Chapter 25
Aggregate Demand and Supply Analysis

■ Multiple Choice

1) The aggregate demand curve is
(a) the total quantity of an economy's intermediate goods demanded at all price levels.
(b) the total quantity of an economy's intermediate goods demanded at a particular price level.
(c) the total quantity of an economy's final goods and services demanded at a particular price level.
(d) the total quantity of an economy's final goods and services demanded at different price levels.
(e) none of the above.
Answer: D
Question Status: New

2) The total quantity of an economy's final goods and services demanded at different price levels is
(a) the aggregate supply curve.
(b) the aggregate demand curve.
(c) the Phillips curve.
(d) the aggregate expenditure function.
(e) both (b) and (d) of the above.
Answer: B
Question Status: New

3) The aggregate supply curve is
(a) the total quantity of raw materials offered for sale at different prices.
(b) the total quantity of final goods and services offered for sale at the current price level.
(c) the total quantity of final goods and services offered for sale at different price levels.
(d) the total quantity of intermediate and final goods and service offered for sale at different price levels.
(e) the total quantity of final services offered for sale at different price levels.
Answer: C
Question Status: New

4) The total quantity of final goods and services offered for sale at different price levels is
(a) the aggregate supply curve.
(b) the aggregate demand curve.
(c) the Phillips curve.
(d) the 45° line.
(e) both (a) and (d) of the above.
Answer: A
Question Status: New

5) In Friedman's modern quantity theory, changes in the money supply are
(a) unrelated to changes in the price level.
(b) unrelated to changes in inflation.
(c) unrelated to shifts in the aggregate demand curve.
(d) the primary source of changes in aggregate spending.
Answer: D
Question Status: Previous Edition

6) Friedman's modern quantity theory of money concludes that changes in aggregate spending are primarily determined by changes in
(a) government spending and taxes.
(b) the velocity of money.
(c) interest rates.
(d) the money supply.
Answer: D
Question Status: Previous Edition

7) The average number of times per year that a dollar is spent on final goods and services is called
(a) velocity.
(b) acceleration.
(c) the equation of exchange.
(d) none of the above.
Answer: A
Question Status: Previous Edition

8) The modern quantity theory of money is derived from
(a) the concept of velocity.
(b) the Keynesian monetary transmission mechanism.
(c) the equation of exchange.
(d) all of the above.
Answer: C
Question Status: Previous Edition

9) Monetarists determine the aggregate demand curve from
(a) the equation of exchange.
(b) its three component parts: consumer expenditure, investment spending, and government spending.
(c) its four component parts: consumer expenditure, investment spending, government spending, and net exports.
(d) the spending multiplier.

Answer: A
Question Status: Previous Edition

10) The aggregate demand curve slopes downward because a decrease in the price level means a(n) _____ in the real money supply and therefore a _____ level of real spending.
(a) increase; higher
(b) increase; lower
(c) decrease; lower
(d) decrease; higher

Answer: A
Question Status: Previous Edition

11) According to the monetarists an increase in the money supply, other things equal, shifts the aggregate _____ curve to the _____.
(a) demand; right
(b) demand; left
(c) supply; left
(d) supply; right

Answer: A
Question Status: Previous Edition

12) According to monetarists, a decline in the money supply, holding other factors constant, shifts the aggregate _____ curve to the _____.
(a) demand; right
(b) demand; left
(c) supply; right
(d) supply; left

Answer: B
Question Status: Previous Edition

13) Keynesians analyze aggregate demand in terms of its four component parts:
(a) consumer expenditures, planned investment spending, government spending, and net exports.
(b) consumer expenditures, actual investment spending, government spending, and net exports.
(c) consumer expenditures, planned investment spending, government spending, and gross exports.
(d) consumer expenditures, planned investment spending, government spending, and taxes.

Answer: A
Question Status: Previous Edition

14) The Keynesian analysis of aggregate demand indicates that a decline in the price level causes
(a) a decline in the real money supply, an increase in interest rates, a decline in investment spending, and a decline in aggregate output demanded.
(b) a decline in the real money supply, a decline in interest rates, an increase in investment spending, and an increase in aggregate output demanded.
(c) an increase in the real money supply, a decline in interest rates, an increase in investment spending, and an increase in aggregate output demanded.
(d) an increase in the real money supply, an increase in interest rates, a decline in investment spending, and a decline in aggregate output demanded.

Answer: C
Question Status: Previous Edition

15) The aggregate demand curve is downward sloping because
(a) a lower price level, holding the nominal quantity of money constant, leads to a larger quantity of money in real terms, causes the interest rate to fall, and stimulates planned investment spending.
(b) a lower price level, holding the nominal quantity of money constant, leads to a larger quantity of money in nominal terms, causes the interest rate to rise, and stimulates planned investment spending.
(c) a higher price level, holding the nominal quantity of money constant, leads to a larger quantity of money in real terms, causes the interest rate to fall, and stimulates planned investment spending.
(d) a higher price level, holding the nominal quantity of money constant, leads to a smaller quantity of money in real terms, causes the interest rate to fall, and stimulates planned investment spending.

Answer: A
Question Status: Previous Edition

16) The aggregate demand curve is downward sloping because
(a) a lower price level leads to a larger quantity of money in real terms, causing the interest rate to rise, lowering the value of the dollar, and raising net exports.
(b) a lower price level leads to a larger quantity of money in real terms, causing the interest rate to fall, lowering the value of the dollar, and raising net exports.
(c) a higher price level leads to a smaller quantity of money in real terms, causing the interest rate to rise, lowering the value of the dollar, and raising net exports.
(d) a higher price level leads to a smaller quantity of money in real terms, causing the interest rate to rise, raising the value of the dollar, and raising net exports.

Answer: B
Question Status: Previous Edition

17) The aggregate demand curve is downward sloping because

(a) a lower price level, holding the nominal quantity of money constant, leads to a larger quantity of money in real terms, causes the interest rate to fall, and stimulates planned investment spending.

(b) a lower price level leads to a larger quantity of money in real terms, causing the interest rate to fall, lowering the value of the dollar, and raising net exports.

(c) a higher price level, holding the nominal quantity of money constant, leads to a smaller quantity of money in real terms, causes the interest rate to fall, and stimulates planned investment spending.

(d) of both (a) and (b) of the above.

(e) of both (b) and (c) of the above.

Answer: D
Question Status: Previous Edition

18) Keynesians contend that a ______ price level ______ the real quantity of money, _____ higher spending.

(a) lower; expands; encouraging

(b) lower; expands; discouraging

(c) lower; contracts; discouraging

(d) higher; expands; encouraging

(e) higher; expands; discouraging

Answer: A
Question Status: Study Guide

19) The Keynesian analysis of aggregate demand indicates that changes in the money supply

(a) have no effect on aggregate demand.

(b) shift the aggregate demand curve in the opposite direction of the change in government spending.

(c) shift the aggregate demand curve in the same direction as the change in government spending.

(d) move the economy along the aggregate demand curve rather than shifting it.

Answer: C
Question Status: Revised

20) According to the Keynesians, an increase in government spending, other things equal, shifts the aggregate _____ curve to the _____.

(a) demand; right

(b) demand; left

(c) supply; left

(d) supply; right

Answer: A
Question Status: Previous Edition

21) According to the Keynesians, a decrease in government spending, other things equal, shifts the aggregate _____ curve to the _____.
(a) demand; right
(b) demand; left
(c) supply; left
(d) supply; right
Answer: B
Question Status: Previous Edition

22) According to the Keynesians, an increase in taxes, other things equal, shifts the aggregate _____ curve to the _____.
(a) demand; right
(b) demand; left
(c) supply; left
(d) supply, right
Answer: B
Question Status: Previous Edition

23) The Keynesian analysis of aggregate demand indicates that a change in taxes
(a) shifts the aggregate demand curve in the same direction as the change in government spending.
(b) shifts the aggregate demand curve in the direction opposite to that of the change in government spending.
(c) moves the economy along the aggregate demand curve rather than shifting it.
(d) has no effect on aggregate demand.
Answer: B
Question Status: Revised

24) According to the Keynesians, an increase in net exports, other things equal, shifts the aggregate _____ curve to the _____.
(a) demand; right
(b) demand; left
(c) supply; left
(d) supply; right
Answer: A
Question Status: Previous Edition

25) According to the Keynesians, a decrease in net exports, other things equal, shifts the aggregate_____ curve to the _____.
(a) demand; right
(b) demand; left
(c) supply; left
(d) supply; right
Answer: B
Question Status: Previous Edition

26) The Keynesian analysis of aggregate demand indicates that a change in net exports
(a) shifts the aggregate demand curve in the same direction as the change in government spending.
(b) shifts the aggregate demand curve in the direction opposite of the change in government spending.
(c) moves the economy along the aggregate demand curve rather than shifting it.
(d) has no effect on aggregate demand.

Answer: A
Question Status: Revised

27) The Keynesian analysis of aggregate demand indicates that a change in "animal spirits"
(a) shifts the aggregate demand curve in the same direction as the change in government spending.
(b) shifts the aggregate demand curve in the direction opposite to that of the change in government spending.
(c) moves the economy along the aggregate demand curve rather than shifting it.
(d) has no effect on aggregate demand.

Answer: A
Question Status: Revised

28) According to the Keynesian view of aggregate demand
(a) an increase in the money supply lowers interest rates and stimulates planned investment spending.
(b) changes in government spending and taxes, and net exports are important sources of shifts in the aggregate demand curve.
(c) changes in consumer or business optimism can also shift the aggregate demand curve.
(d) all of the above are true.

Answer: D
Question Status: Previous Edition

29) According to the Keynesian view of aggregate demand
(a) an increase in the money supply lowers interest rates and stimulates planned investment spending.
(b) changes in government spending and taxes, and net exports are important sources of shifts in the aggregate demand curve.
(c) changes in consumer or business optimism can also shift the aggregate demand curve.
(d) all of the above are true.

Answer: D
Question Status: Previous Edition

30) According to the Keynesian view of aggregate demand
(a) an increase in the money supply does not shift the aggregate demand curve.
(b) changes in government spending and taxes, and net exports are important sources of shifts in the aggregate demand curve.
(c) changes in consumer or business optimism are not independent sources of shifts in the aggregate demand curve.
(d) all of the above are true.

Answer: B
Question Status: Previous Edition

31) Keynesians believe that
(a) the aggregate demand curve is downward-sloping.
(b) a change in the quantity of money causes the aggregate demand curve to shift.
(c) changes in government spending and taxes do not cause the aggregate demand curve to shift.
(d) all of the above.
(e) only (a) and (b) of the above.

Answer: E
Question Status: Previous Edition

32) Keynesians believe that
(a) the aggregate demand curve is downward-sloping.
(b) a change in the quantity of money causes the aggregate demand curve to shift.
(c) changes in government spending and taxes cause the aggregate demand curve to shift.
(d) all of the above.
(e) only (a) and (b) of the above.

Answer: D
Question Status: Previous Edition

33) Keynesians believe that
(a) the aggregate demand curve is downward-sloping.
(b) changes in government spending and taxes cause the aggregate demand curve to shift.
(c) a change in the quantity of money does not cause the aggregate demand curve to shift.
(d) all of the above.
(e) only (a) and (b) of the above.

Answer: E
Question Status: Previous Edition

34) Keynesians believe all of the following except that
(a) the aggregate demand curve is downward-sloping.
(b) changes in government spending and taxes cause the aggregate demand curve to shift.
(c) a change in the quantity of money does not cause the aggregate demand curve to shift.
(d) none of the above.

Answer: C
Question Status: Previous Edition

35) Keynesians believe all of the following except that
(a) the Federal Reserve should follow a monetary growth rule.
(b) a change in the quantity of money does not cause the aggregate demand curve to shift.
(c) the aggregate demand curve is downward-sloping.
(d) both (a) and (b) of the above.

Answer: D
Question Status: Previous Edition

36) Keynesians believe all of the following except that
(a) the Federal Reserve should follow a monetary growth rule.
(b) a change in the quantity of money causes the aggregate demand curve to shift.
(c) the aggregate demand curve is downward-sloping.
(d) both (a) and (b) of the above.

Answer: A
Question Status: Previous Edition

37) Keynesians believe
(a) that changes in government spending and taxes cause the aggregate demand curve to shift.
(b) that changes in consumer and business willingness to spend can not cause the aggregate demand curve to shift.
(c) that changes in the money supply can not cause the aggregate demand curve to shift.
(d) all of the above.

Answer: A
Question Status: Previous Edition

38) The aggregate demand curve shifts to the right when
(a) taxes are cut.
(b) government spending is reduced.
(c) animal spirits decrease.
(d) the money supply is reduced.
(e) all of the above.

Answer: A
Question Status: New

39) The aggregate demand curve shifts to the right when
(a) the money supply increases.
(b) net exports increase.
(c) taxes are increased.
(d) all of the above.
(e) both (a) and (b) of the above.

Answer: E
Question Status: New

40) The aggregate demand curve increases when
(a) net exports decrease.
(b) taxes increase.
(c) animal spirits increase.
(d) all of the above.
(e) both (b) and (c) of the above.

Answer: C
Question Status: New

41) The aggregate demand curve decreases when
(a) government spending is decreased.
(b) net exports decline.
(c) taxes are increased.
(d) all of the above.
(e) both (a) and (b) of the above.

Answer: D
Question Status: New

42) The aggregate demand curve shifts to the left when
(a) the money supply falls.
(b) the price level increases.
(c) taxes are increased.
(d) all of the above.
(e) both (b) and (c) of the above.

Answer: C
Question Status: New

43) Which of the following does not cause the aggregate demand curve to shift to the right?
(a) An increase in net exports
(b) An increase in government spending
(c) An increase in taxes
(d) An increase in consumer optimism
(e) An increase in the money supply

Answer: C
Question Status: Previous Edition

44) Which of the following does not cause the aggregate demand curve to shift to the left?
(a) A decrease in net exports
(b) A decrease in government spending
(c) A decrease in taxes
(d) A decrease in consumer optimism
(e) A decrease in the money supply

Answer: C
Question Status: Previous Edition

45) Which of the following does not cause the aggregate demand curve to shift to the left?
(a) A decrease in net exports
(b) A decrease in government spending
(c) A decrease in taxes
(d) A decrease in business optimism
(e) A decrease in the money supply

Answer: C
Question Status: Revised

46) A movement up a given aggregate demand curve is the result of

(a) a rising price level.
(b) a rising money supply.
(c) increased taxes.
(d) all of the above.
(e) both (a) and (b) of the above.

Answer: A
Question Status: New

47) A movement down an aggregate demand curve results from

(a) a decrease in the level of prices.
(b) an increase in the money supply.
(c) a negative supply shock.
(d) all of the above.
(e) both (a) and (b) of the above.

Answer: A
Question Status: New

48) "Crowding out" refers to a decrease in

(a) the price level caused by a beneficial supply shock.
(b) investment spending caused by an increase in the interest rate.
(c) excess reserves caused by a currency drain.
(d) excess reserves caused by an increase in reserve requirements.

Answer: B
Question Status: Previous Edition

49) ______ question the effectiveness of ______ policy in changing aggregate _____, since they believe that crowding out of investment will be nearly complete.

(a) Keynesians; fiscal; demand
(b) Keynesians; monetary; demand
(c) Monetarists; monetary; demand
(d) Monetarists; fiscal; demand
(e) Monetarists; monetary; supply

Answer: D
Question Status: Study Guide

50) Monetarists believe that

(a) the aggregate demand curve is downward-sloping.
(b) a change in the quantity of money causes the aggregate demand curve to shift.
(c) changes in government spending and taxes do not cause the aggregate demand curve to shift.
(d) all of the above.

Answer: D
Question Status: Previous Edition

51) Monetarists believe that
(a) the aggregate demand curve is downward-sloping.
(b) a change in the quantity of money causes the aggregate demand curve to shift.
(c) changes in government spending and taxes cause the aggregate demand curve to shift.
(d) all of the above.
(e) only (a) and (b) of the above.
Answer: E
Question Status: Previous Edition

52) While both monetarists and Keynesians view the aggregate demand curve as downward-sloping, monetarists argue that
(a) changes in government spending and taxes are the only factors causing the aggregate demand curve to shift.
(b) a change in the quantity of money is the primary factor causing the aggregate demand curve to shift.
(c) changes in government spending and taxes, in addition to changes in the money supply, cause the aggregate demand curve to shift.
(d) a change in the quantity of money will have no effect on the aggregate demand curve.
Answer: B
Question Status: Previous Edition

53) Although _____ contend that an increase in government spending will "crowd out" private spending, _____ contend that only partial crowding out occurs.
(a) Keynesians; monetarists
(b) Keynesians; Hicksians
(c) monetarists; Keynesians
(d) monetarists; Hicksians
Answer: C
Question Status: Previous Edition

54) Keynesians argue that if crowding out does occur, it will be
(a) incomplete.
(b) complete.
(c) temporary.
(d) none of the above.
Answer: A
Question Status: Previous Edition

55) While both monetarists and Keynesians view the aggregate demand curve as downward sloping, Keynesians believe that
(a) changes in government spending and taxes are the only forces causing the aggregate demand curve to shift.
(b) a change in the quantity of money is the only factor causing the aggregate demand curve to shift.
(c) changes in government spending and taxes, as well as in the money supply, can cause the aggregate demand curve to shift.
(d) a change in the quantity of money will have no effect on the aggregate demand curve.
Answer: C
Question Status: Previous Edition

56) The aggregate supply curve shows the relationship between
(a) the level of inputs and aggregate output.
(b) the price level and the level of inputs.
(c) the wage rate and the level of employment.
(d) the price level and the level of aggregate output supplied.
Answer: D
Question Status: Previous Edition

57) Along a given aggregate supply curve an increase in the price level leads to an increase in aggregate output because
(a) firms increase production in response to higher profits.
(b) workers work more hours, due to the increase in the real wage.
(c) workers work more hours, due to the decrease in the real wage.
(d) none of the above are true.
Answer: A
Question Status: Previous Edition

58) The aggregate supply curve is upward sloping because in the _____ run, costs of many factors that go into producing goods and services are _____, meaning that the price for a unit of output will _____ relative to input prices and the profit per unit will rise.
(a) short; fixed; rise
(b) short; fixed; fall
(c) long; flexible; rise
(d) short; flexible; fall
(e) long; fixed; fall
Answer: A
Question Status: Revised

59) The positively sloped short-run aggregate supply curve reflects the assumption that
(a) factor prices are more flexible than output prices.
(b) output prices are more flexible than factor prices.
(c) factor prices are fixed in the long run.
(d) factor prices are perfectly flexible in both the short run and the long run.
(e) both (a) and (d) of the above.
Answer: B
Question Status: Study Guide

60) The long-run rate of unemployment to which an economy always gravitates is the
(a) normal rate of unemployment.
(b) natural rate of unemployment.
(c) neutral rate of unemployment.
(d) minimum rate of unemployment.
(e) inflationary rate of unemployment.
Answer: B
Question Status: New

61) Which of the following statements are true of the aggregate supply curve?
(a) The aggregate supply curve describes the relationship between the quantity of output supplied in the short run and the price level.
(b) The aggregate supply curve shifts leftward when costs of production increase.
(c) The aggregate supply curve shifts rightward when costs of production decrease.
(d) All of the above.
Answer: D
Question Status: Revised

62) Which of the following statements are true of the aggregate supply curve?
(a) The aggregate supply curve describes the relationship between the quantity of output supplied in the short run and the price level.
(b) The aggregate supply curve shifts to the right when costs of production increase.
(c) The aggregate supply curve shifts to the left when costs decrease.
(d) None of the above.
Answer: A
Question Status: Previous Edition

63) An increase in the cost of production shifts the aggregate _____ curve to the _____.
(a) demand; right
(b) demand; left
(c) supply; right
(d) supply; left
Answer: D
Question Status: Revised

64) When output is _____ the natural rate level, wages will begin to _____, shifting the aggregate supply curve outward.
(a) above; fall
(b) above; rise
(c) below; fall
(d) below; rise
Answer: C
Question Status: Previous Edition

65) When output is _____ the natural rate level, wages will begin to fall, shifting the aggregate _____ curve outward.

(a) above; supply
(b) above; demand
(c) below; supply
(d) below; demand

Answer: C
Question Status: Previous Edition

66) When output is _____ the natural rate level, wages will begin to _____, shifting the aggregate supply curve to the _____.

(a) above; fall; right
(b) above; rise; right
(c) below; fall; right
(d) below; rise; left

Answer: C
Question Status: Revised

67) When output is _____ the natural rate level, wages will begin to rise, shifting the aggregate _____ curve to the _____.

(a) above; supply; right
(b) above; demand; left
(c) below; supply; right
(d) below; demand; left
(e) above; supply; left

Answer: E
Question Status: Previous Edition

68) When actual output exceeds the natural rate level of output

(a) the aggregate demand curve shifts to the left.
(b) the aggregate demand curve shifts to the right.
(c) the aggregate supply curve shifts to the left.
(d) the aggregate supply curve shifts to the right.
(e) neither curve shifts.

Answer: C
Question Status: New

69) When actual output is less than the natural rate level of output

(a) the aggregate demand curve shifts to the left.
(b) the aggregate demand curve shifts to the right.
(c) the aggregate supply curve shifts to the left.
(d) the aggregate supply curve shifts to the right.
(e) neither curve shifts.

Answer: D
Question Status: New

70) The long-run aggregate supply curve is
(a) a vertical line through the non-inflationary rate of output.
(b) a vertical line through the current level of output.
(c) a vertical line through the natural rate level of output.
(d) a horizontal line through the current level of output.
Answer: C
Question Status: Previous Edition

71) The long-run aggregate supply curve is a vertical line passing through
(a) the natural rate of output.
(b) the natural-rate price level.
(c) the actual rate of unemployment.
(d) the expected rate of inflation.
(e) all of the above.
Answer: A
Question Status: Study Guide

72) The fact that an economy always returns to the natural rate level of output is known as
(a) the excess demand hypothesis.
(b) the price-adjustment mechanism.
(c) the self-correcting mechanism.
(d) the NAIRU.
(e) the natural rate of unemployment.
Answer: C
Question Status: New

73) Keynesians believe that the self-correcting mechanism
(a) returns the economy to the natural rate level of aggregate output relatively quickly.
(b) is sufficiently quick to rule out the need for active government involvement to restore the economy to full employment.
(c) takes a long time to restore the economy to the natural rate level of output.
(d) never works.
Answer: C
Question Status: Previous Edition

74) Keynesians contend that
(a) the self-correcting mechanism works slowly because wages are inflexible.
(b) the aggregate supply curve does not move quickly to restore the economy to the natural rate of unemployment.
(c) there is little need for active government policy to restore the economy to full employment when unemployment is high.
(d) only (a) and (b) of the above.
Answer: D
Question Status: Previous Edition

75) Keynesians contend that

(a) the self-correcting mechanism works quickly as competition assures that wages are relatively flexible.

(b) the aggregate supply curve does not move quickly to restore the economy to the natural rate of unemployment.

(c) the Federal Reserve should adopt and follow a money growth rule.

(d) all of the above.

Answer: B
Question Status: Previous Edition

76) Keynesians believe all of the following except

(a) the self-correcting mechanism works slowly because wages are inflexible.

(b) the aggregate supply curve does not move quickly to restore the economy to the natural rate of unemployment.

(c) active government policy is required to restore the economy to full employment when unemployment is high.

(d) the Federal Reserve should adopt and follow a money growth rule.

Answer: D
Question Status: Previous Edition

77) Some economists, particularly Keynesians, believe that the self-correcting mechanism takes a _____ time so that the approach to long-run equilibrium is _____.

(a) long; quick

(b) long; slow

(c) short; quick

(d) short; slow

Answer: B
Question Status: Previous Edition

78) Keynesians

(a) see wages as being sufficiently flexible so that the wage and price adjustment process is reasonably rapid.

(b) see little need for active government policy to restore the economy to full employment when unemployment is high.

(c) advocate the use of a “rule” in which the money supply grows at a constant rate.

(d) hold all of the above views.

(e) hold none of the above views.

Answer: E
Question Status: Previous Edition

79) Evidence suggesting that prices and wages are slow to adjust in response to aggregate demand and supply changes would tend to support
(a) the view that activist macropolicy is necessary to maintain full employment.
(b) the monetarist position regarding macropolicy.
(c) the Keynesian position regarding macropolicy.
(d) both (a) and (c) of the above.
Answer: D
Question Status: Previous Edition

80) Evidence suggesting rapid price and wage adjustment would support
(a) the view that activist macropolicy is necessary to maintain full employment.
(b) the monetarist position regarding macropolicy.
(c) the Keynesian position regarding macropolicy.
(d) both (a) and (b) of the above.
Answer: B
Question Status: Previous Edition

81) Doubts regarding the monetarist contention that the economy adjusts quickly to its long-run equilibrium would be raised by evidence suggesting that
(a) wages are extremely slow to adjust and rigid in the downward direction.
(b) wages and prices are extremely flexible.
(c) supply shocks have almost no effect on the U.S. economy.
(d) none of the above occur.
Answer: A
Question Status: Revised

82) Monetarists contend that
(a) wages are sufficiently flexible so that the wage and price adjustment process is reasonably rapid.
(b) the aggregate supply curve does not move quickly to restore the economy to the natural rate of unemployment.
(c) active government policy is required to restore the economy to full employment when unemployment is high.
(d) none of the above.
Answer: A
Question Status: Previous Edition

83) Monetarists argue that the Federal Reserve should pursue
(a) an interest-rate targeting strategy.
(b) an exchange-rate targeting strategy.
(c) a discretionary monetary policy.
(d) a constant growth rate rule.
Answer: D
Question Status: Previous Edition

84) Monetarists

(a) see wages as being sufficiently flexible so that the wage and price adjustment process is reasonably rapid.
(b) are skeptical of the need for active government policies to restore the economy to full employment.
(c) advocate the use of a money growth rule.
(d) all of the above.
(e) only (a) and (b) of the above.

Answer: D
Question Status: Previous Edition

85) Monetarists

(a) see wages as being sufficiently sticky so that the wage and price adjustment process is reasonably slow.
(b) are skeptical of the need for active government policies to restore the economy to full employment.
(c) argue for active government policy to restore the economy to full employment when unemployment is high.
(d) only (a) and (b) of the above.

Answer: B
Question Status: Previous Edition

86) Monetarists contend that

(a) the self-correcting mechanism works slowly because wages are inflexible.
(b) the aggregate supply curve does not move quickly to restore the economy to the natural rate of unemployment.
(c) active government policy is required to restore the economy to full employment when unemployment is high.
(d) the Federal Reserve should adopt and follow a money growth rule.

Answer: D
Question Status: Previous Edition

87) Monetarists

(a) are skeptical of the need for active government policies to restore the economy to full employment.
(b) advocate the use of a money growth rule.
(c) contend that the self-correcting mechanism works slowly because wages are inflexible.
(d) all of the above.
(e) only (a) and (b) of the above.

Answer: E
Question Status: Previous Edition

88) Monetarists believe all of the following except
(a) that wages are sufficiently flexible so that the wage and price adjustment process is reasonably rapid.
(b) that the aggregate supply curve does not move quickly to restore the economy to the natural rate of unemployment.
(c) that active government policy is required to restore the economy to full employment when unemployment is high.
(d) both (b) and (c) of the above.

Answer: D
Question Status: Revised

89) Monetarists believe all of the following except that
(a) active government policies are required to restore the economy to full employment.
(b) the Federal Reserve should adopt and follow a money growth rule.
(c) the self-correcting mechanism works quickly because wages are sufficiently flexible.
(d) the aggregate supply curve shifts quickly to restore the economy to the natural rate of unemployment.

Answer: A
Question Status: Previous Edition

90) Monetarists
(a) see wages as being sufficiently flexible so that the wage and price adjustment process is reasonably rapid.
(b) see little need for active government policy to restore the economy to full employment when unemployment is high.
(c) advocate the use of a "rule" in which the money supply grows at a constant rate.
(d) hold all of the above views.

Answer: D
Question Status: Previous Edition

91) Monetarists
(a) see wages as being inflexible so that the wage and price adjustment process is relatively slow.
(b) believe in active government policy to restore the economy to full employment when unemployment is high.
(c) advocate the use of a "rule" in which the money supply grows at a constant rate.
(d) hold all of the above views.

Answer: C
Question Status: Previous Edition

92) Economists who believe that the appropriate response to high unemployment is a government policy change to reduce unemployment are known as

(a) activists.
(b) Keynesians.
(c) monetarists.
(d) both (a) and (b) of the above.
(e) both (a) and (c) of the above.

Answer: D
Question Status: New

93) Economists who believe that high unemployment does not require a government policy change to reduce unemployment are known as

(a) nonactivists.
(b) Keynesians.
(c) monetarists.
(d) both (a) and (b) of the above.
(e) both (a) and (c) of the above.

Answer: E
Question Status: New

94) While the initial effect of a _____ shift in the aggregate _____ curve is a rise in both the price level and output, the ultimate effect is only a rise in the price level.

(a) leftward; supply
(b) leftward; demand
(c) rightward; supply
(d) rightward; demand

Answer: D
Question Status: Previous Edition

95) A summary of aggregate demand and supply analysis suggests that

(a) a one-time increase in the money supply will mean a permanent increase in aggregate output.
(b) a one-time increase in government spending will mean a permanent increase in aggregate output.
(c) both (a) and (b) are correct.
(d) none of the above are correct.

Answer: D
Question Status: Previous Edition

96) A summary of aggregate demand and supply analysis suggests that

(a) a one-time increase in the money supply will mean a permanent increase in aggregate output.
(b) a one-time increase in government spending will mean a permanent increase in aggregate output.
(c) changes in monetary or fiscal policy affect output only in the short run.
(d) both (a) and (b) are correct.

Answer: C
Question Status: Previous Edition

97) The aggregate demand-aggregate supply framework indicates that the long-run effect of a ______ in the money supply is an increase in ______.
(a) fall; aggregate output
(b) fall; the price level
(c) rise; aggregate output
(d) rise; the price level
(e) rise; the unemployment rate
Answer: D
Question Status: Study Guide

98) A period of rising prices and rising unemployment indicates that the economy has experienced
(a) a leftward shift of the aggregate demand curve.
(b) a rightward shift of the aggregate demand curve.
(c) a leftward shift of the aggregate supply curve.
(d) a rightward shift of the aggregate supply curve.
(e) a rightward shift of the natural level of output.
Answer: C
Question Status: Study Guide

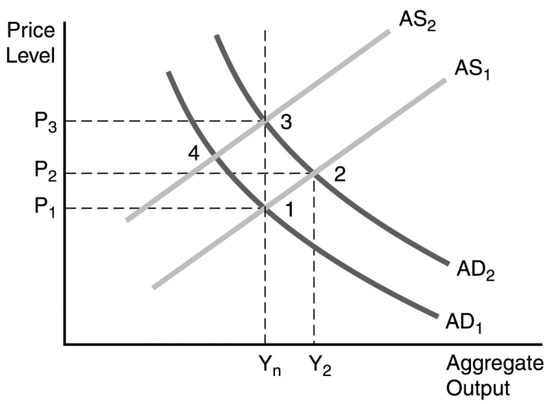


Figure 25-1

99) In Figure 25-1 the economy could be in long-run equilibrium only at
(a) point 1.
(b) point 2.
(c) point 3.
(d) points 1 and 3.
(e) points 1, 2, 3, and 4.
Answer: D
Question Status: Previous Edition

100) In Figure 25-1 the economy could be in short-run equilibrium only at
(a) point 4.
(b) point 2.
(c) points 1 and 3.
(d) points 2 and 4.
(e) points 1, 2, 3, and 4.
Answer: E
Question Status: Previous Edition

101) In Figure 25-1 the economy is not in long-run equilibrium at point 2 because
(a) the labor market is relatively tight, putting upward pressure on wages.
(b) the labor market is relatively tight, putting downward pressure on wages.
(c) the labor market is relatively easy, putting upward pressure on wages.
(d) the labor market is relatively easy, putting downward pressure on wages.
Answer: A
Question Status: Previous Edition

102) In Figure 25-1 the initial effect of an increase in the money supply is illustrated as a movement from
(a) point 1 to point 2.
(b) point 2 to point 3.
(c) point 1 to point 3.
(d) point 2 to point 1.
Answer: A
Question Status: Previous Edition

103) In Figure 25-1 the ultimate effect of an increase in the money supply is illustrated as a movement from
(a) point 1 to point 2.
(b) point 2 to point 3.
(c) point 1 to point 3.
(d) point 2 to point 1.
Answer: C
Question Status: Previous Edition

104) In Figure 25-1 the initial effect of an increase in taxes is illustrated as a movement from
(a) point 4 to point 2.
(b) point 2 to point 1.
(c) point 4 to point 3.
(d) point 3 to point 4.
Answer: D
Question Status: Previous Edition

105) In Figure 25-1 the ultimate effect of an increase in taxes is illustrated as a movement from
(a) point 1 to point 2.
(b) point 2 to point 3.
(c) point 4 to point 3.
(d) point 2 to point 4.
(e) point 3 to point 1.
Answer: E
Question Status: Previous Edition

106) In Figure 25-1 the initial effect of an increase in government spending is illustrated as a movement from
(a) point 1 to point 2.
(b) point 2 to point 3.
(c) point 1 to point 3.
(d) point 2 to point 1.
Answer: A
Question Status: Previous Edition

107) In Figure 25-1 the ultimate effect of an increase in government spending is illustrated as a movement from
(a) point 1 to point 2.
(b) point 2 to point 3.
(c) point 1 to point 3.
(d) point 2 to point 1.
Answer: C
Question Status: Previous Edition

108) In Figure 25-1 the initial effect of a decrease in the money supply is illustrated as a movement from
(a) point 1 to point 4.
(b) point 3 to point 4.
(c) point 1 to point 3.
(d) point 4 to point 1.
(e) point 4 to point 3.
Answer: B
Question Status: Revised

109) In Figure 25-1 the ultimate effect of a decrease in the money supply is illustrated as a movement from
(a) point 1 to point 2.
(b) point 3 to point 1.
(c) point 4 to point 3.
(d) point 1 to point 3.
Answer: B
Question Status: Previous Edition

110) If workers demand and receive higher real wages (a successful wage push), the cost of production _____ and the aggregate supply curve shifts _____.

(a) rises; left
(b) rises; right
(c) falls; left
(d) falls; right

Answer: A
Question Status: Previous Edition

111) If workers expect an increase in the price level, the aggregate _____ curve shifts to the _____.

(a) demand; right
(b) demand; left
(c) supply; left
(d) supply; right

Answer: C
Question Status: Previous Edition

112) A change in workers expectations about the aggregate price level will cause

(a) the aggregate demand curve to shift.
(b) the aggregate supply curve to shift.
(c) the production function to shift.
(d) the transformation function to shift.

Answer: B
Question Status: Previous Edition

113) A decrease in the availability of raw materials that increases the price level is called a(n)

(a) adverse demand shock.
(b) beneficial demand shock.
(c) adverse supply shock.
(d) beneficial supply shock.

Answer: C
Question Status: Previous Edition

114) An adverse or negative supply shock causes the aggregate _____ curve to shift to the _____.

(a) demand; right
(b) demand; left
(c) supply; left
(d) supply; right

Answer: C
Question Status: Previous Edition

115) Which of the following shifts the aggregate supply curve to the right?
(a) An increase in the price of crude oil
(b) A successful wage push by workers
(c) Expectations of a higher aggregate price level
(d) A technological improvement that increases worker productivity

Answer: D
Question Status: Previous Edition

116) A _____ supply shock shifts the aggregate supply curve to the left, while a _____ supply shock shifts the aggregate supply curve to the right.
(a) negative; negative
(b) negative; positive
(c) positive; negative
(d) positive; positive

Answer: B
Question Status: Previous Edition

117) A _____ supply shock, such as unusually good weather or the development of a new technology, _____ production costs and shifts the aggregate supply curve _____.
(a) negative; lowers; rightward
(b) negative; raises; leftward
(c) positive; lowers; rightward
(d) positive; raises; leftward
(e) positive; raises; rightward

Answer: C
Question Status: Previous Edition

118) A _____ supply shock, such as a reduction in the availability of raw materials (like oil), _____ production costs and shifts the aggregate supply curve _____.
(a) negative; lowers; rightward
(b) negative; raises; leftward
(c) positive; lowers; rightward
(d) negative; raises; rightward
(e) positive; raises; rightward

Answer: B
Question Status: Previous Edition

119) OPEC oil price increases or citrus fruit crop freezes are referred to as _____ _____ shocks and cause the aggregate _____ curve to shift ______.
(a) negative demand; demand; left
(b) negative demand; demand; right
(c) negative supply; supply; left
(d) positive supply; supply; left
(e) positive supply; supply; right

Answer: C
Question Status: Study Guide

120) The _____ supply shock from declining oil prices in 1986 did not produce the business cycle boom that had been predicted, in part, because a _____ in net exports that year weakened aggregate _____.

(a) negative; decline; demand
(b) negative; rise; supply
(c) positive; decline; supply
(d) positive; rise; supply
(e) positive; decline; demand

Answer: E
Question Status: Study Guide

121) If negative supply shocks are accommodated by increasing the money supply, output will return to the natural level sooner, but

(a) the price level will return to its pre-shock level.
(b) the price level will increase in the long run.
(c) the price level will decline in the long run.
(d) the price level will remain fixed at the post-shock level.
(e) none of the above.

Answer: B
Question Status: Study Guide

122) Of the following factors, the ones causing the aggregate supply curve to shift include

(a) changes in labor market tightness.
(b) changes in inflationary expectations.
(c) supply shocks including commodity price changes.
(d) attempts by workers to increase their real wages.
(e) all of the above.

Answer: E
Question Status: Study Guide

123) A situation of rising prices and falling output is known as

(a) stagflation.
(b) hyperinflation.
(c) deflation.
(d) disinflation.
(e) accelerating inflation.

Answer: A
Question Status: New

124) Stagflation is a situation of

(a) stable prices and falling output.
(b) stable prices and rising output.
(c) falling prices and falling output.
(d) rising prices and rising output.
(e) rising prices and falling output.

Answer: E
Question Status: New

125) Stagflation is the result of a
(a) positive supply shock.
(b) negative supply shock.
(c) positive demand shock.
(d) negative demand shock.
(e) none of the above.
Answer: B
Question Status: New

126) While a leftward shift in the aggregate supply curve initially _____ the price level and _____ output, the ultimate effect is that output and the price level are unchanged.
(a) raises; lowers
(b) raises; raises
(c) lowers; lowers
(d) lowers; raises
Answer: A
Question Status: Previous Edition

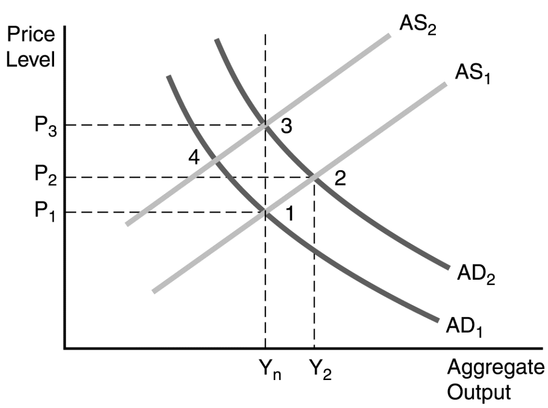


Figure 25-2

127) In Figure 25-2, a negative supply shock shifts the economy from
(a) point 1 to point 4.
(b) point 1 to point 2.
(c) point 3 to point 2.
(d) point 3 to point 4.
(e) point 1 to point 3.
Answer: A
Question Status: New

128) In Figure 25-2, a positive supply shock shifts the economy from
(a) point 1 to point 4.
(b) point 1 to point 2.
(c) point 3 to point 2.
(d) point 3 to point 4.
(e) point 1 to point 3.
Answer: C
Question Status: New

129) In Figure 25-2, an increase in aggregate demand that is followed by wage adjustments causes an economy to follow a path from point
(a) 1 to 2 to 3.
(b) 1 to 4 to 3.
(c) 3 to 2 to 1.
(d) 3 to 4 to 1.
(e) 1 directly to 3.
Answer: A
Question Status: New

130) In Figure 25-2, a reduction of the money supply that is followed by a reduction of wages moves an economy along a path from point
(a) 1 to 2 to 3.
(b) 1 to 4 to 3.
(c) 3 to 2 to 1.
(d) 3 to 4 to 1.
(e) 1 directly to 3.
Answer: D
Question Status: New

131) In Figure 25-2, a negative supply shock that is not accommodated by a demand changing policy moves the economy from point
(a) 1 to 2 to 1.
(b) 3 to 2 to 1.
(c) 1 to 4 to 1.
(d) 3 to 4 to 1.
(e) 3 directly to 1.
Answer: C
Question Status: New

132) A theory of aggregate economic fluctuations called real business cycle theory holds that
(a) changes in the real money supply are the only demand shocks that affect the natural rate of output.
(b) aggregate demand shocks do affect the natural rate of output.
(c) aggregate supply shocks do affect the natural rate of output.
(d) changes in net exports are the only demand shocks that affect the natural rate of output.
Answer: C
Question Status: Previous Edition

133) This theory views shocks to tastes (workers' willingness to work, for example) and technology (productivity) as the major driving forces behind short-run fluctuations in the business cycle because these shocks lead to substantial short-run fluctuations in the natural rate of output.

(a) The natural rate hypothesis
(b) Hysteresis
(c) Real business cycle theory
(d) The Phillips curve model

Answer: C
Question Status: Previous Edition

134) Because shifts in aggregate demand are not viewed as being particularly important to aggregate output fluctuations, they do not see much need for activist policy to eliminate high unemployment. "They" refers to proponents of

(a) the natural rate hypothesis.
(b) monetarism.
(c) the Phillips curve model.
(d) real business cycle theory.

Answer: D
Question Status: Previous Edition

135) A group of economists believe that the natural rate of output is affected by aggregate _____ shocks. They contend that the natural rate level of unemployment and output are subject to _____, a departure from full employment levels as a result of past high unemployment.

(a) supply; hysterisis
(b) supply; systerisis
(c) demand; hysterisis
(d) demand; systerisis

Answer: C
Question Status: Previous Edition

136) A reduction of aggregate demand may raise the natural rate of unemployment above the full employment level, meaning that the self-correcting mechanism will only be able to return the economy to the natural rate level of output and unemployment—not to the full employment levels. Such a view is consistent with

(a) monetarism.
(b) hysterisis.
(c) Keynesianism.
(d) real business cycle theory.

Answer: B
Question Status: Previous Edition

137) Proponents of hysterisis
(a) do not advocate activist, expansionary policies to eliminate high unemployment.
(b) advocate the use of a "rule" in which the money supply grows at a constant rate.
(c) advocate activist, expansionary policies to eliminate high unemployment.
(d) do both (a) and (b) of the above.
Answer: C
Question Status: Previous Edition

138) According to aggregate demand and supply analysis, America's involvement in the Vietnam War had the effect of
(a) increasing aggregate output.
(b) lowering unemployment.
(c) raising the price level.
(d) doing all of the above.
(e) doing only (a) and (b) of the above.
Answer: D
Question Status: Previous Edition

139) According to aggregate demand and supply analysis, America's involvement in the Vietnam War had the effect of
(a) increasing aggregate output and lowering unemployment.
(b) decreasing aggregate output and lowering unemployment.
(c) raising the price level.
(d) doing only (a) and (c) of the above.
(e) doing only (b) and (c) of the above.
Answer: D
Question Status: Previous Edition

140) According to aggregate demand and supply analysis, America's involvement in the Vietnam War had the effect of
(a) increasing aggregate output, lowering unemployment, and raising the price level.
(b) decreasing aggregate output, lowering unemployment, and lowering the price level.
(c) increasing aggregate output, raising unemployment, and raising the price level.
(d) decreasing aggregate output, raising unemployment, and lowering the price level.
(e) increasing aggregate output, lowering unemployment, and lowering the price level.
Answer: A
Question Status: Previous Edition

141) According to aggregate demand and supply analysis, the negative supply shocks of 1973–1975 and 1978–1980 had the effect of
(a) increasing aggregate output.
(b) lowering unemployment.
(c) raising the price level.
(d) doing all of the above.
(e) doing only (a) and (b) of the above.
Answer: C
Question Status: Previous Edition

142) According to aggregate demand and supply analysis, the negative supply shocks of 1973–1975 and 1978–1980 had the effect of

(a) increasing aggregate output and lowering unemployment.
(b) decreasing aggregate output and raising unemployment.
(c) raising the price level.
(d) doing only (a) and (c) of the above.
(e) doing only (b) and (c) of the above.

Answer: E
Question Status: Previous Edition

143) According to aggregate demand and supply analysis, the negative supply shocks of 1973–1975 and 1978–1980 had the effect of

(a) increasing aggregate output, lowering unemployment, and raising the price level.
(b) decreasing aggregate output, raising unemployment, and raising the price level.
(c) increasing aggregate output, raising unemployment, and raising the price level.
(d) decreasing aggregate output, raising unemployment, and lowering the price level.
(e) increasing aggregate output, lowering unemployment, and lowering the price level.

Answer: B
Question Status: Revised

144) According to aggregate demand and supply analysis, the favorable supply shocks of 1995–1999 had the effect of

(a) increasing aggregate output.
(b) lowering unemployment.
(c) lowering inflation.
(d) doing all of the above.
(e) doing only (a) and (b) of the above.

Answer: D
Question Status: Previous Edition

145) According to aggregate demand and supply analysis, the favorable supply shocks of 1995–1999 had the effect of

(a) increasing aggregate output and lowering unemployment.
(b) decreasing aggregate output and raising unemployment.
(c) raising the price level.
(d) doing only (a) and (c) of the above.
(e) doing only (b) and (c) of the above.

Answer: A
Question Status: Previous Edition

146) According to aggregate demand and supply analysis, the favorable supply shocks of 1995–1999 had the effect of
(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.
(e) increasing aggregate output, raising unemployment, and raising inflation.
Answer: C
Question Status: Revised

These additional questions cover the material that is in the appendix to chapter 25, which can be found at the Mishkin textbook web site.

147) The Phillips curve indicates that when the labor market is _____, production costs will _____ and the aggregate supply curve shifts out.
(a) easy; rise
(b) easy; fall
(c) tight; fall
(d) tight; rise
Answer: B
Question Status: Previous Edition

148) The Phillips curve indicates that when the labor market is _____, production costs will _____ and the aggregate supply curve shifts in.
(a) easy; rise
(b) easy; fall
(c) tight; fall
(d) tight; rise
Answer: D
Question Status: Previous Edition

149) In 1967, Milton Friedman criticized the Phillips curve analysis because it failed to account for
(a) changes in workers' expectations of inflation.
(b) changes in nominal wages.
(c) changes in the natural rate of unemployment.
(d) all of the above.
Answer: A
Question Status: Previous Edition

150) The expectations-augmented Phillips curve implies that as expected inflation increases, nominal wages _____ to prevent real wages from _____.
(a) fall; rising
(b) fall; falling
(c) rise; falling
(d) rise; rising
Answer: C
Question Status: Previous Edition

151) According to the expectations-augmented Phillips curve analysis,
(a) continually higher inflation causes continually lower unemployment.
(b) disinflation causes lower unemployment.
(c) no long-run tradeoff between unemployment and wage inflation exists.
(d) none of the above.

Answer: C
Question Status: Previous Edition

152) The Lucas supply function indicates that the deviations of unemployment from the natural rate level respond to
(a) any increase in aggregate demand.
(b) unanticipated inflation.
(c) either (a) or (b) of the above.
(d) neither (a) nor (b) of the above.

Answer: B
Question Status: Previous Edition

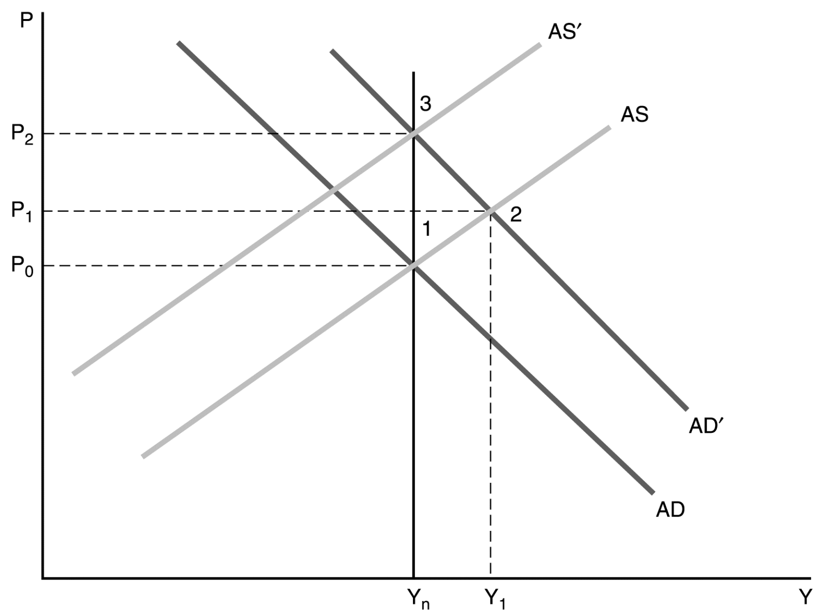
■ Essay Questions

1) Explain why Keynesians believe the aggregate demand curve slopes down with respect to the price level. Be sure to discuss two channels through which changes in prices affect demand.

Answer: A fall in the price level increases the real value of a fixed nominal money supply. This increase in the real money supply lowers interest rates. Lower rates increase investment, thereby increasing aggregate demand. Lower interest rates also cause depreciation of the domestic currency, increasing net exports and aggregate demand.

2) Using the aggregate demand-aggregate supply model, explain and demonstrate graphically the short-run and log-run effects of an increase in the money supply.

Answer: An increase in the money supply shifts the aggregate demand curve to the right, from AD to AD′. The economy moves from point 1 to point 2. In the short run both the price level and real output increase. In the long run, wages adjust, shifting the short-run aggregate supply curve to the left, to AS′, raising prices further and reducing real output until the economy returns to the natural level of output. The long-run result is to only increase the price level. The path is from 1 to 2 to 3.



3) Explain and demonstrate graphically the effects of a negative supply shock. What happens to the economy if no action is taken? What happens if monetary and or fiscal policy is used to reduce unemployment?

Answer: The supply shock shifts the aggregate supply curve back to AS′, reducing real output and raising the price level. If no action is taken, the supply curve eventually adjusts back to the original position. The economy adjusts from 1 to 4 back to 1. If policy actions are implemented, aggregate demand increases to AD′, and the economy returns to full employment at a higher price level. The path is from 1 to 4 to 3.