

12. Assume that the economy begins in long-run equilibrium. Then the Fed reduces the money supply. In the short run _____, whereas in the long run, prices _____ and output returns to its original level.
- A) output decreases and prices are unchanged; rise
 B) output decreases and prices are unchanged; fall
 C) output and prices both decrease; rise
 D) output and prices both decrease; fall
13. Which of the following is an example of a demand shock?
- A) a large oil-price increase
 B) the introduction and greater availability of credit cards
 C) a drought that destroys agricultural crops
 D) unions obtaining a substantial wage increase
14. Starting from long-run equilibrium, if the velocity of money increases (due to, for example, the invention of automatic teller machines), the Fed might be able to stabilize output by:
- A) decreasing the money supply. B) increasing the money supply.
 C) decreasing the price level. D) increasing the price level.
15. An adverse supply shock _____ the short-run aggregate supply curve _____ the natural level of output.
- A) raises; but cannot affect B) raises; and may also lower
 C) lowers; but cannot affect D) lowers; and may also lower

1. John Maynard Keynes wrote that responsibility for low income and high unemployment in economic downturns should be placed on:
- A) low levels of capital. B) an untrained labor force.
 C) inadequate technology. D) low aggregate demand.
2. For the purposes of the Keynesian cross, planned expenditure consists of:
- A) planned investment. B) planned government spending.
 C) planned investment and government spending.
 D) planned investment, government spending, and consumption expenditures.
3. With planned expenditure and the equilibrium condition $Y = PE$ drawn on a graph with income along the horizontal axis, if income exceeds expenditure, then income is to the _____ of equilibrium income and there is unplanned inventory _____.
- A) right; decumulation B) right; accumulation C) left; decumulation D) left; accumulation
4. When firms experience unplanned inventory accumulation, they typically:
- A) build new plants. B) lay off workers and reduce production.
 C) hire more workers and increase production. D) call for more government spending.
5. In the Keynesian-cross model, if taxes are reduced by 250, then the equilibrium level of income:
- A) increases by 250. B) increases by more than 250.
 C) decreases by 250. D) increases, but by less than 250.
6. Tax cuts stimulate _____ by improving worker's incentive and expand _____ by raising households' disposable income.
- A) velocity; demand for loanable funds B) demand for loanable funds; velocity
 C) aggregate demand; aggregate supply D) aggregate supply; aggregate demand

7. The simple investment function shows that investment _____ as _____ increases.
 A) decreases; the interest rate
 B) increases; the interest rate
 C) decreases; government spending
 D) increases; government spending
8. Along any given IS curve:
 A) tax rates are fixed, but government spending varies.
 B) government spending is fixed, but tax rates vary.
 C) both government spending and tax rates vary.
 D) both government spending and tax rates are fixed.
9. One argument in favor of tax cuts over spending on infrastructure to increase production is that:
 A) tax cuts increase the MPC by a larger amount than spending on infrastructure.
 B) tax cuts increase planned spending, but spending on infrastructure offsets private spending.
 C) the tax multiplier is larger than the government spending multiplier.
 D) it takes longer to implement spending on infrastructure than to implement tax cuts.
10. An IS curve shows combinations of:
 A) taxes and government spending.
 B) nominal money balances and price levels.
 C) interest rates and income that bring equilibrium in the market for real balances.
 D) interest rates and income that bring equilibrium in the market for goods and services.
11. The theory of liquidity preference implies that:
 A) as the interest rate rises, the demand for real balances will fall.
 B) as the interest rate rises, the demand for real balances will rise.
 C) the interest rate will have no effect on the demand for real balances.
 D) as the interest rate rises, income will rise.

12. The theory of liquidity preference implies that, other things being equal, an increase in the real money supply will:
 A) lower the interest rate.
 B) raise the interest rate.
 C) have no effect on the interest rate.
 D) first lower and then raise the interest rate.
13. When Paul Volcker tightened the money supply:
 A) the inflation rate immediately fell.
 B) nominal interest rates fell in the short run.
 C) nominal interest rates fell in the long run.
 D) real balances rose in the short run.
14. An explanation for the slope of the LM curve is that as:
 A) the interest rate increases, income becomes higher.
 B) the interest rate increases, income becomes lower.
 C) income rises, money demand rises, and a higher interest rate is required.
 D) income rises, money demand rises, and a lower interest rate is required.
15. For any given interest rate and price level, an increase in the money supply:
 A) lowers income.
 B) raises income.
 C) has no effect on income.
 D) lowers velocity.