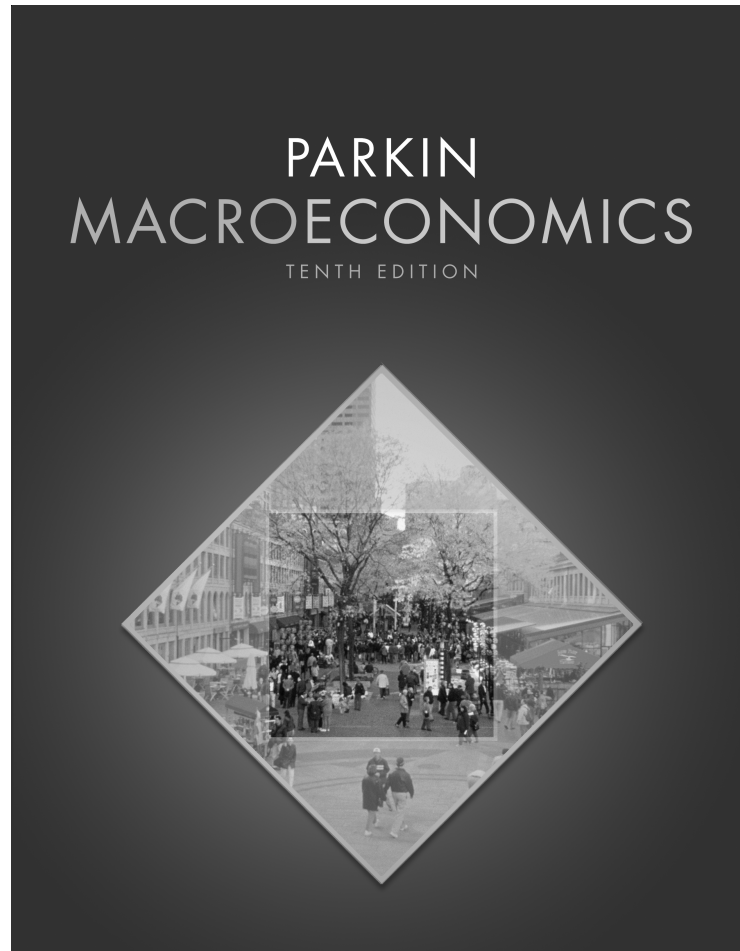


# TEST ITEM FILE 3

## CHAPTERS 10–15

for



**Luke Armstrong**  
Lee College

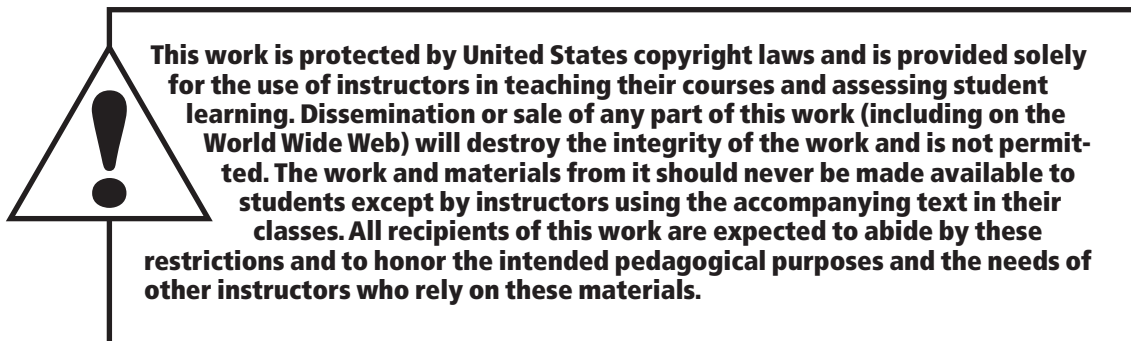
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University of Central Florida

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## ■ Introduction

This book is one of six test banks, each carefully crafted to be part of the most complete package of test banks ever offered to support a beginning economics textbook. Three of the test banks are designed to accompany Michael Parkin's *Microeconomics*, Tenth Edition and three accompany Michael Parkin's *Macroeconomics*, Tenth Edition. The complete set of six books comprises *Microeconomics Test Item File*, Volumes I, II, and III and *Macroeconomics Test Item File*, Volumes I, II, and III. Volume 1 of the *Microeconomics Test Item File* contains questions from Chapters 1 through 7; volume 2 contains questions from Chapters 8 through 13; and volume 3 contains questions from Chapters 14 through 20. Volume 1 of the *Macroeconomics Test Item File* contains questions from Chapters 1 through 5; volume 2 contains questions from Chapters 6 through 9; and volume 3 contains questions from Chapters 10 through 15.

## ■ Test Bank Principles

Three principles guided the writing and revising of the questions:

- ◆ The questions should be “fail-safe” insofar as the topic of the questions has been explained in the textbook.
- ◆ A question should not be a guessing game forcing the students to puzzle out what the question asks.
- ◆ An instructor must be absolutely secure in the knowledge that each question contains material covered in the textbook.

I endeavored to insure that all questions meet all the criteria so that they are, as Donald Dutkowsky put it, “bullet proof.”

## ■ Tenth Edition Revisions

We have made significant revisions in preparing the test banks for the Tenth Edition:

- ◆ All the questions have been reviewed to ensure consistency with the text as well as clarity for the students. Questions dealing with material eliminated from the ninth edition of the textbook were deleted and some duplicative questions were eliminated. New questions were added to cover both the new as well as the old topics in the tenth edition.
- ◆ A large number of the questions have been reworded to enhance clarity. The AACSB standards were checked for accuracy and, if necessary, changed.
- ◆ The artwork was reviewed and changed to remain consistent with the tenth edition of the textbook.
- ◆ To the greatest extent possible, the questions have been ordered so that they follow the order the material is presented in the corresponding textbook chapter. If you assign only part of a chapter to the students, it will be easy to select questions from that specific part.
- ◆ Though not strictly a new revision, it remains worthwhile to note that the test banks are available in a user-friendly computerized test bank.

## ■ Multiple Choice Questions

Taken together, there are nearly 15,000 multiple choice in the test banks. These questions have been written by many contributors. I have edited the questions to ensure that each conformed with the writing style established in the book because this style has been

carefully crafted for maximum student comprehension. I also arranged the questions so that they are in the same order that the topics are presented within the textbook. Among questions dealing with a similar topic, the questions are ordered with non-numerical questions first, questions dealing with a numerical table second, and questions dealing with a figure third.

In addition to questions drawn directly from the text, there also are multiple choice questions that are either the same as or else closely related to the questions in the *Study Guide* and on the *MyEconLab* student website for the book. Each of these questions is identified as to its source. If you have assigned these student supplements to your class, you have the means to “reward” students who are using them by asking questions drawing on what they have been studying.

Each chapter has “News Based Questions.” These questions feature a brief news clip or a sentence with some news or facts and then question(s) based on that information. These are practical questions that stress applying the economics the students are learning to events taking place in the world around them.

The questions in each section of the chapter are based on the material covered only in that section. However we have also included “Part Review” multiple choice questions. These sections feature questions that are drawn from material covered in more than one chapter in each Part. You can use these questions if you want more integrative questions that lead students to think about broader issues.

### ■ Other Styles of Questions

In addition to multiple choice questions, each chapter also features essay questions, numeric questions, graphing questions, true or false questions, and extended problems. Within each chapter, you will find each type of question grouped together—that is, the essay questions for each chapter are first, followed by the numeric/graphing questions for each chapter, and so on. In this fashion, if you want to write a strictly essay question exam, it will be easy to do so. Of course, within each chapter, the questions are arranged in the same order that the topics appear in the textbook.

For each chapter there are 3 to 5 extended problems. These questions are, as the name implies, longer questions. Sometimes the questions for a chapter build upon each other; other times the questions are inde-

pendent. These questions can be used on exam. However, they may also be given to the students and used as homework. I think the best way to view these questions is as a valuable supplement to the outstanding questions already in the textbook.

### ■ Final Comments

I have been teaching principles classes for over two decades, have written hundreds of exams, and won several teaching awards. Nonetheless, I was stunned by the quality of the questions in the test banks. I lost count of the number of times that I marveled at a question and wished that *I* had thought of it. While creating this test bank took significantly more effort than preparing an ordinary test bank, I am sure that the quality you will find made the task worthwhile.

Just as Sir Isaac Newton stood on the shoulders of the giants who came before him, so, too do these test banks reflect the superb work of the authors who initially wrote and compiled them. It is entirely fitting to thank them:

- ◆ Peter von Allmen of Moravian College
- ◆ Sue Bartlett of the University of South Florida
- ◆ Kevin Carey of American University
- ◆ Leo Chan of the University of Kansas
- ◆ Donald H. Dutkowsky of Syracuse University
- ◆ Andrew Foshee of McNeese State University
- ◆ James Giordano of Villanova University
- ◆ John Graham of Rutgers University
- ◆ Jill Boylston Herndon of the University of Florida
- ◆ Veronica Z. Kalich of Baldwin-Wallace College
- ◆ Sang Lee of Southeastern Louisiana University
- ◆ William Mosher of Clark University
- ◆ Melinda Nish of Salt Lake Community College
- ◆ Terry Olson of Truman State University
- ◆ Ed Price of Oklahoma State University
- ◆ Jeff Reynolds of Northern Illinois University
- ◆ Rochelle L. Ruffer of Youngstown State University
- ◆ Virginia Shingleton of Valparaiso University
- ◆ Della Sue of Marist College
- ◆ Robert Whaples of Wake Forest University
- ◆ Peter A. Zaleski of Villanova University
- ◆ Carol Dole, of Jacksonville University
- ◆ Constantin Oglobin of Georgia Southern University

- ◆ Nora Underwood of the University of California, Davis

Contributing questions for the Tenth edition are:

- ◆ Luke Armstrong of Lee College
- ◆ Gary Hoover of the University of Alabama
- ◆ Svitlana Maksymenko of the University of Pittsburgh
- ◆ Barbara Moore of the University of Central Florida
- ◆ James K. Self of the University of Indiana, Bloomington

Working with Luke, Gary, Svitlana, Barbara, and Jim was quite enjoyable. The questions they contributed were often innovative and remarkable!

I have tried to make these *Test Item Files* as helpful and useful as possible. Undoubtedly I have made some mistakes; mistakes that you may see. I have a standing offer in the *Study Guide* asking students who find any errors to notify me and promising that I will acknowledge

them in all future editions of the *Study Guide*. I will make the same offer here: If you find any errors or have any comments or questions, *please* let me know and, if you want, I will note your help in all future editions of the test banks. And so keeping this promise:

- ◆ Dr. B. N. Ghosh of Eastern Mediterranean University in North Cyprus. Dr. Ghosh found several errors and I greatly appreciate his efforts!

My address is below, or you can reach me via E-mail at [MARK.RUSH@CBA.UFL.EDU](mailto:MARK.RUSH@CBA.UFL.EDU).

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January 2011



# Contents

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Chapter 10	Aggregate Supply and Aggregate Demand .....	1
Chapter 11	Expenditure Multipliers: The Keynesian Model.....	131
Chapter 12	U.S. Inflation, Unemployment, and Business Cycle.....	263
Chapter 13	Fiscal Policy .....	386
Chapter 14	Monetary Policy .....	458
Chapter 15	International Trade Policy .....	524
Part 1 Review	.....	576
Part 2 Review	.....	583
Part 3 Review	.....	586
Part 4 Review	.....	591
Part 5 Review	.....	597





# Chapter 10

## Aggregate Supply and Aggregate Demand

### 1 Aggregate Supply

- 1) The supply of real GDP is a function of
- A) the total expenditures of consumers, investors and government.
  - B) the sum of wages, salaries, corporate profits, rents and interest.
  - C) only the state of technology.
  - D) the quantities of labor, capital and the state of technology.

Answer: D

Topic: Aggregate Supply Fundamentals

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 2) The quantity of real GDP supplied depends on the
- A) level of aggregate demand.
  - B) quantity of capital, bonds, and stocks.
  - C) quantity of labor, the quantity of capital, and the state of technology.
  - D) price level, the unemployment rate, and the quantity of government expenditures on goods and services.

Answer: C

Topic: Aggregate Supply Fundamentals

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 3) An aggregate supply curve depicts the relationship between
- A) the price level and nominal GDP.
  - B) household expenditures and household income.
  - C) the price level and the aggregate quantity supplied.
  - D) the price level and the aggregate quantity demanded.

Answer: C

Topic: Aggregate Supply

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 4) In the macroeconomic short run,
- A) actual real GDP may be less than or more than potential GDP.
  - B) the unemployment rate is zero.
  - C) by definition, the economy is always moving away from full employment.
  - D) actual real GDP always equals potential GDP.

Answer: A

Topic: Macroeconomic Long Run and Short Run

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 5) When talking about aggregate supply, it is necessary to
- A) focus on the short run.
  - B) focus on the long run.
  - C) distinguish between long-run aggregate supply and short-run aggregate supply.
  - D) distinguish between long-run full employment and short-run full-employment.

Answer: C

*Topic: Macroeconomic Long Run and Short Run*

*Skill: Recognition*

*Question history: Previous edition, Chapter 10*

*AACSB: Reflective Thinking*

- 6) We distinguish between the long-run aggregate supply curve and the short-run aggregate supply curve. In the long run
- A) technology is fixed but not in the short run.
  - B) the price level is constant but in the short run it fluctuates.
  - C) the aggregate supply curve is horizontal while in the short run it is upward sloping.
  - D) real GDP equals potential GDP.

Answer: D

*Topic: Macroeconomic Long Run and Short Run*

*Skill: Recognition*

*Question history: Previous edition, Chapter 10*

*AACSB: Reflective Thinking*

- 7) In the macroeconomic long run,
- A) GDP always is below potential GDP.
  - B) there is full employment with no unemployment.
  - C) output always is above potential GDP.
  - D) there is full employment and real GDP is equal to potential GDP.

Answer: D

*Topic: Macroeconomic Long Run and Short Run*

*Skill: Recognition*

*Question history: Previous edition, Chapter 10*

*AACSB: Reflective Thinking*

- 8) In the macroeconomic long run,
- A) real GDP equals potential GDP.
  - B) the economy is at full employment.
  - C) regardless of the price level, the economy is producing at potential GDP.
  - D) All of the above are correct.

Answer: D

*Topic: Macroeconomic Long Run and Short Run*

*Skill: Recognition*

*Question history: Previous edition, Chapter 10*

*AACSB: Reflective Thinking*

- 9) In the long-run
- A) the aggregate supply curve is upward sloping.
  - B) real GDP is equal to potential GDP.
  - C) aggregate supply depends on the price level.
  - D) All of the above answers are correct.

Answer: B

Topic: Macroeconomic Long Run and Short Run

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 10) The long-run aggregate supply (LAS) curve
- A) has a positive slope.
  - B) has a negative slope.
  - C) is vertical.
  - D) is horizontal.

Answer: C

Topic: Long-Run Aggregate Supply

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 11) When the labor market is int full employment,
- A) real GDP equals potential GDP.
  - B) the price level is stable.
  - C) the price level equals potential prices.
  - D) the SAS curve is horizontal.

Answer: A

Topic: Long-Run Aggregate Supply

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 12) The long-run aggregate supply curve is vertical because
- A) at full employment prices are stable.
  - B) there is no cyclical inflation.
  - C) potential GDP is independent of the price level.
  - D) the money wage rate increases faster than the price level.

Answer: C

Topic: Long-Run Aggregate Supply

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 13) The long-run aggregate supply curve is
- A) horizontal at the full employment price level.
  - B) vertical at the full employment level of real GDP.
  - C) upward sloping because of the effects of price level changes on real GDP.
  - D) the same as the short-run aggregate supply curve.

Answer: B

Topic: Long-Run Aggregate Supply

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 14) Which of the following statements is TRUE?
- A) The long-run aggregate supply curve is upward sloping.
  - B) The long-run aggregate demand curve is upward sloping.
  - C) The short-run aggregate supply curve is vertical.
  - D) The long-run aggregate supply curve is vertical.

Answer: D

Topic: Long-Run Aggregate Supply

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 15) The long-run aggregate supply curve is \_\_\_\_\_ because along it, as prices rise, the money wage rate \_\_\_\_\_.
- A) vertical; falls
  - B) vertical; rises
  - C) upward sloping; falls
  - D) upward sloping; stays constant

Answer: B

Topic: Long-Run Aggregate Supply

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 16) The long-run aggregate supply curve illustrates the
- A) relationship of the price level and real GDP when the economy is at full employment.
  - B) relationship of aggregate supply and aggregate demand.
  - C) amount of products producers offer at various prices when money wages and other resource prices do not change.
  - D) surpluses, shortages and equilibrium level of GDP.

Answer: A

Topic: Long-Run Aggregate Supply

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 17) The long-run aggregate supply curve is the relationship between the quantity of real GDP supplied and \_\_\_\_\_ when \_\_\_\_\_.
- A) the price level; real GDP equals potential GDP
  - B) real GDP demanded; the wage rate is constant
  - C) the price level; real GDP equals nominal GDP
  - D) real GDP demanded; the price level does not change

Answer: A

Topic: Long-Run Aggregate Supply

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 18) When the price level rises, the long-run aggregate supply curve \_\_\_\_\_.
- A) shifts rightward
  - B) does not shift
  - C) slopes upward
  - D) shifts leftward

Answer: B

Topic: Long-Run Aggregate Supply Curve

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 19) For movements along the long-run aggregate supply curve,
- A) potential GDP is dependent on the price level.
  - B) the prices of goods and services change while the prices of productive resources hold steady.
  - C) the price level and the money wage rate change by the same percentage.
  - D) All of the above are correct.

Answer: C

Topic: Long-Run Aggregate Supply

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 20) The long-run aggregate supply curve shows the
- A) maximum GDP the nation will ever produce.
  - B) full-employment level of real GDP.
  - C) level of real GDP associated with a constant price level.
  - D) level of output at which real GDP equals nominal GDP.

Answer: B

Topic: Long-Run Aggregate Supply

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 21) Which of the following is true about the long-run aggregate supply curve?
- A) It is vertical at the level of potential GDP.
  - B) It shows the relationship between the price level and real GDP when the economy is at full employment.
  - C) It does not shift in response to temporary changes in aggregate demand.
  - D) All of the above are true.

Answer: D

Topic: Long-Run Aggregate Supply

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 22) Which of the following events will increase long-run aggregate supply?
- A) an increase in the interest rate
  - B) an increase in resource prices
  - C) a decrease in expected profit
  - D) an advance in technology

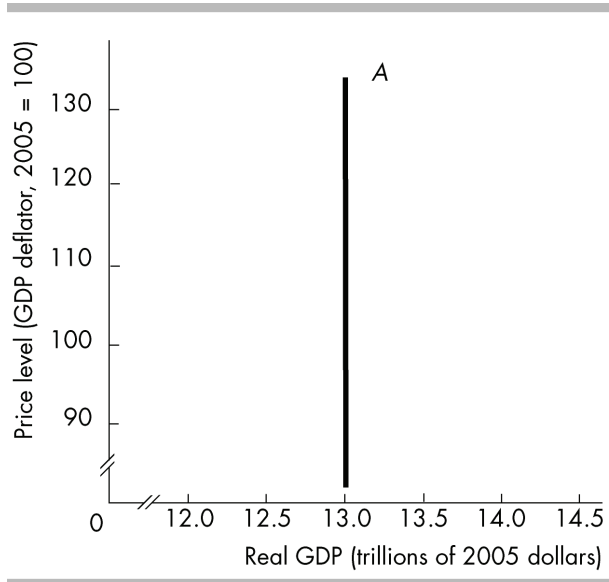
Answer: D

Topic: Long-Run Aggregate Supply

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking



- 23) The curve labeled *A* in the above figure is a
- A) short-run aggregate demand curve.
  - B) short-run aggregate supply curve.
  - C) long-run aggregate demand curve.
  - D) long-run aggregate supply curve.

Answer: D

Topic: Long-Run Aggregate Supply

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

- 24) The curve labeled *A* in the above figure will shift rightward when
- A) the price level falls.
  - B) technology increases.
  - C) population falls.
  - D) the price level rises.

Answer: B

Topic: Changes in Aggregate Supply, Technology

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

- 25) The short-run aggregate supply curve
- A) shows what each producer is willing and able to produce at each level of income holding constant potential GDP and all resource prices.
  - B) shows the relationship between aggregate production and the price level holding constant potential GDP and all resource prices.
  - C) becomes vertical if there is excess production capacity within the economy.
  - D) shows a negative relationship between the price level and real national income holding constant potential GDP and all resource prices.

Answer: B

Topic: Short-Run Aggregate Supply

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 26) The short-run aggregate supply curve
- A) is vertical.
  - B) has a negative slope.
  - C) has a positive slope.
  - D) is horizontal.

Answer: C

Topic: Short-Run Aggregate Supply

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 27) The short-run aggregate supply curve is upward sloping because in the short run the
- A) money wage rate changes but the price level does not.
  - B) price level changes but the money wage rate does not.
  - C) both the money wage rate and the price level change.
  - D) neither the money wage rate nor the price level can change.

Answer: B

Topic: Short-Run Aggregate Supply

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 28) The positive relationship between short-run aggregate supply and the price level indicates that, in the short run,
- A) firms produce more output as the price level falls.
  - B) firms produce more output as the price level rises.
  - C) the money wage rate increases when moving along the short-run aggregate supply curve.
  - D) lower price levels are more profitable for firms.

Answer: B

Topic: Short-Run Aggregate Supply

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking



- 29) Moving upward along the SAS results in a \_\_\_\_\_ in the price level and \_\_\_\_\_ in real GDP.
- A) rise; an increase
  - B) rise; a decrease
  - C) fall; an increase
  - D) fall; a decrease

Answer: A

Topic: Short-Run Aggregate Supply

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 30) The short-run aggregate supply curve is upward sloping because
- A) a lower price level creates a wealth effect.
  - B) lower taxes motivate people to work more.
  - C) money wage rates do not immediately change when the price level changes.
  - D) most business firms operate with long-term contracts for output but not labor.

Answer: C

Topic: Short-Run Aggregate Supply

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 31) The short-run aggregate supply curve
- A) is vertical.
  - B) shows the impact changes in the price level have on the quantity of real GDP when resource prices are constant.
  - C) illustrates the level of potential real GDP.
  - D) shifts whenever the price level changes.

Answer: B

Topic: Short-Run Aggregate Supply

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 32) In the short-run
- A) the aggregate supply curve is upward sloping.
  - B) real GDP is always equal to potential GDP.
  - C) the money wage rate can change.
  - D) the price level does not change.

Answer: A

Topic: Short-Run Aggregate Supply

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 33) Along a short-run aggregate supply curve, a decrease in the price level means that
- A) more output is produced as consumer demand increases.
  - B) less output is produced as firms decrease production.
  - C) more output is produced as firms increase production because wages fall more than the price level falls, making it profitable to hire more workers.
  - D) output does not change because firms do not change the quantity they produce.

Answer: B

Topic: Short-Run Aggregate Supply

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 34) In the short run, firms expand their production when the price level rises because
- A) the money wage rate remains constant so the higher prices for their product makes it profitable for firms to expand production.
  - B) each firm must keep its production up to the level of its rivals, and some firms will expand production as the price level increases.
  - C) the higher prices allow the firm to hire more workers by offering higher wages, thereby increasing productivity and profits.
  - D) firms can increase their profits by increasing their maintenance.

Answer: A

Topic: Short-Run Aggregate Supply

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 35) Moving along the short-run aggregate supply curve, \_\_\_\_\_.
- A) the real wage rate is constant
  - B) real GDP equals potential GDP
  - C) the money wage rate, the prices of other resources, and potential GDP remain constant
  - D) real GDP equals nominal GDP

Answer: C

Topic: Short-Run Aggregate Supply Curve

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 36) If the money wage and other resource prices do not change when the price level rises by 10 percent, \_\_\_\_\_.
- A) the long-run aggregate supply curve shifts leftward
  - B) the short-run aggregate supply curve shifts leftward
  - C) the long-run aggregate supply curve shifts rightward
  - D) there is movement along the short-run aggregate supply curve

Answer: D

Topic: Movements Along the SAS Curve

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 37) A change in \_\_\_\_\_ results in a movement along the short-run aggregate supply curve but does not shift the short-run aggregate supply curve.
- A) the money wage rate
  - B) technology
  - C) the quantity of capital
  - D) the price level

Answer: D

Topic: Movements Along the SAS Curve

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 38) Which of the following does NOT shift the short-run aggregate supply curve?
- A) a change in the money wage rate
  - B) technological progress
  - C) a reduction in the price of a raw material
  - D) a change in the price level

Answer: D

Topic: Movements Along the SAS Curve

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 39) Which of the following occurs while moving along a short-run aggregate supply curve?
- A) The money wage rate and the price level change by the same percentage.
  - B) The money wage rate changes and the price level is constant.
  - C) The price level changes and the money wage rate is constant.
  - D) Neither the price level nor the money wage rate changes.

Answer: C

Topic: Movements Along the SAS Curve

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 40) For movements along the short-run aggregate supply curve,
- A) the money wage rate is constant.
  - B) the real wage rate changes.
  - C) potential GDP remains constant.
  - D) All of the above are correct.

Answer: D

Topic: Movements Along the SAS Curve

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 41) Moving along a short-run aggregate supply curve, resource prices \_\_\_\_\_, the money wage \_\_\_\_\_, and potential GDP \_\_\_\_\_.
- A) do not change; changes; does not change
  - B) do not change; does not change; changes
  - C) change; does not change; does not change
  - D) do not change; does not change; does not change

Answer: D

Topic: *Movements Along the SAS Curve*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 42) A decrease in the price level accompanied by no change in the money wage rate leads to \_\_\_\_\_ movement along the \_\_\_\_\_ aggregate supply curve.
- A) a downward; short-run
  - B) an upward; short-run
  - C) a downward; long-run
  - D) an upward; long-run

Answer: A

Topic: *Movements Along the SAS Curve*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 43) The SAS curve and the LAS curve
- A) intersect at potential GDP.
  - B) are parallel at potential GDP.
  - C) are perpendicular to one another at potential GDP.
  - D) None of the above answers is correct.

Answer: A

Topic: *The LAS and SAS Curves*

Skill: *Recognition*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 44) Suppose the price level, the money wage, and the price of all other resources rise by 10 percent. This set of changes leads to
- A) an upward movement along the LAS curve.
  - B) a downward movement along the LAS curve.
  - C) an upward movement along the SAS curve.
  - D) a leftward shift of the LAS curve.

Answer: A

Topic: *Movements Along the LAS and SAS Curves*

Skill: *Recognition*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 45) Suppose the price level rises and the money wage remains constant. This set of changes leads to
- A) an upward movement along the *LAS* curve.
  - B) an upward movement along the *SAS* curve.
  - C) a leftward shift of the *SAS* curve.
  - D) a leftward shift of the *SAS* curve and the *LAS* curve.

Answer: B

Topic: *Movements Along the LAS and SAS Curves*

Skill: *Recognition*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 46) Which of the following statements regarding aggregate supply are correct?
- A) Moving along the long-run aggregate supply curve, both the price level and the money wage rate change by the same percentage.
  - B) Moving along the short-run aggregate supply curve, both the price level and the money wage rate change by the same percentage.
  - C) Moving along the long-run aggregate supply curve, the money wage rate changes but the price level is constant.
  - D) Moving along the short-run aggregate supply curve, the money wage rate changes but the price level is constant.

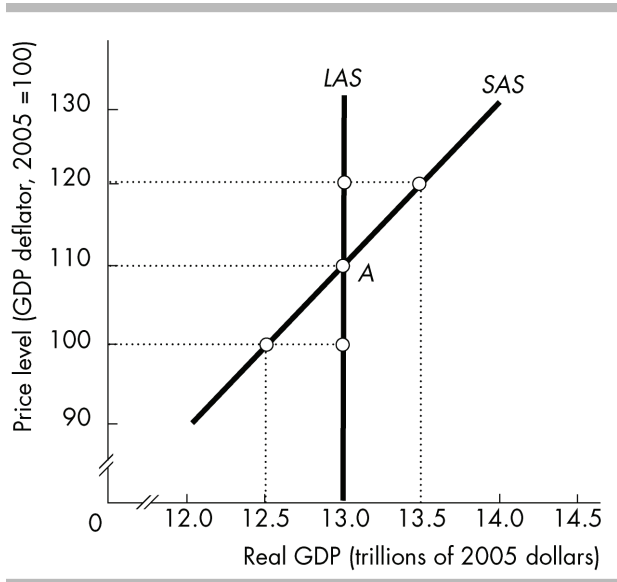
Answer: A

Topic: *Movements Along the LAS and SAS Curves*

Skill: *Recognition*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*



- 47) In the figure above, potential GDP equals
- A) \$12.5 trillion.
  - B) \$13.0 trillion.
  - C) \$13.5 trillion.
  - D) None of the above answers is correct.

Answer: B

Topic: Long-Run Aggregate Supply

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

- 48) In the figure above, the economy is at point A when the price level rises to 120. Money wage rates and other resource prices remain constant. Firms are willing to supply output equal to
- A) \$12.5 trillion.
  - B) \$13.0 trillion.
  - C) \$13.5 trillion.
  - D) None of the above answers is correct.

Answer: C

Topic: Short-Run Aggregate Supply

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

- 49) In the figure above, the economy is at point *A* when the price level falls to 100. Money wage rates and all other resource prices remain constant. Firms are willing to supply output equal to
- \$12.5 trillion.
  - \$13.0 trillion.
  - \$13.5 trillion.
  - None of the above answers is correct.

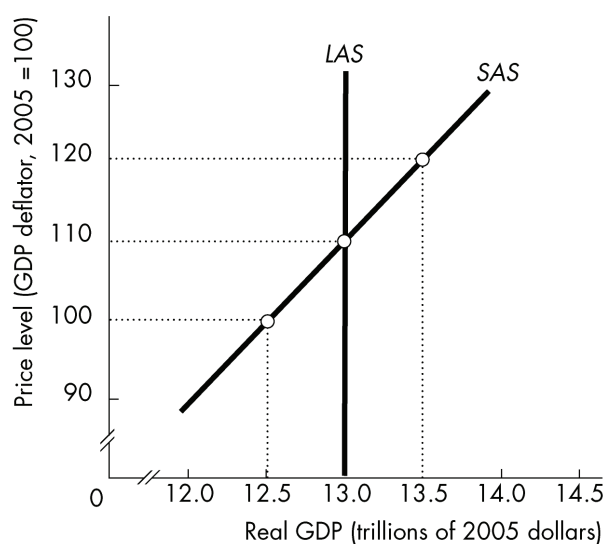
Answer: A

Topic: Short-Run Aggregate Supply

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills



- 50) In the above figure, the economy will be at full employment if the price level
- is 110.
  - is above 110.
  - is below 100.
  - All of the above are possible because the economy will be at full employment at any price level at, above, or below 110.

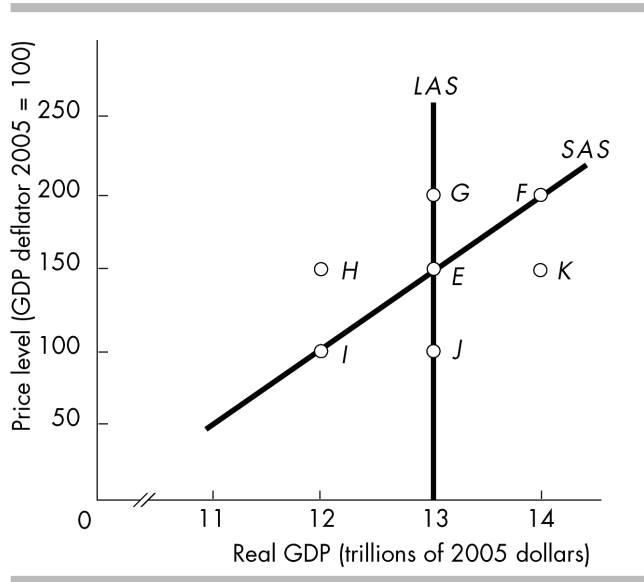
Answer: A

Topic: Short-Run and Long-Run Aggregate Supply

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills



- 51) In the above figure, which movement illustrates the impact of a falling price level and a constant money wage rate?
- A) E to I
  - B) E to F
  - C) E to J
  - D) E to H

Answer: A

Topic: *Movements Along the LAS and SAS Curves*

Skill: *Analytical*

Question history: *Previous edition, Chapter 10*

AACSB: *Analytical Skills*

- 52) In the above figure, which movement illustrates the impact of a rising price level and a constant money wage rate?
- A) E to I
  - B) E to F
  - C) E to G
  - D) E to K

Answer: B

Topic: *Movements Along the LAS and SAS Curves*

Skill: *Analytical*

Question history: *Previous edition, Chapter 10*

AACSB: *Analytical Skills*



- 53) In the above figure, which movement illustrates the impact of the price level and money wage rate falling at the same rate?
- A) E to H
  - B) E to K
  - C) E to J
  - D) E to G

Answer: C

Topic: Movements Along the LAS and SAS Curves

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

- 54) In the above figure, which movement illustrates the impact of a constant price level and a rising money wage rate?
- A) E to I
  - B) E to F
  - C) E to J
  - D) E to H

Answer: D

Topic: Movements Along the LAS and SAS Curves

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

- 55) Which of the following events will increase short-run aggregate supply?
- A) an advance in technology
  - B) an increase in resource prices
  - C) an increase in the natural unemployment rate
  - D) an increase in foreign income

Answer: A

Topic: Changes in Short-Run Aggregate Supply

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 56) The short-run aggregate supply curve shifts when
- i. the full-employment quantity of capital changes.
  - ii. technology advances.
- A) i only
  - B) ii only
  - C) neither i nor ii
  - D) i and ii

Answer: D

Topic: Changes in Short-Run Aggregate Supply

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 57) The SAS curve shifts if there is a change in
- A) the price level.
  - B) real GDP.
  - C) nominal GDP.
  - D) potential GDP.

Answer: D

Topic: *Changes in Short-Run Aggregate Supply*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 58) Which of the following changes does NOT shift the short-run aggregate supply curve?
- A) an increase in the price level
  - B) an increase in technology
  - C) an increase in the quantity of capital
  - D) an increase in the money wage rate

Answer: A

Topic: *Changes in Short-Run Aggregate Supply*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 59) Which of the following changes does NOT shift the long-run aggregate supply curve?
- A) a decrease in the labor force
  - B) a fall in the price level
  - C) a rise in number of college graduates in the labor force
  - D) a tax hike that reduces the capital stock

Answer: B

Topic: *Changes in Short-Run Aggregate Supply*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 60) All of the following shift the LAS curve EXCEPT
- A) a change in the capital stock.
  - B) an increase in the money wage rate.
  - C) an increase in the stock of human capital.
  - D) technological progress.

Answer: B

Topic: *Changes in Long-Run Aggregate Supply*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 61) All of the following shift the short-run aggregate supply curve EXCEPT
- A) a change in the price level.
  - B) a change in the money wage rate.
  - C) a change in the price of a raw material.
  - D) technological progress.

Answer: A

Topic: Changes in Short-Run Aggregate Supply

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 62) Which of the following directly shifts the short-run aggregate supply curve?
- A) a change in aggregate demand
  - B) a change in the price level
  - C) a change in resource prices
  - D) all of the above

Answer: C

Topic: Changes in Short-Run Aggregate Supply

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 63) Which of the following shifts the short-run aggregate supply curve?
- I. changes in the size of the labor force
  - II. changes in the money wage rate
- A) I only
  - B) II only
  - C) both I and II
  - D) neither I nor II

Answer: C

Topic: Changes in Short-Run Aggregate Supply

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 64) The short-run aggregate supply curve shifts leftward when the
- A) price level increases.
  - B) general level of technology advances.
  - C) money wage rate increases.
  - D) availability of on-the-job training expands to all workers.

Answer: C

Topic: Changes in Short-Run Aggregate Supply

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 65) Suppose there is a temporary increase in the price of oil. This is represented by
- A) a leftward shift of the *SAS* and the *LAS* curve.
  - B) a leftward shift of the *LAS* curve.
  - C) a rightward shift of the *SAS* curve.
  - D) a leftward shift of the *SAS* curve.

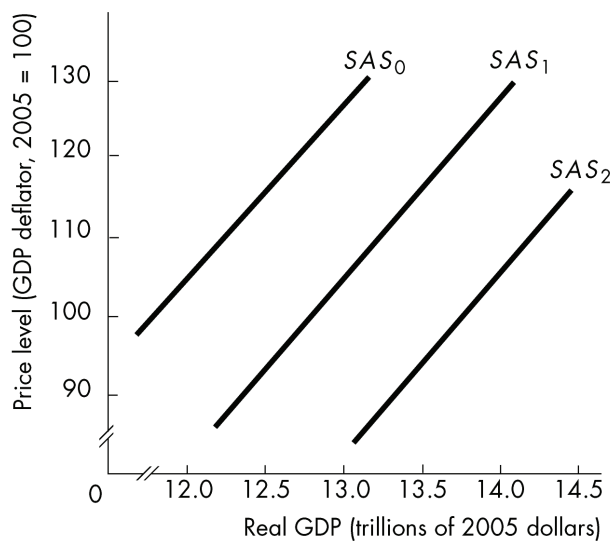
Answer: D

Topic: Changes in Short-Run Aggregate Supply

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking



- 66) In the above figure, the short-run aggregate supply curve is *SAS*<sub>1</sub>. Suppose that the price level in the economy increases. As a result there is
- A) an upward movement along *SAS*<sub>1</sub>.
  - B) a downward movement along *SAS*<sub>1</sub>.
  - C) a shift to *SAS*<sub>0</sub>.
  - D) a shift to *SAS*<sub>2</sub>.

Answer: A

Topic: Changes in Short-Run Aggregate Supply

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

67) In the above figure, the short-run aggregate supply curve is  $SAS_1$ . If technology advances, there is

- A) an upward movement along  $SAS_1$ .
- B) a downward movement along  $SAS_1$ .
- C) a shift to  $SAS_0$ .
- D) a shift to  $SAS_2$ .

Answer: D

Topic: Changes in Short-Run Aggregate Supply

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

68) In the above figure, the short-run aggregate supply curve is  $SAS_1$ . If the money wage rate increases, there is

- A) an upward movement along  $SAS_1$ .
- B) a downward movement along  $SAS_1$ .
- C) a shift to  $SAS_0$ .
- D) a shift to  $SAS_2$ .

Answer: C

Topic: Changes in Short-Run Aggregate Supply

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

69) In the above figure, the short-run aggregate supply curve is  $SAS_1$ . If the prices of resources fall, there is

- A) an upward movement along  $SAS_1$ .
- B) a downward movement along  $SAS_1$ .
- C) a shift to  $SAS_0$ .
- D) a shift to  $SAS_2$ .

Answer: D

Topic: Changes in Short-Run Aggregate Supply

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

70) A change in the full-employment quantity of labor \_\_\_\_\_ the short-run aggregate supply curve and \_\_\_\_\_ the long-run aggregate supply curve.

- A) shifts; shifts
- B) shifts; does not shift
- C) does not shift; shifts
- D) does not shift; does not shift

Answer: A

Topic: Change in Aggregate Supply; Full Employment Quantity of Labor

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 71) If the full-employment quantity of labor increases, then the
- A) *LAS* curve shifts rightward and the *SAS* curve does not shift.
  - B) *SAS* curve shifts rightward and the *LAS* curve does not shift.
  - C) *SAS* curve shifts rightward and the *LAS* curve shifts rightward.
  - D) *SAS* curve shifts rightward and the *LAS* curve does shifts leftward.

Answer: C

Topic: *Changes in Aggregate Supply; Full-Employment Quantity of Labor*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 72) When the quantity of capital increases, then the
- A) *LAS* curve shifts rightward and the *SAS* curve does not shift.
  - B) *SAS* curve shifts rightward and the *LAS* curve does not shift.
  - C) *SAS* curve shifts rightward and the *LAS* curve shifts rightward.
  - D) *SAS* curve shifts rightward and the *LAS* curve does shifts leftward.

Answer: C

Topic: *Changes in Aggregate Supply, Capital*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 73) With an increase in the capital stock, the short-run aggregate supply curve
- A) remains as it is.
  - B) shifts rightward.
  - C) shifts leftward.
  - D) becomes steeper.

Answer: B

Topic: *Changes in Aggregate Supply, Capital*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 74) An increase in the amount of human capital \_\_\_\_\_ the short-run aggregate supply curve and \_\_\_\_\_ the long-run aggregate supply curve.
- A) shifts; shifts
  - B) shifts; does not shift
  - C) does not shift; shifts
  - D) does not shift; does not shift

Answer: A

Topic: *Changes in Aggregate Supply, Capital*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 75) A change in the capital stock \_\_\_\_\_ the short-run aggregate supply curve and \_\_\_\_\_ the long-run aggregate supply curve.
- A) shifts; shifts
  - B) shifts; does not shift
  - C) does not shift; shifts
  - D) does not shift; does not shift

Answer: A

Topic: Changes in Aggregate Supply, Capital

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 76) The land of Ur increases its capital stock. As a result, the long-run aggregate supply curve shifts \_\_\_\_\_ and so does the \_\_\_\_\_ curve.
- A) rightward; aggregate demand
  - B) leftward; aggregate demand
  - C) rightward; short-run aggregate supply
  - D) leftward; short-run aggregate supply

Answer: C

Topic: Changes in Aggregate Supply, Capital

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 77) Which of the following shifts both the LAS and SAS curves?
- A) a change in the price level
  - B) a change in the money wage rate
  - C) a simultaneous change in both the price level and the money wage rate
  - D) an advance in technology

Answer: D

Topic: Changes in Aggregate Supply, Technology

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 78) A technological advance \_\_\_\_\_ the long-run aggregate supply curve and \_\_\_\_\_ the short-run aggregate supply curve.
- A) shifts; shifts
  - B) shifts; does not shift
  - C) does not shift; shifts
  - D) does not shift; does not shift

Answer: A

Topic: Changes in Aggregate Supply, Technology

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

79) Technological progress will

- A) shift the *LAS* curve rightward but will not shift the *SAS* curve.
- B) not shift either the *LAS* or the *SAS* curve.
- C) shift both the *LAS* and *SAS* curves rightward.
- D) shift the *SAS* curve rightward but will not shift the *LAS* curve.

Answer: C

Topic: *Changes in Aggregate Supply, Technology*

Skill: *Recognition*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

80) The short-run aggregate supply curve shifts because of changes in all of the following EXCEPT

- A) the capital stock.
- B) technological progress.
- C) money wage rates.
- D) the price level.

Answer: D

Topic: *Changes in Short-Run Aggregate Supply*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

81) If the money prices of resources changes,

- A) the *LAS* curve shifts.
- B) the *SAS* curve shifts.
- C) the *AD* curve shifts.
- D) the macroeconomic equilibrium is unaffected.

Answer: B

Topic: *Change in Aggregate Supply-Money Wages & Prices of Resources*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

82) If the money wage rate rises, then the

- A) *SAS* curve shifts rightward.
- B) *SAS* curve shifts leftward.
- C) *LAS* curve shifts rightward.
- D) *LAS* curve shifts leftward.

Answer: B

Topic: *Change in Aggregate Supply-Money Wages & Prices of Resources*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*



83) If the money price of a resource such as oil falls, then the

- A) LAS curve shifts rightward.
- B) LAS curve shifts leftward.
- C) SAS curve shifts leftward.
- D) SAS curve shifts rightward.

Answer: D

Topic: Change in Aggregate Supply–Money Wages & Prices of Resources

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

84) Suppose that the money wage in the economy increases by 8 percent. As a result the

- A) long-run aggregate supply will decrease.
- B) long-run and the short-run aggregate supply both decrease.
- C) short-run aggregate supply will decrease.
- D) long-run aggregate supply will increase and the short-run aggregate supply will decrease.

Answer: C

Topic: Change in Aggregate Supply–Money Wages & Prices of Resources

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

85) A decrease in the money wage rate

- A) increases the long-run aggregate supply.
- B) decreases the long-run aggregate supply.
- C) increases the short-run aggregate supply.
- D) decreases the short-run aggregate supply.

Answer: C

Topic: Changes in Money Wages and Other Resource Prices

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

86) An increase in the money wage rate

- A) increases the long-run aggregate supply.
- B) decreases the long-run aggregate supply.
- C) increases the short-run aggregate supply.
- D) decreases the short-run aggregate supply.

Answer: D

Topic: Changes in Money Wages and Other Resource Prices

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 87) A change in the money wage rate shifts  
 A) both the *SAS* and *LAS* curves.  
 B) the *LAS* curve but not the *SAS* curve.  
 C) the *SAS* curve but not the *LAS* curve.  
 D) neither the *SAS* nor the *LAS* curve.

Answer: C

Topic: *Changes in Money Wages and Other Resource Prices*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 88) An increase in the money wage rate shifts the short-run aggregate supply curve \_\_\_\_\_; an increase in technology shifts the long-run aggregate supply curve \_\_\_\_\_.  
 A) rightward; rightward  
 B) rightward; leftward  
 C) leftward; rightward  
 D) leftward; leftward

Answer: C

Topic: *Changes in Aggregate Supply*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 89) A decrease in the money wage rate increases \_\_\_\_\_ and an increase in the full employment quantity of labor increases \_\_\_\_\_.  
 A) the *SAS* and the *LAS*; only the *SAS*  
 B) the *SAS* and the *LAS*; only the *LAS*  
 C) only the *SAS*; the *SAS* and the *LAS*  
 D) only the *LAS*; the *SAS* and the *LAS*

Answer: C

Topic: *Changes in Aggregate Supply*

Skill: *Conceptual*

Question history: *New 10th edition*

AACSB: *Reflective Thinking*

- 90) An increase in the quantity of capital increases \_\_\_\_\_ and increase in the full employment quantity of labor increases \_\_\_\_\_.  
 A) the *SAS* and the *LAS*; only the *SAS*  
 B) the *SAS* and the *LAS*; only the *LAS*  
 C) the *SAS* and the *LAS*; the *SAS* and the *LAS*  
 D) only the *LAS*; the *SAS* and the *LAS*

Answer: C

Topic: *Changes in Aggregate Supply*

Skill: *Conceptual*

Question history: *New 10th edition*

AACSB: *Reflective Thinking*

- 91) Suppose there is an increase in short-run aggregate supply with no change in long-run aggregate supply. This situation could be the result of
- an increase in the price of oil.
  - a decrease in the money wage rate.
  - a technological advancement.
  - an increase in the quantity of capital.

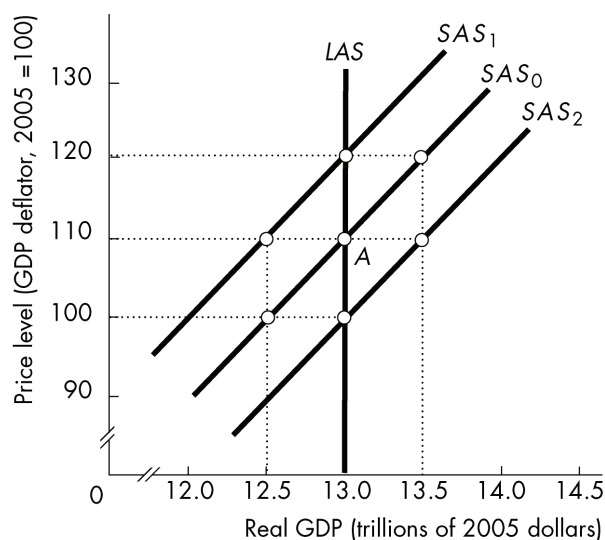
Answer: B

Topic: Changes in Aggregate Supply

Skill: Conceptual

Question history: New 10th edition

AACSB: Reflective Thinking



- 92) In the above figure, the economy is at point A when the money wage rate and the price level both fall by 10 percent. Firms will be willing to supply output equal to
- less than \$13.0 trillion
  - \$13.0 trillion
  - more than \$13.0 trillion
  - Without more information, it is impossible to determine which of the above answers is correct.

Answer: B

Topic: Long-Run Aggregate Supply

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

- 93) In the above figure, the economy is at point *A*. Then the price level falls to 90 while the money wage rate does not change. Firms will be willing to supply output equal to
- A) less than \$13.0 trillion
  - B) \$13.0 trillion
  - C) more than \$13.0 trillion
  - D) Without more information, it is impossible to determine which of the above answers is correct.

Answer: A

Topic: *Short-Run Aggregate Supply*

Skill: *Analytical*

Question history: *Previous edition, Chapter 10*

AACSB: *Analytical Skills*

- 94) In the above figure, the economy is at point *A*. Then the price level rises to 110 while the money wage rate remains constant. Firms will be willing to supply output equal to
- A) less than \$13.0 trillion
  - B) \$13.0 trillion
  - C) more than \$13.0 trillion
  - D) Without more information, it is impossible to determine which of the above answers is correct.

Answer: C

Topic: *Short-Run Aggregate Supply*

Skill: *Analytical*

Question history: *Previous edition, Chapter 10*

AACSB: *Analytical Skills*

- 95) In the above figure, the economy is at point *A* and the money wage rate falls by 10 percent. If the price level is constant, firms will be willing to supply output equal to
- A) less than \$13.0 trillion
  - B) \$13.0 trillion
  - C) more than \$13.0 trillion
  - D) Without more information, it is impossible to determine which of the above answers is correct.

Answer: C

Topic: *Changes in Money Wages and Other Resource Prices*

Skill: *Analytical*

Question history: *Previous edition, Chapter 10*

AACSB: *Analytical Skills*

- 96) In the above figure, the economy is at point *A* and the money wage rate rises by 10 percent. If the price level is constant, firms will be willing to supply output equal to
- A) less than \$13.0 trillion
  - B) \$13.0 trillion
  - C) more than \$13.0 trillion
  - D) Without more information, it is impossible to determine which of the above answers is correct.

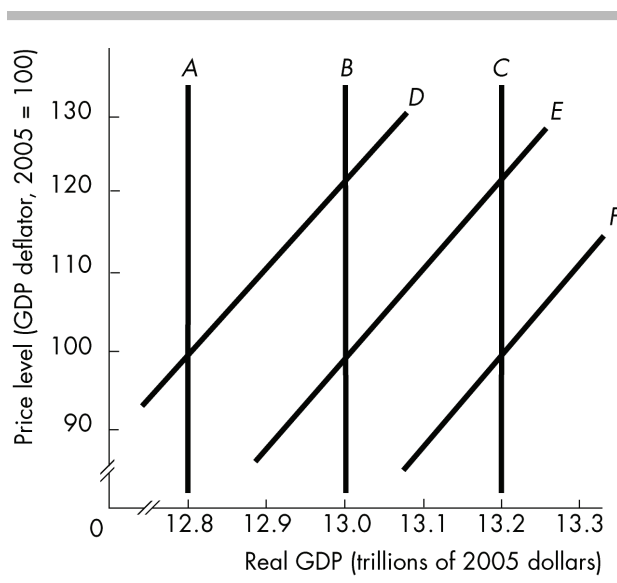
Answer: A

Topic: *Changes in Money Wages and Other Resource Prices*

Skill: *Analytical*

Question history: *Previous edition, Chapter 10*

AACSB: *Analytical Skills*



- 97) In the above figure, *B* is the current long-run aggregate supply curve and *E* is the current short-run aggregate supply curve. If there is an increase in the full-employment quantity of labor, then the long-run aggregate supply curve and the short-run aggregate supply curve
- remain *B* and *E*.
  - shift to *A* and *D*, respectively.
  - shift to *C* and *F*, respectively.
  - shift to *A* and *F*, respectively.

Answer: C

Topic: Changes in Aggregate Supply; Full-Employment Quantity of Labor

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

- 98) In the above figure, *B* is the current long-run aggregate supply curve and *E* is the current short-run aggregate supply curve. Technological advances mean the long-run aggregate supply curve and short-run aggregate supply curve
- remain *B* and *E*.
  - shift to *A* and *D*, respectively.
  - shift to *C* and *F*, respectively.
  - shift to *C* and remain *E*, respectively.

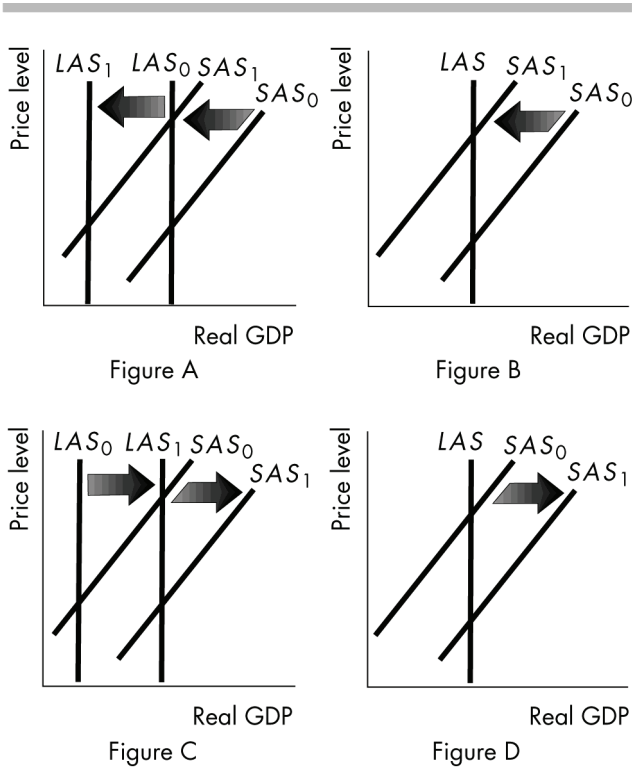
Answer: C

Topic: Changes in Aggregate Supply, Technology

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills



99) In the above figure, which part corresponds to a destruction of part of the nation's capital stock?

- A) Figure A
- B) Figure B
- C) Figure C
- D) Figure D

Answer: A

Topic: Changes in Aggregate Supply, Capital

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

100) In the above figure, which point corresponds to an increase in technology?

- A) Figure A
- B) Figure B
- C) Figure C
- D) Figure D

Answer: C

Topic: Changes in Aggregate Supply, Technology

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

- 101) In the above figure, which part corresponds to an increase in the money wage rate?
- A) Figure A
  - B) Figure B
  - C) Figure C
  - D) Figure D

Answer: B

Topic: Changes in Money Wages and Other Resource Prices

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

- 102) In the above figure, which part corresponds to a fall in the money wage rate?
- A) Figure A
  - B) Figure B
  - C) Figure C
  - D) Figure D

Answer: D

Topic: Changes in Money Wages and Other Resource Prices

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

- 103) Moving along which curve does the money wage rate and the price level change in the same proportions?
- A) the AD curve
  - B) the SAS curve
  - C) the LAS curve
  - D) None of the above because there is no curve along which both the money wage rate and the price level change in the same proportions.

Answer: C

Topic: Study Guide Question, Long-Run Aggregate Supply

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 104) Long-run aggregate supply will decrease for all of the following reasons EXCEPT
- A) reduced money wages.
  - B) decreased human capital.
  - C) decrease in the level of full employment.
  - D) decreased capital.

Answer: A

Topic: Study Guide Question, Long-Run Aggregate Supply

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 105) A fall in the money wage rate shifts
- A) both the *SAS* and *LAS* curves rightward.
  - B) both the *SAS* and *LAS* curves leftward.
  - C) the *SAS* curve rightward but leaves the *LAS* curve unchanged.
  - D) the *LAS* curve rightward but leaves the *SAS* curve unchanged.

Answer: C

Topic: Study Guide Question, Change in Money Wages & Other Resource

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 106) An increase in the level of technology shifts
- A) both the *SAS* and *LAS* curves rightward.
  - B) both the *SAS* and *LAS* curves leftward.
  - C) the *SAS* curve rightward but leaves the *LAS* unchanged.
  - D) the *LAS* curve rightward but leaves the *SAS* curve unchanged.

Answer: A

Topic: Study Guide Question, Changes in Aggregate Supply, Technology

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

## 2 Aggregate Demand

- 1) The aggregate demand curve shows
- A) total expenditures at different levels of national income.
  - B) the quantity of real GDP demanded at different price levels.
  - C) that real income is directly (positively) related to the price level.
  - D) All of the above answers are correct.

Answer: B

Topic: The Aggregate Demand Curve

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 2) The *AD* curve shows the sum of
- A) the price level, employment, and real GDP.
  - B) consumption expenditure, investment, and real GDP.
  - C) consumption expenditure, investment, government expenditures on goods and services, and net exports.
  - D) consumption expenditure, investment, the price level, and real GDP.

Answer: C

Topic: The Aggregate Demand Curve

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking



- 3) The aggregate demand curve
- A) has a negative slope.
  - B) has a positive slope.
  - C) is vertical.
  - D) is horizontal.

Answer: A

Topic: Aggregate Demand Curve

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 4) Aggregate demand is the relationship between the quantity of real GDP demanded and the \_\_\_\_\_.
- A) price level
  - B) money wage rate
  - C) real wage rate
  - D) nominal GDP demanded

Answer: A

Topic: Aggregate Demand Curve

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 5) Moving along the aggregate demand curve, a decrease in the quantity of real GDP demanded is a result of
- A) an increase in the price level.
  - B) a decrease in the price level.
  - C) an increase in income.
  - D) a decrease in income.

Answer: A

Topic: Aggregate Demand Curve

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 6) Other things constant, the economy's aggregate demand curve shows that
- A) as the price level falls, real GDP decreases.
  - B) any change in the price level shifts the aggregate demand curve.
  - C) the quantity of real GDP demanded decreases when the price level rises.
  - D) the quantity of real GDP demanded and the price level are not related.

Answer: C

Topic: The Aggregate Demand Curve

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 7) The aggregate demand curve shows the \_\_\_\_\_ relationship between the price level and \_\_\_\_\_.
- A) positive; the quantity of real GDP demanded
  - B) negative; aggregate labor demanded
  - C) positive; aggregate labor demand
  - D) negative; the quantity of real GDP demanded

Answer: D

Topic: *The Aggregate Demand Curve*

Skill: *Recognition*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 8) Other things equal, along the aggregate demand curve, a higher price level is associated with
- A) an increase in the quantity of real GDP demanded.
  - B) a decrease in the quantity of real GDP demanded.
  - C) a decrease in the quantity of nominal GDP demanded.
  - D) higher income levels.

Answer: B

Topic: *Aggregate Demand Curve*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 9) The aggregate demand curve shows that, if other factors are held constant, the higher the price level, the
- A) greater the quantity of real GDP demanded.
  - B) smaller the quantity of real GDP demanded.
  - C) larger consumption expenditure.
  - D) None of the above answers is correct.

Answer: B

Topic: *The Aggregate Demand Curve*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 10) The aggregate demand curve shows that, if other factors are held constant, a
- A) higher price level results in a decrease in the quantity of real GDP demanded.
  - B) higher price level results in an increase in the quantity of real GDP demanded.
  - C) higher price level results in a lower interest rate.
  - D) lower price level results in inflationary conditions.

Answer: A

Topic: *The Aggregate Demand Curve*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 11) The quantity of real GDP demanded equals \$12.2 trillion when the price level is 90. If the price level rises to 95, the quantity of real GDP demanded equals
- A) less than \$12.2 trillion.
  - B) \$12.2 trillion.
  - C) more than \$12.2 trillion.
  - D) more information is needed to determine if the quantity of real GDP demanded increases, decreases, or does not change.

Answer: A

Topic: The Aggregate Demand Curve

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Analytical Skills

- 12) The quantity of real GDP demanded equals \$12.4 trillion when the price level is 95. If the price level falls to 90, the quantity of real GDP demanded equals
- A) less than \$12.4 trillion.
  - B) \$12.4 trillion.
  - C) more than \$12.4 trillion.
  - D) more information is needed to determine if the quantity of real GDP demanded increases, decreases, or does not change.

Answer: C

Topic: The Aggregate Demand Curve

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Analytical Skills

- 13) Which of the following changes while moving along the aggregate demand curve?
- A) future incomes of households
  - B) the price level
  - C) the amount of money in the economy
  - D) future profits from investment projects

Answer: B

Topic: Aggregate Demand Curve

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 14) The AD curve slopes
- A) downward due to the wealth and price effects.
  - B) downward due to the wealth and substitution effects.
  - C) upward due to the price and substitution effects.
  - D) upward due to the wealth and substitution effects.

Answer: B

Topic: The Aggregate Demand Curve

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 15) Your real wealth is measured as the
- A) amount of assets you have in dollar terms.
  - B) amount of money you have.
  - C) amount of goods and services your wealth will buy.
  - D) amount of goods you have divided by the price level.

Answer: C

Topic: Aggregate Demand, Wealth Effect

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 16) As the price level falls and other things remain the same, real wealth \_\_\_\_\_ and \_\_\_\_\_.
- A) decreases; short-run aggregate supply decreases
  - B) decreases; the quantity of real GDP demanded decreases
  - C) increases; aggregate demand increases
  - D) increases; the quantity of real GDP demanded increases

Answer: D

Topic: Aggregate Demand, Wealth Effect

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 17) If you have \$1,000 of money in the bank and the price level rises 5 percent, your
- A) money is worth more in terms of what it can purchase.
  - B) money is worth less in terms of what it can purchase.
  - C) money is worth the same in terms of what it can purchase.
  - D) purchasing power has risen.

Answer: B

Topic: Aggregate Demand, Wealth Effect

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 18) According to the wealth effect, if real wealth decreases then people
- A) decrease their consumption expenditure.
  - B) increase their consumption expenditure.
  - C) do not respond if their nominal wealth does not change.
  - D) decrease their consumption expenditure only if their nominal wealth also decreases.

Answer: A

Topic: Aggregate Demand, Wealth Effect

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 19) An individual holds \$10,000 in a checking account and the price level rises significantly. Hence
- A) the individual's real wealth and consumption expenditure decrease.
  - B) the *individual's* real wealth decreases but real *national* wealth increases.
  - C) there is no change in the individual's real wealth.
  - D) the individual's wealth increases.

Answer: A

Topic: Aggregate Demand, Wealth Effect

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 20) If you have \$1,000 in wealth and the price level increases 20 percent, then
- A) the \$1,000 will buy fewer goods and services.
  - B) the \$1,000 dollars will buy 20 percent more goods and services.
  - C) the real value of the \$1,000 increases.
  - D) you will be able to buy fewer goods, but the real value of those goods will increase.

Answer: A

Topic: Aggregate Demand, Wealth Effect

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 21) If you have \$5,000 in wealth and the price level decreases 20 percent, then
- A) the \$5,000 will buy fewer goods and services.
  - B) the \$5,000 will buy more goods and services.
  - C) the real value of the \$5,000 decreases.
  - D) the real value of the \$5,000 remains constant.

Answer: B

Topic: Aggregate Demand, Wealth Effect

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 22) A rise in the price level changes aggregate demand because
- A) firms increase their investment when prices are higher.
  - B) the real value of people's wealth varies directly with the price level and so does their spending.
  - C) the real value of people's wealth decreases and so they decrease their consumption.
  - D) the more money people have, the more it is worth and hence the more goods and services they demand.

Answer: C

Topic: Aggregate Demand, Wealth Effect

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 23) One reason that the aggregate demand curve has a negative slope is because
- A) people buy fewer goods and save more when the price level rises because their real wealth decreases.
  - B) firms produce more when the price rises.
  - C) people earn more money when output rises.
  - D) The premise of the question is wrong because the aggregate demand curve has a positive slope.

Answer: A

Topic: Aggregate Demand, Wealth Effect

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 24) The intertemporal substitution effect refers to substitution of
- A) goods for services.
  - B) goods and services for less expensive goods and services.
  - C) goods and services today for goods and services in the future.
  - D) goods and services produced domestically for goods and services produced in another country.

Answer: C

Topic: Aggregate Demand, Intertemporal Substitution Effect

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 25) According to the intertemporal substitution effect, when the price level rises and other things remain the same
- A) the interest rate falls.
  - B) the interest rate rises.
  - C) the quantity of money increases.
  - D) government taxes rise.

Answer: B

Topic: Aggregate Demand, Intertemporal Substitution Effect

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 26) Substitution effects help explain the slope of the aggregate demand curve. One substitution effect refers to the
- A) inverse relationship between the interest rate and the price level.
  - B) direct relationship between the interest rate and the real value of wealth.
  - C) effect on investment expenditures that result from a change in interest rates produced by a change in the price level.
  - D) change in wealth that results from a change in the interest rate.

Answer: C

Topic: Aggregate Demand, Intertemporal Substitution Effect

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 27) According to the intertemporal substitution effect, a fall in the price level will
- A) decrease the real value of wealth, which increases the quantity of real GDP demanded.
  - B) cause the interest rate to fall so that investment increases and the quantity of real GDP demanded increases.
  - C) increase net exports, which causes the quantity of real GDP demanded to increase.
  - D) increase the real value of wealth, which raises the interest rate so that the quantity of real GDP demanded decreases.

Answer: B

Topic: Aggregate Demand, Intertemporal Substitution Effect

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 28) According to the intertemporal substitution effect, when the price level increases, the interest rate
- A) rises and the quantity of real GDP demanded increases.
  - B) rises and the quantity of real GDP demanded decreases.
  - C) falls and the quantity of real GDP demanded decreases.
  - D) is not affected.

Answer: B

Topic: Aggregate Demand, Intertemporal Substitution Effect

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 29) According to the intertemporal substitution effect, a higher price level
- A) decreases the quantity of real GDP demanded.
  - B) lowers the costs of building new plants and equipment.
  - C) increases the quantity of real GDP demanded.
  - D) makes it less costly for people to buy houses and cars.

Answer: A

Topic: Aggregate Demand, Intertemporal Substitution Effect

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 30) The intertemporal substitution effect of the price level on aggregate demand
- A) is the same as the real wealth effect.
  - B) is one reason that the aggregate demand curve has a negative slope.
  - C) explains why aggregate demand increases when the amount of money increases.
  - D) is one reason that the aggregate demand curve has a positive slope.

Answer: B

Topic: Aggregate Demand, Intertemporal Substitution Effect

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 31) One reason that the aggregate demand curve has a negative slope is that when the domestic price level rises,
- A) firms produce more goods and services.
  - B) firms produce fewer goods and services.
  - C) people substitute toward more imported goods and services.
  - D) peoples' wealth increases.

Answer: C

Topic: *Aggregate Demand, International Price Substitution Effect*

Skill: *Recognition*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 32) One reason that the aggregate demand curve has a negative slope is because
- A) firms supply more when prices rise.
  - B) people buy more foreign goods when the domestic price level rises.
  - C) the amount of money in the economy increases when the price level rises.
  - D) firms supply less when prices rise.

Answer: B

Topic: *Aggregate Demand, International Price Substitution Effect*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 33) There are several reasons why the aggregate demand curve is downward sloping. Which of the following correctly describes one of these explanations?
- A) A rise in the price level raises the purchasing power wealth and increases desired consumption.
  - B) A rise in the price level raises interest rates and increases investment spending.
  - C) A fall in the price level, holding foreign prices and the exchange rate constant, increases net exports.
  - D) A rise in the price level lowers the interest rate and increases investment spending.

Answer: C

Topic: *Aggregate Demand, International Price Substitution Effect*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 34) When the prices of U.S.–produced goods rise and the price of foreign–produced goods do not change, the result is
- A) an increase in exports.
  - B) a decrease in exports.
  - C) a decrease in imports.
  - D) no change in imports or exports.

Answer: B

Topic: *Aggregate Demand, International Price Substitution Effect*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*



- 35) When the price level in France increases while the exchange rate and the price level in the United States remain the same, the result is
- A) U.S.-made goods become relatively cheaper compared to French-made goods.
  - B) French citizens are more likely to buy U.S.-made goods.
  - C) U.S. citizens are less likely to buy French-made goods.
  - D) All of the above answers are correct.

Answer: D

*Topic: Aggregate Demand, International Price Substitution Effect*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 10*

*AACSB: Reflective Thinking*

- 36) A change in \_\_\_\_\_ creates a movement along the aggregate demand curve but does not shift the aggregate demand curve.
- A) tax rates
  - B) the price level
  - C) fiscal policy
  - D) None of the above because they all shift the aggregate demand curve.

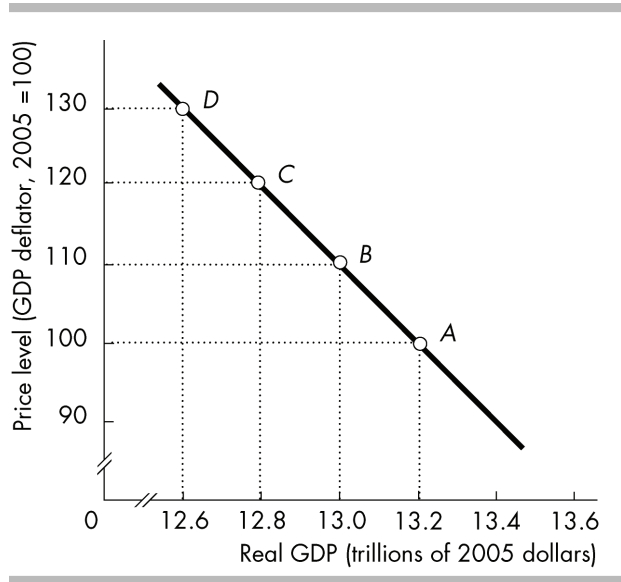
Answer: B

*Topic: The Aggregate Demand Curve*

*Skill: Conceptual*

*Question history: Modified 10th edition*

*AACSB: Reflective Thinking*



- 37) In the above figure, the economy is initially at point B. Then the price level falls by 10. The wealth effect will help
- move the economy to point A.
  - move the economy to point C.
  - move the economy to point D.
  - keep the economy to point B.

Answer: A

Topic: Aggregate Demand, Wealth Effect

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

- 38) In the above figure, the economy initially is at point B. Then price level rises by 10. The wealth effect will help
- move the economy to point A.
  - move the economy to point C.
  - move the economy to point D.
  - keep the economy to point B.

Answer: B

Topic: Aggregate Demand, Wealth Effect

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

39) In the above figure, the economy initially is at point C. Then the domestic price level rises by 10.

A

- A) substitution effect would help move the economy to point D.
- B) substitution effect would help move the economy to point B.
- C) substitution effect would keep the economy at point C.
- D) wealth effect would help move the economy to point B.

Answer: A

Topic: Aggregate Demand, International Price Substitution Effect

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

40) An increase in aggregate demand is shown by a

- A) rightward shift the AD curve.
- B) movement upward along the AD curve.
- C) movement downward along the AD curve.
- D) leftward shift the AD curve.

Answer: A

Topic: Changes in Aggregate Demand

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

41) Which of the following does NOT shift the aggregate demand curve?

- A) a decrease in the quantity of money
- B) an increase in people's expected future incomes
- C) an increase in the price level
- D) an increase in current foreign income

Answer: C

Topic: Changes in Aggregate Demand

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

42) Which of the following would NOT shift the U.S. aggregate demand curve?

- A) a change in income in Canada
- B) a change in the quantity of capital in the United States
- C) an expectation that inflation will be lower in the future
- D) U.S. monetary and fiscal policy

Answer: B

Topic: Changes in Aggregate Demand

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 43) Which of the following changes would NOT shift the aggregate demand curve?
- A) a change in fiscal policy
  - B) a change in monetary policy
  - C) a change in expectations about future income
  - D) an increase in technology

Answer: D

Topic: *Changes in Aggregate Demand*

Skill: *Recognition*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 44) Aggregate demand increases when
- A) foreign incomes fall.
  - B) interest rates rise.
  - C) the exchange rate rises.
  - D) None of the above answers is correct.

Answer: D

Topic: *Changes in Aggregate Demand*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 45) Which of the following does NOT shift the aggregate demand curve?
- A) a decrease in the quantity of money
  - B) an increase in investment
  - C) an increase in the price level
  - D) a decrease in taxes

Answer: C

Topic: *Changes in Aggregate Demand*

Skill: *Recognition*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 46) A change in \_\_\_\_\_ creates a movement along the aggregate demand curve, while a change in \_\_\_\_\_ shifts the aggregate demand curve.
- A) expected profits; tax rates
  - B) the price level; government expenditures
  - C) foreign income; the foreign exchange rate
  - D) real wealth; human capital

Answer: B

Topic: *Changes in Aggregate Demand*

Skill: *Recognition*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 47) Which of the following shifts the aggregate demand curve rightward?
- A) a decrease in consumption
  - B) an increase in investment
  - C) a decrease in net exports
  - D) a decrease in government expenditure on goods and services

Answer: B

Topic: Changes in Aggregate Demand, Investment

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 48) Suppose consumers decrease their consumption expenditure because they worry about what their income will be in the future. There is
- A) a rightward shift of the aggregate demand curve.
  - B) an upward movement along the aggregate demand curve.
  - C) a downward movement along the aggregate demand curve.
  - D) a leftward shift of the aggregate demand curve.

Answer: D

Topic: Changes in Aggregate Demand, Expectations

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 49) If the expected future inflation rate decreases, then
- A) aggregate demand increases.
  - B) short-run aggregate supply increases.
  - C) aggregate demand decreases.
  - D) long-run aggregate supply decreases.

Answer: C

Topic: Changes in Aggregate Demand, Expectations

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 50) If higher inflation is expected in the future, then the
- A) SAS curve shifts rightward.
  - B) AD curve shifts rightward.
  - C) LAS curve shifts rightward.
  - D) None of the above answers is correct.

Answer: B

Topic: Changes in Aggregate Demand, Expectations

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

51) People expect their incomes will decrease next year. As a result, the \_\_\_\_\_ will shift \_\_\_\_\_.

- A) short-run aggregate supply curve; rightward
- B) aggregate demand curve; rightward
- C) aggregate demand curve; leftward
- D) long-run aggregate supply curve; rightward

Answer: C

Topic: Changes in Aggregate Demand, Expectations

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

52) People expect that the El Nino effect will cause drought in Australia in coming years. If most Australian firms expect their profits will fall during the next five years, Australia's \_\_\_\_\_ this year.

- A) aggregate demand will increase
- B) long-run aggregate supply will increase
- C) aggregate demand will decrease
- D) short-run aggregate supply will increase

Answer: C

Topic: Changes in Aggregate Demand, Expectations

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

53) Which of the following statements is FALSE?

- A) Fiscal policy is the attempt to influence the economy using taxes, transfer payments, and government expenditures.
- B) Government expenditure affects aggregate demand directly because government expenditure is a component of aggregate demand.
- C) Taxes and transfer payments affect aggregate demand by changing disposable income.
- D) An increase in disposable income leads to a decrease in aggregate demand.

Answer: D

Topic: Changes in Aggregate Demand, Fiscal Policy

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

54) A decrease in government transfer payments

- A) increases aggregate demand.
- B) increases the aggregate quantity demanded.
- C) decreases the aggregate quantity demanded.
- D) decreases aggregate demand.

Answer: D

Topic: Changes in Aggregate Demand, Transfer Payments

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 55) An increase in government expenditure on goods and services
- A) increases aggregate demand.
  - B) increases the aggregate quantity demanded.
  - C) decreases the aggregate quantity demanded.
  - D) decreases aggregate demand.

Answer: A

Topic: Changes in Aggregate Demand, Government Expenditure

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 56) A decrease in government expenditure on goods and services
- A) increases aggregate demand.
  - B) increases the aggregate quantity demanded.
  - C) decreases the aggregate quantity demanded.
  - D) decreases aggregate demand.

Answer: D

Topic: Changes in Aggregate Demand, Government Expenditure

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 57) A decrease in government expenditure shifts the AD curve \_\_\_\_\_ and a decrease in taxes shifts the AD curve \_\_\_\_\_.
- A) rightward; rightward
  - B) rightward; leftward
  - C) leftward; rightward
  - D) leftward; leftward

Answer: C

Topic: Changes in Aggregate Demand, Government Expenditure

Skill: Analytical

Question history: Previous edition, Chapter 13

AACSB: Analytical Skills

- 58) Which of the following shifts the aggregate demand curve leftward?
- A) an increase in consumption expenditures
  - B) a decrease in taxes
  - C) a decrease in government expenditures on goods and services
  - D) an increase in net exports of goods and services

Answer: C

Topic: Changes in Aggregate Demand, Government Expenditure

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 59) Disposable income \_\_\_\_\_ when \_\_\_\_\_.
- A) decreases; taxes increase
  - B) decreases; transfer payments increase
  - C) increases; government expenditures decrease
  - D) decreases; aggregate income increases

Answer: A

Topic: *Changes in Aggregate Demand, Taxes*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 60) The aggregate demand curve
- A) shifts rightward when the price level increases and leftward when the price level falls.
  - B) shifts rightward when taxes are decreased.
  - C) shifts rightward when foreign incomes decrease and shifts leftward when foreign incomes increase.
  - D) does not shift, unlike market demand curves.

Answer: B

Topic: *Changes in Aggregate Demand, Taxes*

Skill: *Recognition*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 61) If taxes are increased, the AD curve
- A) is not affected because a change in taxes is a nominal change not real change.
  - B) shifts rightward and aggregate demand decreases.
  - C) shifts leftward and aggregate demand decreases.
  - D) does not shift but there is a movement down along the curve.

Answer: C

Topic: *Changes in Aggregate Demand, Taxes*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 62) Which of the following shifts the aggregate demand curve rightward?
- A) a decrease in government expenditure
  - B) expectations that future incomes will fall
  - C) a decrease in the quantity of money and an increase in interest rates
  - D) a tax cut

Answer: D

Topic: *Changes in Aggregate Demand, Taxes*

Skill: *Conceptual*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*



- 63) Which of the following decreases aggregate demand?
- A) The government increases taxes on both business and personal income.
  - B) Foreign incomes rise.
  - C) The quantity of money in the economy increases.
  - D) Households believe that the economy is headed for good times, with higher future incomes.

Answer: A

Topic: Changes in Aggregate Demand, Taxes

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 64) Which of the following increases aggregate demand?
- A) a decrease in taxes
  - B) a decrease in foreign income
  - C) a decrease in government expenditure
  - D) a rise in the interest rate

Answer: A

Topic: Changes in Aggregate Demand, Taxes

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 65) Which of the following shifts the aggregate demand curve rightward?
- A) an increase in the tax rate
  - B) a decrease in the price level
  - C) an increase in the quantity of money
  - D) an increase in the exchange rate

Answer: C

Topic: Changes in Aggregate Demand, Money

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 66) Which of the following increases aggregate demand?
- A) an increase in taxes
  - B) an increase in the quantity of money
  - C) an increase in the exchange rate
  - D) a decrease in government expenditures

Answer: B

Topic: Changes in Aggregate Demand, Money

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 67) If the quantity of money increases, the
- A) price level rises and the *AD* curve does not shift.
  - B) *AD* curve shifts leftward and aggregate demand decreases.
  - C) *AD* curve does not shift and there is a movement upward along the curve.
  - D) *AD* curve shifts rightward and aggregate demand increases.

Answer: D

Topic: *Changes in Aggregate Demand, Money*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 68) Which of the following shifts the aggregate demand curve rightward?
- A) a decrease in the price level
  - B) a decrease in government expenditures
  - C) an increase in the quantity of money
  - D) a decrease in transfer payments

Answer: C

Topic: *Changes in Aggregate Demand, Money*

Skill: *Conceptual*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

- 69) The U.S. aggregate demand curve shifts leftward if
- A) the economic conditions in Europe improve so that European incomes increase.
  - B) there is a tax cut.
  - C) the Federal Reserve hikes the interest rate.
  - D) the exchange rate falls.

Answer: C

Topic: *Changes in Aggregate Demand, Money*

Skill: *Conceptual*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

- 70) Which of the following increases aggregate demand and shifts the *AD* curve rightward?
- A) a fall in the price level
  - B) an increase in the quantity of money and a resulting fall in the interest rate
  - C) predictions of a recession that lead to expectations of lower future income
  - D) an increase in the exchange rate that makes imports less expensive

Answer: B

Topic: *Changes in Aggregate Demand, Money*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 71) Aggregate demand increases if the quantity of money \_\_\_\_\_.  
A) decreases or tax rates increase  
B) or transfer payments decrease  
C) remains constant or tax rates increase  
D) increases or tax rates decrease

Answer: D

Topic: Changes in Aggregate Demand, Money

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 72) The U.S. exchange rate rises. As a result, there is a  
A) movement along the U.S. aggregate demand curve but the curve does not shift.  
B) rightward shift in the U.S. aggregate demand curve.  
C) leftward shift in the U.S. aggregate demand curve.  
D) rightward shift in the long-run U.S. aggregate supply curve.

Answer: C

Topic: Changes in Aggregate Demand, Foreign Exchange Rate

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 73) When the exchange rises, then the  
A) AD curve shifts rightward.  
B) AD curve shifts leftward.  
C) LAS curve shifts rightward.  
D) LAS curve shifts leftward.

Answer: B

Topic: Changes in Aggregate Demand, Foreign Exchange Rate

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 74) Suppose the exchange rate falls from \$1.20 Canadian per U.S. dollar to \$1.10 Canadian per U.S. dollar. U.S. exports will \_\_\_\_\_, U.S. imports will \_\_\_\_\_, and U.S. aggregate demand will \_\_\_\_\_.  
A) decrease; increase; decrease  
B) decrease; increase; increase  
C) increase; decrease; increase  
D) increase; increase; increase

Answer: C

Topic: Changes in Aggregate Demand, Foreign Exchange Rate

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

75) A decrease in foreign incomes

- A) increases aggregate demand in the United States.
- B) increases the aggregate quantity demanded in the United States.
- C) decreases the aggregate quantity demanded in the United States.
- D) decreases aggregate demand in the United States.

Answer: D

*Topic: Changes in Aggregate Demand, Foreign Incomes*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 10*

*AACSB: Reflective Thinking*

76) An increase in foreign incomes

- A) increases aggregate demand in the United States.
- B) increases the aggregate quantity demanded in the United States.
- C) decreases the aggregate quantity demanded in the United States.
- D) decreases aggregate demand in the United States.

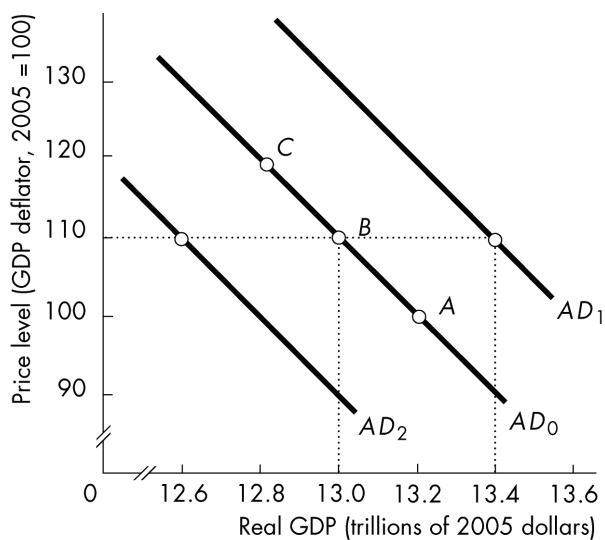
Answer: A

*Topic: Changes in Aggregate Demand, Foreign Incomes*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 10*

*AACSB: Reflective Thinking*



- 77) In the above figure, the economy is initially at point B. If the government decreases transfer payments, there is
- a movement to point C.
  - a movement to point A.
  - a shift to AD<sub>2</sub>.
  - a shift to AD<sub>1</sub>.

Answer: C

Topic: Changes in Aggregate Demand, Transfer Payments

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

- 78) In the above figure, the economy is initially at point B. If taxes increase, there is
- a movement to point C.
  - a movement to point A.
  - a shift to AD<sub>2</sub>.
  - a shift to AD<sub>1</sub>.

Answer: C

Topic: Changes in Aggregate Demand, Taxes

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

- 79) In the above figure, the economy is initially at point *B*. If the Fed decreases the quantity of money, there is
- A) a movement to point *C*.
  - B) a movement to point *A*.
  - C) a shift to  $AD_2$ .
  - D) a shift to  $AD_1$ .

Answer: C

Topic: *Changes in Aggregate Demand, Money*

Skill: *Analytical*

Question history: *Previous edition, Chapter 10*

AACSB: *Analytical Skills*

- 80) In the above figure, the economy is initially at point *B*. If the Fed increases the quantity of money, there is
- A) a movement to point *C*.
  - B) a movement to point *A*.
  - C) a shift to  $AD_2$ .
  - D) a shift to  $AD_1$ .

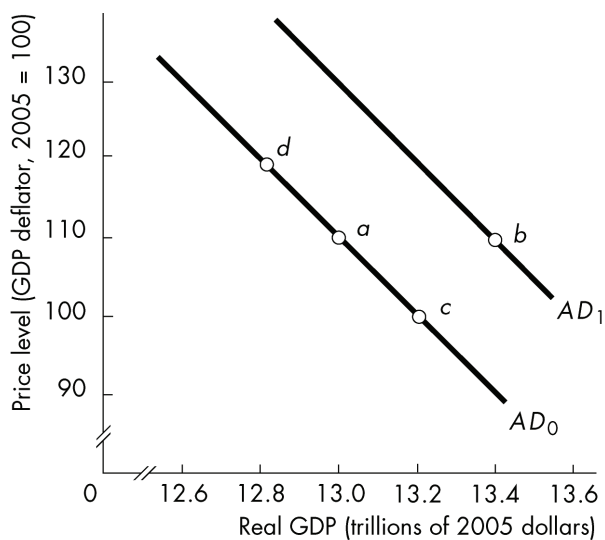
Answer: D

Topic: *Changes in Aggregate Demand, Money*

Skill: *Analytical*

Question history: *Previous edition, Chapter 10*

AACSB: *Analytical Skills*



- 81) In the above figure, if the economy is at point *a*, an increase in \_\_\_\_\_ will move the economy to \_\_\_\_\_.
- A) real wealth from the fall in the price level; point *b*
  - B) real wealth from the fall in the price level; point *c*
  - C) expected future income; point *c*
  - D) expected future income; point *d*

Answer: B

Topic: Aggregate Demand, Wealth Effect

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

- 82) In the above figure, if the economy is at point *a*, an increase in \_\_\_\_\_ will move the economy to \_\_\_\_\_.
- A) real wealth; point *d*
  - B) real wealth from a fall in the price level; point *d*
  - C) expected future income; point *b*
  - D) expected future income; point *d*

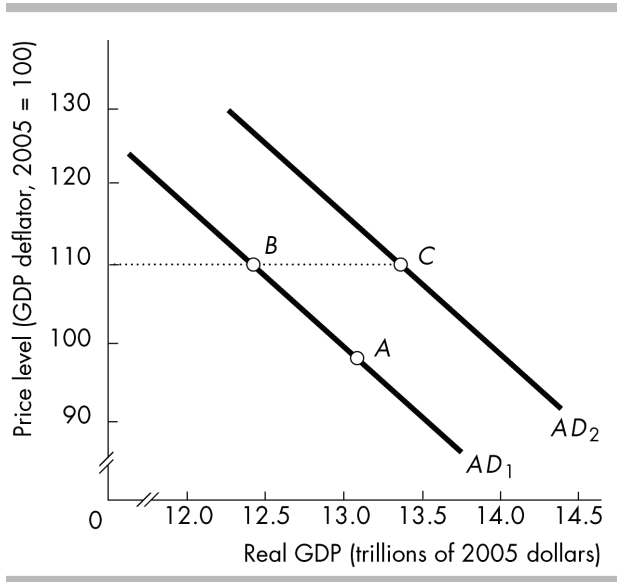
Answer: C

Topic: Changes in Aggregate Demand, Expectations

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills



- 83) In the above figure, the movement from point *B* to point *A* might be the result of
- A) an increase in government expenditures because of a war.
  - B) an increase in government expenditures because of increases in education expenditures.
  - C) an increase in the demand for manufacturing goods because of new technology.
  - D) a fall in the price level.

Answer: D

Topic: *The Aggregate Demand Curve*

Skill: *Analytical*

Question history: *Previous edition, Chapter 10*

AACSB: *Analytical Skills*

- 84) In the above figure, the shift from point *C* to point *B* might be the result of
- A) an increase in the price level.
  - B) a decrease in the price level.
  - C) a decrease in government expenditures.
  - D) an increase in the quantity of money.

Answer: C

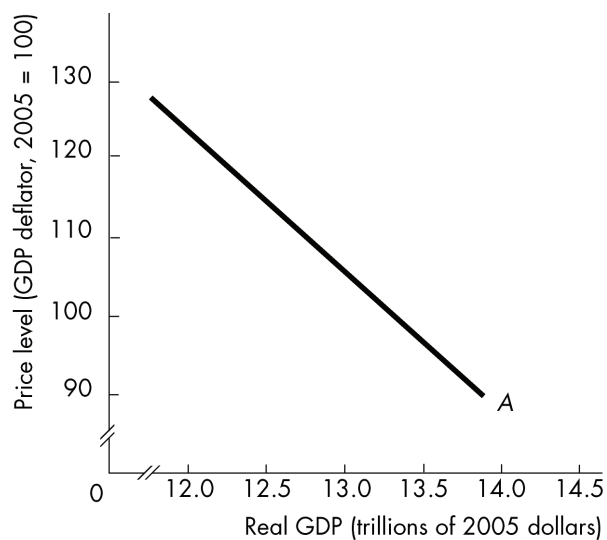
Topic: *Changes in Aggregate Demand, Government Expenditure*

Skill: *Analytical*

Question history: *Previous edition, Chapter 10*

AACSB: *Analytical Skills*





- 85) The curve labeled *A* in the above figure is
- A) a short-run aggregate supply curve.
  - B) an aggregate demand curve.
  - C) a long-run aggregate supply curve.
  - D) a production possibilities curve.

Answer: B

Topic: The Aggregate Demand Curve

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

- 86) In the above figure, the curve labeled *A* shifts rightward if
- A) expected future profits decrease.
  - B) the quantity of money decreases.
  - C) the substitution effect occurs.
  - D) taxes decrease.

Answer: D

Topic: Changes in Aggregate Demand, Taxes

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

- 87) The U.S. fiscal policy implemented in 2008 was an attempt to
- A) give billions of dollars to businesses and low- and middle-income Americans in order to stimulate business investment and consumption expenditure, thereby increasing AD.
  - B) give billions of dollars to businesses and low- and middle-income Americans in order to stimulate business investment and consumption expenditure, thereby increasing SAS.
  - C) decrease interest rates in order to stimulate business investment and consumption expenditure, thereby increasing AD.
  - D) decrease the exchange rate in order to boost net exports, thereby increasing AD.

Answer: A

Topic: *Recession of 2008*

Skill: *Recognition*

Question history: *New 10th edition*

AACSB: *Reflective Thinking*

- 88) The U.S. monetary policy implemented in 2008 was an attempt to
- A) give billions of dollars to businesses and low- and middle-income Americans in order to stimulate business investment and consumption expenditure, thereby increasing AD.
  - B) decrease interest rates in order to stimulate business investment and consumption expenditure, thereby increasing SAS.
  - C) decrease interest rates in order to stimulate business investment and consumption expenditure, thereby increasing AD.
  - D) decrease the exchange rate in order to boost net exports, thereby increasing AD.

Answer: C

Topic: *Recession of 2008*

Skill: *Recognition*

Question history: *New 10th edition*

AACSB: *Reflective Thinking*

- 89) The aggregate demand curve illustrates that, as the price level rises,
- A) the quantity of real GDP demanded increases.
  - B) the quantity of real GDP demanded decreases.
  - C) the AD curve shifts rightward.
  - D) the AD curve shifts leftward.

Answer: B

Topic: *Study Guide Question, Aggregate Demand*

Skill: *Recognition*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 90) As the price level falls, the quantity of real wealth \_\_\_\_\_ and the aggregate quantity of real GDP demanded \_\_\_\_\_.
- A) increases; increases
  - B) increases; decreases
  - C) decreases; increases
  - D) decreases; decreases

Answer: A

Topic: *Study Guide Question, Aggregate Demand, Wealth Effect*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

### 3 Explaining Macroeconomic Trends and Fluctuations

- 1) The AS/AD model studies the relationship between
- A) the price level and unemployment.
  - B) the price level and real GDP.
  - C) unemployment and real GDP.
  - D) nominal GDP and inflation.

Answer: B

Topic: The AS-AD Model

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 2) By using only the aggregate demand curve, we can determine
- A) only the price level.
  - B) only the quantity of real GDP.
  - C) both the price level and quantity of real GDP.
  - D) neither the price level nor the quantity of real GDP.

Answer: D

Topic: Macroeconomic Equilibrium

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 3) In short-run macroeconomic equilibrium
- A) real GDP equals potential GDP and aggregate demand determines the price level.
  - B) the price level is fixed and short-run aggregate supply determines real GDP.
  - C) real GDP and the price level are determined by short-run aggregate supply and aggregate demand.
  - D) real GDP is less than potential GDP.

Answer: C

Topic: Short-Run Macroeconomic Equilibrium

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 4) The economy is in its short run equilibrium at the point where the
- A) price level is stable.
  - B) SAS curve intersects the LAS curve.
  - C) AD curve intersects the LAS curve.
  - D) AD curve intersects the SAS curve.

Answer: D

Topic: Short-Run Macroeconomic Equilibrium

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 5) Short-run equilibrium occurs at the intersection of
- A) the SAS and AD curves.
  - B) the SAS, LAS, and AD curves.
  - C) the SAS and LAS curves.
  - D) the LAS and AD curves.

Answer: A

Topic: Short-Run Macroeconomic Equilibrium

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 6) If the economy is in short run equilibrium then
- A) real GDP equals potential GDP.
  - B) nominal GDP equals potential GDP.
  - C) real GDP cannot be equal to potential GDP.
  - D) real GDP can be greater than, less than, or equal to potential GDP.

Answer: D

Topic: Short-Run Macroeconomic Equilibrium

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 7) In the short-run, real GDP can be greater than or less than potential GDP because in the short run the
- A) money wage rate is fixed.
  - B) quantity of capital is fixed.
  - C) full-employment level of employment is fixed.
  - D) price level is fixed.

Answer: A

Topic: Short-Run Macroeconomic Equilibrium

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 8) Short-run macroeconomic equilibrium occurs when the quantity of real GDP demanded \_\_\_\_\_.
- A) equals potential GDP
  - B) equals full-employment GDP
  - C) does not equal full-employment GDP
  - D) equals the quantity of real GDP supplied

Answer: D

Topic: Short-Run Macroeconomic Equilibrium

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 9) In the short run, the equilibrium level of real GDP
- A) is necessarily less than potential GDP.
  - B) is necessarily equal to potential GDP.
  - C) is necessarily greater than potential GDP.
  - D) could be less than, equal to, or greater than potential GDP.

Answer: D

Topic: Short-Run Macroeconomic Equilibrium

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 10) In the short run, the intersection of the aggregate demand and the short-run aggregate supply curves,
- A) determines the equilibrium price level.
  - B) is a point where there is neither a surplus nor a shortage of goods.
  - C) determines the equilibrium level of real GDP.
  - D) All of the above answers are correct.

Answer: D

Topic: Short-Run Macroeconomic Equilibrium

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 11) A short-run macroeconomic equilibrium occurs
- A) at the intersection of the short-run aggregate supply curve and the long-run aggregate supply curve.
  - B) at the intersection of the short-run aggregate supply curve and the aggregate demand curve.
  - C) at the intersection of the short-run aggregate supply curve, the long-run aggregate supply curve, and the aggregate demand curve.
  - D) when the rate at which prices of goods and services increase equals the rate at which money wage rates increase.

Answer: B

Topic: Short-Run Macroeconomic Equilibrium

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 12) Last year in the country of Union, the price level increased and real GDP increased. Such an outcome might have occurred because short-run aggregate supply \_\_\_\_\_ and aggregate demand \_\_\_\_\_.
- A) decreased; decreased
  - B) increased; did not change
  - C) increased; decreased
  - D) did not change; increased

Answer: D

Topic: Short-Run Macroeconomic Equilibrium

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 13) At long-run macroeconomic equilibrium, \_\_\_\_\_.
- A) an inflationary gap exists
  - B) real GDP equals potential GDP
  - C) a recessionary gap exists
  - D) real GDP is less than potential GDP but is as close as it is possible to be

Answer: B

Topic: Long-Run Macroeconomic Equilibrium

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 14) If the economy is at long run equilibrium then
- A) real GDP equals potential GDP.
  - B) nominal GDP equals potential GDP.
  - C) real GDP cannot be equal to potential GDP.
  - D) real GDP can be greater than, less than, or equal to potential GDP.

Answer: A

Topic: Long-Run Macroeconomic Equilibrium

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 15) Full-employment equilibrium occurs when
- A) real GDP exceeds potential GDP.
  - B) real GDP equals potential GDP.
  - C) potential GDP exceeds real GDP.
  - D) a result of an increase in long-run aggregate supply.

Answer: B

Topic: Long-Run Macroeconomic Equilibrium

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 16) In long-run macroeconomic equilibrium,
- A) real GDP equals potential GDP.
  - B) the price level is fixed and aggregate demand determines real GDP.
  - C) real GDP and the price level are determined by short-run aggregate supply and aggregate demand and long-run aggregate supply is irrelevant.
  - D) real GDP is less than potential GDP.

Answer: A

Topic: Long-Run Macroeconomic Equilibrium

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

Real GDP supplied

Price level	Real GDP demanded (dollars)	Short run (dollars)	Long run (dollars)
90	700	300	600
100	600	400	600
110	500	500	600
120	400	600	600

- 17) The table above gives the aggregate demand and aggregate supply schedules in Lotus Land. With no changes in aggregate demand or long-run aggregate supply, in long-run macroeconomic equilibrium, the price level will be \_\_\_\_\_ and real GDP will be \_\_\_\_\_.
- A) 120; \$400  
 B) 110; \$500  
 C) 90; \$400  
 D) 100; \$600

Answer: D

Topic: Long-Run Macroeconomic Equilibrium

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

Price level	Aggregate demand (trillions of 2005 dollars)	Short-run aggregate supply (trillions of 2005 dollars)	Long-run aggregate supply (trillions of 2005 dollars)
130	8	12	10
120	9	11	10
110	10	10	10
100	11	9	10
90	12	8	10

- 18) The data in the above table indicate that when the price level is 120,
- A) inventories fall and the price level rises.  
 B) the economy is in a long-run macroeconomic equilibrium.  
 C) inventories rise and the price level falls.  
 D) the unemployment rate is at its equilibrium level.

Answer: C

Topic: Short-Run Macroeconomic Equilibrium

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

- 19) The data in the above table indicate that when the price level is 100,
- A) inventories fall and the price level rises.
  - B) the economy is in a long-run macroeconomic equilibrium.
  - C) inventories rise and the price level falls.
  - D) the unemployment rate is at its equilibrium level.

Answer: A

Topic: *Short-Run Macroeconomic Equilibrium*

Skill: *Analytical*

Question history: *Previous edition, Chapter 10*

AACSB: *Analytical Skills*

- 20) The data in the above table indicate that when the price level is 100,
- A) firms have unexpectedly low inventories, so prices will rise.
  - B) inventories are at levels planned by firms.
  - C) firms will plan to decrease the level of output.
  - D) firms have unexpectedly high inventories, so prices fall.

Answer: A

Topic: *Short-Run Macroeconomic Equilibrium*

Skill: *Analytical*

Question history: *Previous edition, Chapter 10*

AACSB: *Analytical Skills*

- 21) The data in the above table indicate that when the price level is 120,
- A) firms have unexpectedly low inventories, so prices will rise.
  - B) inventories are at levels planned by firms.
  - C) firms will plan to increase the level of output.
  - D) firms have unexpectedly high inventories, so prices fall.

Answer: D

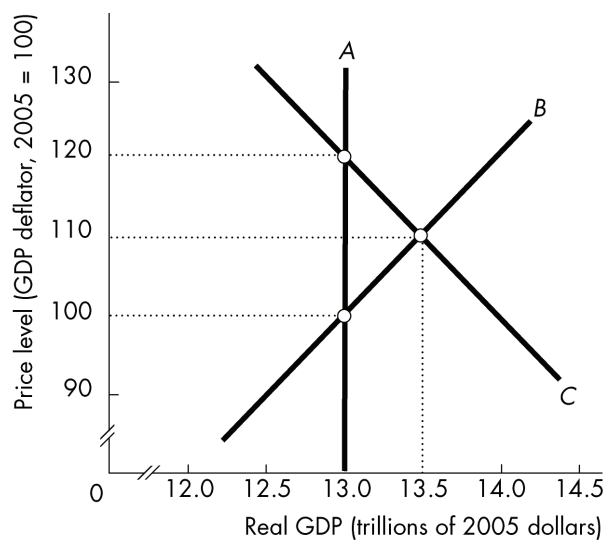
Topic: *Short-Run Macroeconomic Equilibrium*

Skill: *Analytical*

Question history: *Previous edition, Chapter 10*

AACSB: *Analytical Skills*





- 22) In the above figure, curve *A* is the \_\_\_\_\_ curve, curve *B* is the \_\_\_\_\_ curve, and curve *C* is the \_\_\_\_\_ curve.
- A) long-run aggregate supply; short-run aggregate supply; aggregate demand
  - B) aggregate demand; short-run aggregate supply; long-run aggregate supply
  - C) short-run aggregate supply; long-run aggregate supply; aggregate demand
  - D) long-run aggregate supply; aggregate demand; short-run aggregate supply

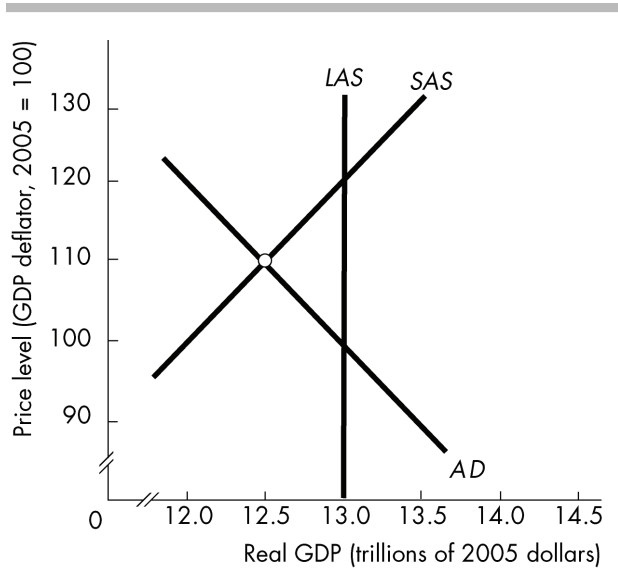
Answer: A

Topic: Long-Run Macroeconomic Equilibrium

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills



23) In the figure above, in the short-run macroeconomic equilibrium,

- A) there is no structural unemployment.
- B) real GDP is greater than potential GDP.
- C) real GDP equals potential GDP.
- D) real GDP is less than potential GDP.

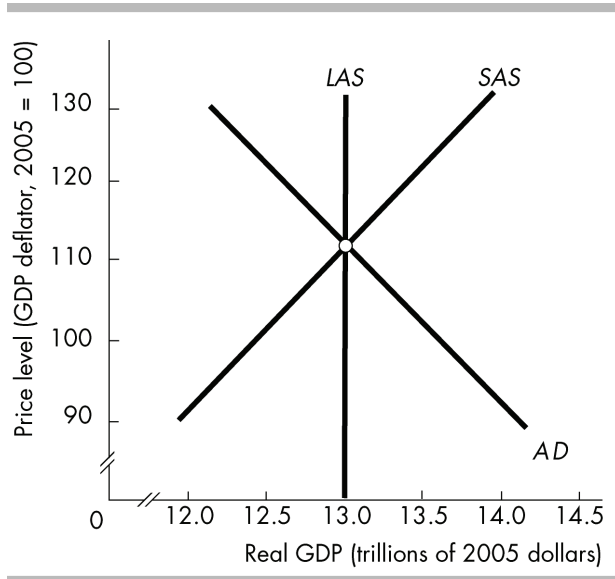
Answer: D

Topic: Short-Run Macroeconomic Equilibrium

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills



24) The above figure depicts an economy with a short-run equilibrium

- A) at full employment.
- B) below full employment.
- C) at higher than full-employment.
- D) None of the above answers are correct.

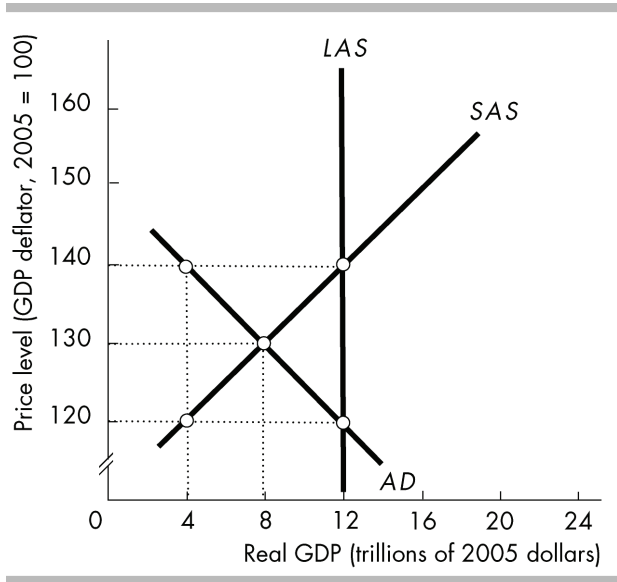
Answer: A

Topic: Short-Run Macroeconomic Equilibrium

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills



- 25) In the above figure, at the price level of 140 and real GDP of
- A) \$12 trillion, firms will not be able to sell all their output.
  - B) \$4 trillion, firms will not be able to sell all their output.
  - C) \$4 trillion, consumers will not be able to buy all the goods and services they demand.
  - D) \$12 trillion, consumers will not be able to buy all the goods and services they demand.

Answer: A

Topic: Short-Run Macroeconomic Equilibrium

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

- 26) Based on the figure above, short-run equilibrium occurs at the price level of
- A) 120 and real GDP of \$4 trillion.
  - B) 130 and real GDP of \$8 trillion.
  - C) 140 and real GDP of \$12 trillion.
  - D) 130 and real GDP of \$12 trillion.

Answer: B

Topic: Short-Run Macroeconomic Equilibrium

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

- 27) The data in the above figure indicate that the economy will be in a long-run macroeconomic equilibrium at a price level of
- A) 140.
  - B) 130.
  - C) 100.
  - D) 120.

Answer: D

Topic: Long-Run Macroeconomic Equilibrium

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

- 28) Which of the following can be said about economic growth?
- I. Economic growth is the result of increases in long-run aggregate supply.
  - II. Economic growth is the result of increases in aggregate demand.
- A) I only
  - B) II only
  - C) I and II
  - D) neither I or II

Answer: A

Topic: Economic Growth Rate

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 29) Economic growth is best defined as
- A) decreases in potential GDP.
  - B) increases in potential GDP.
  - C) rightward shifts of the AD curve.
  - D) rightward shifts of the SAS curve.

Answer: B

Topic: Economic Growth Rate

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 30) Which of the following helps determine the growth rate of potential GDP?
- I. capital accumulation
  - II. technology advances
  - III. growth in the quantity of money
- A) I
  - B) I and II
  - C) I and III
  - D) I, II and III

Answer: B

Topic: Economic Growth Rate

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

31) Economic growth

- A) occurs when the long-run aggregate supply curve shifts upward.
- B) is an increase in potential GDP as the long-run aggregate supply curve shifts rightward.
- C) requires a compensating decrease in aggregate demand to offset the increase in aggregate supply.
- D) All of the above answers are correct.

Answer: B

Topic: *Economic Growth Rate*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

32) Over time in a growing economy, the long-run aggregate supply curve will

- A) become horizontal at the long-run potential price level.
- B) shift rightward.
- C) shift leftward.
- D) become increasingly steep.

Answer: B

Topic: *Economic Growth Rate*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

33) The country of Mu has continuous strong economic growth and a steady price level. This situation is most likely the result of aggregate demand growing \_\_\_\_\_ aggregate supply.

- A) at the same pace as long-run
- B) slower than long-run
- C) slower than short-run
- D) faster than long-run

Answer: A

Topic: *Economic Growth Rate*

Skill: *Conceptual*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

34) If aggregate demand grows only slightly faster than potential GDP, then the economy will \_\_\_\_\_.

- A) experience economic growth with high inflation
- B) experience recession
- C) experience economic growth with low inflation
- D) be at a business-cycle peak

Answer: C

Topic: *Economic Growth Rate*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

35) In the United States, during the past 5 decades economic growth was most rapid during the \_\_\_\_\_.

- A) 1960s
- B) 1990s
- C) 1970s
- D) 2000s

Answer: A

Topic: Economic Growth Rate

Skill: Recognition

Question history: New 10th edition

AACSB: Reflective Thinking

36) In the United States, during the past 5 decades inflation was highest during the \_\_\_\_\_.

- A) 1970s
- B) 1990s
- C) 1960s
- D) 2000s

Answer: A

Topic: Inflation

Skill: Recognition

Question history: New 10th edition

AACSB: Reflective Thinking

37) Inflation occurs over time as a result of

- A) long-run aggregate supply increasing faster than aggregate demand.
- B) long-run aggregate supply increasing faster than short-run aggregate supply.
- C) decreases in aggregate demand.
- D) aggregate demand increasing faster than long-run aggregate supply.

Answer: D

Topic: Inflation

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

38) If the aggregate demand curve shifts \_\_\_\_\_ faster than the long-run aggregate supply curve, then \_\_\_\_\_ occurs.

- A) leftward; economic growth
- B) leftward; inflation
- C) rightward; economic growth
- D) rightward; inflation

Answer: D

Topic: Inflation

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 39) When an increase in aggregate demand exceeds the increase in aggregate supply,
- A) real GDP decreases while nominal GDP increases.
  - B) the price level falls while real GDP increases.
  - C) nominal GDP decreases and real GDP decreases.
  - D) the economy will experience inflation as the price level rises.

Answer: D

Topic: Inflation

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 40) Business cycles are the result of
- A) regular shifts of the *AD* curve only.
  - B) irregular shifts of the *SAS* curve only.
  - C) regular shifts of both the *AD* and *SAS* curves.
  - D) irregular shifts of both the *AD* and *SAS* curves.

Answer: D

Topic: Business Cycle

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 41) One result of a decrease in aggregate demand and no change in aggregate supply is
- A) a recession.
  - B) an increase in employment levels.
  - C) an economic expansion.
  - D) a rise in the price level.

Answer: A

Topic: Business Cycle

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 42) Starting at full employment, a business cycle can be described by the following sequence:  
\_\_\_\_\_ equilibrium, \_\_\_\_\_ equilibrium, \_\_\_\_\_ equilibrium.
- A) full-employment; below full-employment; above full-employment
  - B) below full-employment; full-employment; above full-employment
  - C) above full-employment; below full-employment; full-employment
  - D) below full-employment; full-employment; below full-employment

Answer: B

Topic: Business Cycle

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking



- 43) When real GDP exceeds potential GDP, then the economy has
- A) an inflationary gap.
  - B) a below full-employment equilibrium.
  - C) a recessionary gap.
  - D) None of the above answers are correct.

Answer: A

Topic: Inflationary Gap

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 44) An inflationary gap is occurs when
- A) real GDP is less than potential GDP.
  - B) real GDP exceeds potential GDP.
  - C) real GDP equals potential GDP.
  - D) the economy is at full employment.

Answer: B

Topic: Inflationary Gap

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 45) When the economy is at an above full-employment equilibrium, \_\_\_\_\_.
- A) nominal GDP exceeds real GDP
  - B) an inflationary gap exists
  - C) a recessionary gap exists
  - D) real GDP is less than potential GDP

Answer: B

Topic: Inflationary Gap

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 46) An above full-employment equilibrium is
- A) a theoretical possibility but cannot happen in reality.
  - B) the equilibrium in which the economy is in most of the time.
  - C) when real GDP exceeds potential GDP.
  - D) the period of time when prices are falling.

Answer: C

Topic: Inflationary Gap

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 47) A recessionary gap means that short-run macroeconomic equilibrium GDP
- A) is less than full-employment GDP.
  - B) equals full-employment GDP.
  - C) is more than full-employment GDP.
  - D) may be less than, more than, or the same as full-employment GDP depending on the level of potential GDP.

Answer: A

Topic: *Recessionary Gap*

Skill: *Recognition*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 48) If real GDP is less than potential GDP, then the economy is \_\_\_\_\_ equilibrium.
- A) at an above full-employment
  - B) not in short-run macroeconomic
  - C) at a below full-employment
  - D) in long-run macroeconomic

Answer: C

Topic: *Recessionary Gap*

Skill: *Recognition*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 49) A recessionary gap occurs when
- A) real GDP is less than potential GDP.
  - B) nominal GDP is less than potential GDP.
  - C) high rates of inflation occur.
  - D) nominal GDP is greater than potential GDP.

Answer: A

Topic: *Recessionary Gap*

Skill: *Recognition*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 50) If aggregate demand decreases and neither short-run nor long-run aggregate supply changes, then
- A) the price level increases in the short-run and decreases in the long-run.
  - B) there is an inflationary gap.
  - C) there is a recessionary gap.
  - D) in the long run, the long-run aggregate supply will decrease.

Answer: C

Topic: *Recessionary Gap*

Skill: *Conceptual*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

- 51) A below full-employment equilibrium
- A) is not possible in the U.S. economy.
  - B) occurs when real GDP is less than potential GDP.
  - C) occurs when the price level is rising very quickly.
  - D) occurs when real GDP exceeds potential GDP.

Answer: B

Topic: Recessionary Gap

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 52) An economy is at full employment. Which of the following events can create a recessionary gap?
- A) an increase in foreign income
  - B) an increase in taxes
  - C) a decrease in the quantity of capital
  - D) a decrease in money wages

Answer: B

Topic: Recessionary Gap

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 53) The Great Depression, in which real GDP fell and unemployment rose, can be characterized as a \_\_\_\_\_.
- A) inflationary gap
  - B) long-run equilibrium
  - C) recessionary gap
  - D) full-employment equilibrium

Answer: C

Topic: Recessionary Gap

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 54) Suppose the economy is experiencing a recessionary gap. In the long run, if aggregate demand does not change the money wage rate \_\_\_\_\_, unemployment \_\_\_\_\_, and the price level \_\_\_\_\_.
- A) falls; rises; falls
  - B) falls; falls; falls
  - C) rises; rises; rises
  - D) rises; falls; rises

Answer: B

Topic: Recessionary Gap

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 55) An above full-employment equilibrium occurs when
- A) aggregate demand decreases while neither the short-run nor long-run aggregate supply changes.
  - B) short-run aggregate supply decreases while neither aggregate demand nor long-run aggregate supply changes.
  - C) the equilibrium level of real GDP is greater than potential GDP.
  - D) the equilibrium level of real GDP is less than potential GDP.

Answer: C

Topic: Above Full-Employment Equilibrium

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

Real GDP supplied

Price level	Real GDP demanded (dollars)	Short run (dollars)	Long run (dollars)
90	700	300	600
100	600	400	600
110	500	500	600
120	400	600	600

- 56) The table above gives the aggregate demand and aggregate supply schedules in Lotus Land. The short-run macroeconomic equilibrium is a price level of \_\_\_\_\_ and a real GDP of \_\_\_\_\_.
- A) 90; \$400
  - B) 100; \$400
  - C) 110; \$500
  - D) 120; \$400

Answer: C

Topic: Short-Run Macroeconomic Equilibrium

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

- 57) The table above gives the aggregate demand and aggregate supply schedules in Lotus Land. In short-run equilibrium, there is \_\_\_\_\_.
- A) an inflationary gap of \$100
  - B) a recessionary gap of \$100
  - C) a recessionary gap of \$200
  - D) an inflationary gap of \$200

Answer: B

Topic: Recessionary Gap

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

- 58) The table above gives the aggregate demand and aggregate supply schedules in Lotus Land. Lotus Land is in short-run macroeconomic equilibrium. In the long run, if aggregate demand does not change then Lotus Land will return to full-employment as \_\_\_\_\_.
- A) the money wage rate rises
  - B) the money wage rate falls
  - C) businesses cut their imports
  - D) the government cuts taxes

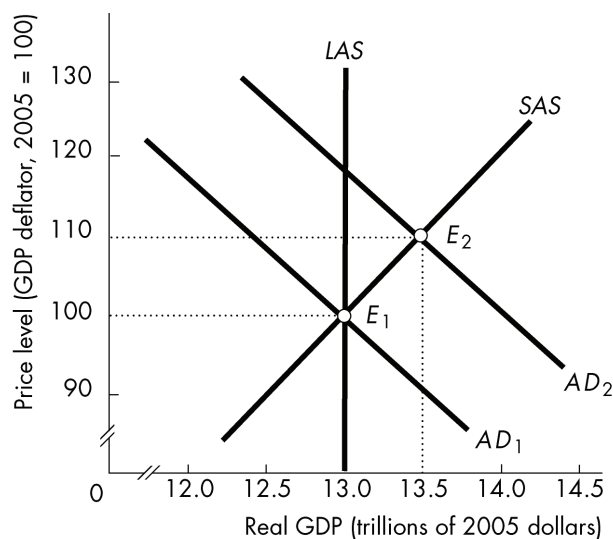
Answer: B

Topic: Recessionary Gap

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills



- 59) In the above figure, the inflationary gap when  $AD_2$  is the aggregate demand curve equals
- A) the difference between 110 and 100.
  - B) the difference between \$12.5 trillion and \$12.0 trillion.
  - C)  $LAS$  minus  $SAS$  at a price level of 100.
  - D)  $AD_1$ .

Answer: B

Topic: Inflationary Gap

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

60) The reason that it is possible for the economy in the above figure to be at equilibrium  $E_2$  rather than at  $E_1$  is that

- A) in the long run there is always less than full employment.
- B) in the short run the economy can produce more than it can in a long-run situation.
- C)  $AD$  always shifts rightward and never shifts leftward.
- D) the economy must be in a recession.

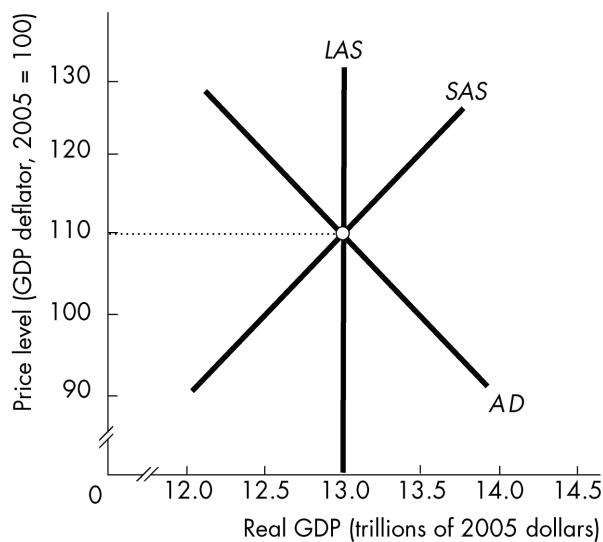
Answer: B

Topic: *Inflationary Gap*

Skill: *Analytical*

Question history: *Previous edition, Chapter 10*

AACSB: *Analytical Skills*



61) The above figure illustrates

- A) a recessionary gap.
- B) a full-employment equilibrium.
- C) an inflationary gap.
- D) an equilibrium at the economy's physical limits.

Answer: B

Topic: *Full-Employment Equilibrium*

Skill: *Analytical*

Question history: *Previous edition, Chapter 10*

AACSB: *Analytical Skills*

- 62) An inflationary gap means that short-run macroeconomic equilibrium GDP
- A) is less than full-employment GDP.
  - B) equals full-employment GDP.
  - C) is more than full-employment GDP.
  - D) may be less than, more than, or the same as full-employment GDP depending on the level of potential GDP.

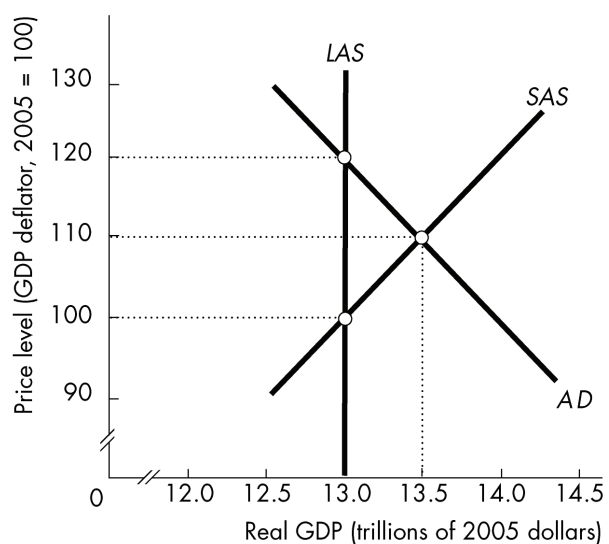
Answer: C

Topic: Inflationary Gap

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills



- 63) The above figure illustrates
- A) a recessionary gap.
  - B) a full-employment equilibrium.
  - C) an inflationary gap.
  - D) an equilibrium at the economy's physical limits.

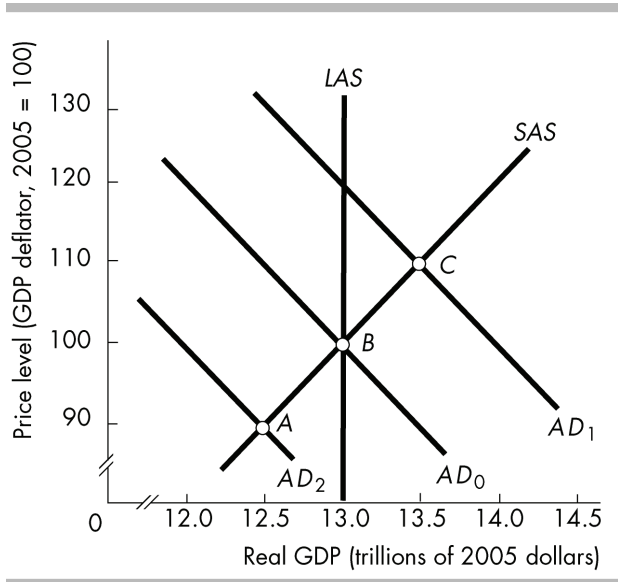
Answer: C

Topic: Inflationary Gap

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills



- 64) In the above figure, point A represents
- A) a recessionary gap.
  - B) a full-employment equilibrium.
  - C) an inflationary gap.
  - D) an increase in aggregate demand.

Answer: A

Topic: Recessionary Gap

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

- 65) In the above figure, point B represents
- A) a recessionary gap.
  - B) a full-employment equilibrium.
  - C) an inflationary gap.
  - D) a decrease in aggregate demand.

Answer: B

Topic: Full-Employment Equilibrium

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills



- 66) In the above figure, point C represents
- A) a recessionary gap.
  - B) a full-employment equilibrium.
  - C) an inflationary gap.
  - D) a decrease in aggregate demand.

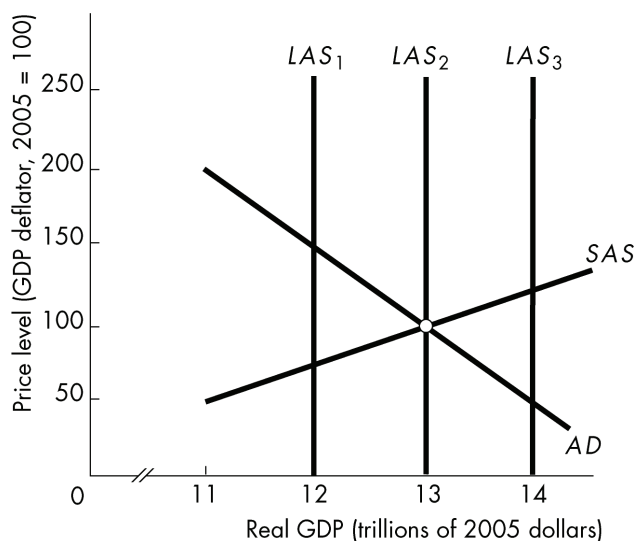
Answer: C

Topic: Inflationary Gap

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills



- 67) In the above figure, the short-run aggregate supply curve is  $SAS$  and the aggregate demand curve is  $AD$ . A recessionary gap exists
- A) if the long-run aggregate supply curve is  $LAS_1$ .
  - B) if the long-run aggregate supply curve is  $LAS_2$ .
  - C) if the long-run aggregate supply curve is  $LAS_3$ .
  - D) All of the above answers are correct.

Answer: C

Topic: Recessionary Gap

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

- 68) In the above figure, the short-run aggregate supply curve is *SAS* and the aggregate demand curve is *AD*. An inflationary gap exists
- A) if the long-run aggregate supply curve is *LAS*<sub>1</sub>.
  - B) if the long-run aggregate supply curve is *LAS*<sub>2</sub>.
  - C) if the long-run aggregate supply curve is *LAS*<sub>3</sub>.
  - D) All of the above answers are correct.

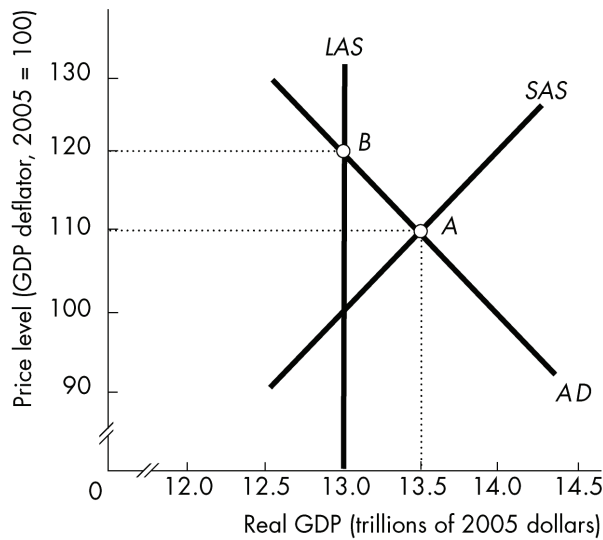
Answer: A

Topic: Inflationary Gap

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills



- 69) In the above figure, if the economy is at point *A*, which of the following is true?
- A) Point *A* is the long-run equilibrium point.
  - B) The economy is in a recession.
  - C) Money wages can be expected to fall.
  - D) The economy might be at point *A* as a result of a recent cut in the tax rate.

Answer: D

Topic: Short-Run Macroeconomic Equilibrium

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

70) In the above figure, if the economy is at point *A*, which of the following is true?

- A) There is a recessionary gap.
- B) There is an inflationary gap.
- C) Point *A* is the long-run equilibrium point.
- D) None of the above answers are correct.

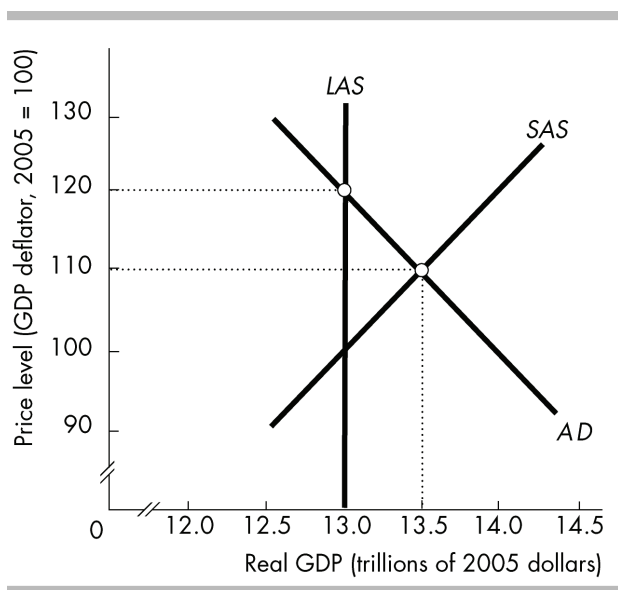
Answer: B

Topic: Inflationary Gap

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills



71) The above figure depicts an economy

- A) with an inflationary gap.
- B) with a recessionary gap.
- C) producing at full employment.
- D) None of the above answers is correct.

Answer: A

Topic: Inflationary Gap

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

- 72) In the above figure, the short-run equilibrium will eventually adjust to a long-run equilibrium with a
- A) lower price level and smaller real GDP
  - B) higher price level and larger real GDP.
  - C) higher price level and smaller real GDP.
  - D) lower price level and larger real GDP.

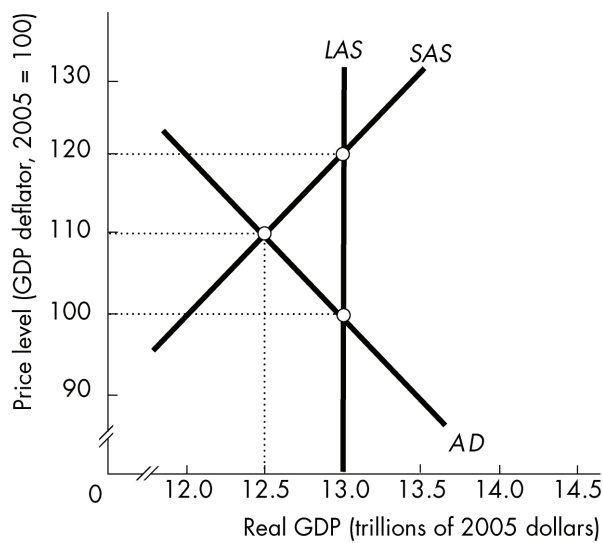
Answer: C

Topic: Long-Run Macroeconomic Equilibrium

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills



- 73) The above figure illustrates
- A) a recessionary gap.
  - B) a full-employment equilibrium.
  - C) an inflationary gap.
  - D) an equilibrium at the economy's physical limits.

Answer: A

Topic: Recessionary Gap

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

- 74) In the above figure, if aggregate demand does not change the short-run equilibrium will
- A) eventually adjust to a long-run equilibrium with a higher price level.
  - B) will not adjust on its own.
  - C) eventually adjust to a long-run equilibrium with a lower price level.
  - D) None of the above answers are correct.

Answer: C

Topic: Long-Run Macroeconomic Equilibrium

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

- 75) Suppose the economy was initially in a long-run equilibrium. Then the world economy expands so that foreign incomes rise. U.S. aggregate demand \_\_\_\_\_ and eventually the money wage rate \_\_\_\_\_.
- A) increases; rises
  - B) increases; falls
  - C) decreases; rises
  - D) decreases; falls

Answer: A

Topic: Fluctuations in Aggregate Demand

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 76) If the economy is in long run equilibrium and aggregate demand increases, then in the short run
- A) nothing happens because the economy is in long run equilibrium.
  - B) the price level rises and real GDP does not change.
  - C) real GDP increases and the price level does not change.
  - D) the price level rises and real GDP increases.

Answer: D

Topic: Fluctuations in Aggregate Demand

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 77) The Federal Reserve lowers interest rates. As a result, in the short run, real GDP \_\_\_\_\_ and the price level \_\_\_\_\_.
- A) increases; rises
  - B) increases; falls
  - C) decreases; rises
  - D) decreases; falls

Answer: A

Topic: Fluctuations in Aggregate Demand

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

78) The government increases taxes. As a result, in the short run, real GDP \_\_\_\_\_ and the price level \_\_\_\_\_.

- A) increases; rises
- B) decreases; falls
- C) decreases; rises
- D) increases; falls

Answer: B

*Topic: Fluctuations in Aggregate Demand*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 10*

*AACSB: Reflective Thinking*

79) In the short run, an increase in government expenditure on goods and services \_\_\_\_\_ real GDP and \_\_\_\_\_ the price level.

- A) increases; rises
- B) increases; falls
- C) decreases; rises
- D) decreases; falls

Answer: A

*Topic: Fluctuations in Aggregate Demand*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 10*

*AACSB: Reflective Thinking*

80) In the short-run, a decrease in government expenditure \_\_\_\_\_ real GDP and \_\_\_\_\_ the price level.

- A) increases; increases
- B) increases; decreases
- C) decreases; increases
- D) decreases; decreases

Answer: D

*Topic: Fluctuations in Aggregate Demand*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 10*

*AACSB: Reflective Thinking*

81) In the short run, an increase in aggregate demand

- A) lowers the price level and decreases real GDP.
- B) lowers the price level and increases real GDP.
- C) raises the price level and increases real GDP.
- D) raises the price level and decreases real GDP.

Answer: C

*Topic: Fluctuations in Aggregate Demand*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 10*

*AACSB: Reflective Thinking*

- 82) A lower price level combined with a decrease in real GDP occurs when the
- short-run aggregate supply curve shifts rightward.
  - short-run aggregate supply curve shifts leftward.
  - aggregate demand curve shifts rightward.
  - aggregate demand curve shifts leftward.

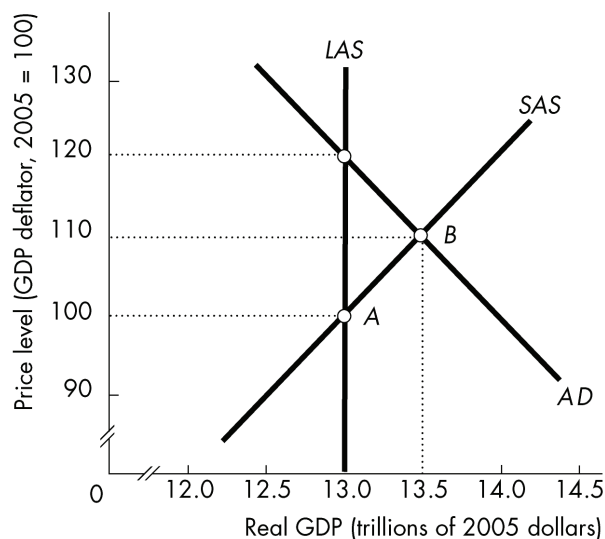
Answer: D

Topic: Fluctuations in Aggregate Demand

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking



- 83) In the above figure, suppose the economy had been at point *A* and now is at *B*. What could have lead to the movement to *B*?
- A tax hike.
  - Government expenditures on goods and services increased.
  - Winter storms cause factories in the north to be shut down for several weeks.
  - Money wage rates rose.

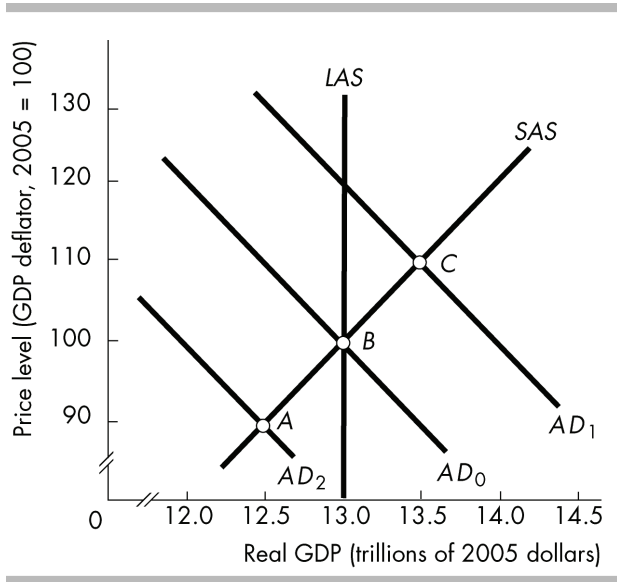
Answer: B

Topic: Fluctuations in Aggregate Demand

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills



- 84) Suppose the economy is at point *B*. If firms expect profits will be higher in the future, to what point might the economy's move in the short run?
- A) It stays at point *B*.
  - B) It shifts to a point such as *A*.
  - C) It shifts to a point such as *C*.
  - D) None of the above answers are correct because it is the *SAS* curve that shifts, not the *AD* curve.

Answer: C

Topic: *Fluctuations in Aggregate Demand*

Skill: *Analytical*

Question history: *Previous edition, Chapter 10*

AACSB: *Analytical Skills*

- 85) Suppose the economy is at point *B*. If a recession in another country decreases exports, to what point might economy move in the short run?
- A) It stays at point *B*.
  - B) It shifts to a point such as *A*.
  - C) It shifts to a point such as *C*.
  - D) None of the above answers are correct because it is the *SAS* curve that shifts, not the *AD* curve.

Answer: B

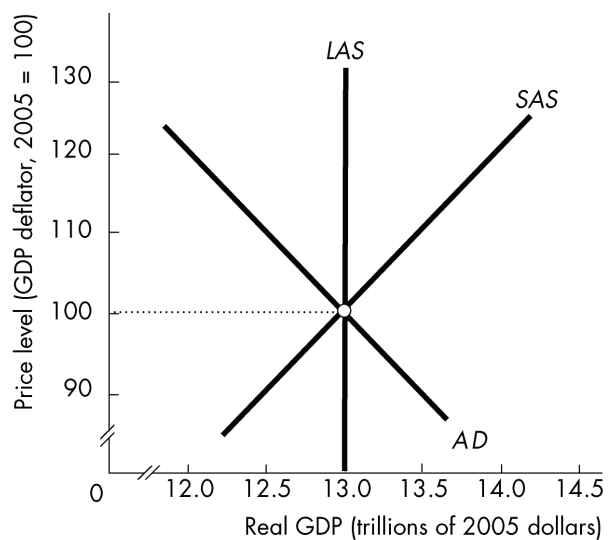
Topic: *Fluctuations in Aggregate Demand*

Skill: *Analytical*

Question history: *Previous edition, Chapter 10*

AACSB: *Analytical Skills*





- 86) The figure illustrates aggregate demand and aggregate supply in Sparta. Which of the following events will decrease Sparta's real GDP in the short run?
- A) a decrease in taxes
  - B) a fall in resource prices
  - C) a decrease in government expenditure
  - D) an increase in investment

Answer: C

Topic: Fluctuations in Aggregate Demand

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

- 87) The figure above illustrates aggregate demand and aggregate supply in Sparta. Sparta's price level will rise above 100 if \_\_\_\_\_.
- A) government expenditure decreases
  - B) the quantity of money increases
  - C) the quantity of capital increases
  - D) taxes increase

Answer: B

Topic: Fluctuations in Aggregate Demand

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

- 88) In a short-run macroeconomic equilibrium, potential GDP exceeds real GDP. If aggregate demand does not change, then the
- A) short-run aggregate supply curve will shift rightward as the money wage rate falls.
  - B) short-run aggregate supply curve will shift leftward as the money wage rate rises.
  - C) long-run aggregate supply curve will shift leftward as the money wage rate rises.
  - D) long-run aggregate supply curve will shift leftward as the money wage rate falls.

Answer: A

Topic: *Movement to the Long-Run Equilibrium*

Skill: *Conceptual*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

- 89) In a short-run macroeconomic equilibrium, real GDP exceeds potential GDP. If aggregate demand does not change, then the
- A) short-run aggregate supply curve will shift rightward as the money wage rate falls.
  - B) short-run aggregate supply curve will shift leftward as the money wage rate rises.
  - C) long-run aggregate supply curve will shift leftward as the money wage rate rises.
  - D) long-run aggregate supply curve will shift leftward as the money wage rate falls.

Answer: B

Topic: *Movement to the Long-Run Equilibrium*

Skill: *Conceptual*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

- 90) The country of Stanley is at an above-full employment equilibrium. Which of the following events will return Stanley to full-employment?
- A) an increase in government expenditures
  - B) a decrease in the interest rate
  - C) an increase in the money wage rate
  - D) an increase in the quantity of money

Answer: C

Topic: *Movement to the Long-Run Equilibrium*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 91) An economy currently has an inflationary gap. An increase in the money wage rate will \_\_\_\_\_ the inflationary gap and \_\_\_\_\_ the price level.
- A) decrease; decrease
  - B) increase; increase
  - C) increase; decrease
  - D) decrease; increase

Answer: D

Topic: *Movement to the Long-Run Equilibrium*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 92) Suppose the current situation is such that the price level is 120, real GDP is \$13 trillion, and GDP along the long-run aggregate supply curve is \$12.6 trillion. What will take place to restore the long-run equilibrium?
- A) The price level will fall until long-run aggregate supply increases to \$13 trillion.
  - B) The price level will fall and money wage rates will rise until real GDP along the long-run aggregate supply curve is \$13 trillion.
  - C) Money wage rates will rise until real GDP is \$12.6 trillion.
  - D) Aggregate demand will increase until both short-run and long-run aggregate supply equal \$13 trillion.

Answer: C

Topic: Movement to the Long-Run Equilibrium

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 93) The long-run aggregate supply curve is vertical at \$12 trillion but the short-run aggregate supply curve intersects the aggregate demand curve at \$13 trillion. We know that
- A) the economy is producing below full employment in the short run, and will adjust by hiring more workers, thus decreasing unemployment.
  - B) the price level is too high. The long-run equilibrium will occur with a lower price level.
  - C) adjustments will occur so that the long-run aggregate supply equals \$13 trillion.
  - D) adjustments will occur so that the short-run aggregate supply eventually intersects the aggregate demand curve at \$12 trillion.

Answer: D

Topic: Movement to the Long-Run Equilibrium

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 94) In long-run macroeconomic equilibrium, the
- A) real wage rate has adjusted so that the economy is on the short-run aggregate supply curve but not on the long-run aggregate supply curve.
  - B) long-run aggregate supply curve has shifted so that potential GDP equals real GDP.
  - C) aggregate demand curve adjusts to the point where the long-run aggregate supply curve and the short-run aggregate supply curve intersect.
  - D) None of the above answers is correct.

Answer: D

Topic: Movement to the Long-Run Equilibrium

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 95) If the economy is in long run equilibrium and then aggregate demand increases, in the long run the increase in aggregate demand means that the
- A) price level will be higher but real GDP will be unaffected.
  - B) real GDP will be larger but the price level will be unaffected.
  - C) the price level will be higher and real GDP will be larger.
  - D) neither the price level nor real GDP will be unaffected.

Answer: A

Topic: *Long-Run Macroeconomic Equilibrium*

Skill: *Analytical*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 96) In the long-run equilibrium, an increase in the quantity of capital leads to
- A) an increase in the equilibrium price level and an increase in equilibrium real GDP.
  - B) a decrease in the equilibrium price level and an increase in equilibrium real GDP.
  - C) a decrease in the equilibrium price level, but no change in equilibrium real GDP.
  - D) no change in the equilibrium price level, but an increase in equilibrium real GDP.

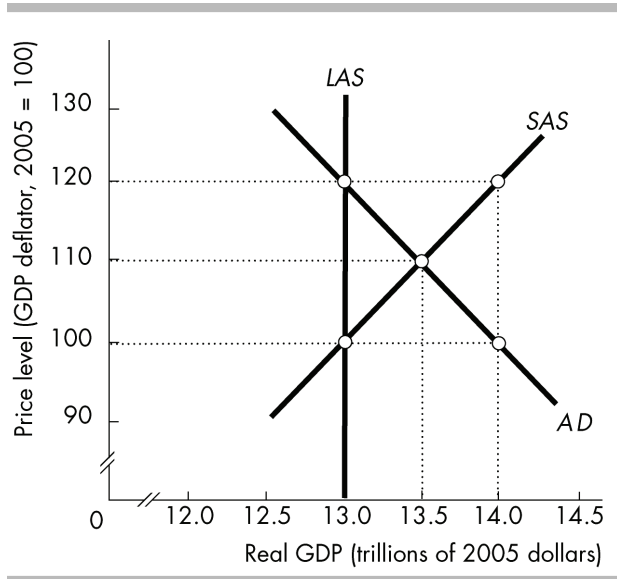
Answer: B

Topic: *Long-Run Macroeconomic Equilibrium*

Skill: *Analytical*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*



97) In the above figure, at the point where  $AD$  equals  $SAS$ ,

- A) real GDP exceeds potential GDP.
- B) potential GDP exceeds real GDP.
- C) the economy is in a recession.
- D) the unemployment rate is zero.

Answer: A

Topic: Short-Run Macroeconomic Equilibrium

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

98) In the above figure, as the economy adjusts toward equilibrium, the

- A)  $AD$  curve will shift rightward.
- B)  $SAS$  curve will shift rightward.
- C)  $AD$  curve will shift leftward.
- D)  $SAS$  curve will shift leftward.

Answer: D

Topic: Movement to the Long-Run Equilibrium

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

- 99) In the above figure, when the economy is in a long-run equilibrium, the price level will be
- A) 90.
  - B) 100.
  - C) 110.
  - D) 120.

Answer: D

Topic: Long-Run Macroeconomic Equilibrium

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

- 100) In the above figure, when the economy is in a long-run equilibrium, real GDP will be
- A) \$12.5 trillion.
  - B) \$13.0 trillion.
  - C) \$13.5 trillion.
  - D) \$14.0 trillion.

Answer: B

Topic: Long-Run Macroeconomic Equilibrium

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

Price level	Aggregate demand (trillions of 2005 dollars)	Short-run aggregate supply (trillions of 2005 dollars)	Long-run aggregate supply (trillions of 2005 dollars)
140	9.0	11.5	10.0
130	9.5	11.0	10.0
120	10.0	10.5	10.0
110	10.5	10.0	10.0
100	11.0	9.5	10.0

- 101) The data in the above table indicate that the economy will be in a short-run macroeconomic equilibrium at a price level
- A) between 130 and 121.
  - B) between 119 and 111.
  - C) of 120.
  - D) of 110.

Answer: B

Topic: Short-Run Macroeconomic Equilibrium

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

- 102) From the data in the above table, when the economy is at its short-run equilibrium, if aggregate demand does not change, then as time passes the
- A) short-run aggregate supply curve shifts rightward.
  - B) short-run aggregate supply curve shifts leftward.
  - C) long-run aggregate supply curve shifts rightward.
  - D) long-run aggregate supply curve shifts leftward.

Answer: B

Topic: Movement to the Long-Run Equilibrium

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

Price level	Aggregate demand (trillions of 2005 dollars)	Short-run aggregate supply (trillions of 2005 dollars)	Long-run aggregate supply (trillions of 2005 dollars)
100	11	7	10
110	10	8	10
120	9	9	10
130	8	10	10
140	7	11	10

- 103) Based on the data in the table above, the economy will be in short-run equilibrium at a price level of
- A) 90.
  - B) 110.
  - C) 100.
  - D) 120.

Answer: D

Topic: Short-Run Macroeconomic Equilibrium

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

- 104) Based on the data in the table above, at the short-run equilibrium
- A) the unemployment rate is less than the natural unemployment rate.
  - B) the unemployment rate is greater than the natural unemployment rate.
  - C) money wage rates will rise in long-run.
  - D) the economy is at full employment.

Answer: B

Topic: Short-Run Macroeconomic Equilibrium

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

- 105) Based on the data in the table above, in the adjustment towards the long-run equilibrium
- A) money wage rates will rise.
  - B) the aggregate demand curve will shift leftward.
  - C) the short-run aggregate supply curve will shift leftward.
  - D) the short-run aggregate supply curve will shift rightward.

Answer: D

Topic: *Movement to the Long-Run Equilibrium*

Skill: *Analytical*

Question history: *Previous edition, Chapter 10*

AACSB: *Analytical Skills*

Price level	Aggregate demand (trillions of 2005 dollars)	Short-run aggregate supply (trillions of 2005 dollars)	Long-run aggregate supply (trillions of 2005 dollars)
140	4	8	7
130	5	7	7
120	6	6	7
110	7	5	7
100	8	4	7

- 106) The data in the above table show that the economy will be in a short-run macroeconomic equilibrium at a price level of
- A) 90.
  - B) 110.
  - C) 100.
  - D) 120.

Answer: D

Topic: *Short-Run Macroeconomic Equilibrium*

Skill: *Analytical*

Question history: *Previous edition, Chapter 10*

AACSB: *Analytical Skills*

- 107) The data in the above table show that when the price level is 120,
- A) the unemployment rate is below its natural rate.
  - B) the unemployment rate is above its natural rate.
  - C) money wages rates will rise in the future.
  - D) the long-run aggregate supply curve will shift leftward in the future.

Answer: B

Topic: *Recessionary Gap*

Skill: *Analytical*

Question history: *Previous edition, Chapter 10*

AACSB: *Analytical Skills*



- 108) The data in the above table show that when the price level is 120, the economy
- A) is in a long-run macroeconomic equilibrium.
  - B) has an inflationary gap.
  - C) has a recessionary gap.
  - D) will have falling money wage rates sometime in the future.

Answer: C

Topic: Recessionary Gap

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

- 109) The data in the above table show that when the price level is 120, if aggregate demand does not change then the
- A) money wage rate will rise in the future.
  - B) money wage rate will fall in the future.
  - C) short-run aggregate supply curve will shift leftward.
  - D) long-run aggregate supply curve will shift leftward.

Answer: B

Topic: Movement to the Long-Run Equilibrium

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

- 110) The data in the above table show that when the price level is 120, if aggregate demand does not change then the
- A) short-run aggregate supply curve will shift rightward.
  - B) short-run aggregate supply curve will shift leftward.
  - C) long-run aggregate supply curve will shift rightward.
  - D) long-run aggregate supply curve will shift leftward.

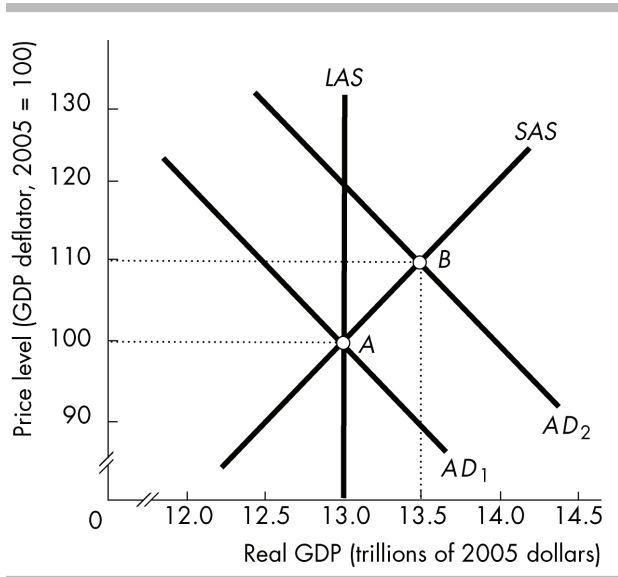
Answer: A

Topic: Movement to the Long-Run Equilibrium

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills



- 111) In the above figure, point *B* depicts
- A) an inflationary gap with real GDP in excess of potential GDP.
  - B) an inflationary gap with real GDP less than potential GDP.
  - C) a recessionary gap with real GDP in excess of potential GDP.
  - D) a recessionary gap with real GDP less than potential GDP.

Answer: A

Topic: Short-Run Macroeconomic Equilibrium

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

- 112) In the above figure, real GDP at full employment is
- A) \$13 trillion.
  - B) \$13.5 trillion.
  - C) more than \$13 and less than \$13.5 trillion.
  - D) None of the above answers is correct.

Answer: A

Topic: Short-Run Macroeconomic Equilibrium

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

- 113) In the above figure, the aggregate demand curve is  $AD_2$ , so the short-run equilibrium level of real GDP is
- A) \$13 trillion.
  - B) \$13.5 trillion.
  - C) more than \$13 and less than \$13.5 trillion.
  - D) None of the above answers is correct.

Answer: B

Topic: Short-Run Macroeconomic Equilibrium

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

- 114) In the above figure, the aggregate demand curve is  $AD_2$ , so the long-run equilibrium level of real GDP is
- A) \$13 trillion.
  - B) \$13.5 trillion.
  - C) more than \$13 and less than \$13.5 trillion.
  - D) None of the above answers is correct.

Answer: A

Topic: Long-Run Macroeconomic Equilibrium

Skill: Analytical

Question history: New 10th edition

AACSB: Analytical Skills

- 115) In the above figure, the shift from  $AD_1$  to  $AD_2$  might have been the result of
- A) an increase in government expenditure.
  - B) a decrease in taxes.
  - C) an increase in the quantity of money.
  - D) All of the above answers are correct.

Answer: D

Topic: Fluctuations in Aggregate Demand

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

- 116) Higher resource prices shift the
- A) long-run aggregate supply curve leftward, decreasing real GDP and increasing potential GDP.
  - B) short-run aggregate supply curve leftward, raising the price level and decreasing potential GDP.
  - C) short-run aggregate supply curve leftward, raising the price level and decreasing real GDP so it is less than potential GDP.
  - D) short-run aggregate supply curve rightward, raising the price level and decreasing real GDP so it is less than potential GDP.

Answer: C

Topic: Fluctuations in Aggregate Supply

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 117) Suppose that the economy begins at a long-run equilibrium. Which of the following raises the price level and decrease real GDP in the short run?
- A) a decrease in the quantity of money
  - B) an increase in the price of oil that decreases aggregate supply
  - C) an increase in the stock of capital that increases aggregate supply
  - D) an increase in government expenditures

Answer: B

Topic: *Fluctuations in Aggregate Supply*

Skill: *Analytical*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 118) A decrease in short-run aggregate supply \_\_\_\_\_ the equilibrium price level and \_\_\_\_\_ the equilibrium quantity of real GDP.
- A) increases; increases
  - B) increases; decreases
  - C) decreases; increases
  - D) decreases; decreases

Answer: B

Topic: *Fluctuations in Short-Run Aggregate Supply*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 119) In the short run, a rightward shift of the short-run aggregate supply curve \_\_\_\_\_ real GDP and \_\_\_\_\_ the price level.
- A) decreases; lowers
  - B) increases; raises
  - C) decreases; raises
  - D) increases; lowers

Answer: D

Topic: *Fluctuations in Short-Run Aggregate Supply*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 120) In the short run, a supply shock that shifts the short-run aggregate supply curve leftward \_\_\_\_\_ real GDP and \_\_\_\_\_ the price level.
- A) increases; raises
  - B) decreases; raises
  - C) increases; lowers
  - D) decreases; lowers

Answer: B

Topic: *Fluctuations in Short-Run Aggregate Supply*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 121) Assume the economy is at long run equilibrium and oil prices rise. As a result, the \_\_\_\_\_ shifts \_\_\_\_\_.
- A) AD; rightward
  - B) AD; leftward
  - C) SAS; rightward
  - D) SAS; leftward

Answer: D

Topic: *Fluctuations in Short-Run Aggregate Supply*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Analytical Skills*

- 122) In the short-run, a rise in the money wage rate leads to
- A) an increase in the price level and an increase in real GDP.
  - B) an increase in the price level and a decrease in real GDP.
  - C) an increase in the price level, but no change in real GDP.
  - D) no change in the price level, but an increase in real GDP.

Answer: B

Topic: *Fluctuations in Short-Run Aggregate Supply*

Skill: *Analytical*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 123) Stagflation is the combination of
- A) inflation and increasing real GDP.
  - B) deflation and recession.
  - C) inflation and recession.
  - D) deflation with increasing real GDP.

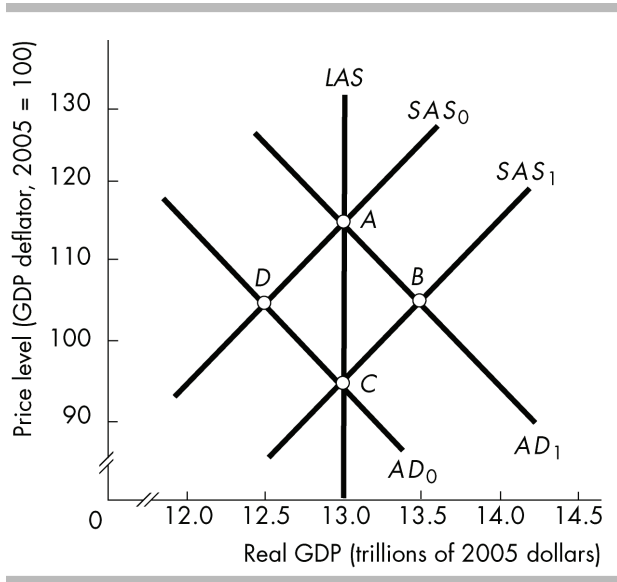
Answer: C

Topic: *Stagflation*

Skill: *Recognition*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*



- 124) The economy is initially at point *A* in the figure. An increase in \_\_\_\_\_ will move the economy to point \_\_\_\_\_ and then an increase in \_\_\_\_\_ will move the economy to point \_\_\_\_\_.
- A) taxes; *D*; government expenditure; *B*
  - B) the money wage rate; *B*; government expenditure; *C*
  - C) the money wage rate; *C*; taxes; *D*
  - D) government expenditure; *D*; the money wage rate; *B*

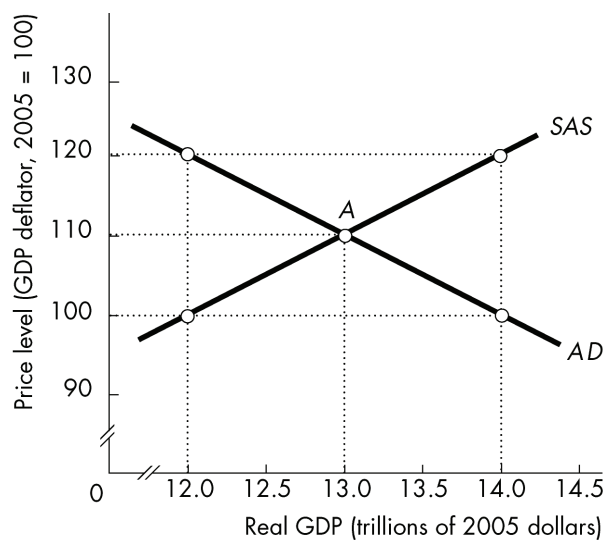
Answer: A

Topic: Fluctuations in Short-Run Aggregate Supply

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills



- 125) In the above figure, the economy is at point *A* when changes occur. If the new equilibrium has a price level of 120 and real GDP of \$12.0 trillion, then it must be the case that
- aggregate demand has increased.
  - aggregate demand has decreased.
  - aggregate supply has decreased.
  - aggregate supply has increased.

Answer: C

Topic: *Fluctuations in Short-Run Aggregate Supply*

Skill: *Analytical*

Question history: *Previous edition, Chapter 10*

AACSB: *Analytical Skills*

- 126) In the above figure, the economy is at point *A* when changes occur. If the new equilibrium has a price level of 100 and real GDP of \$14.0 trillion, then it must be the case that
- aggregate demand has decreased.
  - aggregate supply has decreased.
  - aggregate demand has increased.
  - aggregate supply has increased.

Answer: D

Topic: *Fluctuations in Short-Run Aggregate Supply*

Skill: *Analytical*

Question history: *Previous edition, Chapter 10*

AACSB: *Analytical Skills*

- 127) In the above figure, the economy is at point *A* when changes occur. If the new equilibrium has a price level of 100 and real GDP of \$12.0 trillion, then it must be the case that
- A) aggregate demand has increased.
  - B) aggregate demand has decreased.
  - C) aggregate supply has decreased.
  - D) aggregate supply has increased.

Answer: B

Topic: *Fluctuations in Aggregate Demand*

Skill: *Analytical*

Question history: *Previous edition, Chapter 10*

AACSB: *Analytical Skills*

- 128) If the actual real GDP is less than potential real GDP, the economy is
- A) not in macroeconomic equilibrium.
  - B) at full employment.
  - C) in an above full-employment equilibrium.
  - D) in a below full-employment equilibrium.

Answer: D

Topic: *Study Guide Question, Below Full-Employment Equilibrium*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

Price level	Aggregate demand (trillions of 2005 dollars)	Short-run aggregate supply (trillions of 2005 dollars)	Long-run aggregate supply (trillions of 2005 dollars)
100	13	9	10
105	12	10	10
110	11	11	10
115	10	13	10

- 129) Using the data in the above table, in the short-run macroeconomic equilibrium, the price level is \_\_\_\_\_ and the level of real GDP is \_\_\_\_\_.
- A) 105; \$10 trillion
  - B) 110; \$10 trillion
  - C) 110; \$11 trillion
  - D) 115; \$10 trillion

Answer: C

Topic: *Study Guide Question, Short-Run Macroeconomic Equilibrium*

Skill: *Analytical*

Question history: *Previous edition, Chapter 10*

AACSB: *Analytical Skills*



- 130) Using the data in the above table, in the short-run macroeconomic equilibrium, there is
- A) an inflationary gap of \$1 trillion.
  - B) an inflationary gap of \$2 trillion.
  - C) a recessionary gap of \$1 trillion.
  - D) a recessionary gap of \$2 trillion.

Answer: A

Topic: Study Guide Question, Inflationary Gap

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

- 131) Using the data in the above table, in the long-run macroeconomic equilibrium, the price level is \_\_\_\_\_ and the level of real GDP is \_\_\_\_\_.
- A) 115; \$10 trillion
  - B) 110; \$10 trillion
  - C) 105; \$11 trillion
  - D) 115; \$11 trillion

Answer: A

Topic: Study Guide Question, Long-Run Macroeconomic Equilibrium

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

#### 4 Macroeconomic Schools of Thought

- 1) \_\_\_\_\_ economists believe that the economy is self-regulating and always at full employment.
- A) Keynesian
  - B) Monetarist
  - C) Classical
  - D) All

Answer: C

Topic: Classical View

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 2) A classical economist believes that
- A) if the economy was left alone, it would rarely operate at full employment.
  - B) the economy is self-regulating and always at full employment.
  - C) the economy is self-regulating and will normally, though not always, operate at full employment if monetary policy is not erratic.
  - D) the economy is self-regulating and will normally, though not always, operate at full employment if fiscal policy is not erratic.

Answer: B

Topic: Classical View

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

3) Which of the following statements is INCORRECT?

- A) A monetarist believes that recessions are the result of erratic monetary policy.
- B) A new classical macroeconomist believes the business cycle is the efficient response to the uneven pace of technological change.
- C) A Keynesian believes the business cycle is mainly influenced by changes in people's expectations.
- D) A classical macroeconomist believes that the money wage rate adjusts slowly.

Answer: D

Topic: *Classical View*

Skill: *Recognition*

Question history: *New 10th edition*

AACSB: *Reflective Thinking*

4) Which of the following statements correctly describes the policy stance of a macroeconomist?

- A) A monetarist believes that the quantity of money should be constantly changed in order to offset changes in aggregate demand.
- B) A new classical macroeconomist believes that fiscal and monetary policy are required to maintain full employment.
- C) A Keynesian would believe that if taxes are always kept low and the quantity of money is kept on a steady growth path, no policy actions will be needed to maintain full employment.
- D) A classical macroeconomist believes that maintaining consistently low taxes will allow the economy to expand at an appropriate and rapid pace.

Answer: D

Topic: *Schools of Thought*

Skill: *Recognition*

Question history: *New 10th edition*

AACSB: *Reflective Thinking*

5) A Keynesian economist believes that

- A) if the economy was left alone, it would rarely operate at full employment.
- B) the economy is self-regulating and always at full employment.
- C) the economy is self-regulating and will normally, though not always, operate at full employment if monetary policy is not erratic.
- D) the economy is self-regulating and will normally, though not always, operate at full employment if fiscal policy is not erratic.

Answer: A

Topic: *Keynesian View*

Skill: *Recognition*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 6) \_\_\_\_\_ economists believe that active help from fiscal and monetary policy is needed to insure that the economy is operating at full employment.
- A) Keynesian
  - B) Monetarist
  - C) Classical
  - D) All

Answer: A

Topic: Keynesian View

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 7) \_\_\_\_\_ economists believe that the economy is self-regulating and will be at full employment as long as monetary policy is not erratic.
- A) Keynesian
  - B) Monetarist
  - C) Classical
  - D) All

Answer: B

Topic: Monetarist View

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 8) A monetarist economist believes that
- A) if the economy was left alone, it would rarely operate at full employment.
  - B) the economy is self-regulating and always at full employment.
  - C) the economy is self-regulating and will normally, though not always, operate at full employment if monetary policy is not erratic.
  - D) the economy is self-regulating and will normally, though not always, operate at full employment if fiscal policy is not erratic.

Answer: C

Topic: Monetarist View

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 9) Which school of thought believes that recessions are the result of inappropriate monetary policy?
- A) only classical
  - B) only Keynesian
  - C) Monetarist
  - D) both Keynesian and classical

Answer: C

Topic: Study Guide Question, Monetarist View

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 10) Which school of thought believes that real GDP always equals potential GDP?
- A) only classical
  - B) only Keynesian
  - C) Monetarist
  - D) both Keynesian and classical

Answer: A

Topic: *Study Guide Question, Classical View*

Skill: *Recognition*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

## 5 News Based Questions

- 1) Consider a BMW automobile plant. If the price of BMWs increase by 10 percent and the money wage rate and other costs \_\_\_\_\_, there will be \_\_\_\_\_.
- A) increase by 10 percent; an increase in BMWs profits
  - B) do not change; an increase in BMW's production and profit
  - C) increase by 10 percent; an increase in BMWs production
  - D) do not change; no change in production

Answer: B

Topic: *Aggregate Supply*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 2) In Japan in 2000 the price level fell by 5 percent and nominal wage rates did not change. As a result, there was a
- A) movement down along Japan's short-run aggregate demand curve.
  - B) movement down along Japan's short-run aggregate supply curve.
  - C) rightward shift in Japan's short-run aggregate supply curve.
  - D) movement down along Japan's long-run aggregate supply curve.

Answer: B

Topic: *Short-Run Aggregate Supply Curve*

Skill: *Analytical*

Question history: *Previous edition, Chapter 10*

AACSB: *Analytical Skills*

- 3) In recent years, Japan's capital stock has increased by about 6 percent from one year to the next. As a result, we would expect
- A) a leftward shift in Japan's aggregate demand curve.
  - B) a movement up along Japan's short-run aggregate supply curve.
  - C) only Japan's long-run aggregate supply curve to shift rightward.
  - D) rightward shifts in both Japan's short-run aggregate supply and long-run aggregate supply curves.

Answer: D

Topic: *Short-Run and Long-Run Aggregate Supply*

Skill: *Analytical*

Question history: *Previous edition, Chapter 10*

AACSB: *Analytical Skills*

- 4) According to [www.oecd.org](http://www.oecd.org), the United States spends a larger portion of expenditures on higher education compared to any other country. Increasing the amount of higher education produces
- rightward shifts in the U.S. long-run aggregate supply curve
  - movements up along the U.S. aggregate demand curve
  - increases in U.S. human capital.
- A) i and iii only.  
B) i, ii and iii.  
C) ii and iii only.  
D) iii only.

Answer: A

Topic: Aggregate Supply

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 5) In 2008 the money wage rate in Ireland increased by 4 percent while the price level increased by 8 percent. As a result, Ireland's
- short-run aggregate supply curve shifted leftward.
  - short-run aggregate supply curve shifted rightward.
  - long-run aggregate supply curve shifted rightward.
  - short-run and long-run aggregate supply curves shifted rightward.

Answer: B

Topic: Short-Run Aggregate Supply

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

- 6) If the price level in Great Britain increases from 102 to 105 (holding all else constant), real wealth \_\_\_\_\_ and there is a movement \_\_\_\_\_ along Great Britain's aggregate demand curve.
- decreases; upward
  - increases; upward
  - decreases; downward
  - increases; downward

Answer: A

Topic: Aggregate Demand, Wealth Effect

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

- 7) The price level in India increases from 131 to 137 while its trading partners' price levels remain constant. As a result, people will buy \_\_\_\_\_ Indian-made goods and there will be a movement \_\_\_\_\_ along India's aggregate demand curve.
- A) more; upward
  - B) more; downward
  - C) less; downward
  - D) less; upward

Answer: D

Topic: *Aggregate Demand, International Price Substitution Effect*

Skill: *Analytical*

Question history: *Previous edition, Chapter 10*

AACSB: *Analytical Skills*

- 8) In 2008, the Bank of England increased the country's money supply and lowered its interest rate. This policy was designed to
- A) encourage people to buy more goods and services.
  - B) shift the aggregate demand curve rightward.
  - C) cause a movement up along the aggregate demand curve.
  - D) Both A and B are correct.

Answer: D

Topic: *Changes in Aggregate Demand, Monetary Policy*

Skill: *Analytical*

Question history: *Previous edition, Chapter 10*

AACSB: *Analytical Skills*

- 9) In 2008, Japan's government approved a \$1 trillion fiscal stimulus plan comprised of both tax cuts and government expenditure increases. As a result,
- A) Japan's aggregate demand curve shifted rightward.
  - B) Japan's aggregate supply curve shifted leftward.
  - C) Japan's aggregate demand curve shifted leftward.
  - D) Japan's long-run aggregate supply curve shifted leftward.

Answer: A

Topic: *Changes in Aggregate Demand, Fiscal Policy*

Skill: *Analytical*

Question history: *Previous edition, Chapter 10*

AACSB: *Analytical Skills*

- 10) China is one of the world's largest exporters. As the world's economies slipped into a worldwide recession in 2008, there was a \_\_\_\_\_ China's aggregate demand curve as China's exports \_\_\_\_\_.
- A) rightward shift of; decreased
  - B) movement upward along; increased
  - C) leftward shift of; decreased
  - D) movement upward along; decreased

Answer: C

Topic: *Changes in Aggregate Demand, Foreign Incomes*

Skill: *Analytical*

Question history: *Modified 10th edition*

AACSB: *Analytical Skills*

11) In 2008, the dollar appreciated relative to the euro. This appreciation caused \_\_\_\_\_ and a \_\_\_\_\_.

- A) a movement up along the U.S. aggregate demand curve; decrease in U.S. exports to Europe
- B) a decrease in U.S. exports to Europe; leftward shift in the U.S. aggregate demand curve
- C) an increase in U.S. exports to Europe; movement up along the U.S. aggregate demand curve
- D) a decrease in U.S. exports to Europe; a movement up along the U.S. aggregate demand curve

Answer: B

Topic: *Changes in Aggregate Demand, Foreign Exchange Rate*

Skill: *Analytical*

Question history: *Previous edition, Chapter 10*

AACSB: *Analytical Skills*

12) As world economies start to recover from the 2008 financial crisis and firms expect profits to increase,

- A) the price level in the U.S. will decrease as firms increase investment.
- B) the U.S. short-run aggregate supply curve immediately will shift rightward.
- C) investment will increase and there will be a movement up along the aggregate demand curve.
- D) both investment and aggregate demand will increase.

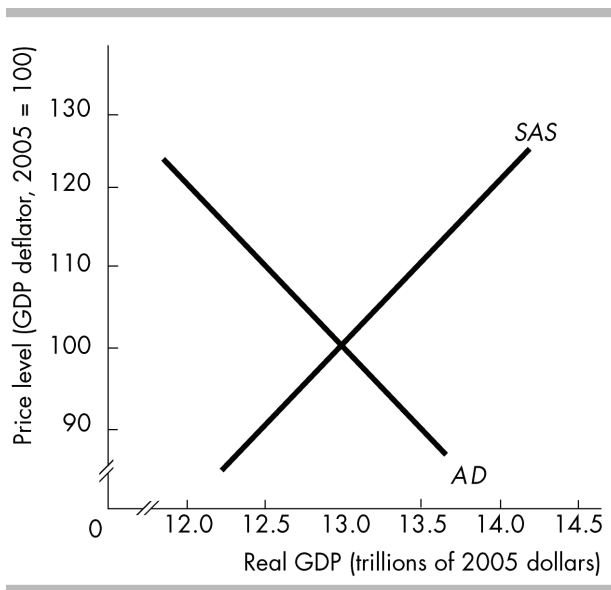
Answer: D

Topic: *Changes in Aggregate Demand, Investment*

Skill: *Analytical*

Question history: *Previous edition, Chapter 10*

AACSB: *Analytical Skills*



- 13) Use the figure above to answer this question. At a price level of 110,
- A) real GDP is greater than the aggregate quantity demanded and firms will cut production.
  - B) real GDP is less than the aggregate quantity demanded and firms will increase production.
  - C) inventories will decrease.
  - D) real GDP less than the aggregate quantity demanded and firms will increase prices.

Answer: A

Topic: *Equilibrium GDP and the Price Level*

Skill: *Analytical*

Question history: *Previous edition, Chapter 10*

AACSB: *Analytical Skills*

- 14) Use the figure above to answer this question. At a price level of 90,
- A) people will be forced to cut consumption so that aggregate demand will decrease.
  - B) the aggregate quantity demanded exceeds real GDP and inventories will decrease.
  - C) inventories increase and firms will increase production.
  - D) the aggregate quantity demanded exceeds real GDP, inventories increase and the price level will rise.

Answer: B

Topic: *Equilibrium GDP and the Price Level*

Skill: *Analytical*

Question history: *Previous edition, Chapter 10*

AACSB: *Analytical Skills*



15) The table below shows data for India's economy. Real GDP is measured in millions of rupees.

	Price level	Real GDP supplied in the short run	Real GDP demanded
a	114	23,501	35,898
b	120	25,355	32,341
c	125	27,670	27,670
d	131	30,366	18,569
e	138	33,164	15,898

If potential GDP in India is \_\_\_\_\_ million rupees, India is experiencing \_\_\_\_\_.

- A) 26,500; an inflationary gap
- B) 28,500; an above full-employment gap
- C) 26,500; a recessionary gap
- D) 30,000; a potential GDP gap

Answer: A

Topic: Inflationary Gap

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

- 16) Economic growth in India has averaged about 8.5 percent in recent years and while inflation averaged almost 9 percent. The AS-AD model shows this process as
- A) rightward shifts in the short-run aggregate supply curve.
  - B) rightward shifts in the both the aggregate demand and long-run aggregate supply curves.
  - C) movements upward along the aggregate demand curve.
  - D) rightward shifts in the aggregate demand curve and leftward shifts in the short-run aggregate supply curve.

Answer: B

Topic: Fluctuations in Aggregate Demand

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

- 17) Aggregate demand in India increased in 2008. In addition, real GDP grew strongly and inflation approached 10 percent. The best explanation for this inflation is that
- A) aggregate supply did not change.
  - B) potential GDP decreased.
  - C) there was a movement up along the aggregate demand curve in 2008.
  - D) potential GDP increased, but at a slower rate than aggregate demand.

Answer: D

Topic: Fluctuations in Aggregate Demand

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

18) The table below shows data for India's economy. Real GDP is measured in millions of rupees. Suppose that full employment occurs when real GDP is 27,000 million rupees.

	Price level	Real GDP supplied in the short run	Real GDP demanded
a	114	23,501	35,898
b	120	25,355	32,341
c	125	27,670	27,670
d	131	30,366	18,569
e	138	33,164	15,898

The economy is experiencing \_\_\_\_\_ gap and firms will \_\_\_\_\_.

- A) an inflationary gap; increase production
- B) an inflationary gap; increase money wages paid to workers
- C) a recessionary gap; increase production
- D) a recessionary gap; decrease money wages paid to workers

Answer: B

Topic: *Inflationary Gap*

Skill: *Analytical*

Question history: *Previous edition, Chapter 10*

AACSB: *Analytical Skills*

19) In the first half of 2008, food and energy costs in the United States increased. At the same time, the financial crisis slowed production. As a result, economists warned that the economy would

- A) suffer an inflationary gap.
- B) see a decrease in aggregate demand and an increase in long-run aggregate supply.
- C) experience stagflation.
- D) see an increase in potential GDP.

Answer: C

Topic: *Stagflation*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

20) In the first half of 2008, food and energy costs in the United States increased. At the same time, the financial crisis slowed production as firms predicted lower profits. A \_\_\_\_\_ macroeconomist would support the use of \_\_\_\_\_.

- A) classical; taxes to push the economy back to full employment
- B) Keynesian; fiscal or monetary policy to stimulate aggregate demand
- C) classical; monetary policy to stimulate aggregate demand
- D) Keynesian; technology to push the economy back to full employment

Answer: B

Topic: *Keynesian Theory*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 21) In 2008, Japan's economy suffered as world economies slowed. If authorities in Japan followed the monetarist viewpoint, \_\_\_\_\_ to bring the economy back to full employment.
- A) taxes would be decreased and the money supply should be increased
  - B) nothing should be done
  - C) aggregate supply would shift leftward
  - D) the money supply would be kept growing at a steady pace

Answer: D

Topic: Monetarist Theory

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 22) In 2008, Germany passed a stimulus package of \$29 billion as its economy slowed. This policy action follows the \_\_\_\_\_ to restore full employment.
- A) Keynesian viewpoint that supports increases in federal government expenditure
  - B) Keynesian viewpoint that supports increases in the money supply
  - C) monetarist viewpoint that supports increases in expenditure by the federal government
  - D) new classical viewpoint that discourages the use of expenditure by the federal government

Answer: A

Topic: Keynesian Theory

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

## 6 Essay Questions

- 1) In the aggregate demand–aggregate supply framework, how does an increase in the price level affect potential GDP?

Answer: An increase in the price level has no effect on potential GDP. Potential GDP is independent of the price level, so increases or decreases in the price level have no effect on potential GDP.

Topic: Changes in Aggregate Supply

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 2) How are potential GDP, full employment and the *LAS* curve related?

Answer: When the economy is at full employment there is no cyclical unemployment and the economy is at its potential level of real GDP. The *LAS* curve is vertical at the level of potential real GDP.

Topic: Aggregate Supply

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 3) Give examples of factors that decrease short-run aggregate supply. Which way does the *SAS* curve shift?

Answer: Aggregate supply decreases if potential GDP decreases. In addition, cost hikes such as a rise in the money wage rate or the price of oil, decreases short-run aggregate supply. Whenever short-run aggregate supply decreases, the *SAS* curve shifts leftward.

Topic: *Changes in Aggregate Supply*

Skill: *Recognition*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 4) What is the difference between the long-run aggregate supply and the short-run aggregate supply curves?

Answer: The long-run aggregate supply curve, *LAS*, is the relationship between the price level and real GDP when real GDP equals potential GDP. The *LAS* curve is vertical. Along the *LAS* curve, both the prices of goods and services *and* the prices of resources, such as the money wage rate, change. The short-run aggregate supply curve, *SAS*, is the relationship between the price level and the quantity of real GDP supplied in the short run when the money wage rate and other resource prices are constant. The *SAS* curve slopes upward. Along the *SAS* curve, only the price level changes; the money wage rate and other resource prices are constant. The *SAS* curve shifts leftward when the money wage rate (or other costs) rise.

Topic: *Long-Run and Short-Run Aggregate Supply*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Communication*

- 5) How do changes in the money wage rate affect the *LAS* and *SAS* curves? Explain your answer.

Answer: If the money wage rate changes, the *LAS* curve is not affected but the *SAS* curve shifts. For instance, if the money wage rate rises, the *LAS* curve does not change but the *SAS* curve shifts leftward. The difference occurs because moving along the *LAS* curve *both* the money wage rate and price level change in the same proportion. So in this case, a change in the money wage rate is matched by a change in the price level and firms have no incentive to change their production of goods and services. But moving along the *SAS* curve, only the price level changes. So when the money wage rate changes and the price level does not change, firms have an incentive to change their production. For instance, if the money wage rate rises and the price level does not change, then firms decrease their production of goods and services and the *SAS* curve shifts leftward.

Topic: *Long-Run and Short-Run Aggregate Supply*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Communication*

- 6) What are the factors that can shift the short-run aggregate supply curve but not the long-run aggregate supply curve? Explain your answer.

Answer: The only factor that shifts the short-run aggregate supply curve but not the long-run aggregate supply curve is a change in the money wage rate or the money prices of other resources. For instance, an increase in the money wage rate shifts the *SAS* curve leftward, but does not shift the *LAS* curve.

*Topic: Long-Run and Short-Run Aggregate Supply*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 10*

*AACSB: Reflective Thinking*

- 7) Explain the reasons why the *AD* curve slopes downward.

Answer: There are two reasons why the *AD* curve slopes downward: the wealth effect and substitution effects.

The wealth effect points out how changes in the price level cause changes in the real value of wealth. Price increases decrease real wealth and so people consume less in order to increase their wealth through saving. As a result, an increase in the price level decreases the aggregate quantity of goods and services demanded.

There are two substitution effects. The first is the intertemporal substitution effect: an increase in the price level raises the interest rate because the amount of real loans banks can make decreases. The higher interest rate leads consumers to decrease their consumption expenditure and firms to decrease their investment spending. The second substitution effect is the international price substitution effect: an increase in the U.S. price level raises the price of U.S.-made goods relative to foreign-made goods. So people and firms decrease the quantity of U.S.-made goods they purchase and increase the quantity of foreign-made goods they purchase. So both substitution effects also lead to a rise in the price level decreasing the aggregate quantity demanded.

*Topic: The Aggregate Demand Curve*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 10*

*AACSB: Communication*

- 8) What is the effect on the aggregate demand curve from an increase in the price level? In particular, does the aggregate demand curve shift leftward or rightward?

Answer: When the price level increases, there is a movement along the aggregate demand curve.

The quantity of real GDP demanded decreases in response to an increase in the price level. However, the aggregate demand curve does *not* shift. Factors that change aggregate demand and shift the aggregate demand curve are changes in the interest rate, in the quantity of money, in government expenditure, in taxes, in the exchange rate, and in real GDP in the rest of the world.

*Topic: The Aggregate Demand Curve*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 10*

*AACSB: Reflective Thinking*

9) What are the substitution effects that affect aggregate demand?

Answer: There are two substitution effects that affect aggregate demand and help account for the negative slope of the *AD* curve. First, an increase in the price level raises the interest rate, which reduces the quantity of real GDP demanded. Second, an increase in the U.S. price level raises the price of U.S. goods relative to foreign goods which also decreases the quantity of U.S. real GDP demanded.

*Topic: Aggregate Demand, Substitution Effect*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 10*

*AACSB: Reflective Thinking*

10) How does the aggregate demand curve reflect an increase in aggregate demand?

Answer: A rightward shift of the aggregate demand curve reflects an increase in aggregate demand.

*Topic: Changes in Aggregate Demand*

*Skill: Recognition*

*Question history: Previous edition, Chapter 10*

*AACSB: Reflective Thinking*

11) Give examples of factors that decrease aggregate demand. Which way does the aggregate demand curve shift?

Answer: Anything that decreases aggregate spending decreases aggregate demand. A rise in the interest rate, a decrease in the quantity of money, a decrease in government expenditure, a tax hike, a rise in the exchange rate, and a decrease in real GDP in the rest of the world all decrease aggregate demand. The aggregate demand curve shifts leftward.

*Topic: Changes in Aggregate Demand*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 10*

*AACSB: Reflective Thinking*

12) What are fiscal and monetary policies? Do they have an immediate effect on the *AD* curve or the *SAS* curve?

Answer: Fiscal policy is defined as changes in government spending and taxation to affect the level of economic activity. Monetary policy consists of changing interest rates and changing the quantity of money in the economy in order to affect the level of economic activity. Both policies have an impact on the *AD* curve.

*Topic: Changes in Aggregate Demand*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 10*

*AACSB: Reflective Thinking*

- 13) What are the components of fiscal policy? Explain how fiscal policy affects aggregate demand.

**Answer:** Fiscal policy affects aggregate demand through government expenditure, transfer payments and taxes. Because government purchases are a component of total spending, a change in government expenditure directly changes aggregate demand. A change in transfer payments changes disposable income which, in turn, changes consumption expenditure and aggregate demand. Finally, taxes alter disposable income and thus impact consumption expenditure and aggregate demand.

*Topic: Changes in Aggregate Demand, Fiscal Policy*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 10*

*AACSB: Reflective Thinking*

- 14) What happens to the aggregate demand curve in the United States if the exchange rate increases so that U.S.-made products become more expensive?

**Answer:** Net exports decrease so U.S. aggregate demand decreases.

*Topic: Changes in Aggregate Demand, Foreign Exchange Rate*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 10*

*AACSB: Reflective Thinking*

- 15) What two variables are determined in an aggregate supply–aggregate demand figure? Is the slope of the short-run aggregate supply curve positive or negative? Is the slope of the aggregate demand curve positive or negative?

**Answer:** The aggregate supply–aggregate demand framework determines the equilibrium price level and equilibrium real GDP. The aggregate supply curve is positively sloped, indicating that an increase in the price level increases the aggregate quantity of goods and services supplied. The aggregate demand curve is negatively sloped, indicating that an increase in the price level decreases the aggregate quantity of goods and services demanded.

*Topic: Macroeconomic Equilibrium*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 10*

*AACSB: Reflective Thinking*

- 16) Explain the relationship of the long-run aggregate supply curve, the short-run aggregate supply curve and the aggregate demand curve in determining a long-run and short-run macroeconomic equilibrium.

**Answer:** Short-run macroeconomic equilibrium occurs when the quantity of GDP demanded equals the quantity supplied, which is where the *AD* and *SAS* curves intersect. The short-run equilibrium does not necessarily take place at full employment. The long-run macroeconomic equilibrium occurs when real GDP equals potential GDP. This means that the economy is on the *LAS* curve, where the *AD* and *SAS* curves both intersect the *LAS* curve.

*Topic: Macroeconomic Equilibrium*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 10*

*AACSB: Reflective Thinking*

- 17) Assume the equilibrium price level is 140 and the equilibrium real GDP is \$15 trillion. What happens if the current price level equals 125?

Answer: The quantity of real GDP demanded is greater than the quantity of real GDP supplied. The price level rises to 140 because of the excess aggregate demand and when the price level reaches 140, macroeconomic equilibrium would be established.

*Topic: Macroeconomic Equilibrium*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 10*

*AACSB: Reflective Thinking*

- 18) Suppose that during 2009, the actual real GDP of Chile was 3.5 billion pesos at the same time the potential GDP was 3.4 billion pesos. What sort of equilibrium existed in Chile?

Answer: Chile's actual real GDP exceeded its potential GDP, so Chile was in an above full-employment, inflationary gap equilibrium.

*Topic: Macroeconomic Equilibrium*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 10*

*AACSB: Reflective Thinking*

- 19) What is the difference between a recessionary gap and an inflationary gap?

Answer: A recessionary gap exists when the economy is in a below full-employment equilibrium when potential GDP exceeds real GDP. The recessionary gap is the amount by which potential GDP exceeds real GDP. An inflationary gap occurs when the economy is in an above full-employment equilibrium when real GDP exceeds potential GDP. In this case, the inflationary gap is the difference between real GDP and potential GDP.

*Topic: Inflationary Gap and Recessionary Gap*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 10*

*AACSB: Reflective Thinking*

- 20) What happens if the economy is at its long-run equilibrium and aggregate demand increases?

Answer: The increase in aggregate demand means that the *AD* curve shifts rightward. Initially short-run aggregate supply does not change, so the *SAS* curve remains stationary. As a result, the price level rises and real GDP increases. The economy is an above full-employment equilibrium. Eventually, however, the tight labor market leads to a rise in the money wage rate. When the money wage rate rises, short-run aggregate supply decreases and the *SAS* curve shifts leftward. The price level rises and real GDP decreases. In the long run, the short-run aggregate supply decreases so that real GDP returns to potential level of GDP and the only effect is that the price level is permanently higher.

*Topic: Fluctuations in Aggregate Demand*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 10*

*AACSB: Communication*



- 21) If the world economy expands so that foreign demand for U.S.-made goods increases, in the short run what will happen to aggregate demand, the price level, and real GDP in the U.S.?

Answer: Net exports increase so U.S. aggregate demand increases. The U.S. price level and real GDP both increase.

*Topic: Fluctuations in Aggregate Demand*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 10*

*AACSB: Reflective Thinking*

- 22) Compare the policy prescriptions of Keynesian, Classical, and Monetarist economists.

Answer: Keynesians believe that without assistance the economy would almost never be at full employment. They prescribe activist fiscal and monetary policy to drive the economy to full employment. Classical economists believe the economy is self-regulating and will always tend towards full employment. Their main policy initiatives center on removing tax created disincentives for growth. Monetarists call for low taxes and consistent money growth because Monetarists believe that recessions are the result of fluctuations in the quantity of money.

*Topic: Schools of Thought*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 10*

*AACSB: Reflective Thinking*

## 7 Numeric and Graphing Questions

Price level (GDP deflator, 2005 = 100)	Quantity of real GDP demanded (trillions of 2005 dollars)	Quantity of real GDP supplied (trillions of 2005 dollars)
115	8.8	12.0
110	9.4	11.0
105	10.0	10.0
100	10.6	9.0
95	11.2	8.0
90	11.8	7.0

1) Based on the table above,

- a) What is the equilibrium price level and real GDP?
- b) If potential GDP is \$11.0 trillion, what does that imply about the economy's level of employment?
- c) If potential GDP is \$9.0 trillion, what does that imply about the economy's level of employment?

Answer: a) The equilibrium price level is 105; the equilibrium real GDP is \$10.0 trillion.

b) If potential GDP is \$11.0 trillion, then the economy is at an equilibrium that is a below full-employment equilibrium.

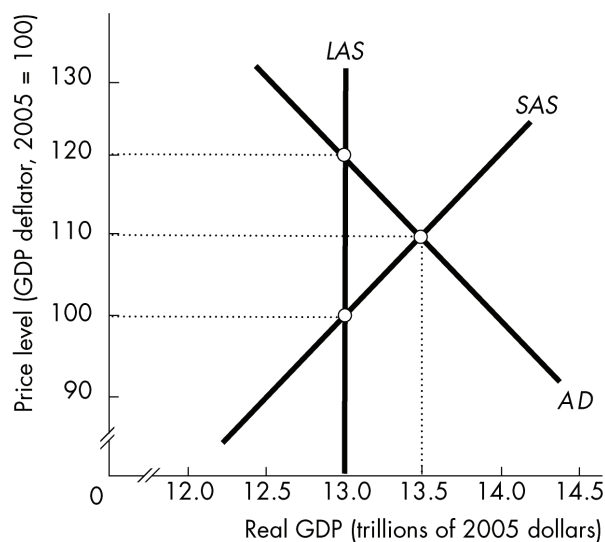
c) If potential GDP is \$9.0 trillion, then the economy is at an equilibrium that is an above full-employment equilibrium.

*Topic: Macroeconomic Equilibrium*

*Skill: Analytical*

*Question history: Previous edition, Chapter 10*

*AACSB: Analytical Skills*



- 2) In the above figure, what is the short-run equilibrium real GDP and the short-run equilibrium price level?

Answer: The short-run equilibrium occurs where the *AD* curve intersects the *SAS* curve. So in the figure the short run equilibrium real GDP is \$13.5 trillion and the short-run equilibrium price level is 110.

Topic: Macroeconomic Equilibrium

Skill: Analytical

Question history: New 10th edition

AACSB: Analytical Skills

## 8 True or False

- 1) The long-run aggregate supply curve is upward sloping.

Answer: FALSE

Topic: Long-Run Aggregate Supply

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 2) The long-run aggregate supply curve is vertical.

Answer: TRUE

Topic: Long-Run Aggregate Supply

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

3) The level of output when there is full employment is called actual GDP.

Answer: FALSE

Topic: *Short-Run Aggregate Supply*

Skill: *Recognition*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

4) In the long-run, the quantity of real GDP supplied increases when the price level increases.

Answer: FALSE

Topic: *Short-Run Aggregate Supply*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

5) The short-run aggregate supply curve shows a positive relationship between the price level and real GDP.

Answer: TRUE

Topic: *Short-Run Aggregate Supply*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

6) The SAS curve shifts if there is a change in the price level.

Answer: FALSE

Topic: *Changes in Aggregate Supply*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

7) If there is an increase in technology, the long-run aggregate supply curve shifts rightward, but the short-run aggregate supply curve does not shift.

Answer: FALSE

Topic: *Changes in Aggregate Supply, Technology*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

8) If the money prices of resources changes, the LAS curve shifts.

Answer: FALSE

Topic: *Change in Aggregate Supply; Money Wages & Prices of Resource*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

9) If the money prices of resources changes, the SAS curve shifts.

Answer: TRUE

Topic: *Change in Aggregate Supply; Money Wages & Prices of Resource*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 10) An increase in the quantity of capital shifts both the long-run and short-run aggregate supply curves.

Answer: TRUE

Topic: *Changes in Aggregate Supply, Capital*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 11) If the money wage rate increases, the short-run aggregate supply curve shifts rightward.

Answer: FALSE

Topic: *Changes in Money Wages and Other Resource Prices*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 12) The aggregate demand curve shows total expenditures at different levels of national income.

Answer: FALSE

Topic: *The Aggregate Demand Curve*

Skill: *Recognition*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 13) A change in the price level does not shift the aggregate demand curve.

Answer: TRUE

Topic: *The Aggregate Demand Curve*

Skill: *Conceptual*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

- 14) The wealth effect points out that consumption decreases when people's real wealth decreases.

Answer: TRUE

Topic: *Aggregate Demand Curve, Wealth and Substitution Effects*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 15) Wealth and substitution effects explain why the aggregate demand curve has a positive slope.

Answer: FALSE

Topic: *Aggregate Demand Curve, Wealth and Substitution Effects*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 16) An increase in the quantity of money shifts the aggregate demand curve rightward.

Answer: TRUE

Topic: *Changes in Aggregate Demand, Money*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

17) In the short-run, real GDP can be greater than or less than potential GDP because in the short run the money wage rate is fixed.

Answer: TRUE

Topic: *Short-Run Macroeconomic Equilibrium*

Skill: *Recognition*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

18) The level of output at which the short-run aggregate supply curve and the aggregate demand curve intersect is the full employment level of GDP.

Answer: FALSE

Topic: *Short-Run Macroeconomic Equilibrium*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

19) In the short run, a supply shock that shifts the short-run aggregate supply curve leftward raises the price level and increases real GDP.

Answer: FALSE

Topic: *Fluctuations in Short-Run Aggregate Supply*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

20) In the short run, a supply shock that shifts the short-run aggregate supply curve leftward raises the price level and decreases real GDP.

Answer: TRUE

Topic: *Fluctuations in Short-Run Aggregate Supply*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

21) Long-run macroeconomic equilibrium is achieved when the money wage rate has adjusted so that employment is such that real GDP equals potential GDP.

Answer: TRUE

Topic: *Long-Run Macroeconomic Equilibrium*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

22) During an above full-employment equilibrium, actual GDP is greater than potential GDP.

Answer: TRUE

Topic: *Above Full-Employment Equilibrium*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

23) Fluctuations in aggregate demand and aggregate supply explain why real GDP fluctuates.

Answer: TRUE

Topic: U.S. Economic Growth, Inflation and Cycles

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

24) The business cycle occurs because aggregate demand and aggregate supply change at uneven rates.

Answer: TRUE

Topic: U.S. Economic Growth, Inflation and Cycles

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

25) The Keynesian theory of business cycle views volatile expectations of future sales and profits as the main source of economic fluctuations.

Answer: TRUE

Topic: Keynesian Theory

Skill: Recognition

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

26) A monetarist economist believes that if the economy was left alone, it would rarely operate at full employment.

Answer: FALSE

Topic: Monetarist View

Skill: Recognition

Question history: Previous edition, Chapter 10

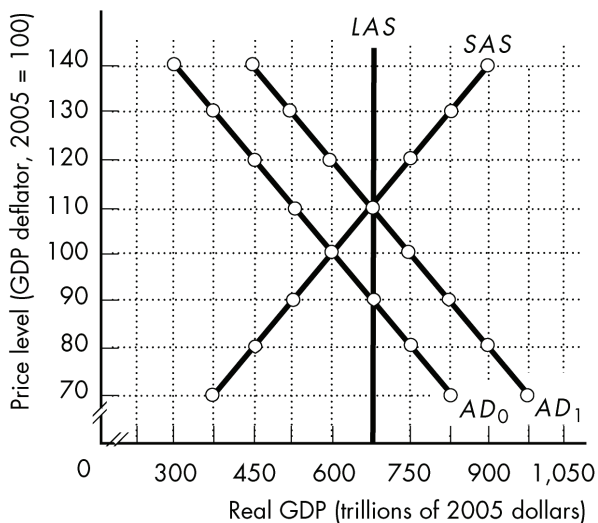
AACSB: Reflective Thinking

### 9 Extended Problems

Price level	Real GDP demanded (billions of 2005 dollars)	Real GDP supplied (billions of 2005 dollars)
70	825	375
80	750	450
90	675	525
100	600	600
110	525	675
120	450	750
130	375	825
140	300	900

- 1) The table above shows Purpleland's economy aggregate demand and supply schedules. Purpleland's potential GDP is \$675 billion.
  - a) Plot the aggregate demand curve, the short-run aggregate supply curve, and the long-run aggregate supply curve.
  - b) What are the short-run equilibrium real GDP and price level in Purpleland?
  - c) What is the long-run equilibrium real GDP?
  - d) Is Purpleland's short-run macroeconomic equilibrium a full-employment equilibrium, below full-employment equilibrium, or above full-employment equilibrium? What is the recessionary gap (if any)? What is the inflationary gap (if any)?
  - e) Suppose aggregate demand increases by \$150 billion. Plot the new aggregate demand curve. How do real GDP and the price level change in the short run?
  - f) Is Purpleland's new short-run macroeconomic equilibrium a full-employment equilibrium, below full-employment equilibrium, or above full-employment equilibrium? What is the recessionary gap (if any)? What is the inflationary gap (if any)?

Answer:



- a) See the figure above. The aggregate demand curve is  $AD_0$ .



- b) A short-run macroeconomic equilibrium occurs where the aggregate demand curve,  $AD_0$ , intersects the short-run aggregate supply curve,  $SAS$ . As the figure shows, the short-run equilibrium real GDP is \$600 billion, and the short-run equilibrium price level is 100.
- c) Long-run equilibrium real GDP equals potential GDP. So the long-run equilibrium real GDP in Purpleland is \$675 billion.
- d) Purpleland's short-run macroeconomic equilibrium is a below full-employment equilibrium because the short-run equilibrium GDP is less than potential GDP. The amount by which potential GDP exceeds real GDP is a recessionary gap, so the recessionary gap is \$75 billion. An inflationary gap exists when real GDP is above potential GDP, so there is no inflationary gap in Purpleland.
- e) As the figure above shows, the aggregate demand curve shifts from  $AD_0$  to  $AD_1$ . As a result, real GDP increases from \$600 billion to \$675 billion, and the price level rises from 100 to 110.
- f) Purpleland's new short-run macroeconomic equilibrium is a full-employment equilibrium because the equilibrium real GDP equals the potential GDP. When real GDP equals potential GDP, there is neither a recessionary gap nor an inflationary gap.

*Topic: Recessionary Gap*

*Skill: Analytical*

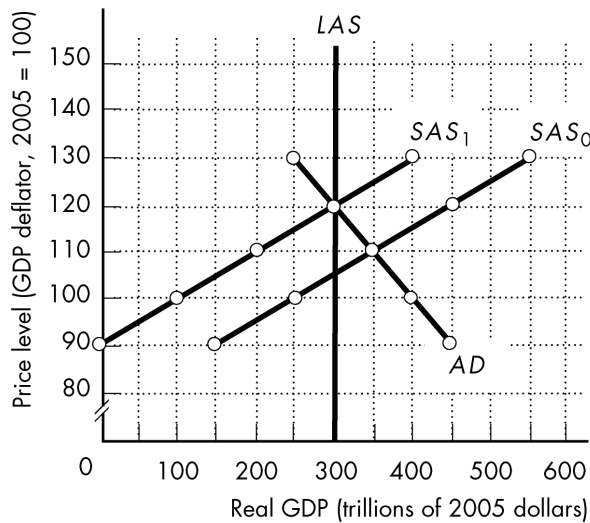
*Question history: Previous edition, Chapter 10*

*AACSB: Analytical Skills*

Price level	Real GDP demanded (billions of 2005 dollars)	Real GDP supplied (billions of 2005 dollars)
90	450	150
100	400	250
110	350	350
120	300	450
130	250	550

- 2) The table above shows Yellowland's economy aggregate demand and supply schedules. Yellowland's potential GDP is \$300 billion.
- a) Plot the aggregate demand curve, the short-run aggregate supply curve, and the long-run aggregate supply curve.
- b) What are the short-run equilibrium real GDP and price level in Yellowland?
- c) What is the long-run equilibrium real GDP?
- d) Is Yellowland's short-run macroeconomic equilibrium a full-employment equilibrium, below full-employment equilibrium, or above full-employment equilibrium? What is the recessionary gap (if any)? What is the inflationary gap (if any)?
- e) Suppose aggregate supply decreases by \$150 billion. Plot the new aggregate supply curve. How do real GDP and the price level change in the short run?
- f) Is Yellowland's new short-run macroeconomic equilibrium a full-employment equilibrium, below full-employment equilibrium, or above full-employment equilibrium? What is the recessionary gap (if any)? What is the inflationary gap (if any)?

Answer:



- a) See the figure above. The short-run aggregate supply curve is  $SAS_0$ .
- b) A short-run macroeconomic equilibrium occurs where the aggregate demand curve,  $AD$ , intersects the short-run aggregate supply curve,  $SAS_0$ . As the figure shows, the short-run equilibrium real GDP is \$350 billion, and the short-run equilibrium price level is 110.
- c) Long-run equilibrium real GDP equals potential GDP. So the long-run equilibrium real GDP in Yellowland is \$300 billion.
- d) Yellowland's short-run macroeconomic equilibrium is an above full-employment equilibrium because the short-run equilibrium GDP exceeds potential GDP. The amount by which real GDP exceeds potential GDP is an inflationary gap. So the inflationary gap is \$50 billion. A recessionary gap exists when real GDP is below potential GDP. So there is no recessionary gap in Yellowland.
- e) As the figure above shows, the short-run aggregate supply curve shifts from  $SAS_0$  to  $SAS_1$ . As a result, real GDP decreases from \$350 billion to \$300 billion, and the price level rises from 110 to 120.
- f) Yellowland's new short-run macroeconomic equilibrium is a full-employment equilibrium because the equilibrium real GDP equals the potential GDP. When real GDP equals potential GDP, there is neither a recessionary gap nor an inflationary gap.

Topic: *Inflationary Gap*

Skill: *Analytical*

Question history: *Previous edition, Chapter 10*

AACSB: *Analytical Skills*

# Chapter 11

## Expenditure Multipliers: The Keynesian Model

### 1 Fixed Prices and Expenditure Plans

- 1) In the Keynesian model of aggregate expenditure, real GDP is determined by the
- A) price level.
  - B) level of aggregate demand.
  - C) level of aggregate supply.
  - D) level of taxes.

Answer: B

Topic: Keynesian Model

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 2) The Keynesian model of aggregate expenditure describes the economy in
- A) the short run.
  - B) the long run.
  - C) both the short run and the long run.
  - D) only a strong expansion.

Answer: A

Topic: Keynesian Model

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 3) The Keynesian model of aggregate expenditure assumes that
- A) individual firms' prices are flexible but the price level is fixed.
  - B) both individual firms' prices and the price level are flexible.
  - C) both individual firms' prices and the price level are fixed.
  - D) individual firms' prices are fixed but the price level is flexible.

Answer: C

Topic: Keynesian Model

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 4) In the Keynesian model of aggregate expenditure, we assume that firms will
- A) not change prices.
  - B) change prices only when inventory levels rise.
  - C) raise prices when inventory levels fall.
  - D) lower prices when inventory levels rise.

Answer: A

Topic: Keynesian Model

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 5) According to the Keynesian theory, the typical firm
- A) changes its prices frequently in response to fluctuations in aggregate demand.
  - B) lowers its prices when inventories are decreasing.
  - C) does not change its prices immediately when aggregate demand fluctuates.
  - D) lowers its prices if sales exceed production.

Answer: C

Topic: *Aggregate Implications of Fixed Prices*

Skill: *Recognition*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 6) If firms set prices and then keep them fixed for a period of time, their fixed prices imply that
- A) the aggregate price level is fixed and that aggregate demand determines the quantity of goods and services sold.
  - B) prices are set by aggregate demand and supply.
  - C) the aggregate price level adjusts continuously.
  - D) the aggregate price level is fixed and that aggregate supply determines the quantity of goods and services sold.

Answer: A

Topic: *Aggregate Implications of Fixed Prices*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 7) In the very short term, in the Keynesian model, which of the following is fixed and does not change when GDP changes?
- A) planned investment
  - B) planned consumption
  - C) planned imports
  - D) All of the above answers are correct

Answer: A

Topic: *Expenditure Plans*

Skill: *Recognition*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 8) In the very short term, planned investment \_\_\_\_\_ when GDP changes and planned consumption expenditure \_\_\_\_\_ when GDP changes.
- A) changes; changes.
  - B) changes; does not change
  - C) does not change; changes
  - D) does not change; does not change

Answer: C

Topic: *Expenditure Plans*

Skill: *Recognition*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

9) The components of aggregate expenditure include

- I. imports.
  - II. consumption.
  - III. government transfer payments.
- A) I and II
  - B) II only
  - C) II and III
  - D) I, II and III

Answer: A

Topic: Expenditure Plans

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

10) In the very short run, the components of aggregate planned expenditure that depend on the level of real GDP are

- A) planned consumption expenditure and planned imports.
- B) planned investment and planned imports.
- C) planned investment and planned exports.
- D) planned government expenditure on goods and services and planned imports.

Answer: A

Topic: Expenditure Plans

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

11) An increase in real GDP leads to

- A) a decrease aggregate planned expenditure.
- B) no change in aggregate planned expenditure.
- C) an increase in aggregate planned expenditure.
- D) a change in aggregate planned expenditure but whether the change is an increase or a decrease depends on whether nominal GDP increases or decreases.

Answer: C

Topic: Expenditure Plans

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

12) Disposable income is

- A) income minus saving.
- B) income minus taxes plus transfer payments.
- C) income plus transfer payments minus consumption expenditure.
- D) total income divided by the price level.

Answer: B

Topic: Consumption Function Basics

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 13) Which of the following statements is FALSE?
- A) Disposable income - saving = consumption expenditure.
  - B) Consumption expenditure + saving = disposable income.
  - C) Saving = disposable income - consumption expenditure.
  - D) Consumption expenditure = saving - disposable income.

Answer: D

Topic: Consumption Function Basics

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 14) Disposable income is equal to
- A) consumption expenditure minus taxes plus transfer payments.
  - B) aggregate income minus taxes plus government expenditures on goods and services.
  - C) aggregate income minus taxes plus transfer payments.
  - D) aggregate income plus transfer payments.

Answer: C

Topic: Consumption Function Basics

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 15) Real GDP
- A) is always greater than aggregate income.
  - B) is always less than aggregate income.
  - C) might be less than or more than aggregate income depending on consumption.
  - D) is equal to aggregate income.

Answer: D

Topic: Consumption Function Basics

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 16) Disposable income is divided into
- A) consumption and taxes.
  - B) saving and taxes.
  - C) consumption, saving, and taxes.
  - D) consumption and saving.

Answer: D

Topic: Consumption Function Basics

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

17) Saving equals

- A) disposable income minus taxes.
- B) disposable income minus consumption expenditure.
- C) disposable income plus consumption expenditure.
- D) consumption expenditure minus disposable income.

Answer: B

*Topic: Consumption Function Basics*

*Skill: Recognition*

*Question history: Previous edition, Chapter 11*

*AACSB: Reflective Thinking*

18) A consumption function shows a

- A) negative (inverse) relationship between consumption expenditure and saving.
- B) positive (direct) relationship between consumption expenditure and price level.
- C) negative (inverse) relationship between consumption expenditure and disposable income.
- D) positive (direct) relationship between consumption expenditure and disposable income.

Answer: D

*Topic: Consumption Function*

*Skill: Recognition*

*Question history: Previous edition, Chapter 11*

*AACSB: Reflective Thinking*

19) The consumption function relates consumption expenditure to

- A) the interest rate.
- B) disposable income.
- C) saving.
- D) the price level.

Answer: B

*Topic: Consumption Function*

*Skill: Recognition*

*Question history: Previous edition, Chapter 11*

*AACSB: Reflective Thinking*

20) The consumption function relates the consumption expenditure decisions of households to

- A) the level of disposable income.
- B) investment decisions of firms.
- C) saving decisions of households.
- D) the nominal interest rate.

Answer: A

*Topic: Consumption Function*

*Skill: Recognition*

*Question history: Previous edition, Chapter 11*

*AACSB: Reflective Thinking*

- 21) The graph of the consumption function has consumption expenditure on the vertical axis and
- A) the interest rate on the horizontal axis.
  - B) time on the horizontal axis.
  - C) disposable income on the horizontal axis.
  - D) the Consumer Price Index on the horizontal axis.

Answer: C

Topic: *Consumption Function*

Skill: *Recognition*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 22) The consumption function shows how much
- A) all households plan to consume at each level of real disposable income.
  - B) all households plan to consume at each possible real interest rate.
  - C) real disposable income people will earn at each income tax bracket.
  - D) all households plan to consume at each level of savings.

Answer: A

Topic: *Consumption Function*

Skill: *Recognition*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 23) The slope of the consumption function is
- A) less than 1.
  - B) 1.
  - C) greater than 1.
  - D) negative.

Answer: A

Topic: *Consumption Function*

Skill: *Recognition*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 24) The slope of the consumption function is
- A) less than the slope of the 45-degree line but not equal to zero.
  - B) greater than the slope of the 45-degree line.
  - C) equal to the slope of the 45-degree line.
  - D) equal to zero.

Answer: A

Topic: *Consumption Function and the 45-Degree Line*

Skill: *Recognition*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*



- 25) A movement along the consumption function is the result of changes in
- A) the real interest rate.
  - B) disposable income.
  - C) expected future income.
  - D) All of the above answers are correct.

Answer: B

Topic: Consumption Function

Skill: Conceptual

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 26) There is a movement along the consumption function if there is \_\_\_\_\_.
- A) an increase in autonomous consumption
  - B) a decrease in the real interest rate
  - C) an increase in the expected future income
  - D) an increase in disposable income

Answer: D

Topic: Consumption Function

Skill: Conceptual

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 27) A movement along the consumption function to higher levels of consumption expenditure arises because
- A) the level of disposable income decreases.
  - B) household wealth rises.
  - C) the level of disposable income increases.
  - D) the level of desired saving rises.

Answer: C

Topic: Consumption Function

Skill: Conceptual

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 28) If disposable income increases,
- A) the consumption function shifts upward.
  - B) there is a movement upward along the consumption function.
  - C) the consumption function shifts downward.
  - D) there is movement downward along the consumption function.

Answer: B

Topic: Consumption Function

Skill: Conceptual

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 29) The positive slope of the consumption function indicates that
- A) consumers spend less out of each extra dollar of income.
  - B) the amount of household wealth is subject to change.
  - C) when prices fall consumers spend more.
  - D) consumers increase their total consumption expenditure when disposable income increases.

Answer: D

Topic: *Consumption Function*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 30) As disposable income increases, consumption expenditures
- A) increase by the same amount.
  - B) increase by a smaller amount.
  - C) increase by a larger amount.
  - D) remain constant.

Answer: B

Topic: *Consumption Function*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 31) If real disposable income increases by \$1500, consumption expenditures will
- A) stay constant.
  - B) decrease by less than \$1500.
  - C) increase by less than \$1500.
  - D) increase by more than \$1500.

Answer: C

Topic: *Consumption Function*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 32) Which of the following will NOT shift the consumption function upward?
- A) an increase in disposable income
  - B) a fall in the real interest rate
  - C) an increase in wealth
  - D) None of the above shift the consumption function upward.

Answer: A

Topic: *Consumption Function*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 33) An increase in expected future income \_\_\_\_\_.
- A) decreases consumption expenditure
  - B) increases saving
  - C) shifts the consumption function upward
  - D) shifts the saving function upward

Answer: C

Topic: Consumption Function

Skill: Conceptual

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 34) Autonomous consumption is that portion of consumption expenditure that is not influenced by
- A) income.
  - B) preferences.
  - C) prices.
  - D) the legal authorities.

Answer: A

Topic: Autonomous Consumption

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 35) Autonomous consumption
- A) increases with income.
  - B) is independent of income.
  - C) is independent of income and must be equal to zero.
  - D) decreases with income.

Answer: B

Topic: Autonomous Consumption

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 36) \_\_\_\_\_ consumption is consumption that will occur \_\_\_\_\_ the level of GDP and disposable income.
- A) Autonomous; independent of
  - B) Autonomous; depending on
  - C) Induced; independent of
  - D) None of the above answers is correct.

Answer: A

Topic: Autonomous Consumption

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 37) Autonomous consumption is equal to
- A) saving when consumption equals disposable income.
  - B) consumption when disposable income is zero.
  - C) consumption caused by an increase in disposable income.
  - D) dissaving when disposable income is greater than zero.

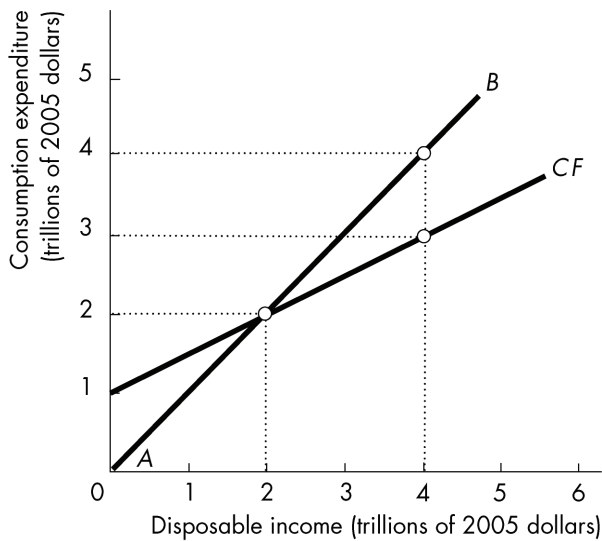
Answer: B

Topic: Autonomous Consumption

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking



- 38) In the above figure, consumption and disposable income are equal at
- A) any point along the consumption function.
  - B) a saving level of \$1 trillion and disposable income level of \$4 trillion.
  - C) a disposable income level of \$0.
  - D) a disposable income level of \$2 trillion.

Answer: D

Topic: Consumption Function

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

- 39) In the above figure, at a disposable income level of \$2 trillion, saving equals
- A) disposable income.
  - B) zero.
  - C) \$4 trillion.
  - D) consumption expenditures.

Answer: B

Topic: Saving Function

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

- 40) In the above figure, the line AB is called
- A) the saving function.
  - B) the consumption function.
  - C) the 45-degree line.
  - D) the expenditure function.

Answer: C

Topic: Consumption Function and the 45-Degree Line

Skill: Analytical

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

- 41) Induced consumption is equal to
- A) saving when consumption equals disposable income.
  - B) consumption when disposable income is zero.
  - C) consumption caused by an increase in disposable income.
  - D) dissaving when disposable income is greater than zero.

Answer: C

Topic: Induced Consumption

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 42) In a diagram with the consumption function, the 45-degree line indicates all points where
- A) consumption expenditures and saving are equal.
  - B) saving and investment are equal.
  - C) consumption expenditures and disposable income are equal.
  - D) saving and disposable income are equal.

Answer: C

Topic: Consumption Function and the 45-Degree Line

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 43) In a diagram with the consumption function, the \_\_\_\_\_ shows all points where disposable income equals consumption expenditures.
- A) consumption function
  - B) aggregate demand curve
  - C) 45-degree line
  - D) saving function

Answer: C

Topic: *Consumption Function and the 45-Degree Line*

Skill: *Recognition*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 44) Consumption expenditures equal disposable income
- A) at every point on the consumption function.
  - B) at every point on the saving function.
  - C) at every point on the 45-degree line.
  - D) when saving equals disposable income.

Answer: C

Topic: *Consumption Function and the 45-Degree Line*

Skill: *Recognition*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 45) With consumption expenditure on the vertical axis and disposable income on the horizontal axis, the consumption function intersects the 45-degree line at \$8 trillion. This result indicates that
- A) autonomous consumption spending is \$8 trillion.
  - B) consumption spending is \$8 trillion when disposable income is \$8 trillion.
  - C) consumption spending is less than \$8 trillion because taxes must be paid.
  - D) consumption spending is more than \$8 trillion because taxes have been paid.

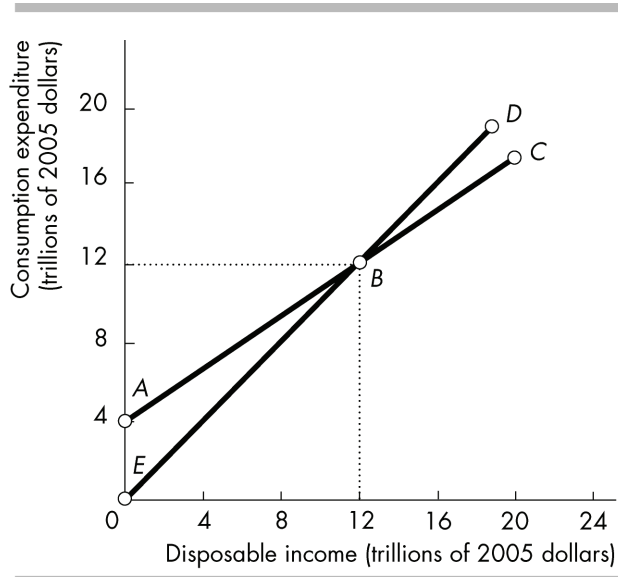
Answer: B

Topic: *Consumption Function and the 45-Degree Line*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*



46) In the above figure, line  $ABC$  is called

- A) the 45-degree line.
- B) the consumption function.
- C) the saving function.
- D) aggregate supply.

Answer: B

Topic: Consumption Function

Skill: Analytical

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

47) In the above figure, autonomous consumption equals

- A) 0.
- B) \$4 trillion.
- C) \$12 trillion.
- D) -\$4 trillion.

Answer: B

Topic: Autonomous Consumption

Skill: Analytical

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

- 48) When disposable income equals \$800 billion, planned consumption expenditure equals \$600 billion, and when disposable income equals \$1,000 billion, planned consumption expenditure equals \$640 billion. What is planned saving when disposable income is \$800 billion?
- A) \$200 billion
  - B) \$360 billion
  - C) \$560 billion
  - D) \$1,400 billion

Answer: A

Topic: *Consumption and Saving*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 49) As real disposable income increases, consumption expenditure \_\_\_\_\_ and saving \_\_\_\_\_.
- A) increases; increases
  - B) increases; decreases
  - C) decreases; increases
  - D) decreases; decreases

Answer: A

Topic: *Consumption Function and Saving Function*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 50) Planned saving equals
- A) disposable income minus planned consumption expenditure.
  - B) planned consumption expenditure minus disposable income.
  - C) zero when disposable income is less than planned consumption expenditure.
  - D) planned consumption expenditure plus disposable income.

Answer: A

Topic: *Saving Function*

Skill: *Recognition*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 51) "Dissaving" occurs when
- A) income exceeds consumption expenditure.
  - B) saving is negative.
  - C) the consumption function is below the 45-degree line drawn from the origin.
  - D) saving is positive.

Answer: B

Topic: *Saving Function*

Skill: *Recognition*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*



52) Dissaving

- A) is equal to consumption expenditure when disposable income is greater than zero.
- B) is equal to the amount of saving when consumption is less than disposable income.
- C) is equal to taxation when disposable income is zero.
- D) occurs when consumption is greater than disposable income.

Answer: D

Topic: Saving Function

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

53) \_\_\_\_\_ consumption expenditure is greater than disposable income.

- A) It is always the case that
- B) Saving is positive whenever
- C) Dissaving occurs whenever
- D) None of the above answers is correct because it is impossible for consumption expenditure to be greater than disposable income.

Answer: C

Topic: Saving Function

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

54) When disposable income equals consumption expenditure, then

- A) saving is zero.
- B) the  $MPC = \text{zero}$ .
- C) the  $MPS = \text{zero}$ .
- D) None of the above is correct.

Answer: A

Topic: Saving Function

Skill: Conceptual

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

55) Where the consumption function crosses the  $45^\circ$  line

- A) consumption expenditure equals saving.
- B) saving is positive.
- C) saving is negative.
- D) consumption expenditure equals disposable income.

Answer: D

Topic: Saving Function

Skill: Conceptual

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 56) When the consumption function lies above the 45-degree line, households
- A) spend on consumption an increasing percentage of any increase in income.
  - B) spend on consumption a decreasing percentage of any increase in income.
  - C) are dissaving.
  - D) save all of any increase in income.

Answer: C

Topic: *Saving Function*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 57) If the consumption function lies below the 45-degree line, then saving at these levels of disposable income will
- A) be positive.
  - B) be negative.
  - C) equal zero.
  - D) be some amount that cannot be determined without additional information.

Answer: A

Topic: *Saving Function*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 58) The vertical distance between the 45-degree line and the consumption line represents
- A) investment.
  - B) total consumption expenditure.
  - C) the difference between consumption expenditure and investment.
  - D) saving or dissaving.

Answer: D

Topic: *Saving Function*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 59) Saving rather than dissaving occurs at any level of disposable income at which
- A) the consumption function is above the 45-degree line.
  - B) the consumption function intersects the saving/income curve.
  - C) the consumption function is below the 45-degree line.
  - D) autonomous consumption is positive.

Answer: C

Topic: *Saving Function*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 60) The saving function shows a \_\_\_\_\_ relationship between \_\_\_\_\_.
- A) positive; disposable income and saving
  - B) positive; disposable income and dissaving
  - C) negative; disposable income and consumption expenditure
  - D) negative; real GDP and saving

Answer: A

Topic: *Saving Function*

Skill: *Recognition*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 61) An increase in disposable income
- A) shifts the saving function upward.
  - B) results in a movement upward along the saving function.
  - C) shifts the saving function downward.
  - D) results in a movement downward along the saving function.

Answer: B

Topic: *Saving Function*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 62) A movement along the saving function occurs when
- A) the real interest rate rises.
  - B) wealth increases.
  - C) disposable income decreases.
  - D) None of the above answers is correct.

Answer: C

Topic: *The Saving Function*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 63) As disposable income increases, there is a \_\_\_\_\_ the saving function.
- A) leftward shift of the
  - B) movement along
  - C) rightward shift of
  - D) change in the slope of

Answer: B

Topic: *Saving Function*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 64) At a level of disposable income of \$0, consumption expenditure is \$3500. Therefore when disposable income is \$0,
- A) saving and dissaving equal \$0.
  - B) saving equals -\$3500.
  - C) saving equals \$3500.
  - D) the  $MPC = \text{zero}$ .

Answer: B

Topic: *Saving Function*

Skill: *Analytical*

Question history: *Modified 10th edition*

AACSB: *Analytical Skills*

- 65) When disposable income is 0, consumption is \$2000. Then
- A) saving = \$0.
  - B) saving = -\$2000.
  - C) saving = \$2000.
  - D) the  $MPC = 0.2$ .

Answer: B

Topic: *Saving Function*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 66) An increase in disposable income shifts
- A) both the consumption and savings functions upward.
  - B) the consumption function upward and leads to a movement along the savings function.
  - C) both the consumption and savings functions downward.
  - D) neither the consumption function or the savings function because it leads to a movement along both the consumption and savings function.

Answer: D

Topic: *The Consumption Function and the Saving Function*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 67) What is the marginal propensity to consume?
- A) the change in consumption expenditure divided by the change in disposable income.
  - B) the percentage of disposable income that is consumed.
  - C) one minus the fraction of total disposable income that is saved.
  - D) the percentage of total income that is consumed.

Answer: A

Topic: *Marginal Propensity to Consume*

Skill: *Recognition*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

- 68) The marginal propensity to consume refers to
- A) the additional saving that occurs out of an additional dollar of disposable income.
  - B) the additional consumption expenditure that occurs out of an additional dollar of disposable income.
  - C) the additional consumption expenditure that occurs out of an additional dollar of investment.
  - D) total consumption expenditure divided by total disposable income.

Answer: B

Topic: *Marginal Propensity to Consume*

Skill: *Recognition*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 69) The marginal propensity to consume is the
- A) fraction of a change in disposable income spent on consumption expenditure.
  - B) amount saving increases when consumption expenditure decreases.
  - C) fraction of a change in saving spent on consumption expenditure.
  - D) fraction of a change in consumption expenditure that is not saved.

Answer: A

Topic: *Marginal Propensity to Consume*

Skill: *Recognition*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 70) The marginal propensity to consume is the \_\_\_\_\_.
- A) fraction of total disposable income consumed
  - B) fraction of GDP consumed
  - C) fraction of a change in disposable income that is consumed.
  - D) total amount of disposable income consumed

Answer: C

Topic: *Marginal Propensity to Consume*

Skill: *Recognition*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 71) The MPC is the fraction of
- A) total disposable income that is consumed.
  - B) total disposable income that is not consumed.
  - C) a change in disposable income that is consumed.
  - D) a change in disposable income that is saved.

Answer: C

Topic: *Marginal Propensity to Consume*

Skill: *Recognition*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 72) The marginal propensity to consume is equal to
- A) what people spend out of total disposable income.
  - B) the desired amount of consumption expenditure as a proportion of disposable income.
  - C) the average, after-tax consumption amount.
  - D) the change in consumption expenditure from a change in disposable income.

Answer: D

Topic: *Marginal Propensity to Consume*

Skill: *Recognition*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

- 73) The marginal propensity to consume measures
- A) how much of a given level of disposable income is consumed.
  - B) what percentage of disposable income goes to saving.
  - C) how much consumption expenditure occurs at the equilibrium level of income.
  - D) the fraction of a change in disposable income that is spent on consumption expenditure.

Answer: D

Topic: *Marginal Propensity to Consume*

Skill: *Recognition*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 74) The marginal propensity to consume is
- A) total consumption expenditure divided by the change in disposable income.
  - B) the change in consumption expenditure divided by total disposable income.
  - C) the change in consumption expenditure divided by the change in disposable income.
  - D) the change in consumption expenditure divided by total saving.

Answer: C

Topic: *Marginal Propensity to Consume*

Skill: *Recognition*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 75) The marginal propensity to consume is found by
- A) dividing consumption expenditure by disposable income.
  - B) dividing disposable income by consumption expenditure.
  - C) dividing the change in disposable income by the change in consumption expenditure.
  - D) dividing the change in consumption expenditure by the change in disposable income.

Answer: D

Topic: *Marginal Propensity to Consume*

Skill: *Recognition*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

76) The MPC is equal to

- A)  $\Delta C / \Delta S$ .
- B)  $\Delta S / \Delta C$ .
- C)  $\Delta C / \Delta YD$ .
- D)  $\Delta S / \Delta YD$ .

Answer: C

Topic: Marginal Propensity to Consume

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

77) The value of the marginal propensity to consume is

- A) between 0 and 1.
- B) between 1 and 10.
- C) between -1 and +1.
- D) between 1 percent and 10 percent.

Answer: A

Topic: Marginal Propensity to Consume

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

78) The marginal propensity to consume is

- A) the slope of the savings function.
- B) never greater than 1.
- C) the percentage or fraction of income that is consumed.
- D) the percentage change in disposable income.

Answer: B

Topic: Marginal Propensity to Consume

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

79) The size of the marginal propensity to consume

- A) is negative if dissaving is present.
- B) is between 0 and 1.
- C) equals 1.
- D) exceeds 1.

Answer: B

Topic: Marginal Propensity to Consume

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 80) If consumption expenditures for a household increase from \$1000 to \$1800 when disposable income rises from \$1000 to \$2000, the marginal propensity to consume is
- A) 0.8.
  - B) 0.18.
  - C) 0.3.
  - D) 0.2.

Answer: A

Topic: *Marginal Propensity to Consume*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 81) If the marginal propensity to consume is 0.8, every \$10 increase in disposable income increases
- A) consumption expenditure by \$0.80.
  - B) consumption expenditure by \$18.00.
  - C) saving by \$0.20.
  - D) consumption expenditure by \$8.00.

Answer: D

Topic: *Marginal Propensity to Consume*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 82) Suppose disposable income increases from \$7 trillion to \$8 trillion. At the same time, consumption expenditure increases from \$6.8 trillion to \_\_\_\_\_. Thus the MPC must equal \_\_\_\_\_.
- A) \$7.8 trillion; 0.80
  - B) \$7.6 trillion; 0.80
  - C) \$7.4 trillion; 0.40
  - D) \$8 trillion; 1.00

Answer: B

Topic: *Marginal Propensity to Consume*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 83) When disposable income increases from \$6 trillion to \$6.5 trillion, consumption expenditure increase from \$5.5 trillion to \$5.9 trillion. The MPC equals
- A) 0.75.
  - B) 0.76.
  - C) 0.8.
  - D) 0.2.

Answer: C

Topic: *Marginal Propensity to Consume*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*



- 84) Suppose disposable income increases from \$5 trillion to \$6 trillion. As a result, consumption expenditure increases from \$4 trillion to \_\_\_\_\_. This result means the *MPC* equals \_\_\_\_\_.
- A) \$4.5 trillion; 4.50
  - B) \$5 trillion; 0.80
  - C) \$4.8 trillion; 0.80
  - D) \$6 trillion; 1.00

Answer: C

Topic: *Marginal Propensity to Consume*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 85) The marginal propensity to save is
- A) total saving divided by total disposable income.
  - B) total saving divided by the change in disposable income.
  - C) the change in saving divided by the change in consumption expenditure.
  - D) the change in saving divided by the change in disposable income.

Answer: D

Topic: *Marginal Propensity to Save*

Skill: *Recognition*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 86) The size of the marginal propensity to save
- A) is negative if dissaving is present.
  - B) is between 0 and 1.
  - C) equals 1.
  - D) exceeds 1.

Answer: B

Topic: *Marginal Propensity to Save*

Skill: *Recognition*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

- 87) The *MPS* equals the ratio of
- A) saving to real GDP.
  - B) the change in saving to the change in consumption expenditure.
  - C) saving to consumption expenditure.
  - D) None of the above answers is correct.

Answer: D

Topic: *Marginal Propensity to Save*

Skill: *Recognition*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 88) The marginal propensity to save equals the
- A) change in savings resulting from a one dollar change in disposable income.
  - B) change in savings from a change in consumption expenditure.
  - C) average amount of income saved.
  - D) ability to save the same percentage of income each month.

Answer: A

Topic: *Marginal Propensity to Save*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 89) When disposable income increases from \$7 trillion to \$7.5 trillion, consumption expenditure increase from \$6.5 trillion to \$6.9 trillion. The *MPS* is equal to
- A) 0.75.
  - B) 0.76.
  - C) 0.8.
  - D) 0.2.

Answer: D

Topic: *Marginal Propensity to Save*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 90) When disposable income equals \$800 billion, planned consumption expenditure equals \$600 billion, and when disposable income equals \$1,000 billion, planned consumption expenditure equals \$760 billion. What is the marginal propensity to save?
- A) 0.80
  - B) 0.64
  - C) 0.25
  - D) 0.20

Answer: D

Topic: *Marginal Propensity to Save*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 91) Suppose real GDP increases from \$13 trillion to \$14 trillion. As a result, consumption expenditure increases from \$13 trillion to \$13.75 trillion. This result implies the *MPS* equals
- A) 0.75.
  - B) 0.25.
  - C) 0.
  - D) some amount that cannot be determined without more information.

Answer: B

Topic: *Marginal Propensity to Save*

Skill: *Analytical*

Question history: *Modified 10th edition*

AACSB: *Analytical Skills*

- 92) The *MPC* and *MPS* measure changes in consumption expenditure and saving that result from changes in
- A) expected inflation.
  - B) disposable income.
  - C) expected future income.
  - D) government expenditures on goods and services.

Answer: B

Topic: *Marginal Propensity to Consume & Marginal Propensity to Save*

Skill: *Recognition*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 93) Which of the following is true?

- A)  $MPS = MPC$
- B)  $MPS + MPC = 1$
- C)  $MPS + MPC = 0$
- D)  $MPS - MPC = 1$

Answer: B

Topic: *Marginal Propensity to Consume & Marginal Propensity to Save*

Skill: *Recognition*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 94) The *MPC* and *MPS*

- A) sum to 1.
- B) can sum to anything greater than 0.
- C) sum to 100.
- D) each are usually less than .5.

Answer: A

Topic: *Marginal Propensity to Consume & Marginal Propensity to Save*

Skill: *Recognition*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 95) If the marginal propensity to save is 0.6, then the marginal propensity to consume is

- A) 0.6.
- B) 0.4.
- C) 1.0.
- D) not determinable.

Answer: B

Topic: *Marginal Propensity to Consume & Marginal Propensity to Save*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 96) For a household, the marginal propensity to save plus the marginal propensity to consume
- A) equals 1.
  - B) equals 0.
  - C) equals a number that is larger the larger the household's disposable income.
  - D) equals a number that is smaller the larger the household's disposable income.

Answer: A

Topic: *Marginal Propensity to Consume & Marginal Propensity to Save*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 97)  $1 - MPC$  equals
- A) autonomous consumption.
  - B) the marginal propensity to save.
  - C) induced consumption.
  - D) the net national product.

Answer: B

Topic: *Marginal Propensity to Consume & Marginal Propensity to Save*

Skill: *Recognition*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 98) If the  $MPC$  equals 0.75, then
- A) for every \$100 increase in consumption expenditure, disposable income increases by \$75.
  - B) consumption expenditure is always more than disposable income.
  - C) for every \$100 increase in disposable income, saving increases by \$75.
  - D) for every \$100 increase in disposable income, saving increases by \$25.

Answer: D

Topic: *Marginal Propensity to Consume & Marginal Propensity to Save*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

Disposable income (thousands of dollars)	Consumption expenditure (thousands of dollars)
200	225
300	300
400	375
500	450

- 99) According to the data in the above table, at what level of disposable income is savings negative?
- A) 200
  - B) 300
  - C) 400
  - D) Never because saving cannot be negative.

Answer: A

Topic: *The Consumption Function and the Saving Function*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 100) According to the data in the above table, what is the marginal propensity to consume?
- A) 75.
  - B) 100.
  - C) 0.75.
  - D) 1.

Answer: C

Topic: *Marginal Propensity to Consume*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

Disposable income (dollars)	Consumption expenditure (dollars)
0	100
100	180
300	340
500	500
700	660
900	820

- 101) In the above table, savings are positive when disposable income is greater than
- A) zero.
  - B) \$100.
  - C) \$300.
  - D) \$500.

Answer: D

Topic: *Saving Function*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 102) In the above table, savings equal zero when disposable income equals
- A) 0.
  - B) \$200.
  - C) \$300.
  - D) \$500.

Answer: D

Topic: *Saving Function*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 103) In the above table, the marginal propensity to consume equals
- A) 0.90.
  - B) 0.75.
  - C) 0.80.
  - D) 0.85.

Answer: C

Topic: *Marginal Propensity to Consume*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

Disposable income (billions of dollars)	Consumption expenditure (billions of dollars)
400	450
600	600
800	750
1000	900
1200	1050

104) Based upon the above table, if disposable income is \$400 billion, saving equals

- A) -\$50 billion.
- B) \$0 billion.
- C) \$50 billion.
- D) \$100 billion.

Answer: A

Topic: Saving Function

Skill: Analytical

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

105) Based upon the above table, saving equals \$100 billion when disposable income equals

- A) \$800 billion.
- B) \$1000 billion.
- C) \$1200 billion.
- D) some amount but we need more information to calculate the amount.

Answer: B

Topic: Saving Function

Skill: Analytical

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

106) Based upon the above table, the MPC for the consumption function is

- A) increasing as income rises.
- B) equal to 1.0 at \$600 billion.
- C) constant at 0.75.
- D) constant at 0.25.

Answer: C

Topic: Marginal Propensity to Consume

Skill: Analytical

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

Disposable income (dollars)	Consumption expenditure (dollars)
100	225
200	300
300	375
400	450
500	525
600	600

- 107) Using the above table, if disposable income is \$400, saving is
- A) -\$50.
  - B) \$0.
  - C) \$50.
  - D) \$100.

Answer: A

Topic: *Saving Function*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 108) Using the data in above table, the marginal propensity to consume is
- A) increasing as disposable income increases.
  - B) equal to 1.0 when disposable income equals \$600.
  - C) constant at 0.75.
  - D) constant at 0.25.

Answer: C

Topic: *Marginal Propensity to Consume*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 109) Using the data from the above table, the marginal propensity to save is
- A) falling as disposable income is rising.
  - B) 0 when disposable income is \$600.
  - C) constant at 0.25.
  - D) constant at 0.75.

Answer: C

Topic: *Marginal Propensity to Save*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*



- 110) The slope of the consumption function
- A) is positive and equals  $1 - MPC$ .
  - B) is negative.
  - C) equals the  $MPC$ .
  - D) is undefined below the 45-degree line.

Answer: C

Topic: Slopes and Marginal Propensities

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 111) The slope of the consumption function is
- A) perfectly horizontal at the equilibrium level.
  - B) equal to 1.
  - C) equal to the  $MPC$ .
  - D) vertical at the full employment level of income.

Answer: C

Topic: Slopes and Marginal Propensities

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 112) When the consumption function becomes steeper,
- A) less of every dollar is consumed.
  - B) the saving function also become steeper.
  - C) the  $MPC$  rises.
  - D) the  $MPC$  falls.

Answer: C

Topic: Slopes and Marginal Propensities

Skill: Conceptual

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 113) Which of the following concerning the marginal propensity to consume and the consumption function is true?
- I. The larger the marginal propensity to consume, the greater the amount of autonomous consumption.
  - II. The larger the marginal propensity to consume, the steeper the consumption function.
- A) I is true.
  - B) II is true.
  - C) I and II are true.
  - D) Neither I nor II is true.

Answer: B

Topic: Slopes and Marginal Propensities

Skill: Conceptual

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 114) If an increase in a household's disposable income from \$10,000 to \$12,000 boosts its consumption expenditure from \$8,000 to \$9,000, the
- A) household is dissaving.
  - B) slope of the consumption function is 0.2
  - C) slope of the consumption function is 0.5
  - D) slope of the consumption function is 1000.

Answer: C

Topic: Slopes and Marginal Propensities

Skill: Analytical

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

- 115) The marginal propensity to save is \_\_\_\_\_.
- A) always greater than the marginal propensity to consume
  - B) equal to the slope of the saving function
  - C) equal to 1 plus the slope of the consumption function
  - D) equal to the inverse of the marginal propensity to consume

Answer: B

Topic: Slopes and Marginal Propensities

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 116) The marginal propensity to save (MPS) is equal to the
- A) slope of the savings function.
  - B) slope of the 45 degree.
  - C) reciprocal value of the MPC.
  - D) difference between consumption and income.

Answer: A

Topic: Slopes and Marginal Propensities

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 117) The slope of the saving function is equal to
- A) the MPS.
  - B) the MPC.
  - C)  $1 - MPS$ .
  - D) None of the above answers is correct.

Answer: A

Topic: Slopes and Marginal Propensities

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 118) If the slope of the saving function is 0.27, then the marginal propensity to \_\_\_\_\_.
- A) import is less than 0.27
  - B) save is 0.73
  - C) consume is 0.73
  - D) consume is 0.27

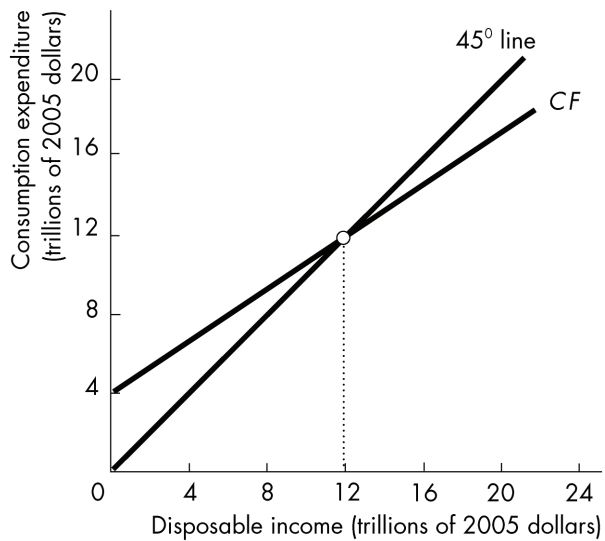
Answer: C

Topic: Slopes and Marginal Propensities

Skill: Conceptual

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills



- 119) In the figure above, autonomous consumption is
- A) zero.
  - B) \$2 trillion.
  - C) \$4 trillion.
  - D) \$6 trillion.

Answer: C

Topic: Consumption Function

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

- 120) In the figure above, the induced consumption when real GDP is \$12 trillion is
- A) zero.
  - B) \$2 trillion.
  - C) \$8 trillion.
  - D) \$12 trillion.

Answer: C

Topic: *Consumption Function*

Skill: *Analytical*

Question history: *Modified 10th edition*

AACSB: *Analytical Skills*

- 121) In the figure above, negative saving occurs
- A) at all levels of disposable income.
  - B) when disposable income is \$8 trillion.
  - C) when disposable income is \$12 trillion.
  - D) when disposable income is \$16 trillion.

Answer: B

Topic: *Saving Function*

Skill: *Analytical*

Question history: *Modified 10th edition*

AACSB: *Analytical Skills*

- 122) In the figure above, the marginal propensity to consume is
- A) 3.00.
  - B) 1.00.
  - C) 0.67.
  - D) 0.25.

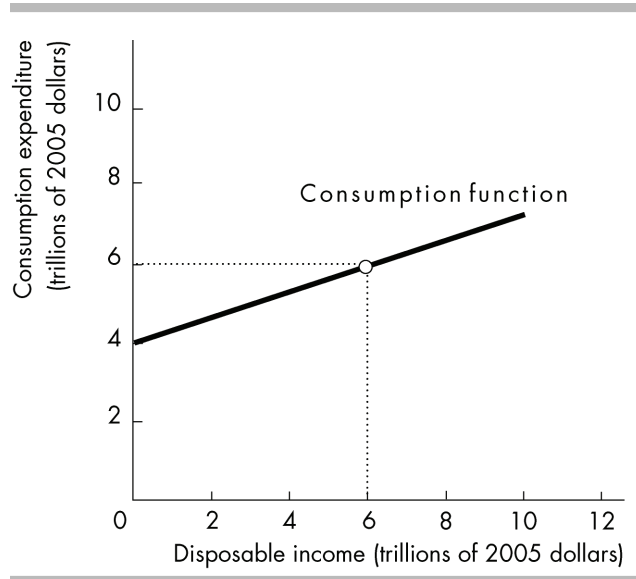
Answer: C

Topic: *Slopes and Marginal Propensities*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*



- 123) The figure above illustrates an economy's consumption function. What is the marginal propensity to consume in this economy?
- A) 0.67
  - B) 1.00
  - C) 0.75
  - D) 0.33

Answer: D

Topic: Slopes and Marginal Propensities

Skill: Analytical

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

- 124) The figure above illustrates an economy's consumption function. What is the marginal propensity to save in this economy?
- A) 0.67
  - B) 1.00
  - C) 0.75
  - D) 0.33

Answer: A

Topic: Slopes and Marginal Propensities

Skill: Analytical

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

- 125) The figure above illustrates an economy's consumption function. What is autonomous consumption in this economy?
- A) \$0
  - B) \$4 trillion
  - C) \$6 trillion
  - D) None of the above answers is correct.

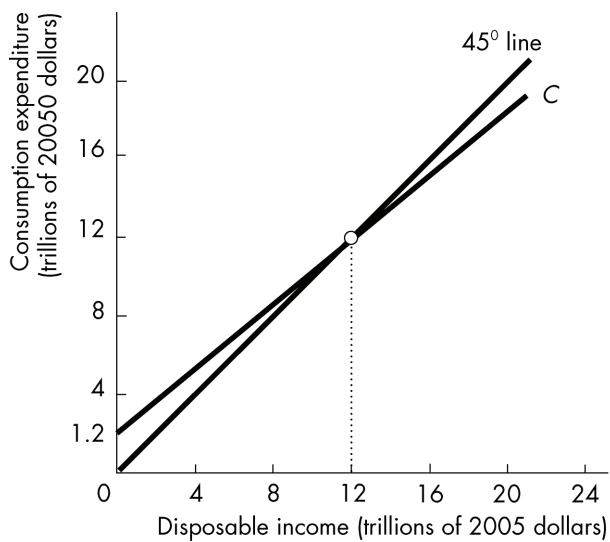
Answer: B

Topic: Consumption Function

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills



- 126) In the above figure, when disposable income is greater than \$12 trillion, then
- A) savings are negative.
  - B) the MPC is greater than 1.
  - C) savings are positive.
  - D) the MPS is negative.

Answer: C

Topic: Saving Function

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

- 127) In the above figure, the marginal propensity to consume equals
- A) 0.80.
  - B) 0.90.
  - C) 0.75.
  - D) 0.85.

Answer: B

Topic: Marginal Propensity to Consume

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

- 128) In the above figure, a change in autonomous consumption to \$4 trillion with no change to the MPC would cause the consumption function to
- A) become steeper.
  - B) become flatter.
  - C) shift downward.
  - D) shift upward.

Answer: D

Topic: Shifts in the Consumption Function

Skill: Analytical

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

- 129) In the short run, a factor that leads to changes in U.S. imports is
- A) the level of income in foreign nations.
  - B) the real interest rate.
  - C) U.S. real GDP.
  - D) U.S. exports.

Answer: C

Topic: Import Function

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 130) When U.S. real GDP increases, then quantity of U.S. imports
- A) decreases.
  - B) increases.
  - C) remains constant.
  - D) at first decreases and then increases.

Answer: B

Topic: Import Function

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 131) The marginal propensity to import reflects the relationship between changes in imports and changes in
- A) consumption expenditure.
  - B) investment spending.
  - C) exports.
  - D) real GDP.

Answer: D

Topic: *Import Function*

Skill: *Recognition*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

- 132) As globalization has increased, the trend in the U.S. marginal propensity to import has been for it to
- A) decrease to less than 0.8.
  - B) increase.
  - C) remain steady.
  - D) decrease to more than 0.8.

Answer: B

Topic: *Import Function*

Skill: *Recognition*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 133) The marginal propensity to import is the \_\_\_\_\_ that is spent on imports.
- A) fraction of an increase in real GDP
  - B) total amount of real GDP
  - C) total amount of potential GDP
  - D) fraction of an increase in potential GDP

Answer: A

Topic: *Marginal Propensity to Import*

Skill: *Recognition*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 134) The U.S. consumption function
- A) has shifted upward over time.
  - B) has a positive slope.
  - C) has a slope of about 0.9.
  - D) All of the above answers are correct.

Answer: D

Topic: *The U.S. Consumption Function*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*



- 135) Since 1970, U.S. consumption function has generally shifted \_\_\_\_\_ because of \_\_\_\_\_.
- A) upward; higher expected future income and rising wealth
  - B) upward; higher real interest rates
  - C) downward; higher real interest rates
  - D) downward; falling wealth

Answer: A

Topic: *The U.S. Consumption Function*

Skill: *Conceptual*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

- 136) Consumption expenditure decreases when \_\_\_\_\_ decreases.
- A) the interest rate
  - B) the price level
  - C) disposable income
  - D) saving

Answer: C

Topic: *Study Guide Question, Consumption Function*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 137) The slope of the saving function is equal to the
- A) marginal propensity to save.
  - B) marginal propensity to consume.
  - C) marginal propensity to consume divided by the marginal propensity to save.
  - D) marginal propensity to save divided by the marginal propensity to consume.

Answer: A

Topic: *Study Guide Question, Saving Function*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

## 2 Real GDP with a Fixed Price Level

- 1) Read the two statements below and indicate if they are true or false.
- I. Autonomous expenditures change when GDP changes.
  - II. Aggregate planned expenditure is the sum of planned consumption expenditure, investment, government expenditure, and net exports.
- A) I and II are both true.
  - B) I and II are both false.
  - C) I is true and II is false
  - D) I is false and II is true.

Answer: D

Topic: *Aggregate Planned Expenditure*

Skill: *Recognition*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

2) Aggregate expenditure equals

- A)  $C + I + G + X - M$ .
- B)  $G + X - M$ .
- C)  $C + I + G$ .
- D)  $C + I + G + X$ .

Answer: A

Topic: Aggregate Expenditure

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

3) The aggregate expenditure curve shows

- A) how consumption changes in response to a change in disposable income.
- B) how planned aggregate expenditure and real GDP are related.
- C) a negative relationship between the price level and real GDP.
- D) Both answers B and C are correct.

Answer: B

Topic: Aggregate Expenditure Curve

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

4) The graph of the aggregate expenditure curve has \_\_\_\_\_ on the  $y$ -axis and \_\_\_\_\_ on the  $x$ -axis.

- A) real GDP; aggregate planned expenditure
- B) aggregate actual expenditure; real GDP
- C) household expenditures; real GDP
- D) aggregate planned expenditure; real GDP

Answer: D

Topic: Aggregate Expenditure Curve

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

5) The slope of the aggregate expenditure curve equals the change in

- A) planned expenditure divided by the change in real GDP.
- B) autonomous expenditure divided by the change in real GDP.
- C) government expenditure divided by the change in real GDP.
- D) real GDP divided by the change in planned expenditure.

Answer: A

Topic: Aggregate Expenditure Curve

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

6) The slope of the aggregate expenditure curve is

- A) 0.
- B) greater than 0 and less than 1.
- C) 1.
- D) greater than 1.

Answer: B

Topic: Aggregate Expenditure Curve

Skill: Conceptual

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

7) One reason the aggregate expenditure curve slopes upward is because \_\_\_\_\_ increases when real GDP increases.

- A) investment
- B) consumption expenditure
- C) government expenditure on goods and services
- D) exports

Answer: B

Topic: Aggregate Expenditure Curve

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

8) The sum of the components of aggregate expenditure that vary with real GDP is called

- A) induced expenditures.
- B) the MPC.
- C) autonomous expenditures.
- D) autonomous consumption.

Answer: A

Topic: Induced Expenditures

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

9) Induced expenditure includes \_\_\_\_\_.

- A) induced consumption and government expenditure
- B) induced consumption expenditure and imports
- C) all autonomous expenditure
- D) induced consumption expenditure and exports

Answer: B

Topic: Induced Expenditures

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 10) Any expenditure component that depends on the level of real GDP is called
- A) spurious expenditure.
  - B) equilibrium expenditure.
  - C) induced expenditure.
  - D) autonomous expenditure.

Answer: C

Topic: *Induced Expenditures*

Skill: *Recognition*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 11) As a nation's GDP increases, that nation's
- A) autonomous consumption increases.
  - B) autonomous consumption decreases.
  - C) exports increase.
  - D) imports increase.

Answer: D

Topic: *Induced Expenditures*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 12) A change in imports caused by rising U.S. incomes is
- A) an increase in autonomous expenditure.
  - B) a decrease in autonomous expenditure.
  - C) an increase in induced exports.
  - D) a change in induced expenditure.

Answer: D

Topic: *Induced Expenditures*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 13) The part of aggregate planned expenditure that does not vary with real GDP \_\_\_\_\_.
- A) equals equilibrium expenditure
  - B) is autonomous expenditure
  - C) is induced expenditure
  - D) equals zero

Answer: B

Topic: *Autonomous Expenditures*

Skill: *Recognition*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 14) The sum of the components of aggregate expenditure that are not influenced by real GDP is called
- A) induced expenditures.
  - B) the MPC.
  - C) autonomous expenditures.
  - D) autonomous consumption.

Answer: C

Topic: Autonomous Expenditures

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 15) Autonomous expenditure is not influenced by
- A) the price level.
  - B) the interest rate.
  - C) real GDP.
  - D) any other variable.

Answer: C

Topic: Autonomous Expenditures

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 16) Expenditure that does NOT depend on real GDP is called
- A) spurious expenditure.
  - B) equilibrium expenditure.
  - C) induced expenditure.
  - D) autonomous expenditure.

Answer: D

Topic: Autonomous Expenditures

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 17) Autonomous expenditure refers to
- A) aggregate expenditure solely prompted by policy.
  - B) changes in short-run aggregate supply.
  - C) aggregate expenditure that does not change when real GDP changes.
  - D) aggregate expenditure that varies because of changes in real GDP.

Answer: C

Topic: Autonomous Expenditures

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 18) All else being constant, autonomous expenditure
- A) increases as real GDP increases.
  - B) increases as real GDP decreases.
  - C) does not change with changes in real GDP.
  - D) is assumed to be zero.

Answer: C

Topic: *Autonomous Expenditures*

Skill: *Recognition*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 19) An increase in U.S. exports because of increasing foreign incomes is \_\_\_\_\_ in the United States.
- A) an increase in autonomous expenditure
  - B) a decrease in autonomous expenditure
  - C) an increase in induced expenditure
  - D) a decrease in induced expenditure

Answer: A

Topic: *Autonomous Expenditures*

Skill: *Recognition*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 20) An increase in investment by U.S. firms that is intended to maintain U.S. competitiveness in world markets is \_\_\_\_\_ in the United States.
- A) an increase in autonomous expenditure
  - B) a decrease in autonomous expenditure
  - C) an increase in induced expenditure
  - D) a decrease in induced expenditure

Answer: A

Topic: *Autonomous Expenditures*

Skill: *Recognition*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 21) Which of the following is NOT an autonomous expenditure in the aggregate expenditures model?
- A) investment
  - B) government expenditures
  - C) imports
  - D) exports

Answer: C

Topic: *Autonomous Expenditures*

Skill: *Recognition*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 22) A decrease in autonomous consumption will
- A) shift the aggregate expenditure function downward.
  - B) decrease the marginal propensity to save.
  - C) decrease the marginal propensity to consume.
  - D) change the slope of the aggregate expenditure curve

Answer: A

Topic: Autonomous Expenditures

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 23) Aggregate planned expenditure
- A) always equals actual aggregate expenditure.
  - B) is always less than actual aggregate expenditure.
  - C) is always greater than actual aggregate expenditure.
  - D) equals actual aggregate expenditure at the equilibrium level of real GDP.

Answer: D

Topic: Actual Expenditures and Planned Expenditures

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 24) Actual aggregate expenditure is
- A) always equal to real GDP.
  - B) only equal to real GDP at the equilibrium level of aggregate planned expenditure.
  - C) never greater than real GDP but can be less than real GDP.
  - D) never less than real GDP but can be greater than real GDP.

Answer: A

Topic: Actual Expenditures and Planned Expenditures

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 25) When aggregate planned expenditure is less than real GDP, unplanned
- A) consumption expenditure occurs.
  - B) investment occurs.
  - C) government expenditures are made.
  - D) exports are made.

Answer: B

Topic: Actual Expenditures and Planned Expenditures

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 26) The difference between planned and unplanned spending is \_\_\_\_\_.
- A) always negative
  - B) inventories
  - C) unplanned changes in inventories
  - D) always positive

Answer: C

Topic: *Actual Expenditures and Planned Expenditures*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 27) When there is unplanned inventory investment, aggregate planned expenditure is \_\_\_\_\_ real GDP and actual investment is \_\_\_\_\_ planned investment.
- A) greater than; greater than
  - B) greater than; less than
  - C) less than; greater than
  - D) less than; less than

Answer: C

Topic: *Actual Expenditures and Planned Expenditures*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 28) If aggregate planned expenditure exceeds real GDP,
- A) firms are not maximizing their profits.
  - B) planned investment is greater than planned savings.
  - C) actual inventories decrease below their target.
  - D) planned consumption expenditure is less than actual consumption expenditure.

Answer: C

Topic: *Actual Expenditures and Planned Expenditures*

Skill: *Conceptual*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

- 29) If planned expenditures equal \$13 trillion when real GDP is \$13.5 trillion, then
- A) inventories will decrease by \$0.5 trillion.
  - B) actual investment will exceed planned investment.
  - C) there will be excess demand for most goods.
  - D) the economy must have a trade surplus to sell the excess goods and services.

Answer: B

Topic: *Actual Expenditures and Planned Expenditures*

Skill: *Conceptual*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*



- 30) Suppose that in 2013, firms discover that their inventories are falling below their planned levels. Which of the following statements is correct?
- A) The level of aggregate savings must equal the level of desired investment.
  - B) Even though firms are trying, they are unable to maximize profits.
  - C) Aggregate demand is less than aggregate supply.
  - D) Real GDP is less than equilibrium expenditure.

Answer: D

Topic: Actual Expenditures and Planned Expenditures

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 31) Actual expenditure might differ from planned expenditure because
- A) actual consumption expenditure differs from planned consumption expenditure.
  - B) actual investment differs from planned investment.
  - C) actual government expenditure differ from planned government expenditure.
  - D) actual net exports differ from planned net exports.

Answer: B

Topic: Actual Expenditures and Planned Expenditures

Skill: Conceptual

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 32) If real GDP is \$13 trillion and planned aggregate expenditure is \$13.5 trillion, inventories will be
- A) below their target and real GDP will increase.
  - B) below their target and real GDP will decrease.
  - C) above their target and real GDP will decrease.
  - D) above their target and real GDP will increase.

Answer: A

Topic: Actual Expenditures and Planned Expenditures

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

- 33) Which of the following statements is correct?
- A) Actual aggregate expenditures does not always equal real GDP.
  - B) Planned investment exceeds actual investment when real GDP is greater than aggregate planned expenditures.
  - C) Actual investment exceeds planned investment when real GDP is less than aggregate planned expenditures.
  - D) None of the above is correct.

Answer: D

Topic: Convergence to Equilibrium

Skill: Conceptual

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 34) If prices are fixed, when aggregate planned expenditure exceeds real GDP, then
- A) inventories decrease, signaling firms to increase production and increase real GDP.
  - B) inventories increase, signaling firms to decrease production and decrease real GDP.
  - C) profits fall, signaling firms to decrease production and decrease real GDP.
  - D) None of the above answers are correct.

Answer: A

Topic: *Convergence to Equilibrium*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 35) When real GDP exceeds aggregate planned expenditure,
- A) actual inventories decrease below their target.
  - B) the circular flow will increase.
  - C) GDP will decrease.
  - D) a higher level of equilibrium income will prevail.

Answer: C

Topic: *Convergence to Equilibrium*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 36) If aggregate planned expenditure is less than real GDP,
- A) real GDP will increase.
  - B) real GDP remain unchanged.
  - C) real GDP will either decrease or increase, depending on the *MPC*.
  - D) inventories will increase above their target level and real GDP will decrease.

Answer: D

Topic: *Convergence to Equilibrium*

Skill: *Conceptual*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

- 37) Suppose the equilibrium level of expenditure is \$13 trillion. If real GDP is \$12 trillion, then inventories are \_\_\_\_\_ their target levels and real GDP will \_\_\_\_\_.
- A) above; increase
  - B) above; decrease
  - C) below; increase
  - D) below; decrease

Answer: C

Topic: *Convergence to Equilibrium*

Skill: *Conceptual*

Question history: *Modified 10th edition*

AACSB: *Analytical Skills*

- 38) Suppose the equilibrium level of expenditure is \$13 trillion. If real GDP is \$14 trillion, then planned expenditures
- A) exceed real GDP, and real GDP will increase.
  - B) are less than real GDP, and real GDP will decrease.
  - C) are equal to real GDP, and there will be no change in real GDP.
  - D) are less than real GDP, and real GDP will increase.

Answer: B

Topic: Convergence to Equilibrium

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Analytical Skills

- 39) If aggregate planned expenditure is less than real GDP then
- A) consumers increase their planned expenditure until aggregate planned expenditure increases to equal real GDP.
  - B) firms increase their planned expenditure until aggregate planned expenditure increases to equal real GDP.
  - C) firms' inventories will increase and real GDP will decrease as production falls.
  - D) firms' inventories will decrease and real GDP will decrease as production falls.

Answer: C

Topic: Convergence to Equilibrium

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Analytical Skills

- 40) When investment is less than planned investment, aggregate planned expenditure is \_\_\_\_\_ than actual aggregate expenditure and inventories are \_\_\_\_\_ than planned.
- A) greater; greater
  - B) greater; less
  - C) less; greater
  - D) less; less

Answer: B

Topic: Convergence to Equilibrium

Skill: Conceptual

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 41) When investment exceeds planned investment, aggregate planned expenditure is \_\_\_\_\_ than actual aggregate expenditure and inventories are \_\_\_\_\_ than planned.
- A) greater; greater
  - B) greater; less
  - C) less; greater
  - D) less; less

Answer: C

Topic: Convergence to Equilibrium

Skill: Conceptual

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 42) In the aggregate expenditure model, when real GDP is greater than aggregate planned expenditure,
- A) unplanned inventories are being accumulated.
  - B) inventories are being depleted.
  - C) inventories are not being changed.
  - D) this cannot happen, because the two variables are always equal.

Answer: A

Topic: *Convergence to Equilibrium*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 43) Equilibrium expenditure is defined as the level of aggregate expenditure where
- A) actual aggregate expenditure equals real GDP.
  - B) total inventories equal zero.
  - C) aggregate planned expenditure equals real GDP.
  - D) spending equals output.

Answer: C

Topic: *Equilibrium Expenditure*

Skill: *Recognition*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 44) When the economy is in equilibrium,
- A) planned investment equals actual investment.
  - B) planned savings will equal zero.
  - C) there can be no unemployment.
  - D) changes in autonomous spending will have no impact on real GDP.

Answer: A

Topic: *Equilibrium Expenditure*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 45) At equilibrium expenditure
- A) consumers' expenditures on goods and services equal firms' purchases of investment goods.
  - B) firms hold no inventories of raw materials or final goods.
  - C) aggregate planned expenditure equals real GDP.
  - D) aggregate planned expenditure equals real GDP minus net exports.

Answer: C

Topic: *Equilibrium Expenditure*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 46) At equilibrium expenditure, unplanned changes in inventory
- A) must be positive.
  - B) must be zero.
  - C) must be negative.
  - D) might be either positive or negative.

Answer: B

Topic: Equilibrium Expenditure

Skill: Conceptual

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 47) Equilibrium expenditure occurs where
- A) the aggregate expenditure curve crosses the 45-degree line.
  - B) planned expenditures exceed national income.
  - C) savings exceed planned investment.
  - D) All of the answers are correct.

Answer: A

Topic: Equilibrium Expenditure

Skill: Conceptual

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 48) Equilibrium expenditure occurs where the aggregate expenditure curve crosses the
- A) 45-degree line.
  - B) horizontal axis.
  - C) vertical axis.
  - D) consumption function.

Answer: A

Topic: Equilibrium Expenditure

Skill: Conceptual

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

Real GDP	C	I	G	X - M
2500	1430	540	400	90
2400	1360	540	400	100
2300	1290	540	400	110
2200	1220	540	400	120
2100	1150	540	400	130

- 49) In the above table, C is consumption expenditure, I is investment, G is government expenditure, and X - M is net exports. All entries are in dollars. The equilibrium level of real GDP is
- A) \$2,500.
  - B) \$2,400.
  - C) \$2,300.
  - D) \$2,200.

Answer: B

Topic: Equilibrium Expenditure

Skill: Analytical

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

- 50) In the above table, C is consumption expenditure, I is investment, G is government expenditure, and X - M is net exports. All entries are in dollars. The slope of the aggregate expenditure function is
- A) -0.10.
  - B) 0.10.
  - C) 0.60.
  - D) 0.70.

Answer: C

Topic: Slope of the AE Curve

Skill: Analytical

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

Real GDP	C	I	G	X	M
100	75	25	95	10	1
200	150	25	95	10	2
300	225	25	95	10	3
400	300	25	95	10	4
500	375	25	95	10	5
600	450	25	95	10	6
700	525	25	95	10	7
800	600	25	95	10	8
900	675	25	95	10	9
1000	750	25	95	10	10

- 51) In the above table, *C* is consumption expenditure, *I* is investment, *G* is government expenditure, *X* is exports, and *M* is imports. All entries are in dollars. What is the marginal propensity to consume?
- A) 0.20
  - B) 0.25
  - C) 0.75
  - D) 0.80

Answer: C

Topic: Marginal Propensity to Consume

Skill: Analytical

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

- 52) In the above table, *C* is consumption expenditure, *I* is investment, *G* is government expenditure, *X* is exports, and *M* is imports. All entries are in dollars. What is the level of aggregate planned expenditure when real GDP is equal to \$900 billion?
- A) \$675
  - B) \$796
  - C) \$814
  - D) \$1,714

Answer: B

Topic: Actual Expenditures and Planned Expenditures

Skill: Analytical

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

- 53) In the above table, *C* is consumption expenditure, *I* is investment, *G* is government expenditure, *X* is exports, and *M* is imports. All entries are in dollars. What is the unplanned inventory change when GDP is equal to \$400?
- A) \$26
  - B) -\$26
  - C) \$5
  - D) -\$5

Answer: B

*Topic: Actual Expenditures and Planned Expenditures*

*Skill: Analytical*

*Question history: Previous edition, Chapter 11*

*AACSB: Analytical Skills*

- 54) In the above table, *C* is consumption expenditure, *I* is investment, *G* is government expenditure, *X* is exports, and *M* is imports. All entries are in dollars. What is the equilibrium expenditure?
- A) \$200
  - B) \$500
  - C) \$700
  - D) \$1,000

Answer: B

*Topic: Equilibrium Expenditure*

*Skill: Analytical*

*Question history: Previous edition, Chapter 11*

*AACSB: Analytical Skills*

- 55) In the above table, *C* is consumption expenditure, *I* is investment, *G* is government expenditure, *X* is exports, and *M* is imports. All entries are in dollars. If investment increased by \$26 to \$51 then equilibrium expenditure will
- A) increase by \$25.
  - B) decrease by \$50.
  - C) increase by \$100.
  - D) decrease by \$100.

Answer: C

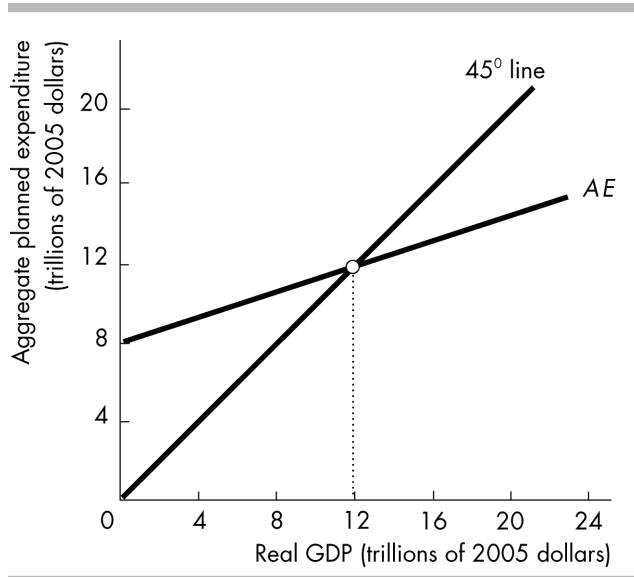
*Topic: Equilibrium Expenditure*

*Skill: Analytical*

*Question history: Previous edition, Chapter 11*

*AACSB: Analytical Skills*





56) In the above figure, at the equilibrium, induced expenditure is

- A) \$4 trillion.
- B) \$8 trillion.
- C) \$12 trillion.
- D) some amount not given in the above answers.

Answer: A

Topic: Induced Expenditures

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

57) In the above figure, autonomous expenditure is

- A) \$4 trillion.
- B) \$8 trillion.
- C) \$12 trillion.
- D) some amount not given in the above answers.

Answer: B

Topic: Autonomous Expenditures

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

- 58) In the above figure, if real GDP is below \$12 trillion, inventories will be
- A) below target levels, so firms increase production.
  - B) below target levels, so firms decrease production.
  - C) above target levels, so firms increase production.
  - D) above target levels, so firms decrease production.

Answer: A

*Topic: Actual Expenditures and Planned Expenditures*

*Skill: Analytical*

*Question history: Modified 10th edition*

*AACSB: Analytical Skills*

- 59) In the above figure, if real GDP is greater than \$12 trillion, inventories will be
- A) below target levels so firms increase production.
  - B) below target levels so firms decrease production.
  - C) above target levels so firms increase production.
  - D) above target levels so firms decrease production.

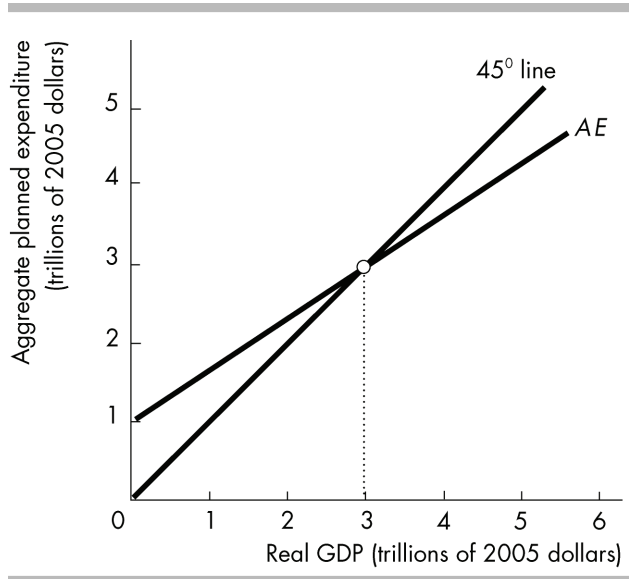
Answer: D

*Topic: Actual Expenditures and Planned Expenditures*

*Skill: Analytical*

*Question history: Modified 10th edition*

*AACSB: Analytical Skills*



- 60) The figure shows Tropical Isle's aggregate planned expenditure curve. When aggregate planned expenditure is \$2 trillion, aggregate planned expenditure is \_\_\_\_\_ than real GDP, firms' inventories \_\_\_\_\_, and firms \_\_\_\_\_ their production.
- A) greater; increase; decrease
  - B) less; decrease; increase
  - C) less; increase; decrease
  - D) greater; decrease; increase

Answer: D

Topic: Actual Expenditures and Planned Expenditures

Skill: Analytical

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

- 61) Real GDP equals \$20 billion and aggregate planned expenditure is \$30 billion. There is an unplanned \_\_\_\_\_ in inventories of \_\_\_\_\_ and real GDP will \_\_\_\_\_.
- A) increase; \$10 billion; increase
  - B) increase; \$50 billion; decrease
  - C) decrease; \$10 billion; increase
  - D) decrease; \$10 billion; decrease

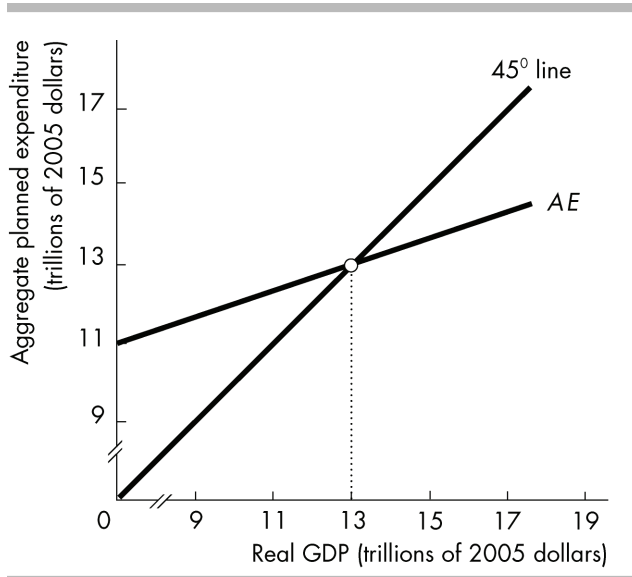
Answer: C

Topic: Actual Expenditures and Planned Expenditures

Skill: Analytical

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills



62) In the above figure, if real GDP equals \$12 trillion, there would be

- A) an increase in autonomous consumption expenditure.
- B) an increase in autonomous inventories.
- C) no change in GDP.
- D) an unplanned increase in firms' inventories.

Answer: C

Topic: *Equilibrium Expenditure*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

63) In the above figure, if real GDP equals \$15 trillion,

- A) actual and planned investment will both increase.
- B) unplanned inventories will increase.
- C) actual investment will decrease but planned investment will increase.
- D) unplanned inventories will decrease.

Answer: B

Topic: *Actual Expenditures and Planned Expenditures*

Skill: *Analytical*

Question history: *Modified 10th edition*

AACSB: *Analytical Skills*

- 64) In the above figure, if real GDP equals \$11 trillion,
- actual and planned investment will both increase.
  - unplanned inventories will increase.
  - actual investment will decrease but planned investment will increase.
  - unplanned inventories will decrease.

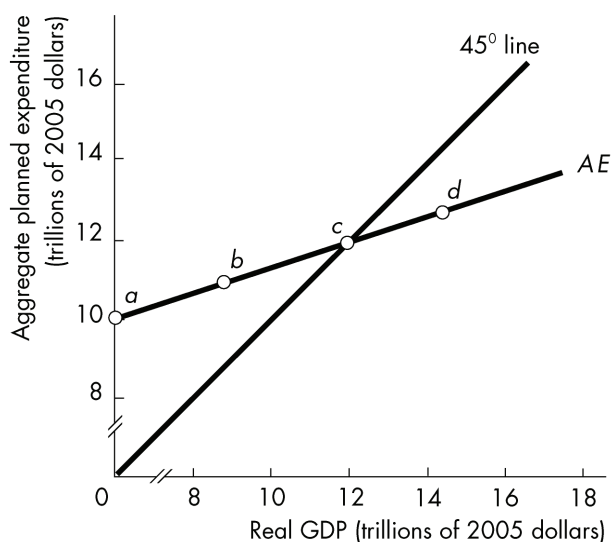
Answer: D

Topic: Actual Expenditures and Planned Expenditures

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills



- 65) In the above figure, if the marginal propensity to consume increases, the slope of the *AE* curve would
- increase.
  - decrease.
  - stay the same but the *AE* curve would shift upwards.
  - stay the same but the *AE* curve would shift downwards.

Answer: A

Topic: Aggregate Expenditure Curve

Skill: Analytical

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

- 66) In the above figure, point *d* represents planned expenditures \_\_\_\_\_ real GDP.
- A) greater than
  - B) equal to
  - C) less than
  - D) There is not enough information to answer the question.

Answer: C

Topic: Actual Expenditures and Planned Expenditures

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

- 67) In the above figure, at point *d* firms would find themselves with inventories \_\_\_\_\_ their target level and so would \_\_\_\_\_ production.
- A) increasing above; increase
  - B) increasing above; decrease
  - C) decreasing below; increase
  - D) decreasing below; decrease

Answer: B

Topic: Actual Expenditures and Planned Expenditures

Skill: Analytical

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

- 68) The equilibrium in the above figure is shown at point
- A) *a*.
  - B) *b*.
  - C) *c*.
  - D) *d*.

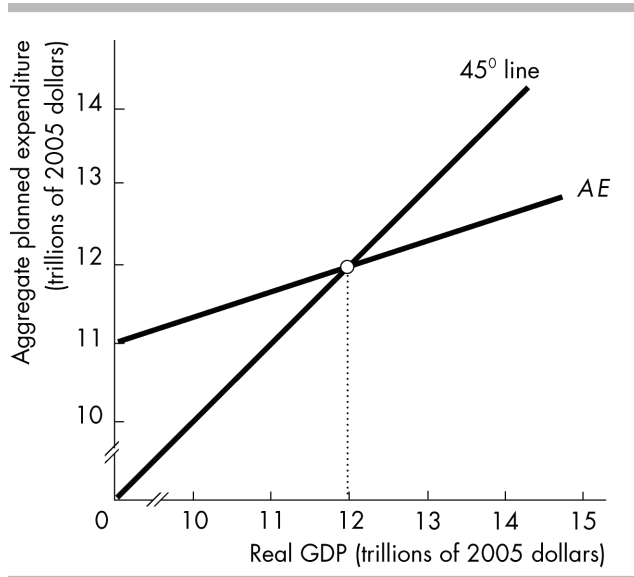
Answer: C

Topic: Equilibrium Expenditure

Skill: Analytical

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills



- 69) In the above figure, equilibrium expenditure is
- A) less than \$12 trillion.
  - B) \$12 trillion.
  - C) more than \$12 trillion.
  - D) some amount that cannot be determined without more information.

Answer: B

Topic: Equilibrium Expenditure

Skill: Analytical

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

- 70) In the above figure, if the level of real GDP is \$13 trillion,
- A) inventories are above the levels planned by firms.
  - B) inventories are below the levels planned by firms.
  - C) inventories are equal to the levels planned by firms.
  - D) planned expenditures are zero.

Answer: A

Topic: Actual Expenditures and Planned Expenditures

Skill: Analytical

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

- 71) In the above figure, if the level of real GDP is \$11 trillion,  
A) inventories are above the levels planned by firms.  
B) inventories are below the levels planned by firms.  
C) inventories are equal to the levels planned by firms.  
D) planned expenditures are zero.

Answer: B

Topic: *Actual Expenditures and Planned Expenditures*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 72) If firms' inventories are less than they planned, aggregate planned expenditure is \_\_\_\_\_ real GDP and firms \_\_\_\_\_ their production.  
A) greater than; increase  
B) greater than; decrease  
C) less than; increase  
D) less than; decrease

Answer: A

Topic: *Study Guide Question, Convergence to Equilibrium*

Skill: *Analytical*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

- 73) If aggregate planned expenditure is less than real GDP, in the short run  
A) aggregate planned expenditure will increase.  
B) exports change to restore equilibrium.  
C) the price level will fall.  
D) real GDP will decrease.

Answer: D

Topic: *Study Guide Question, Convergence to Equilibrium*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

### 3 The Multiplier

- 1) When autonomous expenditure decreases, \_\_\_\_\_.  
A) the AE curve shifts downward  
B) there is a movement down along the AE curve  
C) the AE curve becomes less steep  
D) the AE curve shifts upward

Answer: A

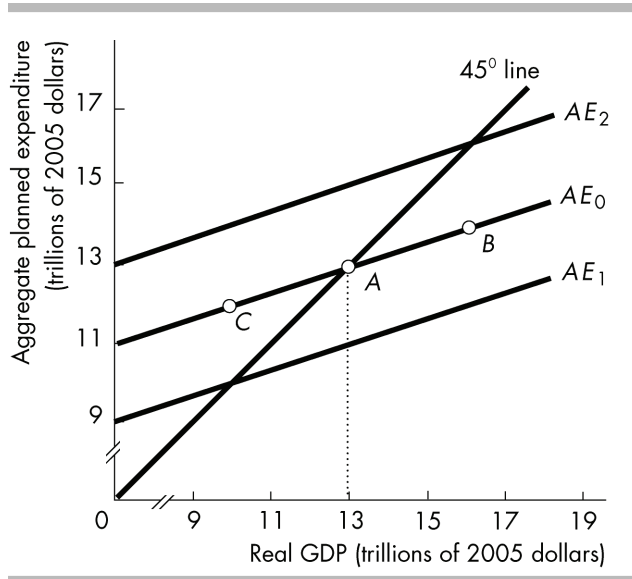
Topic: *Changes in Autonomous Expenditure*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*





- 2) In the above figure the economy is initially at point A on aggregate expenditure curve  $AE_0$ . Suppose firms expect profits to increase and decide to increase investment. As a result
- the AE curve shifts upward to a curve such as  $AE_2$ .
  - the AE curve shifts downward to a curve such as  $AE_1$ .
  - there is a movement along  $AE_1$  to a point such as B.
  - there is a movement along  $AE_1$  to a point such as C.

Answer: A

Topic: Changes in Autonomous Expenditure

Skill: Analytical

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

- 3) In the above figure the economy is initially at point A on aggregate expenditure curve  $AE_0$ . Suppose investment decreases. As a result
- the AE curve shifts upward to a curve such as  $AE_2$ .
  - the AE curve shifts downward to a curve such as  $AE_1$ .
  - there is a movement along  $AE_1$  to a point such as B.
  - there is a movement along  $AE_1$  to a point such as C.

Answer: B

Topic: Changes in Autonomous Expenditure

Skill: Analytical

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

- 4) If prices are fixed, an increase in aggregate expenditures results in an increase in equilibrium GDP that
- A) is greater than the change in aggregate expenditure.
  - B) is equal to the change in aggregate expenditure.
  - C) is less than the change in aggregate expenditure.
  - D) has no necessary relationship to the size of the change in aggregate expenditure.

Answer: A

Topic: *The Multiplier Effect*

Skill: *Recognition*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 5) The multiplier effect on real GDP occurs because
- A) changes in price levels affect our willingness to invest, consume, import and export.
  - B) an autonomous change in expenditure causes an induced change in consumption expenditure.
  - C) of government stabilization policies.
  - D) of income taxes.

Answer: B

Topic: *The Multiplier Effect*

Skill: *Conceptual*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

- 6) The multiplier effect exists because a change in autonomous expenditure
- A) leaves the economy in the form of imports.
  - B) leads to changes in income, which generate further spending.
  - C) prompts further exports.
  - D) will undergo its complete effect in one round.

Answer: B

Topic: *The Multiplier Effect*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 7) The multiplier effect
- A) generates instability in autonomous expenditure.
  - B) promotes stability of the general price level.
  - C) magnifies small changes in spending into larger changes in real GDP.
  - D) increases the MPC.

Answer: C

Topic: *The Multiplier Effect*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 8) When autonomous expenditure increases, equilibrium aggregate expenditure
- A) decreases by an equal amount to offset the unplanned portion.
  - B) increases by an equal amount.
  - C) decreases by a greater amount due to the multiplier.
  - D) increases by a greater amount due to the multiplier.

Answer: D

Topic: The Multiplier Effect

Skill: Conceptual

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 9) In the short run with fixed prices, an increase in investment of \$100 billion
- A) increases real GDP by \$100 billion.
  - B) increases real GDP by less than \$100 billion.
  - C) increases real GDP by more than \$100 billion.
  - D) decreases real GDP because of the decrease in induced expenditures.

Answer: C

Topic: The Multiplier Effect

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 10) The multiplier is the amount by which \_\_\_\_\_ is multiplied to determine \_\_\_\_\_.
- A) autonomous expenditure; real GDP
  - B) induced expenditure; real GDP
  - C) a change in autonomous expenditure; the change in equilibrium expenditure
  - D) a change in induced expenditure; the change in equilibrium expenditure

Answer: C

Topic: The Multiplier

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 11) The multiplier is the ratio of the
- A) change in real GDP to the change in autonomous expenditures.
  - B) equilibrium level of real GDP to the change in induced expenditures.
  - C) change in induced expenditures to the change in autonomous expenditures.
  - D) change in autonomous expenditures to the change in real GDP.

Answer: A

Topic: The Multiplier

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 12) When prices are fixed and there are no imports or income taxes, the value of the multiplier is
- A) less than one.
  - B) greater than one.
  - C) equal to one.
  - D) equal to zero.

Answer: B

Topic: *The Multiplier*

Skill: *Recognition*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 13) The multiplier shows that as \_\_\_\_\_ changes, real GDP changes by a \_\_\_\_\_ amount.
- A) induced expenditure; larger
  - B) induced expenditure; smaller
  - C) autonomous expenditure; larger
  - D) autonomous expenditure; smaller

Answer: C

Topic: *The Multiplier*

Skill: *Recognition*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 14) Because of the multiplier, a one-time change in expenditure will
- A) have little secondary effect on real GDP.
  - B) expand real GDP by an infinite amount.
  - C) generate more additional real GDP than the initial change in expenditure.
  - D) decrease saving and investment activity and thereby decrease future real GDP.

Answer: C

Topic: *The Multiplier*

Skill: *Conceptual*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

- 15) The multiplier is greater than 1 because
- A) most households are unable to save.
  - B) household spending exceeds income.
  - C) one person's spending becomes another's income.
  - D) corporate spending exceeds corporate income.

Answer: C

Topic: *The Multiplier*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

16) The multiplier is greater than 1 because the change in autonomous expenditure leads to \_\_\_\_\_.

- A) more investment
- B) more saving
- C) less consumption expenditure
- D) more induced expenditure

Answer: D

Topic: The Multiplier

Skill: Conceptual

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

17) If a \$75 billion increase in autonomous expenditure increases equilibrium expenditure by \$150 billion, then the multiplier is \_\_\_\_\_.

- A) \$225 billion
- B) 0.625
- C) \$75 billion
- D) 2

Answer: D

Topic: The Multiplier

Skill: Analytical

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

18) If investment increases by \$300 and, in response, equilibrium aggregate expenditure increases by \$600, the multiplier is

- A) 0.2.
- B) 0.5.
- C) 2.
- D) 5.

Answer: C

Topic: The Multiplier

Skill: Analytical

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

19) If the multiplier is 6 and exports decrease by \$30, what impact will that have on aggregate expenditure?

- A) increase by \$30
- B) increase by \$180
- C) decrease by \$30
- D) decrease by \$180

Answer: D

Topic: The Multiplier

Skill: Analytical

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

- 20) The multiplier is larger if the
- A) marginal propensity to consume is larger.
  - B) marginal propensity to save is larger.
  - C) income tax rate is higher.
  - D) marginal propensity to import is larger.

Answer: A

Topic: *The Multiplier and the MPC*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 21) If the MPC increases from 0.75 to 0.80 and there are no income taxes or imports,
- A) the multiplier becomes larger.
  - B) the multiplier becomes smaller.
  - C) the slope of the consumption function becomes smaller.
  - D) the slope of the savings function becomes larger.

Answer: A

Topic: *The Multiplier and the MPC*

Skill: *Recognition*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 22) An increase in the size of the multiplier can be caused by
- A) an increase in the *MPS*.
  - B) an increase in the *MPC*.
  - C) a decrease in induced expenditures.
  - D) an increase in the marginal propensity to import.

Answer: B

Topic: *The Multiplier and the MPC*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 23) The relationship between the multiplier and the *MPC* is
- A) that as the *MPC* increases, so does the value of the multiplier.
  - B) that as the *MPC* increases, the value of the multiplier decreases.
  - C) unrelated because the multiplier relates to the *MPS* not the *MPC*.
  - D) converging at higher incomes.

Answer: A

Topic: *The Multiplier and the MPC*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 24) Which of the following makes the multiplier larger?
- A) an increase in the marginal propensity to import
  - B) an increase in the tax rate
  - C) an increase in the marginal propensity to consume
  - D) an increase in the marginal propensity to save

Answer: C

Topic: *The Multiplier and the MPC*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 25) An increase in the value of the multiplier can be caused by
- A) a decrease in the marginal propensity to consume.
  - B) an increase in the marginal propensity to import.
  - C) an increase in autonomous consumption expenditure.
  - D) an increase in the marginal propensity to consume.

Answer: D

Topic: *The Multiplier and the MPC*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 26) In an economy with no income taxes or imports, the multiplier equals
- A)  $1/MPC$ .
  - B)  $1/MPS$ .
  - C)  $1/(1 - MPS)$ .
  - D)  $1/(MPC + MPS)$ .

Answer: B

Topic: *The Multiplier and the MPS*

Skill: *Recognition*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 27) The larger the slope of the *AE* curve, the
- A) larger the value of the multiplier.
  - B) smaller the value of the multiplier.
  - C) less likely that the multiplier will be affected.
  - D) more likely that the multiplier will be inconsequential.

Answer: A

Topic: *Slope of the Aggregate Expenditure Curve and The Multiplier*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 28) If the slope of the *AE* curve increases, the multiplier
- A) decreases.
  - B) increases.
  - C) stays the same.
  - D) can either increase or decrease depending on what happens to the *MPC*.

Answer: B

Topic: *Slope of the Aggregate Expenditure Curve and The Multiplier*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 29) The expenditure multiplier equals
- A)  $APC - APS$  where *APC* is the average propensity to consume and *APS* is the average propensity to save.
  - B)  $1/(1 - \text{slope of } AE \text{ curve})$ .
  - C)  $MPC - MPS$  where *MPC* is the marginal propensity to consume and *MPS* is the marginal propensity to consume.
  - D)  $1/(\text{slope of } AE \text{ curve})$ .

Answer: B

Topic: *Slope of the Aggregate Expenditure Curve and The Multiplier*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 30) If there are no income taxes or imports, the multiplier equals
- A)  $1/(1 - \text{marginal propensity to consume})$ .
  - B)  $1/(1 - \text{marginal propensity to save})$ .
  - C)  $1/(1 - \text{marginal propensity to import})$ .
  - D)  $1/(1 - \text{marginal propensity to invest})$ .

Answer: A

Topic: *The Multiplier and the MPC*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 31) If there are no taxes or imports and  $MPC = 0.67$ , the multiplier is
- A) 1.5.
  - B) 3.
  - C) 6.
  - D) 0.33.

Answer: B

Topic: *The Multiplier*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*



32) If there are no taxes or imports and  $MPC = 0.75$ , the multiplier equals

- A) 0.25.
- B) 1.33.
- C) 4.0.
- D) 6.0.

Answer: C

Topic: The Multiplier

Skill: Analytical

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

33) If there are no taxes or imports and  $MPC = 0.5$ , the multiplier equals

- A) 0.5.
- B) 5.0.
- C) 6.0.
- D) 2.0.

Answer: D

Topic: The Multiplier

Skill: Analytical

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

34) If the marginal propensity to consume is 0.8 and there no income taxes or imports, the multiplier for a change in autonomous expenditure equals

- A) 0.8.
- B) 1.0
- C) 4.0.
- D) 5.0.

Answer: D

Topic: The Multiplier

Skill: Analytical

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

35) If the  $MPC$  is .9 and there are no income taxes or imports, the multiplier for a change in autonomous expenditure equals

- A) 0.1.
- B) 9.0.
- C) 10.0.
- D) 100.0.

Answer: C

Topic: The Multiplier

Skill: Analytical

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

- 36) If the multiplier for a change in autonomous expenditure is 10 and there are no income taxes or imports, then the MPC is
- A) 0.9.
  - B) 0.1.
  - C) 1.0.
  - D) 9.0.

Answer: A

Topic: *The Multiplier*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 37) If the multiplier is 4 and there are no imports or income taxes, the marginal propensity to consume is
- A) 0.25.
  - B) 0.50.
  - C) 0.75.
  - D) 1.00.

Answer: C

Topic: *The Multiplier*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 38) If the multiplier is 3.33 and there are no imports or income taxes, then the
- A) MPC is 0.7.
  - B) MPS is 0.3.
  - C) Both of the above answers are correct.
  - D) None of the above answers are correct.

Answer: C

Topic: *The Multiplier*

Skill: *Analytical*

Question history: *Modified 10th edition*

AACSB: *Analytical Skills*

- 39) If the slope of the AE curve is 0.60, the value of the multiplier is
- A) 2.5.
  - B) 0.4.
  - C) 1.67.
  - D) 4.0.

Answer: A

Topic: *The Multiplier*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 40) Suppose that last year the slope of the  $AE$  curve is 0.67 and this year the slope of the  $AE$  curve changes to 0.8. Which of the following best describes what happens to the multiplier?
- A) It rises from 3 to 5.
  - B) It falls from 5 to 3.
  - C) It rises from 1.25 to 1.49.
  - D) It falls from 1.49 to 1.25.

Answer: A

Topic: *The Multiplier*

Skill: *Analytical*

Question history: *Modified 10th edition*

AACSB: *Analytical Skills*

- 41) In general, the steeper the aggregate expenditure curve, the
- A) greater autonomous expenditure.
  - B) lower the marginal propensity to consume.
  - C) larger the multiplier.
  - D) smaller the multiplier.

Answer: C

Topic: *Slope of the Aggregate Expenditure Curve and The Multiplier*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 42) In general, the flatter the aggregate expenditure curve, the
- A) greater the autonomous expenditure.
  - B) larger the marginal propensity to consume.
  - C) larger the multiplier.
  - D) smaller the multiplier.

Answer: D

Topic: *Slope of the Aggregate Expenditure Curve and The Multiplier*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 43) The smaller the slope of the  $AE$  curve, \_\_\_\_\_.
- A) the greater is the value of the multiplier
  - B) the smaller is slope of the saving function
  - C) the steeper is the consumption function
  - D) the smaller is the value of the multiplier

Answer: D

Topic: *Slope of the Aggregate Expenditure Curve and The Multiplier*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 44) The slope of the aggregate expenditure curve increases when the marginal propensity to consume \_\_\_\_\_ or the marginal propensity to import \_\_\_\_\_.
- A) increases; decreases
  - B) decreases; increases
  - C) decreases; decreases
  - D) increases; increases

Answer: A

Topic: *Slope of the Aggregate Expenditure Curve and The Multiplier*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 45) A change in which of the following changes the slope of the aggregate expenditure curve?
- A) an increase in autonomous government expenditures
  - B) an increase in the marginal propensity to consume
  - C) a decrease in autonomous consumption expenditures
  - D) All of the above answers are correct because they all change the slope of the aggregate expenditure curve.

Answer: B

Topic: *Slope of the Aggregate Expenditure Curve and The Multiplier*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 46) Given an MPC of 0.80, if there are no income taxes or imports and prices are constant, then when investment increases by \$50 million, when prices are fixed equilibrium GDP would
- A) increase by \$50 million.
  - B) increase by \$250 million.
  - C) increase by \$400 million.
  - D) To answer the question more information on income is needed.

Answer: B

Topic: *The Multiplier*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 47) In a simple economy in which prices are constant and with no income taxes or imports, the marginal propensity to save is 0.2. If exports increase \$50, what impact will that have on aggregate expenditure?
- A) increase by \$250
  - B) increase by \$100
  - C) decrease by \$250
  - D) decrease by \$100

Answer: A

Topic: *The Multiplier*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 48) Suppose that the slope of the *AE* curve is 0.80. Then an increase of investment of \$10 billion leads to an increase in equilibrium real GDP equal to
- A) \$8.0 billion.
  - B) \$10.0 billion.
  - C) \$12.5 billion.
  - D) \$50.0 billion.

Answer: D

Topic: Slope of the Aggregate Expenditure Curve and The Multiplier

Skill: Analytical

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

- 49) The slope of the *AE* curve is 0.9. Investment decreases by \$100 million and the price level is constant. Real GDP
- A) decreases by \$10 million.
  - B) increases by \$90 million.
  - C) decreases by \$1 billion.
  - D) increases by \$1 billion.

Answer: C

Topic: Slope of the Aggregate Expenditure Curve and The Multiplier

Skill: Conceptual

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

- 50) If the price level is constant and the slope of the *AE* curve is 0.75, a decrease in investment of \$100 leads to a decrease in real GDP of
- A) \$25.
  - B) \$100.
  - C) \$400.
  - D) \$800.

Answer: C

Topic: Slope of the Aggregate Expenditure Curve and The Multiplier

Skill: Conceptual

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

- 51) An economy has no imports and no taxes. The marginal propensity to save is 0.2. The multiplier is \_\_\_\_\_ so a \_\_\_\_\_ increase in autonomous expenditure increases equilibrium expenditure by \$60 billion.
- A) 1.25; \$48 billion
  - B) 5; \$12 billion
  - C) 10; \$6 billion
  - D) none of the above answers are correct.

Answer: B

Topic: Slope of the Aggregate Expenditure Curve and The Multiplier

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

- 52) In a simple economy in which prices are constant and with no income taxes or imports, the slope of the *AE* curve is 0.8. In order to increase real GDP by \$500 billion, then
- A) consumption expenditure needs to increase by \$500 billion.
  - B) saving needs to be reduced by \$500 billion will lead to the increase of \$500 billion.
  - C) an increase in investment of \$200 billion will lead to the increase of \$500 billion.
  - D) an increase in autonomous expenditure of \$100 billion will lead to the increase of \$500 billion.

Answer: D

*Topic: Slope of the Aggregate Expenditure Curve and The Multiplier*

*Skill: Analytical*

*Question history: Modified 10th edition*

*AACSB: Analytical Skills*

- 53) Suppose that the slope of the *AE* curve is 0.75. Then a \$100 increase in autonomous spending means equilibrium expenditure will
- A) decrease by \$400.
  - B) increase by \$400.
  - C) decrease by \$750.
  - D) increase by \$750.

Answer: B

*Topic: The Multiplier*

*Skill: Analytical*

*Question history: Previous edition, Chapter 11*

*AACSB: Analytical Skills*

- 54) Suppose that the slope of the *AE* curve is 0.75. Then a \$100 decrease in autonomous spending means equilibrium expenditure will
- A) decrease by \$400.
  - B) increase by \$400.
  - C) decrease by \$750.
  - D) increase by \$750.

Answer: A

*Topic: The Multiplier*

*Skill: Analytical*

*Question history: Previous edition, Chapter 11*

*AACSB: Analytical Skills*

- 55) Suppose that the slope of the *AE* curve is 0.67. Then a \$100 decrease in autonomous spending means equilibrium expenditure will
- A) decrease by \$200.
  - B) increase by \$200.
  - C) decrease by \$300.
  - D) increase by \$300.

Answer: C

*Topic: The Multiplier*

*Skill: Analytical*

*Question history: Previous edition, Chapter 11*

*AACSB: Analytical Skills*

- 56) Suppose that the slope of the  $AE$  curve is 0.67. Then a \$100 increase in autonomous spending means equilibrium expenditure will
- A) decrease by \$200.
  - B) increase by \$200.
  - C) decrease by \$300.
  - D) increase by \$300.

Answer: D

Topic: *The Multiplier*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 57) Suppose that the slope of the  $AE$  curve is 0.80. If prices remain constant and government expenditure increases by \$10 billion, what will be the change in real GDP?
- A) \$8 billion
  - B) \$2 billion
  - C) \$10 billion
  - D) \$50 billion

Answer: D

Topic: *The Multiplier*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 58) An economy saves 20 percent of any increase in income and there are no income taxes or imports. Then, an increase in investment of \$2 billion leads to a short run increase in real GDP of
- A) \$2 billion.
  - B) \$10 billion.
  - C) \$0.4 billion.
  - D) \$1.6 billion.

Answer: B

Topic: *Slope of the Aggregate Expenditure Curve and The Multiplier*

Skill: *Conceptual*

Question history: *Modified 10th edition*

AACSB: *Analytical Skills*

- 59) Equilibrium real GDP is \$400 billion, the  $MPC = 0.9$ , and there are no income taxes or imports. Investment increases \$40 billion. If the price level is constant, after the increase in investment, equilibrium real GDP will be
- A) \$440 billion.
  - B) \$360 billion.
  - C) \$600 billion.
  - D) \$800 billion.

Answer: D

Topic: *Slope of the Aggregate Expenditure Curve and The Multiplier*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

Real GDP (trillions of 2005 dollars)	Aggregate expenditure (trillions of 2005 dollars)
0	0.3
1.0	1.2
2.0	2.1
3.0	3.0
4.0	3.9
5.0	4.8

- 60) The data in the above table indicate that autonomous expenditure is
- A) \$0.3 trillion.
  - B) \$3.0 trillion.
  - C) \$4.8 trillion.
  - D) None of the above answers is correct.

Answer: A

Topic: *Autonomous Expenditures*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 61) In the above table, equilibrium expenditure is
- A) \$0.3 trillion.
  - B) \$3.0 trillion.
  - C) \$4.8 trillion.
  - D) None of the above answers are correct.

Answer: B

Topic: *Equilibrium Expenditure*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 62) The data in the above table indicate that the slope of the *AE* curve is
- A) 0.30.
  - B) 0.50.
  - C) 0.90.
  - D) None of the above answers are correct.

Answer: C

Topic: *Slope of the Aggregate Expenditure Curve and The Multiplier*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*



- 63) In the above table, suppose investment decreases by \$0.1 trillion. The multiplier equals
- A) 5.0.
  - B) 9.0.
  - C) 10.0.
  - D) None of the above answers are correct.

Answer: C

Topic: *The Multiplier*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

Real GDP (dollars)	Consumption expenditure (dollars)	Investment (dollars)	Government expenditure (dollars)
3,000	2,500	500	500
4,000	3,250	500	500
5,000	4,000	500	500
6,000	4,750	500	500
7,000	5,500	500	500
8,000	6,250	500	500

- 64) In the above table, there are no taxes (so that that real GDP equals disposable income) and no imports or exports. If real GDP decreases from \$6,000 to \$5,000, the marginal propensity to consume is
- A) -750.
  - B) -0.75.
  - C) 0.75.
  - D) 0.80.

Answer: C

Topic: *Marginal Propensity to Consume*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 65) In the above table, there are no taxes and no imports or exports. The equilibrium level of expenditure for this economy is
- A) any level because investment always equals government expenditures.
  - B) no level because consumption expenditure is always less than real GDP.
  - C) \$3,000.
  - D) \$5,000.

Answer: D

Topic: *Equilibrium Expenditure*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 66) In the above table, there are no taxes and no imports or exports. The total level of expenditure in the economy when real GDP is \$7,000 is
- A) \$7,000.
  - B) \$6,500.
  - C) \$13,500.
  - D) 0.75.

Answer: B

Topic: *Actual Expenditures and Planned Expenditures*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 67) In the above table, there are no taxes and no imports or exports. The change in unplanned inventories when real GDP is \$7,000 is
- A) \$6,500.
  - B) \$500.
  - C) -\$500.
  - D) \$1,500.

Answer: B

Topic: *Convergence to Equilibrium*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 68) In the above table, there are no taxes and no imports or exports. If current real GDP is equal to \$7,000, then firms will
- A) not change production because \$7,000 is the equilibrium level of real GDP.
  - B) increase production to rebuild inventories to their target level.
  - C) decrease production to restore inventories to their target level.
  - D) None of the above answers is correct.

Answer: C

Topic: *Convergence to Equilibrium*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 69) In the above table, there are no taxes and no imports or exports. The value of the multiplier for this economy is
- A) 0.75.
  - B) 1.33.
  - C) 4.0.
  - D) 0.25.

Answer: C

Topic: *The Multiplier*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

70) In the above table, there are no taxes and no imports or exports. Suppose that investment increases from \$500 to \$750 at each level of real GDP. After the increase, what is the level of planned expenditure when real GDP equals \$5,000?

- A) \$5,000
- B) \$5,250
- C) \$1,000
- D) \$250

Answer: B

*Topic: Actual Expenditures and Planned Expenditures*

*Skill: Analytical*

*Question history: Previous edition, Chapter 11*

*AACSB: Analytical Skills*

71) In the above table, there are no taxes and no imports or exports. Investment increases from \$500 to \$750. After the increase in investment, the new equilibrium level of output is

- A) \$5,000.
- B) \$7,000.
- C) \$6,000.
- D) \$5,750.

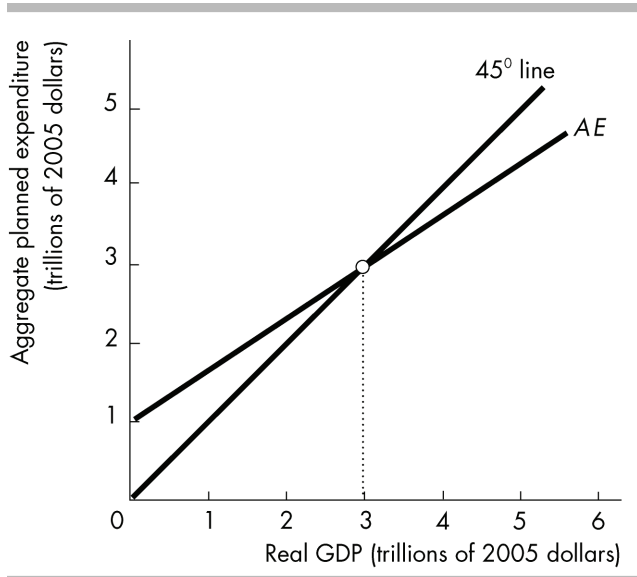
Answer: C

*Topic: The Multiplier Effect*

*Skill: Analytical*

*Question history: Previous edition, Chapter 11*

*AACSB: Analytical Skills*



- 72) Suppose the price level is fixed. If investment increases by \$1 trillion and the aggregate expenditure curve is shown in the figure above, in response equilibrium expenditure increases by \_\_\_\_\_.
- A) \$1 trillion.
  - B) \$3 trillion.
  - C) less than \$1 trillion.
  - D) None of the above answers are correct.

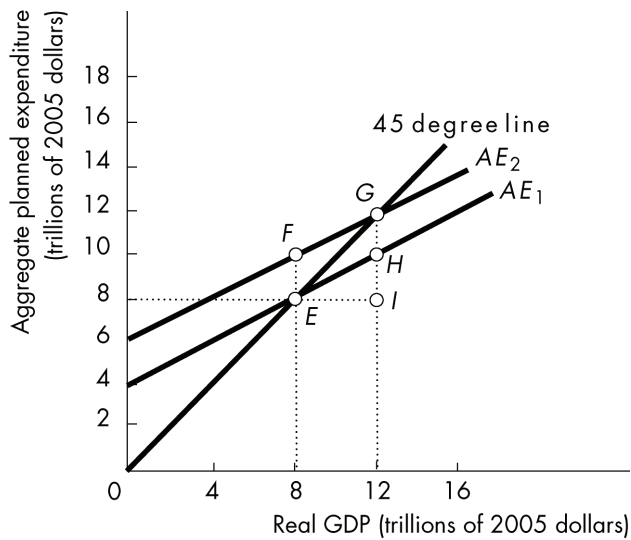
Answer: B

Topic: *The Multiplier*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*



- 73) In the above figure, an increase in autonomous expenditure is depicted by the movement from point E to
- A) point F.
  - B) point G.
  - C) point H.
  - D) point I.

Answer: A

Topic: Autonomous Expenditures

Skill: Analytical

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

- 74) In the above figure, the increase in autonomous expenditure moves the economy from point E to
- A) point F.
  - B) point G.
  - C) point H.
  - D) point I.

Answer: B

Topic: The Multiplier Effect

Skill: Analytical

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

- 75) In the above figure, the multiplier is equal to
- A) zero.
  - B) one.
  - C) two.
  - D) three.

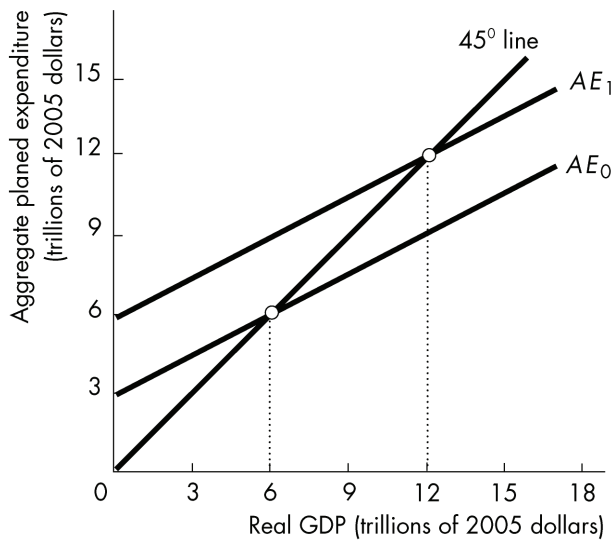
Answer: C

Topic: *The Multiplier*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*



- 76) In the above figure, autonomous expenditure along  $AE_1$  equals
- A) \$3 trillion.
  - B) \$6 trillion.
  - C) \$12 trillion.
  - D) an amount not given in the above answers.

Answer: A

Topic: *Autonomous Expenditures*

Skill: *Analytical*

Question history: *Modified 10th edition*

AACSB: *Analytical Skills*

77) In the above figure, autonomous expenditure along  $AE_2$  equals

- A) \$3 trillion.
- B) \$6 trillion.
- C) \$12 trillion.
- D) an amount not given in the above answers.

Answer: B

Topic: Autonomous Expenditures

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

78) If  $AE_0$  is the aggregate planned expenditure curve, then equilibrium real GDP in the figure above is

- A) \$3 trillion.
- B) \$6 trillion.
- C) \$12 trillion.
- D) None of the above answers is correct.

Answer: B

Topic: Equilibrium Expenditure

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

79) In the above figure, equilibrium expenditure along  $AE_2$  is

- A) \$3 trillion.
- B) \$6 trillion.
- C) \$12 trillion.
- D) an amount not given in the above answers.

Answer: C

Topic: Equilibrium Expenditure

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

80) In the above figure, the shift from  $AE_0$  to  $AE_1$  might have been caused by

- A) an increase in government expenditures.
- B) an increase in the real interest rate.
- C) an increase in the price level.
- D) All of the above answers are correct.

Answer: A

Topic: Autonomous Expenditures

Skill: Analytical

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

- 81) The value of the multiplier in the economy illustrated in the figure above is
- A) 2.0.
  - B) 2.5.
  - C) 4.0.
  - D) 10.0.

Answer: A

Topic: *Slope of the Aggregate Expenditure Curve and The Multiplier*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 82) In the above figure,  $AE_0$  is the aggregate planned expenditure curve and then investment increases by an additional \$3 trillion. As a result, the new equilibrium GDP will be
- A) \$3 trillion.
  - B) \$6 trillion.
  - C) \$12 trillion.
  - D) None of the above answers is correct.

Answer: C

Topic: *Changes in Autonomous Expenditure*

Skill: *Analytical*

Question history: *Modified 10th edition*

AACSB: *Analytical Skills*

- 83) The presence of income taxes and imports make the slope of the aggregate expenditure curve
- A) the same as it would be without income taxes and exports.
  - B) steeper than it would be without income taxes and exports.
  - C) flatter than it would be without income taxes and exports.
  - D) probably different than it would be without income taxes and exports but income taxes make it steeper while imports make it flatter.

Answer: C

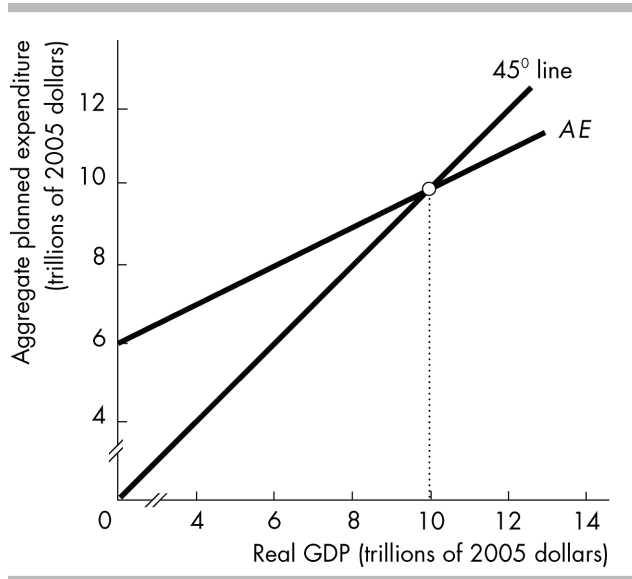
Topic: *Slope of the Aggregate Expenditure Curve and The Multiplier*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*





- 84) In the figure above, the multiplier equals
- A) 0.5.
  - B) 2.5.
  - C) 10.0.
  - D) some amount that cannot be calculated without additional information.

Answer: B

Topic: Slope of the Aggregate Expenditure Curve and The Multiplier

Skill: Analytical

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

- 85) In the figure above, if income taxes increase,
- A) the AE curve becomes steeper.
  - B) the AE curve becomes flatter.
  - C) there is a movement leftward along the unchanged AE curve.
  - D) there is a movement rightward along the unchanged AE curve.

Answer: B

Topic: Slope of the Aggregate Expenditure Curve and The Multiplier

Skill: Analytical

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

86) Imports

- A) increase the size of the multiplier because imports make disposable income less than real GDP.
- B) decrease the size of the multiplier because spending on imports does not increase real GDP in the domestic nation.
- C) increase the size of the multiplier because imports are paid for by exports.
- D) decrease the size of the multiplier because imports lead to an increase in taxes and government purchases.

Answer: B

Topic: *The Multiplier and Imports*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

87) The relationship between net exports and GDP makes the slope of the aggregate expenditure curve

- A) flatter than it would be otherwise.
- B) steeper than it would be otherwise.
- C) neither flatter nor steeper than it would be otherwise.
- D) steeper at low levels of GDP and flatter at high levels of GDP.

Answer: A

Topic: *Slope of the Aggregate Expenditure Curve and The Multiplier*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

88) If the marginal propensity to import increases, then the

- A) multiplier will decrease in value.
- B) multiplier will increase in value.
- C) multiplier will not change in value.
- D) effect on the multiplier will depend on what happens to exports.

Answer: A

Topic: *The Multiplier and Imports*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

89) The presence of imports \_\_\_\_\_ the size of the U.S. multiplier because with an increase of U.S. real GDP, \_\_\_\_\_.

- A) increases; U.S. consumers buy goods from other countries
- B) increases; U.S. firms can sell goods to other countries
- C) decreases; U.S. consumers buy goods from other countries
- D) decreases; U.S. firms can sell goods to other countries

Answer: C

Topic: *The Multiplier and Imports*

Skill: *Conceptual*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

90) Changes in which of the following will affect the size of the multiplier?

- I. marginal propensity to import
- II. marginal propensity to consume
- III. marginal income tax rate

- A) I only
- B) II only
- C) I and II only
- D) I, II, and III

Answer: D

*Topic: The Multiplier, Imports, and Income Taxes*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 11*

*AACSB: Reflective Thinking*

91) The presence of income taxes and imports make the multiplier

- A) fall in value but remain positive.
- B) rise in value.
- C) not change in value.
- D) become negative.

Answer: A

*Topic: The Multiplier, Imports, and Income Taxes*

*Skill: Analytical*

*Question history: Previous edition, Chapter 11*

*AACSB: Reflective Thinking*

92) You observe that unplanned inventories are increasing. You predict that there will be \_\_\_\_\_.

- A) a business cycle
- B) an expansion
- C) a trough
- D) a recession

Answer: D

*Topic: The Multiplier and Business Cycle Turning Points*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 11*

*AACSB: Reflective Thinking*

93) Business cycle turning points are

- A) unaffected by, and unrelated to the multiplier.
- B) easy to predict.
- C) brought about by changes in autonomous expenditures that are then subject to the multiplier effect.
- D) None of the above is correct.

Answer: C

*Topic: The Multiplier and Business Cycle Turning Points*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 11*

*AACSB: Reflective Thinking*

- 94) Which of the following does NOT occur as the economy moves from an expansion to a recession?
- A) An initial decrease in autonomous spending is the trigger that creates the business cycle turning point.
  - B) The change in planned spending exceeds the change in real GDP.
  - C) The multiplier process reinforces any decrease in spending and pushes the economy into recession.
  - D) Incomes fall during recessions as firms cut production in response to unplanned increases in inventories.

Answer: B

Topic: *The Multiplier and Business Cycle Turning Points*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 95) Which of the following is INCORRECT?
- A) Expansions usually begin with an increase in autonomous spending.
  - B) Firms experience unplanned decreases in inventories as expansions begin.
  - C) Firms increase production in response to unplanned decreases in inventories.
  - D) The multiplier dampens the increase in income that occurs during expansions and brings the economy to a new equilibrium GDP.

Answer: D

Topic: *The Multiplier and Business Cycle Turning Points*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 96) A decrease in autonomous expenditure shifts the *AE* curve
- A) downward and leaves its slope unchanged.
  - B) downward and makes it steeper.
  - C) downward and makes it flatter.
  - D) upward and makes it steeper.

Answer: A

Topic: *Study Guide Question, Autonomous Expenditure*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 97) If investment increases by \$150 and, in response, equilibrium expenditure rises by \$600,
- A) the multiplier is 0.25.
  - B) the multiplier is 4.0.
  - C) the *MPC* is 4.
  - D) the slope of the *AE* curve is 3.0.

Answer: B

Topic: *Study Guide Question, The Multiplier Effect*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

## 4 The Multiplier and the Price Level

- 1) The aggregate demand curve slopes downward because of
- A) the multiplier.
  - B) the MPC.
  - C) wealth and substitution effects.
  - D) import and taxation effects.

Answer: C

Topic: Aggregate Demand Curve and the Price Level

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 2) If the price level rises, the purchasing power of wealth
- A) increases.
  - B) does not change.
  - C) decreases.
  - D) increases at first but in the long run decreases.

Answer: C

Topic: Aggregate Demand Curve and the Price Level

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 3) The intertemporal substitution effect of a change in the price level results from a
- A) change in the price of current goods relative to future goods.
  - B) change in the purchasing power of wealth.
  - C) change in the price of foreign goods relative to domestic goods.
  - D) Both answers B and C are correct.

Answer: A

Topic: Aggregate Demand Curve and the Price Level

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 4) Intertemporal substitution means changes in purchases
- A) through time.
  - B) between imports and exports.
  - C) across different stores.
  - D) across different goods and services.

Answer: A

Topic: Aggregate Demand Curve and the Price Level

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 5) The larger the multiplier, the \_\_\_\_\_ the *AE* curve and the \_\_\_\_\_ the *AD* curve from an increase in investment.
- A) steeper; smaller the shift in
  - B) steeper; larger the shift in
  - C) flatter; larger the movement along
  - D) flatter; smaller the movement along

Answer: B

Topic: *AE, AD, and Change in Autonomous Expenditure*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 6) If investment decreases, the *AE* curve shifts
- A) upward and the *AD* curve shifts rightward.
  - B) downward and the *AD* curve shifts leftward.
  - C) upward and there is a movement along the *AD* curve.
  - D) downward and there is a movement along the *AD* curve.

Answer: B

Topic: *AE, AD, and Change in Autonomous Expenditure*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 7) Which of the following shifts the aggregate demand curve rightward?
- A) an increase in the price level
  - B) an increase in the income tax rate
  - C) an increase in government expenditure
  - D) a decrease in investment

Answer: C

Topic: *AE, AD, and Change in Autonomous Expenditure*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 8) An increase in investment spending results in a \_\_\_\_\_ the aggregate expenditure curve and \_\_\_\_\_ the aggregate demand curve.
- A) movement along; a shift in
  - B) shift in; a movement along
  - C) shift in; has no effect on
  - D) shift in; a shift in

Answer: D

Topic: *AE, AD, and Change in Autonomous Expenditure*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 9) Which of the following shifts the aggregate expenditure curve AND shifts the aggregate demand curve?
- I. a decrease in investment
  - II. a change in the price level
  - III. an increase in exports
- A) I and II
  - B) I and III
  - C) II and III
  - D) III only

Answer: B

Topic: AE, AD, and Change in Autonomous Expenditure

Skill: Analytical

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 10) Because the short-run aggregate expenditure model assumes that the price level is \_\_\_\_\_, its predicted effect of changes in autonomous expenditure on equilibrium output is \_\_\_\_\_ than the prediction of the AD/SAS model.
- A) fixed; greater
  - B) fixed; less
  - C) flexible; greater
  - D) flexible; less

Answer: A

Topic: AE Curve, AD Curve, and the Price Level

Skill: Conceptual

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 11) A fall in the price level
- A) shifts the aggregate expenditure curve upward and increases the quantity of real GDP demanded.
  - B) shifts the aggregate demand curve rightward and increases equilibrium GDP.
  - C) decreases aggregate planned expenditures and shifts the aggregate demand curve leftward.
  - D) shifts both the aggregate expenditures curve and aggregate demand curve upward.

Answer: A

Topic: AE Curve, AD Curve, and the Price Level

Skill: Conceptual

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

- 12) An increase in the price level results in a
- A) downward shift in the AE curve and a movement up along the AD curve.
  - B) downward shift in both the AE and AD curves.
  - C) downward shift in the AD curve and a movement down along the AE curve.
  - D) leftward movement along both the AE and AD curves.

Answer: A

Topic: AE, AD, and the Price Level

Skill: Conceptual

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

- 13) A shift in the aggregate expenditure curve as a result of an increase in the price level results in a
- A) leftward shift in the aggregate demand curve.
  - B) movement down along the aggregate demand curve.
  - C) rightward shift in the aggregate demand curve.
  - D) movement up along the aggregate demand curve.

Answer: D

Topic: *AE, AD, and the Price Level*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 14) Any change in the price level will result in a
- A) shift in the *AE* curve and a movement along the *AD* curve.
  - B) movement along the *AE* curve and a shift of the *AD* curve.
  - C) shift in the *AE* and *AD* curves in the same direction.
  - D) shift in the *AE* and *AD* curves in opposite directions.

Answer: A

Topic: *AE Curve, AD Curve, and the Price Level*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 15) If the price level increases, the *AE* curve shifts
- A) upward and the *AD* curve shifts leftward.
  - B) downward and the *AD* curve shifts rightward.
  - C) upward and we move along the *AD* curve.
  - D) downward and we move along the *AD* curve.

Answer: D

Topic: *AE Curve, AD Curve, and the Price Level*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 16) An increase in \_\_\_\_\_ shifts the *AE* curve \_\_\_\_\_ and an increase in \_\_\_\_\_ shifts the aggregate demand curve \_\_\_\_\_.
- A) autonomous expenditure; upward; the price level; leftward
  - B) the price level; downward; autonomous expenditure; rightward
  - C) the price level; upward; autonomous expenditure; leftward
  - D) autonomous expenditure; upward; the price level; rightward

Answer: B

Topic: *AE, AD, and the Price Level*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*



- 17) The multiplier measures the
- A) horizontal shift in the aggregate demand curve from an increase in autonomous spending.
  - B) vertical shift in the aggregate demand curve from an increase in autonomous spending.
  - C) horizontal difference between two points on the same aggregate demand curve.
  - D) vertical difference between two points on the same aggregate demand curve.

Answer: A

Topic: *The Multiplier and the Change in Aggregate Demand Level*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 18) An increase in the price level decreases planned expenditure because
- A) real wealth decreases, thus decreasing expenditure.
  - B) current prices rise relative to future prices, increasing expenditure.
  - C) domestic prices rise relative to foreign prices, increasing net exports.
  - D) the real interest rate rises, increasing consumption expenditure.

Answer: A

Topic: *Aggregate Expenditure and the Price Level*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 19) An increase in the price level decreases planned expenditures because
- A) real wealth increases, decreasing expenditure.
  - B) current prices rise relative to future prices, decreasing expenditure.
  - C) domestic prices rise relative to foreign prices, increasing net exports.
  - D) the real interest rate rises, increasing expenditure.

Answer: B

Topic: *Aggregate Expenditure and the Price Level*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 20) When autonomous expenditure changes, the horizontal distance by which the aggregate demand curve shifts
- A) depends on the size of the multiplier.
  - B) depends on the size of the wealth effect.
  - C) is increased by the existence of automatic stabilizers.
  - D) is determined by the inverse of the multiplier.

Answer: A

Topic: *Aggregate Demand Curve*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 21) In general, an increase in autonomous expenditure that is NOT created by a change in the price level results in a
- A) rightward shift of the *AD* curve.
  - B) movement upward along the *AD* curve.
  - C) movement downward along the *AD* curve.
  - D) leftward shift of the *AD* curve.

Answer: A

Topic: *Change in Aggregate Demand*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 22) Suppose that in a particular economy, the multiplier is equal to 5. In terms of aggregate demand and aggregate supply, this value for the multiplier means that after an increase in investment
- A) at each level of real GDP, the aggregate demand curve shifts upward by an amount equal to 5 times the change in investment.
  - B) at each level of real GDP, the aggregate supply curve shifts upward by an amount equal to 5 times the change in investment.
  - C) at each price level, the aggregate supply curve shifts rightward by an amount equal to 5 times the change in investment.
  - D) at each price level, the aggregate demand curve shifts rightward by an amount equal to 5 times the change in investment.

Answer: D

Topic: *The Multiplier and the Price Level*

Skill: *Recognition*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 23) In an economy, the multiplier is 3. If government expenditure increases by \$1 million, then in the short run, the price level \_\_\_\_\_ and real GDP \_\_\_\_\_ \$3 million.
- A) falls; decreases by less than
  - B) rises; equals
  - C) rises; increases by less than
  - D) rises; decreases by less than

Answer: C

Topic: *The Multiplier and the Price Level*

Skill: *Analytical*

Question history: *Previous edition, Chapter 13*

AACSB: *Analytical Skills*

- 24) The government increases its expenditures. The steeper the *SAS* curve, the \_\_\_\_\_ will be the increase in the price level and the \_\_\_\_\_ will be the increase in real GDP.
- A) larger; larger
  - B) larger; smaller
  - C) smaller; larger
  - D) smaller; smaller

Answer: B

Topic: *The Multiplier and the Price Level*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 13*

AACSB: *Analytical Skills*

- 25) With a steep short-run aggregate supply curve,
- A) an increase in government expenditure will not have an impact on the price level.
  - B) fiscal policy will be an effective tool to reduce unemployment without raising prices too much.
  - C) an increase in taxes that does not change potential GDP will not decrease real GDP by much.
  - D) there is a large change in real GDP whenever the price level rises.

Answer: C

Topic: Contractionary Fiscal Policy

Skill: Analytical

Question history: Previous edition, Chapter 13

AACSB: Analytical Skills

- 26) Taking into account the upward-sloping short-run aggregate supply curve, the *short-run* effect of an increase in government expenditure on real GDP is that
- A) real GDP increases by more in the short run than in the long run.
  - B) real GDP increases by the same amount in the short run as in the long run.
  - C) real GDP increases by less in the short run than in the long run.
  - D) real GDP does not change in the short run because the price level increases.

Answer: A

Topic: The Multiplier and the Price Level

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

- 27) Because of changes in the \_\_\_\_\_, the long-run effect of a \$10 increase in investment on real GDP equals \_\_\_\_\_.
- A) interest rate; zero
  - B) interest rate; \$10
  - C) money wage rate and price level; zero
  - D) money wage rate and price level; \$10

Answer: C

Topic: The Multiplier and the Price Level

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

- 28) The size of the multiplier
- A) is unaffected by the amount of time that elapses.
  - B) increases in the long run.
  - C) decreases in the long run.
  - D) is constant in the long run.

Answer: C

Topic: Long-Run Multiplier

Skill: Conceptual

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 29) The multiplier effect is smallest
- A) in the long run.
  - B) in the short run.
  - C) when the price level is fixed.
  - D) when the economy is in a recession.

Answer: A

Topic: Long-Run Multiplier

Skill: Conceptual

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 30) The short-run multiplier is equal to 3, real GDP equals potential GDP of \$8,000, and the price level is equal to 100. Suppose that government expenditure decreases by \$200. The *long-run* effect of the decrease in government expenditure changes real GDP by
- A) a decrease of 600.
  - B) an increase of 600.
  - C) nothing; that is, in the long run real GDP equals \$8,000.
  - D) a decrease of \$200 because the long-run multiplier is 1.

Answer: C

Topic: Long-Run Multiplier

Skill: Recognition

Question history: Modified 10th edition

AACSB: Analytical Skills

- 31) After an increase in autonomous spending, in the long run, changes in the price level
- A) will make the *AE* curve steeper.
  - B) will make the *AE* curve flatter.
  - C) will reduce the effect of the multiplier.
  - D) will not affect the multiplier.

Answer: C

Topic: Long-Run Multiplier

Skill: Conceptual

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 32) In the long run, the multiplier
- A) is greater than 1 because of the position and slope of the *SAS* curve.
  - B) is twice the short-run multiplier.
  - C) is 0.
  - D) depends on the slope of the *AD* curve.

Answer: C

Topic: Long-Run Multiplier

Skill: Conceptual

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 33) When the economy is at full employment and investment increases, in the long run the price level will \_\_\_\_\_ and, if potential GDP does not change, in the long run real GDP will \_\_\_\_\_.
- A) increase; increase
  - B) decrease; not change
  - C) decrease; decrease
  - D) increase; not change

Answer: D

Topic: Long-Run Multiplier

Skill: Conceptual

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 34) A fall in the price level shifts the AE curve \_\_\_\_\_ and \_\_\_\_\_ equilibrium expenditure.
- A) upward; increases
  - B) upward; decreases
  - C) downward; increases
  - D) downward; decreases

Answer: A

Topic: Study Guide Question, Aggregate Demand and the Price Level

Skill: Conceptual

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

- 35) If the multiplier is 4.0 and investment decreases by \$2.5 billion, the AD curve
- A) shifts rightward by \$10 billion.
  - B) shifts rightward by less than \$10 billion.
  - C) shifts leftward by \$10 billion.
  - D) shifts leftward by more than \$30 billion.

Answer: C

Topic: Study Guide Question, The Multiplier and Aggregate Demand

Skill: Analytical

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

- 36) The multiplier is 2.5 and the SAS curve is upward sloping. Investment increases by \$20 billion. In the short run, equilibrium real GDP will
- A) increase by \$50 billion.
  - B) increase by less than \$50 billion.
  - C) decrease by \$50 billion.
  - D) decrease by less than \$50 billion.

Answer: B

Topic: Study Guide Question, Short-Run Multiplier

Skill: Analytical

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

- 37) The multiplier is 5.0 and autonomous expenditure increases by \$30 billion. If potential real GDP is unaffected, in the long run, equilibrium real GDP will
- A) increase by \$50 billion.
  - B) increase by more than \$50 billion.
  - C) increase by less than \$50 billion.
  - D) not change.

Answer: D

Topic: *Study Guide Question, Long-Run Multiplier*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

## 5 Mathematical Note: The Algebra of the Keynesian Model

- 1) Suppose the consumption function is given by the equation  $C = 100 + 0.8YD$ , where  $YD$  is disposable income. What is the marginal propensity to consume?
- A) 0.2
  - B) 0.8
  - C) 2.0
  - D) 100

Answer: B

Topic: *Marginal Propensity to Consume*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 2) Suppose the consumption function is given by the equation  $C = 100 + 0.8YD$ , where  $YD$  is disposable income. What is the marginal propensity to save?
- A) 0.2
  - B) 0.8
  - C) 2.0
  - D) 100

Answer: A

Topic: *Marginal Propensity to Save*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

## 6 News Based Questions

- 1) In 2007, investment in France increased by 7 billion euros. Assume the price level was constant, the multiplier was 5 and the economy was at full employment. As a result, equilibrium expenditure
- A) increased by 35 billion euros.
  - B) increased by 1.4 billion euros
  - C) decreased by 35 billion euros.
  - D) decreased by .71 billion euros.

Answer: A

Topic: *The Multiplier Effect*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 2) In 2007, investment in France increased by 7 billion euros, consumption increased by 4 billion euros and government spending increased by 1.5 billion euros. Assume the price level was constant and the economy was at full employment. As a result, suppose that equilibrium expenditure increased by 21 billion euros. In this example, \_\_\_\_\_ is the induced expenditure and \_\_\_\_\_ is autonomous expenditure.
- A) consumption; government spending
  - B) investment; consumption
  - C) investment; government spending
  - D) government spending; equilibrium expenditure

Answer: B

Topic: *Autonomous Expenditures*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 3) "Few if any economists anticipated the extent of the inventory adjustment... Production cutbacks have been much greater than expected. Those cuts have weakened the industrial sector considerably." As a result of these changes, the U.S. government lowered its estimate of fourth-quarter growth in real GDP.

www.businessweek.com 3/12/2007

The article suggests that \_\_\_\_\_.

- A) planned expenditures exceeded real GDP in 2006.
- B) real GDP exceeded planned expenditures in 2006.
- C) the AE curve shifted upward in 2007.
- D) the AD curve shifted rightward in 2007.

Answer: B

Topic: *Real GDP with a Fixed Price Level*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 4) The software and related services sector has a multiplier effect on the Indian economy with every one-rupee input spent by the "information technology sector" producing an increase in real GDP by two rupees.

www.ft.com, 2/28/2008

According to the story, if \_\_\_\_\_ in the software and related services sector increases by \$15 billion, real GDP will increase by \_\_\_\_\_.

- A) investment; \$30 billion.
- B) consumption; \$30 billion.
- C) consumption; \$2 billion.
- D) investment; \$2 billion.

Answer: A

Topic: *The Multiplier Effect*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 5) Mauritius, an island off the coast of Africa, competes with other countries producing goods with low-skilled labor. In 2006, it was reported that its "... factories have been exposed to ... competition from China, India and other Asian mass producers." As a result, "the main export industry has seen a 30 per cent reduction in volume ..."

www.ft.com, 3/13/2006

The story describes

- A) a decrease in autonomous expenditure.
- B) a decrease in induced expenditure.
- C) an unplanned decrease in inventories.
- D) an increase in equilibrium expenditure.

Answer: A

Topic: *Autonomous Expenditures*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Communication*

- 6) Mauritius, an island off the coast of Africa, competes with other countries producing goods with low-skilled labor. In 2006, it was reported that "... its clothing factories have been exposed to frontal competition from China, India and other Asian mass producers." As a result, "the main export industry has seen a 30 per cent reduction in volume ..."

www.ft.com, 3/13/2006

Suppose real GDP is \$14 billion, exports total \$2 billion and the multiplier is 4. If exports decline by \$600,000,000, real GDP in Mauritius will

- A) increase by \$2.4 billion
- B) decrease by \$2.4 billion.
- C) decrease by \$8 billion.
- D) increase by \$4 billion.

Answer: B

Topic: *The Multiplier Effect*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*



- 7) In an article regarding Bangladesh's economy, the author suggests that the government ..."[g]ive double tax breaks on investment dollars. Give a tax break to R&D [research and development]. Give a tax break on donations to educational institutions."

www.groundreport.com, March 24, 2008

The increase in investment is considered \_\_\_\_\_ and will generate a larger increase in \_\_\_\_\_.

- A) equilibrium spending; autonomous expenditure
- B) autonomous expenditure; induced expenditure
- C) induced expenditure; autonomous expenditure
- D) autonomous expenditure; multiplier spending.

Answer: B

Topic: Autonomous Expenditures

Skill: Conceptual

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

- 8) In an article regarding Bangladesh's economy, the author suggests that the government ..."[g]ive double tax breaks on investment dollars. Give a tax break to R&D [research and development]. Give a tax break on donations to educational institutions."

www.groundreport.com, March 24, 2008

Suppose the multiplier in Bangladesh is 2. If the government enacts the proposed policies and \_\_\_\_\_, aggregate expenditure \_\_\_\_\_ in the short run.

- A) induced expenditure increases by \$5 billion; increases by \$10 billion.
- B) autonomous expenditure decreases by \$10; decreases by \$5 billion.
- C) equilibrium expenditure increases by \$8 billion; increases by \$16 billion.
- D) autonomous expenditure increases by \$10 billion; increases by \$20 billion.

Answer: D

Topic: The Multiplier Effect

Skill: Analytical

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

- 9) In an article regarding Bangladesh's economy, the author suggests that the government ... "[g]ive double tax breaks on investment dollars. Give a tax break to R&D [research and development]. Give a tax break on donations to educational institutions."

www.groundreport.com, March 24, 2008

Suppose the multiplier in Bangladesh is 2. As a result of enacting the proposed policies, which of the following describe possible outcomes in the short run?

- i. an \$20 billion increase in investment will increase aggregate expenditure by \$40 billion.
  - ii. the *AE* curve will shift upward.
  - iii. there will be an unplanned increase in inventories.
- A) i,ii and iii.
  - B) i and ii only.
  - C) i and iii only.
  - D) ii and iii only.

Answer: B

Topic: *The Multiplier Effect*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 10) In the third quarter of 2008, investment in the U.S. totaled \$1.4 trillion and in 2007, investment was \$1.3 trillion. The change in investment
- A) is a change in autonomous expenditure.
  - B) is a change in equilibrium expenditure.
  - C) is a change in induced expenditure.
  - D) will increase the multiplier.

Answer: A

Topic: *Autonomous Expenditures*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 11) An estimate of the *MPC* in the U.S. is 0.90.

Paul Krugman, the 2008 Nobel Prize winner in economics, stated, "... you'd be hard pressed to argue for an overall multiplier as high as 2."

www.nytimes.com, 11/10/2008

What factors could explain the difference between the *MPC* and Krugman's estimate of the multiplier?

- A) exports and investment.
- B) investment and imports.
- C) imports and taxes.
- D) taxes and investment.

Answer: C

Topic: *The Multiplier, Imports, and Income Taxes*

Skill: *Conceptual*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

- 12) In the third quarter of 2008, investment in the U.S. totalled \$1.4 trillion and in 2007, investment was \$1.3 trillion. In addition, third quarter real GDP was \$11 trillion. Suppose the *MPC* in the U.S. is 0.80.

Ignoring the effects of imports and taxes, the multiplier is \_\_\_\_\_ and the change in investment will decrease equilibrium expenditure by \_\_\_\_\_.

- A) 2; \$1 trillion.
- B) 5; \$1 trillion.
- C) 2; \$200 million.
- D) 5; \$500 million.

Answer: D

Topic: *The Multiplier Effect*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 13) In an article regarding Bangladesh's economy, the author suggests that the government ..."[g]ive double tax breaks on investment dollars. Give tax break to R&D [research and development]. Give tax break on donations to educational institutions."

www.groundreport.com, March 24, 2008

As a result of enacting the policies, the *AE* curve will shift \_\_\_\_\_ and the *AD* curve will shift \_\_\_\_\_.

- A) upward; leftward
- B) upward; rightward
- C) downward; rightward
- D) downward; rightward

Answer: B

Topic: *AE, AD, and Change in Autonomous Expenditure*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 14) Mauritius, an island off the coast of Africa, competes with other countries producing goods with low-skilled labor. In 2006, it was reported that its "... factories have been exposed to ... competition from China, India and other Asian mass producers." As a result, "the main export industry has seen a 30 per cent reduction in volume ..."

www.ft.com, 3/13/2006

The decrease in exports represents a change in \_\_\_\_\_ expenditure and will cause \_\_\_\_\_.

- A) induced; a downward shift in the *AE* curve and a leftward shift in the *AD* curve
- B) autonomous; a downward shift in the *AE* curve and a leftward shift in the *AD* curve
- C) induced; an upward shift in the *AE* curve and a leftward shift in the *AD* curve
- D) autonomous; a downward shift in the *AE* curve and a rightward shift in the *AD* curve

Answer: B

Topic: *AE, AD, and Change in Autonomous Expenditure*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 15) Mauritius, an island off the coast of Africa, competes with other countries producing goods with low-skilled labor. In 2006, it was reported that its "... factories have been exposed to ... competition from China, India and other Asian mass producers." As a result, "the main export industry has seen a 30 per cent reduction in volume ..."

www.ft.com, 3/13/2006

The decrease in exports will cause \_\_\_\_\_ and the price level will \_\_\_\_\_.

- A) a downward shift in the *AE* curve; decrease as the *AD* curve shifts leftward in the short run
- B) an upward shift in the *AE* curve; increase as the *AD* curve shifts rightward in the long run
- C) a leftward shift in the *AD* curve; fall in the short run and rise in the long run
- D) a leftward shift in the *AD* curve; rise in the long run as goods become more scarce

Answer: A

Topic: *AE, AD, and the Price Level*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 16) In 2007, investment in France increased by 7 billion euros. Which of following occurs?

- i. an upward shift in the *AE* curve.
- ii. a leftward shift in the *AD* curve.
- iii. an increase in the price level and real GDP in the short run.
- iv. an increase in the price level and no change in real GDP in the long run.

- A) i, ii, iii and iv.
- B) i and iii only.
- C) i, iii and iv only.
- D) iii and iv only.

Answer: C

Topic: *AE, AD, and the Price Level*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 17) "The global financial crisis has had a considerable impact on China's export growth, which will continue to show weakness with recession in the U.S. and Europe," said a report by JP Morgan & Co.

www.money.cnn.com, 11/11/2008

If Chinese exports continue to decline, the *AE* curve will shift \_\_\_\_\_, the price level will \_\_\_\_\_ in the short run and real GDP will \_\_\_\_\_ in the short run.

- A) upward; decrease; decrease
- B) downward; decrease; decrease
- C) upward; decrease; not change
- D) downward; decrease; not change

Answer: B

Topic: *AE, AD, and Change in Autonomous Expenditure*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 18) "The global financial crisis has had a considerable impact on China's export growth, which will continue to show weakness with recession in the U.S. and Europe," said a report by JP Morgan & Co.

www.money.cnn.com, 11/11/2008

If Chinese exports continue to decline, the *AE* curve will shift \_\_\_\_\_, the price level will \_\_\_\_\_ in the long run and real GDP will \_\_\_\_\_ in the long run.

- A) downward; decrease; not change
- B) downward; decrease; decrease
- C) decrease; not change; not change
- D) upward; decrease; not change

Answer: A

Topic: *AE, AD, and Change in Autonomous Expenditure*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

## 7 Essay Questions

- 1) List the four components of aggregate expenditure. Explain the two-way link with real GDP.

Answer: The four components of aggregate expenditure are consumption expenditure, investment, government expenditure on goods and services, and net exports. These four components sum to real GDP. The two-way link between these four parts and real GDP exists through consumption expenditure and imports, both of which are influenced by the level of real GDP. Specifically, an increase in real GDP increases these components of aggregate expenditure and an increase in aggregate expenditure increases real GDP.

Topic: *Expenditure Plans*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Communication*

- 2) What is the consumption function? What factor leads to a movement along the consumption function?

Answer: The consumption function is the relationship between disposable income and the amount of consumption expenditure, other things remaining the same. A change in disposable income results in a movement along the consumption function.

Topic: *Consumption Function*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

3) Please explain the relationship between consumption, disposable income and saving.

Answer: In general, the greater the level of disposable income the greater the level of consumption. Therefore, as disposable income rises consumption rises. Any amount of disposable income not spent, or consumed, is saved. Disposable income is split between consumption and saving. Consumption, however, is not solely determined by disposable income. In fact at low levels of disposable income consumption can be greater than disposable income. This is true in the extreme when disposable income is zero and consumption is greater than zero. At times when consumption is greater than disposable income saving is negative. We are dissaving. On the other hand, if disposable income is high enough, consumption can be less than disposable income. In this case we have positive saving. Lastly, as disposable income rises, consumption rises but by less.

*Topic: Consumption Function*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 11*

*AACSB: Communication*

4) What is the difference between movements along the consumption function and shifts in the consumption function? What factor or factors lead to movements along the consumption function and what factor or factors lead to shifts in the consumption function?

Answer: The consumption function describes the relationship between disposable income and consumption expenditure: If disposable income increases, consumption increases and if disposable income decreases consumption decreases. Because the consumption function is illustrated using disposable income along the horizontal axis, changes in disposable income lead to movements along the consumption function. Changes in other factors that affect consumption expenditure, such as the real interest rate, wealth, and expected future income, shift the consumption function. Specifically, if the real interest rate falls, if wealth increases, or if future income is expected to increase, the consumption function shifts upward so that at any level of disposable income, consumption is greater than it otherwise would have been.

*Topic: Consumption Function*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 11*

*AACSB: Communication*

5) List and explain factors that influence consumption expenditure.

Answer: Disposable income is an important factor that influences consumption expenditure. There is a direct relationship between the two, so that an increase in disposable income leads to an increase in consumption expenditure. There also are three other factors that influence consumption expenditure: the real interest rate, the buying power of money, and expected future disposable income. When the real interest rate falls, the buying power of money increases, or expected future disposable income increases, consumption increases. Alternatively, when the real interest rate rises, the buying power of money decreases, or expected future income decreases, consumption expenditure decreases.

*Topic: Consumption Function*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 11*

*AACSB: Communication*

- 6) How is it possible for consumption expenditure to be positive even when disposable income is zero?

Answer: Consumption expenditure can be positive when disposable income is zero because people can "dissave," that is, they can use their past saving to finance current consumption expenditure. Dissaving cannot occur indefinitely because eventually people's savings will be dissipated.

Topic: *Autonomous Consumption*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 7) What is the marginal propensity to consume? Why it is an important concept?

Answer: The marginal propensity to consume,  $MPC$ , is the fraction of a change in disposable income that is consumed, or  $MPC = \frac{\Delta C}{\Delta YD}$  where  $\Delta$  means "change in." The  $MPC$  tells what fraction of an increase in disposable income is spent on consumption. The  $MPC$  is an important concept because it affects the multiplier: The larger the  $MPC$ , everything else the same, the larger the multiplier.

Topic: *Marginal Propensity to Consume*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 8) What is the marginal propensity to consume? Can the marginal propensity to consume be greater than 1?

Answer: The marginal propensity to consume is the change in consumption expenditure divided by the change in disposable income that brought it about. The marginal propensity to consume cannot be greater than 1. Indeed, it is less than 1 because people save part of an increase in disposable income.

Topic: *Marginal Propensity to Consume*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 9) What does the marginal propensity to consume measure and how is it related to the consumption function?

Answer: The marginal propensity to consume, or  $MPC$ , is the change in consumption expenditure divided by the change in disposable income. The  $MPC$ , tells the proportion of any change in disposable income spent on consumption expenditure. The marginal propensity to consume is equal to the slope of the consumption function.

Topic: *Marginal Propensity to Consume*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

10) What is the relationship between U.S. real GDP and U.S. imports?

Answer: When U.S. real GDP increases, so does U.S. income. And the increase in income leads to an increase in U.S. imports.

*Topic: Import Function*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 11*

*AACSB: Reflective Thinking*

11) Discuss the link between real GDP and imports.

Answer: Imports are one of two components that are influenced by changes in U.S. real GDP and so imports are referred to as an induced expenditure. Other things the same, an increase in U.S. real GDP leads to an increase in U.S. imports. As U.S. income increases, households purchase more domestic as well as more foreign goods and services.

*Topic: Import Function*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 11*

*AACSB: Reflective Thinking*

12) What is the difference between induced and autonomous expenditure? Which components of aggregate expenditure fall under which category?

Answer: Induced expenditure is expenditure that depends on the level of real GDP, so that when real GDP changes, induced expenditure changes. Autonomous expenditure is independent of the level of real GDP, so that when real GDP changes, autonomous expenditure does not change. Consumption expenditure includes elements of both autonomous and induced expenditure. So, too, do imports. However, investment, government expenditure on goods and services, and exports are all autonomous expenditures.

*Topic: Induced Versus Autonomous Expenditure*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 11*

*AACSB: Reflective Thinking*

13) Define induced expenditure and autonomous expenditure. Which expenditure items are induced expenditure and which are autonomous expenditure?

Answer: Induced expenditure is aggregate expenditure that changes as real GDP changes. Consumption expenditure and imports respond to changes in real GDP, so they have induced components. Autonomous expenditure is aggregate expenditure that does not change as real GDP changes. Investment, government expenditure, and exports are autonomous expenditures. Consumption expenditure also has an autonomous component.

*Topic: Induced Versus Autonomous Expenditure*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 11*

*AACSB: Reflective Thinking*



- 14) List the components of aggregate expenditure and describe how each of them change as real GDP increases.

Answer: The components of aggregate expenditure are consumption expenditure, investment, government expenditure on goods and services, exports, and imports. As real GDP increases, consumption expenditure and imports increase. However, investment, government expenditure on goods and services, and exports do not change—they are examples of autonomous expenditure, spending that does not change when real GDP changes.

*Topic: Induced Versus Autonomous Expenditure*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 11*

*AACSB: Reflective Thinking*

- 15) "Similar to imports, U.S. exports depend on the level of U.S. real GDP so that if real GDP increases, U.S. exports increase." Explain whether the previous sentence is correct or incorrect.

Answer: The sentence is incorrect along two dimensions. First, U.S., exports do not depend on U.S. real GDP. Indeed, U.S. exports are part of autonomous spending. Second, because U.S. exports do not depend on U.S. real GDP, they definitely do not increase when U.S. real GDP increases.

*Topic: Autonomous Expenditures*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 11*

*AACSB: Reflective Thinking*

- 16) "Aggregate planned expenditure is the sum of planned consumption expenditure, investment, government expenditure on goods and services, and exports minus imports." Is the previous statement correct or incorrect?

Answer: The statement accurately describes aggregate planned expenditure.

*Topic: Aggregate Expenditure*

*Skill: Recognition*

*Question history: Previous edition, Chapter 11*

*AACSB: Reflective Thinking*

- 17) Explain the relationships between real GDP, aggregate planned expenditure, induced expenditure, and unplanned investment.

**Answer:** All buyers in the economy make expenditure plans. Aggregate planned expenditure equals the sum of these buying plans. Aggregate planned expenditure is divided into four components: consumption expenditure, investment, government expenditure on goods and services, and net exports. Investment, government expenditure, and exports are autonomous expenditures because they do not vary with the level of real GDP. Consumption expenditure and imports, however, are affected by the level of real GDP and so are induced expenditures. If aggregate planned expenditure differs from real GDP, not all planned expenditure can be carried out. In this situation, firms' inventories change in an unplanned manner. When aggregate planned expenditure is less than real GDP, inventories increase beyond what was planned and when aggregate planned expenditure is greater than real GDP, inventories decrease beyond what was planned. Because changes in inventories are included in investment, when there are unplanned changes in inventories there is unplanned investment.

*Topic: Aggregate Expenditure*

*Skill: Conceptual*

*Question history: Modified 10th edition*

*AACSB: Communication*

- 18) At the equilibrium level of aggregate expenditure, what does aggregate planned expenditure equal? What happens at other levels of real GDP to bring about an equilibrium?

**Answer:** At the equilibrium level of aggregate expenditure, aggregate planned expenditure is equal to real GDP. At levels of real GDP where aggregate planned expenditure is greater than real GDP, business inventories are less than their target levels. In this situation, businesses increase their production, so output increases and real GDP increases. At levels of real GDP where aggregate planned expenditure is less than real GDP, business inventories are greater than their target levels. In this situation, businesses decrease their production, so output decreases and real GDP decreases.

*Topic: Equilibrium Expenditure*

*Skill: Conceptual*

*Question history: Modified 10th edition*

*AACSB: Communication*

- 19) "If aggregate planned expenditure exceeds real GDP, then real GDP will increase." Explain whether the previous sentence is correct or incorrect.

**Answer:** The sentence is correct. If aggregate planned expenditure exceeds real GDP, then firms find that their inventories are being decreased more than planned. As a result, firms increase production in order to restore their inventories back to their planned levels. When firms increase their production of goods and services, real GDP increases.

*Topic: Equilibrium Expenditure*

*Skill: Conceptual*

*Question history: Modified 10th edition*

*AACSB: Reflective Thinking*

20) What is unplanned investment? How does it occur?

Answer: Unplanned investment occurs when inventories grow larger than planned. The difference between the actual change in inventories and the planned change is unplanned investment. Unplanned investment occurs when aggregate planned expenditure is less than real GDP so firms sell less output than they had planned.

*Topic: Convergence to Equilibrium*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 11*

*AACSB: Reflective Thinking*

21) If real GDP exceeds aggregate planned expenditure, what happens to firm's unplanned inventories?

Answer: If real GDP exceeds aggregate planned expenditure, firms are producing more goods and services than households, firms, and governments are planning to buy. As a result, firms will not be able to sell all of their production. The unsold amounts will wind up in their inventories and so unplanned inventory increases.

*Topic: Convergence to Equilibrium*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 11*

*AACSB: Reflective Thinking*

22) If unplanned inventory changes are positive, what is the relationship between aggregate planned expenditure and real GDP?

Answer: If unplanned inventory changes are positive, firms are not selling all the goods and services they had produced. In this case, aggregate planned expenditure is less than real GDP.

*Topic: Convergence to Equilibrium*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 11*

*AACSB: Reflective Thinking*

23) How do firms respond to unplanned inventory changes? What is the effect on their production and GDP?

Answer: If inventories are above their target levels, that is, more than planned so there is an unplanned increase in inventories, firms decrease their production. As a result, GDP decreases. Conversely, if inventories are below their target levels, that is, less than planned so there is an unplanned decrease in inventories, firms increase their production. In this case, GDP increases.

*Topic: Convergence to Equilibrium*

*Skill: Conceptual*

*Question history: Modified 10th edition*

*AACSB: Reflective Thinking*

- 24) Explain the relationship between real GDP and aggregate planned expenditure, *AE*. What change to inventories takes place when the two are not equal?

Answer: If the GDP and aggregate planned expenditure are equal, then there is an equilibrium. But if aggregate planned expenditure is not equal to real GDP, the economy is out of equilibrium. If aggregate planned expenditure is greater than real GDP, then households, firms, and governments plan to buy more goods and services than firms are producing. Firms meet the extra demand by allowing their inventories to decrease. The decrease is unplanned on the part of firms. So when aggregate planned expenditure exceeds real GDP, there is an unplanned decrease in inventories. Similarly, if aggregate planned expenditure is less than real GDP, households, firms, and governments plan to buy less than firms produce and so there is an unplanned increase in firms' inventories.

*Topic: Convergence to Equilibrium*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 11*

*AACSB: Reflective Thinking*

- 25) Does aggregate planned expenditure always equal real GDP?

Answer: No, aggregate planned expenditure does not always equal real GDP. *Actual* aggregate expenditure always equals real GDP, but aggregate planned expenditure equals real GDP only when the economy is at an expenditure equilibrium.

*Topic: Actual Expenditures and Planned Expenditures*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 11*

*AACSB: Reflective Thinking*

- 26) Suppose that firms find that their inventories are less than planned. In this case, what is the initial relationship between aggregate planned expenditure and real GDP? Using the aggregate expenditure model, what adjustments, if any, take place?

Answer: If inventories are less than planned, aggregate planned expenditure exceeds real GDP. In order to restore their inventories to their desired levels, firms will increase their production. As a result, real GDP increases. Inventories remain less than planned and real GDP continues to increase until eventually real GDP reaches its equilibrium level, at which point actual and planned inventories are equal.

*Topic: Convergence to Equilibrium*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 11*

*AACSB: Reflective Thinking*

27) How does the economy adjust so that aggregate planned expenditure equals real GDP?

Answer: Equilibrium occurs when real GDP equals the aggregate planned expenditure so that unplanned inventory change is zero. The unplanned changes to inventory are the key signal that induces firms to change their production and drive the economy to its equilibrium. For example, if aggregate planned expenditure is greater than real GDP, firms find their inventory levels falling. This change is an unplanned reduction so firms respond by increasing production and, as a result, real GDP and disposable income increase. The increase in real GDP moves the economy closer to equilibrium but the increase in disposable income leads to an increase in induced aggregate expenditures. However the increase in induced aggregate expenditures is less than the increase in real GDP, so the difference between aggregate planned expenditure and real GDP shrinks. As long as there is unplanned decreases in inventories, firms continue to increase their production so that real GDP continues to increase. Ultimately equilibrium is reached when unplanned inventory changes are zero and so aggregate planned expenditures equal real GDP.

*Topic: Convergence to Equilibrium*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 11*

*AACSB: Communication*

28) A country reports that it has an unplanned inventory increase of \$1.0 trillion. Discuss how the economy adjusts until it reaches an unplanned inventory change of \$0.0 trillion.

Answer: When unplanned inventory changes are positive, real GDP exceeds aggregate planned expenditures. There is an inventory build up, so firms decrease production and as a result real GDP decreases. Firms continue to decrease production until real GDP equals aggregate planned expenditures and unplanned inventory changes equal zero.

*Topic: Convergence to Equilibrium*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 11*

*AACSB: Reflective Thinking*

29) Explain the basic idea of the expenditure multiplier and the role consumers play in determining its magnitude.

Answer: The basic idea of the multiplier is that any increase in expenditure will increase real GDP by a larger (a multiple) amount. The magnitude of the multiplier basically depends on how strongly consumers respond to additional income. Any initial increase in expenditure increases aggregate expenditure, which leads to more production and an increase in real GDP and income. Thus an increase, say in investment, generates an increase in income and this increase, in turn, induces an increase in consumption expenditure. The second round, the increase in consumption expenditure, is the result of the first round, the increase in investment. But the story does not stop with just two rounds. The initial increase in expenditure sets off a chain of increases because the second round increase in consumption leads to yet another increase in GDP and income. As a result of this next increase in income, consumption expenditure increases another time and a third round of expenditure increases occurs. The final result of all the rounds has real GDP increasing many fold compared to the initial increase in investment.

*Topic: The Multiplier*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 11*

*AACSB: Communication*

30) Explain why the multiplier is greater than 1.

Answer: The multiplier is greater than 1 because increases in real GDP induce further increases in expenditure. For instance, suppose Intel spends \$500 million building a new factory. As a result, the disposable income of the workers constructing the factory increase. With the increase in their disposable income, these workers increase their consumption expenditure. Perhaps they all purchase new Ford SUVs. Ford must employ additional workers to build these SUVs, and so these workers' incomes increase. Possibly the Ford workers all buy new stoves. Hence the initial increase in Intel's investment has induced additional consumption expenditure upon SUVs and stoves. And the process won't stop with the stoves because the workers who make the stoves will increase their consumption expenditure. All of the added consumption expenditure makes the multiplier greater than 1.

Topic: *The Multiplier*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Communication*

31) What effect does an increase in the *MPC* have on the slope of the *AE* curve?

Answer: An increase in the *MPC* increases the slope of the *AE* curve and thereby makes it steeper.

Topic: *Slope of the Aggregate Expenditure Curve and The Multiplier*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

32) What is the relationship between the *MPC* and the slope of the *AE* curve?

Answer: If there are no imports or income taxes, then the slope of the *AE* curve equals the *MPC*. If there are imports and income taxes, then the slope of the *AE* curve is less than the *MPC*.

In either case, an increase in the *MPC* increases the slope of the *AE* curve.

Topic: *The Slope of the Aggregate Expenditure Curve and the Multiplier*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

33) What is the relationship between the slope of the aggregate expenditure curve and the multiplier?

Answer: The multiplier equals  $\frac{1}{(1 - \text{slope of the } AE \text{ curve})}$ . This result does not change regardless

of the existence or absence of imports or income taxes.

Topic: *Slope of the Aggregate Expenditure Curve and The Multiplier*

Skill: *Conceptual*

Question history: *Modified 10th edition*

AACSB: *Analytical Skills*

34) What is the mathematical formula for the multiplier? Why is there a multiplier?

Answer: In general, the multiplier equals  $\frac{1}{(1 - \text{slope of the } AE \text{ curve})}$ . If, however, there are no income taxes or imports, the multiplier equals  $\frac{1}{(1 - MPC)}$ , or, equivalently,  $\frac{1}{MPS}$ . There is a multiplier because a change in autonomous expenditure creates an additional change in induced expenditure. As a result, the equilibrium total change in aggregate expenditure exceeds the initial autonomous change. The multiplier is the amount by which the initial change in autonomous expenditure is multiplied to determine the change in equilibrium expenditure.

*Topic: The Multiplier*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 11*

*AACSB: Analytical Skills*

35) Explain what happens to equilibrium expenditure if autonomous expenditure increases by \$100 million.

Answer: Equilibrium expenditure will increase by more than \$100 million because of the multiplier. Basically, the \$100 million increase in spending induces further increases in aggregate expenditure because the initial increase in expenditure increases income, which, in turn, causes further increases in expenditure and income.

*Topic: The Multiplier*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 11*

*AACSB: Analytical Skills*

36) Suppose the  $MPC = 0.90$  and there are no taxes or imports. What does the multiplier equal? If the initial equilibrium aggregate expenditure is \$12 trillion, what will be the effect on aggregate expenditure of a \$100 billion increase in investment?

Answer: The multiplier equals  $1/(1 - MPC)$ , so the multiplier equals  $1/(1 - 0.9) = 1/(0.1) = 10$ . With a multiplier of 10, a \$100 billion increase in investment results in a  $(10) \times (\$100 \text{ billion}) = \$1 \text{ trillion}$  increase in aggregate expenditure, so the new equilibrium aggregate expenditure is \$13 trillion.

*Topic: The Multiplier*

*Skill: Analytical*

*Question history: Previous edition, Chapter 11*

*AACSB: Analytical Skills*

37) How do imports and income taxes affect the multiplier? Why do they have this effect?

Answer: Income taxes and imports shrink the multiplier. They have this effect because they mean that increases in GDP translate into smaller increases of spending on domestic goods and services.

*Topic: The Multiplier, Imports, and Income Taxes*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 11*

*AACSB: Analytical Skills*

- 38) "If the income tax rate is high enough, the multiplier can be negative." Is the previous statement correct or incorrect?

Answer: The statement is incorrect. The higher the income tax rate, the smaller the multiplier, but the multiplier always remains positive.

Topic: *The Multiplier, Imports, and Income Taxes*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 39) Discuss how the marginal propensity to consume, imports, and income tax rates influence the multiplier.

Answer: The simple multiplier, in an economy with no imports or income taxes, is  $1/(1 - MPC)$ , where  $MPC$  is the marginal propensity to consume. The  $MPC$  measures how much consumption changes when disposable income changes. The larger is the  $MPC$ , the larger is the multiplier. Both the taxes and imports decrease the size of the multiplier because both taxes and imports "divert" changes in GDP from consumption expenditure on domestic goods and services. The larger the income tax rate and the larger the marginal propensity to import, the smaller the multiplier. The larger the income tax rate, the smaller the change in disposable income from any change in GDP and, as a result, the smaller than induced change in consumption expenditure. The larger the marginal propensity to import, the more increased consumption expenditure falls on imported goods and so the smaller the effect on domestically produced goods and services.

Topic: *The Multiplier, Imports, and Income Taxes*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 40) List and explain factors that determine the size of the multiplier in the aggregate expenditure model when prices are constant.

Answer: The size of the multiplier depends on three factors: the marginal propensity to consume, the marginal propensity to import, and the income tax rate. The larger the marginal propensity to import and the larger the tax rate, the smaller the multiplier. These two factors decrease the size of the multiplier because imports reduce spending on U.S. produced products and income taxes reduce the impact of a change in real GDP on consumption expenditure. On the other hand, the larger the marginal propensity to consume, the larger the multiplier.

Topic: *The Multiplier, Imports, and Income Taxes*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*



41) How does the concept of the multiplier help explain business cycle turning points?

Answer: Business cycle turning points are the point in the business cycle during which the economy either goes from expansion to recession, or recession to expansion. If the economy is at a peak, an expansion is turning into a recession. At this point, aggregate planned expenditures decrease because of a decrease in an autonomous component of expenditure. Real GDP is now greater than aggregate planned expenditure. Inventories rise and firms respond to rising inventories by cutting production, so that real GDP decreases. The multiplier process works and consumption falls by a multiple of the decrease in real GDP. The economy moves into recession. Just the reverse occurs at a trough. At a trough the economy moves from a recession to an expansion. Expansions start as an increase in an autonomous component of aggregate expenditure. This increase boosts aggregate planned expenditures so that it exceeds real GDP. Inventories unexpectedly fall. Firms respond by raising their production, so that real GDP and disposable income increase. Induced expenditure rises by more because of the multiplier effect and so the expansion has begun.

*Topic: The Multiplier and Business Cycle Turning Points*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 11*

*AACSB: Communication*

42) Discuss the relationship between the business cycle and changes in autonomous expenditures.

Answer: An increase in autonomous expenditure increases aggregate planned expenditure. At the moment the economy turns the corner into expansion, aggregate planned expenditure exceeds real GDP. Firms' inventories become less than their target levels, so firms increase production in order to build up their inventories. The reverse happens when a recession begins. A decrease in autonomous expenditure decreases aggregate planned expenditure. When the economy turns the corner into recession, aggregate planned expenditure is less than real GDP. As a result firms' inventories exceed their target levels, and so firms decrease production in order to decrease their inventories.

*Topic: The Multiplier and Business Cycle Turning Points*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 11*

*AACSB: Communication*

43) "When the price level increases, aggregate planned expenditure increases and equilibrium expenditure increases." Is the preceding statement correct or incorrect? Briefly explain your answer.

Answer: The statement is incorrect. An increase in the price level *decreases* aggregate planned expenditure because the purchasing power of money falls, the real interest rises, and the price of imports become less expensive relative to domestically produced goods. Because aggregate planned expenditure decreases, equilibrium expenditure *decreases*.

*Topic: AE Curve, AD Curve, and the Price Level*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 11*

*AACSB: Reflective Thinking*

- 44) How does an increase in the price level affect the aggregate expenditure curve and the aggregate demand curve?

Answer: An increase in the price level shifts the aggregate expenditure curve downward and leads to a movement upward along the aggregate demand curve.

Topic: *AE Curve, AD Curve, and the Price Level*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Analytical Skills*

- 45) An increase in the price level shifts the aggregate expenditure curve downward and results in a movement along the aggregate demand curve. Why does an increase in the price level result in a shift in the aggregate expenditure curve rather than a movement along it?

Answer: The increase in the price level shifts the aggregate expenditure curve because the aggregate expenditure curve plots expenditure against real GDP. In other words, the curve shows how aggregate planned expenditure changes when real GDP changes. Thus a change in real GDP results in a movement along the aggregate expenditure curve. But the effect from an increase in the price level creates a shift in the curve because at any level of real GDP, a higher price level means a lower level of expenditure. Because the effect of the higher price level applies at *all* levels of real GDP, the aggregate expenditure curve shifts downward.

Topic: *AE Curve, AD Curve, and the Price Level*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

- 46) What is the relationship between the aggregate expenditure curve and the aggregate demand curve? Explain the relationship.

Answer: The aggregate demand curve is derived using the aggregate expenditure curve. The aggregate expenditure curve shows how equilibrium expenditure changes when the price level changes. Then the aggregate demand curve plots the price level and the resulting equilibrium expenditure to illustrate how equilibrium expenditure (and hence the aggregate quantity of real GDP demanded) depends on the price level.

Topic: *AE Curve, AD Curve, and the Price Level*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

## 8 Numeric and Graphing Questions

Disposable income (trillions of 2005 dollars)	Consumption expenditure (trillions of 2005 dollars)
0.0	0.8
1.0	1.6
2.0	2.4
3.0	3.2
4.0	4.0

1) The above table has data on the consumption function in the nation of Mojo.

- What is the amount of autonomous consumption expenditure?
- What is the marginal propensity to consume?

Answer: a) Autonomous consumption expenditure equals the consumption expenditure when disposable income is \$0, so autonomous consumption expenditure is \$0.8 trillion.

b) The marginal propensity to consume equals 0.80.

*Topic: Consumption Function*

*Skill: Analytical*

*Question history: Previous edition, Chapter 11*

*AACSB: Analytical Skills*

2) When disposal income is \$5.0 trillion, consumption expenditure is \$4.5 trillion. When disposal income is \$6.0 trillion, consumption expenditure is \$5.0 trillion. What is the marginal propensity to consume?

Answer: The marginal propensity to consume is the change in consumption expenditure divided by the change in disposable income that brought it about. In this case, the marginal propensity to consume equals  $(\$0.5 \text{ trillion})/(\$1.0 \text{ trillion}) = 0.50$ .

*Topic: Marginal Propensity to Consume*

*Skill: Analytical*

*Question history: Previous edition, Chapter 11*

*AACSB: Analytical Skills*

3) When Audrey's disposable income is \$40,000, her consumption expenditure is \$39,000. When her disposable income is \$50,000, Audrey's consumption expenditure is \$47,000. What is Audrey's marginal propensity to consume?

Answer: The marginal propensity to consume is the change in consumption expenditure divided by the change in disposable income that brought it about. In this case, the marginal propensity to consume equals  $(\$8,000)/(\$10,000) = 0.80$ .

*Topic: Marginal Propensity to Consume*

*Skill: Analytical*

*Question history: Modified 10th edition*

*AACSB: Analytical Skills*

Real GDP (billions of 2005 dollars)	C (billions of 2005 dollars)	I (billions of 2005 dollars)	G (billions of 2005 dollars)
100	150	150	150
200	200	150	150
300	250	150	150
400	300	150	150
500	350	150	150
600	400	150	150
700	450	150	150
800	500	150	150
900	550	150	150

- 4) The above table gives information for the nation of North Hampton. There are no imports to or exports from North Hampton.
- Find aggregate planned expenditure for each level of real GDP.
  - What is the equilibrium level of real GDP?

Answer:

Real GDP (trillions of 2005 dollars)	Aggregate expenditure (trillions of 2005 dollars)
100	450
200	500
300	550
400	600
500	650
600	700
700	750
800	800

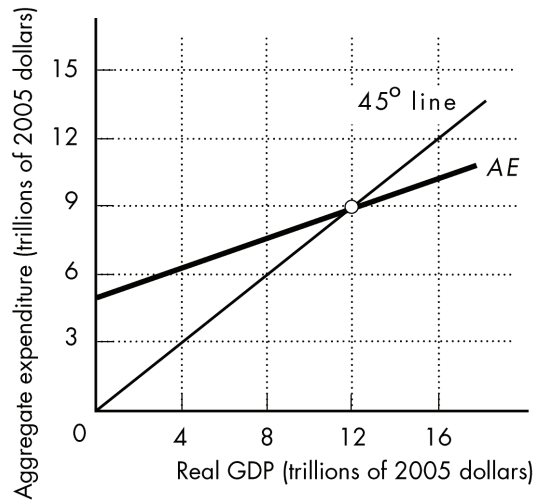
- To calculate aggregate expenditure, for each level of real GDP sum consumption expenditure plus investment plus government purchases. The above table has the answers for each level of real GDP.
- Equilibrium real GDP is \$800 billion because that is the level of real GDP that equals aggregate planned expenditure.

*Topic: Equilibrium Expenditure*

*Skill: Analytical*

*Question history: Previous edition, Chapter 11*

*AACSB: Analytical Skills*



- 5) The above figure shows the *AE* curve and  $45^\circ$  line for an economy.
- If real GDP equals \$8 trillion, how do firms' inventories compare to their planned inventories?
  - If real GDP equals \$16 trillion, how do firms' inventories compare to their planned inventories?
  - What is the equilibrium level of expenditure? Why is this amount the equilibrium?

Answer: a) If real GDP equals \$8 trillion, aggregate expenditure exceeds GDP and so firms' inventories are less than planned.  
 b) If real GDP equals \$16 trillion, aggregate expenditure is less than GDP and so firms' inventories are more than planned.  
 c) The equilibrium level of expenditure is \$12 trillion because at this level of GDP, aggregate expenditure equals GDP. As a result, firms' inventories equal planned inventories so firms have no incentive to either increase or decrease production.

*Topic: Equilibrium Expenditure*

*Skill: Analytical*

*Question history: Previous edition, Chapter 11*

*AACSB: Analytical Skills*

- 6) The slope of the *AE* curve is .80. What is the multiplier? Everything else the same, by how much does equilibrium aggregate expenditure increase if
- exports increase from \$1.75 trillion to \$2.25 trillion.
  - government expenditure on goods and services decrease from \$2.0 trillion to \$1.8 trillion.
  - investment increases from \$1.2 trillion to \$2.3 trillion.

Answer: a) The change in equilibrium aggregate expenditure equals the multiplier times the change in autonomous expenditure, which is \$0.5 trillion. So the change in equilibrium expenditure is  $5 \times (\$0.5 \text{ trillion}) = \$2.5 \text{ trillion}$ .

b) The change in equilibrium aggregate expenditure equals the multiplier times the change in autonomous expenditure, which is  $-\$0.2 \text{ trillion}$ , that is, government expenditure decreases by \$0.2 trillion. So the change in equilibrium expenditure is  $5 \times (-\$0.2 \text{ trillion}) = -\$1.0 \text{ billion}$ .

c) The change in equilibrium aggregate expenditure equals the multiplier times the change in autonomous expenditure, which is \$1.1 trillion. So the change in equilibrium expenditure is  $5 \times (\$1.1 \text{ trillion}) = \$5.5 \text{ trillion}$ .

*Topic: Slope of the Aggregate Expenditure Curve and The Multiplier*

*Skill: Analytical*

*Question history: Previous edition, Chapter 11*

*AACSB: Analytical Skills*

- 7) Suppose a country has no income taxes or imports. If the *MPC* is 0.75, what does the multiplier equal?

Answer: The multiplier equals  $\frac{1}{(1 - MPC)}$ , so in this case it equals  $\frac{1}{(1 - 0.75)} = \frac{1}{0.25} = 4.0$ .

*Topic: The Multiplier*

*Skill: Analytical*

*Question history: Modified 10th edition*

*AACSB: Analytical Skills*

- 8) Suppose the economy has no income taxes or imports. The *MPC* equals 0.8. What does the expenditure model predict will be the change in real GDP if investment increases by \$200 billion?

Answer: The multiplier equals  $\frac{1}{(1 - MPC)}$ , so for the case in the question, the multiplier equals  $\frac{1}{(1 - 0.8)} = \frac{1}{0.2} = 5.0$ . The change in real GDP equals the multiplier times the change in investment, or  $5.0 \times \$200 \text{ billion} = \$1,000 \text{ billion}$ .

*Topic: The Multiplier*

*Skill: Analytical*

*Question history: Previous edition, Chapter 11*

*AACSB: Analytical Skills*

- 9) Suppose the economy has no income taxes or imports. How is the size of the expenditure multiplier related to the marginal propensity to consume? What is the multiplier if the  $MPC$  equals 0.25? If the  $MPC$  equals 0.50? If the  $MPC$  equals 0.90?

Answer: The multiplier equals  $\frac{1}{(1 - MPC)}$ , so the larger the  $MPC$ , the larger the multiplier. If the

$MPC$  is 0.25, the multiplier is  $\frac{1}{(1 - 0.25)} = \frac{1}{0.75} = 1.3$ . If the  $MPC$  is 0.50, the multiplier

equals  $\frac{1}{(1 - 0.50)} = \frac{1}{0.50} = 2.0$ . And if the  $MPC$  is 0.90, the multiplier equals  $\frac{1}{(1 - 0.90)} =$

$\frac{1}{0.10} = 10.0$ . So, the larger the  $MPC$ , the larger the multiplier.

*Topic: The Multiplier*

*Skill: Analytical*

*Question history: Previous edition, Chapter 11*

*AACSB: Analytical Skills*

## 9 True or False

- 1) Components of aggregate expenditure include saving, consumption expenditure, investment and government expenditure.

Answer: FALSE

*Topic: Expenditure Plans*

*Skill: Recognition*

*Question history: Previous edition, Chapter 11*

*AACSB: Reflective Thinking*

- 2) In the very short term, planned investment, planned government expenditure, planned exports, planned consumption, and planned imports are all fixed and do not change when GDP changes.

Answer: FALSE

*Topic: Fixed Prices and Expenditure Plans*

*Skill: Recognition*

*Question history: Previous edition, Chapter 11*

*AACSB: Reflective Thinking*

- 3) The positive relationship between consumption expenditure and disposable income is shown by a movement along the consumption function.

Answer: TRUE

*Topic: Consumption Function*

*Skill: Recognition*

*Question history: Previous edition, Chapter 11*

*AACSB: Reflective Thinking*

- 4) A change in the real interest rate creates a movement along the consumption function.

Answer: FALSE

*Topic: Consumption Function*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 11*

*AACSB: Reflective Thinking*

5) A movement along the consumption function is the result of changes in disposable income.

Answer: TRUE

Topic: *Consumption Function*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

6) If wealth increases, the consumption function shifts upward.

Answer: TRUE

Topic: *Shifts in the Consumption Function, Wealth*

Skill: *Analytical*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

7) As disposable income increases, saving increases.

Answer: TRUE

Topic: *Saving Function*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

8) The marginal propensity to consume must increase as disposable income increases.

Answer: FALSE

Topic: *Marginal Propensity to Consume*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

9) The autonomous components of aggregate expenditures are consumption, savings, and investment.

Answer: FALSE

Topic: *Autonomous Expenditures*

Skill: *Recognition*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

10) Components of induced aggregate expenditure include government expenditure, investment and consumption expenditure.

Answer: FALSE

Topic: *Induced Expenditures*

Skill: *Recognition*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

11) When aggregate planned expenditure is greater than real GDP, inventories decrease.

Answer: TRUE

Topic: *Actual Expenditures and Planned Expenditures*

Skill: *Conceptual*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*



12) Actual aggregate expenditure does not always equal real GDP.

Answer: FALSE

Topic: Convergence to Equilibrium

Skill: Conceptual

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

13) If the price level is constant, a change in investment has a multiplied impact on real GDP.

Answer: TRUE

Topic: The Multiplier Effect

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

14) In the short run, the multiplier typically is less than 1.

Answer: FALSE

Topic: The Multiplier

Skill: Recognition

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

15) If the change in autonomous investment equals \$1 trillion and the change in real GDP equals \$4 trillion, the multiplier equals 1/4.

Answer: FALSE

Topic: The Multiplier

Skill: Conceptual

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

16) If the multiplier is 3, a \$750,000 increase in autonomous expenditure increases equilibrium expenditure by \$2.25 million.

Answer: TRUE

Topic: The Multiplier

Skill: Conceptual

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

17) If there are no income taxes or imports, the multiplier equals  $1/(1 - \text{marginal propensity to consume})$ .

Answer: TRUE

Topic: The Multiplier and the MPC

Skill: Analytical

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

18) Income taxes reduce the size of the multiplier.

Answer: TRUE

Topic: The Multiplier, Imports, and Income Taxes

Skill: Conceptual

Question history: Previous edition, Chapter 11

AACSB: Reflective Thinking

19) Imports and income taxes make the multiplier larger than it would otherwise be.

Answer: FALSE

Topic: *The Multiplier, Imports, and Income Taxes*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

20) In the short run, an upward shift in the aggregate expenditure curve leads to a leftward shift in the short-run aggregate supply curve.

Answer: FALSE

Topic: *Shifts in the Aggregate Demand Curve*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

21) A fall in the price level shifts the aggregate expenditure curve upward and increases the quantity of real GDP demanded.

Answer: TRUE

Topic: *AE Curve, AD Curve, and the Price Level*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

22) The short-run impact changes in autonomous spending have on real GDP and the price level depends on aggregate supply.

Answer: TRUE

Topic: *Shifts in the Aggregate Demand Curve*

Skill: *Conceptual*

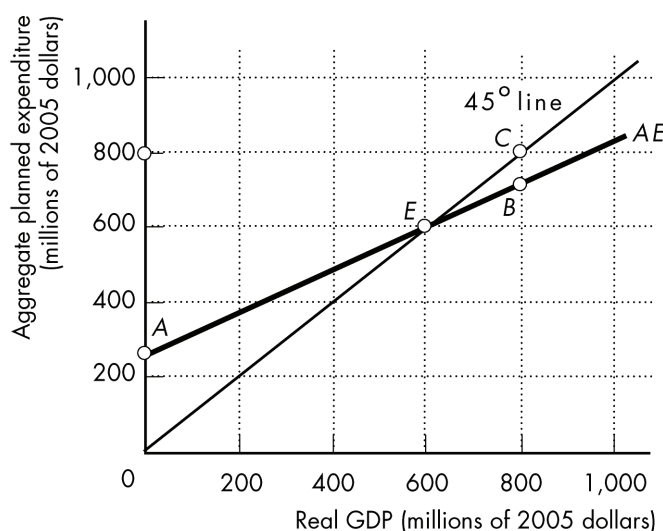
Question history: *Previous edition, Chapter 11*

AACSB: *Reflective Thinking*

## 10 Extended Problems

- 1) In the country of Midland, autonomous consumption expenditure is \$60 million, and the marginal propensity to consume is 0.6. Investment is \$110 million, government expenditure is \$70 million, and there are no income taxes. Investment and government expenditure are constant—they do not vary with income. The nation does not trade with the rest of the world.
- Draw the aggregate expenditure curve.
  - What is the autonomous aggregate expenditure?
  - What is the size of the multiplier in Midland's economy?
  - What is aggregate planned expenditure and what is happening to inventories when real GDP is \$800 million?
  - What is the economy's equilibrium aggregate expenditure?

Answer:



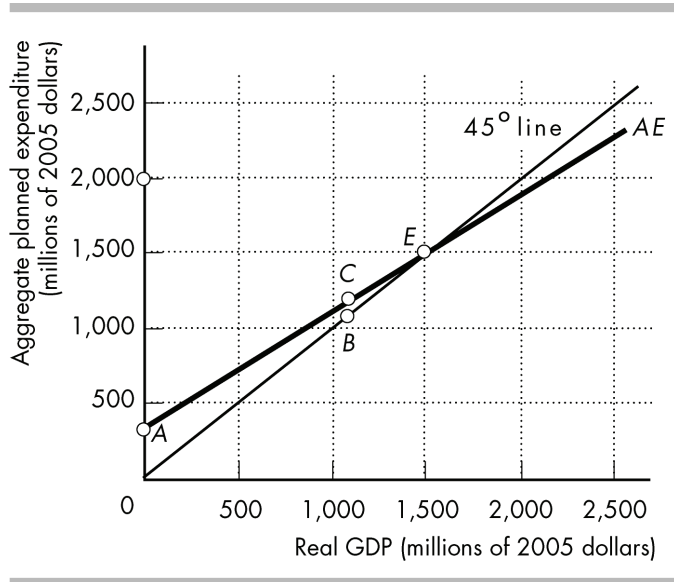
- See the figure above. Because the nation does not trade with the rest of the world, net exports are zero. When net exports are zero, aggregate expenditure, or  $AE$ , is given by  $AE = C + I + G$ . Consumption equals \$60 million plus 0.6 of income, so the consumption function is  $C = \$60 \text{ million} + 0.6Y$ , where \$60 million is autonomous consumption, 0.60 is the marginal propensity to consume, and  $Y$  is real GDP which equals real income. Using the formula in the equation for aggregate expenditure gives  $AE = \$60 \text{ million} + 0.6Y + \$110 \text{ million} + \$70 \text{ million}$ , so the formula for aggregate expenditure is  $AE = \$240 \text{ million} + 0.6Y$ .
- Autonomous expenditure is expenditure that does not vary with real GDP; it is the amount of aggregate expenditure when real GDP equals zero. In Midland, if  $Y = 0$ ,  $AE = \$240 + 0.6 \times 0$ , so autonomous expenditure is \$240 million, shown by point  $A$  in the figure above.
- The multiplier is the amount by which a change in autonomous expenditure is multiplied to determine the change in equilibrium expenditure and real GDP. The multiplier equals  $1/(1 - MPC)$ . So in Midland, the multiplier is  $1/(1 - 0.6) = 2.5$ .
- When real GDP is \$800 million, aggregate planned expenditure,  $AE$ , equals  $\$240 + 0.6 \times \$800 \text{ million}$ , which is \$720 million. This level of aggregate planned expenditure is point  $B$  in the figure above. Because this level of aggregate planned expenditures is less than real GDP, point  $C$  in the figure, inventories increase.

e) Equilibrium expenditure is the level of aggregate expenditure that occurs when aggregate planned expenditure,  $AE$ , equals real GDP. Midland's equilibrium expenditure is at point  $E$  in the figure, when real GDP and aggregate expenditure equal \$600 million. Equilibrium expenditure also can be calculated by solving the equation  $Y = \$240 \text{ million} + 0.6Y$  for  $Y$ . Start by subtracting  $0.6Y$  from both sides to give  $0.4Y = \$240 \text{ million}$ . Then divide both sides by  $0.4$  to obtain  $Y = \$240 \text{ million}/0.4$ , so that  $Y$ , which is real GDP, equals \$600 million.

Topic: *Equilibrium Expenditure*  
 Skill: *Analytical*  
 Question history: *Modified 10th edition*  
 AACSB: *Analytical Skills*

- 2) In the economy of St. Maynard Island, autonomous consumption expenditure is \$185 million, and the marginal propensity to consume is 0.75. Investment is \$150 million, government expenditure is \$100 million, and net taxes are \$80 million. Investment, government expenditure, and taxes are constant—they do not vary with income. The island does not trade with the rest of the world.
- Draw the aggregate expenditure curve.
  - What is the island's autonomous aggregate expenditure?
  - What is the size of the multiplier in St. Maynard Island's economy?
  - What is the island's aggregate planned expenditure and what is happening to inventories when real GDP is \$1,100 million?
  - What is the economy's equilibrium aggregate expenditure?

Answer:



a) See the figure above. Because the island does not trade with the rest of the world, net exports are zero. When net exports are zero, aggregate expenditure, or  $AE$ , is given by  $AE = C + I + G$ . Consumption equals \$185 million plus 0.75 of disposable income, so the consumption function is  $C = \$185 \text{ million} + 0.75(Y - T)$ , where \$185 million is autonomous consumption, 0.75 is the marginal propensity to consume, and  $Y - T$  is disposable income, real income minus net taxes. (Real income also equals real GDP.) Because net taxes are constant, the consumption function is  $C = \$185 \text{ million} + 0.75(Y - \$80 \text{ million})$ . Using the formula in the equation for aggregate

expenditure gives  $AE = \$185 \text{ million} + 0.75(Y - \$80 \text{ million}) + \$150 \text{ million} + \$100 \text{ million}$ , so aggregate expenditure is given by  $AE = \$375 \text{ million} + 0.75Y$ .

b) Autonomous expenditure is expenditure that does not vary with real GDP; it is the level of aggregate expenditure if real GDP were equal to zero. In the economy of St. Maynard Island, if  $Y = 0$ ,  $AE = \$375 \text{ million} + 0.75(0)$ , so autonomous expenditure is \$375 million, which is point *A* in the figure above.

c) The multiplier is the amount by which a change in autonomous expenditure is multiplied to determine the change in equilibrium expenditure and real GDP. The multiplier equals  $1/(1 - \text{slope of } AE \text{ curve})$ . The slope of the *AE* curve is 0.75, so in the economy of St. Maynard Island, the multiplier is  $1/(1 - 0.75) = 4$ .

d) When real GDP is \$1,100 million, aggregate planned expenditure, *AE*, equals  $\$375 \text{ million} + 0.75 \times \$1,100 \text{ million}$ , which is \$1,200 million. This level of aggregate planned expenditure is point *B* in the figure above. Because this level of aggregate planned expenditures exceeds real GDP, point *C* in the figure, inventories decrease.

e) Equilibrium expenditure is the level of aggregate expenditure that occurs when aggregate planned expenditure, *AE*, equals real GDP. In the economy of St. Maynard Island equilibrium is at point *E* in the figure, when real GDP and aggregate expenditure equal \$1,500 million. Equilibrium expenditure also can be calculated by solving the equation  $Y = \$375 \text{ million} + 0.75Y$  for *Y*. Start by subtracting  $0.75Y$  from both sides to give  $0.25Y = \$375 \text{ million}$ . Then divide both sides by 0.25 to obtain  $Y = \$375 \text{ million}/0.25$ , so that *Y*, which is real GDP, equals \$1,500 million.

*Topic: Equilibrium Expenditure*

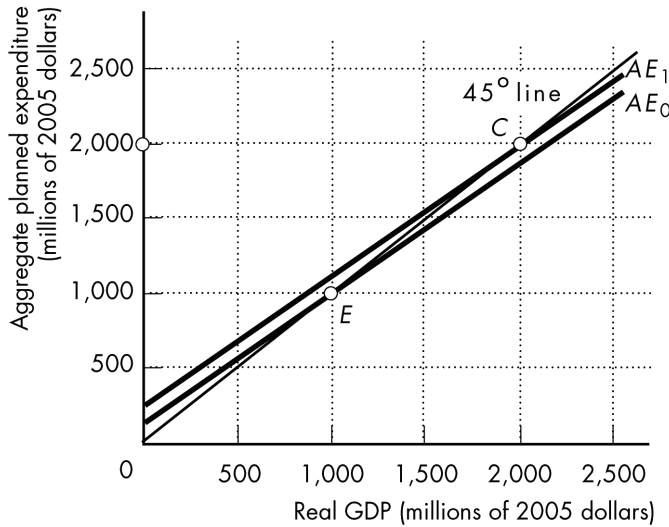
*Skill: Analytical*

*Question history: Previous edition, Chapter 11*

*AACSB: Analytical Skills*

- 3) In the economy of Keynesian Island, autonomous consumption expenditure is \$50 million, and the marginal propensity to consume is 0.8. Investment is \$160 million, government expenditure is \$190 million, and net taxes are \$250 million. Investment, government purchases, and taxes are constant—they do not vary with income. The island does not trade with the rest of the world.
- Draw the aggregate expenditure curve.
  - What is equilibrium real GDP for Keynesian Island?
  - What is the size of the multiplier in Keynesian Island's economy?
  - If the government increases its purchases by \$200 million, what will be the change in the economy's equilibrium real GDP?

Answer:



- a) See the figure above. The aggregate expenditure line is  $AE_0$ . Because the island does not trade with the rest of the world, net exports are zero. When net exports are zero, aggregate expenditure, is given by  $AE = C + I + G$ . Consumption equals \$50 million plus 0.8 of disposable income, so the consumption function is  $C = \$50 \text{ million} + 0.8(Y - T)$ , where \$50 million is autonomous consumption, 0.8 is the marginal propensity to consume, and  $Y - T$  is disposable income, real income minus net taxes. (Real income also equals real GDP.) Because net taxes are constant, the consumption function is  $C = \$50 \text{ million} + 0.8(Y - \$250 \text{ million})$ . Using the formula in the equation for aggregate expenditure gives  $AE = \$50 \text{ million} + 0.8(Y - \$250 \text{ million}) + \$160 \text{ million} + \$190 \text{ million}$ , so aggregate expenditure is given by  $AE = \$200 \text{ million} + 0.8Y$ .
- b) Equilibrium expenditure is the level of aggregate expenditure that occurs when aggregate planned expenditure,  $AE$ , equals real GDP. In the economy of Keynesian Island equilibrium is at point  $E$  in the figure, when real GDP and aggregate expenditure equal \$1,000 million. Equilibrium expenditure also can be calculated by solving the equation  $Y = \$200 \text{ million} + 0.8Y$  for  $Y$ . Start by subtracting  $0.8Y$  from both sides to give  $0.2Y = \$200 \text{ million}$ . Then divide both sides by 0.2 to obtain  $Y = \$200 \text{ million}/0.2$ , so that  $Y$ , which is real GDP, equals \$1,000 million.
- c) The multiplier is the amount by which a change in autonomous expenditure is multiplied to determine the change in equilibrium expenditure and real GDP. The multiplier equals  $1/(1 - \text{slope of the } AE \text{ curve})$ . The slope of the  $AE$  curve is 0.80, so in the economy of Keynesian Island, the multiplier is  $1/(1 - 0.8) = 5$ .
- d) If the government increases its expenditure by \$200 million, the aggregate expenditure curve shifts up by the amount of additional purchases to the aggregate expenditure line  $AE_1$ . (The new formula for aggregate expenditure is  $AE = \$400 \text{ million} + 0.8Y$ .) The economy's equilibrium real GDP increases by the amount of the additional expenditure multiplied by the multiplier. So the increase in real GDP is  $\$200 \text{ million} \times 5$ , which equals \$1,000 million. So the new equilibrium level of real GDP is \$2,000 million, point  $C$  in the figure above.

Topic: The Multiplier

Skill: Analytical

Question history: Previous edition, Chapter 11

AACSB: Analytical Skills

# Chapter 12

## U.S. Inflation, Unemployment, and Business Cycle

### 1 Inflation Cycles

- 1) Which of the following can start an inflation?
- A) an increase in aggregate demand
  - B) an increase in aggregate supply
  - C) a decrease in aggregate supply
  - D) Both answers A and C are correct.

Answer: D

Topic: Inflation

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 2) Inflation can be started by
- A) a decrease in aggregate supply or a decrease in aggregate demand.
  - B) a decrease in aggregate supply or an increase in aggregate demand.
  - C) an increase in aggregate supply or an increase in aggregate demand.
  - D) an increase in aggregate supply or a decrease in aggregate demand.

Answer: B

Topic: Inflation

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 3) Demand-pull inflation starts with
- A) an increase in aggregate demand.
  - B) a decrease in aggregate demand.
  - C) an increase in short-run aggregate supply.
  - D) a decrease in short-run aggregate supply.

Answer: A

Topic: Initial Effect of an Increase in Aggregate Demand

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 4) Demand-pull inflation is an inflation that results from an initial \_\_\_\_\_.
- A) increase in aggregate demand
  - B) decrease in aggregate demand
  - C) increase in wage rates
  - D) increase in natural resource prices

Answer: A

Topic: Demand-Pull Inflation

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 5) Demand-pull inflation starts with a shift of the
- A) *SAS* curve rightward.
  - B) *AD* curve rightward.
  - C) *SAS* curve leftward.
  - D) *AD* curve leftward.

Answer: B

*Topic: Initial Effect of an Increase in Aggregate Demand*

*Skill: Recognition*

*Question history: Previous edition, Chapter 12*

*AACSB: Reflective Thinking*

- 6) Demand-pull inflation starts as the
- A) *LAS* curve shifts leftward.
  - B) *LAS* curve shifts rightward.
  - C) *AD* curve shifts rightward.
  - D) *AD* curve shifts leftward.

Answer: C

*Topic: Initial Effect of an Increase in Aggregate Demand*

*Skill: Recognition*

*Question history: Previous edition, Chapter 12*

*AACSB: Reflective Thinking*



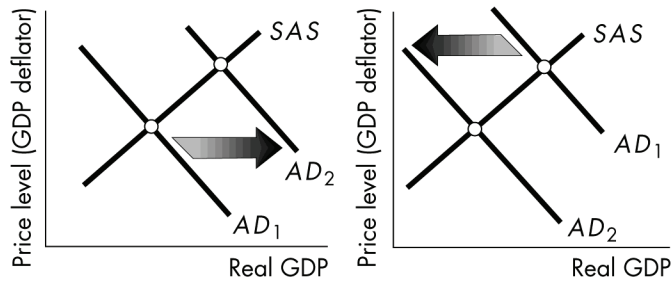


Figure A

Figure B

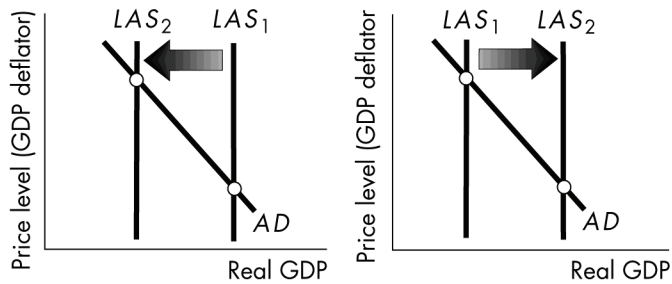


Figure C

Figure D

7) Which of the above figures best shows the start of a demand-pull inflation?

- A) Figure A
- B) Figure B
- C) Figure C
- D) Figure D

Answer: A

Topic: Initial Effect of an Increase in Aggregate Demand

Skill: Analytical

Question history: Previous edition, Chapter 12

AACSB: Analytical Skills

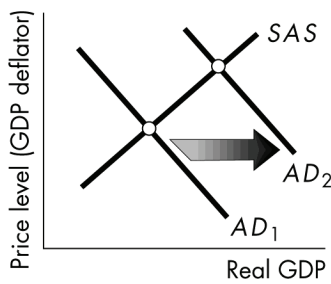


Figure A

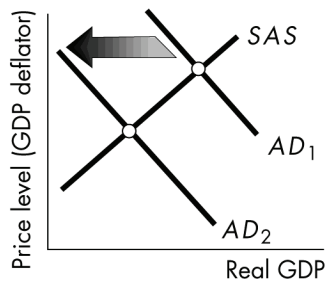


Figure B

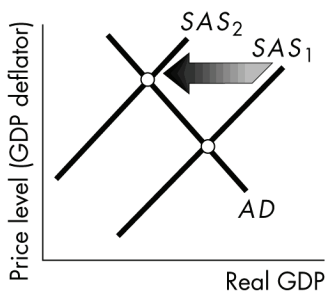


Figure C

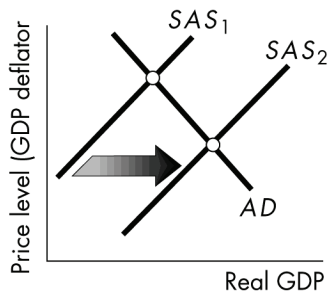


Figure D

8) Which of the above figures best shows the start of a demand-pull inflation?

- A) Figure A
- B) Figure B
- C) Figure C
- D) Figure D

Answer: A

Topic: Initial Effect of an Increase in Aggregate Demand

Skill: Analytical

Question history: Previous edition, Chapter 12

AACSB: Analytical Skills

9) Demand-pull inflation can start when

- A) money wage rates rise but the price level does not change.
- B) money wage rates rise faster than prices.
- C) the short-run aggregate supply curve shifts rightward.
- D) the aggregate demand curve shifts rightward.

Answer: D

Topic: Initial Effect of an Increase in Aggregate Demand

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 10) Demand pull inflation can be started by
- A) a decrease in the quantity of money.
  - B) an increase in government expenditure.
  - C) a decrease in net exports.
  - D) an increase in the price of oil

Answer: B

Topic: Initial Effect of an Increase in Aggregate Demand

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 11) Which of the following factors could start a demand-pull inflation ?
- A) an increase in tax rates
  - B) a decrease in government expenditure
  - C) a decrease in wage rates
  - D) an increase in exports

Answer: D

Topic: Initial Effect of an Increase in Aggregate Demand

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 12) Which of the following could lead to demand-pull inflation?
- A) an increase in the money wage rate
  - B) an increase in the quantity of money
  - C) a decrease in exports
  - D) an increase in oil prices

Answer: B

Topic: Initial Effect of an Increase in Aggregate Demand

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 13) Which of the following could start a demand-pull inflation?
- A) an increase in government expenditure
  - B) an increase in imports
  - C) a decrease in the quantity of money
  - D) an increase in the money prices of raw materials

Answer: A

Topic: Initial Effect of an Increase in Aggregate Demand

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 14) Increases in the quantity of money can start a \_\_\_\_\_ inflation and an increase in government expenditure can start a \_\_\_\_\_ inflation.
- A) demand-pull; demand-pull
  - B) demand-pull; cost-push
  - C) cost-push; cost-push
  - D) cost-push; demand-pull

Answer: A

Topic: *Initial Effect of an Increase in Aggregate Demand*

Skill: *Recognition*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 15) Which of the following can start a demand-pull inflation?
- A) An improvement in technology
  - B) A decrease in productivity
  - C) An increase in imports
  - D) None of the above can start a demand-pull inflation.

Answer: D

Topic: *Initial Effect of an Increase in Aggregate Demand*

Skill: *Conceptual*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

- 16) Demand-pull inflation could start with
- A) an increase in government expenditure followed by an increase in the money wage rate.
  - B) an increase in the quantity of money followed by a decrease in the money wage rate.
  - C) a rise in prices of raw materials followed by an increase in the quantity of money.
  - D) a decrease in exports followed by a decrease in the quantity of money.

Answer: A

Topic: *Initial Effect of an Increase in Aggregate Demand*

Skill: *Recognition*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

- 17) Which of the following is NOT a potential start of a demand-pull inflation?
- A) an increase in the money wage rate
  - B) an increase in the quantity of money
  - C) an increase in government expenditure
  - D) an increase in exports

Answer: A

Topic: *Initial Effect of an Increase in Aggregate Demand*

Skill: *Recognition*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 18) Which of the following is NOT a potential start of a demand-pull inflation?
- A) an increase in the quantity of money
  - B) an increase in government expenditure
  - C) an increase in taxes
  - D) an increase in exports

Answer: C

Topic: Initial Effect of an Increase in Aggregate Demand

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 19) Which of the following is a change that would NOT start a demand-pull inflation?
- A) an increase in exports
  - B) an increase in labor productivity
  - C) an increase in government expenditure on goods and services
  - D) an increase in the quantity of money

Answer: B

Topic: Initial Effect of an Increase in Aggregate Demand

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 20) Which of the following could NOT start a demand-pull inflation?
- A) increases in government expenditure
  - B) increases in net exports
  - C) increases in oil prices
  - D) increases in the quantity of money

Answer: C

Topic: Initial Effect of an Increase in Aggregate Demand

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 21) Initially, demand-pull inflation will
- A) increase the price level and not change real GDP.
  - B) increase both the price level and increase real GDP.
  - C) increase the price level and decrease real GDP.
  - D) shift the aggregate supply curve rightward.

Answer: B

Topic: Initial Effect of an Increase in Aggregate Demand

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 22) A demand-pull inflation initially is characterized by
- A) increasing real output and a labor shortage.
  - B) increasing real output and a labor surplus.
  - C) decreasing real output and a labor shortage.
  - D) decreasing real output and a labor surplus.

Answer: A

Topic: *Initial Effect of an Increase in Aggregate Demand*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 23) If demand pull inflation occurs when the economy is already at potential GDP, then following the initial increase in aggregate demand, the
- A) SAS curve shifts rightward.
  - B) LAS curve shifts rightward.
  - C) SAS curve shifts leftward.
  - D) LAS curve shifts leftward.

Answer: C

Topic: *Wage Response*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Analytical Skills*

- 24) If an economy at potential GDP experiences a demand shock that shifts the aggregate demand curve rightward, there will be
- A) an eventual leftward shift in the short-run aggregate supply curve.
  - B) unemployment below the natural rate.
  - C) upward pressure on money wage rates.
  - D) All of the above answers are correct.

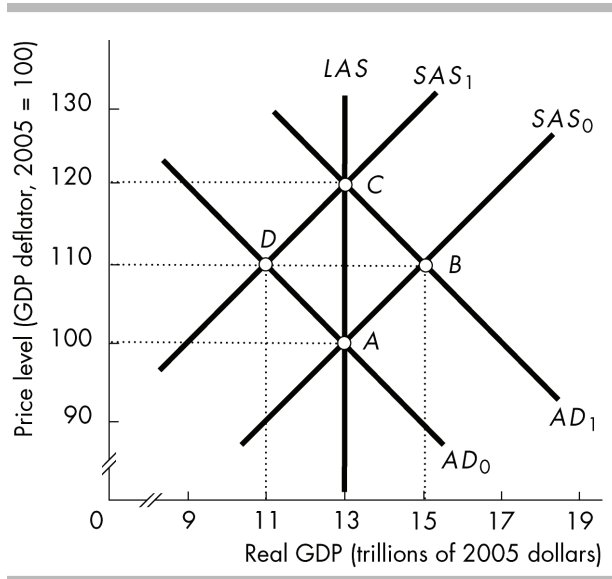
Answer: D

Topic: *Wage Response*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Analytical Skills*



25) In the above figure, suppose that the economy is at point *A* when the quantity of money increases. In the short run, the economy will move to point \_\_\_\_\_.

- A) *A*, that is, the price level and level of real GDP will not change.
- B) *B*
- C) *C*
- D) *D*

Answer: B

Topic: Initial Effect of an Increase in Aggregate Demand

Skill: Analytical

Question history: Previous edition, Chapter 12

AACSB: Analytical Skills

26) In the above figure, suppose that the economy is at point *A* when foreign countries begin an expansion and buy more U.S.-made goods. In the short run, this change creates a movement to point \_\_\_\_\_ and an eventual increase in \_\_\_\_\_.

- A) *B*; money wage rates
- B) *D*; the natural unemployment rate
- C) *B*; the natural unemployment rate
- D) *D*; money wage rates

Answer: A

Topic: Wage Response

Skill: Analytical

Question history: Previous edition, Chapter 12

AACSB: Analytical Skills

- 27) An initial increase in aggregate demand that is NOT followed by an increase in the quantity of money results in a long-run equilibrium with
- A) a higher price level but the same real GDP.
  - B) a higher price level and an increased level of real GDP.
  - C) the same price level and a lower level of real GDP.
  - D) None of the above answers are correct.

Answer: A

Topic: *Initial Effect of an Increase in Aggregate Demand*

Skill: *Analytical*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 28) Suppose that a shock causes the aggregate demand curve to shift rightward. If the Fed does nothing,
- A) the economy will experience a temporary reduction in employment but will eventually return to full employment.
  - B) output initially will exceed potential GDP, but the economy will return to potential GDP with a higher price level.
  - C) the short-run aggregate supply curve will not shift leftward and there will be continued inflation.
  - D) eventually the short-run aggregate supply curve will shift leftward and there will be continued inflation.

Answer: B

Topic: *A Demand-Pull Inflation Process*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 29) For an economy at full employment, an increase in the quantity of money will lead to which of the following sequences of shifts in aggregate demand and supply curves?
- A) decreased aggregate demand, increased short-run aggregate supply, constant long-run aggregate supply
  - B) decreased aggregate demand, decreased short-run aggregate supply, decreased long-run aggregate supply
  - C) increased aggregate demand, increased short-run aggregate supply, increased long-run aggregate supply
  - D) increased aggregate demand, decreased short-run aggregate supply, constant long-run aggregate supply

Answer: D

Topic: *A Demand-Pull Inflation Process*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*



- 30) A one-time rise in the price level can turn into a demand-pull inflation when \_\_\_\_\_.
- A) the money wage rate continues to increase
  - B) the quantity of money persistently decreases
  - C) taxes consistently increase
  - D) the quantity of money persistently increases

Answer: D

Topic: A Demand-Pull Inflation Process

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 31) A demand-pull inflation consists of \_\_\_\_\_ shifts in the *AD* curve and \_\_\_\_\_ shifts in the *SAS* curve.
- A) rightward; rightward
  - B) rightward; leftward
  - C) leftward; rightward
  - D) leftward; leftward

Answer: B

Topic: A Demand-Pull Inflation Process

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 32) In a persisting demand-pull inflation
- A) short-run aggregate supply decreases and aggregate demand increases.
  - B) aggregate demand and short-run aggregate supply both decrease.
  - C) aggregate demand increases and long-run aggregate supply decreases.
  - D) None of the above answers are correct.

Answer: A

Topic: A Demand-Pull Inflation Process

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 33) Demand-pull inflation results from continually increasing the quantity of money, which leads to a continually
- A) decreasing long-run aggregate supply.
  - B) increasing aggregate supply.
  - C) decreasing aggregate demand.
  - D) increasing aggregate demand.

Answer: D

Topic: A Demand-Pull Inflation Process

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 34) Demand-pull inflation persists because of
- A) continuing increases in government expenditures.
  - B) continuing increases in the quantity of money.
  - C) continuing increases in real wage rates.
  - D) continuing increases in aggregate supply.

Answer: B

Topic: A Demand-Pull Inflation Process

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 35) A demand-pull inflation requires persistent increases in
- A) tax rates.
  - B) real wages.
  - C) the quantity of money.
  - D) government expenditures.

Answer: C

Topic: A Demand-Pull Inflation Process

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 36) If the Fed responds to an initial increase in aggregate demand by increasing the quantity of money,
- A) there will be no inflationary gap.
  - B) real GDP will begin to decrease more rapidly than if the quantity of money had remained constant.
  - C) money wages will fall to reduce the unemployment.
  - D) there is the risk of continued inflation.

Answer: D

Topic: A Demand-Pull Inflation Process

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 37) In a demand-pull inflation brought about by increases in the quantity of money, real GDP might increase at times because
- A) tax rates decline.
  - B) real wages fall.
  - C) money wages fall.
  - D) real wages rise.

Answer: B

Topic: A Demand-Pull Inflation Process

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 38) If the Fed responds to an increase in aggregate demand by increasing the quantity of money,
- A) nothing happens because aggregate demand had already increased.
  - B) output will begin to decrease more rapidly than otherwise.
  - C) money wage rates will fall to reduce the unemployment.
  - D) there will be continued inflation.

Answer: D

Topic: A Demand–Pull Inflation Process

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 39) If the economy is at potential GDP and the Fed increases the quantity of money, then
- A) potential GDP rises.
  - B) real GDP rises temporarily above potential GDP.
  - C) real GDP rises permanently above potential GDP.
  - D) potential GDP and real GDP both decrease.

Answer: B

Topic: A Demand–Pull Inflation Process

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 40) During a demand–pull inflation, if the Fed tries to maintain a level of real GDP above potential GDP,
- A) there will be a one–time shift in the *AD* and the *SAS* curves.
  - B) the *AD* curve will shift rightward continuously and *SAS* curves will shift leftward continuously.
  - C) the *AD* curve will shift rightward continuously and the *SAS* curve will not shift.
  - D) the *SAS* curve will shift leftward continuously and the *AD* curve will not shift.

Answer: B

Topic: A Demand–Pull Inflation Process

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Analytical Skills

- 41) In a demand–pull inflation, money wage rates rise because
- A) a decrease in aggregate demand creates a labor shortage.
  - B) an increase in aggregate demand creates a labor surplus.
  - C) an increase in aggregate demand creates a labor shortage.
  - D) a decrease in aggregate demand creates a labor surplus.

Answer: C

Topic: A Demand–Pull Inflation Process

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 42) As the money wage rate rises,
- A) the long-run aggregate supply curve shifts rightward.
  - B) the short-run aggregate supply curve shifts rightward.
  - C) both the long-run aggregate supply curve and the short-run aggregate supply curve shift leftward.
  - D) the short-run aggregate supply curve shifts leftward.

Answer: D

Topic: A Demand-Pull Inflation Process

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Analytical Skills

- 43) When the *AD* and *SAS* curves intersect at a level of real GDP which exceeds potential GDP and there is no government policy undertaken, which of the following will occur?
- A) The *AD* curve shifts rightward because the Fed decreases the money supply.
  - B) The *SAS* curve shifts leftward because the money wage rate rises.
  - C) The *AS* curve shifts leftward because the money wage rate falls.
  - D) The *AD* curve shifts leftward because the money wage rate rises.

Answer: B

Topic: A Demand-Pull Inflation Process

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Analytical Skills

- 44) To prevent demand-pull inflation
- A) firms must refuse to increase wages.
  - B) the Fed must not let the quantity of money persistently rise.
  - C) the natural unemployment rate must increase.
  - D) real GDP must increase.

Answer: B

Topic: A Demand-Pull Inflation Process

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 45) To stop a demand-pull inflation using monetary policy, you would recommend that the Fed
- A) increase the quantity of money.
  - B) not increase the quantity of money.
  - C) increase tax rates.
  - D) purchase government bonds in the open market.

Answer: B

Topic: A Demand-Pull Inflation Process

Skill: Analytical

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 46) In a demand-pull inflation, if the Fed stops expanding the quantity of money,  
 A) a cost-push inflation will occur.  
 B) government expenditure will cause the demand-pull inflation to continue.  
 C) a deflation will occur.  
 D) the demand-pull inflation ends.

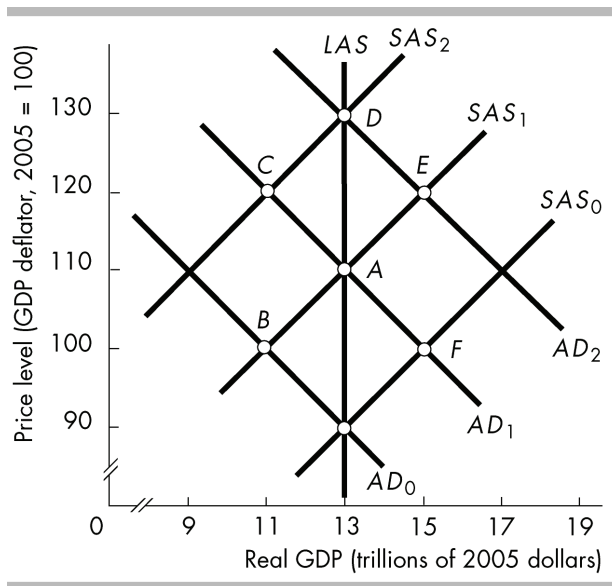
Answer: D

Topic: A Demand-Pull Inflation Process

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking



- 47) The figure above shows the aggregate demand, short-run aggregate supply, and long-run aggregate supply curves for the U.S. economy. The economy is currently at point A. A demand-pull rise in the price level will initially move the economy to point \_\_\_\_\_ and to point \_\_\_\_\_.  
 A) E when aggregate demand increases; D when the wage rate rises  
 B) B when aggregate demand decreases; C when the wage rate rises  
 C) E; A when aggregate demand changes  
 D) C when the wage rate rises; D when aggregate demand increases

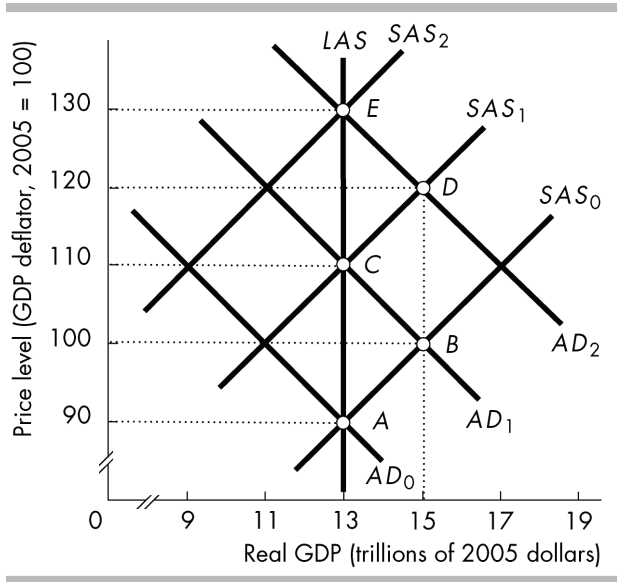
Answer: A

Topic: A Demand-Pull Inflation Process

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills



- 48) In the above figure, the movement from point A to B to C to D to E represents
- A) demand-pull inflation resulting solely from wage responses to excess labor demand.
  - B) demand-pull inflation resulting from persistent increases in the quantity of money.
  - C) cost-push inflation resulting solely from wage responses to excess labor demand.
  - D) cost-push inflation resulting from persistent increases in the quantity of money.

Answer: B

Topic: A Demand-Pull Inflation Process

Skill: Analytical

Question history: Previous edition, Chapter 12

AACSB: Analytical Skills

- 49) In the above figure, suppose the economy is at point A initially. For real GDP to increase to and consistently remain above \$13 trillion,
- I. the price level must increase to above 90.
  - II. there must be continued increases in the quantity of money.
- A) only I
  - B) only II
  - C) Both I and II are correct.
  - D) Neither I nor II is correct.

Answer: D

Topic: A Demand-Pull Inflation Process

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

- 50) In the above figure, if the economy moves from point *A* to point *E*,
- A) money wage rates have increased.
  - B) there may have been demand-pull inflation.
  - C) there has been economic growth.
  - D) Both answers A and B are correct.

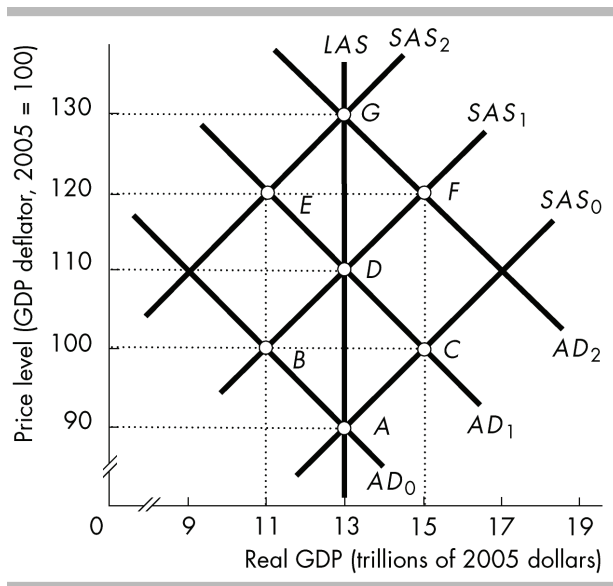
Answer: D

Topic: A Demand-Pull Inflation Process

Skill: Analytical

Question history: Previous edition, Chapter 12

AACSB: Analytical Skills



- 51) In the above figure, which path represents a demand-pull inflation?
- A) point *A* to *C* to *D* to *F* to *G*
  - B) point *A* to *B* to *D* to *E* to *G*
  - C) point *A* to *C* to *D* to *E* to *G*
  - D) point *A* to *B* to *D* to *F* to *G*

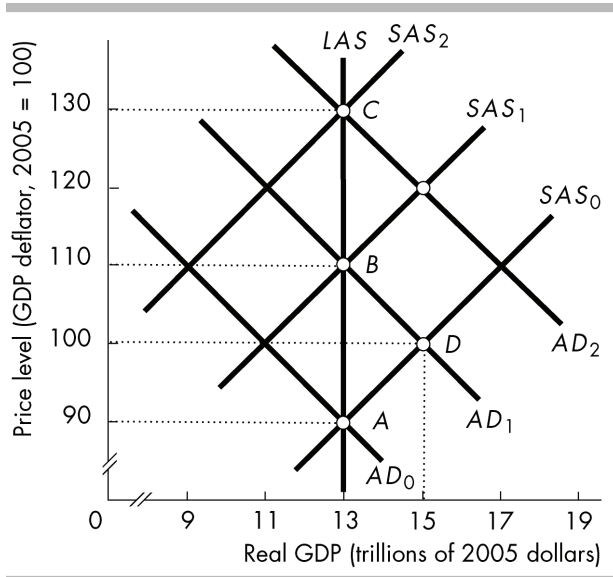
Answer: A

Topic: A Demand-Pull Inflation Process

Skill: Analytical

Question history: Previous edition, Chapter 12

AACSB: Analytical Skills



- 52) In the above figure, the economy initially is at point *A* and then an increase in the quantity of money moves the economy to point *D*. At point *D*, the real wage rate has
- A) risen by the same percentage as the price level.
  - B) remained constant.
  - C) risen.
  - D) fallen.

Answer: D

Topic: Initial Effect of an Increase in Aggregate Demand

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Analytical Skills

- 53) In the above figure, the economy initially is at point *A* and then an increase in the quantity of money moves the economy to point *D*. The money wage rate will
- A) rise because a labor shortage now exists.
  - B) fall because a labor shortage now exists.
  - C) rise because a labor surplus now exists.
  - D) fall because a labor surplus now exists.

Answer: A

Topic: Wage Response

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Analytical Skills



- 54) In the above figure, the economy initially is at point *A* and then an increase in the quantity of money moves the economy to point *D*. If the quantity of money remains constant, the economy will adjust with
- A) short-run aggregate supply shifting leftward to  $SAS_1$ .
  - B) short-run aggregate supply shifting leftward to  $SAS_2$ .
  - C) aggregate demand shifting back to  $AD_0$ .
  - D) aggregate demand shifting to  $AD_2$ .

Answer: A

Topic: A Demand-Pull Inflation Process

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Analytical Skills

- 55) A demand-pull inflation occurred in the United States during most of the later part of the
- A) 1960s.
  - B) 2000s.
  - C) 1980s.
  - D) 1990s.

Answer: A

Topic: Demand-Pull Inflation in the United States

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 56) As far as demand-pull inflation goes, the United States
- A) has never experienced this type of inflation.
  - B) experienced this type of inflation during the 1990s.
  - C) experienced this type of inflation during the 1960s.
  - D) experienced this type of inflation during the 1950s.

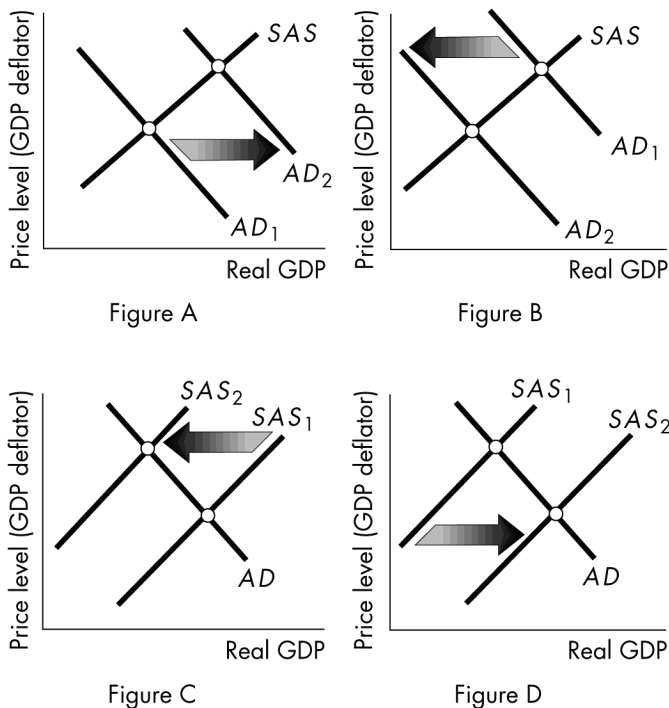
Answer: C

Topic: Demand-Pull Inflation in the United States

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking



57) In the above, which figure shows the start of a cost-push inflation?

- A) Figure A
- B) Figure B
- C) Figure C
- D) Figure D

Answer: C

Topic: Initial Effect of a Decrease in Aggregate Supply

Skill: Analytical

Question history: Previous edition, Chapter 12

AACSB: Analytical Skills

58) The main sources of cost-push inflation are increases in

- A) money wage rates and the cost of raw materials.
- B) real wage rates and the cost of raw materials.
- C) money wage rates and aggregate demand.
- D) aggregate demand and real wage rates.

Answer: A

Topic: Cost-Push Inflation

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 59) Assuming that GDP currently equals potential GDP, a cost-push inflation could result from which of the following?
- A) a decrease in tax rates
  - B) an increase in the labor force
  - C) a large crop failure that boosts the prices of raw food materials
  - D) an increase in the nation's capital stock

Answer: C

Topic: Cost-Push Inflation

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 60) Cost-push inflation can be started by
- A) a decrease in the money wage rate.
  - B) an increase in the money prices of raw materials.
  - C) an increase in the quantity of money.
  - D) a decrease in government expenditure on goods and services.

Answer: B

Topic: Cost-Push Inflation

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 61) Cost-push inflation can start with
- A) lower taxes.
  - B) an increase in government expenditure.
  - C) higher money wage rates.
  - D) an increase in transfer payments.

Answer: C

Topic: Cost-Push Inflation

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 62) Cost-push inflation can start with
- A) a decrease in investment.
  - B) an increase in oil prices.
  - C) an increase in government expenditure.
  - D) a decrease in the quantity of money.

Answer: B

Topic: Cost-Push Inflation

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 63) Cost-push inflation might initially result from
- A) an increase in the quantity of money.
  - B) the use of new technology.
  - C) an increase in government expenditure.
  - D) an increase in the cost of resources.

Answer: D

Topic: *Cost-Push Inflation*

Skill: *Recognition*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 64) Cost-push inflation is an inflation that results from an initial \_\_\_\_\_.
- A) increase in money wage rates or money prices of raw materials
  - B) decrease in taxes
  - C) increase in investment
  - D) increase in taxes

Answer: A

Topic: *Cost-Push Inflation*

Skill: *Recognition*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 65) The *initial* factors that can create a cost-push inflation do NOT include
- A) increases in money wage rates.
  - B) increases in the money prices of raw materials.
  - C) increases in the quantity of money.
  - D) None of the above answers is correct because all of the above could be the initial cause of a cost-push inflation.

Answer: C

Topic: *Cost-Push Inflation*

Skill: *Recognition*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 66) At the start of a cost-push inflation,
- A) productivity rises.
  - B) real GDP increases faster than the quantity of money.
  - C) the short-run aggregate supply curve shifts rightward.
  - D) prices and unemployment are rising.

Answer: D

Topic: *Initial Effect of a Decrease in Aggregate Supply*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 67) Cost-push inflation starts with a
- A) falling GDP and falling unemployment rate.
  - B) raising GDP and rising unemployment rate.
  - C) falling GDP and rising unemployment rate.
  - D) raising GDP and falling unemployment rate.

Answer: C

Topic: Initial Effect of a Decrease in Aggregate Supply

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 68) Cost-push inflation starts with
- A) an increase in aggregate demand.
  - B) a decrease in aggregate demand.
  - C) an increase in short-run aggregate supply.
  - D) a decrease in short-run aggregate supply.

Answer: D

Topic: Initial Effect of a Decrease in Aggregate Supply

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 69) A leftward shift in the aggregate supply curve
- A) is the result of the Fed increasing the quantity of money.
  - B) is the result of a rise the price of a key resource.
  - C) is the result of consumer expenditures exceeding available output.
  - D) increases both the price level and real GDP.

Answer: B

Topic: Initial Effect of a Decrease in Aggregate Supply

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 70) When a cost-push inflation starts
- A) the price level falls and the money wages rises.
  - B) real GDP rises faster than the quantity of money.
  - C) the short-run aggregate supply curve shifts rightward.
  - D) the price level rises and real GDP decreases.

Answer: D

Topic: Initial Effect of a Decrease in Aggregate Supply

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 71) At the start of a cost-push inflation,
- A) only real GDP changes while the price level remains constant.
  - B) the price level and real GDP both increase.
  - C) the price level rises and real GDP decreases.
  - D) the price level rises and real GDP does not change.

Answer: C

Topic: Initial Effect of a Decrease in Aggregate Supply

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 72) Suppose that the money prices of raw materials increase so that short-run aggregate supply decreases. If the Federal Reserve does not respond, the higher money price of raw materials will
- I. repeatedly shift the aggregate demand curve rightward and raise the price level.
  - II. shift the aggregate demand curve rightward and the aggregate supply curve leftward, raising prices.
  - III. result initially in lower employment and a higher price level.
- A) I only
  - B) both I and II
  - C) both II and III
  - D) III only

Answer: D

Topic: Initial Effect of a Decrease in Aggregate Supply

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Analytical Skills

- 73) An increase in the money wage rate shifts the SAS curve \_\_\_\_\_ and an increase in the money prices of raw materials shifts the SAS curve \_\_\_\_\_.
- A) rightward; rightward
  - B) leftward; leftward
  - C) rightward; leftward
  - D) leftward; rightward

Answer: B

Topic: Initial Effect of a Decrease in Aggregate Supply

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Analytical Skills

- 74) A higher price for oil shifts the
- A) SAS curve leftward.
  - B) LAS curve leftward.
  - C) SAS curve rightward.
  - D) AD curve rightward.

Answer: A

Topic: Initial Effect of a Decrease in Aggregate Supply

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Analytical Skills

- 75) By itself, an increase in the price of oil shifts the
- A) short-run aggregate supply curve leftward and does not shift the aggregate demand curve.
  - B) short-run aggregate supply curve rightward and does not shift the aggregate demand curve.
  - C) aggregate demand curve leftward and does not shift the short-run aggregate supply curve.
  - D) aggregate demand curve rightward and does not shift the short-run aggregate supply curve.

Answer: A

Topic: Initial Effect of a Decrease in Aggregate Supply

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Analytical Skills

- 76) By itself, a fall in the price of oil shifts the
- A) short-run aggregate supply curve leftward and does not shift the aggregate demand curve.
  - B) short-run aggregate supply curve rightward and does not shift the aggregate demand curve.
  - C) aggregate demand curve leftward and does not shift the short-run aggregate supply curve.
  - D) aggregate demand curve rightward and does not shift the short-run aggregate supply curve.

Answer: B

Topic: Initial Effect of a Decrease in Aggregate Supply

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Analytical Skills

- 77) The SAS curve shifts leftward if
- A) good weather increases agricultural harvests.
  - B) OPEC reduces world oil prices.
  - C) tax cuts stimulate labor supply.
  - D) the money wage rate increases.

Answer: D

Topic: Initial Effect of a Decrease in Aggregate Supply

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Analytical Skills

- 78) If the prices of crucial raw materials increase,
- A) the short-run aggregate supply curve shifts leftward.
  - B) stagflation could occur.
  - C) a cost-push inflation could occur depending on the behavior of the Federal Reserve.
  - D) All of the above answers are correct.

Answer: D

Topic: Initial Effect of a Decrease in Aggregate Supply

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 79) An increase in the price of a resource such as oil
- I. shifts the aggregate demand curve leftward.
  - II. shifts the long-run aggregate supply curve rightward.
  - III. shifts the short-run aggregate supply curve leftward.
  - IV. increases the price level and decreases real GDP in the short run.
- A) Only I is correct.
  - B) Both I and II are correct.
  - C) Only III is correct.
  - D) Both III and IV are correct.

Answer: D

Topic: Initial Effect of a Decrease in Aggregate Supply

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Analytical Skills

- 80) If oil prices increase, then in the short run, real GDP will \_\_\_\_\_ and the price level will \_\_\_\_\_.
- A) increase; rise
  - B) increase; fall
  - C) decrease; rise
  - D) decrease; fall

Answer: C

Topic: Initial Effect of a Decrease in Aggregate Supply

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Analytical Skills

- 81) In the short-run, an increase in the price of raw materials will \_\_\_\_\_ the price level and \_\_\_\_\_ real GDP.
- A) raise; increase
  - B) raise; decrease
  - C) lower; increase
  - D) lower; decrease

Answer: B

Topic: Initial Effect of a Decrease in Aggregate Supply

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking



- 82) In the short run, if there is an increase in the money wage rate, then
- A) short-run aggregate supply increases and the price level rises.
  - B) short-run aggregate supply decreases and the price level rises.
  - C) aggregate demand decreases and the price level falls.
  - D) aggregate demand increases and the price level rises.

Answer: B

Topic: Initial Effect of a Decrease in Aggregate Supply

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 83) By itself, a supply shock such as a hike in the price of oil, can
- A) cause real GDP to permanently decrease year after year.
  - B) not cause inflation.
  - C) be inflationary as long as there is no policy response.
  - D) cause a wage-price spiral.

Answer: B

Topic: Initial Effect of a Decrease in Aggregate Supply

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 84) Stagflation occurs when the price level \_\_\_\_\_ and real GDP \_\_\_\_\_.
- A) falls; increases
  - B) falls; decreases
  - C) rises; decreases
  - D) rises; increases

Answer: C

Topic: Stagflation

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 85) Stagflation is the result of
- A) an increase in aggregate demand.
  - B) a decrease in short-run aggregate supply.
  - C) a decrease in aggregate demand.
  - D) an increase in short-run aggregate supply.

Answer: B

Topic: Stagflation

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 86) Stagflation is the combination of a \_\_\_\_\_ and \_\_\_\_\_.
- A) falling inflation rate; an increasing real GDP
  - B) falling price level; an increasing real GDP
  - C) rising price level; a decreasing real GDP
  - D) rising inflation rate; a decreasing real GDP

Answer: C

Topic: Stagflation

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 87) Stagflation occurs when the
- A) price level and real GDP are increasing at the same time.
  - B) price level and real GDP are decreasing at the same time.
  - C) price level is increasing and real GDP is decreasing.
  - D) price level is decreasing and real GDP is increasing.

Answer: C

Topic: Stagflation

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 88) The term "stagflation" refers to the situation when
- A) the aggregate supply curve shifts leftward, prices increase and real GDP decreases.
  - B) real GDP and the price level both rise because of an increase in aggregate demand.
  - C) prices become stagnant and do not increase or decrease.
  - D) the short-run aggregate supply curve and the aggregate demand curve shift in opposite directions.

Answer: A

Topic: Stagflation

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 89) Stagflation is associated with
- A) cost-push inflation.
  - B) demand-pull inflation.
  - C) both types of inflation.
  - D) neither cost-push inflation or demand-pull inflation because it is a different concept altogether.

Answer: A

Topic: Stagflation

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 90) When the price level is rising and simultaneously real GDP is decreasing,
- A) the natural unemployment rate increases.
  - B) stagflation occurs.
  - C) there is an expansionary gap.
  - D) the Fed has increased the discount rate.

Answer: B

Topic: Stagflation

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 91) Stagflation results from
- A) a leftward shift in the short-run aggregate supply curve.
  - B) a rightward shift in the aggregate demand curve.
  - C) a rightward shift in the short-run aggregate supply curve.
  - D) an increase in government expenditures financed by an increase in the quantity of money.

Answer: A

Topic: Stagflation

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 92) Stagflation is characterized by
- A) an increase in both output and the price level.
  - B) a decrease in output and the price level.
  - C) an increase in the unemployment rate and an increase in the price level.
  - D) an economy which is growing at a rate equal to its historical average growth rate.

Answer: C

Topic: Stagflation

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 93) A one-time increase in the price of oil followed by a one-time increase in aggregate demand produce
- A) continuing cost-push inflation.
  - B) continuing demand-pull inflation.
  - C) a one-time decrease in the price level.
  - D) a one-time increase in the price level.

Answer: D

Topic: Aggregate Demand Response

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 94) A cost-push inflation spiral results if the Fed's response to stagflation is to keep
- A) decreasing aggregate demand.
  - B) decreasing aggregate supply.
  - C) increasing aggregate demand.
  - D) increasing aggregate supply.

Answer: C

Topic: A Cost-Push Inflation Process

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 95) During a cost-push inflation spiral, the money wage rate \_\_\_\_\_ and the quantity of money \_\_\_\_\_.
- A) increases; increases
  - B) increases; does not change
  - C) does not change; increases
  - D) does not change; does not change

Answer: A

Topic: A Cost-Push Inflation Process

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 96) For a cost-push inflation to occur, oil price increases must be accompanied by
- A) decreased investment spending.
  - B) lower personal tax rates.
  - C) increases in the quantity of money.
  - D) increases in government expenditures.

Answer: C

Topic: A Cost-Push Inflation Process

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 97) Oil prices increase sharply, raising the price level and decreasing real GDP. The Fed has an incentive to
- A) increase the quantity of money in order to reduce unemployment.
  - B) decrease the quantity of money in order to reduce unemployment.
  - C) increase the quantity of money in order to reduce the price level.
  - D) increase the quantity of money in order to reduce the price level and unemployment.

Answer: A

Topic: A Cost-Push Inflation Process

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 98) Suppose oil prices rise and short-run aggregate supply decreases. If the Fed responds by increasing the quantity of money, then in the short run
- A) real GDP increases and the price level falls.
  - B) real GDP increases and the price level rises still higher.
  - C) the Fed is more concerned about fighting inflation than unemployment.
  - D) None of the above answers is correct.

Answer: B

Topic: A Cost-Push Inflation Process

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 99) Suppose oil prices rise. The Fed can \_\_\_\_\_ the quantity of money to \_\_\_\_\_ the unemployment rate back to its natural rate.
- A) increase; raise
  - B) increase; lower
  - C) decrease; raise
  - D) decrease; lower

Answer: B

Topic: A Cost-Push Inflation Process

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 100) One example of cost-push inflation is an increase in
- A) the money prices of raw materials followed by no government policy.
  - B) the money prices of raw materials followed by increases in the quantity of money.
  - C) the money prices of raw materials followed by decreases in the quantity of money.
  - D) government expenditure followed by increases in the quantity of money.

Answer: B

Topic: A Cost-Push Inflation Process

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 101) In a cost-push inflation,
- A) increases in  $AD$  lead to increases in  $SAS$ .
  - B) decreases in  $AD$  lead to increases in  $SAS$ .
  - C) increases in  $SAS$  lead to decreases in  $AD$ .
  - D) decreases in  $SAS$  lead to increases in  $AD$ .

Answer: D

Topic: A Cost-Push Inflation Process

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 102) If the Fed responds to repeated decreases in the short-run aggregate supply with repeated increases in the quantity of money, the economy will be faced with
- A) a one-time increase in prices.
  - B) continuous inflation.
  - C) alternating periods of inflation and deflation.
  - D) steady decreases in real GDP.

Answer: B

Topic: A Cost-Push Inflation Process

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 103) When there is a cost-push inflation,
- A) workers demand higher money wages because of the inflation.
  - B) the short-run aggregate supply curve shifts rightward.
  - C) the aggregate demand curve shifts leftward because of the cost hikes.
  - D) None of the above answers is correct.

Answer: A

Topic: A Cost-Push Inflation Process

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 104) To prevent cost-push inflation
- A) there must not be an excess demand for money.
  - B) interest rates must not rise.
  - C) there must not be an increase in government purchases.
  - D) the Fed must not let the quantity of money rise persistently.

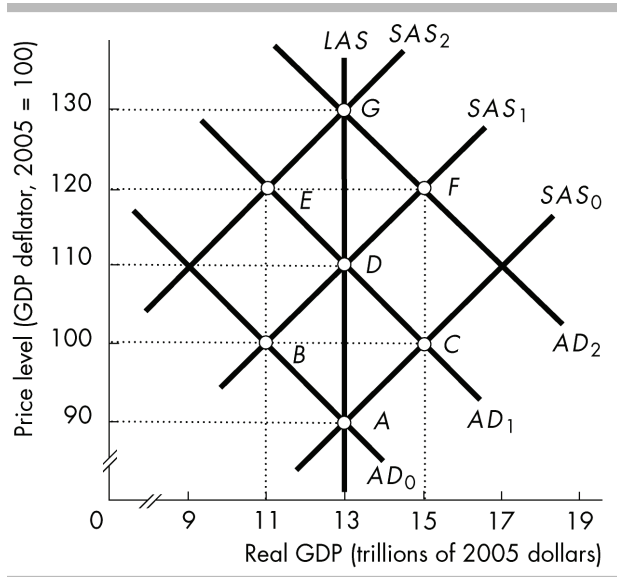
Answer: D

Topic: A Cost-Push Inflation Process

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking



105) In the above figure, which path represents a cost-push inflation?

- A) point A to C to D to F to G
- B) point A to B to D to E to G
- C) point A to C to D to E to G
- D) point A to B to D to F to G

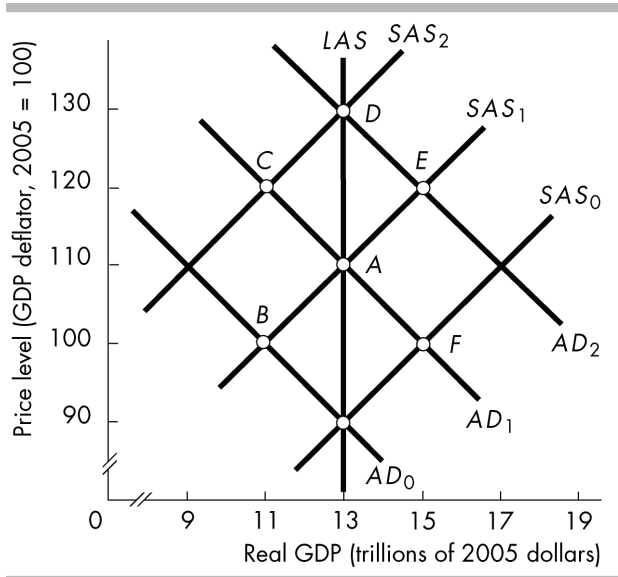
Answer: B

Topic: A Cost-Push Inflation Process

Skill: Analytical

Question history: Previous edition, Chapter 12

AACSB: Analytical Skills



106) The figure above shows the aggregate demand, short-run aggregate supply, and long-run aggregate supply curves for the U.S. economy. The economy is currently at point *A*. A cost-push rise in the price level will initially move the economy to point \_\_\_\_\_ and to point \_\_\_\_\_.

- A) *E* when aggregate demand increases; *D* when the money prices of raw materials rise
- B) *C* when the money prices of raw materials rise; *D* when aggregate demand increases
- C) *F*; *A* when the money prices of raw materials change
- D) *B* when aggregate demand decreases; *C* when the money prices of raw materials rise

Answer: B

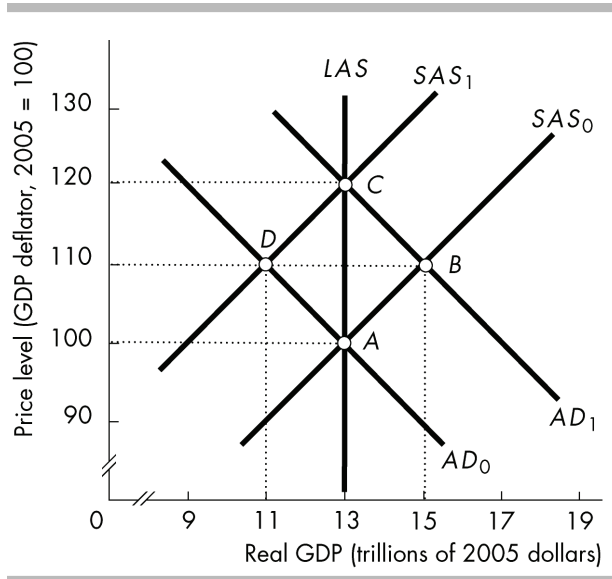
Topic: A Cost-Push Inflation Process

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Analytical Skills





- 107) In the above figure, the economy is at point *A*. An increase in oil prices that sets off a cost-push inflation will initially move the economy from point *A* to point
- A*, that is, the economy does not change.
  - B*.
  - C*.
  - D*.

Answer: D

Topic: Initial Effect of a Decrease in Aggregate Supply

Skill: Analytical

Question history: Previous edition, Chapter 12

AACSB: Analytical Skills

- 108) In the above figure, the economy is at point *A*. An increase in money wage rates that sets off a cost-push inflation will initially move the economy from point *A* to point
- A*, that is, the economy does not change.
  - B*.
  - C*.
  - D*.

Answer: D

Topic: Initial Effect of a Decrease in Aggregate Supply

Skill: Analytical

Question history: Previous edition, Chapter 12

AACSB: Analytical Skills

- 109) In the above figure, the economy is at point *A*. An increase in oil prices occurs after which the Fed responds by increasing the quantity of money. The economy moves from point *A* to
- A) *D* to point *C*.
  - B) *B* to point *C*.
  - C) *C* to point *D*.
  - D) *C* to point *B*.

Answer: A

Topic: *A Cost–Push Inflation Process*

Skill: *Analytical*

Question history: *Previous edition, Chapter 12*

AACSB: *Analytical Skills*

- 110) During which decade did the United States suffer from the worst cost–push inflation?
- A) 1960s
  - B) 1970s
  - C) 1980s
  - D) 1990s

Answer: B

Topic: *Cost–Push Inflation in the United States*

Skill: *Recognition*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 111) As far as cost–push inflation goes, the United States
- A) has never experienced this type of inflation.
  - B) has experienced only this type of inflation.
  - C) experienced this type of inflation in the 1970s.
  - D) experienced this type of inflation during the 1990s.

Answer: C

Topic: *Cost–Push Inflation in the United States*

Skill: *Recognition*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 112) If people correctly anticipate an increase in aggregate demand, a result is
- A) an increase in the real value of outstanding government debt.
  - B) workers demanding higher money wages to keep the real wage unchanged.
  - C) a lower rate of inflation in the current time period.
  - D) there are no predictable results associated with an anticipated increase in aggregate demand.

Answer: B

Topic: *Anticipated Inflation*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 113) The anticipated inflation rate is 5 percent. In order for purchasing power to remain constant, the money wage rate must rise by
- A) 2 percent.
  - B) 5 percent.
  - C) 7 percent.
  - D) 12 percent.

Answer: B

Topic: Anticipated Inflation

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Analytical Skills

- 114) When workers and employers correctly anticipate an increase in inflation caused by an increase in aggregate demand,
- A) there will be no unemployment.
  - B) workers will overestimate the real wage rate.
  - C) unemployment will be at the natural rate.
  - D) workers will underestimate the real wage rate.

Answer: C

Topic: Anticipated Inflation

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 115) The economy is at potential GDP when people correctly anticipate an increase in government expenditure on goods and services. If the money wage rate adjusts immediately, then
- A) real GDP and the price level will increase in the short run, but the real wage rate will fall.
  - B) real GDP remains at potential GDP.
  - C) real GDP, the price level, and the real wage rate all increase in the short run.
  - D) real GDP remains at potential GDP, there is no change in the price level, and the real wage rate rises in the short run.

Answer: B

Topic: Anticipated Inflation

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 116) If the economy is initially at potential GDP and people correctly anticipate an increase in inflation so that their money wage rate adjusts immediately, then
- A) only real GDP increases with no change in the price level.
  - B) only the price level rises with no change in real GDP.
  - C) both the price level and real GDP increase.
  - D) neither the price level nor real GDP increase.

Answer: B

Topic: Anticipated Inflation

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 117) If people correctly expect an increase in aggregate demand, their money wage rate \_\_\_\_\_ immediately, the SAS curve shifts \_\_\_\_\_.
- A) rises; rightward
  - B) rises; leftward
  - C) falls; rightward
  - D) fall; leftward

Answer: B

Topic: Anticipated Inflation

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Analytical Skills

- 118) Suppose aggregate demand increases by more than expected. Which of the following describes what will occur?
- A) Real GDP will be greater than potential GDP.
  - B) The price level will increase.
  - C) Unemployment will fall.
  - D) All of the above answers are correct.

Answer: D

Topic: Unanticipated Inflation

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 119) Suppose aggregate demand increases by less than expected. Which of the following describes what will occur?
- A) Real GDP will be less than potential GDP.
  - B) The price level will fall.
  - C) Real GDP will be more than potential GDP.
  - D) Both answers A and B are correct.

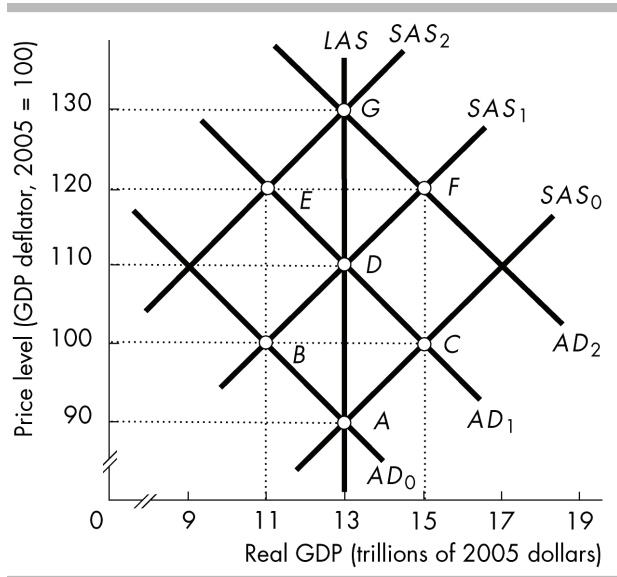
Answer: A

Topic: Unanticipated Inflation

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking



120) In the above figure, if people correctly anticipate the increases in aggregate demand and the resulting inflation, the path will be from

- A) point A to C to D to F to G.
- B) point A to B to D to E to G.
- C) point A to D to G.
- D) point A to B to D to F to G.

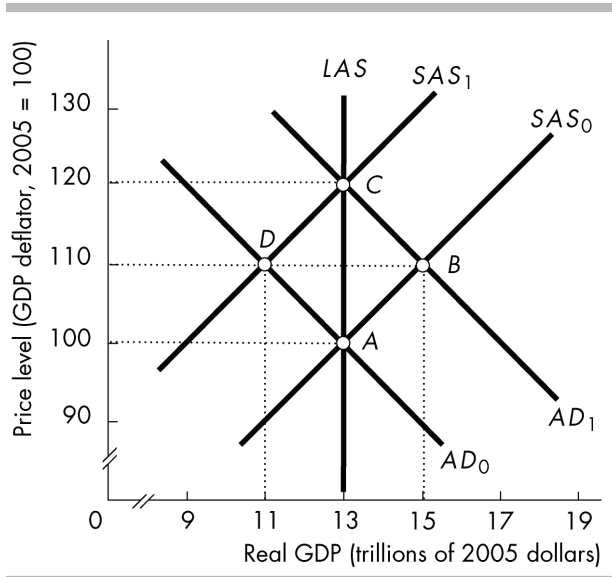
Answer: C

Topic: Anticipated Inflation

Skill: Analytical

Question history: Previous edition, Chapter 12

AACSB: Analytical Skills



- 121) In the above figure, the economy is initially at point A. If workers and firms correctly anticipate the increase in aggregate demand and the resulting inflation rate, the economy will move to point
- A) A, that is, the price level and level of real GDP will not change.
  - B) B.
  - C) C.
  - D) D.

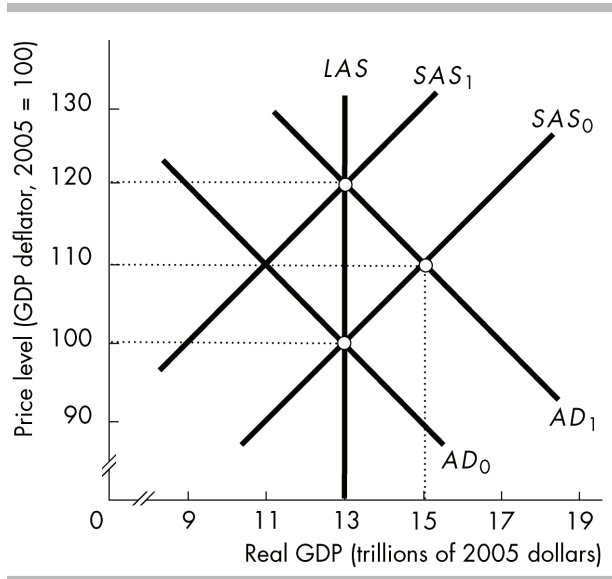
Answer: C

Topic: Anticipated Inflation

Skill: Analytical

Question history: Previous edition, Chapter 12

AACSB: Analytical Skills



- 122) An economy is at potential GDP and the price level is 100 in the figure above. If aggregate demand unexpectedly increases so that the aggregate demand curve shifts to  $AD_1$ , the inflation rate is \_\_\_\_\_.
- A) 0 percent a year
  - B) 10 percent a year
  - C) 20 percent a year
  - D) More than 20 percent a year

Answer: B

Topic: Unanticipated Inflation

Skill: Analytical

Question history: Previous edition, Chapter 12

AACSB: Analytical Skills

- 123) An economy is in long-run equilibrium and the price level is 100 in the figure above. Aggregate demand increases and the aggregate demand curve shifts to  $AD_1$ . If the increase in aggregate demand is expected, then the inflation rate is \_\_\_\_\_.
- A) 0 percent a year
  - B) 10 percent a year
  - C) 20 percent a year
  - D) More than 20 percent a year

Answer: C

Topic: Anticipated Inflation

Skill: Analytical

Question history: Previous edition, Chapter 12

AACSB: Analytical Skills

- 124) Suppose that the economy is at full employment and aggregate demand increases by more than it is anticipated to increase. Other things remaining the same, \_\_\_\_\_.
- A) long-run aggregate supply decreases
  - B) real GDP remains at potential GDP
  - C) real GDP increases above potential GDP
  - D) real GDP decreases below potential GDP

Answer: C

Topic: *Unanticipated Inflation*

Skill: *Analytical*

Question history: *Previous edition, Chapter 12*

AACSB: *Analytical Skills*

- 125) A rational expectation is
- A) a forecast devoid of all emotions.
  - B) a forecast which perfectly foretells the future.
  - C) the best possible forecast based upon all relevant information.
  - D) the forecast that automatically carries over from past forecasts.

Answer: C

Topic: *Rational Expectation Theories*

Skill: *Recognition*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 126) A rational expectation of inflation is
- A) how economists make perfect forecasts of inflation.
  - B) how unexpected inflation affects the economy.
  - C) why unexpected inflation redistributes income.
  - D) a forecast of inflation that uses all relevant information.

Answer: D

Topic: *Rational Expectation Theories*

Skill: *Recognition*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 127) A rational expectation is
- A) a correct forecast but it might not be the best available forecast.
  - B) an incorrect forecast.
  - C) not necessarily correct but is the best available forecast.
  - D) necessarily correct because it is the best available forecast.

Answer: C

Topic: *Rational Expectation Theories*

Skill: *Recognition*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*



- 128) If Samantha predicts future inflation based on rational expectations, then
- A) her forecast of inflation will always be correct.
  - B) she uses all relevant information to forecast inflation.
  - C) she looks only to the past to help her predict future inflation.
  - D) she never under estimates inflation.

Answer: B

Topic: Rational Expectation Theories

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 129) Which of the following would shift the aggregate demand curve leftward year after year?
- A) a one-time tax cut
  - B) a one-time increase in government expenditures on goods and services
  - C) inflation
  - D) negative growth in the quantity of money

Answer: D

Topic: Study Guide Question, A Demand-Pull Inflation Process

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 130) Which of the following results in the aggregate demand curve shifting rightward year after year?
- A) a one-time tax cut
  - B) a one-time increase in government expenditures on goods and services
  - C) inflation
  - D) growth in the quantity of money

Answer: D

Topic: Study Guide Question, A Demand-Pull Inflation Process

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 131) Demand-pull inflation occurs when
- A) aggregate demand increases persistently.
  - B) aggregate supply and aggregate demand decrease persistently.
  - C) the government increases its expenditures.
  - D) oil prices increase substantially.

Answer: A

Topic: Study Guide Question, A Demand-Pull Inflation Process

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 132) In a demand-pull inflation, the AD curve shifts \_\_\_\_\_ and the SAS curve shifts \_\_\_\_\_.
- A) rightward; rightward
  - B) rightward; leftward
  - C) leftward; rightward
  - D) leftward; leftward

Answer: B

Topic: Study Guide Question, A Demand-Pull Inflation Process

Skill: Analytical

Question history: Previous edition, Chapter 12

AACSB: Analytical Skills

- 133) A rise in the price level because of an increase in the money wage rate
- A) definitely triggers a cost-push inflation.
  - B) definitely triggers a demand-pull inflation.
  - C) might trigger a cost-push inflation.
  - D) might trigger a demand-pull inflation.

Answer: C

Topic: Study Guide Question, Initial Effect of a Decrease in Aggregate Supply

Skill: Analytical

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 134) A rise in the price level because of an increase in the price of oil
- A) definitely triggers a cost-push inflation.
  - B) definitely triggers a demand-pull inflation.
  - C) might trigger a cost-push inflation.
  - D) might trigger a demand-pull inflation.

Answer: C

Topic: Study Guide Question, Initial Effect of a Decrease in Aggregate Supply

Skill: Analytical

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 135) Cost-push inflation might start with
- A) a rise in money wage rates.
  - B) an increase in government expenditures.
  - C) an increase in the quantity of money.
  - D) a fall in the prices of raw materials.

Answer: A

Topic: Study Guide Question, Initial Effect of a Decrease in Aggregate Supply

Skill: Analytical

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 136) Which of the following statements about a cost-push inflation is correct?
- A) Cost-push inflation starts when an increase in aggregate demand "pushes" costs higher.
  - B) Cost-push inflation might start with a rise in the price of raw materials, but it requires increases in the quantity of money to persist.
  - C) To persist, cost-push inflation needs a continual series of cost hikes with no change in aggregate demand.
  - D) The United States has never experienced a cost-push inflation.

Answer: B

Topic: Study Guide Question, Cost-Push Inflation

Skill: Analytical

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

## 2 Inflation and Unemployment: The Phillips Curve

- 1) Phillips curves show the relationship between the
- A) nominal interest rate and the real interest rate.
  - B) expected rate of inflation and the nominal interest rate.
  - C) real interest rate and the unemployment rate.
  - D) unemployment rate and the inflation rate.

Answer: D

Topic: Inflation and Unemployment: The Phillips Curve

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 2) Phillips curves describe the relationship between
- A) aggregate expenditures and aggregate demand.
  - B) the quantity of money and interest rates.
  - C) unemployment and inflation.
  - D) aggregate demand and the price level.

Answer: C

Topic: Inflation and Unemployment: The Phillips Curve

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 3) A Phillips curve measures the relationship between
- A) the unemployment rate and inflation.
  - B) the level of money wage rates and GDP.
  - C) unemployment and GDP.
  - D) inflation and GDP.

Answer: A

Topic: Inflation and Unemployment: The Phillips Curve

Skill: Analytical

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 4) A Phillips curve shows the relationship between the
- A) price level and real GDP.
  - B) unemployment rate and real GDP.
  - C) inflation rate and the unemployment rate.
  - D) inflation rate and real GDP.

Answer: C

Topic: *Inflation and Unemployment: The Phillips Curve*

Skill: *Recognition*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 5) For a given level of anticipated inflation and natural unemployment rate, the short-run Phillips curve shows the relationship between
- A) potential GDP and real GDP.
  - B) real GDP growth and the unemployment rate.
  - C) inflation and money growth.
  - D) inflation and the unemployment rate.

Answer: D

Topic: *The Short-Run Phillips Curve*

Skill: *Recognition*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 6) The short-run Phillips curve gives much the same information as
- A) the AD curve.
  - B) the SAS curve.
  - C) the LAS curve.
  - D) none of the above

Answer: B

Topic: *The Short-Run Phillips Curve*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 7) A movement along the SAS curve that brings a lower price level and a decrease in real GDP is equivalent to a
- A) movement along a short-run Phillips curve that brings a decrease in the inflation rate and an increase in the unemployment rate.
  - B) movement along a short-run Phillips curve that brings an increase in the inflation rate and an increase in the unemployment rate.
  - C) shift in the short-run Phillips curve that brings a decrease in the inflation rate and an increase in the unemployment rate.
  - D) shift in the short-run Phillips curve that brings an increase in the inflation rate and an increase in the unemployment rate.

Answer: A

Topic: *The Short-Run Phillips Curve*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

8) The short-run Phillips curve

- A) slopes downward.
- B) slopes upward.
- C) is horizontal.
- D) is vertical.

Answer: A

Topic: *The Short-Run Phillips Curve*

Skill: *Recognition*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

9) Moving along a short-run Phillips curve,

- A) the price level is constant.
- B) unemployment is constant.
- C) the expected inflation rate is constant.
- D) the inflation rate is constant.

Answer: C

Topic: *The Short-Run Phillips Curve*

Skill: *Recognition*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

10) Which of the following is held constant when moving along a short-run Phillip's curve?

- A) the inflation rate
- B) the unemployment rate
- C) the expected inflation rate
- D) the growth rate of the quantity of money

Answer: C

Topic: *The Short-Run Phillips Curve*

Skill: *Recognition*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

11) The short-run Phillips curve shows the tradeoff between \_\_\_\_\_, holding the expected inflation rate and the natural unemployment rate constant.

- A) the price level and real GDP
- B) inflation and unemployment
- C) the price level and unemployment
- D) inflation and employment

Answer: B

Topic: *The Short-Run Phillips Curve*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 12) The short-run Phillips curve shows a
- A) positive relationship between the quantity of money and interest rates.
  - B) positive relationship between the price level and real GDP.
  - C) negative relationship between interest rates and the price level.
  - D) negative relationship between the unemployment rate and the inflation rate.

Answer: D

Topic: *The Short-Run Phillips Curve*

Skill: *Recognition*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

- 13) In the short run, an unexpected increase in the inflation rate leads to
- A) a higher unemployment rate.
  - B) a decrease in aggregate demand.
  - C) a lower unemployment rate.
  - D) workers thinking the money wage rate has fallen.

Answer: C

Topic: *The Short-Run Phillips Curve*

Skill: *Conceptual*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

- 14) Moving along the short-run Phillips curve indicates
- A) that higher inflation leads to a higher unemployment rate.
  - B) that higher unemployment leads to a higher inflation rate.
  - C) a tradeoff between inflation and unemployment so that higher inflation is related to lower unemployment.
  - D) that the natural unemployment rate falls when the inflation rate rises.

Answer: C

Topic: *The Short-Run Phillips Curve*

Skill: *Conceptual*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

- 15) Movements upward along the short-run Phillips curve result from
- A) expected increases in the inflation rate.
  - B) unexpected increases in the inflation rate.
  - C) expected decreases in the inflation rate.
  - D) unexpected decreases in the inflation rate.

Answer: B

Topic: *The Short-Run Phillips Curve*

Skill: *Conceptual*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

- 16) If the unemployment rate initially equals its natural rate, then if the inflation rate rises above its expected rate, the unemployment rate \_\_\_\_\_.
- A) equals the natural rate
  - B) remains constant
  - C) falls below its natural rate
  - D) rises above its natural rate

Answer: C

Topic: *The Short-Run Phillips Curve*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 17) Along a short-run Phillips curve, suppose the expected inflation rate is 6 percent. If the inflation rate turns out to be 8 percent instead,
- A) there is a movement upward along the short-run Phillips curve.
  - B) there is a movement downward along the short-run Phillips curve.
  - C) there is a downward shift of the short-run Phillips curve.
  - D) None of the above answers are correct.

Answer: A

Topic: *The Short-Run Phillips Curve*

Skill: *Conceptual*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

- 18) Suppose the expected inflation rate is 8 percent and the unemployment rate is 3 percent. If the inflation rate rises to 10 percent and the expected inflation rate does not change,
- A) the short-run Phillips curve will shift upward.
  - B) the short-run Phillips curve will shift downward.
  - C) there will be a movement along the short-run Phillips curve.
  - D) the natural unemployment rate will rise.

Answer: C

Topic: *The Short-Run Phillips Curve*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 19) Suppose that last year the economy of Suffera was experiencing an expected inflation rate of 8 percent and unemployment rate of 12 percent. An unexpected increase in the inflation rate would
- A) increase the unemployment rate.
  - B) increase the inflation rate and decrease the unemployment rate.
  - C) increase the inflation rate but have no effect on the unemployment rate.
  - D) None of the above answers is correct.

Answer: B

Topic: *The Short-Run Phillips Curve*

Skill: *Conceptual*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

- 20) Which of the following leads to a rightward shift in the short-run Phillips curve?
- I. a reduction in the expected inflation rate
  - II. an increase in the natural unemployment rate
- A) I only
  - B) II only
  - C) I and II
  - D) neither I nor II

Answer: B

Topic: *The Short-Run Phillips Curve*

Skill: *Conceptual*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

- 21) An increase in the expected inflation rate shifts the
- A) short-run Phillips curve downward.
  - B) short-run Phillips curve upward.
  - C) long-run Phillips curve upward.
  - D) long-run Phillips curve downward.

Answer: B

Topic: *The Short-Run Phillips Curve*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 22) An increase in the expected inflation rate leads to \_\_\_\_\_ the short-run Phillips curve.
- A) a movement upward along
  - B) a movement downward along
  - C) an upward shift of
  - D) a downward shift of

Answer: C

Topic: *The Short-Run Phillips Curve*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 23) Which of the following leads to a downward shift in the short-run Phillips curve?
- A) People expected inflation to be 5 percent last year and now expect inflation to be 3 percent this year.
  - B) People expect the unemployment rate to increase.
  - C) The long-run Phillips curve shifts rightward.
  - D) Unexpected inflation increases.

Answer: A

Topic: *The Short-Run Phillips Curve*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*



- 24) Suppose the expected inflation rate is 12 percent and the unemployment rate is 5 percent. If the expected inflation rate increases to 13 percent,
- the short-run Phillips curve will shift upward.
  - the short-run Phillips curve will shift downward.
  - there will be a movement along the short-run Phillips curve.
  - the natural unemployment rate will rise.

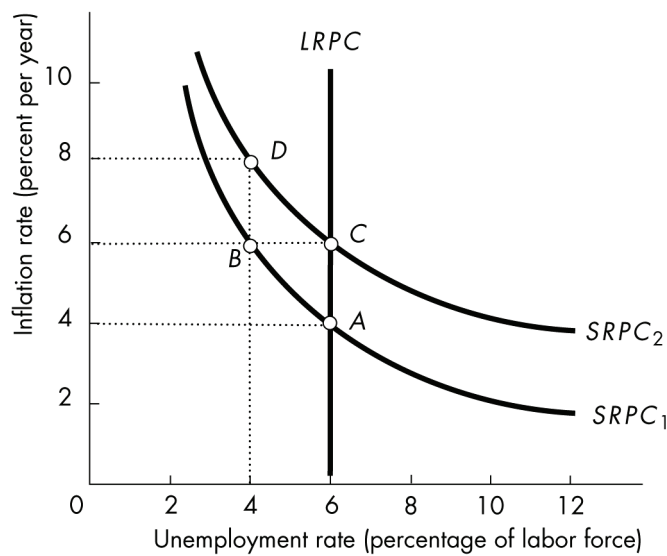
Answer: A

Topic: The Short-Run Phillips Curve

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking



- 25) In the above figure, suppose the economy is at point A. An unexpected increase in the inflation rate to 6 percent will result in a movement to point
- A, that is, there is no movement.
  - B.
  - C.
  - D.

Answer: B

Topic: The Short-Run Phillips Curve

Skill: Analytical

Question history: Previous edition, Chapter 12

AACSB: Analytical Skills

- 26) In the above figure, suppose the economy is at point A. An expected increase in the inflation rate to 6 percent will result in a movement to point
- A) A, that is, there is no movement.
  - B) B.
  - C) C.
  - D) D.

Answer: C

Topic: *The Short-Run Phillips Curve*

Skill: *Analytical*

Question history: *Previous edition, Chapter 12*

AACSB: *Analytical Skills*

- 27) The long-run Phillips curve shows the relationship between the inflation rate and the unemployment rate when the
- A) real interest rate equals the nominal interest rate.
  - B) real interest rate is zero.
  - C) actual inflation rate equals the expected inflation rate.
  - D) inflation rate is zero.

Answer: C

Topic: *The Long-Run Phillips Curve*

Skill: *Recognition*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 28) The long-run Phillips curve is
- A) vertical at potential GDP.
  - B) the horizontal sum of the short-run Phillips curves.
  - C) vertical at the natural unemployment rate.
  - D) the vertical sum of the short-run Phillips curves.

Answer: C

Topic: *The Long-Run Phillips Curve*

Skill: *Recognition*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 29) The long-run Phillips curve is \_\_\_\_\_.
- A) horizontal at the expected inflation rate
  - B) vertical at the natural unemployment rate
  - C) horizontal at the actual inflation rate
  - D) vertical at the actual inflation rate

Answer: B

Topic: *The Long-Run Phillips Curve*

Skill: *Recognition*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 30) Along the long-run Phillips curve,
- A) actual inflation is greater than expected inflation.
  - B) actual inflation is equal to expected inflation.
  - C) actual inflation is less than expected inflation.
  - D) None of the above answers is correct.

Answer: B

Topic: *The Long-Run Phillips Curve*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 31) The long-run Phillips curve shows that in the long run, policymakers can
- A) lower unemployment if they are willing to accept more inflation forever.
  - B) lower inflation if they are willing to accept higher unemployment forever.
  - C) choose the unemployment rate but not the inflation rate.
  - D) lower inflation without increasing unemployment.

Answer: D

Topic: *The Long-Run Phillips Curve*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 32) The position of the long-run Phillips curve is determined by
- A) the quantity of money.
  - B) the natural unemployment rate.
  - C) the inflation rate.
  - D) the expected inflation rate.

Answer: B

Topic: *The Long-Run Phillips Curve*

Skill: *Conceptual*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

- 33) Which of the following statements about the long-run Phillips curve is correct?
- A) The long-run Phillips curve is horizontal.
  - B) The long-run Phillips curve shifts leftward if the natural unemployment rate decreases.
  - C) The long-run Phillips curve shifts rightward and upward if the expected inflation rate increases.
  - D) None of the above statements is correct.

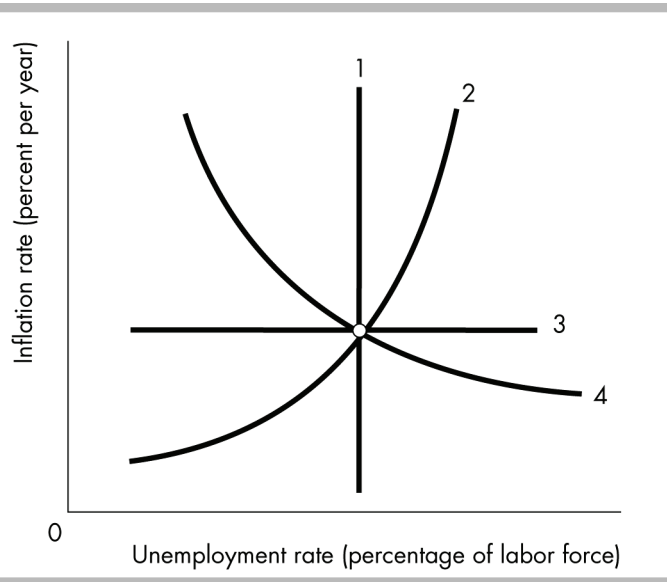
Answer: B

Topic: *The Long-Run Phillips Curve*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*



34) In the above figure, which of the following curves represents the long-run Phillips curve?

- A) 1
- B) 2
- C) 3
- D) 4

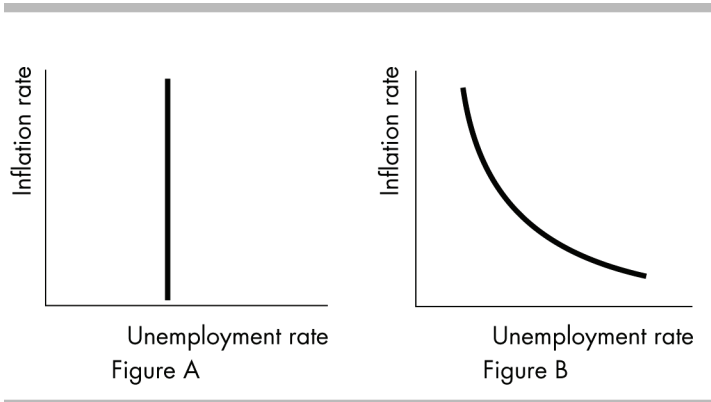
Answer: A

Topic: *The Long-Run Phillips Curve*

Skill: *Recognition*

Question history: *Previous edition, Chapter 12*

AACSB: *Analytical Skills*



35) Which of the diagrams in the above figure best illustrates a short-run Phillips curve?

- A) Figure A
- B) Figure B
- C) both Figure A and Figure B
- D) neither Figure A nor Figure B

Answer: B

Topic: The Short-Run Phillips Curve

Skill: Analytical

Question history: Previous edition, Chapter 12

AACSB: Analytical Skills

36) In Figure B above, which of the following are being held constant while moving along the curve in the figure?

- A) the expected inflation rate
- B) the natural unemployment rate
- C) the AD curve
- D) Both answers A and B are correct.

Answer: D

Topic: The Short-Run Phillips Curve

Skill: Analytical

Question history: Previous edition, Chapter 12

AACSB: Analytical Skills

37) Which of the diagrams in the above figure best illustrates a long-run Phillips curve?

- A) Figure A
- B) Figure B
- C) both Figure A and Figure B
- D) neither Figure A nor Figure B

Answer: A

Topic: The Long-Run Phillips Curve

Skill: Analytical

Question history: Previous edition, Chapter 12

AACSB: Analytical Skills

- 38) The short-run Phillips curve intersects the long-run Phillips curve at the
- A) natural interest rate.
  - B) nominal interest rate.
  - C) natural inflation rate.
  - D) expected inflation rate.

Answer: D

Topic: *The Short-Run and Long-Run Phillips Curve*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 39) The short-run Phillips curve and the long-run Phillips curve intersect at the \_\_\_\_\_ and \_\_\_\_\_.
- A) expected inflation rate; the expected unemployment rate
  - B) expected inflation rate; the natural unemployment rate
  - C) natural inflation rate; the expected employment rate
  - D) expected inflation rate; the expected employment rate

Answer: B

Topic: *The Short-Run and Long-Run Phillips Curve*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 40) An increase in the expected inflation rate shifts
- A) both the short-run and the long-run Phillips curves upward.
  - B) the short-run but not the long-run Phillips curve upward.
  - C) the long-run but not the short-run Phillips curve upward.
  - D) neither the short-run nor the long-run Phillips curve.

Answer: B

Topic: *The Short-Run and Long-Run Phillips Curve*

Skill: *Recognition*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 41) A decrease in the expected inflation rate shifts the short-run Phillips curve
- A) downward and shifts the long-run Phillips curve leftward.
  - B) upward and shifts long-run Phillips curve rightward.
  - C) downward and creates a movement downward along the long-run Phillips curve.
  - D) upward and creates a movement upward along the long-run Phillips curve.

Answer: C

Topic: *The Short-Run and Long-Run Phillips Curve*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 42) An increase in the natural unemployment rate shifts
- A) both the short-run and the long-run Phillips curves rightward.
  - B) the short-run but not the long-run Phillips curve rightward.
  - C) the long-run but not the short-run Phillips curve rightward.
  - D) neither the short-run nor the long-run Phillips curve.

Answer: A

Topic: *The Short-Run and Long-Run Phillips Curve*

Skill: *Recognition*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 43) A change in the natural unemployment rate \_\_\_\_\_.
- A) shifts only the short-run Phillips curve
  - B) causes a movement along the short-run Phillips curve
  - C) shifts only the long-run Phillips curve
  - D) shifts both the short-run and long-run Phillips curves

Answer: D

Topic: *The Short-Run and Long-Run Phillips Curve*

Skill: *Recognition*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 44) If the natural unemployment rate increases, then the short-run Phillips curve shifts \_\_\_\_\_ and the long-run Phillips curve shifts \_\_\_\_\_.
- A) rightward; rightward
  - B) rightward; leftward
  - C) leftward; rightward
  - D) leftward; leftward

Answer: A

Topic: *The Short-Run and Long-Run Phillips Curve*

Skill: *Recognition*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

Inflation rate (percent per year)	Unemployment rate (percent)
8	3
6	4
4	5
2	6

- 45) An economy's natural unemployment rate is 4 percent. The table above gives some points on the economy's short-run Phillips curve. When the unemployment rate is 4 percent \_\_\_\_\_.
- A) actual inflation is greater than expected inflation
  - B) actual inflation is less than expected inflation
  - C) and the inflation rate is 6 percent a year, the short-run and long-run Phillips curves intersect
  - D) and the expected inflation rate is 8 percent a year, the short-run Phillips curve shifts downward

Answer: C

Topic: *The Short-Run Phillips Curve and the Long-Run Phillips Curve*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Analytical Skills*

- 46) An economy's natural unemployment rate is 4 percent. The table above gives some points on the economy's short-run Phillips curve. If the expected inflation rate becomes 8 percent per year, then the \_\_\_\_\_.
- A) short-run Phillips curve shifts upward
  - B) long-run Phillips curve shifts rightward
  - C) long-run Phillips curve shifts leftward
  - D) short-run Phillips curve shifts downward

Answer: A

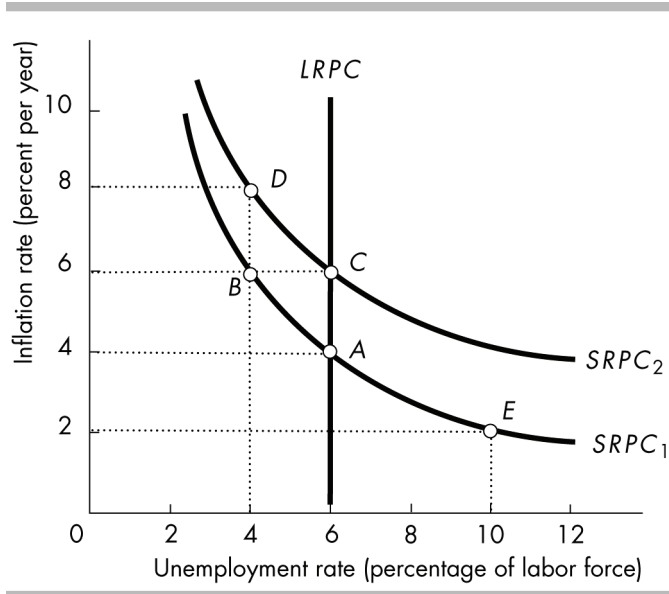
Topic: *The Short-Run Phillips Curve*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Analytical Skills*





- 47) In the above figure, suppose that the economy currently is at point A. If the inflation rate falls and this fall is unanticipated by the public, the economy moves to a point such as point
- A) B.
  - B) C.
  - C) D.
  - D) E.

Answer: D

Topic: The Short-Run Phillips Curve

Skill: Analytical

Question history: Previous edition, Chapter 12

AACSB: Analytical Skills

- 48) In the above figure, suppose that the economy currently is at point A. If the inflation rate rises and this rise is NOT expected by the public, the economy moves to a point such as point
- A) B.
  - B) C.
  - C) D.
  - D) E.

Answer: A

Topic: The Short-Run Phillips Curve

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

- 49) In the above figure, what might have shifted the short-run Phillips curve from  $SRPC_1$  to  $SRPC_2$  while leaving the long-run Phillips curve unchanged at  $LRPC$ ?
- A) The natural unemployment rate increased.
  - B) The natural unemployment rate decreased.
  - C) The expected inflation rate increased.
  - D) The expected inflation rate decreased.

Answer: C

Topic: *The Short-Run Phillips Curve*

Skill: *Analytical*

Question history: *Modified 10th edition*

AACSB: *Analytical Skills*

- 50) In the above figure, suppose that the economy currently is at point *A*. If the inflation rate rises and this rise is anticipated by the public, the economy moves to a point such as point
- A) *B*.
  - B) *C*.
  - C) *D*.
  - D) *E*.

Answer: B

Topic: *The Long-Run Phillips Curve*

Skill: *Analytical*

Question history: *Previous edition, Chapter 12*

AACSB: *Analytical Skills*

- 51) In the above figure, suppose that the economy is at point *C*. If the inflation rate is lower than expected,
- A) the  $LRPC$  will shift rightward.
  - B) the  $SRPC$  will shift downward.
  - C) the  $SRPC$  will shift upward.
  - D) Neither the  $LRPC$  nor the  $SRPC$  will shift.

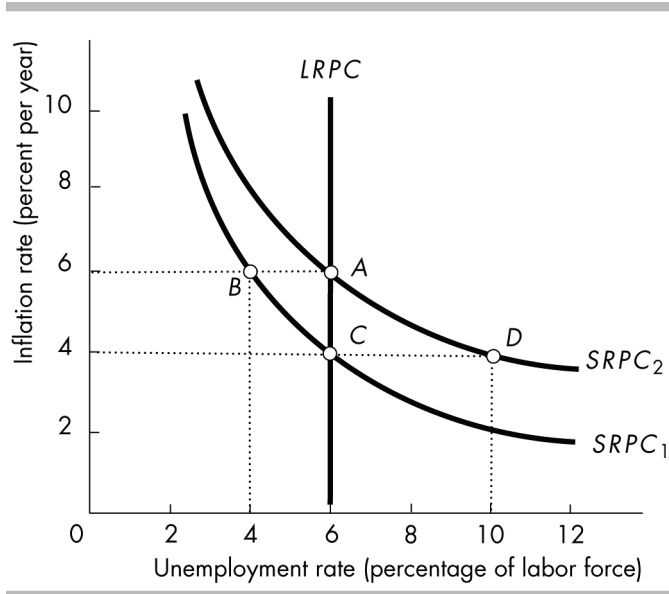
Answer: D

Topic: *The Short-Run and Long-Run Phillips Curve*

Skill: *Analytical*

Question history: *Previous edition, Chapter 12*

AACSB: *Analytical Skills*



- 52) In the above figure, the economy is at point A. The inflation rate unexpectedly falls by two percentage points. As a result, the economy moves to point
- A) A, that is, there is no movement.
  - B) B.
  - C) C.
  - D) D.

Answer: D

Topic: The Short-Run Phillips Curve

Skill: Analytical

Question history: Previous edition, Chapter 12

AACSB: Analytical Skills

- 53) In the above figure, the economy is at point A. The inflation rate falls by two percentage points and people correctly expected the fall. As a result, the economy moves to point
- A) A, that is, there is no movement.
  - B) B.
  - C) C.
  - D) D.

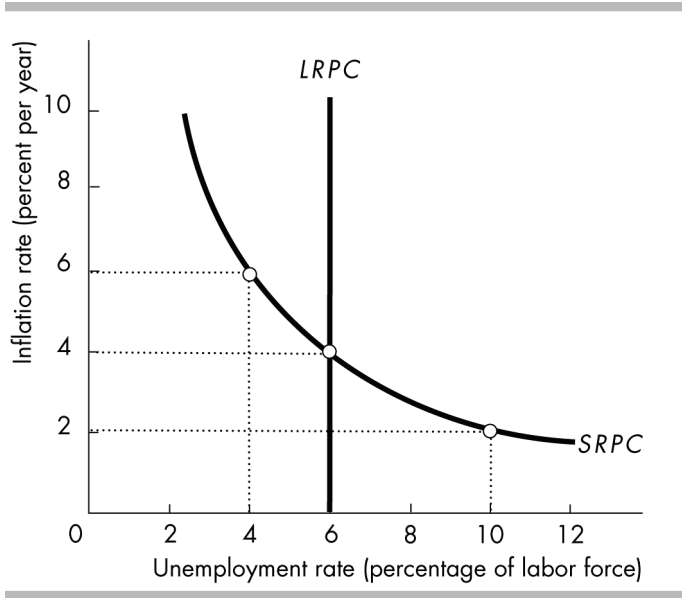
Answer: C

Topic: The Long-Run Phillips Curve

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills



- 54) The figure above shows an economy's Phillips curves. Currently, the inflation rate is 6 percent a year. The natural unemployment rate is \_\_\_\_\_ percent and the expected inflation rate is \_\_\_\_\_ percent a year.
- A) 6; 6
  - B) 6; 10
  - C) 4; 6
  - D) 6; 4

Answer: D

Topic: *The Short-Run and Long-Run Phillips Curve*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Analytical Skills*

- 55) The figure above shows an economy's Phillips curves. Currently, the inflation rate is 6 percent a year. If inflation expectations remain unchanged, the current unemployment rate is \_\_\_\_\_.
- A) less than the natural rate
  - B) greater than the natural rate
  - C) equal to the natural rate
  - D) 6 percent

Answer: A

Topic: *The Short-Run and Long-Run Phillips Curve*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Analytical Skills*

- 56) Consider the U.S. data for inflation and the unemployment rate for the last five decades. Which of the following statements describes the relationship between the two variables?
- A) The natural unemployment rate did not change but the expected inflation rate did change over these years.
  - B) Several different short-run Phillips curves representing different natural unemployment rates and different expected inflation rates existed.
  - C) There is a positive relationship.
  - D) None of the above answers is correct.

Answer: B

Topic: *The U.S. Phillips Curve*

Skill: *Recognition*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 57) During the 1970s when both the unemployment rate and inflation rate rose, it is reasonable to conclude that
- A) both the short-run and long-run Phillips curves shifted rightward.
  - B) both the short-run and long-run Phillips curves shifted leftward.
  - C) only the short-run Phillips curve shifted.
  - D) only the long-run Phillips curve shifted.

Answer: A

Topic: *The U.S. Phillips Curve*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 58) The short-run Phillips curve shows the relationship between
- A) the price level and real GDP in the short run.
  - B) the price level and unemployment in the short run.
  - C) inflation and unemployment when expected inflation equals the actual inflation.
  - D) inflation and unemployment when expected inflation does not change.

Answer: D

Topic: *Study Guide Question, The Short-Run Phillips Curve*

Skill: *Recognition*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 59) The short-run Phillips curve shows the \_\_\_\_\_ relationship between \_\_\_\_\_.
- A) negative; unemployment and real GDP
  - B) positive; unemployment and real GDP
  - C) negative; inflation and unemployment
  - D) positive; real GDP and inflation

Answer: C

Topic: *Study Guide Question, The Short-Run Phillips Curve*

Skill: *Recognition*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 60) The long-run Phillips curve shows the relationship between
- A) the price level and real GDP in the long run.
  - B) the price level and unemployment in the long run.
  - C) inflation and unemployment when expected inflation equals the actual inflation.
  - D) inflation and unemployment when expected inflation does not change.

Answer: C

Topic: Study Guide Question, The Long-Run Phillips Curve

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 61) A decrease in the natural unemployment rate shifts the long-run Phillips curve \_\_\_\_\_ and \_\_\_\_\_ the short-run Phillips curve.
- A) rightward; does not shift
  - B) leftward; shifts rightward
  - C) rightward; shifts rightward
  - D) leftward; shifts leftward

Answer: D

Topic: Study Guide Question, Short-Run and Long-Run Phillips Curve

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 62) A rise in the expected inflation rate leads to \_\_\_\_\_ in the long-run Phillips curve and \_\_\_\_\_ in the short-run Phillips curve.
- A) an upward shift; no shift
  - B) a leftward shift; an upward shift
  - C) no shift; no shift
  - D) no shift; an upward shift

Answer: D

Topic: Study Guide Question, Short-Run and Long-Run Phillips Curve

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 63) A decrease in the expected inflation rate leads to \_\_\_\_\_ in the long-run Phillips curve and \_\_\_\_\_ in the short-run Phillips curve.
- A) an upward shift; no shift
  - B) a leftward shift; an upward shift
  - C) no shift; no shift
  - D) no shift; a downward shift

Answer: D

Topic: Study Guide Question, Short-Run and Long-Run Phillips Curve

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

### 3 The Business Cycle

- 1) Business cycle events that arise solely from aggregate demand shifts are emphasized by the
- A) Keynesian and real business cycle theories.
  - B) monetarist and real business cycle theories.
  - C) Keynesian and monetarist cycle theories.
  - D) none of the major theories

Answer: C

Topic: Aggregate Demand Theories of the Business Cycle

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 2) Which of the following are business cycle theories that regard fluctuations in aggregate demand as the factor creating business cycles?
- I. Keynesian cycle theory
  - II. real business cycle theory
  - III. monetarist cycle theory
- A) I only
  - B) I and II
  - C) I and III
  - D) I, II and III

Answer: C

Topic: Aggregate Demand Theories of the Business Cycle

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 3) Which of the following is NOT an aggregate demand, mainstream theory of the business cycle?
- A) Keynesian cycle theory
  - B) monetarist cycle theory
  - C) new Keynesian cycle theory
  - D) real business cycle theory

Answer: D

Topic: Aggregate Demand Theories of the Business Cycle

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 4) In the Keynesian business cycle theory, business cycles begin with changes in
- A) inflation expectations.
  - B) consumer sentiment.
  - C) business confidence.
  - D) the public's expectations about Fed policies.

Answer: C

Topic: Keynesian Theory

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 5) The \_\_\_\_\_ states that the main source of economic fluctuations is volatile business confidence.
- A) real business cycle theory
  - B) new classical cycle theory
  - C) Keynesian cycle theory
  - D) monetarist cycle theory

Answer: C

Topic: *Keynesian Theory*

Skill: *Recognition*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 6) Fluctuations in business confidence is the factor leading to business cycles in the \_\_\_\_\_.
- A) Keynesian cycle theory
  - B) new Keynesian cycle theory
  - C) new classical cycle theory
  - D) monetarist cycle theory

Answer: A

Topic: *Keynesian Theory*

Skill: *Recognition*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 7) The factor leading to business cycles in the Keynesian model is \_\_\_\_\_.
- A) changes in business confidence
  - B) a speed up in money growth
  - C) unanticipated changes in aggregate demand
  - D) unanticipated changes in aggregate supply

Answer: A

Topic: *Keynesian Theory*

Skill: *Recognition*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 8) The Keynesian explanation of the business cycle is based on
- A) the inability of government policy-makers to predict the future course of the economy.
  - B) shifts in monetary policy undertaken by the Federal Reserve.
  - C) fluctuations in business confidence.
  - D) unstable inflationary expectations.

Answer: C

Topic: *Keynesian Theory*

Skill: *Recognition*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*



- 9) The factor that leads to business cycles within Keynesian cycle theory is
- A) the growth rate in labor productivity.
  - B) the growth rate in the quantity of money.
  - C) adverse shocks to international trade.
  - D) fluctuations in business confidence.

Answer: D

Topic: Keynesian Theory

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 10) Keynes used the term "animal spirits" to represent
- A) changes in people's consumption expenditures.
  - B) the ease of forecasting.
  - C) fluctuations in business confidence.
  - D) investment based on hard facts about the future.

Answer: C

Topic: Keynesian Theory

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 11) Which theory emphasizes frequent changes in investment because of "animal spirits" as the main source of economic fluctuations?
- A) real business cycle theory
  - B) new classical cycle theory
  - C) Keynesian cycle theory
  - D) monetarist cycle theory

Answer: C

Topic: Keynesian Theory

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 12) One model of the business cycle claims that volatile business confidence is the primary factor in starting a business cycle. This model is the
- A) real business cycle model.
  - B) Keynesian cycle theory.
  - C) aggregate supply model.
  - D) new classical theory.

Answer: B

Topic: Keynesian Theory

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 13) Which theory assumes that business cycles occur because of changes in business confidence?
- A) monetarist cycle theory
  - B) real business cycle theory
  - C) new classical cycle theory
  - D) Keynesian cycle theory

Answer: D

Topic: *Keynesian Theory*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 14) Which of the following describes the Keynesian approach to the business cycle?
- I. Unanticipated shocks to aggregate supply drive expansions and recessions.
  - II. The Keynesian theory is a real business cycle model of the economy.
  - III. A decrease in business confidence can trigger a recession.
- A) I only
  - B) III only
  - C) I and II
  - D) II and III

Answer: B

Topic: *Keynesian Theory*

Skill: *Recognition*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 15) Suppose that managers forecasted a large decline in expected sales and profits and so their confidence plummets. According to the \_\_\_\_\_, this forecast might start a business cycle.
- A) Keynesian cycle theory
  - B) circular flow theory
  - C) monetarist cycle theory
  - D) new classical cycle theory

Answer: A

Topic: *Keynesian Theory*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 16) Keynesians believe that
- A) money wage rate adjustments will quickly eliminate unemployment.
  - B) aggregate demand changes tend to induce aggregate supply changes, offsetting any effect from changes in government expenditures.
  - C) the economy will normally operate at full employment.
  - D) a change in business confidence can affect the amount of investment in the economy.

Answer: D

Topic: *Keynesian Theory*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 17) The Keynesian explanation of the business cycle rests on several concepts, including
- A) rigid money wage rates.
  - B) unstable monetary policy by the Fed.
  - C) shocks to the rate of technological change.
  - D) the desire of politicians to be re-elected.

Answer: A

Topic: Keynesian Theory

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 18) Based on the Keynesian theory of the business cycle, if the economy is at its full-employment equilibrium and aggregate demand increases then
- A) the price level and real GDP both increase.
  - B) the price level rises but real GDP remains unchanged.
  - C) the price level and GDP both decrease.
  - D) real GDP decreases and the price level remains unchanged.

Answer: A

Topic: Keynesian Theory

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 19) For monetarists the main cause of economic fluctuations is changes in
- A) investment.
  - B) consumption expenditure.
  - C) the growth rate of the quantity of money.
  - D) the levels of household debt.

Answer: C

Topic: Monetarist Theory

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 20) The monetarist theory of the business cycle regards \_\_\_\_\_ as the factor that leads to business cycles.
- A) unexpected increases in aggregate demand
  - B) changes in the growth rate of the quantity of money
  - C) volatility in the interest rate
  - D) volatility in the demand for money

Answer: B

Topic: Monetarist Theory

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 21) What, according to the monetarist theory of the business cycle, leads to changes in real GDP?
- A) a change in profit expectations
  - B) a change in the growth rate in tax revenue
  - C) a change in the growth rate of the quantity of money
  - D) an unanticipated change in aggregate demand

Answer: C

Topic: *Monetarist Theory*

Skill: *Recognition*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 22) In monetarist business cycle theory, the factor leading to a business cycle is changes in
- A) consumer spending.
  - B) investment spending.
  - C) the growth rate of the quantity of money.
  - D) net exports.

Answer: C

Topic: *Monetarist Theory*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 23) In monetarist business cycle theory, decreasing the growth rate of the quantity of money \_\_\_\_\_ and increasing the growth rate of the quantity of money \_\_\_\_\_.
- A) increases real GDP; decreases the inflation rate
  - B) decreases real GDP; decreases the inflation rate
  - C) causes the economy to enter a recession; causes the economy to enter an expansion
  - D) causes the economy to enter an expansion; causes the economy to enter a recession

Answer: C

Topic: *Monetarist Theory*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 24) In monetarist business cycle theory, increases in money growth temporarily \_\_\_\_\_ real GDP and \_\_\_\_\_ the price level.
- A) increase; rise
  - B) increase; lower
  - C) decrease; rise
  - D) decrease; lower

Answer: A

Topic: *Monetarist Theory*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 25) Using the monetarist model, place the following events in the order in which they occur in a business cycle.
- I. Money wages fall and the *SAS* curve shifts rightward.
  - II. The Federal Reserve decreases the growth rate of the quantity of money.
  - III. The *AD* curve shifts leftward.
- A) II, III, I
  - B) III, II, I
  - C) I, III, II
  - D) The events are not part of a monetarist model of the business cycle.

Answer: A

Topic: Monetarist Theory

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 26) Suppose the growth rate of the quantity of money increased from 5 percent per year to 8 percent per year. According to the \_\_\_\_\_, this event would trigger a business cycle expansion.
- A) Keynesian cycle model
  - B) real business cycle model
  - C) aggregate supply cycle model
  - D) monetarist cycle model

Answer: D

Topic: Monetarist Theory

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 27) Which of the following is TRUE regarding the monetarist theory of the business cycle?
- I. Monetarists assume that the quantity of money increases at a constant rate.
  - II. Fluctuations in interest rates cause business cycles.
  - III. Changes in the growth rate of the quantity of money affect aggregate demand.
- A) I only
  - B) III only
  - C) I and II
  - D) II and III

Answer: B

Topic: Monetarist Theory

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 28) Which of the following pieces of evidence is most consistent with the monetarist theory?
- A) Labor supply decisions do not seem to depend on real interest rates.
  - B) Changes in real GDP and the quantity of money move closely together.
  - C) Money wage rates take some time to adjust to price changes.
  - D) Productivity and GDP move closely together.

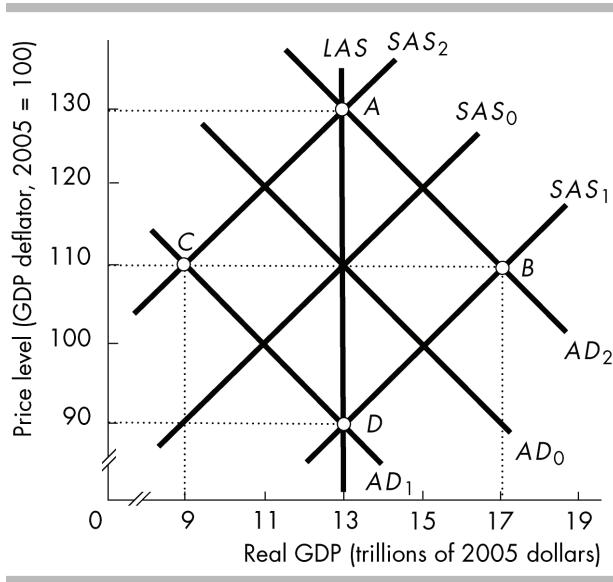
Answer: B

Topic: Monetarist Theory

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking



- 29) In the above figure, suppose the economy has moved from point *A* to point *C*. According to the monetarist theory of the business cycle, what could have caused this movement?
- A) an increase in the money wage rate
  - B) an increase in the growth rate of the quantity of money
  - C) a decrease in the growth rate of the quantity of money
  - D) an increase in uncertainty

Answer: C

Topic: Monetarist Theory

Skill: Analytical

Question history: Previous edition, Chapter 12

AACSB: Analytical Skills

- 30) In the above figure, suppose the economy has moved from point *D* to point *B*. According to the monetarist theory of the business cycle, what could have caused this movement?
- A) a decrease in the money wage rate
  - B) an increase in uncertainty about future sales and profits
  - C) an increase in the growth rate of the quantity of money
  - D) an increase in the money wage rate

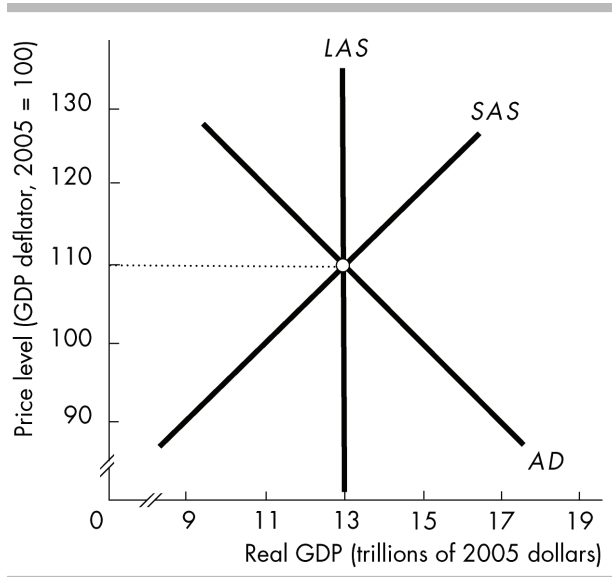
Answer: C

Topic: Monetarist Theory

Skill: Analytical

Question history: Previous edition, Chapter 12

AACSB: Analytical Skills



31) Using the above figure, a recession in the monetarist model would start with a

- A) rightward shift in the *AD* curve.
- B) leftward shift in the *AD* curve.
- C) leftward shift in the *SAS* curve.
- D) leftward shift in the *LAS* curve.

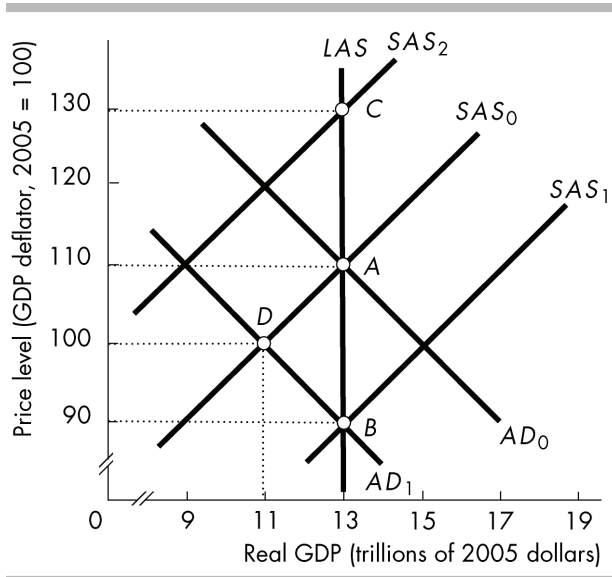
Answer: B

Topic: Monetarist Theory

Skill: Analytical

Question history: Previous edition, Chapter 12

AACSB: Analytical Skills



32) In the above figure, the economy is initially at point A. Which point best represents the short-run response to a decrease in the growth rate of the quantity of money, according to the monetarists?

- A) A, that is, there is no change.
- B) B
- C) C
- D) D

Answer: D

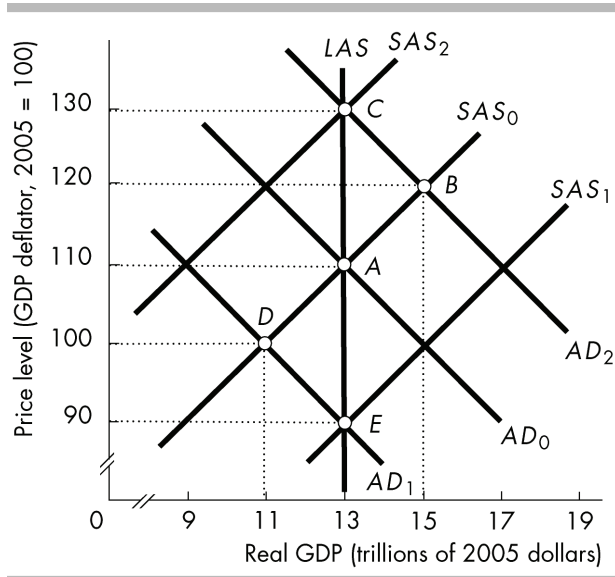
Topic: Monetarist Theory

Skill: Analytical

Question history: Previous edition, Chapter 12

AACSB: Analytical Skills





- 33) In the above figure, suppose the economy starts at point *A*. The short-run response to a decrease in the growth rate of the quantity of money in monetarist business cycle theory moves the economy to point
- A) *B*.
  - B) *C*.
  - C) *D*.
  - D) *E*.

Answer: *C*

Topic: *Monetarist Theory*

Skill: *Analytical*

Question history: *Previous edition, Chapter 12*

AACSB: *Analytical Skills*

- 34) In the above figure, suppose the economy starts at point *A*. The short-run response to an increase in the growth rate of the quantity of money in monetarist business cycle theory moves the economy to point
- A) *B*.
  - B) *C*.
  - C) *D*.
  - D) *E*.

Answer: *A*

Topic: *Monetarist Theory*

Skill: *Analytical*

Question history: *Previous edition, Chapter 12*

AACSB: *Analytical Skills*

- 35) In the above figure, suppose the economy starts at point A. The short-run response to an increase in the growth rate of the quantity of money in the monetarist business cycle theory is for the price level to \_\_\_\_\_ and real GDP to \_\_\_\_\_.
- A) fall to 90; remain at \$13 trillion
  - B) rise to 120; increase to \$15 trillion
  - C) rise to 130; remain at \$13 trillion
  - D) remain at 110; remain at \$13 trillion

Answer: B

Topic: *Monetarist Theory*

Skill: *Analytical*

Question history: *Modified 10th edition*

AACSB: *Analytical Skills*

- 36) The new classical cycle theory predicts that an unexpected increase in aggregate demand \_\_\_\_\_ create a business cycle and an expected increase in aggregate demand \_\_\_\_\_ create a business cycle.
- A) will; will
  - B) will; will not
  - C) will not; will
  - D) will not; will not

Answer: B

Topic: *Rational Expectations Theories*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 37) The \_\_\_\_\_ cycle theory states that only unexpected fluctuations in aggregate demand are the main source of business cycles.
- A) new Keynesian
  - B) new classical
  - C) Keynesian
  - D) monetarist

Answer: B

Topic: *New Classical Theory*

Skill: *Recognition*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 38) The business cycle impulse in the new classical theory of the business cycle is
- A) unexpected changes in aggregate demand.
  - B) expected changes in aggregate demand.
  - C) fluctuations in money growth with rigid wages.
  - D) fluctuations in investment coupled with rigid wages.

Answer: A

Topic: *New Classical Theory*

Skill: *Recognition*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 39) The new classical theory argues that the primary factor leading to business cycles are
- A) expected changes in aggregate demand.
  - B) expected changes in aggregate supply.
  - C) unexpected changes in aggregate demand.
  - D) unexpected changes in aggregate supply.

Answer: C

Topic: *New Classical Theory*

Skill: *Recognition*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 40) Which theory distinguishes between expected and unexpected fluctuations in aggregate demand and asserts that only unexpected changes can affect real GDP?
- A) new classical cycle theory
  - B) Keynesian cycle theory
  - C) monetarist cycle theory
  - D) real business cycle theory

Answer: A

Topic: *New Classical Theory*

Skill: *Recognition*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 41) According to the new classical model, changes in aggregate demand change real GDP
- A) all of the time.
  - B) only when the short-run aggregate supply curve is vertical.
  - C) only when the changes in aggregate demand are expected.
  - D) only when the changes in aggregate demand are unexpected.

Answer: D

Topic: *New Classical Theory*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 42) Suppose that forecasters have incorrectly estimated aggregate demand. According to the \_\_\_\_\_, this mistake could trigger a business cycle.
- A) Keynesian cycle model
  - B) the monetarist cycle model
  - C) the new classical cycle model
  - D) the real business cycle model

Answer: C

Topic: *New Classical Theory*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 43) A larger than expected increase in aggregate demand will lead to \_\_\_\_\_ in the \_\_\_\_\_ of the business cycle.
- A) a recession; new Keynesian cycle theory
  - B) a recession; Keynesian cycle theory
  - C) an expansion; new classical cycle theory
  - D) an expansion; real business cycle theory

Answer: C

Topic: *New Classical Theory*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 44) Which of the following correctly describes the new classical cycle theory of the business cycle?
- A) An unexpected change in the quantity of money can trigger a business cycle.
  - B) An expected tax rate change can trigger a business cycle.
  - C) An expected change in the level of exports can trigger a business cycle.
  - D) Rational expectations keep the money wage from changing quickly.

Answer: A

Topic: *New Classical Theory*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 45) One assumption of the new classical model is that
- A) money wage rates are rigid.
  - B) prices are "sticky" upward.
  - C) people make rational expectations about aggregate demand.
  - D) markets are not purely competitive.

Answer: C

Topic: *New Classical Theory*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 46) Both new Keynesian and new classical cycle theories claim that \_\_\_\_\_.
- A) animal spirits can trigger a business cycle
  - B) shifts in the SAS curve are the main impulse for a business cycle
  - C) unexpected changes in aggregate demand trigger a business cycle
  - D) expected changes in the quantity of money can trigger a business cycle

Answer: C

Topic: *New Classical and New Keynesian Theories*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 47) Both the new classical and new Keynesian business cycle theories agree that
- A) expected changes in aggregate demand lead to the business cycle.
  - B) unexpected changes in aggregate demand cannot result in a business cycle.
  - C) the money wage rate is influenced by rational expectations of the price level.
  - D) the long-term nature of wage contracts allow expected changes in the price level to cause business cycles.

Answer: C

Topic: *New Classical and New Keynesian Theories*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 48) A key *difference* between the new classical and the new Keynesian views of the business cycle is the role played by
- A) unexpected changes in aggregate demand.
  - B) government expenditure on goods and services.
  - C) expected changes in aggregate demand.
  - D) the growth rate of the quantity of money.

Answer: C

Topic: *New Classical and New Keynesian Theories*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 49) The key difference between the new classical theory of the business cycle and the new Keynesian theory of the business cycle is that the new classical theory believes that \_\_\_\_\_ while the new Keynesian theory believes that \_\_\_\_\_.
- A) expected changes in aggregate demand will change real GDP; expected changes in aggregate demand will not change real GDP
  - B) only unexpected changes in aggregate demand will change real GDP; only expected changes in aggregate demand will change real GDP
  - C) only unexpected changes in aggregate demand will change real GDP; both expected and unexpected changes in aggregate demand will change real GDP
  - D) the short-run aggregate supply curve is horizontal; the short-run aggregate supply curve is vertical.

Answer: C

Topic: *New Classical and New Keynesian Theories*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 50) The factor leading to business cycles in the \_\_\_\_\_ cycle theory is unexpected fluctuations in aggregate demand while in the \_\_\_\_\_ cycle theory both unexpected and expected fluctuations in aggregate demand are factors that lead to business cycles.
- A) new classical; monetarist
  - B) new classical; new Keynesian
  - C) new Keynesian; Keynesian
  - D) monetarist; new Keynesian

Answer: B

*Topic: New Classical and New Keynesian Theories*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 12*

*AACSB: Reflective Thinking*

- 51) According to the new classical theory, \_\_\_\_\_ policy changes have no effect on real GDP and according to the new Keynesian theory, \_\_\_\_\_ policy changes have an effect on real GDP.
- A) expected; expected
  - B) unexpected; expected
  - C) fiscal; monetary
  - D) fiscal; fiscal

Answer: A

*Topic: New Classical and New Keynesian Theories*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 12*

*AACSB: Reflective Thinking*

- 52) An unexpected decrease in aggregate demand will trigger a recession in the \_\_\_\_\_ theory of the business cycle.
- A) new Keynesian cycle
  - B) new classical cycle
  - C) Keynesian cycle
  - D) Both answers A and B are correct.

Answer: D

*Topic: New Classical and New Keynesian Theories*

*Skill: Recognition*

*Question history: Previous edition, Chapter 12*

*AACSB: Reflective Thinking*

- 53) The new Keynesian cycle theory of the business cycle regards \_\_\_\_\_ as the main source of economic fluctuations.
- A) unexpected fluctuations in aggregate demand
  - B) expected and unexpected fluctuations in aggregate demand
  - C) expected fluctuations in aggregate supply
  - D) changes in business confidence

Answer: B

*Topic: New Keynesian Theory*

*Skill: Recognition*

*Question history: Previous edition, Chapter 12*

*AACSB: Reflective Thinking*

- 54) New Keynesian economists believe that \_\_\_\_\_ is influenced by \_\_\_\_\_.
- A) yesterday's money wage rate ; today's rational expectations of the money wage
  - B) today's money wage rate; yesterday's rational expectations of the price level
  - C) yesterday's rational expectations of the price level; today's money wage rate
  - D) today's money wage rate; today's rational expectations of the price level

Answer: B

Topic: *New Keynesian Theory*

Skill: *Recognition*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 55) Which business cycle theory emphasizes that, because of long-term wage agreements, both expected and unexpected fluctuations in aggregate demand can change real GDP?
- A) the new classical cycle theory
  - B) the new Keynesian cycle theory
  - C) monetarist cycle theory
  - D) Keynesian cycle theory

Answer: B

Topic: *New Keynesian Theory*

Skill: *Recognition*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 56) The \_\_\_\_\_ theory of the business cycle asserts that expected and unexpected changes in aggregate demand lead to fluctuations in real GDP.
- A) real business cycle
  - B) new classical cycle
  - C) new Keynesian cycle
  - D) None of the above answers are correct.

Answer: C

Topic: *New Keynesian Theory*

Skill: *Recognition*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

- 57) According to the new Keynesian cycle theory of the business cycle, which of the following can trigger a business cycle expansion?
- I. an unexpected increase in the quantity of money
  - II. an expected increase in the quantity of money
  - III. an expected increase in government expenditure
- A) I only
  - B) II and III
  - C) I, II and III
  - D) None of the three will trigger an expansion.

Answer: C

Topic: *New Keynesian Theory*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 58) In the new Keynesian business cycle theory, \_\_\_\_\_ can effect real GDP.
- A) only expected changes in aggregate demand
  - B) expected and unexpected changes in aggregate demand
  - C) only unexpected changes in aggregate demand
  - D) only unexpected changes in the money wage rate

Answer: B

Topic: *New Keynesian Theory*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 59) Suppose that the Federal Reserve is expected to expand the quantity of money by 5 percent but ends up expanding it by only 2 percent. If the new Keynesian theory is correct, which of the following describes the effect on the economy?
- A) The economy experience a boom because the quantity of money is still growing.
  - B) Inflation will be higher than expected.
  - C) Workers' decisions about when to work will be affected.
  - D) A recession will ensue.

Answer: D

Topic: *New Keynesian Theory*

Skill: *Analytical*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 60) Suppose the data show that an unexpected change in tax rates caused a recent recession. These data support which model of the business cycle?
- A) new classical cycle theory
  - B) new Keynesian cycle theory
  - C) real business cycle theory
  - D) Both answers A and B are correct.

Answer: D

Topic: *New Classical and New Keynesian Theories*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*



- 61) Which of the following are TRUE?
- I. New Keynesian economists believe that money wage rates are influenced by rational expectations of the price level.
  - II. New classical economists believe that money wage rates are influenced by rational expectations of the price level.
  - III. New classical economists believe expected changes in aggregate demand trigger business cycles.
- A) I and II
  - B) I and III
  - C) II and III
  - D) I, II and III

Answer: A

Topic: New Classical and New Keynesian Theories

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 62) Real business cycle theory says that the factor leading to the business cycle is changes in
- A) animal spirits.
  - B) the growth rate of the quantity of money.
  - C) only aggregate demand.
  - D) productivity.

Answer: D

Topic: RBC Impulse

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 63) The real business cycle theory asserts that changes in \_\_\_\_\_ lead to changes in \_\_\_\_\_.
- A) the quantity of money; real GDP
  - B) technology; productivity
  - C) animal spirits; real GDP
  - D) consumption expenditure; real GDP

Answer: B

Topic: RBC Impulse

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 64) The factor leading to business cycles according to the real business cycle theory is changes in
- A) the growth rate of the quantity of money.
  - B) technological change caused by changes in productivity.
  - C) productivity caused by changes in technology.
  - D) investment caused by changes in business confidence.

Answer: C

Topic: RBC Impulse

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 65) Real business cycle (RBC) theory predicts that the main source of economic fluctuations is
- A) sticky money wage rates.
  - B) rational expectations based on complete information.
  - C) changes in the growth rate of productivity.
  - D) None of the above answers is correct.

Answer: C

Topic: RBC Impulse

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 66) Real business cycle theory explains the business cycle as the result of
- A) excess growth of the quantity of money.
  - B) unstable investment demand.
  - C) shocks to consumer spending habits.
  - D) fluctuations in productivity.

Answer: D

Topic: RBC Impulse

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 67) The factor that leads to business cycle events within real business cycle theory is
- A) changes in growth rate in productivity.
  - B) changes in the growth rate in the quantity of money.
  - C) adverse shocks to international trade.
  - D) changes in expected future sales and profits of firms.

Answer: A

Topic: RBC Impulse

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 68) In real business cycle theory, the factor leading to a business cycle is
- A) changes in investment.
  - B) changes in the quantity of money.
  - C) unexpected changes in aggregate demand.
  - D) fluctuations in the pace of technological change.

Answer: D

Topic: RBC Impulse

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 69) The factor leading to business cycles in the real business cycle theory is changes in the growth rate of
- A) the quantity of money.
  - B) productivity.
  - C) labor supply.
  - D) the money wage rate.

Answer: B

Topic: RBC Impulse

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 70) According to the real business cycle (RBC) theory, recessions are the result of
- A) a fall in growth rate of productivity.
  - B) an increase in growth rate of the quantity of money.
  - C) an increase in investment.
  - D) a decrease in growth rate of the quantity of money.

Answer: A

Topic: RBC Mechanism

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 71) The theory that regards random fluctuations in productivity as the main source of economic fluctuations is the \_\_\_\_\_ of the business cycle.
- A) real business cycle theory
  - B) productivity theory
  - C) dynamic general equilibrium theory
  - D) Keynesian cycle theory

Answer: A

Topic: RBC Impulse

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 72) Which theory views fluctuations in productivity as the main source of business cycle fluctuations?
- A) real business cycle theory
  - B) Keynesian cycle theory
  - C) monetarist cycle theory
  - D) new classical cycle theory

Answer: A

Topic: RBC Impulse

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 73) According to the real business cycle theory, technological change
- A) occurs at a constant rate.
  - B) happens only occasionally.
  - C) happens at an uneven pace.
  - D) is increasing in recent years at an increasing rate.

Answer: C

Topic: RBC Impulse

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 74) According to the real business cycle theory, technological change
- A) always increases productivity.
  - B) never increases productivity.
  - C) can initially decrease productivity.
  - D) is caused by changes in productivity.

Answer: C

Topic: RBC Impulse

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 75) The real business cycle (RBC) theory asserts that the impact on real GDP of technological change is
- A) always positive.
  - B) usually positive but occasionally negative.
  - C) always negative.
  - D) nonexistent.

Answer: B

Topic: RBC Impulse

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 76) According to the \_\_\_\_\_ theory, technological change can be so rapid that some existing capital becomes obsolete and \_\_\_\_\_.
- A) real business cycle; aggregate demand increases
  - B) new classical; productivity falls
  - C) new classical; aggregate demand increases
  - D) real business cycle; productivity falls

Answer: D

Topic: RBC Impulse

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 77) Evidence indicates that a recession occurs at about the same time as a decrease in investment. According to the real business cycle theory, the decrease in investment is attributable to
- A) a fall in animal spirits.
  - B) a decrease in productivity.
  - C) a decrease in the growth rate of the quantity of money.
  - D) intertemporal substitution in working decisions.

Answer: B

Topic: RBC Impulse

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 78) Which of the following pieces of evidence is most consistent with the real business cycle theory?
- A) Labor supply decisions do not seem to depend on real interest rates.
  - B) Real GDP and the quantity of money move closely together.
  - C) Money wage rates take some time to adjust to price changes.
  - D) Productivity and GDP move closely together.

Answer: D

Topic: RBC Impulse

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 79) Looking at U.S. economic history between 1964 and 2009, we see that growth in real GDP
- A) was not correlated with fluctuations in productivity growth.
  - B) falls following an increase in productivity growth.
  - C) rises following an increase in productivity growth.
  - D) rises following a decrease in productivity growth.

Answer: C

Topic: RBC Impulse

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 80) The key ripple effect in real business cycle theory is the \_\_\_\_\_ decision and it depends on the \_\_\_\_\_.
- A) when-to-invest; real interest rate
  - B) when-to-work; real interest rate
  - C) what-to-save; nominal interest rate
  - D) where-to-work; real wage rate

Answer: B

Topic: Real Business Cycle Theory

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 81) According to the real business cycle theory, the immediate effects from a change in productivity include which of the following?
- I. Investment demand changes.
  - II. Demand for labor changes.
  - III. Government expenditures change.
- A) I
  - B) I and II
  - C) I and III
  - D) II and III

Answer: B

Topic: RBC Mechanism

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 82) "Intertemporal substitution" in labor supply describes changes in labor supply in response to changes in
- A) personal tax rates.
  - B) investment spending.
  - C) the real interest rate.
  - D) consumer demand for goods.

Answer: C

Topic: RBC Mechanism

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 83) Which theory maintains that the money wage rate always adjusts freely?
- A) Keynesian cycle theory
  - B) monetarist cycle theory
  - C) both the new classical cycle theory and the new Keynesian cycle theory
  - D) real business cycle theory

Answer: D

Topic: RBC Mechanism

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 84) In real business cycle theory, a decrease in productivity leads to all of the following events EXCEPT \_\_\_\_\_.

- A) a decrease in the demand for labor
- B) a decrease in investment demand
- C) a rise in the real wage rate
- D) a fall in the real interest rate

Answer: C

Topic: RBC Mechanism

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 85) In a real business cycle model, labor supply
- A) increases if the nominal interest rate rises.
  - B) is independent of the real interest rate.
  - C) decreases if the real interest rate rises.
  - D) decreases if the real interest rate falls.

Answer: D

Topic: RBC Mechanism

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 86) In the real business cycle framework, a technology shock that increases investment demand and the demand for loanable funds leads to a \_\_\_\_\_ quantity of saving and a \_\_\_\_\_ real interest rate.
- A) higher; higher
  - B) higher; lower
  - C) lower; higher
  - D) lower; lower

Answer: A

Topic: RBC Mechanism

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 87) Suppose that a severe shock that decreases the demand for loanable funds hits the United States. Which of the following can we expect to occur according to the real business cycle model?
- A) The real interest rate will fall.
  - B) People will work fewer hours.
  - C) The real wage rate will fall.
  - D) All of the above are true.

Answer: D

Topic: RBC Mechanism

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 88) According to the real business cycle theory, an increase in the price of a resource, such as oil, that decreases the demand for loanable funds will \_\_\_\_\_ employment and \_\_\_\_\_ real GDP.
- A) increase; increase
  - B) increase; decrease
  - C) decrease; increase
  - D) decrease; decrease

Answer: D

Topic: RBC Mechanism

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 89) According to real business proponents, in an increase in productivity \_\_\_\_\_ the demand for loanable funds, \_\_\_\_\_ the demand for labor, and \_\_\_\_\_ the supply of labor. The real interest rate will \_\_\_\_\_.
- A) increases; increases; there is no change in; fall
  - B) increases; increases; there is no change in; rise
  - C) decreases; decreases; decreases; fall
  - D) increases; increases; increases; rise

Answer: D

Topic: RBC Mechanism

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 90) According to the real business cycle (RBC) theory, during a recession the demand for labor \_\_\_\_\_ and the supply of labor \_\_\_\_\_.
- A) increases; decreases
  - B) decreases; does not change
  - C) does not change; decreases
  - D) decreases; decreases

Answer: D

Topic: Real Business Cycle Theory

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 91) According to real business cycle theory, a fall in the real interest rate \_\_\_\_\_ current labor supply and \_\_\_\_\_ current employment.
- A) increases; increases
  - B) increases; decreases
  - C) decreases; increases
  - D) decreases; decreases

Answer: D

Topic: RBC Mechanism

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 92) Real business cycle economists claim that the intertemporal substitution effect
- A) plays a small role in the labor market.
  - B) depends on the real interest rate.
  - C) plays a large role in the economy only during expansions.
  - D) has unpredictable effects on the economy.

Answer: B

Topic: RBC Mechanism

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking



- 93) According to real business cycle theory, workers' decisions to work now versus later depend on
- A) the real wage rate today but not the real wage rate in the future.
  - B) the money wage rate.
  - C) the real interest rate.
  - D) labor productivity.

Answer: C

Topic: RBC Mechanism

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 94) Suppose that in response to a decrease in real interest rates, a person decides to reduce his labor supply today and increase it in the future. This behavior is most consistent with the
- A) new classical theory of the business cycle.
  - B) Keynesian theory of the business cycle.
  - C) new Keynesian theory of the business cycle.
  - D) real business cycle theory.

Answer: D

Topic: RBC Mechanism

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 95) If the real interest rate is 4 percent and workers expect real wages to be 2 percent year higher next year, according to real business cycle theory, workers will work
- A) more this year and less next year.
  - B) less this year and less next year.
  - C) more this year and more next year.
  - D) less this year and more next year.

Answer: A

Topic: RBC Mechanism

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 96) If the real interest rate is 2 percent and workers expect real wages to be 4 percent higher next year, according to real business cycle theory, workers will work
- A) more this year and less next year.
  - B) less this year and less next year.
  - C) more this year and more next year.
  - D) less this year and more next year.

Answer: D

Topic: RBC Mechanism

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Analytical Skills

- 97) In the real business cycle model, the quantity of money
- A) can change the real wage rate.
  - B) can increase the real interest rate.
  - C) has no effect on real GDP.
  - D) can decrease the effect from technology shocks.

Answer: C

Topic: Real Business Cycle Theory

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 98) According to real business cycle (RBC) theory, a change in the quantity of money leads to
- A) a change in the price level and in real GDP.
  - B) a change in the price level but no change in real GDP.
  - C) a change in investment and real GDP.
  - D) a change in the real wage rate and the money wage rate.

Answer: B

Topic: Real Business Cycle Theory

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 99) According to which theory of the business cycle do changes in the quantity of money *never* play a role in helping to explaining fluctuations in real variables?
- A) Keynesian
  - B) monetarist
  - C) new Keynesian
  - D) real business cycle

Answer: D

Topic: Real Business Cycle Theory

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 100) In real business cycle models, in order to increase real GDP after a negative technology shock, the government can
- I. increase the quantity of money.
  - II. decrease the quantity of money.
- A) only I
  - B) only II
  - C) both I and II
  - D) neither I nor II

Answer: D

Topic: Real Business Cycle Theory

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 101) Critics of the real business cycle model argue that
- A) investment spending is strongly related to the real interest rate.
  - B) labor supply is only weakly related to the real interest rate.
  - C) investment spending is only weakly related to the real interest rate.
  - D) labor supply is very strongly related to the real interest rate.

Answer: B

Topic: Criticisms of Real Business Cycle Theory

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 102) Which of the following is NOT one of the criticisms of real business cycle theory?
- A) The money wage rate is sticky in the short run.
  - B) Inter-temporal substitution is too weak.
  - C) Productivity fluctuations are the result of the business cycle, not the cause of business cycles.
  - D) The theory is built on weak microeconomic foundations.

Answer: D

Topic: Criticisms of Real Business Cycle Theory

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 103) Critics of the real business cycle theory claim that
- A) both real and nominal variables change during the business cycle.
  - B) the intertemporal substitution effect is too weak to account for changes in labor supply.
  - C) changes in technology cannot cause economic growth.
  - D) Both answers B and C are correct.

Answer: B

Topic: Criticisms of Real Business Cycle Theory

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 104) Suppose that an economist finds that in most recessions, which are times when employment is low, that real interest rates are extremely high. This finding would pose the biggest problem for the
- A) new classical theory of the business cycle.
  - B) real business cycle theory.
  - C) new Keynesian theory of the business cycle.
  - D) Keynesian theory of the business cycle.

Answer: B

Topic: Criticisms of Real Business Cycle Theory

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 105) A criticism of the real business cycle (RBC) theory is that
- A) the money wage rate is flexible.
  - B) potential GDP does not vary with changes in the quantity of money.
  - C) productivity fluctuations might be caused by the business cycle.
  - D) All of the above answers are correct.

Answer: C

Topic: *Criticisms of Real Business Cycle Theory*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 106) Which of the following is a criticism of real business cycle theory?
- A) Real business cycle theory fails to explain the phenomenon of economic growth.
  - B) Real business cycle theory assumes that money wage rates are sticky.
  - C) Real business cycle theory believes that productivity changes are caused by technology changes when in fact they are caused by changes in aggregate demand.
  - D) None of the above are criticisms of real business cycle theory.

Answer: C

Topic: *Criticisms of Real Business Cycle Theory*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 107) Which of the following theories is criticized for assuming the money wage rate is not sticky?
- A) monetarist cycle theory
  - B) real business cycle theory
  - C) Keynesian cycle theory
  - D) new Keynesian cycle theory

Answer: B

Topic: *Criticisms of Real Business Cycle Theory*

Skill: *Recognition*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 108) Which of the following is the factor that creates business cycles in the real business cycle theory?
- A) an unexpected change in aggregate demand
  - B) a change by the Fed in the growth rate of the quantity of money
  - C) a change in expectations about future sales and profits
  - D) a change in the growth rate of productivity

Answer: D

Topic: *Study Guide Question, Real Business Cycle Theory*

Skill: *Recognition*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 109) By itself, an increase in aggregate demand increases GDP by the least amount in the \_\_\_\_\_.
- A) Keynesian theory
  - B) monetarist theory
  - C) new Keynesian theory
  - D) real business cycle theory

Answer: D

Topic: Study Guide Question, Real Business Cycle Theory

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 110) Which of the following is the factor that leads to business cycles in the Keynesian business cycle theory?
- A) an unexpected change in aggregate demand
  - B) a change by the Fed in the growth rate of the quantity of money
  - C) a change in business confidence
  - D) a change in the growth rate of productivity

Answer: C

Topic: Study Guide Question, Keynesian Theory

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 111) Which of the following is the factor that leads to business cycles in the monetarist business cycle theory?
- A) an unexpected change in aggregate demand
  - B) a change by the Fed in the growth rate of the quantity of money
  - C) a change in business confidence
  - D) a change in the growth rate of productivity

Answer: B

Topic: Study Guide Question, Monetarist Theory

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

- 112) Which of the following is the factor that leads to business cycles in the new classical business cycle theory?
- A) an unexpected change in aggregate demand
  - B) a change by the Fed in the growth rate of the quantity of money
  - C) a change in business confidence
  - D) a change in the growth rate of productivity

Answer: A

Topic: Study Guide Question, New Classical Theory

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

#### 4 News Based Questions

- 1) The data below show data for Germany including real GDP (in billions of euros) and the price level.

	Real GDP	Price Level
2002	2088	102.6
2003	2083	103.6
2004	2105	106
2005	2121	108.2
2006	2182	109.7
2007	2237	109.5

In which of the following year(s) did Germany experience inflation?

- A) 2003, 2004, 2005 and 2006.
- B) 2006 and 2007.
- C) 2007.
- D) 2002, 2005 and 2006 only.

Answer: A

Topic: *Inflation Rate*

Skill: *Analytical*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 2) "UK Inflation Surges to 16-year High"

According to the story, "High inflation in July will also lead to ... "further rises next January ..."  
Economists also noted that inflation may get worse because the current data did not yet include "announced rises in gas and electricity prices."

www.ft.com, 8/12/2008

The story reflects the concept of

- A) cost-push inflation.
- B) the short-run Phillips curve.
- C) demand-pull inflation.
- D) the long-run Phillips curve.

Answer: A

Topic: *Cost-Push Inflation*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Communication*

## 3) "Inflation Gives Saudis Food for Thought"

"My boss sent me back to return the milk – it's too expensive," said the Pakistani driver for a middle-class Saudi family at the checkout counter of the Al-Othaim supermarket. ... Saudi Arabia is enjoying an unprecedented economic boom ...as sectors [have] increased activity to meet the big internal demand."  
www.ft.com, 1/18/2008

The type of inflation described in the story

- A) begins with stagflation.
- B) starts with an increase in aggregate demand.
- C) is the result of money wage rate spiral.
- D) starts with a decrease in aggregate demand.

Answer: B

Topic: Demand-Pull Inflation

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Communication

## 4) "Inflation Gives Saudis Food for Thought"

"My boss sent me back to return the milk – it's too expensive," said the Pakistani driver for a middle-class Saudi family at the checkout counter of the Al-Othaim supermarket. ... Saudi Arabia is enjoying an unprecedented economic boom ...as sectors [have] increased activity to meet the big internal demand."  
www.ft.com, 1/18/2008

The story describes

- A) cost-push inflation.
- B) demand-pull inflation.
- C) a rightward shift in the short-run Phillips curve.
- D) stagflation.

Answer: B

Topic: Demand-Pull Inflation

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Communication

5) "Shoe Industry under Pressure Amid Rising Costs "

Rising costs have forced about 15 per cent of shoe manufacturers in a major south China industrial centre to shut down or relocate in the past year... [the firms have] identified rising wages as a key factor behind the closures and relocations from Dongguan...The problems in the footwear industry reflect broader issues affecting manufacturers across China's Pearl River Delta..."

www.ft.com, 2/26/2008

As the same pressures affect other industries across China, we expect to see

- A) demand-pull inflation.
- B) a combination of cost-push and demand-pull inflation.
- C) cost-push inflation.
- D) a downward movement along the short-run Phillips curve.

Answer: C

*Topic: Cost-Push Inflation*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 12*

*AACSB: Communication*

6) "Shoe Industry under Pressure Amid Rising Costs"

Rising costs have forced about 15 per cent of shoe manufacturers in a major south China industrial centre to shut down or relocate in the past year... [the firms have] identified rising wages as a key factor behind the closures and relocations from Dongguan...The problems in the footwear industry reflect broader issues affecting manufacturers across China's Pearl River Delta..."

www.ft.com, 2/26/2008

Using an *AS/AD* framework to describe the events in the story, there would be a

- A) leftward shift in the *AD* curve.
- B) leftward shift in the *SAS* curve.
- C) rightward shift in the *AD* curve.
- D) rightward shift in the *SAS* curve.

Answer: B

*Topic: Cost-Push Inflation*

*Skill: Analytical*

*Question history: Previous edition, Chapter 12*

*AACSB: Analytical Skills*



## 7) "All for One, but None for All"

In an article regarding how Great Britain and France are addressing the economic crisis in 2008, Britain's prime minister "is eager to encourage consumer spending" while France's president "wants to boost investment in both the private and public sectors." Both leaders are concerned because "hardly a day goes by without some manufacturing company announcing painful restructuring, plant closures or temporary lay-offs."

www.ft.com, 11/24/2008

If the governments can increase consumption or investment while holding the expected inflation constant, there would be

- A) a rightward shift of the long-run Phillips curve.
- B) a movement down along the short-run Phillips curve
- C) a movement up along the short-run Phillips curve.
- D) a leftward shift of the *AD* curve.

Answer: C

Topic: *The Short-Run Phillips Curve*

Skill: *Analytical*

Question history: *Previous edition, Chapter 12*

AACSB: *Analytical Skills*

## 8) "All for One, but None for All"

In an article regarding how Great Britain and France are addressing the economic crisis in 2008, Britain's prime minister "is eager to encourage consumer spending" while France's president "wants to boost investment in both the private and public sectors." Both leaders are concerned because "hardly a day goes by without some manufacturing company announcing painful restructuring, plant closures or temporary lay-offs."

www.ft.com, 11/24/2008

If consumption and investment are increased by the governments' policies, we would expect \_\_\_\_\_ and a \_\_\_\_\_ the short-run Phillips curve.

- A) increase in aggregate demand; rightward shift of
- B) increase in aggregate demand; movement up along
- C) movement up along the *AD* curve; rightward shift of
- D) movement down along the *AD* curve; movement down along

Answer: B

Topic: *Inflation and Unemployment: The Phillips Curve*

Skill: *Analytical*

Question history: *Previous edition, Chapter 12*

AACSB: *Analytical Skills*

- 9) In a speech to Asia Pacific Economic Cooperation summit in Peru in November 2008, President Hu of China commented on his country's \$586 billion fiscal stimulus plan by saying, "Instead of relying mainly on investment and export we will adopt a coordinated approach that combines consumption, investment and export to boost the economy. And instead of relying heavily on higher consumption of material resources we will achieve development by making scientific and technological progress."

If his country's plan works and the expected inflation rate does not change, there will be a

- A) movement up along the short-run Phillips curve.
- B) movement down along the short-run Phillips curve.
- C) rightward shift of the long-run Phillips curve.
- D) leftward shift of the long-run Phillips curve.

Answer: A

Topic: *The Short-Run Phillips Curve*

Skill: *Analytical*

Question history: *Previous edition, Chapter 12*

AACSB: *Analytical Skills*

- 10) In late 2008, Great Britain's inflation rate fell from 5.2 percent to 4.5 percent while unemployment was increased from 5.4 percent to 6 percent. These changes would be shown as a

- A) leftward shift of the long-run Phillips curve.
- B) movement up along the short-run Phillips curve.
- C) movement down the short-run Phillips curve.
- D) rightward shift of the long-run Phillips curve.

Answer: C

Topic: *The Short-Run Phillips Curve*

Skill: *Analytical*

Question history: *Previous edition, Chapter 12*

AACSB: *Analytical Skills*

- 11) As world economies recover from the financial crisis in 2008 and 2009, the U.S. economy returns to full employment and expected inflation equals actual inflation,
- A) there will be a movement back to the long-run Phillips curve.
  - B) the long-run Phillips curve will shift leftward.
  - C) there will be a movement upward along the short-run Phillips curve.
  - D) there will be a movement downward along the short-run Phillips curve.

Answer: A

Topic: *Inflation and Unemployment: The Phillips Curve*

Skill: *Analytical*

Question history: *Previous edition, Chapter 12*

AACSB: *Analytical Skills*

- 12) A story from [www.ft.com](http://www.ft.com) (1/31/2005) describing Ireland's transformation to a prosperous economy noted that "Ireland's story is unique: a small, English-speaking, non-industrialized country on the edge of Europe was able to secure structural funds from the EU, cut taxes, deregulate faster than its neighbours and attract lots of foreign companies in the process." If the natural rate of unemployment in Ireland decreased as a result of these policies, then \_\_\_\_\_ would shift \_\_\_\_\_.

- A) the long-run and short-run Phillips curves; rightward
- B) the long-run and short-run Phillips curves; leftward
- C) only the long-run Phillips curve; leftward
- D) only the short-run Phillips curve; rightward

Answer: B

Topic: *The Long-Run Phillips Curve*

Skill: *Analytical*

Question history: *Previous edition, Chapter 12*

AACSB: *Analytical Skills*

- 13) Over the last several years, the money supply in Indonesia as increased by 9 percent in 2003 to 14 percent in 2005 and 23 percent in 2007. At the same time, real GDP has grown steadily at over 4 percent annually.

These changes would be shown as

- i. rightward shifts of the *AD* curve
  - ii. a movement down along the short-run Phillips curve
  - iii. rightward shifts of the *LAS* curve
- A) i and iii.
  - B) i, ii and iii.
  - C) ii only.
  - D) i only.

Answer: A

Topic: *The Business Cycle*

Skill: *Analytical*

Question history: *Previous edition, Chapter 12*

AACSB: *Analytical Skills*

- 14) In a story from [www.Forbes.com](http://www.Forbes.com) (5/30/2003), it was reported that the Chief Technology Officer of the U.S. plans for the country to spend \$58.1 billion on technology that year. He was planning to buy technology from Cisco Systems, Oracle and Sun Microsystems in addition to other software makers.

This story reports on technological change which is the stressed in the \_\_\_\_\_ of business cycles.

- A) real business cycle theory
- B) new Keynesian cycle theory
- C) new classical cycle theory
- D) monetarist cycle theory

Answer: A

Topic: *RBC Impulse*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Communication*

## 5 Essay Questions

1) What is demand–pull inflation?

Answer: An inflation that starts from an initial increase in aggregate demand is a demand–pull inflation.

Topic: *Demand–Pull Inflation*

Skill: *Recognition*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

2) What are sources that can start a demand–pull inflation?

Answer: Demand–pull inflation starts with an increase in aggregate demand. This increase can arise by increases in the quantity of money, increases in government expenditure, or increases in net exports because any of these three shift increase aggregate demand and shift the *AD* curve rightward. The increase in aggregate demand leads to a higher price level and, temporarily, a higher level of real GDP. If the economy began at full employment, then temporarily the level of real GDP will be above potential. In the long run, however, the money wage rate rises to offset the increase in the price level, so the short-run aggregate supply decreases and the *SAS* curve shifts leftward. The decrease in aggregate supply also raises the price level. So the only way the inflation can continue is if aggregate demand continues to increase.

Topic: *Demand–Pull Inflation*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Communication*

3) Describe how a demand–pull inflation can occur.

Answer: Demand–pull inflation starts from an initial increase in aggregate demand. But if this increase is a one–time only event, the result is a higher price level but not inflation. For inflation to occur, aggregate demand needs to continue to increase. Continuing increases in the quantity of money result in continuing increases in aggregate demand, so monetary growth is necessary for a demand–pull inflation.

Topic: *Demand–Pull Inflation*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

4) What was the U.S. experience with demand pull inflation during the 1960s and early 1970s?

Answer: The United States experienced demand pull inflation notably during the late 1960s. Government spending increased enormously during the decade because of spending on the Vietnam War and on social programs related to the Great Society of Lyndon Johnson. These increases in spending were matched by increases in the quantity of money. The *AD* curve shifted rightward, driving prices higher. The decade had begun with inflation of 2 percent per year. By the end of the decade the rate was 5 percent and would reach 10 percent by 1975.

Topic: *Demand–Pull Inflation*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

5) What is a cost-push inflation?

Answer: A cost-push inflation is an inflation that starts as a result of an increase in costs. Money wage rates and the cost of raw materials are the main sources of cost-push inflation.

Topic: *Cost-Push Inflation*

Skill: *Recognition*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

6) What factors can start a cost-push inflation? What must the Fed's response be for the inflation to continue?

Answer: Cost push inflation starts with a decrease in the short-run aggregate supply, that is, a leftward shift of the *SAS* curve. The decrease in short-run aggregate supply can be the result of an increase in the money wage rate or an increase in the money price of other raw materials. In either instance firms' costs have risen and they respond by decreasing production, which decreases the short-run aggregate supply. The dilemma for the Fed is that the decreases in short-run aggregate supply means that real GDP falls below potential GDP and the price level rises. If the Fed responds by increasing the quantity of money in order to increase aggregate demand and move real GDP back to potential GDP, the price level will rise still higher. And if the initial agent that raised costs responds to the higher price level by again raising its costs, then a cost-push inflation might well occur.

Topic: *Cost-Push Inflation*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Communication*

7) What is the Phillips curve? Discuss both the short-run and long-run Phillips curve.

Answer: In general, a Phillips curve shows a relationship between the inflation rate and the unemployment rate. There is a short-run Phillips curve and a long-run Phillips curve. Moving along a short-run Phillips curve, expected inflation and the natural unemployment rate are constant. The short-run Phillips curve shows the relationship between the inflation rate and unemployment rate: a higher inflation rate results in a lower unemployment rate. The long-run Phillips curve shows the relationship between the inflation rate and unemployment rate when the inflation rate equals the expected inflation rate. Moving along the long-run Phillips curve there is no tradeoff between the inflation rate and the unemployment rate: a higher inflation rate has no effect on unemployment rate, which remains equal to the natural unemployment rate.

Topic: *Inflation and Unemployment: The Phillips Curve*

Skill: *Analytical*

Question history: *Previous edition, Chapter 12*

AACSB: *Communication*

8) "The short-run Phillips curve shows the relationship between real GDP and inflation." Is the previous statement correct or incorrect? Briefly explain your answer.

Answer: The statement is incorrect. The short-run Phillips curve shows the relationship between the unemployment rate and the inflation rate.

Topic: *The Short-Run Phillips Curve*

Skill: *Recognition*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

9) Define and describe the short-run Phillips curve.

Answer: The short-run Phillips curve shows the relationship between the inflation rate and the unemployment rate when the natural unemployment rate and the expected inflation rate do not change. The short-run Phillips curve is downward sloping, indicating that there is a tradeoff between inflation and unemployment: inflation can be lowered only at the cost of higher unemployment and unemployment can be lowered only at the cost of higher inflation.

Topic: *The Short-Run Phillips Curve*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

10) "The short-run Phillips curve is vertical at the natural unemployment rate." Is the previous statement correct or incorrect?

Answer: The statement is incorrect. The *long-run* Phillips curve is vertical at the natural unemployment rate but the *short-run* Phillips curve is downward sloping.

Topic: *The Short-Run Phillips Curve*

Skill: *Recognition*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

11) What does the short-run Phillips curve indicate about the relationship between inflation and unemployment?

Answer: Because the slope of the short-run Phillips curve is negative, the short-run Phillips curve indicates that a tradeoff between inflation and unemployment exists. Lower inflation can be obtained, but the price is higher unemployment. Similarly, lower unemployment is possible but the price is higher inflation.

Topic: *The Short-Run Phillips Curve*

Skill: *Recognition*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

12) "The short-run Phillips curve shifts leftward when the inflation rate rises." Is the previous statement correct or incorrect?

Answer: The statement is incorrect. An increase in the inflation rate leads to a movement along the short-run Phillips curve.

Topic: *The Short-Run Phillips Curve*

Skill: *Recognition*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 13) If the short-run Phillips curve shifts rightward, what happens to the relationship between inflation and unemployment? If the short-run Phillips curve shifts leftward, what happens to the relationship between inflation and unemployment?

Answer: A rightward shift of the short-run Phillips curve worsens the tradeoff between inflation and unemployment. With the rightward shift, a given level of inflation is now associated with a higher unemployment rate, or stated another way, a given unemployment rate is now associated with a higher inflation rate. A leftward shift of the short-run Phillips curve improves the tradeoff between inflation and unemployment. With the leftward shift, a given level of inflation is now associated with a lower unemployment rate, or stated another way, a given unemployment rate is now associated with a lower inflation rate.

*Topic: The Short-Run Phillips Curve*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 12*

*AACSB: Communication*

- 14) "As the economy moves upward along its short-run aggregate supply curve, the economy also moves upward along its short-run Phillips curve." Is the previous statement correct or incorrect? Briefly explain your answer.

Answer: The statement is correct. As the economy moves upward along its short-run aggregate supply curve, the price level rises so that there is inflation. And as the economy moves upward along its short-run aggregate supply curve, real GDP increases so that the unemployment rate decreases. So, moving upward along the short-run aggregate supply curve is associated with inflation and lower unemployment, which is what we see when we move along the short-run Phillips curve.

*Topic: Short-Run Phillips Curve & Short-Run Aggregate Supply Curve*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 12*

*AACSB: Reflective Thinking*

- 15) Discuss the relationship between the short-run aggregate supply curve and the short-run Phillips curve.

Answer: The short-run Phillips curve and the short-run aggregate supply curve arise because the money wage rate does not change in the short run. When the price level increases, the inflation rate is positive. And when the price level increases, the money wage rate does not change, so the real wage rate declines. As a result of the lower real wage rate, the quantity of labor employed increases so that the quantity of real GDP increases and the unemployment rate decreases. Therefore the higher price level is associated with an increase in real GDP and a higher inflation rate is associated with a decrease in unemployment.

*Topic: Short-Run Phillips Curve & Short-Run Aggregate Supply Curve*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 12*

*AACSB: Reflective Thinking*

- 16) Explain how the expected inflation rate affects the short-run Phillips curve. Be sure to mention the role played by the money wage rate.

**Answer:** When the expected inflation rate falls, the short-run Phillips curve shifts downward and when the expected inflation rate rises, the short-run Phillips curve shifts upward. To see why the expected inflation rate affects the short-run Phillips curve, the key is that the expected inflation rate affects the money wage rate. Suppose the expected inflation rate increases. As a result, labor contracts will now specify higher money wage rates in the present and in the future. In turn, the higher the money wage rates, the more the aggregate supply decreases. And, the more the aggregate supply decreases, the lower the level of employment and the higher the level of unemployment. Therefore for a given price level and inflation rate, an increase in the expected inflation rate increases the unemployment rate, which means that the short-run Phillips curve shifts higher.

*Topic: The Short-Run Phillips Curve*

*Skill: Analytical*

*Question history: Previous edition, Chapter 12*

*AACSB: Reflective Thinking*

- 17) "The long-run Phillips curve is downward sloping." Is the previous statement correct or incorrect?

**Answer:** The statement is incorrect because the long-run Phillips curve is vertical. The short-run Phillips curve is downward sloping.

*Topic: The Long-Run Phillips Curve*

*Skill: Recognition*

*Question history: Previous edition, Chapter 12*

*AACSB: Reflective Thinking*

- 18) "The long-run Phillips curve is vertical at the expected inflation rate." Is the previous statement correct or incorrect?

**Answer:** The statement is incorrect because the long-run Phillips curve is vertical at the natural unemployment rate.

*Topic: The Long-Run Phillips Curve*

*Skill: Recognition*

*Question history: Previous edition, Chapter 12*

*AACSB: Reflective Thinking*

- 19) In the long run, what is the tradeoff between inflation and unemployment? Explain your answer using Phillips curve analysis.

**Answer:** In the long run, there is no tradeoff between inflation and unemployment. In particular, in the long run, changes in the inflation rate have no effect on the unemployment rate. The long-run Phillips curve is vertical, thereby showing that in the long run, *any* inflation rate can occur but in the long run the unemployment rate will equal the natural unemployment rate.

*Topic: The Long-Run Phillips Curve*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 12*

*AACSB: Reflective Thinking*



20) Distinguish between the short-run and long-run Phillips curves.

Answer: The long-run Phillips curve shows the relationship between inflation and unemployment when the unemployment rate equals the natural rate and the inflation rate equals the expected inflation rate. There is no long-run tradeoff between inflation and unemployment. The short-run Phillips curve, however, shows the relationship between the inflation rate and the unemployment rate when the natural unemployment rate and the expected inflation rate do not change. The short-run Phillips curve is downward sloping, so that it shows a tradeoff between inflation and unemployment.

*Topic: The Short-Run and Long-Run Phillips Curve*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 12*

*AACSB: Reflective Thinking*

21) Explain how the short-run and long-run Phillips curves are related.

Answer: The short-run Phillips curve is the relationship between the inflation rate and the unemployment rate when the natural unemployment rate and the expected inflation rate remain constant. The long-run Phillips curve is the relationship between the inflation rate and the unemployment rate when the economy is at full employment. The short-run Phillips curve is downward sloping, indicating that if the expected inflation rate and natural unemployment rate do not change, a higher inflation rate decreases the unemployment rate. The long-run Phillips curve is a vertical line illustrating that in the long run, the economy at full employment can have any inflation rate. The short-run Phillips curve intersects the long-run Phillips curve at the expected inflation rate. A change in the expected inflation rate shifts the short-run Phillips curve but has no effect on the long-run Phillips curve. An increase in the natural unemployment rate shifts both the short-run and the long-run Phillips curve.

*Topic: The Short-Run and Long-Run Phillips Curve*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 12*

*AACSB: Communication*

22) When the expected inflation rate changes, what happens to the short-run Phillips curve? To the long-run Phillips curve?

Answer: When the expected inflation rate changes, the short-run Phillips curve shifts but the long-run Phillips curve does not shift. In particular, if the expected inflation rate increases, the short-run Phillips curve shifts upward and if the expected inflation rate decreases, the short-run Phillips curve shifts downward.

*Topic: The Short-Run and Long-Run Phillips Curve*

*Skill: Analytical*

*Question history: Previous edition, Chapter 12*

*AACSB: Reflective Thinking*

23) When the natural unemployment rate changes, what happens to the short-run Phillips curve?

To the long-run Phillips curve?

Answer: When the natural unemployment rate changes, both the short-run Phillips curve and the long-run Phillips curve shift. If the natural unemployment rate increases, both Phillips curves shift rightward; if the natural unemployment rate decreases, both Phillips curves shift leftward.

*Topic: The Short-Run and Long-Run Phillips Curve*

*Skill: Analytical*

*Question history: Modified 10th edition*

*AACSB: Reflective Thinking*

24) Using the Phillips curves, what are the short-run and long-run effects of a decrease in the inflation rate?

Answer: In the short run, there is first a downward movement along the short-run Phillips curve as the inflation rate falls and the unemployment rate increases. In the long run, however, the expected inflation rate falls and the short-run Phillips curve shifts downward. Therefore in the long run the inflation rate remains low and the unemployment rate returns to the natural unemployment rate.

*Topic: The Short-Run and Long-Run Phillips Curve*

*Skill: Analytical*

*Question history: Previous edition, Chapter 12*

*AACSB: Reflective Thinking*

25) What is the factor that leads to business cycles in the Keynesian cycle theory?

Answer: The impulse in the Keynesian theory is changes in firms' expectations about future sales and profits, which changes investment. Keynes referred to these expectations as "animal spirits."

*Topic: Keynesian Theory*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 12*

*AACSB: Reflective Thinking*

26) What is the factor that leads to business cycles in the monetarist cycle theory?

Answer: The factor leading to business cycles in the monetarist theory is changes in the growth rate of the quantity of money.

*Topic: Monetarist Theory*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 12*

*AACSB: Reflective Thinking*

27) Compare and contrast the Keynesian and Monetarist business cycle theories.

Answer: Both theories are centered about changes in aggregate demand as the central cause of the business cycle. Keynesian's use the concept of 'animal spirits' and the inability to forecast the future as the factor that leads to changes in investment. Monetarists assert that changes in the growth rate of the quantity of money is the factor that leads to business cycles. As for the adjustment following the initial shock of a change in the level of investment, both theories envision a multiplier effect. This effect causes a greater change in aggregate demand (and hence real GDP) than would occur strictly as a result of the initial change in real GDP. Both theories also believe that sticky wages limit the ability of the money wage rate to adjust to changes in aggregate demand.

Topic: *Keynesian and Monetarist Theory*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Communication*

28) What is the factor that leads to business cycles in the new classical cycle theory?

Answer: The factor leading to business cycles in the new classical theory is unexpected changes in aggregate demand.

Topic: *New Classical Theory*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

29) What is the factor that leads to business cycles in the new Keynesian cycle theory?

Answer: The *major* factor in the new Keynesian cycle theory is unexpected changes in aggregate demand, but expected changes in aggregate demand also play a role in creating business cycles.

Topic: *New Keynesian Theory*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

30) What is the impulse in the real business cycle theory of the business cycle?

Answer: The impulse in the real business cycle theory is technological changes that affect the growth rate of productivity.

Topic: *RBC Impulse*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

31) What is the impulse that leads to business cycle in the real business cycle, RBC, theory?

Answer: The real business cycle theory focuses on changes in the growth rate of productivity as the main source of economic fluctuations. Furthermore, the RBC theory views these changes as random and mainly as a result of changes in the rate of technological change. It asserts that most of the time technological change is steady, allowing for productivity to grow at a moderate pace. Occasionally productivity growth speeds up or slows down. If it speeds up, an expansion can be triggered while if it slows down a recession can result.

Topic: *RBC Impulse*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

32) What is the intertemporal substitution effect and what role does it play in the real business cycle model?

**Answer:** The intertemporal substitution effect is the idea that people choose when they will work by comparing the real wage rate they receive this year to the real wage rate next year, taking into account the real interest rate. Basically, employees compare how much they would have earned if they worked this year (and received the real wage rate) and then saved this amount (and thereby increased the amount by the real interest rate) to the real interest rate they would earn by working next year. This effect plays a key role in the real business cycle theory because it means that the supply of labor changes when the real interest rate changes. For instance, as the economy heads into a recession with investment demand decreasing, the decrease in investment demand lowers the real interest rate, so the intertemporal substitution effect decreases the supply of labor and hence employment. As a result, potential GDP decreases.

*Topic: RBC Mechanism*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 12*

*AACSB: Communication*

33) What are criticisms of the real business cycle theory?

**Answer:** Four criticisms of the real business cycle theory are frequently made. First is the criticism that money wage rates are sticky, whereas the real business cycle theory assumes they are flexible. Second is the assertion that intertemporal substitution is too weak to account for large fluctuations in employment. Third is the criticism that technology shocks are implausible as an impulse that causes a business cycle. Fourth is the comment is that productivity shocks, as measured, are correlated with factors that change aggregate demand and so are the *result* of the business cycle not a *cause* of the business cycle.

*Topic: Criticisms of Real Business Cycle Theory*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 12*

*AACSB: Communication*

34) How do defenders of the real business cycle theory, (RBC theory) respond to critics of the theory?

**Answer:** The defenders of the real business cycle theory state that the theory works because it accurately describes the real-life experiences of both growth and the cyclical nature of growth. The theory is also consistent with much microeconomic evidence about labor supply, labor demand and investment demand decisions. They believe that although the quantity of money is correlated with real GDP, real GDP changes cause the changes in the quantity of money. Lastly, RBC theory proponents assert that the theory is important because it points out that business cycles might be a normal state of affairs, which suggests that government attempts to dampen them are futile.

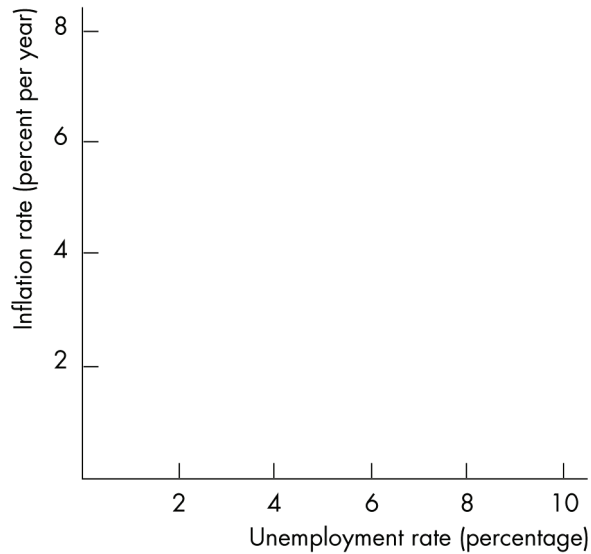
*Topic: Defenses of Real Business Cycle Theory*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 12*

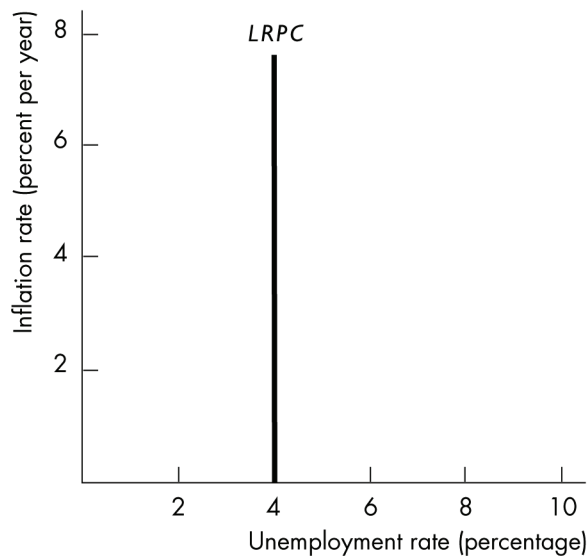
*AACSB: Communication*

## 6 Numeric and Graphing Questions



- 1) Suppose the natural unemployment rate is 4 percent and the expected inflation rate is 6 percent. In the above figure, illustrate the long-run Phillips curve. What does the long-run Phillips curve reveal about the long-run tradeoff between inflation and unemployment?

Answer:



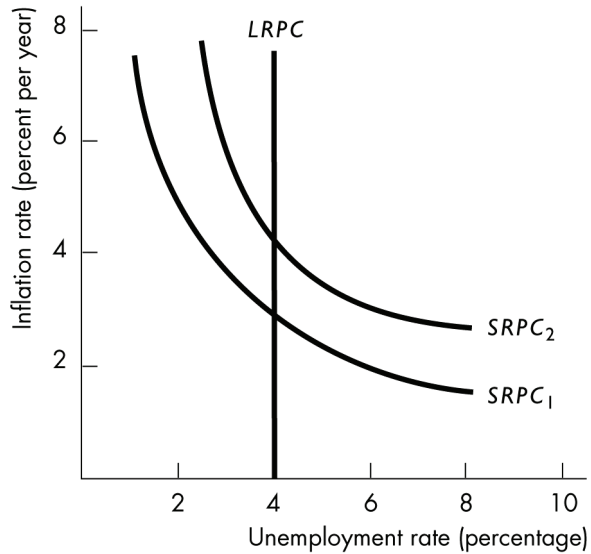
The long-run Phillips curve is illustrated in the above figure. It is vertical at the natural unemployment rate. The fact that the long-run Phillips curve is vertical means that in the long run there is no tradeoff between inflation and unemployment. In other words, in the long run higher inflation does not decrease unemployment nor does low inflation increase unemployment.

Topic: *The Long-Run Phillips Curve*

Skill: *Analytical*

Question history: *Previous edition, Chapter 12*

AACSB: *Analytical Skills*



- 2) In the above figure, what factor might have led to the shift in the short-run Phillips curve from SRPC<sub>1</sub> to SRPC<sub>2</sub>?

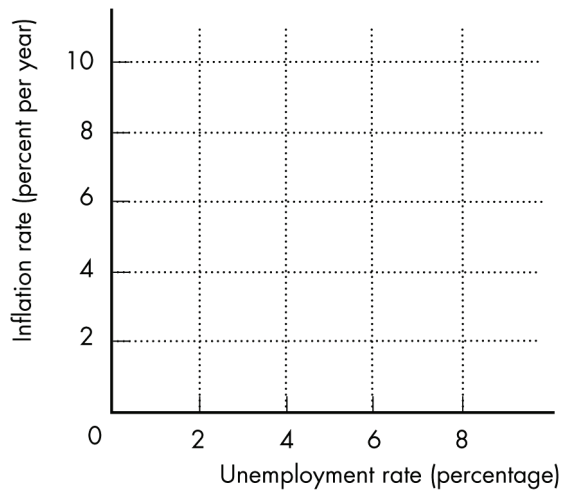
Answer: The long-run Phillips curve did not shift. Therefore the factor that shifted the short-run Phillips curve was an increase in the expected inflation rate.

Topic: *The Short-Run and Long-Run Phillips Curve*

Skill: *Analytical*

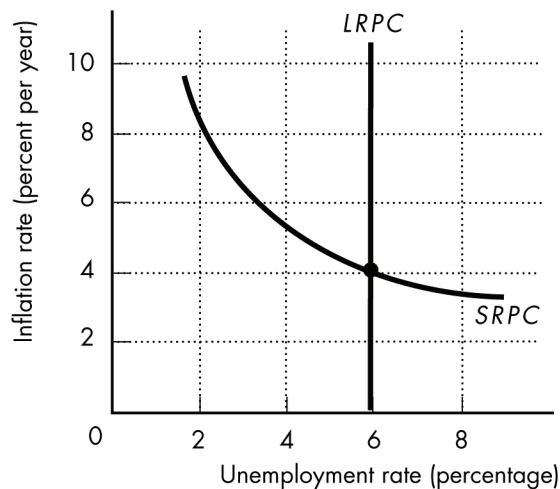
Question history: *Previous edition, Chapter 12*

AACSB: *Analytical Skills*



- 3) In the figure above, draw a short-run Phillips curve and a long-run Phillips curve if the expected inflation rate is 4 percent and the natural unemployment rate is 6 percent. Explain how the two change in the short run if:
- slower growth in aggregate demand causes a recession.
  - the inflation rate increases.
  - the natural unemployment rate increases.

Answer:



The figure with the Phillips curves is above.

- There is a downward movement along the short-run Phillips curve.
- There is an upward movement along the short-run Phillips curve.
- There is a rightward shift of both the long-run and short-run Phillips curves.

*Topic: The Short-Run and Long-Run Phillips Curve*

*Skill: Analytical*

*Question history: Previous edition, Chapter 12*

*AACSB: Analytical Skills*

## 7 True or False

- 1) Inflation describes the event of increasing output and rising prices.

Answer: FALSE

*Topic: Inflation and the Price Level*

*Skill: Recognition*

*Question history: Previous edition, Chapter 12*

*AACSB: Reflective Thinking*

- 2) A one-time increase in aggregate demand creates inflation.

Answer: FALSE

*Topic: Inflation and the Price Level*

*Skill: Recognition*

*Question history: Previous edition, Chapter 12*

*AACSB: Reflective Thinking*

- 3) Increases in the quantity of money can create demand-pull inflation.

Answer: TRUE

*Topic: A Demand-Pull Inflation Process*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 12*

*AACSB: Reflective Thinking*

- 4) For a persistent demand-pull inflation to occur, government expenditure must persistently increase.

Answer: FALSE

*Topic: A Demand-Pull Inflation Process*

*Skill: Conceptual*

*Question history: Modified 10th edition*

*AACSB: Reflective Thinking*

- 5) The early 1990s were the last period of substantial demand-pull inflation in the U.S.

Answer: FALSE

*Topic: Demand-Pull Inflation in the United States*

*Skill: Recognition*

*Question history: Previous edition, Chapter 12*

*AACSB: Reflective Thinking*

- 6) Increases in government expenditure can create cost-push inflation.

Answer: FALSE

*Topic: Cost-Push Inflation*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 12*

*AACSB: Reflective Thinking*



7) Increases in the prices of raw materials can create cost-push inflation.

Answer: TRUE

Topic: Cost-Push Inflation

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

8) For a persistent cost-push inflation to occur, the Fed must persistently increase the quantity of money.

Answer: TRUE

Topic: A Cost-Push Inflation Process

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

9) Stagflation occurs when the SAS curve shifts leftward.

Answer: TRUE

Topic: A Cost-Push Inflation Process

Skill: Conceptual

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

10) The Phillips curve describes the relationship between real GDP and inflation.

Answer: FALSE

Topic: Inflation and Unemployment: The Phillips Curve

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

11) The short-run Phillips curve is vertical at the natural unemployment rate.

Answer: FALSE

Topic: The Short-Run Phillips Curve

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

12) An increase in the expected inflation rate leads to a movement upward along the short-run Phillips curve.

Answer: FALSE

Topic: The Short-Run Phillips Curve

Skill: Analytical

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

13) The long-run Phillips curve slopes downward.

Answer: FALSE

Topic: The Long-Run Phillips Curve

Skill: Recognition

Question history: Previous edition, Chapter 12

AACSB: Reflective Thinking

14) The long-run Phillips curve is vertical at the natural unemployment rate.

Answer: TRUE

Topic: *The Long-Run Phillips Curve*

Skill: *Recognition*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

15) The short-run Phillips curve intersects the long-run Phillips curve at the actual inflation rate.

Answer: FALSE

Topic: *The Short-Run Phillips Curve and the Long-Run Phillips Curve*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

16) The short-run Phillips curve intersects the long-run Phillips curve at the expected inflation rate.

Answer: TRUE

Topic: *The Short-Run Phillips Curve and the Long-Run Phillips Curve*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

17) An increase in the natural unemployment rate shifts *both* the long-run Phillips curve *and* the short-run Phillips curve rightward.

Answer: TRUE

Topic: *The Short-Run Phillips Curve and the Long-Run Phillips Curve*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

18) Monetarists believe in changes in animal spirits are the factor that leads to business cycles.

Answer: FALSE

Topic: *Monetarist Theory*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

19) The monetarist theory of the business cycle views fluctuations in the growth rate of the quantity of money as the main source of economic fluctuations.

Answer: TRUE

Topic: *Monetarist Theory*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

20) The new classical cycle theory views anticipated fluctuations in aggregate demand as the main source of business cycle economic fluctuations.

Answer: FALSE

Topic: *New Classical Theory*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 21) The new Keynesian cycle theory views only anticipated changes in aggregate demand as the source of business cycle economic fluctuations.

Answer: FALSE

Topic: *New Keynesian Theory*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 22) The real business cycle theory views fluctuations in the quantity of money as the main source of business cycles.

Answer: FALSE

Topic: *RBC Impulse*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 23) The real business cycle theory views fluctuations in productivity as the main source of business cycles.

Answer: TRUE

Topic: *RBC Impulse*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 24) The intertemporal substitution effect is the factor that creates business cycles in the Keynesian theory of the business cycle.

Answer: FALSE

Topic: *RBC Mechanism*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

AACSB: *Reflective Thinking*

- 25) According to the real business cycle theory, a decrease in the real interest rate today increases current labor supply.

Answer: FALSE

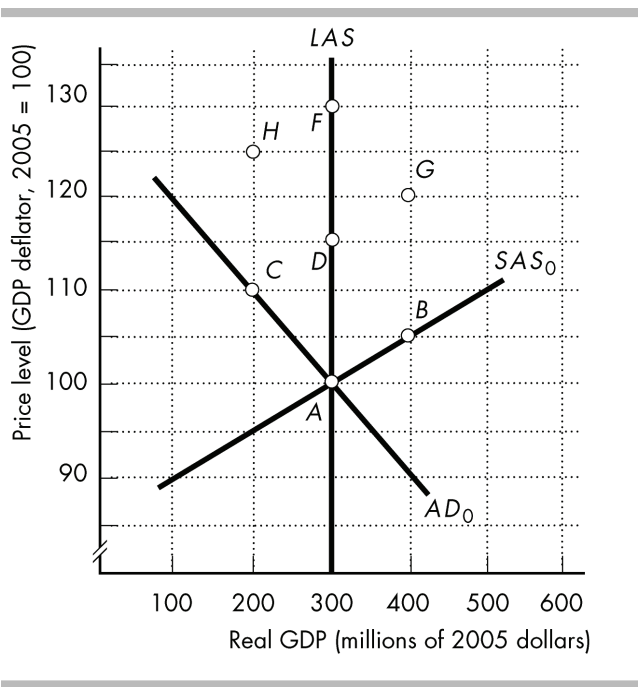
Topic: *RBC Mechanism*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 12*

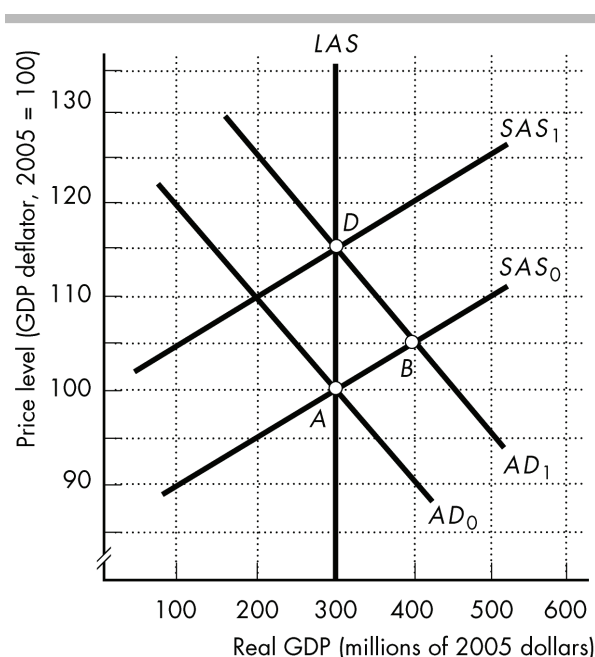
AACSB: *Reflective Thinking*

### 8 Extended Problems



- 1) The figure above shows the initial aggregate demand curve,  $AD_0$ , the initial short-run aggregate supply curve,  $SAS_0$ , and the long-run aggregate supply curve,  $LAS$ . The points in the figure show possible combinations of real GDP and the price level at which the economy of Atlantia is in macroeconomic equilibrium. The economy is initially at point A. Then, the government increases its expenditure on goods and services. Draw the new aggregate demand and short-run aggregate supply curves in the figure to show the effects of this event on Atlantia's real GDP and price level.
- What happens to Atlantia's potential GDP?
  - In the short run, what happens to aggregate supply and aggregate demand?
  - What are the new short-run equilibrium real GDP and price level?
  - In the long run, what happens to the short-run aggregate supply and aggregate demand?
  - What are the new long-run equilibrium real GDP and price level?

Answer: a) Atlantia's potential GDP is not affected. Potential GDP depends on the economy's factors of production and available technology, not on aggregate spending.



- b) See the figure above. The increase in government expenditure increases aggregate demand. The aggregate demand curve shifts from  $AD_0$  to  $AD_1$ . Because there is no change in potential GDP and no change in the money wage rate, short run aggregate supply is not affected. The short-run aggregate supply curve remains at  $SAS_0$ .
- c) In the short run the economy is at point  $B$ , where real GDP is \$400 million and the price level is 105.
- d) Because at point  $B$  real GDP is above potential GDP, unemployment is less than the natural rate so the tight conditions in the labor market means that the money wage rate begins to rise. As it does, short-run aggregate supply decreases. The short-run aggregate supply curve shifts from  $SAS_0$  to  $SAS_1$ . Because nothing further affects aggregate demand, the aggregate demand curve remains at  $AD_1$ .
- e) In the long run the economy is at point  $D$ , where real GDP is \$300 million and the price level is 115.

Topic: Demand-Pull Inflation

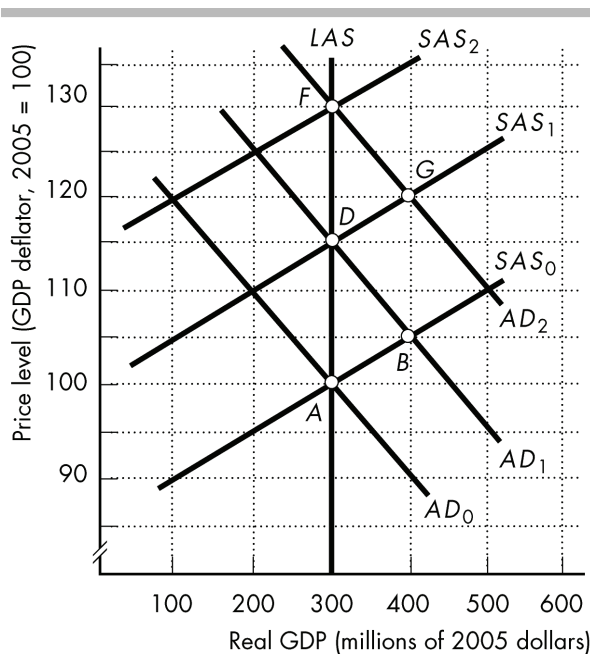
Skill: Analytical

Question history: Previous edition, Chapter 12

AACSB: Analytical Skills

- 2) The figure above shows the initial aggregate demand curve,  $AD_0$ , the initial short-run aggregate supply curve,  $SAS_0$ , and the long-run aggregate supply curve,  $LAS$ . The points in the figure show possible combinations of real GDP and the price level at which the economy of Atlantia is in macroeconomic equilibrium. The economy is initially at point  $A$ . Atlantia's Central Bank then increases the quantity of money year after year. Draw the necessary curves in the figure to show the effects of this on Atlantia's real GDP and price level.
- What happens to Atlantia's potential GDP?
  - In the short run, what happens to aggregate supply and aggregate demand?
  - What are the new short-run equilibrium real GDP and price level?
  - In the long run, what happens to aggregate supply and aggregate demand?
  - In the long run, what process is unfolding?

Answer: a) Atlantia's potential GDP is not affected. Potential GDP depends on the economy's factors of production and available technology, not on monetary factors.



- b) See the figure above. The increase in the quantity of money lowers the interest rate and increases aggregate demand. The aggregate demand curve shifts rightward from  $AD_0$  to  $AD_1$ . Because there is no change in potential GDP and no change in the money wage rate, the short-run aggregate supply is not affected. The short-run aggregate supply curve remains at  $SAS_0$ .
- c) In the short run the economy is at point  $B$ , where real GDP is \$400 million and the price level is 105.
- d) Because at point  $B$  real GDP exceeds potential GDP, unemployment is less than the natural rate so the tight conditions in the labor market means that the money wage rate begins to rise. As it does, short-run aggregate supply decreases. The short-run aggregate supply curve shifts from  $SAS_0$  to  $SAS_1$ , bringing the economy to point  $D$ . But the Central Bank increases the quantity of money again, and aggregate demand continues to increase. The aggregate demand curve shifts rightward to  $AD_2$ . The economy moves to point  $G$ , so that the price level rises still more to 120 and real GDP again exceeds potential GDP at \$400 million. The money wage rate rises once again, further decreasing short-run aggregate supply. The short-run aggregate supply curve shifts from  $SAS_1$  to  $SAS_2$ , bringing the economy to point  $F$ . As the quantity of money continues to grow, aggregate demand continues to increase and short-run aggregate supply continues to decrease.
- e) In the long run, the price level rises continuously as the economy moves from point  $A$  to point  $B$  to point  $D$  to point  $G$  to point  $F$  and so on. An ongoing demand-pull inflation process is the result.

Topic: Demand-Pull Inflation

Skill: Analytical

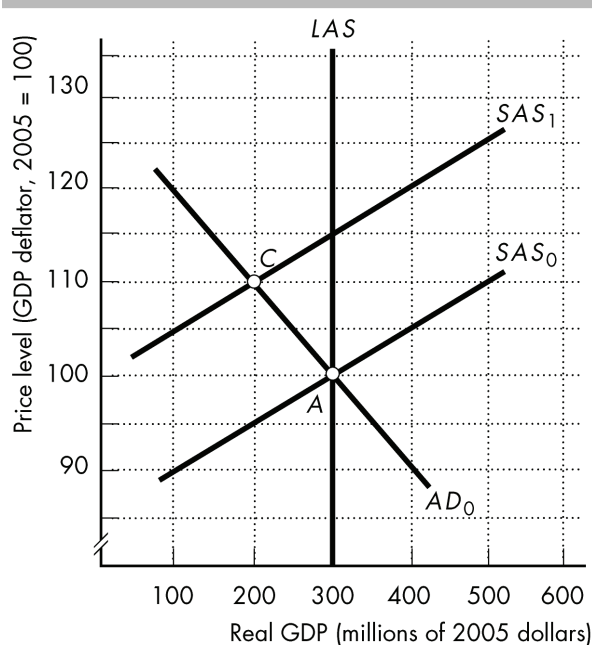
Question history: Previous edition, Chapter 12

AACSB: Analytical Skills

3) The figure above shows the initial aggregate demand curve,  $AD_0$ , the initial short-run aggregate supply curve,  $SAS_0$ , and the long-run aggregate supply curve,  $LAS$ . The points in the figure show possible combinations of real GDP and the price level at which the economy of Atlantia is in macroeconomic equilibrium. The economy is initially at point A. Then, Atlantia's oil producers form a price-fixing organization and increase the price of oil. Suppose that potential GDP does not change and that Atlantia's Central Bank takes no action. Draw the new aggregate demand and short-run aggregate supply curves in the figure to show the effects of this event on Atlantia's real GDP and price level.

- What happens to aggregate supply and aggregate demand?
- What are the new equilibrium real GDP and price level?
- Will the rise in the price of oil lead to inflation in Atlantia? Why or why not?

Answer:



- See the figure above. The increase in the price of oil raises the cost of production and decreases short-run aggregate supply. The short-run aggregate supply curve shifts leftward from  $SAS_0$  to  $SAS_1$ . Aggregate demand is not affected, so the aggregate demand curve remains at  $AD_0$ .
- In the short run the economy moves to point C, where real GDP is \$200 million and the price level is 110.
- The rise in the price of oil results in a one-time rise in the price level, but not ongoing inflation. A one-time rise in the price level can only be converted into inflation if it is accompanied by growth in the quantity of money.

Topic: Cost-Push Inflation

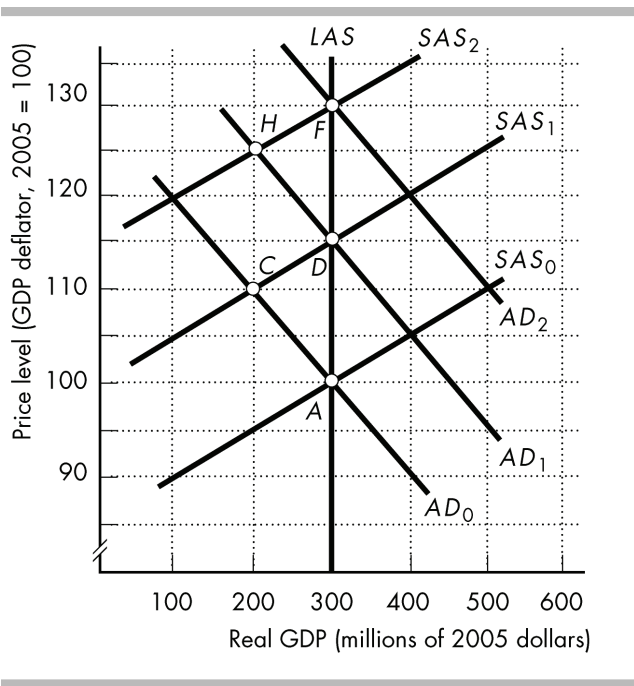
Skill: Analytical

Question history: Previous edition, Chapter 12

AACSB: Analytical Skills

- 4) The figure above shows the initial aggregate demand curve,  $AD_0$ , the initial short-run aggregate supply curve,  $SAS_0$ , and the long-run aggregate supply curve,  $LAS$ . The points in the figure show possible combinations of real GDP and the price level at which the economy of Atlantia is in macroeconomic equilibrium. The economy is initially at point  $A$ . Then, Atlantia's oil producers form a price-fixing organization and increase the price of oil. Suppose that potential GDP does not change and that Atlantia's Central Bank responds by increasing the quantity of money. Draw necessary curves in the figure to show the effects of this on Atlantia's real GDP and price level.
- In the short run, what happens to aggregate supply and aggregate demand?
  - What are the new short-run equilibrium real GDP and price level?
  - In the long run, if Atlantia's continue to hike the price of oil and the Central Bank continues to increase the quantity of money, what happens to aggregate supply and aggregate demand?
  - If Atlantia's oil producers continue to hike the price of oil and Atlantia's Central Bank responds by increasing the quantity of money, what process unfolds?

Answer:



- See the figure above. The increased price of oil raises the cost of production and decreases short-run aggregate supply. The short-run aggregate supply curve shifts from  $SAS_0$  to  $SAS_1$ . As the Central Bank increases the quantity of money, the interest rate falls, and aggregate demand increases. The aggregate demand curve rightward shifts from  $AD_0$  to  $AD_1$ .
- In the short run, the economy moves to point  $D$ , where real GDP is \$300 million and the price level is 115.
- As the oil producers respond to the higher price level by raising the price of oil, short-run aggregate supply decreases again and the short-run aggregate supply curve shifts leftward again, from  $SAS_1$  to  $SAS_2$ . As the Central Bank increases the quantity of money again, aggregate demand increases once more and the aggregate demand curve shifts rightward from  $AD_1$  to  $AD_2$ . The economy moves to point  $F$ , where the price level is even higher. This invites another oil price hike that will call forth yet a further increase



in the quantity of money. So short-run aggregate supply continues to decrease and aggregate demand continues to increase.

d) If Atlantia's oil producers continue to hike the price of oil and Atlantia's central bank continues to increase the quantity of money, a cost-push inflation process unfolds. The price level rises continuously as the economy moves from point *A* to point *C* to point *D* to point *H* to point *F* and so on.

*Topic: Cost-Push Inflation*

*Skill: Analytical*

*Question history: Previous edition, Chapter 12*

*AACSB: Analytical Skills*

# Chapter 13

## Fiscal Policy

### 1 The Federal Budget

- 1) Prior to the Great Depression, the purpose of the federal budget was to \_\_\_\_\_.
- A) stabilize the economy
  - B) finance the activities of the government
  - C) maintain low interest rates
  - D) decrease unemployment

Answer: B

Topic: *The Federal Budget*

Skill: *Recognition*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

- 2) The use of the U.S. federal budget to help stabilize the economy grew in reaction to the \_\_\_\_\_ and is known as \_\_\_\_\_.
- A) stagflation of the 1970s; fiscal policy
  - B) Great Depression of the 1930s; fiscal policy
  - C) stagflation of the 1970s; government policy
  - D) Great Depression of the 1930s; monetary policy

Answer: B

Topic: *The Federal Budget*

Skill: *Recognition*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

- 3) Fiscal policy includes
- A) only decisions related to government expenditure on goods and services.
  - B) only decisions related to government expenditure on goods and services and the value of transfer payments.
  - C) only decisions related to the value of transfer payments and tax revenue.
  - D) decisions related to government expenditure on goods and services, the value of transfer payments, and tax revenue.

Answer: D

Topic: *Fiscal Policy*

Skill: *Recognition*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

- 4) Fiscal policy involves
- A) the use of interest rates to influence the level of GDP.
  - B) the use of tax and spending policies by the government.
  - C) decreasing the role of the Federal Reserve in the everyday life of the economy.
  - D) the use of tax and money policies by government to influence the level of interest rates.

Answer: B

Topic: Fiscal Policy

Skill: Recognition

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 5) Fiscal policy
- A) is enacted by the Federal Reserve.
  - B) involves changing interest rates.
  - C) involves changing taxes and government spending.
  - D) involves changing the money supply.

Answer: C

Topic: Fiscal Policy

Skill: Recognition

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 6) Fiscal policy attempts to achieve all of the following objectives EXCEPT \_\_\_\_\_.
- A) a stable money supply
  - B) price level stability
  - C) full employment
  - D) sustained economic growth

Answer: A

Topic: Fiscal Policy

Skill: Recognition

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 7) Changes in which of the following is included as part of fiscal policy?
- A) the quantity of money
  - B) the level of interest rates
  - C) monetary policy
  - D) tax rates

Answer: D

Topic: Fiscal Policy

Skill: Recognition

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 8) All of the following are part of fiscal policy EXCEPT
- A) setting tax rates.
  - B) setting government spending.
  - C) choosing the size of the government deficit.
  - D) controlling the money supply.

Answer: D

Topic: Fiscal Policy

Skill: Recognition

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 9) The budget process includes the
- A) President proposing and Congress passing the budget.
  - B) President passing the budget as proposed by Congress.
  - C) House of Representatives proposing and the Senate passing the budget.
  - D) Senate proposing and the House of Representatives passing the budget.

Answer: A

Topic: The Federal Budget

Skill: Recognition

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 10) Which branches of the government play a role in the enacting the federal budget?
- I. the President.
  - II. the House of Representatives.
  - III. the Senate.
- A) I and II
  - B) II and III
  - C) I, II and III
  - D) I

Answer: C

Topic: The Federal Budget

Skill: Recognition

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 11) Which of the following government bodies does NOT participate directly in formulating U.S. fiscal policy?
- A) the President and his cabinet
  - B) the Federal Reserve Board
  - C) the House of Representatives
  - D) the Senate

Answer: B

Topic: The Federal Budget

Skill: Recognition

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 12) The purpose of the Employment Act of 1946 was to
- A) establish goals for the federal government that would promote maximum employment, purchasing power, and production.
  - B) establish an unemployment compensation system.
  - C) set up the Federal Reserve System.
  - D) set targets for the unemployment rate to be achieved by the president.

Answer: A

Topic: *The Employment Act of 1946*

Skill: *Recognition*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

- 13) The Employment Act of 1946 made it the responsibility of the federal government to
- A) balance its budget because that policy would create the maximum level of employment.
  - B) promote maximum employment.
  - C) provide full employment and a stable balance of payments.
  - D) improve the distribution of income.

Answer: B

Topic: *The Employment Act of 1946*

Skill: *Recognition*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

- 14) The Employment Act of 1946 states that it is the responsibility of the federal government to
- A) promote full employment.
  - B) promote economic equality.
  - C) maintain the inflation rate at below 10 percent per year.
  - D) All of the above answers are correct.

Answer: A

Topic: *The Employment Act of 1946*

Skill: *Recognition*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

- 15) The Council of Economic Advisers
- A) proposes the president's budget each year.
  - B) approves fiscal policy changes.
  - C) helps the president and the public stay informed about the state of the economy.
  - D) helps the president make changes in monetary policy.

Answer: C

Topic: *Council of Economic Advisers*

Skill: *Recognition*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

- 16) The Council of Economic Advisors advises the
- A) President.
  - B) Congress.
  - C) Senate.
  - D) House of Representatives.

Answer: A

Topic: Council of Economic Advisers

Skill: Recognition

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 17) The largest source of government revenues is \_\_\_\_\_.
- A) personal income taxes
  - B) indirect taxes
  - C) corporate income taxes
  - D) social security taxes

Answer: A

Topic: Tax Revenues

Skill: Recognition

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 18) What is the largest source of revenue for the federal government?
- A) Social Security taxes
  - B) corporate income taxes
  - C) personal income taxes
  - D) sales tax

Answer: C

Topic: Tax Revenues

Skill: Recognition

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 19) Which of the following is the largest source of federal government revenue?
- A) corporate income taxes
  - B) Social Security taxes
  - C) personal income taxes
  - D) borrowing

Answer: C

Topic: Tax Revenues

Skill: Recognition

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 20) The government receives tax revenues from several sources. Rank the following sources from largest to the smallest.
- I. corporate income taxes
  - II. personal income taxes
  - III. Social Security taxes
- A) I, II, III
  - B) II, III, I
  - C) I, III, II
  - D) III, II, I

Answer: B

Topic: Tax Revenues

Skill: Recognition

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 21) Which of the following is NOT a revenue source for the Federal government?
- A) personal income taxes
  - B) indirect taxes
  - C) interest on corporate bond holdings
  - D) social security taxes

Answer: C

Topic: Tax Revenues

Skill: Recognition

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 22) The largest item of government outlays is \_\_\_\_\_.
- A) debt interest
  - B) transfer payments
  - C) expenditures on goods and services
  - D) debt reduction

Answer: B

Topic: The Federal Budget

Skill: Recognition

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 23) Expenditures such as Social Security benefits, farm subsidies and grants are considered
- A) expenditures on goods and services
  - B) transfer payments
  - C) debt reduction
  - D) debt interest

Answer: B

Topic: The Federal Budget

Skill: Recognition

Question history: New 10th edition

AACSB: Reflective Thinking

- 24) Social Security benefits and expenditures on Medicare and Medicaid are classified as
- A) debt interest.
  - B) purchases of goods and services.
  - C) production of goods and services.
  - D) transfer payments.

Answer: D

Topic: *Government Expenditures*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

- 25) Rank the following federal government outlays from the largest to the smallest.
- I. debt interest
  - II. transfer payments
  - III. expenditure on goods and services
- A) I, II, III
  - B) III, II, I
  - C) III, I, II
  - D) II, III, I

Answer: D

Topic: *Government Expenditures*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

- 26) Which of the following is NOT a government outlay?
- A) transfer payments
  - B) expenditure on goods and services
  - C) debt interest on the government's debt
  - D) purchases of foreign bonds

Answer: D

Topic: *Government Expenditures*

Skill: *Recognition*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

- 27) All of the following are government outlays EXCEPT
- A) interest on the government's debt.
  - B) transfer payments.
  - C) purchases of corporate bonds.
  - D) expenditure on goods and services.

Answer: C

Topic: *Government Expenditures*

Skill: *Recognition*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*



- 28) Federal government outlays as a percentage of GDP are approximately
- A) 10 percent.
  - B) 25 percent.
  - C) 50 percent.
  - D) 66 percent.

Answer: B

Topic: Government Expenditures

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

Component	Dollars (billion)
Personal income taxes	500
Social security taxes	400
Corporate income taxes	150
Indirect taxes	75
Transfer payments	1,200
Expenditure on goods and services	225
Debt interest	75

- 29) The table above has data for a country's government budget. The country has government revenues of \_\_\_\_\_ billion.
- A) \$900
  - B) \$1125
  - C) \$725
  - D) \$1700

Answer: B

Topic: Tax Revenues

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

- 30) The table above has data for a country's government budget. Government outlays for the economy equal \_\_\_\_\_ billion.
- A) \$1200
  - B) \$1275
  - C) \$1500
  - D) \$1425

Answer: C

Topic: Government Expenditures

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

- 31) The table above has data for a country's government budget. The data show the government is running a \_\_\_\_\_ billion.
- A) budget surplus of \$300
  - B) budget deficit of \$375
  - C) budget deficit of \$550
  - D) budget surplus of \$650

Answer: B

Topic: *Budget Surplus and Deficit*

Skill: *Analytical*

Question history: *Modified 10th edition*

AACSB: *Analytical Skills*

- 32) The largest source of revenue for the federal government is \_\_\_\_\_ and the largest outlay is for \_\_\_\_\_.
- A) corporate taxes; Social Security
  - B) personal income taxes; Medicare
  - C) personal income taxes; interest on national debt
  - D) personal income taxes; transfer payments

Answer: D

Topic: *Government Revenues and Expenditures*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

- 33) The government's budget deficit or surplus equals the
- A) change in outlays divided by change in revenue.
  - B) average outlay divided by average revenue.
  - C) change in revenue minus change in outlays.
  - D) total tax revenue minus total government outlays.

Answer: D

Topic: *Budget Surplus and Deficit*

Skill: *Recognition*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

- 34) A budget surplus occurs when government
- A) outlays exceeds tax revenues.
  - B) tax revenues exceeds outlays.
  - C) tax revenues equals outlays.
  - D) tax revenues equal social security expenditures.

Answer: B

Topic: *Budget Surplus and Deficit*

Skill: *Recognition*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

- 35) Whenever the federal government spends more than it receives in tax revenue, then by definition it
- A) runs a budget surplus.
  - B) operates a balanced budget.
  - C) runs a budget deficit.
  - D) increases economic growth.

Answer: C

Topic: Budget Surplus and Deficit

Skill: Recognition

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 36) The budget deficit
- A) is the total outstanding borrowing by the government.
  - B) is the difference between government outlays and tax revenues.
  - C) decreased during the Obama Administration.
  - D) reached its peak in the year 2000.

Answer: B

Topic: Budget Surplus and Deficit

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 37) A government incurs a budget deficit when
- A) taxes are greater than government outlays.
  - B) taxes are less than government outlays.
  - C) exports are greater than imports.
  - D) exports are less than imports.

Answer: B

Topic: Budget Surplus and Deficit

Skill: Recognition

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 38) If taxes exactly equaled government outlays the
- A) federal government debt would be zero.
  - B) federal government debt would decrease.
  - C) budget deficit would not change.
  - D) budget deficit would be zero.

Answer: D

Topic: Budget Surplus and Deficit

Skill: Recognition

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 39) If the federal government's tax revenues are greater than its outlays, then the federal budget has
- a
  - A) deficit.
  - B) surplus.
  - C) transfer payment.
  - D) balanced budget.

Answer: B

Topic: *Budget Surplus and Deficit*

Skill: *Recognition*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

- 40) By definition, a government budget deficit is the situation that occurs when the
- A) government outlays exceed what it receives in taxes.
  - B) government miscalculated how much it will receive in taxes.
  - C) government spends money on things which do not produce revenue, such as schools.
  - D) economy goes into a recession.

Answer: A

Topic: *Budget Surplus and Deficit*

Skill: *Recognition*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

- 41) The U.S. government's budget
- A) must be balanced each year.
  - B) has mostly been in surplus during the past 30 years.
  - C) has mostly been in deficit during the past 30 years.
  - D) has always been in deficit during the past 30 years.

Answer: C

Topic: *Budget Surplus and Deficit*

Skill: *Recognition*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

- 42) When tax revenues exceed outlays, the government has a \_\_\_\_\_, and when outlays exceed tax revenues, the government has a \_\_\_\_\_.
- A) budget surplus; budget debt
  - B) budget deficit; budget surplus
  - C) budget debt; budget surplus
  - D) budget surplus; budget deficit

Answer: D

Topic: *Budget Surplus and Deficit*

Skill: *Recognition*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

- 43) A government that currently has a budget deficit can balance its budget by \_\_\_\_\_.
- A) increasing tax revenues by more than it increases outlays
  - B) increasing both tax revenues and outlays by the same amount
  - C) decreasing tax revenues by more than it decreases outlays
  - D) decreasing tax revenues by more than it increases outlays

Answer: A

Topic: Budget Surplus and Deficit

Skill: Conceptual

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 44) In 2011, the U.S. government budget had a deficit. By definition, then,
- A) tax revenues were less than government outlays.
  - B) tax revenues were equal to government outlays.
  - C) tax revenues were greater than government outlays.
  - D) the government debt became negative.

Answer: A

Topic: Budget Surplus and Deficit

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 45) Suppose the only revenue taken in by the government is in the form of income tax, and the tax rate is 10 percent. If aggregate income is \$800 billion, and government outlays are \$100 billion then the government budget has
- A) a deficit of \$20 billion.
  - B) a surplus of \$20 billion.
  - C) neither a surplus nor a deficit.
  - D) a deficit of \$80 billion.

Answer: A

Topic: Budget Surplus and Deficit

Skill: Analytical

Question history: Previous edition, Chapter 13

AACSB: Analytical Skills

- 46) In 2011, the federal government of Happy Isle had tax revenues of \$1 million, and spent \$500,000 on transfer payments, \$250,000 on goods and services and \$300,000 on debt interest. In 2011, the government of Happy Isle had a \_\_\_\_\_.
- A) balanced budget
  - B) budget deficit of \$50,000
  - C) budget surplus of \$50,000
  - D) budget deficit of \$1,050,000

Answer: B

Topic: Budget Surplus and Deficit

Skill: Analytical

Question history: Previous edition, Chapter 13

AACSB: Analytical Skills

- 47) The federal government debt is equal to the
- A) obligations of benefits from federal taxes and expenditures.
  - B) sum of all annual federal government outlays.
  - C) sum of past budget deficits minus the sum of past budget surpluses.
  - D) annual difference between federal government tax revenues and outlays.

Answer: C

Topic: *Deficits and Debt*

Skill: *Recognition*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

- 48) The sum of past budget deficits minus the sum of past budget surpluses refers to
- A) the national debt.
  - B) the cyclically unbalanced budget.
  - C) the structural national debt.
  - D) the federal government net worth.

Answer: A

Topic: *Deficits and Debt*

Skill: *Recognition*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

- 49) If the government has a balanced budget, the total amount of government debt is
- A) increasing.
  - B) decreasing.
  - C) constant.
  - D) zero.

Answer: C

Topic: *Deficits and Debt*

Skill: *Recognition*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

- 50) If the government runs a surplus, the total amount of government debt is
- A) increasing.
  - B) decreasing.
  - C) constant.
  - D) zero.

Answer: B

Topic: *Deficits and Debt*

Skill: *Recognition*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

- 51) If the government runs a deficit, the total amount of government debt is
- A) increasing.
  - B) decreasing.
  - C) constant.
  - D) zero.

Answer: A

Topic: Deficits and Debt

Skill: Recognition

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 52) An increase in the government \_\_\_\_\_ reduces the government's \_\_\_\_\_.
- A) budget deficit; debt
  - B) budget surplus; debt
  - C) debt; budget deficit
  - D) None of the above answers is correct.

Answer: B

Topic: Deficits and Debt

Skill: Conceptual

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 53) Suppose a country has been running a persistent government budget deficit. If the deficit is reduced, but remains positive,
- A) government debt will increase.
  - B) government debt will decrease.
  - C) the country will experience a budget surplus.
  - D) interest payments on the debt immediately will decrease.

Answer: A

Topic: Deficits and Debt

Skill: Conceptual

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 54) If tax revenue equal \$1.5 billion and government outlays equal \$1.6 billion, then the
- A) government budget has a deficit of \$0.1 billion.
  - B) government budget has a surplus of \$0.1 billion.
  - C) government debt is equal to \$0.1 billion.
  - D) government debt declines by \$0.1 billion.

Answer: A

Topic: Deficits and Debt

Skill: Conceptual

Question history: Previous edition, Chapter 13

AACSB: Analytical Skills

55) A country has been in existence for only two years. In the first year, tax revenues were \$1.0 million and outlays were \$1.5 million. In the second year, tax revenues were \$1.5 million and outlays were \$2.0 million. At the end of the second year, the total government debt was \_\_\_\_\_.

- A) \$0.5 million
- B) \$1 million
- C) \$2.5 million
- D) \$3.5 million

Answer: B

Topic: *Deficits and Debt*

Skill: *Analytical*

Question history: *Modified 10th edition*

AACSB: *Analytical Skills*

Year	Government tax revenues (billions of dollars)	Government expenditures (billions of dollars)
1	240	240
2	250	245
3	260	255
4	300	320
5	325	340

56) What is the amount of the surplus or deficit incurred in year 1 by the government shown in the above table?

- A) \$0
- B) \$25 billion deficit
- C) \$25 billion surplus
- D) \$240 billion surplus

Answer: A

Topic: *Budget Surplus or Deficit*

Skill: *Analytical*

Question history: *Previous edition, Chapter 13*

AACSB: *Analytical Skills*

57) What is the amount of the surplus or deficit incurred in year 2 by the government shown in the above table?

- A) \$0
- B) \$5 billion surplus
- C) \$5 billion deficit
- D) \$250 billion surplus

Answer: B

Topic: *Budget Surplus or Deficit*

Skill: *Analytical*

Question history: *Previous edition, Chapter 13*

AACSB: *Analytical Skills*



- 58) What is the amount of the surplus or deficit incurred in year 3 by the government shown in the above table?
- A) \$0
  - B) \$5 billion surplus
  - C) \$5 billion deficit
  - D) \$260 billion surplus

Answer: B

Topic: Budget Surplus or Deficit

Skill: Analytical

Question history: Previous edition, Chapter 13

AACSB: Analytical Skills

- 59) What is the amount of the surplus or deficit incurred in year 4 by the government shown in the above table?
- A) \$20 billion deficit
  - B) \$35 billion surplus
  - C) \$5 billion surplus
  - D) \$320 billion surplus

Answer: A

Topic: Budget Surplus or Deficit

Skill: Analytical

Question history: Previous edition, Chapter 13

AACSB: Analytical Skills

- 60) What is the amount of the surplus or deficit incurred in year 5 by the government shown in the above table?
- A) \$15 billion deficit
  - B) \$35 billion surplus
  - C) \$5 billion surplus
  - D) \$325 billion surplus

Answer: A

Topic: Budget Surplus or Deficit

Skill: Analytical

Question history: Previous edition, Chapter 13

AACSB: Analytical Skills

- 61) The government begins year 1 with \$25 billion of debt. Based on the information in the above table, what is the amount of debt following year 1?
- A) \$0
  - B) \$25 billion
  - C) \$240 billion
  - D) Not enough information is provided to answer the question.

Answer: B

Topic: Deficits and Debt

Skill: Analytical

Question history: Previous edition, Chapter 13

AACSB: Analytical Skills

- 62) The government begins year 1 with \$25 billion of debt. Based on the information in the above table, what is the amount of debt following year 2?
- A) \$245 billion
  - B) \$5 billion
  - C) \$250 billion
  - D) \$20 billion

Answer: D

Topic: *Deficits and Debt*

Skill: *Analytical*

Question history: *Previous edition, Chapter 13*

AACSB: *Analytical Skills*

- 63) The government begins year 1 with \$25 billion of debt. Based on the information in the above table, what is the amount of debt following year 3?
- A) \$15 billion
  - B) \$5 billion
  - C) \$20 billion
  - D) \$260 billion

Answer: A

Topic: *Deficits and Debt*

Skill: *Analytical*

Question history: *Previous edition, Chapter 13*

AACSB: *Analytical Skills*

- 64) The government begins year 1 with \$25 billion of debt. Based on the information in the above table, what is the amount of debt following year 4?
- A) -\$20 billion (The government has net saving rather than debt.)
  - B) \$35 billion
  - C) \$5 billion
  - D) \$320 billion

Answer: B

Topic: *Deficits and Debt*

Skill: *Analytical*

Question history: *Previous edition, Chapter 13*

AACSB: *Analytical Skills*

- 65) The government begins year 1 with \$25 billion of debt. Based on the information in the above table, what is the amount of debt following year 5?
- A) -\$20 billion (The government has net saving rather than debt.)
  - B) \$35 billion
  - C) \$50 billion
  - D) \$325 billion

Answer: C

Topic: *Deficits and Debt*

Skill: *Analytical*

Question history: *Previous edition, Chapter 13*

AACSB: *Analytical Skills*

- 66) The U.S. federal budget over the past 30 years has been
- A) in balance most years.
  - B) in deficit most of the years.
  - C) in surplus most of the years.
  - D) in surplus about half the time and deficit the other half.

Answer: B

Topic: Federal Budget History

Skill: Recognition

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 67) Comparing the U.S. budget position for 2010 to the rest of the world, we see that as a percentage of GDP, the \_\_\_\_\_ than in most other countries.
- A) U.S. budget deficit is smaller
  - B) U.S. budget deficit is larger
  - C) U.S. budget surplus is smaller
  - D) U.S. budget surplus is larger

Answer: B

Topic: Federal Budget History

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 68) If the government's outlays are \$1.5 trillion and its tax revenues are \$2.2 trillion, the government is running a budget
- A) surplus of \$0.7 trillion.
  - B) surplus of \$3.7 trillion.
  - C) deficit of \$0.7 trillion.
  - D) deficit of \$3.7 trillion.

Answer: A

Topic: Study Guide Question, Budget Surplus and Deficit

Skill: Conceptual

Question history: Previous edition, Chapter 13

AACSB: Analytical Skills

## 2 Supply-Side Effects of Fiscal Policy

- 1) Looking at the supply-side effects on aggregate supply shows that a tax hike on labor income
- A) weakens the incentive to work.
  - B) decreases potential GDP.
  - C) increases potential GDP because people work more to pay the higher taxes.
  - D) Both answers A and B are correct.

Answer: D

Topic: Supply Side Effects of an Income Tax

Skill: Conceptual

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 2) Once supply side effects are taken into account, tax cuts for labor income can change
- I. the supply of labor
  - II. potential GDP.
- A) I only
  - B) I and II
  - C) II only
  - D) Neither I nor II.

Answer: B

Topic: *Supply Side Effects of an Income Tax*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

- 3) Taking account of the supply-side effects, a tax cut on labor income \_\_\_\_\_ employment and \_\_\_\_\_ potential GDP.
- A) increases; increases
  - B) increases; decreases
  - C) decreases; increases
  - D) decreases; decreases

Answer: A

Topic: *Supply Side Effects of an Income Tax*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

- 4) If a tax cut increases people's labor supply, then
- A) tax cuts increase potential GDP.
  - B) tax cuts decrease aggregate demand.
  - C) tax cuts cannot affect aggregate demand.
  - D) Both answers A and B are correct.

Answer: A

Topic: *Supply Side Effects of an Income Tax*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

- 5) The supply side effects of a change in taxes on labor income means that \_\_\_\_\_ in taxes on labor income shift the \_\_\_\_\_.
- A) an increase; labor supply curve rightward
  - B) an increase; labor supply curve leftward
  - C) a decrease; labor demand curve rightward
  - D) a decrease; labor demand curve leftward

Answer: B

Topic: *Supply Side Effects of an Income Tax*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

- 6) An increase in taxes on labor income \_\_\_\_\_ the labor supply curve and \_\_\_\_\_ the labor demand curve..
- A) shifts; does not shift
  - B) shifts; shifts
  - C) does not shift; does not shift
  - D) does not shift; shifts

Answer: A

Topic: Supply Side Effects of an Income Tax

Skill: Conceptual

Question history: New 10th edition

AACSB: Reflective Thinking

- 7) An increase in taxes on labor income shifts the labor supply curve \_\_\_\_\_ and the \_\_\_\_\_.
- A) leftward; after-tax wage rate falls
  - B) rightward; before-tax wage rate rises
  - C) leftward; after-tax wage rate rises
  - D) rightward; before-tax wage rate falls

Answer: A

Topic: Supply Side Effects of an Income Tax

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 8) An income tax \_\_\_\_\_ potential GDP by shifting the \_\_\_\_\_ curve \_\_\_\_\_.
- A) increases; labor demand; rightward
  - B) decreases; labor demand; leftward
  - C) increases; labor supply; rightward
  - D) decreases; labor supply; leftward

Answer: D

Topic: Supply Side Effects of an Income Tax

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Analytical Skills

- 9) The difference between the before-tax and after-tax rates is referred to as the
- A) tax plug.
  - B) deadweight gain.
  - C) tax wedge.
  - D) taxation penalty.

Answer: C

Topic: Tax Wedge

Skill: Recognition

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 10) If we compare the United States to France, the U.S. tax wedge is \_\_\_\_\_ the French tax wedge.
- A) larger than
  - B) equals to
  - C) smaller than
  - D) not comparable to

Answer: C

Topic: Tax Wedge

Skill: Recognition

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 11) If we compare the United States to France, we see that potential GDP per person in France is \_\_\_\_\_ than that in the United States because the French tax wedge is \_\_\_\_\_ than the U.S. tax wedge.
- A) greater; larger
  - B) greater; smaller
  - C) less; larger
  - D) less; smaller

Answer: C

Topic: Tax Wedge

Skill: Conceptual

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 12) An increase in taxes on interest income \_\_\_\_\_ supply of loanable funds curve and \_\_\_\_\_ the demand for loanable funds curve.
- A) shifts; does not shift
  - B) does not shift; shifts
  - C) does not shift; does not shift
  - D) shifts; shifts

Answer: A

Topic: Fiscal Policy and Aggregate Supply

Skill: Conceptual

Question history: New 10th edition

AACSB: Reflective Thinking

- 13) The supply side effects of a cut in tax rates include \_\_\_\_\_ in the supply of labor and \_\_\_\_\_ in the supply of loanable funds.
- A) an increase; an increase
  - B) an increase; a decrease
  - C) a decrease; an increase
  - D) a decrease; a decrease

Answer: A

Topic: Fiscal Policy and Aggregate Supply

Skill: Conceptual

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 14) When interest income is taxed and the inflation rate rises, the tax revenue collected by the government
- A) increases.
  - B) doesn't change.
  - C) decreases.
  - D) could either increase or decrease.

Answer: A

Topic: After-Tax Real Interest Rate

Skill: Conceptual

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 15) Suppose the tax rate on interest income is 50 percent, the real interest rate is 3 percent, and the inflation rate is 4 percent. In this case, the real after-tax interest rate is
- A) -0.5 percent.
  - B) 3.5 percent.
  - C) 3.0 percent.
  - D) 4.0 percent.

Answer: A

Topic: After-Tax Real Interest Rate

Skill: Analytical

Question history: Previous edition, Chapter 13

AACSB: Analytical Skills

- 16) Suppose the tax rate on interest income is 25 percent, the real interest rate is 4 percent, and the inflation rate is 4 percent. In this case, the real after-tax interest rate is
- A) .5 percent.
  - B) 3.5 percent.
  - C) 4.0 percent.
  - D) 2.0 percent.

Answer: D

Topic: After-Tax Real Interest Rate

Skill: Analytical

Question history: Previous edition, Chapter 13

AACSB: Analytical Skills

- 17) The Laffer curve is the relationship between
- A) government purchases and potential GDP.
  - B) tax rates and potential GDP.
  - C) tax revenue and potential GDP.
  - D) tax rates and tax revenue.

Answer: D

Topic: Laffer Curve

Skill: Recognition

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 18) During the Reagan administration in the 1980s, tax rates were \_\_\_\_\_ and the budget deficit \_\_\_\_\_.
- A) raised; increased
  - B) raised; decreased
  - C) cut; increased
  - D) cut; decreased

Answer: C

Topic: *Laffer Curve*

Skill: *Recognition*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

- 19) According to the Laffer curve, raising the tax rate
- A) always increases the amount of tax revenue.
  - B) always decreases the amount of tax revenue.
  - C) does not change the amount of tax revenue.
  - D) might increase, decrease, or not change the amount of tax revenue.

Answer: D

Topic: *Laffer Curve*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

- 20) The Laffer curve shows that increasing \_\_\_\_\_ increases \_\_\_\_\_ when \_\_\_\_\_ low.
- A) tax revenue; potential GDP; tax revenue is
  - B) tax rates; tax revenue; tax rates are
  - C) potential GDP; tax revenue; tax revenue is
  - D) None of the above answers is correct.

Answer: B

Topic: *Laffer Curve*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

- 21) A decrease in the income tax rate
- A) decreases potential GDP.
  - B) increases the supply of labor.
  - C) increases the tax wedge.
  - D) decreases the demand for labor.

Answer: B

Topic: *Study Guide Question, Supply Side Effects of an Income Tax*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*



- 22) An increase in the income tax rate \_\_\_\_\_ employment and \_\_\_\_\_ potential GDP.
- A) increases; increases
  - B) increases; decreases
  - C) decreases; increases
  - D) decreases; decreases

Answer: D

Topic: Study Guide Question, Supply Side Effects of an Income Tax

Skill: Conceptual

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 23) An increase in the tax on interest income \_\_\_\_\_ the supply of loanable funds and \_\_\_\_\_ the equilibrium investment.
- A) increases; increases
  - B) increases; decreases
  - C) decreases; increases
  - D) decreases; decreases

Answer: D

Topic: Study Guide Question, Supply Side Effects of Tax on Interest Income

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

### 3 Generational Effects of Fiscal Policy

- 1) The system that measures the lifetime tax burden and benefits of each generation is called
- A) actuarial genealogy.
  - B) generational actuary.
  - C) generational accounting.
  - D) actuarial accounting.

Answer: C

Topic: Generational Accounting

Skill: Recognition

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 2) Generational accounting does NOT investigate issues involving
- A) the budget deficit
  - B) government obligations such as Social Security
  - C) the ownership of corporate stock
  - D) the burden of taxes

Answer: C

Topic: Generational Accounting

Skill: Recognition

Question history: New 10th edition

AACSB: Reflective Thinking

- 3) The \_\_\_\_\_ the interest rate, the \_\_\_\_\_ the present value of a given future amount.
- A) higher; larger
  - B) higher; smaller
  - C) lower; lower
  - D) None of the above answers is correct because the interest rate has nothing to do with the present value.

Answer: C

Topic: Present Value

Skill: Conceptual

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 4) If \$1,000 is invested at 3 percent per year for 10 years the investment grows to \$1,343.92. This means the present value \$1,343.92 at an interest rate of 3 percent 10 years from now is
- A) 3 percent.
  - B) \$1,000.
  - C) \$343.92.
  - D) \$1,343.92.

Answer: B

Topic: Present Value

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

- 5) The present value of the government's commitments to pay benefits minus the present value of its tax revenues is called
- A) calculated fiscal obligations.
  - B) fiscal imbalance.
  - C) fiscal balance.
  - D) fiscal obligations.

Answer: B

Topic: Fiscal Imbalance

Skill: Recognition

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 6) The largest component of the fiscal imbalance is
- A) Social Security.
  - B) Medicare.
  - C) Defense spending.
  - D) none of the above

Answer: B

Topic: Fiscal Imbalance

Skill: Recognition

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 7) Splitting the fiscal imbalance between current and future generations is called
- A) genealogical accounting.
  - B) actuarial accounting.
  - C) generational imbalance.
  - D) actuarial balance.

Answer: C

Topic: Fiscal Imbalance

Skill: Recognition

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 8) Comparing the fiscal imbalance for the current generation versus future generations, it is the case that
- A) future generations pay a larger share of the fiscal imbalance.
  - B) the current generation pays a larger share of the fiscal imbalance.
  - C) each generation pays half of the fiscal imbalance.
  - D) each generation pays all of its fiscal imbalance.

Answer: A

Topic: Fiscal Imbalance

Skill: Recognition

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 9) To eliminate the fiscal imbalance the government could
- A) lower benefits and lower tax revenues.
  - B) increase benefits and increase tax revenues.
  - C) lower benefits and increase tax revenues.
  - D) increase benefits and lower tax revenues.

Answer: C

Topic: Fiscal Imbalance

Skill: Conceptual

Question history: New 10th edition

AACSB: Reflective Thinking

- 10) In order for the United States to repay its international debt, the United States would need to
- A) have a current account deficit.
  - B) cut taxes.
  - C) have a surplus of imports over exports.
  - D) have a surplus of exports over imports.

Answer: D

Topic: International Debt

Skill: Recognition

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 11) Generational accounting shows that the present value of the government's commitments to pay benefits are \_\_\_\_\_ the present value of its taxes.
- A) greater than
  - B) less than
  - C) equal to
  - D) not comparable to

Answer: A

Topic: *Study Guide Question, Fiscal Imbalance*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

#### 4 Fiscal Stimulus

- 1) Taxes and government expenditures that, without need for additional government action, change in response to changes in the level of economic activity are examples of
- A) discretionary fiscal variables.
  - B) automatic fiscal policy.
  - C) built-in monetary stabilizers.
  - D) cyclically balanced budgets.

Answer: B

Topic: *Automatic Fiscal Policy*

Skill: *Recognition*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

- 2) One characteristic of automatic fiscal policy is that it
- A) requires no legislative action by Congress to be made effective.
  - B) automatically produces surpluses during recessions and deficits during inflation.
  - C) has no effect on unemployment.
  - D) reduces the size of the federal government debt during times of recession.

Answer: A

Topic: *Automatic Fiscal Policy*

Skill: *Recognition*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

- 3) A fiscal action that is triggered by the state of the economy is called
- A) the government expenditure multiplier.
  - B) discretionary fiscal policy.
  - C) automatic fiscal policy.
  - D) generational fiscal policy.

Answer: C

Topic: *Automatic Fiscal Policy*

Skill: *Recognition*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

- 4) A discretionary fiscal policy is a fiscal policy that
- A) involves a change in government defense spending.
  - B) is triggered by the state of the economy.
  - C) requires action by the Congress.
  - D) involves a change in corporate tax rates.

Answer: C

Topic: Discretionary Fiscal Policy

Skill: Recognition

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 5) A fiscal action that is initiated by an act of Congress is called
- A) the government expenditure multiplier.
  - B) discretionary fiscal policy.
  - C) automatic fiscal policy.
  - D) generational fiscal policy.

Answer: B

Topic: Discretionary Fiscal Policy

Skill: Recognition

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 6) Deliberate changes in government expenditures and taxes to influence GDP
- A) are examples of automatic fiscal policy because the politicians automatically respond.
  - B) are discretionary fiscal policy.
  - C) are enacted by the Council of Economic Advisers.
  - D) operate without time lags.

Answer: B

Topic: Discretionary Fiscal Policy

Skill: Recognition

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 7) The stimulus package passed by Congress in 2009 is an example of
- A) automatic fiscal policy
  - B) discretionary fiscal policy
  - C) monetary policy
  - D) increased taxation

Answer: B

Topic: Discretionary Fiscal Policy

Skill: Recognition

Question history: New 10th edition

AACSB: Reflective Thinking

- 8) The difference between automatic fiscal policy and discretionary fiscal policy is that
- A) Congress initiates automatic fiscal policy.
  - B) the President has nothing to do with discretionary fiscal policy.
  - C) Congress must pass laws implementing discretionary fiscal policy.
  - D) the President initiates discretionary fiscal policy.

Answer: C

Topic: *Discretionary Fiscal Policy*

Skill: *Recognition*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

- 9) When the economy is hit by spending fluctuations, the government can try to minimize the effects by
- A) changing government expenditures on goods.
  - B) changing taxes.
  - C) changing government expenditures on services.
  - D) all of the above

Answer: D

Topic: *Discretionary Fiscal Policy*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

- 10) An example of a discretionary fiscal policy is when
- A) tax receipts fall as incomes fall.
  - B) unemployment compensation payments rise with unemployment rates.
  - C) food stamp payments rise when the economy is in a recession.
  - D) Congress passes a law that raises personal marginal tax rates.

Answer: D

Topic: *Discretionary Fiscal Policy*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

- 11) An increase in the tax rates as a result of a new tax law passed by Congress is an example of \_\_\_\_\_.
- A) discretionary fiscal policy
  - B) increasing the government debt
  - C) increasing the government deficit
  - D) needs-tested taxing change.

Answer: A

Topic: *Discretionary Fiscal Policy*

Skill: *Recognition*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

- 12) The tax rebates passed by Congress in 2008 to help move the economy more rapidly toward potential GDP are an example of
- A) automatic fiscal policy.
  - B) discretionary fiscal policy.
  - C) lump-sum taxes.
  - D) contractionary fiscal policy.

Answer: B

Topic: Discretionary Fiscal Policy

Skill: Conceptual

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 13) Tax revenues
- A) are autonomous.
  - B) are independent of real GDP.
  - C) vary with real GDP.
  - D) are fixed over time.

Answer: C

Topic: Automatic Fiscal Policy

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 14) A fall in income that results in a decrease in tax revenues is an example of \_\_\_\_\_.
- A) automatic fiscal policy
  - B) needs-tested tax programs
  - C) a recession
  - D) discretionary fiscal policy

Answer: A

Topic: Automatic Fiscal Policy

Skill: Recognition

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 15) When the economy grows, \_\_\_\_\_ increase because real GDP \_\_\_\_\_.
- A) tax revenues; decreases
  - B) tax revenues; increases
  - C) structural deficits; decreases
  - D) recognition lags; increases

Answer: B

Topic: Automatic Fiscal Policy

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 16) Income taxes in the United States are part of automatic fiscal policy because
- A) tax revenues increase when income increases, thus offsetting some of the increase in aggregate demand.
  - B) tax revenues decrease when income increases, intensifying the increase in aggregate demand.
  - C) the President can increase tax rates whenever the President deems such a policy appropriate.
  - D) tax rates can be adjusted by the Congress to counteract economic fluctuations.

Answer: A

Topic: Automatic Fiscal Policy

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 17) An example of automatic fiscal policy is when
- A) tax revenues decrease as real GDP decreases.
  - B) Congress passes a law that raises tax rates.
  - C) Congress decides to cut government expenditure.
  - D) the president drafts a bill to reduce defense spending.

Answer: A

Topic: Automatic Fiscal Policy

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 18) Tax revenues \_\_\_\_\_ during recessions and \_\_\_\_\_ during expansions.
- A) decrease; decrease
  - B) decrease; increase
  - C) increase; expansions
  - D) increase; increase

Answer: B

Topic: Automatic Fiscal Policy

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 19) Spending on programs that result in transfer payments that depend on the economic state of individuals and businesses is called \_\_\_\_\_.
- A) transfer spending
  - B) welfare
  - C) needs-tested spending
  - D) business subsidies

Answer: C

Topic: Automatic Fiscal Policy

Skill: Recognition

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking



- 20) Needs-tested spending \_\_\_\_\_ during recessions and \_\_\_\_\_ during expansions.
- A) decreases; decreases
  - B) decreases; increases
  - C) increases; decreases
  - D) increases; increases

Answer: C

Topic: Automatic Fiscal Policy

Skill: Conceptual

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 21) If the economy falls into a recession, which of the following responses constitutes the use of automatic fiscal policy?
- A) an income tax cut voted on by Congress and quickly signed by the President
  - B) an existing system to make government payments to the growing ranks of unemployed workers
  - C) a new program to fund local governments' hiring of 100,000 street sweepers within a year
  - D) All of the above answers are correct.

Answer: B

Topic: Automatic Fiscal Policy

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 22) Automatic fiscal policy occurs
- A) because monetary policy is effective.
  - B) because tax revenues and transfer payments fluctuate with real GDP.
  - C) because government expenditures on goods and services fluctuate with real GDP.
  - D) when the Congress makes changes to transfer payment programs.

Answer: B

Topic: Automatic Fiscal Policy

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 23) Automatic fiscal policy is at work if, as real GDP increases, \_\_\_\_\_.
- A) transfer payments decrease and interest rates decrease
  - B) transfer payments increase and tax revenues decrease
  - C) tax revenues increase and transfer payments decrease
  - D) tax revenues decrease and interest rates increase

Answer: C

Topic: Automatic Fiscal Policy

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 24) Because of automatic fiscal policy, when real GDP decreases
- A) government expenditures decrease and tax revenues increase.
  - B) government expenditures increase and tax revenues decrease.
  - C) government expenditures equal tax revenues.
  - D) the economy will automatically go to full employment.

Answer: B

Topic: *Automatic Fiscal Policy*

Skill: *Conceptual*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

- 25) Government transfer payments \_\_\_\_\_ during expansions and \_\_\_\_\_ during recessions.
- A) increase; increase
  - B) increase; decrease
  - C) decrease; increase
  - D) decrease; decrease

Answer: C

Topic: *Budget Deficit Over the Business Cycle*

Skill: *Recognition*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

- 26) During an expansion, tax revenues \_\_\_\_\_, while during a recession, tax revenues \_\_\_\_\_.
- A) decrease; increase
  - B) increase; decrease
  - C) remain stable; decrease
  - D) fail to cover expenditures; fail to match transfer payments

Answer: B

Topic: *Budget Deficit Over the Business Cycle*

Skill: *Recognition*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

- 27) During an expansion, tax revenues \_\_\_\_\_ and government transfer payments \_\_\_\_\_.
- A) increase; increase
  - B) increase; decrease
  - C) decrease; increase
  - D) decrease; decrease

Answer: B

Topic: *Budget Deficit Over the Business Cycle*

Skill: *Recognition*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

- 28) The government budget deficit tends to decrease during the expansion phase of a business cycle because tax revenues \_\_\_\_\_ and government transfer payments \_\_\_\_\_.
- A) increase; increase
  - B) increase; decrease
  - C) decrease; increase
  - D) decrease; decrease

Answer: B

Topic: Budget Deficit Over the Business Cycle

Skill: Recognition

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 29) The structural deficit or surplus is the
- A) difference between actual government outlays and actual government receipts.
  - B) change in national debt that will result from current budgetary policies.
  - C) government budget deficit or surplus that would occur if the economy were at potential GDP.
  - D) actual government budget deficit or surplus minus expenditures for capital improvements.

Answer: C

Topic: Cyclical and Structural Balances

Skill: Recognition

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 30) The structural deficit is the deficit
- A) during a recession.
  - B) during an expansion.
  - C) that would occur at full employment.
  - D) caused by the business cycle.

Answer: C

Topic: Cyclical and Structural Balances

Skill: Recognition

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 31) The structural deficit is the deficit that occurs when
- A) real GDP departs from potential GDP.
  - B) real GDP equals potential GDP.
  - C) aggregate demand is greater than short-run aggregate supply.
  - D) short-run aggregate supply is greater than aggregate demand.

Answer: B

Topic: Cyclical and Structural Balances

Skill: Recognition

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

32) The structural surplus

- A) equals the actual surplus plus the cyclical surplus.
- B) is the government budget surplus that would exist if the economy was at potential GDP.
- C) is, by definition, equal to the negative of the cyclical deficit.
- D) is legally required to be positive.

Answer: B

Topic: *Cyclical and Structural Balances*

Skill: *Recognition*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

33) A structural deficit occurs when the government budget has a deficit

- A) even though real GDP is less than potential GDP.
- B) even though real GDP is greater than structural GDP.
- C) even though real GDP is equal to potential GDP.
- D) that is nominal, as opposed to a real budget deficit.

Answer: C

Topic: *Cyclical and Structural Balances*

Skill: *Recognition*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

34) The structural deficit is that deficit that would exist

- A) with the taxes and outlays that would occur if the economy was at the equilibrium level of real GDP.
- B) with the taxes and outlays that would occur if the economy was at the full employment level of real GDP.
- C) if tax rates were set to maximize tax revenues.
- D) if there were no discretionary fiscal interventions into the economy.

Answer: B

Topic: *Cyclical and Structural Balances*

Skill: *Recognition*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

35) The cyclical deficit is the portion of the deficit

- A) created by fluctuations in real GDP.
- B) that is the result of nondiscretionary federal spending.
- C) that would exist if the economy were at potential real GDP.
- D) the result of discretionary federal spending.

Answer: A

Topic: *Cyclical and Structural Balances*

Skill: *Recognition*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

- 36) A cyclical surplus is a
- A) budget surplus only because real GDP is less than potential GDP.
  - B) budget surplus only because real GDP is greater than potential GDP.
  - C) budget surplus only because real GDP is equal to potential GDP.
  - D) nominal, as opposed to real, budget surplus.

Answer: B

Topic: Cyclical and Structural Balances

Skill: Recognition

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 37) Which of the following relationships is correct?
- A) actual budget deficit = structural deficit - cyclical deficit
  - B) cyclical surplus = actual budget deficit - cyclical deficit
  - C) actual budget deficit = structural deficit + cyclical deficit
  - D) cyclical deficit = actual budget deficit + structural deficit

Answer: C

Topic: Cyclical and Structural Balances

Skill: Conceptual

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 38) When an economy is above full employment and the government has a budget deficit, that deficit \_\_\_\_\_.
- A) exceeds the structural deficit
  - B) is equal to the structural deficit minus the cyclical deficit
  - C) is equal to the cyclical deficit minus the structural deficit
  - D) is less than the structural deficit

Answer: D

Topic: Cyclical and Structural Balances

Skill: Analytical

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 39) The actual budget deficit is equal to the
- A) structural deficit.
  - B) cyclical deficit.
  - C) structural deficit minus the cyclical deficit.
  - D) structural deficit plus the cyclical deficit.

Answer: D

Topic: Cyclical and Structural Balances

Skill: Conceptual

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 40) If the budget deficit is \$50 billion and the structural deficit is \$10 billion, the cyclical deficit is
- A) \$10 billion.
  - B) \$40 billion.
  - C) \$60 billion.
  - D) \$50 billion

Answer: B

Topic: Cyclical and Structural Deficits

Skill: Analytical

Question history: Previous edition, Chapter 13

AACSB: Analytical Skills

- 41) If the economy has a structural deficit of \$25 billion and a cyclical deficit of \$75, we can conclude that the current budget deficit is \_\_\_\_\_ billion.
- A) \$25
  - B) \$50
  - C) \$75
  - D) \$100

Answer: D

Topic: Cyclical and Structural Deficits

Skill: Analytical

Question history: Previous edition, Chapter 13

AACSB: Analytical Skills



- 42) Economic data for a mythical economy in the years 2006–2010 are summarized in the figure above. Assume that the spending formulas and tax schedules are identical for all years. When the economy is at full employment, the government has a
- A) budget surplus.
  - B) balanced budget.
  - C) budget deficit.
  - D) procyclical policy.

Answer: B

Topic: Cyclical and Structural Balances

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

- 43) Economic data for a mythical economy in the years 2006–2010 are summarized in the figure above. Assume that the spending formulas and tax schedules are identical for all years. When the economy is above full employment, the government has a
- A) budget surplus.
  - B) balanced budget.
  - C) budget deficit.
  - D) procyclical policy.

Answer: A

*Topic: Cyclical and Structural Balances*

*Skill: Analytical*

*Question history: Modified 10th edition*

*AACSB: Analytical Skills*

- 44) Economic data for a mythical economy in the years 2006–2010 are summarized in the figure above. Assume that the spending formulas and tax schedules are identical for all years. When the economy is at less than full employment, the government has a
- A) budget surplus.
  - B) balanced budget.
  - C) budget deficit.
  - D) procyclical policy.

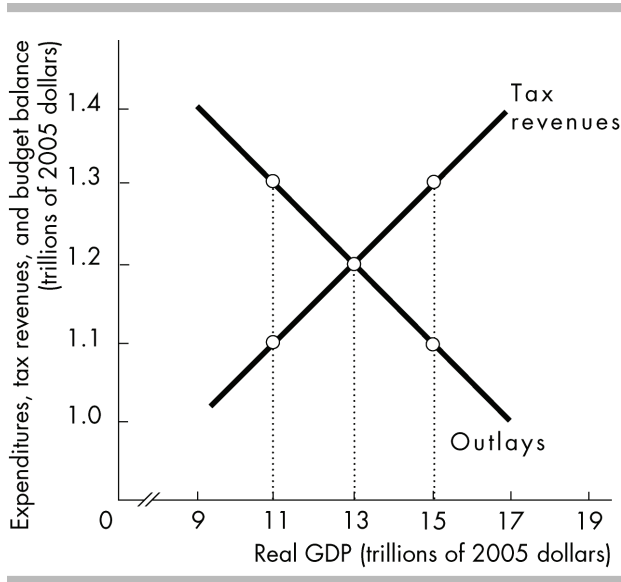
Answer: C

*Topic: Cyclical and Structural Balances*

*Skill: Analytical*

*Question history: Modified 10th edition*

*AACSB: Analytical Skills*



- 45) Using the above figure, if full employment occurs at \$15 trillion and the economy is actually producing \$15 trillion, then there is a
- A) cyclical deficit.
  - B) cyclical surplus.
  - C) structural deficit.
  - D) structural surplus.

Answer: D

Topic: Cyclical and Structural Deficits

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

- 46) Using the above figure, if full employment occurs at \$13 trillion, but the economy is actually producing \$15 trillion, then there is a
- A) cyclical deficit.
  - B) cyclical surplus.
  - C) structural deficit.
  - D) structural surplus.

Answer: B

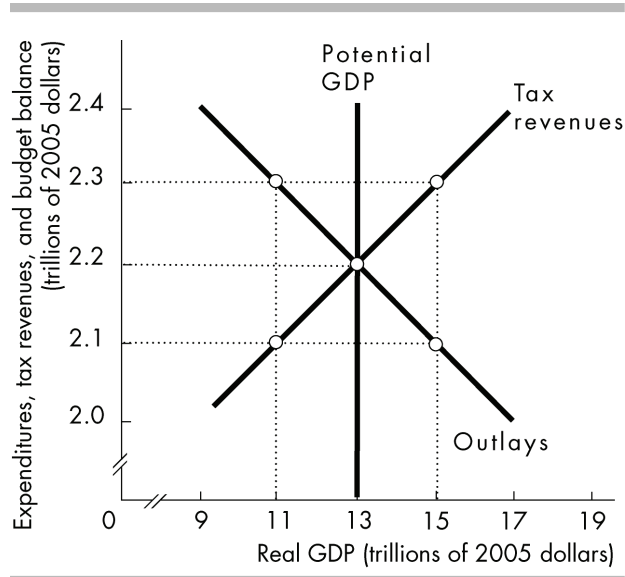
Topic: Cyclical and Structural Deficits

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills





47) In the above figure, if actual GDP = \$15 trillion, there is a budget \_\_\_\_\_ equal to \_\_\_\_\_.

- A) surplus; \$0.2 trillion
- B) surplus; \$1.3 trillion
- C) deficit; \$0.2 trillion
- D) deficit; \$1.1 trillion

Answer: A

Topic: Cyclical and Structural Balances

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

48) In the above figure,

- A) the structural deficit equals zero.
- B) any surpluses are cyclical surpluses.
- C) any deficits are cyclical deficits.
- D) All of the above answers are correct.

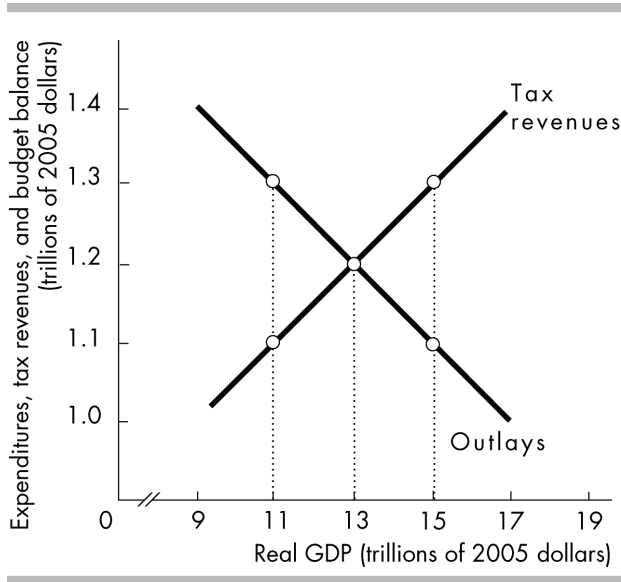
Answer: D

Topic: Cyclical and Structural Balances

Skill: Analytical

Question history: Previous edition, Chapter 13

AACSB: Analytical Skills



- 49) The figure above shows tax revenues and government expenditures in the economy of Meadowlake. Potential GDP is \$13 trillion. If real GDP is \$13 trillion, then the government has a \_\_\_\_\_.
- A) cyclical surplus
  - B) structural surplus
  - C) balanced budget
  - D) cyclical deficit

Answer: C

Topic: Cyclical and Structural Balances

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

- 50) The figure above shows tax revenues and government expenditures in the economy of Meadowlake. Potential GDP is \$15 trillion. If real GDP is \$11 trillion, then the government has a \_\_\_\_\_.
- A) cyclical deficit
  - B) structural deficit
  - C) structural surplus
  - D) cyclical surplus

Answer: A

Topic: Cyclical and Structural Balances

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

- 51) In the short run, an increase in government expenditure will
- I. shift the aggregate demand curve rightward.
  - II. increase real GDP.
  - III. increase the government expenditure multiplier.
  - IV. increase the tax multiplier.
- A) I and II
  - B) I and III
  - C) I, II and III
  - D) III and IV

Answer: A

Topic: Government Expenditure Multiplier

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Analytical Skills

- 52) A reason the government expenditure multiplier is larger than 1 is because
- A) investment increases when government expenditure increases.
  - B) government expenditure always increases.
  - C) government expenditure generates changes in consumption expenditure.
  - D) taxes are left unchanged.

Answer: C

Topic: Government Expenditure Multiplier

Skill: Conceptual

Question history: New 10th edition

AACSB: Reflective Thinking

- 53) The magnitude of the tax multiplier \_\_\_\_\_ the magnitude of the government expenditure multiplier.
- A) is smaller than
  - B) is larger than
  - C) is equal to
  - D) is not comparable to

Answer: A

Topic: Tax Multiplier

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 54) Suppose the government increases taxes. One effect of this change is that it decreases
- A) disposable income, which decreases consumption expenditure and aggregate demand.
  - B) government expenditure, which decreases aggregate demand.
  - C) the size of the government expenditure multiplier.
  - D) disposable income which then decreases aggregate supply.

Answer: A

Topic: Tax Multiplier

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 55) The demand-side effect of a change in taxes is less than the same sized change in government expenditure because
- A) only part of the increase in disposable income from the tax cut is spent.
  - B) the amount by which taxes change is affected by the *MPC*.
  - C) changes in government expenditure do not directly affect consumption.
  - D) tax rates are the same regardless of income levels.

Answer: A

Topic: *Tax Multiplier*

Skill: *Conceptual*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

- 56) The aggregate demand curve is shifted rightward by
- A) an increase in tax rates.
  - B) a decrease in government expenditure.
  - C) an increase in the federal budget surplus.
  - D) an increase in government expenditure.

Answer: D

Topic: *Fiscal Stimulus*

Skill: *Analytical*

Question history: *Previous edition, Chapter 13*

AACSB: *Analytical Skills*

- 57) An increase in government expenditure shifts the *AD* curve \_\_\_\_\_ and an increase in taxes shifts the *AD* curve \_\_\_\_\_.
- A) rightward; rightward
  - B) rightward; leftward
  - C) leftward; rightward
  - D) leftward; leftward

Answer: B

Topic: *Fiscal Stimulus*

Skill: *Analytical*

Question history: *Previous edition, Chapter 13*

AACSB: *Analytical Skills*

- 58) Suppose the government of Japan increases its expenditure on goods and services. In the short run, this increase will
- A) shift the *AD* curve in Japan rightward.
  - B) shift the *AD* curve in Japan leftward.
  - C) cause the price level in Japan to fall.
  - D) None of the above answers is correct.

Answer: A

Topic: *Fiscal Stimulus*

Skill: *Analytical*

Question history: *Modified 10th edition*

AACSB: *Analytical Skills*

- 59) If the government wants to engage in fiscal policy to increase real GDP, it could
- A) increase government expenditure in order to increase short-run aggregate supply.
  - B) decrease government expenditure in order to increase short-run aggregate supply.
  - C) increase government expenditure in order to increase aggregate demand.
  - D) decrease government expenditure in order to decrease aggregate demand.

Answer: C

Topic: Fiscal Stimulus

Skill: Conceptual

Question history: Previous edition, Chapter 13

AACSB: Analytical Skills

- 60) If real GDP is less than potential GDP, which of the following fiscal policies would increase real GDP?
- A) only a decrease government expenditure
  - B) only an increase taxes
  - C) increase government expenditure and/or decrease taxes
  - D) decrease government expenditure and/or increase taxes

Answer: C

Topic: Fiscal Stimulus

Skill: Conceptual

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 61) Using the AD-AS model, an increase in government expenditure
- A) has no impact on real GDP.
  - B) has no impact on real GDP, but will increase potential GDP.
  - C) increases both real GDP and the price level.
  - D) has a full multiplier effect on real GDP, leaving the price level unchanged in the long run.

Answer: C

Topic: Fiscal Stimulus

Skill: Conceptual

Question history: Previous edition, Chapter 13

AACSB: Analytical Skills

- 62) Using fiscal policy, to increase real GDP and employment the government could \_\_\_\_\_ government expenditure on goods and services or \_\_\_\_\_ taxes.
- A) increase; increase
  - B) increase; decrease
  - C) decrease; increase
  - D) decrease; decrease

Answer: B

Topic: Fiscal Stimulus

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Analytical Skills

- 63) When real GDP is less than potential GDP, an increase in government expenditures will \_\_\_\_\_ real GDP and \_\_\_\_\_ the price level.
- A) increase; raise
  - B) increase; lower
  - C) decrease; raise
  - D) decrease; lower

Answer: A

Topic: *Fiscal Stimulus*

Skill: *Analytical*

Question history: *Previous edition, Chapter 13*

AACSB: *Analytical Skills*

- 64) Suppose the economy is at a short-run equilibrium with real GDP greater than potential GDP. Which of the following fiscal policies would decrease real GDP and the price level?
- A) an increase in government expenditure
  - B) a decrease in taxes
  - C) an increase in taxes
  - D) None of the above answers is correct.

Answer: C

Topic: *Equilibrium GDP and the Price Level*

Skill: *Analytical*

Question history: *Previous edition, Chapter 13*

AACSB: *Analytical Skills*

- 65) Suppose real GDP exceeds potential real GDP. If the government decreases its expenditures on goods and services, then real GDP \_\_\_\_\_ and the price level \_\_\_\_\_.
- A) decreases; rises
  - B) increases; falls
  - C) decreases; falls
  - D) increases; rises

Answer: C

Topic: *Equilibrium GDP and the Price Level*

Skill: *Analytical*

Question history: *Previous edition, Chapter 13*

AACSB: *Analytical Skills*

- 66) Suppose that the government decreases its expenditures on goods and services. Within the AS-AD model, the result will be \_\_\_\_\_ in real GDP and \_\_\_\_\_ in the price level.
- A) an increase; an increase
  - B) an increase; a decrease
  - C) a decrease; an increase
  - D) a decrease; a decrease

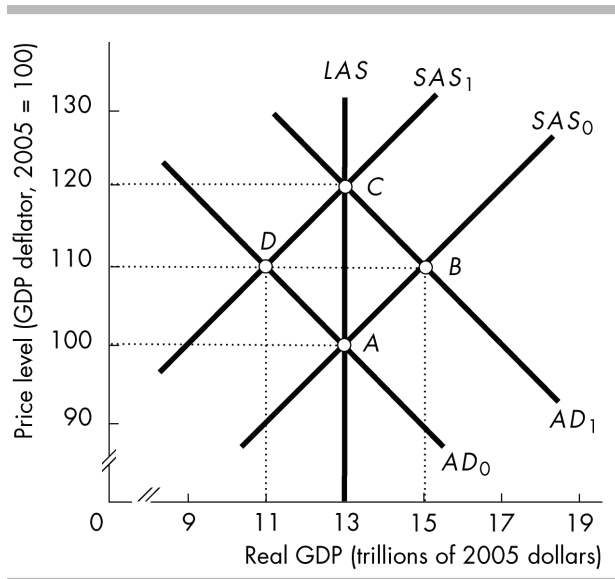
Answer: D

Topic: *Equilibrium GDP and the Price Level*

Skill: *Analytical*

Question history: *Previous edition, Chapter 13*

AACSB: *Analytical Skills*



- 67) In the above figure, if the economy is initially at point *D* and government expenditure increases, the economy will move to point
- A) move to point *C*.
  - B) move to point *A*.
  - C) move to point *B*.
  - D) stay at point *D*.

Answer: A

Topic: Fiscal Stimulus

Skill: Analytical

Question history: Previous edition, Chapter 13

AACSB: Analytical Skills

- 68) In the above figure, if the economy is initially at point *B* and government expenditure decreases, the economy will
- A) move to point *C*.
  - B) move to point *A*.
  - C) move to point *D*.
  - D) stay at point *B*.

Answer: B

Topic: Equilibrium GDP and the Price Level

Skill: Analytical

Question history: Previous edition, Chapter 13

AACSB: Analytical Skills

- 69) In the above figure, if the economy is initially at point *D* and taxes are cut, if potential GDP does not change then the economy will move to point
- A) move to point *C*.
  - B) move to point *A*.
  - C) move to point *B*.
  - D) stay at point *D*.

Answer: A

Topic: *Fiscal Stimulus*

Skill: *Analytical*

Question history: *Previous edition, Chapter 13*

AACSB: *Analytical Skills*

- 70) In the above figure, if the economy is initially at point *B* and taxes are raised, if potential GDP does not change then the economy will move to point
- A) move to point *C*.
  - B) move to point *A*.
  - C) move to point *D*.
  - D) stay at point *B*.

Answer: B

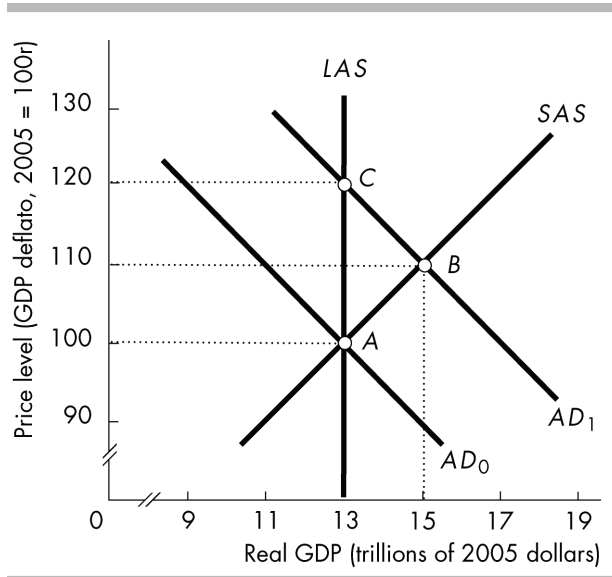
Topic: *Equilibrium GDP and the Price Level*

Skill: *Analytical*

Question history: *Previous edition, Chapter 13*

AACSB: *Analytical Skills*





- 71) In the above figure, if the economy initially is at point *A* and government expenditure increases, in the short run the economy will move to point
- A) *B*.
  - B) *C*.
  - C) *A*, that is, the equilibrium will NOT change.
  - D) None of the above answers is correct.

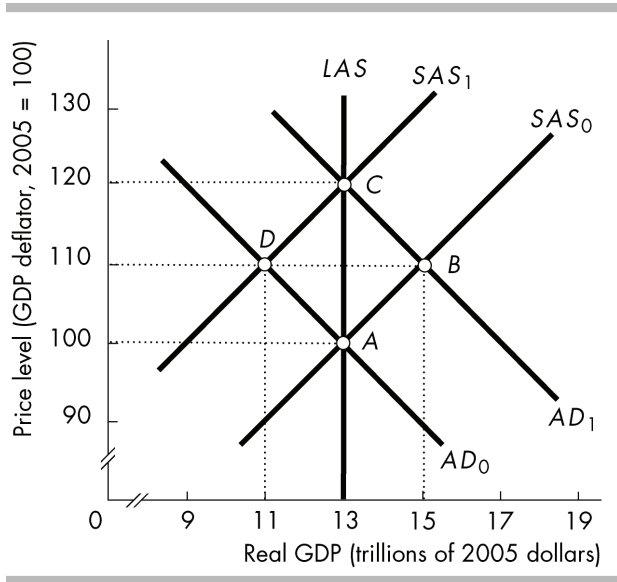
Answer: A

Topic: Fiscal Stimulus

Skill: Analytical

Question history: Previous edition, Chapter 13

AACSB: Analytical Skills



- 72) The figure above illustrates the aggregate demand, short-run aggregate supply, and long-run aggregate supply in Lotus Land. The economy is currently at point *D* and the government increases its expenditure on goods and services. The economy will move to \_\_\_\_\_. The price level will \_\_\_\_\_, and the change in real GDP will be \_\_\_\_\_ the increase in aggregate demand.
- A) point *A*; fall; less than
  - B) point *D*; rise; less than
  - C) point *C*; rise; less than
  - D) point *B*; remain constant; the same as

Answer: C

Topic: Fiscal Stimulus

Skill: Analytical

Question history: Previous edition, Chapter 13

AACSB: Analytical Skills

- 73) The figure above illustrates the aggregate demand, short-run aggregate supply, and long-run aggregate supply in Lotus Land. The economy is currently at point *D* and the government decreases its taxes. The economy will move to \_\_\_\_\_. The price level will \_\_\_\_\_, and the change in real GDP will be \_\_\_\_\_ the increase in aggregate demand.
- A) point *A*; fall; less than
  - B) point *D*; rise; less than
  - C) point *C*; rise; less than
  - D) point *B*; remain constant; the same as

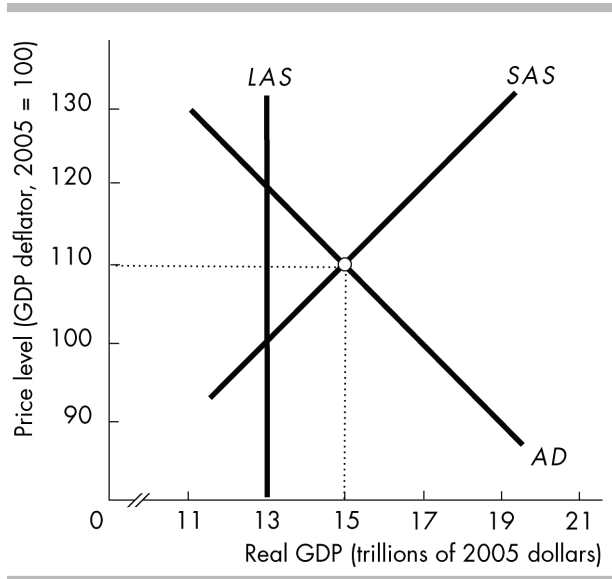
Answer: C

Topic: Fiscal Stimulus

Skill: Analytical

Question history: Previous edition, Chapter 13

AACSB: Analytical Skills



74) In the above figure, which fiscal policy could help move the economy to potential GDP?

- A) decreasing government expenditure
- B) decreasing autonomous taxes
- C) increasing government expenditure
- D) Both answers A and B are correct.

Answer: A

Topic: Equilibrium GDP and the Price Level

Skill: Analytical

Question history: Previous edition, Chapter 13

AACSB: Analytical Skills

75) In the above figure, which of the following policies could move the economy to potential GDP?

- A) decreasing government expenditures and increasing taxes
- B) decreasing taxes and not changing government expenditures
- C) increasing government expenditures and decreasing taxes
- D) None of the above answers is correct.

Answer: A

Topic: Equilibrium GDP and the Price Level

Skill: Analytical

Question history: Previous edition, Chapter 13

AACSB: Analytical Skills

- 76) Suppose that real GDP equals potential GDP, but the government believes that the economy is in a below full-employment equilibrium. As a result, the government increases its expenditure on goods and services. In response to the government's fiscal policy,
- A) aggregate demand will increase.
  - B) an equilibrium with real GDP less than potential GDP will occur.
  - C) potential GDP decreases.
  - D) None of the above answers is correct..

Answer: A

Topic: *Limitations of Fiscal Policy*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

- 77) The use of fiscal policy is limited because
- A) there is never a long enough time lag.
  - B) the economy is almost always at full employment.
  - C) the President may have different goals than Congress.
  - D) time lags associated with fiscal policy may cause the policy to take effect too late to solve the problem it was supposed to address.

Answer: D

Topic: *Limitations of Fiscal Policy*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

- 78) The use of discretionary fiscal policy to end a recession is limited because
- A) the legislative process is slow.
  - B) potential GDP changes too rapidly.
  - C) the real-world multiplier is too small to have an impact on real GDP.
  - D) in the real world, taxes are not induced.

Answer: A

Topic: *Limitations of Fiscal Policy*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

- 79) Which of the following are a limitation of fiscal policy?
- I. There is a lag between recognizing that fiscal policy might be needed and when it actually takes effect.
  - II. Economic forecasts might be incorrect.
  - III. Monetary policy might counter fiscal policy.
- A) I only
  - B) I and II
  - C) I and III
  - D) I, II and III

Answer: B

Topic: *Limitations of Fiscal Policy*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

- 80) Which of the following policies shifts the *AD* curve the farthest leftward?
- A) a rise in taxes of \$10 billion
  - B) a cut in taxes of \$10 billion
  - C) a decrease in government expenditure of \$10 billion
  - D) a decrease in both government expenditure and taxes of \$10 billion

Answer: C

Topic: Study Guide Question, Multipliers

Skill: Conceptual

Question history: Previous edition, Chapter 13

AACSB: Analytical Skills

- 81) If the government's budget is in surplus even when the economy is at full employment, the surplus is said to be
- A) persisting.
  - B) cyclical.
  - C) discretionary.
  - D) structural.

Answer: D

Topic: Study Guide Question, Cyclical and Structural Balances

Skill: Conceptual

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

## 5 News Based Questions

- 1) In 2007, Norway's government had revenue of \$226.3 billion and expenditures of \$158.7 billion. At the same time, GDP totalled \$392 billion and government debt was about 67 percent of GDP. In 2007, Norway's government ran a government budget \_\_\_\_\_ and government debt \_\_\_\_\_.
- A) surplus; decreased
  - B) deficit; decreased
  - C) surplus; increased
  - D) deficit; increased

Answer: A

Topic: Deficits and Debt

Skill: Conceptual

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 2) In 2007, France's government had revenue of \$1.287 trillion while expenditures totalled \$1.356 trillion. GDP was \$2.56 trillion. In 2007, the government budget balance was \_\_\_\_\_ and government debt \_\_\_\_\_.
- A) -\$0.69 billion; increased
  - B) \$1.27 trillion; increased
  - C) \$0.69 billion; decreased
  - D) \$1.02 trillion; decreased

Answer: A

Topic: Deficits and Debt

Skill: Analytical

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 3) In 2007, Denmark's government had expenditures of \$157 billion and spending of \$171 billion. GDP in 2007 was \$312 billion. The government ran a budget \_\_\_\_\_ and government debt \_\_\_\_\_.
- A) deficit; decreased
  - B) deficit; increased
  - C) surplus decreased
  - D) surplus; increased

Answer: B

Topic: *Deficits and Debt*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

- 4) In October 2008, President Bush enacted the Alternative Minimum Tax Relief Act of 2008, which resulted in lower taxes on labor income. According the supply-side view, this would result in
- A) an increase in the tax wedge.
  - B) a leftward shift in the supply of labor curve.
  - C) a movement along the supply of labor curve.
  - D) a rightward shift in the supply of labor curve.

Answer: D

Topic: *Tax Wedge*

Skill: *Analytical*

Question history: *Previous edition, Chapter 13*

AACSB: *Analytical Skills*

- 5) In October 2008, President Bush enacted the Alternative Minimum Tax Relief Act of 2008, which resulted in lower taxes on labor income. According the supply-side view, as a result of this act the incentive to work \_\_\_\_\_ and the tax wedge \_\_\_\_\_.
- A) decreases; increases
  - B) increases; does not change
  - C) increases; decreases
  - D) increases; increases

Answer: C

Topic: *Tax Wedge*

Skill: *Analytical*

Question history: *Previous edition, Chapter 13*

AACSB: *Analytical Skills*

- 6) In 2007, Germany increased the value added tax (VAT) on consumption from 16 percent to 19 percent. The supply-side view, this will \_\_\_\_\_.
- A) increase the tax wedge and lower the incentive to work.
  - B) decrease the tax wedge and lower the incentive to work.
  - C) shift the labor supply curve to the right.
  - D) increase the incentive to work in order to pay the higher tax.

Answer: A

Topic: *Tax Wedge*

Skill: *Analytical*

Question history: *Previous edition, Chapter 13*

AACSB: *Analytical Skills*

- 7) In 2007, Germany increased the value added tax (VAT) on consumption from 16 percent to 19 percent. According to the supply-side view,
- A) the incentive to work increases.
  - B) the supply of labor increases.
  - C) there will be an increase in potential GDP due to the increase tax revenue.
  - D) the after-tax wage rate falls.

Answer: D

Topic: Tax Wedge

Skill: Analytical

Question history: Previous edition, Chapter 13

AACSB: Analytical Skills

- 8) In 2008, Britain decided to cut its value added tax (VAT) to 15 percent from 17.5 percent. The VAT is similar to a sales tax. According to the supply-side view, this change will increase
- i. the after-tax wage
  - ii. the incentive to work
  - iii. the supply of labor
- A) ii only.
  - B) i and ii only.
  - C) i, ii and iii.
  - D) ii and iii only.

Answer: C

Topic: Tax Wedge

Skill: Analytical

Question history: Previous edition, Chapter 13

AACSB: Analytical Skills

- 9) A report on the EU economic stimulus plan suggested that "... Governments must consider ... cutting VAT [value added tax] and labor taxes ..." The VAT is similar to a sales tax. If governments follow the suggestions, there will be \_\_\_\_\_ according to the supply-side view.
- A) an increase in labor supply and a decrease in the tax wedge
  - B) an upward shift in the aggregate production function
  - C) an increase in the labor supply and an increase in the tax wedge
  - D) an increase in saving and an increase in the tax wedge

Answer: A

Topic: Tax Wedge

Skill: Analytical

Question history: Previous edition, Chapter 13

AACSB: Analytical Skills

- 10) In response to the economic crisis in 2008, President Merkel "highlighted in her speech what the German government has already done: a financial sector rescue package worth up to €500 billion, and a proposed stimulus package of tax breaks [on income] and spending measures aimed at triggering investments of up to €50 billion over the next two years."

www.iht.com, 11/26/2008

Which parts of the stimulus plan will increase labor supply?

- A) financial sector rescue package
- B) spending measures targeted at investment
- C) tax breaks
- D) all of the above

Answer: C

Topic: *Fiscal Policy and Aggregate Supply*

Skill: *Analytical*

Question history: *Previous edition, Chapter 13*

AACSB: *Analytical Skills*

- 11) Norway has a lower tax on dividend and interest income than does United Kingdom. We would expect Norway to have a \_\_\_\_\_ tax wedge and a \_\_\_\_\_ growth rate of real GDP.
- A) smaller; slower
  - B) larger; faster
  - C) larger; slower
  - D) smaller; faster

Answer: D

Topic: *Supply-Side Effects of Fiscal Policy*

Skill: *Analytical*

Question history: *Previous edition, Chapter 13*

AACSB: *Analytical Skills*

- 12) Between 2000 and 2005, Finland increased its tax on interest income. As a result, the supply curve for loanable funds shifted \_\_\_\_\_ and the tax wedge \_\_\_\_\_.
- A) leftward; increased
  - B) rightward; increased
  - C) leftward; decreased
  - D) rightward; decreased

Answer: A

Topic: *After-Tax Real Interest Rate*

Skill: *Analytical*

Question history: *Modified 10th edition*

AACSB: *Analytical Skills*



- 13) Between 2000 and 2005, Finland increased its tax on interest income. As a result, the tax wedge \_\_\_\_\_ and the growth rate of real GDP \_\_\_\_\_.
- A) decreased; slowed
  - B) increased; slowed
  - C) decreased; increased
  - D) increased; increased

Answer: B

Topic: Fiscal Policy and Aggregate Supply

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

- 14) "More than 9,000 laid-off Nevada workers will qualify for a second 13-week round of extended unemployment benefits, under federal legislation signed by President Bush. [The] workers exhausted their first 13 weeks of extended benefits and will now be eligible for the new benefits, which pay an average of \$293 a week."

www.mercurynews.com 11/24/2008

Unemployment benefits are considered part of \_\_\_\_\_ fiscal policy. The extension of benefits would \_\_\_\_\_ fiscal policy.

- A) automatic; be discretionary
- B) discretionary; be automatic
- C) automatic; also be considered automatic
- D) discretionary; also be considered discretionary

Answer: A

Topic: Discretionary Fiscal Policy

Skill: Conceptual

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 15) In response to the economic downturn, New Zealand's government had enacted a \$3.8 stimulus package.

www.iht.com, 11/26/2008

The stimulus plan is considered

- A) automatic fiscal policy.
- B) contractionary fiscal policy.
- C) discretionary fiscal policy.
- D) needs-tested spending.

Answer: C

Topic: Discretionary Fiscal Policy

Skill: Conceptual

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

16) "European Economic Recovery Plan"

"The European Commission urged EU governments to jointly combat the economic slowdown with 200 billion euros (\$256 billion) in spending and tax cuts to boost growth and consumer and business confidence." The plan "...would see the 27 EU governments spend 1.5 percent of the bloc's gross domestic product to halt the slowdown that has already pushed some European nations into recession."

www.iht.com, 11/26/2008

Which of the following describe the EU's plan?

- i. It is discretionary fiscal policy
  - ii. It will generate a cyclical surplus.
- A) i and ii.
  - B) ii only.
  - C) i only.
  - D) neither i nor ii.

Answer: C

*Topic: Cyclical and Structural Deficits*

*Skill: Conceptual*

*Question history: Modified 10th edition*

*AACSB: Reflective Thinking*

17) In response to the 2008 recession, New Zealand's Finance Minister Bill English stated that "... the 7 billion New Zealand dollars would be allocated to new infrastructure spending, providing financial aid to workers hit by layoffs as the economy slows and includes tax cuts planned for April."

www.iht.com, 11/26/2008

New Zealand's government expects the policies to shift the \_\_\_\_\_ but at this point in time the \_\_\_\_\_ might weaken its ability to affect real GDP.

- A) AD curve rightward; recognition lag
- B) LAS curve leftward; impact lag.
- C) SAS curve rightward; law-making lag
- D) AD curve rightward; impact lag

Answer: D

*Topic: Stabilizing the Business Cycle*

*Skill: Analytical*

*Question history: Previous edition, Chapter 13*

*AACSB: Analytical Skills*

## 18) "European Economic Recovery Plan"

"The European Commission urged EU governments to jointly combat the economic slowdown with 200 billion euros (\$256 billion) in spending and tax cuts to boost growth and consumer and business confidence." The plan "...would see the 27 EU governments spend 1.5 percent of the bloc's gross domestic product to halt the slowdown that has already pushed some European nations into recession."

www.iht.com, 11/26/2008

The plan is expected to

- A) shift the *AD* curve rightward and increase real GDP.
- B) shift the *AD* curve leftward and decrease the recessionary gap.
- C) decrease the recessionary gap and decrease the price level.
- D) use the autonomous tax multiplier to eliminate the inflationary gap.

Answer: A

Topic: *Equilibrium GDP and the Price Level*

Skill: *Analytical*

Question history: *Previous edition, Chapter 13*

AACSB: *Analytical Skills*

## 19) "Obama Considers Delaying Tax Increase"

"U.S. President-elect Barack Obama is considering delaying his proposal to repeal the Bush tax cuts for the wealthiest Americans in light of the economic downturn."

www.nytimes.com 11/23/2008

Obama's possible decision to delay the tax increase recognizes the fact that a tax increase will \_\_\_\_\_ disposable income and \_\_\_\_\_ real GDP.

- A) decrease; increase
- B) decrease; decrease
- C) increase; increase
- D) increase; decrease

Answer: B

Topic: *Stabilizing the Business Cycle*

Skill: *Analytical*

Question history: *Modified 10th edition*

AACSB: *Analytical Skills*

- 20) In January 2008, the unemployment rate was only 4.9 percent and real GDP was growing. But President Bush "acknowledged that Americans were 'anxious about the economy.' As a result, it was reported that "...the Bush administration and Congressional leaders, increasingly concerned about a possible recession, are moving closer to agreeing that an economic stimulus package is needed soon." In order for the package to be approved, the leaders in Washington implied that "... they might be able to put aside longstanding partisan differences ."

www.nytimes.com 1/12/2008

Which of the following lags are government officials trying to avoid?

- A) the recognition lag
- B) the impact lag
- C) the law-making lag
- D) all of the above

Answer: D

Topic: *Limitations of Fiscal Policy*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 13*

AACSB: *Communication*

## 6 Essay Questions

- 1) What is fiscal policy and what are its purposes?

Answer: Fiscal policy is the use of the federal budget (for instance, government expenditure or government taxes) to achieve macroeconomic objectives such as full employment or low inflation.

Topic: *Fiscal Policy*

Skill: *Recognition*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

- 2) What does the Employment Act of 1946 specify? Why is it an important economic milestone?

Answer: The Employment Act of 1946 said that the Federal Government would use all practicable means to promote maximum employment, production, and purchasing power. It also established the President's Council of Economic Advisors. The Employment Act of 1946 is an important economic milestone because it explicitly recognizes that the Federal government has a role to play in attempting to stabilize the business cycle.

Topic: *The Employment Act of 1946*

Skill: *Recognition*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

- 3) According to tax receipt and outlay categories, what are the main components of the federal government budget?

Answer: The budget is divided between the tax receipt side and the outlay side. On the taxation side, the largest components are personal income taxes and social security taxes. Between them they account for over 80 percent of total government tax receipts. The remainder of tax revenue comes from corporate income taxes and indirect taxes, such as taxes on items such as gasoline. On the outlay side, the major three categories are transfer payments, the expenditure on goods and service, and interest payments on the government debt. The first category is the largest and continues to grow, accounting for well over half of all payments. These include payments to individuals, businesses, other levels of government, and governments around the world. These payments come in the form of Social Security benefits, unemployment payments, and subsidies, grants and loans to farmers, local and state governments and foreign governments. The last category, debt interest, is the smallest and even fell during the late 2000s because the interest rate was low.

*Topic: The Federal Budget*

*Skill: Conceptual*

*Question history: Modified 10th edition*

*AACSB: Reflective Thinking*

- 4) Depending on the relative size of the federal government's outlays and tax receipts, the federal government's budget can be in three possible conditions. What are the three possible conditions and what is the relationship of federal government outlays and tax receipts for each?

Answer: The federal government's budget could have a budget surplus, a budget deficit, or a balanced budget. A budget surplus occurs when tax receipts are greater than government outlays; a deficit occurs when tax receipts are less than government outlays; and a balanced budget occurs when tax receipts are equal to government outlays.

*Topic: Budget Surplus and Deficit*

*Skill: Recognition*

*Question history: Previous edition, Chapter 13*

*AACSB: Reflective Thinking*

- 5) What is the difference between budget surplus, budget deficit and a balanced budget? Which of these three budget outcomes is currently the case in the United States?

Answer: A budget surplus occurs if tax revenues exceed outlays; a budget deficit occurs if tax revenues are less than outlays; and a balanced budget occurs if tax revenues equal outlays. Currently the United States is running a budget deficit.

*Topic: Budget Surplus and Deficit*

*Skill: Recognition*

*Question history: Previous edition, Chapter 13*

*AACSB: Reflective Thinking*

- 6) "The federal budget is required by law to balance." Is the previous statement correct or incorrect?

Answer: The statement is incorrect because the federal budget is not legally required to balance. It is legal for the government to run a budget surplus or a budget deficit.

*Topic: The Federal Budget*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 13*

*AACSB: Reflective Thinking*

- 7) How has the federal government debt as a percentage of GDP changed since the end of World War II?

**Answer:** As a percentage of GDP, the federal government debt hit its high at the end of World War II when it was about 120 percent of GDP. The percentage then fell steadily into the 1970s. The large deficits of the 1980s raised the percentage during the 1980s and into the 1990s. From 1995 to 2001, the percentage fell but since then has risen, rapidly in the last few years.

*Topic: Federal Government Debt*

*Skill: Conceptual*

*Question history: Modified 10th edition*

*AACSB: Reflective Thinking*

- 8) How does a tax on labor income affect potential GDP?

**Answer:** The income tax reduces the incentive to work by driving a wedge between gross and net income. The tax shifts the supply of labor curve leftward and decreases the supply of labor as workers decide to work fewer hours. The decrease in the supply of labor decreases the equilibrium level of employment, which decreases potential GDP.

*Topic: Tax on Labor Income*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 13*

*AACSB: Reflective Thinking*

- 9) What is the Laffer curve? Where on their Laffer curves are the United States, the United Kingdom and France located?

**Answer:** The Laffer curve is graphed with tax revenue on the  $y$ -axis and tax rates on the  $x$ -axis. The Laffer curve captures the concept that raising the tax rate eventually leads to lower tax revenues being collected. At low tax rates, an increase in the tax rate raises the total tax revenue collected. But if government raises the tax rate high enough, an increase in the tax rate leads to lower total tax revenue collected. This effect takes place because when the tax rate is high enough, the disincentive effect of the tax becomes so large that enough people give up working and saving so that the total tax revenue declines. While most economists believe the United States is on the upward sloping part of its Laffer curve, so that an increase in the tax rate raises total tax revenue. The United Kingdom is believed to be also on the upward sloping part of its Laffer curve. But France might be at the peak of its curve or even on the downward sloping part, where an increase in the tax rate lowers total tax revenue.

*Topic: Laffer Curve*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 13*

*AACSB: Communication*

- 10) If the government raises taxes on labor income and interest income, explain how potential GDP and economic growth are affected.

**Answer:** Tax increases on labor income decrease the supply of labor and so decrease equilibrium employment, which decreases potential GDP. Tax increases on the income from capital decrease saving and so decrease the supply of capital, which decreases equilibrium investment and capital and so decreases economic growth.

*Topic: Supply Side Effects*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 13*

*AACSB: Reflective Thinking*

11) What is the difference between discretionary fiscal policy and automatic fiscal policy?

Answer: Discretionary fiscal policy is a policy action initiated by an act of Congress. Automatic fiscal policy are mechanisms that help stabilize GDP and operate without the need for explicit action. Both taxes (such as income taxes, whose receipts rise when the economy expands and fall when the economy contracts) and needs-tested spending (such as welfare spending, which decreases when the economy expands and increases when the economy contracts) are examples of automatic fiscal policy.

*Topic: Discretionary Fiscal Policy*

*Skill: Conceptual*

*Question history: Modified 10th edition*

*AACSB: Reflective Thinking*

12) What is automatic fiscal policy? How does it affect the budget deficit and/or budget surplus during a recession and during an expansion?

Answer: Automatic fiscal policy are features of fiscal policy that stabilize real GDP without the need for explicit policy action by the government. Automatic fiscal policy includes automatic changes in taxes and needs-tested spending. The government often sets tax rates rather than a total dollar amount of taxes. During a recession, taxes receipts automatically decrease and needs-tested spending increases, so the budget deficit increases (or the budget surplus decreases). During an expansion, tax receipts automatically increase and means-tested spending decreases, so the budget deficit decreases (or the budget surplus increases).

*Topic: Automatic Fiscal Policy*

*Skill: Recognition*

*Question history: Modified 10th edition*

*AACSB: Reflective Thinking*

13) What is the government expenditure multiplier?

Answer: The government expenditure multiplier is the magnification effect of a change in government expenditure on aggregate demand. It exists because an increase in government expenditure increases aggregate and thereby increases real GDP. In turn the increase in real GDP induces increases in consumption expenditure which future increase aggregate expenditure and real GDP. So the ultimate increase in aggregate demand exceeds the initiating increase in government expenditure.

*Topic: Government Expenditure Multiplier*

*Skill: Recognition*

*Question history: Previous edition, Chapter 13*

*AACSB: Reflective Thinking*

14) What is needs-tested spending and how does it affect the government expenditure multiplier?

Answer: Needs-tested spending is government spending that changes when GDP changes. Unemployment compensation payments is an example: They decrease when the economy expands and increase when the economy contracts. Needs-tested spending decreases the magnitude of the government expenditure multiplier. For instance, when government expenditure increases, people's disposable income increases but needs-tested spending thereby decreases. The decrease in needs-tested spending offsets some of the initial increase in disposable income, thereby decreasing the multiplier.

*Topic: Government Expenditure Multiplier*

*Skill: Analytical*

*Question history: Modified 10th edition*

*AACSB: Reflective Thinking*

- 15) Ignoring any supply-side effects, how does the magnitude of the government expenditure multiplier compare to the magnitude of the tax multiplier? Explain your answer.

Answer: The magnitude of the government expenditure multiplier is larger than the magnitude of the tax multiplier. The government expenditure multiplier is larger because a \$1 change in government expenditure has an initial effect on aggregate demand of \$1. In other words, a \$1 increase in government expenditure initially increases aggregate demand by the entire \$1. However, a \$1 change in taxes does *not* initially affect aggregate demand by the entire \$1. Instead, it affects aggregate demand by less than \$1. For instance, a \$1 decrease in taxes increases aggregate demand by less than \$1. Why? Because part of the \$1 decrease in taxes is saved and the amount saved does not increase aggregate demand.

*Topic: Fiscal Policy Multipliers*

*Skill: Recognition*

*Question history: Modified 10th edition*

*AACSB: Analytical Skills*

- 16) What is the effect on aggregate demand and the *AD* curve from either an increase in government expenditure or a cut in taxes?

Answer: Both an increase in government expenditure and a cut in taxes increase aggregate demand and shift the *AD* curve rightward.

*Topic: Fiscal Stimulus*

*Skill: Recognition*

*Question history: Previous edition, Chapter 13*

*AACSB: Reflective Thinking*

- 17) If employment is less than full employment, what fiscal policy should the government pursue?

Answer: To restore full employment, the government should increase its expenditure on goods or services or decrease its taxes.

*Topic: Fiscal Stimulus*

*Skill: Recognition*

*Question history: Previous edition, Chapter 13*

*AACSB: Reflective Thinking*

- 18) How can discretionary fiscal policy be used to close a recessionary gap?

Answer: If real GDP is less than potential GDP, then the economy is experiencing a recessionary gap. To close this gap the government could use discretionary fiscal policy. In this case, the proper fiscal policy is either an increase in government expenditure or a cut in taxes.

*Topic: Fiscal Stimulus*

*Skill: Conceptual*

*Question history: Modified 10th edition*

*AACSB: Reflective Thinking*

- 19) If employment exceeds full employment, what fiscal policy actions could eliminate the gap?

Answer: To restore the economy to full employment, the government could decrease its expenditure on goods and services, increase its taxes, or do both. Both a decrease in government expenditure and an increase in taxes decrease aggregate demand and move the economy back toward full employment.

*Topic: Contractionary Fiscal Policy*

*Skill: Analytical*

*Question history: Modified 10th edition*

*AACSB: Reflective Thinking*



20) What are some of the limitations of fiscal policy? Briefly discuss them.

Answer: One limitation of fiscal policy is the fact that implementing fiscal policy is slow and so it is difficult to have the proper policy in place. Another limitation is that at times it is difficult to determine if GDP is less than, equal to, or greater than potential GDP. As a result, it is difficult to determine if fiscal policy should be expansionary or contractionary.

Topic: *Limitations of Fiscal Policy*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

## 7 Numeric and Graphing Questions

1) A country reports that its government outlays total \$1.8 trillion and its receipts total \$1.6 trillion. Does the country have a budget surplus or deficit and what is the surplus or deficit?

Answer: The country has a budget deficit. The deficit equals \$0.2 trillion.

Topic: *Budget Surplus and Deficit*

Skill: *Analytical*

Question history: *Previous edition, Chapter 13*

AACSB: *Analytical Skills*

Year	Government outlays (trillions of 2005 dollars)	Tax receipts (trillions of 2005 dollars)
2007	0.75	0.80
2008	0.80	0.83
2009	0.87	0.86
2010	0.95	0.95
2011	1.06	1.02

2) The above table gives a country's government outlays and tax receipts for 2007 through 2011. During which years did the country have a balanced budget, budget surplus, and budget deficit?

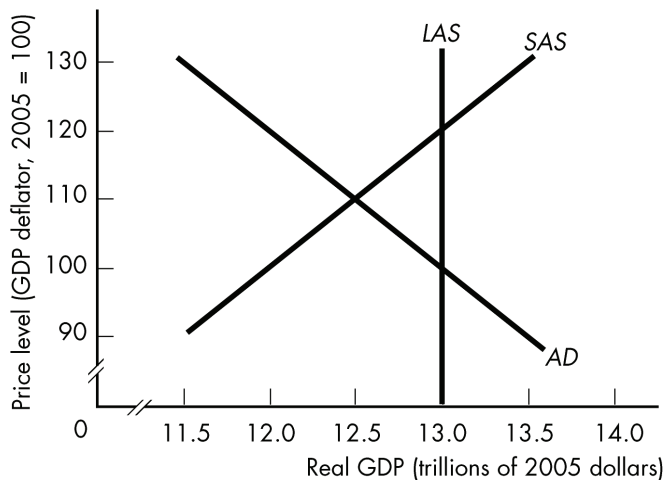
Answer: The country had a balanced budget in 2010 because in that year government outlays equaled tax receipts. The country had a budget surplus in 2007 and 2008 because in those years tax receipts exceeded government outlays. The country had a budget deficit in 2009 and 2011 because in those years government outlays exceeded tax receipts.

Topic: *Budget Surplus and Deficit*

Skill: *Analytical*

Question history: *Modified 10th edition*

AACSB: *Analytical Skills*



- 3) Does the figure above illustrate a recessionary or an inflationary gap? What do potential GDP and real GDP equal? What is an appropriate fiscal policy to restore real GDP to potential real GDP?

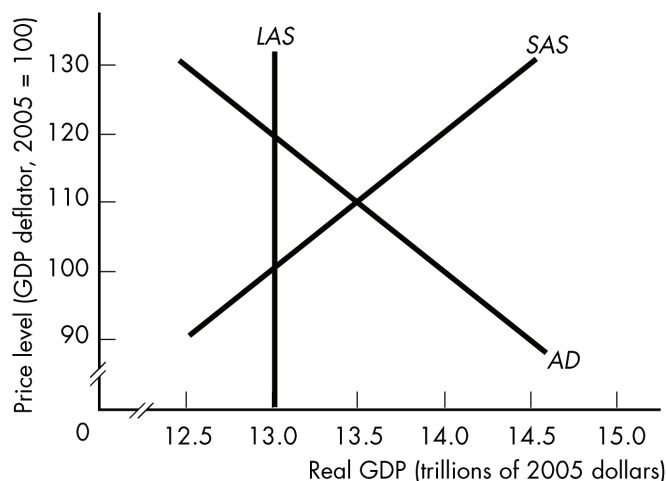
**Answer:** A recessionary gap occurs when real GDP is less than potential GDP, which is precisely what the figure illustrates. In the figure, potential GDP equals \$13 trillion but real GDP equals only \$12.5 trillion. In order to restore real GDP back to potential GDP using fiscal policy, the government could increase government expenditure on goods and services and/or decrease taxes.

*Topic: Fiscal Stimulus*

*Skill: Analytical*

*Question history: Previous edition, Chapter 13*

*AACSB: Analytical Skills*



- 4) Does the figure above illustrate a recessionary or an inflationary gap? What do potential GDP and real GDP equal? What is an appropriate fiscal policy to restore real GDP to potential real GDP?

Answer: An inflationary gap occurs when real GDP is less than potential GDP, which is precisely what the figure illustrates. In the figure, potential GDP equals \$13 trillion but real GDP equals \$13.5 trillion. In order to restore real GDP back to potential GDP using fiscal policy, the government could decrease government expenditure on goods and services and/or increase taxes.

Topic: Fiscal Policy and Aggregate Demand

Skill: Analytical

Question history: Previous edition, Chapter 13

AACSB: Analytical Skills

## 8 True or False

- 1) Each president can decide when to submit a budget to Congress.

Answer: FALSE

Topic: The Federal Budget

Skill: Recognition

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 2) Government expenditure on goods and services is the largest component of total federal government expenditures.

Answer: FALSE

Topic: The Federal Budget

Skill: Recognition

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

3) Corporate income taxes are the largest source of revenue for the federal government.

Answer: FALSE

Topic: Tax Revenues

Skill: Recognition

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

4) Personal income taxes are the largest source of revenue for the federal government.

Answer: TRUE

Topic: Tax Revenues

Skill: Recognition

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

5) Federal government expenditures as a percentage of GDP are currently equal to approximately 10 percent.

Answer: FALSE

Topic: Government Expenditures

Skill: Recognition

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

6) If tax receipts are greater than government outlays the government has a budget surplus.

Answer: TRUE

Topic: Financing Investment

Skill: Recognition

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

7) If tax receipts exactly equaled government outlays in a year, the federal government debt would be zero.

Answer: FALSE

Topic: Budget Surplus and Deficit

Skill: Conceptual

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

8) If tax receipts exactly equaled government outlays in a year, the budget deficit would be zero.

Answer: TRUE

Topic: Budget Surplus and Deficit

Skill: Conceptual

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

9) The main goal of fiscal policy is to produce a balanced budget.

Answer: FALSE

Topic: Fiscal Policy

Skill: Conceptual

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 10) All developed countries have about the same ratio of the government deficit to GDP.  
Answer: FALSE  
Topic: *The Budget Deficit in Global Perspective*  
Skill: *Recognition*  
Question history: *Modified 10th edition*  
AACSB: *Reflective Thinking*
- 11) An increase in taxes on labor income decreases potential GDP.  
Answer: TRUE  
Topic: *Supply Side Effects*  
Skill: *Conceptual*  
Question history: *Previous edition, Chapter 13*  
AACSB: *Reflective Thinking*
- 12) An increase in taxes on labor income shifts the labor supply curve leftward and the after-tax wage rate falls.  
Answer: TRUE  
Topic: *Supply Side Effects*  
Skill: *Conceptual*  
Question history: *Previous edition, Chapter 13*  
AACSB: *Reflective Thinking*
- 13) A tax cut decreases government saving and can thereby crowd out investment.  
Answer: TRUE  
Topic: *Fiscal Policy and Crowding Out*  
Skill: *Conceptual*  
Question history: *Previous edition, Chapter 13*  
AACSB: *Reflective Thinking*
- 14) The Ricardo-Barro effect implies that a budget deficit will not raise interest rates or reduce investment.  
Answer: TRUE  
Topic: *Ricardo-Barro Effect*  
Skill: *Conceptual*  
Question history: *Previous edition, Chapter 13*  
AACSB: *Reflective Thinking*
- 15) Deliberate changes in government expenditures and taxes to influence GDP are discretionary fiscal policy.  
Answer: TRUE  
Topic: *Discretionary Fiscal Policy*  
Skill: *Recognition*  
Question history: *Previous edition, Chapter 13*  
AACSB: *Reflective Thinking*
- 16) Discretionary policy requires an act of Congress.  
Answer: TRUE  
Topic: *Discretionary Fiscal Policy*  
Skill: *Recognition*  
Question history: *Previous edition, Chapter 13*  
AACSB: *Reflective Thinking*

17) The structural surplus measures whether a budget surplus is cyclical or structural.

Answer: TRUE

Topic: *Cyclical and Structural Balances*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

18) By its very definition, every budget deficit is structural in nature.

Answer: FALSE

Topic: *Cyclical and Structural Balances*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

19) A fiscal stimulus is used to increase production and employment.

Answer: TRUE

Topic: *Fiscal Policy*

Skill: *Recognition*

Question history: *New 10th edition*

AACSB: *Reflective Thinking*

20) An increase in government expenditure leads to rightward shift of the *AD* curve.

Answer: TRUE

Topic: *Fiscal Policy and Aggregate Demand*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

21) The aggregate demand curve is shifted rightward by an increase in tax rates.

Answer: FALSE

Topic: *Expansionary Fiscal Policy*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

22) The aggregate demand curve is shifted rightward by an increase in government expenditure.

Answer: TRUE

Topic: *Expansionary Fiscal Policy*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 13*

AACSB: *Reflective Thinking*

23) Automatic fiscal policy is not subject to all the same time lags to which discretionary fiscal policy is subject.

Answer: TRUE

Topic: *Limitations of Fiscal Policy*

Skill: *Analytical*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

## 9 Extended Problems

Labor (millions of hours per year)	Real GDP (millions of 2005 dollars)
200	6,800
240	7,680
280	8,400
320	8,960
360	9,360

1) The table above shows the aggregate production function in the economy of Prescottia. The people of Prescottia pay no taxes and are willing to work 248 million hours a year for a real wage rate of \$8 an hour, and for each dollar increase in the real wage, they are willing to work 4 million additional hours per year.

a) Draw the economy's aggregate production function.

Wage rate (dollars per hour)	Quantity of labor demanded (millions of hours per year)
24	200
20	240
16	280
12	320

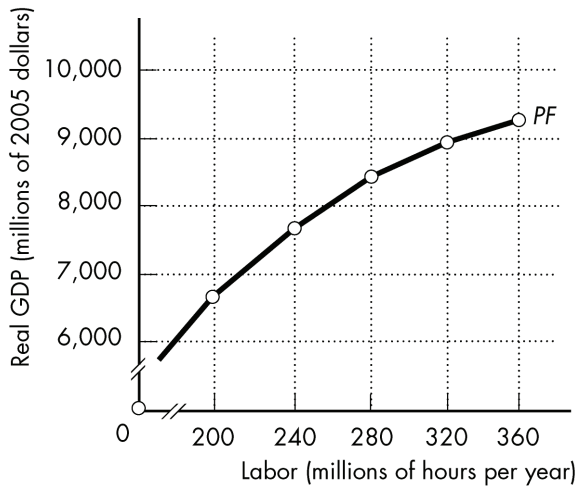
b) Prescottia's demand for labor schedule is in the table above. Draw Prescottia's demand for labor and supply of labor curves.

c) What are the economy's full-employment quantity of labor and real wage rate? What is the country's potential GDP?

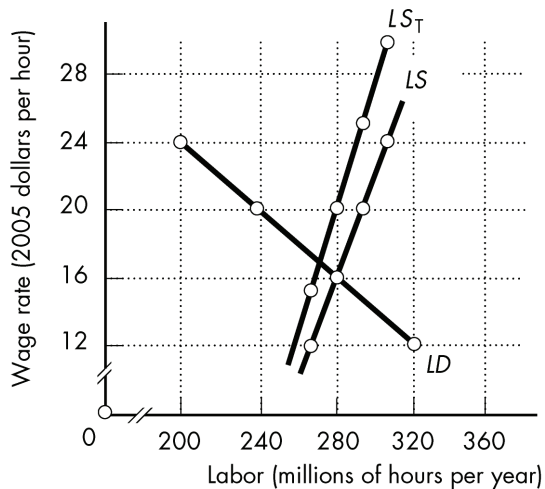
d) Suppose that Prescottia's government introduces a 25 percent income tax. Using your graph, what happens to the demand for labor? What happens to the supply of labor? Explain.

e) After the tax is imposed, what happens to Prescottia's full-employment quantity of labor? What happens to Prescottia's potential GDP?

Answer:



a) See the figure above.



b) See the figure above. Prescottia's demand for labor curve is *LD* and the supply of labor curve is *LS*.

c) As shown in the second figure, the labor market is in equilibrium when the quantity of labor employed is 280 million hours and the real wage rate is \$16 per hour. So the economy's full-employment quantity of labor is 280 million hours at a real wage rate of \$16 per hour. Potential GDP is the level of real GDP at full employment. The production function in the first figure shows that if 280 million hours of labor are employed, the country's real GDP is \$8,400 million. So the economy's potential GDP is \$8.4 billion.

d) The income tax has no effect on the demand for labor because the quantity of labor that firms plan to hire depends only on how productive labor is and what it costs—its real wage. But the tax weakens the incentive to work and decreases the supply of labor. When



the income tax is imposed, workers look at the after-tax wage rate and, to supply the same quantity of labor as with no tax, they demand a before-tax wage rate that is 25 percent higher than before. So the supply of labor decreases and the supply of labor curve shifts from  $LS$  to  $LS_T$ .

e) As shown in the second figure illustrating the labor market, with the tax Prescottia's full-employment quantity of labor decreases from 280 to 270 million hours per year. And the production function shown in the first figure illustrates that as the full-employment quantity of labor decreases from 280 to 270 million hours per year, the economy's potential GDP falls from \$8,400 million to (approximately) \$8,235 million.

*Topic: Supply Side Effects of an Income Tax*

*Skill: Analytical*

*Question history: Previous edition, Chapter 13*

*AACSB: Analytical Skills*

# Chapter 14

## Monetary Policy

### 1 Monetary Policy Objectives and Framework

- 1) Which of the following is one of the Fed's policy goals?
- A) help the President win reelection
  - B) exchange rate
  - C) monetary base
  - D) price level stability

Answer: D

Topic: Policy Goals

Skill: Recognition

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 2) The Fed's goals include
- A) open market operations.
  - B) price level stability.
  - C) the monetary base.
  - D) the federal funds rate.

Answer: B

Topic: Policy Goals

Skill: Recognition

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 3) Federal Reserve monetary policy goals include
- A) ensuring banks can meet their profit maximization objectives.
  - B) discount rate stability
  - C) zero percent unemployment in the domestic economy.
  - D) price level stability

Answer: D

Topic: Policy Goals

Skill: Recognition

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 4) The Federal Reserve monetary policy goals of maximum employment means
- A) a zero percent unemployment rate.
  - B) a zero percent natural unemployment rate.
  - C) keeping the unemployment rate close to the natural unemployment rate.
  - D) cyclical unemployment should not necessarily be minimized.

Answer: C

Topic: Policy Goals

Skill: Recognition

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 5) Which of the following are NOT Federal Reserve monetary policy goals?
- A) moderate long-term interest rates
  - B) price level stability
  - C) maximum employment
  - D) zero percent unemployment.

Answer: D

Topic: Policy Goals

Skill: Recognition

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 6) The key goal of monetary policy is to
- A) reverse the productivity growth slowdown
  - B) keep the budget deficit small and/or the budget surplus large.
  - C) lower taxes
  - D) maintain low inflation

Answer: D

Topic: Policy Goals

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 7) The key aim of monetary policy is to
- A) change government spending to spur innovation.
  - B) maintain price stability
  - C) change tax rates to boost investment.
  - D) change tax rates to boost saving.

Answer: B

Topic: Policy Goals

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 8) Which of the following is the most important Federal Reserve monetary policy goal?
- A) moderate long-term interest rates
  - B) minimum unemployment.
  - C) maximum employment
  - D) price level stability

Answer: D

Topic: Policy Goals

Skill: Recognition

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 9) In the short run, the Federal Reserve faces a tradeoff between
- A) economic growth and employment.
  - B) inflation and price stability.
  - C) inflation and unemployment.
  - D) real GDP growth and potential GDP growth.

Answer: C

Topic: Policy Goals

Skill: Recognition

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 10) In the short run, the Federal Reserve faces a tradeoff between
- A) economic growth and employment.
  - B) inflation and price stability.
  - C) inflation and real GDP.
  - D) interest rates and unemployment.

Answer: C

Topic: Policy Goals

Skill: Recognition

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 11) The core inflation rate, measured by the core PCE deflator, measures changes in the
- A) price of only two consumer goods: food and fuel
  - B) prices of all consumer goods
  - C) prices of consumer goods except food and fuel.
  - D) prices of consumer goods except health care.

Answer: C

Topic: Price Stability

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 12) To determine whether the goal of stable prices is being achieved, the Federal Reserve monitors the \_\_\_\_\_ but uses as its operational guide the \_\_\_\_\_.
- A) core CPI; core inflation rate
  - B) core inflation rate; CPI inflation rate
  - C) CPI; core inflation rate
  - D) GDP price deflator; CPI

Answer: C

Topic: Price Stability

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

13) Ben Bernanke has been more precise than his predecessor, suggesting a core inflation rate of \_\_\_\_\_ per year is the same as price stability.

- A) 0 to 1 percent
- B) 0 to 2 percent
- C) 1 to 2 percent
- D) 1 to 4 percent

Answer: C

Topic: Price Stability

Skill: Recognition

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

14) Federal Reserve Chairman Ben Bernanke has defined price stability as occurring when core inflation is

- A) exactly 0 percent.
- B) less than 10 percent.
- C) between 1 and 2 percent.
- D) used in wage-setting contracts.

Answer: C

Topic: Price Stability

Skill: Recognition

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

15) Ben Bernanke has suggested that a core inflation rate of \_\_\_\_\_ is the equivalent of price stability.

- A) between 1 percent to 2 percent
- B) zero
- C) less than 5 percent.
- D) less than zero

Answer: A

Topic: Price Stability

Skill: Recognition

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

16) The output gap is the

- A) percentage deviation of real GDP from potential GDP.
- B) difference between actual inflation and core inflation.
- C) difference in graduation levels between high school and college.
- D) percentage increase in the economic growth rate of real GDP.

Answer: A

Topic: Output Gap

Skill: Recognition

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 17) When the output gap is positive, it represents \_\_\_\_\_ gap, and when it is negative, it represents \_\_\_\_\_ gap.
- A) a recessionary; an inflationary
  - B) an inflationary; an employment
  - C) an inflationary; a recessionary
  - D) an employment; an unemployment

Answer: C

Topic: Output Gap

Skill: Conceptual

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 18) The output gap can be used to estimate the extent to which the Fed misses its goal of
- A) maximum employment.
  - B) stable prices.
  - C) moderate long-term interest rates.
  - D) monetary policy.

Answer: A

Topic: Output Gap

Skill: Conceptual

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 19) Which of the following bodies are responsible for the conduct of monetary policy?
- A) the Federal Reserve System
  - B) Congress
  - C) the President
  - D) Congress and the President, jointly

Answer: A

Topic: The Federal Reserve System

Skill: Recognition

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 20) Monetary policy is controlled by
- A) Congress.
  - B) the president.
  - C) the Federal Reserve.
  - D) the Treasury Department.

Answer: C

Topic: The Federal Reserve System

Skill: Recognition

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

21) The current chairman of the Federal Reserve is

- A) Ben Bernanke.
- B) Alan Greenspan.
- C) Paul Volcker.
- D) Milton Friedman.

Answer: A

Topic: *The Federal Reserve System*

Skill: *Recognition*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

22) The Federal Open Market Committee meets \_\_\_\_\_ times per year.

- A) 8
- B) 2
- C) 26
- D) 52

Answer: A

Topic: *The Federal Reserve System*

Skill: *Recognition*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

23) Read the following statements and determine if they are true or false.

- I. The Federal Reserve's monetary policy must be approved by the President of the United States .
  - II. The Federal Reserve Board of Governors meets approximately every six months to review the state of the economy and determine monetary policy.
- A) I and II are both true.
  - B) I and II are both false.
  - C) I is true and II is false.
  - D) I is false and II is true.

Answer: B

Topic: *The Federal Reserve System*

Skill: *Conceptual*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

24) Price level stability

- A) has no relationship to growth in potential GDP.
- B) is thought by most economists to be reached with a measured inflation rate of between 0 and 2 percent a year.
- C) is the most important tool of the Federal Reserve.
- D) was attained by the Fed for the period between 1979 and 2001.

Answer: B

Topic: *Study Guide Question, Price Stability*

Skill: *Recognition*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

## 2 The Conduct of Monetary Policy

- 1) Which of the following are policy instruments available to the Fed as it tries to achieve its macroeconomic goals?
- I. government expenditures on goods and services and taxes
  - II. the government budget deficit or surplus
  - III. changes in the federal funds rate
- A) I and II
  - B) III only
  - C) II and III
  - D) II only

Answer: B

Topic: Policy Instruments

Skill: Recognition

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 2) Which of the following is a potential monetary policy instrument for the Fed?
- A) federal funds rate
  - B) government budget deficit
  - C) income tax rates
  - D) profit rates

Answer: A

Topic: Policy Instruments

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 3) The monetary policy instrument the Federal Reserve choose to use is the
- A) quantity of money.
  - B) exchange rate.
  - C) federal funds rate.
  - D) required reserves rate.

Answer: C

Topic: Policy Instruments

Skill: Recognition

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 4) The federal funds rate is the interest rate
- A) banks charge each other on overnight loans.
  - B) on the 3-month Treasury bill.
  - C) on the 30-year treasury bond.
  - D) also known as the prime rate.

Answer: A

Topic: Policy Instruments

Skill: Recognition

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking



- 5) Currently the Fed targets
- A) both the monetary base and the federal funds rate simultaneously.
  - B) the exchange rate.
  - C) the federal funds rate.
  - D) the price level.

Answer: C

Topic: Policy Instruments

Skill: Recognition

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 6) Usually, the Federal Reserve changes its target for the federal funds rate in units of
- A) 1/4 of 1 percentage point.
  - B) 1 percentage point.
  - C) 2 percentage points.
  - D) 5 percentage points.

Answer: A

Topic: Policy Instruments

Skill: Recognition

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 7) Federal Reserve open market operations directly influence
- A) firms.
  - B) consumers.
  - C) banks.
  - D) Congress.

Answer: C

Topic: Policy Instruments

Skill: Recognition

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 8) The higher the federal funds rate, the \_\_\_\_\_ the opportunity cost of holding reserves, which \_\_\_\_\_ the incentive to economize on reserves.
- A) higher; increases
  - B) higher; decreases
  - C) lower; increases
  - D) lower; decreases

Answer: A

Topic: The Market for Reserves

Skill: Recognition

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 9) Equilibrium in the market for bank reserves determines the
- A) federal funds rate.
  - B) inflation rate.
  - C) 30-year Treasury bond rate.
  - D) exchange rate.

Answer: A

Topic: *The Market for Reserves*

Skill: *Recognition*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 10) If the federal funds rate is greater than the federal funds rate target, there is a \_\_\_\_\_ of reserves and the federal funds rate \_\_\_\_\_.
- A) surplus; falls
  - B) surplus; rises
  - C) shortage; falls
  - D) shortage; rises

Answer: A

Topic: *The Market for Reserves*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 11) Within the market for reserves, an increase in the quantity of reserves results in a
- A) rise in the equilibrium federal funds rate.
  - B) fall in the equilibrium federal funds rate.
  - C) rise in the equilibrium real wage rate.
  - D) fall in the equilibrium money wage rate.

Answer: B

Topic: *Changing the Interest Rate, Fed Policy*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 12) If the demand for reserves is unchanged, an increase in the quantity of reserves will
- A) increase the federal funds rate.
  - B) lower the federal funds rate.
  - C) not affect the federal funds rate.
  - D) None of the above answers is correct.

Answer: B

Topic: *Changing the Interest Rate, Fed Policy*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 13) In the market for bank reserves, if the federal funds rate target is higher than the federal funds rate, the Fed will take action to \_\_\_\_\_ reserves.
- A) decrease the supply of
  - B) increase the supply of
  - C) increase the demand for
  - D) decrease the demand for

Answer: A

Topic: Changing the Interest Rate, Fed Policy

Skill: Conceptual

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 14) Open market operations by the Fed lead to
- A) changes in the number of banks.
  - B) immediate changes in aggregate supply.
  - C) changes in the federal funds rate.
  - D) shifts in the demand curve for reserves.

Answer: C

Topic: Changing the Interest Rate, Fed Policy

Skill: Recognition

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 15) If the Fed sells U.S. government securities,
- A) the federal funds rate rises.
  - B) the U.S. Treasury gains some revenue.
  - C) bank reserves increase.
  - D) None of the above answers is correct.

Answer: A

Topic: Changing the Interest Rate, Fed Policy

Skill: Conceptual

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 16) If the Fed carries out an open market operation and sells U.S. government securities, the federal funds rate \_\_\_\_\_ and the quantity of reserves \_\_\_\_\_.
- A) falls; increases
  - B) rises; increases
  - C) falls; decreases
  - D) rises; decreases

Answer: D

Topic: Changing the Interest Rate, Fed Policy

Skill: Conceptual

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 17) An increase in the quantity of reserves leads to a
- A) fall in the federal funds rate.
  - B) decrease in the price level.
  - C) reduction in the velocity of circulation.
  - D) leftward shift in the demand curve for reserves.

Answer: A

Topic: *Changing the Interest Rate, Fed Policy*

Skill: *Conceptual*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

- 18) An open market sale of government securities by the Federal Reserve shifts the \_\_\_\_\_ reserves curve \_\_\_\_\_.
- A) supply of; leftward
  - B) supply of; rightward
  - C) demand for; rightward
  - D) demand for; leftward

Answer: A

Topic: *Changing the Interest Rate, Fed Policy*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 19) The Fed engages in open market operations and sells government securities. The result is
- A) a lower federal funds rate.
  - B) a higher federal funds rate.
  - C) an unchanged federal funds rate because other interest rates did not change.
  - D) More information is needed to determine what happens to the federal funds rate.

Answer: B

Topic: *Changing the Interest Rate, Fed Policy*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 20) If the Fed wants to raise the federal funds rate it will
- A) buy government securities in order to increase the quantity of reserves.
  - B) sell government securities in order to decrease the quantity of reserves.
  - C) buy government securities in order to decrease the quantity of reserves.
  - D) sell government securities in order to increase the quantity of reserves.

Answer: B

Topic: *Changing the Interest Rate, Fed Policy*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 21) If the Fed buys U.S. government securities,
- A) the federal funds rate will fall.
  - B) the federal funds rate will rise.
  - C) bank reserves will decrease.
  - D) the discount rate will rise.

Answer: A

Topic: *Changing the Interest Rate, Fed Policy*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 22) If the Fed carries out an open market operation to buy U.S. government securities, the federal funds rate \_\_\_\_\_ and the quantity of reserves \_\_\_\_\_.
- A) falls; increases
  - B) rises; increases
  - C) falls; decreases
  - D) rises; decreases

Answer: A

Topic: *Changing the Interest Rate, Fed Policy*

Skill: *Conceptual*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

- 23) The Fed buys U.S. government securities from banks in order to
- A) lower the federal funds rate.
  - B) reduce the government's budget deficit.
  - C) decrease banks' reserves.
  - D) None of the above answers are correct.

Answer: A

Topic: *Changing the Interest Rate, Fed Policy*

Skill: *Recognition*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 24) If the Fed wants to lower the federal funds rate, it can
- A) decrease the budget deficit.
  - B) sell government securities in the open market.
  - C) instruct banks to print more money.
  - D) buy government securities on the open market.

Answer: D

Topic: *Changing the Interest Rate, Fed Policy*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 25) An open market purchase of government securities by the Federal Reserve shifts the \_\_\_\_\_ reserves curve \_\_\_\_\_.
- A) supply of; leftward
  - B) supply of; rightward
  - C) demand for; rightward
  - D) demand for; leftward

Answer: B

*Topic: Changing the Interest Rate, Fed Policy*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 14*

*AACSB: Reflective Thinking*

- 26) If the Fed increases the quantity of reserves, a new equilibrium is reached by a
- A) rightward shift of the demand for reserves curve.
  - B) movement down the demand for reserves curve.
  - C) leftward shift of the demand for reserves curve.
  - D) movement up the demand for reserves curve.

Answer: B

*Topic: Changing the Interest Rate, Fed Policy*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 14*

*AACSB: Reflective Thinking*

- 27) To lower the federal funds rate, the Federal Reserve should
- A) buy government securities.
  - B) raise the Treasury bill rate.
  - C) raise the exchange rate.
  - D) decrease bank reserves.

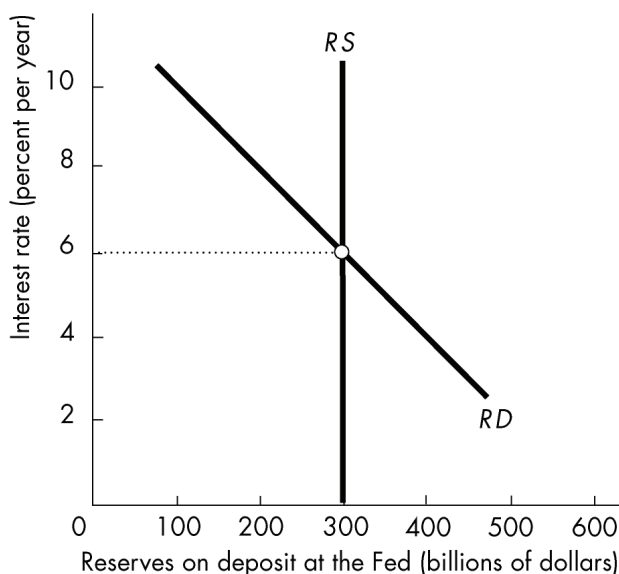
Answer: A

*Topic: Changing the Interest Rate, Fed Policy*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 14*

*AACSB: Reflective Thinking*



- 28) The figure above shows the market for bank reserves in Futureland. If the Bank of Futureland undertakes an open market purchase of government securities that changes the quantity of reserves by \$100 billion, then the federal funds rate will \_\_\_\_\_.
- A) rise to 8 percent a year
  - B) remain at 6 percent a year
  - C) fall to 4 percent a year
  - D) None of the above answers is correct.

Answer: C

Topic: Changing the Interest Rate, Fed Policy

Skill: Analytical

Question history: Previous edition, Chapter 14

AACSB: Analytical Skills

- 29) The figure above shows the market for bank reserves in Futureland. If the Bank of Futureland undertakes an open market sale of government securities that changes the quantity of reserves by \$100 billion, then the federal funds rate will \_\_\_\_\_.
- A) rise to 8 percent a year
  - B) remain at 6 percent a year
  - C) fall to 4 percent a year
  - D) None of the above answers is correct.

Answer: A

Topic: Changing the Interest Rate, Fed Policy

Skill: Analytical

Question history: Previous edition, Chapter 14

AACSB: Analytical Skills

- 30) By using open market operations, the Federal Reserve
- A) adjusts the supply of reserves to keep the federal funds interest rate equal to its target.
  - B) adjusts the supply *and* demand of reserves to keep the federal funds interest rate equal to its target.
  - C) adjusts the demand of reserves to keep bank rates in line with the federal funds rate target.
  - D) controls banks' demand for reserves, thereby keeping the federal funds rate equal to its target.

Answer: A

Topic: *The Market for Reserves*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 31) When the federal funds interest rate is 6 percent, the quantity of reserves demanded is \$100 billion. If the quantity of reserves is actually \$110 billion, then the
- A) demand for reserves increases and the demand for reserves curve shifts rightward.
  - B) demand for reserves decreases and the demand for reserves curve shifts leftward.
  - C) federal funds rate rises.
  - D) federal funds rate falls.

Answer: D

Topic: *Study Guide Question, The Market for Reserves*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

### 3 Monetary Policy Transmission

- 1) Monetary policy affects real GDP by
- A) changing aggregate supply.
  - B) creating budget surpluses.
  - C) changing aggregate demand.
  - D) creating budget deficits.
- 2) Monetary policy includes adjustments in \_\_\_\_\_ so as to change \_\_\_\_\_.
- A) the federal funds rate; short-run aggregate supply
  - B) open market operations; long-run aggregate supply
  - C) the quantity of money; short-run aggregate supply
  - D) the federal funds rate; aggregate demand

Answer: D

Topic: *Monetary Policy*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*



- 3) Monetary policy produces ripple effects, some of which happen quickly and some that can take years to produce change. Which of the following takes the longest to change?
- A) inflation rate
  - B) federal funds rate
  - C) exchange rate
  - D) monetary base

Answer: A

Topic: *The Ripple Effects of Monetary Policy*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 4) If the interest rate on Treasury bills is higher than the federal funds rate, the quantity of overnight loans supplied \_\_\_\_\_ and the \_\_\_\_\_ for Treasury bills increases.
- A) decreases; demand
  - B) decreases; supply
  - C) increases; demand
  - D) increases; supply

Answer: A

Topic: *The Ripple Effects of Monetary Policy*

Skill: *Recognition*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 5) Long-term interest rates are \_\_\_\_\_ than short-term because long-term loans are \_\_\_\_\_ than short-term loans.
- A) higher; riskier
  - B) higher; safer
  - C) lower; safer
  - D) lower; riskier

Answer: A

Topic: *The Ripple Effects of Monetary Policy*

Skill: *Recognition*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 6) If the Fed *lowers* the federal funds rate, then
- A) investment and consumption expenditure decrease.
  - B) the price of the dollar rises on the foreign exchange market and so net exports decrease.
  - C) a multiplier process that affects aggregate demand occurs.
  - D) All of the above answers are correct.

Answer: C

Topic: *The Ripple Effects of Monetary Policy*

Skill: *Recognition*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 7) When the Fed lowers the federal funds rate, aggregate demand
- A) increases.
  - B) decreases.
  - C) stays the same.
  - D) could increase, decrease or stay the same.

Answer: A

Topic: *The Ripple Effects of Monetary Policy*

Skill: *Recognition*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 8) To increase the quantity of money in the economy, the Federal Reserve is likely to
- A) print more money and give it to the banks.
  - B) lower tax rates
  - C) sell government securities in an open market operation.
  - D) buy government securities in an open market operation.

Answer: D

Topic: *How an Open Market Operation Works*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 9) If the Fed wants to increase the quantity of money, it can
- A) lower income tax rates.
  - B) purchase U.S. government securities.
  - C) increase the government budget deficit.
  - D) raise the exchange rate.

Answer: B

Topic: *How an Open Market Operation Works*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 10) If the Fed wants to decrease the quantity of money, it can
- A) decrease the government budget deficit.
  - B) purchase U.S. government securities.
  - C) sell U.S. government securities.
  - D) raise income tax rates.

Answer: C

Topic: *How an Open Market Operation Works*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 11) Which of the following increases the quantity of money?
- A) an individual's cash withdrawal from a bank
  - B) an individual's purchase of a government security from the Fed
  - C) the Fed's purchase of a government security
  - D) an increase in the government's budget deficit

Answer: C

Topic: *How an Open Market Operation Works*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 12) Open market purchases by the Federal Reserve System (the Fed)
- A) raise the federal funds rate.
  - B) increase bank reserves.
  - C) occur when the Fed wants to decrease the quantity of money.
  - D) All of the above answers are correct.

Answer: D

Topic: *How an Open Market Operation Works*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 13) When the Fed raises the federal funds rate,
- A) net exports increase.
  - B) the value of the dollar falls on the foreign exchange market.
  - C) the value of the dollar rises on the foreign exchange market.
  - D) consumption increases.

Answer: C

Topic: *The Ripple Effects of Monetary Policy*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 14) If the Fed raises the federal funds rate so that the exchange rate rises, then imports \_\_\_\_\_ and exports \_\_\_\_\_.
- A) increase; increase
  - B) increase; decrease
  - C) decrease; increase
  - D) decrease; decrease

Answer: B

Topic: *The Ripple Effects of Monetary Policy*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 15) If the Fed lowers the federal funds rate so that the exchange rate falls, then imports \_\_\_\_\_ and exports \_\_\_\_\_.
- A) increase; increase
  - B) increase; decrease
  - C) decrease; increase
  - D) decrease; decrease

Answer: C

Topic: *The Ripple Effects of Monetary Policy*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 16) If the U.S. interest rate rises, the exchange rate \_\_\_\_\_ and net exports \_\_\_\_\_.
- A) rises; increase
  - B) rises; decrease
  - C) falls; increase
  - D) falls; decrease

Answer: B

Topic: *The Ripple Effects of Monetary Policy*

Skill: *Conceptual*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

- 17) When the Fed lowers the federal funds rate, the U.S. dollar \_\_\_\_\_ on the foreign exchange market and \_\_\_\_\_.
- A) depreciates; aggregate demand decreases
  - B) appreciates; aggregate demand decreases
  - C) depreciates; the increase in imports is greater than the increase in exports
  - D) depreciates; aggregate demand increases

Answer: D

Topic: *The Ripple Effects of Monetary Policy*

Skill: *Conceptual*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

- 18) The ripple effects that occur when the Fed changes the federal funds rate include \_\_\_\_\_.
- A) a decrease in consumption and investment
  - B) an increase in net exports
  - C) a decrease in interest rates
  - D) an increase in short-run aggregate supply

Answer: A

Topic: *The Ripple Effects of Monetary Policy*

Skill: *Conceptual*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

- 19) When the Fed raises the federal funds rate, in the foreign exchange market people \_\_\_\_\_ dollars and the price of the dollar \_\_\_\_\_ on the foreign exchange market.
- A) sell; rises
  - B) sell; falls
  - C) buy; rises
  - D) buy; falls

Answer: C

Topic: *The Ripple Effects of Monetary Policy*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 20) If the Federal Reserve lowers the Federal funds rate,
- A) other short-term interest rates fall.
  - B) other short-term interest rates rise.
  - C) the exchange rate falls.
  - D) Both answers A and C are correct.

Answer: D

Topic: *The Ripple Effects of Monetary Policy*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 21) When the Federal Reserve increases the Federal funds rate, the U.S. interest rate differential \_\_\_\_\_ and the U.S. exchange rate \_\_\_\_\_.
- A) rises; appreciates
  - B) rises; depreciates
  - C) falls; appreciates
  - D) falls; depreciates

Answer: A

Topic: *The Ripple Effects of Monetary Policy*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 22) If the Federal Reserve decreases the Federal funds rate, other short-term interest rates \_\_\_\_\_ and the exchange rate \_\_\_\_\_.
- A) fall; falls
  - B) fall; does not change
  - C) fall; rises
  - D) do not change; falls

Answer: A

Topic: *The Ripple Effects of Monetary Policy*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 23) When the Fed raises the federal funds rate, other
- A) interest rates fall, consumption, investment and net exports increase, and the aggregate demand curve shifts rightward.
  - B) interest rates fall, consumption, investment and net exports decrease, and the aggregate demand curve shifts leftward.
  - C) interest rates rise, consumption, investment and net exports decrease, and the aggregate demand curve shifts leftward.
  - D) interest rates rise, consumption, investment and net exports increase, and the aggregate demand curve shifts rightward.

Answer: C

Topic: *The Ripple Effects of Monetary Policy*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 24) A decrease in the federal funds rate
- A) increases other short-term interest rates, decreases investment, and decreases aggregate demand.
  - B) lowers the exchange rate, increases the supply of loanable funds, and increases aggregate demand.
  - C) lowers other short-term interest rate, raises the real interest rate, and increases aggregate demand.
  - D) decreases the demand for loanable funds, lowers the real interest rate, and decreases aggregate demand.

Answer: B

Topic: *The Ripple Effects of Monetary Policy*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 25) A decrease in the federal funds rate leads to
- A) an increase in the quantity of money.
  - B) a fall in the exchange rate.
  - C) an increase in exports.
  - D) All of the above answers are correct.

Answer: D

Topic: *The Ripple Effects of Monetary Policy*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 26) If the Fed increases the quantity of reserves, the federal funds rate \_\_\_\_\_ and the quantity of money \_\_\_\_\_.
- A) rises; increases
  - B) rises; decreases
  - C) falls; increases
  - D) falls; decreases

Answer: C

Topic: *The Ripple Effects of Monetary Policy*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 27) Suppose that the market for reserves is in equilibrium and then the Federal Reserve decreases the quantity of reserves by \$2 billion. The federal funds rate will \_\_\_\_\_ and the supply of loanable funds will \_\_\_\_\_.
- A) rise; increase
  - B) rise; decrease
  - C) fall; increase
  - D) fall; decrease

Answer: B

Topic: *The Ripple Effects of Monetary Policy*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 28) In the short run, an increase in the federal funds rate \_\_\_\_\_ the real interest rate and \_\_\_\_\_ investment.
- A) lowers; increases
  - B) raises; increases
  - C) lowers; decreases
  - D) raises; decreases

Answer: D

Topic: *The Ripple Effects of Monetary Policy*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 29) When the Federal Reserve increases the Federal funds rate,
- A) the quantity of reserves, the quantity of deposits, and bank loans all decrease.
  - B) the quantity of reserves decreases, while the quantity of deposits and bank loans both increase.
  - C) both the quantity of reserves and the quantity of deposits decrease, while bank loans increase.
  - D) the quantity of reserves, the quantity of deposits, and bank loans all increase.

Answer: A

Topic: *The Ripple Effects of Monetary Policy*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 30) When the Federal Reserve increases the Federal funds rate,
- A) both the supply of bank loans and the supply of loanable funds decrease, thereby increasing the real interest rate.
  - B) the supply of bank loans decreases, while the supply of loanable funds and the real interest rate both increase.
  - C) both the supply of bank loans and the supply of loanable funds increase, while the real interest rate increases.
  - D) both the supply of bank loans and the supply of loanable funds increase, thereby decreasing the real interest rate.

Answer: A

Topic: *The Ripple Effects of Monetary Policy*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 31) When the Fed lowers the federal funds rate,
- A) consumption expenditures decrease.
  - B) the dollar increases in value on foreign exchange markets.
  - C) net exports decrease.
  - D) investment expenditures increase.

Answer: D

Topic: *The Ripple Effects of Monetary Policy*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 32) The Fed lowers the federal funds rate. A mechanism through which aggregate demand increases is that the lower federal funds rate
- A) increases other short-term interest rates, which decreases investment, thereby decreasing aggregate demand.
  - B) decreases other short-term interest rate, which decreases investment, thereby increasing aggregate demand.
  - C) raises the exchange rate so that net exports decrease, which increases investment, thereby increasing aggregate demand.
  - D) decreases other short-term interest rates, which increases investment, thereby increasing aggregate demand.

Answer: D

Topic: *The Ripple Effects of Monetary Policy*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*



- 33) In the short run, a decrease in the federal funds rate by the Fed
- A) lowers the real interest rate, decreases investment, and shifts the *AD* curve rightward.
  - B) lowers the real interest rate, increases investment, and shifts the *AD* curve leftward.
  - C) raises the real interest rate, decreases investment, and shifts the *AD* curve rightward.
  - D) None of the above answers is correct.

Answer: D

Topic: *The Ripple Effects of Monetary Policy*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 34) In the short run, monetary policy can
- A) raise the federal funds rate, thereby decreasing the supply of loanable funds, raising the real interest rate, and decreasing investment.
  - B) lower the federal funds rate, thereby increasing the supply of loanable funds, and lowering the exchange rate.
  - C) raise the federal funds rate and shift the aggregate demand curve leftward.
  - D) All of the above answers are correct.

Answer: D

Topic: *The Ripple Effects of Monetary Policy*

Skill: *Conceptual*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

- 35) In the short run, a cut in the federal funds rate
- A) raises other interest rates as people increase their saving.
  - B) increases potential GDP.
  - C) increases aggregate demand.
  - D) decreases aggregate demand.

Answer: C

Topic: *Effect of Monetary Policy on Aggregate Demand*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 36) When the Federal Reserve lowers the federal funds rate, in the short run
- A) the long-run aggregate supply curve shifts leftward.
  - B) the aggregate demand curve shifts rightward.
  - C) the economy moves along a given aggregate demand curve.
  - D) banks decrease the quantity of loans they make.

Answer: B

Topic: *Effect of Monetary Policy on Aggregate Demand*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 37) If the Fed lowers the federal funds rate, the Fed's goal is to
- A) increase aggregate demand.
  - B) decrease aggregate supply.
  - C) increase aggregate supply.
  - D) decrease the inflation rate as firms produce more goods and services.

Answer: A

Topic: *Effect of Monetary Policy on Aggregate Demand*

Skill: *Conceptual*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

- 38) In an AS/AD figure, lowering the federal funds rate initially shifts the
- A) AD curve leftward.
  - B) AD curve rightward.
  - C) long-run AS curve leftward.
  - D) long-run AS curve rightward.

Answer: B

Topic: *Effect of Monetary Policy on Aggregate Demand*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Analytical Skills*

- 39) In the aggregate supply–aggregate demand model, raising the federal funds rate initially
- A) increases aggregate demand.
  - B) decreases aggregate demand.
  - C) increases long-run aggregate supply.
  - D) decreases long-run aggregate supply.

Answer: B

Topic: *Effect of Monetary Policy on Aggregate Demand*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Analytical Skills*

- 40) Which of the following is NOT a short-run effect of a decrease in the federal funds rate?
- A) Aggregate demand increases.
  - B) Net exports increase.
  - C) Aggregate supply increases.
  - D) Inflation rate increases.

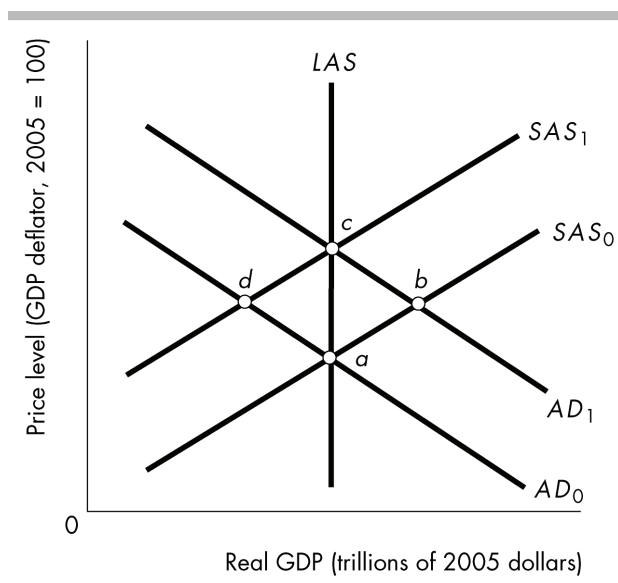
Answer: C

Topic: *Effect of Monetary Policy on Aggregate Demand*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*



- 41) In the above figure, if the economy is initially at point *a*, the short-run effect of a cut in the federal funds rate is given by movement from point
- a* to point *b*, increasing output and the unemployment rate.
  - a* to point *b*, increasing output and decreasing the unemployment rate.
  - a* to point *d*, decreasing output and increasing the unemployment rate.
  - a* to point *c*, keeping output and the unemployment rate constant.

Answer: B

Topic: Effect of Monetary Policy on Aggregate Demand

Skill: Analytical

Question history: Previous edition, Chapter 14

AACSB: Analytical Skills

- 42) In the above figure, if the economy is initially at point *c*, the short-run effect of a hike in the federal funds rate is given by movement from point
- c* to point *d*, decreasing output and increasing the unemployment rate.
  - c* to point *d*, increasing output and decreasing the unemployment rate.
  - c* to point *b*, increasing output and decreasing the unemployment rate.
  - c* to point *a*, keeping output and the unemployment rate constant.

Answer: A

Topic: Effect of Monetary Policy on Aggregate Demand

Skill: Analytical

Question history: Previous edition, Chapter 14

AACSB: Analytical Skills

- 43) In the above figure, if the economy is initially at point *d*, the short-run effect of a cut in the federal funds rate is given by movement from point
- A) *d* to point *c*, increasing output and decreasing the unemployment rate.
  - B) *d* to point *a*, increasing output and decreasing the unemployment rate.
  - C) *d* to point *b*, increasing output and decreasing the unemployment rate.
  - D) *d* to point *b*, keeping output and the unemployment rate constant.

Answer: A

Topic: *Effect of Monetary Policy on Aggregate Demand*

Skill: *Analytical*

Question history: *Modified 10th edition*

AACSB: *Analytical Skills*

- 44) To fight a recession the Fed will
- A) raise the federal funds rate.
  - B) lower the federal funds rate.
  - C) increase the budget deficit.
  - D) decrease taxes.

Answer: B

Topic: *Fed Eases to Fight Recession*

Skill: *Recognition*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

- 45) If the Fed is concerned with recession it will \_\_\_\_\_ the federal funds rate in order to \_\_\_\_\_ aggregate demand.
- A) raise; increase
  - B) lower; increase
  - C) raise; decrease
  - D) lower; decrease

Answer: B

Topic: *Fed Eases to Fight Recession*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 46) The Federal Reserve fights recession via open market operations, the supply of loanable funds curve shifts \_\_\_\_\_ and the aggregate demand curve shifts \_\_\_\_\_.
- A) leftward; leftward
  - B) leftward; rightward
  - C) rightward; leftward
  - D) rightward; rightward

Answer: D

Topic: *Fed Eases to Fight Recession*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Analytical Skills*

- 47) If the Fed wanted to stimulate the economy to limit the effects of a recessionary gap, then it should \_\_\_\_\_ the federal funds rate in order to \_\_\_\_\_ the real interest rate and thereby \_\_\_\_\_ investment.
- A) lower; lower; increase
  - B) lower; raise; increase
  - C) raise; raise; decrease
  - D) lower; lower; decrease

Answer: A

Topic: Fed Eases to Fight Recession

Skill: Conceptual

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 48) If the Fed lowers the federal funds rate, the first effect in an *AS/AD* figure is a \_\_\_\_\_ shift of the \_\_\_\_\_ curve.
- A) rightward; *AD*
  - B) leftward; *AD*
  - C) rightward; *SAS*
  - D) leftward; *SAS*

Answer: A

Topic: Fed Eases to Fight Recession

Skill: Conceptual

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 49) In the short-run, lowering the federal funds rate will shift the \_\_\_\_\_ and \_\_\_\_\_ real GDP.
- A) aggregate demand curve leftward; decrease
  - B) aggregate demand curve rightward; increase
  - C) aggregate supply curve rightward; increase
  - D) aggregate demand curve leftward; increase

Answer: B

Topic: Fed Eases to Fight Recession

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 50) The central bank of Cobra sells securities in an open market operation. In the short run, aggregate demand \_\_\_\_\_, real GDP \_\_\_\_\_, and the price level \_\_\_\_\_.
- A) does not change; increases; falls
  - B) decreases; decreases; falls
  - C) increases; increases; rises
  - D) does not change; decreases; rises

Answer: B

Topic: Effect of Monetary Policy on Aggregate Demand

Skill: Conceptual

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 51) The short-run effect of lowering the federal funds rate
- A) raises the price level and increases real GDP.
  - B) raises the price level and decreases real GDP.
  - C) lowers the price level and increases real GDP.
  - D) lowers the price level and decreases real GDP.

Answer: A

Topic: Fed Eases to Fight Recession

Skill: Conceptual

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 52) When the Fed cuts the Federal funds rate, real GDP growth \_\_\_\_\_ and the inflation rate \_\_\_\_\_.
- A) increases; increases
  - B) increases; decreases
  - C) decreases; increases
  - D) decreases; decreases

Answer: A

Topic: Fed Eases to Fight Recession

Skill: Conceptual

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 53) The Federal Reserve fights recession via open market operations, the supply of reserves curve shifts \_\_\_\_\_ and the supply of money curve shifts \_\_\_\_\_.
- A) leftward; leftward
  - B) leftward; rightward
  - C) rightward; leftward
  - D) rightward; rightward

Answer: D

Topic: Fed Eases to Fight Recession

Skill: Conceptual

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 54) In the short run, \_\_\_\_\_ in the federal funds rate \_\_\_\_\_ the price level and \_\_\_\_\_ real GDP.
- A) lowering; increases; decreases
  - B) lowering; increases; does not change
  - C) lowering; increases; increases
  - D) raising; decreases; does not change

Answer: C

Topic: Fed Eases to Fight Recession

Skill: Conceptual

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 55) Suppose the economy is in a recession and the Fed lowers the federal funds rate. Then
- A) real GDP and the price level will both decrease.
  - B) real GDP will increase and the price level will decrease.
  - C) real GDP will decrease and the price level will increase.
  - D) real GDP and the price level will both increase.

Answer: D

Topic: Fed Eases to Fight Recession

Skill: Conceptual

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 56) Which of the following describes the chain of events the Fed uses to fight recession?
- A) Raise the federal funds rate target, sell government securities, decrease reserves and loans, increase aggregate demand.
  - B) Raise the federal funds rate target, buy government securities, increase reserves and loans, decrease aggregate demand.
  - C) Lower the federal funds rate target, buy government securities, decrease reserves and loans, decrease aggregate demand.
  - D) Lower the federal funds rate target, buy government securities, increase reserves and loans, increase aggregate demand.

Answer: D

Topic: Fed Eases to Fight Recession

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 57) In order to combat a recession, the Fed will \_\_\_\_\_ the federal funds rate thereby \_\_\_\_\_ the quantity of money.
- A) raise; increase
  - B) lower; increase
  - C) raise; decrease
  - D) lower; decrease

Answer: B

Topic: Fed Eases to Fight Recession

Skill: Conceptual

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 58) If the aggregate demand curve shifts rightward following a decrease in the federal funds rate, what can be concluded if the short-run aggregate supply curve is rather steep?
- A) There will be a significant increase in real GDP with little impact on the price level.
  - B) There will be a significant increase in both real GDP and the price level.
  - C) There will be little increase in real GDP but a significant increase in the price level.
  - D) There is significant unemployment and slack in the economy.

Answer: C

Topic: Fed Eases to Fight Recession

Skill: Analytical

Question history: Previous edition, Chapter 14

AACSB: Analytical Skills

- 59) In response to an inflationary gap, the Fed
- A) waits until the price level falls before acting.
  - B) lowers the federal funds rate by buying U.S. government securities.
  - C) raises the federal funds rate by selling U.S. government securities.
  - D) lowers the federal funds rate by buying U.S. government securities.

Answer: C

Topic: Fed Tightens to Fight Inflation

Skill: Conceptual

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 60) If the Fed wished to eliminate an inflationary gap, which of the following would be an appropriate policy?
- A) raise the federal funds rate
  - B) lower the federal funds rate
  - C) buy government securities
  - D) decrease the government budget deficit

Answer: A

Topic: Fed Tightens to Fight Inflation

Skill: Conceptual

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 61) If the Fed is concerned with inflation it will \_\_\_\_\_ the federal funds rate in order to \_\_\_\_\_ aggregate demand.
- A) raise; increase
  - B) lower; increase
  - C) raise; decrease
  - D) lower; decrease

Answer: C

Topic: Fed Tightens to Fight Inflation

Skill: Conceptual

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 62) If the Fed fears inflation it will undertake an open market \_\_\_\_\_ of securities, the federal funds rate will \_\_\_\_\_ and the long-term real interest rate will \_\_\_\_\_.
- A) sale; rise; fall
  - B) sale; rise; rise
  - C) purchase; rise; fall
  - D) purchase; fall; rise

Answer: B

Topic: Fed Tightens to Fight Inflation

Skill: Conceptual

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking



- 63) The Federal Reserve fights inflation via open market operations, the supply of reserves curve shifts \_\_\_\_\_ and the supply of money curve shifts \_\_\_\_\_.
- A) leftward; leftward
  - B) leftward; rightward
  - C) rightward; leftward
  - D) rightward; rightward

Answer: A

Topic: Fed Tightens to Fight Inflation

Skill: Conceptual

Question history: Previous edition, Chapter 14

AACSB: Analytical Skills

- 64) The Federal Reserve fights inflation via open market operations, the supply of loanable funds curve shifts \_\_\_\_\_ and the aggregate demand curve shifts \_\_\_\_\_.
- A) leftward; leftward
  - B) leftward; rightward
  - C) rightward; leftward
  - D) rightward; rightward

Answer: A

Topic: Fed Tightens to Fight Inflation

Skill: Conceptual

Question history: Previous edition, Chapter 14

AACSB: Analytical Skills

- 65) If the Fed raises the interest rate, the first effect in an *AS/AD* figure is a \_\_\_\_\_ shift of the \_\_\_\_\_ curve.
- A) rightward; *AD*
  - B) leftward; *AD*
  - C) rightward; *SAS*
  - D) leftward; *SAS*

Answer: B

Topic: Fed Tightens to Fight Inflation

Skill: Conceptual

Question history: Previous edition, Chapter 14

AACSB: Analytical Skills

- 66) If the Fed wants to fight inflation, it will \_\_\_\_\_ the federal funds rate, which in the short run shifts the \_\_\_\_\_.
- A) lower; *AD* curve rightward
  - B) lower; *AD* curve leftward
  - C) raise; *AD* curve rightward
  - D) raise; *AD* curve leftward

Answer: D

Topic: Fed Tightens to Fight Inflation

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Analytical Skills

- 67) In the short run, the Fed's actions to fight inflation shift the
- A) aggregate demand curve rightward.
  - B) aggregate demand curve leftward.
  - C) short-run aggregate supply curve rightward.
  - D) short-run aggregate supply curve leftward.

Answer: B

Topic: Fed Tightens to Fight Inflation

Skill: Conceptual

Question history: Previous edition, Chapter 14

AACSB: Analytical Skills

- 68) According to the AS/AD model, in the short run an increase in the federal funds rate will
- A) decrease the price level and decrease real GDP.
  - B) increase the price level and decrease real GDP.
  - C) decrease the price level but leave real GDP unchanged.
  - D) decrease real GDP but leave the price level unchanged.

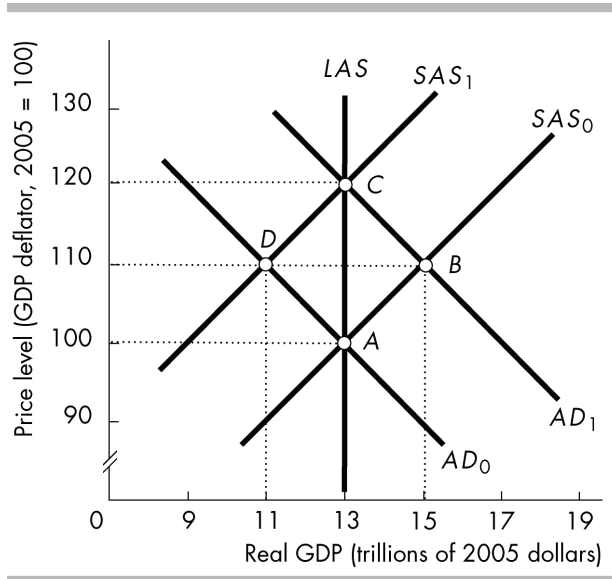
Answer: A

Topic: Fed Tightens to Fight Inflation

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Analytical Skills



- 69) In the above figure, suppose the economy is at point *D*. Which of the following occurs as a result of an open market purchase of government securities by the Fed?
- A) a decrease in the real interest rate
  - B) an increase in exports
  - C) an increase in investment
  - D) All of the above occur.

Answer: D

Topic: The Ripple Effects of Monetary Policy

Skill: Analytical

Question history: Previous edition, Chapter 14

AACSB: Analytical Skills

- 70) In the above figure, suppose the economy was initially in an equilibrium at point *D*. Where would the economy move if the Fed makes an open market purchase of government securities?
- A) *A*
  - B) *B*
  - C) *C*
  - D) *D*, that is, the economy would not change its equilibrium.

Answer: C

Topic: Monetary Policy

Skill: Analytical

Question history: Previous edition, Chapter 14

AACSB: Analytical Skills

71) In the above figure, suppose the economy is at point *B*. Which of the following policy options for the Fed will move the economy toward its *LAS*?

- A) lower the federal funds rate
- B) raise the federal funds rate
- C) decrease the government's budget deficit
- D) decrease taxes

Answer: B

Topic: Fed Tightens to Fight Inflation

Skill: Analytical

Question history: Previous edition, Chapter 14

AACSB: Analytical Skills

72) In the above figure, if the economy is initially at point *D*, then if the Fed lowers the federal funds rate

- A) the supply of loanable funds decreases, the real interest rate falls, and the *AD* curve shifts rightward.
- B) other short-term interest rates fall, net exports increase, and the *AD* curve shifts rightward.
- C) the exchange rate rises, investment increases, and the *SAS* curve shifts rightward.
- D) the demand for loanable fund and supply of loanable funds both increase by the same amount so that the *AD* curve shifts rightward.

Answer: B

Topic: Monetary Policy

Skill: Analytical

Question history: Previous edition, Chapter 14

AACSB: Analytical Skills

73) In the above figure, suppose the economy is at point *D*. If the Fed eases to fight the recession, the economy will move to

- A) point *A*.
- B) point *B*.
- C) point *C*.
- D) Either point *A* or point *C*, depending on precisely how the Fed eased.

Answer: C

Topic: Fed Eases to Fight Recession

Skill: Analytical

Question history: Previous edition, Chapter 14

AACSB: Analytical Skills

74) Suppose that several European countries enter a recession decreasing U.S. exports. To move U.S. GDP back to potential GDP, the Fed should

- A) lower the federal funds rate.
- B) raise the federal funds rate.
- C) increase the government's budget deficit.
- D) decrease the government's budget deficit.

Answer: A

Topic: Stabilizing Aggregate Demand Shocks

Skill: Conceptual

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 75) Consumer confidence in the economy rises, and as a result, real GDP increases above potential GDP. To move U.S. GDP back to potential GDP, the Fed should
- A) lower the federal funds rate.
  - B) raise the federal funds rate.
  - C) increase the government's budget deficit.
  - D) decrease the government's budget deficit.

Answer: B

*Topic: Stabilizing Aggregate Demand Shocks*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 14*

*AACSB: Reflective Thinking*

- 76) A worldwide recession reduces the amount of U.S. exports, and as a result, aggregate demand decreases. To move U.S. GDP back to potential GDP, the Fed should
- A) lower the federal funds rate.
  - B) raise the federal funds rate.
  - C) increase the government's budget deficit.
  - D) decreasing the quantity of money of money.

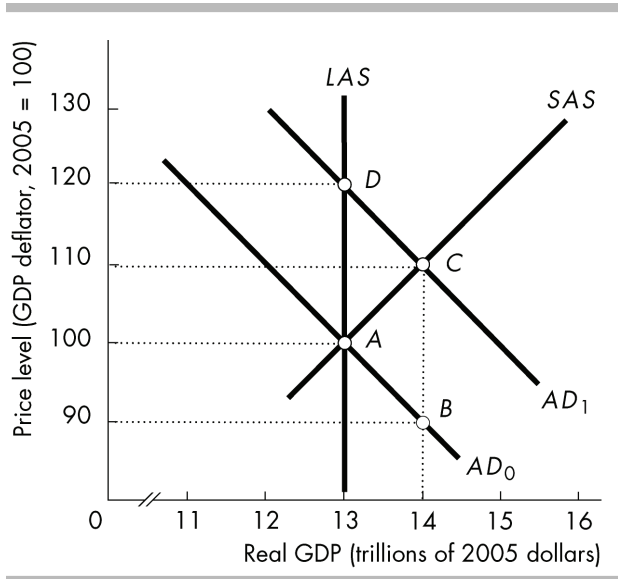
Answer: A

*Topic: Stabilizing Aggregate Demand Shocks*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 14*

*AACSB: Reflective Thinking*



- 77) In the above figure, suppose point C is the original equilibrium. If the Fed hikes the federal funds rate, the new equilibrium is given by point
- A) A.
  - B) B.
  - C) C (that is, the equilibrium does not change).
  - D) D.

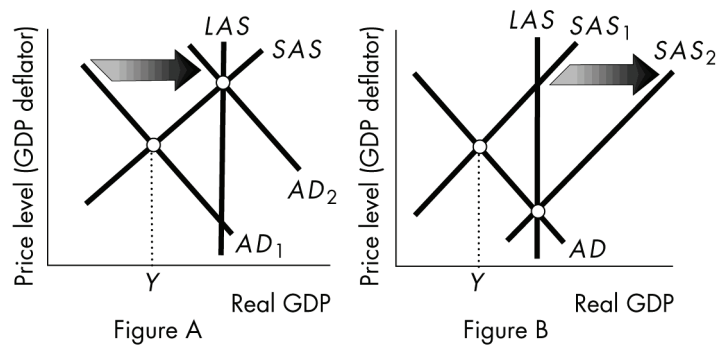
Answer: A

Topic: Fed Tightens to Fight Inflation

Skill: Analytical

Question history: Previous edition, Chapter 14

AACSB: Analytical Skills



78) Which aggregate supply–aggregate demand diagram above shows the effect on real GDP and the price level of monetary policy when it is used to fight a recession?

- A) Only Figure A
- B) Only Figure B
- C) Both Figure A and Figure B
- D) Neither Figure A nor Figure B

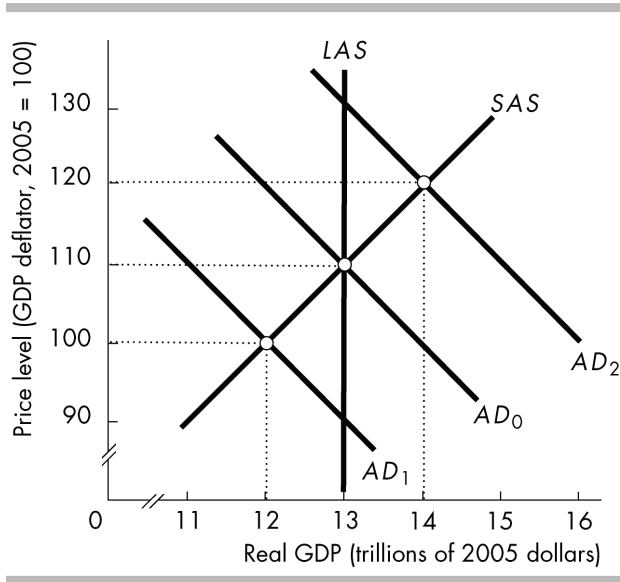
Answer: A

Topic: Stabilizing Aggregate Demand Shocks

Skill: Analytical

Question history: Previous edition, Chapter 14

AACSB: Analytical Skills



- 79) In the above figure, the economy experiences a decrease in aggregate demand so that the aggregate demand curve shifts from  $AD_0$  to  $AD_1$ . If the Fed wants to offset this change, it would \_\_\_\_\_.
- A) purchase government securities on the open market
  - B) sell government securities on the open market
  - C) lower taxes
  - D) increase government expenditures

Answer: A

Topic: Stabilizing Aggregate Demand Shocks

Skill: Analytical

Question history: Previous edition, Chapter 14

AACSB: Analytical Skills

- 80) In the above figure, the economy experiences an increase in aggregate demand so that the aggregate demand curve shifts from  $AD_0$  to  $AD_2$ . If the Fed wants to offset this change, it would \_\_\_\_\_.
- A) purchase government securities on the open market
  - B) sell government securities on the open market
  - C) raise taxes
  - D) increase government expenditures

Answer: B

Topic: Stabilizing Aggregate Demand Shocks

Skill: Analytical

Question history: Previous edition, Chapter 14

AACSB: Analytical Skills



- 81) Suppose that initially real GDP equals potential GDP. Then an increase in aggregate demand occurs. According to the Taylor rule, the Fed should \_\_\_\_\_ the federal funds rate by \_\_\_\_\_ government securities in the open market.
- A) raise; selling
  - B) lower; selling
  - C) raise; buying
  - D) lower; buying

Answer: A

Topic: Stabilizing Aggregate Demand Shocks

Skill: Analytical

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 82) Suppose that initially real GDP equals potential GDP. Then a decrease in aggregate demand occurs. According to the Taylor rule, the Fed should \_\_\_\_\_ the federal funds rate by \_\_\_\_\_ government securities in the open market.
- A) raise; selling
  - B) lower; selling
  - C) raise; buying
  - D) lower; buying

Answer: D

Topic: Stabilizing Aggregate Demand Shocks

Skill: Analytical

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 83) Which of the following is a problem in pursuing monetary policy?
- A) The lag between a change in the quantity of money and its effect on economic activity may be long.
  - B) Monetary policy must be approved by the Congress.
  - C) The Fed cannot control the federal funds rate.
  - D) None of the above answers is correct.

Answer: D

Topic: Problems with Monetary Policy

Skill: Conceptual

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 84) One problem with the ripple effect from the Fed's monetary policy is
- A) the fact that the monetary policy transmission process is long and drawn out.
  - B) that changing the Federal funds target rate seldom has an effect on the markets for reserves and loanable funds.
  - C) the tight relationship between that the Federal funds rate has to aggregate spending.
  - D) the frequent misalignment of the spread between the Federal funds rate and the Federal funds rate target.

Answer: A

Topic: Problems with Monetary Policy

Skill: Conceptual

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 85) In order to combat inflation, the Fed will \_\_\_\_\_ the federal funds rate thereby \_\_\_\_\_ the quantity of money.
- A) raise; increase
  - B) lower; increase
  - C) raise; decrease
  - D) lower; decrease

Answer: C

Topic: *Study Guide Question, Fed Tightens to Fight Inflation*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 86) In the short run, the Fed's actions to fight an inflationary gap shift the
- A) aggregate demand curve rightward.
  - B) aggregate demand curve leftward.
  - C) short-run aggregate supply curve rightward.
  - D) short-run aggregate supply curve leftward.

Answer: B

Topic: *Study Guide Question, Fed Tightens to Fight Inflation*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 87) In the short run, a rise in the federal funds rate shifts the
- A) AD curve leftward.
  - B) SAS curve leftward.
  - C) LAS curve leftward.
  - D) None of the above because a decrease in the quantity of money does not shift a curve.

Answer: A

Topic: *Study Guide Question—Monetary Policies Effect on Agg. Demand*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Analytical Skills*

- 88) The Fed's actions to fight an inflation shift the
- A) aggregate demand curve rightward.
  - B) aggregate demand curve leftward.
  - C) long-run aggregate supply curve rightward.
  - D) long-run aggregate supply curve leftward.

Answer: B

Topic: *Study Guide Question, Fed Tightens to Fight Inflation*

Skill: *Analytical*

Question history: *Previous edition, Chapter 14*

AACSB: *Analytical Skills*

- 89) In the short run, a rise in the federal funds rate \_\_\_\_\_ the price level and \_\_\_\_\_ real GDP.
- A) lowers; decreases
  - B) lowers; does not change
  - C) lowers; increases
  - D) does not change; increases

Answer: A

Topic: Study Guide Question, Fed Tightens to Fight Inflation

Skill: Analytical

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 90) Businesses become convinced that future profits from investment will be less than initially believed. This conviction leads to a change in aggregate \_\_\_\_\_ and so the Fed should \_\_\_\_\_ the federal funds rate if it wants to try to offset this change.
- A) demand; raise
  - B) demand; lower
  - C) supply; raise
  - D) supply; lower

Answer: B

Topic: Study Guide Question, Stabilizing Aggregate Demand Shocks

Skill: Conceptual

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 91) A rise in the federal funds rate
- A) raises the long-term real interest rate.
  - B) does not change the long-term real interest rate.
  - C) lowers the long-term real interest rate.
  - D) may raise or lower the long-term real interest rate, depending on whether the demand for loanable funds curve has a negative or a positive slope.

Answer: A

Topic: Study Guide Question, Changing the Interest Rate

Skill: Conceptual

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

#### 4 Extraordinary Monetary Stimulus

- 1) A widespread fall in asset prices means that banks might become
- A) insolvent.
  - B) solvent.
  - C) illiquid.
  - D) too liquid.

Answer: A

Topic: Financial Crisis

Skill: Recognition

Question history: New 10th edition

AACSB: Reflective Thinking

- 2) During the financial crisis of 2008–2009, the Fed was concerned about
- A) the bubble that was forcing asset prices higher.
  - B) the public's rush to deposit its currency into banks.
  - C) keeping the federal funds rate from falling too far.
  - D) providing the banking system with enough liquidity.

Answer: D

Topic: *Financial Crisis*

Skill: *Recognition*

Question history: *New 10th edition*

AACSB: *Reflective Thinking*

- 3) During the financial crisis of 2008–2009, the Fed's actions to supply reserves to the banking system was an attempt to
- A) limit the troubling rise in asset prices.
  - B) increase the public's belief that their deposits were insured.
  - C) help the U.S. Treasury finance the TARP.
  - D) make certain that banks had enough liquidity to avoid collapse.

Answer: D

Topic: *Financial Crisis*

Skill: *Recognition*

Question history: *New 10th edition*

AACSB: *Reflective Thinking*

- 4) Uncertainty about monetary policy
- A) was the factor that started the financial crisis in 2008.
  - B) can keep investment low.
  - C) is why the Fed does not use inflation rate targeting.
  - D) makes deposits in banks more desirable because they become safer.

Answer: B

Topic: *Financial Crisis*

Skill: *Recognition*

Question history: *New 10th edition*

AACSB: *Reflective Thinking*

- 5) The Taylor rule
- A) focuses on only fluctuations in real GDP.
  - B) ignores price level stability to focus on responding to fluctuations in real GDP.
  - C) is the rule actually followed by the Fed.
  - D) shows how the Fed could set the federal funds rate.

Answer: D

Topic: *Taylor Rule*

Skill: *Recognition*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 6) The Taylor rule
- A) focuses on only fluctuations in real GDP.
  - B) ignores price level stability to focus on responding to fluctuations in real GDP.
  - C) is the rule actually followed by the Fed.
  - D) shows how the Fed could set the federal funds rate.

Answer: D

Topic: Taylor Rule

Skill: Recognition

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 7) The Taylor Rule states that the
- A) Fed should target the monetary base and not the federal funds rate.
  - B) use of an exchange rate target, although costly, is economically efficient.
  - C) Fed should adjust the federal funds rate to take account of deviations of inflation from its target and real GDP from potential GDP.
  - D) None of the above is correct.

Answer: C

Topic: The Taylor Rule

Skill: Recognition

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 8) The Taylor rule uses three variables to determine the target for the federal funds rate. Which of the following is NOT one of those variables?
- A) monetary base
  - B) equilibrium real interest rate
  - C) inflation rate
  - D) output gap

Answer: A

Topic: Taylor Rule

Skill: Recognition

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 9) If the Fed follows the Taylor rule and the economy goes into a recession, the Fed would
- A) lower the federal funds rate.
  - B) reduce tax rates.
  - C) increase government expenditures.
  - D) None of the above answers are correct.

Answer: A

Topic: Taylor Rule

Skill: Conceptual

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 10) Suppose the equilibrium real interest rate is 2 percent per year, inflation is 2.5 percent and the output gap is 1 percent. Using the Taylor rule, what is the federal funds rate?
- A) 3 percent
  - B) 3.5 percent
  - C) 5.25 percent
  - D) 5.5 percent

Answer: C

Topic: *The Taylor Rule*

Skill: *Analytical*

Question history: *Previous edition, Chapter 14*

AACSB: *Analytical Skills*

- 11) Suppose the inflation rate is 3 percent and the output gap is -1 percent. Assuming the equilibrium real interest rate is 2 percent, using the Taylor rule, what target should the Fed set for the federal funds rate?
- A) 5 percent
  - B) 6 percent
  - C) 4 percent
  - D) 1 percent

Answer: A

Topic: *Taylor Rule*

Skill: *Analytical*

Question history: *Previous edition, Chapter 14*

AACSB: *Analytical Skills*

- 12) An inflation rate targeting rule
- A) reduces uncertainty about monetary policy.
  - B) will not work if the Fed continues to sue open market operations.
  - C) has been adopted the by the Fed in response to the financial crisis of 2008–2009.
  - D) means that the inflation rate must exceed 5 percent in order for the rule to be effective.

Answer: A

Topic: *Inflation Rate Targeting Rule*

Skill: *Recognition*

Question history: *New 10th edition*

AACSB: *Analytical Skills*

## 5 News Based Questions

- 1) The People's Bank of China announced that it was lowering by 1.08 percentage points the one-year lending rate in response to the slowdown in the Chinese economy. This rate is the Chinese equivalent of the federal funds rate in the United States.

www.nytimes.com, 11/26/2008

This policy \_\_\_\_\_ the supply of loanable funds. As a result, the long-term real interest rate \_\_\_\_\_, and planned expenditures \_\_\_\_\_.

- A) increases; increases; increase
- B) decreases; decreases; decrease
- C) increases; decreases; increase
- D) decreases; increases; increase

Answer: C

Topic: *The Ripple Effects of Monetary Policy*

Skill: *Analytical*

Question history: *Previous edition, Chapter 14*

AACSB: *Analytical Skills*

- 2) The People's Bank of China announced that it was lowering by 1.08 percentage points the one-year lending rate in response to the slowdown in the Chinese economy. This rate is the Chinese equivalent of the federal funds rate in the United States.

www.nytimes.com, 11/26/2008

Other things remaining the same, there will be \_\_\_\_\_ in the exchange rate, \_\_\_\_\_ in imports and \_\_\_\_\_ in exports.

- A) a decrease; a decrease; an increase
- B) a decrease; an increase; a decrease
- C) an increase; a decrease; a increase
- D) an increase; an increase; a decrease

Answer: A

Topic: *The Ripple Effects of Monetary Policy*

Skill: *Analytical*

Question history: *Previous edition, Chapter 14*

AACSB: *Analytical Skills*

- 3) The People's Bank of China announced that it was lowering by 1.08 percentage points the one-year lending rate in response to the slowdown in the Chinese economy. This rate is the Chinese equivalent of the federal funds rate in the United States.

www.nytimes.com, 11/26/2008

Other things remaining the same, which of the following components will decrease in response to the bank's actions?

- i. exchange rate
  - ii. interest rate
  - iii. investment
- A) i and ii only.
  - B) i, ii and iii.
  - C) ii and iii only.
  - D) ii only.

Answer: A

Topic: *The Ripple Effects of Monetary Policy*

Skill: *Analytical*

Question history: *Previous edition, Chapter 14*

AACSB: *Analytical Skills*

- 4) In October 2008, central banks around the world coordinated a decrease in interest rates. Ben Bernanke, Chairman of the Federal Reserve stated that "policy makers will remain in close contact, monitor developments closely and stand ready to take additional steps should conditions warrant."

If all the banks enacted the policy simultaneously, the U.S. interest rate differential would \_\_\_\_\_ and so the U.S. exchange rate would \_\_\_\_\_.

- A) increase; fall
- B) decrease; rise
- C) not change; not change
- D) not change; rise

Answer: C

Topic: *The Ripple Effects of Monetary Policy*

Skill: *Analytical*

Question history: *Previous edition, Chapter 14*

AACSB: *Analytical Skills*



- 5) In October 2008, central banks around the world coordinated a decrease in interest rates. Ben Bernanke, Chairman of the Federal Reserve stated that "policy makers will remain in close contact, monitor developments closely and stand ready to take additional steps should conditions warrant."

If all the banks enacted the policy simultaneously, which of the following expenditure components would increase in the United States?

- i. exports
  - ii. consumption
  - iii. investment
- A) i, ii and iii.
  - B) ii and iii only.
  - C) ii only.
  - D) i and iii only.

Answer: B

Topic: *The Ripple Effects of Monetary Policy*

Skill: *Analytical*

Question history: *Previous edition, Chapter 14*

AACSB: *Analytical Skills*

- 6) In November 2008, the Reserve Bank of India (RBI) lowered its "repo" rate, the rate at which it lends to banks, from 8 percent to 7.5 percent. Only two weeks earlier, it had lowered the rate from 9 percent to 8 percent.

*The Economist*, 11/6/2008

The Reserve Bank of India is lowering its rates to fight

- A) inflation
- B) recession
- C) rising net exports.
- D) a decrease in money demand.

Answer: B

Topic: *The Ripple Effects of Monetary Policy*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Communication*

- 7) In November 2008, the Reserve Bank of India (RBI) lowered its "repo" rate, the rate at which it lends to banks, from 8 percent to 7.5 percent. Only two weeks earlier, it had lowered the rate from 9 percent to 8 percent.

*The Economist*, 11/6/2008

In its attempt to change real GDP, which of following sequences correctly describes the transmission of RBI's monetary policy?

- i. the real interest rate falls
  - ii. the money supply increases
  - iii. bank reserves increase
  - iv. supply of loanable funds increases
  - v. aggregate demand increases
- A) iii, ii, iv, i, v.
  - B) ii, i, iii, v, iv.
  - C) v, i, ii, iv, iii
  - D) iii, iv, i, iii, v

Answer: A

*Topic: The Ripple Effects of Monetary Policy*

*Skill: Analytical*

*Question history: Previous edition, Chapter 14*

*AACSB: Analytical Skills*

- 8) "As the Fed Chases Inflation, Critics Shout, 'Faster!'"

"For weeks, the Fed has broadcast its intention to raise interest rates glacially." The Fed was moving slowly, according to an economist because "... the declining price of oil, economic fundamentals, including productivity and global competition, will keep inflation in check." The Fed, recognizing that the economy was improving stated it planned to "respond to changes in economic prospects as needed to fulfill its obligation to maintain price stability." Other economists disagree with the Fed's restrained policy as a "mistake."

www.nytimes, 7/1/2004

By increasing the federal funds target, the Fed will \_\_\_\_\_ reserves and \_\_\_\_\_ the quantity of money.

- A) increase; increase
- B) decrease; decrease
- C) decrease; increase
- D) increase; decrease

Answer: B

*Topic: How an Open Market Operation Works*

*Skill: Analytical*

*Question history: Modified 10th edition*

*AACSB: Analytical Skills*

## 9) "As the Fed Chases Inflation, Critics Shout, 'Faster!'"

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www.nytimes, 7/1/2004

Economists estimate that if the Fed's policy was enacted in July 2004, the impact on the economy

- A) will occur to its fullest extent within one month.
- B) can be expected to stretch over one to two years.
- C) will not be evident in the exchange rate market until 2005.
- D) will reach its fullest extent, affecting real GDP, in three to six months.

Answer: B

Topic: Monetary Policy

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Communication

## 10) "As the Fed Chases Inflation, Critics Shout, 'Faster!'"

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www.nytimes, 7/1/2004

The Fed's policy will \_\_\_\_\_ the quantity of money and \_\_\_\_\_ the supply of loanable funds.

- A) decrease; decrease
- B) increase; decrease
- C) decrease; increase
- D) increase; increase

Answer: A

Topic: The Ripple Effects of Monetary Policy

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

## 11) "As the Fed Chases Inflation, Critics Shout, 'Faster!'"

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www.nytimes, 7/1/2004

As a result of the Fed's policy, which of the rates will increase?

- A) the long-term interest rate
- B) the short-term interest rate
- C) the exchange rate
- D) All of the above answers are correct.

Answer: D

*Topic: The Ripple Effects of Monetary Policy*

*Skill: Analytical*

*Question history: Modified 10th edition*

*AACSB: Analytical Skills*

## 12) "As the Fed Chases Inflation, Critics Shout, 'Faster!'"

"For weeks, the Fed has broadcast its intention to raise interest rates glacially." The Fed was moving slowly, according to an economist because "... the declining price of oil, economic fundamentals, including productivity and global competition, will keep inflation in check." The Fed, recognizing that the economy was improving stated it planned to "respond to changes in economic prospects as needed to fulfill its obligation to maintain price stability." Other economists disagree with the Fed's restrained policy as a "mistake"

www.nytimes, 7/1/2004

The goal of the Fed's policy in 2004 was to decrease

- A) the exchange rate
- B) consumption expenditure
- C) the long-term interest rate
- D) the short-term interest rate

Answer: B

*Topic: The Ripple Effects of Monetary Policy*

*Skill: Analytical*

*Question history: Modified 10th edition*

*AACSB: Analytical Skills*

- 13) In December, the Bank of England reduced interest rates by another 50 basis points (a basis point is 0.01 percentage point) after it had cut them by 150 basis points in November. But the rate cut may even be larger. Economists "... expect the Monetary Policy Committee [MPC] to cut rates to 2.5 percent,"...while others "...saw a bigger 75 point cut"...or "a 100 basis point move."

Reuters, 11/27/2008

In order to \_\_\_\_\_, the Bank of England's rate cut must \_\_\_\_\_.

- A) decrease consumption; increase the long-run interest rate.
- B) increase real GDP; decrease the nominal long-run interest rate.
- C) decrease real GDP; increase the real long-run interest rate.
- D) increase consumption; decrease the real long-run interest rate.

Answer: D

Topic: *The Ripple Effects of Monetary Policy*

Skill: *Analytical*

Question history: *Modified 10th edition*

AACSB: *Analytical Skills*

- 14) In December, the Bank of England reduced interest rates by another 50 basis points after points (a basis point is 0.01 percentage point) it had cut them by 150 basis points in November. But the rate cut may even be larger. Economists "... expect the Monetary Policy Committee [MPC] to cut rates to 2.5 percent,"...while others "...saw a bigger 75 point cut"...or "a 100 basis point move." Data show that "... inflation staged its biggest drop since records began ...potentially opening the door to even bigger cuts."

Reuters, 11/27/2008

If the Bank's policies given above can \_\_\_\_\_ the real long-term interest rate, the Bank will be able to \_\_\_\_\_.

- A) lower; decrease investment
- B) lower; increase aggregate demand
- C) raise; increase short-run aggregate supply
- D) lower; raise the exchange rate

Answer: B

Topic: *The Ripple Effects of Monetary Policy*

Skill: *Analytical*

Question history: *Modified 10th edition*

AACSB: *Analytical Skills*

- 15) "The Bank of Israel lowered its benchmark lending rate by half a percentage point, the fourth cut in seven weeks, as the global financial turmoil slows economic growth and inflation expectations ease."

www.bloomberg.com 11/24/2008

The Bank of Israel's actions \_\_\_\_\_ bank reserves and have the goal of \_\_\_\_\_ consumption

- A) decrease; decreasing
- B) increase; decreasing
- C) increase; increasing
- D) decrease; increasing

Answer: C

Topic: *The Ripple Effects of Monetary Policy*

Skill: *Analytical*

Question history: *Previous edition, Chapter 14*

AACSB: *Analytical Skills*

- 16) In an effort to address the troubled economy, ..."For the ninth time in just over a year, the Federal Reserve is expected to cut interest rates, quite possibly its last reduction in this downturn." Rates have not been this low "... since 2003, when the economy was growing at a snail's pace."

www.csmonitor.com , 10/28/2008

The "interest rates" the Fed is cutting is the \_\_\_\_\_.

- A) reserve interest rate
- B) Federal Funds rate
- C) nominal long-term interest rate
- D) real long-term interest rate

Answer: B

Topic: *The Ripple Effects of Monetary Policy*

Skill: *Recognition*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 17) In an effort to address the troubled economy, ..."For the ninth time in just over a year, the Federal Reserve is expected to cut interest rates, quite possibly its last reduction in this downturn." Rates have not been this low "... since 2003, when the economy was growing at a snail's pace."

www.csmonitor.com, 10/28/2008

The Fed's rate cuts will \_\_\_\_\_ bank reserves and \_\_\_\_\_.

- A) increase; increase the money supply and real GDP
- B) decrease; decrease the money supply and real GDP
- C) increase; increase the exchange rate and real GDP
- D) decrease bank reserves; decrease the exchange rate and real GDP

Answer: A

Topic: *The Ripple Effects of Monetary Policy*

Skill: *Analytical*

Question history: *Previous edition, Chapter 14*

AACSB: *Analytical Skills*

- 18) In an effort to address the troubled economy, ..."For the ninth time in just over a year, the Federal Reserve is expected to cut interest rates, quite possibly its last reduction in this downturn." Rates have not been this low "... since 2003, when the economy was growing at a snail's pace."

www.csmonitor.com, 10/28/2008

The Fed's rates cuts will initially impact \_\_\_\_\_ and eventually \_\_\_\_\_.

- A) bank reserves; government spending
- B) the money supply; bank reserves
- C) bank reserves; real GDP
- D) investment; the real interest rate

Answer: C

Topic: *The Ripple Effects of Monetary Policy*

Skill: *Analytical*

Question history: *Previous edition, Chapter 14*

AACSB: *Analytical Skills*

- 19) In an effort to address the troubled economy, ..."For the ninth time in just over a year, the Federal Reserve is expected to cut interest rates, quite possibly its last reduction in this downturn." Rates have not been this low "... since 2003, when the economy was growing at a snail's pace."

www.csmonitor.com, 10/28/2008

These rate cuts are designed to

- A) decrease the real long-term interest rate and increase real GDP.
- B) increase the exchange rate and decrease government spending.
- C) increase bank reserves and the exchange rate.
- D) decrease the exchange rate and investment.

Answer: A

Topic: *The Ripple Effects of Monetary Policy*

Skill: *Analytical*

Question history: *Previous edition, Chapter 14*

AACSB: *Analytical Skills*

## 6 Essay Questions

- 1) Why does the Fed pursue price stability as its ultimate goal?

Answer: The economy works best when the price level is stable and is predictable. Uncertainty increases if the inflation rate fluctuates unpredictably because these fluctuations increase the risk to borrowers and lenders and to employers and employees. In both instances, long-term agreements are made and if inflation differs from what was expected, one person wins and the other loses. With the lower risk from the lower inflation, more transactions are conducted, which means more economic activity and more rapid economic growth.

Topic: *Price Stability*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Communication*

- 2) Describe how open market operations change the quantity of money.

Answer: Open market operations affect the quantity of banks' reserves. Suppose the Fed buys U.S. government securities. When the Fed buys government securities, banks' reserves increase. (These reserves rise whether the Fed buys securities from a bank or from a member of the public.) The rise in banks' reserves leads them to increase their lending, so the quantity of money increases.

*Topic: How an Open Market Operation Works*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 14*

*AACSB: Reflective Thinking*

- 3) Does an open market operation in which the Fed buys securities from the general public decrease or increase the banking system's reserves?

Answer: An open market purchase of government securities by the Fed increases the banking system's reserves.

*Topic: How an Open Market Operation Works*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 14*

*AACSB: Reflective Thinking*

- 4) Suppose in the money market the equilibrium interest rate is 5 percent and quantity of money demanded and supplied are both equal to \$2 trillion dollars. If the Fed increases the quantity of money, what is the effect on the interest rate?

Answer: If the Fed increases the quantity of money, the supply of money curve shifts rightward and the interest rate falls.

*Topic: Changing the Interest Rate, Fed Policy*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 14*

*AACSB: Reflective Thinking*

- 5) Assume the Fed is concerned with a possible recession so it wants to lower the interest rate. How does the Fed lower the interest rate in the short run?

Answer: In order to lower the interest rate, the Fed lowers the federal funds rate by increasing banks' reserves. With the increase in reserves, the quantity of money increases. In the short run, when the quantity of money increases, the interest rate falls.

*Topic: Changing the Interest Rate, Fed Policy*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 14*

*AACSB: Reflective Thinking*



- 6) What is the effect of lowering the interest rate on net exports? Explain your answer.

Answer: A decrease in the interest rate increases net exports. Net exports equals the value of exports minus the value of imports. Lowering the interest rate makes U.S. securities less attractive to foreign buyers. As a result, the demand for U.S. dollars decreases because foreigners no longer need to purchase as many dollars in order to buy U.S. securities. The decrease in the demand for the U.S. dollar lowers the exchange rate on the foreign exchange market. The fall in the exchange rate makes U.S. exports less expensive to foreigners because it now takes less foreign currency to buy a U.S. dollar and hence less foreign currency to buy U.S. exports. Simultaneously, the price of U.S. imports rises to U.S. residents. Therefore U.S. exports increase and U.S. imports decrease, both of which increase net exports.

*Topic: The Ripple Effects of Monetary Policy*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 14*

*AACSB: Reflective Thinking*

- 7) List and briefly explain the steps in how monetary policy affects real GDP in the *AS/AD* model. Tell what is the impact when the Fed eases monetary policy to fight a recession.

Answer: There are several steps. Step one is a change in the federal funds rate. To fight a recession, the Fed lowers the federal funds rate. It does so by using open market operations to increase banks' reserves. With the increase in reserves, the quantity of money increases, which then lowers the interest rate. Next the fall in the interest rate increases investment, net exports (though a fall in the exchange rate), and other interest sensitive parts of aggregate demand and thereby increases aggregate demand. Aggregate demand increases with a multiplied effect. The increase in aggregate demand raises the price level and increases real GDP.

*Topic: The Ripple Effects of Monetary Policy*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 14*

*AACSB: Communication*

- 8) Discuss how the Fed raising the federal funds rate ripples through the different sectors of the economy.

Answer: To raise the federal funds rate, the Fed sells securities in the open market. When the Fed sells securities in the open market, banks' reserves decrease, which raises the federal funds. In addition, the decrease in reserves decreases the quantity of money. The decrease in the quantity of money leads to a higher interest rate. A higher interest rate decreases investment and consumption expenditure, especially consumption expenditure on durable goods. In the foreign exchange market, the higher interest rate increase the attractiveness of U.S. securities. Foreigners increase their demand for U.S. dollars in order to purchase these securities and so the exchange rate of the dollar rises on the foreign exchange market. The rise in the exchange rate makes exports more expensive to foreigners and imports less expensive to U.S. residents. As a result, exports decrease and imports increase so that net exports decrease. All of the changes decrease aggregate demand.

*Topic: The Ripple Effects of Monetary Policy*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 14*

*AACSB: Communication*

9) Explain the ripple effects of a sale of securities in an open market operation.

**Answer:** The Fed's actions ripple through the economy. For instance, if the Fed tries to fight a recession, the Fed lowers the federal funds rate by buying securities in open market operations. The Fed pays for its purchases of securities by increasing banks' reserves, which lowers the federal funds rate. In addition, the increase in banks' reserves increases the quantity of money. The interest rate falls and thereby consumption expenditure and investment increase. In addition, the value of the dollar on the foreign exchange market falls as fewer foreign investors demand dollars to purchase assets in the United States. As a result, net exports increase. All these changes in expenditure lead to a multiplier effect that increases aggregate demand, thereby raising the price level and increasing real GDP.

*Topic: The Ripple Effects of Monetary Policy*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 14*

*AACSB: Communication*

10) Suppose the economy is in recession. Write a letter to the brand-new chairman of the Federal Reserve suggesting how the Fed might help end the recession. Be sure to explain how a change in monetary policy will affect economic activity.

**Answer:** The Fed needs to lower the federal funds rate. It can do so by conducting open market operations that buy government securities. This action supplies banks with new excess reserves that result in lowering the federal funds rate and allowing banks to make additional loans, thereby expanding the quantity of money. When the quantity of money increases, the interest rate falls. The fall in the interest rate stimulates consumption expenditure and investment, and also reduce the value of the dollar in foreign exchange markets, thereby stimulating net exports. These increases in spending will shift the *AD* curve rightward and real GDP will increase, although the price level might also rise, depending on the slope of the *SAS* curve.

*Topic: The Ripple Effects of Monetary Policy*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 14*

*AACSB: Communication*

11) In the aggregate demand/aggregate supply framework, lowering the federal funds rate has what short-run effects on real GDP?

**Answer:** In the aggregate demand/aggregate supply framework, lowering the federal funds rate increases the quantity of money and lowers the interest rate, which then increases aggregate demand. In the short run, the economy moves along its short-run aggregate supply curve so that the price level rises and real GDP increases.

*Topic: Effect of Monetary Policy on Aggregate Demand*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 14*

*AACSB: Reflective Thinking*

- 12) Explain how the Fed's response to inflation works its through the economy to ultimately affecting real GDP and the price level.

Answer: When the Fed is concerned with inflation, the Fed raises the federal funds rate target. To then boost the federal funds rate up to the new target, the Fed conducts open market operations that sell government securities. This sale requires that banks and other purchasers pay for their purchases by using banks' reserves, which decreases the amount of reserves available for banks. The decrease in reserves raises the federal funds rate. It also decreases the quantity of money. The decrease in the quantity of money shifts the supply of money curve leftward and the interest rate rises. The higher interest rate leads to a decrease in the demand for investment and other interest-sensitive sectors of the economy. These decreases mean that aggregate demand decreases so that the *AD* curve shifts leftward. Following the original decrease in aggregate demand, a multiplier process begins which decreases aggregate demand even further, so that there is a further leftward shift of the *AD* curve. As a result of the decrease in aggregate demand, the price level falls and real GDP decreases.

*Topic: Fed Tightens to Fight Inflation*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 14*

*AACSB: Communication*

- 13) "When the Fed is concerned with inflation, it buys government securities." Is the previous statement correct or incorrect? Explain your answer.

Answer: The statement is incorrect. When the Fed is concerned with inflation, the Fed wants to decrease aggregate demand and thereby decrease inflation. In order to decrease aggregate demand, the Fed needs to raise the federal funds rate. But when the Fed buys government securities, it *lowers* the federal funds rate. Therefore the proper Fed policy when it is concerned about inflation is to sell government securities and thereby raise the federal funds rate.

*Topic: Fed Tightens to Fight Inflation*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 14*

*AACSB: Reflective Thinking*

- 14) If the Fed is concerned about inflation, in the short run what is the proper monetary policy to restore price stability? What actions can the Fed undertake to restore price stability?

Answer: In order to avoid the inflation, the Fed needs to decrease aggregate demand. To decrease aggregate demand, the Fed must raise the federal funds rate and decrease the quantity of money. To do so, the Fed will sell government securities, which decreases banks' reserves because the reserves are used to pay the Fed for the government securities. The decrease in banks' reserves raises the federal funds rate and decreases the quantity of money.

*Topic: Fed Tightens to Fight Inflation*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 14*

*AACSB: Reflective Thinking*

15) When would the Fed want to carry out a monetary policy that decreases aggregate demand?

Answer: The Fed wants to decrease aggregate demand when it is worried about inflation. In this case, real GDP exceeds potential GDP and during the adjustment back to potential GDP, the price level will rise (so that inflation occurs) as aggregate supply decreases. In this situation, the Fed might well want to decrease aggregate demand in order to restore the economy to potential GDP and avoid the rising price level.

*Topic: Fed Tightens to Fight Inflation*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 14*

*AACSB: Reflective Thinking*

16) Explain how the Fed's response to a recession works its through the economy to ultimately affecting real GDP and the price level.

Answer: When the Fed is concerned with recession, the Fed lowers the federal funds rate target. To then lower the federal funds rate to the new target, the Fed conducts open market operations that buy government securities. The Fed pays for its purchases by increasing banks' reserves. The increase in reserves lowers the federal funds rate. It also increases the quantity of money. The increase in the quantity of money shifts the supply of money curve rightward and the interest rate falls. The lower interest rate leads to an increase in the demand for investment and other interest-sensitive sectors of the economy. These increases mean that aggregate demand increases so that the *AD* curve shifts rightward. Following the original increase in aggregate demand, a multiplier process begins which increases aggregate demand even further, so that there is a further rightward shift of the *AD* curve. As a result of the increase in aggregate demand, the price level rises and real GDP increases.

*Topic: Fed Eases to Fight Recession*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 14*

*AACSB: Communication*

17) In the short run, if the Fed wants to fight a recession, should it buy or sell government securities? Why?

Answer: The Fed should buy government securities. When the Fed buys government securities, the federal funds rate falls and banks' reserves increase. The increase in reserves increases the quantity of money and the interest rate falls. As a result, consumption expenditure, investment, and net exports increase, which increases aggregate demand. The increase in aggregate demand increases real GDP, which is the policy required when real GDP is less than potential GDP, that is, when the economy is in a recession.

*Topic: Fed Eases to Fight Recession*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 14*

*AACSB: Communication*

- 18) When the economy is in recession, does the Fed want to raise the interest rate so as to increase aggregate demand and increase real GDP? Explain your answer.

Answer: When the economy is in a recession, the Fed wants to increase aggregate demand and hence GDP, but raising the interest rate is the wrong policy. A boost in the interest rate decreases consumption expenditure, investment, and net exports and therefore *decreases* aggregate demand. The proper policy for the Fed to pursue is a cut in the interest rate.

Topic: *Fed Eases to Fight Recession*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

## 7 True or False

- 1) The core inflation rate is more volatile than the total CPI inflation rate.

Answer: FALSE

Topic: *Core CPI*

Skill: *Recognition*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 2) A positive output gap is an inflationary gap.

Answer: TRUE

Topic: *Output Gap*

Skill: *Recognition*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 3) The President of the United States is also the chairman of the Federal Reserve.

Answer: FALSE

Topic: *The Federal Reserve System*

Skill: *Recognition*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 4) The Fed targets the 30-year bond rate as its monetary policy instrument.

Answer: FALSE

Topic: *Monetary Policy*

Skill: *Recognition*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 5) When the Fed purchases U.S. government securities in the open market, the federal funds falls.

Answer: TRUE

Topic: *Changing the Interest Rate, Fed Policy*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 6) If the Fed carries out an open market operation and sells U.S. government securities, the federal funds rate falls and the quantity of money increases.

Answer: FALSE

*Topic: Changing the Interest Rate, Fed Policy*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 14*

*AACSB: Reflective Thinking*

- 7) If the Fed carries out an open market operation and sells U.S. government securities, the federal funds rate rises and the quantity of money decreases.

Answer: TRUE

*Topic: Changing the Interest Rate, Fed Policy*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 14*

*AACSB: Reflective Thinking*

- 8) If the federal funds rate is below the Fed target, the Fed will conduct an open market sale to increase the federal funds rate to the desired level.

Answer: TRUE

*Topic: Changing the Interest Rate, Fed Policy*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 14*

*AACSB: Reflective Thinking*

- 9) Long-term interest rates fluctuate more than short-term rates.

Answer: FALSE

*Topic: The Ripple Effects of Monetary Policy*

*Skill: Recognition*

*Question history: Previous edition, Chapter 14*

*AACSB: Reflective Thinking*

- 10) If the Fed sells bonds in the open market, net exports will increase.

Answer: FALSE

*Topic: The Ripple Effects of Monetary Policy*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 14*

*AACSB: Reflective Thinking*

- 11) If the Fed sells bonds in the open market, net exports will decrease.

Answer: TRUE

*Topic: The Ripple Effects of Monetary Policy*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 14*

*AACSB: Reflective Thinking*

- 12) A decrease in the supply of loanable funds decreases the real interest rate.

Answer: FALSE

*Topic: The Ripple Effects of Monetary Policy*

*Skill: Recognition*

*Question history: Previous edition, Chapter 14*

*AACSB: Reflective Thinking*

- 13) When the Fed lowers the federal funds rate, it increases reserves and increases the quantity of deposits and loans created.

Answer: TRUE

Topic: *Changing the Interest Rate, Fed Policy*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 14) To decrease inflation, the Federal Reserve would adjust its target for the federal funds rate upward.

Answer: TRUE

Topic: *Changing the Interest Rate, Fed Policy*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 15) If the Fed lowers the federal funds rate, aggregate demand decreases.

Answer: TRUE

Topic: *Effect of Monetary Policy on Aggregate Demand*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 16) The less sensitive to the interest rate are consumption expenditure and investment, the smaller is the shift in the AD curve when the Fed changes the federal funds rate.

Answer: TRUE

Topic: *Effect of Monetary Policy on Aggregate Demand*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 17) In the short run, the Fed's actions to fight inflation shift the aggregate demand curve leftward.

Answer: TRUE

Topic: *Fed Tightens to Fight Inflation*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 14*

AACSB: *Reflective Thinking*

- 18) The Taylor Rule maintains that the Fed should set the growth rate of the quantity of money equal to the growth rate of real GDP.

Answer: FALSE

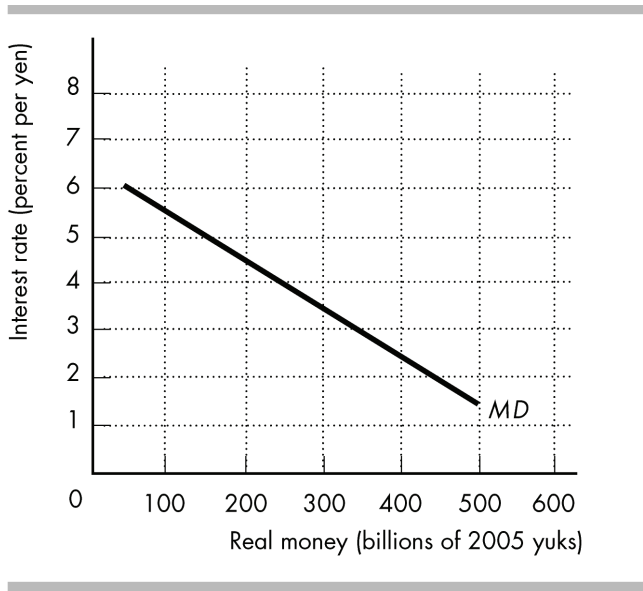
Topic: *The Taylor Rule*

Skill: *Recognition*

Question history: *Previous edition, Chapter 14*

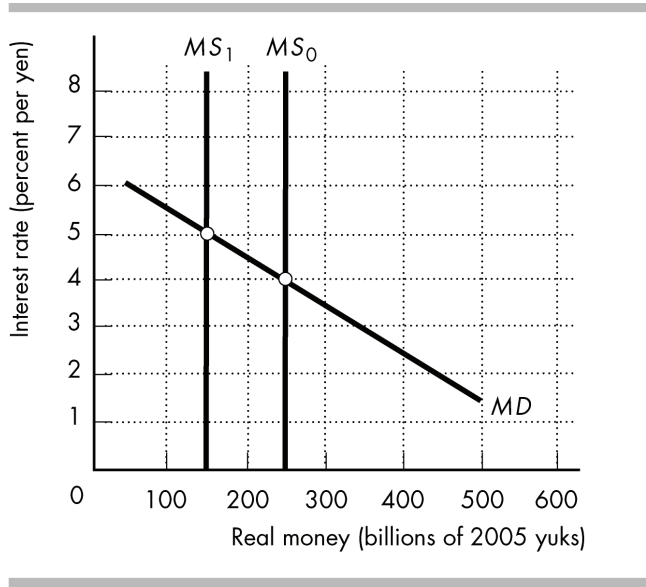
AACSB: *Reflective Thinking*

### 8 Extended Problems



- 1) The figure above shows the demand for money in Kiteland.
  - a) If the Kiteland Central Bank has set the quantity of money so that the equilibrium interest rate is 4 percent, draw the supply of money curve.
  - b) Suppose that Kiteland's Central Bank wants to raise the interest rate by 1 percentage point. By how much must it change the quantity of real money?
  - c) In order to change the quantity of money to raise the interest rate by one percentage point, if the Central Bank uses an open market operation, does it make an open market purchase or an open market sale? Explain your answer.

Answer:



- a) See the figure above. When the supply of money is 250 billion yuks, or  $MS_0$ , the



interest rate is 4 percent

b) See the figure above. To raise the interest rate from 4 percent to 5 percent, the Central Bank decreases the supply of money from 250 billion yuks,  $MS_0$ , to 150 billion yuks,  $MS_1$ . So the Central Bank decreases the quantity of real money by 100 billion yuks.

c) The Central Bank conducts an open market sale. As it does so, the bank reserves decrease, the banks cut their lending until the amount of loans is consistent with the new level of reserves. As bank loans decrease, the quantity of money decreases.

*Topic: Changing the Interest Rate, Fed Policy*

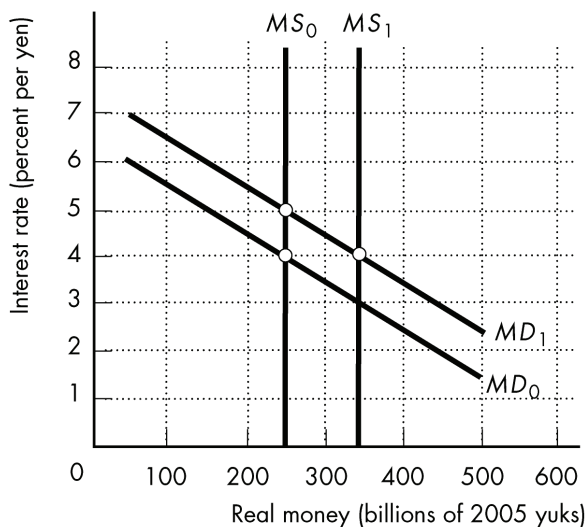
*Skill: Analytical*

*Question history: Previous edition, Chapter 14*

*AACSB: Analytical Skills*

- 2) The figure above shows the demand for money in Kiteland.
- If the Kiteland Central Bank has set the quantity of money so that the equilibrium interest rate is 4 percent, draw the supply of money curve.
  - Suppose Kiteland's real GDP increases so that the demand for money changes by 100 billion yuks. The Kiteland Central Bank takes no actions. Show the effects of this event on your figure. What happens to the interest rate? What happens to the quantity of money in the economy?
  - If the Central Bank wants to prevent the interest rate from changing, what must it do to the quantity of money? Draw the new supply of money curve.
  - In order to change the quantity of money to keep the interest rate constant, suppose the Kiteland Central Bank uses open market operations. Does it make an open market purchase or an open market sale? Explain your answer.

Answer:



- See the figure above. When the demand for money is the initial demand,  $MD_0$ , and the supply of money is  $MS$ , 250 billion yuks, then the interest rate is 4 percent.
- When real GDP increases, the demand for money increases. In this case, the increase in real GDP increases the demand for money so that the demand for money curve shifts rightward from  $MD_0$  to  $MD_1$ . Because the Kiteland Central Bank takes no action, the quantity of money remains the same, 250 billion yuks, and the supply of money curve remains  $MS_0$ . With no change in the quantity of money, the increase in the demand for money raises the interest rate from 4 percent to 5 percent.
- To prevent the interest rate from rising, the Kiteland Central Bank increases the quantity of money from  $MS_0$  to  $MS_1$ .
- The Kiteland Central Bank makes an open market purchase. As it does so, the bank reserves increase, the banks increase their lending and so the quantity of money increases.

Topic: Changing the Interest Rate, Fed Policy

Skill: Analytical

Question history: Previous edition, Chapter 14

AACSB: Analytical Skills

- 3) In the economy of Rulewania, the current inflation rate is 6 percent and the Central Bank's target inflation rate is 2 percent. Real GDP exceeds potential GDP by 1 percent, and the long-term growth rate of real GDP is 5 percent. The medium-term growth rate of the velocity of circulation of the monetary base is 2 percent. According to the Taylor rule, what federal funds rate should the Central Bank set?

Answer: The Taylor rule is to set the federal funds rate equal to 2 percent plus the inflation rate plus one half of the gap between the actual inflation rate and the target inflation rate plus one half of the percentage deviation of real GDP from potential GDP. So the federal funds rate is equal to: 2 percent + 6 percent +  $0.5 \times 4$  percent +  $0.5 \times 1$  percent = 10.5 percent.

*Topic: Taylor Rule and McCallum Rule*

*Skill: Analytical*

*Question history: Previous edition, Chapter 14*

*AACSB: Analytical Skills*

# Chapter 15

## International Trade Policy

### 1 How Global Markets Work

- 1) The fundamental force that generates international trade is
- A) absolute advantage.
  - B) comparative advantage.
  - C) law of diminishing returns.
  - D) law of increasing costs.

Answer: B

Topic: *Comparative Advantage*

Skill: *Recognition*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*

- 2) The fundamental force that drives international trade is:
- A) Comparative advantage
  - B) Absolute advantage
  - C) Countries' desire to increase their trade surplus
  - D) Cheap labor in countries like China or India

Answer: A

Topic: *Comparative Advantage*

Skill: *Recognition*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*

- 3) Comparative advantage implies that a country will
- A) import those goods in which the country has a comparative advantage.
  - B) export those goods in which the country has a comparative advantage.
  - C) find it difficult to conclude free trade agreements with other nations.
  - D) export goods produced by domestic industries with low wages relative to its trading partners.

Answer: B

Topic: *Comparative Advantage*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*

- 4) Prior to international trade, if country A has a lower price of good X than does country B, then we know definitely that
- A) country B has an absolute advantage in the production of good X.
  - B) country B has a comparative advantage in the production of good X.
  - C) country A has an absolute advantage in the production of good X.
  - D) country A has a comparative advantage in the production of good X.

Answer: D

Topic: *Comparative Advantage*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*

- 5) When the principle of comparative advantage is used to guide trade, then a country will specialize by producing only
- A) goods with the highest opportunity cost.
  - B) goods with the lowest opportunity costs.
  - C) goods for which production takes fewer worker-hour than another country.
  - D) goods for which production costs are more than average total costs.

Answer: B

Topic: Comparative Advantage

Skill: Conceptual

Question history: Previous edition, Chapter 15

AACSB: Reflective Thinking

- 6) The United States decides to follow its comparative advantage and specialize in the production of airplanes. Which of the following will occur?
- A) more airplanes will be produced in the United States
  - B) there will be no change in the price of airplanes in the United States
  - C) the world price of airplanes will increase
  - D) the quantity of airplanes demanded in the United States will increase

Answer: A

Topic: Gains from Trade, Changes in Production

Skill: Conceptual

Question history: Previous edition, Chapter 15

AACSB: Analytical Skills

- 7) A country specializes in the production of goods for which it has a comparative advantage. We find that
- A) some producers and consumers win, some lose, but overall the gains exceed the losses
  - B) all producers win
  - C) all consumers win
  - D) producers win, consumers lose, but overall the gains exceed the losses

Answer: A

Topic: Gains from Trade

Skill: Conceptual

Question history: Previous edition, Chapter 15

AACSB: Analytical Skills

- 8) Consider a market that sells some of its goods as exports. Who does NOT benefit?
- A) domestic consumers
  - B) domestic producers
  - C) workers in the industry
  - D) foreign consumers

Answer: A

Topic: Gains from Trade

Skill: Conceptual

Question history: Previous edition, Chapter 15

AACSB: Analytical Skills

- 9) Who benefits from imports?
- A) domestic consumers
  - B) domestic producers
  - C) foreign consumers
  - D) domestic workers in the industry

Answer: A

Topic: *Gains from Trade, Imports*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Analytical Skills*

- 10) Consider a market that, with no international trade, is initially in equilibrium with quantity demanded equal to quantity supplied at a price of \$20. If the world price of the good is \$10 and the country opens up to international trade then in this market
- A) imports will increase, price will fall, and quantity supplied will fall
  - B) exports will increase, price will be unchanged, and quantity supplied will increase
  - C) imports will increase, price will decrease, and the supply curve will shift to the left
  - D) quantity demanded will decrease, quantity supplied will decrease, and price will decrease

Answer: A

Topic: *Gains from Trade, Imports*

Skill: *Conceptual*

Question history: *Modified 10th edition*

AACSB: *Analytical Skills*

- 11) Based on the table below, at what world price would the country import?

Price	QDemanded	QSupplied
2	100	70
4	95	75
6	90	80
8	85	85
10	80	90
12	75	95

- A) all prices below \$8
- B) at exactly \$8
- C) all prices above \$8
- D) it is impossible to say

Answer: A

Topic: *Imports*

Skill: *Analytical*

Question history: *Modified 10th edition*

AACSB: *Analytical Skills*

12) Suppose the world price of a good is \$4. Based on the table below, the country will

Price	QDemanded	QSupplied
2	100	70
4	95	75
6	90	80
8	85	85
10	80	90
12	75	95

- A) import 20 units
- B) export 20 units
- C) import 10 units
- D) export 10 units

Answer: A

Topic: Imports

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

13) In a market open to international trade, at the world price the quantity demanded is 150 and quantity supplied is 200. This country will

- A) export 50 units.
- B) import 50 units.
- C) export 200 units.
- D) import 150 units.

Answer: A

Topic: Gains from Trade, Exports

Skill: Conceptual

Question history: Previous edition, Chapter 15

AACSB: Analytical Skills

14) Based on the table below, at what world price would the country export?

Price	QDemanded	QSupplied
2	100	70
4	95	75
6	90	80
8	85	85
10	80	90
12	75	95

- A) all prices above \$8
- B) at only \$8
- C) all prices below \$8
- D) it is impossible to say

Answer: A

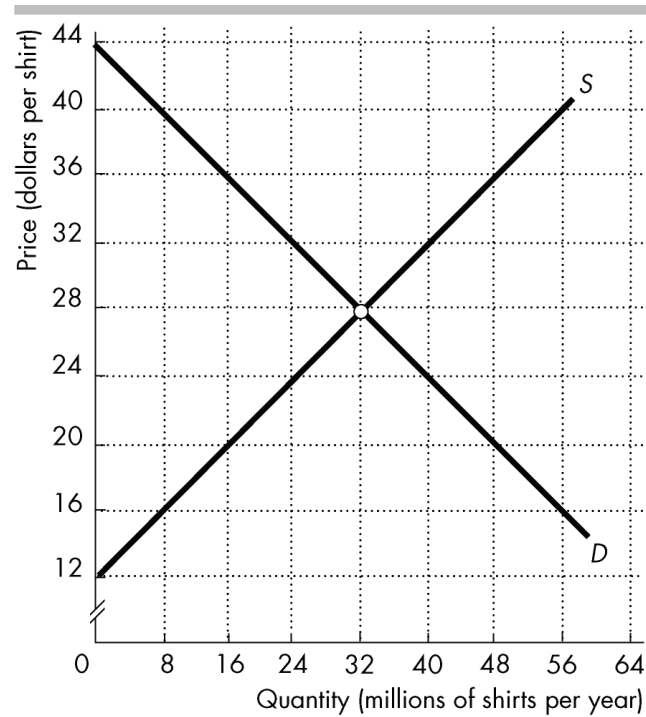
Topic: Exports

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills





The figure shows the market for shirts in the United States, where D is the domestic demand curve and S is the domestic supply curve. The world price is \$20 per shirt.

15) In the figure above, with international trade Americans buy \_\_\_\_\_ million shirts per year.

- A) 48
- B) 32
- C) 16
- D) 24

Answer: A

Topic: Gains from Trade

Skill: Analytical

Question history: Previous edition, Chapter 15

AACSB: Analytical Skills

16) In the figure above, with international trade \_\_\_\_\_ million shirts per year are produced in the United States.

- A) 48
- B) 32
- C) 16
- D) 20

Answer: C

Topic: Gains from Trade

Skill: Analytical

Question history: Previous edition, Chapter 15

AACSB: Analytical Skills

- 17) In the figure above, with international trade the United States \_\_\_\_\_ million shirts per year.
- A) imports 32
  - B) imports 48
  - C) exports 16
  - D) exports 32

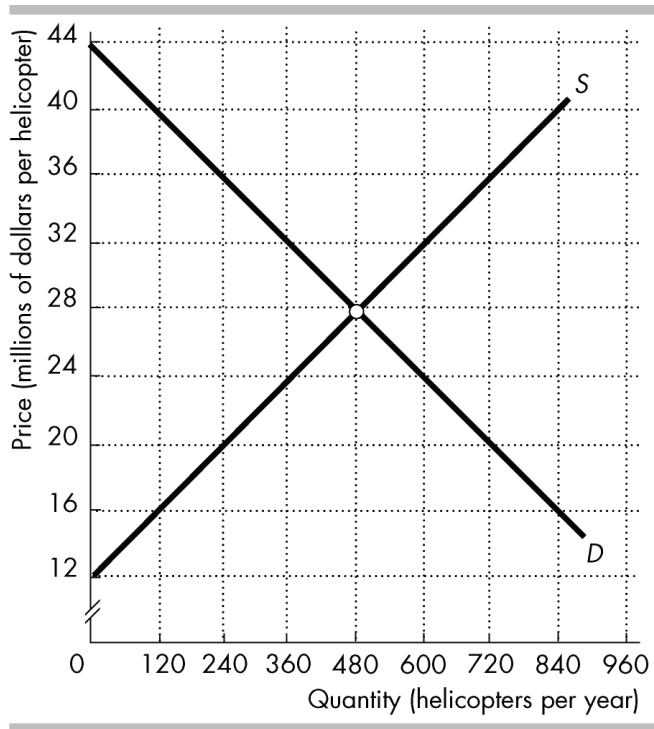
Answer: A

Topic: Imports

Skill: Analytical

Question history: Previous edition, Chapter 15

AACSB: Analytical Skills



The figure shows the market for helicopters in the United States, where *D* is the domestic demand curve and *S* is the domestic supply curve. The United States trades helicopters with the rest of the world at a price of \$36 million per helicopter.

- 18) In the figure above, with international trade U.S. companies buy \_\_\_\_\_ helicopters per year.
- A) 240
  - B) 480
  - C) 720
  - D) 360

Answer: A

Topic: Gains from Trade

Skill: Analytical

Question history: Previous edition, Chapter 15

AACSB: Analytical Skills

- 19) In the figure above, with international trade \_\_\_\_\_ helicopters per year are produced in the United States.
- A) 360
  - B) 480
  - C) 720
  - D) 240

Answer: C

Topic: Gains from Trade

Skill: Analytical

Question history: Previous edition, Chapter 15

AACSB: Analytical Skills

- 20) In the figure above, the United States \_\_\_\_\_ helicopters per year.
- A) exports 480
  - B) exports 720
  - C) imports 480
  - D) imports 240

Answer: A

Topic: Exports

Skill: Analytical

Question history: Previous edition, Chapter 15

AACSB: Analytical Skills

- 21) Which of the following statements about U.S. international trade in 2009 is correct?
- A) The value of U.S. exports exceeded the value of U.S. imports
  - B) The value of U.S. exports was about 33 percent of the value of total U.S. production
  - C) The United States imported only goods.
  - D) The United States was the world's largest trader.

Answer: D

Topic: Study Guide Question, International Trade Today

Skill: Recognition

Question history: Previous edition, Chapter 15

AACSB: Reflective Thinking

- 22) The United States has a comparative advantage in producing cotton if the U.S. price of cotton before international trade is \_\_\_\_\_ the world price
- A) less than
  - B) equal to
  - C) greater than
  - D) not comparable to

Answer: A

Topic: Study Guide Question, Comparative Advantage

Skill: Conceptual

Question history: Previous edition, Chapter 15

AACSB: Reflective Thinking

- 23) Compared to the situation before international trade, after the United States exports a good production in the United States \_\_\_\_\_ and consumption in the United States \_\_\_\_\_.
- A) increases; increases
  - B) increases; decreases
  - C) decreases; increases
  - D) decreases; decreases

Answer: B

Topic: Study Guide Question, Comparative Advantage

Skill: Conceptual

Question history: Previous edition, Chapter 15

AACSB: Analytical Skills

- 24) Compared to the situation before international trade, after the United States imports a good production in the United States \_\_\_\_\_ and consumption in the United States \_\_\_\_\_.
- A) increases; increases
  - B) increases; decreases
  - C) decreases; increases
  - D) decreases; decreases

Answer: C

Topic: Study Guide Question, Comparative Advantage

Skill: Conceptual

Question history: Previous edition, Chapter 15

AACSB: Analytical Skills

## 2 International Trade Restrictions

- 1) A tariff is a
- A) tax on an exported good or service.
  - B) tax on an imported good or service.
  - C) subsidy on an exported good.
  - D) subsidy on an imported good.

Answer: B

Topic: Trade Restrictions

Skill: Recognition

Question history: Previous edition, Chapter 15

AACSB: Reflective Thinking

- 2) A tariff
- A) is a tax imposed on imported goods.
  - B) is a tax imposed on exported goods.
  - C) encourages worldwide specialization according to the principle of comparative advantage.
  - D) has no effect on prices paid by domestic consumers even though it increases the revenue collected by domestic producers.

Answer: A

Topic: Trade Restrictions

Skill: Recognition

Question history: Previous edition, Chapter 15

AACSB: Reflective Thinking

- 3) A tariff is
- A) a licensing regulation that limits imports.
  - B) a tax on an exported good.
  - C) a tax on an imported good.
  - D) an agreement to restrict the volume of exports.

Answer: C

Topic: Trade Restrictions

Skill: Recognition

Question history: Previous edition, Chapter 15

AACSB: Reflective Thinking

- 4) A tax that is imposed by the importing country when an imported good crosses its international boundary is called
- A) an import quota.
  - B) dumping.
  - C) a voluntary export restraint.
  - D) a tariff.

Answer: D

Topic: Trade Restrictions

Skill: Recognition

Question history: Previous edition, Chapter 15

AACSB: Reflective Thinking

- 5) A major purpose of tariffs is to
- A) encourage imports.
  - B) encourage exports.
  - C) discourage imports.
  - D) discourage exports.

Answer: C

Topic: Trade Restrictions

Skill: Conceptual

Question history: Previous edition, Chapter 15

AACSB: Reflective Thinking

- 6) Tariffs and import quotas differ in that
- A) one is a form of trade restriction, while the other is not.
  - B) one is a tax, while the other is a limit.
  - C) one is imposed by the government, while the other is imposed by the private sector.
  - D) one is legal, while the other is not.

Answer: B

Topic: Trade Restrictions

Skill: Conceptual

Question history: Previous edition, Chapter 15

AACSB: Reflective Thinking

- 7) Tariffs and import quotas *both* result in
- A) lower levels of domestic production.
  - B) the domestic government gaining revenue.
  - C) lower levels of imports.
  - D) higher levels of domestic consumption.

Answer: C

Topic: Trade Restrictions

Skill: Conceptual

Question history: Previous edition, Chapter 15

AACSB: Analytical Skills

- 8) If the United States imposes a tariff on imported cars, the
- A) U.S. demand curve shifts rightward.
  - B) U.S. demand curve shifts leftward.
  - C) U.S. supply curve shifts rightward.
  - D) price in the United States rises but neither the U.S. demand curve nor the U.S. supply curve shift..

Answer: D

Topic: Effects of a Tariff

Skill: Recognition

Question history: Previous edition, Chapter 15

AACSB: Analytical Skills

- 9) Suppose the country of Atlantica imposes a tariff on foreign-produced cars. As a result of the tariff,
- A) tariff revenue collected by the government in the Atlantica increases.
  - B) there is an increase in the number of imported cars.
  - C) the gains from trade rise.
  - D) there are more efficient trade agreements between Atlantica and its trade partners.

Answer: A

Topic: Effects of a Tariff

Skill: Recognition

Question history: Previous edition, Chapter 15

AACSB: Analytical Skills

- 10) Which of the following statements concerning tariffs is NOT true?
- A) A tariff results in a loss for for domestic consumers of the good.
  - B) A tariff creates revenue for the government.
  - C) A tariff decreases international trade.
  - D) A tariff leaves the price of imports unchanged.

Answer: D

Topic: Effects of a Tariff

Skill: Recognition

Question history: Modified 10th edition

AACSB: Communication

- 11) If a country imposes a tariff on an imported good, the tariff \_\_\_\_\_ the price in the importing country and \_\_\_\_\_ the quantity of imports.
- A) raises; decreases
  - B) raises; increases
  - C) raises; does not change
  - D) lowers; does not change

Answer: A

Topic: *Effects of a Tariff*

Skill: *Analytical*

Question history: *Modified 10th edition*

AACSB: *Analytical Skills*

- 12) A tariff \_\_\_\_\_ the quantity of the good imported and \_\_\_\_\_ the domestic price of the imported good.
- A) decreases; decreases
  - B) decreases; increases
  - C) increases; lowers
  - D) does not change; increases

Answer: B

Topic: *Effects of a Tariff*

Skill: *Recognition*

Question history: *Previous edition, Chapter 15*

AACSB: *Analytical Skills*

- 13) A tariff imposed by the United States on Japanese cars \_\_\_\_\_ the price of cars in the United States and \_\_\_\_\_ the quantity of Japanese cars imported into the United States.
- A) raises; increases
  - B) raises; decreases
  - C) lowers; increases
  - D) lowers; decreases

Answer: B

Topic: *Effects of a Tariff*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Analytical Skills*

- 14) If a tariff is imposed, the price paid by domestic consumers will \_\_\_\_\_ and the amount imported will \_\_\_\_\_.
- A) increase; decrease
  - B) increase; not change
  - C) not change; increase
  - D) increase; increase

Answer: A

Topic: *Effects of a Tariff*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Analytical Skills*

- 15) If the United States imposes a tariff of \$1 per imported shirt, the higher tariff
- A) raises the price of a shirt to U.S. consumers.
  - B) benefits U.S. shirt consumers.
  - C) increases imports of shirts into the United States.
  - D) None of the above

Answer: A

Topic: *Effects of a Tariff*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Communication*

- 16) If the United States imposes a tariff on imported steel, the tariff will
- A) raise the U.S. price of imported steel.
  - B) decrease the U.S. production of steel.
  - C) increase the total U.S. consumption of steel.
  - D) decrease employment in the U.S. steel industry.

Answer: A

Topic: *Effects of a Tariff*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Analytical Skills*

- 17) Suppose the country of Mooland imposes tariffs on imported beef from the country of Aqualand. As a result of the tariffs, the
- A) price of beef in Mooland falls.
  - B) quantity of beef exported by Mooland increases.
  - C) quantity of beef imported by Mooland decreases.
  - D) quantity of beef imported by Mooland increases.

Answer: C

Topic: *Effects of a Tariff*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Analytical Skills*

- 18) Lowering the tariff on good X will
- A) increase domestic employment in industry X.
  - B) increase the domestic imports of good X.
  - C) increase the domestic price of good X.
  - D) have no effect unless the nation's trading partner also lowers its tariff on good X.

Answer: B

Topic: *Effects of a Tariff*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Analytical Skills*



19) Reducing a tariff will \_\_\_\_\_ the domestic production of the good and \_\_\_\_\_ the total domestic consumption of the good.

- A) increase; increase
- B) increase; decrease
- C) decrease; increase
- D) decrease; decrease

Answer: C

Topic: *Effects of a Tariff*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Analytical Skills*

20) Increasing a tariff will \_\_\_\_\_ the domestic quantity consumed of the good, while \_\_\_\_\_ the domestic production of the good.

- A) increase; increasing
- B) increase; decreasing
- C) decrease; increasing
- D) decrease; decreasing

Answer: C

Topic: *Effects of a Tariff*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Analytical Skills*

21) A U.S. tariff on textiles would \_\_\_\_\_ U.S. clothing prices and \_\_\_\_\_ jobs in the U.S. textile industry.

- A) reduce; decrease
- B) reduce; increase
- C) raise; decrease
- D) raise; increase

Answer: D

Topic: *Effects of a Tariff*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Analytical Skills*

22) Tariffs

- A) generate revenue for consumers.
- B) generate revenue for the government.
- C) encourage domestic consumers to buy more imports.
- D) encourage domestic producers to produce less.

Answer: B

Topic: *Effects of a Tariff*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*

- 23) The United States imports cars from Japan. If the United States imposes a tariff on cars imported from Japan, American
- A) consumers will lose and Japanese producers will gain.
  - B) tariff revenue will equal the loss inflicted on American consumers.
  - C) consumers will lose and American producers will gain.
  - D) car manufacturers will gain revenue equal to the revenue lost by Japanese car manufacturers.

Answer: C

Topic: *Effects of a Tariff*

Skill: *Analytical*

Question history: *Previous edition, Chapter 15*

AACSB: *Analytical Skills*

- 24) The winners from a tariff on imports are
- A) producers and government
  - B) producers
  - C) consumers
  - D) consumers, producers, and government

Answer: A

Topic: *Effects of a Tariff*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Ethical Reasoning*

- 25) A tariff is imposed on a good. The tariff will \_\_\_\_\_ quantity supplied, \_\_\_\_\_ quantity demanded, and \_\_\_\_\_ price in the home country.
- A) increase; decrease; increase
  - B) increase; remain unchanged; remain unchanged
  - C) increase; increase; increase
  - D) increase; decrease; decrease

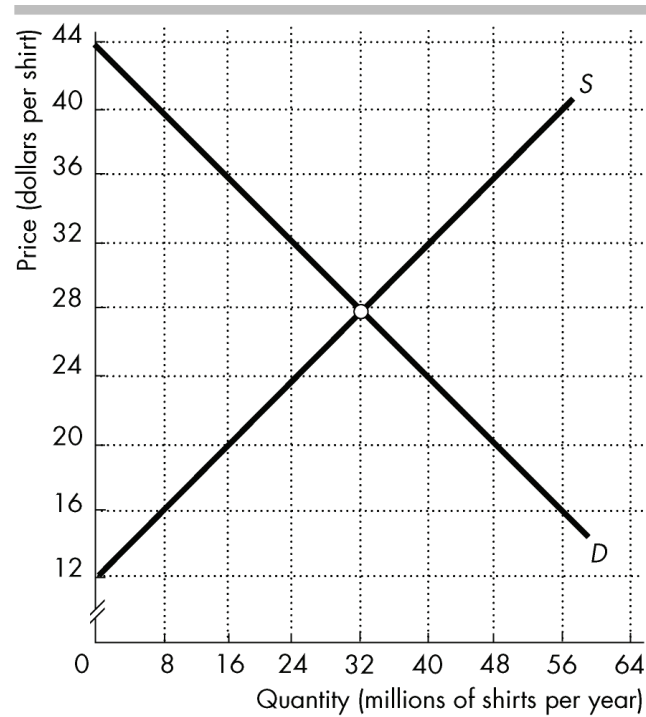
Answer: A

Topic: *Effects of a Tariff*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*



The figure shows the market for shirts in the United States, where D is the domestic demand curve and S is the domestic supply curve. The world price is \$20 per shirt. The United States imposes a tariff on imported shirts, \$4 per shirt.

- 26) In the figure above, with the tariff Americans buy \_\_\_\_\_ million shirts per year.
- A) 40
  - B) 48
  - C) 32
  - D) 16

Answer: A

Topic: Effects of a Tariff

Skill: Analytical

Question history: Previous edition, Chapter 15

AACSB: Analytical Skills

- 27) In the figure above, with the tariff the United States imports \_\_\_\_\_ million shirts per year.
- A) 24
  - B) 8
  - C) 32
  - D) 16

Answer: D

Topic: Effects of a Tariff

Skill: Analytical

Question history: Previous edition, Chapter 15

AACSB: Analytical Skills

- 28) In the figure above, the tariff \_\_\_\_\_ U.S. imports of shirts by \_\_\_\_\_ million shirts per year.
- A) decreases; 16
  - B) decreases; 8
  - C) increases; 8
  - D) increases; 4

Answer: A

Topic: *Effects of a Tariff*

Skill: *Analytical*

Question history: *Previous edition, Chapter 15*

AACSB: *Analytical Skills*

- 29) In the figure above, the tariff \_\_\_\_\_ the domestic production of shirts in the United States by \_\_\_\_\_ per year.
- A) increases; 8 million
  - B) decreases; 16 million
  - C) increases; 4 million
  - D) decreases; 8 million

Answer: A

Topic: *Effects of a Tariff*

Skill: *Analytical*

Question history: *Previous edition, Chapter 15*

AACSB: *Analytical Skills*

- 30) In the figure above, the U.S. government's revenue from the tariff is \_\_\_\_\_.
- A) \$64 million
  - B) \$32 million
  - C) \$128 million
  - D) \$48 million

Answer: A

Topic: *Effects of a Tariff*

Skill: *Analytical*

Question history: *Previous edition, Chapter 15*

AACSB: *Analytical Skills*

- 31) During the Great Depression in the 1930s, the average tariff level in the United States peaked at about
- A) zero.
  - B) 6 percent.
  - C) 20 percent.
  - D) 100 percent.

Answer: C

Topic: *History of Tariffs*

Skill: *Recognition*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*

- 32) Average tariff levels in the United States in the last decade are
- A) about equal to the average since 1930.
  - B) above the average since 1930.
  - C) positive, but below the average since 1930.
  - D) zero, as there are no longer any tariffs in the United States.

Answer: C

Topic: History of Tariffs

Skill: Recognition

Question history: Previous edition, Chapter 15

AACSB: Reflective Thinking

- 33) The Smoot-Hawley Act was enacted in
- A) 1980.
  - B) 2000.
  - C) 1930.
  - D) 1950.

Answer: C

Topic: Smoot-Hawley Act

Skill: Recognition

Question history: Previous edition, Chapter 15

AACSB: Reflective Thinking

- 34) The Smoot-Hawley Act introduced
- A) opportunities for expanding U.S. foreign trade.
  - B) the highest tariffs set by the United States in the last 80 years.
  - C) a framework promoting international free trade.
  - D) revenue tariffs as a major source of U.S. government revenues.

Answer: B

Topic: The History of Tariffs

Skill: Recognition

Question history: Previous edition, Chapter 15

AACSB: Reflective Thinking

- 35) The Smoot-Hawley Act
- A) made most tariffs illegal.
  - B) greatly raised tariffs.
  - C) gave the President the right to broker trade deals with other nations.
  - D) recognized Congress's right to deny trade authorization powers to the President.

Answer: B

Topic: The History of Tariffs

Skill: Recognition

Question history: Previous edition, Chapter 15

AACSB: Reflective Thinking

- 36) U.S. tariffs in the peaked in
- A) 1992.
  - B) 1961.
  - C) 1940.
  - D) 1933.

Answer: D

Topic: *The History of Tariffs*

Skill: *Recognition*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*

- 37) Since 1930, tariff levels in the United States have
- A) generally declined.
  - B) steadily risen.
  - C) increased during expansions.
  - D) decreased during recessions.

Answer: A

Topic: *The History of Tariffs*

Skill: *Recognition*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*

- 38) Of the following, in which decade were U.S. tariffs at their lowest level?
- A) 2000s
  - B) 1970s
  - C) 1950s
  - D) 1930s

Answer: A

Topic: *The History of Tariffs*

Skill: *Recognition*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

- 39) Which of the following best describes the history of tariffs in the United States over the past 70 years?
- A) Tariffs were at their highest level in the 1970s and now average just over 10 percent.
  - B) Tariffs have declined overall since the early 1930s and now average just over 10 percent.
  - C) Tariffs reached a maximum in the early 1930s and now average less than 5 percent
  - D) Average tariff rates have not changed much since the early 1930s and are less than 5 percent.

Answer: C

Topic: *The History of Tariffs*

Skill: *Recognition*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*

- 40) The current U.S. average tariff rate
- A) less than 5 percent.
  - B) greater than 10 percent.
  - C) approximately 20 percent.
  - D) over 50 percent.

Answer: A

Topic: *The History of Tariffs*

Skill: *Recognition*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*

- 41) An import quota is
- A) a tariff that is a fixed percentage of the price of a good.
  - B) a tariff that is a fixed dollar amount per unit of a good.
  - C) an agreed upon price for a good to be imported at a specified future date.
  - D) a restriction that specifies the maximum amount of a good that may be imported.

Answer: D

Topic: *Import Quota*

Skill: *Recognition*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*

- 42) Import quotas
- A) are the same as tariffs.
  - B) set the maximum number of units of a good that can be imported.
  - C) are not used by the United States.
  - D) set the minimum percentage of the value of a product that must consist of imported components.

Answer: B

Topic: *Import Quota*

Skill: *Recognition*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*

- 43) An import quota is a
- A) tariff imposed on goods that are dumped in the country.
  - B) law that prevents ecologically damaging goods from being imported into a country.
  - C) market-imposed balancing factor that keeps prices of imports and exports in equilibrium.
  - D) government-imposed restriction on the quantity of a specific good that can be imported.

Answer: D

Topic: *Import Quota*

Skill: *Recognition*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*

- 44) An import quota specifies the
- A) highest price that can be charged for an imported good.
  - B) per unit tax that must be paid on an imported good.
  - C) maximum quantity of a good that may be imported during a specified time period.
  - D) minimum quantity of a good that must be exported during a specified time period.

Answer: C

Topic: *Import Quota*

Skill: *Recognition*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*

- 45) Import quotas
- A) encourage freer trade.
  - B) are a tax on an imported good.
  - C) set the number of units of a good that can be imported.
  - D) set the minimum percentage of the value of a good that can consist of imported components.

Answer: C

Topic: *Import Quota*

Skill: *Recognition*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*

- 46) An import quota protects domestic producers by
- A) setting a limit on the amount of imports.
  - B) placing a prohibitive tax on imports.
  - C) encouraging competition among domestic producers.
  - D) increasing the total supply of the product.

Answer: A

Topic: *Import Quota*

Skill: *Recognition*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*

- 47) The effect of an import quota is to
- A) increase the supply of the good and lower its price.
  - B) increase the supply of the good and increase its price.
  - C) increase the demand for the good and increase its price.
  - D) decrease the supply of the good and raise its price.

Answer: D

Topic: *Effects of an Import Quota*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Analytical Skills*



- 48) An import quota directly restricts \_\_\_\_\_ and are designed to protect domestic \_\_\_\_\_.
- A) exports; consumers
  - B) exports; producers
  - C) imports; consumers
  - D) imports; producers

Answer: D

Topic: *Effects of an Import Quota*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Analytical Skills*

- 49) Import quotas \_\_\_\_\_ the price of imported goods and \_\_\_\_\_ the quantity consumed in the nation imposing the quota.
- A) raise; increase
  - B) raise; decrease
  - C) lower; increase
  - D) lower; decrease

Answer: B

Topic: *Effects of an Import Quota*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Analytical Skills*

- 50) If a government imposes a quota on imports of a popular doll, the price of the doll in the country will \_\_\_\_\_ and the quantity purchased in the country will \_\_\_\_\_.
- A) rise; increase
  - B) rise; decrease
  - C) fall; increase
  - D) fall; decrease

Answer: B

Topic: *Effects of an Import Quota*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Analytical Skills*

- 51) A key difference between tariffs and quotas is that
- A) consumers are hurt with quotas but not with tariffs.
  - B) consumers are hurt with tariffs but not with quotas.
  - C) the government receives revenue with tariffs, but the importer receives the added revenue with quotas.
  - D) the government receives revenue with quotas, but the importer receives the added revenue with tariffs.

Answer: C

Topic: *Tariffs and Import Quotas*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*

- 52) A difference between a quota and a tariff is that with a quota the
- A) person who has the right to import the good captures an extra gain.
  - B) exporting government collects an extra gain in the form of revenue.
  - C) importing government collects an extra gain in the form of revenue.
  - D) domestic consumers are not harmed.

Answer: A

Topic: *Tariffs and Import Quotas*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*

- 53) A difference between a quota and a tariff is that
- A) a tariff generates a higher price than does a quota.
  - B) a tariff generates a greater reduction in exports than does a quota.
  - C) a quota increases profits of domestic producers more than does a tariff.
  - D) the government collects revenues from a tariff but does not collect revenues from a quota.

Answer: D

Topic: *Tariffs and Import Quotas*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*

- 54) A key difference between a quota and a tariff is that
- A) a quota has a larger effect on quantity than on price.
  - B) a tariff has a larger effect on quantity than on price.
  - C) the government of the importing country gains revenue from a tariff, but the price gap caused by a quota benefits domestic importers.
  - D) All of the above answers are correct.

Answer: C

Topic: *Tariffs and Import Quotas*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*

- 55) Voluntary export restraints (VERs)
- A) do not protect domestic producers.
  - B) raise revenue for the governments involved.
  - C) raise the prices paid by domestic consumers.
  - D) Both answers B and C are correct.

Answer: C

Topic: *Voluntary Export Restraints*

Skill: *Recognition*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*

- 56) A tariff is
- A) a government imposed limit on the amount of a good that can be exported from a nation.
  - B) a government imposed barrier that sets a fixed limit on the amount of a good that can be imported into a nation.
  - C) a tax on a good imported into a nation.
  - D) an agreement between governments to limit exports from a nation.

Answer: C

Topic: Study Guide Question, How Tariffs Work

Skill: Conceptual

Question history: Previous edition, Chapter 15

AACSB: Reflective Thinking

- 57) Who benefits from a tariff on a good?
- A) Domestic consumers of the good
  - B) Foreign governments
  - C) Domestic producers of the good
  - D) Foreign producers of the good

Answer: C

Topic: Study Guide Question, How Tariffs Work

Skill: Conceptual

Question history: Previous edition, Chapter 15

AACSB: Analytical Skills

- 58) Who benefits from an import quota on a good?
- A) Domestic consumers of the good
  - B) Foreign governments
  - C) Domestic producers of the good
  - D) Foreign producers of the good

Answer: C

Topic: Study Guide Question, How Import Quotas Work

Skill: Conceptual

Question history: Previous edition, Chapter 15

AACSB: Analytical Skills

- 59) Tariffs \_\_\_\_\_ the domestic price of the good and import quotas \_\_\_\_\_ the domestic price of the good.
- A) lower; lower
  - B) lower; raise
  - C) raise; lower
  - D) raise; raise

Answer: D

Topic: Study Guide Question, Effects of Tariffs and Import Quotas

Skill: Conceptual

Question history: Previous edition, Chapter 15

AACSB: Analytical Skills

- 60) When does the domestic government gain the MOST revenue?
- A) when it imposes a tariff
  - B) when it imposes an import quota
  - C) when it negotiates a voluntary export restraint
  - D) The amount of revenue it gains is the same with a tariff and a voluntary export restraint.

Answer: A

Topic: Study Guide Question, How Tariffs Work

Skill: Conceptual

Question history: Previous edition, Chapter 15

AACSB: Reflective Thinking

### 3 The Case Against Protection

- 1) Economists usually agree with which of the following arguments that favor protectionism?
- A) the competition with cheap foreign labor defense
  - B) the job protection defense
  - C) the dumping defense
  - D) None of the above. Economists generally agree that arguments in favor of protection are flawed.

Answer: D

Topic: The Case Against Protection

Skill: Recognition

Question history: Previous edition, Chapter 15

AACSB: Ethical Reasoning

- 2) Most economists agree that valid reasons for protecting trade include which of the following?
- I. The economies of scale argument.
  - II. The saving jobs argument.
  - III. The protection of high wages argument.
- A) I only
  - B) I and II
  - C) I and III
  - D) None of the reasons are valid.

Answer: D

Topic: The Case Against Protection

Skill: Recognition

Question history: Previous edition, Chapter 15

AACSB: Ethical Reasoning

- 3) Which of the following are valid reasons advanced by almost all economists? Protection
- A) saves jobs.
  - B) prevents rich countries from exploiting poorer countries.
  - C) is a good way for governments in developed nations to raise revenue.
  - D) Economists would not support any of the above reasons.

Answer: D

Topic: The Case Against Protection

Skill: Recognition

Question history: Previous edition, Chapter 15

AACSB: Ethical Reasoning

- 4) Which of the following are reasons economists consider valid for trade protection?
- I. Protection penalizes countries that have weak environmental standards.
  - II. Protection limits dumping of low-wage jobs into the domestic economy.
  - III. Protection prevents low-wage jobs in foreign countries from lowering wages in the United States.
- A) I and II
  - B) II and III
  - C) I, II, and III
  - D) none of the above

Answer: D

Topic: *The Case Against Protection*

Skill: *Recognition*

Question history: *Previous edition, Chapter 15*

AACSB: *Ethical Reasoning*

- 5) The idea of dynamic comparative advantage is the basis for which of the following arguments for protection from foreign competition?
- A) the cheap foreign labor argument
  - B) the infant-industry argument
  - C) the dumping argument
  - D) the saves jobs argument

Answer: B

Topic: *The Case Against Protection; Infant Industry*

Skill: *Recognition*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*

- 6) The most efficient way to encourage the growth of an infant-industry is through a
- A) voluntary export restraint.
  - B) tariff.
  - C) subsidy.
  - D) an import quota.

Answer: C

Topic: *The Case Against Protection; Infant Industry*

Skill: *Recognition*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*

- 7) The infant industry argument is based on the idea of
- A) dynamic comparative advantage.
  - B) absolute productivity advantage.
  - C) Global monopoly.
  - D) countervailing duties.

Answer: A

Topic: *The Case Against Protection; Infant Industry*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*

- 8) Which of the following statements is true?
- A) The infant-industry argument is valid only if the benefits of learning-by-doing in the infant industry spill over to other parts of the economy.
  - B) A subsidy to an infant industry is a more efficient way to protect it from foreign competition than a tariff on the competing foreign goods.
  - C) Both statements are true.
  - D) Neither of the statements is true.

Answer: C

Topic: *The Case Against Protection; Infant Industry*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*

- 9) An assumption behind the infant-industry argument for tariff protection is that
- A) foreign competitors are selling output below average cost.
  - B) the domestic industry will be facing an upward adjustment in its average cost.
  - C) the domestic industry will eventually gain a comparative advantage in producing the good.
  - D) the market needs additional competition to satisfy consumer demand.

Answer: C

Topic: *The Case Against Protection; Infant-Industry*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*

- 10) Dumping occurs when a foreign firm \_\_\_\_\_.
- A) pollutes international waters
  - B) disposes of waste material internationally
  - C) sells inferior output to foreigners
  - D) sells its exports at a lower price than its cost of production

Answer: D

Topic: *The Case Against Protection; Dumping*

Skill: *Recognition*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*

- 11) \_\_\_\_\_ occurs when a foreign firm sells its exports at a lower price than it costs to produce the goods.
- A) Dumping
  - B) Comparative advantage
  - C) Learning-by-doing
  - D) A tariff

Answer: A

Topic: *The Case Against Protection; Dumping*

Skill: *Recognition*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*

- 12) When a foreign firm sells its exports at a lower price than its cost of production, the firm is
- A) imposing an economies of scale cost.
  - B) dumping.
  - C) avoiding a tariff.
  - D) competing in an infant industry.

Answer: B

Topic: *The Case Against Protection; Dumping*

Skill: *Recognition*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*

- 13) Which of the following statements is true?
- A) Dumping is illegal under the rules of the WTO.
  - B) Dumping occurs when a foreign firm sells its exports at a higher price than its cost of production.
  - C) Both statements are true.
  - D) Neither of the statements is true.

Answer: A

Topic: *The Case Against Protection; Dumping*

Skill: *Recognition*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*

- 14) Suppose that the country of Pacifica sold its cars in Atlantica for less than it costs to produce the cars. Pacifica could be accused of
- A) avoiding import quotas.
  - B) increasing its gains from trade.
  - C) dumping.
  - D) engaging in learning-by-doing.

Answer: C

Topic: *The Case Against Protection; Dumping*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*

- 15) When a firms "dumps" some of its products in another country, it
- A) creates an environmental hazard in the receiving country.
  - B) sells its products abroad at a price lower than it costs to produce the goods.
  - C) increases the total level of employment in the receiving country.
  - D) is specializing according to comparative advantage.

Answer: B

Topic: *The Case Against Protection; Dumping*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*

- 16) Japan was accused of dumping in the steel industry within the United States when it
- A) negotiated an illegal agreement to raise prices with U.S. steel industries.
  - B) prohibited imports of U.S. steel into Japan.
  - C) sold steel in the United States at a price below its cost of production.
  - D) negotiated a illegal trade deal with Canada.

Answer: C

Topic: *The Case Against Protection; Dumping*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*

- 17) Some observers opposing free trade argue that when we buy shoes from Brazil or shirts from Taiwan, U.S. workers lose their jobs. The fact of the matter is that
- A) no U.S. worker has actually lost a job because of free trade.
  - B) most jobs lost because of free trade pay less than the poverty level.
  - C) free trade creates jobs in export industries.
  - D) the jobs lost are concentrated in restricted geographic areas.

Answer: C

Topic: *The Case Against Protection; Saves Jobs*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*

- 18) Using calculations of the cost to Americans per job saved in protected industries, it can be concluded that
- A) import quotas are an efficient way to redistribute income.
  - B) each job saved is worth more than the cost imposed on consumers per job saved.
  - C) each job saved is worth less than the cost imposed on consumers per job saved.
  - D) tariffs are an efficient way to redistribute income to disadvantaged groups.

Answer: C

Topic: *The Case Against Protection; Saves Jobs*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*

- 19) It is possible for the United States to compete against cheap foreign labor because expensive domestic workers
- A) pay U.S. taxes.
  - B) receive subsidies.
  - C) are more productive.
  - D) belong to unions.

Answer: C

Topic: *The Case Against Protection; Cheap Foreign Labor*

Skill: *Recognition*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*



- 20) In poorer countries, free trade \_\_\_\_\_ the demand for labor in these countries and \_\_\_\_\_ the wages paid in these countries.
- A) decreases; lowers
  - B) decreases; raises
  - C) increases; lowers
  - D) increases; raises

Answer: D

Topic: *The Case Against Protection; Cheap Foreign Labor*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*

- 21) Which of the following statements is true?
- A) International trade raises wages in developing countries.
  - B) International trade with rich industrial countries forces people in the developing countries to work for lower wages.
  - C) International trade leads to job losses in both import competing industries and exporting industries.
  - D) Unlike other types of international trade, offshoring does not bring any gains from trade.

Answer: A

Topic: *The Case Against Protection; Cheap Foreign Labor*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*

- 22) Which of the following is an effective counter argument to the claim that protectionism saves domestic jobs?
- A) Protectionism eliminates domestic jobs in export industries.
  - B) Imports create jobs in this country for people selling and servicing imported items.
  - C) The cost of saving domestic jobs through protectionism may be high.
  - D) all of the above

Answer: D

Topic: *The Case Against Protection; Saves Jobs*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*

- 23) The reason that average labor costs are higher in the United States than in Haiti is that
- A) workers are more productive in the United States.
  - B) U.S. workers have a comparative advantage.
  - C) Haitian workers have a comparative advantage.
  - D) Haitian workers do not have union representation.

Answer: A

Topic: *The Case Against Protection; Cheap Foreign Labor*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*

- 24) Which of the following are TRUE regarding the argument that trade barriers protect U.S. workers from cheap foreign labor?
- I. Low-wage foreigners are just as productive as U.S. workers.
  - II. U.S. workers have a comparative advantage in low-wage jobs.
- A) I only
  - B) II only
  - C) I and II
  - D) Neither I nor II is correct.

Answer: D

Topic: *The Case Against Protection; Cheap Foreign Labor*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Communication*

- 25) The argument that protection \_\_\_\_\_.
- A) penalizes poor environmental standards is true
  - B) allows us to compete with cheap foreign wages is true
  - C) is necessary for infant industries is true
  - D) saves jobs is flawed

Answer: D

Topic: *The Case Against Protection*

Skill: *Recognition*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*

- 26) Which of the following is an explanation for the existence of trade restrictions?
- A) Tariffs generate revenue for the government.
  - B) rent seeking
  - C) inefficient quotas
  - D) Both answers A and B are key explanations.

Answer: D

Topic: *Why Is International Trade Restricted?*

Skill: *Recognition*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*

- 27) International trade is restricted because
- A) there is an uneven distribution of benefits and costs of free trade.
  - B) free trade creates an inefficient use of resources.
  - C) free trade leads to higher costs.
  - D) free trade stifles diversity and stability.

Answer: A

Topic: *Why Is International Trade Restricted?*

Skill: *Recognition*

Question history: *Previous edition, Chapter 15*

AACSB: *Ethical Reasoning*

28) In industrial countries, there is more reliance on \_\_\_\_\_, as opposed to \_\_\_\_\_ for government revenue.

- A) tariffs; tax collection
- B) quotas; tariffs
- C) tax collection; tariffs
- D) tariffs; quotas

Answer: C

Topic: Tariff Revenues

Skill: Conceptual

Question history: Previous edition, Chapter 15

AACSB: Reflective Thinking

29) In developing countries, there is more reliance on \_\_\_\_\_ as opposed to \_\_\_\_\_ for government revenue.

- A) tariffs; tax collection
- B) quotas; tariffs
- C) tax collection; tariffs
- D) tariffs; quotas

Answer: A

Topic: Tariff Revenues

Skill: Conceptual

Question history: Previous edition, Chapter 15

AACSB: Reflective Thinking

30) Which of the following is a TRUE statement?

- A) Everyone benefits from free trade.
- B) Only exporters benefit from trade.
- C) All producers benefit from trade and but not all consumers benefit.
- D) Free trade harms domestic producers of goods that face import competition.

Answer: D

Topic: Rent Seeking

Skill: Conceptual

Question history: Previous edition, Chapter 15

AACSB: Ethical Reasoning

31) Suppose that the country of Pacifica imposes a quota on bananas. The reason that the government imposed this trade restriction could be

- A) that the government of Pacifica needs to increase its revenue.
- B) lobbying from banana farmers in Pacifica.
- C) comparative advantage.
- D) Both answers A and B are correct.

Answer: B

Topic: Rent Seeking

Skill: Recognition

Question history: Previous edition, Chapter 15

AACSB: Ethical Reasoning

32) Of the groups listed below, which is most likely to lobby for protection?

- A) workers in the import industry
- B) workers in the export industry
- C) consumers in the import industry
- D) producers in the export industry

Answer: A

Topic: Rent Seeking

Skill: Recognition

Question history: Previous edition, Chapter 15

AACSB: Ethical Reasoning

33) Rent seeking is one reason why countries choose to

- A) restrict trade.
- B) export and import the same goods.
- C) work for freer trade.
- D) follow the theory of comparative advantage.

Answer: A

Topic: Rent Seeking

Skill: Conceptual

Question history: Previous edition, Chapter 15

AACSB: Reflective Thinking

34) When a group lobbies for the prevention of free trade, the most likely reason is

- A) rent seeking.
- B) tariff revenue.
- C) defense against expensive domestic labor.
- D) preservation of the environment.

Answer: A

Topic: Rent Seeking

Skill: Recognition

Question history: Previous edition, Chapter 15

AACSB: Reflective Thinking

35) When considering rent seeking, which of the following is TRUE?

- A) The anti-free trade group generally will lobby more than the pro-free trade group.
- B) The pro-free trade group generally will lobby more than the anti-free trade group.
- C) Usually only the anti-free trade group is concerned about what is best for society at large.
- D) Only the pro-free trade group is concerned about the government's revenue from tariffs.

Answer: A

Topic: Rent Seeking

Skill: Recognition

Question history: Previous edition, Chapter 15

AACSB: Reflective Thinking

- 36) A tariff will benefit
- A) domestic producers by maintaining a higher than free-trade price.
  - B) foreign producers by allowing them to sell at a higher price in markets with tariffs.
  - C) consumers who are able to better afford domestically produced goods.
  - D) All of the above answers are correct.

Answer: A

Topic: Rent Seeking

Skill: Conceptual

Question history: Previous edition, Chapter 15

AACSB: Reflective Thinking

- 37) A tariff hurts
- A) the government by decreasing its revenue.
  - B) domestic producers who can't compete with cheaper imports.
  - C) consumers who will pay more for the imported good.
  - D) All of the above answers are correct.

Answer: C

Topic: Rent Seeking

Skill: Conceptual

Question history: Previous edition, Chapter 15

AACSB: Ethical Reasoning

- 38) The reason tariffs and quotas are imposed is that
- A) their costs are spread among many people and their benefits are concentrated.
  - B) their costs are concentrated and their benefits are spread among many people.
  - C) they create net benefits in the long run.
  - D) they reduce import dependence.

Answer: A

Topic: Rent Seeking

Skill: Conceptual

Question history: Previous edition, Chapter 15

AACSB: Ethical Reasoning

- 39) One reason that international trade is restricted is that
- A) the individual gain to parties who benefit from the protection will be much larger than the individual loss to parties who lose.
  - B) the government completely pays the losers from international trade for their losses.
  - C) protectionism benefits consumers.
  - D) the government cannot measure the cost of protectionism.

Answer: A

Topic: Rent Seeking

Skill: Conceptual

Question history: Previous edition, Chapter 15

AACSB: Ethical Reasoning

- 40) Usually the *removal* of trade barriers affecting a particular good benefits \_\_\_\_\_ people domestically, each of whom gains a \_\_\_\_\_.
- A) a few; little
  - B) a few; lot
  - C) many; little
  - D) many; lot

Answer: C

Topic: Rent Seeking

Skill: Conceptual

Question history: Previous edition, Chapter 15

AACSB: Ethical Reasoning

- 41) Usually the *imposition* of trade barriers affecting a particular good benefits \_\_\_\_\_ people domestically, each of whom gains a \_\_\_\_\_.
- A) a few; little
  - B) a few; lot
  - C) many; little
  - D) many; lot

Answer: B

Topic: Rent Seeking

Skill: Conceptual

Question history: Previous edition, Chapter 15

AACSB: Ethical Reasoning

- 42) The gains from free trade are enjoyed by a \_\_\_\_\_ number of people and the costs of free trade are imposed by \_\_\_\_\_ number of people.
- A) small; large
  - B) large; small
  - C) small; small
  - D) large; large

Answer: B

Topic: Rent Seeking

Skill: Conceptual

Question history: Previous edition, Chapter 15

AACSB: Reflective Thinking

- 43) Trade barriers are politically popular because
- A) they are a way to avoid trade wars and still protect domestic producers.
  - B) people recognize their use as a negotiating tool in international relations.
  - C) their benefits are widespread, while their costs are highly concentrated.
  - D) their benefits are concentrated, while their costs are widespread.

Answer: D

Topic: Rent Seeking

Skill: Conceptual

Question history: Previous edition, Chapter 15

AACSB: Ethical Reasoning

- 44) Which of the following reasons explains why rich countries persistently restrict textile imports from poor countries?
- A) The trade restrictions make textile consumers better off.
  - B) The trade restrictions make workers in poor countries better off.
  - C) The trade restrictions benefit an organized visible special interest in rich countries.
  - D) Rich countries have a strong need for the revenue from these trade restrictions.

Answer: C

Topic: Rent Seeking

Skill: Analytical

Question history: Previous edition, Chapter 15

AACSB: Ethical Reasoning

- 45) When NAFTA was approved, Congress attempted to soften the losses suffered by some industries by
- A) creating new jobs to hire workers who lost their jobs because of NAFTA.
  - B) setting aside funds to support and retrain workers who lost their jobs because of NAFTA.
  - C) reducing tariffs.
  - D) imposing quotas.

Answer: B

Topic: Compensating Losers

Skill: Conceptual

Question history: Previous edition, Chapter 15

AACSB: Reflective Thinking

- 46) Which of the following is a reason why only limited attempts are made to compensate those who lose from free international trade?
- A) Free trade advocates consistently lobby to eliminate compensation.
  - B) It would be difficult to determine the extent to which someone's sufferings were because of free trade and not due to reasons under their own control.
  - C) No one loses in the from free trade in the long run.
  - D) None of the above answers are correct.

Answer: B

Topic: Compensating Losers

Skill: Conceptual

Question history: Previous edition, Chapter 15

AACSB: Reflective Thinking

- 47) Selling a product in a foreign nation at a price less than its cost of production is called
- A) infant-industry exploitation.
  - B) absolute advantage.
  - C) dumping.
  - D) net exporting.

Answer: C

Topic: Study Guide Question, Dumping

Skill: Conceptual

Question history: Previous edition, Chapter 15

AACSB: Reflective Thinking

- 48) The (false) idea that an industry should be protected because of learning-by-doing until it is large enough to compete successfully in world markets is the \_\_\_\_\_ argument for protection.
- A) cheap foreign labor
  - B) infant industry
  - C) dumping
  - D) comparative advantage

Answer: B

Topic: Study Guide Question, Infant Industry

Skill: Conceptual

Question history: Previous edition, Chapter 15

AACSB: Reflective Thinking

- 49) When a rich nation buys a product made in a poor nation, in the poor nation the demand for labor \_\_\_\_\_ and the wage rate \_\_\_\_\_.
- A) increases; rises
  - B) increases; falls
  - C) decreases; rises
  - D) decreases; falls

Answer: A

Topic: Study Guide Question, Exploiting Poor Nations

Skill: Conceptual

Question history: Previous edition, Chapter 15

AACSB: Analytical Skills

- 50) Which of the following is a valid reason for protecting an industry?
- A) The industry is unable to compete with low-wage foreign competitors.
  - B) Protection penalizes lax environmental standards.
  - C) Protection keeps richer nations from exploiting the workers of poorer countries.
  - D) None of the above reasons is a valid reason for protection.

Answer: D

Topic: Study Guide Question, The Case Against Protection

Skill: Conceptual

Question history: Previous edition, Chapter 15

AACSB: Communication

- 51) Which of the statements about the gains from international trade is correct?
- A) Everyone gains from international trade.
  - B) Some people gain from international trade and some lose, though overall the gains exceed the losses.
  - C) Some people gain from international trade and some lose; overall the gains exceed the losses.
  - D) Everyone loses from international trade.

Answer: B

Topic: Study Guide Question, Rent Seeking

Skill: Conceptual

Question history: Previous edition, Chapter 15

AACSB: Ethical Reasoning



#### 4 News Based Questions

- 1) Between August 2007 and July 2008, Brazil exported more than 3.5 billion pounds of coffee to the rest of the world. Because of this, we know definitively that:
- A) Brazil has comparative advantage in coffee production
  - B) The rest of the world has comparative advantage in coffee production
  - C) The rest of the world has absolute advantage in coffee production
  - D) Brazil has absolute advantage in coffee production

Answer: A

Topic: Comparative Advantage

Skill: Conceptual

Question history: Previous edition, Chapter 15

AACSB: Communication

- 2) Between August 2007 and July 2008, Brazil exported more than 3.5 billion pounds of coffee to the rest of the world. Because of this, we know that:
- A) Brazilian coffee workers "gain" from this trade
  - B) Brazilian producers "lose" from this trade
  - C) Brazilian consumers "gain" from this trade
  - D) Brazilian car manufacturers "lose" from this trade

Answer: A

Topic: Gains from Trade, Exports

Skill: Conceptual

Question history: Previous edition, Chapter 15

AACSB: Communication

- 3) During 2005–2006 Europe imported more than \$70 million worth of US long–grain rice. How is the gain from trade distributed?
- A) European rice consumers gain from trade
  - B) There is no gain from trade
  - C) European rice producers gain from trade
  - D) American rice consumers gain from trade

Answer: A

Topic: Gains from Trade, Imports

Skill: Conceptual

Question history: Previous edition, Chapter 15

AACSB: Communication

- 4) During 2005–2006 Europe imported more than \$70 million worth of US long–grain rice. In 2006, the European Union threatened to restrict imports of long–grain rice because traces of genetically modified rice were found mixed in to commercial supplies. What would NOT be an effect in the European rice market if U.S. imports were banned?
- A) There would be a increase in long–grain rice consumption
  - B) There would be an increase European in rice production
  - C) The price of long–grain rice would increase
  - D) The quantity of long–grain rice imports would decrease

Answer: A

Topic: Effects of an Import Quota

Skill: Conceptual

Question history: Previous edition, Chapter 15

AACSB: Communication

- 5) In 2006, the European Union (EU) threatened to ban imports of long-grain rice because traces of genetically modified rice were found mixed in to commercial supplies. Instead of a ban, suppose the EU placed a tariff on the import of long-grain rice. Which of the following would be an outcome of this tariff?
- A) The EU would gain tariff revenue
  - B) The social loss would decrease
  - C) European rice producers would decrease production
  - D) The price of long-grain rice in the EU would be higher with a tariff than if rice imports were completely banned

Answer: A

Topic: *Effects of a Tariff*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Communication*

- 6) In 2006, the European Union (EU) threatened to ban imports of long-grain rice because traces of genetically modified rice were found mixed in to commercial supplies. Instead of a complete ban, suppose the EU placed a tariff on the import of long-grain rice. Which of the following would be an outcome of this tariff?
- A) The price of long-grain rice in the EU would be lower with a tariff than if rice imports were completely banned, but higher than with free trade
  - B) The price of long-grain rice in the EU would be higher with a tariff than if rice imports were completely banned
  - C) The price of long-grain rice in the EU would be higher with a tariff than if rice imports were completely banned, but lower than with free trade
  - D) The price of long-grain rice in the EU would be lower with a tariff than if rice imports were completely banned, but lower than with free trade

Answer: A

Topic: *Effects of a Tariff*

Skill: *Analytical*

Question history: *Previous edition, Chapter 15*

AACSB: *Communication*

- 7) The European Union imports bananas from Latin America as well as imports from Europe's former colonies in the African, Caribbean and Pacific (ACP) group. In 2006 the tariff on bananas from Latin America was higher than on ACP bananas. Which of the following statements is NOT true?
- A) European consumers are better off with tariff than with free trade
  - B) For European consumers, the price of ACP bananas is lower than Latin American bananas
  - C) The gain from free trade is decreased because of banana tariffs
  - D) The price European consumers pay for bananas is higher with the tariff than the free trade price

Answer: A

Topic: *Effects of a Tariff*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Communication*

- 8) In 2007, European Union (EU) negotiators have offered to cut tariffs for Latin American bananas to avoid "banana wars." What are the effects of a cut in tariffs?
- A) The quantity of bananas imported into the EU will increase
  - B) The price of bananas for consumers will increase
  - C) The quantity of bananas produced in the EU (such as in France and Spain) will increase
  - D) Tariff revenue will increase

Answer: A

Topic: *Effects of a Tariff*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Communication*

- 9) In 2006, European Union tariff on imported bananas from Latin America was €176 a ton. Suppose 2.5 million tons of bananas were imported in 2006 but then the tariff decreased to €152 a ton in 2007 and as a result, 3 million tons were imported in 2007. What is the change in tariff revenue between 2006 and 2007?
- A) €1,000,000
  - B) €440,000,000
  - C) €445,000,000
  - D) - €1,000,000

Answer: A

Topic: *Effects of a Tariff*

Skill: *Analytical*

Question history: *Previous edition, Chapter 15*

AACSB: *Communication*

- 10) In 2006, European Union tariff on imported bananas from Latin America was €176 a ton. Suppose 2.5 million tons of bananas were imported in 2006 but then the tariff decreased to €152 a ton in 2007 and as a result, 3 million tons were imported in 2007. What is the tariff revenue in 2007?
- A) €445,000,000
  - B) €528,000,000
  - C) €440,000,000
  - D) €375,000,000

Answer: A

Topic: *Effects of a Tariff*

Skill: *Analytical*

Question history: *Previous edition, Chapter 15*

AACSB: *Communication*

- 11) During the first 6 months of 2008, the United States imported 1,655,740,870 pounds of coffee. Suppose the United States is considering placing trade restrictions on the importation of coffee. If the United States has a goal of raising tax revenue from coffee imports, what policy should they pursue?
- A) Tariff on imported coffee
  - B) Subsidy on imported coffee
  - C) Quota on imported coffee
  - D) Voluntary export restraints on coffee

Answer: A

Topic: *Effects of a Tariff*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Communication*

- 12) During the first 6 months of 2008, the United States imported more than 1.6 billion pounds of coffee. Suppose the United States is considering placing trade restrictions on the importation of coffee. What would be a potential consequence of such a trade restriction?
- A) The U.S. price of coffee would increase
  - B) U.S. consumers would drink more coffee
  - C) The quantity of coffee imported into the United States would increase
  - D) If the United States instead imposed a quota on coffee imports, government tax revenue would increase by more than with a tariff

Answer: A

Topic: *Effects of a Tariff*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Communication*

- 13) During the first 6 months of 2008, the United States imported from Africa, Asia, and Latin America more than 1.6 billion pounds of coffee and did not export any coffee. Based on this, we know definitively that:
- A) The Africa, Asia, and Latin America has comparative advantage in coffee production
  - B) The US has absolute advantage in coffee production
  - C) The Africa, Asia, and Latin America has absolute advantage in coffee production
  - D) The US has comparative advantage in coffee production

Answer: A

Topic: *Comparative Advantage*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Communication*

- 14) During the first 6 months of 2008, the United States imported from Africa, Asia, and Latin America more than 1.6 billion pounds of coffee and did not export any coffee. How is the gain from imports distributed between consumers and domestic producers?
- A) U.S. producers are harmed and U.S. consumers are harmed
  - B) U.S. producers are harmed and U.S. consumers are helped
  - C) U.S. producers are helped and U.S. consumers are harmed
  - D) U.S. producers are harmed and U.S. consumers are helped

Answer: D

Topic: *Gains from Trade, Imports*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Communication*

- 15) Currently Belize, a country in Central America, has a small coffee industry but does not export any coffee. Suppose the government of Belize, in order to protect the new coffee industry to enable it to grow into a mature industry that can compete in world markets, places a tariff on the importation of coffee. What is the argument for placing the tariff on coffee?
- A) The infant-industry argument
  - B) The dumping argument
  - C) To protect Belize coffee workers
  - D) To prevent rich countries from exploiting developing countries

Answer: A

Topic: *The Case Against Protection; Infant Industry*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Communication*

- 16) Belize, a country in Central America, has a small coffee industry. Suppose Belize does not have free trade but it has comparative advantage in coffee production. If Belize allowed international trade, what would be the gains from trade?
- A) Belize coffee producers would gain from trade
  - B) Belize coffee consumers would gain from trade
  - C) Belize would gain tariff revenue from trade
  - D) All of these answers are gains from trade

Answer: A

Topic: *Gains from Trade, Exports*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Communication*

- 17) During the first 6 months of 2008, the European Union (EU) initiated an anti-dumping case against China for imports of taper candles. What is dumping?
- A) When China sells its candles to the EU at a lower price than China's cost of production
  - B) When China does not pay the tariff on the candles
  - C) When China sells its candles to the EU at a lower price than other producers
  - D) When China tries to sell more candles to the EU than is allowed by the import quota

Answer: A

Topic: *The Case Against Protection; Dumping*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Communication*

- 18) The U.S.—Colombia Trade Promotion Agreement was signed on November 22, 2006, in Washington, D.C. This comprehensive trade agreement eliminated tariffs and other barriers to goods and services. Currently, no U.S. agricultural exports enjoy tariff-free access to the Colombian market. If the United States has a comparative advantage in agricultural, which of the following is true?
- A) Columbian agricultural producers were better off before free trade
  - B) Columbian agricultural consumers were better off before free trade
  - C) Columbia was better off before the international trade
  - D) Columbia must have comparative disadvantage in all production

Answer: A

Topic: *Gains from Trade*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Communication*

- 19) The U.S.—Colombia Trade Promotion Agreement was signed on November 22, 2006, in Washington, D.C. This comprehensive trade agreement eliminated tariffs and other barriers to goods and services. Colombia will immediately eliminate tariffs on wheat, barley, peanuts, and many other products in which Columbia does not have a comparative advantage. This policy means that the price of peanuts in Columbia will become
- A) equal to the free trade price
  - B) lower than the free trade price
  - C) higher than the price when a tariff was in place
  - D) higher than the free trade price

Answer: A

Topic: *Gains from Trade*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Communication*

- 20) Agriculture Secretary Ed Schafer today announced that Chile's Livestock and Agricultural Service approved the U.S. inspection, control and certification systems for poultry, allowing these products to enter the Chilean market effective immediately. What is NOT an effect of this change in Chilean policy on the Chilean poultry market?
- A) Chile's tariff revenue will increase
  - B) The quantity of poultry consumed in Chile will increase
  - C) The quantity of Chilean imports will increase
  - D) The price for poultry in Chile will decrease

Answer: A

Topic: *Gains from Trade, Imports*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Communication*

## 5 Essay Questions

- 1) Define comparative advantage and discuss its role in international trade.

Answer: Comparative advantage is the factor that drives international trade. A country has a comparative advantage in the production of a good if the country can produce it at a lower opportunity cost than any other country. Because the cost of production of a good is lower in the nation with the comparative advantage in the good, that country will export the good. The country will then gain by buying the goods from other nations that those nations produce at the lowest opportunity cost, that is, those goods in which the other nations have a comparative advantage.

*Topic: Comparative Advantage*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 15*

*AACSB: Communication*

- 2) "Because the United States is the largest economy in the world and can produce anything it needs domestically, there are no gains from trade for the United States." Is the previous statement correct or incorrect?

Answer: The statement is incorrect. The United States, like any other nation, gains from trade when it specializes according to comparative advantage.

*Topic: Gains from Trade*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 15*

*AACSB: Communication*

- 3) Why do nations engage in international trade?

Answer: Nations engage in international trade because they gain from trade. International trade results in a more efficient use of resources and thereby increases world output. As a result, it increases the amount of goods and services available for consumption in all nations and thereby makes all countries better off.

*Topic: Gains from Trade*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 15*

*AACSB: Communication*

- 4) During 2007, as oil and gas prices continued to increase, a growing number of Americans called for the United States to become less reliant on Middle-Eastern oil. Would it make sense for the United States to try to become totally self-reliant in the production of oil? Why or why not?

Answer: It would be foolish for the United States to try to become totally self-reliant in oil production. There is a reason that approximately 58 percent of our oil comes from OPEC nations: Middle-Eastern countries can produce oil at a far lower opportunity cost than U.S. producers. In the Middle East the vast reserves of oil, combined with more lax regulations imposed by the government, have combined to drive down the per barrel opportunity cost of oil extraction to very low levels. Hence the United States gains from trade with these nations. Even though the price of oil in 2007 was higher than it was in 2001, that price was much less than what would be the opportunity cost of producing enough oil domestically so that the United States was totally self-reliant.

*Topic: Gains from Trade; Consumption Possibilities*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 15*

*AACSB: Communication*

- 5) Give a brief description of the history of tariffs in the U.S.

Answer: Today, U.S. tariffs are low compared to their historical levels. The average U.S. tariff was highest in the early 1930s when the Smoot–Hawley tariff was passed. The average tariff at that time was about 20 percent. Since then there has been a general downward trend so that today the average tariff is less than 5 percent. The downward trend was fairly rapid until 1950 and has slowed since then.

*Topic: History of Tariffs*

*Skill: Recognition*

*Question history: Previous edition, Chapter 15*

*AACSB: Communication*

- 6) How does a tariff affect the domestic price of the import, the domestic consumption, the domestic production, and the quantity imported?

Answer: A tariff raises the price of the good. As a result, domestic consumption decreases as domestic consumers decrease the quantity they demand. And, also as a result, domestic production increases as domestic producers increase the quantity they supply. Because domestic consumption decreases and domestic production increases, the quantity imported decreases.

*Topic: Effects of a Tariff*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 15*

*AACSB: Communication*

- 7) The United States imposes a tariff on foreign limes. How does the tariff affect the U.S. price of a lime and the production of limes in the United States?

Answer: The tariff raises the price of limes in the United States. As a result of the higher price, U.S. lime production increases.

*Topic: Effects of a Tariff*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 15*

*AACSB: Communication*

- 8) What are the effects of a tariff?

Answer: A tariff is a tax on goods that are imported into the country imposing the tariff. The tariff decreases the supply of the imported good, so the tariff raises the domestic price of the good and decreases the quantity imported. Because the price of the good rises, the quantity produced in the country imposing the tariff increases.

*Topic: Effects of a Tariff*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 15*

*AACSB: Communication*

- 9) Explain the effects of a quota.

Answer: A quota is a quantitative restriction on the maximum amount of a good that can be imported. Because quotas limit the supply of the good, they raise the prices of imported goods and decrease the quantities imported. Unlike a tariff, however, the government gets no revenue from a quota; the revenue from the higher price goes to importers.

*Topic: Quotas*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 15*

*AACSB: Communication*



- 10) Currently, the United States has a quota on the amount of sugar that is allowed to be imported into the United States. What would happen to the price of sugar in the United States if the quota was removed? What would happen to U.S. consumption and U.S. production of sugar?

Answer: If the quota is removed, the price of sugar in the United States would fall, U.S. consumption of sugar would increase, and U.S. production of sugar would decrease.

*Topic: Quotas*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 15*

*AACSB: Communication*

- 11) How does a quota affect the domestic price of the import, the domestic consumption, the domestic production, and the quantity imported?

Answer: A quota raises the price of the good because it decreases the amount that can be imported. As a result, domestic consumption decreases as domestic consumers decrease the quantity they demand. And, also as a result, domestic production increases as domestic producers increase the quantity they supply.

*Topic: Quotas*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 15*

*AACSB: Communication*

- 12) How does a tariff affect the government's revenue? How does a quota affect the government's revenue?

Answer: A tariff is a tax on an imported good. Like all taxes, a tariff increases the government's revenue. However, a quota is quantitative restriction on the amount of a good that can be imported. As such, a quota has no effect on the government's revenue.

*Topic: Quotas*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 15*

*AACSB: Communication*

- 13) Discuss reasons why we see trade restrictions. Are any of these reasons valid?

Answer: There are several reasons advanced to restrict trade. These include: the infant-industry argument (that the nation should protect a young industry that will reap learning-by-doing gains in productivity and eventually be able to compete successfully in the world market); dumping (the nation should protect an industry from foreign competitors who sell goods below cost); protection saves jobs (the claim that imports cost U.S. jobs); cheap foreign labor (the assertion that tariffs are necessary to compete with cheap foreign labor); lax environmental standards (the claim that protection is needed to compete against nations with weak environmental standards); and, rich nations exploit developing countries (the suggestion that protection prevents developed nations from forcing people in poor nations to work for slave wages). Economists reject all of these claims as valid reasons for protection.

*Topic: Why Is International Trade Restricted?*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 15*

*AACSB: Communication*

- 14) Two arguments used to promote trade barriers are the infant–industry argument, and the dumping argument. Explain each of these arguments and evaluate whether each one has any flaws.

**Answer:** The infant–industry argument is that it is necessary to protect a new industry to enable it to grow into a mature industry that can compete in world markets. The problem with this argument is that if an industry can eventually compete, then its backers should be willing to fund it until that time. In addition, if the industry has benefits that spill over to other industries, then the more efficient government policy is to subsidize the industry rather than protect it from competition. The dumping argument asserts that protection is needed to protect domestic industries from foreign dumping practices designed to eliminate competition. (Dumping is selling a good for a price that is less than its cost of production.) The problems with this argument are two–fold. First, it is extremely difficult to determine if a firm is dumping because determining the cost of production is difficult. Second, even if a firm is dumping, its success in establishing a monopoly is in doubt and its success in maintaining its global (!) monopoly is even more doubtful. Hence dumping to obtain a monopoly is likely a very uncommon practice.

*Topic: Why Is International Trade Restricted?*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 15*

*AACSB: Communication*

- 15) What is dumping?

**Answer:** Dumping is the situation in which a firm sells its export goods and services for a lower price than its cost of production.

*Topic: The Case Against Protection; Dumping*

*Skill: Recognition*

*Question history: Previous edition, Chapter 15*

*AACSB: Communication*

- 16) Because wage rates are so low in Africa, why don't Microsoft, Cisco and other major corporations close down their American operations and move to Africa?

**Answer:** Wage rates must be weighed against productivity. It is not just wages that influence where production occurs. Wages divided by the productivity of the workers gives the average cost of production. In Africa, workers have low levels of skill, education, and training so their productivity is much less than in the United States. Therefore the cost of production would be far higher in Africa than in America. So even though U.S. wage rates are high, industries stay here because the cost of production is lower because U.S. productivity is so high.

*Topic: The Case Against Protection; Cheap Foreign Labor*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 15*

*AACSB: Communication*

- 17) Some people assert that protection from foreign competition prevents rich countries from exploiting developing countries. What is this argument in more detail and what is its flaw?

Answer: The argument claims that rich nations will exploit poor nations by importing goods from the poor nations and that the workers in the poor nations are paid slave wages to produce these goods. This argument has a truly fatal flaw. Free trade increases the demand for the goods produced by workers in developing countries. Thus in order to produce more of these goods, the firms must hire more workers. Hence the demand for the labor used to produce the goods increases, which means that the wage rates paid the workers in the developing countries rises. Thus rather than exploiting the workers in the poor nations, free international trade is one of their few hopes for better lives!

*Topic: The Case Against Protection, Exploits Poor Countries*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 15*

*AACSB: Communication*

- 18) Explain how governments restrict international trade and who benefits as well as who loses from the restrictions.

Answer: Governments use tariffs and nontariff barriers, such as quotas, to restrict trade. Tariffs and quotas both boost the domestic price of the protected good. Consumers in that country lose because of the higher price. The domestic suppliers, however, gain from the higher price. Tariffs are source of revenue for the government that imposes it on imported goods, so the domestic government gains from a tariff. Quotas, on the other hand, do not create revenue for government so the government does not gain from a quota.

*Topic: Rent Seeking*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 15*

*AACSB: Communication*

- 19) What is "rent seeking?" How does it apply to restricting imports?

Answer: Rent seeking is lobbying and other political activity that seeks to capture the gains from trade. When imports are restricted, some people gain from the restrictions. Rent seekers, such as domestic producers of import-competing goods or services, lobby the government to impose import restrictions because restrictions allow the rent seekers to gain revenue and/or profit.

*Topic: Rent Seeking*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 15*

*AACSB: Communication*

- 20) Economics demonstrates that opening up unrestricted free international trade is beneficial to all nations. However, are there any losers from such a policy change?

Answer: Yes, there are losers from opening up to free trade. Domestic suppliers of imported goods lose from allowing free trade. Owners of the businesses lose as do workers who had jobs in the import-competing industries. However, it is important to realize that although there are losers from free trade, there also are substantial gains and the gains exceed the losses so that the nation as a whole is made better off with free trade.

*Topic: Compensating Losers*

*Skill: Conceptual*

*Question history: Previous edition, Chapter 15*

*AACSB: Communication*

21) How does the United States attempt to compensate losers from lower trade restrictions?

Answer: The U.S. government attempts to compensate workers who lose from lowering U.S. trade restrictions. For instance, the U.S. government set up a fund to support and retrain workers who lost their jobs because of NAFTA. Job losers can also collect unemployment compensation benefits.

Topic: *Compensating Losers*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Communication*

## 6 Numeric and Graphing Questions

Price (dollars per pound)	Quantity supplied (thousands of pounds per year)	Quantity demanded (thousands of pounds per year)
21	120	60
18	100	100
15	80	140
12	60	180
9	40	220

1) The United States imports cheese from a variety of countries. The table above gives the domestic supply of, and demand for, cheese in the United States. The world price of cheese is \$12 per pound, and trade is unrestricted.

- a) How many pounds of cheese are consumed in the United States?
- b) How many pounds of cheese are produced in the United States?
- c) How many pounds of cheese are imported into the United States?

If a \$3 per pound tariff is imposed,

- d) How many pounds of cheese are consumed in the United States?
- e) How many pounds of cheese are produced in the United States?
- f) How many pounds of cheese are imported into the United States?
- g) How much will the U.S. government collect in tariff revenue?
- h) Who benefits from the tariff? Who loses?

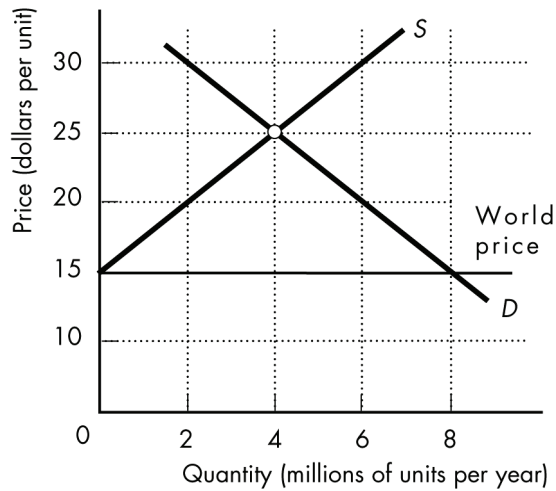
Answer: a) 180,000 pounds of cheese are consumed.  
 b) 60,000 pounds of cheese are produced.  
 c) 120,000 pounds of cheese are imported.  
 d) 140,000 pounds of cheese are consumed.  
 e) 80,000 pounds of cheese are produced.  
 f) 60,000 pounds of cheese are imported.  
 g) The government collects \$3 per pound × 60,000 pounds = \$180,000.  
 h) U.S. producers and the U.S. government gain while U.S. consumers and foreign producers lose.

Topic: *Effects of a Tariff*

Skill: *Analytical*

Question history: *Previous edition, Chapter 15*

AACSB: *Analytical Skills*



2) The above figure shows the domestic supply of and domestic demand for an imported good. The world price is \$15 per unit.

- At the world price of \$15 per unit, what is the domestic consumption and domestic production?
- At the world price of \$15 per unit, what is the quantity imported?
- If the government imposes a tariff of \$5 per unit, what is the domestic consumption and domestic production?
- With the \$5 per unit tariff, what is the quantity imported?
- How much revenue does the government collect with a tariff of \$5 per unit?

Answer: a) Domestic consumption is 8 million units per year and domestic production is 0.  
 b) The quantity imported is 8 million units per year.  
 c) Domestic consumption is 6 million units per year and domestic production is 2 million units per year.  
 d) The quantity imported is 4 million units per year.  
 e) The government collects \$5 per unit imported and 4 million units are imported, so the government's revenue from the tariff is  $\$5 \times 4 \text{ million} = \$20 \text{ million per year}$ .

Topic: *Effects of a Tariff*

Skill: *Analytical*

Question history: *Previous edition, Chapter 15*

AACSB: *Analytical Skills*

- 3) Suppose that elimination of tariffs on agricultural products means that 1,000 farm workers lose jobs that pay an average of \$20,000 per year. At the same time, because of the importation of relatively cheaper foreign vegetables, 150 million consumers save \$2 per year on their grocery bills.
- What is the total income lost by farm workers because of the free trade?
  - What is the total dollar amount saved by all consumers combined?
  - Which is greater, the lost income or the consumer savings? Do the benefits of free trade out-weigh the costs in this simple example?
  - Which group is most likely to become politically involved over the issue of removing the tariffs, the farm workers or the consumers? Why?

Answer: a) The total income lost by farm workers is  $1,000 \times \$20,000 = \$20,000,000$ .  
 b) The total saving by all consumers is  $150,000,000 \times \$2 = \$300,000,000$ .  
 c) The consumer savings is much larger than the lost income, so the benefits of free trade outweigh the costs.  
 d) The farm workers are more likely to become involved, because their individual loss is much greater than an individual consumer's gain.

Topic: Rent Seeking

Skill: Analytical

Question history: Previous edition, Chapter 15

AACSB: Analytical Skills

## 7 True or False

- 1) As a result of an increase in tariffs, imports decrease and government revenue increases.

Answer: TRUE

Topic: Trade Restrictions; Effects of a Tariff

Skill: Conceptual

Question history: Previous edition, Chapter 15

AACSB: Reflective Thinking

- 2) Tariffs and quotas *both* decrease the amount of a good consumed and raise the price paid by domestic residents for the good.

Answer: TRUE

Topic: Trade Restrictions; Effects of a Tariff and a Quota

Skill: Conceptual

Question history: Previous edition, Chapter 15

AACSB: Reflective Thinking

- 3) Quotas are less damaging to an economy than are tariffs.

Answer: FALSE

Topic: Trade Restrictions; Quota

Skill: Conceptual

Question history: Previous edition, Chapter 15

AACSB: Reflective Thinking

- 4) Dumping occurs when a foreign firm sells its exports at a lower price than it costs to produce them.

Answer: TRUE

Topic: *The Case Against Protection; Dumping*

Skill: *Recognition*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*

- 5) Most economists would agree that "saving jobs" is a valid reason for restricting trade.

Answer: FALSE

Topic: *The Case Against Protection; Saves Jobs*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*

- 6) The infant-industry argument is the only perfectly valid argument for protection.

Answer: FALSE

Topic: *The Case Against Protection; Infant Industry*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*

- 7) Over the past 80 years, the United States has reduced its average tariff rate so today it is less than 5 percent.

Answer: TRUE

Topic: *History of Tariffs*

Skill: *Recognition*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*

- 8) Less developed countries, compared to industrialized ones, are more likely to have higher tariff rates.

Answer: TRUE

Topic: *Why Is International Trade Restricted?; Tariff Revenue*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 15*

AACSB: *Reflective Thinking*

# Part 1 Review

## 1 Introduction

- 1) All economic questions arise because
- A) of scarcity.
  - B) production possibilities are unlimited.
  - C) our wants are limited.
  - D) people are irrational.

Answer: A

Topic: Scarcity

Skill: Recognition

Question history: Previous edition, Part Review 1

AACSB: Reflective Thinking

- 2) Which of the following is NOT a factor of production?
- A) mineral resources
  - B) money
  - C) a computer programmer
  - D) a commercial aircraft

Answer: B

Topic: Factors of Production

Skill: Recognition

Question history: Previous edition, Part Review 1

AACSB: Reflective Thinking

- 3) The opportunity cost of a good is
- A) the income you forgo to get it.
  - B) the lowest valued alternative you give up to get it.
  - C) the highest valued alternative you give up to get it.
  - D) all alternatives you give up to get it.

Answer: C

Topic: Opportunity Cost

Skill: Recognition

Question history: Previous edition, Part Review 1

AACSB: Reflective Thinking

- 4) Jen won \$900 in a lottery. She has a choice between using the money to buy a sofa, a television, or going on a vacation. If she chooses to buy a television, the opportunity cost of this decision is
- A) zero because she won the money.
  - B) the sofa and the vacation trip.
  - C) the sofa, the vacation trip, and \$900.
  - D) the sofa if that was her second choice.

Answer: D

Topic: Opportunity Cost

Skill: Analytical

Question history: Previous edition, Part Review 1

AACSB: Reflective Thinking



Cheese (tons)	DVDs (thousands)
0	60
2	56
4	48
6	36
8	20
10	0

- 5) The table above lists six points on the production possibilities frontier for cheese and DVDs. Given this information, which of the following combinations is unattainable?

A) 2 tons of cheese and 56 thousand DVDs  
 B) 8 tons of cheese and 21 thousand DVDs  
 C) 6 tons of cheese and 34 thousand DVDs  
 D) 7 tons of cheese and 20 thousand DVDs

Answer: B

Topic: Production Possibilities Frontier

Skill: Analytical

Question history: Previous edition, Part Review 1

AACSB: Analytical Skills

- 6) The table above lists six points on the production possibilities frontier for cheese and DVDs. From this information you can conclude that production is inefficient if this economy produces

A) 2 tons of cheese and 56 thousand DVDs.  
 B) 8 tons of cheese and 21 thousand DVDs.  
 C) 5 tons of cheese and 48 thousand DVDs.  
 D) 7 tons of cheese and 20 thousand DVDs.

Answer: D

Topic: Production Possibilities Frontier

Skill: Analytical

Question history: Previous edition, Part Review 1

AACSB: Analytical Skills

- 7) The table above lists six points on the production possibilities frontier for cheese and DVDs. What is the opportunity cost of producing the 7th ton of cheese?

A) 16 DVDs per ton of cheese  
 B) 8 DVDs per ton of cheese  
 C) 20 DVDs per ton of cheese  
 D) 28 DVDs per ton of cheese

Answer: B

Topic: Opportunity Cost

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

- 8) An opportunity cost of economic growth is
- A) the capital accumulation given up to increase present consumption.
  - B) the increased future consumption.
  - C) the present consumption given up to accumulate capital.
  - D) None of the above because there is no opportunity cost since if an economy grows, it can produce more of all goods.

Answer: C

Topic: *Economic Growth Rate*

Skill: *Conceptual*

Question history: *Previous edition, Part Review 1*

AACSB: *Reflective Thinking*

- 9) Country X devoted 70 percent of its resources to consumption, while Country Y devoted 80 percent to consumption. Other things being equal, you can predict that
- A) Country X's opportunity cost of economic growth is lower than Country Y's.
  - B) Country Y's rate of capital accumulation is higher than Country X's
  - C) Country Y's economy will grow faster than Country X's.
  - D) Country X's economy will grow faster than Country Y's.

Answer: D

Topic: *Economic Growth Rate*

Skill: *Conceptual*

Question history: *Previous edition, Part Review 1*

AACSB: *Reflective Thinking*

- 10) Lizzie takes 20 seconds to stuff an envelope and 10 seconds to seal it. Arnold takes 15 seconds to stuff an envelope and 5 seconds to seal it. Lizzie has a comparative advantage in \_\_\_\_\_ and Arnold has a comparative advantage in \_\_\_\_\_.
- A) sealing envelopes; stuffing them
  - B) stuffing envelopes; sealing them
  - C) neither of these activities; both activities
  - D) both activities; neither of these activities

Answer: B

Topic: *Comparative Advantage*

Skill: *Analytical*

Question history: *Previous edition, Part Review 1*

AACSB: *Analytical Skills*

- 11) According to the principle of comparative advantage, if the United States trades with Mexico, most likely,
- A) the United States will benefit and Mexico will lose.
  - B) the United States will lose and Mexico will benefit.
  - C) neither of the countries will benefit.
  - D) both countries will benefit.

Answer: D

Topic: *Comparative Advantage and Trade*

Skill: *Conceptual*

Question history: *Previous edition, Part Review 1*

AACSB: *Reflective Thinking*

- 12) Which of the following increases the demand for chicken?
- A) an increase in the price of the grain used to feed chickens
  - B) an increase in the number of chicken farmers
  - C) an increase in the price of beef, a substitute for chicken
  - D) a fall in the price of chicken

Answer: C

Topic: *Change in Demand, Prices of Related Goods*

Skill: *Conceptual*

Question history: *Previous edition, Part Review 1*

AACSB: *Reflective Thinking*

- 13) If pizza is a normal good, then an increase in people's incomes shifts the \_\_\_\_\_ curve \_\_\_\_\_.
- A) demand; rightward
  - B) demand; leftward
  - C) supply; rightward
  - D) supply; leftward

Answer: A

Topic: *Change in Demand, Income*

Skill: *Conceptual*

Question history: *Previous edition, Part Review 1*

AACSB: *Reflective Thinking*

- 14) If the wood used to produce houses rises in price, then the \_\_\_\_\_ houses shifts \_\_\_\_\_.
- A) demand curve for; rightward
  - B) demand curve for; leftward
  - C) supply curve of; rightward
  - D) supply curve of; leftward

Answer: D

Topic: *Change in Supply, Prices of Resources*

Skill: *Conceptual*

Question history: *Previous edition, Part Review 1*

AACSB: *Reflective Thinking*

- 15) If the wood used to produce houses rises in price, then the \_\_\_\_\_ houses \_\_\_\_\_.
- A) demand for; increases
  - B) demand for; decreases
  - C) supply of; increases
  - D) supply of; decreases

Answer: D

Topic: *Change in Supply, Prices of Resources*

Skill: *Conceptual*

Question history: *Previous edition, Part Review 1*

AACSB: *Reflective Thinking*

- 16) If OPEC cuts oil production, then the
- A) demand for gasoline will decrease.
  - B) price of gasoline will fall.
  - C) demand for gasoline will increase.
  - D) supply of gasoline will decrease.

Answer: D

Topic: *Change in Supply, Prices of Resources*

Skill: *Conceptual*

Question history: *Previous edition, Part Review 1*

AACSB: *Reflective Thinking*

- 17) A processor of alligator hides can produce either purses or shoes. If the demand for alligator shoes increases, then the \_\_\_\_\_ alligator purses will \_\_\_\_\_.
- A) supply of; increase
  - B) supply of; decrease
  - C) demand for; decrease
  - D) demand for; increase

Answer: B

Topic: *Change in Supply, Prices of Related Goods Produced*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 3*

AACSB: *Analytical Skills*

- 18) Jelly beans and popcorn are substitutes. A fall in the price of a bag of jelly beans will \_\_\_\_\_ the demand for popcorn and the price of popcorn will \_\_\_\_\_.
- A) increase; rise
  - B) increase; fall
  - C) decrease; fall
  - D) decrease; rise

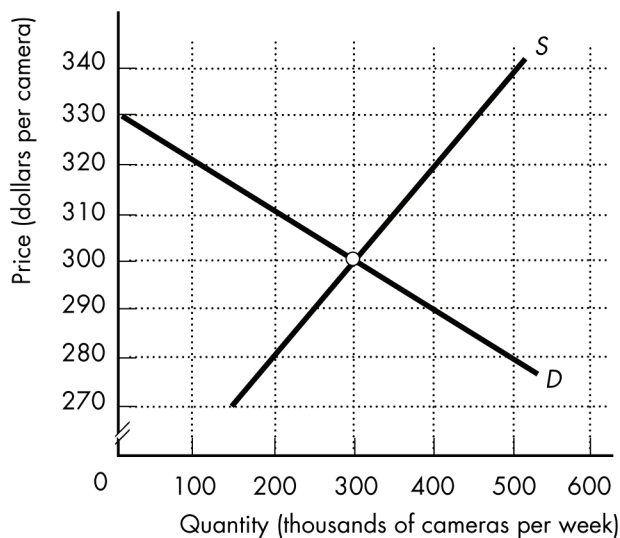
Answer: C

Topic: *Predicting Changes in Price and Quantity; Demand Changes*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 3*

AACSB: *Analytical Skills*



- 19) The figure above shows the market for film cameras. If the price of digital cameras falls, the equilibrium quantity of film cameras will be \_\_\_\_\_ thousand cameras and the price of a film camera will be \_\_\_\_\_.
- A) less than 300; less than \$300
  - B) greater than 300; less than \$300
  - C) 300; greater than \$300
  - D) greater than 400; greater than \$310

Answer: A

Topic: Predicting Changes in Price and Quantity; Demand Changes

Skill: Analytical

Question history: Previous edition, Part Review 1

AACSB: Analytical Skills

- 20) The figure above shows the market for digital cameras. If consumers' incomes rise and a digital camera is a normal good, the equilibrium quantity of digital cameras will be \_\_\_\_\_ thousand cameras and the price of a digital camera will be \_\_\_\_\_.
- A) less than 300; less than \$300
  - B) greater than 300; less than \$300
  - C) 300; greater than \$300
  - D) greater than 300; greater than \$300

Answer: D

Topic: Predicting Changes in Price and Quantity; Demand Changes

Skill: Analytical

Question history: Previous edition, Part Review 1

AACSB: Analytical Skills

- 21) Shoes are a normal good and people's incomes rise. As a result, the equilibrium price of a pair of shoes \_\_\_\_\_ and the equilibrium quantity \_\_\_\_\_.
- A) rises; increases
  - B) rises; decreases
  - C) falls; increases
  - D) falls; decreases

Answer: A

Topic: Predicting Changes in Price and Quantity; Demand Changes

Skill: Analytical

Question history: Previous edition, Part Review 1

AACSB: Analytical Skills

- 22) The number of companies making shoes decreases. As a result, the equilibrium price of a pair of shoes \_\_\_\_\_ and the equilibrium quantity \_\_\_\_\_.
- A) rises; increases
  - B) rises; decreases
  - C) falls; increases
  - D) falls; decreases

Answer: B

Topic: Predicting Changes in Price and Quantity; Supply Decreases

Skill: Analytical

Question history: Previous edition, Part Review 1

AACSB: Analytical Skills

- 23) Shoes are a normal good and people's incomes rise. Simultaneously the number of companies making shoes decreases. As a result, the equilibrium price of a pair of shoes \_\_\_\_\_ and the equilibrium quantity \_\_\_\_\_.
- A) definitely rises; might increase, decrease, or not change
  - B) definitely rises; definitely increases
  - C) might rise, fall, or not change; might increase, decrease, or not change
  - D) None of the above answers is correct.

Answer: A

Topic: Predicting Changes: Demand Increases, Supply Decreases

Skill: Analytical

Question history: Previous edition, Part Review 1

AACSB: Analytical Skills

# Part 2 Review

## 1 Monitoring Macroeconomic Performance

- 1) GDP is defined as
- A) gross demanded prices.
  - B) generally demanded product.
  - C) gross domestic product.
  - D) generally demanded prices.

Answer: C

Topic: GDP

Skill: Recognition

Question history: Previous edition, Part Review 2

AACSB: Reflective Thinking

- 2) In the United States, over time GDP
- A) stays relatively constant with occasional increases.
  - B) increases most of the time and decreases occasionally.
  - C) increases and decreases roughly about the same amount.
  - D) decreases more often than it increases.

Answer: B

Topic: GDP

Skill: Recognition

Question history: Previous edition, Part Review 2

AACSB: Reflective Thinking

- 3) A significant decline in activity spread across the economy, lasting more than a few months is called
- A) a recession.
  - B) an expansion.
  - C) a peak.
  - D) inflation.

Answer: A

Topic: Business Cycle

Skill: Recognition

Question history: Previous edition, Part Review 2

AACSB: Reflective Thinking

- 4) In the expenditure approach to measuring GDP, the components of GDP are
- A) consumption, investment, government expenditure, and net exports.
  - B) consumption, taxes, saving, and investment.
  - C) inflation, unemployment, saving, and investment.
  - D) frictional unemployment, structural unemployment, and cyclical unemployment.

Answer: A

Topic: GDP

Skill: Recognition

Question history: Previous edition, Part Review 2

AACSB: Reflective Thinking

- 5) The labor force is defined as
- A) all people aged 16 and over and not institutionalized.
  - B) the entire population.
  - C) those people employed and unemployed.
  - D) only those people with jobs.

Answer: C

Topic: Labor Force

Skill: Recognition

Question history: Previous edition, Part Review 2

AACSB: Reflective Thinking

- 6) The circular flow model shows that GDP can be calculated by
- A) both the expenditure and income methods because aggregate expenditure equals aggregate income.
  - B) only the expenditure method in which the four components of aggregate expenditure must be measured in the aggregate.
  - C) both the expenditure and income methods, even though aggregate expenditure is usually less than aggregate income.
  - D) only the income method in which the four components of aggregate income must be measured separately.

Answer: A

Topic: Circular Flow

Skill: Recognition

Question history: Previous edition, Part Review 2

AACSB: Reflective Thinking

- 7) Comparing the unemployment rate and the business cycle we see that
- A) the unemployment rate generally increases during expansions and generally decreases during recessions.
  - B) there is virtually no relationship between the business cycle and the unemployment rate.
  - C) the unemployment rate eventually falls during expansions and rises during recessions.
  - D) higher unemployment rates are the cause of most business cycles.

Answer: C

Topic: Unemployment and the Business Cycle

Skill: Conceptual

Question history: Previous edition, Part Review 2

AACSB: Reflective Thinking

- 8) In the United States over the past 40 years, the
- A) labor force participation rate has remained relatively constant and the unemployment rate has trended upwards.
  - B) both the unemployment rate and real GDP have tended to increase.
  - C) labor force participation rate has fallen and real GDP has increased.
  - D) unemployment rate has fluctuated and the labor force participation rate has risen.

Answer: D

Topic: Trends in Employment

Skill: Recognition

Question history: Previous edition, Part Review 2

AACSB: Reflective Thinking



- 9) The accumulated loss of output that results from a slowdown in the growth rate of GDP per person is called the
- A) Keynesian gap.
  - B) Okun gap.
  - C) Lucas wedge.
  - D) unemployment wedge.

Answer: C

Topic: GDP

Skill: Recognition

Question history: Previous edition, Part Review 2

AACSB: Reflective Thinking

- 10) The difference between nominal GDP and real GDP is that real GDP eliminates the effects from
- A) depreciation.
  - B) inflation.
  - C) the unemployment rate.
  - D) changes in productivity.

Answer: B

Topic: Nominal versus Real

Skill: Conceptual

Question history: Previous edition, Part Review 2

AACSB: Reflective Thinking

- 11) At full employment,
- A) real GDP equals potential GDP.
  - B) the unemployment rate is zero.
  - C) real GDP is above potential GDP.
  - D) the business cycle is at its peak.

Answer: A

Topic: Full Employment

Skill: Recognition

Question history: Previous edition, Part Review 2

AACSB: Reflective Thinking

# Part 3 Review

## 1 Macroeconomic Trends

- 1) \_\_\_\_\_ increases real GDP.
- A) A fall in the price level
  - B) An increase in employment
  - C) An increase in the natural rate of unemployment
  - D) A decrease in government spending

Answer: B

Topic: Economic Growth Rate

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 2) An increase in the amount of capital leads to \_\_\_\_\_ the aggregate production function \_\_\_\_\_ and a technological advance leads to \_\_\_\_\_ the aggregate production function.
- A) a movement along; a movement along
  - B) a movement along; an upward shift
  - C) an upward shift; an upward shift
  - D) a downward shift; an upward shift

Answer: C

Topic: Aggregate Production Function

Skill: Conceptual

Question history: Previous edition, Part Review 3

AACSB: Reflective Thinking

- 3) Purchasing new capital \_\_\_\_\_.
- A) creates an upward movement along the aggregate production function
  - B) creates a downward movement along the aggregate production function
  - C) shifts the aggregate production function upward
  - D) shifts the aggregate production function downward

Answer: C

Topic: Aggregate Production Function

Skill: Recognition

Question history: Previous edition, Part Review 3

AACSB: Reflective Thinking

- 4) The demand for labor \_\_\_\_\_ and the accumulated skill and knowledge of human is called \_\_\_\_\_.
- A) increases when productivity rises; technology
  - B) depends on the nominal wage rate; human capital
  - C) depends on the real wage rate; human capital
  - D) is independent of technology; the marginal product of labor

Answer: C

Topic: Labor and Growth

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 5) An increase in the productivity will \_\_\_\_\_ potential GDP, \_\_\_\_\_ employment, and \_\_\_\_\_ the real wage.
- A) decrease; increase; raise
  - B) increase; increase; raise.
  - C) increase; decrease; lower
  - D) increase; increase; lower

Answer: B

Topic: Increase in Productivity

Skill: Analytical

Question history: Previous edition, Part Review 3

AACSB: Analytical Skills

- 6) An increase in the population will \_\_\_\_\_ potential GDP, \_\_\_\_\_ employment, and \_\_\_\_\_ the real wage.
- A) decrease; increase; raise
  - B) increase; increase; raise.
  - C) increase; decrease; lower
  - D) increase; increase; lower

Answer: D

Topic: Increase in Population

Skill: Analytical

Question history: Previous edition, Part Review 3

AACSB: Analytical Skills

- 7) If productivity constantly increases, then the real wage rate \_\_\_\_\_ and employment \_\_\_\_\_.
- A) constantly rises; constantly increases
  - B) does not change; constantly decreases
  - C) constantly decreases; does not change
  - D) constantly rises; does not change

Answer: A

Topic: Increase in Productivity

Skill: Conceptual

Question history: Previous edition, Part Review 3

AACSB: Reflective Thinking

- 8) The \_\_\_\_\_ growth theory assumes that population growth is not driven by real GDP per person and the \_\_\_\_\_ growth theory predicts that differences in the economic growth rate can last indefinitely.
- A) new; classical
  - B) neoclassical; new
  - C) classical; neoclassical
  - D) neoclassical; neoclassical

Answer: B

Topic: Growth Theories

Skill: Conceptual

Question history: Previous edition, Part Review 3

AACSB: Reflective Thinking

- 9) When money is accepted as payment in a market transaction, it is functioning as
- A) a factor that shifts the aggregate production function
  - B) the velocity of circulation.
  - C) a medium of exchange.
  - D) the real interest rate.

Answer: C

Topic: *Medium of Exchange*

Skill: *Conceptual*

Question history: *Previous edition, Part Review 3*

AACSB: *Reflective Thinking*

- 10) The opportunity cost of holding money is the
- A) price level.
  - B) real interest rate.
  - C) velocity of circulation.
  - D) nominal interest rate.

Answer: D

Topic: *Influences on Money Holding, The Interest Rate*

Skill: *Recognition*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

- 11) If the Fed makes an open market \_\_\_\_\_ of securities, in the quantity theory  $M$  \_\_\_\_\_ and  $V$  \_\_\_\_\_.
- A) purchase; increases; increases
  - B) sale; increases; decreases
  - C) purchase; does not change; does not change
  - D) sale; decreases; does not change

Answer: D

Topic: *Monetary Policy*

Skill: *Conceptual*

Question history: *Modified 10th edition*

AACSB: *Reflective Thinking*

- 12) The velocity of circulation is
- A) equal to the price level multiplied by real GDP.
  - B) the same as the aggregate demand curve.
  - C) the average number of times a dollar bill is used in a year to buy the goods and services in GDP.
  - D) increased when the Fed lowers the required reserve ratio.

Answer: C

Topic: *Quantity Theory of Money, Velocity of Circulation*

Skill: *Conceptual*

Question history: *Previous edition, Part Review 3*

AACSB: *Reflective Thinking*

- 13) According to the quantity theory of money,
- A) the only way the Fed can change the quantity of money without affecting the velocity of circulation is by using open market operations.
  - B) a change in the discount rate changes real GDP.
  - C) a decrease in the quantity of money will decrease the velocity of circulation.
  - D) a decrease in the quantity of money will decrease the price level.

Answer: D

Topic: Predictions of the Quantity Theory of Money

Skill: Conceptual

Question history: Previous edition, Part Review 3

AACSB: Reflective Thinking

- 14) The major component of the capital and finance account is
- A) net exports.
  - B) investment both abroad and domestically.
  - C) imports and exports of services.
  - D) the official settlements account.

Answer: B

Topic: Capital Account

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 15) The main component of the current account is
- A) net exports.
  - B) investment both abroad and domestically.
  - C) net interest income.
  - D) the official settlements account.

Answer: A

Topic: Current Account Balance

Skill: Recognition

Question history: Previous edition, Part Review 3

AACSB: Reflective Thinking

- 16) If the U.S. interest rate differential \_\_\_\_\_, the demand for dollars \_\_\_\_\_ and the U.S. exchange rate \_\_\_\_\_.
- A) increases; increase; appreciates
  - B) decreases; increase; appreciates
  - C) increases; decrease; depreciates
  - D) decreases; decreases; appreciates

Answer: A

Topic: The Exchange Rate

Skill: Conceptual

Question history: Previous edition, Part Review 3

AACSB: Reflective Thinking

- 17) If the Fed hikes the U.S. interest rate relative to interest rates in other countries, in the foreign exchange market the demand for dollars will \_\_\_\_\_, the supply of dollars will \_\_\_\_\_, and the exchange rate will \_\_\_\_\_.
- A) increase; increase; rise
  - B) decrease; decrease; fall
  - C) increase; decrease; rise
  - D) decrease; increase; fall

Answer: C

Topic: *The Exchange Rate*

Skill: *Conceptual*

Question history: *Previous edition, Part Review 3*

AACSB: *Reflective Thinking*

- 18) In the foreign exchange market, if the supply of dollars \_\_\_\_\_ and simultaneously the demand for dollars \_\_\_\_\_, then the exchange rate definitely \_\_\_\_\_.
- A) increases; increases; depreciates
  - B) decreases; increases; depreciates
  - C) increases; decreases; depreciates
  - D) decreases; decreases; appreciates

Answer: C

Topic: *The Exchange Rate*

Skill: *Conceptual*

Question history: *Previous edition, Part Review 3*

AACSB: *Reflective Thinking*

- 19) If two currencies allow for the equal value of money so that the same bundle of goods cost the same in two countries, there is
- A) trade equalization parity.
  - B) interest rate parity.
  - C) tariff application parity.
  - D) purchasing power parity.

Answer: D

Topic: *Purchasing Power Parity*

Skill: *Recognition*

Question history: *Previous edition, Part Review 3*

AACSB: *Reflective Thinking*

# Part 4 Review

## 1 Macroeconomic Fluctuations

- 1) The level of potential GDP
- A) increases when the inflation rate rises.
  - B) rises and falls with the business cycle.
  - C) determines the location of the long-run aggregate supply curve.
  - D) changes when cyclical unemployment changes.

Answer: C

Topic: *The AS-AD Model*

Skill: *Conceptual*

Question history: *Previous edition, Part Review 4*

AACSB: *Reflective Thinking*

- 2) Business cycles result when
- A) aggregate demand grows faster than potential GDP.
  - B) the labor force participation rate changes.
  - C) aggregate supply and aggregate demand change at an uneven pace.
  - D) real GDP equals potential GDP.

Answer: C

Topic: *Business Cycle*

Skill: *Conceptual*

Question history: *Previous edition, Part Review 4*

AACSB: *Reflective Thinking*

- 3) Long-run macroeconomic equilibrium occurs when
- A) real GDP is equal to potential GDP.
  - B) real GDP is at a point along the short-run aggregate supply curve.
  - C) the unemployment rate is zero.
  - D) all able-bodied adults have jobs.

Answer: A

Topic: *Long-Run Equilibrium*

Skill: *Conceptual*

Question history: *Previous edition, Part Review 4*

AACSB: *Reflective Thinking*

- 4) If the economy is at the natural unemployment rate,
- A) real GDP > potential GDP.
  - B) real GDP < potential GDP.
  - C) real GDP = potential GDP.
  - D) All of the above can occur when the economy is at the natural unemployment rate.

Answer: C

Topic: *Long-Run Equilibrium*

Skill: *Conceptual*

Question history: *Previous edition, Chapter 10*

AACSB: *Reflective Thinking*

- 5) At potential GDP
- A) there is no unemployment but there is not necessarily full employment.
  - B) there is no unemployment and there is full employment.
  - C) unemployment is at its natural rate.
  - D) None of the above is correct.

Answer: C

Topic: Macroeconomic Long Run and Short Run

Skill: Conceptual

Question history: Previous edition, Chapter 10

AACSB: Reflective Thinking

- 6) Japan's population increased by 3 percent in 2010. As a result, which of the following occurred?
- i. an increase in potential GDP
  - ii. a rightward shift in the long-run aggregate supply curve
  - iii. a rightward shift in the short-run aggregate supply curve.
- A) i, ii and iii.
  - B) iii only.
  - C) i and ii only.
  - D) ii and iii.

Answer: A

Topic: Short-Run and Long-Run Aggregate Supply

Skill: Analytical

Question history: Previous edition, Chapter 10

AACSB: Analytical Skills

- 7) Keynesian economists believe that
- A) the economy automatically adjusts towards full employment.
  - B) monetary policy causes business cycles.
  - C) there are no business cycles.
  - D) activist government policy is needed to get the economy to full employment.

Answer: D

Topic: Keynesian View

Skill: Recognition

Question history: Previous edition, Part Review 4

AACSB: Reflective Thinking

- 8) A recessionary gap occurs when
- A) the short-run aggregate supply curve shifts rightward.
  - B) real GDP is less than potential GDP.
  - C) the economy is at its long-run equilibrium.
  - D) government interferes with the economy.

Answer: B

Topic: Recessionary Gap

Skill: Recognition

Question history: Previous edition, Part Review 4

AACSB: Reflective Thinking



- 9) Classical economists believe that the economy
- A) requires activist government intervention to reach its potential level of GDP.
  - B) is self-regulating and does not require government intervention.
  - C) can be affected by only monetary policy.
  - D) is persistently below its potential level of GDP.

Answer: B

Topic: Classical View

Skill: Recognition

Question history: Previous edition, Part Review 4

AACSB: Reflective Thinking

- 10) The impulse leading to business cycles in the Keynesian model is changes in
- A) the structural deficit.
  - B) open market operations.
  - C) business confidence.
  - D) the expected future price level.

Answer: C

Topic: Keynesian Model

Skill: Conceptual

Question history: Previous edition, Part Review 4

AACSB: Reflective Thinking

- 11) The order for the chain of events for the Keynesian model is for a change in \_\_\_\_\_ to lead to a change in \_\_\_\_\_, which is then multiplied resulting in a change in \_\_\_\_\_.
- A) investment; animal spirits; the price level
  - B) business confidence; investment; real GDP
  - C) the Fed's intermediate targets; the Fed's goals; real GDP
  - D) real GDP; income; consumption

Answer: B

Topic: Keynesian Model

Skill: Conceptual

Question history: Previous edition, Part Review 4

AACSB: Reflective Thinking

- 12) If the Fed increases the quantity of money, \_\_\_\_\_ economists believe that the \_\_\_\_\_.
- A) Keynesian; aggregate supply curve shifts rightward
  - B) Keynesian; structural deficit increases
  - C) monetarist; cyclical deficit increases
  - D) monetarist; aggregate demand curve shifts rightward

Answer: D

Topic: The Monetarist Model

Skill: Recognition

Question history: Previous edition, Part Review 4

AACSB: Reflective Thinking

- 13) Keynesians and monetarists believe that economic fluctuations are caused
- A) by shifts in both the *AS* and *AD* curves.
  - B) largely by shifts in the *AD* curve.
  - C) changes in the structural deficit.
  - D) by fiscal policy.

Answer: B

Topic: *The Monetarist Model*

Skill: *Conceptual*

Question history: *Previous edition, Part Review 4*

AACSB: *Reflective Thinking*

- 14) The growth rate of productivity is a major feature of
- A) Keynesian and monetarist economists.
  - B) monetarist economists.
  - C) real business cycle economists.
  - D) why the marginal propensity to consume is less than 1.0.

Answer: C

Topic: *Real Business Cycle Model*

Skill: *Recognition*

Question history: *Previous edition, Part Review 4*

AACSB: *Reflective Thinking*

- 15) Suppose that a severe shock that decreases investment demand hits the United States. Which of the following can we expect to occur according to the real business cycle model?
- A) The Fed will lower the federal funds rate.
  - B) The structural deficit will increase.
  - C) The real wage rate will rise.
  - D) The real interest rate will fall.

Answer: D

Topic: *RBC Mechanism*

Skill: *Conceptual*

Question history: *Previous edition, Part Review 4*

AACSB: *Reflective Thinking*

- 16) The Keynesian aggregate expenditure model best describes the economy in the \_\_\_\_\_ run when prices are \_\_\_\_\_.
- A) long; fixed
  - B) short; variable
  - C) long; variable
  - D) short; fixed

Answer: D

Topic: *Keynesian Model*

Skill: *Recognition*

Question history: *Previous edition, Part Review 4*

AACSB: *Reflective Thinking*

- 17) The Keynesian aggregate expenditure model focuses on changes in
- A) the price level.
  - B) real GDP.
  - C) potential GDP.
  - D) the SAS curve.

Answer: B

Topic: Keynesian Model

Skill: Recognition

Question history: Previous edition, Part Review 4

AACSB: Reflective Thinking

- 18) The marginal propensity to consume measures
- A) the cyclical deficit.
  - B) the structural deficit.
  - C) how much consumption expenditure occurs at the equilibrium level of income.
  - D) how much of a change in consumption expenditure results from a change in disposable income.

Answer: D

Topic: Marginal Propensity to Consume

Skill: Recognition

Question history: Previous edition, Part Review 4

AACSB: Reflective Thinking

- 19) Suppose disposable income increases from \$11 trillion to \$12 trillion. At the same time, consumption expenditure increases from \$4.2 trillion to \_\_\_\_\_. Thus the MPC must equal \_\_\_\_\_.
- A) \$5.0 trillion; 0.50
  - B) \$5.0 trillion; 0.80
  - C) \$4.4 trillion; 0.40
  - D) \$5.5 trillion; 0.50

Answer: B

Topic: Marginal Propensity to Consume

Skill: Conceptual

Question history: Previous edition, Part Review 4

AACSB: Analytical Skills

- 20) Which of the following is true?
- A) The structural deficit changes over the business cycle.
  - B)  $MPS + MPC = 1$ .
  - C) At equilibrium expenditure, unplanned changes in inventory must be positive.
  - D) In the real business cycle model, there is no AD curve.

Answer: B

Topic: Marginal Propensities to Consume and Save

Skill: Recognition

Question history: Previous edition, Part Review 4

AACSB: Reflective Thinking

21) The multiplier effect

- A) is nonexistent in the Keynesian model.
- B) has no effect if the cyclical deficit is positive.
- C) magnifies small changes in spending into larger changes in output and income.
- D) increases the *MPC*.

Answer: C

Topic: *The Multiplier Effect*

Skill: *Conceptual*

Question history: *Previous edition, Part Review 4*

AACSB: *Reflective Thinking*

22) The presence of imports \_\_\_\_\_ the size of the \_\_\_\_\_.

- A) increases; government budget deficit
- B) increases; multiplier
- C) decreases; multiplier
- D) decreases; government budget deficit

Answer: C

Topic: *The Multiplier and Imports*

Skill: *Conceptual*

Question history: *Previous edition, Part Review 4*

AACSB: *Reflective Thinking*

23) Which of the following leads to a rightward shift in the short-run Phillips curve?

- I. a reduction in inflationary expectations.
  - II. an increase in the natural rate of unemployment.
  - III. an increase in the velocity of circulation
- A) I only
  - B) II only
  - C) I and II
  - D) I and III

Answer: B

Topic: *The Short-Run Phillips Curve*

Skill: *Conceptual*

Question history: *Previous edition, Part Review 4*

AACSB: *Reflective Thinking*

# Part 5 Review

## 1 Macroeconomic Policy

- 1) Fiscal policy entails changes in
- A) the quantity of money.
  - B) the MPC.
  - C) government spending and taxes.
  - D) the multiplier.

Answer: C

Topic: Fiscal Policy

Skill: Recognition

Question history: Previous edition, Part Review 5

AACSB: Reflective Thinking

- 2) If we compare the United States to France, we see that potential GDP per person in France is \_\_\_\_\_ than that in the United States because the French \_\_\_\_\_ is greater than that in the United States.
- A) greater; tax wedge
  - B) less; structural deficit
  - C) less; tax wedge
  - D) less; MPC

Answer: C

Topic: Tax Wedge

Skill: Conceptual

Question history: Previous edition, Part Review 5

AACSB: Reflective Thinking

- 3) A fiscal action that is triggered by the state of the economy is called
- A) monetarist policy.
  - B) the tax wedge.
  - C) automatic fiscal policy.
  - D) the multiplier.

Answer: C

Topic: Automatic Fiscal Policy

Skill: Recognition

Question history: Previous edition, Part Review 5

AACSB: Reflective Thinking

- 4) An example of a fiscal policy designed to decrease real GDP is
- A) a cut in taxes.
  - B) an increase in taxes.
  - C) an increase in government expenditure.
  - D) None of the above answers is correct.

Answer: B

Topic: Fiscal Policy

Skill: Recognition

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 5) A decrease in government expenditures on goods and services is an example of \_\_\_\_\_.
- A) a fiscal policy designed to increase real GDP
  - B) decreasing needs-tested spending programs
  - C) increasing induced taxes
  - D) a fiscal policy designed to decrease real GDP

Answer: D

Topic: Fiscal Policy

Skill: Conceptual

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 6) An increase in taxes
- I. violates the Taylor rule.
  - II. decreases real GDP.
  - III. forces the Fed to change its instruments.
- A) I only
  - B) II only
  - C) I and III
  - D) I and II

Answer: B

Topic: Fiscal Policy

Skill: Conceptual

Question history: Previous edition, Part Review 5

AACSB: Reflective Thinking

- 7) An example of a fiscal policy designed to increase real GDP is
- A) a cut in taxes.
  - B) an increase in taxes.
  - C) a decrease in government expenditure.
  - D) None of the above answers is correct.

Answer: A

Topic: Fiscal Policy

Skill: Recognition

Question history: Previous edition, Chapter 13

AACSB: Reflective Thinking

- 8) An economy has real GDP of \$300 billion and potential GDP of \$240 billion. To move the economy to potential GDP, the government should \_\_\_\_\_ taxes and/or \_\_\_\_\_ government expenditure.
- A) increase; increase
  - B) increase; decrease
  - C) decrease; increase
  - D) decrease; decrease

Answer: B

Topic: Equilibrium GDP and the Price Level

Skill: Conceptual

Question history: Previous edition, Chapter 13

AACSB: Analytical Skills

- 9) The crowding out effect refers to
- A) the presence of the Ricardo–Barro effect.
  - B) how a cyclical budget deficit changes over the business cycle.
  - C) government investment crowding out private investment.
  - D) the wealth effect's impact on the aggregate demand curve.

Answer: C

Topic: Crowding Out Effect

Skill: Recognition

Question history: Previous edition, Part Review 5

AACSB: Reflective Thinking

- 10) The Fed's instruments include
- A) open market operations.
  - B) the structural budget deficit.
  - C) the Ricardo–Barro effect.
  - D) the federal funds rate base.

Answer: D

Topic: Policy Instruments

Skill: Recognition

Question history: Previous edition, Part Review 5

AACSB: Reflective Thinking

- 11) The Laffer curve studies the relationship between
- A) open market operations and the interest rate.
  - B) taxes and the real interest rate.
  - C) tax rates and tax revenues.
  - D) monetary policy and tax revenues.

Answer: C

Topic: Laffer Curve

Skill: Recognition

Question history: Previous edition, Part Review 5

AACSB: Reflective Thinking

- 12) An income tax hike \_\_\_\_\_ potential GDP by \_\_\_\_\_.
- A) increases; not crowding out investment
  - B) decreases; limiting the use of discretionary monetary policy
  - C) increases; offsetting the Barro–Ricardo effect
  - D) decreases; decreasing the supply of labor

Answer: D

Topic: Income Tax Effects

Skill: Conceptual

Question history: Previous edition, Part Review 5

AACSB: Reflective Thinking

- 13) If net taxes are less than government outlays, the government sector has a budget \_\_\_\_\_ and government saving \_\_\_\_\_.
- A) surplus; is positive
  - B) deficit; cannot be used for discretionary fiscal policy
  - C) deficit; is negative
  - D) None of the above answers is correct.

Answer: C

Topic: *Government Saving*

Skill: *Conceptual*

Question history: *Previous edition, Part Review 5*

AACSB: *Reflective Thinking*

- 14) The Fed can change the federal funds rate
- A) lowering taxes.
  - B) increasing spending.
  - C) purchasing government securities.
  - D) increasing aggregate demand.

Answer: C

Topic: *The Fed*

Skill: *Conceptual*

Question history: *Previous edition, Part Review 5*

AACSB: *Reflective Thinking*

- 15) A decrease in the reserves of commercial banks could be the result of
- A) an increase in the velocity of circulation.
  - B) the sale of government securities by the Federal Reserve.
  - C) a decrease in the velocity of circulation.
  - D) an increase in the required reserve ratio.

Answer: B

Topic: *How an Open Market Operation Works*

Skill: *Conceptual*

Question history: *Previous edition, Part Review 5*

AACSB: *Reflective Thinking*

- 16) If the Fed makes an open market \_\_\_\_\_ of government securities, the federal funds rate will \_\_\_\_\_ as the quantity of money \_\_\_\_\_.
- A) purchase; rise; increases
  - B) sale; fall; increases
  - C) purchase; fall; decreases
  - D) sale; rise; decreases

Answer: D

Topic: *Monetary Policy*

Skill: *Conceptual*

Question history: *Previous edition, Part Review 5*

AACSB: *Reflective Thinking*



- 17) If the Fed makes an open market \_\_\_\_\_ of government securities, the federal funds rate \_\_\_\_\_ and the immediate impact is to shift the aggregate \_\_\_\_\_ curve.
- A) purchase; falls; demand
  - B) sale; falls; demand
  - C) sale; rises; supply
  - D) purchase; rises; supply

Answer: A

Topic: Monetary Policy

Skill: Conceptual

Question history: Previous edition, Part Review 5

AACSB: Analytical Skills

- 18) If the Fed makes an unexpected open market \_\_\_\_\_ of government securities, the aggregate \_\_\_\_\_ curve shifts rightward and \_\_\_\_\_.
- A) sale; supply; the short-run Phillips curve shifts upward
  - B) purchase; demand; the short-run Phillips curve shifts downward
  - C) sale; demand; there is a movement along the short-run Phillips curve
  - D) purchase; demand; the long-run Phillips curve shifts rightward

Answer: C

Topic: Monetary Policy

Skill: Conceptual

Question history: Previous edition, Part Review 5

AACSB: Analytical Skills

- 19) When the Fed enacts monetary policy, in the short run it changes
- A) the AD curve.
  - B) the SAS curve.
  - C) both the AD and SAS curves.
  - D) potential GDP.

Answer: A

Topic: Monetary Policy

Skill: Conceptual

Question history: Previous edition, Part Review 5

AACSB: Analytical Skills

- 20) If the economy is at potential GDP and the Fed makes an open market sale of government securities, in the long run the aggregate \_\_\_\_\_ curve shifts \_\_\_\_\_ and the price level \_\_\_\_\_.
- A) demand; rightward; rises
  - B) supply; leftward; rises
  - C) demand; leftward; falls
  - D) supply; leftward; falls

Answer: C

Topic: Monetary Policy

Skill: Conceptual

Question history: Previous edition, Part Review 5

AACSB: Analytical Skills

- 21) If the economy is at potential GDP and the Fed makes an open market purchase of government securities, in the short run bank reserves \_\_\_\_\_, the nominal interest rate \_\_\_\_\_, and the aggregate demand curve \_\_\_\_\_.
- A) stay constant; does not change; does not shift
  - B) increase; rises; shifts rightward
  - C) decrease; falls; shifts rightward
  - D) increase; falls; shifts rightward

Answer: D

Topic: Monetary Policy

Skill: Conceptual

Question history: Previous edition, Part Review 5

AACSB: Analytical Skills

- 22) If the Fed is concerned with lowering \_\_\_\_\_ it will make an open market \_\_\_\_\_ of government securities, which will shift aggregate demand curve \_\_\_\_\_.
- A) inflation; sale; leftward
  - B) unemployment; sale; leftward
  - C) inflation; purchase; rightward
  - D) unemployment; purchase; leftward

Answer: A

Topic: Monetary Policy

Skill: Conceptual

Question history: Previous edition, Part Review 5

AACSB: Analytical Skills

- 23) If the Fed is concerned with lowering \_\_\_\_\_ it will make an open market \_\_\_\_\_ of government securities, which will \_\_\_\_\_ real GDP.
- A) unemployment; sale; increase
  - B) inflation; purchase; decrease
  - C) inflation; sale; decrease
  - D) unemployment; sale; decrease

Answer: C

Topic: Monetary Policy

Skill: Conceptual

Question history: Previous edition, Part Review 5

AACSB: Reflective Thinking

- 24) Which of the following is true?
- I. The quantity theory predicts that in the long run the inflation rate equals the money growth rate minus the growth rate of potential GDP.
  - II. If the Fed decreases the federal funds rate, aggregate demand increases.
  - III. The Fed's monetary policy works by shifting the short-run aggregate supply curve.
- A) I and II
  - B) II and III
  - C) I and III
  - D) I, II and III

Answer: A

Topic: Monetary Policy

Skill: Conceptual

Question history: Previous edition, Part Review 5

AACSB: Reflective Thinking

- 25) \_\_\_\_\_ occurs when a foreign firm sells its exports at a lower price than its cost of production.
- A) A quota
  - B) Dumping
  - C) A tariff
  - D) A nontariff barrier

Answer: B

*Topic: Trade*

*Skill: Recognition*

*Question history: New 10th edition*

*AACSB: Reflective Thinking*