Question #1 of 101

Question ID: 1457068

Which one of the following Federal Reserve monetary policies, when pursued in line with the U.S. government's fiscal policies, would help increase aggregate demand during a period of high unemployment?

A) A decrease in the discount rate. ✓

B) An increase in the reserve requirements for financial institutions. ✗

C) The sale of bonds by the Fed. ✗

Explanation

A decrease in the Fed's lending rate is a monetary tool that the Fed can use to increase the money supply, thereby increasing aggregate demand during recessionary times when there is high unemployment. An increase in the reserve requirements and the sale of bonds by the Fed would all be restrictive monetary policies that would reduce the amount of money in the economy and reduce aggregate demand.

(Module 12.3, LOS 12.t)

Question #2 of 101

Question ID: 1456987

Assume the Federal Reserve purchases $1 billion of securities in the open market. What is the maximum increase in the money supply that can result from this action, if the required reserve ratio is 15%?

A) $1.00 billion. ✗

B) $6.67 billion. ✓

C) $850 million. ✗

Explanation

The money multiplier is 1 / 0.15 = 6.67, so the open market purchase can increase the money supply by a maximum of $6.67 billion.

(Module 12.1, LOS 12.c)

Question #3 of 101

Question ID: 1456992

The supply of money is primarily determined by:

A) inflation.

B) interest rates.

C) the monetary authorities.

Explanation

The monetary authorities determine the quantity of money available to the economy. Inflation and interest rates affect the demand for money balances.

(Module 12.1, LOS 12.d)

Question #4 of 101

Question ID: 1457005

If a bank needs to borrow funds from the Federal Reserve to fund a temporary shortage in reserves, it would borrow funds at the:

A) federal funds rate.

B) prime rate.

C) discount rate.

Explanation

Banks are able to borrow from the Fed at the discount rate. The federal funds rate is the interest rate banks charge other banks to borrow reserves from other banks. The prime rate is the rate that commercial banks charge their best customers.

(Module 12.1, LOS 12.f)

Question #5 of 101

Question ID: 1456974

A distinction between fiscal policy and monetary policy is that fiscal policy:

A) concerns taxes and government spending, while monetary policy concerns the money supply.

B) is typically expansionary, while monetary policy is typically contractionary.

C) is aimed at promoting economic growth, while monetary policy is aimed at promoting price stability.

Explanation

The distinction between fiscal and monetary policy is that a country's government determines fiscal policy through taxes and spending, but its central bank determines monetary policy by controlling the money supply. Both fiscal and monetary policy can be used to promote economic growth and price stability. Either fiscal policy or monetary policy can be expansionary or contractionary.

(Module 12.1, LOS 12.a)

Question #6 of 101

Question ID: 1457042

Which of the following statements regarding the monetary policy transmission mechanism is *most* accurate?

A) Central banks can control long-term interest rates directly because decisions by consumers and businesses are based on these rates.

B) Central banks can control short-term interest rates by increasing the money supply to increase interest rates or by decreasing the money supply to decrease interest rates.

C) Central banks can control short-term interest rates directly, but long-term interest rates are beyond their control.

Explanation

Central banks can control short-term interest rates directly. However, the decisions of consumers and businesses are based on long-term interest rates, which are beyond the control of central banks. Increasing the money supply will decrease interest rates and decreasing the money supply will increase interest rates.

(Module 12.2, LOS 12.n)

Question #7 of 101

Question ID: 1457046

Which of the following statements *best* explains how automatic stabilizers work? Even without a change in fiscal policy, automatic stabilizers tend to promote:

A) a budget surplus during a recession and a budget deficit during an inflationary expansion.

B) a budget deficit during a recession and a budget surplus during an inflationary expansion.

C) a budget deficit during a recession but do not promote a budget surplus during an inflationary expansion.

Explanation

Automatic stabilizers such as unemployment compensation, corporate profits tax, and the progressive income tax run a deficit during a business slowdown but run a surplus during an economic expansion. Therefore, they automatically implement countercyclical fiscal policy without the delays associated with policy changes that require legislative action.

(Module 12.3, LOS 12.o)

Question #8 of 101

Question ID: 1457014

Which of the following statements regarding U.S. Federal Reserve open market operations is *least accurate*?

A) If the Fed wants to stimulate the economy, it will sell Treasury securities to banks.

B) When the Fed buys Treasury securities, short-term interest rates will generally decrease.

C) When the Fed sells Treasury securities, excess reserves decrease.

Explanation

If the Fed intends to stimulate the economy, they will buy, not sell, Treasury securities. Buying Treasury securities injects reserves into the banking system.

(Module 12.2, LOS 12.h)

Question #9 of 101

Question ID: 1457055

Assuming the federal government maintains a balanced budget, the *most likely* effects of a tax increase on government expenditures and real GDP are:

	Government Expenditures	Real GDP
A)	Decrease	Decrease
B)	Increase	Decrease

C) Increase	Increase	✓

Explanation

The amount of the spending program exactly offsets the amount of the tax increase, leaving the budget unaffected (balanced budget). The multiplier effect is stronger for government spending versus the tax increase. Therefore, the balanced budget multiplier will be positive. All of the government spending enters the economy as increased expenditure, whereas only a portion of the tax increase results in lessened expenditure (determined by the marginal propensity to consume), because part of the tax increase will come from the savings of the taxpayer (determined by the marginal propensity to save).

(Module 12.3, LOS 12.q)

Question #10 of 101

Question ID: 1456980

Which of the following is the *most* accurate definition of the velocity of money? The velocity of money is the:

A) GDP of a country divided by its price level. ✗

B) money supply of a country divided by its price level. ✗

C) GDP of a country divided by its money supply. ✓

Explanation

Velocity is the average number of times per year each dollar is used to buy goods and services (velocity = nominal GDP / money). Therefore, the money supply multiplied by velocity must equal nominal GDP. The equation of exchange must hold with velocity defined in this way. Letting money supply = M, velocity = V, price = P, and real output = Y, the equation of exchange may be symbolically expressed as: MV = PY.

(Module 12.1, LOS 12.c)

Question #11 of 101

Question ID: 1457065

A government that is implementing a contractionary fiscal policy is *most likely* to:

A) increase spending on public works. ✗

B) decrease transfer payments to households. ✓

C) decrease income tax rates. ✗

Explanation

Decreasing spending or increasing taxes are contractionary fiscal policy actions. Increasing spending or decreasing taxes are expansionary.

(Module 12.3, LOS 12.s)

Question #12 of 101

Question ID: 1457002

The Fisher effect holds that a nominal rate of interest equals a real interest rate:

A) plus the expected inflation rate. ✓

B) minus the observed inflation rate. ✗

C) plus the observed inflation rate. ✗

Explanation

The Fisher effect states that a nominal rate of interest equals a real rate plus expected inflation.

(Module 12.1, LOS 12.e)

Question #13 of 101

Question ID: 1462788

According to the quantity theory of money, the *most appropriate* means to combat inflation is to:

A) reduce the velocity of money. ✗

B) increase the excess reserves of banks. ✗

C) reduce the money supply. ✓

Explanation

The quantity theory focuses on the quantity of money. The quantity theory states that velocity is not affected by monetary policy. Increasing banks' excess reserves would most likely lead to higher inflation. (Module 12.1, LOS 12.c)

Question #14 of 101

Question ID: 1457057

Assuming the economy currently is experiencing high inflation, an example of appropriate discretionary fiscal policy is:

A) increase the federal funds target rate. ✗

B) reduce government expenditures on major government construction projects. ✓

C) reduce the money supply. ✗

Explanation

Discretionary fiscal policy refers to the federal government's decisions regarding government spending and taxing. A reduction in government spending on major government construction projects is likely to lead to a reduction in aggregate demand and less pressure on prices, reducing inflation.

(Module 12.3, LOS 12.q)

Question #15 of 101

Question ID: 1456990

If households and firms are holding larger real money balances than they desire:

A) the interest rate is higher than its equilibrium rate. ✓

B) the opportunity cost of holding money balances is likely to increase. ✗

C) the central bank must sell securities to absorb the excess money supply and establish equilibrium. ✗

Explanation

If real money balances are larger than households and firms desire, the interest rate (opportunity cost of holding money balances) is higher than its equilibrium rate. Households and firms will use their undesired cash to buy securities, bidding up securities prices and reducing the interest rate until the equilibrium rate is achieved. This market process does not require any action by the central bank.

(Module 12.1, LOS 12.d)

Question #16 of 101

Question ID: 1457017

If the Federal Reserve wishes to lower market interest rates without changing the discount rate, it can:

A) buy Treasury securities. ✓

B) increase bank reserve requirements.

C) raise the yield on Treasury securities.

Explanation

Buying Treasury securities pumps money into the economy, lowering interest rates. Higher reserve requirements will restrict the money supply, causing rates to rise. The Federal Reserve has no direct control over the yield on existing Treasury securities.

(Module 12.2, LOS 12.h)

Question #17 of 101

Question ID: 1457018

Which of the following policy tools is the *least likely* to be available to the U.S. Federal Reserve Board?

A) Requiring the banking system to tighten or loosen its credit policies.

B) Buying and selling Treasury securities in the open market.

C) Setting the discount rate at which banks can borrow from the Federal Reserve.

Explanation

The U.S. Federal Reserve can encourage or persuade banks as a whole to tighten or loosen their credit policies, but it cannot compel them to do so.

(Module 12.2, LOS 12.h)

Question #18 of 101

Question ID: 1457009

Which of the following is *least likely* a function or objective of a central bank?

A) Issuing currency.

B) Keeping inflation within an acceptable range.

C) Lending money to government agencies.

Explanation

Lending money to government agencies is not typically a function of a central bank. Central bank functions include controlling the country's money supply to keep inflation within acceptable levels and promoting a sustainable rate of economic growth, as well as issuing currency and regulating banks.

(Module 12.1, LOS 12.f)

Question #19 of 101

Question ID: 1456982

On January 5, the U.S. Federal Reserve (the Fed) bought $10,000,000 of U.S. Treasury securities in the open market. At the time, the reserve requirement was 25%, and all banks had zero excess reserves. What is the potential impact of the Fed's purchase on the U.S. money supply?

A) $10,000,000 increase. ✗

B) $25,000,000 decrease. ✗

C) $40,000,000 increase. ✓

Explanation

Buying securities by the Fed increases the money supply because they are injecting money into the banking system. The money supply can potentially increase by 1 / 0.25 × $10,000,000 = $40,000,000.

(Module 12.1, LOS 12.c)

Question #20 of 101

Question ID: 1457041

The *most likely* reason for deflation to persist despite expansionary monetary policy is:

A) a liquidity trap. ✓

B) bond market vigilantes. ✗

C) inelastic demand for money. ✗

Explanation

Deflation is often associated with liquidity trap conditions. A liquidity trap is a situation in which demand for money becomes highly elastic. Expanding the money supply has little effect on economic activity under these conditions because individuals and firms choose to hold the additional money in cash. "Bond market vigilantes" is an expression referring to the fact that expansionary monetary policy may cause long-term interest rates to increase, instead of decreasing as intended, if bond market participants expect the expansionary policy to increase future inflation rates.

(Module 12.2, LOS 12.n)

Question #21 of 101

Question ID: 1457004

The primary objective of a central bank is typically to:

A) stabilize exchange rates.

B) achieve full employment.

C) control inflation.

Explanation

Although some central banks have other stated goals including stabilizing exchange rates and achieving full employment, the primary objective for a central bank is to control inflation and promote price stability.

(Module 12.1, LOS 12.f)

Question #22 of 101

Question ID: 1462789

Assume that the required reserve ratio is 20%, and banks currently have no excess reserves. If the Federal Reserve then buys $100 million of Treasury bills from the banks, the money supply could potentially increase by:

A) $20 million.

B) $500 million.

C) $100 million.

Explanation

$$\text{Potential expansion multiplier} = \frac{1}{\text{required reserve ratio}} = \frac{1}{0.2} = 5$$

(100)(5) = 500

(Module 12.1, LOS 12.c)

Question #23 of 101

Question ID: 1457039

To determine whether monetary policy is expansionary or contractionary, an analyst should compare the central bank's policy rate to the:

A) neutral interest rate. ✓

B) target inflation rate. ✗

C) trend rate of real growth. ✗

Explanation

The neutral interest rate is the sum of the trend rate of real economic growth and the target inflation rate. Monetary policy is expansionary if the policy rate is less than the neutral interest rate and contractionary if the policy rate is greater than the neutral interest rate.

(Module 12.2, LOS 12.m)

Question #24 of 101

Question ID: 1462790

Assume that the long-term equilibrium money market interest rate is 4% and the current money market interest rate is 3%. At this current rate of 3%, there will be an excess:

A) demand for money in the money market, and investors will tend to be net buyers of securities. ✗

B) demand for money in the money market, and investors will tend to be net sellers of securities. ✓

C) supply of money in the money market, and investors will tend to be net buyers of securities. ✗

Explanation

At interest rates below 4% (the long-term equilibrium rate), the quantity of money demanded exceeds the quantity of money supplied. At below-equilibrium rates, investors will sell bonds to obtain the desired extra cash. As they sell more bonds, the prices of bonds fall, and interest rates start to move back towards the 4% equilibrium. (Module 12.1, LOS 12.d)

Question #25 of 101

Question ID: 1457020

If a central bank's targeted inflation rate is above the current rate, the central bank is *most likely* to:

A) increase the reserve requirement. ✗

B) buy government securities. ✓

C) increase the overnight lending rate. ✗

Explanation

Buying government securities is an expansionary policy that would increase the money supply and allow the inflation rate to increase to the targeted range. Increasing reserve requirements and overnight lending rates are contractionary and would have the opposite effects.

(Module 12.2, LOS 12.h)

Question #26 of 101

Question ID: 1457013

If a monetary policy is focused on combating inflation, which open market actions by the Federal Reserve will *most* effectively accomplish this?

A) Sell Treasury securities, causing aggregate demand to decrease. ✓

B) Purchase Treasury securities, causing aggregate demand to decrease. ✗

C) Sell Treasury securities, causing aggregate demand to increase. ✗

Explanation

If the Federal Reserve wants to slow inflation, it needs to decrease aggregate demand (i.e., business investment, consumer purchases of durable goods, and exports). To accomplish this, the Federal Reserve could engage in open market sales of Treasury securities.

(Module 12.2, LOS 12.h)

Question #27 of 101

Question ID: 1457069

The government is reducing its spending to balance the budget, while the central bank is lowering its official policy rate. What will *most likely* be the combined effect on the economy?

A) The private sector as a percentage of GDP will increase.

B) The public and private sectors as a percentage of GDP will neither decrease nor increase.

C) The public sector as a percentage of GDP will increase.

Explanation

The private sector will expand as a percentage of GDP because (1) the public sector will decrease as a percentage of GDP due to government spending cuts and (2) lower interest rates should cause the private sector to expand.

(Module 12.3, LOS 12.t)

Question #28 of 101

Question ID: 1457051

The crowding-out model implies that a:

A) budget surplus will retard aggregate demand and trigger an economic downturn.

B) budget deficit will increase the real interest rate and thereby retard private investment.

C) budget deficit will stimulate aggregate demand and trigger a multiplier effect which will lead to inflation.

Explanation

Increased budget deficits will increase the demand for loanable funds and lead to higher interest rates and thus lower private investment. Crowding-out implies that an increase in government spending will choke off private investment and reduce the intended impact of fiscal policy changes on aggregate demand.

(Module 12.3, LOS 12.p)

Question #29 of 101

Question ID: 1456993

Which of the following statements about the demand for and supply of money is *least* accurate?

A) As the interest rate rises, the supply of money also rises.

B) As inflation rises, the demand for money by households and businesses also rises.

C) As gross domestic product rises, the demand for money balances also rises.

Explanation

The supply of money is determined by the monetary authorities and is not affected by changes in interest rates. Thus, the supply of money curve is vertical.

(Module 12.1, LOS 12.d)

Question #30 of 101

Question ID: 1457030

Xanadu attempts to decrease its inflation rate by implementing contractionary monetary policy. Which of the following is *most likely* to be the long-run effect on Xanadu's trade balance as a result of the monetary policy change?

A) Improve.

B) Remain the same.

C) Worsen.

Explanation

Contractionary monetary policy likely will cause higher domestic interest rates and attract foreign capital. As foreign capital flows in, the currency will appreciate relative to other currencies. The higher cost of its currency will result in higher cost exports that become less attractive to other countries. Xanadu's trade balance will most likely worsen.

(Module 12.2, LOS 12.j)

Question #31 of 101

Question ID: 1457060

The time it takes for policy makers to determine that the economy requires a fiscal policy action is *best* described as:

A) recognition lag.

B) action lag.

C) impact lag.

Explanation

Recognition lag refers to the time it takes for fiscal policy makers to determine the need for a policy action. Action lag is the time it takes policymakers to discuss, enact, and implement fiscal policy measures. Impact lag is the time it takes for a fiscal policy measure to have its effect on the economy.

(Module 12.3, LOS 12.r)

Question #32 of 101

Question ID: 1456983

When additional or excess reserves are injected into the U.S. banking system, the money supply can potentially increase by an amount equal to the additional excess reserves multiplied by which of the following?

A) Reciprocal of one minus the required reserve ratio. ✗

B) Reciprocal of the required reserve ratio. ✓

C) Required reserve ratio. ✗

Explanation

The potential deposit expansion multiplier = 1 / (required reserve ratio)

The potential increase in the money supply = potential deposit expansion multiplier × increase in excess reserves

(Module 12.1, LOS 12.c)

Question #33 of 101

Question ID: 1456975

When the central bank increases short-term interest rates, its monetary policy is *best* described as:

A) accommodative. ✗

B) contractionary. ✓

C) expansionary. ✗

Explanation

When the central bank increases short-term interest rates, it is attempting to decrease the growth rate of money and credit in an economy, and policy is said to be contractionary, restrictive, or tight. Accommodative or expansionary monetary policy attempts to increase the growth rate of money and credit (e.g., by decreasing short-term interest rates).

(Module 12.1, LOS 12.a)

Question #34 of 101

Question ID: 1457027

If a country's economy is growing at an unsustainably rapid rate and the central bank decreases its target overnight interest rate, the country's:

A) expected rate of inflation is likely to decline. ✗

B) inflation rate is likely to increase. ✓

C) long-term rate of economic growth will increase. ✗

Explanation

The central bank should increase target interest rates when the economy is growing at an unsustainable (above-full-employment) level. Decreasing the target overnight rate is likely to further increase aggregate demand and cause inflation to accelerate, which will be detrimental to the long-term growth rate of the economy.

(Module 12.2, LOS 12.j)

Question #35 of 101

Question ID: 1457025

Contractionary monetary policy is *least likely* to decrease consumption spending by decreasing:

A) expectations for economic growth. ✗

B) securities prices. ✗

C) the foreign exchange value of the currency. ✓

Explanation

Contractionary monetary policy is likely to increase the value of the domestic currency in the foreign exchange market, which decreases foreign demand for the country's exports. Contractionary monetary policy should cause both securities prices and expectations for economic growth to decrease, each of which is likely to cause consumers to decrease spending.

(Module 12.2, LOS 12.i)

Question #36 of 101

Question ID: 1457033

Central banks that are able to define how inflation is computed and determine its desired level are *best described* as having:

A) operational independence. ✗

B) target independence. ✓

C) transparency. ✗

Explanation

Target independence means the central bank defines how inflation is computed, sets the target inflation level, and determines the horizon over which the target is to be achieved. Central banks that have operational independence are allowed to determine the policy rate. Transparency refers to the degree to which central banks report to the public on the state of the economic environment and is one of the three essential qualities of an effective central bank.

(Module 12.2, LOS 12.k)

Question #37 of 101

Question ID: 1456976

Promoting economic growth and price stability are the goals of:

A) monetary policy, but not fiscal policy. ✗

B) fiscal policy, but not monetary policy. ✗

C) both fiscal and monetary policy. ✓

Explanation

Both monetary and fiscal policies are used by policymakers with the goals of maintaining stable prices and producing positive economic growth.

(Module 12.1, LOS 12.a)

Question #38 of 101

Question ID: 1457036

A central bank follows an inflation targeting monetary policy. If the permissible band is plus-or-minus 2% around the target inflation rate, the central bank is *most likely* to choose a target inflation rate of:

A) 0%.

B) 1%.

C) 3%.

Explanation

Because they consider deflation to be disruptive to an economy, central banks typically choose inflation targets and bands that do not include a negative rate of inflation.

(Module 12.2, LOS 12.l)

Question #39 of 101

Question ID: 1457047

The term "automatic stabilizers" refers to:

A) changes in taxes and expenditure programs legislators automatically enact in response to changes the level of economic activity in order to smooth economic cycles.

B) increases in transfer payments and decreases in tax revenues that result from an economic contraction without new legislation.

C) government expenditures and tax receipts that are required to balance over the course of the business cycle, although they may be out of balance in any single year.

Explanation

Automatic stabilizers refers the increase (decrease) in transfer payments such as unemployment compensation and the decrease (increase) in tax revenue that result from a decrease (increase) in the level of economic activity. These effects tend to move the fiscal budget toward a deficit when economic activity decreases and toward surplus when economic activity increases, and tend to dampen economic cycles.

(Module 12.3, LOS 12.o)

Question #40 of 101

Question ID: 1456984

If a bank receives a deposit of $1 million in cash which has been held outside the banking system and the reserve requirement is 10%, the maximum increase in the money supply that could result is:

A) $100,000. ✗

B) $900,000. ✗

C) $10,000,000. ✓

Explanation

The maximum increase in the money supply from a fractional reserve banking system is the money multiplier (1 / reserve requirement) times the amount of a new deposit of cash. 1/0.10 × $1 million = $10 million.

(Module 12.1, LOS 12.c)

Question #41 of 101

Question ID: 1456996

If the money interest rate is measured on the y-axis and the quantity of money is measured on the x-axis, the money supply curve is:

A) downward sloping to the lower right. ✗

B) upward sloping to the upper right. ✗

C) vertical. ✓

Explanation

The money supply schedule is vertical because it is not affected by changes in the interest rate but is determined by the monetary authorities such as the Federal Reserve System (Fed) in the United States.

(Module 12.1, LOS 12.d)

Question #42 of 101

Question ID: 1456979

When comparing a barter economy with an economy that uses money as a medium of exchange we would expect increased efficiencies due to a reduction in which of the following?

A) Nominal interest rates.

B) The need to specialize.

C) Transaction costs.

Explanation

Money functions as a medium of exchange because it is accepted as payment for goods and services. Compare this to a barter economy, where if I have goat and want an ox, I have to find someone willing to trade. Finding someone takes time and time is costly. With money, I can sell the goat and buy the ox. Thus, transaction costs are reduced. Having money as a medium of exchange would not reduce the inflation rate, interest rates, or the need to specialize in the production of those goods in which we have a comparative advantage (low opportunity cost producer).

(Module 12.1, LOS 12.b)

Question #43 of 101

Question ID: 1456978

Money functions as a store of value because:

A) money is accepted as the form of payment for goods.

B) money received for work or goods can be saved to purchase goods or services in the future.

C) prices of goods and services are expressed in units of money.

Explanation

Money has three primary functions: it provides a store of value because money received for work or goods can be saved for future consumption; it serves as a unit of account because prices of all goods and services are expressed in units of money; and it serves as a medium of exchange because money is accepted as a form a payment.

(Module 12.1, LOS 12.b)

Question #44 of 101

Question ID: 1456991

Which of the following statements about the relationship between interest rates and the demand for and supply of money is *most* accurate? Interest rates affect:

A) the demand for money only. ✓

B) both the demand for and supply of money. ✗

C) the supply of money only. ✗

Explanation

Interest rates only affect the demand for money. With higher interest rates, the opportunity cost of holding money increases, and people hold less money and more interest-earning assets. Monetary authorities determine the supply of money. Therefore, the supply of money is independent of the interest rate.

(Module 12.1, LOS 12.d)

Question #45 of 101

Question ID: 1457050

Arguments for being concerned about the size of a fiscal deficit *least likely* include:

A) a reduction in long-term economic growth. ✗

B) Ricardian equivalence. ✓

C) the crowding-out effect. ✗

Explanation

If Ricardian equivalence holds, private savings will increase in anticipation of the future taxes required by a fiscal deficit. The crowding-out effect of government borrowing on private investment and the reduction in long-term economic growth due to higher future taxes argue in favor of being concerned about the size of a fiscal deficit.

(Module 12.3, LOS 12.p)

Question #46 of 101

Question ID: 1457012

An individual has just purchased a home by taking on a 30-year fixed rate mortgage. She would benefit *most* from this transaction if future inflation rates are:

A) exactly as anticipated.

B) lower than anticipated.

C) higher than anticipated.

Explanation

Inflation that is higher than anticipated will result in a transfer of wealth from lenders to borrowers.

(Module 12.1, LOS 12.g)

Question #47 of 101

Question ID: 1457056

Robert Necco and Nelson Packard are economists at Economic Research Associates. ERA asks Necco and Packard for their opinions about the effects of fiscal policy on real GDP for an economy currently experiencing a recession. Necco states that real GDP is likely to increase if both government spending and taxes are increased by the same amount. Packard states that if both government spending and taxes are increased by the same amount, there is no expected net effect on real GDP.

Are the statements made by Necco and Packard CORRECT?

	Necco	Packard
A)	Correct	Incorrect
B)	Incorrect	Correct
C)	Incorrect	Incorrect

Explanation

Necco is correct because the multiplier effect is stronger for government expenditures versus government taxes. All of the increase in government spending enters the economy as increased expenditure, whereas only a portion of the tax increase results in lessened expenditure (determined by the marginal propensity to consume), because part of the tax increase will come from the savings of the taxpayer (determined by the marginal propensity to save). Packard is incorrect; the effect on real GDP of an increase in government spending combined with equal increase in taxes will be positive because the multiplier effect is stronger for government spending versus the tax increase.

(Module 12.3, LOS 12.q)

Question #48 of 101

Question ID: 1457064

An example of a contractionary fiscal policy change is a(n):

A) decrease in a fiscal surplus. ✗

B) increase in a fiscal deficit. ✗

C) increase in a fiscal surplus. ✓

Explanation

An increase in a fiscal surplus or a decrease in a fiscal deficit is contractionary. An increase in a fiscal deficit or a decrease in a fiscal surplus is expansionary.

(Module 12.3, LOS 12.s)

Question #49 of 101

Question ID: 1457062

Which of the following statements *best* explains the importance of the timing of changes in discretionary fiscal policy? Changes in discretionary fiscal policy must be timed properly if they are going to:

A) enable the government to control the money supply. ✗

B) exert a stabilizing influence on an economy. ✓

C) help the government achieve a balanced budget. ✗

Explanation

Proper timing of discretional policy is needed to reduce economic instability. If timed incorrectly, the fiscal policy change could increase rather than reduce economic instability.

(Module 12.3, LOS 12.r)

Question #50 of 101

Question ID: 1457063

The country of Zurkistan is experiencing both high interest rates and high inflation. The government passes laws that reduce government spending and increase taxes. It takes many months before interest rates fall and inflation is reduced. This is an example of:

A) impact lag in discretionary fiscal policy. ✓

B) recognition lag in discretionary fiscal policy. ✗

C) action lag and automatic stabilizers. ✗

Explanation

This is an example of discretionary fiscal policy involving impact lag because it takes time for the impact of the change in taxing and spending to be felt throughout the economy.

(Module 12.3, LOS 12.r)

Question #51 of 101

Question ID: 1457003

The Fisher effect describes the relationship between:

A) expected and unexpected inflation. ✗

B) money supply growth and actual inflation. ✗

C) nominal and real interest rates. ✓

Explanation

The Fisher effect states that a nominal interest rate is equal to a real interest rate plus the expected rate of inflation.

(Module 12.1, LOS 12.e)

Question #52 of 101

Question ID: 1456995

The demand for money curve represents the relationship between the quantity of money demanded and:

A) short-term interest rates. ✓

B) the price level. ✗

C) the quantity of money supplied. ✗

Explanation

The demand for money curve represents the relationship between short-term interest rates and the quantity of real money that households and firms demand to hold.

(Module 12.1, LOS 12.d)

Question #53 of 101

Question ID: 1457058

The time it takes for a fiscal policy action to affect the economy is *best* described as:

A) recognition lag. ✗

B) action lag. ✗

C) impact lag. ✓

Explanation

The time it takes for a fiscal policy action, once implemented, to have its effect on the economy is referred to as impact lag. Recognition lag is the time it takes policymakers to realize a fiscal policy response is needed. Action lag is the time it takes policymakers to discuss, enact, and implement fiscal policy measures.

(Module 12.3, LOS 12.r)

Question #54 of 101

Question ID: 1457044

Discretionary fiscal policy refers to:

A) buying or selling securities in the open market to influence interest rates. ✗

B) active decisions regarding spending and taxing to affect economic growth. ✓

C) government spending programs that counteract the business cycle without the intervention of policymakers. ✗

Explanation

Discretionary fiscal policy, in contrast to automatic stabilizers, refers to active decisions by the government to affect economic growth through changes in government spending and taxation. Buying or selling securities in the open market is an example of monetary policy.

(Module 12.3, LOS 12.o)

Question #55 of 101

Question ID: 1456999

The three reasons for holding money are *most accurately* described as:

A) broad money demand, narrow money demand, and transaction demand.

B) narrow money demand, precautionary demand, and speculative demand.

C) transaction demand, precautionary demand, and speculative demand.

Explanation

The three reasons for holding money are: transaction demand, for buying goods and services; precautionary demand, to meet unforeseen future needs; and speculative demand, to take advantage of investment opportunities. Narrow money and broad money refer to measures of money in circulation.

(Module 12.1, LOS 12.d)

Question #56 of 101

Question ID: 1457045

Unemployment compensation is an example of:

A) a discretionary fiscal policy stabilizer.

B) an automatic monetary policy stabilizer.

C) an automatic fiscal policy stabilizer.

Explanation

Unemployment compensation automatically rises and falls with the business cycle, therefore it is an example of an automatic fiscal policy stabilizer.

(Module 12.3, LOS 12.o)

Question #57 of 101

Question ID: 1456997

Which of the following statements about the demand and supply of money is *most* accurate? People who are:

A) holding money when interest rates are lower will try to increase their money balances and, as a result, the supply of money increases.

B) holding money when interest rates are higher will try to reduce their money balances and, as a result, the demand for money decreases.

C) buying bonds to reduce their money balances will increase the demand for bonds with an associated increase in interest rates.

Explanation

Buying bonds would drive bond prices up and interest rates down. Selling bonds would have the opposite effect; driving bond prices down and interest rates up. When interest rates are lower, there is an excess demand for money. The supply of money is determined by the monetary authorities.

(Module 12.1, LOS 12.d)

Question #58 of 101

Question ID: 1457061

Which of the following statements about achieving proper timing in fiscal policy is *least accurate*?

A) Improvements in quantitative methods have made the occurrence of recessions or expansions quite predictable.

B) Policy errors are inevitable due to unpredictable events.

C) There is usually a time lag between when a change in policy is needed and when the need is recognized by policy makers.

Explanation

One problem in achieving proper timing in fiscal policy is the inability to accurately predict a recession or expansion.

(Module 12.3, LOS 12.r)

Question #59 of 101

Question ID: 1457066

The government budget deficit of Country M is increasing. At the same time, the government budget surplus of Country N is decreasing. Are the fiscal policies of these countries expansionary or contractionary?

A) Both are contractionary.

B) Both are expansionary.

C) One is expansionary and one is contractionary.

Explanation

Expansionary fiscal policy increases a budget deficit or decreases a budget surplus. Contractionary fiscal policy decreases a budget deficit or increases a budget surplus.

(Module 12.3, LOS 12.s)

Question #60 of 101

Question ID: 1457001

According to the Fisher effect, which of the following interest rates includes a premium for the expected rate of inflation?

A) Both yields on short-term government debt and yields on long-term corporate debt.

B) Neither yields on short-term government debt nor yields on long-term corporate debt.

C) Yields on long-term corporate debt, but not yields on short-term government debt.

Explanation

The Fisher effect holds that all nominal interest rates include a premium for expected inflation.

(Module 12.1, LOS 12.e)

Question #61 of 101

Question ID: 1462794

The crowding-out effect suggests that:

A) greater government deficits will drive up interest rates, thereby reducing private investment.

B) as government spending increases, so will incomes and taxes, and the higher taxes will reduce both aggregate demand and output.

C) government borrowing will lead to an increase in private savings.

Explanation

The crowding-out effect refers to a reduction in private borrowing and investment as a result of higher interest rates generated by budget deficits that are financed by borrowing in the private loanable funds market. (Module 12.3, LOS 12.p)

Question #62 of 101

Question ID: 1456973

Attempting to influence economic growth and inflation by changing tax rates and government spending is *best* described as:

A) a combination of fiscal and monetary policy.

B) monetary policy.

C) fiscal policy.

Explanation

Fiscal policy refers to actions by a government to influence economic activity through changes in taxes and government spending.

(Module 12.1, LOS 12.a)

Question #63 of 101

Question ID: 1462791

The Federal Reserve has decided to increase the federal funds rate (the interest rate that banks charge each other for overnight loans). To implement this policy, the Federal Reserve will *most likely*:

A) sell government securities in the open market.

B) increase currency exchange rates (cause domestic currency to appreciate).

C) set a lower price on Treasury bills and notes that it is auctioning.

Explanation

Selling government securities on the open market reduces bank reserves and drives up the federal funds rate. The other two statements are incorrect because the Federal Reserve does not directly control exchange rates or the prices of government securities. (Module 12.2, LOS 12.h)

Question #64 of 101

Question ID: 1457007

Which of the following is *least likely* to be a function of the central bank?

A) Issue currency. ✗

B) Regulate the banking system. ✗

C) Collect tax payments. ✓

Explanation

The three functions of a central bank are to issue a country's currency, regulate its banking system, and to manage the money supply. Tax collection is typically conducted by a government agency created specifically to carry out that function.

(Module 12.1, LOS 12.f)

Question #65 of 101

Question ID: 1457028

Silvano Jimenez, an analyst at Banco del Rey, is reviewing recent actions taken by the U.S. Federal Reserve (the Fed) in setting monetary policy. Recently, the Fed decided to increase the money supply, which has resulted in a decrease in real interest rates. At a staff meeting, Jimenez brings this matter to the attention of his colleagues and makes the following statements:

Statement 1: Although the money supply increase has led to a decrease in real interest rates, we should begin to see U.S. investors decrease their investments abroad and the U.S. dollar will appreciate in the foreign exchange market.

Statement 2: The Fed's increase in the money supply will increase the amount of imports into the U.S.

Are Statement 1 and Statement 2 as made by Jimenez CORRECT?

	Statement 1	Statement 2

A) Incorrect	Correct	✗
B) Correct	Incorrect	✗
C) Incorrect	Incorrect	✓

Explanation

If the Fed increases the money supply and real interest rates decline, U.S. investors will seek higher real rates of return abroad and the U.S. dollar will depreciate as the dollar will be exchanged for foreign currencies in order to buy the foreign investments. Likewise, the decrease in real interest rates will reduce the inflow of funds from abroad as foreign investors seek higher rates of return outside the U.S. With a dollar that has depreciated, U.S. exports should increase, as U.S. products will become cheaper for foreign buyers. As such, both statements are incorrect.

(Module 12.2, LOS 12.j)

Question #66 of 101

Question ID: 1457008

Central banks are *most likely* to pursue a target inflation rate:

A) between 0% and 2%. ✗

B) between 2% and 3%. ✓

C) equal to 0%. ✗

Explanation

Central banks typically define price stability as a stable inflation rate of about 2% to 3%. A target of zero is not typically used because it would risk deflation.

(Module 12.1, LOS 12.f)

Question #67 of 101

Question ID: 1456981

The amount of money a commercial bank has available to lend is known as:

A) fractional reserves. ✗

B) excess reserves. ✓

C) required reserves. ✗

Explanation

Excess reserves are the amount of money a commercial bank has available with which to make new loans, after depositing its required reserves with the central bank.

(Module 12.1, LOS 12.c)

Question #68 of 101

Question ID: 1457031

A central bank has operational independence if it can independently determine:

A) the horizon over which to achieve its inflation target. ✗

B) the policy rate. ✓

C) how inflation is calculated. ✗

Explanation

A central bank is said to have operational independence if it has the authority to determine the policy rate independently. Determining how inflation is calculated and the time horizon for achieving its target rate of inflation refer to a central bank that has target independence.

(Module 12.2, LOS 12.k)

Question #69 of 101

Question ID: 1457032

What are the three essential qualities an effective central bank should possess?

A) Independence, credibility, and transparency. ✓

B) Transparency, independence, and consistency. ✗

C) Credibility, relevance, and reliability. ✗

Explanation

A central bank that is independent from political interference, possesses credibility, and exhibits transparency is more likely to achieve its monetary policy objectives than a central bank that lacks these qualities. The other characteristics listed in the answer choices relate to financial statements and financial reporting standards.

(Module 12.2, LOS 12.k)

Question #70 of 101

Question ID: 1457038

An analyst has determined the projected trend rate of real GDP growth is 2.5% and the central bank's inflation target is 2.5%. If the central bank policy rate is 5.0%, monetary policy is *most likely*:

A) expansionary.

B) neutral.

C) contractionary.

Explanation

The neutral rate of interest is real trend rate of economic growth plus the inflation target. In this example, the neutral rate = 2.5% + 2.5% = 5.0%. Because the policy rate is the same as the neutral rate of interest, monetary policy is neither contractionary nor expansionary.

(Module 12.2, LOS 12.m)

Question #71 of 101

Question ID: 1457023

If the U.S. Federal Reserve decides to decrease the money supply, which of the following is *most likely* to occur in the short run?

A) A decrease in the unemployment rate.

B) An increase in the real rate of interest.

C) An increase in the velocity of money similar to decrease in the money supply.

Explanation

If the U.S. Federal Reserve decreases the money supply, an increase in nominal and real interest rates will occur. Higher real rates will cause businesses to invest less, which will cause the unemployment rate to increase. Furthermore, households will decrease purchases of durable goods, automobiles, and other items that are typically financed at short-term rates. This will decrease aggregate demand. The decrease in aggregate demand and expenditures will cause incomes to go down, which further decreases consumption and investment. Moreover, this decrease in aggregate demand will decrease real GDP and the price level in the short run and the long run.

(Module 12.2, LOS 12.i)

Question #72 of 101

Question ID: 1462795

Arguments for being concerned with the size of a fiscal deficit relative to GDP *least likely* include:

A) a likely need for higher future taxes.

B) higher interest rates due to government borrowing.

C) a high proportion of government debt owed to the country's citizens.

Explanation

That a government owes its own citizens much of its outstanding debt is an argument against being concerned about fiscal deficits. Arguments for being concerned about fiscal deficits include the need for higher future taxes and the potential for government borrowing to increase interest rates and crowd out private investment. (Module 12.3, LOS 12.p)

Question #73 of 101

Question ID: 1457035

If a central bank implements an exchange rate targeting policy successfully, the country's inflation rate is *most likely* to be:

A) the same as that of the target currency.

B) greater than that of the target currency.

C) less than that of the target currency.

Explanation

Successful exchange rate targeting should result in the same inflation rate in the targeting country as in the country of the target currency.

(Module 12.2, LOS 12.l)

Question #74 of 101

Question ID: 1462792

The velocity of transactions in an economy has been increasing rapidly for the past seven years. Over the same time period, the economy has experienced minimal growth in real output. According to the equation of exchange, inflation over the last seven years has:

A) been minimal, consistent with the slow growth in real output.

B) increased more than the growth in the money supply.

C) increased at a rate similar to the growth rate in the money supply.

Explanation

The equation of exchange is MV = PY. If velocity (V) is increasing faster than real output (Y), inflation (P) would have to be increasing faster than the money supply (M) to keep the equation in balance. (Module 3.3, LOS 3.k)

Question #75 of 101

Question ID: 1457059

The time it takes for policy makers to enact a fiscal policy action is *best* described as:

A) implementation lag. ✗

B) action lag. ✓

C) legislative lag. ✗

Explanation

The time it takes for fiscal policy actions to be proposed, approved, and implemented is referred to as action lag.

(Module 12.3, LOS 12.r)

Question #76 of 101

Question ID: 1457070

Which of the following policy combinations would *most likely* lead to private sector growth and a decreasing government share of GDP?

A) Contractionary fiscal policy and expansionary monetary policy. ✓

B) Contractionary fiscal policy and contractionary monetary policy. ✗

C) Expansionary fiscal policy and contractionary monetary policy. ✗

Explanation

Contractionary fiscal policy combined with expansionary monetary policy is more likely to increase private sector growth and decrease the government share of GDP than the other policy combinations.

(Module 12.3, LOS 12.t)

Question #77 of 101

Question ID: 1457040

An economy's long-term trend rate of real GDP growth is 3% and the central bank's target inflation rate is 2%. If the policy rate is 6%, monetary policy is:

A) contractionary.

B) expansionary.

C) neutral.

Explanation

Monetary policy is contractionary when the policy rate is greater than the neutral rate, which is the sum of the real trend rate of economic growth and the target rate of inflation. Here, the neutral rate is 3% + 2% = 5% and the policy rate of 6% is greater than the neutral rate. Monetary policy is expansionary when the policy rate is less than the neutral interest rate.

(Module 12.2, LOS 12.m)

Question #78 of 101

Question ID: 1457006

A country is experiencing a core inflation rate of 7% during a recessionary period of real GDP growth. If the central bank has a single mandate to achieve price stability and uses inflation targeting with an acceptable range of zero to 4%, its monetary policy response is *most likely* to decrease:

A) GDP growth in the short run.

B) short-term interest rates.

C) the foreign exchange value of the country's currency.

Explanation

If the central bank has a price stability mandate, it will most likely respond to the above-target inflation rate by decreasing the money supply, even though GDP growth is in a recessionary phase. Decreasing the money supply will result in higher short-term interest rates and appreciation of the currency, but will likely cause GDP growth to decrease further in the short run.

(Module 12.1, LOS 12.f)

Question #79 of 101

Question ID: 1457021

A central bank that wants to increase short-term interest rates is *most likely* to:

A) issue long-term bonds. ✗

B) sell government securities. ✓

C) decrease bank reserve requirements. ✗

Explanation

Open market operations to sell securities will decrease the outstanding supply of cash balances and increase short-term interest rates. The central bank does not issue long-term bonds but may buy and sell bonds issued by the government. Decreasing reserve requirements or purchasing government securities would tend to decrease short-term interest rates.

(Module 12.2, LOS 12.h)

Question #80 of 101

Question ID: 1456985

Banks choose to hold a higher percentage of deposits as reserves because they believe general business conditions in the economy are subject to greater uncertainty. If all else is held constant, what is the *most likely* impact of this action?

A) The money supply will decrease. ✓

B) There will be no effect on the money supply. ✗

C) The money supply will increase during a period of inflation, but will decrease if the economy goes into a recession. ✗

Explanation

If banks choose to hold excess reserves, they will decrease their lending. Less bank lending will cause the money supply to decrease.

(Module 12.1, LOS 12.c)

Question #81 of 101

Question ID: 1457049

An argument against being concerned with the size of a fiscal deficit is that a deficit can:

A) cause government borrowing to crowd out private borrowing. ✗

B) aid in increasing GDP and employment if the economy is operating at less than potential GDP. ✓

C) lead to higher future taxes that will increase government revenues.

Explanation

One potential argument against being concerned about the size of fiscal deficits is that a deficit can help increase GDP and employment if output is below potential GDP and the spending does not divert capital from productive uses. Higher deficits that lead to crowding out or higher future taxes that result in lower long-term economic growth are arguments for concern about the size of fiscal deficits.

(Module 12.3, LOS 12.p)

Question #82 of 101

Question ID: 1456994

Which of the following statements regarding money demand and supply is *least* accurate?

A) As the Fed reduces the money supply, short-term interest rates decrease.

B) The supply of money is determined by the monetary authority and is not affected by changes in interest rates.

C) The supply curve for money is vertical.

Explanation

As the Fed reduces the money supply, short-term interest rates increase. The other statements concerning the demand and supply for money are true.

(Module 12.1, LOS 12.d)

Question #83 of 101

Question ID: 1456998

Which of the following is determined by the equilibrium between the demand for money and the supply of money?

A) Interest rate.

B) Inflation rate.

C) Money supply.

Explanation

Interest rates are determined by the equilibrium between money supply and money demand.

(Module 12.1, LOS 12.d)

Question #84 of 101

Question ID: 1457037

Which of the following is currently the most-used target for central banks?

A) Interest rate targeting.

B) Money supply targeting.

C) Inflation targeting.

Explanation

Inflation targeting is the most-used tool of central banks for making monetary policy decisions.

(Module 12.2, LOS 12.l)

Question #85 of 101

Question ID: 1462793

A central bank is said to have credibility if:

A) it issues inflation reports monthly.

B) economic actors base decisions on the central bank's stated inflation targets.

C) it determines both the policy rate and the method for computing the inflation rate.

Explanation

If a central bank has credibility, economic actors come to believe the inflation rate will be near the central bank's target and factor this inflation rate into their decisions. Periodic inflation reports enhance the transparency of a central bank. A central bank that determines both the policy rate and the method for computing the inflation rate is said to have independence. (Module 12.2, LOS 12.k)

Question #86 of 101

Question ID: 1457043

Which of the following conditions is difficult for monetary policy to address because a central bank cannot reduce its nominal policy rate much below zero?

A) Deflation.

B) Inflation.

C) Stagflation.

Explanation

Deflation is difficult for central banks to address when policy rates cannot be lowered any further. Inflation can be addressed by contractionary monetary policy. Stagflation is difficult to address because monetary policy cannot pursue higher growth and lower inflation at the same time.

(Module 12.2, LOS 12.n)

Question #87 of 101

Question ID: 1456986

Which of the following relationships in regard to the quantity theory of money is *least accurate*?

A) Money × Velocity = Money Supply × Velocity.

B) Nominal GDP = Money Supply × Velocity = Price × Real Output.

C) Nominal GDP = Price × Money Supply.

Explanation

The quantity theory of money holds that: Money Supply × Velocity = Nominal GDP = Price × Real Output.

(Module 12.1, LOS 12.c)

Question #88 of 101

Question ID: 1457011

Compared to the costs of inflation that is unexpected, costs of inflation that is correctly anticipated are *most likely* to be:

A) equally severe.

B) less severe.

C) more severe.

Explanation

Costs of inflation are less severe when inflation is correctly anticipated than when inflation is unexpected. Unexpected inflation results in wealth being transferred from lenders to borrowers. In addition, producers might misallocate resources if they cannot determine whether an increase in the price of their output reflects inflation or a genuine increase in demand.

(Module 12.1, LOS 12.g)

Question #89 of 101

Question ID: 1456971

Policies used with the goal of maintaining stable prices and producing economic growth include:

A) both fiscal policy and monetary policy.

B) monetary policy only.

C) fiscal policy only.

Explanation

Both fiscal and monetary policies are used to maintain stable prices and produce economic growth. Fiscal policy does so by mechanisms that involve spending and taxation, and monetary policy uses central bank tools to modify the availability of money and credit.

(Module 12.1, LOS 12.a)

Question #90 of 101

Question ID: 1457067

Which of the following fiscal and monetary policy scenarios is *most likely* to increase the size of the public sector relative to the private sector?

A) Contractionary fiscal and monetary policy.

B) Expansionary fiscal policy and contractionary monetary policy.

C) Expansionary monetary policy and contractionary fiscal policy.

Explanation

Expansionary fiscal policy tends to expand the public sector. Contractionary monetary policy tends to contract the private sector.

(Module 12.3, LOS 12.t)

Question #91 of 101

Question ID: 1456972

Monetary policy is *most accurately* described as actions that influence economic activity by increasing or decreasing:

A) currency exchange rates.

B) the supply of money and credit.

C) tax rates on income and consumption.

Explanation

Monetary policy attempts to influence economic growth and inflation by increasing or decreasing the money supply and the availability of credit in the economy. Taxes and government spending are tools of fiscal policy. Monetary and fiscal policy can both influence currency exchange rates, but this is not typically their primary goal or tool.

(Module 12.1, LOS 12.a)

Question #92 of 101

Question ID: 1457019

Central banks pursuing expansionary policies may:

A) decrease the policy rate and make open market purchases of securities.

B) decrease the policy rate and make open market sales of securities.

C) increase the policy rate and make open market purchases of securities.

Explanation

Decreasing the policy rate, decreasing reserve requirements, and purchasing securities in the open market are expansionary monetary policy actions.

(Module 12.2, LOS 12.h)

Question #93 of 101

Question ID: 1457016

When the Federal Reserve sells government securities on the open market, bank reserves are:

A) decreased, which reduces the amount of money banks are able to lend, causing a decrease in the federal funds rate.

B) decreased, which reduces the amount of money banks are able to lend, causing an increase in the federal funds rate.

C) increased, which increases the amount of money banks are able to lend, causing a decrease in the federal funds rate.

Explanation

When the Federal Reserve wants to increase the federal funds rate through open market operations, it sells government securities. Open-market sales reduce bank reserves and cause the federal funds rate to increase.

(Module 12.2, LOS 12.h)

Question #94 of 101

Question ID: 1457029

Which of the following is the *most likely* result of a central bank's shift to an expansionary monetary policy?

A) Domestic currency appreciates.

B) Exports increase.

C) Interest rates increase.

Explanation

Expansionary monetary policy decreases interest rates. This should cause the domestic currency to depreciate, which should increase foreign demand for the country's exports.

(Module 12.2, LOS 12.j)

Question #95 of 101

Question ID: 1457015

Assume the U.S. economy is undergoing a recession. In its efforts to stimulate the economy by trying to influence short-term interest rates the Fed is *most likely* to take which two actions?

A) Buy Treasury securities and decrease bank reserve requirements.

B) Sell Treasury securities and decrease bank reserve requirements.

C) Sell Treasury securities and increase bank reserve requirements.

Explanation

If the economy is in a recession, the Fed is likely to attempt to decrease short-term interest rates. Thus, the Fed will buy Treasury securities and decrease bank reserve requirements.

(Module 12.2, LOS 12.h)

Question #96 of 101

Question ID: 1456970

Policies that can be used as tools for redistribution of wealth and income include:

A) both fiscal policy and monetary policy.

B) fiscal policy only.

C) monetary policy only.

Explanation

Fiscal policy can be used as a tool for redistribution of income and wealth, through a variety of taxation and spending policies.

(Module 12.1, LOS 12.a)

Question #97 of 101

Question ID: 1456977

Money serves as a unit of account because:

A) money is accepted as the form of payment for goods.

B) money received for work or goods can be saved to purchase goods or services in the future.

C) prices of goods and services are expressed in units of money.

Explanation

Money has three primary functions: it serves as a unit of account because prices of goods and services are expressed in units of money; it provides a store of value because money received for work or goods can be saved to purchase goods or services at another time; and it serves as a medium of exchange because money is accepted as a form a payment.

(Module 12.1, LOS 12.b)

Question #98 of 101

Question ID: 1457024

The open market sale of Treasury securities by the Federal Reserve is *least likely* to result in:

A) increased longer-term interest rates. ✗

B) a decreased rate of inflation. ✗

C) increased exports of U.S. goods. ✓

Explanation

When the Fed sells Treasuries, it causes both short- and long-term interest rates to increase. This rate increase causes the dollar to appreciate, which reduces foreign demand for domestic goods, causing exports to decline. The interest rate increase also puts downward pressure on price levels, which causes inflation to slow.

(Module 12.2, LOS 12.i)

Question #99 of 101

Question ID: 1457048

When an economy dips into a recession, automatic stabilizers will tend to alter government spending and taxation so as to:

A) reduce the budget deficit (or increase the surplus). ✗

B) enlarge the budget deficit (or reduce the surplus). ✓

C) reduce interest rates, thus stimulating aggregate demand. ✗

Explanation

During a recession unemployment is high, so the government will pay out more in unemployment compensation at the exact time that tax receipts from corporations and individuals are low. This will increase the size of the deficit and also maintain aggregate demand during recessionary periods.

(Module 12.3, LOS 12.o)

Question #100 of 101

Question ID: 1457010

Frequent changes in advertised prices are one of the costs of:

A) expected inflation only.

B) both expected and unexpected inflation.

C) unexpected inflation only.

Explanation

Inflation imposes "menu costs" on an economy as businesses must frequently change their advertised prices, regardless of whether inflation is expected or unexpected.

(Module 12.1, LOS 12.g)

Question #101 of 101

Question ID: 1457052

Arguments against being concerned about the size of a fiscal deficit include:

A) higher future taxes.

B) Ricardian equivalence.

C) the crowding-out effect.

Explanation

Ricardian equivalence suggests that it does not matter whether a government finances its spending with debt or a tax increase because the effect on the total level of demand in the economy is the same. Arguments for being concerned about the size of the fiscal deficit include the crowding-out effect of government borrowing taking the place of private sector borrowing and the negative effects on work incentives and entrepreneurship from higher future taxes.

(Module 12.3, LOS 12.p)