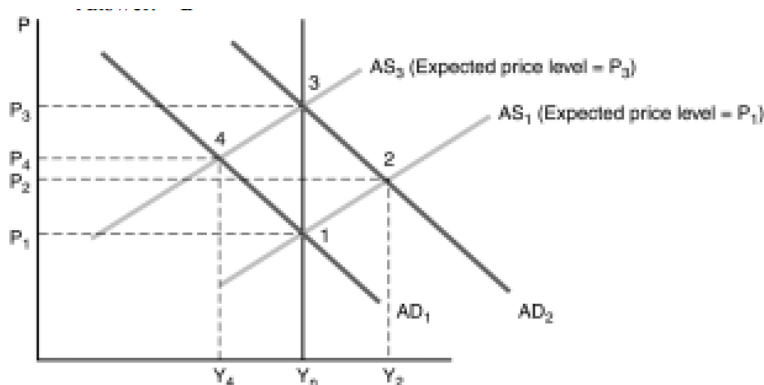


Practice Questions with Answers (for Final)

**13. CHAPTER: Aggregate Supply**

- 1-) What can you expect when there's an oil shock? (c)
- a-) Downward movement along a fixed Phillips curve
  - b-) Upward movement along a fixed Phillips curve
  - c-) Shift up of the Phillips curve
  - d-) Shift down of the Phillips curve
- 2-) Okun's law expresses a relationship between a change in (c)
- a-) the price level and a change in real GDP.
  - b-) the price level and a change in nominal GDP.
  - c-) real GDP and change in the unemployment rate.
  - d-) nominal GDP and a change in the unemployment rate
- 3-) The tradeoff between inflation and unemployment does not exist in the long run because people will adjust their expectations so that expected inflation: (b)
- a-) exceeds the inflation rate.
  - b-) equals the inflation rate.
  - c-) is below the inflation rate.
  - d-) equals the inflation rate of the previous year
- 4-) According to aggregate demand and supply analysis, the favorable supply shocks of 1995–1999 had the effect of (c)
- a-) increasing aggregate output, lowering unemployment, and raising inflation.
  - b-) decreasing aggregate output, raising unemployment, and raising inflation.
  - c-) increasing aggregate output, lowering unemployment, and lowering inflation.
  - d-) decreasing aggregate output, raising unemployment, and lowering inflation.

5-) According to the new classical model, in the Figure below, an anticipated expansionary monetary policy (c)



- a-) shifts the economy from point 1 to point 2 to point 3.
- b-) shifts the economy from point 1 to point 4 to point 3.
- c-) shifts the economy from point 1 to point 3.
- d-) shifts the economy from point 3 to point 1.

6-) Which of the following will shift the aggregate supply curve up to the left? (c)

- a-) an increase in the price level
- b-) a decrease in the level of output
- c-) an increase in the expected price level
- d-) a decrease in the price level

7-) This is an aggregate supply-aggregate demand graph



Which of the following statements best describes the situation shown in the graph? (d)

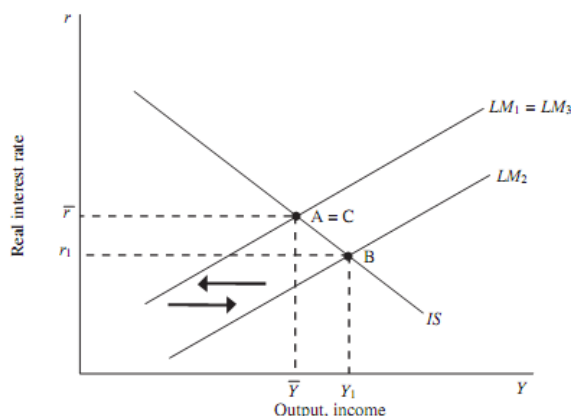
- a-) The economy is suffering from a recession.
- b-) The unemployment rate is greater than the natural rate of unemployment.
- c-) There is not sufficient aggregate demand for the economy to reach long-run equilibrium.
- d-) The economy is producing more than the natural rate of output.

8-) All of the following characteristics that lead to an upward sloping short-run aggregate supply curve (SRAS) except (a)

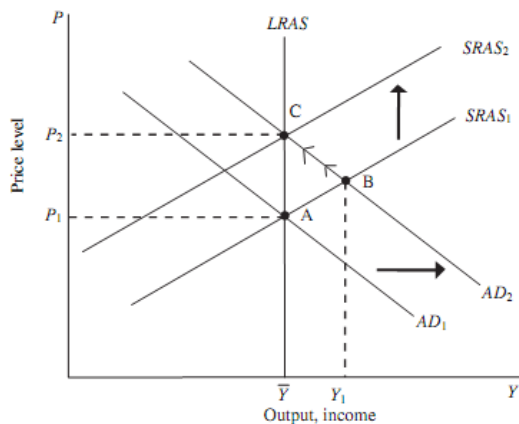
- a-) goods market clearing
- b-) imperfect (sticky) information
- c-) sticky prices or sticky wages
- d-) rational expectations or adaptive expectations

9-) Assume that an economy is in equilibrium where output is at its natural level and the CB decides to increase the money supply.

a-) What happens in the IS-LM model? (Answer: This increase in the money supply will shift the LM curve to the right, resulting in a lower interest rate and higher level of output at point b- In the long run, the price level will rise. Real money balances will decline, and the LM curve will shift back to its original position)

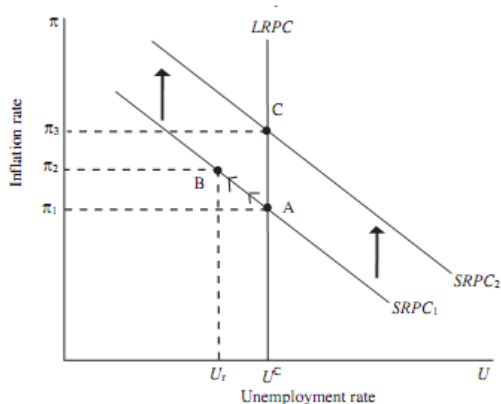


b-) What happens in the AS-AD model?



c-) How does the Phillips Curve for the economy respond? (Answer: The unemployment rate falls below its natural level. This causes a movement along the short run Phillips curve

to point B, where inflation is higher and unemployment is lower. In the long run, expected inflation will rise, causing the Phillips curve to shift upward. The economy ends up at point C with higher inflation and no change in the unemployment rate. The economy moves through this expansionary cycle because the increase in the money supply does not immediately cause expected inflation to rise)



10-) Suppose we have an economy with a natural rate of unemployment of 6%, current expected inflation of 2%, and a Phillips Curve slope parameter of 1/2. Suppose that the CB has a target  $u_t$  for the unemployment rate and a target  $\pi_t$  for the inflation rate, and suppose that for each percentage point inflation is above its target level the CB raises unemployment by an extra percentage point above its target level.

a-) If the target for the inflation rate is 2% and the target for the unemployment rate is 6%, what will inflation and unemployment be?                      2%    %6

b-) If the target for the inflation rate is 3% and the target for the unemployment rate is 4%, what will inflation and unemployment be?                      3.33%    3.33%

## 14. CHAPTER: Stabilization Policy?

- 1-) The outside lag is the time between a:                      (b)
- a-) Shock to the economy and the policy action responding to that shock.
  - b-) Policy action and its influence on the economy.
  - c-) Shock to the economy and the realization that some policy action needs to be taken.
  - d-) Decision to implement a policy and the enactment of that policy.
- 2-) Which of the following is a FALSE statement about automatic stabilizers                      (c)

- a-) They are policies that stimulate or depress the economy when necessary without any deliberate policy change
- b-) They are designed to reduce the lags associated with stabilization policy
- c-) Defense spending is one of them.
- d-) The existence of automatic stabilizers is one of the arguments against active stabilization policy

3-) Which of the following does not describe stabilization policy adequately?. (c)

- a-) It is a demand-side policy
- b-) It consists of fiscal policy and monetary policy
- c-) It aims at long-run trend of the economy.
- d-) It aims at stabilizing business cycles.

4-) The time-inconsistency problem in discretionary policymaking about unemployment and inflation can be effectively avoided when the: (a)

- a-) policymaker has and is known to have an extremely strong preference for very low inflation over unemployment.
- b-) policymaker does not care about the rate of inflation and simply sets policy to avoid unemployment.
- c-) private agents in the economy are not "rational."
- d-) policymaker has more information than do the private agents in the economy

5-) The central bank often deviates from simple policy rules because (d)

- a-) the rules are always wrong.
- b-) they have new and more detailed information.
- c-) they have no discretion.
- d-) the governments are more interested in unemployment.

6-) Monetarists believe all of the following except: (a)

- a-) fiscal policy is responsible for most large fluctuations in the economy.
- b-) the CB should keep the money supply growing at a steady rate
- c-) slow and steady growth of the money supply would yield stable output, employment, and prices.
- d-) the CB should adjust the money supply to adjust to various shocks to the economy

7-) If in response to an increase in government spending, the central bank decides to keep interest rates constant, then in the short run, income will increase (a)

- a-) more than in the case where the central bank keeps the money supply constant.
- b-) less than in the case where the central bank keeps the money supply constant.

- c-) the same as in the case where the central bank keeps the money supply constant.
- d-) more or less than in the case where the central bank keeps money supply constant.
- e-) None of the above answers.

- 8-) What is stagflation? (b)
- a-) Inflation and output both stay low for some years.
  - b-) Inflation stays high and output stays low for some years.
  - c-) Inflation stays low and output stays high for some years.
  - d-) Inflation and output stay high for some years.

## 15. CHAPTER: Government Debt

- 1-) The government is running a budget surplus if (b)
- a-) government spending is greater than tax revenue.
  - b-) tax revenue is greater than government spending.
  - c-) tax revenue is greater than consumption spending.
  - d-) tax revenue is greater than investment spending
- 2-) The financing of government spending by issuing debt (d)
- a-) causes both reserves and the monetary base to rise.
  - b-) causes both reserves and the monetary base to decline.
  - c-) causes reserves to rise, but the monetary base to decline.
  - d-) has no net effect on the monetary base.
- 3-) Which of the following shortcomings with standard national debt and deficit data cause the size of the debt or deficit to be overstated? (d)
- a-) reporting values in nominal terms and not in real terms
  - b-) not counting capital assets
  - c-) not counting future liabilities such as government pensions or social security
  - d-) not adjusting debt levels during an economic boom because tax revenues are higher than average

4-) According to the theory of Ricardian equivalence, if consumers are forward-looking, they will view a tax cut that has no plans to reduce government spending as ..., so their consumption will ... (d)

a-) additional disposable income; increase.

b-) additional disposable income; remain unchanged

c-) a rescheduling of taxes into the future; increase.

d-) a rescheduling of taxes into the future; remain unchanged

5-) When my income was \$100,000, I paid \$10,000 in taxes. When my income became \$200,000, I paid \$30,000 in taxes. My marginal tax rate is: (c)

a-) 10%

b-) 15%

c-) 20%

d-) 30%

6-) Which of the following taxes is progressive? (a)

a-) the income tax

c-) the cigarette tax

b-) the sales tax

d-) the Social Security tax