Chapter 32
The Influence of Monetary and Fiscal Policy on Aggregate Demand
Test B

1. Of the effects that help explain why the U.S. aggregate demand curve slopes downward the
   a. wealth effect is most important and the exchange rate effect is least important.
   b. exchange-rate effect is most important and the interest rate effect is least important.
   c. interest-rate effect is most important and the wealth effect is least important.
   d. None of the above is correct.

ANSWER: c. interest-rate effect is most important and the wealth effect is least important.
TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 1 RANDOM: Y

2. Liquidity preference theory is most relevant to the
   a. short run and supposes that the interest rate adjusts to bring money supply and money demand into balance.
   b. short run and supposes that the price level adjusts to bring money supply and money demand into balance.
   c. long run and supposes that the interest rate adjusts to bring money supply and money demand into balance.
   d. long run and supposes that the price level adjusts to bring money supply and money demand into balance.

ANSWER: a. short run and supposes that the interest rate adjusts to bring money supply and money demand into balance.
TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 1 RANDOM: Y

3. An increase in interest rates
   a. increases the cost of holding money and increases the quantity demanded.
   b. increases the cost of holding money and decreases the quantity demanded.
   c. decreases the cost of holding money and increases the quantity demanded.
   d. decreases the cost of holding money and decreases the quantity demanded.

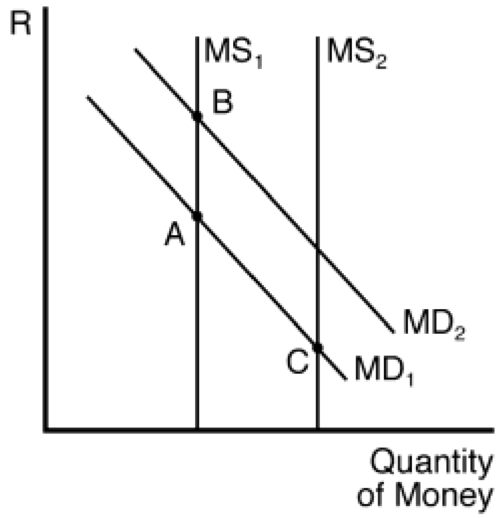
ANSWER: b. increases the cost of holding money and decreases the quantity demanded.
TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 1 RANDOM: Y

4. According to the theory of liquidity preference if there is a surplus of money, the interest rate will
   a. rise and the quantity of money demanded will increase.
   b. rise and the quantity of money demanded will decrease.
   c. fall and the quantity of money demanded will increase.
   d. fall and the quantity of money demanded will decrease.

ANSWER: c. fall and the quantity of money demanded will increase.
TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 1 RANDOM: Y

5. With the interest rate on the vertical axis, an increase in the price level shifts money
   a. supply right.
   b. supply left.
   c. demand right.
   d. demand left.

ANSWER: c. demand right.
TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 1 RANDOM: Y



6. Refer the graph. If we start at point A an increase in the price level results in a move to
   a. B and investment rises.
   b. B and investment falls.
   c. C and investment rises.
   d. C and investment falls.

ANSWER: b. B and investment falls.
TYPE: M KEY1: G SECTION: 1 OBJECTIVE: 1 RANDOM: Y GRAPH: 1

7. Which of the following properly describes the interest-rate effect?
   a. A higher price level leads to higher money demand, higher money demand leads to higher interest rates, and a higher interest rate increases the quantity of goods and services demanded.
   b. A higher price level leads to higher money demand, higher money demand leads to lower interest rates, and a lower interest rate reduces the quantity of goods and services demanded.
   c. A lower price level leads to lower money demand, lower money demand leads to lower interest rates, and a lower interest rate reduces the quantity of goods and services demanded.
   d. A lower price level leads to lower money demand, lower money demand leads to lower interest rates, and a lower interest rate increases the quantity of goods and services demanded.

ANSWER: d. A lower price level leads to lower money demand, lower money demand leads to lower interest rates, and a lower interest rate increases the quantity of goods and services demanded.
TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 1 RANDOM: Y

8. When the money supply increases interest rates
   a. rise and aggregate demand shifts right.
   b. fall and aggregate demand shifts left.
   c. rise and aggregate demand shifts left.
   d. None of the above is correct.

ANSWER: d. None of the above is correct.
TYPE: M KEY1: C SECTION: 1 OBJECTIVE: 2 RANDOM: Y

9. Which of the following shifts aggregate demand right?
   a. The price level rises.
   b. The price level falls.
   c. The money supply rises.
   d. Both a and b are correct.

ANSWER: c. The money supply rises.
TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 2 RANDOM: Y

NOTE: THE FOLLOWING QUESTION IS REPEATED FROM THE ON-LINE QUIZZES. YOUR STUDENTS MAY HAVE ALREADY SEEN THIS QUESTION AND ITS ANSWER.

10. Suppose the Federal Reserve decreases the money supply. As a result:
    a. investment, real output, and the price level are all lower.
    b. investment is higher, real output is lower, and the price level is unchanged.
    c. investment, real output, and the price level are all higher.
    d. investment is lower, real output is higher, and the price level is lower.

ANSWER: a. investment, real output, and the price level are all lower.
TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 2 RANDOM: Y

11. If the stock market booms household spending
    a. increases. To offset the effects of this on the price level and real GDP, the Fed would increase the money supply.
    b. increases. To offset the effects of this on the price level and real GDP, the Fed would decrease the money supply.
    c. decreases. To offset the effects of this on the price level and real GDP, the Fed would increase the money supply.
    d. decreases. To offset the effects of this on the price level and real GDP, the Fed would decrease the money supply.

ANSWER: b. increases. To offset the effects of this on the price level and real GDP, the Fed would decrease the money supply.
TYPE: M KEY1: C SECTION: 1 OBJECTIVE: 2 RANDOM: Y

12. In early January 2000 the Fed announced that it would cut interest rates one-half percentage point. To do this requires the Fed to
    a. increase the money supply and so increase aggregate demand.
    b. increase the money supply and so decrease aggregate demand.
    c. decrease the money supply and so increase aggregate demand.
    d. decrease the money supply and so decrease aggregate demand.

ANSWER: a. increase the money supply and so increase aggregate demand.
TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 2 RANDOM: Y

13. In the last quarter of 1999 German real GDP grew at a very low rate. Some economists attributed the low growth to monetary policy that by itself would have decreased real GDP. If they are correct, we should observe that the German money supply
    a. and interest rates had increased.
    b. and interest rates had decreased.
    c. had increased and interest rates had decreased.
    d. had decreased and interest rates had increased.

ANSWER: d. had decreased and interest rates had increased.
TYPE: M KEY1: C SECTION: 1 OBJECTIVE: 2 RANDOM: Y

14. When the Fed decreases the money supply we expect interest rates
    a. and stock prices to rise.
    b. and stock prices to fall.
    c. to rise and stock prices to fall.
    d. to fall and stock prices to rise.

ANSWER: c. to rise and stock prices to fall.
TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 2 RANDOM: Y

15. If the government increases its expenditures the price level
    a. and real GDP both rise.
    b. and real GDP both fall.
    c. rises and real GDP falls.
    d. falls and real GDP rises.

ANSWER: a. and real GDP both rise.
TYPE: M KEY1: D SECTION: 2 OBJECTIVE: 3 RANDOM: Y

16. Suppose that the MPC is .60 and there is no investment accelerator or crowding out. Then if government expenditures increase $10 billion, aggregate demand shifts right
    a. $40 billion.
    b. $25 billion.
    c. $16 billion.
    d. None of the above is correct.

ANSWER: b. $25 billion.
TYPE: M KEY1: E SECTION: 2 OBJECTIVE: 3 RANDOM: Y

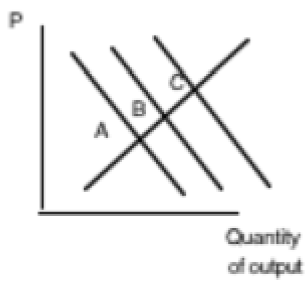
NOTE: THE FOLLOWING QUESTION IS REPEATED FROM THE ON-LINE QUIZZES. YOUR STUDENTS MAY HAVE ALREADY SEEN THIS QUESTION AND ITS ANSWER.

17. The multiplier effect occurs because an increase in government purchases will
    a. increase income which will result in further rounds of spending.
    b. increase interest rates which will reduce further rounds of spending.
    c. increase the government deficit which will decrease further rounds of spending.
    d. stimulate monetary policy which will increase further rounds of spending.

ANSWER: a. increase income which will result in further rounds of spending.
TYPE: M KEY1: D SECTION: 2 OBJECTIVE: 3 RANDOM: Y

18. Which of the following correctly explains the crowding-out effect?
    a. An increase in government expenditures decreases the interest rate and so increases investment spending.
    b. An increase in government expenditures increases the interest rate and so reduces investment spending.
    c. A decrease in government expenditures increases the interest rate and so increases investment spending.
    d. A decrease in government expenditures decreases the interest rate and so reduces investment spending.

ANSWER: b. An increase in government expenditures increases the interest rate and so reduces investment spending.
TYPE: M KEY1: D SECTION: 2 OBJECTIVE: 3 RANDOM: Y



19. According to the graph, which of the following is correct?
    a. An increase in government expenditures could initially move the economy from A to B and then the crowding-out effect would move it out to C.
    b. An increase in government expenditures could initially move the economy from A to C and then the multiplier effect would move it back to B.
    c. An increase in the price level would cause demand to shift so that the economy would move from A to B.
    d. None of the above is correct.

ANSWER: d. None of the above is correct.
TYPE: M KEY1: G SECTION: 2 OBJECTIVE: 3 RANDOM: Y GRAPH: 2

20. When the government increases expenditures the money demand curve shifts
    a. right and interest rates rise.
    b. right and interest rates fall.
    c. left and interest rates rise.
    d. left and interest rates fall.

ANSWER: a. right and interest rates rise.
TYPE: M KEY1: D SECTION: 2 OBJECTIVE: 3 RANDOM: Y

21. Permanent tax cuts shift the AD curve
    a. farther to the right than temporary tax cuts.
    b. less to the right than temporary tax cuts.
    c. farther to the left than temporary tax cuts.
    d. less to the left than temporary tax cuts.

ANSWER: a. farther to the right than temporary tax cuts.
TYPE: M KEY1: D SECTION: 2 OBJECTIVE: 3 RANDOM: Y

22. Suppose that net exports fall. Which of the following policies is most likely to stabilize the economy?
    a. a decrease in the money supply
    b. a tax increase
    c. an increase in government expenditures
    d. None of the above would be likely to stabilize the economy.

ANSWER: c. an increase in government expenditures
TYPE: M KEY1: C SECTION: 3 OBJECTIVE: 4 RANDOM: Y

23. If the government wanted to stabilize the economy when it was in recession it would
    a. raise interest rates and government expenditures.
    b. decrease interest rates and government expenditures.
    c. raise interest rates and decrease government expenditures.
    d. decrease interest rates and increase government expenditures.

ANSWER: d. decrease interest rates and increase government expenditures.
TYPE: M KEY1: D SECTION: 3 OBJECTIVE: 4 RANDOM: Y

NOTE: THE FOLLOWING QUESTION IS REPEATED FROM THE ON-LINE QUIZZES. YOUR STUDENTS MAY HAVE ALREADY SEEN THIS QUESTION AND ITS ANSWER.

24. Critics of using fiscal and monetary policies to solve economic problems believe that
    a. it can take too long for monetary policy to have an impact on the economy.
    b. the political process results in a lag when using fiscal policy.
    c. economic forecasting is imprecise.
    d. All of the above are correct.

ANSWER: d. All of the above are correct.
TYPE: M KEY1: D SECTION: 3 OBJECTIVE: 4 RANDOM: Y

25. The most important automatic stabilizer is
    a. open market transactions.
    b. the tax system.
    c. unemployment compensation.
    d. welfare benefits.

ANSWER: b. the tax system.
TYPE: M KEY1: D SECTION: 3 OBJECTIVE: 4 RANDOM: Y

1 ANSWER: c. interest-rate effect is most important and the wealth effect is least important.
TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 1 RANDOM: Y

2 ANSWER: a. short run and supposes that the interest rate adjusts to bring money supply and money demand into balance.
TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 1 RANDOM: Y

3 ANSWER: b. increases the cost of holding money and decreases the quantity demanded.
TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 1 RANDOM: Y

4 ANSWER: c. fall and the quantity of money demanded will increase.
TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 1 RANDOM: Y

5 ANSWER: c. demand right.
TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 1 RANDOM: Y

6 ANSWER: b. B and investment falls.
TYPE: M KEY1: G SECTION: 1 OBJECTIVE: 1 RANDOM: Y GRAPH: 1

7 ANSWER: d. A lower price level leads to lower money demand, lower money demand leads to lower interest rates, and a lower interest rate increases the quantity of goods and services demanded.
TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 1 RANDOM: Y

8 ANSWER: d. None of the above is correct.
TYPE: M KEY1: C SECTION: 1 OBJECTIVE: 2 RANDOM: Y

9 ANSWER: c. The money supply rises.
TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 2 RANDOM: Y

10 ANSWER: a. investment, real output, and price level are all lower.
TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 2 RANDOM: Y

11 ANSWER: b. increases. To offset the effects of this on the price level and real GDP, the Fed would decrease the money supply.
TYPE: M KEY1: C SECTION: 1 OBJECTIVE: 2 RANDOM: Y

12 ANSWER: a. increase the money supply and so increase aggregate demand.
TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 2 RANDOM: Y

13 ANSWER: d. had decreased and interest rates had increased.
TYPE: M KEY1: C SECTION: 1 OBJECTIVE: 2 RANDOM: Y

14 ANSWER: c. to rise and stock prices to fall.
TYPE: M KEY1: D SECTION: 1 OBJECTIVE: 2 RANDOM: Y

15 ANSWER: a. and real GDP both rise.
TYPE: M KEY1: D SECTION: 2 OBJECTIVE: 3 RANDOM: Y

16 ANSWER: b. $25 billion.
TYPE: M KEY1: E SECTION: 2 OBJECTIVE: 3 RANDOM: Y

17 ANSWER: a. increase income which will result in further rounds of spending.
TYPE: M KEY1: D SECTION: 2 OBJECTIVE: 3 RANDOM: Y

18 ANSWER: b. An increase in government expenditures increases the interest rate and so reduces investment spending.
TYPE: M KEY1: D SECTION: 2 OBJECTIVE: 3 RANDOM: Y

19 ANSWER: d. None of the above is correct.
TYPE: M KEY1: G SECTION: 2 OBJECTIVE: 3 RANDOM: Y GRAPH: 2

20 ANSWER: a. right and interest rates rise.
TYPE: M KEY1: D SECTION: 2 OBJECTIVE: 3 RANDOM: Y

21 ANSWER: a. farther to the right than temporary tax cuts.
TYPE: M KEY1: D SECTION: 2 OBJECTIVE: 3 RANDOM: Y

22 ANSWER: c. an increase in government expenditures
TYPE: M KEY1: C SECTION: 3 OBJECTIVE: 4 RANDOM: Y

23 ANSWER: d. decrease interest rates and increase government expenditures.
TYPE: M KEY1: D SECTION: 3 OBJECTIVE: 4 RANDOM: Y

24 ANSWER: d. All of the above are correct.
TYPE: M KEY1: D SECTION: 3 OBJECTIVE: 4 RANDOM: Y

25 ANSWER: b. the tax system.
TYPE: M KEY1: D SECTION: 3 OBJECTIVE: 4 RANDOM: Y