

Note: This exam consists of 50 multiple choice questions, 2 points each for the maximum total of 100. *Select the best choice and summarize your answers in the separate answer sheet. Turn in both your answers and the exam when you are finished.*

1. The relationship between the quantity of output demanded and the aggregate price level is called:  
A) aggregate demand.  
B) aggregate supply.  
C) aggregate output.  
D) aggregate consumption.
  
2. For a fixed money supply, the aggregate demand curve slopes downward because at a lower price level real money balances are \_\_\_\_\_ generating a \_\_\_\_\_ quantity of output demanded.  
A) higher; greater  
B) higher; smaller  
C) lower; greater  
D) lower; smaller
  
3. If the short-run aggregate supply curve is horizontal, then the:  
A) classical dichotomy is satisfied.  
B) money supply cannot affect prices in the short run.  
C) money supply cannot affect output in the short run.  
D) money supply is irrelevant in the short run.
  
4. If a short-run equilibrium occurs at a level of output above the natural rate, then in the transition to the long run prices will \_\_\_\_\_ and output will \_\_\_\_\_.  
A) increase; increase  
B) decrease; decrease  
C) increase; decrease  
D) decrease; increase
  
5. An adverse supply shock \_\_\_\_\_ the short-run aggregate supply curve \_\_\_\_\_ the natural level of output.  
A) raises; but cannot affect  
B) raises; and may also lower  
C) lowers; but cannot affect  
D) lowers; and may also lower

6. According to the analysis underlying the Keynesian cross, when planned expenditure exceeds income:
- A) income falls.
  - B) planned expenditure falls.
  - C) unplanned inventory investment is negative.
  - D) prices rise.
7. In the loanable funds model, a decrease in income \_\_\_\_\_ national saving and \_\_\_\_\_ the equilibrium interest rate.
- A) increases; increases
  - B) increases; decreases
  - C) decreases; decreases
  - D) decreases; increases
8. The *IS* and *LM* curves together generally determine:
- A) income only.
  - B) the interest rate only.
  - C) both income and the interest rate.
  - D) income, the interest rate, and the price level.
9. Equilibrium levels of income and interest rates are \_\_\_\_\_ related in the goods and services market, and equilibrium levels of income and interest rates are \_\_\_\_\_ related in the market for real money balances.
- A) positively; positively
  - B) positively; negatively
  - C) negatively; negatively
  - D) negatively; positively
10. In the *IS-LM* model when taxation increases, in short-run equilibrium, in the usual case, the interest rate \_\_\_\_\_ and output \_\_\_\_\_.
- A) rises; falls
  - B) rises; rises
  - C) falls; rises
  - D) falls; falls
11. If  $MPC = 0.75$  (and there are no income taxes) when  $G$  increases by 100, then the *IS* curve for any given interest rate shifts to the right by:
- A) 100.
  - B) 200.
  - C) 300.
  - D) 400.

12. Using the *IS-LM* analysis, if the *LM* curve is not horizontal, the multiplier for an increase in government spending is \_\_\_\_\_ for an increase in government purchases using the Keynesian-cross analysis.
- A) larger than the multiplier
  - B) the same as the multiplier
  - C) smaller than the multiplier
  - D) sometimes larger and sometimes smaller than the multiplier
13. The monetary transmission mechanism in the *IS-LM* model is a process whereby an increase in the money supply increases the demand for goods and services:
- A) directly.
  - B) by lowering the interest rate so that investment spending increases.
  - C) by raising the interest rate so that investment spending increases.
  - D) by increasing government spending on goods and services.
14. An increase in the demand for money, at any given income level and level of interest rates, will, within the *IS-LM* framework, \_\_\_\_\_ output and \_\_\_\_\_ interest rates.
- A) increase; lower
  - B) increase; raise
  - C) lower; lower.
  - D) lower; raise
15. In the *IS-LM* model, a decrease in output would be the result of a(n):
- A) decrease in taxes.
  - B) increase in the money supply.
  - C) decrease in money demand.
  - D) increase in government purchases.
16. If domestic saving exceeds domestic investment, then net exports are \_\_\_\_\_ and net capital outflows are \_\_\_\_\_.
- A) positive; positive
  - B) positive; negative
  - C) negative; negative
  - D) negative; positive
17. If a U.S. corporation sells a product in Europe and uses the proceeds to purchase shares in a European corporation, then U.S. net exports \_\_\_\_\_ and net capital outflows \_\_\_\_\_.
- A) increase; increase
  - B) increase; decrease
  - C) decrease; increase
  - D) decrease; decrease

18. If the real exchange rate is high, foreign goods:
- A) and domestic goods are both relatively expensive.
  - B) and domestic goods are both relatively cheap.
  - C) are relatively expensive and domestic goods are relatively cheap.
  - D) are relatively cheap and domestic goods are relatively expensive.
19. In a small open economy, if the government encourages investment, say through an investment tax credit, investment:
- A) increases and is financed through an increase in national saving.
  - B) increases and is financed through an increase in exports.
  - C) increases and is financed through an inflow of foreign capital.
  - D) does not increase; the interest rate rises instead.
20. A depreciation of the real exchange rate in a small open economy could be the result of:
- A) a domestic tax cut.
  - B) an increase in government spending.
  - C) a decrease in the world interest rate.
  - D) the expiration of an investment tax-credit provision.
21. In a small open economy with perfect capital mobility, if the domestic interest rate were to rise above the world interest rate, then \_\_\_\_\_ would drive the domestic interest rate back to the level of the world interest rate.
- A) capital inflow
  - B) capital outflow
  - C) the central bank
  - D) a decline in domestic saving
22. In a small, open economy with a floating exchange rate, an effective policy to decrease equilibrium output is to:
- A) decrease government spending.
  - B) decrease taxes.
  - C) increase the money supply.
  - D) decrease the money supply.
23. In a small, open economy with a floating exchange rate, the exchange rate will appreciate if:
- A) the money supply is increased.
  - B) the money supply is decreased.
  - C) government spending is decreased.
  - D) taxes are decreased.

24. In a small open economy with a floating exchange rate, a rise in government spending in the new short-run equilibrium:
- A) chokes off investment, but not by as much as the new government spending.
  - B) chokes off an amount of investment just equal to the new government spending.
  - C) attracts foreign capital, thus raising the exchange rate and reducing net exports, but not by as much as the new government spending.
  - D) attracts foreign capital, thus raising the exchange rate and reducing net exports by an amount just equal to the new government spending.
25. To maintain a fixed-exchange-rate system, if the exchange rate moves below the fixed-exchange-rate level, then the central bank must:
- A) buy foreign currency.
  - B) sell foreign currency from reserves.
  - C) raise taxes.
  - D) decrease government spending.
26. In a small, open economy with a fixed exchange rate, an effective policy to increase equilibrium output is to:
- A) decrease government spending.
  - B) decrease taxes.
  - C) increase the money supply.
  - D) decrease the money supply.
27. In a small open economy with a fixed exchange rate, if the central bank tries to increase the money supply, then in the new short-run equilibrium:
- A) income rises.
  - B) income falls.
  - C) the exchange rate falls.
  - D) income remains constant.
28. According to the sticky-wage model, an unexpected increase in the price level \_\_\_\_\_ the real wage, \_\_\_\_\_ the quantity of labor hired, and \_\_\_\_\_ the quantity of output produced.
- A) lowers; increases; increases
  - B) lowers; decreases; decreases
  - C) raises; increases; increases
  - D) raises; decreases; decreases

29. According to the imperfect-information model, when the price level rises and the producer expects the price level to rise, the producer:
- A) increases production.
  - B) does not change production.
  - C) decreases production.
  - D) hires more workers.
30. Along a short-run aggregate supply curve, output is related to unexpected movements in the \_\_\_\_\_. Along a Phillips curve, unemployment is related to unexpected movements in the \_\_\_\_\_.
- A) price level; inflation rate
  - B) inflation rate; price level
  - C) unemployment rate; price level
  - D) price level; level of output
31. Fiscal policy has a relatively long \_\_\_\_\_ lag, and monetary policy has a relatively long \_\_\_\_\_ lag.
- A) inside; outside
  - B) outside; inside
  - C) inside; inside
  - D) outside; outside
32. In the case of demand-pull inflation, other things being equal:
- A) both the inflation rate and the unemployment rate rise at the same time.
  - B) the unemployment rate rises but the inflation rate falls.
  - C) the inflation rate rises but the unemployment rate falls.
  - D) both the inflation rate and the unemployment rate fall.
33. In the case of cost-push inflation, other things being equal:
- A) both the inflation rate and the unemployment rate rise at the same time.
  - B) the unemployment rate rises but the inflation rate falls.
  - C) the inflation rate rises but the unemployment rate falls.
  - D) both the inflation rate and the unemployment rate fall.
34. Advocates of the rational expectations approach predict that a credible policy to lower inflation will \_\_\_\_\_ the sacrifice ratio.
- A) raise
  - B) lower
  - C) not change
  - D) sometimes raise and sometimes lower

35. Economists who view the economy as inherently unstable generally argue that:
- A) stabilization policy is too dangerous to be used.
  - B) the economy should be stimulated when it is depressed and slowed when it is overheated.
  - C) the economy should be slowed when it is depressed and stimulated when it is overheated.
  - D) monetary and fiscal policies should follow rigid rules of constant growth.
36. Active economic policy seeks to do *all* of the following *except*:
- A) offset fluctuations in real GDP.
  - B) use monetary and fiscal policy to shift aggregate demand.
  - C) respond to changing economic conditions.
  - D) take a hands-off approach to macroeconomic policy.
37. The lag between the time that economic stimulus is needed and the time that a tax cut is passed by Congress is an example of a:
- A) fiscal inside lag.
  - B) fiscal outside lag.
  - C) monetary inside lag.
  - D) monetary outside lag.
38. Because monetary and fiscal lags are long and variable:
- A) stronger policies must be used.
  - B) successful stabilization policy is completely impossible.
  - C) attempts to stabilize the economy are often destabilizing.
  - D) policy must be completely passive.
39. According to the Lucas critique, when economists evaluate alternative policies they must take into consideration:
- A) how the policies will affect expectations and behavior.
  - B) whether the policy will offset the impact of automatic stabilizers.
  - C) the stage of the political business cycle in which the policy is to be implemented.
  - D) the length of the inside lags associated with the policies.

40. Policy is conducted by rule if policymakers:
- A) announce in advance how policy will respond to various situations and commit themselves to following through on this announcement.
  - B) are free to size up the situation case by case and choose whatever policy seems appropriate at the time.
  - C) set policy according to election results, i.e., set policy by rule of the ballot box.
  - D) manipulate policy to ensure both low inflation and unemployment on election day.
41. A time-inconsistency problem in macroeconomic policy can occur when the policymaker:
- A) is made to follow a strict and an inflexible rule.
  - B) has discretion in the short run but follows a rule in the long run.
  - C) has discretion to act as it seems best in each situation, based on his or her own knowledge and experience.
  - D) has no discretion.
42. In a time of inflation when the government budget is balanced in the conventional sense, the real (i.e., deflated) value of the government debt is:
- A) growing at the rate of inflation.
  - B) growing, but at a rate less than the rate of inflation.
  - C) constant.
  - D) decreasing at the rate of inflation.
43. An estimate of what government spending and tax revenue would be if the economy were operating at its natural rate of output and employment is called the \_\_\_\_\_ budget.
- A) cyclically adjusted
  - B) inflation adjusted
  - C) capital asset
  - D) generational accounting
44. According to the traditional view, if taxes are cut without cutting government spending, then the long-run effects will be \_\_\_\_\_ capital and \_\_\_\_\_ consumption.
- A) higher; higher
  - B) lower; lower
  - C) higher; lower
  - D) lower; higher

45. According to the traditional view, if taxes are cut without cutting government spending, then the short-run effects will be:
- A) higher output and lower unemployment.
  - B) higher output and higher unemployment.
  - C) no change in output or unemployment.
  - D) no change in output and higher unemployment.
46. Ricardian equivalence refers to the same impact of financing government:
- A) whether by printing money or raising taxes.
  - B) in the long run as in the short run.
  - C) whether by debt or taxes.
  - D) in an open economy as in a closed economy.
47. 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 \_\_\_\_\_.
- 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.
48. In response to a tax cut, the consumption of a consumer who is borrowing-constrained \_\_\_\_\_, whereas the consumption of a forward-looking unconstrained consumer acting in accord with Ricardian equivalence \_\_\_\_\_.
- A) increases; increases
  - B) increases; remains unchanged
  - C) remains unchanged; remains unchanged
  - D) remains unchanged; increases
49. Assume that there is a short-run tradeoff between inflation and unemployment, that the central bank desires both low inflation and low unemployment, and that the central bank uses discretion in conducting monetary policy. Initially, households and firms expect high inflation. Following an announcement by the central bank of a low-inflation policy, households and firms will \_\_\_\_\_ the central bank's announcement and \_\_\_\_\_ their expectations of inflation.
- A) believe; lower
  - B) not believe; not change
  - C) believe; not change
  - D) not believe; lower

50. According to the Phillips curve, other things being equal, inflation depends positively on *all* of the following *except*:
- A) expected inflation.
  - B) the unemployment rate.
  - C) the natural unemployment rate.
  - D) a supply shock, if one occurs.