Chapter 34
The Influence of Monetary and Fiscal Policy On Aggregate Demand

TRUE/FALSE

1. Both monetary policy and fiscal policy affect aggregate demand.
   ANS: T    DIF: 1    REF: 34-0
   NAT: Analytic    LOC: Monetary and fiscal policy
   TOP: Monetary policy | Fiscal policy    MSC: Definitional

2. For the U.S. economy, the most important reason for the downward slope of the aggregate-demand curve is the interest-rate effect.
   ANS: T    DIF: 2    REF: 34-1
   NAT: Analytic    LOC: Aggregate demand and aggregate supply
   TOP: Interest-rate effect    MSC: Interpretive

3. According to the theory of liquidity preference, the interest rate adjusts to balance the supply of, and demand for, loanable funds.
   ANS: F    DIF: 2    REF: 34-1
   NAT: Analytic    LOC: The role of money
   TOP: Theory of liquidity preference    MSC: Interpretive

4. The theory of liquidity preference was developed by Irving Fisher.
   ANS: F    DIF: 1    REF: 34-1
   NAT: Analytic    LOC: The role of money
   TOP: Theory of liquidity preference | Economists    MSC: Interpretive

5. An increase in the money supply decreases the equilibrium interest rate and shifts the aggregate-demand curve to the right.
   ANS: T    DIF: 2    REF: 34-1
   NAT: Analytic    LOC: Monetary and fiscal policy
   TOP: Monetary injections    MSC: Interpretive

6. Other things the same, an increase in the price level causes the real value of the dollar to fall in the market for foreign-currency exchange.
   ANS: F    DIF: 2    REF: 34-1
   NAT: Analytic    LOC: Aggregate demand and aggregate supply
   TOP: Exchange-rate effect    MSC: Applicative

7. Changes in monetary policy aimed at reducing aggregate demand involve decreasing the money supply or increasing the interest rate.
   ANS: T    DIF: 2    REF: 34-1
   NAT: Analytic    LOC: Monetary and fiscal policy
   TOP: Monetary policy    MSC: Interpretive

8. For the most part, fiscal policy affects the economy in the short run while monetary policy primarily matters in the long run.
   ANS: F    DIF: 1    REF: 34-1
   NAT: Analytic    LOC: Monetary and fiscal policy
   TOP: Fiscal policy | Monetary policy    MSC: Interpretive

9. For a country such as the U.S., the wealth effect exerts a very important influence on the slope of the aggregate-demand curve, since U.S. wealth is large relative to wealth in most other countries.
   ANS: F    DIF: 1    REF: 34-1
   NAT: Analytic    LOC: Monetary and fiscal policy
   TOP: Wealth effect    MSC: Interpretive

10. If the inflation rate is zero, then the nominal and real interest rate are the same.
    ANS: T    DIF: 1    REF: 34-1
     NAT: Analytic    LOC: Monetary and fiscal policy
     TOP: Nominal interest rate | Real interest rate    MSC: Interpretive
11. In liquidity preference theory, an increase in the interest rate, other things the same, decreases the quantity of money demanded, but does not shift the money demand curve.

ANS: T DIF: 1 REF: 34-1
NAT: Analytic LOC: Monetary and fiscal policy
TOP: Theory of liquidity preference
MSC: Analytical

12. An increase in the price level shifts the money demand curve to the left, causing interest rates to increase.

ANS: F DIF: 1 REF: 34-1
NAT: Analytic LOC: Monetary and fiscal policy
TOP: Money demand
MSC: Interpretive

13. An increase in the money supply shifts the aggregate-supply curve to the right.

ANS: F DIF: 1 REF: 34-1
NAT: Analytic LOC: Monetary and fiscal policy
TOP: Monetary policy
MSC: Interpretive

14. When the Fed increases the money supply, the interest rate decreases. This decrease in the interest rate increases consumption and investment demand, so the aggregate-demand curve shifts to the right.

ANS: T DIF: 2 REF: 34-1
NAT: Analytic LOC: Monetary and fiscal policy
TOP: Monetary policy | Aggregate-demand curve
MSC: Analytical

15. Stock prices often rise when the Fed raises interest rates.

ANS: F DIF: 1 REF: 34-1
NAT: Analytic LOC: Monetary and fiscal policy
TOP: Stock market | Monetary policy
MSC: Interpretive

16. When the Fed announces a target for the federal funds rate, it essentially accommodates the day-to-day fluctuations in money demand by adjusting the money supply accordingly.

ANS: T DIF: 2 REF: 34-1
NAT: Analytic LOC: Monetary and fiscal policy
TOP: Federal funds rate | Monetary policy
MSC: Interpretive

17. If the marginal propensity to consume is 6/7, then the multiplier is 7.

ANS: T DIF: 2 REF: 34-2
NAT: Analytic LOC: Monetary and fiscal policy
TOP: Multiplier effect
MSC: Applicative

18. If the marginal propensity to consume is 4/5, then a decrease in government spending of $1 billion decreases the demand for goods and services by $5 billion.

ANS: T DIF: 2 REF: 34-2
NAT: Analytic LOC: Monetary and fiscal policy
TOP: Multiplier effect
MSC: Applicative

19. Both the multiplier effect and the investment accelerator tend to make the aggregate-demand curve shift further than it does due to an initial increase in government expenditures.

ANS: T DIF: 1 REF: 34-2
NAT: Analytic LOC: Monetary and fiscal policy
TOP: Multiplier effect | Investment
MSC: Applicative

20. The multiplier is computed as \( MPC / (1 - MPC) \).

ANS: F DIF: 1 REF: 34-2
NAT: Analytic LOC: Monetary and fiscal policy
TOP: Multiplier effect
MSC: Definition

21. Permanent tax cuts have a larger impact on consumption spending than temporary ones.

ANS: T DIF: 1 REF: 34-2
NAT: Analytic LOC: Monetary and fiscal policy
TOP: Taxes
MSC: Applicative
22. Some economists, called supply-siders, argue that changes in the money supply exert a strong influence on aggregate supply.

ANS: F  DIF: 2  REF: 34-2
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Supply-side economics
MSC: Applicative

23. In principle, the government could increase the money supply or increase government expenditures to try to offset the effects of a wave of pessimism about the future of the economy.

ANS: T  DIF: 1  REF: 34-3
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Stabilization policy
MSC: Applicative

24. The main criticism of those who doubt the ability of the government to respond in a useful way to the business cycle is that the theory by which money and government expenditures change output is flawed.

ANS: F  DIF: 2  REF: 34-3
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Stabilization policy
MSC: Definitional

25. A significant lag for monetary policy is the time it takes for a change in the money supply to change the economy. A significant lag for fiscal policy is the time it takes to pass legislation authorizing it.

ANS: T  DIF: 1  REF: 34-3
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Stabilization policy
MSC: Definitional

26. Unemployment insurance and welfare programs work as automatic stabilizers.

ANS: T  DIF: 1  REF: 34-3
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Automatic stabilizers
MSC: Definitional

27. Depending on the size of the multiplier and crowding-out effects, the rightward shift in aggregate demand from a tax cut could be larger or smaller than the tax cut.

ANS: T  DIF: 2  REF: 34-3
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Multiplier effect
MSC: Analytic

28. During recessions, unemployment insurance payments tend to rise.

ANS: T  DIF: 2  REF: 34-3
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Automatic stabilizers
MSC: Interpretive

29. During recessions, the government tends to run a budget deficit.

ANS: T  DIF: 1  REF: 34-3
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Automatic stabilizers
MSC: Applicative

30. An implication of the Employment Act of 1946 is that the government should respond to changes in the private economy to stabilize aggregate demand.

ANS: T  DIF: 2  REF: 34-3
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Employment Act of 1946
MSC: Interpretive

SHORT ANSWER

1. What is the difference between monetary policy and fiscal policy?

ANS:
The Federal Reserve Bank conducts U.S. monetary policy. It consists of policies to affect the financial side of the economy—most notably the supply of money in the economy. Fiscal policy is conducted by the executive and legislative branches of government, and entails decisions about taxes and government spending.

DIF: 2  REF: 34-1  NAT: Analytic
LOC: Monetary and fiscal policy  TOP: Fiscal policy | Monetary policy
MSC: Definitional
2. There are three factors that help explain the slope of the aggregate demand curve. Which two are less important? Why are they less important?

ANS: The wealth effect and the exchange-rate effect are less important than the interest-rate effect in the United States.

The wealth effect is not very important because it operates through changes in the real value of money, and money is only a small fraction of household wealth. So it is unlikely that changes in the price level will lead to large changes in consumption spending through this channel. The exchange-rate effect is not very important in the United States because trade with other countries represents a relatively small fraction of U.S. GDP. So a change in net-exports due to a change in the exchange rate is likely to have a relatively small impact on real GDP.

DIF: 2  REF: 34-1  NAT: Analytic
LOC: Monetary and fiscal policy  TOP: Wealth effect | Exchange-rate effect
MSC: Analytical

3. Explain why the interest rate is the opportunity cost of holding currency. What is the benefit of holding currency?

ANS: The nominal interest rate on currency is zero. The next best alternative is to buy a bond and earn interest. Currency is used as a medium of exchange. Bonds are illiquid and so are costly to convert to a medium of exchange.

DIF: 2  REF: 34-1  NAT: Analytic
LOC: Monetary and fiscal policy  TOP: Currency | Interest rates
MSC: Interpretive

4. Describe the process in the money market by which the interest rate reaches its equilibrium value if it starts above equilibrium.

ANS: If the interest rate is above equilibrium, there is an excess supply of money. People with more money than they want to hold given the current interest rate deposit the money in banks and buy bonds. The increase in funds to lend out causes the interest rate to fall. As the interest rate falls, the quantity of money demanded increases, which tends to diminish the excess supply of money.

DIF: 3  REF: 34-1  NAT: Analytic
LOC: Monetary and fiscal policy  TOP: Money market
MSC: Analytical

5. Use the money market to explain the interest-rate effect and its relation to the slope of the aggregate demand curve.

ANS: When the price level falls, people need less money for their transactions. The decreased demand for money leads to a decrease in interest rates as money demand shifts left. Lower interest rates encourage consumption and investment spending. Thus, a decrease in the price level raises the aggregate quantity of goods and services demanded.

DIF: 2  REF: 34-1  NAT: Analytic
LOC: Monetary and fiscal policy  TOP: Interest-rate effect
MSC: Analytical

6. Explain the logic according to liquidity preference theory by which an increase in the money supply changes the aggregate demand curve.

ANS: When the money supply increases, the interest rate falls. As the interest rate falls people will want to spend more and firms will want to build more factories and other capital goods. This increase in aggregate demand happens for any given price level, so aggregate demand shifts right.

DIF: 2  REF: 34-1  NAT: Analytic
LOC: Monetary and fiscal policy  TOP: Monetary policy | Aggregate-demand curve
MSC: Analytical
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7. How does a reduction in the money supply by the Fed make owning stocks less attractive?

ANS:
The reduction in the money supply raises the interest rate. So the return on bonds increases relative to the return on stocks. The increase in the interest rate also causes spending to fall, so that revenues and profits fall, making shares of ownership in corporations less valuable.

DIF: 2       REF: 34-1       NAT: Analytic
LOC: Monetary and fiscal policy       TOP: Money supply | Stock market
MSC: Applicative

8. Suppose that the government spends more on a missile defense program. What does this do to aggregate demand? How is your answer affected by the presence of the multiplier, crowding-out, taxes, and investment-accelerator effects?

ANS:
The increase in expenditures means that government spending rises. The aggregate demand curve shifts to the right. Aggregate demand shifts farther if there is a multiplier effect or an investment accelerator and shifts less if there is crowding out or if taxes are raised to increase government expenditures.

DIF: 2       REF: 34-2       NAT: Analytic
LOC: Monetary and fiscal policy       TOP: Multiplier effect | Crowding out | Investment
MSC: Interpretive

9. Suppose that there are no crowding-out effects and the MPC is .9. By how much must the government increase expenditures to shift the aggregate demand curve right by $10 billion?

ANS:
An MPC of .9 means the multiplier = 1/(1 - .9) = 10. The increase in aggregate demand equals the multiplier times the change in government expenditures. So to increase aggregate demand by $10 billion, the government would have to increase expenditures by $1 billion.

DIF: 2       REF: 34-2       NAT: Analytic
LOC: Monetary and fiscal policy       TOP: Multiplier effect
MSC: Analytical

10. Suppose that the government increases expenditures by $150 billion while increasing taxes by $150 billion. Suppose that the MPC is .80 and that there are no crowding out or accelerator effects. What is the combined effect of these changes? Why is the combined change not equal to zero?

ANS:
The multiplier is 1/(1 - MPC) = 1/(1 - .8) = 5. The increase of $150 in government expenditures leads to a shift of $150 billion x 5 = $750 billion in aggregate demand. The increase in taxes decreases income by $150 and so initially decreases consumption by $150 billion x MPC = $150 billion x .8 = $120 billion. This change in consumption will create a multiplier effect of $120 billion x 5 = $600. Thus the net change is $750 billion - $600 billion = $150 billion. The changes don’t cancel each other out, because a tax increase decreases consumption by less than the tax increase.

DIF: 3       REF: 34-3       NAT: Analytic
LOC: Monetary and fiscal policy       TOP: Multiplier effect | Taxes
MSC: Analytical

11. Suppose that consumers become pessimistic about the future health of the economy. What will happen to aggregate demand and to output? What might the president and Congress have to do to keep output stable?

ANS:
As consumers become pessimistic about the future of the economy, they cut their expenditures so that aggregate demand shifts left and output falls. The president and Congress could adjust fiscal policy to increase aggregate demand. They could either increase government spending, or cut taxes, or both.

DIF: 2       REF: 34-3       NAT: Analytic
LOC: Monetary and fiscal policy       TOP: Stabilization policy | Expectations
MSC: Analytical
12. Explain how unemployment insurance acts as an automatic stabilizer.

ANS:
As income falls, unemployment rises. More people will apply for unemployment compensation from the government which raises government spending. An increase in government spending tends to increase aggregate demand, output, and income thereby lessening the effects of the recession.

DIF: 2  REF: 34-3  NAT: Analytic
LOC: Monetary and fiscal policy  TOP: Automatic stabilizers
MSC: Applicative

Sec00 - The Influence of Monetary and Fiscal Policy on Aggregate Demand

MULTIPLE CHOICE

1. Shifts in the aggregate-demand curve can cause fluctuations in
   a. neither the level of output nor the level of prices.
   b. the level of output, but not in the level of prices.
   c. the level of prices, but not in the level of output.
   d. the level of output and in the level of prices.

ANS: D  DIF: 1  REF: 34-0
NAT: Analytic  LOC: Aggregate demand and aggregate supply
TOP: Economic fluctuations | Aggregate demand  MSC: Interpretive

2. Fiscal policy affects the economy
   a. only in the short run.
   b. only in the long run.
   c. in both the short and long run.
   d. in neither the short nor the long run.

ANS: C  DIF: 1  REF: 34-0
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Fiscal policy
MSC: Interpretive

Sec01 - The Influence of Monetary and Fiscal Policy on Aggregate Demand - How Monetary Policy Influences Aggregate Demand

MULTIPLE CHOICE

1. The interest-rate effect
   a. depends on the idea that increases in interest rates increase the quantity of money demanded.
   b. depends on the idea that increases in interest rates increase the quantity of money supplied.
   c. is the most important reason, in the case of the United States, for the downward slope of the aggregate-demand curve.
   d. is the least important reason, in the case of the United States, for the downward slope of the aggregate-demand curve.

ANS: C  DIF: 2  REF: 34-1
NAT: Analytic  LOC: Aggregate demand and aggregate supply
TOP: Interest-rate effect  MSC: Interpretive

2. The interest-rate effect
   a. depends on the idea that increases in interest rates decrease the quantity of goods and services demanded.
   b. depends on the idea that increases in interest rates decrease the quantity of goods and services supplied.
   c. is responsible for the downward slope of the money-demand curve.
   d. is the least important reason, in the case of the United States, for the downward slope of the aggregate-demand curve.

ANS: A  DIF: 2  REF: 34-1
NAT: Analytic  LOC: Aggregate demand and aggregate supply
TOP: Interest-rate effect  MSC: Interpretive
3. The wealth effect stems from the idea that a higher price level
   a. increases the real value of households’ money holdings.
   b. decreases the real value of households’ money holdings.
   c. increases the real value of the domestic currency in foreign-exchange markets.
   d. decreases the real value of the domestic currency in foreign-exchange markets.

ANS: B  DIF: 2  REF: 34-1
NAT: Analytic  LOC: Aggregate demand and aggregate supply  TOP: Wealth effect
MSC: Interpretive

4. With respect to their impact on aggregate demand for the U.S. economy, which of the following represents the correct ordering of the wealth effect, interest-rate effect, and exchange-rate effect from most important to least important?
   a. wealth effect, exchange-rate effect, interest-rate effect
   b. exchange-rate effect, interest-rate effect, wealth effect
   c. interest-rate effect, wealth effect, exchange-rate effect
   d. interest-rate effect, exchange-rate effect, wealth effect

ANS: D  DIF: 2  REF: 34-1
NAT: Analytic  LOC: Aggregate demand and aggregate supply  TOP: Aggregate-demand curve
MSC: Interpretive

5. For the U.S. economy, which of the following is the most important reason for the downward slope of the aggregate-demand curve?
   a. the wealth effect
   b. the interest-rate effect
   c. the exchange-rate effect
   d. the real-wage effect

ANS: B  DIF: 1  REF: 34-1
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Interest-rate effect
MSC: Definitional

6. Which of the following is likely more important for explaining the slope of the aggregate-demand curve of a small economy than it is for the United States?
   a. the wealth effect
   b. the interest-rate effect
   c. the exchange-rate effect
   d. the real-wage effect

ANS: C  DIF: 1  REF: 34-1
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Exchange-rate effect
MSC: Interpretive

7. For the U.S. economy, which of the following helps explain the slope of the aggregate-demand curve?
   a. An increase in the price level decreases the interest rate.
   b. An increase in the price level increases the interest rate.
   c. An increase in the money supply decreases the interest rate.
   d. An increase in the money supply increases the interest rate.

ANS: B  DIF: 2  REF: 34-1
NAT: Analytic  LOC: Aggregate demand and aggregate supply  TOP: Interest-rate effect
MSC: Analytic
8. The wealth effect helps explain the slope of the aggregate-demand curve. This effect is
   a. relatively important in the United States because expenditures on consumer durables is very
      responsive to changes in wealth.
   b. relatively important in the United States because consumption spending is a large part of GDP.
   c. relatively unimportant in the United States because money holdings are a small part of consumer
      wealth.
   d. relatively unimportant because it takes a large change in wealth to cause a significant change in
      interest rates.

   ANS: C  DIF: 1  REF: 34-1
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Wealth effect
   MSC: Definitional

9. Which of the following claims concerning the importance of effects that explain the slope of the U.S.
   aggregate-demand curve is correct?
   a. The exchange-rate effect is relatively small because exports and imports are a small part of real
      GDP.
   b. The interest-rate effect is relatively small because investment spending is not very responsive to
      interest rate changes.
   c. The wealth effect is relatively large because money holdings are a significant portion of most
      households' wealth.
   d. None of the above is correct.

   ANS: A  DIF: 1  REF: 34-1
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Aggregate-demand slope
   MSC: Interpretive

10. Which particular interest rate(s) do we attempt to explain using the theory of liquidity preference?
    a. only the nominal interest rate
    b. both the nominal interest rate and the real interest rate
    c. only the interest rate on long-term bonds
    d. only the interest rate on short-term government bonds

    ANS: B  DIF: 2  REF: 34-1
    NAT: Analytic  LOC: The role of money
    TOP: Theory of liquidity preference  MSC: Interpretive

11. According to John Maynard Keynes,
    a. the demand for money in a country is determined entirely by that nation’s central bank.
    b. the supply of money in a country is determined by the overall wealth of the citizens of that country.
    c. the interest rate adjusts to balance the supply of, and demand for, money.
    d. the interest rate adjusts to balance the supply of, and demand for, goods and services.

    ANS: C  DIF: 2  REF: 34-1
    NAT: Analytic  LOC: The role of money
    TOP: Theory of liquidity preference  MSC: Interpretive

12. 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.

    ANS: C  DIF: 2  REF: 34-1
    NAT: Analytic  LOC: The role of money
    TOP: Theory of liquidity preference  MSC: Interpretive
13. According to classical macroeconomic theory,
   a. the price level is sticky in the short run and it plays only a minor role in the short-run adjustment process.
   b. for any given level of output, the interest rate adjusts to balance the supply of, and demand for, money.
   c. output is determined by the supplies of capital and labor and the available production technology.
   d. All of the above are correct.

ANS: C  DIF: 2  REF: 34-1
NAT: Analytic  LOC: The role of money  TOP: Classical dichotomy
MSC: Interpretive

14. According to classical macroeconomic theory,
   a. output is determined by the supplies of capital and labor and the available production technology.
   b. for any given level of output, the interest rate adjusts to balance the supply of, and demand for, loanable funds.
   c. given output and the interest rate, the price level adjusts to balance the supply of, and demand for, money.
   d. All of the above are correct.

ANS: D  DIF: 2  REF: 34-1
NAT: Analytic  LOC: The role of money  TOP: Classical dichotomy
MSC: Interpretive

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.

ANS: A  DIF: 2  REF: 34-1
NAT: Analytic  LOC: The role of money  TOP: Theory of liquidity preference
MSC: Interpretive

16. On the graph that depicts the theory of liquidity preference,
   a. the demand-for-money curve is vertical.
   b. the supply-of-money curve is vertical.
   c. the interest rate is measured along the horizontal axis.
   d. the price level is measured along the vertical axis.

ANS: B  DIF: 1  REF: 34-1
NAT: Analytic  LOC: The role of money  TOP: Theory of liquidity preference
MSC: Interpretive

17. Using the liquidity-preference model, when the Federal Reserve increases the money supply,
   a. the equilibrium interest rate decreases.
   b. the aggregate-demand curve shifts to the left.
   c. the quantity of goods and services demanded is unchanged for a given price level.
   d. the long-run aggregate-supply curve shifts to the right.

ANS: A  DIF: 2  REF: 34-1
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Theory of liquidity preference
MSC: Interpretive
18. In recent years, the Federal Reserve has conducted policy by setting a target for the
   a. size of the money supply.
   b. growth rate of the money supply.
   c. federal funds rate.
   d. discount rate.
ANS: C  DIF: 2  REF: 34-1
NAT: Analytic  LOC: Monetary and fiscal policy  MSC: Definitional

19. 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.”
ANS: A  DIF: 2  REF: 34-1
NAT: Analytic  LOC: Monetary and fiscal policy  MSC: Interpretive

20. Monetary policy
   a. must be described in terms of interest-rate targets.
   b. must be described in terms of money-supply targets.
   c. can be described either in terms of the money supply or in terms of the interest rate.
   d. cannot be accurately described in terms of the interest rate or in terms of the money supply.
ANS: C  DIF: 2  REF: 34-1
NAT: Analytic  LOC: Monetary and fiscal policy  MSC: Interpretive

21. Which of the following is not a reason the aggregate-demand curve slopes downward? As the price level increases,
   a. firms may believe the relative price of their output has risen.
   b. real wealth declines.
   c. the interest rate increases.
   d. the exchange rate increases.
ANS: A  DIF: 1  REF: 34-1
NAT: Analytic  LOC: Monetary and fiscal policy  MSC: Definitional

22. Which of the following would not be an expected response from a decrease in the price level and so help to explain the slope of the aggregate-demand curve?
   a. When interest rates fall, Sleepwell Hotels decides to build some new hotels.
   b. The exchange rate falls, so French restaurants in Paris buy more Iowa pork.
   c. Janet feels wealthier because of the price-level decrease and so she decides to remodel her bathroom.
   d. With prices down and wages fixed by contract, Millio’s Frozen Pizzas decides to lay off workers.
ANS: D  DIF: 1  REF: 34-1
NAT: Analytic  LOC: Monetary and fiscal policy  MSC: Interpretive
23. Liquidity preference refers directly to Keynes' theory concerning
   a. the effects of changes in money demand and supply on interest rates.
   b. the effects of changes in money demand and supply on exchange rates.
   c. the effects of wealth on expenditures.
   d. the difference between temporary and permanent changes in income.

ANS: A   DIF: 1   REF: 34-1
NAT: Analytic   LOC: Monetary and fiscal policy   TOP: Theory of liquidity preference   MSC: Definitional

24. According to liquidity preference theory, equilibrium in the money market is achieved by adjustments in
   a. the price level.
   b. the interest rate.
   c. the exchange rate.
   d. real wealth.

ANS: B   DIF: 1   REF: 34-1
NAT: Analytic   LOC: Monetary and fiscal policy   TOP: Money market equilibrium   MSC: Definitional

25. Liquidity preference theory is most relevant to the
   a. short run and supposes that the price level adjusts to bring money supply and money demand into balance.
   b. short run and supposes that the interest rate adjusts to bring money supply and money demand into balance.
   c. long run and supposes that the price level adjusts to bring money supply and money demand into balance.
   d. long run and supposes that the interest rate adjusts to bring money supply and money demand into balance.

ANS: B   DIF: 2   REF: 34-1
NAT: Analytic   LOC: Monetary and fiscal policy   TOP: Theory of liquidity preference   MSC: Interpretive

26. The theory of liquidity preference is most helpful in understanding
   a. the wealth effect.
   b. the exchange-rate effect.
   c. the interest-rate effect.
   d. misperceptions theory.

ANS: C   DIF: 1   REF: 34-1
NAT: Analytic   LOC: Monetary and fiscal policy   TOP: Theory of liquidity preference | Interest-rate effect   MSC: Interpretive

27. People choose to hold a smaller quantity of money if
   a. the interest rate rises, which causes the opportunity cost of holding money to rise.
   b. the interest rate falls, which causes the opportunity cost of holding money to rise.
   c. the interest rate rises, which causes the opportunity cost of holding money to fall.
   d. the interest rate falls, which causes the opportunity cost of holding money to fall.

ANS: A   DIF: 2   REF: 34-1
NAT: Analytic   LOC: The role of money   TOP: Money demand   MSC: Interpretive

28. If expected inflation is constant, then when the nominal interest rate increases, the real interest rate
   a. increases by more than the change in the nominal interest rate.
   b. increases by the change in the nominal interest rate.
   c. decreases by the change in the nominal interest rate.
   d. decreases by more than the change in the nominal interest rate.

ANS: B   DIF: 1   REF: 34-1
NAT: Analytic   LOC: Monetary and fiscal policy   TOP: Nominal interest rate | Real interest rate   MSC: Interpretive
29. If expected inflation is constant, then when the nominal interest rate falls, the real interest rate
a. falls by more than the change in the nominal interest rate.
b. falls by the change in the nominal interest rate.
c. rises by the change in the nominal interest rate.
d. rises by more than the change in the nominal interest rate.

ANS: B  DIF: 1  REF: 34-1
NAT: Analytic  LOC: Monetary and fiscal policy
TOP: Nominal interest rate | Real interest rate  MSC: Interpretive

30. If expected inflation is constant and the nominal interest rate increases by 2 percentage points, then the real interest rate
a. increases by 2 percentage points.
b. increases, but by less than 2 percentage points.
c. decreases, but by less than 2 percentage points.
d. decreases by 2 percentage points.

ANS: A  DIF: 1  REF: 34-1
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Real interest rate
MSC: Analytical

31. The theory of liquidity preference assumes that the nominal supply of money is determined by the
a. level of real output only.
b. interest rate only.
c. level of real output and by the interest rate.
d. Federal Reserve.

ANS: D  DIF: 1  REF: 34-1
NAT: Analytic  LOC: Monetary and fiscal policy
TOP: Theory of liquidity preference | Money supply  MSC: Definitional

32. According to the theory of liquidity preference, the money supply
a. and money demand are positively related to the interest rate.
b. and money demand are negatively related to the interest rate.
c. is negatively related to the interest rate while money demand is positively related to the interest rate.
d. is independent of the interest rate, while money demand is negatively related to the interest rate.

ANS: D  DIF: 2  REF: 34-1
NAT: Analytic  LOC: Monetary and fiscal policy
TOP: Theory of liquidity preference  MSC: Interpretive

33. According to liquidity preference theory, the money-supply curve is
a. upward sloping.
b. downward sloping.
c. vertical.
d. horizontal.

ANS: C  DIF: 1  REF: 34-1
NAT: Analytic  LOC: Monetary and fiscal policy
TOP: Theory of liquidity preference  MSC: Definitional

34. According to liquidity preference theory, the money-supply curve would shift rightward
a. if the money demand curve shifted right.
b. if the Federal Reserve chose to increase money supply.
c. if the interest rate increased.
d. All of the above are correct.

ANS: B  DIF: 1  REF: 34-1
NAT: Analytic  LOC: Monetary and fiscal policy
TOP: Theory of liquidity preference  MSC: Applicative
35. According to liquidity preference theory, the money-supply curve would shift if the Fed
   a. engaged in open-market transactions.
   b. changed the discount rate.
   c. changed the reserve requirement.
   d. did any of the above.
   ANS: D  DIF: 1  REF: 34-1
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Theory of liquidity preference  MSC: Applicative

36. In the graph of the money market, the money supply curve is
   a. vertical.  It shifts rightward if the Fed buys bonds.
   b. vertical.  It shifts rightward if the Fed sells bonds.
   c. upward sloping.  It shifts rightward if the Fed buys bonds.
   d. upward sloping.  It shifts rightward if the Fed sells bonds.
   ANS: A  DIF: 1  REF: 34-1
   NAT: Analytic  LOC: The role of money  TOP: Money market  MSC: Applicative

37. Which of the following Fed actions would both increase the money supply?
   a. buy bonds and raise the reserve requirement
   b. buy bonds and lower the reserve requirement
   c. sell bonds and raise the reserve requirement
   d. sell bonds and lower the reserve requirement
   ANS: B  DIF: 1  REF: 34-1
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Money supply  MSC: Definitional

38. When the Fed buys government bonds, the reserves of the banking system
   a. increase, so the money supply increases.
   b. increase, so the money supply decreases.
   c. decrease, so the money supply increases.
   d. decrease, so the money supply decreases.
   ANS: A  DIF: 2  REF: 34-1
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Open-market operations  MSC: Analytical

39. When the Fed sells government bonds, the reserves of the banking system
   a. increase, so the money supply increases.
   b. increase, so the money supply decreases.
   c. decrease, so the money supply increases.
   d. decrease, so the money supply decreases.
   ANS: D  DIF: 2  REF: 34-1
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Open-market operations  MSC: Analytical

40. *Liquidity* refers to
   a. the relation between the price and interest rate of an asset.
   b. the risk of an asset relative to its selling price.
   c. the ease with which an asset is converted into a medium of exchange.
   d. the sensitivity of investment spending to changes in the interest rate.
   ANS: C  DIF: 1  REF: 34-1
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Liquidity  MSC: Definitional
41. Which among the following assets is the most liquid?
   a. capital goods
   b. stocks and bonds with a low risk
   c. stocks and bonds with a high risk
   d. funds in a checking account

   ANS: D   DIF: 1   REF: 34-1
   NAT: Analytic   LOC: Monetary and fiscal policy   TOP: Liquidity
   MSC: Interpretive

42. Which among the following assets is the most liquid?
   a. corporate bonds
   b. fine art
   c. deposits that can be withdrawn using ATMs
   d. mutual funds

   ANS: C   DIF: 1   REF: 34-1
   NAT: Analytic   LOC: Monetary and fiscal policy   TOP: Liquidity
   MSC: Interpretive

43. People hold money primarily because it
   a. has a guaranteed nominal return.
   b. serves as a store of value.
   c. can directly be used to buy goods and services.
   d. functions as a unit of account.

   ANS: C   DIF: 1   REF: 34-1
   NAT: Analytic   LOC: Monetary and fiscal policy   TOP: Money demand
   MSC: Definitional

44. According to liquidity preference theory, the opportunity cost of holding money is
   a. the interest rate on bonds.
   b. the inflation rate.
   c. the cost of converting bonds to a medium of exchange.
   d. the difference between the inflation rate and the interest rate on bonds.

   ANS: A   DIF: 1   REF: 34-1
   NAT: Analytic   LOC: Monetary and fiscal policy   TOP: Money demand
   MSC: Definitional

45. When the interest rate increases, the opportunity cost of holding money
   a. increases, so the quantity of money demanded increases.
   b. increases, so the quantity of money demanded decreases.
   c. decreases, so the quantity of money demanded increases.
   d. decreases, so the quantity of money demanded decreases.

   ANS: B   DIF: 1   REF: 34-1
   NAT: Analytic   LOC: Monetary and fiscal policy   TOP: Money demand
   MSC: Analytical

46. When the interest rate decreases, the opportunity cost of holding money
   a. increases, so the quantity of money demanded increases.
   b. increases, so the quantity of money demanded decreases.
   c. decreases, so the quantity of money demanded increases.
   d. decreases, so the quantity of money demanded decreases.

   ANS: C   DIF: 1   REF: 34-1
   NAT: Analytic   LOC: Monetary and fiscal policy   TOP: Money demand
   MSC: Analytical
47. The opportunity cost of holding money
   a. decreases when the interest rate increases, so people desire to hold more of it.
   b. decreases when the interest rate increases, so people desire to hold less of it.
   c. increases when the interest rate increases, so people desire to hold more of it.
   d. increases when the interest rate increases, so people desire to hold less of it.

   **ANS:** D
   **DIF:** 1
   **REF:** 34-1
   **NAT:** Analytic
   **LOC:** Monetary and fiscal policy
   **TOP:** Money demand
   **MSC:** Analytical

48. In which of the following cases would the quantity of money demanded be **smallest**?
   a. \( r = 0.07, P = 1.0 \)
   b. \( r = 0.05, P = 1.0 \)
   c. \( r = 0.04, P = 1.2 \)
   d. \( r = 0.04, P = 1.0 \)

   **ANS:** A
   **DIF:** 2
   **REF:** 34-1
   **NAT:** Analytic
   **LOC:** Monetary and fiscal policy
   **TOP:** Money demand
   **MSC:** Applicative

49. In which of the following cases would the quantity of money demanded be **largest**?
   a. \( r = 0.03, P = 1.4 \)
   b. \( r = 0.03, P = 1.2 \)
   c. \( r = 0.04, P = 1.2 \)
   d. \( r = 0.06, P = 1.0 \)

   **ANS:** A
   **DIF:** 2
   **REF:** 34-1
   **NAT:** Analytic
   **LOC:** Monetary and fiscal policy
   **TOP:** Money demand
   **MSC:** Applicative

50. People are likely to want to hold more money if the interest rate
   a. increases, making the opportunity cost of holding money rise.
   b. increases, making the opportunity cost of holding money fall.
   c. decreases, making the opportunity cost of holding money rise.
   d. decreases, making the opportunity cost of holding money fall.

   **ANS:** D
   **DIF:** 1
   **REF:** 34-1
   **NAT:** Analytic
   **LOC:** Monetary and fiscal policy
   **TOP:** Money demand slope
   **MSC:** Analytical

51. According to liquidity preference theory, an increase in money demand for some reason other than a change in
    the price level causes
   a. the interest rate to fall, so aggregate demand shifts right.
   b. the interest rate to fall, so aggregate demand shifts left.
   c. the interest rate to rise, so aggregate demand shifts right.
   d. the interest rate to rise, so aggregate demand shifts left.

   **ANS:** D
   **DIF:** 3
   **REF:** 34-1
   **NAT:** Analytic
   **LOC:** Monetary and fiscal policy
   **TOP:** Money market equilibrium | Aggregate demand shifts
   **MSC:** Analytical

52. According to liquidity preference theory, the slope of the money demand curve is explained as follows:
   a. Interest rates rise as the Fed reduces the quantity of money demanded.
   b. Interest rates fall as the Fed reduces the supply of money.
   c. People will want to hold less money as the cost of holding it falls.
   d. People will want to hold more money as the cost of holding it falls.

   **ANS:** D
   **DIF:** 1
   **REF:** 34-1
   **NAT:** Analytic
   **LOC:** Monetary and fiscal policy
   **TOP:** Money demand slope
   **MSC:** Interpretive
53. According to liquidity preference theory,
   a. an increase in the interest rate reduces the quantity of money demanded. This is shown as a movement along the money-demand curve. An increase in the price level shifts money demand to the right.
   b. an increase in the interest rate increases the quantity of money demanded. This is shown as a movement along the money-demand curve. An increase in the price level shifts money demand leftward.
   c. an increase in the price level reduces the quantity of money demanded. This is shown as a movement along the money-demand curve. An increase in the interest rate shifts money demand rightward.
   d. an increase in the price level increases the quantity of money demanded. This is shown as a movement along the money-demand curve. An increase in the interest rate shifts money demand leftward.

ANS: A  DIF: 2  REF: 34-1
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Theory of liquidity preference  MSC: Interpretive

54. According to the theory of liquidity preference, which variable adjusts to balance the supply and demand for money?
   a. interest rate
   b. money supply
   c. quantity of output
   d. price level

ANS: A  DIF: 1  REF: 34-1
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Money market equilibrium  MSC: Definitional

Figure 34-1

55. Refer to Figure 34-1. If the current interest rate is 2 percent,
   a. there is an excess supply of money.
   b. people will sell more bonds, which drives interest rates up.
   c. as the money market moves to equilibrium, people will buy more goods.
   d. All of the above are correct.

ANS: B  DIF: 2  REF: 34-1
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Money market equilibrium  MSC: Interpretive
56. Refer to Figure 34-1. There is an excess demand for money at an interest rate of
   a. 2 percent.
   b. 3 percent.
   c. 4 percent.
   d. None of the above is correct.
ANS: A  DIF: 1  REF: 34-1
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Money market equilibrium
MSC: Interpretive

57. Refer to Figure 34-1. At an interest rate of 4 percent, there is an excess
   a. demand for money equal to the distance between points a and b.
   b. demand for money equal to the distance between points b and c.
   c. supply of money equal to the distance between points a and b.
   d. supply of money equal to the distance between points b and c.
ANS: C  DIF: 2  REF: 34-1
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Money market equilibrium
MSC: Interpretive

58. Refer to Figure 34-1. Which of the following is correct?
   a. If the interest rate is 4 percent, there is excess money demand, and the interest rate will fall.
   b. If the interest rate is 3 percent, there is excess money supply, and the interest rate will rise.
   c. Starting with an interest rate of 4 percent, the demand for goods and services will increase until the
      money market reaches a new equilibrium.
   d. None of the above is correct.
ANS: C  DIF: 2  REF: 34-1
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Money market equilibrium
MSC: Interpretive

Figure 34-2. On the left-hand graph, MS represents the supply of money and MD represents the demand for
money; on the right-hand graph, AD represents aggregate demand. The usual quantities are measured along the
axes of both graphs.

59. Refer to Figure 34-2. What is measured along the horizontal axis of the left-hand graph?
   a. nominal output
   b. real output
   c. the opportunity cost of holding money
   d. the quantity of money
ANS: D  DIF: 1  REF: 34-1
NAT: Analytic  LOC: Aggregate demand and aggregate supply  TOP: Money market
MSC: Interpretive
60. Refer to Figure 34-2. What does \( Y \) represent on the horizontal axis of the right-hand graph?
   a. the quantity of money
   b. the rate of inflation
   c. real output
   d. nominal output

ANS: C  DIF: 1  REF: 34-1
NAT: Analytic  LOC: Aggregate demand and aggregate supply
TOP: Aggregate-demand curve  MSC: Interpretive

61. Refer to Figure 34-2. Which of the following quantities is held constant as we move from one point to another on either graph?
   a. the nominal interest rate
   b. the quantity of money demanded
   c. investment
   d. the expected rate of inflation

ANS: D  DIF: 2  REF: 34-1
NAT: Analytic  LOC: Aggregate demand and aggregate supply
TOP: Aggregate-demand curve | Expected inflation  MSC: Interpretive

62. Refer to Figure 34-2. If the graphs apply to an economy such as the U.S. economy, then the slope of the AD curve is primarily attributable to the
   a. wealth effect.
   b. interest-rate effect.
   c. exchange-rate effect.
   d. Fisher effect.

ANS: B  DIF: 2  REF: 34-1
NAT: Analytic  LOC: Aggregate demand and aggregate supply
TOP: Aggregate-demand curve | Interest-rate effect  MSC: Interpretive

63. Refer to Figure 34-2. A decrease in \( Y \) from \( Y_1 \) to \( Y_2 \) is explained as follows:
   a. The Federal Reserve increases the money supply, causing the money-demand curve to shift from \( MD_1 \) to \( MD_2 \); this shift of MD causes \( r \) to increase from \( r_1 \) to \( r_2 \); and this increase in \( r \) causes \( Y \) to decrease from \( Y_1 \) to \( Y_2 \).
   b. An increase in \( P \) from \( P_1 \) to \( P_2 \) causes the money-demand curve to shift from \( MD_1 \) to \( MD_2 \); this shift of MD causes \( r \) to increase from \( r_1 \) to \( r_2 \); and this increase in \( r \) causes \( Y \) to decrease from \( Y_1 \) to \( Y_2 \).
   c. A decrease in \( P \) from \( P_2 \) to \( P_1 \) causes the money-demand curve to shift from \( MD_1 \) to \( MD_2 \); this shift of MD causes \( r \) to decrease from \( r_2 \) to \( r_1 \); and this decrease in \( r \) causes \( Y \) to decrease from \( Y_1 \) to \( Y_2 \).
   d. An increase in the price level causes the money-demand curve to shift from \( MD_2 \) to \( MD_1 \); this shift of MD causes \( r \) to decrease from \( r_2 \) to \( r_1 \); and this decrease in \( r \) causes \( Y \) to decrease from \( Y_1 \) to \( Y_2 \).

ANS: B  DIF: 3  REF: 34-1
NAT: Analytic  LOC: Aggregate demand and aggregate supply
TOP: Aggregate-demand curve | Money market  MSC: Interpretive

64. Refer to Figure 34-2. As we move from one point to another along the money-demand curve \( MD_1 \),
   a. the price level is held fixed at \( P_1 \).
   b. the interest rate is held fixed at \( r_1 \).
   c. the money supply is changing so as to keep the money market in equilibrium.
   d. the expected inflation rate is changing so as to keep the real interest rate constant.

ANS: A  DIF: 2  REF: 34-1
NAT: Analytic  LOC: Aggregate demand and aggregate supply
TOP: Aggregate-demand curve | Money demand  MSC: Interpretive
65. **Refer to Figure 34-2.** If the money-supply curve MS on the left-hand graph were to shift to the right, this would
   a. represent an action taken by the Federal Reserve.
   b. shift the AD curve to the left.
   c. create, until the interest rate adjusted, an excess demand for money at the interest rate that equilibrated the money market before the shift.
   d. All of the above are correct.

   **ANS:** A  **DIF:** 2  **REF:** 34-1

66. **Refer to Figure 34-2.** Assume the money market is always in equilibrium. Under the assumptions of the model,
   a. the real interest rate is higher at \( Y_2 \) than it is at \( Y_1 \).
   b. the quantity of money is the same at \( Y_1 \) as it is at \( Y_2 \).
   c. the price level is higher at \( r_2 \) than it is at \( r_1 \).
   d. All of the above are correct.

   **ANS:** D  **DIF:** 2  **REF:** 34-1

67. **Refer to Figure 34-2.** Assume the money market is always in equilibrium. Under the assumptions of the model,
   a. the quantity of goods and services demanded is higher at \( P_2 \) than it is at \( P_1 \).
   b. the quantity of money is higher at \( Y_1 \) than it is at \( Y_2 \).
   c. an increase in \( r \) from \( r_1 \) to \( r_2 \) is associated with a decrease in \( Y \) from \( Y_1 \) to \( Y_2 \).
   d. All of the above are correct.

   **ANS:** C  **DIF:** 2  **REF:** 34-1

68. **Refer to Figure 34-2.** Assume the money market is always in equilibrium, and suppose \( r_1 = 0.08 \); \( r_2 = 0.12 \);
   \( Y_1 = 13,000 \); \( Y_2 = 10,000 \); \( P_1 = 1.0 \); and \( P_2 = 1.2 \). Which of the following statements is correct?
   a. When \( r = r_2 \), nominal output is higher than it is when \( r = r_1 \).
   b. When \( r = r_2 \), real output is higher than it is when \( r = r_1 \).
   c. When \( r = r_2 \), the expected rate of inflation is higher than it is when \( r = r_1 \).
   d. If the velocity of money is 4 when \( r = r_2 \), then the quantity of money is $3,000.

   **ANS:** D  **DIF:** 3  **REF:** 34-1

69. **Refer to Figure 34-2.** Assume the money market is always in equilibrium, and suppose \( r_1 = 0.08 \); \( r_2 = 0.12 \);
   \( Y_1 = 13,000 \); \( Y_2 = 10,000 \); \( P_1 = 1.0 \); and \( P_2 = 1.2 \). Which of the following statements is correct? When \( P = P_2 \),
   a. investment is lower than it is when \( P = P_1 \).
   b. nominal output is higher than it is when \( P = P_1 \).
   c. the expected rate of inflation is higher than it is when \( P = P_1 \).
   d. the velocity of money is higher than it is when \( P = P_1 \).

   **ANS:** A  **DIF:** 3  **REF:** 34-1
70. Refer to Figure 34-3. What quantity is represented by the vertical line on the left-hand graph?
   a. the supply of money
   b. the demand for money
   c. the rate of inflation
   d. the quantity of bonds that was most recently sold or purchased by the Federal Reserve
   
   ANS: A  DIF: 1  REF: 34-1
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Interest-rate effect
   MSC: Analytical

71. Refer to Figure 34-3. Which of the following sequences (numbered arrows) shows the logic of the interest-rate effect?
   a. 1, 2, 3, 4
   b. 1, 4, 3, 2
   c. 3, 4, 2, 1
   d. 3, 2, 1, 4
   
   ANS: D  DIF: 2  REF: 34-1
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Interest-rate effect
   MSC: Analytical

72. Refer to Figure 34-3. For an economy such as the United States, what component of the demand for goods
and services is most responsible for the decrease in output from \( Y_1 \) to \( Y_2 \)?
   a. consumption
   b. investment
   c. net exports
   d. government spending
   
   ANS: B  DIF: 2  REF: 34-1
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Interest-rate effect
   MSC: Analytical

73. According to liquidity preference theory, if the quantity of money demanded is greater than the quantity supplied, then the interest rate will
   a. increase and the quantity of money demanded will decrease.
   b. increase and the quantity of money demanded will increase.
   c. decrease and the quantity of money demanded will decrease.
   d. decrease and the quantity of money demanded will increase.
   
   ANS: A  DIF: 2  REF: 34-1
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Money market equilibrium
   MSC: Analytical
74. According to liquidity preference theory, if the quantity of money supplied is greater than the quantity demanded, then the interest rate will
   a. increase and the quantity of money demanded will decrease.
   b. increase and the quantity of money demanded will increase.
   c. decrease and the quantity of money demanded will decrease.
   d. decrease and the quantity of money demanded will increase.
ANS: D  DIF: 2  REF: 34-1
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Money market equilibrium
MSC: Analytical

75. According to liquidity preference theory, if there were a shortage of money, then
   a. the interest rate would be above equilibrium and the quantity of money demanded would be too large for equilibrium.
   b. the interest rate would be above equilibrium and the quantity of money demanded would be too small for equilibrium.
   c. the interest rate would be below equilibrium and the quantity of money demanded would be too small for equilibrium.
   d. the interest rate would be below equilibrium and the quantity of money demanded would be too large for equilibrium.
ANS: D  DIF: 2  REF: 34-1
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Money market equilibrium
MSC: Analytical

76. The interest rate would fall and the quantity of money demanded would
   a. increase if there were a surplus in the money market.
   b. increase if there were a shortage in the money market.
   c. decrease if there were a surplus in the money market.
   d. decrease if there were a shortage in the money market.
ANS: A  DIF: 2  REF: 34-1
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Money market equilibrium
MSC: Analytical

77. As the interest rate falls,
   a. the quantity of money demanded falls, which would reduce a shortage.
   b. the quantity of money demanded falls, which would reduce a surplus.
   c. the quantity of money demanded rises, which would reduce a shortage.
   d. the quantity of money demanded rises, which would reduce a surplus.
ANS: D  DIF: 2  REF: 34-1
NAT: Analytic  LOC: The role of money  TOP: Money market
MSC: Analytical

78. The interest rate falls if
   a. the price level falls or the money supply falls.
   b. the price level falls or the money supply rises.
   c. the price level rises or the money supply falls.
   d. the price level rises or the money supply rises.
ANS: B  DIF: 3  REF: 34-1
NAT: Analytic  LOC: Aggregate demand and aggregate supply  TOP: Money market
MSC: Applicative

79. If, at some interest rate, the quantity of money demanded is greater than the quantity of money supplied, people will desire to
   a. sell interest-bearing assets, causing the interest rate to decrease.
   b. sell interest-bearing assets, causing the interest rate to increase.
   c. buy interest-bearing assets, causing the interest rate to decrease.
   d. buy interest-bearing assets, causing the interest rate to increase.
ANS: B  DIF: 2  REF: 34-1
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Money market equilibrium
MSC: Analytical
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80. If, at some interest rate, the quantity of money supplied is greater than the quantity of money demanded, people will desire to
   a. sell interest-bearing assets, causing the interest rate to decrease.
   b. sell interest-bearing assets, causing the interest rate to increase.
   c. buy interest-bearing assets, causing the interest rate to decrease.
   d. buy interest-bearing assets, causing the interest rate to increase.

ANS: C    DIF: 2    REF: 34-1
NAT: Analytic    LOC: Monetary and fiscal policy    TOP: Money market equilibrium
MSC: Analytical

81. Which of the following is correct?
   a. A higher price level shifts money demand rightward.
   b. When money demand shifts rightward, the interest rate rises.
   c. A higher interest rate reduces the quantity of goods and services demanded.
   d. All of the above are correct.

ANS: D    DIF: 2    REF: 34-1
NAT: Analytic    LOC: The role of money    TOP: Money market
MSC: Applicative

82. If the Fed increases the money supply,
   a. the interest rate increases, which tends to raise stock prices.
   b. the interest rate increases, which tends to reduce stock prices.
   c. the interest rate decreases, which tends to raise stock prices.
   d. the interest rate decreases, which tends to reduce stock prices.

ANS: C    DIF: 2    REF: 34-1
NAT: Analytic    LOC: Monetary and fiscal policy    TOP: Monetary policy
MSC: Applicative

83. If there is excess demand for money, then people will
   a. deposit more money into interest-bearing accounts, and the interest rate will fall.
   b. deposit more money into interest-bearing accounts, and the interest rate will rise.
   c. withdraw money from interest-bearing accounts, and the interest rate will fall.
   d. withdraw money from interest-bearing accounts, and the interest rate will rise.

ANS: D    DIF: 2    REF: 34-1
NAT: Analytic    LOC: Monetary and fiscal policy    TOP: Money market equilibrium
MSC: Analytical

84. If there is excess money supply, people will
   a. deposit more into interest-bearing accounts, and the interest rate will fall.
   b. deposit more into interest-bearing accounts, and the interest rate will rise.
   c. withdraw money from interest-bearing accounts, and the interest rate will fall.
   d. withdraw money from interest-bearing accounts, and the interest rate will rise.

ANS: A    DIF: 2    REF: 34-1
NAT: Analytic    LOC: Monetary and fiscal policy    TOP: Money market equilibrium
MSC: Analytical

85. People might deposit more money into interest-bearing accounts,
   a. making the interest rate fall, if there is a surplus in the money market.
   b. making the interest rate rise, if there is a surplus in the money market.
   c. making the interest rate fall, if there is a shortage in the money market.
   d. making the interest rate rise, if there is a shortage in the money market.

ANS: A    DIF: 2    REF: 34-1
NAT: Analytic    LOC: Monetary and fiscal policy    TOP: Money market equilibrium
MSC: Analytical
86. Which of the following statements is correct?
   a. Both liquidity preference theory and classical theory assume the interest rate adjusts to bring the money market into equilibrium.
   b. Both liquidity preference theory and classical theory assume the price level adjusts to bring the money market into equilibrium.
   c. Liquidity preference theory assumes the interest rate adjusts to bring the money market into equilibrium; classical theory assumes the price level adjusts to bring the money market into equilibrium.
   d. Liquidity preference theory assumes the price level adjusts to bring the money market into equilibrium; classical theory assumes the interest rate adjusts to bring the money market into equilibrium.
   
   ANS: C   DIF: 2   REF: 34-1
   NAT: Analytic   LOC: Monetary and fiscal policy
   TOP: Liquidity preference | Classical theory   MSC: Definitional

87. Changes in the interest rate bring the money market into equilibrium according to
   a. both liquidity preference theory and classical theory.
   b. neither liquidity preference theory nor classical theory.
   c. liquidity preference theory, but not classical theory.
   d. classical theory, but not liquidity preference theory.
   
   ANS: C   DIF: 2   REF: 34-1
   NAT: Analytic   LOC: Monetary and fiscal policy
   TOP: Liquidity preference | Classical theory   MSC: Definitional

88. If the price level falls, then
   a. the interest rate falls and spending on goods and services falls.
   b. the interest rate falls and spending on goods and services rises.
   c. the interest rate rises and spending on goods and services falls.
   d. the interest rate rises and spending on goods and services rises.
   
   ANS: B   DIF: 2   REF: 34-1
   NAT: Analytic   LOC: The role of money
   TOP: Money market   MSC: Applicative

89. A surplus or shortage in the money market is eliminated by adjustments in the price level according to
   a. both liquidity preference theory and classical theory.
   b. neither liquidity preference theory nor classical theory.
   c. liquidity preference theory, but not classical theory.
   d. classical theory, but not liquidity preference theory.
   
   ANS: D   DIF: 2   REF: 34-1
   NAT: Analytic   LOC: Monetary and fiscal policy
   TOP: Liquidity preference | Classical theory   MSC: Definitional

90. Which of the following statements is correct for the long run?
   a. Output is determined by the amount of capital, labor, and technology; the interest rate adjusts to balance the supply and demand for money; the price level adjusts to balance the supply and demand for loanable funds.
   b. Output is determined by the amount of capital, labor, and technology; the interest rate adjusts to balance the supply and demand for loanable funds; the price level adjusts to balance the supply and demand for money.
   c. Output is determined by the amount of capital, labor, and technology; the interest rate adjusts to balance the supply and demand for loanable funds; the price level is relatively slow to adjust.
   d. Output responds to the aggregate demand for goods and services; the interest rate adjusts to balance the supply and demand for loanable funds; the price level adjusts to balance the supply and demand for money.
   
   ANS: B   DIF: 2   REF: 34-1
   NAT: Analytic   LOC: Monetary and fiscal policy
   TOP: Classical theory   MSC: Definitional
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91. Which of the following statements is correct for the short run?
   a. Output is determined by the amount of capital, labor, and technology; the interest rate adjusts to balance the supply and demand for money; the price level adjusts to balance the supply and demand for loanable funds.
   b. Output is determined by the amount of capital, labor, and technology; the interest rate adjusts to balance the supply and demand for loanable funds; the price level adjusts to balance the supply and demand for money.
   c. Output responds to the aggregate demand for goods and services; the interest rate adjusts to balance the supply and demand for money; the price level is relatively slow to adjust.
   d. Output responds to the aggregate demand for goods and services; the interest rate adjusts to balance the supply and demand for loanable funds; the price level adjusts to balance the supply and demand for money.

ANS: C  DIF: 2  REF: 34-1
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Short-run equilibrium
MSC: Definitional

92. The short-run effects on the interest rate are
   a. shown equally well using either liquidity preference theory or classical theory.
   b. best shown using classical theory.
   c. best shown using liquidity preference theory.
   d. not shown well by either liquidity preference theory or classical theory.

ANS: C  DIF: 2  REF: 34-1
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Interest rates
MSC: Definitional

93. A decrease in the interest rate could have been caused by the money-demand curve shifting
   a. leftward because the price level fell.
   b. leftward because the price level rose.
   c. rightward because the price level fell.
   d. rightward because the price level rose.

ANS: A  DIF: 2  REF: 34-1
NAT: Analytic  LOC: The role of money  TOP: Money market
MSC: Analytic

94. The interest rate falls if
   a. either money demand or money supply shifts right.
   b. money demand shifts right or money supply shifts left.
   c. either money demand or money supply shifts left.
   d. money demand shifts left or money supply shifts right.

ANS: D  DIF: 2  REF: 34-1
NAT: Analytic  LOC: The role of money  TOP: Money market
MSC: Applicative

95. People will want to hold more money if the price level
   a. or if the interest rate increases.
   b. or if the interest rate decreases.
   c. increases or if the interest rate decreases.
   d. decreases or if the interest rate increases.

ANS: C  DIF: 2  REF: 34-1
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Money demand
MSC: Analytical
96. People will want to hold less money if the price level
   a. increases or if the interest rate decreases.
   b. decreases or if the interest rate increases.
   c. increases or if the interest rate decreases.
   d. decreases or if the interest rate increases.

   ANS: D  DIF: 2  REF: 34-1
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Money demand
   MSC: Definitional

97. If the interest rate increases
   a. or if the price level increases, then people will want to hold more money.
   b. or if the price level increases, then people will want to hold less money.
   c. or if the price level decreases, then people will want to hold more money.
   d. or if the price level decreases, then people will want to hold less money.

   ANS: D  DIF: 2  REF: 34-1
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Money demand
   MSC: Analytical

98. Which of the following events would shift money demand to the right?
   a. an increase in the price level
   b. a decrease in the price level
   c. an increase in the interest rate
   d. a decrease in the interest rate

   ANS: A  DIF: 1  REF: 34-1
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Money demand shifts
   MSC: Applicative

99. Which of the following events would shift money demand to the right?
   a. an increase in the interest rate or an increase in the price level
   b. an increase in the interest rate, but not an increase in the price level
   c. an increase in the price level, but not an increase in the interest rate
   d. neither an increase in the interest rate nor an increase in the price level

   ANS: C  DIF: 1  REF: 34-1
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Money demand shifts
   MSC: Applicative

100. Which of the following events would shift money demand to the left?
    a. an increase in the price level
    b. a decrease in the price level
    c. an increase in the interest rate
    d. a decrease in the interest rate

    ANS: B  DIF: 1  REF: 34-1
    NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Money demand shifts
    MSC: Applicative

101. Which of the following events would shift money demand to the left?
    a. an increase in the interest rate or an increase in the price level
    b. an increase in the interest rate, but not an increase in the price level
    c. an increase in the price level, but not an increase in the interest rate
    d. neither an increase in the interest rate nor an increase in the price level

    ANS: D  DIF: 1  REF: 34-1
    NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Money demand shifts
    MSC: Applicative
102. Assume the money market is initially in equilibrium. If the price level increases, then according to liquidity preference theory there is an excess
   a. supply of money until the interest rate increases.
   b. supply of money until the interest rate decreases.
   c. demand for money until the interest rate increases.
   d. demand for money until the interest rate decreases.
ANS: C  DIF: 2  REF: 34-1
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Money market equilibrium
MSC: Analytical

103. Assume the money market is initially in equilibrium. If the price level decreases, then according to liquidity preference theory there is an excess
   a. supply of money until the interest rate increases.
   b. supply of money until the interest rate decreases.
   c. demand for money until the interest rate increases.
   d. demand for money until the interest rate decreases.
ANS: B  DIF: 2  REF: 34-1
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Money market equilibrium
MSC: Analytical

104. Other things the same, which of the following happens if the price level falls?
   b. Initially there is an excess demand for money in the money market.
   c. The interest rate falls.
   d. None of the above is correct.
ANS: C  DIF: 2  REF: 34-1
NAT: Analytic  LOC: The role of money  TOP: Money market
MSC: Applicative

105. According to liquidity preference theory, if the price level decreases, then
   a. the interest rate falls because money demand shifts right.
   b. the interest rate falls because money demand shifts left.
   c. the interest rate rises because money supply shifts right.
   d. the interest rate rises because money supply shifts left.
ANS: B  DIF: 2  REF: 34-1
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Money market equilibrium
MSC: Analytical

106. According to liquidity preference theory, if the price level increases, then the equilibrium interest rate
   a. rises and the aggregate quantity of goods demanded rises.
   b. rises and the aggregate quantity of goods demanded falls.
   c. falls and the aggregate quantity of goods demanded rises.
   d. falls and the aggregate quantity of goods demanded falls.
ANS: B  DIF: 2  REF: 34-1
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Interest-rate effect
MSC: Analytical

107. According to liquidity preference theory, an increase in the price level shifts the
   a. money demand curve rightward, so the interest rate increases.
   b. money demand curve rightward, so the interest rate decreases.
   c. money demand curve leftward, so the interest rate decreases.
   d. money demand curve leftward, so the interest rate increases.
ANS: A  DIF: 1  REF: 34-1
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Money market equilibrium
MSC: Analytical
108. According to liquidity preference theory, a decrease in the price level shifts the
   a. money demand curve rightward, so the interest rate increases.
   b. money demand curve rightward, so the interest rate decreases.
   c. money demand curve leftward, so the interest rate decreases.
   d. money demand curve leftward, so the interest rate increases.

   ANS: C   DIF: 1   REF: 34-1
   NAT: Analytic   LOC: Monetary and fiscal policy   TOP: Money market equilibrium
   MSC: Analytical

109. An increase in the U.S. interest rate
   a. reduces the opportunity cost of holding dollars.
   b. induces households to increase consumption.
   c. shifts money demand to the right.
   d. leads to an appreciation of the U.S. dollar.

   ANS: D   DIF: 2   REF: 34-1
   NAT: Analytic   LOC: Monetary and fiscal policy   TOP: Interest-rate effect
   MSC: Applicative

110. Other things the same, a decrease in the U.S. interest rate
   a. induces firms to invest more.
   b. shifts money demand to the left.
   c. makes the U.S. dollar appreciate.
   d. increases the opportunity cost of holding dollars.

   ANS: A   DIF: 2   REF: 34-1
   NAT: Analytic   LOC: Monetary and fiscal policy   TOP: Interest-rate effect
   MSC: Applicative

111. Other things the same, which of the following responses would we expect from an increase in U.S. interest rates?
   a. Your aunt puts more money in her savings account.
   b. Foreign citizens decide to buy fewer U.S. bonds.
   c. You decide to purchase a new oven for your cookie factory.
   d. All of the above are correct.

   ANS: A   DIF: 1   REF: 34-1
   NAT: Analytic   LOC: Monetary and fiscal policy   TOP: Interest-rate effect
   MSC: Applicative

112. Other things the same, which of the following responses would we expect to result from an decrease in U.S. interest rates?
   a. U.S. citizens decide to hold more foreign bonds.
   b. People choose to hold more currency.
   c. You decide to purchase a new oven for your cookie factory.
   d. All of the above are correct.

   ANS: D   DIF: 2   REF: 34-1
   NAT: Analytic   LOC: Monetary and fiscal policy   TOP: Interest-rate effect
   MSC: Applicative

113. Other things equal, in the short run a higher price level leads households to
   a. increase consumption and firms to buy more capital goods.
   b. increase consumption and firms to buy fewer capital goods.
   c. decrease consumption and firms to buy more capital goods.
   d. decrease consumption and firms to buy fewer capital goods.

   ANS: D   DIF: 2   REF: 34-1
   NAT: Analytic   LOC: Monetary and fiscal policy   TOP: Interest-rate effect
   MSC: Definitional
114. According to liquidity preference theory, an increase in the price level causes the interest rate to
a. increase, which increases the quantity of goods and services demanded.
b. increase, which decreases the quantity of goods and services demanded.
c. decrease, which increases the quantity of goods and services demanded.
d. decrease, which decreases the quantity of goods and services demanded.

ANS: B  DIF: 2  REF: 34-1
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Interest-rate effect
MSC: Analytical

115. According to liquidity preference theory, a decrease in the price level causes the interest rate to
a. increase, which increases the quantity of goods and services demanded.
b. increase, which decreases the quantity of goods and services demanded.
c. decrease, which increases the quantity of goods and services demanded.
d. decrease, which decreases the quantity of goods and services demanded.

ANS: C  DIF: 2  REF: 34-1
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Interest-rate effect
MSC: Analytical

116. According to the theory of liquidity preference, an increase in the price level causes the
a. interest rate and investment to rise.
b. interest rate and investment to fall.
c. interest rate to rise and investment to fall.
d. interest rate to fall and investment to rise.

ANS: C  DIF: 2  REF: 34-1
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Interest-rate effect
MSC: Analytical

117. According to the theory of liquidity preference, a decrease in the price level causes the
a. interest rate and investment to rise.
b. interest rate and investment to fall.
c. interest rate to rise and investment to fall.
d. interest rate to fall and investment to rise.

ANS: D  DIF: 2  REF: 34-1
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Interest-rate effect
MSC: Analytical

118. According to liquidity preference theory, investment spending would rise if the price level
a. fell, making the interest rate rise.
b. fell, making the interest rate fall.
c. rose, making the interest rate rise.
d. rose, making the interest rate fall.

ANS: B  DIF: 2  REF: 34-1
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Interest-rate effect
MSC: Analytical

119. The most important reason for the slope of the aggregate-demand curve is that as the price level
a. increases, interest rates increase, and investment decreases.
b. increases, interest rates decrease, and investment increases.
c. decreases, interest rates increase, and investment increases.
d. decreases, interest rates decrease, and investment decreases.

ANS: A  DIF: 2  REF: 34-1
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Interest-rate effect
MSC: Analytical
120. Which of the following properly describes the interest-rate effect that helps explain the slope of the aggregate-demand curve?
   a. As the money supply increases, the interest rate falls, so spending rises.
   b. As the money supply increases, the interest rate rises, so spending falls.
   c. As the price level increases, the interest rate falls, so spending rises.
   d. As the price level increases, the interest rate rises, so spending falls.

   **ANS:** D  **DIF:** 2  **REF:** 34-1
   **NAT:** Analytic  **LOC:** Monetary and fiscal policy  **TOP:** Interest-rate effect
   **MSC:** Analytical

121. Other things the same, as the price level rises,
   a. the interest rate rises causing aggregate demand to shift.
   b. the interest rate rises causing a movement along a given aggregate-demand curve.
   c. the interest rate falls causing aggregate demand to shift.
   d. the interest rate falls causing a movement along a given aggregate-demand curve.

   **ANS:** B  **DIF:** 2  **REF:** 34-1
   **NAT:** Analytic  **LOC:** Monetary and fiscal policy  **TOP:** Interest-rate effect
   **MSC:** Analytical

122. Which of the following properly describes the interest-rate effect?
   a. A higher price level leads to higher money demand; higher money demand leads to higher interest rates; a higher interest rate increases the quantity of goods and services demanded.
   b. A higher price level leads to higher money demand; higher money demand leads to lower interest rates; a higher interest rate reduces the quantity of goods and services demanded.
   c. A lower price level leads to lower money demand; lower money demand leads to lower interest rates; a lower interest rate reduces the quantity of goods and services demanded.
   d. A lower price level leads to lower money demand; lower money demand leads to lower interest rates; a lower interest rate increases the quantity of goods and services demanded.

   **ANS:** D  **DIF:** 2  **REF:** 34-1
   **NAT:** Analytic  **LOC:** Monetary and fiscal policy  **TOP:** Interest-rate effect
   **MSC:** Analytical

123. In the short run, an increase in the money supply causes interest rates to
   a. increase, and aggregate demand to shift right.
   b. increase, and aggregate demand to shift left.
   c. decrease, and aggregate demand to shift right.
   d. decrease, and aggregate demand to shift left.

   **ANS:** C  **DIF:** 2  **REF:** 34-1
   **NAT:** Analytic  **LOC:** Monetary and fiscal policy  **TOP:** Aggregate demand shifts
   **MSC:** Analytical

124. In the short run, a decrease in the money supply causes interest rates to
   a. increase, and aggregate demand to shift right.
   b. increase, and aggregate demand to shift left.
   c. decrease, and aggregate demand to shift right.
   d. decrease, and aggregate demand to shift left.

   **ANS:** B  **DIF:** 2  **REF:** 34-1
   **NAT:** Analytic  **LOC:** Monetary and fiscal policy  **TOP:** Aggregate demand shifts
   **MSC:** Analytical

125. If the Federal Reserve decided to lower interest rates, it could
   a. buy bonds to lower the money supply.
   b. buy bonds to raise the money supply.
   c. sell bonds to lower the money supply.
   d. sell bonds to raise the money supply.

   **ANS:** B  **DIF:** 2  **REF:** 34-1
   **NAT:** Analytic  **LOC:** Monetary and fiscal policy  **TOP:** Money market
   **MSC:** Applicative
126. Which of the following shifts aggregate demand to the right?
   a. an increase in the price level
   b. an increase in the money supply
   c. a decrease in the price level
   d. a decrease in the money supply
   ANS: B  DIF: 1  REF: 34-1
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Aggregate demand shifts
   MSC: Applicative

127. Which of the following shifts aggregate demand to the left?
   a. an increase in the price level
   b. an increase in the money supply
   c. a decrease in the price level
   d. a decrease in the money supply
   ANS: D  DIF: 2  REF: 34-1
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Aggregate demand shifts
   MSC: Applicative

128. Which of the following shifts aggregate demand to the right?
   a. The price level rises.
   b. The price level falls.
   c. The money supply falls.
   d. None of the above is correct.
   ANS: D  DIF: 1  REF: 34-1
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Aggregate demand shifts
   MSC: Applicative

129. If the Fed conducts open-market sales, the money supply
   a. increases and aggregate demand shifts right.
   b. increases and aggregate demand shifts left.
   c. decreases and aggregate demand shifts right.
   d. decreases and aggregate demand shifts left.
   ANS: D  DIF: 2  REF: 34-1
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Open-market operations | Aggregate demand shifts
   MSC: Analytical

130. If the Fed conducts open-market sales, which of the following quantities increase(s)?
   a. interest rates, prices, and investment spending
   b. interest rates and prices, but not investment spending
   c. interest rates and investment, but not prices
   d. interest rates, but not investment or prices
   ANS: D  DIF: 3  REF: 34-1
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Open-market operations | Aggregate demand shifts
   MSC: Analytical

131. If the Fed conducts open-market purchases, the money supply
   a. increases and aggregate demand shifts right.
   b. increases and aggregate demand shifts left.
   c. decreases and aggregate demand shifts right.
   d. decreases and aggregate demand shifts left.
   ANS: A  DIF: 2  REF: 34-1
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Open-market operations | Aggregate-demand shifts
   MSC: Analytical
132. If the Fed conducts open-market purchases, then which of the following quantities increase(s)?
   a. interest rates, prices, and investment spending
   b. interest rates and prices, but not investment spending
   c. prices and investment spending, but not interest rates
   d. interest rates, but not prices or investment spending

   ANS: C  DIF:  3  REF:  34-1
   NAT: Analytic  LOC: Monetary and fiscal policy
   TOP: Open-market operations | Aggregate demand shifts
   MSC: Analytical

133. In which of the following cases does the aggregate-demand curve shift to the right?
   a. The price level rises, causing the interest rate to fall.
   b. The price level falls, causing the interest rate to fall.
   c. The money supply increases, causing the interest rate to fall.
   d. The money supply decreases, causing the interest rate to fall.

   ANS: C  DIF:  2  REF:  34-1
   NAT: Analytic  LOC: Monetary and fiscal policy
   TOP: Aggregate demand shifts
   MSC: Analytical

134. Open-market purchases
   a. increase the price level and real GDP.
   b. decrease the price level and real GDP.
   c. increase the price level and decrease real GDP.
   d. decrease the price level and increase real GDP.

   ANS: A  DIF:  2  REF:  34-1
   NAT: Analytic  LOC: Monetary and fiscal policy
   TOP: Open-market operations | Short-run equilibrium
   MSC: Analytical

135. Open-market purchases
   a. increase investment and real GDP.
   b. decrease investment and increase real GDP.
   c. increase investment and decrease real GDP.
   d. decrease investment and real GDP.

   ANS: A  DIF:  2  REF:  34-1
   NAT: Analytic  LOC: Monetary and fiscal policy
   TOP: Open-market operations | Short-run equilibrium
   MSC: Analytical

136. In the short run, open-market sales
   a. increase the price level and real GDP.
   b. decrease the price level and real GDP.
   c. increases the price level and decreases real GDP.
   d. decreases the price level and increases real GDP.

   ANS: B  DIF:  2  REF:  34-1
   NAT: Analytic  LOC: Monetary and fiscal policy
   TOP: Open-market operations | Short-run equilibrium
   MSC: Analytical

137. The economy is in long-run equilibrium. Suppose that automatic teller machines become cheaper and more convenient to use, and as a result the demand for money falls. Other things equal, we would expect that, in the short run,
   a. the price level and real GDP would rise, but in the long run they would both be unaffected.
   b. the price level and real GDP would rise, but in the long run the price level would rise and real GDP would be unaffected.
   c. the price level and real GDP would fall, but in the long run they would both be unaffected.
   d. the price level and real GDP would fall, but in the long run the price level would fall and real GDP would be unaffected.

   ANS: B  DIF:  3  REF:  34-1
   NAT: Analytic  LOC: Monetary and fiscal policy
   TOP: Money demand | Short-run equilibrium | Long-run equilibrium
   MSC: Analytical
138. When the price level falls, the interest rate
   a. rises. When the money supply falls, the interest rate rises.
   b. rises. When the money supply falls, the interest rate falls.
   c. falls. When the money supply falls, the interest rate rises.
   d. falls. When the money supply falls, the interest rate falls.

   ANS: C  DIF: 2  REF: 34-1
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Money market equilibrium
   MSC: Analytical

139. In recent years, the Federal Reserve has conducted policy by setting a target for
   a. bank reserves.
   b. the monetary growth rate.
   c. the exchange rate.
   d. the federal funds rate.

   ANS: D  DIF: 1  REF: 34-1
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Federal funds rate
   MSC: Definitional

140. The Federal Funds rate is the interest rate
   a. banks charge each other for short-term loans.
   b. the Fed charges depository institutions for short-term loans.
   c. the Fed pays on deposits.
   d. interest rate on 3 month Treasury bills.

   ANS: A  DIF: 1  REF: 34-1
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Federal funds rate
   MSC: Definitional

141. In recent years, the Fed has chosen to target interest rates rather than the money supply because
   a. Congress passed a law requiring them to do so.
   b. the President requested them to do so.
   c. the money supply is hard to measure with sufficient precision.
   d. changes in the interest rate change aggregate demand, but changes in the money supply do not.

   ANS: C  DIF: 1  REF: 34-1
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Interest-rate targeting
   MSC: Definitional

142. The theory of liquidity preference illustrates the principle that
   a. monetary policy can be described either in terms of the money supply or in terms of the interest rate.
   b. monetary policy can be described either in terms of the exchange rate or the interest rate.
   c. monetary policy must be described in terms of the money supply.
   d. monetary policy must be described in terms of the interest rate.

   ANS: A  DIF: 1  REF: 34-1
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Interest-rate targeting
   MSC: Analytical

143. If the interest rate is above the Fed's target, the Fed should
   a. buy bonds to increase the money supply.
   b. buy bonds to decrease the money supply.
   c. sell bonds to increase the money supply.
   d. sell bonds to decrease the money supply.

   ANS: A  DIF: 2  REF: 34-1
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Interest-rate targeting
   MSC: Analytical
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144. If the interest rate is below the Fed’s target, the Fed would
   a. buy bonds to increase the money supply.
   b. buy bonds to decrease the money supply.
   c. sell bonds to increase the money supply.
   d. sell bonds to decrease the money supply.

   ANS: D  DIF: 2  REF: 34-1
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Interest-rate targeting
   MSC: Analytical

145. The Fed is concerned about stock market booms because the booms
   a. increase consumption spending.
   b. increase investment spending.
   c. increase both consumption and investment spending.
   d. None of the above is correct.

   ANS: C  DIF: 1  REF: 34-1
   NAT: Analytic  LOC: Monetary and fiscal policy
   TOP: Federal Reserve system | Stock prices
   MSC: Definitional

146. Which of the following actions might we logically expect to result from rising stock prices?
   a. Jim increases his consumption spending.
   b. Firms sell fewer shares of new stock.
   c. Firms spend less on investment.
   d. None of the above is correct.

   ANS: A  DIF: 1  REF: 34-1
   NAT: Analytic  LOC: Monetary and fiscal policy
   TOP: Federal Reserve system | Stock prices
   MSC: Applicative

147. If the stock market booms, then
   a. aggregate demand increases, which the Fed could offset by increasing the money supply.
   b. aggregate supply increases, which the Fed could offset by increasing the money supply.
   c. aggregate demand increases, which the Fed could offset by decreasing the money supply.
   d. aggregate supply increases, which the Fed could offset by decreasing the money supply.

   ANS: C  DIF: 2  REF: 34-1
   NAT: Analytic  LOC: Monetary and fiscal policy
   TOP: Federal Reserve system | Stock prices
   MSC: Analytical

148. If the stock market booms, then
   a. household spending increases. To offset the effects of this on the price level and real GDP, the Fed
      would increase the money supply.
   b. household spending increases. To offset the effects of this on the price level and real GDP, the Fed
      would decrease the money supply.
   c. household spending decreases. To offset the effects of this on the price level and real GDP, the Fed
      would increase the money supply.
   d. household spending decreases. To offset the effects of this on the price level and real GDP, the Fed
      would decrease the money supply.

   ANS: B  DIF: 2  REF: 34-1
   NAT: Analytic  LOC: Monetary and fiscal policy
   TOP: Federal Reserve system | Stock prices
   MSC: Analytical

149. If the stock market crashes, then
   a. aggregate demand increases, which the Fed could offset by increasing the money supply.
   b. aggregate demand increases, which the Fed could offset by decreasing the money supply.
   c. aggregate demand decreases, which the Fed could offset by increasing the money supply.
   d. aggregate demand decreases, which the Fed could offset by decreasing the money supply.

   ANS: C  DIF: 1  REF: 34-1
   NAT: Analytic  LOC: Monetary and fiscal policy
   TOP: Federal Reserve system | Stock prices
   MSC: Analytical
150. Suppose that the Federal reserve is concerned about the effects of rising stock prices on the economy. What could it do?
   a. buy bond to raise the interest rate
   b. buy bonds to lower the interest rate
   c. sell bonds to raise the interest rate
   d. sell bonds to raise the interest rate

   ANS: C      DIF: 2      REF: 34-1
   NAT: Analytic  LOC: Monetary and fiscal policy
   TOP: Aggregate demand | Stock prices  MSC: Analytical

151. When the Fed decreases the money supply, we expect
   a. interest rates and stock prices to rise.
   b. interest rates and stock prices to fall.
   c. interest rates to rise and stock prices to fall.
   d. interest rates to fall and stock prices to rise.

   ANS: C      DIF: 2      REF: 34-1
   NAT: Analytic  LOC: Monetary and fiscal policy
   TOP: Federal Reserve system | Stock prices | Money supply shifts
   MSC: Applicative

Sec02 - The Influence of Monetary and Fiscal Policy on Aggregate Demand - How Fiscal Policy Influences Aggregate Demand

MULTIPLE CHOICE

1. In the long run, fiscal policy influences
   a. saving, investment, and growth; in the short run, fiscal policy primarily influences technology and the production function.
   b. saving, investment, and growth; in the short run, fiscal policy primarily influences the aggregate demand for goods and services.
   c. technology and the production function; in the short run, fiscal policy primarily influences saving, investment, and growth.
   d. the aggregate demand for goods and services; in the short run, fiscal policy primarily influences technology and the production function.

   ANS: B      DIF: 2      REF: 34-2
   NAT: Analytic  LOC: Monetary and fiscal policy
   TOP: Fiscal policy | Long run | Short run  MSC: Interpretive

2. In the long run, fiscal policy primarily affects
   a. aggregate demand. In the short run, it affects primarily aggregate supply.
   b. aggregate supply. In the short run, it affects primarily saving, investment, and growth.
   c. saving, investment, and growth. In the short run, it affects primarily aggregate demand.
   d. saving, investment, and growth. In the short run, it affects primarily aggregate supply.

   ANS: C      DIF: 1      REF: 34-2
   NAT: Analytic  LOC: Monetary and fiscal policy
   TOP: Fiscal policy  MSC: Interpretive

3. Fiscal policy refers to the idea that aggregate demand is affected by changes in
   a. the money supply.
   b. government spending and taxes.
   c. trade policy.
   d. All of the above are correct.

   ANS: B      DIF: 1      REF: 34-2
   NAT: Analytic  LOC: Monetary and fiscal policy
   TOP: Fiscal policy  MSC: Definitional
4. The marginal propensity to consume (MPC) is defined as the fraction of
   a. extra income that a household consumes rather than saves.
   b. extra income that a household either consumes or saves.
   c. total income that a household consumes rather than saves.
   d. total income that a household either consumes or saves.

   **ANS:** A  **DIF:** 1  **REF:** 34-2
   **NAT:** Analytic  **LOC:** Monetary and fiscal policy
   **TOP:** Marginal propensity to consume  **MSC:** Definitional

5. The multiplier for changes in government spending is calculated as
   a. \( MPC \).
   b. \( 1 - MPC \).
   c. \( 1/MPC \).
   d. \( 1/(1 - MPC) \).

   **ANS:** D  **DIF:** 1  **REF:** 34-2
   **NAT:** Analytic  **LOC:** Monetary and fiscal policy  **TOP:** Multiplier
   **MSC:** Definitional

6. The multiplier for changes in government spending is calculated as
   a. \( 1/MPC \).
   b. \( 1/(1 - MPC) \).
   c. \( MPC/(1 - MPC) \).
   d. \( (1 - MPC)/MPC \).

   **ANS:** B  **DIF:** 1  **REF:** 34-2
   **NAT:** Analytic  **LOC:** Monetary and fiscal policy  **TOP:** Multiplier
   **MSC:** Definitional

7. If the \( MPC = 3/5 \), then the government purchases multiplier is
   a. \( 5/3 \).
   b. \( 5/2 \).
   c. \( 5 \).
   d. \( 15 \).

   **ANS:** B  **DIF:** 2  **REF:** 34-2
   **NAT:** Analytic  **LOC:** Monetary and fiscal policy  **TOP:** Multiplier
   **MSC:** Applicative

8. If the \( MPC = 0.85 \), then the government purchases multiplier is about
   a. \( 1.18 \).
   b. \( 3.33 \).
   c. \( 6.67 \).
   d. \( 8.5 \).

   **ANS:** C  **DIF:** 2  **REF:** 34-2
   **NAT:** Analytic  **LOC:** Monetary and fiscal policy  **TOP:** Multiplier
   **MSC:** Applicative

9. If the multiplier is 5, then the \( MPC \) is
   a. \( 0.05 \).
   b. \( 0.5 \).
   c. \( 0.6 \).
   d. \( 0.8 \).

   **ANS:** D  **DIF:** 2  **REF:** 34-2
   **NAT:** Analytic  **LOC:** Monetary and fiscal policy  **TOP:** Multiplier
   **MSC:** Applicative
10. If the multiplier is 2.5, then the **MPC** is
   a. 0.2.
   b. 0.6.
   c. 0.75.
   d. 1.00.

   **ANS:** B  **DIF:** 2  **REF:** 34-2
   **NAT:** Analytic  **LOC:** Monetary and fiscal policy  **TOP:** Multiplier
   **MSC:** Applicative

11. In a certain economy, when income is $100, consumer spending is $60. The value of the multiplier for this economy is 3. It follows that, when income is $101, consumer spending is
   a. $60.60.
   b. $60.67.
   c. $61.33.
   d. $63.00.

   **ANS:** B  **DIF:** 2  **REF:** 34-2
   **NAT:** Analytic  **LOC:** Monetary and fiscal policy  **TOP:** Consumption | Multiplier
   **MSC:** Definitional

12. In a certain economy, when income is $200, consumer spending is $145. The value of the multiplier for this economy is 6.25. It follows that, when income is $230, consumer spending is
   a. $151.25.
   b. $166.75.
   c. $170.20.
   d. $175.00.

   **ANS:** C  **DIF:** 2  **REF:** 34-2
   **NAT:** Analytic  **LOC:** Monetary and fiscal policy  **TOP:** Consumption | Multiplier
   **MSC:** Definitional

13. In a certain economy, when income is $200, consumer spending is $145. The value of the multiplier for this economy is 6.25. It follows that, when income is $230, consumer spending is
   a. $166.75. For this economy, an initial impulse of $10 in consumer spending translates into a $62.50 increase in aggregate demand.
   b. $166.75. For this economy, an initial impulse of $10 in consumer spending translates into a $66.75 increase in aggregate demand.
   c. $170.20. For this economy, an initial impulse of $10 in consumer spending translates into a $62.50 increase in aggregate demand.
   d. $170.20. For this economy, an initial impulse of $10 in consumer spending translates into a $70.20 increase in aggregate demand.

   **ANS:** C  **DIF:** 3  **REF:** 34-2
   **NAT:** Analytic  **LOC:** Monetary and fiscal policy  **TOP:** Consumption | Multiplier
   **MSC:** Definitional

14. Suppose an economy’s marginal propensity to consume (**MPC**) is 0.6. Then
   a. \(1 + \text{MPC} + \text{MPC}^2 + \text{MPC}^3 = 1.844\) and, if we continued adding up terms in this geometric series, we would get closer and closer to the multiplier value of 1.96.
   b. \(1 + \text{MPC} + \text{MPC}^2 + \text{MPC}^3 = 1.844\) and, if we continued adding up terms in this geometric series, we would get closer and closer to the multiplier value of 3.
   c. \(1 + \text{MPC} + \text{MPC}^2 + \text{MPC}^3 = 2.176\) and, if we continued adding up terms in this geometric series, we would get closer and closer to the multiplier value of 3.
   d. \(1 + \text{MPC} + \text{MPC}^2 + \text{MPC}^3 = 2.176\) and, if we continued adding up terms in this geometric series, we would get closer and closer to the multiplier value of 2.5.

   **ANS:** D  **DIF:** 3  **REF:** 34-2
   **NAT:** Analytic  **LOC:** Monetary and fiscal policy  **TOP:** Multiplier
   **MSC:** Definitional
15. Which of the following policy actions shifts the aggregate-demand curve?
   a. an increase in the money supply
   b. an increase in taxes
   c. an increase in government spending
   d. All of the above are correct.

   ANS: D
   DIF: 2
   REF: 34-2
   NAT: Analytic
   LOC: Monetary and fiscal policy
   TOP: Monetary policy | Fiscal policy | Aggregate demand shifts
   MSC: Interpretive

16. Government purchases are said to have a
   a. multiplier effect on aggregate supply.
   b. multiplier effect on aggregate demand.
   c. liquidity-enhancing effect on aggregate supply.
   d. liquidity-enhancing effect on aggregate demand.

   ANS: B
   DIF: 1
   REF: 34-2
   NAT: Analytic
   LOC: Monetary and fiscal policy
   TOP: Fiscal policy
   MSC: Interpretive

17. The logic of the multiplier effect applies
   a. only to changes in government spending.
   b. to any change in spending on any component of GDP.
   c. only to changes in the money supply.
   d. only when the crowding-out effect is sufficiently strong.

   ANS: B
   DIF: 2
   REF: 34-2
   NAT: Analytic
   LOC: Monetary and fiscal policy
   TOP: Multiplier effect
   MSC: Interpretive

Scenario 34-1. Take the following information as given for a small, imaginary economy:
   • When income is $10,000, consumption spending is $6,500.
   • When income is $11,000, consumption spending is $7,300.

18. Refer to Scenario 34-1. The marginal propensity to consume for this economy is
   a. 0.650.
   b. 0.664.
   c. 0.650 or 0.664, depending on whether income is $10,000 or $11,000.
   d. 0.800.

   ANS: D
   DIF: 2
   REF: 34-2
   NAT: Analytic
   LOC: Monetary and fiscal policy
   TOP: Consumption
   MSC: Applicative

19. Refer to Scenario 34-1. The multiplier for this economy is
   a. 2.86.
   b. 2.98.
   c. 4.00.
   d. 5.00.

   ANS: D
   DIF: 2
   REF: 34-2
   NAT: Analytic
   LOC: Monetary and fiscal policy
   TOP: Multiplier effect
   MSC: Applicative

20. Refer to Scenario 34-1. For this economy, an initial increase of $500 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.

   ANS: D
   DIF: 2
   REF: 34-2
   NAT: Analytic
   LOC: Monetary and fiscal policy
   TOP: Multiplier effect | Crowding out
   MSC: Applicative
Chapter 34/The Influence of Monetary and Fiscal Policy On Aggregate Demand

**Figure 34-4.** On the figure, MS represents money supply and MD represents money demand.

21. **Refer to Figure 34-4.** What is measured along the vertical axis of the graph?
   a. the quantity of output
   b. the amount of crowding out
   c. the interest rate
   d. the price level

   **ANS:** C  **DIF:** 1  **REF:** 34-2  
   **NAT:** Analytic  **LOC:** The role of money  
   **TOP:** Theory of liquidity preference | Fiscal policy  **MSC:** Interpretve

22. **Refer to Figure 34-4.** A shift of the money-demand curve from MD₁ to MD₂ could be a result of
   a. a decrease in taxes.
   b. an increase in government spending.
   c. an increase in the price level.
   d. All of the above are correct.

   **ANS:** D  **DIF:** 2  **REF:** 34-2  
   **NAT:** Analytic  **LOC:** The role of money  
   **TOP:** Theory of liquidity preference | Fiscal policy  **MSC:** Interpretve

23. **Refer to Figure 34-4.** A shift of the money-demand curve from MD₂ to MD₁ 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.

   **ANS:** B  **DIF:** 2  **REF:** 34-2  
   **NAT:** Analytic  **LOC:** The role of money  
   **TOP:** Theory of liquidity preference | Fiscal policy  **MSC:** Interpretve
**Figure 34-5.** On the left-hand graph, MS represents the supply of money and MD represents the demand for money; on the right-hand graph, AD represents aggregate demand. The usual quantities are measured along the axes of both graphs.

24. Refer to Figure 34-5. Suppose the multiplier is 5 and the government increases its purchases by $10 billion. Also, suppose the AD curve would shift from AD$_1$ to AD$_2$ if there were no crowding out; the AD curve actually shifts from AD$_1$ to AD$_3$ with crowding out. Also, suppose the horizontal distance between the curves AD$_1$ and AD$_3$ is $20 billion. The extent of crowding out, for any particular level of the price level, is
a. the horizontal distance between the curves MD$_1$ and MD$_2$.
b. $40 billion.
c. $30 billion.
d. $20 billion.

ANS: C  DIF: 3  REF: 34-2
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Crowding out  MSC: Applicative

25. Refer to Figure 34-5. Suppose the multiplier is 3 and the government increases its purchases by $25 billion. Also, suppose the AD curve would shift from AD$_1$ to AD$_2$ if there were no crowding out; the AD curve actually shifts from AD$_1$ to AD$_3$ with crowding out. Finally, assume the horizontal distance between the curves AD$_1$ and AD$_3$ is $30 billion. The extent of crowding out, for any particular level of the price level, is
a. $25 billion.
b. $30 billion.
c. $45 billion.
d. $60 billion.

ANS: C  DIF: 3  REF: 34-2
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Crowding out  MSC: Applicative

26. Refer to Figure 34-5. Suppose the graphs are drawn to show the effects of an increase in government purchases. If it were not for the increase in $r$ from $r_1$ to $r_2$, then
a. there would be no crowding out.
b. the full multiplier effect of the increase in government purchases would be realized.
c. the AD curves that actually apply, before and after the change in government purchases, would be separated horizontally by the distance equal to the multiplier times the change in government purchases.
d. All of the above are correct.

ANS: D  DIF: 2  REF: 34-2
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Crowding out  MSC: Applicative
27. An increase in government spending initially and primarily shifts
   a. aggregate demand to the right.
   b. aggregate demand to the left.
   c. aggregate supply to the right.
   d. neither aggregate demand nor aggregate supply in either direction.

ANS: A    DIF: 1    REF: 34-2
NAT: Analytic   LOC: Monetary and fiscal policy   TOP: Fiscal policy | Aggregate demand shifts   MSC: Applicative

28. A decrease in government spending initially and primarily shifts
   a. aggregate demand to the right.
   b. aggregate demand to the left.
   c. aggregate supply to the right.
   d. neither aggregate demand nor aggregate supply.

ANS: B    DIF: 1    REF: 34-2
NAT: Analytic   LOC: Monetary and fiscal policy   TOP: Fiscal policy | Aggregate demand shifts   MSC: Applicative

29. In the short run, an increase in government expenditures
   a. raises the price level, but not real GDP.
   b. raises real GDP, but not the price level.
   c. raises real GDP and the price level.
   d. raises neither real GDP nor the price level.

ANS: C    DIF: 1    REF: 34-2
NAT: Analytic   LOC: Monetary and fiscal policy   TOP: Fiscal policy | Short-run equilibrium   MSC: Applicative

30. Which of the following events shifts aggregate demand rightward?
   a. an increase in government expenditures or a decrease in the price level
   b. a decrease in government expenditures or an increase in the price level
   c. an increase in government expenditures, but not a change in the price level
   d. a decrease in the price level, but not an increase in government expenditures

ANS: C    DIF: 1    REF: 34-2
NAT: Analytic   LOC: Monetary and fiscal policy   TOP: Fiscal policy | Aggregate demand shifts   MSC: Applicative

31. Which of the following tends to make aggregate demand shift further to the right than the amount by which
    government expenditures increase?
   a. the crowding-out effect
   b. the multiplier effect
   c. the exchange-rate effect
   d. the interest-rate effect

ANS: B    DIF: 1    REF: 34-2
NAT: Analytic   LOC: Monetary and fiscal policy   TOP: Multiplier   MSC: Interpretive

32. The multiplier effect is exemplified by the multiplied impact on
   a. the money supply of a given increase in government purchases.
   b. tax revenues of a given increase in government purchases.
   c. investment of a given increase in interest rates.
   d. aggregate demand of a given increase in government purchases.

ANS: D    DIF: 1    REF: 34-2
NAT: Analytic   LOC: Monetary and fiscal policy   TOP: Multiplier   MSC: Interpretive
33. Suppose the multiplier has a value that exceeds 1, and there are no crowding out or investment accelerator effects. Which of the following would shift aggregate demand to the right by more than the increase in expenditures?
   a. an increase in government expenditures
   b. an increase in net exports
   c. an increase in investment spending
   d. All of the above are correct.
   ANS: D   DIF: 2   REF: 34-2
   NAT: Analytic   LOC: Monetary and fiscal policy   TOP: Multiplier
   MSC: Interpretive

34. The government builds a new water-treatment plant. The owner of the company that builds the plant pays her workers. The workers increase their spending. Firms from which the workers buy goods increase their output. This type of effect on spending illustrates
   a. the multiplier effect.
   b. the crowding-out effect.
   c. the Fisher effect.
   d. the wealth effect.
   ANS: A   DIF: 1   REF: 34-2
   NAT: Analytic   LOC: Monetary and fiscal policy   TOP: Multiplier effect
   MSC: Interpretive

35. The government buys new weapons systems. The manufacturers of weapons pay their employees. The employees spend this money on goods and services. The firms from which the employees buy the goods and services pay their employees. This sequence of events illustrates
   a. the accelerator effect.
   b. the multiplier effect.
   c. the chain effect.
   d. the bandwagon effect.
   ANS: B   DIF: 1   REF: 34-2
   NAT: Analytic   LOC: Monetary and fiscal policy   TOP: Multiplier effect
   MSC: Interpretive

36. Which of the following illustrates how the investment accelerator works?
   a. An increase in government expenditures increases the interest rate so that the Burgerville chain of restaurants decides to build fewer new restaurants.
   b. An increase in government expenditures increases aggregate spending so that Burgerville finds it profitable to build more new restaurants.
   c. An increase in government expenditures increases the interest rate so that the demand for stocks and bonds issued by Burgerville increases.
   d. An increase in government expenditures decreases the interest rate so that Burgerville decides to build more new restaurants.
   ANS: B   DIF: 2   REF: 34-2
   NAT: Analytic   LOC: Monetary and fiscal policy   TOP: Investment accelerator
   MSC: Interpretive

37. Which of the following illustrates how the investment accelerator works?
   a. An increase in government expenditures increases aggregate spending so that Gas-n-Go decides to modernize its gas stations.
   b. An increase in government expenditures increases the interest rate so that Gas-n-Go decides to modernize its gas stations.
   c. An increase in government expenditures increases the interest rate so that the demand for stocks and bonds issued by Gas-n-Go rises.
   d. An increase in government expenditures decreases the interest rate so that Gas-n-Go decides to modernize its gas stations.
   ANS: A   DIF: 2   REF: 34-2
   NAT: Analytic   LOC: Monetary and fiscal policy   TOP: Investment accelerator
   MSC: Interpretive
38. The positive feedback from aggregate demand to investment is called
   a. the investment multiplier.
   b. the stock-market effect.
   c. the investment accelerator.
   d. the crowding-in multiplier.
   ANS: C  DIF: 1  REF: 34-2
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Investment accelerator
   MSC: Definitional

39. The change in aggregate demand that results from fiscal expansion changing the interest rate is called the
   a. multiplier effect.
   b. crowding-out effect.
   c. accelerator effect.
   d. Ricardian equivalence effect.
   ANS: B  DIF: 2  REF: 34-2
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Crowding out
   MSC: Definitional

40. Which of the following correctly explains the crowding-out effect?
   a. An increase in government expenditures decreases the interest rate and so increases investment spending.
   b. An increase in government expenditures increases the interest rate and so reduces investment spending.
   c. A decrease in government expenditures increases the interest rate and so increases investment spending.
   d. A decrease in government expenditures decreases the interest rate and so reduces investment spending.
   ANS: B  DIF: 2  REF: 34-2
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Crowding out
   MSC: Interpretive

41. 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.
   ANS: C  DIF: 2  REF: 34-2
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Fiscal policy | Crowding out
   MSC: Interpretive

42. An increase in government spending
   a. increases the interest rate and so investment spending increases.
   b. increases the interest rate and so investment spending decreases.
   c. decreases the interest rate and so increases investment spending increases.
   d. decreases the interest rate and so investment spending decreases.
   ANS: B  DIF: 2  REF: 34-2
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Crowding out
   MSC: Analytical
43. A decrease in government spending
   a. increases the interest rate and so investment spending increases.
   b. increases the interest rate and so decreases investment spending decreases.
   c. decreases the interest rate and so investment spending increases.
   d. decreases the interest rate and so investment spending decreases.

ANS: C  DIF: 2  REF: 34-2
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Crowding out
MSC: Analytical

44. To reduce the effects of crowding out caused by an increase in government expenditures, the Federal Reserve could
   a. increase the money supply by buying bonds.
   b. increase the money supply by selling bonds.
   c. decrease the money supply by buying bonds.
   d. increase the money supply by selling bonds.

ANS: A  DIF: 2  REF: 34-2
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Crowding out  MSC: Analytical

45. Sometimes during wars, government expenditures are larger than normal. To reduce the effects this spending creates on interest rates,
   a. the Federal Reserve could increase the money supply by buying bonds.
   b. the Federal Reserve could increase the money supply by selling bonds.
   c. the Federal Reserve could decrease the money supply by buying bonds.
   d. the Federal Reserve could decrease the money supply by selling bonds.

ANS: A  DIF: 2  REF: 34-2
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Crowding out  MSC: Analytical

46. Suppose there are both multiplier and crowding out effects but without any accelerator effects. An increase in government expenditures would definitely
   a. shift aggregate demand right by a larger amount than the increase in government expenditures.
   b. shift aggregate demand right by the same amount as the increase in government expenditures.
   c. shift aggregate demand right by a smaller amount than the increase in government expenditures.
   d. Any of the above outcomes are possible.

ANS: D  DIF: 1  REF: 34-2
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Multiplier | Crowding out
MSC: Applicative

47. Assume there is a multiplier effect, some crowding out, and no accelerator effect. An increase in government expenditures changes aggregate demand more,
   a. the smaller the MPC and the stronger the influence of income on money demand.
   b. the smaller the MPC and the weaker the influence of income on money demand.
   c. the larger the MPC and the stronger the influence of income on money demand.
   d. the larger the MPC and the weaker the influence of income on money demand.

ANS: D  DIF: 3  REF: 34-2
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Multiplier | Crowding out
MSC: Analytical

48. Assuming no crowding-out, investment-accelerator, or multiplier effects, a $100 billion increase in government expenditures shifts aggregate demand
   a. right by more than $100 billion.
   b. right by $100 billion.
   c. left by more than $100 billion.
   d. left by $100 billion.

ANS: B  DIF: 2  REF: 34-2
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Multiplier | Investment accelerator | Crowding out
MSC: Applicative
49. Assuming a multiplier effect, but no crowding-out or investment-accelerator effects, a $100 billion increase in government expenditures shifts aggregate demand rightward by more than $100 billion.

ANS: A  
DIF: 2
REF: 34-2

NAT: Analytic  
LOC: Monetary and fiscal policy

TOP: Multiplier | Crowding out | Investment accelerator

MSC: Applicative

50. If net exports fall $20 billion and the \(MPC\) is 7/10 and there is a multiplier effect, but no crowding out and no investment accelerator, then aggregate demand falls by \(7/10 \times 20\) billion.

ANS: A  
DIF: 2
REF: 34-2

NAT: Analytic  
LOC: Monetary and fiscal policy

TOP: Multiplier

MSC: Applicative

51. If the marginal propensity to consume is 5/6, and there is no investment accelerator or crowding out, a $20 billion increase in government expenditures would shift the aggregate demand curve right by $120 billion, but the effect would be larger if there were an investment accelerator.

ANS: C  
DIF: 2
REF: 34-2

NAT: Analytic  
LOC: Monetary and fiscal policy

TOP: Multiplier | Investment accelerator

MSC: Applicative

52. If the \(MPC\) is 0.80 and there are no crowding-out or accelerator effects, then an initial increase in aggregate demand of $100 billion will eventually shift the aggregate demand curve to the right by $80 billion.

ANS: C  
DIF: 2
REF: 34-2

NAT: Analytic  
LOC: Monetary and fiscal policy

TOP: Multiplier

MSC: Applicative

53. Suppose that the \(MPC\) is 0.60; there is no investment accelerator; and there are no crowding-out effects. If government expenditures increase by $25 billion, then aggregate demand shifts rightward by $15 billion.

ANS: A  
DIF: 2
REF: 34-2

NAT: Analytic  
LOC: Monetary and fiscal policy

TOP: Multiplier

MSC: Applicative

54. Assume the \(MPC\) is 0.75. The multiplier is 4.

ANS: C  
DIF: 2
REF: 34-2

NAT: Analytic  
LOC: Monetary and fiscal policy

TOP: Multiplier

MSC: Applicative
55. Assume the \( \text{MPC} \) is 0.75. Assuming only the multiplier effect matters, a decrease in government purchases of $100 billion will shift the aggregate demand curve to the
a. left by $200 billion.
b. left by $400 billion.
c. right by $800 billion.
d. None of the above is correct.

ANS: B  DIF: 2  REF: 34-2
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Multiplier
MSC: Applicative

56. Assume the \( \text{MPC} \) is 0.625. Assuming only the multiplier effect matters, a decrease in government purchases of $10 billion will shift the aggregate demand curve to the
a. left by about $13.3 billion.
b. left by about $26.7 billion.
c. right by about $36.7 billion.
d. None of the above is correct.

ANS: B  DIF: 2  REF: 34-2
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Multiplier
MSC: Applicative

57. Assume the \( \text{MPC} \) is 0.75. Assume there is a multiplier effect and that the total crowding-out effect is $6 billion. An increase in government purchases of $10 billion will shift aggregate demand to the
a. left by $24 billion.
b. left by $36 billion.
c. right by $34 billion.
d. right by $36 billion.

ANS: C  DIF: 2  REF: 34-2
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Multiplier | Crowding out
MSC: Analytical

58. Assume the multiplier is 5 and that the crowding-out effect is $20 billion. An increase in government purchases of $10 billion will shift the aggregate-demand curve to the
a. right by $15 billion.
b. right by $70 billion.
c. right by $30 billion.
d. None of the above is correct.

ANS: C  DIF: 2  REF: 34-2
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Multiplier | Crowding out
MSC: Analytical

59. If the \( \text{MPC} \) is 0, then the multiplier is
a. 0.
b. 1.
c. infinite.
d. None of the above is correct.

ANS: B  DIF: 2  REF: 34-2
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Multiplier
MSC: Analytical

60. As the \( \text{MPC} \) gets close to 1, the value of the multiplier approaches
a. 0.
b. 1.
c. infinity.
d. None of the above is correct.

ANS: C  DIF: 2  REF: 34-2
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Multiplier
MSC: Analytical
61. An increase in the MPC
   a. increases the multiplier, so that changes in government expenditures have a larger effect on
      aggregate demand.
   b. increases the multiplier, so that changes in government expenditures have a smaller effect on
      aggregate demand.
   c. decreases the multiplier, so that changes in government expenditures have a larger effect on
      aggregate demand.
   d. decreases the multiplier, so that changes in government expenditures have a smaller effect on
      aggregate demand.

   ANS: A   DIF: 1   REF: 34-2
   NAT: Analytic   LOC: Monetary and fiscal policy   TOP: Multiplier
   MSC: Interpretive

62. An increase in government purchases is likely to
   a. decrease interest rates.
   b. result in a net decrease in aggregate demand.
   c. crowd out investment spending by business firms.
   d. decrease money demand.

   ANS: C   DIF: 2   REF: 34-2
   NAT: Analytic   LOC: Monetary and fiscal policy   TOP: Fiscal policy
   MSC: Interpretive

63. The multiplier effect
   a. and the crowding-out effect both amplify the effects of an increase in government expenditures.
   b. and the crowding-out effect both diminish the effects of an increase in government expenditures.
   c. diminishes the effects of an increase in government expenditures, while the crowding-out effect
      amplifies the effects.
   d. amplifies the effects of an increase in government expenditures, while the crowding-out effect
      diminishes the effects.

   ANS: D   DIF: 2   REF: 34-2
   NAT: Analytic   LOC: Monetary and fiscal policy   TOP: Crowding out | Investment accelerator
   MSC: Interpretive

64. Tax cuts
   a. and increases in government expenditures shift aggregate demand right.
   b. and increases in government expenditures shift aggregate demand left.
   c. shift aggregate demand right while increases in government expenditures shift aggregate demand
      left.
   d. shift aggregate demand left while increases in government expenditures shift aggregate demand
      right.

   ANS: A   DIF: 1   REF: 34-2
   NAT: Analytic   LOC: Monetary and fiscal policy
   TOP: Fiscal policy | Aggregate demand shifts   MSC: Applicative

65. If taxes
   a. increase, then consumption increases, and aggregate demand shifts rightward.
   b. increase, then consumption decreases, and aggregate demand shifts leftward.
   c. decrease, then consumption increases, and aggregate demand shifts leftward.
   d. decrease, then consumption decreases, and aggregate demand shifts rightward.

   ANS: B   DIF: 1   REF: 34-2
   NAT: Analytic   LOC: Monetary and fiscal policy
   TOP: Fiscal policy | Aggregate demand shifts   MSC: Applicative
66. When the government reduces taxes, which of the following decreases?
   a. consumption
   b. take-home pay
   c. household saving
   d. None of the above is correct.

   ANS: D   DIF: 1   REF: 34-2
   NAT: Analytic   LOC: Monetary and fiscal policy   TOP: Taxes
   MSC: Interpretive

67. Which of the following tends to make the size of a shift in aggregate demand resulting from a tax cut smaller than it otherwise would be?
   a. the multiplier effect
   b. the crowding-out effect
   c. the accelerator effect
   d. None of the above is correct.

   ANS: B   DIF: 1   REF: 34-2
   NAT: Analytic   LOC: Monetary and fiscal policy
   TOP: Multiplier | Crowding out | Investment accelerator   MSC: Definitional

68. Imagine that the government increases its spending by $20 billion. Which of the following by itself would tend to make the change in aggregate demand different from $20 billion?
   a. both the multiplier effect and the crowding-out effect
   b. the multiplier effect, but not the crowding-out effect
   c. the crowding-out effect, but not the multiplier effect
   d. neither the crowding out effect nor the multiplier effect

   ANS: A   DIF: 2   REF: 34-2
   NAT: Analytic   LOC: Monetary and fiscal policy   TOP: Fiscal policy
   MSC: Applicative

69. When there is an increase in government expenditures, which of the following raises investment spending?
   a. the investment accelerator and crowding out
   b. the investment accelerator but not crowding out
   c. crowding out but not the investment accelerator
   d. neither the investment accelerator or crowding out

   ANS: B   DIF: 1   REF: 34-2
   NAT: Analytic   LOC: Monetary and fiscal policy
   TOP: Investment accelerator | Crowding out   MSC: Definitional

70. If the multiplier is 7 and if there is no crowding-out effect, then a $50 billion increase in government expenditures causes aggregate demand to
   a. increase by $250 billion.
   b. increase by $175 billion.
   c. increase by $350 billion.
   d. None of the above are correct.

   ANS: C   DIF: 2   REF: 34-2
   NAT: Analytic   LOC: Monetary and fiscal policy   TOP: Fiscal policy
   MSC: Applicative

71. If a $1,000 increase in income leads to a $750 increase in consumption expenditures, then the marginal propensity to consume is
   a. 0.75 and the multiplier is 1 1/3.
   b. 0.75 and the multiplier is 4.
   c. 0.25 and the multiplier is 1 1/3.
   d. 0.25 and the multiplier is 4.

   ANS: B   DIF: 3   REF: 34-2
   NAT: Analytic   LOC: Monetary and fiscal policy   TOP: Multiplier
   MSC: Applicative
72. As income rises
   a. money demand rises, so the interest rate rises.
   b. money demand rises, so the interest rate falls
   c. money demand falls, so the interest rate rises.
   d. money demand falls, so the interest rate falls.

   ANS: A   DIF: 2   REF: 34-2
   NAT: Analytic   LOC: Monetary and fiscal policy   TOP: Fiscal policy
   MSC: Analytic

73. A tax increase has
   a. a multiplier effect but not a crowding out effect
   b. a crowding out effect but not a multiplier effect
   c. both a crowding out and multiplier effect
   d. neither a multiplier or crowding out effect

   ANS: C   DIF: 2   REF: 34-2
   NAT: Analytic   LOC: Monetary and fiscal policy   TOP: Multiplier | Crowding out
   MSC: Interpretive

74. An aide to a U.S. Senator computes the effect on aggregate demand of a $20 billion tax cut. The actual increase in aggregate demand is less than the aide expected. Which of the following errors in the aide's computation would be consistent with an overestimation of the impact on aggregate demand?
   a. The actual MPC was larger than the MPC the aide used to compute the multiplier.
   b. The aide thought the tax cut would be permanent, but the actual tax cut was temporary.
   c. The increase in income shifted money demand less than the aide had anticipated.
   d. The increase in income resulted in investment rising more than the aide had anticipated.

   ANS: B   DIF: 3   REF: 34-2
   NAT: Analytic   LOC: Monetary and fiscal policy   TOP: Stabilization policy | Multiplier
   MSC: Analytical

75. Initially, the economy is in long-run equilibrium. Aggregate demand then shifts leftward by $50 billion. The government wants to increase its spending in order to avoid a recession. If the crowding-out effect is always half as strong as the multiplier effect, and if the MPC equals 0.8, then by how much do government purchases have to increase in order to offset the $50 billion leftward shift?
   a. by $5 billion
   b. by $10 billion
   c. by $20 billion
   d. by $50 billion

   ANS: C   DIF: 3   REF: 34-2
   NAT: Analytic   LOC: Monetary and fiscal policy   TOP: Stabilization policy | Multiplier | Crowding out
   MSC: Analytical

76. Initially, the economy is in long-run equilibrium. The aggregate demand curve then shifts $40 billion to the left. The government wants to change its spending to offset this decrease in demand. The MPC is 0.60. Suppose the effect on aggregate demand from a change in taxes is 3/5 the size of the change from government expenditures. There is no crowding out and no accelerator effect. What should the government do if it wants to offset the decrease in real GDP?
   a. Raise both taxes and expenditures by $40 billion dollars.
   b. Raise both taxes and expenditures by $40 billion dollars.
   c. Reduce both taxes and expenditures by $10 billion dollars.
   d. Reduce both taxes and expenditures by $10 billion dollars.

   ANS: A   DIF: 3   REF: 34-2
   NAT: Analytic   LOC: Monetary and fiscal policy   TOP: Stabilization policy | Multiplier | Taxes
   MSC: Analytical
77. Initially, the economy is in long-run equilibrium. The aggregate demand curve then shifts $80 billion to the left. The government wants to change spending to offset this decrease in demand. The $MPC$ is 0.75. Suppose the effect on aggregate demand of a tax change is $\frac{3}{4}$ as strong as the effect of a change in government expenditure. There is no crowding out and no accelerator effect. What should the government do if it wants to offset the decrease in real GDP?
   a. Raise both taxes and expenditures by $80 billion dollars.
   b. Raise both taxes and expenditures by $10 billion dollars.
   c. Reduce both taxes and expenditures by $80 billion dollars.
   d. Reduce both taxes and expenditures by $10 billion dollars.

ANS: A       DIF: 3       REF: 34-2
NAT: Analytic    LOC: Monetary and fiscal policy
TOP: Stabilization policy | Multiplier | Taxes
MSC: Analytical

78. Suppose the $MPC$ is 0.75. There are no crowding out or investment accelerator effects. If the government increases its expenditures by $200 billion, then by how much does aggregate demand shift to the right? If the government decreases taxes by $200 billion, then by how far does aggregate demand shift to the right?
   a. $800 billion and $800 billion
   b. $800 billion and $600 billion
   c. $600 billion and $600 billion
   d. $600 billion and $450 billion

ANS: B       DIF: 3       REF: 34-2
NAT: Analytic    LOC: Monetary and fiscal policy
TOP: Multiplier | Taxes
MSC: Analytical

79. Suppose the $MPC$ is 0.60. Assume there are no crowding out or investment accelerator effects. If the government increases expenditures by $200 billion, then by how much does aggregate demand shift to the right? If the government decreases taxes by $200 billion, then by how much does aggregate demand shift to the right?
   a. $300 billion and $180 billion
   b. $300 billion and $300 billion
   c. $500 billion and $300 billion
   d. $500 billion and $500 billion

ANS: C       DIF: 3       REF: 34-2
NAT: Analytic    LOC: Monetary and fiscal policy
TOP: Multiplier | Taxes
MSC: Analytical

80. A tax cut shifts aggregate demand
   a. by more than the amount of the tax cut.
   b. by the same amount as the tax cut.
   c. by less than the tax cut.
   d. None of the above is necessarily correct.

ANS: D       DIF: 3       REF: 34-2
NAT: Analytic    LOC: Monetary and fiscal policy
TOP: Multiplier
MSC: Analytical

81. If households view a tax cut as temporary, then the tax cut
   a. has no affect on aggregate demand.
   b. has more of an affect on aggregate demand than if households view it as permanent.
   c. has the same affect as when households view the cut as permanent.
   d. has less of an affect on aggregate demand than if households view it as permanent.

ANS: D       DIF: 2       REF: 34-2
NAT: Analytic    LOC: Monetary and fiscal policy
TOP: Taxes
MSC: Definitional
82. The most extreme example of a temporary tax cut was the one announced in 1992 by President George H. W. Bush. The effect of that tax cut on consumer spending and aggregate demand was
   a. zero.
   b. likely smaller than if the cut had been permanent.
   c. likely about the same as if the cut had been permanent.
   d. likely larger than if the cut had been permanent.

ANS: B  DIF: 1  REF: 34-2
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Taxes
MSC: Definitional

83. Permanent tax cuts shift the AD curve
   a. farther to the right than do temporary tax cuts.
   b. not as far to the right as do temporary tax cuts.
   c. farther to the left than do temporary tax cuts.
   d. not as far to the left as do temporary tax cuts.

ANS: A  DIF: 1  REF: 34-2
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Taxes
MSC: Applicative

84. A tax cut shifts the aggregate demand curve the farthest if
   a. the MPC is large and if the tax cut is permanent.
   b. the MPC is large and if the tax cut is temporary.
   c. the MPC is small and if the tax cut is permanent.
   d. the MPC is small and if the tax cut is temporary.

ANS: A  DIF: 3  REF: 34-2
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Multiplier | Taxes
MSC: Analytical

85. Most economists believe that fiscal policy
   a. only affects aggregate demand and not aggregate supply.
   b. primarily affects aggregate demand.
   c. primarily affects aggregate supply.
   d. only affects aggregate supply and not aggregate demand.

ANS: B  DIF: 1  REF: 34-2
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Fiscal policy
MSC: Definitional

86. Supply-side economists focus more than other economists on
   a. how fiscal policy affects consumption.
   b. the multiplier affect of fiscal policy.
   c. how fiscal policy affects aggregate supply.
   d. the money supply.

ANS: C  DIF: 1  REF: 34-2
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Supply-side economics
MSC: Definitional

87. If the government cuts the tax rate, workers get to keep
   a. less of each additional dollar they earn, so work effort increases, and aggregate supply shifts right.
   b. less of each additional dollar they earn, so work effort decreases, and aggregate supply shifts left.
   c. more of each additional dollar they earn, so work effort increases, and aggregate supply shifts right.
   d. more of each additional dollar they earn, so work effort decreases, and aggregate supply shifts left.

ANS: C  DIF: 2  REF: 34-2
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Taxes | Aggregate supply
MSC: Interpretive
88. Supply-side economists believe that a reduction in the tax rate
   a. always decrease government tax revenue.
   b. shifts the aggregate supply curve to the right.
   c. provides no incentive for people to work more.
   d. would decrease consumption.

   ANS: B  DIF: 2  REF: 34-2
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Taxes | Aggregate supply
   MSC: Definitional

89. Most economists believe that a cut in tax rates
   a. would generally increase government tax revenue.
   b. would have no effect on aggregate demand.
   c. has a relatively small effect on the aggregate-supply curve.
   d. All of the above are correct.

   ANS: C  DIF: 1  REF: 34-2
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Taxes | Aggregate supply
   MSC: Definitional

90. Supply-side economists believe that changes in government purchases affect
   a. only aggregate demand.
   b. only aggregate supply.
   c. both aggregate demand and aggregate supply.
   d. neither aggregate demand nor aggregate supply.

   ANS: C  DIF: 1  REF: 34-2
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Supply-side economics | Fiscal policy | Aggregate supply
   MSC: Definitional

91. An increase in government spending on goods to build or repair infrastructure
   a. shifts the aggregate demand curve to the right.
   b. has a multiplier effect.
   c. shifts the aggregate supply curve to the right, but this effect is likely more important in the long run.
   d. All of the above are correct.

   ANS: D  DIF: 1  REF: 34-2
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Fiscal policy | Aggregate supply
   MSC: Interpretive

92. If Congress cuts spending to balance the federal budget, the Fed can act to prevent unemployment and recession by
   a. buying bonds to increase the money supply
   b. buying bonds to decrease the money supply.
   c. selling bonds to increase the money supply.
   d. selling bonds to decrease the money supply.

   ANS: A  DIF: 2  REF: 34-2
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Stabilization policy
   MSC: Analytical
MULTIPLE CHOICE

1. The Employment Act of 1946 states that
   a. the Fed should use monetary policy only to control the rate of inflation.
   b. the government should promote full employment and production.
   c. the government should periodically increase the minimum wage and unemployment insurance benefits.
   d. All of the above are correct.

   ANS: B  DIF: 1  REF: 34-3
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Employment Act of 1946
   MSC: Definitional

2. The Employment Act of 1946
   a. implies that the government should avoid being a cause of economic fluctuations.
   b. implies that the government should respond to changes in the private economy to stabilize aggregate demand.
   d. All of the above are correct

   ANS: D  DIF: 1  REF: 34-3
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Employment Act of 1946
   MSC: Definitional

3. Keynes argued that aggregate demand is
   a. stable, because the economy tends to return to its long-run equilibrium quickly after any disturbance to aggregate demand.
   b. stable, because changes in consumption are mostly offset by changes in investment and vice versa.
   c. unstable, because waves of pessimism and optimism create fluctuations in aggregate demand.
   d. unstable, because of long and variable policy lags that worsen economic fluctuations.

   ANS: C  DIF: 1  REF: 34-3
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Keynes
   MSC: Definitional

4. Keynes argued that
   a. irrational waves of pessimism cause decreases in aggregate demand and increases in unemployment.
   b. irrational waves of optimism cause decreases in aggregate demand and decreases in aggregate supply.
   c. changes in business and consumer expectations generally stabilize the economy.
   d. All of the above are correct.

   ANS: A  DIF: 1  REF: 34-3
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Keynes
   MSC: Definitional

5. Keynes used the term "animal spirits" to refer to
   a. policy makers harming the economy in the pursuit of self interest.
   b. arbitrary changes in attitudes of household and firms.
   c. mean-spirited economists who believed in the classical dichotomy.
   d. firms' relentless efforts to maximize profits.

   ANS: B  DIF: 1  REF: 34-3
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Keynes
   MSC: Definitional
6. Who asserted that “the Federal Reserve’s job is to take away the punch bowl just as the party gets going?”
   a. president George W. Bush
   b. president John F. Kennedy
   c. economist John Maynard Keynes
   d. former chairman of the Federal Reserve System William McChesney Martin

ANS: D  DIF: 1  REF: 34-3
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Stabilization policy
MSC: Definitional

7. Which U.S. president, when asked why he had proposed a tax cut, responded by saying “To stimulate the economy. Don’t you remember your Economics 101?”
   a. Dwight D. Eisenhower
   b. John F. Kennedy
   c. Ronald Reagan
   d. Bill Clinton

ANS: B  DIF: 1  REF: 34-3
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Kennedy
MSC: Definitional

8. In the early 1960s, the Kennedy administration made considerable use of
   a. fiscal policy to stimulate the economy.
   b. fiscal policy to slow down the economy.
   c. monetary policy to stimulate the economy.
   d. monetary policy to slow down the economy.

ANS: A  DIF: 2  REF: 34-3
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Kennedy
MSC: Definitional

9. The Kennedy tax cut of 1964 was
   a. successful in stimulating the economy.
   b. designed to shift the aggregate demand curve to the right.
   c. designed to shift the aggregate supply curve to the right.
   d. All of the above are correct.

ANS: D  DIF: 2  REF: 34-3
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Kennedy tax cuts
MSC: Definitional

10. The Kennedy tax cut of 1964 included an investment tax credit that was designed to
    a. increase aggregate demand in the short run and aggregate supply in the long run.
    b. increase aggregate supply in the short run and aggregate demand in the long run.
    c. only increase aggregate supply in the long run.
    d. only increase aggregate demand in the short run.

ANS: A  DIF: 2  REF: 34-3
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Kennedy tax cuts
MSC: Analytical

11. Monetary policy
    a. can be implemented quickly and most of its impact on aggregate demand occurs very soon after policy is implemented.
    b. can be implemented quickly, but most of its impact on aggregate demand occurs months after policy is implemented.
    c. cannot be implemented quickly, but once implemented most of its impact on aggregate demand occurs very soon afterward.
    d. cannot be implemented quickly and most of its impact on aggregate demand occurs months after policy is implemented.

ANS: B  DIF: 2  REF: 34-3
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Policy lags
MSC: Definitional
12. If businesses and consumers become pessimistic, the Federal Reserve can attempt to reduce the impact on the price level and real GDP by
   a. increasing the money supply, which raises interest rates.
   b. increasing the money supply, which lowers interest rates.
   c. decreasing the money supply, which raises interest rates.
   d. decreasing the money supply, which lowers interest rates.

ANS: B  DIF: 2  REF: 34-3
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Stabilization policy
MSC: Applicative

13. Suppose that businesses and consumers become much more optimistic about the future of the economy. To stabilize output, the Federal Reserve could
   a. buy bonds to raise interest rates.
   b. buy bonds to lower interest rates.
   c. sell bonds to raise interest rates.
   d. sell bonds to lower interest rates.

ANS: C  DIF: 2  REF: 34-3
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Stabilization policy
MSC: Applicative

14. Suppose there were a large decline in net exports. If the Fed wanted to stabilize output, it could
   a. buy bonds to raise interest rates.
   b. buy bonds to lower interest rates.
   c. sell bonds to raise interest rates.
   d. sell bonds to lower interest rates.

ANS: B  DIF: 2  REF: 34-3
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Stabilization policy
MSC: Applicative

15. Suppose there were a large increase in net exports. If the Fed wanted to stabilize output, it could
   a. buy bonds to increase the money supply.
   b. buy bonds to decrease the money supply.
   c. sell bonds to increase the money supply.
   d. sell bonds to decrease the money supply.

ANS: D  DIF: 2  REF: 34-3
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Stabilization policy
MSC: Applicative

16. A reduction in U.S. net exports would shift U.S. aggregate demand
   a. rightward. In an attempt to stabilize the economy, the government could raise taxes.
   b. rightward. In an attempt to stabilize the economy, the government could cut taxes.
   c. leftward. In an attempt to stabilize the economy, the government could raise taxes.
   d. leftward. In an attempt to stabilize the economy, the government could cut taxes.

ANS: D  DIF: 3  REF: 34-3
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Fiscal policy
MSC: Analytic

17. What actions could be taken to stabilize output in response to a large decrease in U.S. net exports?
   a. increase government expenditures or increase the money supply
   b. increase government expenditures or decrease the money supply
   c. decrease government expenditures or increase the money supply
   d. decrease government expenditures or decrease the money supply

ANS: A  DIF: 2  REF: 34-3
NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Stabilization policy
MSC: Applicative
18. The price of imported oil rises. If the government wanted to stabilize output, which of the following could it do?
   a. increase government expenditures or increase the money supply
   b. increase government expenditures or decrease the money supply
   c. decrease government expenditures or increase the money supply
   d. decrease government expenditures or decrease the money supply

   ANS: A  DIF: 2  REF: 34-3
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Stabilization policy
   MSC: Applicative

19. Suppose aggregate demand shifts to the left and policymakers want to stabilize output. What can they do?
   a. repeal an investment tax credit or increase the money supply
   b. repeal an investment tax credit or decrease the money supply
   c. institute an investment tax credit or increase the money supply
   d. institute an investment tax credit or decrease the money supply

   ANS: C  DIF: 2  REF: 34-3
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Stabilization policy
   MSC: Applicative

20. Which of the following policy alternatives would be an appropriate response to a sharp increase in investment spending, assuming policymakers want to stabilize output?
   a. increase taxes
   b. increase the money supply
   c. increase government expenditures
   d. All of the above are correct.

   ANS: A  DIF: 1  REF: 34-3
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Stabilization policy
   MSC: Applicative

21. Which of the following policies would be advocated by someone who wants the government to follow an active stabilization policy when the economy is experiencing severe unemployment?
   a. decrease the money supply
   b. increase government expenditures
   c. increase taxes
   d. All of the above are correct.

   ANS: B  DIF: 1  REF: 34-3
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Stabilization policy
   MSC: Applicative

22. Which of the following policies would Keynes's followers support when an increase in business optimism shifts the aggregate demand curve away from long-run equilibrium?
   a. decrease taxes
   b. increase government expenditures
   c. increase the money supply
   d. None of the above is correct.

   ANS: D  DIF: 2  REF: 34-3
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Keynes | Stabilization policy
   MSC: Applicative

23. Which of the following policies would be advocated by proponents of stabilization policy when the economy is experiencing severe unemployment?
   a. a decrease in the money supply
   b. a reduction in tax rates
   c. a decrease in government purchases
   d. None of the above is correct.

   ANS: B  DIF: 2  REF: 34-3
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Stabilization policy
   MSC: Applicative
24. Refer to Figure 34-6. The aggregate-demand curve could shift from $AD_1$ to $AD_2$ as a result of
   a. an increase in government purchases.
   b. a decrease in stock prices.
   c. consumers and firms becoming more optimistic about the future.
   d. an increase in the price level.

   ANS: B  DIF: 1  REF: 34-3
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Aggregate demand shifts
   MSC: Applicative

25. Refer to Figure 34-6. If the economy is at point b, a policy to restore full employment would be
   a. an increase in the money supply.
   b. a decrease in government purchases.
   c. an increase in taxes.
   d. All of the above are correct.

   ANS: A  DIF: 1  REF: 34-3
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Stabilization policy
   MSC: Applicative

26. Refer to Figure 34-6. Which of the following is correct?
   a. A wave of optimism could move the economy from point a to point b.
   b. If aggregate demand moves from $AD_1$ to $AD_2$, the economy will stay at point b in both the short run and long run.
   c. It is possible that either fiscal or monetary policy might have caused the shift from $AD_1$ to $AD_2$.
   d. All of the above are correct.

   ANS: C  DIF: 1  REF: 34-3
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Stabilization policy
   MSC: Applicative

27. Refer to Figure 34-6. Which of the following is correct?
   a. Unemployment rises as the economy moves from point a to point b.
   b. Either fiscal or monetary policy could be used to move the economy from point b to point a.
   c. If the economy is left alone, then as the economy moves from point b to long-run equilibrium, the price level will fall farther.
   d. All of the above are correct.

   ANS: D  DIF: 2  REF: 34-3
   NAT: Analytic  LOC: Monetary and fiscal policy
   TOP: Monetary policy | Fiscal policy  MSC: Interpretive
28. Some economists argue that
   a. monetary policy should actively be used to stabilize the economy.
   b. fiscal policy should actively be used to stabilize the economy.
   c. fiscal policy can be used to shift the $AD$ curve.
   d. All of the above are correct.

   ANS: D    DIF: 1    REF: 34-3
   NAT: Analytic    LOC: Monetary and fiscal policy    TOP: Stabilization policy
   MSC: Definitional

29. Which of the following statements generates the greatest amount of disagreement among economists?
   a. Increases in the money supply shift aggregate demand to the right.
   b. In the long run, increases in the money supply increase prices, but not output.
   c. Recessions are associated with decreases in consumption, investment, and employment.
   d. Government should use fiscal policy to try to stabilize the economy.

   ANS: D    DIF: 1    REF: 34-3
   NAT: Analytic    LOC: Monetary and fiscal policy    TOP: Stabilization policy
   MSC: Interpretive

30. Critics of stabilization policy argue that
   a. there is a lag between the time policy is passed and the time policy has an impact on the economy.
   b. the impact of policy may last longer than the problem it was designed to offset.
   c. policy can be a source of, instead of a cure for, economic fluctuations.
   d. All of the above are correct.

   ANS: D    DIF: 1    REF: 34-3
   NAT: Analytic    LOC: Monetary and fiscal policy    TOP: Stabilization policy
   MSC: Definitional

31. Critics of stabilization policy argue that
   a. policy affects aggregate demand quickly, but the effects on aggregate demand are long-lived.
   b. policy affects aggregate demand with a lag, and the effects on aggregate demand are long-lived.
   c. policy affects aggregate demand with a lag, but the effects are short-lived.
   d. policy does not affect aggregate demand.

   ANS: B    DIF: 2    REF: 34-3
   NAT: Analytic    LOC: Monetary and fiscal policy    TOP: Policy lags
   MSC: Definitional

32. The lag problem associated with monetary policy is due mostly to
   a. the fact that business firms make investment plans far in advance.
   b. the political system of checks and balances that slows down the process of determining monetary policy.
   c. the time it takes for changes in government spending to affect the interest rate.
   d. All of the above are correct.

   ANS: A    DIF: 1    REF: 34-3
   NAT: Analytic    LOC: Monetary and fiscal policy    TOP: Stabilization policy
   MSC: Interpretive

33. The lag problem associated with fiscal policy is due mostly to
   a. the fact that business firms make investment plans far in advance.
   b. the political system of checks and balances that slows down the process of implementing fiscal policy.
   c. the time it takes for changes in government spending or taxes to affect the interest rate.
   d. All of the above are correct.

   ANS: B    DIF: 1    REF: 34-3
   NAT: Analytic    LOC: Monetary and fiscal policy    TOP: Stabilization policy
   MSC: Interpretive
34. When the Fed lowers the growth rate of the money supply, it must take into account
   a. only the short-run effect on production.
   b. only the short-run effects on inflation and production.
   c. only the long-run effect on inflation.
   d. the long-run effect on inflation as well as the short-run effect on production.

   ANS: D  DIF: 1  REF: 34-3
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Monetary policy
   MSC: Definitional

35. Macroeconomic forecasts are
   a. precise; this makes policy lags less relevant.
   b. precise; this makes policy lags more relevant.
   c. imprecise; this makes policy lags less relevant.
   d. imprecise; this makes policy lags more relevant.

   ANS: D  DIF: 2  REF: 34-3
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Policy lags
   MSC: Definitional

36. Opponents of active stabilization policy
   a. advocate a monetary policy designed to offset changes in the unemployment rate.
   b. argue that fiscal policy is unable to change aggregate demand or aggregate supply.
   c. believe that the political process creates lags in the implementation of fiscal policy.
   d. None of the above is correct.

   ANS: C  DIF: 1  REF: 34-3
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Stabilization policy
   MSC: Interpretive

37. Opponents of active stabilization policy
   a. generally don't believe, even in theory, that fiscal policy can stabilize the economy.
   b. generally agree that fiscal policy has no impact in the long run.
   c. believe some effects of monetary policy may be long-lived.
   d. think the Fed should simply try to fine tune the economy.

   ANS: C  DIF: 2  REF: 34-3
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Stabilization policy
   MSC: Interpretive

38. Automatic stabilizers
   a. increase the problems that lags cause in using fiscal policy as a stabilization tool.
   b. are changes in taxes or government spending that increase aggregate demand without requiring policy makers to act when the economy goes into recession.
   c. are changes in taxes or government spending that policy makers quickly agree to when the economy goes into recession.
   d. All of the above are correct.

   ANS: B  DIF: 1  REF: 34-3
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Stabilization policy
   MSC: Definitional

39. Which of the following is not an automatic stabilizer?
   a. the minimum wage
   b. the unemployment compensation system
   c. the federal income tax
   d. the welfare system

   ANS: A  DIF: 1  REF: 34-3
   NAT: Analytic  LOC: Monetary and fiscal policy  TOP: Automatic stabilizers
   MSC: Definitional
40. During recessions, taxes tend to
   a. rise and thereby increase aggregate demand.
   b. rise and thereby decrease aggregate demand.
   c. fall and thereby increase aggregate demand.
   d. fall and thereby decrease aggregate demand.

   ANS: C     DIF:  2     REF:  34-3
   NAT: Analytic     LOC: Monetary and fiscal policy     TOP: Automatic stabilizers
   MSC: Analytical

41. Other things the same, automatic stabilizers tend to
   a. raise expenditures during expansions and recessions.
   b. lower expenditures during expansions and recessions.
   c. raise expenditures during recessions and lower expenditures during expansions.
   d. raise expenditures during expansions and lower expenditures during recessions.

   ANS: C     DIF:  2     REF:  34-3
   NAT: Analytic     LOC: Monetary and fiscal policy     TOP: Automatic stabilizers
   MSC: Analytical

42. During periods of expansion, automatic stabilizers cause government expenditures
   a. and taxes to fall.
   b. and taxes to rise.
   c. to rise and taxes to fall.
   d. to fall and taxes to rise.

   ANS: D     DIF:  1     REF:  34-3
   NAT: Analytic     LOC: Monetary and fiscal policy     TOP: Automatic stabilizers
   MSC: Analytical

43. During recessions, automatic stabilizers tend to make the government's budget
   a. move toward deficit.
   b. move toward surplus.
   c. move toward balance.
   d. not necessarily move the budget in any particular direction.

   ANS: A     DIF:  2     REF:  34-3
   NAT: Analytic     LOC: Monetary and fiscal policy     TOP: Automatic stabilizers
   MSC: Analytical

44. The most important automatic stabilizer is
   a. open-market operations.
   b. the tax system.
   c. unemployment compensation.
   d. welfare benefits.

   ANS: B     DIF:  1     REF:  34-3
   NAT: Analytic     LOC: Monetary and fiscal policy     TOP: Automatic stabilizers
   MSC: Definitional

45. The primary argument against active monetary and fiscal policy is that
   a. attempts to stabilize the economy do not constitute a proper role for government in a democratic
      society.
   b. these policies affect the economy with a long lag.
   c. these policies affect the economy too quickly and with too much impact.
   d. history demonstrates that interest rates respond unpredictably to active policies, leading to
      unpredictable effects on income.

   ANS: B     DIF:  2     REF:  34-3
   NAT: Analytic     LOC: Monetary and fiscal policy
   TOP: Monetary policy, fiscal policy     MSC: Interpretive
46. Other things the same, during recessions taxes tend to
   a. rise. The rise in taxes stimulates aggregate demand.
   b. rise. The rise in taxes contracts aggregate demand.
   c. fall. The fall in taxes stimulates aggregate demand.
   d. fall. The fall in taxes contracts aggregate demand.
   ANS: C DIF: 2 REF: 34-3
   NAT: Analytic LOC: Monetary and fiscal policy TOP: Automatic stabilizers
   MSC: Applicative

47. It is likely that a constitutional amendment that required the government always to run a balanced budget would
   a. contribute to a more stable level of output.
   b. mitigate the crowding-out effect.
   c. eliminate the economy’s automatic stabilizers.
   d. All of the above are correct.
   ANS: C DIF: 2 REF: 34-3
   NAT: Analytic LOC: Monetary and fiscal policy TOP: Automatic stabilizers
   MSC: Interpretive

**Sec04 - The Influence of Monetary and Fiscal Policy on Aggregate Demand - Conclusion**

**MULTIPLE CHOICE**

1. In the short run,
   a. the price level alone adjusts to balance the supply and demand for money.
   b. output responds to changes in the aggregate demand for goods and services.
   c. changes in the money supply cause a proportional change in the price level.
   d. increases in the money supply shift the aggregate supply curve causing output to rise.
   ANS: B DIF: 2 REF: 34-4
   NAT: Analytic LOC: Monetary and fiscal policy TOP: Short run
   MSC: Interpretive

2. In the long run, the level of output
   a. depends on the money supply.
   b. depends on the price level.
   c. is determined by supply-side factors.
   d. All of the above are correct.
   ANS: C DIF: 2 REF: 34-4
   NAT: Analytic LOC: Monetary and fiscal policy TOP: Long run
   MSC: Interpretive

3. In the long run, changes in the money supply affect
   a. prices.
   b. output.
   c. unemployment rates.
   d. All of the above.
   ANS: A DIF: 1 REF: 34-4
   NAT: Analytic LOC: Monetary and fiscal policy TOP: Long run | Monetary policy
   MSC: Interpretive
4. When Congress reduces spending in order to balance the government’s budget, it needs to consider
   a. both the short-run effects on aggregate demand and aggregate supply, and the long-run effects on
      saving and growth.
   b. only the short-run effects on aggregate demand and aggregate supply.
   c. only the long-run effects on saving and growth.
   d. only the long-run effects on aggregate demand and aggregate supply.

ANS: A
DIF: 1
REF: 34-4
NAT: Analytic
LOC: Monetary and fiscal policy
TOP: Fiscal policy | Monetary policy
MSC: Interpretive