edition

3) The largest component of the M1 measure of money is
A) currency.
B) demand deposits.
C) other checking deposits.
D) money-market mutual funds.
Answer: C
Question Status: Previous Edition

4) Fluctuations in the relative demand for checking deposits versus money-market mutual funds causes instability in the overall demand for
A) M1 but not M2.
B) M2 but not M1.
C) M2 and M1.
D) neither M1 nor M2.
Answer: A
Question Status: Previous Edition

5) Fluctuations in the relative demand for stock market mutual funds versus money-market mutual funds causes instability in the overall demand for
A) M1 but not M2.
B) M2 but not M1.
C) M2 and M1.
D) neither M1 nor M2.
Answer: B
Question Status: Previous Edition

6) Imagine a crude banking system based on a reserve of 100 gold coins, with circulating paper deposit claims on 500 gold coins. This situation is sustainable if, among other things, merchants ________ accept paper claims on gold as payment for their goods, and gold coins withdrawn from the banking system are ________ the system.
A) will, returned to
B) will, kept out of
C) will not, returned to
D) will not, kept out of
Answer: A
Question Status: Previous Edition

7) The kind of assets banks can hold as reserves are also called the economy's
A) checkable deposits.
B) money market funds.
C) high-powered money.
D) bankers' acceptances.
Answer: C
Question Status: Previous Edition

13.3 High-Powered Money and Determinants of the Money Supply

1) Given the quantity theory of money demand, a doubling of the money supply will lead to a
A) halving of the velocity of money.
B) doubling of the level of real output.
C) doubling of the level of nominal output.
D) rise in the level of interest rates.
Answer: C
Question Status: Previous Edition

2) In the long run, a 1% increase in real GDP tends to
A) cause a 1% increase in the demand for money.
B) cause a less than 1% increase in the demand for money.
C) cause a greater than 1% increase in the demand for money.
D) have virtually no effect on the demand for money, because the interest rate is the main determinant of the demand for money.
Answer: B
Question Status: Previous Edition

3) The quantity theory of money assumed
A) that an increase in prices causes a proportionate increases in real GDP.
B) a fall in the velocity of money causes a proportionate increase in the money supply.

C) a rise in money supply causes a proportionate fall in velocity.
D) the fraction of income people desire to hold in the form of money is a constant.
Answer: D
Question Status: Previous Edition

4) If interest rates are falling, then, ceteris paribus,
A) bond holders are suffering capital losses.
B) bond prices are rising.
C) the liquidity demand for money will be falling.
D) income must be rising.
Answer: B
Question Status: Previous Edition

5) Keynes' speculative demand for money arises because
A) individuals are continually trying to maximize their wealth and income.
B) money is necessary to finance transactions.
C) there are costs to switching between money and interest-earning assets.
D) capital gains on bonds held can be made when interest rates are rising.
Answer: A
Question Status: Previous Edition

6) According to the "square-root rule" of the transactions demand for money, the demand for money would
A) vary inversely with the interest rate.
B) be zero if there were no costs to switching between money and interest-earning assets.
C) vary less than proportionately with income.
D) All of the above are correct.
Answer: D
Question Status: Previous Edition

7) The decline in the transaction demand for money in the mid- and late 1970s
A) was accompanied by a fall in velocity.
B) was predicted by most economists.
C) may be partly explained by the development of money-market funds and other financial innovations.
D) was the result of the Federal Reserve's easy-money policy.
Answer: C
Question Status: Previous Edition

8) As a result of the financial deregulation that allowed banks to issue new types of interest-bearing checking accounts
A) people are less willing to hold M1 at a given interest rate on alternative assets.
B) the demand for money M1 curve became more stable.
C) the demand for money M1 curve became vertical.
D) the demand for money M1 curve will shift to the right.
Answer: D
Question Status: Previous Edition

9) A share of stock might be included in the definition of the money supply since it serves which of the following functions of money?
A) unit of account and a store of value
B) store of value
C) medium of exchange since it can be easily sold
D) B and C are both correct.
Answer: B
Question Status: Previous Edition

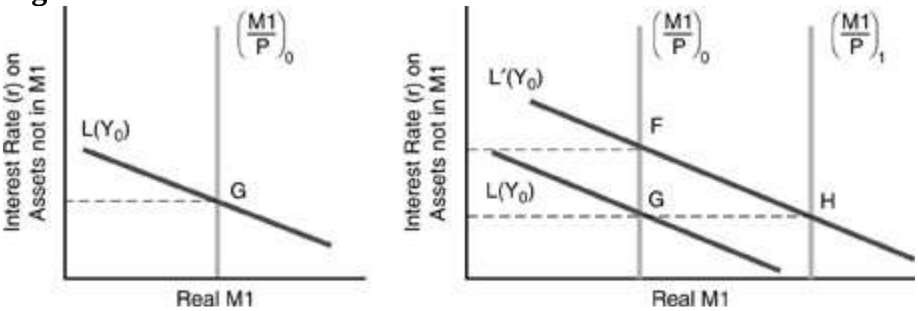
10) M1 is a definition of money largely confined to which function(s) of money?
A) unit of account
B) store of value
C) medium of exchange
D) B and C.
Answer: C
Question Status: Previous Edition

11) M2 is a definition of money largely confined to which function(s) of money?
A) unit of account
B) store of value
C) medium of exchange
D) B and C are both correct.
Answer: D
Question Status: Previous Edition

12) Prior to financial deregulation, the store of value and medium of exchange functions of money were maintained separate among asset classes because the regulatory agencies
A) precluded the payment of interest by checking accounts.
B) allowed the payment of interest by checking accounts.
C) specifically prohibited money market stock funds.
D) allowed the payment of interest on passbook savings accounts.
Answer: A
Question Status: Previous Edition

13) If the LM curve is vertical, then
A) there is partial "crowding out" of an increase in government expenditures.
B) the increase in the money supply will have no impact on the level of real GNP.
C) the demand for money is highly sensitive to the interest rate.
D) the velocity of money is constant.
Answer: D
Question Status: Previous Edition

Figure 13-1



14) In Figure 13-1 above, which money demand curve reflects the introduction of interest-bearing checking accounts?
A) $L'(Y'_0)$
B) $L(Y_0)$
C) $(M1/P)_0$
D) $(M1/P)_1$
Answer: B
Question Status: Previous Edition

15) Money is created through the banking processes of taking deposits and making loans if
A) the banks require individual depositors to hold "reserves."
B) the banks require individual borrowers to hold "reserves."
C) paper deposit receipts are not acceptable means of payment.
D) paper deposit receipts are accepted as a means of payment.
Answer: D
Question Status: Previous Edition

16) High-powered money is
A) total deposits received by banks within the system.
B) reserves held by banks to meet withdrawals.
C) deposits divided by the reserve holding ratio.
D) the reserve holding ratio divided by the level of deposits.
Answer: B
Question Status: Previous Edition

17) If the amount of high-powered money were 100 and the bank reserve holding ratio was 0.25 then the maximum stock of deposits would be (assume that citizens prefer to keep 10% of their money as cash)
A) 100/0.25 times 1.1 which is 440.
B) 100/0.35 which is approximately 286.
C) 100/0.35 times 1.1 which is approximately 314.
D) 100/0.10 which is 1000.
Answer: C
Question Status: Previous Edition

18) If the amount of high-powered money were 100 and the bank reserve holding ratio was 0.25 then the maximum stock of deposits would be (assuming that all money is deposited in the banking system)
A) 500.
B) 450.
C) 400.
D) 350.
Answer: B
Question Status: Previous Edition

19) If the amount of high-powered money were 100 and the bank reserve holding ratio was 0.25 then the maximum stock of money would be (assume that citizens prefer to keep 10% of their money)
A) 100/0.25 which is 400.
B) (100)(1.35) which is 540 0.25.
C) (100)(1.1) which is approximately 314 0.35.
D) (100)(1.35) which is approximately 386 0.35.
Answer: C
Question Status: Previous Edition

20) The stock of high-powered money in the economy is $80 billion. The bank reserve-holding ratio is 0.12 and the public wishes to hold 10% of its deposits as cash. The money supply will be approximately
A) $363 billion assuming the 80 billion of high-powered money is held by banks.
B) $400 billion assuming the 80 billion of high-powered money is held by the Fed or in bank vaults.
C) $327 billion assuming the 80 billion of high-powered money is not held by the Fed or in bank vaults.
D) $425 billion assuming the 80 billion of high-powered money is held by banks.
Answer: B
Question Status: Previous Edition

21) The stock of high-powered money in the economy is $80 billion. The bank reserve-holding ratio is 0.12 and the public wishes to hold 10% of its deposits as cash. The level of bank deposits will be
A) $333 billion.
B) $100 billion.
C) $250 billion.
D) $200 billion.
Answer: C
Question Status: Previous Edition

22) It is believed, by many, that the underground economy has grown in the United States in recent years causing c to increase and to be volatile. This event implies that the money multiplier should ________ and that the Fed should have a(n) ________ job in controlling the money supply.
A) increase; easier
B) increase; more difficult
C) decrease; easier
D) decrease; more difficult
Answer: D
Question Status: Previous Edition

23) Suppose that the interest rate is so low that banks currently refuse to make loans. An increase in the supply of high-powered money will
A) have no effect on the money supply if all the new high-powered money ends up as bank reserves.
B) have no effect on the money supply if all the new high-powered money ends up as cash in the hands of the nonbank public.
C) raise the money supply depending on banks reserve-holding ratio.
D) All of the above are correct.
Answer: A
Question Status: Previous Edition

24) Suppose an individual sells $500 worth of securities to the Fed and puts the proceeds of this sale under his mattress. Then,
A) the money supply will be unaffected.
B) the money supply will rise by $500.
C) the supply of high-powered money will rise by $500 but nothing will happen to the money supply.
D) demand deposits will rise by some multiple of $500, depending on the bank reserve-holding ratio.
Answer: B
Question Status: Previous Edition

25) The supply of high-powered money is $100,000 and the money supply is $500,000. If every individual wishes to hold 5% of his or her deposits in the form of cash, then the bank reserve-holding ratio must be
A) 0.25 if banks have made all loans acceptable by the Federal Reserve requirements.
B) 0.20 if banks have not made all loans acceptable by the Federal Reserve requirements.
C) 0.17 if banks have not made all loans acceptable by the Federal Reserve requirements.
D) 0.16 for any of the legally required reserve amount.
Answer: D
Question Status: Previous Edition

26) Suppose the proportion of deposits that individuals wish to hold as cash were to rise from 5% to 10%. Then,
A) the money supply will rise because people have more cash.
B) bank deposits will fall by the same amount as if the reserve-holding ratio had risen by 5 percentage points.
C) the supply of high-powered money will rise because cash has risen.
D) the money supply will change by the same amount as if the reserve-holding ratio had risen by 5 percentage points.
Answer: B
Question Status: Previous Edition

27) At Christmastime, individuals choose to hold more cash and fewer deposits to facilitate their Christmas shopping. This condition will
A) increase the money supply, for people will be spending more money.
B) have no effect on the money supply because people are just exchanging one form of money (deposits) for another form (cash).
C) reduce the money supply because there will be a drain of reserves out of the banks.
D) reduce the money supply, for all that cash is spent on Christmas presents.
Answer: C
Question Status: Previous Edition

28) Given the bank reserve-holding ratio e and the quantity of bank deposits D, the demand by banks for high-powered money is
A) eD.
B) e/D.
C) D/e.
D) e + D.
E) D - e.
Answer: A
Question Status: Previous Edition

29) The simplest money-creation multiplier is equal to
A) eD.
B) H/e.
C) 1/e.
D) e/H.
E) H/D.
Answer: C
Question Status: Previous Edition

30) A $1 increase in high-powered money raises the quantity of deposits until
A) all of that increase in high-powered money is held as required reserves.
B) required reserves fall back down to zero.
C) required reserves rise back up to zero.
D) deposits rise by $1.
E) GDP rises by $1 times the income-determination multiplier.
Answer: A
Question Status: Previous Edition

31) Given the reserve-holding ratio e and the fraction of deposits held as cash c, the deposit multiplier becomes
A) e - c.
B) 1/(e - c).
C) e/c.
D) ec.
E) 1/(e + c).
Answer: E
Question Status: Previous Edition

32) If e = 0.15, c = 0.07, and H = 140, the quantity of deposits at full multiplier expansion is
A) 1750.00.
B) 13,333.33.
C) 998.67.
D) 636.36.
E) 30.8.
Answer: D
Question Status: Previous Edition

33) If e = 0.125, c = 0.08, and D = 720, the total demand for high-powered money is
A) 32.4.
B) 3512.20.
C) 572.4.
D) 147.6.
Answer: D
Question Status: Previous Edition

34) Given the reserve-holding ratio e and the fraction of deposits held as cash c, the money multiplier becomes
A) ec/(e - c).
B) (1 + c)/(e + c).
C) (1 - c)/ec.
D) 1 - e - c.
E) ec - (1/c).
Answer: B
Question Status: Previous Edition

35) If e = 0.10, c = 0.20, and H = 440, the money supply at full multiplier expansion is
A) 4400.
B) 1467.
C) 1760.
D) 1907.
E) 1173.
Answer: C
Question Status: Previous Edition

36) During a banking panic, c ________, e ________, and the money supply ________.
A) rises, rises, falls
B) rises, falls, is unaffected
C) falls, falls, is unaffected
D) falls, rises, rises
E) falls, falls, falls
Answer: A
Question Status: Previous Edition

37) Currently in the United States, banks count as their reserves
A) only the currency in their vault.
B) the currency in their vault plus their holding of Treasury securities.
C) only their holding of Treasury securities.
D) their liabilities against which they pay no interest.
E) the currency in their vault plus their deposits at the Federal Reserve.
Answer: E
Question Status: Previous Edition

38) In the money-creation formula, the Fed exerts considerable control over
A) H and e.
B) c and e.
C) c alone.
D) H alone.
E) e alone.
Answer: A
Question Status: Previous Edition

39) The most important tool of monetary policy is ________, through which the Fed affects the variable ________ in the money-creation formula.
A) open market operations, e
B) open market operations, H
C) rediscount policy, e
D) rediscount policy, c
E) reserve requirement policy, e
Answer: B
Question Status: Previous Edition

40) When the Fed buys government securities, ________ and the money supply ________.
A) e rises, falls
B) e falls, rises
C) c rises, falls
D) c falls, rises
E) H rises, rises
Answer: E
Question Status: Previous Edition

41) For every dollar's worth of government securities the Fed sells, the money supply
A) rises by more than $1.
B) rises by less than $1.
C) falls by less than $1.
D) falls by more than $1.
Answer: D
Question Status: Previous Edition

42) Suppose that a series of decisions by banks effectively raises e. The resulting ________ in the money supply could be offset by the Fed with a "defensive" open market ________ of government securities.
A) rise, purchase
B) rise, sale
C) fall, purchase
D) fall, sale
Answer: C
Question Status: Previous Edition

13.4 The Fed's Three Tools for Changing the Money Supply

1) Financial intermediaries will be more likely to loan you the savings of other individuals than an individual because
A) they have specialists who research your credit worthiness.
B) they have contingency funds to cover loan losses.
C) they fund credit agencies to collect loan repayment information.
D) All of the above.
Answer: D
Question Status: Previous Edition
2) Which of the following institutions are NOT examples of financial intermediaries?
A) 1st National Bank, Chemical National Bank, Chase Manhattan National Bank
B) Farmer's Credit Union, 1st Mortgage Bank, IBM Credit Union

C) a Savings and Loan, New York Savings and Loan, First American Savings and Loan
D) the New York Stock Markets, Chicago and Pacific
Answer: D
Question Status: Previous Edition

3) Money market instruments are ________ term and ________ relative to capital market instruments.
A) long; risky
B) short; risky
C) short; less risky
D) long; less risky
Answer: C
Question Status: Previous Edition

4) If the level of interest rates increases, then the current value and price of a bond paying a fixed interest payment will
A) remain unchanged since its underlying value, the interest payment is fixed.
B) fall since new bonds offer higher rates.
C) rise since new bonds offer higher rates.
D) first rise then fall as bond investors calculate the effects of the change in rates.
Answer: B
Question Status: Previous Edition

5) A stable regular relation between income and the money stock as the medium of exchange presumes that
A) no interest is paid on the medium of exchange.
B) as interest rates increase the amount of money held increases.
C) as interest rates increase the amount of the medium of exchange held decreases.
D) A and B.
Answer: D
Question Status: Previous Edition

6) In the 1979-82 period, the Fed pursued a monetary policy which targeted the growth rate of the money supply. Given the effects of financial deregulation on money demand you would expect, ceteris paribus,
A) stable interest rates.
B) volatile interest rates.
C) a constant interest rate.
D) slow growth in interest rates.
Answer: B
Question Status: Previous Edition

7) As a result of financial deregulation
A) the IS curve became flatter and the LM curve became steeper, with the result that the interest rate became more volatile.
B) the IS curve became steeper and the LM curve became flatter, with the result that the interest rate became more volatile.
C) both the IS curve and the LM curve became steeper, with the result that the interest rate became more volatile.
D) both the IS curve and the LM curve became flatter, with the result that the interest rate became more volatile.
Answer: C
Question Status: Previous Edition

8) If the Fed wishes to increase the money supply it can
A) increase reserve requirements.
B) sell securities to banks and/or the public.
C) increase the rediscount rate.
D) None of the above is correct.
Answer: D
Question Status: Previous Edition

9) The money-creation multiplier is affected by the
A) public's demand for currency as a proportion of demand deposits.
B) bank reserve-holding ratio as a proportion of demand deposits.
C) rediscount rate applied to loans from the Fed to banks.
D) Both A and B are correct.
Answer: D
Question Status: Previous Edition

10) The money-creation multiplier is the
A) same as the income-determination multiplier.
B) amount by which the money supply would rise with a $1 increase in the supply of high-powered money.
C) amount by which the money supply of high-powered money will increase equilibrium GDP.
D) amount by which a $1 increase in reserves would raise an individual bank's deposit liabilities.
Answer: B
Question Status: Previous Edition

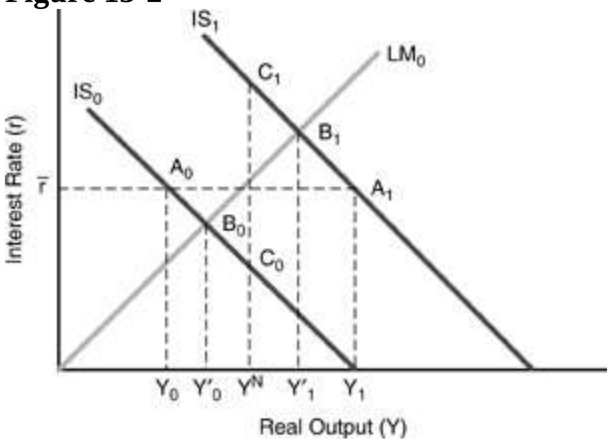
11) The immediate impact when the Federal Reserve buys government securities
A) from banks is that the level of bank reserves will decrease.
B) from government security dealers is that the level of bank reserves and deposits will increase.
C) from government security dealers is that the level of bank reserves will increase and the level of deposits decrease.
D) from banks is that the level of deposits will increase but bank reserves will decline.
Answer: B
Question Status: Previous Edition

12) When the Fed buys $10 million in T-bills, interest rates will ________ because the LM curve shifts ________.
A) fall; left due to the increase in the demand for money and loans
B) rise; right due to the increase in the supply of money and loans
C) fall; right due to the increase in the supply of money and loans
D) rise; left due to the increase in the supply of money and loans
Answer: C
Question Status: Previous Edition

13) Suppose that you are the central bank president in a developing country which is predominantly agricultural. During planting season, c the proportion of demand deposits held as cash doubles, but you wish to keep the money supply constant. You may decide to
A) reduce e and/or buy securities and/or lower the rediscount rate.
B) increase e and/or buy securities and/or lower the rediscount rate.
C) reduce e and/or sell securities and/or raise the rediscount rate.
D) increase e and/or sell securities and/or raise the rediscount rate.
Answer: A
Question Status: Previous Edition

14) If the Fed allows the federal funds rate to fall well below the rediscount rate it is likely that the Fed will
A) lower the rediscount rate and increase c, the proportion of demand deposits held as cash.
B) raise the rediscount rate.
C) increase loans to banks.
D) decrease loans to banks.
Answer: D
Question Status: Previous Edition

Figure 13-2



15) In Figure 13-2 above, suppose that the Fed maintains a constant nominal money supply, commodity prices are fixed, and that commodity demand is unstable ranging from IS_0 to IS_1. Equilibrium Y would then range from

A) A_0 to A_1.

B) B_0 to B_1.

C) C_0 to C_1.

D) Insufficient information.

Answer: A

Question Status: Previous Edition

16) In Figure 13-2 above, suppose that the Fed maintains a constant interest rate, commodity prices are fixed, and that commodity demand is unstable ranging from IS_0 to IS_1. Equilibrium real output would then range from

A) A_0 to A_1.

B) B_0 to B_1.

C) C_0 to C_1.

D) Insufficient information.

Answer: B

Question Status: Previous Edition

17) Figure 13-2 above illustrates an economy with an unstable commodity demand and two possible Fed policies, a constant real money supply or a constant interest. Which policy target promotes a stable economy best?

A) constant money supply, A_0 to A_1

B) constant money supply, B_0 to B_1

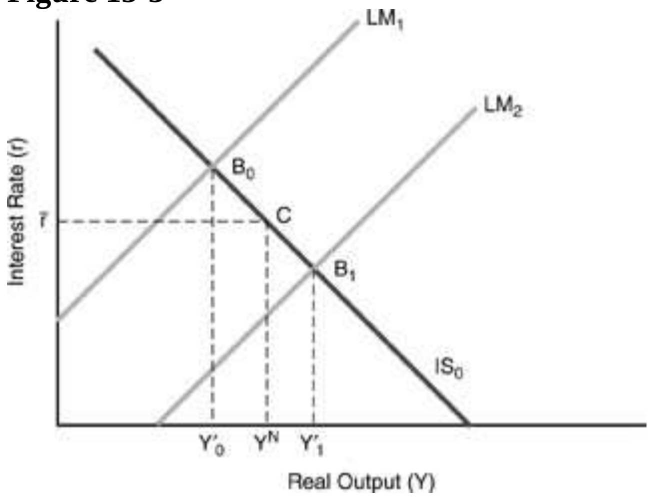
C) constant interest rate, A_0 to A_1

D) constant interest rate, B_0 to B_1

Answer: B

Question Status: Previous Edition

Figure 13-3



18) In Figure 13-3 above, suppose that the Fed maintains a fixed real money supply and that commodity demand is also fixed. The range of shifts in the LM curve, LM_1 to LM_2 can then only be explained by
A) changes in the velocity of money.
B) changes in the price level.
C) changes in the demand for money.
D) A and C.
Answer: D
Question Status: Previous Edition

19) In Figure 13-3 above, suppose that the Fed maintains a fixed real money supply and that commodity demand is also fixed. The range of shifts in the LM curve, LM_1 to LM_2 lead to
A) an unstable equilibrium output, C to B_1.
B) a stable equilibrium output, C.
C) an unstable equilibrium output, B_0 to B_1.
D) a stable equilibrium output, B_0 to B_1.
Answer: D
Question Status: Previous Edition

20) In Figure 13-3 above, given the unstable demand for money and a stable commodity demand, a stable output level at C would best be promoted by
A) targeting interest rates by the Fed.
B) decreasing taxes.
C) increasing expenditures by the government.
D) decreasing expenditures by the government.
Answer: A
Question Status: Previous Edition

21) If there is instability in the demand for commodities,
A) a monetary policy of fixed interest rates will perform better than a policy of holding the real money supply fixed.
B) a countercyclical money-supply policy will cause large swings in interest rates.
C) a fixed money supply policy will perform better than countercyclical changes in money supply.
D) a fixed money supply policy will stabilize interest rates.
Answer: B
Question Status: Previous Edition

22) In the mid-1980s, velocity "fell off the rails," growing much slower than its historical trend of 3.4 percent. Had the Fed assumed a constant growth rate of 3.4 percent and maintained a constant growth rate of money supply rather than increasing the growth rate of the money supply as it did,
A) nominal GDP would have grown more slowly as would real GDP.
B) nominal and real GDP would have grown more rapidly.
C) nominal GDP would have grown more rapidly faster and GDP would have grown more slowly.
D) real GDP would have grown more rapidly faster and nominal GDP would have grown more slowly.
Answer: A
Question Status: Previous Edition

23) If both money demand and commodity demand are unstable, as many activists believe, which type of policy target would most likely lead to a stable economy? (assume no supply-side shocks, and a fixed price level)
A) money supply target
B) real GDP target
C) interest rate target
D) none of the above
Answer: D
Question Status: Previous Edition

24) "The rigid link between monetary growth and inflation . . . had been broken." M1 grew faster in the deflationary 1980s than in the inflationary 1970s. Why?
A) The demand for money increased, reducing spending.
B) The demand for money decreased, due to financial deregulation.
C) The demand for money increased, as did velocity.
D) The demand for money decreased and the Fed targeted the money supply.
Answer: B
Question Status: Previous Edition

25) The Fed attempts to affect the level of borrowed reserves by
A) changing the discount rate.
B) changing legal reserve requirements.
C) open market sales.
D) open market purchases.
Answer: A
Question Status: Previous Edition

26) When the Fed changes money supply by selling government securities, the interest rate will
A) fall unless the LM curve is horizontal.
B) fall unless the IS curve is vertical.
C) rise if the LM curve is vertical or upward sloping.
D) remain constant if the LM curve is vertical.
Answer: C
Question Status: Previous Edition

27) During the 1990s, interest rates became ________ volatile than in the 1980s because the Fed used open market operations to ________ shifts in the IS and LM curves.
A) more, reinforce
B) less, offset
C) more, offset
D) less, reinforce
Answer: B
Question Status: Previous Edition

28) Gradually over the last two decades, ________ policy has emerged as the major stabilization policy tool in the United States.
A) monetary
B) fiscal
C) exchange rates
D) deregulatory
Answer: A
Question Status: Previous Edition

29) Two assumptions made in Gordon's early presentation of the IS-LM model were that the Federal Reserve has ________ control of the money supply and that the money demand function ________ subject to instability.
A) precise, is
B) precise, is not
C) imprecise, is
D) imprecise, is not
Answer: B
Question Status: Previous Edition

30) It is the job of ________ to channel funds from ________.
A) the Federal Reserve, borrowers to lenders
B) the Federal Reserve, lenders to borrowers
C) financial intermediaries, borrowers to lenders
D) financial intermediaries, lenders to borrowers
Answer: D
Question Status: Previous Edition

31) Currently, which sector of the economy is consistently a net saver?
A) the household sector
B) the business sector
C) the federal government
D) the foreign sector
Answer: A
Question Status: Previous Edition

32) The indirect channel of finance runs through ________, where securities ________ purchased by the savers themselves.
A) financial markets, are
B) financial markets, are not
C) financial intermediaries, are
D) financial intermediaries, are not
Answer: D
Question Status: Previous Edition

33) Only the most reputable borrowers operate by ________ finance, such as selling securities ________.
A) indirect, to savings banks
B) indirect, on the bond market
C) direct, to savings banks
D) direct, on the bond market
Answer: D
Question Status: Previous Edition

34) Savers who do not want to research the credit-worthiness of borrowers take advantage of ________ finance, where risk is ________.
A) direct, spread
B) direct, concentrated
C) indirect, spread
D) indirect, concentrated
Answer: C
Question Status: Previous Edition

35) What asset is created by government, not sold on financial markets, not issued by financial intermediaries, and is held directly by savers?
A) checkable deposits
B) currency
C) government bonds
D) mortgages
Answer: B
Question Status: Previous Edition

36) A way governments have of financing their deficits without having to pay interest is to
A) issue currency.
B) sell bonds to financial intermediaries.
C) borrow directly from financial intermediaries.
D) sell bonds in the direct finance market.
Answer: A
Question Status: Previous Edition

37) Financial deregulation and innovation in the United States has greatly ________ the variety of financial market instruments savers can choose from and has also ________ the dominance of banks among the financial intermediaries.
A) reduced, increased
B) reduced, reduced
C) increased, increased
D) increased, reduced
Answer: D
Question Status: Previous Edition

38) The largest category of financial intermediary is the
A) commercial banks.
B) savings-and-loans.
C) insurance companies.
D) mutual funds.
Answer: A
Question Status: Previous Edition

39) An example of a "contractual saving" financial intermediary is
A) a commercial bank.
B) an insurance company.
C) a money market mutual fund.
D) a credit union.
Answer: B
Question Status: Previous Edition

40) If the discount rate is lowered further below the market interest rate, banks tend to
A) lend more to the Fed.
B) lend less to the Fed.
C) borrow more from the Fed.
D) borrow less from the Fed.
Answer: C
Question Status: Previous Edition

41) Discount rate policy is ________ tool of the Fed in its attempts to influence ________, and thus the money supply.
A) an unnecessary, the reserve-holding ratio
B) an unnecessary, high-powered money
C) a necessary, the reserve-holding ratio
D) a necessary, high-powered money
Answer: B
Question Status: Previous Edition

42) Possible ways for the Fed to increase the money supply include ________ the rediscount rate and ________ reserve requirements.
A) lowering, lowering
B) lowering, raising
C) raising, lowering
D) raising, raising
Answer: A
Question Status: Previous Edition

43) The public, by raising the currency-to-deposit ratio, ________ the deposit creation multiplier, ________ the money supply.
A) raises, and raises
B) raises, yet does not affect
C) lowers, yet does not affect
D) lowers, and lowers
E) does not affect, yet raises
Answer: D
Question Status: Previous Edition

44) Beyond the Fed's immediate control, a wave of pessimistic economic forecasts in the banking industry can effectively ________ e and thus ________ the money supply.
A) raise, raise
B) raise, reduce
C) reduce, raise
D) reduce, reduce
Answer: B
Question Status: Previous Edition

45) The Fed's decision to concentrate more on interest rates in conducting near-term monetary policy
A) was the result of deregulation and innovation in financial markets.
B) was necessitated by the inability to identify a stable demand for money.
C) is sometimes misrepresented by the media as the Fed "setting" interest rates.
D) all of the above.
Answer: D
Question Status: Previous Edition

46) In 2008, the share of debit cards and prepaid cards in total retail transactions was ________, the share of credit cards was ________, and the share of checks and cash was ________.
A) 21, 31, 48
B) 48, 21, 31
C) 15, 32, 50
D) 41, 22, 37
Answer: D
Question Status: New

13.5 Theories of the Demand for Money

1) Tobin's generalized portfolio approach to the demand for money is based on the assumption that
A) money is needed for transactions.
B) all interest-bearing assets are risky.
C) the levels of risk and return vary among assets.
D) variations in wealth have little effect on asset demands.
Answer: C
Question Status: Previous Edition

2) The idea that the demand for money is a function of both income and wealth is part of whose theory?
A) Baumol and Friedman
B) the quantity theorists
C) Keynes
D) Tobin
Answer: D
Question Status: Previous Edition

3) An important distinction between Friedman's and others' views of the demand for money is the former's emphasis on the
A) substitution between money and virtually all other goods and assets.
B) nominal rate of interest.
C) substitution between money and other financial assets.
D) effects of wealth.
Answer: A
Question Status: Previous Edition

4) A major point of the Baumol-Tobin model of the transactions demand for money is that they show that the

A) demand for money is related to income.
B) velocity of money is constant.
C) fraction of income that people wish to hold in the form of money is constant.
D) interest sensitivity of the demand for money is based on a transactions motive shared by most people.
Answer: D
Question Status: Previous Edition

5) Milton Friedman's theory of the demand for money
A) is similar to Tobin's portfolio approach to the demand for money.
B) includes permanent income as one of the significant variables.
C) includes the yields on competing nonmonetary assets.
D) All of the above.
Answer: D
Question Status: Previous Edition

6) Given the quantity theory of money 1/V represents
A) the velocity of money.
B) the number of times the average $ changes hands.
C) the proportion of nominal income held as a medium of exchange.
D) PY.
Answer: C
Question Status: Previous Edition

7) If velocity were constant, as assumed by the pre-Keynesian version of the quantity theory, then a 10% change in the money supply would cause
A) a proportionate change in prices.
B) a proportionate change in output.
C) the sum of proportionate change in P and Y equals 10%.
D) the net difference of proportionate change in P and Y equals 10%.
Answer: C
Question Status: Previous Edition

8) When the interest rate is considered higher than normal, the speculative demand for money ________, the transaction demand ________.
A) increases; decreases
B) decreases; increases
C) remains the same; decreases
D) first increases then decreases; remains the same
Answer: B
Question Status: Previous Edition

9) The difference between the Baumol-Tobin formulation of the demand for money and the Keynesian-Baumol formulation is that
A) the speculative demand is a function of income.
B) the transaction demand is a function of interest rates as well as income.
C) the transaction demand is a function of wealth.
D) Both B and C are correct.
Answer: D
Question Status: Previous Edition

10) Which of the following is NOT included in M2?
A) savings deposits and money market deposit accounts
B) government savings bonds held by the public
C) money-market deposit accounts and overnight repurchase agreements
D) overnight repurchase agreements and savings deposits
Answer: B
Question Status: Previous Edition

11) When demand for money is unstable,
A) a constant interest-rate policy will be superior to a policy of constant money-supply growth.
B) constant money-supply growth will be superior to a countercyclical monetary policy.
C) procyclical monetary policy would be needed to keep the interest rate constant.
D) Both A and C are correct.
Answer: A
Question Status: Previous Edition

12) If velocity is constant then targeting the money supply and nominal GDP is
A) effectively an interest rate target.
B) effectively a real GDP target.
C) effectively the same thing.
D) inherently inconsistent.
Answer: C
Question Status: Previous Edition

13) When money-demand shifts are the predominant disturbance
A) the interest rate depends on the position of the IS curve.
B) the interest rate will be more volatile with an interest-rate target than with a money-supply target.
C) the interest rate will be more volatile with a GDP target than with a money-supply target.
D) a rigid money-supply target will allow the interest rate to respond to shifts in demand for money.
Answer: D
Question Status: Previous Edition

14) The major reason tight money fell so heavily on housing in the past was that
A) people didn't like to borrow when interest rates were high.
B) the reserve requirements on deposits at saving and loan institutions were higher than those for commercial banks.
C) the lag effect of tight money on housing was long and variable.
D) there were legal ceilings on the interest rates that saving and loan institutions could pay on their deposits.
Answer: D
Question Status: Previous Edition

15) In the early 1950s, economist William Baumol demonstrated that a lower interest rate ________ the demand for money in a model without bond speculation ________ a "broker's fee" for conversions between money and bonds.
A) raises, and without
B) raises, but with
C) lowers, and without
D) lowers, but with
E) does not affect, and without
Answer: B
Question Status: Previous Edition

16) The Baumol model of money demand strengthens the possibility that the LM curve is
A) horizontal.
B) upward-sloping.
C) vertical.
D) downward-sloping.
Answer: B
Question Status: Previous Edition

17) Economist James Tobin developed a formal model that justifies holding ________, and it goes some way in explaining variations in the demand for ________.
A) only safe assets or only risky assets, M1
B) only safe assets or only risky assets, M2
C) a mix of safe and risky assets, M1
D) a mix of safe and risky assets, M2
Answer: D
Question Status: Previous Edition

18) Economist Milton Friedman's theory of money demand is based on the supposition that money has a very ________ range of substitutes, giving monetary policy a ________ effect on aggregate demand.
A) wide, strong
B) wide, weak
C) narrow, strong
D) narrow, weak
Answer: A
Question Status: Previous Edition
19) Suppose that a bond-financed deficit shifts the IS curve to the right, taking IS-LM equilibrium "northeast" from point A to point B. If government bonds are considered net wealth by the public sector, then by the portfolio theory of asset-holding there is an excess

________ money at point B because the LM curve has shifted ________ with increased wealth, and thus the fiscal policy turns out to be ________ expansionary than without the wealth effect.
A) demand for, downward, more
B) demand for, downward, less
C) demand for, upward, less
D) supply of, downward, more
E) supply of, upward, more
Answer: C
Question Status: Previous Edition

20) If a constant-growth-rate-of-money policy is to achieve constant growth of nominal GDP, velocity
A) does not matter since the money supply is growing steadily.
B) must grow at a steady and predictable rate.
C) must be constant.
D) must shrink over time at the same rate as money grows.
Answer: B
Question Status: Previous Edition

21) A drop in velocity means that at any nominal GDP there is a desire to hold a ________ proportion of assets in money form, thus ________ shift in the LM curve.
A) larger, a downward
B) larger, an upward
C) smaller, a downward
D) smaller, an upward
Answer: B
Question Status: Previous Edition

13.6 Why the Federal Reserve "Sets" Interest Rates

1) Which financial intermediary has been required by regulation to concentrate its lending in the mortgage market?
A) commercial banks
B) savings-and-loans
C) credit unions
D) state and local government retirement funds
Answer: B
Question Status: Previous Edition

2) Which type of financial intermediary is NOT considered a "thrift institution"?
A) commercial banks
B) savings-and-loans
C) mutual savings banks
D) credit unions
Answer: A
Question Status: Previous Edition

3) An example of an "investment" financial intermediary is
A) an insurance company.
B) a private pension fund.
C) a credit union.
D) a mutual fund.
Answer: D
Question Status: Previous Edition

4) The share of U.S. personal saving in contractual form is ________, which helps ________ the effectiveness of stabilization policy.
A) growing, enhance
B) growing, undermine
C) shrinking, enhance
D) shrinking, undermine
Answer: B
Question Status: Previous Edition

5) The largest category of money-market instrument is
A) commercial paper.
B) U.S. Treasury bills.
C) corporate bonds.
D) corporate stock.
Answer: B
Question Status: Previous Edition

6) Compared to money-market instruments, capital-market instruments are of ________ maturity and are generally ________ risky.
A) shorter, less
B) shorter, more
C) longer, less
D) longer, more
Answer: D
Question Status: Previous Edition

7) The largest category of capital-market instrument is
A) corporate stock.
B) large-denomination negotiable certificates of deposit.
C) U.S. government securities.
D) commercial and consumer loans.
Answer: A
Question Status: Previous Edition

8) A passbook savings account serves as
A) a medium of exchange and a store of value.
B) a medium of exchange but not a store of value.
C) a store of value but not a medium of exchange.
D) as neither a store of value nor a medium of exchange.
Answer: C
Question Status: Previous Edition

9) With faster inflation, money in the form of ________ becomes more desirable.
A) currency
B) non-interest-bearing checkable deposits
C) interest-bearing checkable deposits
D) All of these forms are equally desirable when inflation increases.
Answer: C
Question Status: Previous Edition

10) The financial deregulation and financial innovations of the 1970s and 1980s
A) stabilized money demand.
B) stabilized velocity.
C) destabilized velocity.
D) A and C.
Answer: C
Question Status: Previous Edition

11) When the Fed targets interest rates, rightward shifts in the IS curve force the Fed to ________ the money supply to hold to that target, which acts to ________ velocity.
A) raise, destabilize
B) raise, stabilize
C) lower, destabilize
D) lower, stabilize
Answer: B
Question Status: Previous Edition

12) Financial deregulation and innovation since the late 1970s has made spending, especially new housing, ________ sensitive to changes in the market interest rate, leading to a ________ IS curve.
A) more, steeper
B) more, flatter
C) less, steeper
D) less, flatter
Answer: C
Question Status: Previous Edition

13) When some forms of money start to pay interest, then along with a rise in real output it takes a ________ rise in the market interest rate than before to hold the demand for money equal to its supply, which is to say that the LM curve has become ________.
A) larger, steeper
B) larger, flatter
C) smaller, steeper
D) smaller, flatter
Answer: A
Question Status: Previous Edition

14) The effects of financial deregulation on the IS and LM curves ________ the volatility of interest rates as the curves shift, such as the change in the amount that the interest rate must ________ when the Fed conducts open market purchases.
A) decrease, rise
B) decrease, fall
C) increase, rise
D) increase, fall
Answer: D
Question Status: Previous Edition

15) The effect of monetary policy on real output is ________ due to deregulation's effect on the LM curve alone, and ________ due to deregulation's effect on the IS curve alone.
A) strengthened, strengthened
B) strengthened, weakened
C) weakened, strengthened
D) weakened, weakened
Answer: B
Question Status: Previous Edition

16) With unstable commodity demand and thus an unstable ________ curve, fluctuations in output are ________ by the fortuitous selection of ________ targeting.
A) LM, minimized, money supply
B) LM, eliminated, interest rate
C) LM, minimized, interest rate
D) IS, minimized, money supply
E) IS, eliminated, interest rate
Answer: D
Question Status: Previous Edition

17) With unstable money demand and thus an unstable ________ curve, fluctuations in output are ________ by the fortuitous selection of ________ targeting.
A) LM, minimized, money supply
B) LM, eliminated, interest rate
C) LM, minimized, interest rate
D) IS, minimized, money supply
E) IS, eliminated, interest rate
Answer: B
Question Status: Previous Edition

18) Suppose commodity demand is stronger than expected, and money demand is stable. If the Fed is targeting the interest rate, it notices the rate is ________ its target, and action to correct this, shifting the LM curve to the ________, causes GDP to ________ natural GDP.
A) below, right, fall back toward
B) below, right, rise further toward
C) below, left, rise further from
D) above, left, fall back from
E) above, right, rise further from
Answer: E
Question Status: Previous Edition

19) Suppose that the IS curve is stable and money demand is lower than forecasted. If the Fed is targeting the interest rate, it notices the rate is ________ its target, and action to correct this, shifting the LM curve to the ________, causes GDP to ________ natural GDP.
A) below, right, fall back toward
B) below, right, rise further from
C) below, left, return to
D) above, left, fall back from
E) above, right, rise further from
Answer: C
Question Status: Previous Edition

20) Suppose the Fed is targeting real GDP. If the interest rate is below its forecast and the Fed is convinced that this is due to commodity demand instability, it will ________ the money supply, which turns out to be exactly the wrong thing to do if the low interest rate is in fact due to ________ money demand.
A) raise, high
B) raise, low
C) lower, high
D) lower, low
Answer: B
Question Status: Previous Edition

21) Smart cards will not much affect the demand for money if
A) the money supply is defined to include smart card balances.
B) the money supply is defined to exclude smart card balances.
C) the balance of the smart card is not considered to be electronic money.
D) the reserves of the card issuing institution fall when the smart card is "loaded" with funds from an account the customer already has at that institution.
Answer: A
Question Status: Previous Edition

22) In 2004, an example of cashless society is
A) U.S.S. Harry S. Truman.
B) United States.
C) Japan.
D) U.S. Universities.
Answer: A
Question Status: Previous Edition

23) Most of the growth in plastic card use has been in
A) credit cards.
B) debit cards.
C) online purchases.
D) electronic transfer.
Answer: B
Question Status: Previous Edition

24) The first credit card was issued in
A) 1950 by Francis X. McNamara.
B) 1958 by Bank of America.
C) 1981 by James Tobin.
D) 1974 by Citibank.
Answer: A
Question Status: Previous Edition

25) The mass use of credit cards began in 1958 with the BankAmericard. Its name changed in 1976 to
A) Visa
B) Master Card
C) Visa
D) American Express
Answer: A
Question Status: New

26) The use of cash for in-store purchases, declined from ________% in 1995 to ________ % in 2008.
A) 50, 35
B) 60, 29
C) 80, 75
D) 48, 10
Answer: B
Question Status: New

Macroeconomics, 12e **(Gordon)**
Chapter 14 The Goals, Tools, and Rules of Monetary Policy

14.1 The Central Role of Demand Shocks

1) If the demand for money is relatively stable,
A) the velocity of money will be constant.
B) the velocity of money will grow at a steady and predictable rate.
C) a fixed growth rate for the nominal money supply will lead to a stable growth rate of nominal GDP.
D) B and C are both correct.
Answer: D
Question Status: Previous Edition

2) The increase of the real money supply by 10% by the Federal Reserve when the unemployment rate rises by 1% is an example of
A) the conduct of procyclical monetary policy.
B) the utilization of feedback policy rule.
C) the utilization of rigid policy rule.
D) the conduct of nondiscretionary fiscal policy.
Answer: B
Question Status: Previous Edition

14.2 Stabilization Targets and Instruments in the Activists' Paradise

1) Successful activist stabilization policy presumes that
A) the timing of policy impacts on nominal GNP are known.
B) the magnitude, size of impacts, are known.
C) the timing and magnitude of the impact of AD disturbances are known, forecasted with precision.
D) All of the above.
Answer: D

Question Status: Previous Edition

2) According to the Monetarists, "Policy activism" is difficult if not impossible to perform successfully because
A) the timing of policy impacts on nominal GDP are known.
B) the magnitude, size of impacts are known.
C) the timing and magnitude of the impact of AD disturbances are known, forecasted with precision.
D) Monetarists believe all of the above are correct.
Answer: D
Question Status: Previous Edition

3) The central issue in the stabilization policy debate is
A) the effectiveness of monetary policy and fiscal policy.
B) the effectiveness of fiscal policy, but not monetary policy.
C) the role of money in the inflationary process.
D) the location of the sources of economic instability in the economy.
Answer: D
Question Status: Previous Edition

4) Monetarists believe that the major source of macroeconomic instability lies in
A) the private investment sector and the government sector.
B) the government sector.
C) private corporations and the government sector.
D) export and import sector.
Answer: B
Question Status: Previous Edition

5) Which of the following is NOT an argument of non-activists?
A) Private expenditures tend to be stable.
B) Monetary policy is impotent relative to fiscal policy.
C) Prices are flexible in the long-run.
D) Government actions may be destabilizing.
Answer: B
Question Status: Previous Edition

6) If the Fed announces a new policy of slower monetary growth it will result in lower inflation and no change in output only if
A) the policy is credible and price expectations are reduced.
B) the policy is time consistent and expectations remain constant.
C) the policy is time inconsistent and expectations increase.
D) Both A and B are correct.
Answer: B
Question Status: Previous Edition

7) Which of the following is NOT a problem in following an activist policy?
A) ineffectiveness in fiscal policy
B) lags in the effects of policies
C) multiplier uncertainty
D) forecasting errors
Answer: A
Question Status: Previous Edition

8) In the early 1970s monetary growth was relatively stable yet unemployment and prices were quite unstable. This suggests that
A) policy activism is superior to policy rules.
B) government spending must have been destabilizing.
C) monetary rules will not iron out every short-run fluctuation resulting from shocks.
D) the government was following a monetary rule.
Answer: C
Question Status: Previous Edition

9) Which of the following multiplier concepts is most important from the point of view of devising an activist policy?
A) the income and money-creation multipliers
B) the dynamic multipliers, that is the timing of multiplier effects given a policy change
C) the long-term multipliers, that is the total effect from several time periods given a policy change
D) the money-creation multiplier
Answer: B
Question Status: Previous Edition

10) The activists believe that
A) the time required for flexible prices to bring the economy back to the natural rate of unemployment is relatively short.
B) the IS curve is relatively flat because of the broad range of assets whose demand is very sensitive to changes in the interest rate.
C) the time required for flexible prices to return the economy to the natural level of real GDP is intolerably long.
D) the severity of the Great Depression was primarily related to the large decline in the supply of money.
Answer: C
Question Status: Previous Edition

11) The activist response to the monetarist platform says that
A) private spending may show some stability, but monetary or fiscal policy designed to stabilize it will just make things worse.
B) private spending is stable partly because consumption spending is based on permanent income.
C) even if prices are not completely flexible in the short-run, given time there is enough flexibility for the system to return to the natural level of real GDP.
D) None of the above.
Answer: D
Question Status: Previous Edition

12) The activists' paradise requires
A) that government expenditures follow a fairly steady growth path.
B) the ability to forecast perfectly future changes in demand and effects of changes in policy.
C) policy to have powerful direct effects but no side-effects.
D) B and C are both correct.
Answer: D
Question Status: Previous Edition

13) Activists believe that postwar instability is primarily the result of
A) erratic growth of private investment.
B) uneven changes in real government expenditures.
C) uneven changes in private consumption of durables.
D) A and C are both correct.
Answer: D
Question Status: Previous Edition

14.3 Policy Rules

1) Non-activists are most interested in
A) the short-run level of unemployment and the effectiveness of monetary policy.
B) the long-run consequences of policies.
C) the effectiveness of monetary policy and the short-run inflation rate.
D) the short-run rate of inflation and level of unemployment.
Answer: B
Question Status: Previous Edition

2) To non-activists, which of the following is the most useful stabilization policy?
A) procyclical monetary and fiscal policy changes
B) countercyclical monetary changes
C) government spending changes
D) None of these.
Answer: D
Question Status: Previous Edition

3) Non-activists
A) distrust the ability of the political process to formulate sensible economic policy.
B) argue for a constant-growth-rate rule for the money supply.
C) argue that more unemployment now may prevent a lot more unemployment in the future.
D) All of the above.
Answer: D
Question Status: Previous Edition

4) Non-activists believe that the IS curve is
A) very flat and that real output is sometimes very sensitive to monetary policy in the short run.
B) very steep and that real output is sometimes very sensitive to monetary policy in the short run.
C) very flat and that real output is not sensitive to monetary policy in the short run.
D) very steep.
Answer: A
Question Status: Previous Edition

5) Non-activists believe that the principal source of AD instability is
A) private investment spending.
B) private consumption spending.
C) erratic government policy.
D) All of the above.
Answer: C
Question Status: Previous Edition

6) The non-activists believe that
A) the government has been a stabilizing force in the economy.
B) much of the existing unemployment voluntary.
C) the velocity of money is unstable.
D) policymakers are able to accurately forecast the future effect of current policy actions.
Answer: B
Question Status: Previous Edition

7) Which of the following is NOT an argument of non-activists?
A) private spending may show some instability but monetary or fiscal policy designed to stabilize it will just make things worse
B) private spending is stable partly because consumption spending is based on permanent income
C) even if prices are not completely flexible in the short-run, given time there is enough flexibility for the system to return to the natural level of real GNP
D) it is true that monetary and fiscal policy have destabilizing in the past, but economic knowledge is now advanced enough to permit effective countercyclical policy
Answer: D
Question Status: Previous Edition

8) Non-activists believe that postwar instability is primarily the result of
A) erratic growth of private investment.
B) uneven changes in real government expenditures.
C) uneven changes in private consumption of durables.
D) A and C are both correct.
Answer: B
Question Status: Previous Edition

14.4 Policy Pitfalls: Lags and Uncertain Multipliers

1) A policymaker would prefer that the lag in the effect of a policy be
A) long and variable in magnitude or size.
B) short and fixed in magnitude or size.
C) long and fixed in magnitude or size.
D) short and variable in magnitude or size.
Answer: B
Question Status: Previous Edition

2) A major problem in developing an activist policy is
A) uncertainty about the magnitude of the dynamic multiplier.
B) uncertainty about the length and variability of policy lags.
C) uncertainty about the costs of various policies.
D) All of the above are correct.
Answer: D
Question Status: Previous Edition

3) The length of money or commodity demand disturbances is important to the "policy activism" debate between non-activists and activists because
A) changing the money supply affects the economy with a lag.
B) changes in private spending must be offset by policy debate.
C) Both A and B are correct.
D) None of the above is correct.
Answer: A
Question Status: Previous Edition

4) Because of the lag of the effects of changes in monetary policy and the failure of forecasters to anticipate supply-side shocks as well as changes in money demand or velocity, activist policy changes have tended at times during the mid-1970s to
A) accelerate inflation during expansions.
B) increase unemployment during recessions.
C) accelerate inflation and increased unemployment.
D) dampen inflation and decrease unemployment.
Answer: C
Question Status: Previous Edition

5) One of describing the debate between activists and non-activists is that
A) activists are pessimistic about the self-correcting powers of the economy but non-activists are optimistic.
B) activists tend to be oriented to the long-run but non-activists are short-run oriented.
C) non-activists are optimistic about the efficacy of stabilization policy but activists are pessimistic.
D) A and B are both correct.
Answer: A
Question Status: Previous Edition

6) A study of estimated multipliers in the major econometric models shows that
A) the government-spending multiplier tends to increase and then later decrease over time.
B) the monetary multiplier is much larger than the government spending multiplier.

C) there is quite a bit of variation in the value of the multipliers among the models.
D) A and C are both correct.
Answer: D
Question Status: Previous Edition

7) According to the new classical macroeconomists, each of the following statements is true EXCEPT:
A) Disinflation will be harder to bring about because of the time-inconsistency problem.
B) Policymakers are tempted to deviate from the preannounced policy once the public changes its expectations.
C) Feedback rules are preferred to discretionary rules.
D) Disinflation will be painless if the restrictive policies announced by the government are credible.
Answer: C
Question Status: Previous Edition

8) According to the New Classical macroeconomic school,
A) active policy intervention is ineffective.
B) active policy intervention is undesirable and perverse.
C) active policy intervention's benefits exceed its costs.
D) active policy intervention's benefits are less than its costs.
Answer: A
Question Status: Previous Edition

9) In general, activists are ________ about the ability of the economy to remain stable and non-activists are ________.
A) pessimistic; optimistic
B) optimistic; optimistic
C) pessimistic; pessimistic
D) optimistic; pessimistic
Answer: D
Question Status: Previous Edition

10) In general, activists are ________ about the ability of fiscal and monetary policies to stabilize AD and non-activists are ________.
A) pessimistic; optimistic
B) optimistic; optimistic
C) pessimistic; pessimistic
D) optimistic; pessimistic
Answer: D
Question Status: Previous Edition

11) To be successful in stabilizing AD, the application of a constant growth-rate rule for the money supply requires
A) a constant velocity of money.
B) a steady and predictable rate of growth of the velocity of money.
C) a steady and predictable rate of growth of the velocity of income.
D) Both B and C are correct.
Answer: B
Question Status: Previous Edition

12) Activists-believe that AD is unstable because
A) business and consumer attitudes and expectations shift.
B) monetary policy is variable.
C) fiscal policy effects are unpredictable.
D) Both B and C are correct.
Answer: A
Question Status: Previous Edition

13) If both money demand and commodity demand are unstable, as many activists believe, which type of policy target(s) would most likely lead to a stable economy (assuming supply-side shocks are likely to occur)?
A) money supply target
B) real GDP target
C) interest rate target
D) nominal GDP
Answer: B
Question Status: Previous Edition

14) The "policy ineffectiveness proposition" of the new classical attack on policy activism is based on the idea that
A) people will anticipate policy changes particularly those based on a feedback rule.
B) people will anticipate the effects of policy changes and act to offset these effects.
C) Both A and B are correct.
D) None of the above is correct.
Answer: C
Question Status: Previous Edition

15) The "effectiveness lag" in monetary policy is the amount of time it takes
A) to collect the data to determine if a policy change is required.
B) for monetary policy to have an impact on inflation and unemployment.
C) for monetary policy to affect the money supply.
D) to collect the data to determine what effect monetary policy has had on the economy.
Answer: B
Question Status: Previous Edition

16) Economists who support a monetary rule as opposed to an activist monetary policy believe that the effectiveness lag in monetary policy is
A) short and variable, policy changes affect AD quickly and are predictable.
B) zero, policy changes have an immediate effect on expenditures.
C) long and variable, policy changes affect AD slowly over time and are unpredictable.
D) long, but predictable.
Answer: C
Question Status: Previous Edition

17) The time between the policy decision and the subsequent change in policy instruments is called the
A) data lag, the time required to collect and analyze data.
B) effectiveness lag, the time required for the change in money supply to affect real output.
C) legislative lag, the time required for policymaking body to make decisions.
D) transmission lag, the time between the change in policy and the change in policy instruments.
Answer: D
Question Status: Previous Edition

18) Based on the record of past business cycles as well as Fed behavior, we can estimate that for expansionary monetary policy the overall lag is approximately
A) eighteen months, about half of which is the effectiveness lag.
B) twenty months, slightly more than three-quarters of which is the effectiveness lag.
C) ten months, with less than half due to the effectiveness lag.
D) nine months, with the effectiveness lag responsible for about six months.
Answer: B
Question Status: Previous Edition

19) Observers of the economy often complain that indicators of economic activity are often contradictory. This is an example of the ________ lag.
A) data
B) recognition
C) legislative
D) effectiveness
Answer: B
Question Status: Previous Edition

20) The major difference between the lag in monetary policy versus the lag in fiscal policy stems from the
A) data lag.
B) legislative lag.
C) recognition lag.
D) transmission lag.
Answer: B
Question Status: Previous Edition

21) Which of the following is likely to have the shortest transmission lag?
A) a change in personal income tax rates
B) a change in government expenditures
C) an increase in subsidies paid to firms
D) an increase in public-service employment
Answer: A
Question Status: Previous Edition

22) Typically the data lag is about
A) one month.
B) about a month and a half.
C) about three months.
D) about six months.
Answer: B
Question Status: Previous Edition

23) Policy makers usually wait for ________ months of data to confirm a change.
A) two
B) three
C) four
D) six
Answer: A
Question Status: Previous Edition

24) The measure of the effectiveness lag for a change in monetary policy is the length of time necessary for ________ of the ultimate effect to be felt.
A) one-quarter
B) one-half
C) three-quarters
D) all
Answer: B
Question Status: Previous Edition

25) The deregulation of thrift institutions in the 1970s and 1980s have made their deposits and thus their ability to finance mortgages ________ sensitive to movements in the market interest rate, thus ________ the monetary policy multiplier.
A) more, raising
B) more, lowering
C) less, raising
D) less, lowering
Answer: D
Question Status: Previous Edition

26) The switch to flexible exchange rates in 1973 has made the effect of monetary policy on net exports a ________ important component of the monetary policy multiplier process, and thus has ________ the effectiveness lag.
A) more, lengthened
B) more, shortened
C) less, lengthened
D) less, shortened
Answer: A
Question Status: Previous Edition

27) With lags in monetary policy, an effective expansionary policy must be initiated many months ________ the start of the economic downturn it is intended to moderate, and this requires ________ economic forecasts.
A) before, generating accurate
B) before, ignoring
C) after, generating accurate
D) after, ignoring
Answer: A
Question Status: Previous Edition

28) Which of the following groups of economic forecasters have been able to forecast "turning points" when the economy turned up or down?
A) forecasters at the Fed
B) forecasters in branches of the government other than the Fed
C) forecasters at private firms
D) none of the above
E) all of the above
Answer: D
Question Status: Previous Edition

29) Data indicate that the economy's response to monetary policy became noticeably weaker and more stretched out during
A) 1961-75.
B) 1976-90.
C) 1991-2007.
D) None of the above. The response has grown stronger and shorter.
Answer: C
Question Status: Previous Edition

30) Quarterly data for the years 1988-93 for the nominal federal funds interest rate and the output ratio show that the Fed
A) reacted to a high output ratio by raising the interest rate.
B) reacted to a high output ratio by lowering the interest rate.
C) reacted to low output ratios but not to high output ratios.
D) did not react to movements in the output ratio.
Answer: A
Question Status: Previous Edition
31) The one main difficulty with a nominal GDP target rule for monetary policy is that it
A) is a difficult target to hit.
B) provides no nominal anchor.

C) requires a painful extinguishing response to an adverse supply shock.
D) performs badly when there is unstable velocity.
Answer: A
Question Status: Previous Edition

32) Fiscal policy in the United States is hampered by its particularly long ________ lag.
A) data
B) recognition
C) legislative
D) transmission
E) effectiveness
Answer: C
Question Status: Previous Edition

14.5 Case Study: Was the Fed Responsible for the Great Moderation of 1986-2007?

1) During which of the following decades has the output ratio been staying closest to zero?
A) 1960s
B) 1970s
C) 1980s
D) 1990s
Answer: D
Question Status: Previous Edition

2) Which of the following contributed to the negative output ratio experienced in the 1970s?
A) depreciation of the dollar
B) favorable oil price shocks
C) favorable farm price shocks
D) All of the above
Answer: D
Question Status: Previous Edition

3) Since the mid-1980s, Federal Reserve policies have often been described as attempting
A) accelerated takeoffs.
B) sustained growth.
C) stalling tactics.
D) soft landings.
Answer: D
Question Status: Previous Edition

4) Fed policies since the mid-1980s have been intended to
A) steepen the growth path of natural real GDP.
B) taper down the growth rate of actual real GDP as it approaches natural real GDP.
C) accelerate the growth rate of natural real GDP whenever actual real GDP exceeds it.
D) use the "runway" of natural real GDP as a springboard to faster growth.
Answer: B
Question Status: Previous Edition

5) Fed policies since the 1980s have attempted to
A) overshoot natural real GDP.
B) undershoot natural real GDP.
C) "stall" the economy whenever natural real GDP is growing too fast.
D) A and B.
E) none of the above.
Answer: E
Question Status: Previous Edition

6) In which of the following years did oil price movements contribute to holding down inflation?
A) 1986
B) 1998
C) 2001
D) All of the above.
Answer: D
Question Status: Previous Edition

7) Supply shocks after 1985
A) forced the Fed to follow restrictive monetary policy and caused a negative output ratio.
B) forced the Fed to follow restrictive monetary policy and caused a positive output ratio.
C) allowed the Fed to follow accommodative monetary policy and caused a negative output ratio.
D) allowed the Fed to follow accommodative monetary policy and push the output ratio toward zero.
Answer: D
Question Status: Previous Edition

8) During recessions natural real GDP
A) falls.
B) increases.
C) remains constant.
D) A, B, or C do occur during any given recession.
Answer: B
Question Status: Previous Edition

9) Policy activists' hope that they can undertake successful stabilization policy is ________ by the fact that natural real GDP ________ during recessions.
A) improved, falls
B) worsened, falls
C) improved, increases
D) worsened, increases
Answer: C
Question Status: Previous Edition

10) When existing stocks of resources are being heavily utilized, actual output is
A) likely to grow much faster than natural output.
B) likely to grow more slowly than natural output.
C) equal to natural output.
D) no longer tied to natural output.
Answer: C
Question Status: Previous Edition

11) The consensus reached in the late 1990s was that from the 1980s onward the Fed had been
A) quicker to stimulate or restrain the economy when its output fell short of or exceeded its natural level.
B) quicker to stimulate the economy when output fell short of the natural level, but slower to do so when output exceeded the natural level.
C) slower to stimulate the economy when output fell short of the natural level, but quicker to do so when output exceeded its natural level.
D) slower to stimulate or restrain the economy when its output fell short of or exceeded its natural level.
Answer: A
Question Status: Previous Edition

12) To reduce economic volatility the Fed should push the economy toward a
A) positive output ratio.
B) negative output ratio.
C) zero output ratio.
D) All of the above are consistent with reduced volatility.
Answer: C
Question Status: Previous Edition

13) At the end of the 1980s, bank regulators ________ various standards by which bank performance is measured thereby ________ banks willingness to lend.
A) lowered, increasing
B) raised, increasing
C) lowered, decreasing
D) raised, decreasing
Answer: D
Question Status: Previous Edition

14) During which of the following years did the Fed fail to pursue a policy aimed at stabilizing the output ratio?
A) 1988
B) 1990
C) 1994
D) 1997
Answer: D
Question Status: Previous Edition

15) The lag between changes in the Fed's interest rate target and large responses of output means that the Fed may want to ________ interest rates ________ output recovers to its natural level.
A) raise, after
B) lower, before
C) raise, before
D) lower, after
Answer: C
Question Status: Previous Edition

16) A monetary policy which is likely to bring about a "soft landing" requires that interest rates be ________ while inflation is ________ and unemployment is ________ the natural level.
A) raised, rising, above
B) raised, falling, below
C) lowered, falling, above
D) lowered, rising, below
Answer: C
Question Status: Previous Edition

17) Which of the following monetary policies could reduce the amplitude of oscillations of output around its natural level?
A) raising interest rates before actual output attains its natural level
B) lowering interest rates when an economy is still overheated
C) lowering interest rates when output is above its natural level
D) all of the above.
Answer: D
Question Status: Previous Edition

18) A central bank commitment to a ________ rule for monetary growth can be conveyed by maintaining a ________ exchange rate.
A) rigid, fixed
B) rigid, flexible
C) flexible, fixed
D) non-inflationary, flexible
Answer: A
Question Status: Previous Edition

19) Which of the following does NOT contribute to the choice of a policy of hyperinflation?
A) war
B) increased price of energy paid to foreigners
C) price of export commodities increase
D) diminished ability to collect taxes
Answer: C
Question Status: Previous Edition

20) The European Monetary Union, which preceded the Euro, was
A) opposed by most politicians.
B) favored by most economists.
C) likely to improve the use of monetary policy to deal with contractionary shocks which strike only one or two countries in Europe.
D) all of the above.
E) none of the above.
Answer: E
Question Status: Previous Edition

21) The Euro, like the European Monetary Union which preceded it, is
A) opposed by most politicians.
B) favored by most economists.
C) likely to improve the use of monetary policy to deal with contractionary shocks which strike only one or two countries in Europe.
D) all of the above.
E) none of the above.
Answer: E
Question Status: Previous Edition

14.6 Time Inconsistency, Credibility, and Reputation

1) Gordon believes that the expansion which began in 1982 did so because of the
A) expansionary monetary policy which was pursued.
B) Reagan tax cuts, the passage of the Economic Recovery Act in 1981.
C) increases in consumer and business firm optimism concerning future business conditions.
D) A and B are both correct.
Answer: D
Question Status: Previous Edition

2) The major difference in the efficacy of monetary policy relative to fiscal policy is
A) the longer recognition lag for fiscal policy.
B) the shorter recognition lag for fiscal policy.
C) the longer legislative lag for fiscal policy.
D) the longer data lag for fiscal policy.
Answer: C
Question Status: Previous Edition

3) Expenditure changes may be potentially inequitable, as are tax changes, because
A) their spatial distribution must be determined by the legislature.
B) their spatial distribution must be determined by the Fed.
C) the government is slow to implement new programs.
D) unlike Japan, public works projects are the province of the executive branch.
Answer: A
Question Status: Previous Edition

4) If the Federal Reserve wants to control the level of interest rates
A) it must keep the supply of money constant.
B) it must let the money supply grow at a constant rate.
C) it can do so only if it also stabilizes nominal GDP.
D) it will have to give up control of the money supply.
Answer: D
Question Status: Previous Edition

5) The economy has been compared to a supertanker on the ocean to make the point that
A) the larger the economy, the less it is influenced by other economies (the weather).
B) it takes time for a policy change to overcome the economy's momentum and change its direction (as in steering an immense ship).
C) a random shock affects all parts of the economy in the same way (as all of a ship rises or falls together with the waves).
D) the larger the economy, the worse it is for the rest of the world when it goes into a recession (there is enough oil in a supertanker for a spill to stretch across the ocean).
Answer: B
Question Status: Previous Edition

6) In Gordon's early presentation of the IS-LM and AD/SRAS/LRAS models, macro policy was assumed to have ________ effects on aggregate demand.
A) immediate and certain
B) immediate but uncertain
C) delayed but certain
D) delayed and uncertain
Answer: A
Question Status: Previous Edition

7) In the Activists' Paradise, to increase real GDP without affecting the interest rate, it is necessary to change
A) only fiscal policy and shift the IS curve.
B) only monetary policy and shift the LM curve.
C) fiscal and monetary policies and shift both IS and LM.
D) more policy instruments than policymakers are actually able to manipulate.
Answer: C
Question Status: Previous Edition

8) In the long run, monetary and fiscal policies have no control over
A) the unemployment rate
B) nominal GDP.
C) the inflation rate.
D) the interest rate
Answer: A
Question Status: Previous Edition

9) Dividing fiscal policy into two instruments has the effect of introducing another policy target:
A) the interest rate.
B) the national debt.
C) the unemployment rate.
D) the division of output between public and private spending.
Answer: D
Question Status: Previous Edition

10) Linking policy instruments to target variables are the
A) indices of economic welfare.
B) structural economic relations.
C) exogenous nonpolicy variables.
D) irrelevant side effects.
Answer: B
Question Status: Previous Edition

11) In the schematic theory of economic policy, the demand for money is considered
A) a policy instrument.
B) an exogenous nonpolicy variable.
C) a structural relation.
D) a target variable.
E) an irrelevant side effect.
Answer: C
Question Status: Previous Edition

12) In the schematic theory of economic policy, consumer optimism is considered
A) a policy instrument.
B) an exogenous nonpolicy variable.
C) a structural relation.
D) a target variable.
E) an irrelevant side effect.
Answer: B
Question Status: Previous Edition

13) Which of the following is NOT one of the set of assumptions necessary to create the Activists' Paradise?
A) political constraints on the use of policy instruments
B) perfect forecasting of future movements in aggregate demand
C) the absence of costs in changing the policy instruments
D) policy instruments that strongly affect aggregate demand
Answer: A
Question Status: Previous Edition

14) The believer in policy ________ must be pessimistic about the ability of the private economy to self-stabilize and ________ about the accuracy of economic forecasting.
A) activism, pessimistic
B) activism, optimistic
C) rules, pessimistic
D) rules, optimistic
Answer: B
Question Status: Previous Edition

15) A believer in the need for a CGRR of the money supply policy must be ________ about the ability of the private economy to self-stabilize and ________ about the accuracy of discretionary stabilization policy.
A) optimistic, optimistic
B) optimistic, pessimistic
C) pessimistic, optimistic
D) pessimistic, pessimistic
Answer: B
Question Status: Previous Edition

16) If the Fed were required to maintain an absolutely constant growth rate of high-powered money, then the growth rate of the money supply
A) would be zero.
B) would be constant at the growth rate of H.
C) would be constant but not necessarily at the growth rate of H.
D) would fluctuate along with the parameters in the money-creation formula.
Answer: D
Question Status: Previous Edition

17) The Fed has the least degree of discretion and the least to do under a policy rule setting
A) the growth rate of money.
B) the growth rate of high-powered money.
C) the Federal funds rate.
D) nominal GDP.
Answer: B
Question Status: Previous Edition

18) Suppose that the central bank operates under a money supply growth rule, but with changes in the unemployment rate automatically adjusting the money growth target. This is called a ________ rule.
A) CGRR
B) discretionary
C) feedback
D) nominally-anchored
Answer: C
Question Status: Previous Edition

19) The "time inconsistency" argument is that a downward shift of the short-run Phillips Curve, which comes about with a ________ of inflationary expectations, is more likely when monetary policy ________.
A) lowering, follows a rigid rule
B) lowering, is at the discretion of policymakers
C) raising, follows a rigid rule
D) raising, is at the discretion of policymakers
Answer: A
Question Status: Previous Edition

20) Draw two SP curves intersecting LP; call the upper intersection point A and the lower point B. The Fed promises to reduce inflation while maintaining natural unemployment. If the public believes the Fed, the economy moves from ________. Then if the Fed turns out to be time-inconsistent, breaking its promise and trading off ________ inflation for lower unemployment, the public revises the way it forms inflation expectations so that in the long run the economy stays at ________.
A) A to B, lower, B which is superior to A
B) A to B, higher, A which is inferior to B
C) A to B, lower, A which is superior to B
D) B to A, higher, B which is superior to A
E) B to A, lower, B which is inferior to A
Answer: B
Question Status: Previous Edition

21) By refusing to be time inconsistent, a central bank is ________ its reputation and ________ "policy credibility."
A) harming, losing
B) harming, gaining
C) investing in, losing
D) investing in, gaining
Answer: D
Question Status: Previous Edition

22) Central banks that are relatively free from political interference, and are thus ________ likely to be time inconsistent, generally have a ________ record of achieving low inflation.
A) more, better
B) more, worse
C) less, better
D) less, worse
Answer: C
Question Status: Previous Edition

23) Even a monetary policy based on a rigid high-powered money growth rate rule can lack policy credibility, due in part to ________, while a policy that targets the inflation rate itself ________.
A) lags, must have policy credibility by definition
B) lags, can lack credibility due to both lags and multiplier certainty
C) multiplier uncertainty, must have policy credibility by definition
D) multiplier uncertainty, can lack credibility due to both lags and multiplier uncertainty
Answer: D
Question Status: Previous Edition

24) In the past twenty years the economy's responsiveness to monetary policy has become
A) weaker and more stretched out.
B) weaker and shorter.
C) stronger and more stretched out.
D) stronger and shorter.
Answer: A
Question Status: Previous Edition

25) Twenty-four months after a 1 percentage point increase in the short-term (Treasury bill) interest rate, real GDP have fallen by about ________ in 1961-75, by ________ during 1976-1990, and by ________ during 1991-2007 period. 88-2004.
A) 2%, 1%, 3%
B) 0.1%, 2%, 1.8%
C) 1.8%, 0.9%, 0.2%
D) 0.2%, 0.1%, 0.9%
Answer: C
Question Status: Previous Edition

26) The shortest lag monetary policy faces is
A) data.
B) recognition.
C) transmission.
D) legislative.
Answer: C
Question Status: Previous Edition

27) Compared to the previous three decades, after 1982 recessions have been ________ and expansions have been ________ .
A) longer, longer
B) shorter, shorter
C) longer, shorter
D) shorter, longer
Answer: D
Question Status: Previous Edition

28) Which of these policy targets does NOT provide a "nominal anchor?"
A) high-powered money
B) the unemployment rate
C) the money supply
D) the inflation rate
Answer: B
Question Status: Previous Edition

29) The advantage of a nominal anchor is that it prevents a limitless rise in the
A) national debt.
B) nominal interest rate.
C) inflation rate.
D) unemployment rate.
Answer: C
Question Status: Previous Edition

30) Which of these policy rule variables does NOT have the disadvantage of being hard to control?
A) nominal GDP growth
B) high-powered money
C) the unemployment rate
D) the inflation rate
Answer: D
Question Status: Previous Edition

31) Among the prospective rules that set target variables directly, only the nominal GDP rule
A) provides a nominal anchor.
B) is easy for the Fed to achieve.
C) allows a neutral response to a supply shock.
D) is insulated from the effects of unstable velocity.
Answer: C
Question Status: Previous Edition

14.7 Case Study: The Taylor Rule and the Changing Fed Attitude Toward Inflation and Output

1) Some people support the Euro in hopes that the European Central Bank will emulate the monetary policy of the central bank of
A) Germany.
B) France.
C) Italy.
D) Spain.
Answer: A
Question Status: Previous Edition

2) Which of the following equations represent Taylor Rule?
A) $r^{FF} = r^{FF*} - a(p - p^{*}) - b\tilde{Y}$
B) $r^{FF} = r^{FF*} + a(p - p^{*}) + b\tilde{Y}$
C) $r^{FF} = r^{FF*} - a(p - p^{*}) + b\tilde{Y}$
D) $r^{FF} = r^{FF*} + a(p + p^{*}) + b\tilde{Y}$
Answer: B
Question Status: Previous Edition

3) In Taylor Rule equation, high value of parameter *a* indicates that
A) Fed cares more about avoiding recessions and high unemployment than about avoiding inflation.
B) Fed cares more about avoiding inflation than about avoiding recessions and high unemployment.
C) Fed cares more about avoiding recessions than about avoiding high unemployment.
D) Fed cares more about avoiding high unemployment than about avoiding recessions.
Answer: B
Question Status: Previous Edition

4) In Taylor Rule equation, high value of parameter *b* indicates that
A) Fed cares more about avoiding recessions and high unemployment than about avoiding inflation.
B) Fed cares more about avoiding inflation than about avoiding recessions and high unemployment.
C) Fed cares more about avoiding recessions than about avoiding high unemployment.
D) Fed cares more about avoiding high unemployment than about avoiding recessions.
Answer: A
Question Status: Previous Edition

5) "Inflation Targeting Rule" is a special case of a
A) Taylor Rule with zero weight on output.
B) Taylor Rule with zero weight on inflation.
C) Taylor Rule with an equal weight on output and inflation.
D) Taylor Rule with different but positive weights on output and inflation.
Answer: A
Question Status: Previous Edition
6) Admission to the Euro required in 1997 that a country's government deficit not exceed ________ percent of GDP.

A) twenty
B) fourteen
C) seven
D) three
Answer: D
Question Status: Previous Edition

7) Admission to the Euro required in 1997 that a country's government debt not exceed ________ percent of GDP.
A) seven
B) fifteen
C) twenty-five
D) sixty
Answer: D
Question Status: Previous Edition

8) Which of the following countries experienced the sharpest fiscal contraction in order to gain admission to the Euro club?
A) Portugal
B) Spain
C) Italy
D) France
Answer: C
Question Status: Previous Edition

9) Sources of reduced volatility of demand shocks include all of the following EXCEPT
A) smaller ups and downs of military spending.
B) residential construction.
C) inventory changes.
D) saving rates.
Answer: D
Question Status: Previous Edition

10) Which of the following caused pre-1984 volatility in residential construction?
A) financial regulations
B) tax cuts
C) currency volatility
D) interest rates
Answer: A
Question Status: Previous Edition

14.8 Rules Versus Discretion: An Assessment

1) "Monetarism" advocates a monetary policy
A) at the full discretion of the Fed.
B) that fixes the growth rate of money.
C) that fixes a constant short-term interest rate.
D) that fixes the growth rate of real GDP.
E) that fixes the unemployment rate.
Answer: B
Question Status: Previous Edition

2) The Canadian experience with inflation and unemployment in the early 1990s has this to say about policy rules:
A) A central bank independent of political pressure may thereby not be serving the public's politically-revealed preferences.
B) A central bank bowing to political pressure cannot get the inflation rate below the unemployment rate.
C) A constant-growth-rate-of-money rule cannot stabilize inflation if unemployment is allowed to vary substantially.
D) A constant-growth-rate-of-high-powered-money rule allows too much variation in the growth of the actual money supply to hold down inflation.
Answer: A
Question Status: Previous Edition

3) Monetarists believe that there is a ________ link between money supply growth and target variables and that the public is ________ in movements in the money supply.
A) strong, interested
B) strong, disinterested
C) tenuous, interested
D) tenuous, disinterested
Answer: A
Question Status: Previous Edition

4) What is the only policy instrument the Fed really can control directly and precisely?
A) short-term interest rates
B) the money supply
C) high-powered money
D) corporate tax rates
Answer: C
Question Status: Previous Edition

5) A clear-cut "rules versus discretion" debate is no longer possible because those economists advocating rules for ________, such as ________, must leave the Fed with plenty of discretionary power.
A) policy instruments, the money supply
B) policy instruments, the inflation rate
C) target variables, the money supply
D) target variables, the inflation rate
Answer: D
Question Status: Previous Edition

6) Economists who really do want to take discretion away from the Fed, by imposing rules on ________, face the problem of ________.
A) policy instruments, the Fed requiring discretion to adhere to the rule
B) policy instruments, slippages between instruments and target variables
C) target variables, the Fed requiring discretion on how to achieve the rule
D) target variables, slippages between instruments and target variables
Answer: B
Question Status: Previous Edition

7) The longest lag monetary policy suffers is the ________ lag.
A) data
B) recognition
C) legislative
D) transmission
E) effectiveness
Answer: E
Question Status: Previous Edition

8) Monetary policy has one clear advantage over fiscal policy by virtue of its very short
A) data lag.
B) data and recognition lags.
C) legislative and transmissions lags.
D) effectiveness lag.
Answer: C
Question Status: Previous Edition

9) David and Christian Romer's estimate of monetary policy's current effectiveness lag, defined as the time necessary for a policy change to have one-half its ultimate effect on GDP, is approximately ________ months.
A) 2
B) 6
C) 10
D) 19
E) 24
Answer: D
Question Status: Previous Edition

10) Gordon's plots of the effectiveness lags of monetary policy over the periods 1961-1975, 1976-1990, and 1991-2007 show the effectiveness lags have become ________ and the overall response of GDP to monetary policy has ________.

A) shorter, decreased
B) shorter, increased
C) longer, decreased
D) longer, increased
Answer: C
Question Status: Previous Edition

14.9 Case Study: Should Monetary Policy Target the Exchange Rate?

1) The Fed's interest rate response to the rising output ratio experienced from 1997 to 1999 is explained by
A) beneficial supply shocks which pushed down the inflation rate.
B) the Fed's efforts to help end the Asian financial crisis
C) the Fed's uncertainty about the concepts of the natural level of output and natural rate of unemployment.
D) All of the above.
Answer: D
Question Status: Previous Edition

2) The widespread, but not universal, consensus among economists would be to respond to
A) an adverse supply shock with an accommodating policy.
B) an adverse supply shock with an extinguishing policy.
C) an adverse demand shock with a policy to offset the shock.
D) all of the above.
Answer: C
Question Status: Previous Edition

3) Which of the following types of economic data are revised over time as government data collection agencies receive more complete information?
A) interest rates
B) employment
C) stock prices
D) all of the above
Answer: B
Question Status: Previous Edition

4) Compared to the 1960s, the effectiveness lag is ________ due to ________.
A) shorter, changes in fiscal policy
B) longer, structural changes in the economy
C) shorter, deregulation
D) longer, increased sensitivity of consumer spending to interest rates
Answer: B
Question Status: Previous Edition

5) Which of the following changes should make activist policy makers more confident in their capacity to make good policy recommendations?
A) structural change in the economy
B) changes in multipliers
C) a longer estimated lag for monetary policy
D) none of the above

Answer: D
Question Status: Previous Edition

6) During the ________ output tended to exceed its natural level and inflation ________.
A) late 1980s, accelerated
B) 1990s, accelerated
C) 1960s and early 1970s, accelerated
D) early 1980s, decelerated
Answer: C
Question Status: Previous Edition

7) During the ________ output ________ its natural level.
A) late 1990s, exceeded
B) 1960s, deviated relatively little from
C) early 1980s, tended to exceed
D) all of the above
Answer: A
Question Status: Previous Edition

8) Which of the following contributed to the positive output ratio experienced in the 1960s?
A) decreased government spending
B) tax decreases
C) favorable oil price shocks
D) favorable farm price shocks
Answer: B
Question Status: Previous Edition

***Macroeconomics, 12e* (Gordon)**
Chapter 15 The Economics of Consumption Behavior

15.1 Consumption and Economic Stability

1) The largest component of total spending is
A) private investment, the capital consumption allowance.
B) government spending on public goods.
C) private consumption on durable and non-durable goods.
D) public consumption of non-durable goods.
Answer: C
Question Status: Previous Edition

2) Of the three major categories of consumption, ________ is the most volatile because their purchase ________.
A) services; is sensitive to income levels
B) nondurables; is sensitive to income levels
C) durables; can be postponed when incomes decline
D) durables; they are necessities
Answer: C
Question Status: Previous Edition

3) A central tenet of the position against policy activism is that

A) consumption spending is highly unstable.
B) consumption spending is highly stable.
C) aggregate policies have little effect on consumption.
D) instability in private consumption will always be offset by variations in other elements of private spending.
Answer: B
Question Status: Previous Edition

4) The higher the marginal propensity to consume, the
A) smaller will be the simple multiplier.
B) more insulated will be consumption spending from exogenous shocks to the economy.
C) less effective will be any given monetary or fiscal policy.
D) more unstable the economy will be.
Answer: D
Question Status: Previous Edition

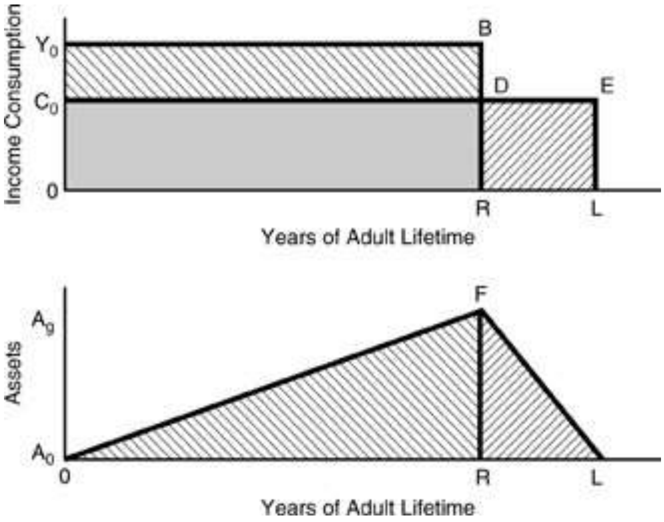
5) Keynes' theory of consumption predicts that the aggregate saving rate
A) increases as society becomes richer.
B) falls as society becomes richer.
C) is constant in the long-run.
D) falls with higher incomes in a cross-section of income.
Answer: A
Question Status: Previous Edition

6) Which of the following is NOT usually assumed about the effect of disposable income on aggregate consumer spending?
A) Consumer spending is at a higher level of disposable income.
B) At low levels of disposable income, saving may be negative.
C) Consumption is always less than disposable income.
D) A rise in income leads to a less than proportionate rise in consumption.
Answer: C
Question Status: Previous Edition

7) In the simple Keynesian consumption function, consumption demand is
A) a function of disposable income alone.
B) a function of disposable income and an autonomous component.
C) simply an autonomous amount exogenous to the model.
D) a function of the interest rate and an autonomous component.
E) a function of the interest rate alone.
Answer: B
Question Status: Previous Edition

15.2 Case Study: Main Features of U.S. Consumption Data

Figure 15-1



1) Figure 15-1 above displays the consumption pattern over the lifetime of an individual. Saving and asset accumulation occur during the years ________ according to ________ theory of consumption.
A) R to L; Keynes'
B) R to L; Modigliani's
C) O to R; Friedman's
D) O to R; Modigliani's
Answer: D
Question Status: Previous Edition

2) Suppose an individual were to win $1,000 in Las Vegas. The permanent-income hypothesis predicts that the individual would NOT be likely to
A) put his winnings in the bank.
B) throw a party.
C) buy a dishwasher.
D) purchase some shares in a corporation.
Answer: B
Question Status: Previous Edition

3) What is the main argument which explains why an increased public deficit financed tax cut may not result in increased consumption?
A) People will increase savings to "finance" debt repayment by future generations.
B) People will increase consumption to "finance" debt repayment by future generations.
C) Savings is determined by uncertain events, the timing of future illnesses and death.
D) Savings is determined by certain events, the timing of future illnesses and death.
Answer: C
Question Status: Previous Edition

4) What is the main argument which explains why the data do not show a positive relation between the deficit producing tax cuts in the early eighties savings rates?
A) People will increase savings to "finance" debt repayment by future generations.
B) People will increase consumption to "finance" debt repayment by future generations.
C) Savings is determined by uncertain events, the timing of future illnesses and death.
D) Savings is determined by certain events, the timing of future illnesses.
Answer: C
Question Status: Previous Edition

5) The largest component of current consumption expenditure is ________, while the most volatile component is ________.
A) durable goods, nondurable goods
B) durable goods, services
C) services, durable goods
D) services, nondurable goods
E) nondurable goods, services
Answer: C
Question Status: Previous Edition

6) The least volatile component of current consumption expenditure is ________, and the changes in its relative importance help explain why the volatility of overall consumption has ________ since the 1950s.
A) nondurable goods, risen
B) nondurable goods, fallen
C) durable goods, stayed the same
D) durable goods, fallen
E) services, stayed the same
Answer: E
Question Status: Previous Edition

7) The Keynesian consumption function implies that at a given moment persons with high incomes are saving ________ persons with low incomes, a prediction which is ________ by

actual cross-section consumption data.
A) a lower fraction of income than, confirmed
B) a lower fraction of income than, not confirmed
C) a higher fraction of income than, confirmed
D) a higher fraction of income than, not confirmed
E) the same fraction of income as, confirmed
Answer: C
Question Status: Previous Edition

8) Keynes was concerned about an implication of his consumption theory: that as an economy becomes more prosperous, its saving rate becomes too ________ to sustain that prosperity. Such a long-term trend in the U.S. saving rate is ________ in the time-series data.
A) large, found
B) large, not found
C) small, found
D) small, not found
Answer: B
Question Status: Previous Edition

9) The ________ nature of consumer durables expenditures ________ a significant drop in the personal-saving-and-consumer-durables-expenditure ratio in a recession.
A) procyclical, helps produce
B) procyclical, prevents
C) countercyclical, helps produce
D) countercyclical, prevents
Answer: A
Question Status: Previous Edition

10) A young college graduate is earning $30,000 per year and would like to borrow $20,000 more for a down payment on a house, but is prevented from doing so by a "liquidity constraint." For her, transitory income is likely to be ________ in its entirety, producing an MPC out of transitory income ________ that predicted by the LCH.
A) consumed, below
B) consumed, above
C) saved, below
D) saved, above
Answer: B
Question Status: Previous Edition

11) The consensus is that approximately ________ percent of U.S. households are subject to a liquidity constraint in consumption.
A) 75
B) 55
C) 35
D) 15
E) 5
Answer: D
Question Status: Previous Edition

12) During the 1990s the household savings rate in the United States as measured by NIPA
A) increased dramatically from two percent to almost six percent.
B) fell sharply and was only 0.7% by the year 2004.
C) increased only slightly because the federal budget deficit was finally eliminated.
D) fell to two percent when a federal budget surplus appeared.
Answer: B
Question Status: Previous Edition

13) The change in the savings rate during the 1990s is NOT consistent with
A) Friedman's permanent-income hypothesis.
B) Modigliani's life cycle hypothesis.
C) the boom in the stock market.
D) All of the above.
Answer: A
Question Status: Previous Edition

14) The stock market boom during the 1990s
A) boosted consumption relative to income.
B) depressed the percentage of disposable income saved by households.
C) may explain the behavior of household savings during that decade.
D) All of the above.
Answer: D
Question Status: Previous Edition

15) The measure of saving in the National Income and Product Accounts includes
A) capital gains on stocks, bonds, houses, and other assets.
B) purchases of consumer durables.
C) nominal interest payments which households receive from corporations.
D) all of the above.
Answer: C
Question Status: Previous Edition

16) The household saving rate as measured by the Flow of Funds Accounts does NOT include
A) capital gains on stocks, bonds, houses, and other assets.
B) net investment in consumer durables.
C) household accumulations in government pensions.
D) All of the above.
Answer: A
Question Status: Previous Edition

15.3 Background: The Conflict Between the Time-Series and Cross-Section Evidence

1) Time-series studies of consumption reveal that
A) the long-term saving ratio is rising.
B) the long-term saving ratio is falling.
C) the long-term saving ratio is constant but the marginal propensity to consume is falling.
D) both the long-term marginal propensity to save and the long-term saving ratio are constant.
Answer: D
Question Status: Previous Edition

2) The challenge for economists in the early postwar period was to develop a consumption hypothesis that could explain how
A) the saving ratio could remain fairly constant across income groups while the aggregate saving ratio increased over time as average real income grew.
B) the saving ratio for high-income families could be lower than for low-income families while the aggregate saving ratio remained fairly constant over time as average real income grew.
C) the saving ratio for high-income families could be higher than for low-income families while the aggregate saving ratio remained fairly constant over time as average real income grew.
Answer: C
Question Status: Previous Edition

3) The apparent conflict between the time-series and cross-section evidence on the U.S. saving ratio, where cross-section studies predict a long-run ________ in the ratio that does not emerge from the time-series studies, is ________ by the permanent-income and life-cycle hypotheses.
A) rise, resolved
B) rise, created
C) fall, resolved
D) fall, created
Answer: A
Question Status: Previous Edition

15.4 Forward-Looking Behavior: The Permanent-Income Hypothesis

1) While Modigliani's LCH is similar to Friedman's PIH in several ways, it does differ in that it
A) assumes individuals base their consumption decisions on a time span greater than one year.
B) assumes that individuals prefer to maintain a stable consumption pattern.
C) attempted to reconcile the seemingly paradoxical cross-section and time-series empirical data.
D) gives an important role to assets as a determinant of consumption behavior.
Answer: D
Question Status: Previous Edition

2) Both the PIH and the LCH predict that
A) the sum of saving and consumer durable purchases should increase in relation to personal income in booms and fall in recessions.
B) the sum of saving and consume nondurable purchases should increase in relation to personal income in booms and fall in recessions.
C) the sum of saving and consumer durable purchases should decrease in relation to personal income in booms and increase in recessions.
D) saving should increase in relation to personal income in booms and fall in recessions, but that consumer durables tend to behave in a more stable manner over a cycle.
Answer: A
Question Status: Previous Edition

3) Friedman measured "permanent" income by assuming that people adjusted their consumption on the basis of
A) an "error learning" process with respect to their expected income.
B) an adaptive expectation formation of their expected income.
C) transitory income and the level of income expected over a period of years in the future.
D) All of the above.
Answer: D
Question Status: Previous Edition

4) The MPC on ________ income is less than the MPC on ________ income according to ________ theory.
A) transitory; permanent; Friedman's
B) transitory; permanent; Modigliani's
C) permanent; transitory; Modigliani's
D) permanent; transitory; Friedman's
Answer: D
Question Status: Previous Edition

5) An individual's permanent income is
A) constant over time.
B) the same as his current income.
C) unaffected by tax changes.
D) equal to his expected average income.
Answer: D
Question Status: Previous Edition

6) The permanent-income hypothesis seeks primarily to explain the
A) observed long-term constancy of the saving ratio.
B) observed variation in the short-term saving ratio.
C) unimportance of transitory income changes.
D) All of the above are correct.
Answer: D
Question Status: Previous Edition

7) Which of the following purchases is most likely to rise as the result of a temporary tax cut, according to the permanent-income hypothesis?
A) television sets and other consumer durables
B) steak dinners and other consumer non-durables
C) trips to the Virgin Islands and other vacation destinations
D) theater tickets and other entertainment expenditures
Answer: A
Question Status: Previous Edition

8) The hypothesis that individuals base consumption on their expected long run average income is the
A) life cycle hypothesis.
B) forward looking expectation hypothesis.
C) permanent-income hypothesis.
D) None of the above.
Answer: C
Question Status: Previous Edition

9) The PIH predicts that temporary tax cuts would
A) be spent on consumer nondurables and services.
B) be offset by an increase in the saving ratio.
C) be offset by a decrease in the saving ratio.
D) be treated the same as permanent tax cuts.
Answer: B
Question Status: Previous Edition

10) Both the permanent-income and life-cycle hypotheses modify Keynesian consumption theory by distinguishing the effects of
A) temporary and permanent changes in disposable income.
B) changes in the disposable income of upper income and lower income classes.
C) changes in labor income and interest income.
D) small and large changes in disposable income.
Answer: A
Question Status: Previous Edition

11) The permanent-income hypothesis was developed in the 1950s by economist
A) Edward Prescott.
B) James Tobin.
C) Robert Solow.
D) Milton Friedman.
Answer: D
Question Status: Previous Edition

12) Both the permanent-income and life-cycle hypotheses are based on the crucial assumption of ________ expectations.
A) rational
B) adaptive
C) backward-looking
D) forward-looking
Answer: D
Question Status: Previous Edition

13) In U.S. recessions, growth in total consumption is ________, which is ________ with the workings of the permanent-income and life-cycle hypotheses.
A) largely uninterrupted, perfectly consistent
B) largely uninterrupted, rather inconsistent
C) noticeably reduced, perfectly consistent
D) noticeably reduced, rather inconsistent
Answer: D
Question Status: Previous Edition

14) A person is calculating his permanent income by adaptive expectations. Last year's permanent income was 38,000, this year's actual income is 44,000, and j = 0.25. This year his permanent income is
A) 39,500.
B) 42,500.
C) 59,000.
D) 20,500
Answer: A
Question Status: Previous Edition

15) Suppose a person calculates her permanent income by adaptive expectations. Last year's permanent income was 38,000, this year's actual income is 41,000, j = 0.30, and k = 0.86. What is her consumption expenditure this year?
A) 30,422
B) 12,174
C) 40,226
D) 38,774
E) 33,454
Answer: E
Question Status: Previous Edition

16) Suppose a person calculates his permanent income by adaptive expectations. Last year's permanent income was 54,000, this year's actual income is 44,000, j = 0.20, and k = 0.82. What is his consumption expenditure this year?

A) 34,840
B) 43,472
C) 36,784
D) 42,640
E) 37,720
Answer: D
Question Status: Previous Edition

17) By the permanent-income hypothesis, for every dollar that actual income increases, consumption expenditure rises in the short run by ________ dollars.
A) kj
B) k + j
C) k/j
D) k - j
E) j + (1/k)
Answer: A
Question Status: Previous Edition

18) By the permanent-income hypothesis, the long-run marginal propensity to consume is
A) j.
B) k.
C) kj.
D) k - j.
E) k/j
Answer: B
Question Status: Previous Edition

19) By the permanent-income hypothesis, the MPC of transitory income is
A) k.
B) j.
C) kj.
D) k - j.
E) 0.
Answer: E
Question Status: Previous Edition

20) The permanent-income hypothesis can reconcile the cross-section and time-series consumption studies by incorporating the reasonable assumption that at any one time many people are rich because they are enjoying unusually high ________ income, causing them to have an unusually ________ saving ratio.
A) permanent, high
B) permanent, low
C) transitory, high
D) transitory, low
Answer: C
Question Status: Previous Edition

21) The permanent-income hypothesis can reconcile the cross-section and time-series consumption studies by incorporating the reasonable assumption that at any one time many people are poor because they have ________ transitory income, causing them to have an unusually ________ saving ratio.
A) positive, high
B) positive, low
C) negative, high
D) negative, low
Answer: D
Question Status: Previous Edition

22) An individual having an unusually good year will be on his short-run consumption function at a point ________ his long-run consumption function, with an unusually ________ saving ratio.
A) above, high
B) above, low
C) below, high
D) below, low
Answer: C
Question Status: Previous Edition

23) An individual having an unusually bad year will be on her short-run consumption function at a point ________ her long-run consumption function, with an unusually ________ saving ratio.
A) above, high
B) above, low
C) below, high
D) below, low
Answer: B
Question Status: Previous Edition

24) In a business cycle boom, we expect an unusually ________ proportion of actual income to be transitory, thus an unusually ________ MPC operating in the short run, which ________ the income multiplier for the short run.
A) high, low, reduces
B) high, low, increases
C) high, high, reduces
D) low, low, increases
E) low, high, reduces
Answer: A
Question Status: Previous Edition

25) Suppose we are working with the simplest possible Keynesian-cross multiplier, but with the permanent-income hypothesis figured in. If k = 0.88, and j = 0.25, the multiplier of a $1 change in government spending goes from ________ in the short run to ________ in the long run.
A) 8.33, 1.28
B) 1.28, 8.33
C) 8.33, 4.00
D) 1.13, 4.00
E) 4.54, 8.33
Answer: B
Question Status: Previous Edition

26) Replacing the simple Keynesian consumption function with the function based on the permanent-income hypothesis results in a ________ short-run multiplier, implying a ________ stable private economy.
A) higher, more
B) higher, less
C) lower, more
D) lower, less
Answer: C
Question Status: Previous Edition

27) Both the permanent-income and life-cycle hypotheses make the assumption that people prefer a ________ consumption pattern in the long run, and so have a ________ short-run MPC out of sudden changes in income.
A) smooth, low
B) smooth, high
C) jagged, low
D) jagged, high
Answer: A
Question Status: Previous Edition

15.5 Forward-Looking Behavior: The Life-Cycle Hypothesis

1) Both the PIH and the LCH predict that
A) total consumption may rise as a fraction of income when actual income rises due to the upsurge in purchases of consumer durables.
B) the saving ratio will fall with higher income when consumer durables are counted as consumption expenditure.
C) the saving ratio will fall with higher income when consumer durables are counted as saving.
D) A and B are both correct.
Answer: D
Question Status: Previous Edition

2) The savings rate ________ over the long run but ________ over the short run.
A) is constant as Keynes assumed; varies as Friedman assumed
B) is constant as Friedman assumed; varies as Keynes assumed
C) is constant as Friedman assumed; varies as Friedman assumed
D) varies as Keynes assumed; varies as Keynes assumed
Answer: C
Question Status: Previous Edition

3) The life cycle hypothesis explains the long run constancy of the savings rate and short run variability of savings rate provided
A) the proportions of working and retired people are constant in each historical era.
B) the saving behavior of each age group does not change from generation to generation.
C) A and B are both required to explain the apparent contradiction.
D) Friedman's PIH is in error.
Answer: C
Question Status: Previous Edition

4) In the life-cycle hypothesis of consumption, two individuals with the same age, tastes, family composition, and income will
A) consume the same amount.
B) each consume less the greater is their accumulated wealth.
C) each have positive saving ratios.
D) consume differing amounts if their wealth differs.
Answer: D
Question Status: Previous Edition

5) The hypothesis that people attempt to stabilize their consumption over their entire lifetime is the
A) life cycle hypothesis.
B) forward looking expectation hypothesis.
C) permanent-income hypothesis.
D) None of the above.
Answer: A
Question Status: Previous Edition

6) Using consumption theories based upon forward looking hypothesis, a temporary increase in government expenditures will have ________ impact on induced consumption.

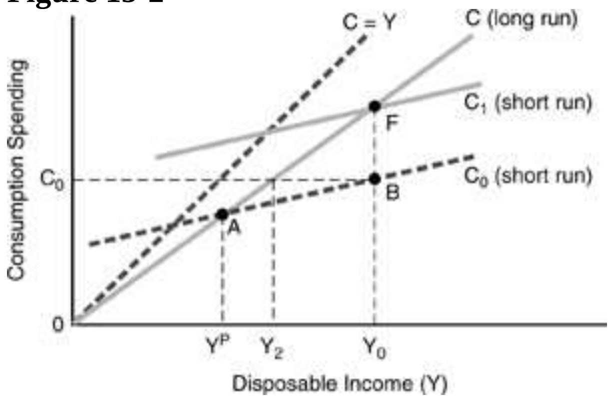
A) a large multiple
B) a small multiple
C) a variable
D) no
Answer: B
Question Status: Previous Edition

7) The consumption theories proposed by Modigliani and Friedman suggest that during recessions consumers reduce
A) consumption and maintain saving.
B) saving and maintain consumption.
C) consumption and saving.
D) consumption and investment.
Answer: B
Question Status: Previous Edition

8) Modigliani's consumption function differs from both Friedman's and Keynes' function in which of the following?
A) It is based on forward looking expectations.
B) It is based on disposable income received over time.
C) It is based on the value of assets accumulated over time.
D) It is based on disposable income or permanent income.
Answer: C
Question Status: Previous Edition

9) A fall in the price level would lead to an increase in consumption according to ________ because ________.
A) Friedman; the value of assets fall
B) Modigliani; the value of assets fall
C) Friedman; the value of assets rise
D) Modigliani; the value of assets rise
Answer: D
Question Status: Previous Edition

Figure 15-2



10) In Figure 15-2 above, the difference between consumption levels at point A and point B is equal to
A) the long run MPC times the change in disposable income.
B) the short run MPC times the change in disposable income.
C) (Y_0 - Y_2) times the short run change in income.
D) the long run change in income times (Y_0 - Y^P).
Answer: B
Question Status: Previous Edition

11) Gordon characterizes Modigliani as a prominent activist yet several implications of his life cycle hypothesis support the non-activists. One of these implications is
A) transitory increases in income associated with the business cycle are not expected to last a lifetime so current consumption is relatively stable.
B) permanent increases in income associated with the business cycle are not expected to last a lifetime so current consumption is relatively stable.
C) transitory increases in income associated with the business cycle are not expected to last a lifetime so current consumption is relatively unstable.
D) transitory increases in income associated with the business cycle are to last a lifetime so current consumption is relatively stable.
Answer: A
Question Status: Previous Edition

12) Gordon characterizes Modigliani as a prominent activist yet several implications of his life cycle hypothesis support the non-activists. One of these implications is
A) the real asset effect would dampen and thus stabilize spending.
B) the real asset effect would dampen and thus destabilize spending.
C) the real asset effect would increase and thus stabilize spending.
D) the real asset effect would increase the size of the multiplier.
Answer: A
Question Status: Previous Edition

13) The application of rational expectations to the permanent-income hypothesis implies that information contained in
A) only past income levels will determine permanent income.
B) only past income levels will determine transitory income.
C) only new changes in income that are unanticipated can change permanent income.
D) only new changes in income that are anticipated can change permanent income.
Answer: C
Question Status: Previous Edition

14) During a recession the Keynesian consumption theory predicts that the savings rate will ________ and the ________ theory that savings rate will ________.
A) fall; PIH; fall
B) fall; LCH; fall
C) rise; PIH and LCH; fall
D) rise; PIH and LCH; rise
Answer: C
Question Status: Previous Edition

15) Less developed countries are often characterized by imperfect capital markets. Assuming that the LCH applies to these countries and that a large proportion of the population is below fifty the
A) MPC should be relatively high.
B) MPC should be relatively low.
C) frequency of liquidity constraints is low.
D) sensitivity of consumption to loans is low.
Answer: A
Question Status: Previous Edition

16) The fact that 80% of the assets accumulated during a lifetime are bequeathed to heirs in the United States suggests that
A) the appropriate time horizon for consumption theory is the lifetime of the earner.
B) the appropriate time horizon for consumption theory is intergenerational.
C) the Barro-Ricardo equivalence theorem is correct.
D) it is true that higher taxes increase savings.
Answer: B
Question Status: Previous Edition

17) The PIH and LCH theories ________ the case for activism, while the procyclical behavior of consumer spending for durable goods ________ the case for activism.
A) supports; supports
B) supports; does not support
C) do not support; does not support
D) do not support; supports
Answer: D
Question Status: Previous Edition

18) The LCH theory argues that
A) over time, the saving rate of low-income people tended to rise at a faster rate than that of other income groups.
B) the aggregate saving rate depended on the age distribution within the economy.
C) over time, the aggregate saving rate was relatively constant.
D) over time, the aggregate saving rate would increase.
Answer: B
Question Status: Previous Edition

19) Suppose that medical researchers discover a new drug which slows the aging process, allowing the average life span in the United States to increase to 95 years of age. The permanent-income hypothesis suggests that
A) consumption spending would increase since lifetime income increases.
B) consumption spending would increase since estimates of permanent income would increase.
C) consumption spending would decrease since savings would rise to provide income for the longer retirement periods.
D) None of the above is correct since predicted future annual incomes may not change.
Answer: D
Question Status: Previous Edition

20) Suppose that medical researchers discover a new drug which slows the aging process allowing the average life span in the United States to increase to 95 years of age. The lifecycle hypothesis suggests that
A) consumption spending would increase since lifetime income increases.
B) consumption spending would increase since estimates of permanent income would increase.
C) consumption spending would decrease since savings would rise to provide income for the longer retirement periods.
D) None of the above is correct since predicted future annual incomes may not change.
Answer: C
Question Status: Previous Edition

21) With a temporary income tax surcharge, according to the ________, household consumption should ________.
A) PIH; fall as disposable income falls
B) PIH; rise since the decrease is disposable income is temporary
C) LCH; fall since disposable income over the lifecycle falls
D) None of the above is correct since a temporary change affects neither permanent income or relative lifecycle earnings.
Answer: D
Question Status: Previous Edition

22) With a temporary income tax surcharge, according to the ________, household consumption should ________.
A) LCH; stay the same
B) PIH; stay the same
C) LCH; fall since earnings over the lifecycle will decrease
D) PIH; fall since disposable income will fall
Answer: B
Question Status: Previous Edition

23) With a temporary income tax surcharge, according to the ________, household consumption should ________.
A) LCH; stay the same since life cycles have not changed
B) LCH; rise even though disposable income falls
C) PIH; fall since disposable income falls
D) None of the above is correct since there would be no change in "permanent" income.
Answer: D
Question Status: Previous Edition

24) Milton Friedman first proposed the hypothesis that individuals consume a fraction of their expected, or ________, income.
A) disposable
B) net
C) attainable
D) permanent
E) life-cycle
Answer: D
Question Status: Previous Edition

25) A lower interest rate
A) lowers the marginal propensity to consume out of permanent income.
B) raises the marginal propensity to consume out of permanent income.
C) lowers the proportion of actual income considered to be permanent income.
D) raises the proportion of actual income considered to be permanent income.
Answer: B
Question Status: Previous Edition

26) The life-cycle hypothesis was developed in the 1950s, primarily by the economist
A) Franco Modigliani.
B) Robert Lucas.
C) Walter Rostow.
D) Nils Hellstrom.
Answer: A
Question Status: Previous Edition

27) In the life-cycle hypothesis, people are assumed to have a consumption pattern that leads them to save
A) at no point in their life.
B) in the working years up to retirement.
C) in their retirement years.
D) in every year of their life.
Answer: B
Question Status: Previous Edition

28) In the life-cycle hypothesis, people are assumed to have a consumption pattern that leads them to dissave
A) at no point in their life.
B) in the working years up to retirement.
C) in their retirement years.
D) in every year of their life.
Answer: C
Question Status: Previous Edition

29) In the life-cycle hypothesis, a person who expects to work for R years earning Y dollars per year, and live for a total of L years, will consume ________ per year.
A) RY - (L - R)Y
B) LRY
C) (L - R)Y
D) (R/L)Y
Answer: D
Question Status: Previous Edition

30) Working with the life-cycle hypothesis, we find in a cross-section study of consumption that as income rises there is a growing proportion of ________ people and thus a ________ saving ratio.
A) retired, rising
B) retired, falling
C) working, rising
D) working, falling
Answer: C
Question Status: Previous Edition

31) According to the life-cycle hypothesis, if the average person expects to live another 48 years, the short-run MPC out of unexpected changes in income is
A) 0.52.
B) 0.48.
C) 0.9792.
D) 0.0208.
Answer: D
Question Status: Previous Edition

32) The life-cycle hypothesis predicts there to be a rather ________ short-run multiplier and thus a rather ________ private economy.
A) low, unstable
B) low, stable
C) high, unstable
D) high, stable
Answer: B
Question Status: Previous Edition

33) In the life-cycle hypothesis, if a person enters working life with an inherited stock of assets, this
A) raises his consumption during the working years.
B) raises his consumption during the retirement years.
C) raises his consumption in every year.
D) lowers his consumption during the retirement years.
E) lowers his consumption during the working years.
Answer: C
Question Status: Previous Edition

34) By the life-cycle hypothesis, a cyclical boom which causes inflation to accelerate and thus causes people to ________ the real value they estimate their wealth to represent, leads them to ________ the proportion of their current income devoted to consumption, which turns out to be a ________ influence on the economy.
A) lower, reduce, stabilizing
B) lower, increase, destabilizing
C) raise, increase, stabilizing
D) raise, reduce, stabilizing
E) raise, reduce, destabilizing
Answer: A
Question Status: Previous Edition

35) In the permanent-income hypothesis incorporating rational expectations, the short-run MPC is high when changes in current income
A) are small.
B) are considered a good predictor of future income changes.
C) are considered a poor predictor of future income changes.
D) occur when the economy is nearing cyclical peaks or troughs.
Answer: B
Question Status: Previous Edition

36) In the permanent-income hypothesis incorporating rational expectations, the actual cyclical pattern of consumption in the United States is too ________ to justify the assumption that a current change in income ________.
A) smooth, is a poor guide to future income changes
B) volatile, is a poor guide to future income changes
C) smooth, leads to a gradual change in permanent income
D) volatile, leads to a gradual change in permanent income
Answer: B
Question Status: Previous Edition

37) When it is assumed that people desire a smooth pattern of consumption enjoyment, if not consumption expenditure, this limits the permanent-income and life-cycle hypotheses to predicting the demand for consumer
A) durables.
B) durables and services.
C) services and nondurables.
D) nondurables and durables.
E) nondurables.
Answer: C
Question Status: Previous Edition

38) By the nature of consumer ________, it is reasonable to treat most of the expenditure on them as a form of saving rather than consumption, which it what it takes in permanent-income and life-cycle models to make the saving ratio ________ with rising income.
A) nondurables, rise
B) services, fall
C) services, rise
D) durables, rise
E) durables, fall
Answer: D
Question Status: Previous Edition

39) Households affected by a "liquidity constraint" have consumption ________ sensitive to changes in current income that is predicted by the LCH, and a saving ratio that may not ________ in a recession.
A) less, rise
B) less, fall
C) more, rise
D) more, fall
Answer: D
Question Status: Previous Edition

40) When uncertainty over the timing of death is added to the LCH, this ________ the planning horizon and ________ the MPC for transitory income.
A) shortens, raises
B) shortens, lowers
C) lengthens, raises
D) lengthens, lowers
Answer: D
Question Status: Previous Edition

41) With a rise in the stock market, the simple LCH model with no bequests predicts ________ in current consumption. Then when adding to the model bequests due to catastrophic illnesses and expenses that fail to occur, current consumption is ________.
A) a fall, still predicted to fall
B) a fall, predicted to rise
C) no change, predicted to rise
D) a rise, still predicted to rise
E) a rise, predicted to remain unchanged
Answer: E
Question Status: Previous Edition

42) Standard life-cycle analysis predicts that a stock market crash that suddenly reduces the sale value of stocks ________ consumption expenditures.
A) reduces
B) increases
C) has no effect on
D) All of the above are possible with a market crash.
Answer: A
Question Status: Previous Edition

43) Leaving out spending on consumer durables, the LCH and the PIH strengthens the case for policy ________ and the essential ________ of the private economy.
A) rules, stability
B) rules, instability
C) activism, stability
D) activism, instability
Answer: A
Question Status: Previous Edition

44) The strong cyclical pattern in consumer ________ spending strengthens the case for policy ________.
A) nondurables, activism
B) nondurables, rules
C) durables, activism
D) durables, rules
E) services, rules
Answer: C
Question Status: Previous Edition
45) Beginning in 1970 there was ________ relationship between the household saving rate and the ratio of the net worth to disposable income.
A) strong positive

B) strong negative
C) very weak but positive
D) weak but negative
Answer: B
Question Status: Previous Edition

46) Between 1984 and 1989, the S&P 500 index more than ________, and between 1994 and 2000 it ________.
A) doubled; tripled
B) tripled; doubled
C) doubled; decreased
D) tripled; decreased
Answer: A
Question Status: Previous Edition

15.6 Rational Expectations and Other Amendments to the Simple Forward-Looking Theories

1) According to Friedman, the apparent conflict between cross-section data which shows a saving rate that varies with income group and time-series data which shows that the saving ratio over the past century is fairly constant is resolved by
A) pointing out that cross-section and time-series data are not comparable.
B) interpreting the low saving of poor people as due to the fact that they must buy necessities.
C) interpreting the high saving of rich people as due to the transitory nature of much income earned by the rich.
D) distinguished between a permanent marginal propensity to consume and a transitory marginal propensity to consume.
Answer: C
Question Status: Previous Edition

2) If you won the state lottery and were guaranteed a monthly income of $5000 for life then ________ would argue that your ________ income has increased.
A) Friedman; permanent
B) Friedman; transitory
C) Modigliani; transitory
D) Modigliani; permanent
Answer: A
Question Status: Previous Edition

15.7 Bequests and Uncertainty

1) If people leave bequests primarily because they are uncertain about the timing of their deaths,
A) the marginal propensity to consume out of a temporary change in income would tend to be higher than in the simple version of the LCH.
B) unrealized capital gains from higher housing prices will probably lead to a higher consumption-to-income ratio than in the simple version of the LCH.
C) increases in wealth from the stock market would be consumed over a longer time horizon than in the simple version of the LCH.
D) A and C are both correct.
Answer: C
Question Status: Previous Edition

15.8 Case Study: Did the Rise and Collapse of Household Assets Cause the Decline and Rise of the Household Saving Rate?

1) All of the following factors came together in 2007-09 to cause a sharp drop in consumer spending EXCEPT
A) asset pyramid.
B) the end of the housing price bubble.
C) stock market crash.
D) increase in household liabilities.
Answer: A
Question Status: New

15.9 Why the Official Household Saving Data are Misleading

1) There are no questions for this section.
Answer:

15.10 Conclusion: Does Consumption Stabilize the Economy?

1) There are no questions for this section.
Answer:

Macroeconomics, 12e **(Gordon)**
Chapter 16   The Economics of Investment Behavior

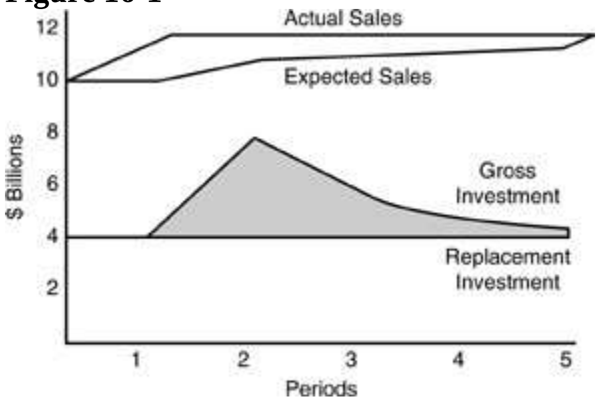
16.1 Investment and Economic Stability

1) Aggregate private spending is unstable according to policy activists, primarily because
A) consumer non-durable spending is volatile.
B) private residential and non-residential investment is volatile.
C) government spending is volatile.
D) the money supply is unstable.
Answer: B
Question Status: Previous Edition

2) Aggregate private spending is stable according to non-activists PRIMARILY because

A) consumer spending is insulated from changes in income according to the PIH and LCH theories.
B) private residential and non-residential investment is volatile.
C) government spending is volatile.
D) the money supply is unstable.
Answer: A
Question Status: Previous Edition

Figure 16-1



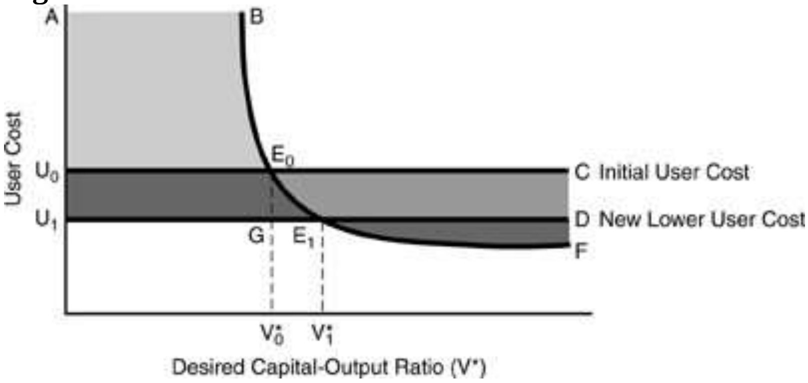
3) In Figure 16-1 above, the increase in gross investment lags actual sales because
A) replacement investment is not determined by actual sales.
B) expected sales lag actual sales and net investment is determined by expected sales.
C) actual sales lag expected sales and net investment is determined by expected sales.
D) expected sales lead actual sales and net investment is determined by expected sales.
Answer: B
Question Status: Previous Edition

4) Which of the following is NOT likely to affect investment?
A) variations in expected output
B) the nominal interest rate
C) the real interest rate
D) the tax treatment of depreciation allowances
Answer: B
Question Status: Previous Edition

5) Which of the following policies would reduce the user cost of capital?
A) a reduction in the money supply
B) a reduction in the personal income tax rate
C) an increase in the corporate profit tax rate
D) an increase in an investment tax credit
Answer: D
Question Status: Previous Edition

6) A fall in the user cost of capital
A) could occur as a result of a higher depreciation rate.
B) would lead to more capital-intensive methods of production.
C) would lead to less capital-intensive methods of production.
D) could occur as a result of a decrease in the marginal product of capital.
Answer: B
Question Status: Previous Edition

Figure 16-2



7) In Figure 16-2 above, the line BF is
A) the MPK less the user cost of capital.
B) the user cost of capital less MPK.
C) the MPK.
D) the demarcation line for profitability.
Answer: C
Question Status: Previous Edition

8) In Figure 16-2 above, if user costs fall, U_0 to U_1, then area ________ represents the opportunity cost.
A) ABE_0U_0
B) $GE_1V_0V_1$
C) $U_0E_0GU_1$
D) E_0E_1G
Answer: D
Question Status: Previous Edition

9) The amount of gross investment in the economy depends on the
A) response of expected output to the error in estimating the past period's actual output.
B) amount of the difference between the desired capital stock and last period's capital stock that can be put in place this period.
C) fraction of the capital stock that is replaced each period.
D) All of the above are correct.
Answer: D
Question Status: Previous Edition

10) What is the largest component of GPDI?
A) residential fixed investment
B) nonresidential fixed investment
C) inventory investment
D) consumer durables
Answer: B
Question Status: Previous Edition

11) GPDI is ________ volatile than total consumption spending.
A) much more
B) slightly more
C) slightly less
D) much less
Answer: A
Question Status: Previous Edition

16.2 Case Study: The Historical Instability of Investment

1) Residential investment did NOT decline in the recession which began in
A) 1973.
B) 1981.
C) 1990.
D) 2001.
Answer: D
Question Status: Previous Edition

2) During the 1987-88 expansion period interest rates in the United States rose as did the rate of investment in the economy. These facts suggest
A) the simple accelerator effect and the effects of higher interest rates complemented each other to raise output growth.
B) the simple accelerator effect and the effects of lower interest rates complemented each other to lower output growth.
C) the effects of the accelerator were greater than those of increased interest rates.
D) the effects of the accelerator were smaller than those of increased interest rates.
Answer: C
Question Status: Previous Edition

3) Over the most recent movement from cyclical trough to peak, 1991:Q1 to 2001:Q1, gross private domestic investment ________ approximately ________ percent.
A) rose, 49
B) rose, 73
C) rose, 6
D) fell, 68
E) fell, 20
Answer: B
Question Status: Previous Edition

4) Residential investment plunged quite noticeably ________ the start of the 1973-1975 and 1981-1982 recessions, with the prospect that recent financial deregulation would make it ________ sensitive to future changes in monetary policy.
A) after, more
B) after, less
C) before, more
D) before, less
Answer: D
Question Status: Previous Edition

5) They very ________ growth of office and retail space in the 1980s was due in part to financial deregulation that ________.
A) slow, limited the growth of bank and S&L deposits
B) slow, gave massive tax advantages to mortgage lending
C) rapid, allowed S&Ls to make business real estate loans
D) rapid, raised the depreciation tax deduction on these structures
Answer: C
Question Status: Previous Edition

6) The see-through office building, and the boarded-up factory outlet mall may be attributed to
A) changing conditions which no longer justify the project for which the buildings were produced.
B) deregulation of S & Ls.
C) extreme business optimism.
D) all of the above.
Answer: D
Question Status: Previous Edition

7) Over the most recent movements from cyclical peak to trough, 1990: Q3 to 1991: Q2, gross private domestic investment ________ approximately ________ percent.
A) fell, 40
B) rose, 5
C) fell, 11
D) rose, 22
Answer: C
Question Status: Previous Edition

8) The high tech boom of the late 1990s and early 2000s came to an end in part because
A) investment to address the Y2K problem was temporary.
B) new computer applications were consumer oriented rather than directed at increasing productivity.
C) the fiber optic cable boom has resulted in most optic cable capacity being unused.
D) All of the above.
Answer: D
Question Status: Previous Edition

16.3 The Accelerator Hypothesis of Net Investment

1) The simple accelerator theory suggests that investment will be rising when
A) output is rising.
B) the growth of output is rising.
C) output is high.
D) the growth of output is high.
Answer: B
Question Status: Previous Edition

2) Which of the following is a primary implication of the accelerator theory of investment?
A) Net investment occurs when the desired and actual capital stocks are equal.
B) In order for gross investment to remain constant, income must remain constant.
C) Rising rather than high levels of output are necessary to maintain a high level of net investment.
D) B and C are both correct.
Answer: C
Question Status: Previous Edition

3) In the simple accelerator model, if expected output declines,
A) gross investment becomes negative.
B) net investment becomes negative.
C) both gross investment and net investment become negative.
D) the desired stock of capital will become negative.
Answer: B
Question Status: Previous Edition

4) In the simple accelerator theory an increase in expected sales will
A) lead to an increase in net investment.
B) not necessarily lead to an increase in net investment.
C) lead to an immediate increase in replacement investment.
D) lead to an increase in net investment in the following period.
Answer: B
Question Status: Previous Edition

5) In the simple accelerator theory an
A) increase in actual sales will always lead to an increase in investment.
B) increase in actual output will not lead to an increase in expected sales.
C) increase in actual sales will lead to an increase in replacement investment.
D) increase in the size of the increase in actual sales will lead to an increase in next period's net investment.
Answer: D
Question Status: Previous Edition

6) In the accelerator theory the
A) smaller the desired capital-output ratio the larger will be net investment.
B) smaller the desired capital-output ratio the larger will be replacement investment.
C) larger the desired capital-output ratio the larger will be net investment.
D) larger the desired capital-output ratio the smaller will be replacement investment.
Answer: C
Question Status: Previous Edition

7) The accelerator theory states that
A) the larger this period's desired capital stock the smaller will be this period's net investment.
B) the larger the previous period's desired capital stock the larger will be this period's net investment.
C) the larger the previous period's desired capital stock the smaller will be this period's net investment.
D) this period's net investment is unrelated to this period's desired capital stock.
Answer: C
Question Status: Previous Edition

8) The idea that business firms attempt to maintain a fixed relation between their stock of capital and their expected sales is the basis for the
A) accelerator hypothesis of net investment.
B) permanent-income hypothesis.
C) life cycle hypothesis.
D) adaptive expectations approach.
Answer: A
Question Status: Previous Edition

9) If the government allows businesses to accelerate (increase) depreciation, then
A) the user cost of capital declines and V^* increases.
B) the user cost of capital declines and V^* decreases.
C) the user cost of capital increases and V^* decreases.
D) the user cost of capital increases and V^* increases.
Answer: A
Question Status: Previous Edition

10) If the government allows business firms an investment credit to lower taxes, then
A) the user cost of capital declines and V^* increases.
B) the user cost of capital declines and V^* decreases.
C) the user cost of capital increases and V^* decreases.
D) the user cost of capital increases and V^* increases.
Answer: A
Question Status: Previous Edition

11) If the government increases the corporate income tax,
A) the user cost of capital declines and V^* increases.
B) the user cost of capital declines and V^* decreases.
C) the user cost of capital increases and V^* decreases.
D) the user cost of capital increases and V^* increases.
Answer: C
Question Status: Previous Edition

12) One "problem" with applying the Jorgenson theory of investment to project investment is that
A) the MPK is known with certainty by business executives but the user cost is uncertain.
B) the MPK is known with uncertainty by business executives but the user cost is certain.
C) both user cost and the MPK are uncertain.
D) it does not explain the accelerator.
Answer: C
Question Status: Previous Edition

13) Which of the following will raise the expected marginal product of capital?
A) a reduction in the interest rate
B) increased business optimism
C) an investment tax credit
D) a reduction in the corporate profits tax
Answer: B
Question Status: Previous Edition

14) Which of the following types of expenditure is most likely NOT determined by an accelerator model?
A) consumer durable spending
B) inventory investment
C) residential housing construction
D) consumer spending on food
Answer: D
Question Status: Previous Edition

15) The minimum level of net investment necessary to maintain the stock of capital depends on
A) the rate of interest and the size of the capital stock.
B) the rate of depreciation and the size of the capital stock.
C) the corporate profits tax and the interest rate.
D) business confidence and the corporate profits tax.
Answer: B
Question Status: Previous Edition

16) The accelerator theory can explain the paradox that both interest rates and investment rise and fall in concert during the business cycle if
A) the effect of changes in Y effect on In dominate the effect of interest rates on investment.
B) the LM curve is constant.
C) the IS curve is constant.
D) the effect of changes in interest rates on In dominate the effect of changes in Y on In.
Answer: A
Question Status: Previous Edition

17) The effects on the economy of a prolonged decrease in investment are ________ if ________ occurs.
A) more pronounced; consumers adjust permanent income downwards
B) less pronounced; consumers do not adjust permanent income upwards
C) more pronounced; consumers adjust permanent income upwards
D) less pronounced; consumers adjust permanent income downwards
Answer: A
Question Status: Previous Edition

18) The "accelerator hypothesis" of investment states that a firm's net investment is most closely related to the
A) level of its actual sales.
B) change in its actual sales.
C) level of its expected sales.
D) change in its expected sales.
Answer: D
Question Status: Previous Edition

19) By the accelerator hypothesis, if a firm's actual sales jump in one period to a higher maintained level, that firm's net investment
A) also jumps in one period to a higher maintained level.
B) gradually drifts upward to a higher maintained level.
C) jumps upward and then falls back to zero.
D) jumps upward and then falls back part of the way.
Answer: C
Question Status: Previous Edition

20) By the accelerator hypothesis, if a firm's actual sales jump in one period to a higher maintained level, that firm's gross investment
A) also jumps in one period to a higher maintained level.
B) gradually drifts upward to a higher maintained level.
C) jumps upward and then falls back to zero.
D) jumps upward and then falls back part of the way.
Answer: D
Question Status: Previous Edition

21) By the accelerator hypothesis, if a firm's actual sales jump in one period to a higher maintained level, that firm's replacement investment
A) also jumps in one period to a higher maintained level.
B) gradually drifts upward to a higher maintained level.
C) jumps upward and then falls back to zero.
D) jumps upward and then falls back part of the way.
Answer: B
Question Status: Previous Edition

22) By the accelerator hypothesis, if a firm's actual sales jump in one period to a higher maintained level, that firm's capital stock
A) also jumps in one period to a higher maintained level.
B) gradually drifts upward to a higher maintained level.
C) jumps upward and then falls back to zero.
D) jumps upward and then falls back part of the way.
Answer: B
Question Status: Previous Edition

23) Where does the interest rate fit into the accelerator hypothesis of investment?
A) It helps determine the error-learning parameter, j.
B) It helps determine the ratio of desired capital to expected sales, v^*.
C) It helps determine the depreciation ratio of capital stock to replacement investment.
D) Nowhere: the hypothesis says that investment is independent of the interest rate.
Answer: B
Question Status: Previous Edition

Suppose that a firm in periods 0 through 5 has the following actual sales: 100, 180, 180, 180, 180, 180. Also suppose that j = 0.5, v^* = 3.5, and the replacement investment fraction is 0.15.

24) Refer to the information above. In which period does net investment reach its peak?
A) 1
B) 2
C) 3
D) 4
E) 5
Answer: B
Question Status: Previous Edition

25) Refer to the information above. In which period does gross investment reach its peak?
A) 1
B) 2
C) 3
D) 4
E) 5
Answer: B
Question Status: Previous Edition

26) Refer to the information above. What is the value of net investment in period 5?
A) 17.5
B) 89.25
C) 106.75
D) 612.5
Answer: A
Question Status: Previous Edition

27) Refer to the information above. What is the highest value of gross investment over these periods?
A) 140.
B) 106.75.
C) 89.25.
D) 192.5
Answer: D
Question Status: Previous Edition

28) Refer to the information above. What is the value of the firm's capital stock at the end of period 5?
A) 612.5
B) 106.75
C) 175
D) 89.25
Answer: A
Question Status: Previous Edition

29) Refer to the information above. Net investment becomes more unstable if j ________ and v^* ________.
A) rises, rises
B) rises, falls
C) falls, rises
D) falls, falls
Answer: A
Question Status: Previous Edition

30) Refer to the information above. The "simple" accelerator model, first derived by American economist J.M. Clark in 1917, comes from setting
A) j = 0.
B) j = 1.
C) $v^* = 0$.
D) $v^* = 1$.
Answer: B
Question Status: Previous Edition

31) Refer to the information above. By accelerator theory, net investment will remain above zero in the long run only so long as
A) expected sales are greater than v^* times the capital stock.
B) replacement investment is above zero.
C) expected sales keep rising.
D) expected sales do not fall.
E) actual sales fall below expected sales.
Answer: C
Question Status: Previous Edition

32) In a simple macroeconomic model, replacing the assumption of exogenous investment with the accelerator theory of investment ________ the effect on equilibrium GDP of fiscal policy changes, and ________ the effect on equilibrium GDP of changes in autonomous consumption.
A) increases, increases
B) increases, dampens
C) dampens, increases
D) dampens, dampens
Answer: A
Question Status: Previous Edition

33) Historical evidence is that net investment usually responds ________ to changes in

output growth, which ________ predicted by the simple accelerator model.
A) instantaneously, is
B) instantaneously, is not
C) with a lag, is
D) with a lag, is not
Answer: D
Question Status: Previous Edition

34) Compared to the 1960s, during most of the 1990s average annual real GDP growth was ________ while the average ratio of net investment to output was ________.
A) slightly lower, much lower
B) much lower, slightly higher
C) much higher, much lower
D) slightly higher, slightly lower
Answer: B
Question Status: Previous Edition

35) (In/Y) is quite ________ in the U.S. economy, and ________ stay away from its long-run average for several consecutive years.
A) stable, yet it can
B) stable, so it does not
C) volatile, yet it can
D) volatile, so it does not
Answer: C
Question Status: Previous Edition

36) If I is gross investment, K is capital stock, and "d" is the ratio of replacement investment to the capital stock, then Tobin's q is
A) q = I/K - d.
B) I = Kq + d.
C) I/K = j (q - 1) = d
D) q = I/K (j - 1) - d.
Answer: C
Question Status: Previous Edition

16.4 Case Study: The Simple Accelerator and the Postwar U.S. Economy

1) It is often stated that the Japanese firms develop and adapt new technology to manufacturing process twice as fast as U.S. firms. If this is true, ceteris paribus, we would conclude that the
A) depreciation rate of capital does not change, but the user cost of capital increases.
B) depreciation rate of capital increases, but the user cost of capital decreases.
C) depreciation rate of capital increases, and the user cost of capital increases.
D) U.S. interest rate is too high, preventing American manufacturers from adopting new technologies.
Answer: C
Question Status: Previous Edition
2) The increase in speed and power of personal computers over the past fifteen years has been phenomenal. Such technological change, with the old being ever more quickly replaced by the new, suggests growing ________ in ________ investment.

A) instability, net
B) instability, net and gross
C) instability, gross
D) stability, net and gross
E) stability, net
Answer: C
Question Status: Previous Edition

3) In an economy's labor-intensive industries are growing relative to its capital-intensive industries, v^* ________, which makes the economy more ________.
A) rises, stable
B) rises, unstable
C) falls, stable
D) falls, unstable
Answer: C
Question Status: Previous Edition

4) The use of bank loans to finance purchases of plant and equipment is most common in which of the following countries?
A) Germany
B) Japan
C) United States
D) United Kingdom
Answer: B
Question Status: Previous Edition

16.5 The Flexible Accelerator

1) The flexible accelerator theory
A) recognizes that the desired capital-output ratio is not a constant.
B) assumes that firms can make this period's actual capital stock equal to the desired capital stock.
C) sets this period's expected output equal to last period's actual output.
D) recognizes that a constant fraction of the capital stock is replaced each period.
Answer: A
Question Status: Previous Edition

2) Employing the error learning model to forecast sales, a firm where sales last period were expected to be $110 million, but actually sold $100 million would forecast that sales this period would be ________ if ________ is the coefficient of adjustment.
A) 103; 0.03
B) 105; 0.5
C) 110; 0.10
D) All of the above are correct.
Answer: B
Question Status: Previous Edition

3) If investment in capital equipment requires two to three years between conceptualization and start-up to production, then
A) the gap between the desired capital stock and the existing capital stocks is closed slowly.
B) a change in expected sales will not increase output.
C) V^* will be smaller than expected.
D) All of the above are correct.
Answer: A
Question Status: Previous Edition

4) In going from the simple to the flexible accelerator, j is set at ________, and v^* is ________.
A) one, allowed to vary
B) one, set at less than one
C) less than one, set at less than one
D) less than one, set at one
E) less than one, allowed to vary
Answer: E
Question Status: Previous Edition

5) Just after a cyclical trough, given the excess capacity in the economy, there should be an unusually ________ rate of closing the gap between desired and actual capital stocks, making net investment respond relatively ________ to rising sales.
A) high, strongly
B) high, weakly
C) low, strongly
D) low, weakly
Answer: A
Question Status: Previous Edition

6) Tobin's q is
A) the ratio of a firm's market value on the stock and bond markets to the replacement cost of its capital stock.
B) the ratio of a firm's gross investment to its capital stock less its replacement cost of capital.
C) a firm's replacement cost of capital less its value on the stock and bond markets.
D) the ratio of a firm's replacement cost of capital to its gross investment.
Answer: A
Question Status: Previous Edition

16.6 The Neoclassical Theory of Investment Behavior

1) In the year that a bakery buys a new $100,000 oven by borrowing at a real interest rate of 5 percent, the oven adds $22,000 to bread sales, depreciates by $8000, and requires $3000 in natural gas and maintenance. Since the MPK is ________ the user cost of capital, the bakery should ________.
A) above, shut down the oven
B) above, consider buying more ovens
C) below, shut down the oven
D) below, consider buying more ovens
Answer: B
Question Status: Previous Edition

2) If a firm's MPK is below its user cost of capital, it is employing too ________ capital and its profit is ________ in the long run.
A) little, above what it will be
B) little, below what it could be
C) much, above what it will be
D) much, below what it could be
Answer: D
Question Status: Previous Edition

3) A reduction in the user cost of capital leads firms to ________ their profit by ________ their capital-output ratio.
A) raise, increasing
B) raise, decreasing
C) lower, increasing
D) lower, decreasing
Answer: A
Question Status: Previous Edition

4) An increase in the user cost of capital leads firms to ________ their profit by ________ their capital-output ratio.
A) raise, increasing
B) raise, decreasing
C) lower, increasing
D) lower, decreasing
Answer: B
Question Status: Previous Edition

5) MPK falls when production becomes more ________-intensive, meaning a ________ in v^* and a ________ in net investment.
A) labor, fall, fall
B) labor, fall, rise
C) labor, rise, fall
D) capital, rise, rise
E) capital, fall, fall
Answer: D
Question Status: Previous Edition

6) A drop in the user cost of capital will lead to an equal ________ in the MPK of profit-maximizing firms, requiring a ________ v^*, thus ________ gross investment.
A) drop, higher, boosting
B) drop, lower, dampening
C) drop, lower, boosting
D) rise, higher, dampening
E) rise, lower, boosting
Answer: A
Question Status: Previous Edition

7) An upturn in business confidence may cause firms to ________ their estimates of MPK, leading to a ________ capital stock that matches MPK to the user cost of capital and thus ________ of net investment.
A) lower, larger, a contraction
B) lower, larger, an expansion
C) lower, smaller, a contraction
D) raise, smaller, a contraction
E) raise, larger, an expansion
Answer: E
Question Status: Previous Edition

8) Keynes felt that the economic effects of business confidence, for example a loss confidence shifting the ________ curve to the left, were of ________ importance.
A) IS, major
B) IS, minor
C) LM, major
D) LM, minor
Answer: A
Question Status: Previous Edition

9) Interest rates and investment are actually observed to move most of time in ________, and this is explained by other factors affecting investment shifting the ________ curve to the right.
A) the same direction, IS
B) the same direction, LM
C) opposite directions, IS
D) opposite directions, LM
Answer: A
Question Status: Previous Edition

16.7 User Cost and the Role of Monetary and Fiscal Policy

1) If the Fed ________ the money supply, the user cost of capital will ________ and V^* will ________.
A) increases; increase; increase
B) increases; decrease; increase
C) decreases; decrease; decrease
D) decreases; decrease; increase
Answer: B
Question Status: Previous Edition

2) Monetarist economists might conclude that the accelerator hypothesis supports their position via fiscal policy since
A) the gap between the desired capital stock and the existing capital stocks is closed slowly.
B) a change in expected sales will not increase output.
C) V□ will be smaller than expected.
D) All of the above are correct.
Answer: A
Question Status: Previous Edition

3) The 1981 economic recovery act ________ net investment according to ________.
A) greatly increased; Barry Bosworth
B) decreased; Barry Bosworth
C) increased; Martin Feldstein
D) decreased; Martin Feldstein
Answer: C
Question Status: Previous Edition

4) The efficacy of tax incentives as an instrument of activist fiscal policy
A) has been proven to be very substantial in the view of most economists.
B) is not plagued by a substantial lag between the passage of tax legislation and the resulting investment spending.
C) is subject to debate but still is limited by the "legislative lag."
D) has been proven to be so limited that it is no longer considered to be a serious option by most economists.
Answer: C
Question Status: Previous Edition

5) "The weather induced failure of the 1999 grain crop leads Russia to quadruple grain

imports from the United States." Assuming that the U.S. grain exports come from government warehouses,
A) net investment in the United States would increase dramatically according to the flexible accelerator theory.
B) net investment in the United States would decrease dramatically according to the flexible accelerator theory.
C) there would be no change in net investment since the Russian demand is temporary.
D) net investment would increase slowly since this is agriculture.
Answer: C
Question Status: Previous Edition

6) "Our knowledge of the factors which govern the yield of an investment some years hence is usually very slight and often negligible." This quote by ________ helps to explain ________.
A) Jorgenson; cycles of overbuilding
B) Keynes; cycles of overbuilding
C) Jorgenson; the accelerator hypothesis
D) Keynes; the accelerator hypothesis
Answer: B
Question Status: Previous Edition

7) Changes in inventory investment are ________ for the Fed to use to time changes in monetary policy.
A) too short-lived
B) short-lived enough
C) gradual enough
D) too gradual
Answer: A
Question Status: Previous Edition

8) Rising government expenditure, through its effect on the real interest rate, ________ v^* and thus ________ net investment.
A) raises, stimulates
B) raises, depresses
C) lowers, stimulates
D) lowers, depresses
Answer: D
Question Status: Previous Edition

9) An easier monetary policy ________ the user cost of capital, which ________ net investment.
A) raises, raises
B) raises, lowers
C) lowers, raises
D) lowers, lowers
Answer: C
Question Status: Previous Edition

10) Lowering the corporate income tax rate ________ the user cost of capital, which

________ investment.
A) raises, depresses
B) raises, stimulates
C) lowers, depresses
D) lowers, stimulates
Answer: D
Question Status: Previous Edition

11) With a rise in the rate of depreciation that ________, the user cost of capital falls, leading to a ________ capital-labor ratio, thus a ________ in investment.
A) actually occurs to capital, higher, rise
B) actually occurs to capital, lower, rise
C) actually occurs to capital, lower, fall
D) is used to calculate corporate taxes, higher, rise
E) is used to calculate corporate taxes, lower, fall
Answer: D
Question Status: Previous Edition

12) An investment tax credit effectively ________ the user cost of capital, and thus ________ gross investment.
A) lowers, raises
B) lowers, lowers
C) raises, raises
D) raises, lowers
Answer: A
Question Status: Previous Edition

13) The growth rate of real computer investment ________ between 1987-95 and 1996-2000.
A) fell from 18% to 5%
B) fell from 34% to 7%
C) rose from 3% to 22%
D) rose from 21% to 35%.
Answer: D
Question Status: Previous Edition

14) Investment tax credits are subject to ________ of the lags that occur with more conventional types of fiscal policy, making them ________ activist fiscal policy tool.
A) none, a promising
B) none, an unpromising
C) some, a promising
D) some, an unpromising
Answer: D
Question Status: Previous Edition

15) A downturn in business confidence may cause a ________ in j, and an ________ of the true user cost of capital, both depressing investment.
A) rise, overestimate
B) rise, underestimate
C) fall, overestimate
D) fall, underestimate
Answer: C
Question Status: Previous Edition

16.8 Business Confidence and Speculation

1) Following a recession businesses are likely to be ________ and thus ________ the user cost of capital.
A) optimistic; overestimate
B) pessimistic; overestimate
C) optimistic; underestimate
D) pessimistic; underestimate
Answer: B
Question Status: Previous Edition

2) Suppose the IRS were to introduce a tax exemption for portion of interest income earned on corporate bonds. This would
A) reduce the user cost of capital.
B) raise the marginal product capital.
C) raise the rate of depreciation.
D) All of the above are correct.
Answer: A
Question Status: Previous Edition

3) The interest income earned on most municipal bonds in the United States is tax exempt. Thus, for such municipalities
A) the level of public investment projects is lower than it would be otherwise.
B) municipal tax revenues are higher than they would be otherwise.
C) the user cost of cost capital is lower than it would be otherwise.
D) All of the above are correct.
Answer: C
Question Status: Previous Edition

4) The tax-exempt status of municipal bonds implies that, for private firms
A) the user cost of capital will be higher than otherwise.
B) the user cost of capital will be lower than otherwise.
C) the marginal product of capital will be lower than otherwise.
D) the accelerator will be higher than otherwise.
Answer: A
Question Status: Previous Edition

5) The desired stock of capital is that stock which
A) firms always obtain.
B) corresponds to the natural level of output.
C) would obtain when net investment is zero.
D) firms are always adjusting toward.
Answer: D
Question Status: Previous Edition

6) Under the adaptive method of estimating expected sales in the simple acceleration theory, if a firm's actual sales increase,
A) expected sales will increase if j is greater than zero.
B) expected sales will remain the same if j equals zero.
C) expected sales will equal the previous period's actual sales if j equals one.
D) All of the above are correct.
Answer: D
Question Status: Previous Edition

7) If the actual capital stock exceeds the desired capital stock due to a cycle of overbuilding, then
A) net investment will fall dramatically.
B) net investment will increase dramatically.
C) net investment will not change.
D) the effect on net investment is unknown.
Answer: A
Question Status: Previous Edition

8) If capital demand shifts to shorter lived equipment, then
A) net investment will fall.
B) net investment will increase.
C) net investment will not change.
D) the effect on net investment is unknown.
Answer: B
Question Status: Previous Edition

9) If actual output increases are believed to be temporary, then
A) net investment will fall.
B) net investment will increase.
C) net investment will not change.
D) the effect on net investment is unknown.
Answer: C
Question Status: Previous Edition

10) Business investment is most similar to what form of consumer expenditures and why?
A) consumer nondurables since they are "used up" in producing consumer welfare
B) consumer durables since they accelerate consume welfare
C) consumer durables since they may be treated as a form of household saving
D) Both A and B are correct.
Answer: C
Question Status: Previous Edition

11) If the economic growth rate SLOWS from 5% to 1%, the simple accelerator hypothesis suggests that
A) investment will continue to rise as output increases.
B) investment will fall as output increases.
C) investment will accelerate since output growth is positive.
D) None of the above is correct.
Answer: B
Question Status: Previous Edition

12) If the economic growth rate INCREASES from 1% to 5%, the simple accelerator hypothesis suggests that
A) investment will continue to rise as output increases.
B) investment will fall as output increases.
C) investment will rise since the rate of change in output increases.
D) None of the above is correct.
Answer: C
Question Status: Previous Edition

16.9 Investment as a Source of Instability of Output and Interest Rates

1) Private investment fluctuates ________, which supports those economists who advocate policy ________.
A) procyclically, rules
B) procyclically, activism
C) countercyclically, rules
D) countercyclically, activism
Answer: B
Question Status: Previous Edition

2) A higher nominal interest rate ________ the profit-maximizing level of MPK for firms, leading firms to a ________ capital-output ratio, thus ________ net investment.
A) raises, higher, raising
B) raises, lower, lowering
C) lowers, higher, raising
D) lowers, higher, lowering
E) lowers, lower, raising
Answer: B
Question Status: Previous Edition

3) A higher inflation rate changes the user cost of capital, which ________ the profit-maximizing level of MPK for firms, leading firms to a ________ capital-output ratio, thus ________ net investment.

A) raises, higher, raising
B) raises, lower, lowering
C) lowers, higher, raising
D) lowers, higher, lowering
E) lowers, lower, raising
Answer: C
Question Status: Previous Edition

16.10 Conclusion: Investment as a Source of Instability

1) In 2010, gross private domestic investment constituted ________ percent of nominal GDP.
A) 70.4
B) 12.4
C) 18
D) -5.4
Answer: B
Question Status: New

2) In 2010, personal consumption expenditures constituted ________ percent of nominal GDP.
A) 70.6
B) 17
C) 18
D) -5.4
Answer: A
Question Status: New

3) Over the most recent movement from cyclical peak to trough 2001: Q1 to 2001: Q4, gross private domestic investment ________ approximately ________ percent.
A) rose; 61
B) fell; 7
C) rose; 21
D) fell; 11
Answer: D
Question Status: Previous Edition

4) Interest rates and investment move in the same direction when demand shifts toward ________-lived equipment, producing a ________ shift in the IS curve.
A) shorter, leftward
B) shorter, rightward
C) longer, leftward
D) longer, rightward
Answer: B
Question Status: Previous Edition

5) The effect of a drop in business confidence on the evaluation of MPK shifts the IS curve to the ________. Suppose the LM curve is fixed. The resulting ________ in the interest rate works through the accelerator model to ________ the fall in equilibrium output.
A) left, rise, increase
B) left, rise, more than offset

C) left, fall, offset part of
D) right, rise, offset part of
E) right, fall, more than offset
Answer: C
Question Status: Previous Edition

6) Policy activists can point to the volatility of ________ of private aggregate demand to score points in arguing for discretionary countercyclical policy.
A) the consumption segment
B) the consumption and net export segments
C) the investment and net export segments
D) none of the segments
Answer: C
Question Status: Previous Edition

7) The strongest point in the case against activism is that
A) so many segments of private aggregate demand are unstable.
B) activist policy, even if desirable, is too difficult to perform well enough.
C) private aggregate demand is basically stable.
D) policy rules for targets have been proven by the record of the Fed in the 1980s and 1990s to be perfectly feasible.
Answer: B
Question Status: Previous Edition

***Macroeconomics, 12e* (Gordon)**
Chapter 17 New Classical Macro and New Keynesian Macro

17.1 Introduction: Classical and Keynesian Economics, Old and New

1) A principle difference between the new Classical and the new Keynesian models has to do with the choices made by business firms. We find that
A) new classical business firms choose the output level given the price level, while new Keynesian firms choose the price level given the level of output.
B) new classical business firms choose the price level given the output level, while new Keynesian firms choose the output level given the level of output.
C) both new classical and new Keynesian firms select the price level, but only new classical firms select the output level.
D) both new classical and new Keynesian firms select the output level, but only Keynesian firms select the price level.
Answer: A
Question Status: Previous Edition

2) One of the major weaknesses of the original Keynesian approach to the business cycle was
A) the assumption that firms were perfectly competitive.
B) the failure to explain why wages were rigid.
C) the denial of the existence of the Pigou effect.
D) the assumption that the demand for labor depended on the real wage.
Answer: B
Question Status: Previous Edition

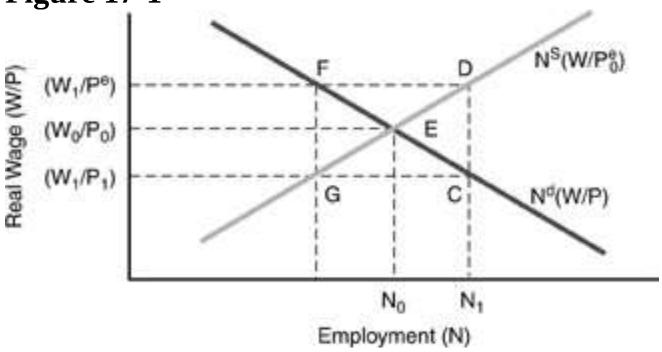
17.2 Imperfect Information and the "Fooling Model"

1) Which of the following is an important assumption about the labor market that is shared by both the original Keynesian model and the Friedman "Fooling Model?"
A) The supply of labor depends on expected real wages.
B) The demand for labor is a function of nominal wages.
C) Workers can be "off" their labor supply function in the short-run equilibrium.
D) Firms can be "off" their labor demand function in the short-run equilibrium.
Answer: C
Question Status: Previous Edition

2) According to Gordon which of the following statements about Friedman's fooling model is accurate?
A) The demand for labor depends on the nominal wage.
B) As prices increase, firms will offer higher real wages; these higher wages will bring forth an increase in the supply curve of labor.
C) The supply curve of labor depends on the expected real wage.
D) All of the above statements are accurate.
Answer: D
Question Status: Previous Edition

3) Which of the following are NOT included among Gordon's criticisms of Friedman's fooling model?
A) Workers buy many goods on a weekly basis and thus could discover quite quickly that prices had risen.
B) Workers could discover movements in the aggregate price level fairly easily.
C) The model relied on a non-market-clearing explanation of the labor market.
D) Workers would predict higher prices if policies that led to higher prices in the past were used again.
Answer: C
Question Status: Previous Edition

Figure 17-1



4) In the Friedman "Fooling Model" a ________ causes the labor supply curve to shift, and in Figure 17-1 above, if the initial equilibrium is at point C then, the new level of price expectations, POe is ________ than the initial level of Pe.
A) change in the money supply; less than
B) change in real wages; less than
C) change in nominal wages; greater than

D) change in price expectations; greater than
Answer: D
Question Status: Previous Edition

5) In the Friedman "Fooling Model" if P(e) is less than P then the labor supply curve in Figure 17-1 above
A) shifts leftward when workers realize their error.
B) always shifts rightward.
C) initially remains the same.
D) Both A and C are correct.
Answer: D
Question Status: Previous Edition

6) The actual real wage must be below the equilibrium real wage in order to encourage firms to produce at any output level above the natural rate. Once workers realize this situation, their expected price level will gradually rise and they will demand a higher nominal wage. This description of a business cycle adjustment is part of which of the following theories?
A) Classical model
B) original Keynesian model
C) Friedman fooling model
D) the RBC model
Answer: C
Question Status: Previous Edition

7) Which of the following assumptions is found in Friedman's model but not in the new classical model?
A) Supply of labor depends on expected real wage.
B) Workers gradually adapt their expectations of the price level to the actual price level.
C) imperfect information
D) market-clearing labor market
Answer: B
Question Status: Previous Edition

8) The assumption of imperfect information is critical to
A) the old Keynesian and all New Classical approaches.
B) all New Classical approaches.
C) the Friedman, Phelps, and Lucas New Classical approaches.
D) the real business cycle approach.
Answer: C
Question Status: Previous Edition

9) The "fooling" model was developed by economist
A) Milton Friedman.
B) Edward Prescott.
C) Robert Lucas, Jr.
D) John Maynard Keynes.
E) Charles Bogle.
Answer: A
Question Status: Previous Edition

10) In the "fooling" model, it is assumed that ________ can have inaccurate perceptions of the price level in the economy.
A) workers
B) firms
C) workers and firms
D) neither workers nor firms
Answer: A
Question Status: Previous Edition

11) In the fooling model, suppose that from an initial AD/SAS/LAS equilibrium a sudden expansion of aggregate demand occurs. With fooling, we would find employment and the actual real wage in the labor market diagram by moving
A) "northeast" along the labor supply curve.
B) "northwest" along the labor demand curve.
C) "southeast" along the labor demand curve.
D) "southwest" along the labor supply curve.
Answer: C
Question Status: Previous Edition

12) In the fooling model, should an expansion of aggregate demand cause fooling, the actual real wage ________ while the expected real wage ________.
A) rises, rises
B) rises, remains constant
C) falls, falls
D) falls, remains constant
E) falls, rises
Answer: E
Question Status: Previous Edition

13) In the fooling model's labor market diagram, from an initial intersection point of the labor supply and demand curves, tracing "northeast" up the labor supply curve shows
A) what happens to real wages and employment when aggregate demand expands.
B) what happens to real wages and employment when aggregate demand contracts.
C) what workers think is happening to real wages if an aggregate demand expansion fools them.
D) what firms think is happening to real wages if an aggregate demand expansion fools them.
Answer: C
Question Status: Previous Edition

14) In the fooling model's labor market diagram, from an initial intersection point of the labor supply and demand curves, tracing "northwest" up the labor demand curve shows
A) what happens to real wages and employment when aggregate demand expands.
B) what happens to real wages and employment when aggregate demand contracts.
C) what workers think is happening to real wages if an aggregate demand expansion fools them.
D) what firms think is happening to real wages if an aggregate demand contraction fools them.
Answer: B
Question Status: Previous Edition

15) In the fooling model's labor market diagram, from an initial intersection point of the labor supply and demand curves, tracing "southwest" down the labor supply curve shows
A) what happens to real wages and employment when aggregate demand expands.
B) what happens to real wages and employment when aggregate demand contracts.
C) what workers think is happening to real wages if an aggregate demand contraction fools them.
D) what firms think is happening to real wages if an aggregate demand expansion fools them.
Answer: C
Question Status: Previous Edition

16) In the fooling model's AD/SAS/LAS diagram, short-run equilibria to the right of the LAS curve require the price level to be
A) above what workers expect.
B) above what firms expect.
C) below what workers expect.
D) below what firms expect.
Answer: A
Question Status: Previous Edition

17) In the fooling model's AD/SAS/LAS diagram, short-run equilibria to the left of the LAS curve require the price level to be
A) above what workers expect.
B) above what firms expect.
C) below what workers expect.
D) below what firms expect.
Answer: C
Question Status: Previous Edition

18) In the fooling model, what is held constant along a SAS curve?
A) the expected price level
B) the nominal wage rate
C) the expected price level and the nominal wage rate
D) the real wage rate
E) the nominal and real wage rates
Answer: A
Question Status: Previous Edition

19) In the fooling model, AD/SAS equilibria to the right of LAS are unstable because ________ nominal wages shift ________.
A) falling, AD downward
B) falling, SAS downward
C) rising, AD upward
D) rising, SAS upward
Answer: D
Question Status: Previous Edition

20) In the fooling model, AD/SAS equilibria to the left of LAS are unstable because ________ nominal wages shift ________.
A) falling, AD downward
B) falling, SAS downward
C) rising, AD upward
D) rising, SAS upward
Answer: B
Question Status: Previous Edition

21) In the fooling model, real wages
A) are countercyclical.
B) are procyclical.
C) are constant.
D) show no clear cyclical pattern.
Answer: A
Question Status: Previous Edition

22) A macroeconomic model obeys the "natural rate hypothesis" by incorporating
A) the assumption of nominal wage stickiness.
B) a vertical LAS curve.
C) imperfect information.
D) a vertical AD curve.
Answer: B
Question Status: Previous Edition

23) The downfall of the fooling model is that it assumes an implausibly ________ level of perception about price on the part of ________.
A) high, firms
B) high, workers
C) low, firms
D) low, workers
Answer: D
Question Status: Previous Edition

24) According to the theory of rational expectations, the "fooling" of workers in Friedman's model
A) is rational, since sudden unforeseeable changes in aggregate demand can and do occur.
B) is rational, since workers are always on their labor supply curve.
C) is not rational, since workers should learn to immediately link unexpected wage changes to wrongly-forecast price levels.
D) is not rational, since workers are often thrown off of their labor supply curve.
Answer: C
Question Status: Previous Edition

25) The "information barrier" that is the root cause of business cycles in the Lucas model is that
A) workers observe the prices of what they personally buy, but cannot observe the general price level.
B) workers do not know when changes in the price level mean changes in the prices of the goods they buy.
C) firms do not know when changes in the price of the good they sell matches changes in the price level and thus their marginal cost.
D) firms do not know if a change in the price level will have any effect on their marginal cost and thus their willingness to supply.
Answer: C
Question Status: Previous Edition

17.3 The Lucas Model and the Policy Ineffectiveness Proposition

1) Which of the following statements best describes the rational expectations hypothesis?
A) Individuals will not enter into long-term agreements unless they are certain about the payments they will receive.
B) It is likely that individuals will consistently make errors.
C) Individuals will make random errors, independent of previous errors.
D) It is reasonable to expect individuals to consistently underestimate the level of inflation.
Answer: C
Question Status: Previous Edition

2) Which of the following best describes the policy ineffectiveness proposition?
A) Monetary policy cannot change real GDP in a regular or predictable way.
B) Policymakers can be effective in changing real GDP only if people's expectations are correct.
C) Monetary policy can change real GDP only if the Fed pursues a consistent, stable growth rate of the real money supply.
D) Fiscal policy is totally ineffective in changing real GDP in both the short run and the long run.
Answer: A
Question Status: Previous Edition

3) Switzerland has experienced the lowest rate of price increases in the post World War II period. Consequently, Lucas would predict
A) small supply responses to variations in the inflation rate.
B) large supply responses to variations in the inflation rate.
C) small demand responses to variations in the inflation rate.
D) large demand responses to variations in the inflation rate.
Answer: B
Question Status: Previous Edition

4) Which of the following is NOT a basic assumption of the "Lucas" model?
A) slow adjustment of wages and prices
B) rational expectations
C) imperfect information
D) market-clearing
Answer: A
Question Status: Previous Edition

5) Robert Lucas Jr. adapted the fooling model to his own way of thinking by replacing that model's assumption of
A) continuous market-clearing.
B) imperfect information.
C) the natural rate hypothesis.
D) the gradual correction of expectational errors.
Answer: D
Question Status: Previous Edition

6) The "real business cycle" (RBC) model adapts the Lucas model by replacing its assumption of
A) demand shocks as primary generators of cycles.

B) adaptive expectations.
C) continuous market-clearing.
D) slow wage and price adjustment.
Answer: A
Question Status: Previous Edition

7) In the RBC model, actual real GDP is
A) never equal to the natural real GDP.
B) equal to the natural real GDP when P = Pe.
C) equal to the natural real GDP when P is equal to or greater than Pe.
D) always equal to the natural real GDP.
Answer: D
Question Status: Previous Edition

8) In the RBC model, supply shocks
A) are always favorable by definition, but come at irregular intervals.
B) are always adverse by definition, but come at irregular intervals.
C) alternate between favorable and adverse shocks.
D) follow demand shocks with the opposite effect on output.
Answer: C
Question Status: Previous Edition

17.4 The Real Business Cycle Model

1) Which of the following theories of business cycles implies that efficient markets, characterized by perfect information and by rational business firms and households, will still be characterized by business cycles?
A) Lucas's rational expectation model
B) the natural rate hypothesis
C) the real business cycle model
D) classical theory
Answer: C
Question Status: Previous Edition

2) According to the Real Business Cycle model real wages should
A) remain constant.
B) fall during recessions.
C) rise during recessions.
D) stay the same during recessions but rise during expansions.
Answer: B
Question Status: Previous Edition

3) Of the four models of the business cycle, which model's implication concerning the change in real wages during recessions is consistent with actual observed changes in real wages during recessions?
A) the Real Business Cycle theory
B) the Friedman-Phelps-Lucas Model
C) the Keynesian Model
D) None of the above.
Answer: A
Question Status: Previous Edition

4) Economist Edward Prescott is associated with the
A) early spread of the old Keynesian approach.
B) creation of the "fooling" model.
C) creation of the first "New Classical" approach.
D) creation of the "real business cycle" model.
Answer: D
Question Status: Previous Edition

5) A favorable supply shock shifts the production function curve ________ and the labor demand curve ________.
A) upward, upward
B) upward, downward
C) downward, upward
D) downward, downward
Answer: A
Question Status: Previous Edition

6) An adverse supply shock shifts the production function curve ________ and the labor demand curve ________.
A) upward, upward
B) upward, downward
C) downward, upward
D) downward, downward
Answer: D
Question Status: Previous Edition

7) In the RBC model, the importance of "intertemporal substitution" of labor supply is ________, which results in a rather ________ labor supply curve.
A) denied, flat
B) denied, steep
C) emphasized, flat
D) emphasized, steep
Answer: C
Question Status: Previous Edition

8) The RBC approach has workers allocating their labor effort over blocks of time, with periods of intense activity when wages are high alternating with slack periods of vacation and leisure. This makes the labor supply curve rather ________, with unemployment an entirely ________ phenomenon.
A) steep, voluntary
B) steep, involuntary
C) flat, voluntary
D) flat, involuntary
Answer: C
Question Status: Previous Edition

9) The RBC model tells us that
A) as the real wage rate rises, the amount of labor supplied and thus output produced falls.
B) as the price level rises, the real wage rises, thus raising the amounts of labor supplied and output produced.
C) as the real interest rate rises, the amount of labor supplied and thus output produced rises.
D) as the price level rises above the expected price level, actual output rises above the natural real GDP.
Answer: C
Question Status: Previous Edition

10) A variable that RBC theory is simply not interested in and seldom attempts to explain or predict is
A) employment.
B) the real interest rate.
C) the real wage rate.
D) the price level.
Answer: D
Question Status: Previous Edition

11) A recent development in the RBC literature is the growing admission of the possible importance of
A) nominal variables.
B) real demand shocks.
C) favorable supply shocks.
D) changes in monetary policy.
E) technological changes.
Answer: B
Question Status: Previous Edition

12) In the RBC model, an adverse supply shock causes the decrease in natural real GDP to be minimized when the labor supply curve is
A) downward sloping and extremely flat.
B) upward-sloping and extremely flat.
C) upward-sloping and extremely steep.
D) vertical.
Answer: D
Question Status: Previous Edition

13) In the RBC model, an adverse supply shock causes the decrease in natural real GDP to be maximized when the labor supply curve is
A) relatively steep.
B) relatively flat.
C) vertical.
D) horizontal.
Answer: D
Question Status: Previous Edition

14) RBC theory leads to ________ government macro-stabilization policy, due to the theory's assumption of ________.
A) a rationale for, slow wage and price adjustment
B) a rationale for, continuous market-clearing
C) a rejection of, slow wage and price adjustment
D) a rejection of, continuous market-clearing
Answer: D
Question Status: Previous Edition

15) Consider an adverse supply shock in the RBC model. The central bank knows that the pre-shock level of output
A) can be maintained only by reducing the money supply.
B) can be maintained only by holding constant the money supply,
C) can be maintained only by increasing the money supply.
D) cannot be maintained by any monetary policy.
Answer: D
Question Status: Previous Edition

16) RBC theorists claim that adverse supply shocks can take forms other than rising raw materials prices. One such shock comes from government policy:
A) reductions in government expenditure.
B) increases in tax rates.
C) more rigorous environmental regulation.
D) reductions in the money growth rate.
Answer: C
Question Status: Previous Edition

17) It is reasonable to assume that in a developed economy technological shocks occur ________ across industries, which ________ the RBC theory of business cycles.
A) randomly, opposes
B) randomly, supports
C) uniformly, opposes
D) uniformly, supports
Answer: A
Question Status: Previous Edition

18) In the United States since the 1920s, there has been only one decade that appears to accord fairly well with the RBC theory of business cycles:
A) the 1930s.
B) the 1960s.
C) the 1970s.
D) the 1980s.
Answer: C
Question Status: Previous Edition

19) The basic RBC model predicts ________ movements in the price level, which in fact occur ________ in the U.S. economy.
A) countercyclical, only occasionally
B) countercyclical, most of the time
C) procyclical, only occasionally
D) procyclical, most of the time
Answer: A
Question Status: Previous Edition

20) The basic RBC model produces ________ movements in the real wage, which in fact are ________ in the statistical evidence.
A) countercyclical, found
B) countercyclical, not found
C) procyclical, found
D) procyclical, not found
Answer: D
Question Status: Previous Edition

21) The flaw of the Real Business Cycle model is that it
A) assumes away output fluctuations.
B) assumes complete wage rigidity.
C) assumes unrealistic fooling of workers.
D) requires procyclical wage movements and continuous labor market equilibrium.
Answer: D
Question Status: Previous Edition

17.5 New Classical Macroeconomics: Limitations and Positive Contributions

1) If the markets in the economy are characterized by rational expectations, then
A) predictable changes cause neither the AD nor the SAS curves to shift.
B) predictable changes in monetary policy are ineffective in changing output.
C) unpredictable monetary policy is ineffective in changing prices.
D) unpredictable fiscal policy is ineffective in changing prices.
Answer: A
Question Status: Previous Edition

2) A positive "price surprise" will result in a
A) leftward shift in the short-run SAS curve.
B) leftward shift in the short-run AD curve.
C) rightward shift in the short-run AD curve.
D) rightward shift in the short-run SAS curve.
Answer: A
Question Status: Previous Edition

3) According to the classical model, real wages should
A) remain constant.
B) fall during recessions.
C) rise during recessions.
D) stay the same during recessions but rise during expansions.
Answer: A
Question Status: Previous Edition

4) In the short-run, a supply shock will lead to
A) movement of prices and output in the same direction.
B) movement of prices and output in opposite directions.
C) a sustained inflation.
D) a movement in prices, but not output.
Answer: B
Question Status: Previous Edition

5) A supply shock, such as the OPEC oil-price increases in the 1970s,
A) can lead to accelerating inflation, if an accommodation policy tries to maintain the pre-shock level of real GDP.
B) will cause lower real wages in long-run equilibrium.
C) will reduce the natural level of real GDP.
D) both B and C
Answer: D
Question Status: Previous Edition

6) A supply shock that reduces labor productivity
A) causes accelerating inflation if the Fed attempts to maintain the original output level.
B) will increase real wages if nominal wages are flexible.
C) will reduce the level of output at the natural level of real GDP even if employment does not decline.
D) A and C.
Answer: D
Question Status: Previous Edition

7) Which of the following is NOT a reason why natural GDP might fall as a result of a supply shock?
A) The production function shifts downward.
B) There might be a voluntary decline in the supply of labor in response to the decline in real wages.
C) The supply of labor is a function of the expected wage rate.
D) none of the above
Answer: C
Question Status: Previous Edition

8) An adverse supply shock with a vertical supply of labor curve will
A) raise the price level and leave unemployment unchanged.
B) raise unemployment and lower the price level.
C) raise both unemployment and the price level.
D) lower both unemployment and the price level.
Answer: A
Question Status: Previous Edition

9) The natural real GDP will ________ following a fall in energy prices because
A) rise; labor productivity increases.
B) fall; labor productivity declines.
C) rise; employment is more attractive relative to leisure.
D) A and C are both correct
Answer: D
Question Status: Previous Edition

10) The natural real GDP will ________ following a rise in energy prices because
A) rise; labor productivity increases.
B) fall; labor productivity increases.
C) fall; real wages are flexible and employment is less attractive relative to leisure.
D) B and C are both correct.
Answer: C
Question Status: Previous Edition

11) Which of the following theories fails to explain persistent unemployment?
A) classical theory
B) Friedman and Phelps fooling theory
C) new Keynesian theory
D) Both A and B are correct.
Answer: A
Question Status: Previous Edition

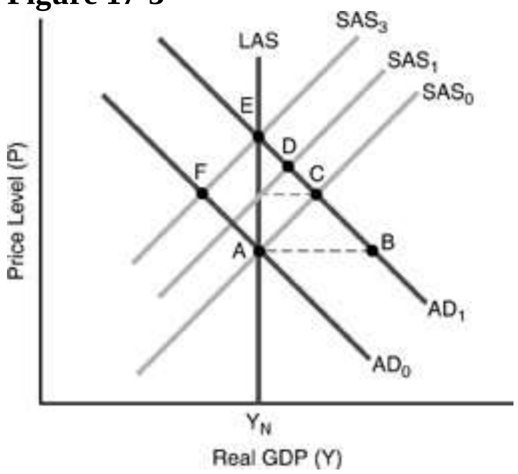
12) Classical macroeconomic theory was discredited and gave way to the first Keynesian approach as a result of
A) the collapse of the gold standard at the outset of World War I.
B) the Great Depression of the 1930s.
C) the wage-price controls of World War II.
D) the rapid inflation of the late 1960s.
E) the switch from fixed to flexible exchange rates in the early 1970s.
Answer: B
Question Status: Previous Edition

13) What all "New Classical" models have in common is the assumption of
A) imperfect information.
B) continuous clearing of product and labor markets.
C) the primary importance of technological and supply shocks in causing business cycles.
D) downward nominal wage rigidity.
E) countercyclical real wages.
Answer: B
Question Status: Previous Edition

14) If a macroeconomic model consists of upward-sloping short-run aggregate supply and downward-sloping aggregate demand, can it possibly generate a constant real GDP with no business cycles over time?
A) No, only a vertical short-run aggregate supply curve can produce that result.
B) No, only a horizontal short-run aggregate supply curve can produce that result.
C) Yes, but the short-run aggregate supply curve must never shift.
D) Yes, if the aggregate demand and short-run aggregate supply curves shift in perfect unison.
Answer: D
Question Status: Previous Edition

15) Suppose the AD and SAS curves shift upward by the same amount. Real GDP would ________ while the price level ________.
A) remain unchanged, rises
B) remain unchanged, remains unchanged
C) remain unchanged, falls
D) rise, remain unchanged
E) fall, rises
Answer: A
Question Status: Previous Edition

Figure 17-3



16) In Figure 17-3 above, suppose we are working under assumptions of the Lucas model. With an expansionary monetary policy, the "policy ineffectiveness proposition" is shown as a movement between points
A) A and C.
B) A and B.
C) D and B.
D) D and A.
E) A and E.
Answer: E
Question Status: Previous Edition

17) In Figure 17-3 above, SAS_0 must shift to SAS_1 when
A) the actual price level rises.
B) the expected price level rises.
C) AD_0 shifts to AD_1.
D) the nominal money supply rises.
Answer: B
Question Status: Previous Edition

18) In Figure 17-3 above, suppose we are working under the assumption of the Lucas model. The Fed has been following an announced policy of "zero money growth for an indefinite period." Suddenly and without warning it produces positive money growth and a "money surprise." This would result in a movement between points
A) A and C.
B) A and B.
C) D and B.
D) D and A.
E) A and D.
Answer: A
Question Status: Previous Edition

19) In Figure 17-3 above, suppose we are working under the assumption of the Lucas model. Suddenly, monetary policy becomes more expansionary and every firm believes that the higher prices bid on their product is not being enjoyed by any other firm. We would picture this as a movement between points
A) A and C.
B) A and B.
C) D and B.
D) D and A.
E) A and D.
Answer: A
Question Status: Previous Edition

20) In Figure 17-3 above, suppose we are working under the assumption of the Lucas model. It is the year of the presidential election, and fiscal policy becomes more expansionary. If every firm is convinced that its price increase is being duplicated across the economy, we would picture this as a movement between points
A) A and C.
B) A and B.
C) D and B.
D) D and A.
E) A and D.
Answer: E
Question Status: Previous Edition

21) After a shift from AD_0 to AD_1, which of the following patterns of adjustment is consistent with the "Price Fooling" model?
A) A to B to E
B) A to F to E
C) A to C to E
D) A to C to A
Answer: C
Question Status: Previous Edition

22) After a shift from AD_0 to AD_1, which of the following patterns of adjustment is consistent with the Lucas model?
A) A to B to E
B) A to F to E
C) A to C to E
D) A to C to A
Answer: C
Question Status: Previous Edition

23) The more that firms in an economy believe that the demand for their goods is mainly influenced by "local conditions" and not the aggregate level of demand, the ________ is the SAS curve and thus the ________ are cycles in real GDP.
A) steeper, larger
B) steeper, smaller
C) flatter, larger
D) flatter, smaller
Answer: C
Question Status: Previous Edition

24) The more that firms in an economy believe that the demand for their goods is mainly influenced by the aggregate level of demand and not "local conditions," the ________ is the SAS curve and thus the ________ are cycles in real GDP.
A) steeper, larger
B) steeper, smaller
C) flatter, larger
D) flatter, smaller
Answer: B
Question Status: Previous Edition

25) When there is extremely high and volatile inflation in an economy, the decision-making of firms leads to a very ________ SAS curve and thus relatively ________ cycles in real GDP.
A) steep, mild
B) steep, violent
C) flat, mild
D) flat, violent
Answer: A
Question Status: Previous Edition

26) Which of the following countries has a flat SAS curve?
A) Brazil
B) U.S.
C) Argentina
D) All of the above.
Answer: B
Question Status: Previous Edition

27) Countries with stable inflation rates tend to have ________ SAS curves.
A) flat
B) steep
C) flat or steep
D) None of the above. All countries have SAS curves with almost the same slope.
Answer: A
Question Status: Previous Edition

28) Information on money growth is available to the public with ________ lags, causing difficulty for the ________ of the New Classical approach.
A) long, Friedman but not Lucas version
B) long, Lucas but not Friedman version
C) long, Friedman and Lucas versions
D) short, Friedman and Lucas versions
E) short, Friedman but not Lucas version
Answer: D
Question Status: Previous Edition

29) The New Classical assumption of how quickly markets clear is actually most appropriate in the analysis of
A) the labor market.
B) the aggregate good market.
C) financial markets.
D) the market for consumer durables.
Answer: C
Question Status: Previous Edition

30) While much of New Classical macroeconomics is being refuted by the evidence, at least one part of it may be a permanent legacy to all macroeconomists: the assumption of
A) continuous clearing of all markets.
B) rational expectations.
C) the unimportance of nominal variables.
D) supply shocks as the main cause of business cycles.
Answer: B
Question Status: Previous Edition

31) While much of New Classical macroeconomics is being refuted by the evidence, at least one part of it may be a permanent legacy to all economists. It is the insistence on a certain aspect of macroeconomic policy:
A) It has as much impact on SAS as on AD.
B) It has its impact on nominal and not real variables.
C) People will try to anticipate it and then act accordingly.
D) It has no impact on SAS or AD, but does affect LAS.
Answer: C
Question Status: Previous Edition

32) One clear triumph for New Classical macroeconomics is its contribution to the analysis of hyperinflation. In bringing extremely rapid inflation to a halt by radical changes in policy, there is generally ________ loss of output, which ________ the Policy Ineffectiveness Proposition.
A) only a modest, supports a mild form of
B) only a modest, completely overturns
C) a major, supports a mild form of
D) a major, completely overturns
Answer: A
Question Status: Previous Edition
33) The flaw of the Classical model of the business cycle is that it
A) assumes away output fluctuations.

B) assumes complete wage rigidity.
C) assumes unrealistic fooling of workers.
D) requires procyclical wage movements and continuous labor market equilibrium.
Answer: A
Question Status: Previous Edition

17.6 Essential Features of the New Keynesian Economics

1) According to the Keynesian model, real wages should
A) remain constant.
B) fall during recessions.
C) rise during recessions.
D) stay the same during recessions but rise during expansions.
Answer: C
Question Status: Previous Edition

2) The new Keynesian models, are examples of
A) market-clearing, wage rigidity models.
B) non-market-clearing, wage rigidity models.
C) imperfect information, wage rigidity models.
D) perfect information, non-clearing market models.
Answer: B
Question Status: Previous Edition

3) A principle difference between the original Keynesian model and the new Keynesian model is that in the new version
A) the traditional assumptions of profit maximization is no longer included.
B) monetary policy is impotent.
C) wages and prices adjust slowly to market conditions.
D) All of the above are correct.
Answer: C
Question Status: Previous Edition

4) Assuming that workers will be pushed off their labor supply curve in response to a change in aggregate demand is part of which of the following theories?
A) Classical
B) Keynesian
C) New Classical
D) Both Classical and Keynesian
Answer: B
Question Status: Previous Edition

5) According to the original Keynesian model, there would be counter-cyclical movements of the real wage rate in response to changes in aggregate demand because
A) firms react to nominal wages and workers respond to real wages.
B) firms react to real wages and workers respond to the expected real wage.
C) firms are on their labor demand curve and workers are off their labor supply curve.
D) firms are off their labor demand curve and workers are on their labor supply curve.
Answer: C
Question Status: Previous Edition

6) In the non-market-clearing model, "involuntary" unemployment results because
A) real wages are too high.
B) real wages rise when aggregate demand increases.
C) real wages fall when aggregate demand increases.
D) wages and prices are sticky.
Answer: D
Question Status: Previous Edition

7) Under the assumptions of the new Keynesian model, an increase in aggregate demand will
A) increase prices and output in the short-run.
B) lead to a decrease in unemployment and an increase in prices in the short run.
C) lead to an increase in the nominal wage rate in the long run and a decrease in unemployment in the short run.
D) All of the above are correct.
Answer: D
Question Status: Previous Edition

8) According to the new Keynesian economists, SAS adjusts slowly to a change in AD because of
A) high menu costs.
B) staggered overlapping wage contracts.
C) efficiency wages.
D) All of the above combinations explain slow adjustments in SAS.
Answer: D
Question Status: Previous Edition

9) Gordon believes that the new Keynesian approach as opposed to other business cycle theories is preferred because
A) it explains information barriers and sticky wages.
B) it explains how workers are "fooled."
C) it explains wage and price stickiness assuming rational firms and workers.
D) it identifies the source of supply side shocks and slow SAS adjustment.
Answer: C
Question Status: Previous Edition

10) Which explanation for persistent unemployment used by the original Keynesian model is no longer needed in the new Keynesian model?
A) shifting IS curve
B) a fixed nominal wage
C) aggregate supply curve is a function of the nominal wage
D) rigid wages and prices
Answer: B
Question Status: Previous Edition

11) The new Keynesian economists argue that prices are relatively rigid because of
A) menu costs.
B) overlapping staggered contracts.
C) efficiency wages.
D) All of the above.
Answer: D
Question Status: Previous Edition

12) The use of bar codes, computerized price lists, and scanners in supermarkets is an example of
A) menu costs.
B) implicit contracts.
C) efficiency pricing.
D) All of the above.
Answer: A
Question Status: Previous Edition

13) In 1989, Sears and Roebuck closed its stores and remarked every price in its stores to reflect a new "lower everyday" pricing strategy. Sears must have believed at that time that
A) the profit from extra sales were less than additional menu costs.
B) the menu costs were less than the gain in profits from additional sales.
C) extra liquidity was more important than menu costs.
D) B and C.
Answer: B
Question Status: Previous Edition

14) American automobile manufacturers and dealers appear to adjust the price (sticker prices plus financing charges) by periodically changing interest rates and by using rebates and surcharges as opposed to directly changing sticker prices. Assuming that they maximize their profits, this pricing approach may reflect
A) a relatively low cost to adjust sticker prices.
B) a relatively low cost to adjust advertising.
C) a relatively high cost to adjust sticker prices.
D) a relatively high cost of advertising.
Answer: C
Question Status: Previous Edition

15) In the "non-market-clearing model" the level of final goods sales and unemployment during a recession are
A) the result of interactions between supply and demand.
B) higher than would be the case in a market clearing model.
C) caused by the rapid adjustment of prices and wages.
D) the result of wage and price rigidities.
Answer: D
Question Status: Previous Edition

16) The "old" Keynesian approach dominated macroeconomic theory until the
A) 1930s.
B) late 1950s.
C) late 1960s.
D) early 1980s.
Answer: C
Question Status: Previous Edition

17) A crucial feature of early Keynesian business cycle theory is that real wages vary ________, which in fact ________ clearly emerge from U.S. data on wages over time.
A) countercyclically, does not
B) countercyclically, does
C) procyclically, does not
D) procyclically, does
Answer: A
Question Status: Previous Edition

18) The "New Keynesian" macroeconomics centered on
A) the assumption of continuous market-clearing.
B) the importance of technological shocks.
C) the imperfectness of the information held by economic decision-makers.
D) the rational reasons for slow price and wage adjustment.
Answer: D
Question Status: Previous Edition

19) Gordon presents several modern business cycle theories. He clearly states after all have been explained that he believes the most plausible of them to be the ________ model.
A) Lucas information-barrier
B) Friedman fooling
C) New Keynesian
D) real business cycle
Answer: C
Question Status: Previous Edition

20) Aggregate price information, such as recalculations of the CPI, is available to the public with ________ lags, causing difficulty for the ________ of the New Classical approach.
A) long, Friedman but not Lucas version
B) long, Lucas but not Friedman version
C) long, Friedman and Lucas versions
D) short, Friedman and Lucas versions
E) short, Friedman but not Lucas version
Answer: D
Question Status: Previous Edition

21) "Non-market-clearing" approaches to macroeconomics include
A) the original Keynesian model, but not the New Keynesian model.
B) the New Keynesian model, but not the original Keynesian model.
C) the original and New Keynesian models.
D) neither the original nor the new Keynesian models.
Answer: C
Question Status: Previous Edition

22) With the assumption that some voluntary exchanges that would make both parties better off are somehow being blocked, we have the basis for a ________ macroeconomic model, such as those constructed by ________ economists.
A) non-market-clearing, New Keynesian
B) non-market-clearing, New Classical
C) market-clearing, New Keynesian
D) market-clearing, New Classical
Answer: A
Question Status: Previous Edition

23) Much of macroeconomic theory has been developed under the simplifying assumption that relative prices and wages are fixed, or equivalently that the economy is producing one good using one input (labor) with one wage rate. Such an assumption is clearly ________ of New Keynesian macroeconomics, given its emphasis on the importance of ________ in explaining business cycles.
A) part, profit maximization
B) part, staggered contracts
C) not part, profit maximization
D) not part, staggered contracts
Answer: D
Question Status: Previous Edition

24) A New Keynesian firm chooses
A) its selling price and how much it sells at that price.
B) its selling price but not how much it sells at that price.
C) how much it sells but not the selling price.
D) neither how much it sells nor the selling price.
Answer: B
Question Status: Previous Edition
25) A New Keynesian firm produces the output at which
A) marginal revenue equals zero.
B) marginal cost equals zero.

C) its selling price equals marginal cost.
D) marginal revenue equals marginal cost.
Answer: D
Question Status: Previous Edition

26) Crucial assertions in the menu-cost literature are that those costs ________ be large for them to have an effect on firms' pricing, while potential total welfare losses ________ menu costs that have been avoided.
A) need not, may be several times larger than
B) need not, are generally much less than
C) must, may be several times larger than
D) must, are generally much less than
Answer: A
Question Status: Previous Edition

27) The flaw of the original Keynesian model of the business cycle is that it
A) assumes away output fluctuations.
B) assumes complete wage rigidity.
C) assumes unrealistic fooling of workers.
D) requires procyclical wage movements and continuous labor market equilibrium.
Answer: B
Question Status: Previous Edition

17.7 Why Small Nominal Rigidities Have Large Macroeconomic Effects

1) Business cycles will occur if either of the two theories below characterizes the behavior of the economy:
A) the classical or the Keynesian theories of aggregate demand.
B) the classical or the real balance theory.
C) deflation impotence or rigid nominal wages.
D) A and C.
Answer: C
Question Status: Previous Edition

2) According to Gordon, a major problem with Keynes' "rigid nominal wage" theory of the business cycle is
A) a horizontal LM curve.
B) it is not a market clearing theory.
C) falling real wages are not countercyclical with business activity or Y.
D) None of the above.
Answer: C
Question Status: Previous Edition

3) If imperfect information characterizes workers' behavior, then there will be a
A) slow adjustment of the demand for labor, Nd.
B) rapid adjustment of the demand for labor, Nd.
C) rapid adjustment of both the demand for labor, Nd, and the supply of labor, Ns.
D) a lagged adjustment of the equilibrium level of employment, Ns.
Answer: D
Question Status: Previous Edition

4) If it is less costly for business firms to adjust the labor demanded as the price level changes than it is for households to adjust Ns, then in the short-run
A) Ns has a positive slope and the demand for labor (Nd) negative slope.
B) Nd has a negative slope and the supply of labor (Ns) a positive slope.
C) AD has a negative slope.
D) SAS has a positive slope.
Answer: D
Question Status: Previous Edition

5) If forecasting errors are rational, then
A) people will always be error-prone.
B) they will be random, and thus independent of previous errors.
C) they will be independent of business firm production and price forecasts.
D) A and C are both correct.
Answer: B
Question Status: Previous Edition

6) According to the real business cycle theory, the supply side shock from dramatic increases in oil prices in the 1970s led to higher unemployment because
A) when the real wage, W/P, fell, workers chose leisure.
B) when the real wage, W/P, rose, workers chose leisure.
C) workers increase Pe.
D) None of the above.
Answer: A
Question Status: Previous Edition

7) Suppose that firms are paying their "efficiency wage" rate and AD shifts leftward. Firms that lower wages and maintain production would
A) achieve lower profits since worker efficiency would fall and total wages paid increase.
B) achieve lower profits since worker efficiency would fall and wages per unit of output increase.
C) achieve higher profits.
D) achieve lower per unit wage costs.
Answer: B
Question Status: Previous Edition

8) The reluctance to change the relative relationships between wage rates is called a
A) coordination failure.
B) real rigidity.
C) menu cost.
D) macroeconomic externality.
Answer: B
Question Status: Previous Edition

9) Suppose there is a 5 percent increase in nominal demand in every industry in an economy. Factors that keep the price level from also rising by 5 percent are called
A) real rigidities.
B) nominal rigidities.
C) macroeconomic externalities.
D) indexations.
Answer: B
Question Status: Previous Edition

10) Business cycles disappear when firms
A) hold nominal wages constant as nominal demand changes.
B) hold prices constant as nominal demand changes.
C) change prices proportionately with nominal demand changes.
D) change wages proportionately with nominal demand changes.
Answer: C
Question Status: Previous Edition

11) Suppose nominal aggregate demand falls by 3 percent while nominal wages are fixed. If firms were to lower their prices by 3 percent, this would ________ the drop in real output, with such pricing ________ an assumption that firms are profit-maximizers.
A) prevent, in violation of
B) prevent, consistent with
C) worsen, in violation of
D) worsen, consistent with
Answer: A
Question Status: Previous Edition

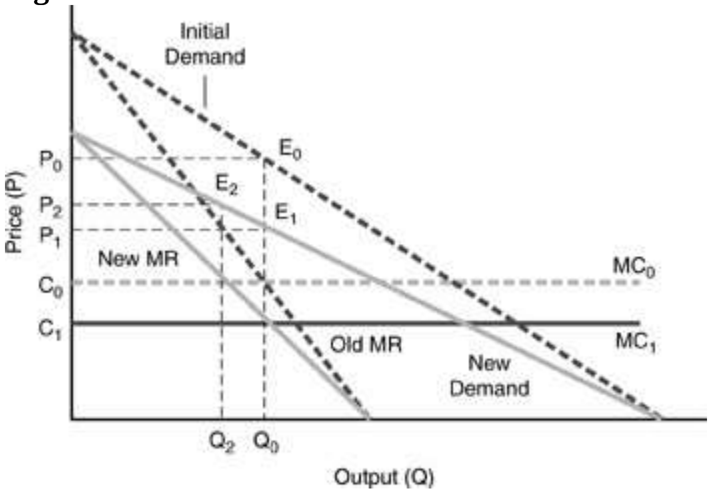
17.8 Coordination Failures and Indexation

1) Higher consumer prices caused by external forces would boost the wage costs of firms without any commensurate increase in the nominal demand for their products if
A) long-term contracts were in force.
B) all labor contracts were one year in duration.
C) there were no COLAs.
D) there were full COLA protection.
Answer: D
Question Status: Previous Edition

2) Gordon suggests that full indexation of production costs to nominal AD would solve the macroeconomic externality. However, individual firms would be unlikely to extend full indexation to their workers because
A) its local customers may not buy its products at the new price level.
B) its suppliers may reside in foreign countries and are therefore, not subject to indexation.
C) other competitor firms will not index their wages.
D) All of the above.
Answer: D
Question Status: Previous Edition

Figure 17-2 represents a monopolist faced with a decrease in the demand for her product. She initially charges P_0 and produces Q_0.

Figure 17-2



3) Without changes in MC to maximize profits, the firm will produce at point ________ on the new demand curve and lower price to ________.
A) E_1; P_1
B) E_0; P_0
C) E_2; P_2
D) E_0 or E_1; P_0
Answer: C
Question Status: Previous Edition

4) If the firm is able to reduce MC from MC_0 to MC_1 the firm will produce at point ________ on the new demand curve and lower price to ________.
A) E_1; P_1
B) E_0; P_0
C) E_2; P_2
D) E_0 or E_1; P_0
Answer: A
Question Status: Previous Edition

5) Faced with a decrease in the demand for its product, a monopolist will lower prices and maintain output at its previous level if

A) the gain in profit is less than the increase in real wages paid.
B) the gain in profit is less than the decrease in real wages paid.
C) the gain in profit is less than the menu costs.
D) the gain in profit is greater than the increase in menu costs.
Answer: D
Question Status: Previous Edition

6) If the labor supply curve is upward-sloping, an adverse supply shock causes ________ in employment and ________ in the real wage.
A) no change, a decrease
B) a decrease, a decrease
C) a decrease, no change
D) a decrease, an increase
E) an increase, an increase
Answer: B
Question Status: Previous Edition

7) If the labor supply curve is vertical, an adverse supply shock causes ________ in employment and ________ in the real wage.
A) no change, a decrease
B) a decrease, a decrease
C) a decrease, no change
D) a decrease, an increase
E) an increase, an increase
Answer: A
Question Status: Previous Edition

17.9 Long-Term Labor Contracts as a Source of the Business Cycle

1) Staggered, overlapping contracts mean
A) the contract between workers and firms can be opened for renegotiation if other key firms in the industry have signed a new contract within the last ninety days.
B) each firm within an industry agrees to negotiate with the union according to a schedule.
C) not all labor contracts within the economy expire at the same time.
D) different contracts are reached for the different skill classifications of workers within a firm.
Answer: C
Question Status: Previous Edition

2) Gordon argues that individual workers and firms prefer long-term contracts, but that such contracts
A) raise the costs of doing business, a macroeconomic externality.
B) insure that output alone is adjusted as AD changes and therefore, such contracts impose high costs of output and employment instability on society.
C) insure that the price level alone is adjusted as AD changes and therefore, such contracts impose high costs of output and employment instability on society.
D) insure a macroeconomic externality, rigid unemployment.
Answer: B
Question Status: Previous Edition

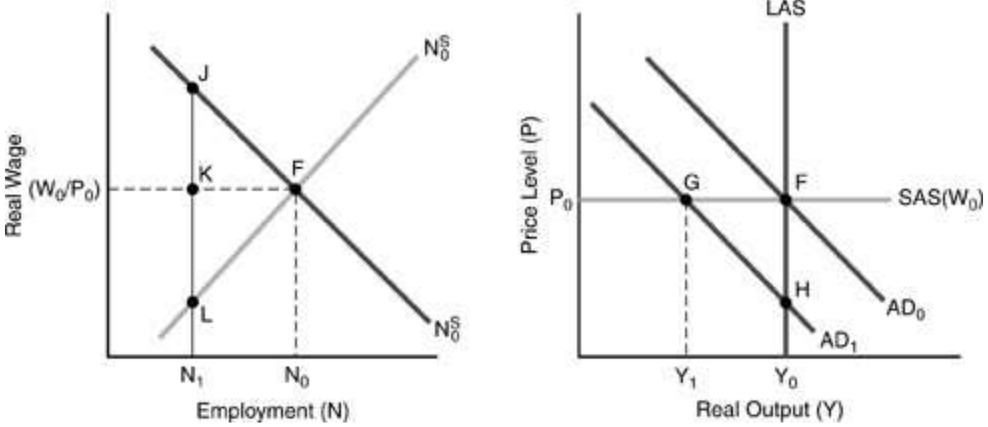
3) Long-term contracts are desirable for both firms and workers for each of the following reasons EXCEPT one. Which of the following does NOT explain the desirability of long-term contracts?
A) Wage negotiations are costly and time consuming on both sides.
B) Contracts insulate workers from changing economic conditions such as decreases in aggregate demand.
C) The incidence of strikes decreases because the contracts are binding for three years.
D) Contracts reduce uncertainty.
Answer: B
Question Status: Previous Edition

4) By the theory of intertemporal substitution of labor, a higher current real interest rate ________ the amount of labor ________ at each real wage rate in the current period.
A) raises, demanded
B) raises, supplied
C) lowers, demanded
D) lowers, supplied
Answer: B
Question Status: Previous Edition

5) Evidence from the United States and Japan on "multifactor productivity" shows it to be highly ________, which is ________ with the RBC theory of technological shocks and their consequences for the business cycle.
A) procyclical, consistent
B) procyclical, inconsistent
C) countercyclical, consistent
D) countercyclical, inconsistent
Answer: A
Question Status: Previous Edition

In Figure 17-4, below, initial demand, marginal cost, and marginal revenue curves (none of them shown) caused the firm to produce the profit-maximizing quantity Y_0 at a price of P_0. Now the demand and marginal cost curves have moved to those shown, with the marginal revenue curve running through point L.

Figure 17-4



6) In Figure 17-4 above, the profit-maximizing quantity, in the absence of "menu costs," ________, with profit equal to ________.

A) remains Y_0, J + K

B) remains Y_0, H + K

C) remains Y_0, G + H + J + K

D) falls to Y_1, G + J

E) falls to Y_1, F + G + J

Answer: A

Question Status: Previous Edition

7) If the firm in Figure 17-4 above maintains its set price of P_0, its profit is

A) G + H.

B) G + J.

C) F + G + J.

D) G + H + J + K.

E) J + K.

Answer: B

Question Status: Previous Edition

8) If the firm in Figure 17-4 above maintains its set price of P_0, rather than dropping price to P_1, this reduces its profit by

A) K - G.

B) K + G.

C) G - K.

D) G + H.

E) G.

Answer: A

Question Status: Previous Edition

9) If the firm in Figure 17-4 above maintains its set price of P_0, rather than dropping price to P_1, it must be facing a "menu cost" of adjusting its price that exceeds
A) K - G.
B) K + G.
C) G - K.
D) J.
E) K.
Answer: A
Question Status: Previous Edition

10) If the firm in Figure 17-4 above maintains its set price of P_0, rather than dropping price to P_1, the loss of consumer surplus due to this decision is
A) J + K.
B) K - G.
C) G + H.
D) H + K.
Answer: C
Question Status: Previous Edition

11) If the firm in Figure 17-4 above maintains its set price of P_0, rather than dropping price to P_1, the welfare loss to society due to this decision is
A) J + K.
B) K - G.
C) G + H.
D) H + K.
E) F + G + H.
Answer: D
Question Status: Previous Edition

12) Suppose that nominal aggregate demand falls by 4 percent, and at the same time every marginal cost also falls by 4 percent. The importance of menu cost theory is that in this situation the price level ________, meaning that a recession ________.
A) must fall by 4 percent as well, does not occur
B) must fall by 4 percent as well, must occur
C) still might not fall, may not occur
D) still might not fall, may occur
Answer: D
Question Status: Previous Edition

13) About what percentage of the U.S. labor force works under union wage contracts?
A) 50 percent
B) 35 percent
C) 25 percent
D) 10 percent
Answer: D
Question Status: Previous Edition

14) Nonunion wages should be modeled as
A) sticky, because they imitate union wages rather closely.

B) sticky, because their contracts cannot contain COLA clauses.
C) perfectly flexible, because wage contracts are illegal outside of unions.
D) perfectly flexible, because workers willing to take the risks of full wage flexibility are precisely those workers who have rejected unionization.
Answer: A
Question Status: Previous Edition

15) Suppose a worker signs a contract containing an 8 percent nominal wage increase with inflation expected to be 3 percent. Inflation turns out to be 6 percent, but the contract also contains 60 percent COLA protection. The worker's real wage under the contract
A) falls by 1.2 percent.
B) falls by 2.4 percent.
C) rises by 3.8 percent.
D) rises by 3.0 percent.
E) rises by 1.8 percent.
Answer: C
Question Status: Previous Edition

16) Suppose a worker signs a contract containing a 7 percent nominal wage increase with inflation expected to be 5 percent. Inflation turns out to be 10 percent, but the contract also contains 50 percent COLA protection. The worker's real wage under the contract
A) falls by 3.0 percent.
B) rises by 0.5 percent.
C) rises by 2.0 percent.
D) rises by 1.0 percent.
E) falls by 0.5 percent.
Answer: E
Question Status: Previous Edition

17) The central idea distinguishing the "efficiency wage model" is that the wage paid by Firm A relative to the wages at other firms helps determine
A) Firm A's demand for labor.
B) the amount of labor Firm A can hire.
C) the productivity of Firm A's workers.
D) Firm A's markup fraction.
Answer: C
Question Status: Previous Edition

18) According to efficiency wage theory, a firm that raises wages by one percent will actually lower the labor cost per unit of output if the wage increase
A) raises output per worker by more than one percent.
B) raises output per worker by less than one percent.
C) does not change output per worker.
D) lowers output per worker by less than one percent.
Answer: A
Question Status: Previous Edition

19) Initially a firm pays a wage and gets an output per worker which are given index numbers of 1.00. Five possible 5 percent increases in the wage and the accompanying output per worker are as follows: 1.05 and 1.09, 1.10 and 1.17, 1.15 and 1.24, 1.21 and 1.28, 1.27 and 1.31. What is the efficiency wage?
A) 1.05
B) 1.10
C) 1.15
D) 1.21
E) 1.27
Answer: C
Question Status: Previous Edition

20) Initially a firm pays a wage and gets an output per worker which are given index numbers of 1.00. Five possible 3 percent increases in the wage and the accompanying output per worker are as follows: 1.03 and 1.09, 1.06 and 1.17, 1.09 and 1.24, 1.13 and 1.29, 1.16 and 1.31. What is the efficiency wage?
A) 1.03
B) 1.06
C) 1.09
D) 1.13
E) 1.16
Answer: D
Question Status: Previous Edition

21) Efficiency wage theory provides a reason for uncontracted nominal wages to ________ when nominal aggregate demand falls, thus ________ a recession.
A) fall proportionately, leading to
B) fall proportionately, preventing
C) remain unchanged, leading to
D) remain unchanged, preventing
Answer: C
Question Status: Previous Edition

22) If all firms are paying efficiency wages and nominal aggregate demand falls, then between maintaining nominal wages and reducing them firms generally find it more profitable to ________ them, thus ________ the unemployment rate.
A) maintain, increasing
B) maintain, maintaining
C) reduce, increasing
D) reduce, maintaining
Answer: A
Question Status: Previous Edition

23) Because efficiency wage theory deals with the consequences of a change in a firm's ________ wage, if all wages were indexed to nominal aggregate demand the theory would be ________.
A) absolute, even more appropriate
B) absolute, rendered inappropriate
C) relative, even more appropriate
D) relative, rendered inappropriate
Answer: D
Question Status: Previous Edition

24) "Input-output" macroeconomics stresses that a change in nominal aggregate demand ________ produces an equal-proportional change in every firm's marginal cost, so that firms should consider indexing their price to nominal aggregate demand a very ________ pricing strategy.
A) need not, safe
B) need not, risky
C) must, safe
D) must, risky
Answer: B
Question Status: Previous Edition

25) Were the government to decree that henceforth all wages and other input prices are to be indexed to nominal aggregate demand, this ________ "coordination failure" of the macroeconomy and ________ business cycles.
A) solves the, amplifies
B) solves the, dampens
C) creates a, amplifies
D) creates a, dampens
Answer: B
Question Status: Previous Edition

26) The more a nation depends on imported raw materials, the ________ closely linked is its marginal cost to its nominal aggregate demand, thus the ________ for the typical firm is a policy of indexing price to nominal aggregate demand.
A) more, riskier
B) more, safer
C) less, riskier
D) less, safer
Answer: C
Question Status: Previous Edition

17.10 The New Keynesian Model Evolves into the DSGE Model

1) One fundamental difference between New Classical and the New Keynesian macroeconomics is that the New Keynesians model firms as ________ competitive price ________.
A) perfectly, setters
B) perfectly, takers
C) imperfectly, setters
D) imperfectly, takers
Answer: C
Question Status: Previous Edition

2) A primary difference between the original and New Keynesian approaches is that in the original model nominal wages are ________, while for the New Keynesians nominal wages are ________.
A) perfectly flexible, slow to adjust
B) slow to adjust, perfectly flexible
C) fixed, slow to adjust
D) slow to adjust, fixed
Answer: C
Question Status: Previous Edition

3) In New Keynesian analysis, firms are assumed to be
A) interested solely in maximizing their profit.
B) interested in both their profit and the avoidance of business cycles.
C) interested solely in avoiding business cycles.
D) interested solely in maximizing production.
Answer: A
Question Status: Previous Edition

4) After a drop in nominal aggregate demand, if menu costs prevent firms from reducing prices, this is considered ________ act by firms ________ a "macroeconomic externality."
A) a rational, because it produces
B) a rational, that happens to produce
C) an irrational, because it produces
D) an irrational, that happens to produce
Answer: B
Question Status: Previous Edition
5) Employing the New Keynesian concepts of "macroeconomic externality" and "coordination failure": if nominal aggregate demand and marginal cost fall by the same

proportion, society ________ afford to compensate firms for the profit they lose when they ________.
A) can, bear the menu costs of changing prices
B) can, hold prices constant
C) cannot, bear the menu costs of changing prices
D) cannot, hold prices constant
Answer: A
Question Status: Previous Edition

6) A transaction between A and B benefits both parties by 50, but imposes a cost on C of 20. C has the right to prevent the transaction. A "coordination failure" in this situation
A) is the cost imposed on C.
B) is the ability of C to prevent a transaction that still has a net overall gain of 80.
C) would occur if A and B do not compensate C by 20 or more to allow the transaction.
D) is that the cost to C is not 100.
Answer: C
Question Status: Previous Edition

7) In New Keynesian macroeconomics, when marginal costs are too sticky to change in proportion to nominal aggregate demand, prices ________ and so menu costs ________ needed to explain business cycles.
A) are also sticky, are
B) are also sticky, are not
C) are still perfectly flexible, are
D) are still perfectly flexible, are not
Answer: B
Question Status: Previous Edition

8) A central concept of New Keynesian macroeconomics is that in setting prices and wages, self-interested firms and workers are acting
A) irrationally, since their self-interest is badly damaged by the ensuing business cycles.
B) irrationally, since this imposes business cycles on everyone not part of their arrangements.
C) rationally, since they do not bear a fully offsetting cost of business cycles.
D) rationally, since the total welfare loss of business cycles must be small enough to justify the price and wage setting.
Answer: C
Question Status: Previous Edition

9) The flaw of the Friedman model of the business cycle is that it
A) assumes away output fluctuations.
B) assumes complete wage rigidity.
C) assumes unrealistic fooling of workers.
D) requires procyclical wage movements and continuous labor market equilibrium.
Answer: C
Question Status: Previous Edition

10) Which of the following is a New Keynesian explanation of wage and price stickiness must be discounted?
A) overlapping wage contracts
B) menu costs

C) efficiency wages
D) all of the above
Answer: D
Question Status: Previous Edition

***Macroeconomics, 12e* (Gordon)**
Chapter 18 Conclusion: Where We Stand

18.1 The Evolution of Events and Ideas

1) The evolution of macroeconomic theory
A) usually precedes and causes major macroeconomic events.
B) usually is in reaction to major macroeconomic events.
C) is evenly divided between causing and reacting to major macroeconomic events.
D) proceeds rather independently of major macroeconomic events.
Answer: B
Question Status: Previous Edition

2) Before the Great Depression, macroeconomic theory was dominated by the ________ approach that presumed the essential ________ of the private economy.
A) Keynesian, stability
B) Keynesian, instability
C) old classical, stability
D) old classical, instability
Answer: C
Question Status: Previous Edition

3) The old classical macroeconomic was based on an assumption of price and wage ________, and thus an economy that ________.
A) flexibility, promptly self-corrected
B) flexibility, failed to self-correct promptly
C) stickiness, promptly self-corrected
D) stickiness, failed to self-correct promptly
Answer: A
Question Status: Previous Edition

18.2 The Reaction of Ideas to Events, 1923-47

1) The Great Depression of the 1930s opened the door to the ________ revolution in macroeconomic theory.
A) Keynesian
B) old classical
C) New Keynesian
D) New classical
Answer: A
Question Status: Previous Edition

2) The Keynesian revolution was based on the assumption of price and wage ________ and thus the need for an activist ________ policy.
A) flexibility, monetary
B) flexibility, fiscal
C) stickiness, monetary
D) stickiness, fiscal
Answer: D
Question Status: Previous Edition

3) The quantity theory of money idea that velocity is ________ link between money growth and nominal GDP growth was ________ in the 1930s.
A) a stable, confirmed
B) a stable, disproved
C) an unstable, confirmed
D) an unstable, disproved
Answer: B
Question Status: Previous Edition

4) The ________ of the U.S. economy during World War II, with its vast defense spending, ________ of Keynesian macroeconomics.
A) continued stagnation, established the supremacy
B) continued stagnation, was the demise
C) rapid recovery, established the supremacy
D) rapid recovery, was the demise
Answer: C
Question Status: Previous Edition

18.3 The Reaction of Ideas to Events, 1947-69

1) In the late 1950s and early 1960s, postwar U.S. economic performance led to the formulation of and belief in a
A) vertical Phillips Curve in the short and long runs.
B) vertical Phillips Curve in the long run.
C) horizontal Phillips Curve in the short and long runs.
D) downward-sloping Phillips Curve in the short and long runs.
Answer: D
Question Status: Previous Edition

2) The U.S. economy in the 1960s was dominated by a massively expansionary ________ policy that ended up ________.
A) monetary, overstimulating the economy
B) monetary, being impotent in ending the long stagnation of that decade
C) fiscal, overstimulating the economy
D) fiscal, being impotent in ending the long stagnation of that decade
Answer: C
Question Status: Previous Edition

3) The great failure of activist fiscal policy in the 1960s was its
A) timidity in the face of persistent stagnation.
B) over-reliance on tax cuts to the exclusion of government spending programs.

C) delay in reversing course as the economy became overstimulated.
D) limited role as an accommodator of an activist monetary policy.
Answer: C
Question Status: Previous Edition

4) By the end of the 1960s, fiscal activism was falling out of favor due to its long ________ lag and, as predicted by the permanent-income hypothesis, the ________ of the 1968 tax surcharge.
A) legislative, ineffectiveness
B) legislative, overstimulation
C) effectiveness, ineffectiveness
D) effectiveness, overstimulation
Answer: A
Question Status: Previous Edition

5) An important failure of the "new economics" of the 1960s was its ________ monetary policy and its ability if made ________ to offset a tighter fiscal policy.
A) denigration of, tighter
B) denigration of, easier
C) overemphasis on, tighter
D) overemphasis on, easier
Answer: B
Question Status: Previous Edition

6) The ________ of the 1968 tax surcharge led to the prominence of the developer of the permanent-income hypothesis that predicted it, ________.
A) success, Walter Heller
B) success, Milton Friedman
C) failure, Walter Heller
D) failure, Milton Friedman
Answer: D
Question Status: Previous Edition

7) In the late 1960s, the Friedman-Phelps "natural rate hypothesis" predicted from the microeconomic structure of the labor market that the long-run Phillips Curve is ________, while macroeconomic events caused a very ________ acceptance of this change in aggregate supply theory.
A) horizontal, rapid
B) horizontal, gradual
C) vertical, rapid
D) vertical, gradual
Answer: C
Question Status: Previous Edition

8) The "new classical" economics took advantage of the disarray and partial eclipse of Keynesian economics to reestablish macro model-building based on the assumption of price ________ and market ________.
A) flexibility, clearing
B) flexibility, non-clearing
C) stickiness, clearing
D) stickiness, non-clearing
Answer: A
Question Status: Previous Edition

9) The work of Robert Lucas and Thomas Sargent ________ the existence of a downward-sloping Phillips Curve in the ________.
A) first proposed, short run
B) first proposed, short and long runs
C) cast further doubt on, long but not short run
D) cast further doubt on, short and long runs
Answer: D
Question Status: Previous Edition

10) Most Keynesian macroeconomists today ________ the natural rate hypothesis, which has helped lead to the ________ of Keynesian macroeconomics in the 1990s.
A) reject, near-total extinction
B) reject, revival
C) accept, near-total extinction
D) accept, revival
Answer: D
Question Status: Previous Edition

11) The U.S. inflation of the 1960s was spread overseas via the ________ exchange rates of the time and led to the ________ of the Bretton Woods system.
A) fixed, collapse
B) fixed, establishment
C) flexible, collapse
D) flexible, establishment
Answer: A
Question Status: Previous Edition

18.4 The Reaction of Ideas to Events, 1970-2010

1) The "stagflation" of the 1970s ________ Keynesian macroeconomics until the Keynesians started to build the consequences of changing inflationary expectations and ________ shocks into their models.
A) reinforced the dominance, supply
B) reinforced the dominance, demand
C) deepened the eclipse, supply
D) deepened the eclipse, demand
Answer: C
Question Status: Previous Edition

2) The tax cuts and entitlement program expansions of the 1980s led to such ________ federal deficits in the 1990s that fiscal policy ________ for smoothing-out business cycle fluctuations.
A) small, again became the preferred tool
B) small, was all but abandoned
C) large, again became the preferred tool
D) large, was all but abandoned
Answer: D
Question Status: Previous Edition

3) The depth of the 1981-1982 recession caused the Fed to abandon its experiment in targeting ________ and move to what now appears to be ________ growth rule.
A) money growth, an interest rate
B) money growth, a real GDP growth
C) money growth, an unemployment rate
D) interest rates, a high-powered money growth
E) interest rates, a nominal GDP growth
Answer: B
Question Status: Previous Edition

4) Memory of the supply shocks of the 1970s ________ the growth of real-business-cycle theory, while it was being ________ by new classical work on model-building methods.
A) assisted, assisted as well
B) assisted, hindered
C) hindered, assisted
D) hindered, hindered as well
Answer: A
Question Status: Previous Edition

5) Two emerging trends in 1990s macroeconomic thinking are that fiscal policy should be designed according to its ________ consequences and that monetary aggregates ________ useful in the conduct of monetary policy.
A) short-run stabilization, are no longer
B) short-run stabilization, continue to be
C) long-run growth, are no longer
D) long-run growth, continue to be
Answer: C
Question Status: Previous Edition

6) There is currently a resurgence in Keynesian macroeconomics, based on the assumptions of market ________ and ________ expectations.
A) non-clearing, adaptive
B) non-clearing, rational
C) clearing, adaptive
D) clearing, rational
Answer: B
Question Status: Previous Edition

7) Flexible exchange rates, proving to be much ________ volatile than economists predicted, have led to ________ calls for a return to fixed exchange rates.
A) less, few
B) less, many
C) more, few
D) more, many
Answer: D
Question Status: Previous Edition

8) When did the Fed *fail* to engage in a pre-emptive strike to keep the economy at or near the natural rate of unemployment?
A) 1994
B) 1998
C) 2001
D) None of the above. The Fed acted in each of these years.
Answer: B
Question Status: Previous Edition

9) The economic expansion which began in March 1991 was unusual in that
A) the first year and a half of the expansion was very weak and unemployment did not peak until 16 months after the trough.
B) the inflation rate decelerated from 1993 to 1997 rather than accelerating.
C) monetary policy was tightened substantially in 1994 even though there was no evidence of accelerating inflation.
D) all of the above.
Answer: D
Question Status: Previous Edition

10) In the 1990s
A) growth of M1 was more stable than growth of nominal GDP, and velocity soared through most of the period.

B) growth of nominal GDP was more stable than growth of M1, and velocity soared through most of the period.
C) growth of M1 was more stable than growth of nominal GDP, and velocity plummeted through most of the period.
D) growth of nominal GDP was more stable than growth of M1, and velocity plummeted through most of the period.
Answer: B
Question Status: Previous Edition

11) From the four asset bubbles discussed in this chapter, the one that has the smallest impact on the economy is
A) the 1927-29 U.S. stock market bubble.
B) the 1987-89 Japanese stock market bubble.
C) the 1996-2000 U.S. stock market bubble.
D) the 2001-2006 U.S. housing bubble.
Answer: C
Question Status: New

18.5 The Reaction of Ideas to Events in the World Economy

1) There are no questions for this section.
Answer:

18.6 Macro Mysteries: Unsettled Issues and Debates

1) There are no questions for this section.
Answer: