Chapter 27
Money and Inflation

Multiple Choice

1) The condition of a continually rising price level is defined as
   (a) stagflation.
   (b) stagnation.
   (c) disinflation.
   (d) inflation.
   Answer: D
   Question Status: Previous Edition

2) The economist who proposed that, “Inflation is always and everywhere a monetary phenomenon”
   was
   (a) John Maynard Keynes.
   (b) John R. Hicks.
   (c) Milton Friedman.
   (d) Franco Modigliani.
   Answer: C
   Question Status: Previous Edition

3) Monetarists and Keynesians both agree with Milton Friedman that
   (a) the demand for money is insensitive to changes in the interest rate.
   (b) velocity is predictable and fairly constant.
   (c) inflation is a monetary phenomenon.
   (d) the price level and the money supply are unrelated.
   (e) all of the above are true.
   Answer: C
   Question Status: Previous Edition

4) Complete Milton Friedman’s famous proposition: “Inflation is always and everywhere a ______
   phenomenon.”
   (a) monetary
   (b) political
   (c) policy
   (d) budgetary
   Answer: A
   Question Status: Previous Edition
5) At first cut, the simple solution to fighting inflation is
(a) reducing the growth rate of the money supply.
(b) limiting the number of terms that politicians can serve in elective office.
(c) returning the economy to barter by prohibiting the use of fiat money.
(d) to impose price controls on businesses that attempt to raise prices.
Answer: A

Question Status: Previous Edition

6) “How do we prevent the inflationary fire from igniting again and stop the roller coaster ride in the inflation rate of the last 40 years?” Milton Friedman’s famous proposition suggests the simple solution:
(a) reduce the number of terms that politicians are allowed to serve.
(b) reduce the growth rate of the money supply.
(c) reduce the marginal tax rate on low-income wage earners.
(d) increase the marginal tax rates on businesses that hike prices in excess of 5 percent per year.
Answer: B

Question Status: Revised

7) Milton Friedman’s proposition concerning the cause of inflation implies a simple solution to the inflation problem:
(a) reduce government budget deficits.
(b) limit the ability of fiscal policymakers to bring pressure to bear on the monetary authority.
(c) limit the number of terms that politicians are allowed to serve.
(d) reduce the growth rate of the money supply.
Answer: D

Question Status: Previous Edition

8) Milton Friedman’s proposition that inflation is always and everywhere a monetary phenomenon holds only if
(a) government budget deficits do not rise continually.
(b) the unemployment rate does not rise continually.
(c) the price level rises continually.
(d) the United States does not experience more than one negative supply shock per decade.
Answer: C

Question Status: Previous Edition

9) The monetarists’ proposition that inflation is always and everywhere a monetary phenomenon holds only if
(a) government budget deficits do not rise continually.
(b) the unemployment rate does not rise continually.
(c) the price level rises continually.
(d) the United States does not experience more than one negative supply shock per decade.
Answer: C

Question Status: Previous Edition
10) The Keynesians are willing to accept the monetarists’ proposition that inflation is a monetary phenomenon under the condition that
(a) government budget deficits do not rise continually.
(b) the unemployment rate does not rise continually.
(c) the price level rises continually.
(d) the United States does not experience more than one negative supply shock per decade.
Answer: C
Question Status: Previous Edition

11) Inflation occurs whenever
(a) the price level rises.
(b) the money supply increases.
(c) the price level rises continuously over a period of time.
(d) the price level falls continuously over a period of time.
(e) none of the above occur.
Answer: C
Question Status: Study Guide

12) Evidence strongly supports the view that countries with high inflation also have
(a) the lowest nominal interest rates.
(b) the highest rates of money growth.
(c) the smallest budget deficits.
(d) the lowest interest rates.
Answer: B
Question Status: Previous Edition

13) Countries with the highest inflation rates are likely to have
(a) the highest rates of money growth.
(b) large budget deficits.
(c) the lowest interest rates.
(d) both (a) and (b) of the above.
Answer: D
Question Status: Previous Edition

14) Countries with the highest inflation rates are likely to have
(a) the highest rates of money growth.
(b) small budget deficits relative to GDP.
(c) the lowest interest rates.
(d) all of the above.
Answer: A
Question Status: Previous Edition
15) The proposition that inflation is the result of a high rate of money growth is
(a) not supported by evidence from the German hyperinflation.
(b) held only by sociologists and is no longer believed by economists.
(c) supported by evidence from inflationary episodes throughout the world.
(d) largely a political fabrication designed to make the Fed a scapegoat for poor fiscal policy.
Answer: C
Question Status: Revised

16) Which of the following would provide the strongest evidence that rapid money growth is the driving force behind inflation?
(a) An endogenous increase in the money supply that preceded the onset of inflation
(b) An exogenous increase in the money supply that preceded the onset of inflation
(c) An endogenous increase in the money supply that lagged the onset of inflation
(d) An exogenous increase in the money supply that lagged the onset of inflation
Answer: B
Question Status: Previous Edition

17) The German hyperinflation of 1921–1923 provides important support for the view that high money growth causes high inflation because
(a) the growth in the German money supply appears to have been due to exogenous forces.
(b) reverse causation in this case is highly implausible.
(c) it is hard to imagine a third factor that could have been the driving force behind both inflation and explosion in the German money supply.
(d) of all of the above.
(e) of only (a) and (b) of the above.
Answer: D
Question Status: Previous Edition

18) The initiating causes of the inflationary monetary policy adopted by the German authorities in the early 1920s included
(a) the government’s unwillingness to raise taxes to finance war reparations.
(b) the government’s inability to borrow sufficient funds to finance its expenditures.
(c) the government’s unwillingness to print additional fiat currency.
(d) all of the above.
(e) only (a) and (b) of the above.
Answer: E
Question Status: New

19) The German authorities in the early 1920s appear to have resorted to increasing the money supply as a way of raising revenues because
(a) raising taxes would have been politically unpopular.
(b) raising taxes would have been unconstitutional.
(c) there was no way to collect taxes in those days.
(d) none of the above.
Answer: A
Question Status: Previous Edition
20) The German hyperinflation of the 1920s supports the proposition that excessive monetary growth causes inflation and not the other way around since the increase in monetary growth appears to have been
   (a) unintentional.
   (b) intentional.
   (c) simultaneous.
   (d) exogenous.
   (e) endogenous.
   Answer: D
   Question Status: Study Guide

21) Evidence for Latin American countries over the ten-year period 1989–1999 indicates that
   (a) in every case in which a country’s inflation rate is extremely high for any sustained period of time, its rate of money growth is extremely high.
   (b) a country can experience high inflation for a sustained period of time without an increase in its rate of money growth.
   (c) a country can experience a significant increase in its money supply for a sustained period of time without an increase in its rate of inflation.
   (d) both (b) and (c) above are possible.
   Answer: A
   Question Status: Revised

22) A one-time increase in the price level
   (a) is rarely reported by the news media as inflation, but is nevertheless considered to be inflation by economists.
   (b) is regularly reported by the news media as inflation, but is not considered to be inflation by economists.
   (c) is rarely reported by the news media as inflation because it is not considered to be inflation by economists.
   (d) is regularly reported by the news media as inflation because it is considered to be inflation by economists.
   Answer: B
   Question Status: Previous Edition

23) A one-time increase in the money supply
   (a) is synonymous with inflation.
   (b) cannot cause inflation.
   (c) leads to an increase in the price level.
   (d) results in both (a) and (c) of the above.
   (e) results in both (b) and (c) of the above.
   Answer: E
   Question Status: Previous Edition
24) If inflation is defined as a condition of a continually, rapidly rising price level, then
(a) monetarists contend that inflation is a monetary phenomenon.
(b) Keynesians are willing to accept that inflation is a monetary phenomenon.
(c) Keynesians are unwilling to accept that inflation is a monetary phenomenon.
(d) both (a) and (b) of the above.
Answer: D
Question Status: Previous Edition

25) If inflation is defined as a condition of a continually, rapidly rising price level, then
(a) Keynesians contend that inflation is not a monetary phenomenon.
(b) monetarists are unwilling to accept that inflation is a monetary phenomenon.
(c) both (a) and (b) of the above.
(d) neither (a) nor (b) of the above.
Answer: D
Question Status: Previous Edition

26) If inflation is defined as a condition of a continually, rapidly rising price level, then
(a) monetarists are unwilling to accept that inflation is a monetary phenomenon.
(b) Keynesians are willing to accept that inflation is a monetary phenomenon.
(c) Keynesians are unwilling to accept that inflation is a monetary phenomenon.
(d) both (a) and (b) of the above.
Answer: B
Question Status: Previous Edition

27) When inflation is defined to be a condition of a continually rising price level,
(a) only monetarists agree with Milton Friedman’s proposition that inflation is a monetary phenomenon.
(b) only Keynesians agree with Milton Friedman’s proposition that inflation is a monetary phenomenon.
(c) both monetarists and Keynesians agree with Milton Friedman’s proposition that inflation is a monetary phenomenon.
(d) neither monetarists nor Keynesians agrees with Milton Friedman’s proposition that inflation is a monetary phenomenon.
Answer: C
Question Status: Previous Edition

28) According to monetarist analysis, in order for inflation to occur,
(a) the money supply must continually increase, causing the aggregate demand curve to continually shift right.
(b) the aggregate supply curve must continually shift left, as wages rise in response to higher prices.
(c) the price level must continually rise.
(d) all of the above must occur.
(e) only (a) and (c) of the above must occur.
Answer: D
Question Status: Previous Edition
29) According to monetarist analysis, in order for inflation to occur,
   (a) the money supply must continually increase, causing the aggregate demand curve to continually shift right.
   (b) the aggregate supply curve must continually shift right, as wages rise in response to higher prices.
   (c) the price level must continually rise.
   (d) only (a) and (c) of the above must occur.
   Answer: D
   Question Status: Previous Edition

30) Factors other than money growth that can generate an inflation in monetarist analysis include:
   (a) an increase in government spending.
   (b) a tax reduction.
   (c) an increase in net exports.
   (d) none of the above.
   Answer: D
   Question Status: Previous Edition

31) According to the monetarists, inflation is caused by
   (a) supply shocks.
   (b) expansionary fiscal policies.
   (c) expansionary monetary policies.
   (d) rising prices.
   Answer: C
   Question Status: Previous Edition

32) According to the monetarists, inflation is caused by
   (a) supply shocks.
   (b) expansionary fiscal policies.
   (c) expansionary monetary policies.
   (d) government regulations.
   Answer: C
   Question Status: Revised

33) According to the monetarist view of inflation, an increase in the money supply will
   (a) increase output above the natural rate level for a brief period of time.
   (b) have no lasting effect on real output.
   (c) cause prices to rise.
   (d) all of the above.
   Answer: D
   Question Status: Previous Edition
34) According to the monetarist view of inflation, an increase in the money supply will cause
(a) output to increase in the short run, but not in the long run.
(b) an increase in the price level, but no permanent effect on aggregate output.
(c) government budget deficits to increase.
(d) all of the above.
(e) only (a) and (b) of the above.
Answer: E
Question Status: Previous Edition

35) According to the monetarist view of inflation, a continually increasing money supply
(a) causes the aggregate demand curve to shift continually to the right.
(b) causes the aggregate demand curve to shift continually to the left.
(c) is shown as a movement along the aggregate demand curve.
(d) does none of the above.
Answer: A
Question Status: Previous Edition

36) According to the monetarist view of inflation, a continually increasing money supply causes
(a) the aggregate demand curve to shift continually to the right, and the price level to increase continually.
(b) the aggregate demand curve to shift continually to the left, and the price level to increase continually.
(c) the aggregate supply curve to shift continually to the right, and the price level to increase continually.
(d) none of the above.
Answer: A
Question Status: Previous Edition

37) According to the monetarist view of inflation, a continually increasing money supply causes
(a) the aggregate demand curve to shift right along a stationary aggregate supply curve, leading to continually increasing aggregate output and prices.
(b) the aggregate supply curve to shift left along a stationary aggregate demand curve, leading to continually contracting aggregate output and prices.
(c) the aggregate demand curve to shift continually to the right as the aggregate supply curve shifts continually inward, leading to higher and higher price levels.
(d) the aggregate demand curve to shift continually to the left as the aggregate supply curve shifts continually outward, leading to higher and higher price levels.
Answer: C
Question Status: Previous Edition
38) In Figure 27-1, the initial effect of an increase in the money supply is to shift the economy from
(a) point 1 to point 2.
(b) point 2 to point 1.
(c) point 1 to point 1’.
(d) point 1’ to point 1.
(e) point 1 to point 4.
Answer: C
Question Status: New

39) In Figure 27-1, a one-time increase in the money supply causes
(a) the aggregate demand curve to shift from \( AD_1 \) to \( AD_2 \).
(b) the aggregate demand curve to shift from \( AD_1 \) to \( AD_2 \) to \( AD_3 \) to \( AD_4 \).
(c) the aggregate supply curve to shift from \( AS_1 \) to \( AS_2 \).
(d) the aggregate supply curve to shift from \( AS_1 \) to \( AS_2 \) to \( AS_3 \) to \( AS_4 \).
(e) no change in the graph.
Answer: A
Question Status: New

40) In Figure 27-1, a continuous increase in the money supply causes
(a) the aggregate demand curve to shift from \( AD_1 \) to \( AD_2 \).
(b) the aggregate demand curve to shift from \( AD_1 \) to \( AD_2 \) to \( AD_3 \) to \( AD_4 \).
(c) the aggregate supply curve to shift from \( AS_1 \) to \( AS_2 \).
(d) the aggregate supply curve to shift from \( AS_1 \) to \( AS_2 \) to \( AS_3 \) to \( AS_4 \).
(e) no change in the graph.
Answer: B
Question Status: New
41) In Figure 27-1, the adjustment of wages to output above the natural rate causes
(a) the aggregate demand curve to shift from AD1 to AD2.
(b) the aggregate demand curve to shift from AD1 to AD2 to AD3 to AD4.
(c) the aggregate supply curve to shift from AS1 to AS2.
(d) the aggregate supply curve to shift from AS1 to AS2 to AS3 to AS4.
(e) no change in the graph.
Answer: D
Question Status: New

42) In Figure 27-1, a one-time increase in government spending causes
(a) the aggregate demand curve to shift from AD1 to AD2.
(b) the aggregate demand curve to shift from AD1 to AD2 to AD3 to AD4.
(c) the aggregate supply curve to shift from AS1 to AS2.
(d) the aggregate supply curve to shift from AS1 to AS2 to AS3 to AS4.
(e) no change in the graph.
Answer: A
Question Status: New

43) In Figure 27-1, the initial impact of a one-time increase in government spending causes the economy to shift from
(a) point 1 to point 2.
(b) point 2 to point 1.
(c) point 1 to point 1′.
(d) point 1′ to point 1.
(e) point 1 to point 4.
Answer: C
Question Status: New

44) According to Keynesian analysis, a continuous increase in the money supply causes
(a) the price level to increase, but has no lasting effect on the inflation rate.
(b) the price level to fall.
(c) inflation.
(d) output to increase, but leaves the price level and inflation unchanged.
(e) none of the above.
Answer: C
Question Status: Study Guide

45) According to Keynesian analysis, in order for inflation to occur,
(a) the money supply must continually increase, causing the aggregate demand curve to continually shift right.
(b) the aggregate supply curve must continually shift left, as wages rise in response to higher prices.
(c) the price level must continually rise.
(d) all of the above.
(e) only (a) and (c) of the above.
Answer: D
Question Status: Previous Edition
46) According to Keynesian analysis, in order for inflation to occur,
   (a) the money supply must continually increase, causing the aggregate demand curve to continually shift right.
   (b) the aggregate supply curve must continually shift right, as wages rise in response to higher prices.
   (c) the price level must continually rise.
   (d) all of the above.
   (e) only (a) and (c) of the above.
   Answer: E
   Question Status: Previous Edition

47) Keynesians conclude that rapidly growing _____ will cause the price level to rise continually, thus generating an inflation.
   (a) money supply
   (b) government spending
   (c) interest rates
   (d) consumer expenditure
   Answer: A
   Question Status: Previous Edition

48) According to Keynesian analysis, an increase in government spending will shift the aggregate demand curve to the _____, causing output to _____ above the natural rate level.
   (a) right; fall
   (b) right; rise
   (c) left; fall
   (d) left; rise
   Answer: B
   Question Status: Previous Edition

49) According to Keynesian analysis, a(n) _____ in government spending will shift the aggregate demand curve to the right, causing output to rise above the natural rate level. The aggregate supply curve will shift _____, and the price level will rise.
   (a) increase; rightward
   (b) increase; leftward
   (c) decrease; rightward
   (d) decrease; leftward
   Answer: B
   Question Status: Previous Edition

50) According to Keynesian analysis,
   (a) a continually increasing level of government expenditure could cause a continually rising price level.
   (b) a continually increasing level of government expenditure is not a politically feasible policy.
   (c) high inflation cannot be driven by fiscal policy alone.
   (d) all of the above.
   Answer: D
   Question Status: Previous Edition
51) According to Keynesian analysis,
   (a) a continually increasing level of government expenditure could cause a continually rising price level, but this is not a politically feasible policy.
   (b) negative supply shocks cannot drive a continually rising price level.
   (c) high inflation cannot be driven by fiscal policy alone.
   (d) all of the above.
   (e) only (a) and (b) of the above.
   Answer: D
   Question Status: Previous Edition

52) According to Keynesian analysis,
   (a) high inflation can be driven by fiscal policy alone.
   (b) negative supply shocks can cause a continually rising price level.
   (c) the money supply must continually increase for inflation to occur.
   (d) only (a) and (c) of the above are true.
   Answer: C
   Question Status: Previous Edition

53) According to Keynesian analysis,
   (a) the net result of the negative supply shock is that we return to full employment at the initial price level and an inflation does not result.
   (b) negative supply shocks cannot drive a continually rising price level.
   (c) high inflation can be driven by fiscal policy alone.
   (d) only (a) and (b) of the above.
   Answer: D
   Question Status: Previous Edition

54) According to the Keynesians, inflation is caused by
   (a) supply shocks.
   (b) expansionary fiscal policies.
   (c) expansionary monetary policies.
   (d) rising prices.
   Answer: C
   Question Status: Previous Edition

55) According to the Keynesians, inflation is caused by
   (a) supply shocks.
   (b) expansionary fiscal policies.
   (c) expansionary monetary policies.
   (d) wage push.
   Answer: C
   Question Status: Previous Edition
56) Keynesian analysis indicates that a continually increasing money supply will cause
   (a) a one-time increase in the price level.
   (b) the price level to rise continually.
   (c) employment to decline continually.
   (d) unemployment to decline continually.
   Answer: B
   Question Status: Previous Edition

57) Keynesian analysis indicates that
   (a) a one-time increase in government expenditures leads to only a temporary increase in the
       inflation rate.
   (b) a continually increasing level of government expenditures is not a feasible policy.
   (c) negative supply shocks are the source of high inflation in the United States.
   (d) only (a) and (b) of the above are correct.
   Answer: D
   Question Status: Previous Edition

58) Keynesian analysis indicates that
   (a) a one-time increase in government expenditures leads to only a temporary increase in the
       inflation rate.
   (b) a continually increasing level of government expenditures is not a feasible policy.
   (c) negative supply shocks are not the source of high inflation in the United States.
   (d) all of the above are correct.
   (e) only (a) and (b) of the above are correct.
   Answer: D
   Question Status: Previous Edition

59) Keynesian analysis indicates that
   (a) supply-side phenomena are one source of high inflation.
   (b) fiscal policy actions drive changes in the price level.
   (c) inflation is not a monetary phenomenon.
   (d) all of the above are correct.
   (e) none of the above are correct.
   Answer: E
   Question Status: Previous Edition

60) Keynesian analysis indicates that
   (a) supply-side phenomena cannot be the sole source of high inflation.
   (b) high inflation cannot be driven by fiscal policy alone.
   (c) inflation is a monetary phenomenon.
   (d) all of the above are correct.
   Answer: D
   Question Status: Previous Edition
61) According to the Keynesian view of inflation, an increase in the money supply will
(a) increase output above the natural rate level for a brief period of time.
(b) have no lasting effect on real output.
(c) cause prices to rise.
(d) do all of the above.
Answer: D
Question Status: Previous Edition

62) According to the Keynesian view of inflation, an increase in the money supply will cause
(a) output to increase in the short run, but not in the long run.
(b) an increase in the price level, but no permanent effect on aggregate output.
(c) government budget deficits to increase.
(d) all of the above.
(e) only (a) and (b) of the above.
Answer: E
Question Status: Previous Edition

63) According to the Keynesian view of inflation, a continually increasing money supply
(a) causes the aggregate demand curve to shift continually to the right.
(b) causes the aggregate demand curve to shift continually to the left.
(c) is shown as a movement along the aggregate demand curve.
(d) does none of the above.
Answer: A
Question Status: Previous Edition

64) According to the Keynesian view of inflation, a continually increasing money supply causes
(a) the aggregate demand curve to shift continually to the right, and the price level to increase continually.
(b) the aggregate demand curve to shift continually to the left, and the price level to increase continually.
(c) the aggregate supply curve to shift continually to the right, and the price level to increase continually.
(d) none of the above.
Answer: A
Question Status: Previous Edition

65) According to the Keynesian view of inflation, a continually increasing money supply causes
(a) the aggregate demand curve to shift right along a stationary aggregate supply curve, leading to continually increasing aggregate output and prices.
(b) the aggregate supply curve to shift left along a stationary aggregate demand curve, leading to continually contracting aggregate output and prices.
(c) the aggregate demand curve to shift continually to the right as the aggregate supply curve shifts continually inward, leading to higher and higher price levels.
(d) the aggregate demand curve to shift continually to the left as the aggregate supply curve shifts continually outward, leading to higher and higher price levels.
Answer: C
Question Status: Previous Edition
66) Keynesian analysis indicates that negative supply shocks
   (a) decrease the price level, but cannot decrease the inflation rate.
   (b) increase the price level, but cannot increase the inflation rate.
   (c) increase both the price level and the inflation rate.
   (d) decrease both the price level and the inflation rate.
   Answer: B
   Question Status: Previous Edition

67) In the absence of accommodating policy, the net result of a negative supply shock is that
   (a) the economy returns to full employment at the initial price level.
   (b) the economy returns to full employment at a higher price level.
   (c) the economy returns to full employment at a lower price level.
   (d) aggregate output increases above the natural rate level, but only temporarily.
   Answer: A
   Question Status: Previous Edition

68) A continually increasing level of government expenditures cannot cause high inflation because
   (a) constitutional budget constraints limit policymakers’ ability to raise spending.
   (b) public and political perceptions impose limits on the degree to which government expenditures can increase.
   (c) politicians cannot increase expenditures without increasing taxes.
   (d) of none of the above.
   Answer: B
   Question Status: Previous Edition

69) Factors other than money growth that can generate an inflation in Keynesian analysis include
   (a) an increase in government spending.
   (b) a tax reduction.
   (c) an increase in net exports.
   (d) none of the above.
   Answer: D
   Question Status: Previous Edition

70) A one-shot increase in government expenditure causes
   (a) continual inflation.
   (b) continual wage increase.
   (c) a one-shot increase in the price level.
   (d) a one-shot increase in unemployment.
   Answer: C
   Question Status: Previous Edition
71) According to Keynesians, a one-shot increase in government spending causes
   (a) a permanent increase in the inflation rate.
   (b) a temporary increase in the inflation rate.
   (c) a permanent decrease in the inflation rate.
   (d) a temporary decrease in the inflation rate.
   (e) no change in aggregate demand.
   Answer: B
   Question Status: Study Guide

Figure 27.2

72) In Figure 27.2, the initial impact of a one-time increase in government spending causes the economy
to move from
   (a) point 1 to point 2.
   (b) point 2 to point 1.
   (c) point 1 to point 1′.
   (d) point 1′ to point 1.
   (e) stay at point 1.
   Answer: C
   Question Status: New

73) In Figure 27.2, the initial impact of a tax cut causes the economy to move from
   (a) point 1 to point 2.
   (b) point 2 to point 1.
   (c) point 1 to point 1′.
   (d) point 1′ to point 1.
   (e) stay at point 1.
   Answer: C
   Question Status: New
74) In Figure 27-2, the long-run effect of a one-time increase in government spending causes the economy to move from
(a) point 1 to point 2.
(b) point 2 to point 1.
(c) point 1 to point 1’.
(d) point 1’ to point 1.
(e) stay at point 1.
Answer: A
Question Status: New

75) In Figure 27-2, the long-run effect of a tax increase causes the economy to move from
(a) point 1 to point 2.
(b) point 2 to point 1.
(c) point 1 to point 1’.
(d) point 1’ to point 1.
(e) stay at point 1.
Answer: B
Question Status: New

76) A one-shot increase in wages due to a successful wage push by labor unions causes
(a) continual inflation.
(b) a one-shot increase in the price level.
(c) a one-shot increase in real output.
(d) both (a) and (c) of the above to occur.
Answer: B
Question Status: Previous Edition
77) In Figure 27-3, the initial impact of a negative supply shock is to cause the economy to move from
(a) point 1 to point 1'.
(b) point 1 to point 1' and then back to point 1.
(c) point 1' to point 1 and then back to point 1'.
(d) point 1' to point 1.
(e) stay at point 1.
Answer: A
Question Status: New

78) In Figure 27-3, the long-run effect of an nonaccommodated negative supply shock is to cause the economy to move from
(a) point 1 to point 1'.
(b) point 1 to point 1' and then back to point 1.
(c) point 1' to point 1 and then back to point 1'.
(d) point 1' to point 1.
(e) stay at point 1.
Answer: B
Question Status: New

79) Keynesian analysis indicates that a continuous increase in the money supply causes
(a) aggregate demand to increase continuously.
(b) the price level to increase continuously.
(c) demand-pull inflation.
(d) all of the above.
(e) only (a) and (b) of the above.
Answer: D
Question Status: Previous Edition
80) If by inflation one means a continual increase in the price level at a rapid rate, then Keynesian and monetarist views of the inflation process are
(a) quite different as Keynesians emphasize the significance of supply shocks while monetarists stress the significance of money growth.
(b) quite different as Keynesians stress the importance of expansionary fiscal actions while monetarists stress the significance of money growth.
(c) quite different as Keynesians stress the importance of business confidence while monetarists stress the significance of money growth.
(d) not very different.
Answer: D
Question Status: Previous Edition

81) To say that inflation is a monetary phenomenon seems to beg the question:
(a) Why does inflationary monetary policy occur?
(b) Why do politicians seek reelection?
(c) Why is the Fed independent?
(d) Why does the U.S. Treasury print so much money?
Answer: A
Question Status: Previous Edition

82) The monetarist position that inflation is a monetary phenomenon should not preclude going behind the proximate cause of inflation. Thus, to say that inflation is a monetary phenomenon is somewhat misleading because
(a) fiscal expansions that are not accommodated by the Fed can be inflationary.
(b) supply shocks that are not accommodated by the Fed can be inflationary.
(c) inflationary monetary policy is an offshoot of other government policies.
(d) both (a) and (b) of the above.
Answer: C
Question Status: Previous Edition

83) To say that inflation is a monetary phenomenon is somewhat misleading since
(a) fiscal expansions that are not accommodated by the Fed can be inflationary.
(b) supply shocks that are not accommodated by the Fed can be inflationary.
(c) excessive money growth often results from an accommodating monetary policy.
(d) both (a) and (b) of the above.
Answer: C
Question Status: Previous Edition

84) An unrealistically low unemployment target will most likely result in
(a) inflation.
(b) an unemployment rate falling below the natural rate.
(c) excessive monetary growth.
(d) all of the above.
(e) both (a) and (c) of the above.
Answer: D
Question Status: Study Guide
85) Which of the following help explain inflationary money growth?
  (a) The federal government’s commitment to high employment since 1946
  (b) One-shot supply shocks
  (c) One-shot tax cuts
  (d) All of the above
  Answer: A
  Question Status: Previous Edition

86) Which of the following help explain inflationary money growth?
  (a) The federal government’s commitment to high employment since 1946
  (b) Successful wage push by workers
  (c) Politicians unwillingness to raise taxes to finance increased government expenditures
  (d) All of the above
  Answer: D
  Question Status: Previous Edition

87) The combination of a successful wage push by workers and the government’s commitment to high employment leads to
  (a) demand-pull inflation.
  (b) supply-side inflation.
  (c) supply-shock inflation.
  (d) cost-push inflation.
  Answer: D
  Question Status: Previous Edition

88) If the Fed responds by increasing the money supply in response to a successful wage push by workers, monetary policy is said to be
  (a) accomplishing.
  (b) nonaccommodating.
  (c) nonaccomplishing.
  (d) accommodating.
  Answer: D
  Question Status: Previous Edition

89) If workers continually demand higher wages, which are accommodated by expansionary monetary policy, the resulting inflation is known as
  (a) demand-pull inflation.
  (b) cost-push inflation.
  (c) not enough information to distinguish.
  (d) none of the above.
  Answer: B
  Question Status: Previous Edition
90) If workers do not believe that policymakers are serious about fighting inflation, they are most likely to push for higher wages, which will shift the aggregate _____ curve _____ and lead to unemployment or inflation or both.
(a) demand; inward
(b) demand; outward
(c) supply; inward
(d) supply; outward
Answer: C  Question Status: Previous Edition

91) If a cost-push inflation occurs because of the push by workers to get higher wages, then one can infer that the government
(a) has a high employment target.
(b) has pursued an accommodating monetary policy.
(c) has chosen to reduce its budget deficit.
(d) only (a) and (b) of the above.
Answer: D  Question Status: Previous Edition

92) Workers are more likely to push for higher wages if they know that the government
(a) will not pursue an accommodating policy.
(b) has a high employment target.
(c) does not desire to pursue stabilization policies.
(d) all of the above.
Answer: B  Question Status: Previous Edition

93) Workers will have greater incentives to push for higher wages when government policymakers place greater concern on _____ than _____ and are thus _____ likely to adopt accommodative policies.
(a) inflation; unemployment; less
(b) inflation; unemployment; more
(c) unemployment; inflation; less
(d) unemployment; inflation; more
(e) unemployment; inflation; not
Answer: D  Question Status: Study Guide

94) In the absence of an accommodating monetary policy, a push by workers to get higher wages will cause
(a) cost-push inflation.
(b) demand-pull inflation.
(c) higher unemployment.
(d) none of the above.
Answer: C  Question Status: Previous Edition
95) Cost-push inflation can result when
(a) workers decide to raise wages because they want to increase their real wages.
(b) workers decide to raise wages because they expect inflation to be high and want higher wages in order to keep up with inflation.
(c) the government gives in to the demands of workers for higher wages by implementing policies to raise aggregate demand.
(d) all of the above occur.
Answer: D
Question Status: Previous Edition

96) Cost-push inflation can result when
(a) workers decide to accept lower wages because they want to remain employed.
(b) government fiscal policies become more expansionary.
(c) the government gives in to the demands of workers for higher wages by implementing policies to raise aggregate demand.
(d) only (a) and (b) of the above occur.
Answer: C
Question Status: Previous Edition

97) If workers believe that government policymakers will increase aggregate demand to avoid a politically unpopular increase in unemployment when workers demand higher wages, then workers will not fear higher unemployment and their wage demands will result in
(a) demand-pull inflation.
(b) hyperinflation.
(c) deflation.
(d) cost-push inflation.
(e) disinflation.
Answer: D
Question Status: Study Guide

98) If workers decide to raise wages because they want to increase their real wages, then inflation results
(a) even when government fiscal and monetary policies remain unchanged.
(b) if government fiscal and monetary policies become more contractionary.
(c) if government fiscal and monetary policies become more expansionary.
(d) when either (a) or (c) occur.
Answer: C
Question Status: Previous Edition
99) If workers decide to raise wages because they want to increase their real wages, then
(a) aggregate output declines below its natural rate level if government fiscal and monetary policy remains unchanged.
(b) the price level will rise if the government gives in to the demands of workers for higher wages by implementing policies to raise aggregate demand.
(c) inflation will result even if the government does not give in to the demands of workers for higher wages by implementing policies to raise aggregate demand.
(d) all of the above are possible.
(e) only (a) and (b) of the above are possible.
Answer: E

Question Status: Previous Edition

100) If policymakers set a target for unemployment that is too low because it is less than the natural rate of unemployment, this can set the stage for a higher rate of money growth and
(a) cost-push inflation.
(b) demand-pull inflation.
(c) cost-pull inflation.
(d) demand-push inflation.
Answer: B

Question Status: Previous Edition

101) Distinguishing a demand-pull inflation from a cost-push inflation is difficult in practice because
(a) economists and policymakers find it difficult to measure the natural rate of unemployment.
(b) a cost-push inflation can be initiated by a demand-pull inflation.
(c) budget deficits are responsible for initiating both types of inflation.
(d) of all of the above.
(e) of only (a) and (b) of the above.
Answer: E

Question Status: Previous Edition

102) Theoretically, one can distinguish a demand-pull inflation from a cost-push inflation by comparing
(a) how fast prices rise relative to wages.
(b) the unemployment rate with its natural rate level.
(c) when prices rise relative to wages.
(d) none of the above.
Answer: B

Question Status: Previous Edition

103) Demand-pull inflation can result when
(a) policymakers set an unemployment target that is too low because it is less than the natural rate of unemployment.
(b) a persistent budget deficit is financed by money creation.
(c) the deficit is financed by selling bonds to the central bank.
(d) all of the above occur.
(e) only (a) and (b) of the above occur.
Answer: D

Question Status: Previous Edition
104) Demand-pull inflation can result when
   (a) policymakers set an unemployment target that is too low because it is less than the natural rate of unemployment.
   (b) a persistent budget deficit is financed by money creation.
   (c) the deficit is financed by selling bonds to the public.
   (d) all of the above occur.
   (e) only (a) and (b) of the above occur.
   Answer: E
   Question Status: Previous Edition

105) Demand-pull inflation can result when
   (a) policymakers set an unemployment target that is too high.
   (b) a persistent budget deficit is financed by money creation.
   (c) the deficit is financed by selling bonds to the public.
   (d) only (a) and (b) of the above occur.
   Answer: B
   Question Status: Previous Edition

106) Governments may pursue inflationary monetary policies
   (a) to promote high employment.
   (b) to accommodate demands of workers for higher wages.
   (c) to finance a persistent budget deficit.
   (d) for all the above reasons.
   Answer: D
   Question Status: Previous Edition

107) Which of the following statements about inflationary monetary policies are true?
   (a) Governments may pursue inflationary monetary policies to promote high employment.
   (b) A cost-push inflation is a monetary phenomenon because it cannot occur without the accommodating policy of an acquiescence by the monetary authorities to a higher rate of money growth.
   (c) Financing a persistent budget deficit by money creation will lead to a sustained inflation.
   (d) All of the above.
   Answer: D
   Question Status: Previous Edition

108) Governments may end up with a high money growth rate and high inflation as a result of policies designed to
   (a) lower unemployment.
   (b) finance persistent government budget deficits through money creation rather than by issuing bonds.
   (c) redistribute wealth from debtors to creditors.
   (d) only (a) and (b) of the above.
   Answer: D
   Question Status: Previous Edition
109) Which of the following is least likely to lead to inflationary monetary policy?
   (a) Rising unemployment
   (b) Expanding federal budget deficits
   (c) Declining oil prices
   (d) Conflict in the Middle East
   Answer: C
   Question Status: Previous Edition

110) Which of the following is most likely to lead to inflationary monetary policy?
   (a) Declining oil prices
   (b) Resolution of conflict in the Middle East
   (c) The enactment of a free-trade agreement with Mexico
   (d) Rising unemployment
   Answer: D
   Question Status: Previous Edition

111) Which of the following is most likely to lead to inflationary monetary policy?
   (a) Declining oil prices
   (b) Resolution of conflict in the Middle East
   (c) The enactment of a free-trade agreement with Mexico
   (d) Rising government budget deficits
   Answer: D
   Question Status: Previous Edition

112) Which of the following is most likely to lead to inflationary monetary policy?
   (a) Rising unemployment
   (b) Rising government budget deficits
   (c) Declining oil prices
   (d) All of the above
   (e) Only (a) and (b) of the above
   Answer: E
   Question Status: Previous Edition
Figure 27-4

113) In Figure 27-4, demand pull inflation is defined as
   (a) the initial move from P₁ to P₂.
   (b) the continuous rise in the price level.
   (c) the initial increase in output from Y₁ to Y₁.
   (d) the continuous rise in output.
   (e) none of the above.
   Answer: B
   Question Status: New

114) The demand pull inflation illustrated in Figure 27-4 is due to
   (a) supply shocks.
   (b) excessive wage demands.
   (c) too low of an unemployment target.
   (d) all of the above.
   (e) only (a) and (c) of the above.
   Answer: C
   Question Status: New

115) The continuous increase in aggregate demand illustrated in Figure 27-4 is the result of
   (a) a one-time increase in government spending.
   (b) a supply shock.
   (c) excessive wage demands.
   (d) continuous monetary growth.
   (e) all of the above.
   Answer: D
   Question Status: New
116) The continuous increase in aggregate supply illustrated in Figure 27-4 is the result of
(a) a one-time increase in government spending.
(b) a supply shock.
(c) the adjustment of wages to output above the natural rate.
(d) continuous monetary growth.
(e) all of the above.
Answer: C
Question Status: New

117) Methods of financing government spending are described by an expression called the government budget constraint, which states the following:
(a) the government budget deficit must equal the sum of the change in the monetary base and the change in government bonds held by the public.
(b) the government budget deficit must equal the difference between the change in the monetary base and the change in government bonds held by the public.
(c) the government budget deficit must equal the difference between the change in the monetary base and the change in government bonds held by the Fed.
(d) the government budget deficit must equal the difference between the change in the monetary base and the change in government bonds held by the Treasury.
Answer: A
Question Status: Previous Edition

118) Methods of financing government spending are described by an expression called the government budget constraint, which states the following:
(a) DEFICIT = (G − T) = ΔMB + ΔBONDS.
(b) DEFICIT = (G − T) = ΔMB − ΔBONDS.
(c) DEFICIT = (G − T) = ΔBONDS − ΔMB.
(d) DEFICIT = (G − T) = ΔMB/ΔBONDS.
Answer: A
Question Status: Previous Edition

119) If the government finances its spending by issuing debt to the public, the monetary base will _______ and the money supply will _______.
(a) increase; increase
(b) increase; decrease
(c) decrease; increase
(d) not change; not change
Answer: D
Question Status: Revised
120) If the government finances its spending by selling bonds to the central bank, the monetary base will ______ and the money supply will ______.
(a) increase; increase
(b) increase; decrease
(c) decrease; decrease
(d) not change; not change
Answer: A
Question Status: Previous Edition

121) Financing government spending with taxes
(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.
Answer: D
Question Status: Previous Edition

122) Financing government spending by selling bonds to the public, which pays for the bonds with currency,
(a) leads to a permanent decline in the monetary base.
(b) leads to a permanent increase in the monetary base.
(c) leads to a temporary increase in the monetary base.
(d) has no net effect on the monetary base.
Answer: D
Question Status: Previous Edition

123) The financing of government spending by issuing debt
(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.
Answer: D
Question Status: Previous Edition

124) The finance of government spending through a Treasury sale of bonds which are then purchased by the Fed
(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.
Answer: A
Question Status: Previous Edition
125) This method of financing government spending is frequently called printing money because high-powered money (the monetary base) is created in the process.
(a) Financing government spending with taxes
(b) The finance of government spending through a Treasury sale of bonds that are then purchased by the Fed
(c) Financing government spending by selling bonds to the public, which pays for the bonds with currency
(d) Financing government spending by selling bonds to the public, which pays for the bonds with checks
Answer: B
Question Status: Previous Edition

126) Only when budget deficits are financed by money creation does the increased government spending lead to a(n) _____ in the _____.
(a) decrease; monetary base
(b) increase; monetary base
(c) decrease; money multiplier
(d) increase; money multiplier
Answer: B
Question Status: Previous Edition

127) A government budget deficit can only lead to an expansion of the monetary base if
(a) the Fed allows this to happen by willingly selling bonds.
(b) the Fed allows this to happen by willingly purchasing bonds.
(c) the economy is operating at full employment.
(d) both (a) and (c) occur.
(e) both (b) and (c) occur.
Answer: B
Question Status: Previous Edition

128) If the deficit is financed by selling bonds to the _____, the money supply will _____, shifting the aggregate demand curve to the right, and leading to a rise in the price level.
(a) public; rise
(b) public; fall
(c) central bank; rise
(d) central bank; fall
Answer: C
Question Status: Previous Edition

129) If the deficit is financed by selling bonds to the _____, the money supply will _____, shifting the aggregate demand curve to the _____.
(a) public; rise; right
(b) public; fall; left
(c) central bank; rise; right
(d) central bank; fall; left
Answer: C
Question Status: Previous Edition
130) If the deficit is financed by selling bonds to
(a) the central bank, the money supply will rise, shifting the aggregate demand curve to the right, and leading to a rise in the price level.
(b) the public, the money supply will rise, shifting the aggregate demand curve to the right, and leading to a rise in the price level.
(c) either the public or to the central bank, the money supply will rise, shifting the aggregate demand curve to the right, and leading to a rise in the price level.
(d) either the government or to the central bank, the money supply will rise, shifting the aggregate demand curve to the right, and leading to a rise in the price level.
Answer:  A
Question Status: Previous Edition

131) Persistent budget deficits will be inflationary if
(a) they are financed by Treasury sales of bonds to the public.
(b) they are financed by Treasury sales of bonds to the Fed.
(c) they are financed by Treasury sales of bonds to commercial banks.
(d) any of the above occurs.
Answer:  B
Question Status: Previous Edition

132) Financing a deficit by money creation will lead to a sustained inflation if the deficit
(a) fails to exceed the Gramm-Rudman-Hollings ceiling.
(b) is persistent.
(c) is temporary.
(d) is none of the above.
Answer:  B
Question Status: Previous Edition

133) For budget deficits to be inflationary, they must be
(a) persistent.
(b) financed by the creation of high-powered money.
(c) financed by issuing bonds.
(d) both (a) and (b) of the above.
(e) both (a) and (c) of the above.
Answer:  D
Question Status: Previous Edition

134) A deficit can be the source of a sustained inflation only if
(a) it is persistent and not temporary.
(b) the government finances it by issuing bonds to the central bank.
(c) the government finances it by issuing bonds to the public.
(d) all of the above occur.
(e) both (a) and (b) of the above occur.
Answer:  E
Question Status: Previous Edition
135) If budget deficits lead to a sustained inflation, it is true that the deficit can be regarded as an initiating factor, but
   (a) money creation is the sustaining factor.
   (b) fiscal policy is the sustaining factor.
   (c) deficits cannot persist for long, so the type of inflation cannot last long.
   (d) none of the above are true.
   Answer: A
   Question Status: Previous Edition

136) Large and persistent budget deficits have frequently been the ultimate source of inflationary monetary policies in developing countries because
   (a) these countries have found it difficult to finance large and persistent budget deficits by issuing bonds to the public.
   (b) these countries have found it difficult to finance large and persistent budget deficits by raising taxes.
   (c) these countries have found it difficult to finance large and persistent budget deficits by issuing bonds to their central banks.
   (d) of none of the above.
   Answer: A
   Question Status: Previous Edition

137) Budget deficits are more likely to be inflationary in those countries that
   (a) do not have well-developed capital markets.
   (b) have well-developed capital markets, since they will be able to finance their deficits by issuing bonds.
   (c) finance deficits by selling bonds to their central banks.
   (d) both (a) and (b) of the above.
   (e) both (a) and (c) of the above.
   Answer: E
   Question Status: Previous Edition

138) In those countries that do not have well-developed capital markets
   (a) inflation is uncommon because they cannot finance budget deficits by issuing bonds.
   (b) inflation is uncommon because government expenditures must be financed with taxes and/or user fees.
   (c) budget deficits will tend to be inflationary.
   (d) both (a) and (b) of the above.
   Answer: C
   Question Status: Previous Edition
139) Kayla, an economist, is interested in knowing if government deficits have been a factor in explaining rapid money growth in her country in the past twenty years. What ratio should Kayla examine?
   (a) The ratio of money to the monetary base
   (b) The ratio of currency to demand deposits
   (c) The ratio of money to government debt
   (d) The ratio of government debt to GNP
   Answer: D
   Question Status: Previous Edition

140) If an economist were interested in testing whether federal budget deficits had been the cause of excessive monetary growth for a country for the period 1950–2000, she would examine the behavior of
   (a) inflation.
   (b) the money supply-to-monetary-base ratio.
   (c) interest rates.
   (d) the government debt-to-GDP ratio.
   (e) the ratio of government spending to GDP.
   Answer: D
   Question Status: Study Guide

141) Evidence from episodes of hyperinflation indicates that
   (a) wage-push demands have been the ultimate source of inflationary monetary policies.
   (b) supply shocks have been the ultimate source of inflationary monetary policies.
   (c) huge government budget deficits have been the ultimate source of inflationary monetary policies.
   (d) there is no common source of inflationary monetary policies.
   Answer: C
   Question Status: Previous Edition

142) The German hyperinflation of 1921–1923 provides important support for the view that high money growth results when
   (a) the government sets an employment target that is too high.
   (b) the government expands the money supply to finance its expenditures.
   (c) the government raises taxes to finance its expenditures.
   (d) the government sells bonds to the public.
   Answer: B
   Question Status: Previous Edition

143) Analysis of episodes of hyperinflation indicate that the rapid money growth leading to the inflation is the result of
   (a) governments financing massive budget deficits by printing money.
   (b) central banks’ attempts to peg interest rates.
   (c) central banks’ attempts to peg exchange rates.
   (d) increases in taxes.
   (e) reductions of reserve requirements.
   Answer: A
   Question Status: Study Guide
Although the U.S. has a well-developed government bond market and has experienced relatively small budget deficits relative to GDP, deficits can be inflationary if
(a) deficits put upward pressure on interest rates, and the Fed attempts to keep interest rates from rising.
(b) deficits put upward pressure on interest rates, and fiscal authorities raise taxes in an attempt to keep interest rates from rising.
(c) the Fed refuses to purchase government bonds.
(d) the world’s supply of gold expands because of new gold discoveries.
Answer: A

Moderate deficits, such as those experienced by the United States in the last decade, present an inflationary problem if
(a) they put upward pressure on interest rates, and the Fed has a goal of preventing high interest rates.
(b) they put upward pressure on interest rates, and the Fed has a goal of preventing interest rates from falling too low.
(c) the Fed responds by reducing the growth of high-powered money.
(d) the Fed cuts money growth to offset the expansionary fiscal effects.
Answer: A

If moderate deficits put _____ pressure on interest rates, the Fed may _____ bonds, leading to an increase in high-powered money.
(a) upward; sell
(b) upward; buy
(c) downward; sell
(d) downward; buy
Answer: B

If moderate deficits put upward pressure on interest rates, the Fed may _____ bonds, leading to a _____ in high-powered money.
(a) sell; fall
(b) buy; fall
(c) sell; rise
(d) buy; rise
Answer: D
148) If the Fed pursues a policy goal of
   (a) preventing high interest rates, and deficits cause interest rates to rise, then deficits will lead to money creation.
   (b) preventing high inflation, and deficits cause inflation to rise, then deficits will lead to money creation.
   (c) preventing high bond prices, and deficits cause bond prices to rise, then deficits will lead to money creation.
   (d) preventing high stock prices, and deficits cause stock prices to rise, then deficits will lead to money creation.
   Answer: A
   Question Status: Previous Edition

149) Proponents of Ricardian Equivalence reject the view that deficits
   (a) cause the monetary base to decrease.
   (b) cause the monetary base to increase.
   (c) have no effect on the monetary base.
   (d) cannot be inflationary, even when financed by tax hikes.
   Answer: B
   Question Status: Revised

150) According to economists who believe in Ricardian Equivalence, when the government runs a deficit and issues bonds,
   (a) the public recognizes that it will be subject to higher taxes in the future in order to pay off these bonds.
   (b) the public saves more in anticipation of these future taxes, causing the demand for bonds to increase to match the increased supply, leaving the interest rate unchanged.
   (c) there is no need for the Fed to purchase bonds to keep the interest rate from rising.
   (d) all of the above occur, explaining why deficits need not be inflationary.
   Answer: D
   Question Status: Revised

151) According to economists who believe in Ricardian Equivalence, when the government runs a deficit and issues bonds,
   (a) the public recognizes that it will be subject to higher taxes in the future in order to pay off these bonds.
   (b) the public works less to avoid these future taxes, causing the demand for bonds to decrease.
   (c) the Fed must purchase bonds to keep the interest rate from rising.
   (d) all of the above occur, explaining why deficits are necessarily inflationary.
   Answer: A
   Question Status: Revised
Figure 27-5

152) In Figure 27-5 assume that the economy is initially at point 1. When the Treasury issues bonds to the public to finance the budget deficit,
   (a) the supply of bonds shifts to the right.
   (b) the supply of bonds shifts to the left.
   (c) the demand for bonds shifts to the right.
   (d) the demand for bonds shifts to the left.

   Answer: A
   Question Status: Previous Edition

153) In Figure 27-5 assume that the economy is initially at point 1. When the Treasury issues bonds to the public to finance the budget deficit,
   (a) the supply of bonds shifts to the right and the demand for bonds shifts to the left if Ricardian Equivalence holds.
   (b) the supply of bonds shifts to the left and the demand for bonds shifts to the left if Ricardian Equivalence holds.
   (c) the supply of bonds shifts to the right and the demand for bonds shifts to the right if Ricardian Equivalence holds.
   (d) the supply of bonds shifts to the left and the demand for bonds shifts to the right if Ricardian Equivalence holds.

   Answer: C
   Question Status: Previous Edition

154) In Figure 27-5 assume that the economy is initially at point 1 when the Treasury issues bonds to finance the budget deficit. Adherents of Ricardian Equivalence suggest that the new equilibrium will be at point
   (a) 1.
   (b) 2.
   (c) 3.
   (d) 4.

   Answer: D
   Question Status: Previous Edition
155) In Figure 27-5 assume that the economy is initially at point 1 when the Treasury issues bonds to finance the budget deficit. Adherents of Ricardian Equivalence suggest that the
(a) the new equilibrium will be at point 5.
(b) the interest rate rises above \( i_1 \) but remains below \( i_2 \).
(c) the interest rate remains at \( i_1 \).
(d) both (a) and (b) of the above occur.
Answer: C
Question Status: Previous Edition

156) In Figure 27-5 assume that the economy is initially at point 1. If the Treasury issues bonds to finance the budget deficit, then advocates of Ricardian Equivalence contend that the new equilibrium will be at point
(a) 1.
(b) 2.
(c) 3.
(d) 4.
Answer: D
Question Status: Revised

157) In Figure 27-5 assume that the economy is initially at point 1 when the Treasury issues bonds to finance the budget deficit. Critics of Ricardian Equivalence suggest that the new equilibrium will be at point
(a) 2.
(b) 3.
(c) 4.
(d) 5.
Answer: D
Question Status: Previous Edition

158) In Figure 27-5 assume that the economy is initially at point 1 when the Treasury issues bonds to finance the budget deficit. Economists who take issue with Ricardian Equivalence analysis contend that the
(a) the new equilibrium will be at point 5.
(b) the interest rate rises above \( i_1 \) but remains below \( i_2 \).
(c) the interest rate rises to \( i_2 \).
(d) both (a) and (b) of the above occur.
(e) both (a) and (c) of the above occur.
Answer: D
Question Status: Revised

159) In Figure 27-5 assume that the economy is initially at point 1 when the Treasury issues bonds to finance the budget deficit. If the public recognizes that it will be subject to higher taxes in the future in order to pay off these bonds, then the
(a) new equilibrium will be at point 1.
(b) new equilibrium will be at point 4.
(c) interest rate will rise to \( i_2 \).
(d) interest rate rises above \( i_1 \) but remains below \( i_2 \).
Answer: B
Question Status: Previous Edition
160) In Figure 27-5 assume that the economy is initially at point 1 when the Treasury issues bonds to finance the budget deficit. If the public recognizes that it will be subject to higher taxes in the future in order to pay off these bonds, then
   (a) the new equilibrium will be at point 5.
   (b) the interest rate rises above $i_1$ but remains below $i_2$.
   (c) the interest rate remains at $i_1$.
   (d) both (a) and (b) of the above occur.
Answer: C
Question Status: Previous Edition

161) In Figure 27-5 assume that the economy is initially at point 1 when the Treasury issues bonds to finance the budget deficit. If the public fails to recognize that it will be subject to higher taxes in the future in order to pay off these bonds, then
   (a) the new equilibrium will be at point 5.
   (b) the interest rate rises above $i_1$ but remains below $i_2$.
   (c) the interest rate remains at $i_1$.
   (d) both (a) and (b) of the above occur.
Answer: D
Question Status: Previous Edition

162) In Figure 27-5 assume that the economy is initially at point 1 when the Treasury issues bonds to finance the budget deficit. If the public fails to recognize that it will be subject to higher taxes in the future in order to pay off these bonds, then the
   (a) new equilibrium will be at point 1.
   (b) new equilibrium will be at point 4.
   (c) interest rate will rise to $i_2$.
   (d) interest rate rises above $i_1$ but remains below $i_2$.
Answer: D
Question Status: Previous Edition
163) In Figure 27-6 assume that the economy is initially at point 1. When the Treasury issues bonds to finance the budget deficit, the supply curve of bonds shifts to the right. Adherents of Ricardian Equivalence suggest that the new equilibrium will be at point
(a) 1.
(b) 2.
(c) 4.
(d) 5.
Answer: B
Question Status: Previous Edition

164) In Figure 27-6 assume that the economy is initially at point 3 when the Treasury issues bonds to finance the budget deficit. Adherents of Ricardian Equivalence suggest that the
(a) new equilibrium will be at point 1.
(b) new equilibrium will be at point 4.
(c) interest rate will fall to $i_1$.
(d) interest rate rises above $i_2$.
Answer: B
Question Status: Previous Edition

165) In Figure 27-6 assume that the economy is initially at point 3 when the Treasury issues bonds to finance the budget deficit. Adherents of Ricardian Equivalence suggest that the new equilibrium will be at point
(a) 1.
(b) 2.
(c) 3.
(d) 4.
Answer: D
Question Status: Revised
166) In Figure 27-6 assume that the economy is initially at point 3 when the Treasury issues bonds to finance the budget deficit. Adherents of Ricardian Equivalence contend that
(a) the new equilibrium will be at point 2.
(b) the equilibrium remains at point 3.
(c) the interest rate remains at \(i_2\).
(d) both (b) and (c) of the above occur.
Answer: C
Question Status: Revised

167) In Figure 27-6 assume that the economy is initially at point 1 when the Treasury issues bonds to finance the budget deficit. Adherents of Ricardian Equivalence contend that
(a) the new equilibrium will be at point 3.
(b) the interest rate rises above \(i_1\) but remains below \(i_2\).
(c) the interest rate remains at \(i_1\).
(d) both (a) and (b) of the above occur.
Answer: C
Question Status: Previous Edition

168) In Figure 27-6 assume that the economy is initially at point 1. When the Treasury issues bonds to finance the budget deficit, the supply curve of bonds shifts to the right. Critics of Ricardian Equivalence suggest that the new equilibrium will be at point
(a) 1.
(b) 2.
(c) 3.
(d) 5.
Answer: C
Question Status: Previous Edition

169) In Figure 27-6 assume that the economy is initially at point 1 when the Treasury issues bonds to finance the budget deficit. Critics of Ricardian Equivalence suggest that the
(a) new equilibrium will be at point 2.
(b) new equilibrium will be at point 5.
(c) interest rate will fall to \(i_1\).
(d) interest rate rises to \(i_2\).
Answer: D
Question Status: Previous Edition

170) In Figure 27-6 assume that the economy is initially at point 1. When the Treasury issues bonds to finance the budget deficit, the supply curve of bonds shifts to the right. Economists who take issue with Ricardian Equivalence analysis contend that the new equilibrium will be at point
(a) 1.
(b) 2.
(c) 3.
(d) 4.
(e) 5.
Answer: C
Question Status: Revised
171) In Figure 27-6 assume that the economy is initially at point 1 when the Treasury issues bonds to finance the budget deficit. Economists who take issue with Ricardian Equivalence analysis contend that the new equilibrium will be at point
(a) new equilibrium will be at point 3.
(b) interest rate will fall to i_2.
(c) interest rate rises to i_2.
(d) both (a) and (b) of the above.
(e) both (a) and (c) of the above.
Answer: E
Question Status: Revised

172) In Figure 27-6 assume that the economy is initially at point 3 when the Treasury issues bonds to finance the budget deficit. If the public recognizes that it will be subject to higher taxes in the future in order to pay off these bonds, then the new equilibrium will be at point
(a) 1.
(b) 2.
(c) 3.
(d) 4.
Answer: D
Question Status: Previous Edition

173) In Figure 27-6 assume that the economy is initially at point 1. When the Treasury issues bonds to finance the budget deficit, the supply curve of bonds shifts to the right. If the public recognizes that it will be subject to higher taxes in the future in order to pay off these bonds, then the
(a) new equilibrium will be at point 3.
(b) new equilibrium will be at point 2.
(c) interest rate will fall to i_2.
(d) interest rate rises to i_2.
(e) both (a) and (d) of the above.
Answer: B
Question Status: Previous Edition

174) In Figure 27-6 assume that the economy is initially at point 1 when the Treasury issues bonds to finance the budget deficit. If the public fails to recognize that it will be subject to higher taxes in the future in order to pay off these bonds, then the new equilibrium will be at point
(a) 1.
(b) 2.
(c) 3.
(d) 4.
(e) 5.
Answer: C
Question Status: Previous Edition
175) In Figure 27-6 assume that the economy is initially at point 1 when the Treasury issues bonds to finance the budget deficit. If the public fails to recognize that it will be subject to higher taxes in the future in order to pay off these bonds, then the
(a) new equilibrium will be at point 1.
(b) new equilibrium will be at point 2.
(c) interest rate will rise to i₂.
(d) interest rate rises above i₁ but remains below i₂.
Answer: C
Question Status: Previous Edition

176) An examination of the inflationary episode in the United States from 1960 through 1980 reveals that
(a) budget deficits constituted the primary source of inflationary monetary policy.
(b) budget deficits do not appear to have been the driving force behind inflationary monetary policy.
(c) the supply shocks of the 1970s appear to have had no effect on the rate of inflation during this period.
(d) none of the above are true.
Answer: B
Question Status: Previous Edition

177) An examination of the inflationary episode in the United States from 1960 through 1980 indicates that
(a) there is a close correlation between movements in the inflation rate and the money growth rate from two years earlier.
(b) government budget deficits probably were not the cause of the higher rate of money growth in the 1960s and 1970s.
(c) government budget deficits probably were the cause of the higher rate of money growth in the 1960s and 1970s.
(d) both (a) and (b) of the above.
Answer: D
Question Status: Previous Edition

178) An examination of the inflationary episode in the United States from 1960 through 1980 indicates that
(a) persistent federal government budget deficits caused rapid money growth during this period.
(b) the Fed’s strategy of targeting interest rates resulted in monetary financing of the federal government budget deficits.
(c) federal government budget deficits were sufficiently small so that the ratio of debt to aggregate output declined.
(d) both (a) and (b) of the above.
Answer: C
Question Status: Previous Edition
179) An examination of the inflationary episode in the United States from 1960 through 1980 indicates that
   (a) persistent federal government budget deficits caused rapid money growth during this period.
   (b) federal government budget deficits were sufficiently small so that the ratio of debt to aggregate
       output declined.
   (c) policymakers tried to achieve an output target that was too high.
   (d) both (a) and (b) of the above.
   (e) both (b) and (c) of the above.
   Answer: E
   Question Status: Previous Edition

180) An examination of the inflationary episode in the United States from 1960 through 1980 indicates that
   (a) there is a close correlation between movements in the inflation rate and the money growth rate
       from two years earlier.
   (b) federal government budget deficits were sufficiently small so that the ratio of debt to aggregate
       output declined.
   (c) policymakers tried to achieve an output target that was too high.
   (d) all of the above.
   (e) only (a) and (b) of the above.
   Answer: D
   Question Status: Previous Edition

181) An examination of the inflationary episode in the United States from 1960 through 1980 indicates that
   (a) inflation in the 1960s was a demand-pull phenomenon, as unemployment remained below the
       natural rate.
   (b) inflation after 1975 was a cost-push phenomenon, as the public came to expect that policymakers
       would try to eliminate high unemployment with expansionary policies.
   (c) there is a relatively weak correlation between the inflation rate and money growth lagged by
       two years.
   (d) only (a) and (b) of the above.
   Answer: D
   Question Status: Previous Edition

182) Evidence from the time period 1960–1980 indicates that inflation in the United States resulted from
   (a) an employment target that was set too high.
   (b) the government’s inability to sell bonds to the Fed.
   (c) an expansion in the money supply to finance federal government expenditures.
   (d) the excessive sale of government bonds to the public.
   Answer: A
   Question Status: Previous Edition
183) Evidence from the time period 1960–1980 indicates that inflation in the United States resulted from
(a) an employment target that was set too high.
(b) an expansion in the money supply.
(c) the excessive sale of government bonds to the public.
(d) both (a) and (b) of the above.
Answer: D
Question Status: Previous Edition

184) Evidence from the time period 1960–1980 indicates that inflation in the United States resulted from
(a) the excessive sale of government bonds to the public.
(b) an employment target that was set too high.
(c) an increase in taxes to finance government expenditures.
(d) both (a) and (b) of the above.
Answer: B
Question Status: Previous Edition

185) Evidence from the United States for the time period 1960–1980 indicates that
(a) inflation in the United States during this period of time was a monetary phenomenon.
(b) increases in money growth led to increases in the inflation rate with an approximate two-year lag.
(c) inflation temporarily surged in 1974–1975 and 1979–1980 as a result of negative supply shocks.
(d) all of the above are true.
Answer: D
Question Status: Previous Edition

186) Evidence from the United States for the time period 1960–1980 indicates that
(a) budget deficits can be ruled out as the initiating source of rapid money growth, as the ratio of government debt to GDP declined from 1960 through 1980.
(b) increases in inflation led increases in money growth with an approximate two-year lag.
(c) inflation temporarily surged in 1974–1975 and 1979–1980 as a result of positive supply shocks.
(d) only (a) and (b) of the above are true.
Answer: A
Question Status: Previous Edition

187) Evidence from the United States for the time period 1960–1980 indicates that
(a) budget deficits can be ruled out as the initiating source of rapid money growth, as the ratio of government debt to GDP declined from 1960 through 1980.
(b) inflation temporarily surged in 1974–1975 and 1979–1980 as a result of negative supply shocks.
(c) increases in inflation led to increases in money growth with an approximate two-year lag.
(d) all of the above are true.
(e) only (a) and (b) of the above are true.
Answer: E
Question Status: Previous Edition
188) Evidence from the United States for the time period 1965–1973 indicates that
(a) budget deficits can be ruled out as the initiating source of rapid money growth, as the ratio of
government debt to GDP declined from 1960 through 1980.
(b) policies were too expansionary from 1965 through 1973, leading to demand-pull inflation.
(c) as the unemployment rate was below the natural rate in all but one year during the 1965–1973
time period, inflation does not appear to have been of the cost-push variety.
(d) all of the above are true.
Answer: D
Question Status: Previous Edition

189) Because policies in the United States were too expansionary from 1965 through 1973,
(a) the U.S. suffered demand-pull inflation.
(b) the U.S. suffered cost-push inflation, as workers sought higher wages in order to keep up with
inflation.
(c) the U.S. suffered both demand-pull and cost-push inflation.
(d) the U.S. suffered neither demand-pull nor cost-push inflation.
Answer: A
Question Status: Previous Edition

190) Economists contend that the United States suffered demand-pull inflation in the 1965–1973 time
period because
(a) the unemployment rate was above the natural rate in all but one year during the 1965–1973 time
period.
(b) the unemployment rate was below the natural rate in all but one year during the 1965–1973 time
period.
(c) the ratio of government debt to GDP increased from 1965 through 1973.
(d) of only (b) and (c) of the above.
Answer: B
Question Status: Previous Edition

191) Economists contend that the United States suffered cost-push inflation in the 1975–1980 time period
because
(a) the unemployment rate was above the natural rate after 1975.
(b) the public had come to expect that government policy would continue to be concerned with
achieving high employment.
(c) the ratio of government debt to GDP increased from 1975 through 1980.
(d) of only (a) and (b) of the above.
Answer: D
Question Status: Revised
192) In the period 1965 through the 1970s, policymakers pursued _____ policies in order to achieve _____.
(a) expansionary; high employment
(b) expansionary; low inflation
(c) contractionary; high employment
(d) contractionary; low inflation
Answer: A
Question Status: Revised

193) If aggregate output is below the natural rate level, advocates of activist policy would recommend that the government
(a) do nothing.
(b) try to eliminate the high unemployment by attempting to shift the aggregate supply curve to the right.
(c) try to eliminate the high unemployment by attempting to shift the aggregate demand curve to the right.
(d) try to eliminate the high unemployment by attempting to shift the aggregate demand curve to the left.
Answer: C
Question Status: Previous Edition

194) If aggregate output is below the natural rate level, advocates of nonactivist policy would recommend that the government
(a) do nothing.
(b) try to eliminate the high unemployment by attempting to shift the aggregate supply curve to the right.
(c) try to eliminate the high unemployment by attempting to shift the aggregate demand curve to the right.
(d) try to eliminate the high unemployment by attempting to shift the aggregate demand curve to the left.
Answer: A
Question Status: Previous Edition

195) If aggregate output is below the natural rate level, policymakers have two choices:
(a) if they do nothing, the aggregate supply curve will shift out bringing the economy back to full employment.
(b) the accommodating, activist alternative is to try to eliminate the high unemployment by attempting to shift the aggregate demand curve out by pursuing expansionary policy.
(c) the accommodating, activist alternative is to try to keep the price level constant by attempting to shift the aggregate demand curve in by pursuing contractionary policy.
(d) both (a) and (b) of the above.
(e) both (a) and (c) of the above.
Answer: D
Question Status: Previous Edition
196) In Figure 27-7, after an initial shock moves the economy from point 1 to point 1′
(a) an activist recommends allowing the economy to adjust on its own from point 1′ back to point 1.
(b) an activist recommends allowing the economy to adjust on its own from point 1′ to point 2.
(c) an activist recommends allowing the economy to adjust on its own from point 1′ to point 2′.
(d) a nonactivist recommends allowing the economy to adjust on its own from point 1′ back to point 1.
(e) a nonactivist recommends allowing the economy to adjust on its own from point 1′ to point 2.
Answer: D
Question Status: New

197) In Figure 27-7, after an initial shock moves the economy from point 1 to point 1′
(a) an activist recommends increasing aggregate demand to allow the economy to adjust from point 1′ back to point 1.
(b) an activist recommends increasing aggregate demand to allow the economy to adjust from point 1′ to point 2.
(c) an activist recommends increasing aggregate demand to allow the economy to adjust from point 1′ to point 2′.
(d) a nonactivist recommends increasing aggregate demand to allow the economy to adjust from point 1′ back to point 1.
(e) a nonactivist recommends increasing aggregate demand to allow the economy to adjust from point 1′ to point 2.
Answer: B
Question Status: New

198) In Figure 27-7, after an initial shock moves the economy from point 1 to point 1′
(a) increasing aggregate demand shifts the economy back to point 1.
(b) increasing aggregate demand shifts the economy to point 2′.
(c) increasing aggregate demand shifts the economy to point 2.
(d) increasing aggregate demand leaves the economy at point 1′.
(e) increasing aggregate demand is impossible, because fiscal policy cannot continuously increase demand.
Answer: C
Question Status: New
199) In Figure 27-7, a positive supply shock initially shifts the economy
   (a) from point 2 to point 1′.
   (b) from point 2 to point 2′.
   (c) from point 2 to point 1.
   (d) from point 1 to point 1′.
   (e) from point 1 to point 2.
   Answer: B
   Question Status: New

200) The time that it takes for an activist policy to actually influence economic activity is called the
   (a) implementation lag.
   (b) effectiveness lag.
   (c) recognition lag.
   (d) legislative lag.
   Answer: B
   Question Status: Previous Edition

201) The time it takes for policymakers to change policy instruments once they have decided on a new
   policy is called the
   (a) implementation lag.
   (b) effectiveness lag.
   (c) legislative lag.
   (d) distributed lag.
   Answer: A
   Question Status: Previous Edition

202) The time it takes for policymakers to change policy instruments once they have decided on the
   direction of a new policy is called the
   (a) implementation lag.
   (b) effectiveness lag.
   (c) legislative lag.
   (d) distributed lag.
   (e) director’s lag.
   Answer: A
   Question Status: Previous Edition

203) The time it takes for a policy to have an impact on the economy, once it has been implemented, is
   called the
   (a) implementation lag.
   (b) effectiveness lag.
   (c) legislative lag.
   (d) distributed lag.
   (e) inside lag.
   Answer: B
   Question Status: Previous Edition
204) The _____ lag is the time it takes for policymakers to obtain the data that tell them what is happening to the economy, while the _____ lag is the time it takes for policymakers to be sure of what the data are signaling about the future course of the economy.

(a) data; recognition
(b) recognition; data
(c) data; implementation
(d) implementation; recognition

Answer: A
Question Status: Previous Edition

205) The _____ lag is the time it takes for policymakers to be sure of what the data are signaling about the future course of the economy, while the _____ lag represents the time it takes to pass legislation to implement to a particular (fiscal) policy.

(a) data; recognition
(b) recognition; legislative
(c) data; legislative
(d) implementation; legislative

Answer: B
Question Status: Previous Edition

206) The _____ lag represents the time it takes to pass legislation to implement to a particular (fiscal) policy, while the _____ lag is the time it takes for policymakers to change policy instruments once they have decided on the new policy.

(a) legislative; effectiveness
(b) legislative; recognition
(c) legislative; implementation
(d) implementation; legislative

Answer: C
Question Status: Revised

207) The _____ lag is the time it takes for policymakers to change policy instruments once they have decided on the new policy, while the _____ lag is the time it takes for the policy to actually have an impact on the economy.

(a) recognition; implementation
(b) legislative; effectiveness
(c) implementation; recognition
(d) implementation; effectiveness

Answer: D
Question Status: Previous Edition
208) The _____ lag is the time it takes for policymakers to obtain the information that tells them what is happening to the economy, while the _____ lag represents the time it takes to implement a particular fiscal policy.

(a) data; legislative
(b) recognition; data
(c) data; implementation
(d) recognition; legislative

Answer: A
Question Status: Previous Edition

209) The _____ lag is the time it takes for policymakers to be sure of what the information is signaling about the future course of the economy, while the _____ lag is the time it takes for policymakers to change policy instruments once they have decided on the new policy.

(a) recognition; implementation
(b) recognition; legislative
(c) data; legislative
(d) data; implementation

Answer: A
Question Status: Previous Edition

210) Of the five time lags that prevent an activist policy from returning aggregate output to full employment instantaneously, two do not slow the effectiveness of monetary policy—the

(a) implementation and effectiveness lags.
(b) legislative and effectiveness lags.
(c) legislative and implementation lags.
(d) recognition and effectiveness lags.

Answer: C
Question Status: Previous Edition

211) The effectiveness lag

(a) according to monetarists is long and variable for changes in the money supply.
(b) according to Keynesians is shorter for fiscal policy than for monetary policy.
(c) is almost nonexistent for monetary policy.
(d) is only (a) and (b) of the above.

Answer: D
Question Status: Previous Edition

212) The effectiveness lag

(a) according to Keynesians is long and variable for changes in the money supply.
(b) according to Keynesians is shorter for fiscal policy than for monetary policy.
(c) is almost nonexistent for monetary policy.
(d) is none of the above.

Answer: B
Question Status: Previous Edition
213) The effectiveness lag
   (a) according to monetarists is long and variable for changes in the money supply.
   (b) according to Keynesians is longer for fiscal policy than for monetary policy.
   (c) is almost nonexistent for monetary policy.
   (d) is almost nonexistent for fiscal policy.
   Answer: A
   Question Status: Previous Edition

214) Keynesians usually view _____ policy as having a shorter effectiveness lag than _____ policy, but there is substantial uncertainty about how long this lag is.
   (a) fiscal; incomes
   (b) fiscal; monetary
   (c) monetary; incomes
   (d) monetary; fiscal
   Answer: B
   Question Status: Previous Edition

215) Keynesians usually view _____ policy as having a longer effectiveness lag than _____ policy, but there is substantial uncertainty about how long this lag is.
   (a) fiscal; incomes
   (b) fiscal; monetary
   (c) monetary; incomes
   (d) monetary; fiscal
   Answer: D
   Question Status: Previous Edition

216) Economists usually view _____ policy as having a shorter implementation lag than _____ policy, but there is substantial uncertainty about how long this lag is.
   (a) fiscal; incomes
   (b) fiscal; monetary
   (c) monetary; incomes
   (d) monetary; fiscal
   Answer: D
   Question Status: Previous Edition

217) Economists usually view _____ policy as having a longer implementation lag than _____ policy, but there is substantial uncertainty about how long this lag is.
   (a) fiscal; incomes
   (b) fiscal; monetary
   (c) monetary; incomes
   (d) monetary; fiscal
   Answer: B
   Question Status: Previous Edition
218) Economists from which of the following schools of thought are most likely to favor activist government policies?
   (a) Keynesian
   (b) Monetarist
   (c) Classical
   (d) All of the above
   Answer: A
   Question Status: Previous Edition

219) The view that the wage and price adjustment process is extremely slow and that failing to implement an expansionary monetary policy to move the economy to full employment results in a significant loss of output is most likely to be held by
   (a) activists.
   (b) Keynesians.
   (c) monetarists.
   (d) only (a) and (b) of the above.
   Answer: D
   Question Status: Previous Edition

220) The view that the wage and price adjustment process is extremely slow and that failing to implement an expansionary monetary policy to move the economy to full employment results in a significant loss of output is most likely to be held by
   (a) nonactivists.
   (b) Keynesians.
   (c) monetarists.
   (d) only (a) and (b) of the above.
   Answer: B
   Question Status: Previous Edition

221) Which of the following statements describe activists’ policy views?
   (a) Wage and price adjustments and, therefore, the economy’s self-correcting mechanism bring the economy back to the natural rate level of output slowly.
   (b) Discretionary economic policies speed the return of the economy back to the natural rate level of output.
   (c) Discretionary economic policies, because of long and variable time lags, are likely to be destabilizing.
   (d) Only (a) and (b) of the above.
   Answer: D
   Question Status: Previous Edition
222) Which of the following statements describe activists’ policy views?
(a) Wage and price adjustments and, therefore, the economy’s self-correcting mechanism bring the economy back to the natural rate level of output quickly.
(b) Discretionary economic policies speed the return of the economy back to the natural rate level of output.
(c) Discretionary economic policies, because of long and variable time lags, are likely to be destabilizing.
(d) Only (a) and (b) of the above.
Answer: B
Question Status: Previous Edition

223) If output adjusts _____ to the natural rate level, and if time lags between policy actions and changes in aggregate output are relatively _____, then the case for activist policy is strengthened.
(a) slowly; short
(b) slowly; long
(c) quickly; short
(d) quickly; long
Answer: A
Question Status: Previous Edition

224) If output adjusts _____ to the natural rate level, and if time lags between policy actions and changes in aggregate output are relatively _____, then the case for activist policy is weakened.
(a) slowly; short
(b) slowly; long
(c) quickly; short
(d) quickly; long
Answer: D
Question Status: Previous Edition

225) Which of the following statements describe nonactivists’ policy views?
(a) Wage and price adjustments and, therefore, the economy’s self-correcting mechanism bring the economy back to the natural rate level of output slowly.
(b) Discretionary economic policies speed the return of the economy back to the natural rate level of output.
(c) Discretionary economic policies, because of long and variable time lags, are likely to be destabilizing.
(d) Only (a) and (b) of the above.
Answer: C
Question Status: Previous Edition
226) Which of the following statements describe nonactivists’ policy views?
(a) Wage and price adjustments and, therefore, the economy’s self-correcting mechanism bring the economy back to the natural rate level of output quickly.
(b) Discretionary economic policies speed the return of the economy back to the natural rate level of output.
(c) Discretionary economic policies, because of long and variable time lags, are likely to be destabilizing.
(d) Only (a) and (b) of the above.
(e) Only (a) and (c) of the above.
Answer: E

227) Nonactivists argue that
(a) the performance of the economy can be improved if the government avoids active policy to eliminate unemployment.
(b) wage and price adjustment and, therefore, the economy’s self-correcting mechanism brings the economy back to the natural rate level of output slowly.
(c) discretionary economic policies speed the return of the economy back to the natural rate level of output.
(d) only (a) and (c) of the above.
Answer: A

228) Nonactivists
(a) view the self-correcting mechanism through wage and price adjustment to be very slow.
(b) believe that the performance of the economy would be improved if the government takes an active role in trying to eliminate unemployment.
(c) both (a) and (b) of the above.
(d) neither (a) nor (b) of the above.
Answer: D

229) Nonactivists contend that an activist policy of shifting the aggregate _____ curve will be costly because it produces _____ volatility in both the price level and output.
(a) supply; less
(b) supply; more
(c) demand; less
(d) demand; more
Answer: D
230) Monetarists contend that a policy of shifting the aggregate demand curve will be costly because it produces more volatility in both the price level and output. Thus monetarists favor
(a) activist policy.
(b) discretionary policy.
(c) demand-management policy.
(d) nonactivist policy.
Answer: D
Question Status: Previous Edition

231) The existence of long and variable policy lags tends to support
(a) monetarist views regarding macropolicy.
(b) Keynesian views regarding macropolicy.
(c) activist views regarding macropolicy.
(d) none of the above.
Answer: A
Question Status: Previous Edition

232) The existence of lags prevents the instantaneous adjustment of the economy to policies changing aggregate demand, thereby strengthening the case for
(a) activist policy.
(b) nonactivist policy.
(c) discretionary policy.
(d) demand-management policy.
Answer: B
Question Status: Revised

233) The existence of lags prevents the instantaneous adjustment of the economy to policies changing aggregate demand, thereby strengthening the case for
(a) activist policy.
(b) discretionary policy.
(c) demand-management policy.
(d) none of the above.
Answer: D
Question Status: Revised

234) Two types of inflation can result from an activist stabilization policy to promote high employment: _____ inflation, which occurs because of negative supply shocks or a push by workers to get higher wages, and _____ demand-pull inflation, which results when policymakers pursue policies that shift out the aggregate demand curve.
(a) demand-pull; demand-pull
(b) demand-pull; cost-push
(c) cost-push; demand-pull
(d) cost-push; cost-push
Answer: C
Question Status: Previous Edition
235) The case for activist policy is strengthened if
(a) policymakers, by shifting the aggregate demand curve out, can move the economy to full employment relatively quickly.
(b) the wage and price adjustment process is extremely slow relative to the time lags that prevent a quick movement to full employment.
(c) the use of activist policy does not influence expectations that matter to the wage-setting process.
(d) all of the above hold.
Answer: D

Question Status: Previous Edition

236) The case for activist policy is strengthened if
(a) the wage and price adjustment process is extremely slow relative to the time lags that prevent a quick movement to full employment.
(b) there is little uncertainty about the length of policy time lags.
(c) the use of activist policy does not influence expectations that matter to the wage-setting process.
(d) all of the above hold.
(e) only (a) and (b) of the above hold.
Answer: D

Question Status: Previous Edition

237) The case for activist policy is strengthened if
(a) policymakers, by shifting the aggregate demand curve out, can move the economy to full employment relatively quickly.
(b) the wage and price adjustment process is extremely slow relative to the time lags that prevent a quick movement to full employment.
(c) the use of activist policy affects expectations that matter to the wage-setting process.
(d) all of the above hold.
(e) only (a) and (b) of the above hold.
Answer: E

Question Status: Previous Edition

238) The case for activist policy is strengthened if
(a) the wage and price adjustment process is extremely slow relative to the time lags that prevent a quick movement to full employment.
(b) there is a great deal of uncertainty about the length of policy time lags.
(c) the use of activist policy affects expectations that matter to the wage-setting process.
(d) only (a) and (b) of the above hold.
Answer: A

Question Status: Previous Edition
239) Which of the following views are consistent with the case for activist macroeconomic policy?
(a) Even with time lags, activist policy moves the economy to full employment before the economy’s self-correcting mechanism would.
(b) The wage and price adjustment process being extremely slow, a nonactivist policy results in a large loss of output.
(c) Workers will come to expect expansionary policies whenever the economy moves below full employment.
(d) All of the above.
(e) Only (a) and (b) of the above.
Answer: E
Question Status: Previous Edition

240) Activists believe in the use of discretionary policy to eliminate excessive unemployment whenever it develops, because
(a) they view the wage and price adjustment process to be sluggish.
(b) they consider the wage and price adjustment process to be unresponsive to expectations about policy.
(c) expectations about policy can matter to the wage-setting process.
(d) of (a) and (b) of the above.
Answer: D
Question Status: Previous Edition

241) Economists who believe that the government should pursue active discretionary policies to eliminate high unemployment whenever it develops
(a) view the self-correcting mechanism through wage and price adjustments to be very slow and unresponsive to expectations about policy.
(b) view the self-correcting mechanism through wage and price adjustments to be relatively rapid.
(c) regard the credibility of a nonaccommodating anti-inflationary policy to be crucial to its success.
(d) only (a) and (b) of the above.
Answer: A
Question Status: Previous Edition

242) Which of the following views are consistent with the case for nonactivist macroeconomic policy?
(a) Even with time lags, activist policy moves the economy to full employment before the economy’s self-correcting mechanism would.
(b) The wage and price adjustment process being extremely slow, a nonactivist policy results in a large loss of output.
(c) Workers will come to expect expansionary policies whenever the economy moves below full employment.
(d) All of the above.
(e) Only (a) and (b) of the above.
Answer: C
Question Status: Previous Edition
243) Which of the following views are consistent with the case for nonactivist macroeconomic policy?
(a) Even with time lags, activist policy moves the economy to full employment before the economy’s self-correcting mechanism would.
(b) The wage and price adjustment process being quite rapid, a nonactivist policy results in a small loss of output.
(c) Workers will come to expect expansionary policies whenever the economy moves below full employment.
(d) Only (b) and (c) of the above.
Answer: D
Question Status: Previous Edition

244) Which of the following views are consistent with the case for nonactivist macroeconomic policy?
(a) An activist, accommodating policy of shifting the aggregate demand curve will be costly because it produces more volatility in both the price level and output due to the substantial time it takes to shift aggregate demand.
(b) The wage and price adjustment process being quite rapid, a nonactivist policy results in a small loss of output.
(c) Workers will come to expect expansionary policies whenever the economy moves below full employment.
(d) All of the above.
Answer: D
Question Status: Previous Edition

245) The case for activist macroeconomic policy is weakened by which of the following considerations?
(a) If workers know policy will be accommodating in the future, they will seek higher wages to keep up with higher expected inflation.
(b) The accommodating, activist policy with its high employment target has the disadvantage that it may lead to inflation.
(c) Policy time lags are long and variable, depending on the state of the economy and the nature of expectations.
(d) All of the above.
Answer: D
Question Status: Previous Edition

246) Implicit in the case for activist macroeconomic policy is the assumption that expectations about policy never change; that is, the activist argument does not allow for the possibility
(a) that expectations about policy matter to the wage-setting process.
(b) that the economy might initially have moved below full employment because of an attempt by workers to raise their wages.
(c) that unemployment is temporarily high because of a negative supply shock.
(d) that all of the above might occur.
(e) that only (a) and (c) of the above might occur.
Answer: D
Question Status: Previous Edition
247) If workers know that policy will be accommodating in the future, they will continue to push their wages up and the aggregate supply curve will keep on shifting inward. Thus, the accommodating, activist policy with its high employment target

(a) will promote stability more effectively than a nonactivist policy.
(b) may not be effective in increasing output and lowering unemployment.
(c) has the hidden cost or disadvantage that it may well lead to inflation.
(d) will do only (b) and (c) of the above.

Answer: D

Question Status: Previous Edition

248) If workers’ opinions about whether policy is accommodating or nonaccommodating matter to the wage-setting process, then

(a) the case for a nonactivist policy is much stronger and the case for an activist policy is much weaker.
(b) the case for an activist policy is much stronger and the case for a nonactivist policy is much weaker.
(c) the case for a policy rule to keep the aggregate demand curve from fluctuating away from the trend rate of growth of the natural rate level of output is much weaker.
(d) only (a) and (c) of the above.

Answer: A

Question Status: Previous Edition

249) If workers’ opinions about whether policy is accommodating or nonaccommodating matter to the wage-setting process, then

(a) the case for a nonactivist policy is much stronger and the case for an activist policy is much weaker.
(b) the case for an activist policy is much stronger and the case for a nonactivist policy is much weaker.
(c) the case for a policy rule to keep the aggregate demand curve from fluctuating away from the trend rate of growth of the natural rate level of output is much stronger.
(d) only (a) and (c) of the above.

Answer: D

Question Status: Previous Edition

250) Nonactivists believe that a discretionary policy that reacts to excessive unemployment is counterproductive, because

(a) wage and price adjustment is rapid.
(b) they consider the wage and price adjustment process to be unresponsive to expectations about policy.
(c) expectations about policy can matter to the wage-setting process.
(d) of (a) and (b) of the above.
(e) of (a) and (c) of the above.

Answer: E

Question Status: Previous Edition
251) If expectations about policy affect how wages are set, then the case for a(n) _____ policy is much stronger.
   (a) activist
   (b) nonactivist
   (c) interventionist
   (d) stabilization

   Answer: B

Question Status: Previous Edition

252) If expectations matter to the wage-setting process, then
   (a) an accommodating, activist policy will likely be inflationary.
   (b) a nonaccommodating, nonactivist policy will have the advantage of keeping inflation low.
   (c) the case for a constant-money-growth-rate rule is weakened.
   (d) all of the above.
   (e) only (a) and (b) of the above.

   Answer: E

Question Status: Previous Edition

253) The advantage of a credible, nonaccommodating policy is that while unemployment may be no higher than what could be achieved under an activist, accommodating policy,
   (a) inflation is likely to be much lower.
   (b) inflation is likely to be much higher.
   (c) the government finds it easier to fool people more frequently.
   (d) none of the above are true.

   Answer: A

Question Status: Previous Edition

254) Economists who believe that the government should avoid active discretionary policies to eliminate high unemployment whenever it develops
   (a) view the self-correcting mechanism through wage and price adjustments to be very slow and unresponsive to expectations about policy.
   (b) view the self-correcting mechanism through wage and price adjustments to be relatively rapid.
   (c) regard the credibility of a nonaccommodating anti-inflationary policy to be crucial to its success.
   (d) only (a) and (c) of the above.
   (e) only (b) and (c) of the above.

   Answer: E

Question Status: Previous Edition

255) Evidence indicating that the wage and price adjustment process is extremely slow would strengthen the case for
   (a) nonactivist policy.
   (b) a constant-money-growth-rate rule.
   (c) discretionary policy.
   (d) none of the above.

   Answer: C

Question Status: Previous Edition
256) If expectations matter to the wage-setting process, then
   (a) an accommodating, activist policy will likely be inflationary.
   (b) a nonaccommodating, nonactivist policy will have the advantage of keeping inflation low.
   (c) the case for a constant-money-growth-rate rule is strengthened.
   (d) all of the above.
   Answer: D
   Question Status: Previous Edition

257) Monetarists emphasize the importance of a constant money growth rate rule more than the balanced-budget amendment or restrictions on union power because
   (a) they regard excessive money growth as the cause of inflation.
   (b) they believe that excessive government spending, not excessive monetary growth, is the cause of inflation.
   (c) they believe that while unions cause inflation, they are too politically powerful to deal with.
   (d) they regard high tax rates as the cause of inflation.
   (e) they believe that monetary growth has no effect on economic activity in the short run.
   Answer: A
   Question Status: Study Guide

258) Monetarists contend that a policy of shifting the aggregate demand curve will be costly because it produces more volatility in both the price level and output. Thus monetarists favor
   (a) activist policy.
   (b) discretionary policy.
   (c) demand-management policy.
   (d) a constant-money-growth-rate rule.
   Answer: D
   Question Status: Previous Edition

259) Evidence indicating that an increase in money growth causes aggregate output to increase with long and variable lags would strengthen the case for
   (a) nonactivist policy.
   (b) a constant-money-growth-rate rule.
   (c) discretionary policy.
   (d) only (a) and (b) of the above.
   Answer: D
   Question Status: Previous Edition

260) A nonaccommodating, nonactivist policy will prevent inflation and also produce the additional benefit of discouraging inward shifts in the aggregate supply curve that lead to excessive unemployment if
   (a) this policy position is regarded as credible.
   (b) monetary authorities are not constrained by a policy rule.
   (c) fiscal authorities are not constrained by a requirement to balance the federal government budget.
   (d) both (a) and (b) of the above.
   Answer: A
   Question Status: Previous Edition
261) A nonaccommodating, nonactivist policy will prevent inflation and also produce the additional benefit of discouraging inward shifts in the aggregate supply curve that lead to excessive unemployment if this policy is regarded as credible. Policies are more likely to be regarded as credible if
(a) monetary authorities are constrained by a policy rule such as a constant-money-growth-rate rule.
(b) fiscal authorities are constrained by a requirement to balance the federal government budget.
(c) fiscal and monetary authorities announce a commitment to high employment.
(d) all of the above.
(e) only (a) and (b) of the above.
Answer: E

Question Status: Previous Edition

262) A credible, nonaccommodating policy rule has the _____ that it makes a cost-push by workers _____ likely and thus helps to reduce the output loss from controlling inflation.
(a) advantage; less
(b) advantage; more
(c) disadvantage; less
(d) disadvantage; more
Answer: A

Question Status: Previous Edition

263) Back to back recessions in 1980 and 1981–1982 indicate that the nonaccommodating policy pursued by the Fed was
(a) not initially regarded as credible.
(b) overly expansionary.
(c) both (a) and (b) of the above.
(d) neither (a) nor (b) of the above.
Answer: A

Question Status: Previous Edition
**Essay Questions**

1) Explain and show graphically why continuous monetary growth is needed to generate inflation. Describe how the inflation process is generated.

Answer: Only continuous monetary growth can cause continuous increases in aggregate demand of the sort needed to generate inflation. Other factors can increase demand and the price level, but none can increase demand continuously. In the graph, the monetary expansion shifts AD to the right. The increase in output above the natural rate increases wages, shift AS to the left. Monetary expansion shifts AD repeatedly, and wages continue to adjust.

![Graph showing the inflation process](image)

2) Explain and show graphically how a tax increase reduces demand and increases unemployment. Why is the speed of the adjustment of wages and/or the role of expectations important in this situation?

Answer: The tax increase shifts AD down from AD₁ to AD₂. Output falls below the natural rate to Y₁, increasing unemployment. If wages are slow to adjust, the economy remains below the natural rate for a long time, but adjustment back to the natural rate is rapid if wages adjust quickly or if expectations lead to rapid adjustment of wages.

![Graph showing the tax increase](image)
3) Explain and show graphically how a positive supply shock, followed by a more restrictive monetary policy, allows policymakers a painless way to reduce inflation.

Answer: The positive supply shock shifts the aggregate supply curve to the right, exerting downward pressure on prices. Policymakers can now reduce demand to further reducing inflationary pressure without reducing output below the natural rate. In the figure, prices fall from $P_0$ to $P_1$ due to the positive supply shock, and fall further to $P_2$ due to the reduction in demand.