Practiced Questions

Chapter 20

1. The model of aggregate demand and aggregate supply
   a. is different from the model of supply and demand for a particular market, in that we cannot focus on the substitution of resources between markets to explain aggregate relationships.
   b. is different from the model of supply and demand for a particular market, in that we have to separate real and nominal variables in the aggregate model.
   c. is a straightforward extension of the model of supply and demand for a particular market, in which substitution of resources between markets is highlighted.
   d. is a straightforward extension of the model of supply and demand for a particular market, in which the interaction between real and nominal variables is highlighted.

2. In the model of aggregate demand and aggregate supply, which of the following effects helps to explain the downward slope of the aggregate-demand curve?
   a. the exchange-rate effect
   b. the wealth effect
   c. the interest-rate effect
   d. All of the above are correct.

3. In the model of aggregate demand and aggregate supply, one part of the explanation for why the aggregate-demand curve slopes downward is that a decrease in the price level
   a. decreases the real value of money.
   b. increases the real value of the dollar in foreign exchange markets.
   c. decreases the interest rate.
   d. All of the above are correct.

4. In the context of the aggregate-demand curve, the interest-rate effect refers to the idea that, when the price level increases,
   a. the real value of money decreases; in turn, the real value of the dollar increases in foreign exchange markets, which decreases net exports.
   b. the real value of money decreases; in turn, interest rates increase, which decreases net exports.
   c. households increase their holdings of money; in turn, interest rates decrease, which reduces spending on consumption goods.
   d. households increase their holdings of money; in turn, interest rates increase, which reduces spending on investment goods.

5. In the context of aggregate demand and aggregate supply, the wealth effect refers to the idea that, when the price level decreases, the real wealth of households increases,
   a. and as a result consumption spending increases. This effect contributes to the downward slope of the aggregate-demand curve.
   b. and as a result consumption spending increases. This effect contributes to the upward slope of the aggregate-supply curve.
   c. and as a result households increase their money holdings; in turn, interest rates increase and investment spending decreases. This effect contributes to the downward slope of the aggregate-demand curve.
   d. and as a result households increase their money holdings; in turn, interest rates increase and investment spending decreases. This effect contributes to the upward slope of the aggregate-supply curve.
6. Sticky nominal wages can result in
   a. lower profits for firms when the price level turns out to be lower than it was expected to be.
   b. an increase in the real wage when the price level increases.
   c. a short-run aggregate-supply curve that is vertical.
   d. a long-run aggregate-supply curve that is upward-sloping.

7. The sticky-price theory suggests that
   a. the short-run aggregate-supply curve is upward-sloping.
   b. an unexpected fall in the price level induces firms to reduce the quantity of goods and services they produce.
   c. menu costs influence the speed of adjustment of prices.
   d. All of the above are correct.

8. Suppose the short-run aggregate-supply curve slopes upward. Then, using the model of aggregate demand and aggregate supply, the short-run effects of an increase in the expected price level include
   a. a lower level of output and a lower price level.
   b. a lower level of output and a higher price level.
   c. a higher level of output and a lower price level.
   d. a higher level of output and a higher price level.

9. Suppose the short-run aggregate-supply curve slopes upward and that international speculators lose confidence in foreign economies and want to move some of their wealth into the U.S. economy. Using the model of aggregate demand and aggregate supply, the short-run effects of this speculative activity would include
   a. an increase in the value of the U.S. dollar in foreign exchange markets, a lower level of U.S. output and a lower U.S. price level.
   b. an increase in the value of the U.S. dollar in foreign exchange markets, a higher level of U.S. output and a higher U.S. price level.
   c. a decrease in the value of the U.S. dollar in foreign exchange markets, a lower level of U.S. output and a lower U.S. price level.
   d. a decrease in the value of the U.S. dollar in foreign exchange markets, a lower level of U.S. output and a higher U.S. price level.

Figure 20-1.
10. **Refer to Figure 20-1.** The appearance of the long-run aggregate-supply (LRAS) curve
   a. is inconsistent with the concept of monetary neutrality.
   b. is consistent with the idea that point A represents a long-run equilibrium but not a short-run equilibrium when the relevant short-run aggregate-supply curve is AS<sub>1</sub>.
   c. indicates that Y<sub>1</sub> is the natural rate of output.
   d. All of the above are correct.

11. **Refer to Figure 20-1.** The shift of the short-run aggregate-supply curve from AS<sub>1</sub> to AS<sub>2</sub>
   a. could be caused by an outbreak of war in the Middle East.
   b. could be caused by a decrease in the expected price level.
   c. causes the economy to experience an increase in the unemployment rate.
   d. causes the economy to experience stagflation.

12. **Refer to Figure 20-1.** Point B represents
   a. a short-run equilibrium and a long-run equilibrium.
   b. a short-run equilibrium but not a long-run equilibrium.
   c. a long-run equilibrium but not a short-run equilibrium.
   d. neither a short-run equilibrium nor a long-run equilibrium.

13. **Refer to Figure 20-1.** Starting from point B and assuming that aggregate demand is held constant, in the long run the economy is likely to experience
   a. a falling price level and a falling level of output.
   b. a falling price level and a rising level of output.
   c. a rising price level and a falling level of output.
   d. a rising price level and a rising level of output.

**Chapter 21**

14. According to the theory of liquidity preference,
   a. if the interest rate is below the equilibrium level, then the quantity of money people want to hold is less than the quantity of money the Fed has created.
   b. if the interest rate is above the equilibrium level, then the quantity of money people want to hold is greater than the quantity of money the Fed has created.
   c. the demand for money is represented by a downward-sloping line on a supply-and-demand graph.
   d. All of the above are correct.

15. According to the liquidity preference theory, an increase in the overall price level of 10 percent
   a. increases the equilibrium interest rate, which in turn decreases the quantity of goods and services demanded.
   b. decreases the equilibrium interest rate, which in turn increases the quantity of goods and services demanded.
   c. increases the quantity of money supplied by 10 percent, leaving the interest rate and the quantity of goods and services demanded unchanged.
   d. decreases the quantity of money demanded by 10 percent, leaving the interest rate and the quantity of goods and services demanded unchanged.
16. While a television news reporter might state that “Today the Fed lowered the federal funds rate from 5.5 percent to 5.25 percent,” a more precise account of the Fed’s action would be as follows:
   a. “Today the Fed told its bond traders to conduct open-market operations in such a way that the equilibrium federal funds rate would decrease to 5.25 percent.”
   b. “Today the Fed lowered the discount rate by a quarter of a percentage point, and this action will force the federal funds rate to drop by the same amount.”
   c. “Today the Fed took steps to decrease the money supply by an amount that is sufficient to decrease the federal funds rate to 5.25 percent.”
   d. “Today the Fed took a step toward contracting aggregate demand, and this was done by lowering the federal funds rate to 5.25 percent.”

17. The term crowding-out effect refers to
   a. the reduction in aggregate supply that results when a monetary expansion causes the interest rate to decrease.
   b. the reduction in aggregate demand that results when a monetary expansion causes the interest rate to decrease.
   c. the reduction in aggregate demand that results when a fiscal expansion causes the interest rate to increase.
   d. the reduction in aggregate demand that results when a decrease in government spending or an increase in taxes causes the interest rate to increase.

Scenario 21-1. Take the following information as given for a small, imaginary economy:
   When income is $10,000, consumption spending is $8,000.
   When income is $12,000, consumption spending is $9,800.

18. Refer to Scenario 21-1. The marginal propensity to consume for this economy is
   a. 0.800.
   b. 0.817.
   c. 0.800 or 0.817, depending on whether income is $10,000 or $12,000.
   d. 0.900.

19. Refer to Scenario 21-1. The multiplier for this economy is
   a. 10.00.
   b. 8.00.
   c. 5.45.
   d. 5.00.

20. Refer to Scenario 21-1. For this economy, an initial increase of $200 in net exports translates into a
   a. $2,000 increase in aggregate demand when the crowding-out effect is taken into account.
   b. $2,500 increase in aggregate demand when the crowding-out effect is taken into account.
   c. $2,000 increase in aggregate demand in the absence of the crowding-out effect.
   d. $2,500 increase in aggregate demand in the absence of the crowding-out effect.
**Figure 21-1.** On the figure, MS represents money supply and MD represents money demand.

![Figure 21-1](image)

___ 21. **Refer to Figure 21-1.** The shift of the money-demand curve from MD₁ to MD₂ could be a result of
   a. an increase in taxes.
   b. a decrease in government spending.
   c. a decrease in the price level.
   d. All of the above are correct.

___ 22. **Refer to Figure 21-1.** The shift of the money-demand curve from MD₁ to MD₂ is consistent with which of the following sets of events?
   a. The government cuts taxes, resulting in an increase in people’s incomes.
   b. The government reduces government spending, resulting in a decrease in people’s incomes.
   c. The Federal Reserve increases the supply of money, which decreases the interest rate.
   d. All of the above are correct.

**Chapter 22**

**Figure 22-1.** The left-hand graph shows a short-run aggregate-supply (SRAS) curve and two aggregate-demand (AD) curves. On the right-hand diagram, U represents the unemployment rate.
23. Refer to Figure 22-1. Assuming the price level in the previous year was 100, point F on the right-hand graph corresponds to
   a. point A on the left-hand graph.
   b. point B on the left-hand graph.
   c. point C on the left-hand graph.
   d. point D on the left-hand graph.

24. Refer to Figure 22-1. Assuming the price level in the previous year was 100, point G on the right-hand graph corresponds to
   a. point A on the left-hand graph.
   b. point B on the left-hand graph.
   c. point C on the left-hand graph.
   d. point D on the left-hand graph.

25. Refer to Figure 22-1. Suppose points F and G on the right-hand graph represent two possible outcomes for an imaginary economy in the year 2008, and those two points correspond to points B and C, respectively, on the left-hand graph. Then it is apparent that the price index equaled
   a. 130 in 2007.
   b. 115 in 2007.
   c. 110 in 2007.
   d. 100 in 2007.

26. Refer to Figure 22-1. Suppose points F and G on the right-hand graph represent two possible outcomes for an imaginary economy in the year 2008, and those two points correspond to points B and C, respectively, on the left-hand graph. Also suppose we know that the price index equaled 120 in 2007. Then the numbers 115 and 130 on the vertical axis of the left-hand graph would have to be replaced by
   a. 155 and 175, respectively.
   b. 138 and 156, respectively.
   c. 137.5 and 154.75, respectively.
   d. 135 and 150, respectively.

27. Refer to Figure 22-1. The Phillips curve that is depicted on the right-hand graph offers policymakers a "menu" of combinations
   a. that applies both in the short run and in the long run.
   b. that is relevant to choices involving fiscal policy, but not to choices involving monetary policy.
   c. of inflation and unemployment.
   d. All of the above are correct.

28. Suppose expected inflation and actual inflation are both relatively high, and unemployment is at its natural rate. If the Fed then pursues a contractionary monetary policy, which of the following results would be expected in the short run?
   a. Expected inflation would exceed actual inflation, and unemployment would exceed its natural rate.
   b. Expected inflation would exceed actual inflation, and unemployment would be below its natural rate.
   c. Actual inflation would exceed expected inflation, and unemployment would exceed its natural rate.
   d. Actual inflation would exceed expected inflation, and unemployment would be below its natural rate.
29. Suppose expected inflation and actual inflation are both low, and unemployment is at its natural rate. If the Fed then pursues an expansionary monetary policy, which of the following results would be expected in the short run?
   a. The short-run Phillips curve would shift to the left.
   b. The short-run Phillips curve would shift to the right.
   c. The economy would move up and to the left along a given short-run Phillips curve.
   d. The economy would move down and to the right along a given short-run Phillips curve.

30. When they are confronted with an adverse shock to aggregate supply, policymakers face a difficult choice in that
   a. if they contract aggregate demand, the unemployment rate will increase further.
   b. if they expand aggregate demand, the inflation rate will increase further.
   c. they face a less favorable trade-off between inflation and unemployment than they did before the shock.
   d. All of the above are correct.
Answer Section

1. A
2. D
3. C
4. D
5. A
6. A
7. D
8. B
9. A
10. C
11. B
12. B
13. C
14. C
15. A
16. A
17. C
18. D
19. A
20. C
21. D
22. B
23. B
24. C
25. D
26. B
27. C
28. A
29. C
30. D