Chapter 14 Recession, Expansion & Debates Answers

1. One similarity between the Great Recession and the Great Depression is that in both economic downturn:

a. real gross domestic product (GDP) fell by over 25%.
b. there were significant problems in financial markets.
c. declining real estate values were a primary cause.
d. the U.S. government allowed the money supply to decrease.
e. the unemployment rate exceeded 20%.

2. During the Great Recession, the unemployment rate climbed as high as ________% and remained around ________% five years after the recession began.

a. 8; 6
b. 10; 8
c. 15; 10
d. 25; 12
e. 30; 15

3. The Great Recession lasted from ________ to ________.

a. August 1929; March 1933
b. May 1937; June 1938
c. March 2001; November 2001
d. December 2007; June 2009
e. July 1991; June 1992

4. The Great Recession was similar to other major recessions in that:

a. there was extremely high inflation.
b. real gross domestic product (GDP) initially declined and then recovered sometime later.
c. real gross domestic product (GDP) increased rapidly and then leveled off.
d. the rate of unemployment was unchanged.
e. the trade deficit fell to zero.

5. The Great Recession was similar to other major recessions in that

a. the rate of unemployment increased and then decreased at a later time.
b. the rate of inflation was extremely high.
c. real gross domestic product (GDP) rapidly increased and then leveled off.
d. the rate of economic growth was unchanged.
e. the rate of unemployment decreased and then increased at a later time.

6. Many economists attribute the troubles of the Great Recession in housing markets to

a. skyrocketing oil prices.
b. excessive monetary expansion in the previous decade.
c. a stock market crash.
d. an increase in aggregate supply.
e. deflation.

7. During the Great Recession, the U.S. aggregate demand curve shifted to the left, in part, because

a. unemployment in the United States decreased.
b. there was excessively high inflation during this time.
c. there was a stock market boom.
d. U.S. housing prices fell.
e. the government dramatically increased taxes.

8. During the Great Recession, the U.S. aggregate demand curve shifted to the left, in part, because

a. there was an increase in expected income.
b. the government dramatically increased taxes.
c. there was a decrease in expected income.
d. the Federal Reserve increased interest rates.
e. U.S. housing prices increased.

9. During the Great Recession, the U.S. aggregate demand curve shifted to the left, in part, because

a. the stock market declined in value by one-third.
b. there was a decline in the U.S. population.
c. there was an increase in expected income.
d. the U.S. government restricted trade with other countries.
e. there was an increase in housing prices.

10. During the Great Recession, the U.S. long-run aggregate supply curve shifted to the left, in part, because

a. the government dramatically increased taxes.
b. there was an institutional breakdown in financial markets.
c. there was a decline in the level of technology.
d. there was a decline in the U.S. population.
e. there was a decrease in expected income.

11. Which of the following caused aggregate demand to decrease during the Great Recession?

a. an increase in consumer confidence
b. a decrease in production resources
c. rising real estate values
d. reduced wealth from falling stock prices
e. a decrease in income tax rates

12. During the Great Recession, long-run aggregate supply decreased. This was caused by a(n)

a. advancement in technology.
b. decrease in income and business tax rates.
c. increase in immigration to the United States.
d. breakdown in the loanable funds market.
e. increase in the U.S. labor force.

13. When stock prices declined during the Great Recession, it caused aggregate demand to decrease because

a. households became more optimistic and increased consumer spending.
b. the government raised taxes and decreased spending.
c. firms' net worth decreased, leading to an increase in investment spending.
d. household wealth decreased, leading to a decline in consumer spending.
e. the government refused to allow the money supply to increase.

14. When U.S. housing prices declined prior to and during the Great Recession, it caused aggregate demand to decrease because

a. the government raised interest rates to prevent inflation.
b. household wealth decreased, causing a decline in consumer spending.
c. the U.S. population and labor force declined abruptly.
d. the government refused to allow the money supply to increase.
e. the government raised taxes and decreased spending.

15. The stock market crash in ________ is generally viewed as the beginning of the Great Depression.

a. December 2007
b. March 1933
c. June 2009
d. October 1929
e. April 1945

16. One similarity between the Great Depression and the Great Recession is that in both cases

a. stock prices remained largely unaffected.
b. housing prices climbed rapidly.
c. there was very high inflation.
d. unemployment remained very low.
e. there was noticeable stress in financial markets.

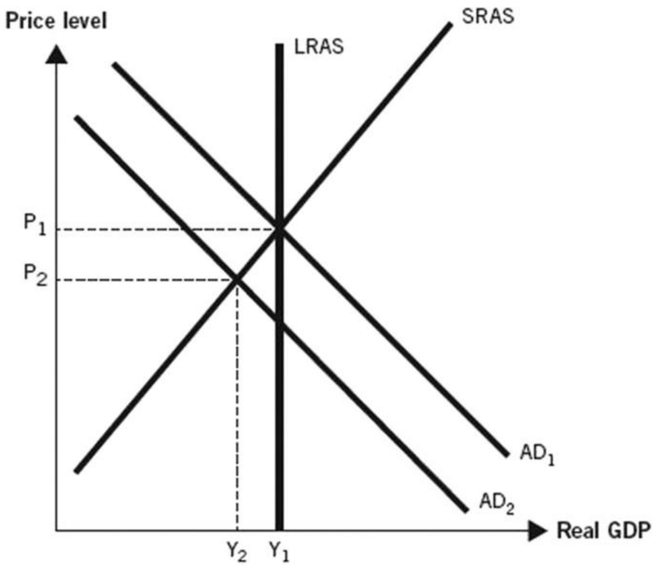
17. In comparison with other recessions, the Great Depression had

a. higher rates of unemployment.
b. higher levels of consumer sentiment.
c. a larger increase in the inflation rate.
d. a smaller decline in stock prices.
e. a smaller decrease in real gross domestic product (GDP).

18. When compared to other recessions, the Great Depression had

a. lower levels of unemployment.
b. smaller decreases in stock prices.
c. larger increases in the price level.
d. a larger decline in real gross domestic product (GDP).
e. fewer bank failures.

Use the following graph to answer the next four questions. This graph shows an economy where aggregate demand has decreased, with no change in either short-run aggregate supply (SRAS) or long-run aggregate supply (LRAS).



19. As a result of decreasing aggregate demand, we can see the price level ________ and real gross domestic product (GDP) ________.

a. increased; increased
b. decreased; decreased
c. remained unchanged; increased
d. decreased; remained unchanged
e. increased; decreased

20. Which of the following would have caused aggregate demand to decrease on the graph, such as occurred during the Great Depression?

a. an increase in real wealth
b. removal of tariffs on imports
c. an increase in the money supply
d. an increase in stock prices
e. lower expected future income

21. The graph accurately summarizes what happened during the Great Depression. During that time, aggregate demand ________, causing the price level to ________ and real gross domestic product (GDP) to ________.

a. decreased; remain unchanged; decrease
b. decreased; increase; remain unchanged
c. decreased; decrease; decrease
d. increased; remain unchanged; decrease
e. increased; decrease; decrease

22. During the Great Depression, the aggregate price level and real gross domestic product (GDP) both decreased, as shown on the graph. Unemployment increased to record levels. Which of the following best explains why this happened?

a. A sudden increase in oil prices caused inflation and a deep recession.
b. A stock market crash, large numbers of bank failures, an increase in tax rates, and a tight money supply caused a recession.
c. A rapid decline in housing prices led to problems in the loanable funds market and a recession.
d. A significant decline in military spending following the end of a war led to a recession.
e. A sharp recession followed the United States abandoning the gold standard.

23. During the Great Depression, the U.S. aggregate demand curve shifted to the _________, in part, because the U.S. government _________ the money supply.

a. right; increased
b. right; decreased
c. left; increased
d. left; decreased
e. left; did not change

24. During the Great Depression, the U.S. aggregate demand curve shifted to the left, in part, because

a. a large number of U.S. banks failed.
b. there was an increase in the U.S. population.
c. the U.S. government decreased taxes.
d. there were advances in technology in manufacturing.
e. there was an increase in stock prices.

25. ______________ economics emphasizes the inherent instability in the macroeconomy and the resulting need for government intervention to move back to full employment.

a. Micro
b. Monetary
c. Classical
d. Fiscal
e. Keynesian

26. Classical economists believe that

a. government intervention is essential.
b. savings is a drain on demand and not good for growth.
c. the economy is inherently stable and self-correcting.
d. prices, particularly wages, are sticky.
e. aggregate demand is more important than aggregate supply.

27. Keynesian economics

a. focuses on the long run rather than the short run.
b. stresses the importance of savings to increase investment and long-run aggregate supply.
c. emphasizes that the economy is inherently stable and self-correcting.
d. maintains that prices and wages are fully flexible.
e. focuses on spending, or aggregate demand, as the fundamental factor in the economy.

28. __________ economists were laissez-faire in their policy recommendations, having faith that the economy would self-correct without government intervention.

a. Fiscal
b. Monetary
c. Micro
d. Classical
e. Keynesian

29. Classical economists believe savings is _________ and stresses the importance of aggregate _________.

a. crucial for growth; demand
b. crucial for growth; supply
c. insignificant; demand
d. a drain on demand; demand
e. a drain on demand; supply

30. Classical economists emphasize that prices are

a. sticky and the economy will never be in long-run equilibrium.
b. sticky and the economy will eventually return to long-run equilibrium.
c. sticky and the economy will always be in long-run equilibrium.
d. fully flexible and the economy will never be in long-run equilibrium.
e. fully flexible and the economy will eventually return to long-run equilibrium.

31. Based on the belief that prices are fully flexible, classical economists conclude that

a. spending, or aggregate demand, is the fundamental factor in the economy.
b. the economy is self-correcting and does not need government intervention.
c. the economy will never be in equilibrium.
d. unemployment will tend to persist over time.
e. government intervention in the economy is essential to maintain full employment.

32. Which of the following policy statements would a classical economist tend to support?

a. The short run deserves more focus than the long run.
b. The market tends toward instability and needs government intervention.
c. Savings is a drain on demand and not good for growth.
d. Prices and wages are sticky and adjust slowly.
e. <u>Aggregate supply is the most important side of the economy.</u>

33. Which of the following economic statements would a classical economist tend to support?

a. <u>Savings is crucial to economic growth because it leads to investment in productive capital.</u>
b. Government intervention is often necessary to stimulate or moderate economic performance.
c. Aggregate demand is the most important side of the economy.
d. Savings is a drain on aggregate demand and can reduce economic growth.
e. The short run is far more important than the long run.

34. Classical economists believe the economy is inherently __________ and __________ government intervention because prices are __________.

a. <u>stable; does not need; flexible</u>
b. stable; does not need; sticky
c. unstable; needs; flexible
d. unstable; needs; sticky
e. unstable; does not need; sticky

35. Keynesian economists believe prices are _________ and focus on the _________ run.

a. flexible; short
b. flexible; long
c. <u>sticky; short</u>
d. sticky; intermediate
e. sticky; long

36. Keynesian economists believe savings is _________ and stresses the importance of aggregate _________.

a. crucial for growth; demand
b. crucial for growth; supply
c. insignificant; supply
d. <u>a drain on demand; demand</u>
e. a drain on demand; supply

37. If prompted to describe fundamental beliefs about the economy, a Keynesian economist would state that

a. the long run is more important than the short run.
b. prices are flexible.
c. <u>more focus should be placed on the short run than on the long run.</u>
d. savings is crucial to growth.
e. the market tends toward stability and full employment.

38. Which statement would likely be made by a Keynesian economist?

a. **“The economy tends toward instability and cyclical unemployment.”**
b. “The economy is self-correcting and does not need government intervention.”
c. “Prices are flexible and the economy quickly adjusts to the natural rate of unemployment.”
d. “The economy tends toward stability and full employment.”
e. “Policy should focus on savings and long-run aggregate supply.”

39. Keynesian economists believe that prolonged recessions are possible because

a. savings is a crucial component of economic growth.
b. prices are flexible and adjust quickly during economic downturn.
c. the most important determinant of economic growth is long-run aggregate supply.
d. government intervention is not necessary to promote full employment.
e. **prices are sticky and do not adjust quickly during economic downturn.**

40. Keynesian economists believe that prices are sticky and slow to adjust, from which they conclude that

a. the economy can self-correct without the need for government intervention.
b. no matter what factors change, the economy automatically maintains full employment.
c. **government intervention is essential to move the economy back to full employment.**
d. an increase in savings is the only way to move the economy to full employment.
e. long-run aggregate supply is the fundamental factor in the economy.

41. During the Great Depression, Keynes recommended

a. fiscal policy in the form of tax increases.
b. **fiscal policy in the form of spending on social programs and infrastructure.**
c. fiscal policy in the form of decreasing government spending.
d. monetary policy in the form of encouraging savings.
e. monetary policy in the form of discouraging spending and investment.

42. The decrease in aggregate demand during the Great Depression was caused, in part, by

a. **misguided macroeconomic policy.**
b. lower income tax rates.
c. an increase in expected future income.
d. a higher price level.
e. decreases in interest rates.

43. As the COVID recession wore on, people’s incomes declined, real wealth decreased, expectations of future income fell, business confidence dropped, and foreign income declined. These factors all shifted the ________ curve to the ________.

a. SRAS; right
b. SRAS; left
c. AD; right
d. **AD; left**
e. LRAS; left

44. During the COVID recession, real GDP fell ________% in the second quarter of 2020 on a non-annualized basis, and ________% on an annualized basis.

a. 1; 15.3
b. 4; 20.6
c. 7; 22.8
d. <u>9; 31.4</u>
e. 12; 50.3

45. Classical economists believe government intervention in the economy is unnecessary to reach full employment. Explain their reasoning.

Answer: Classical economists believe that prices are flexible. Thus, when there are changes in aggregate demand or aggregate supply, prices quickly adjust upward or downward as appropriate. As a result, the changes in demand or supply are quickly absorbed. The economy quickly returns to full employment without government intervention.

46. Assume you are a classical economist. Someone asks you what the government should do when the economy falls into a recession. What is your response?

Answer: Your response would likely be that the government should not attempt to assist when the economy falls into a recession. Your reasoning is that, given flexible prices, the economy will quickly readjust to full employment following a change in aggregate demand. If the government attempts to intervene, it would cause problems, such as inflation.

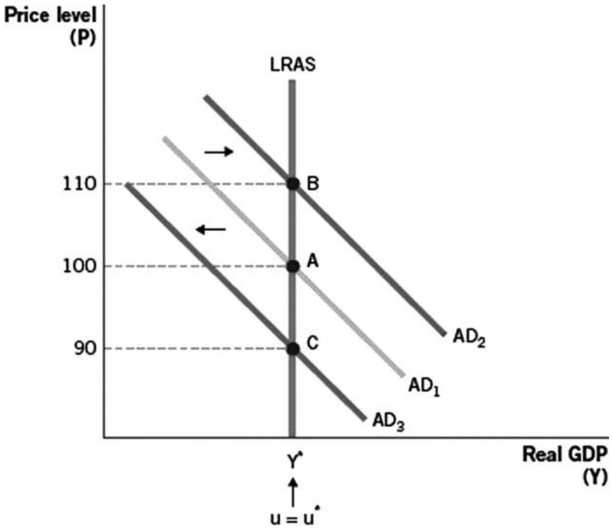
47. Keynesian economists believe government intervention in the economy is sometimes necessary to reach full employment. Explain why this is so.

Answer: Keynesian economists believe prices are sticky. Thus, when there are changes in aggregate demand or aggregate supply, prices do not quickly adjust upward or downward to reflect the change. As a result, the changes in demand or supply can become persistent and permanent. The economy fails to quickly return to full employment without government intervention.

48. Assume you are a Keynesian economist. You are asked what the government should do if the economy enters a recession. What would you say in response?

Answer: You would probably state that the government should make an effort to help the economy recover from the recession. This would be based on your belief that economies tend toward periods of instability and cyclical unemployment. Your view is that if the government does not attempt to stimulate the economy, it can become mired in an economic downturn, much as it did during the Great Depression.

49. Discuss the features on the graph below using a classical perspective on macroeconomics.



Answer: In the classical view, prices adjust easily, as represented by points A, B, and C. Consequently, shifts in aggregate demand (from AD1 to either AD2 or AD3) do not lead to changes in overall output (Y*) or employment levels. Because prices are flexible, aggregate demand is not as relevant as long-run aggregate supply to overall economic productivity and prosperity.