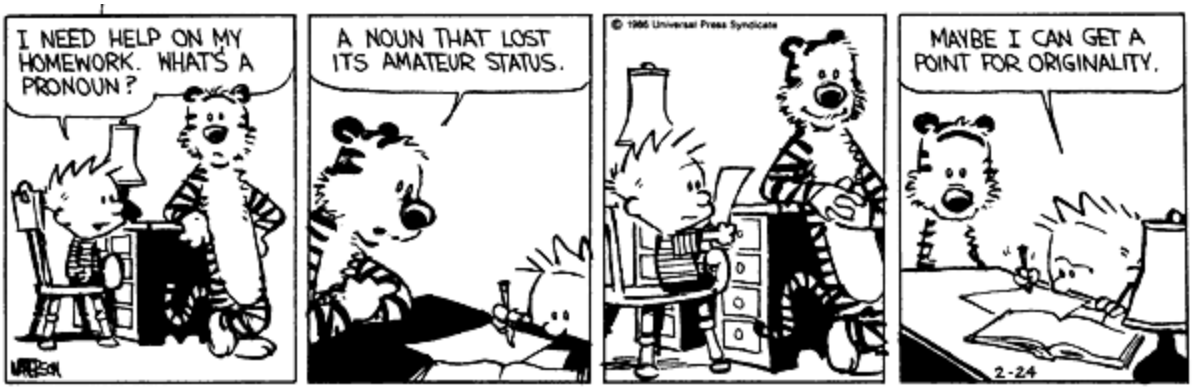
Assignment: Chapter 16



Use this print out copy of the assignment to work on it at your leasure and to keep it as part of your study notes. For your assignment to be graded you MUST submit all you answers on the Blackboard.

Good luck!

Multiple Choice
Identify the choice that best completes the statement or answers the question.

____ 1. 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.

____ 2. 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.

____ 3. 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."

____ 4. 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.

____ 5. 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

____ 6. 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.

____ 7. 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.

____ 8. 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.

____ 9. 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.

____ 10. 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.

____ 11. 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.

____ 12. 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.

____ 13. 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.

____ 14. 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.

____ 15. Suppose that the Federal reserve is concerned about the effects of rising stock prices on the economy. What could it do?
a. buy bonds 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

____ 16. Which of the following sequences best explains the negative slope of the aggregate-demand curve?
a. price level $\uparrow \Rightarrow$ demand for money $\uparrow \Rightarrow$ equilibrium interest rate $\uparrow \Rightarrow$ quantity of goods and services demanded $\downarrow$
b. price level $\uparrow \Rightarrow$ demand for money $\downarrow \Rightarrow$ equilibrium interest rate $\uparrow \Rightarrow$ quantity of goods and services demanded $\downarrow$
c. price level $\downarrow \Rightarrow$ demand for money $\downarrow \Rightarrow$ equilibrium interest rate $\uparrow \Rightarrow$ quantity of goods and services demanded $\downarrow$
d. price level $\uparrow \Rightarrow$ equilibrium interest rate $\uparrow \Rightarrow$ demand for money $\uparrow \Rightarrow$ quantity of goods and services demanded $\downarrow$

____ 17. During the economic downturn of 2008-2009, the Federal Reserve
a. used open-market operations to purchase mortgages and corporate debt, just as it frequently does even when the economy is functioning normally.
b. took the unusual step of using open-market operations to purchase mortgages and corporate debt.
c. explicitly set its target rate of inflation at zero.
d. explicitly set its target rate of inflation well above zero.

____ 18. If the *MPC* = 0.85, then the government purchases multiplier is about
a. 1.18.
b. 3.33.
c. 6.67.
d. 8.5.

____ 19. 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.

____ 20. 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.

____ 21. 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.

____ 22. 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.

____ 23. 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.

____ 24. 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.

____ 25. 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.

____ 26. 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.

____ 27. Assuming a multiplier effect, but no crowding-out or investment-accelerator effects, a $100 billion increase in government expenditures shifts aggregate
a. demand rightward by more than $100 billion.
b. demand rightward by less than $100 billion.
c. supply leftward by more than $100 billion.
d. supply leftward by less than $100 billion.

____ 28. If net exports fall $40 billion and the *MPC* is 8/11 and there is a multiplier effect, but no crowding out and no investment accelerator, then
a. aggregate demand falls by 3 *x* $40 billion.
b. aggregate demand falls by 11/3 *x* $40 billion.
c. aggregate demand falls by 11/8 *x* $40 billion.
d. None of the above is correct.

____ 29. If the *MPC* is 0.75 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
a. $80 billion.
b. $125 billion.
c. $400 billion.
d. $500 billion.

____ 30. Assume the *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.

____ 31. Assume the *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.

____ 32. 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 $150 billion.
b. right by $70 billion.
c. right by $30 billion.
d. None of the above is correct.

Scenario 34-2. The following facts apply to a small, imaginary economy.
- Consumption spending is $5,200 when income is $8,000.
- Consumption spending is $5,536 when income is $8,400.

____ 33. **Refer to Scenario 34-2.** The marginal propensity to consume for this economy is

a. 0.650.
b. 0.659.
c. 0.650 or 0.659, depending on whether income is $8,000 or $8,400.
d. 0.840.

____ 34. **Refer to Scenario 34-2**. The multiplier for this economy is
a. 6.00.
b. 6.25.
c. 8.40
d. 9.00.

____ 35. **Refer to Scenario 34-2.** For this economy, an initial increase of $500 in government purchases translates into a
a. $1,428.57 increase in aggregate demand in the absence of the crowding-out effect.
b. $3,125.00 increase in aggregate demand in the absence of the crowding-out effect.
c. $1,428.57 increase in aggregate demand when the crowding-out effect is taken into account.
d. $3,125.00 increase in aggregate demand when the crowding-out effect is taken into account.

____ 36. **Refer to Scenario 34-2.** In response to which of the following events could aggregate demand increase by $1,500?
a. A stock-market boom stimulates consumer spending by $300, and there is an operative crowding-out effect.
b. A stock-market boom stimulates consumer spending by $225, and there is an operative crowding-out effect.
c. An economic boom overseas increases the demand for U.S. net exports by $300, and there is no crowding-out effect.
d. An economic boom overseas increases the demand for U.S. net exports by $225, and there is no crowding-out effect.

____ 37. **Refer to Scenario 34-2.** In response to which of the following events could aggregate demand increase by $1,500?
a. A stock-market boom increases households' wealth by $300, and there is an operative crowding-out effect.
b. A stock-market boom increases households' wealth by $275, and there is an operative crowding-out effect.
c. An economic boom overseas increases the demand for U.S. net exports by $240, and there is no crowding-out effect.
d. Aggregate demand could increase by $1,500 in response to any of these events.

____ 38. 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.

____ 39. 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.

____ 40. Which of the following sequences best represents the crowding-out effect?
a. government purchases ↑ ⇒ GDP ↑ ⇒ supply of money ↓
⇒ equilibrium interest rate ↑ ⇒ quantity of goods and services demanded ↓
b. government purchases ↓ ⇒ GDP ↓ ⇒ demand for money ↓
⇒ equilibrium interest rate ↓ ⇒ quantity of goods and services demanded ↓
c. government purchases ↑ ⇒ GDP ↑ ⇒ demand for money ↑
⇒ equilibrium interest rate ↑ ⇒ quantity of goods and services demanded ↓
d. taxes ↑ ⇒ GDP ↓ ⇒ demand for money ↓ ⇒ equilibrium interest rate ↑
⇒ quantity of goods and services demanded ↓

____ 41. 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.

____ 42. 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.

____ 43. 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.

____ 44. 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

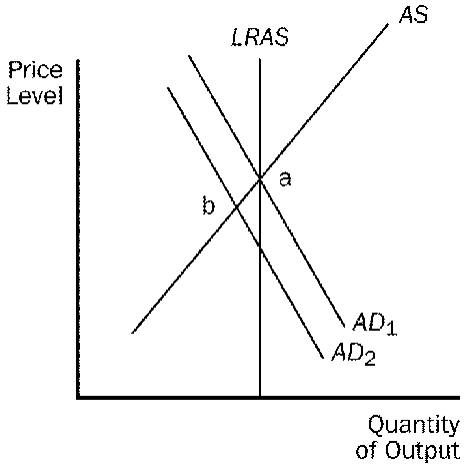
____ 45. The price of imported oil rises. If the government wanted to stabilize output, which of the following could it do?
a. increase government expenditures or increase the money supply
b. increase government expenditures or decrease the money supply
c. decrease government expenditures or increase the money supply
d. decrease government expenditures or decrease the money supply

____ 46. 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

____ 47. 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.

For the following questions, use the diagram below:

Figure 34-7.



____ 48. **Refer to Figure 34-7**. 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.

____ 49. **Refer to Figure 34-7**. 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.

____ 50. **Refer to Figure 34-7**. 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.

____ 51. **Refer to Figure 34-7**. 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.

____ 52. 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.

____ 53. 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.

____ 54. 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.