MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

1) Inflation can be started by
   A) an increase in aggregate supply or a decrease in aggregate demand.
   B) a decrease in aggregate supply or an increase in aggregate demand.
   C) an increase in aggregate supply or an increase in aggregate demand.
   D) a decrease in aggregate supply or a decrease in aggregate demand.

2) Demand pull inflation can be started by
   A) a decrease in net exports.
   B) a decrease in the quantity of money.
   C) an increase in government expenditure.
   D) an increase in the price of oil.

3) Which of the following is NOT a potential start of a demand-pull inflation?
   A) an increase in government expenditure
   B) an increase in the money wage rate
   C) an increase in imports
   D) an increase in the quantity of money

4) Initially, demand-pull inflation will
   A) shift the aggregate supply curve rightward.
   B) increase the price level and decrease real GDP.
   C) increase the price level and not change real GDP.
   D) increase both the price level and increase real GDP.

5) If an economy at potential GDP experiences a demand shock that shifts the aggregate demand curve rightward, there will be
   A) an eventual leftward shift in the short-run aggregate supply curve.
   B) upward pressure on money wage rates.
   C) unemployment below the natural rate.
   D) All of the above answers are correct.

6) For an economy at full employment, an increase in the quantity of money will lead to which of the following sequences of shifts in aggregate demand and supply curves?
   A) decreased aggregate demand, increased short-run aggregate supply, constant long-run aggregate supply
   B) increased aggregate demand, increased short-run aggregate supply, increased long-run aggregate supply
   C) increased aggregate demand, decreased short-run aggregate supply, constant long-run aggregate supply
   D) decreased aggregate demand, decreased short-run aggregate supply, decreased long-run aggregate supply

7) In a persisting demand-pull inflation
   A) aggregate demand increases and long-run aggregate supply decreases.
   B) short-run aggregate supply decreases and aggregate demand increases.
   C) aggregate demand and short-run aggregate supply both decrease.
   D) None of the above answers are correct.
8) In a demand-pull inflation, money wage rates rise because
   A) a decrease in aggregate demand creates a labor surplus.
   B) an increase in aggregate demand creates a labor surplus.
   C) a decrease in aggregate demand creates a labor shortage.
   D) an increase in aggregate demand creates a labor shortage.

9) The figure above shows the aggregate demand, short-run aggregate supply, and long-run aggregate supply curves for the U.S. economy. The economy is currently at point A. A demand-pull rise in the price level will initially move the economy to point ________ and to point ________.
   A) B when aggregate demand decreases; C when the wage rate rises
   B) C when the wage rate rises; D when aggregate demand increases
   C) E; A when aggregate demand changes
   D) E when aggregate demand increases; D when the wage rate rises

10) At the start of a cost-push inflation,
    A) the short-run aggregate supply curve shifts rightward.
    B) productivity rises.
    C) real GDP increases faster than the quantity of money.
    D) prices and unemployment are rising.

11) Cost-push inflation starts with
    A) an increase in aggregate demand.
    B) a decrease in aggregate demand.
    C) a decrease in short-run aggregate supply.
    D) an increase in short-run aggregate supply.
12) A leftward shift in the aggregate supply curve
   A) increases both the price level and real GDP.
   B) is the result of the Fed increasing the quantity of money.
   C) is the result of consumer expenditures exceeding available output.
   D) is the result of a rise the price of a key resource.

13) In the short-run, an increase in the price of raw materials will _______ the price level and _______ real GDP.
   A) lower; increase   B) lower; decrease
   C) raise; increase   D) raise; decrease

14) Stagflation occurs when the
   A) price level is decreasing and real GDP is increasing.
   B) price level and real GDP are increasing at the same time.
   C) price level is increasing and real GDP is decreasing.
   D) price level and real GDP are decreasing at the same time.

15) A Phillips curve shows the relationship between the
   A) price level and real GDP.
   B) inflation rate and the unemployment rate.
   C) unemployment rate and real GDP.
   D) inflation rate and real GDP.

16) Which of the following is held constant when moving along a short-run Phillip's curve?
   A) the growth rate of the quantity of money
   B) the inflation rate
   C) the expected inflation rate
   D) the unemployment rate

17) In the short run, an unexpected increase in the inflation rate leads to
   A) workers thinking the money wage rate has fallen.
   B) a lower unemployment rate.
   C) a higher unemployment rate.
   D) a decrease in aggregate demand.

18) If the unemployment rate initially equals its natural rate, then if the inflation rate rises above its expected rate, the unemployment rate ________.
   A) equals the natural rate   B) rises above its natural rate
   C) remains constant   D) falls below its natural rate

19) An increase in the expected inflation rate shifts the
   A) long-run Phillips curve upward.
   B) short-run Phillips curve upward.
   C) short-run Phillips curve downward.
   D) long-run Phillips curve downward.
20) In the above figure, suppose the economy is at point \( A \). An unexpected increase in the inflation rate to 6 percent will result in a movement to point

A) \( A \), that is, there is no movement.
B) \( B \).
C) \( C \).
D) \( D \).

21) The position of the long-run Phillips curve is determined by

A) the natural unemployment rate.
B) the expected inflation rate.
C) the inflation rate.
D) the quantity of money.

22) Which of the following is NOT an aggregate demand, mainstream theory of the business cycle?

A) monetarist cycle theory
B) real business cycle theory
C) Keynesian cycle theory
D) new Keynesian cycle theory

23) Fluctuations in business confidence is the factor leading to business cycles in the ________.

A) Keynesian cycle theory
B) monetarist cycle theory
C) new Keynesian cycle theory
D) new classical cycle theory

24) Fiscal policy involves

A) the use of tax and money policies by government to influence the level of interest rates.
B) decreasing the role of the Federal Reserve in the everyday life of the economy.
C) the use of interest rates to influence the level of GDP.
D) the use of tax and spending policies by the government.

25) What is the largest source of revenue for the federal government?

A) personal income taxes
B) sales tax
C) corporate income taxes
D) Social Security taxes
26) The largest item of government outlays is ________.
   A) transfer payments       B) debt reduction
   C) expenditures on goods and services   D) debt interest

27) Federal government outlays as a percentage of GDP are approximately ________.
   A) 50 percent.       B) 66 percent.    C) 25 percent.    D) 10 percent.

28) A budget surplus occurs when government________.
   A) tax revenues exceeds outlays.
   B) outlays exceeds tax revenues.
   C) tax revenues equals outlays.
   D) tax revenues equal social security expenditures.

29) If tax revenue equal $1.5 billion and government outlays equal $1.6 billion, then the________.
   A) government debt declines by $0.1 billion.
   B) government debt is equal to $0.1 billion.
   C) government budget has a deficit of $0.1 billion.
   D) government budget has a surplus of $0.1 billion.

30) A country has been in existence for only two years. In the first year, tax revenues were $1.0 million and outlays were $1.5 million. In the second year, tax revenues were $1.5 million and outlays were $2.0 million. At the end of the second year, the total government debt was ________.
   A) $1 million       B) $0.5 million      C) $2.5 million     D) $3.5 million

31) The supply side effects of a change in taxes on labor income means that ________ in taxes on labor income shift the ________.
   A) an increase; labor supply curve leftward
   B) an increase; labor supply curve rightward
   C) a decrease; labor demand curve rightward
   D) a decrease; labor demand curve leftward

32) An income tax ________ potential GDP by shifting the ________ curve ________.
   A) decreases; labor demand; leftward
   B) increases; labor demand; rightward
   C) increases; labor supply; rightward
   D) decreases; labor supply; leftward

33) An increase in taxes on interest income ________ supply of loanable funds curve and ________ the demand for loanable funds curve.
   A) does not shift; shifts
   B) does not shift; does not shift
   C) shifts; does not shift
   D) shifts; shifts

34) The supply side effects of a cut in tax rates include ________ in the supply of labor and ________ in the supply of loanable funds.
   A) a decrease; a decrease
   B) an increase; an increase
   C) a decrease; an increase
   D) an increase; a decrease
35) The Laffer curve is the relationship between
   A) tax rates and potential GDP.
   B) tax rates and tax revenue.
   C) government purchases and potential GDP.
   D) tax revenue and potential GDP.

36) A discretionary fiscal policy is a fiscal policy that
   A) requires action by the Congress.
   B) involves a change in government defense spending.
   C) is triggered by the state of the economy.
   D) involves a change in corporate tax rates.

37) One characteristic of automatic fiscal policy is that it
   A) requires no legislative action by Congress to be made effective.
   B) automatically produces surpluses during recessions and deficits during inflation.
   C) reduces the size of the federal government debt during times of recession.
   D) has no effect on unemployment.

38) An example of automatic fiscal policy is when
   A) Congress passes a law that raises tax rates.
   B) the president drafts a bill to reduce defense spending.
   C) Congress decides to cut government expenditure.
   D) tax revenues decrease as real GDP decreases.

39) Government transfer payments _______ during expansions and _______ during recessions.
   A) increase; decrease
   B) decrease; decrease
   C) increase; increase
   D) decrease; increase

40) The structural deficit is the deficit
   A) during an expansion.
   B) during a recession.
   C) caused by the business cycle.
   D) that would occur at full employment.

41) If the budget deficit is $50 billion and the structural deficit is $10 billion, the cyclical deficit is
   A) $10 billion.
   B) $50 billion
   C) $60 billion.
   D) $40 billion.
42) In the above figure, if actual GDP = $15 trillion, there is a budget ______ equal to ______.
   A) surplus; $0.2 trillion  B) deficit; $0.2 trillion
   C) deficit; $1.1 trillion  D) surplus; $1.3 trillion

43) The aggregate demand curve is shifted rightward by
   A) an increase in tax rates.
   B) an increase in government expenditure.
   C) a decrease in government expenditure.
   D) an increase in the federal budget surplus.
44) In the above figure,  
   A) any deficits are cyclical deficits.    B) the structural deficit equals zero.  
   C) any surpluses are cyclical surpluses.  D) All of the above answers are correct.

45) If the government's budget is in surplus even when the economy is at full employment, the surplus is said to be  

46) Which of the following are NOT Federal Reserve monetary policy goals?  
   A) maximum employment    B) zero percent unemployment.  
   C) moderate long-term interest rates    D) price level stability

47) In the short run, the Federal Reserve faces a tradeoff between  
   A) economic growth and employment.    B) inflation and unemployment.  
   C) inflation and price stability.    D) real GDP growth and potential GDP growth.

48) The core inflation rate, measured by the core PCE deflator, measures changes in the  
   A) prices of all consumer goods  
   B) prices of consumer goods except health care.  
   C) price of only two consumer goods: food and fuel  
   D) prices of consumer goods except food and fuel.

49) Ben Bernanke has suggested that a core inflation rate of ________ is the equivalent of price stability.  
   A) less than 5 percent.    B) less than zero  
   C) zero    D) between 1 percent to 2 percent
50) The output gap is the
   A) percentage deviation of real GDP from potential GDP.
   B) difference in graduation levels between high school and college.
   C) percentage increase in the economic growth rate of real GDP.
   D) difference between actual inflation and core inflation.

51) The monetary policy instrument the Federal Reserve choose to use is the
   A) exchange rate.    B) required reserves rate.
   C) federal funds rate.  D) quantity of money.

52) If the Fed sells U.S. government securities,
   A) the federal funds rate rises.  B) None of the above answers is correct.
   C) bank reserves increase.      D) the U.S. Treasury gains some revenue.

53) Monetary policy affects real GDP by
   A) creating budget deficits.  B) creating budget surpluses.
   C) changing aggregate demand.  D) changing aggregate supply.

54) Long-term interest rates are ________ than short-term because long-term loans are ________ than short-term loans.
   A) lower; riskier  B) higher; riskier  C) lower; safer  D) higher; safer

55) When the Fed lowers the federal funds rate, aggregate demand
   A) could increase, decrease or stay the same.
   B) stays the same.
   C) decreases.
   D) increases.

56) When the Fed raises the federal funds rate,
   A) the value of the dollar rises on the foreign exchange market.
   B) consumption increases.
   C) net exports increase.
   D) the value of the dollar falls on the foreign exchange market.

57) If the Fed raises the federal funds rate so that the exchange rate rises, then imports ________ and exports ________.
   A) decrease; increase  B) increase; decrease
   C) decrease; decrease  D) increase; increase

58) Which of the following is NOT a short-run effect of a decrease in the federal funds rate?
   A) Net exports increase.  B) Aggregate supply increases.
   C) Aggregate demand increases.  D) Inflation rate increases.

59) If the Fed fears inflation it will undertake an open market ________ of securities, the federal funds rate will ________ and the long-term real interest rate will ________.
   A) purchase; fall; rise  B) sale; rise; fall
   C) purchase; rise; fall  D) sale; rise; rise
60) Suppose that several European countries enter a recession decreasing U.S. exports. To move U.S. GDP back to potential GDP, the Fed should
A) raise the federal funds rate.
B) increase the government's budget deficit.
C) decrease the government's budget deficit.
D) lower the federal funds rate.

61) The Taylor Rule states that the
A) Fed should adjust the federal funds rate to take account of deviations of inflation from its target and real GDP from potential GDP.
B) Fed should target the monetary base and not the federal funds rate.
C) use of an exchange rate target, although costly, is economically efficient.
D) None of the above is correct.

62) Suppose the equilibrium real interest rate is 2 percent per year, inflation is 2.5 percent and the output gap is 1 percent. Using the Taylor rule, what is the federal funds rate?
A) 5.5 percent  
B) 5.25 percent  
C) 3 percent  
D) 3.5 percent
Answer Key
Testname: FINAL_REVIEW

1) B
2) C
3) B
4) D
5) D
6) C
7) B
8) D
9) D
10) D
11) C
12) D
13) D
14) C
15) B
16) C
17) B
18) D
19) B
20) B
21) A
22) B
23) A
24) D
25) A
26) A
27) C
28) A
29) C
30) A
31) A
32) D
33) C
34) B
35) B
36) A
37) A
38) D
39) D
40) D
41) D
42) A
43) B
44) D
45) A
46) B
47) B
48) D
Answer Key
Testname: FINAL_REVIEW

49) D
50) A
51) C
52) A
53) C
54) B
55) D
56) A
57) B
58) B
59) D
60) D
61) A
62) B