

Extra Questions from Chapter 13 through Chapter 17

Chapter 13

1. According to the sticky-price model, other things being equal, the greater the proportion,  $s$ , of firms that follow the sticky-price rule, the \_\_\_\_\_ the \_\_\_\_\_ in output in response to an unexpected price increase.
  - A) greater; increase
  - B) smaller; increase
  - C) greater; decrease
  - D) smaller; decrease
  
2. According to the sticky-price model, deviations of output from the natural level are \_\_\_\_\_ deviations of the price level from the expected price level.
  - A) positively associated with
  - B) negatively associated with
  - C) not related to
  - D) equal to
  
3. According to the imperfect-information model, when the price level falls but the producer did not expect it to fall, the producer:
  - A) increases production.
  - B) does not change production.
  - C) decreases production.
  - D) hires more workers.
  
4. Both models of aggregate supply discussed in Chapter 13 imply that if the price level is higher than expected, then output \_\_\_\_\_ natural rate of output.
  - A) exceeds the
  - B) falls below the
  - C) equals the
  - D) moves to a different
  
5. The Phillips curve depends on *all* of the following forces *except*:
  - A) the current exchange rate.
  - B) expected inflation.
  - C) the deviation of unemployment from its natural rate.
  - D) supply shocks.
  
6. The classical dichotomy breaks down for a Phillips curve, which shows the relationship between a nominal variable, \_\_\_\_\_, and a real variable, \_\_\_\_\_.
  - A) output; prices
  - B) money; output
  - C) inflation; unemployment
  - D) unemployment; inflation
  
7. Inflation inertia is represented in the aggregate supply and aggregate demand model by continuing upward shifts in the:
  - A) aggregate demand curve.
  - B) short-run aggregate supply curve.
  - C) long-run aggregate supply curve.
  - D) aggregate demand and short-run aggregate supply curves.

8. Demand-pull inflation is the result of:
  - A) high aggregate demand.
  - B) low aggregate demand.
  - C) favorable supply shocks.
  - D) adverse supply shocks.
  
9. In the 1960s, in the United States:
  - A) both the inflation rate and the unemployment rate rose at the same time.
  - B) the unemployment rate rose but the inflation rate fell.
  - C) the inflation rate rose but the unemployment rate fell.
  - D) both the inflation rate and the unemployment rate fell.
  
10. The Phillips curve analysis described in Chapter 13 implies that there is a negative tradeoff between inflation and unemployment in:
  - A) both the short run and long run.
  - B) in the short run only.
  - C) in the long run only.
  - D) in neither the short run nor the long run.
  
11. The percentage of a year's real GDP that must be foregone to reduce inflation by 1 percentage point is called the:
  - A) NAIRU.
  - B) short-run Phillips curve.
  - C) sacrifice ratio.
  - D) Okun's law.
  
12. *All* of the following are requirements for reducing inflation without causing a recession *except*:
  - A) workers and firms must form expectations rationally.
  - B) the plan must be announced before expectations are formed.
  - C) the plan must be believed by workers and firms.
  - D) the government's budget must be balanced.
  
13. The hypothesis that hysteresis may play an important role in macroeconomics implies, among other things, that:
  - A) the history of economic thought is important to macroeconomics.
  - B) workers get hysterical during long depressions.
  - C) hysteresis lowers the sacrifice ratio.
  - D) the natural rate of unemployment may increase if unemployment is high for a long period of time.
  
14. A recession may alter an economy's natural rate of unemployment in *all* of the following ways *except* by:
  - A) changing an unemployed individual's attitude toward work.
  - B) reducing an unemployed worker's job skills.
  - C) permanently reducing the money supply.
  - D) altering the wage-setting process.

#### Chapter 14

1. The dynamic aggregate demand curve is downward sloping because as inflation falls the central bank reduces the nominal interest rate by more than the fall in the inflation rate, which \_\_\_\_\_ the real interest rate and \_\_\_\_\_ the quantity of goods and services demanded.
  - A) decreases; decreases
  - B) decreases; increases
  - C) increases; increases
  - D) increases; decreases

2. The monetary policy rule specified in the dynamic model of aggregate demand and aggregate supply indicates that the central bank adjusts interest rates in response to fluctuations in:
  - A) inflation expectations.
  - B) money supply and money demand.
  - C) inflation and output.
  - D) nominal and real exchange rates.
  
3. According to the Taylor rule, when real GDP is above its natural level, the nominal federal funds rate should be \_\_\_\_\_, and when inflation is below 2 percent, the nominal Federal funds rate should be \_\_\_\_\_.
  - A) raised; raised
  - B) raised; lowered
  - C) lowered; raised
  - D) lowered; lowered
  
4. That output,  $Y_t$ , and the real interest rate,  $r_t$ , do not depend on the central bank's inflation target in long-run equilibrium in the dynamic model of aggregate demand and aggregate supply demonstrates:
  - A) monetary neutrality.
  - B) an impulse response function.
  - C) adaptive expectations.
  - D) Taylor's principle.
  
5. When the central bank lowers its target inflation rate, it \_\_\_\_\_ the nominal and real interest rate, which shifts the dynamic aggregate demand curve to the \_\_\_\_\_.
  - A) lowers; right
  - B) lowers; left
  - C) raises; right
  - D) raises; left
  
6. In order to achieve the target for the nominal interest rate established by the monetary policy rule, the central banks adjusts:
  - A) the inflation rate.
  - B) the natural rate of interest.
  - C) the money supply.
  - D) the inflation target.
  
7. In the dynamic model of aggregate demand and aggregate supply, one period in time is connected to the next period through:
  - A) the monetary policy rule.
  - B) demand shocks.
  - C) inflation expectations.
  - D) the natural level of output.
  
8. In the dynamic model of aggregate demand and aggregate supply, if the central bank chooses a small value of  $\theta_\pi$ , the responsiveness of nominal interest rates to inflation, and a large value of  $\theta_Y$ , the responsiveness of nominal interest rates to output, then the *DAD* curve will be relatively \_\_\_\_\_ and supply shocks will have relatively \_\_\_\_\_ impacts on inflation than output.
  - A) flat; larger
  - B) flat; smaller
  - C) steep; larger
  - D) steep; smaller

9. A higher real interest rate reduces the demand for goods and services by:
- shifting the dynamic aggregate supply curve.
  - decreasing the natural level of output.
  - increasing inflation expectations.
  - reducing investment and consumption spending.
10. The Taylor rule can be written as  $FF \text{ rate} = \pi + 2.0 + 0.5(\pi - 2.0) + 0.5(\text{GDP gap})$ , where FF rate is the nominal federal funds rate,  $\pi$  is the inflation rate, and the GDP gap is the percentage deviation of real GDP from its natural level. If inflation is 4 percent and the GDP gap is 2 percent, then according to the Taylor rule, the Fed should set the nominal federal funds rate at \_\_\_\_\_ percent.
- 4
  - 8
  - 10
  - 12
11. In the dynamic model, the demand for goods and services decreases as the natural level of output \_\_\_\_\_ or the real rate of interest \_\_\_\_\_.
- increases; increases
  - increases; decreases
  - decreases; decreases
  - decreases; increases
12. The interest rate at which banks make loans to other banks is called the:
- federal funds rate.
  - prime rate.
  - Federal Reserve discount rate.
  - Treasury bill rate.
13. In the dynamic model, changes in fiscal policy are captured in changes in the:
- natural rate of interest.
  - expected rate of inflation.
  - random demand shock.
  - natural level of output.
14. Beginning at long-run equilibrium in the dynamic model of aggregate demand and aggregate supply, in the period in which a positive supply shock occurs the *DAS* curve \_\_\_\_\_ and the *DAD* curve \_\_\_\_\_.
- shifts upward; shifts rightward
  - shifts upward; does not shift
  - does not shift; does not shift
  - shifts downward; shifts leftward
15. The dynamic aggregate demand curve is derived from each of the following equations of the model of aggregate demand and aggregate supply *except*:
- the Fisher equation.
  - the Phillips curve.
  - adaptive expectations.
  - the monetary policy rule.
16. Which of the following would be represented by a negative value of the random supply shock,  $v_t$ ?
- an irrational wave of pessimism among investors
  - a decrease in government spending
  - oil price decreases resulting from a breakdown in the cartel
  - a decrease in the central bank's inflation target

## Chapter 15

1. The political business cycle refers to the:
  - A) pattern of holding primaries, conventions, and general elections every four years.
  - B) cycle of electing U.S. representatives every two years, the U.S. president every four years, and U.S. senators every six years.
  - C) manipulation of the economy to win elections.
  - D) pattern of recession and expansion that follows every election.
2. The lags involved in implementing monetary and fiscal policy are:
  - A) short and predictable.
  - B) long and predictable.
  - C) short and variable.
  - D) long and variable.
3. Increasing government spending when the economy is in a recession is an example of:
  - A) active monetary policy.
  - B) active fiscal policy.
  - C) passive monetary policy.
  - D) passive fiscal policy.
4. Unlike a monetarist policy rule, an inflation target has the advantage of:
  - A) eliminating the need to announce the policy target.
  - B) providing a real target rather than a nominal one.
  - C) allowing the central bank unlimited discretion.
  - D) insulating the economy from changes in money velocity.
5. The lag between the time that the money supply is increased and the time that investment expenditures increase is an example of a:
  - A) fiscal inside lag.
  - B) fiscal outside lag.
  - C) monetary inside lag.
  - D) monetary outside lag.
6. If past economic fluctuations resulted from inept economic policies, then the historical evidence would support using:
  - A) active macroeconomic policy only.
  - B) passive macroeconomic policy only.
  - C) either active or passive macroeconomic policy.
  - D) neither active nor passive macroeconomic policy.
7. The Phillips curve describing an economy takes the form  $u = u^n - \alpha(\pi - E\pi)$ . The central bank directly sets the inflation rate to minimize the following loss function,  $L(u, \pi) = u - \gamma\pi^2$ . The symbol  $u$  denotes the unemployment rate,  $u^n$  is the natural rate of unemployment,  $\pi$  is the inflation rate,  $E\pi$  is the expected inflation rate, and  $\alpha$  and  $\gamma$  are behavioral response parameters of the economy. Private agents form their expectations rationally before the central bank sets the inflation rate. In an economy in which the central bank dislikes inflation much more than unemployment:
  - A)  $\alpha$  will be very large.
  - B)  $\alpha$  will be very small.
  - C)  $\gamma$  will be very large.
  - D)  $\gamma$  will be very small.

8. The time between a shock to the economy and the policy action responding to that shock is called the:
  - A) automatic stabilizer.
  - B) time-inconsistency of policy.
  - C) inside lag.
  - D) outside lag.
  
9. The long and variable lag before a policy influences the economy makes the job of economic forecasters:
  - A) impossible.
  - B) easier.
  - C) less important.
  - D) more important.

## Chapter 16

1. The amount by which government spending exceeds government revenues is called the \_\_\_\_\_, and the accumulation of past government borrowing is called the \_\_\_\_\_.
  - A) deficit; debt
  - B) debt; deficit
  - C) devaluation; deflation
  - D) deflation; devaluation
  
2. The possibility of capital flight is likely to be greater at higher levels of government debt because there is a greater:
  - A) temptation to default on the debt.
  - B) likelihood that the government will begin issuing indexed bonds.
  - C) probability that a balanced budget will be adopted by the government.
  - D) potential for tax-smoothing policies to be eliminated.
  
3. Proponents of Ricardian equivalence argue that, if taxes are cut without cutting government spending and taxes are not expected to increase in the future until after an individual expects to be dead, then the individual will:
  - A) spend all of the increase in income.
  - B) spend some of the increase in income and save the rest.
  - C) use the increase in income to buy government bonds to help finance the deficit.
  - D) save all of the increase in income and leave it as a bequest to his or her children.
  
4. According to the theory of Ricardian equivalence, tax cuts that have no plans to reduce government spending \_\_\_\_\_ public saving and \_\_\_\_\_ private saving.
  - A) reduce; reduce
  - B) reduce; increase
  - C) increase; increase
  - D) increase; reduce
  
5. Each of the following changes would allow the measured budget deficit to provide a truer picture of fiscal policy *except*:
  - A) correcting for the effects of inflation.
  - B) offsetting changes in government liabilities with changes in government assets.
  - C) excluding some liabilities altogether.
  - D) correcting for the effects of the business cycle.

6. An estimate of what government spending and tax revenue would be if the economy were operating at its natural level of output and employment is called the \_\_\_\_\_ budget.
- A) cyclically adjusted
  - B) inflation adjusted
  - C) capital asset
  - D) generational accounting
7. If the debt of the U.S. federal government in 2008 was divided equally among the people in the United States, then the debt per person would equal approximately:
- A) \$1,900.
  - B) \$19,000.
  - C) \$91,000.
  - D) \$190,000.
8. To force politicians to judge whether government spending is worth the costs, some economists have argued for:
- A) a balanced-budget rule for fiscal policy.
  - B) a constant money-growth rule for monetary policy.
  - C) avoiding the assumption of any contingent liabilities.
  - D) the application of Ricardian equivalence.
9. Measuring the size of government debt is complicated by *all* of the following factors *except*:
- A) inflation.
  - B) uncounted liabilities.
  - C) capital assets of the government.
  - D) failure of the Office of Management and Budget to disclose figures on capital expenditures and credit programs.
10. Using fiscal policy, including automatic stabilizers, to stabilize output over a business cycle is not consistent with:
- A) rational expectations.
  - B) inflation targeting.
  - C) the natural-rate hypothesis.
  - D) a strict balanced-budget rule.
11. Government debt equals the:
- A) difference between current government purchases and taxes.
  - B) difference between saving and investment.
  - C) sum of past budget deficits and surpluses.
  - D) *M1* money supply.
12. According to the traditional view (as in the Mundell-Fleming model), if taxes are cut without cutting government spending, then the short-run effects are a(n) \_\_\_\_\_ of the dollar and a(n) \_\_\_\_\_ in net exports.
- A) appreciation; increase
  - B) appreciation; decrease
  - C) depreciation; increase
  - D) depreciation; decrease
13. The large increase in U.S. government debt between 1980 and 1995 was unusual because it occurred:
- A) during peacetime.
  - B) during an extended recessionary period.
  - C) without increased government spending.
  - D) without tax cuts.

14. Assume that the nominal interest rate is 11 percent, the inflation rate is 8 percent, and government debt at the beginning of the year equals \$4 trillion. By how much is the government budget deficit overstated as a result of inflation?
- A) \$0.12 trillion
  - B) \$0.32 trillion
  - C) \$0.44 trillion
  - D) \$0.80 trillion

#### Chapter 17

1. Kuznets' data showed a short-run consumption function with a \_\_\_\_\_ *APC* and a long-run consumption function with a \_\_\_\_\_ *APC*.
  - A) constant; constant
  - B) constant; falling
  - C) falling; constant
  - D) falling; falling
2. During World War II, economists using John Maynard Keynes's theory predicted that the rate of saving after the war would be very:
  - A) high, and that is what happened.
  - B) low, and that is what happened.
  - C) low, but that did not happen.
  - D) high, but that did not happen.
3. Economists based their prediction that secular stagnation would occur as economies prospered on the conjecture that:
  - A) the marginal propensity to consume is greater than zero.
  - B) the marginal propensity to consume is less than one.
  - C) the average propensity to consume falls as income rises.
  - D) income is the primary determinant of consumption.
4. In Irving Fisher's two-period model, if the consumer is initially borrowing in period one and the real interest rate rises, first-period consumption will:
  - A) certainly rise.
  - B) certainly fall.
  - C) remain constant.
  - D) either rise or fall.
5. The pull of instant gratification may lead consumers to save \_\_\_\_\_ they would like to save.
  - A) more than
  - B) less than
  - C) approximately the amount
  - D) precisely the amount
6. Recent research by Laibson and other economists recognizes the importance of incorporating \_\_\_\_\_ effects into the study of consumer behavior.
  - A) technological
  - B) meteorological
  - C) environmental
  - D) psychological

7. In Irving Fisher's two-period consumption model, if  $Y_1 = 20,000$ ,  $Y_2 = 15,000$ , and the interest rate  $r$  is 0.50 (50 percent), then the maximum possible consumption in period one is:
- A) 20,000.
  - B) 25,000.
  - C) 30,000.
  - D) 35,000.
8. According to Modigliani's life-cycle hypothesis, the consumption function shifts upward as \_\_\_\_\_ increases.
- A) income
  - B) wealth
  - C) the marginal propensity to consume out of income
  - D) the number of years until retirement
9. The consumer's budget constraint reflects the fact that because interest is earned on savings:
- A) future income is worth less than current income.
  - B) future income is worth more than current income.
  - C) future consumption costs more than current consumption.
  - D) future consumption is worth more than future income.
10. Economic data suggest that when income is expected to fall by \$1, consumption falls by:
- A) \$1.
  - B) \$0.50.
  - C) the marginal propensity to consume.
  - D) the ratio of years until retirement to the years remaining of life.
11. Milton Friedman argued that, although household studies showed that high-income households generally have lower average propensities to consume, this phenomenon is due to the fact that these households have, on average:
- A) positive transitory income.
  - B) negative transitory income.
  - C) higher permanent income.
  - D) lower permanent income.
12. Simon Kuznets found that, over long periods of time in the United States, as income rose, the average propensity to consume:
- A) rose.
  - B) fell.
  - C) remained constant.
  - D) rose and then fell.
13. If consumers obey the permanent-income hypothesis and have rational expectations, then policy changes affect consumption when the policy changes:
- A) are proposed.
  - B) go into effect.
  - C) change expectations.
  - D) do not surprise consumers.