

Chapter 17

Stabilization in an Integrated World Economy

17.1 Active versus Passive Policymaking

- 1) Active policy making refers to
- A) actions taken by policy makers in response to or in anticipation of some change in the overall economy.
 - B) policy making that is carried out in response to a rule.
 - C) relying on policies that act as automatic stabilizers.
 - D) nondiscretionary policy making.

Answer: A

Diff: 1

Topic: 17.1 Active versus Passive Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 2) Active policy making would include all of the following EXCEPT
- A) interest rate changes by the Fed.
 - B) tax increases.
 - C) unemployment insurance benefits.
 - D) increased government spending by the Congress.

Answer: C

Diff: 2

Topic: 17.1 Active versus Passive Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 3) Which of the following would be an example of passive policy making?
- A) Establishing a system of automatic tax stabilizers
 - B) Marginal rate tax cuts intended to increase real Gross Domestic Product (GDP)
 - C) Government spending decreases intended to decrease real Gross Domestic Product (GDP)
 - D) None of the above

Answer: A

Diff: 2

Topic: 17.1 Active versus Passive Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 4) Monetary and fiscal policy making that is carried out in response to a pre-set rule and does not respond to changes in economic activity is known as
- A) active policy making.
 - B) discretionary policy making.
 - C) nondiscretionary policy making.
 - D) Keynesian policy making.

Answer: C

Diff: 1

Topic: 17.1 Active versus Passive Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 5) With discretionary policy making, fiscal and monetary policies are usually
- A) undertaken in response to or anticipation of some change in the overall economy.
 - B) set according to pre-established standards that do not take into account any changes in the economy.
 - C) immune to any political overtones.
 - D) immune to any lag times that might counter their effectiveness.

Answer: A

Diff: 1

Topic: 17.1 Active versus Passive Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 6) If a policy maker is convinced that time lags frequently negate the impact of short-run stabilization efforts, it is likely she would favor _____ policy making.
- A) nondiscretionary
 - B) discretionary
 - C) active
 - D) aggressive

Answer: A

Diff: 2

Topic: 17.1 Active versus Passive Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 7) When policy makers take actions in response to or in anticipation of some change in the overall economy, there is
- A) active policy making.
 - B) passive policy making.
 - C) rationalization policy making.
 - D) rational expectations policy making.

Answer: A

Diff: 1

Topic: 17.1 Active versus Passive Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 8) Proponents of passive policy making believe that
- A) the existence of time lags makes active policy ineffective or even procyclical.
 - B) time lags do not exist so the economy will adjust too rapidly with active policy.
 - C) government should not follow any particular policy.
 - D) fiscal policy is always better than monetary policy in stabilizing the economy.

Answer: A

Diff: 2

Topic: 17.1 Active versus Passive Policymaking

AACSB: Analytic skills

Question Status: New

- 9) Which of the following scenarios can be classified as passive policy making?
- A) The Federal Reserve cuts the federal funds rate in order to increase economic activity.
 - B) The federal government increases spending in order to create jobs.
 - C) The Federal Reserve adjusts the money supply as appropriate to attain a target rate of inflation.
 - D) Congress increases expenditures in an effort to stimulate economic activity.

Answer: C

Diff: 1

Topic: 17.1 Active versus Passive Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 10) Actions on the part of monetary and fiscal policy makers that are undertaken in response to some change in the overall economy are known as
- A) nondiscretionary policy making.
 - B) passive policy making.
 - C) creative policy making.
 - D) active policy making.

Answer: D

Diff: 1

Topic: 17.1 Active versus Passive Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 11) When policy makers base their actions on a rule there is
- A) active policy making.
 - B) passive policy making.
 - C) rationalization policy making.
 - D) rational expectations policy making.

Answer: B

Diff: 1

Topic: 17.1 Active versus Passive Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 12) An example of nondiscretionary policy making is
- A) a rule under which the Fed targets the inflation rate.
 - B) expansionary fiscal policy.
 - C) changes in the interest rate initiated by the Fed.
 - D) a Congressional tax-rate cut aimed at boosting real GDP.

Answer: A

Diff: 1

Topic: 17.1 Active versus Passive Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 13) If a policy is carried out by a rule, then we have an example of
- A) active policy making.
 - B) discretionary policy making.
 - C) nondiscretionary policy making.
 - D) natural policy making.

Answer: C

Diff: 1

Topic: 17.1 Active versus Passive Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

18) What best defines active policy making?

- A) taking action to offset a change in economic performance
- B) taking action to increase long-term economic growth
- C) taking action to make markets more competitive so as to improve efficiency
- D) taking action to make markets less competitive so as to improve equity

Answer: A

Diff: 2

Topic: 17.1 Active versus Passive Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

19) policy making that is carried out in response to a rule is

- A) active policy making.
- B) passive policy making.
- C) restrictive policy making.
- D) determined policy making.

Answer: B

Diff: 1

Topic: 17.1 Active versus Passive Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

20) The idea of policy making taking place in response to a predetermined set of rules is referred to as

- A) active policy making.
- B) discretionary policy making.
- C) passive policy making.
- D) Keynesianism.

Answer: C

Diff: 1

Topic: 17.1 Active versus Passive Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

21) The idea of policy making being undertaken as a response to a change in the economy is referred to as

- A) active policy making.
- B) non-discretionary policy making.
- C) passive policy making.
- D) Keynesianism.

Answer: A

Diff: 2

Topic: 17.1 Active versus Passive Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

22) If the rate of growth in the money supply is predetermined on the basis of a monetary rule, this is known as

- A) direct policy making.
- B) active policy making.
- C) passive policy making.
- D) fiscal policy making.

Answer: C

Diff: 1

Topic: 17.1 Active versus Passive Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 23) If the Fed engages in open market sales in direct response to an increase in the rate of inflation, this is known as
- A) direct policy making.
B) active policy making.
C) passive policy making.
D) fiscal policy making.
- Answer: B
Diff: 1
Topic: 17.1 Active versus Passive Policymaking
AACSB: Analytic skills
Question Status: Previous Edition
- 24) Explain the difference between active and passive policy making.
- Answer: Active policy making, or discretionary policy making, is a situation when fiscal and monetary policy makers act in response to or in anticipation of some change in the overall economy. They act so as to move the economy more quickly toward full employment and greater price stability. Passive, or nondiscretionary, policy making is policy making that follows some rule rather than one that tries to respond or anticipate some change in economic activity.
- Diff: 1*
Topic: 17.1 Active versus Passive Policymaking
AACSB: Analytic skills
Question Status: Previous Edition

17.2 The Natural Rate of Unemployment

3) What types of unemployment will still exist when the economy is at the natural rate of unemployment?

- A) frictional and cyclical unemployment only
- B) frictional and structural unemployment only
- C) structural and cyclical unemployment only
- D) frictional, structural, and cyclical unemployment

Answer: B

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

4) The Phillips curve shows the relationship between

- A) the price level and real Gross Domestic Product (GDP).
- B) the tax rate and tax revenues.
- C) the unemployment rate and inflation rate.
- D) the interest rate and exchange rate.

Answer: C

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB:

Question Status: Previous Edition

5) Structural unemployment may result from all of the following factors EXCEPT

- A) union wage contracts.
- B) government-imposed licensing arrangements that restrict entry into certain professions.
- C) improved elementary and secondary education.
- D) welfare and unemployment benefits.

Answer: C

Diff: 1

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

6) Your friend recently graduated from college and is actively looking for employment. The economy has completely recovered from the last recession and your friend is taking her time, looking for the "perfect" job. In the meantime, the unemployment she is experiencing is categorized as

- A) cyclical.
- B) structural.
- C) seasonal.
- D) frictional.

Answer: D

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

7) The natural rate of unemployment is

- A) zero.
- B) the unemployment rate when there is no structural unemployment.
- C) the unemployment rate when there is no structural or cyclical unemployment.
- D) the unemployment rate that exists in long-run equilibrium, after adjustments to all changes have occurred.

Answer: D

Diff: 1

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

8) The natural rate of unemployment is defined as the rate of unemployment that

- A) prevails in long-run macroeconomic equilibrium, when all workers and employers have fully adjusted to any changes in the economy.
- B) prevails in the short-run macroeconomic equilibrium, before workers and employers have had a chance to adjust to an economic shock.
- C) exists due to welfare and unemployment benefits that reduce potential workers' incentives to find work.
- D) exists only during periods of recession or depression in the economy.

Answer: A

Diff: 1

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

9) The natural rate of unemployment includes

- A) frictional and cyclical unemployment.
- B) only cyclical unemployment.
- C) only unemployment due to layoffs and corporate downsizing.
- D) frictional unemployment and structural unemployment.

Answer: D

Diff: 1

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

10) According to the text, the probability of an unemployed person finding a job doubles when

- A) his unemployment benefits expire.
- B) his unemployment benefits are extended.
- C) the economy enters a recessionary phase.
- D) he is threatened with arrest.

Answer: A

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 11) According to the text, minimum-wage laws cause increases in
- A) employment possibilities.
 - B) structural unemployment.
 - C) poverty.
 - D) productivity.

Answer: B

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Revised

- 12) Frictional and structural unemployment both exist when
- A) the economy is in an expansionary phase.
 - B) the economy is in long-run equilibrium.
 - C) the economy is at the peak of the business cycle.
 - D) the economy is in short-run equilibrium.

Answer: B

Diff: 1

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 13) An increase in unemployment insurance and other transfer payments may
- A) increase the natural rate of unemployment.
 - B) increase the number of discouraged workers.
 - C) reduce the rate of inflation at every level of unemployment.
 - D) lead to less unanticipated inflation.

Answer: A

Diff: 1

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 14) From 1950 until the late 1980s, the natural rate of unemployment in the United States
- A) fell sharply as government retraining programs helped put the unemployed back to work.
 - B) cycled up and down in tandem with the actual rate of unemployment.
 - C) rose sharply, always exceeding the actual rate of unemployment.
 - D) trended upward.

Answer: D

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB:

Question Status: Previous Edition

- 15) From the late 1980s to 2000, the natural rate of unemployment
- A) climbed sharply.
 - B) held constant.
 - C) fluctuated up and down, following the path of the actual rate of unemployment.
 - D) gradually declined.

Answer: D

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB:

Question Status: Revised

- 16) During a recession, the overall unemployment rate
- A) falls rapidly.
 - B) exceeds the natural rate of unemployment.
 - C) falls below the natural rate of unemployment.
 - D) equals the inflation rate.

Answer: B

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 17) Cyclical unemployment is
- A) the difference between the unemployment rate when the economy is in a recession and the unemployment rate when the economy is at the peak of an expansion.
 - B) the difference between the actual unemployment rate and the natural rate of unemployment.
 - C) the unemployment due to union activities and government-imposed restrictions to entry into specific occupations.
 - D) the unemployment due to the unemployment benefits and welfare programs of the government.

Answer: B

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 18) If cyclical unemployment is negative, then
- A) the actual unemployment rate is below the natural rate of unemployment.
 - B) the natural rate of unemployment is getting smaller.
 - C) there have been some errors in classifying the type of unemployment experienced by some people.
 - D) structural unemployment must be increasing.

Answer: A

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

19) Which of the following unemployment rates can be negative?

- A) the cyclical unemployment rate
- B) the natural unemployment rate
- C) the seasonal unemployment rate
- D) the official unemployment rate reported by the Bureau of Labor Statistics

Answer: A

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: New

20) Which type of unemployment is associated with the slump in aggregate demand that accompanies a recession?

- A) Expansionary unemployment
- B) Cyclical unemployment
- C) Frictional unemployment
- D) Structural unemployment

Answer: B

Diff: 1

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

21) An unexpected increase in aggregate demand typically causes

- A) frictional unemployment to increase but structural unemployment to decrease.
- B) the price level to increase but has no effect on the unemployment rate.
- C) the price level to increase and the unemployment rate to fall.
- D) the price level to increase and the unemployment rate to increase.

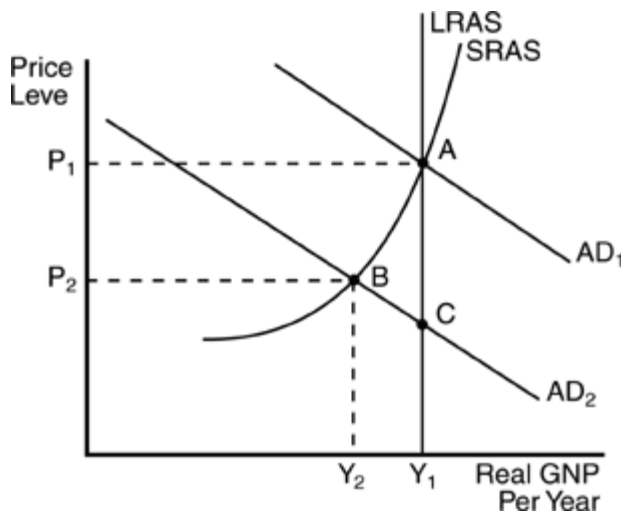
Answer: C

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition



- 22) In the above figure, start with the economy in equilibrium at point A. Then an unanticipated reduction in aggregate demand triggers a shift from AD_1 to AD_2 . In the short run, this would cause
- A) the price level to fall from P_1 to P_2 , real Gross Domestic Product (GDP) to fall from Y_1 to Y_2 , and the rate of unemployment to increase.
 - B) the price level to move from P_1 to P_2 , but real Gross Domestic Product (GDP) would stay at Y_1 .
 - C) the price level to fall by some amount less than P_1 but greater than P_2 , and the rate of unemployment would decrease.
 - D) no change in either the price level or real Gross Domestic Product (GDP), but a decrease in unemployment.

Answer: A

Diff: 1

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 23) Suppose the economy is initially operating at point A in the above figure. Which of the following statements is true?
- A) An unexpected reduction in aggregate demand will cause the economy to move from point A to point B in the long run.
 - B) An unexpected reduction in aggregate demand will cause the economy to move from point A to point B in the short run.
 - C) An unexpected reduction in aggregate demand will cause the economy to move from point A to point C in the short run.
 - D) none of the above

Answer: B

Diff: 1

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 24) One result of an unanticipated reduction in aggregate demand would be that
- A) fewer firms would be hiring.
 - B) more firms would be hiring.
 - C) there would be no change in hiring.
 - D) the price level would rise.

Answer: A

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 25) On average, the greater the unexpected decline in aggregate demand,
- A) the weaker is the resulting deflation.
 - B) the greater is the resulting deflation.
 - C) the greater is the resulting inflation.
 - D) the greater is the rise in the price level.

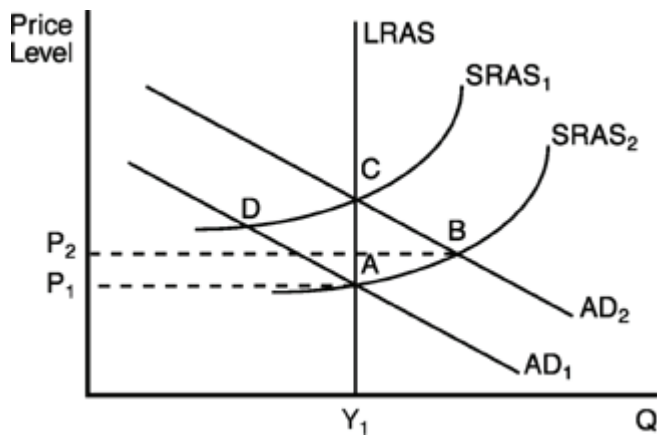
Answer: B

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition



- 26) In the above figure, if A is the initial equilibrium point and there is an unanticipated rise in aggregate demand from AD_1 to AD_2 , then
- A) the new short-run equilibrium will be at point B.
 - B) the new long-run equilibrium will be at point B.
 - C) the new short-run equilibrium will be at point D.
 - D) real Gross Domestic Product (GDP) per year will fall below Y_1 .

Answer: A

Diff: 1

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 27) In the above figure, if initial equilibrium is at point A and if there is an unanticipated increase in aggregate demand from AD_1 to AD_2 , then
- A) in the short run real output will remain at Y_1 .
 - B) in the short run real output will increase above Y_1 , but in the long run it will return to Y_1 .
 - C) in the long run real output will increase above Y_1 .
 - D) real output will increase above Y_1 in both the short run and in the long run.

Answer: B

Diff: 1

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 28) In the above figure, if initial equilibrium is at point A and there is a fully anticipated increase in aggregate demand from AD_1 to AD_2 due to an anticipated increase in the money supply, then
- A) the economy will move directly from point A to point C without passing through point B.
 - B) the economy will move directly from point A to point B, and will remain at point B in the long run.
 - C) the price level will shift to P_2 in the short run.
 - D) the price level will shift to P_2 in the long run.

Answer: A

Diff: 1

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 29) The rate of unemployment below which the rate of inflation tends to rise and above which the rate of inflation tends to fall is known as the
- A) Phillips rate of unemployment.
 - B) contrary rate of unemployment.
 - C) non-accelerating-inflation rate of unemployment (NAIRU).
 - D) menu cost rate of unemployment.

Answer: C

Diff: 1

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 30) The Phillips Curve will shift when
- A) the expected inflation rate changes.
 - B) the price level falls.
 - C) the overall employment rate remains unchanged.
 - D) none of the above.

Answer: A

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 31) Based on the work of economist A.W. Phillips, economists concluded that
- A) there is no trade-off between inflation and unemployment.
 - B) high inflation rates are associated with low unemployment rates.
 - C) unemployment can be effectively combated by raising wages.
 - D) higher rates of inflation are associated with higher rates of unemployment.

Answer: B

Diff: 1

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 32) The Phillips curve shows
- A) a positive relationship in the long run between the rate of inflation and the rate of unemployment.
 - B) a negative relationship between the inflation rate and the unemployment rate, at least in the short run.
 - C) a positive relationship between contractionary monetary policy and higher price levels.
 - D) a positive relationship between price stability and constant, small-increment changes in the fiscal policy on the part of the Fed.

Answer: B

Diff: 1

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 33) What happens to the Phillips curve when the expected rate of inflation rises?
- A) The curve shifts to the right
 - B) The curve shifts to the left
 - C) The curve becomes horizontal
 - D) The Phillips curve is unaffected

Answer: A

Diff: 1

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 34) The short-run Phillips curve suggests what policy making implications?
- A) Active policy making does not yield any predictable results.
 - B) Passive policy making is more effective than active policy making.
 - C) Using discretionary policies, it may be possible to achieve just the right unemployment and inflation mix.
 - D) Maintaining both the inflation and unemployment rates at low levels is possible if policy makers will rely solely on nondiscretionary policy making.

Answer: C

Diff: 1

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 35) Critics of the Phillips curve argue that in the long run,
- A) there is a trade-off between unemployment and inflation.
 - B) for any given unemployment level there is a corresponding inflation rate to which the economy will automatically revert.
 - C) employees are not able to anticipate future rates of inflation, and therefore unemployment can always be reduced by inflating the economy.
 - D) there is no trade-off between inflation and unemployment because workers' expectations adjust to any systematic attempts to reduce unemployment below the natural rate.

Answer: D

Diff: 1

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Revised

- 36) The Phillips curve shows
- A) the relationship between the rate of interest and planned investment.
 - B) the relationship between the money supply and the price level.
 - C) that an increase in government spending will decrease real national income.
 - D) that an increase in inflation may be associated with a decrease in the rate of unemployment.

Answer: D

Diff: 1

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Revised

- 37) The Phillips curve trade-off relationship implies that
- A) the government can fine-tune the economy and generate both the natural rate of unemployment and zero inflation.
 - B) the government can fine-tune the economy and pick the most preferred combination of unemployment and inflation.
 - C) low unemployment can be obtained only by generating rapidly increasing inflation.
 - D) there is no relationship between inflation and unemployment, at least in the long run.

Answer: B

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Revised

- 38) Suppose that the inflation rate has been 3 percent per year for several years, and the unemployment rate has been stable at 5 percent. Unanticipated changes in government policy cause the inflation rate to increase to 6 percent. In the short run, we would expect the unemployment rate to
- A) remain constant.
 - B) increase to 10 percent.
 - C) increase, but the exact amount cannot be known for sure.
 - D) decrease.

Answer: D

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 39) In the short run, unanticipated inflation typically leads to
- A) higher rates of unemployment.
 - B) decreases in aggregate demand.
 - C) lower rates of unemployment.
 - D) workers' thinking the real wage has been reduced.

Answer: C

Diff: 1

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 40) When the actual unemployment rate is greater than the NAIRU, the inflation rate
- A) tends to increase.
 - B) tends to decrease.
 - C) remains unchanged.
 - D) falls to zero.

Answer: B

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 41) Assume that the government decides to use fiscal or monetary policy to stimulate the economy and that this action comes as a surprise to most individuals and businesses. In the short run, the result will be
- A) a decrease in the average duration of unemployment and a decrease in the unemployment rate.
 - B) an increase in the average duration of unemployment and an increase in the unemployment rate.
 - C) a decrease in aggregated demand and a rise in the price level.
 - D) an increase in aggregate demand and a fall in the price level.

Answer: A

Diff: 1

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 42) An important source of structural unemployment is
- A) seasonal variations in aggregate demand.
 - B) unemployment insurance benefits.
 - C) people looking for the right job decide to change jobs.
 - D) recessions.

Answer: B

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 43) Which of the following is NOT a possible cause of structural unemployment?
- A) individuals take the time to search for the best job opportunities
 - B) a mismatch of worker training and skills with requirements of employers
 - C) government-imposed minimum wage laws
 - D) union activity that sets wages above the equilibrium level

Answer: A

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 44) The natural rate of unemployment is
- A) the unemployment rate when cyclical unemployment is the only type of unemployment.
 - B) the unemployment rate when there is no frictional unemployment.
 - C) the rate of unemployment associated with long-run equilibrium.
 - D) zero.

Answer: C

Diff: 1

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 45) A trade-off between unemployment and inflation is reflected in the
- A) natural rate of unemployment.
 - B) Phillips Curve.
 - C) economic stability.
 - D) nonaccelerating inflation rate of unemployment (NAIRU).

Answer: B

Diff: 1

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

46) The natural rate of unemployment consists of

- A) no workers looking for employment.
- B) only seasonal unemployment.
- C) only structural unemployment.
- D) structural and frictional unemployment.

Answer: D

Diff: 1

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

47) When the economy is in long-run equilibrium, there will be

- A) no unemployment.
- B) frictional and structural unemployment.
- C) cyclical unemployment only.
- D) cyclical and seasonal unemployment.

Answer: B

Diff: 1

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

48) Empirical evidence suggests that, when unemployment benefits run out, the probability that an unemployed person will find a job

- A) remains constant.
- B) goes down by 20 percent.
- C) about doubles.
- D) about triples.

Answer: C

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB:

Question Status: Previous Edition

49) Deviations of the actual unemployment rate from the natural rate of unemployment are called

- A) frictional unemployment.
- B) cyclical unemployment.
- C) seasonal unemployment.
- D) underemployment.

Answer: B

Diff: 1

Topic: 17.2 The Natural Rate of Unemployment

AACSB:

Question Status: Previous Edition

50) When the economy is operating at a level of real GDP that is greater than its potential level, we know that

- A) the actual unemployment rate is greater than the natural rate of unemployment.
- B) the structural rate of unemployment is negative.
- C) the frictional unemployment is zero.
- D) the cyclical rate of unemployment is negative.

Answer: D

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

51) During a recession, the

- A) natural rate of unemployment has fallen.
- B) cyclical rate of unemployment is positive.
- C) cyclical rate of unemployment is zero.
- D) cyclical rate of unemployment is negative.

Answer: B

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

52) Deviations of the actual unemployment rate away from the natural rate are

- A) cyclical unemployment.
- B) frictional unemployment.
- C) structural unemployment.
- D) the monetary rule.

Answer: A

Diff: 1

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

53) Suppose the natural rate of unemployment is 5 percent. If the actual unemployment rate is 7 percent, then the cyclical unemployment rate

- A) is 2 percent.
- B) is -2 percent.
- C) is 12 percent.
- D) cannot be determined given the information.

Answer: A

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: New

54) Suppose the natural rate of unemployment is 5 percent. If the actual unemployment rate is 4 percent, then the cyclical unemployment rate is

- A) 9 percent.
- B) 1 percent.
- C) -1 percent.
- D) 0 percent as cyclical unemployment cannot be less than zero.

Answer: C

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: New

- 55) We observe the duration of unemployment falling and wage rates rising. It is likely that
- A) the government has initiated expansionary fiscal policy but the policies haven't taken effect yet.
 - B) summer has arrived.
 - C) aggregate demand has increased.
 - D) aggregate supply has increased.

Answer: C

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 56) Suppose the government abolished the minimum wage law and the law that requires union wage rates to be paid on all government contract jobs. We would expect to see
- A) a decline in the natural rate of unemployment.
 - B) an increase in claims for unemployment benefits.
 - C) the duration of unemployment to increase.
 - D) a recession.

Answer: A

Diff: 3

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 57) Suppose there was an unexpected increase in aggregate demand. We would expect to observe
- A) frictional unemployment to increase.
 - B) the duration of unemployment and the amount of unemployment to decrease.
 - C) higher wages, with the duration of unemployment and the amount of unemployment unchanged.
 - D) a decrease in aggregate demand.

Answer: B

Diff: 3

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 58) An unexpected increase in aggregate demand causes
- A) the unemployment rate to fall, with no change in the price level.
 - B) the price level to rise, but the duration of unemployment will remain constant, so the unemployment rate remains constant.
 - C) simultaneously the price level to rise and the unemployment rate to fall.
 - D) simultaneously the price level to fall and the unemployment rate to fall.

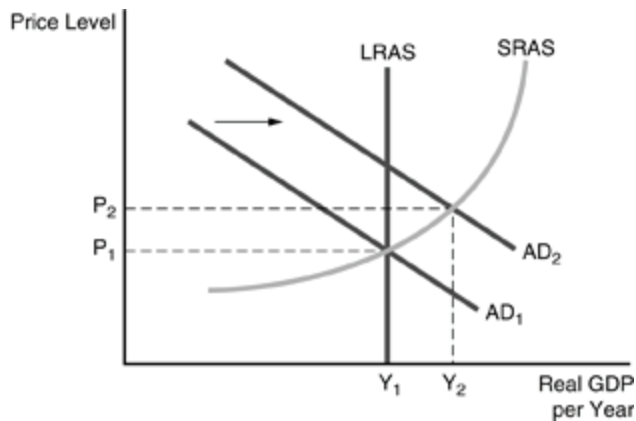
Answer: C

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition



- 59) Refer to the above figure. Unexpected expansionary monetary policy has caused the aggregate demand curve to shift to AD_2 . In the short run,
- A) real GDP will be Y_1 , and the price level will be P_1 .
 - B) real GDP will be Y_2 , and the price level will be P_2 .
 - C) real GDP will be Y_1 , and the price level will be above P_2 .
 - D) real GDP will be between Y_1 and Y_2 , and the price level will be between P_1 and P_2 .

Answer: B

Diff: 3

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 60) Refer to the above figure. Unexpected expansionary monetary policy has caused the aggregate demand curve to shift to AD_2 . In the long run,
- A) real GDP will be Y_1 , and the price level will be P_1 .
 - B) real GDP will be Y_2 , and the price level will be P_2 .
 - C) real GDP will be Y_1 , and the price level will be above P_2 .
 - D) real GDP will be between Y_1 and Y_2 , and the price level will be between P_1 and P_2 .

Answer: C

Diff: 3

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 61) Refer to the above figure. Unexpected expansionary monetary policy has caused the aggregate demand curve to shift to AD₂. In the short run,
- A) the unemployment rate will be the same rate as before the expansionary monetary policy.
 - B) the unemployment rate will be larger than the rate before the expansionary monetary policy.
 - C) the unemployment rate will be smaller than the rate before the expansionary monetary policy.
 - D) the unemployment rate can increase or decrease depending upon how much the LRAS will shift.

Answer: C

Diff: 3

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 62) Refer to the above figure. Unexpected expansionary monetary policy has caused the aggregate demand curve to shift to AD₂. In the long run,
- A) the unemployment rate will be the same rate as before the expansionary monetary policy.
 - B) the unemployment rate will be larger than the rate before the expansionary monetary policy.
 - C) the unemployment rate will be smaller than the rate before the expansionary monetary policy.
 - D) the unemployment rate can increase or decrease depending upon how much the LRAS will shift.

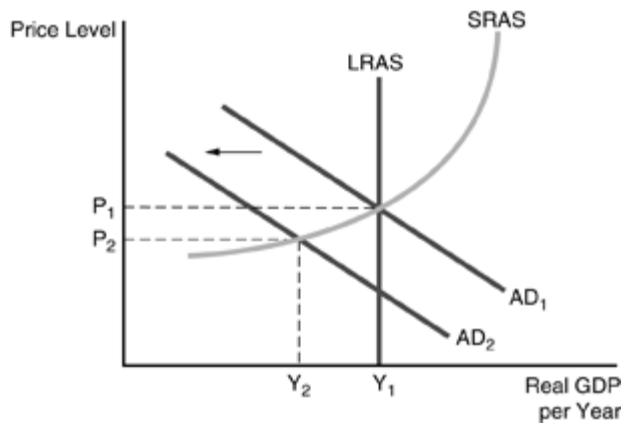
Answer: A

Diff: 3

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition



- 63) Refer to the above figure. Unexpected contractionary monetary policy has caused the aggregate demand curve to shift to AD_2 . In the short run,
- A) real GDP will be Y_1 , and the price level will be P_1 .
 - B) real GDP will be Y_2 , and the price level will be P_2 .
 - C) real GDP will be between Y_1 and Y_2 , and the price level will be above P_1 .
 - D) real GDP will be between Y_1 , and the price level will be below P_2 .

Answer: B

Diff: 3

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 64) Refer to the above figure. Unexpected contractionary monetary policy has caused the aggregate demand curve to shift to AD_2 . In the long run,
- A) real GDP will be Y_1 , and the price level will be P_1 .
 - B) real GDP will be Y_2 , and the price level will be P_2 .
 - C) real GDP will be between Y_1 and Y_2 , and the price level will be above P_1 .
 - D) real GDP will be between Y_1 , and the price level will be below P_2 .

Answer: D

Diff: 3

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 65) Refer to the above figure. Unexpected contractionary monetary policy has caused the aggregate demand curve to shift to AD₂. In the short run,
- A) the unemployment rate will be the same rate as before the expansionary monetary policy.
 - B) the unemployment rate will be larger than the rate before the expansionary monetary policy.
 - C) the unemployment rate will be smaller than the rate before the expansionary monetary policy.
 - D) the unemployment rate can increase or decrease depending upon how much the LRAS will shift.

Answer: B

Diff: 3

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 66) Refer to the above figure. Unexpected contractionary monetary policy has caused the aggregate demand curve to shift to AD₂. In the long run,
- A) the unemployment rate will be the same rate as before the expansionary monetary policy.
 - B) the unemployment rate will be larger than the rate before the expansionary monetary policy.
 - C) the unemployment rate will be smaller than the rate before the expansionary monetary policy.
 - D) the unemployment rate can increase or decrease depending upon how much the LRAS will shift.

Answer: A

Diff: 3

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 67) The inflation rate has been constant for several years at 4 percent, and the unemployment rate has been stable at 6 percent over the same time period. Changes in government policy that cause the inflation rate to rise to 6 percent will
- A) have no effect on the unemployment rate.
 - B) cause the unemployment rate to fall in the short run.
 - C) cause the unemployment rate to rise to 9 percent in the short run.
 - D) cause the unemployment rate to rise in the short run, but we cannot tell by how much.

Answer: B

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

68) The trade-off between unemployment and inflation is known as

- A) the Keynesian mechanism.
- B) the Phillips curve.
- C) an expansionary gap.
- D) passive policy making.

Answer: B

Diff: 1

Topic: 17.2 The Natural Rate of Unemployment

AACSB:

Question Status: Previous Edition

69) The Phillips curve is thought to reflect the relationship between

- A) unemployment and real GDP.
- B) unemployment and inflation.
- C) inflation and real GDP.
- D) the price level and inflation.

Answer: B

Diff: 1

Topic: 17.2 The Natural Rate of Unemployment

AACSB:

Question Status: Previous Edition

70) The nonaccelerating inflation rate of unemployment (NAIRU) is

- A) another name for the natural rate of unemployment.
- B) the unemployment rate associated with a steady rate of inflation.
- C) the unemployment rate associated with a decreasing rate of inflation.
- D) when the number of people entering the job market equals the number leaving the job market.

Answer: B

Diff: 1

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

71) At one time, many economists believed that

- A) the government could determine what the Phillips curve should be.
- B) the government could determine the slope of the Phillips curve.
- C) the government could make the Phillips curve vertical.
- D) the government could decide at which point on the Phillips curve the economy should be.

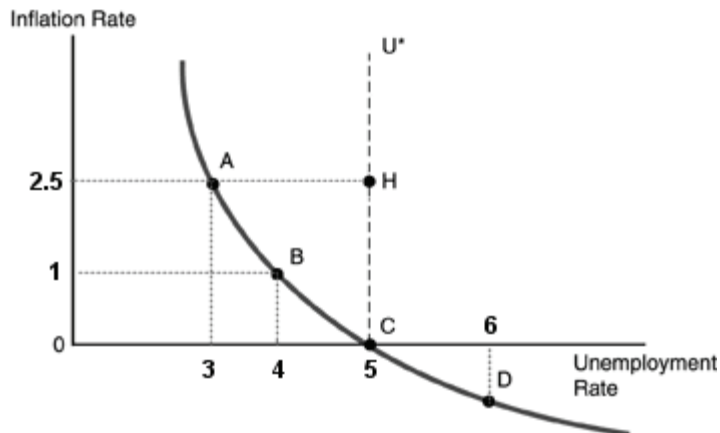
Answer: D

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition



72) Refer to the above figure. Line ABCD is a(n)

- A) aggregate demand curve.
- C) discretionary-policy curve.

- B) Phillips curve.
- D) natural rate of unemployment curve.

Answer: B

Diff: 1

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

73) Refer to the above figure. Government policy that moved the economy from A to B would be accomplished by

- A) an expansionary fiscal policy combined with a contractionary monetary policy.
- B) a contractionary fiscal policy combined with an expansionary monetary policy.
- C) a contractionary policy that would reduce the rate of inflation and would cause workers to remain unemployed longer than they were before.
- D) raising the minimum wage.

Answer: C

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

74) Refer to the above figure. Suppose the economy is at C. If the government tried to reduce the unemployment rate to 3 percent, the new long-run outcome will be at point

- A) A.
- B) C.
- C) D.
- D) H.

Answer: D

Diff: 3

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 75) Refer to the above figure. Suppose the natural rate of unemployment is 5 percent. If the government tried to reduce unemployment to 4 percent and keep it there, it must
- A) raise unemployment benefits.
 - B) accept a permanent inflation rate of 1 percent.
 - C) generate higher and higher inflation rates or else people will adjust their behavior and the unemployment rate will return to 5 percent.
 - D) use contractionary fiscal and expansionary monetary policy.

Answer: C

Diff: 3

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 76) Policymakers' attempts to use the Phillips curve to reduce the unemployment rate below the natural rate
- A) will be successful since the Phillips curve shows the relationship between the inflation rate and the unemployment rate.
 - B) will be successful if monetary policy is used.
 - C) will be unsuccessful if monetary policy is used since monetary policy leads to higher prices.
 - D) will be unsuccessful since workers' expectations adjust to attempts to reduce unemployment below the natural rate.

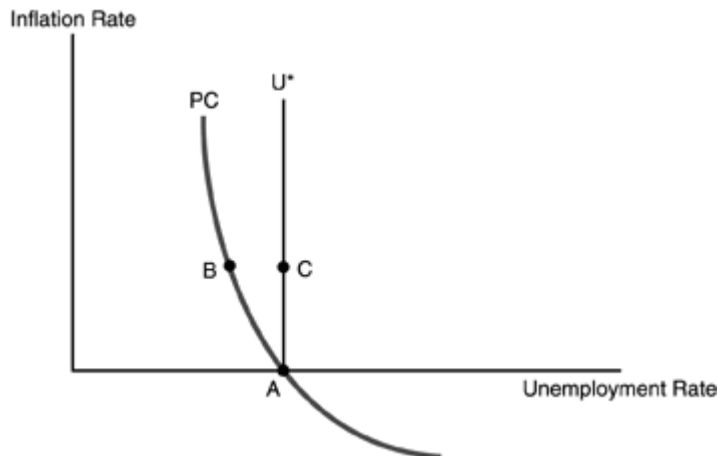
Answer: D

Diff: 1

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition



77) Refer to the above figure. The economy initially is at point A. The Fed unexpectedly increases the money supply. Which of the following statements are true?

- A) In the short run, the economy will move from point A to point C. In the long run, the economy will move to point B.
- B) In the short run, the economy will move from point A to point C. In the long run, the economy will move back to point A.
- C) In the short run, the economy will move from point A to point B. In the long run, the economy will stay at point B.
- D) In the short run, the economy will move from point A to point B. In the long run, the economy will move back to point A.

Answer: D

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

78) If everyone in the economy correctly anticipates the inflation rate, the unemployment rate

- A) will be the natural rate of unemployment.
- B) will be the cyclical rate of unemployment.
- C) will be inversely related to the expected inflation rate.
- D) will be positively related to the expected inflation rate.

Answer: A

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

79) Unemployment that deviates from the natural rate of unemployment is referred to as

- A) frictional unemployment.
- B) cyclical unemployment.
- C) seasonal unemployment.
- D) structural unemployment.

Answer: B

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 80) Suppose the Fed permanently increases the money supply by a given amount. Which of the following is (are) most likely to occur in the long run as a result of this monetary policy action?
- A) an increase in employment
 - B) a reduction in the real interest rate
 - C) a decrease in unemployment
 - D) all of the above
 - E) none of the above

Answer: E

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 81) The rate of unemployment below which the rate of inflation tends to rise and above which the rate of inflation tends to fall is called the
- A) FOMC unemployment rate.
 - B) GDP gap unemployment rate.
 - C) inflation-stabilizing equilibrium rate of unemployment.
 - D) nonaccelerating inflation rate of unemployment.

Answer: D

Diff: 1

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 82) The nonaccelerating inflation rate of unemployment (NAIRU) is the rate of unemployment that
- A) is consistent in each time period with a steady rate of inflation.
 - B) is identical to the natural rate of unemployment.
 - C) includes only structural and cyclical rates of unemployment when there is no inflation.
 - D) includes only frictional and cyclical rates of unemployment when there is no inflation.

Answer: A

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 83) NAIRU stands for
- A) national inflation rate when unemployment is low.
 - B) nonaccelerating inflation rate of unemployment.
 - C) normal average rate of inflation when unemployment rate is zero.
 - D) national average inflation rate at zero unemployment rate.

Answer: B

Diff: 1

Topic: 17.2 The Natural Rate of Unemployment

AACSB:

Question Status: Previous Edition

- 84) When the economy is at its natural rate of unemployment,
- A) it is still experiencing frictional and cyclical unemployment.
 - B) it is still experiencing structural and cyclical unemployment.
 - C) it is still experiencing frictional, seasonal, and structural unemployment.
 - D) it is still experiencing frictional, structural, and cyclical unemployment.

Answer: C

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 85) NAIRU is the rate of unemployment at which
- A) the rate of inflation will be constant.
 - B) the price level will be constant.
 - C) the money supply will be constant.
 - D) the labor force participation rate will be constant.

Answer: A

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 86) All of the following would increase the natural rate of unemployment EXCEPT
- A) union activity restricts the mobility of labor.
 - B) government licensing of teachers restricts employment.
 - C) a mismatch of skills and jobs.
 - D) a downturn in the economy.

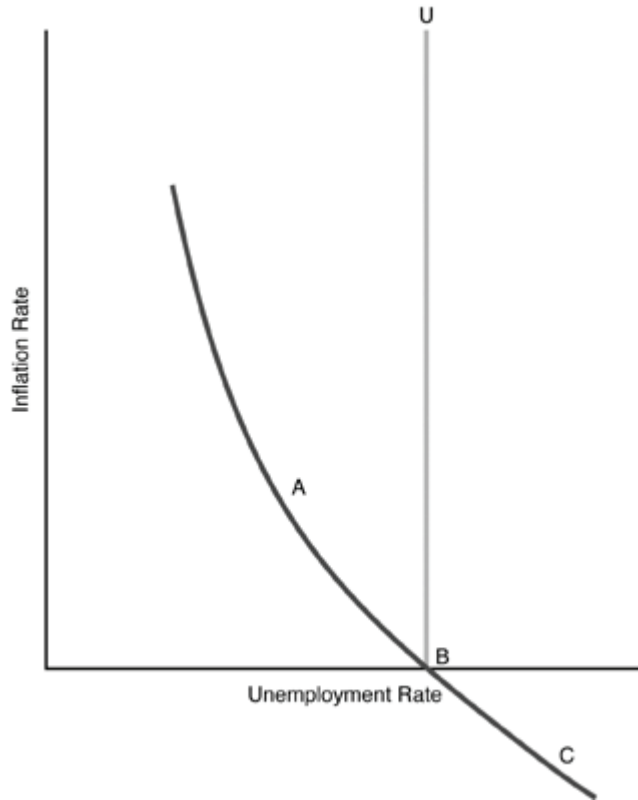
Answer: D

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition



- 87) In the above figure, what does the line U represent?
- A) the Phillips curve
 - B) the Natural Rate of Unemployment
 - C) nominal inflation rate of unemployment (NAIRU)
 - D) full inflation rate of unemployment

Answer: B

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 88) Use the above figure. Assuming that policy actions are unanticipated, if the economy is at point A and the policy makers want to get to point B, they could
- A) increase the money supply.
 - B) decrease taxation.
 - C) decrease the money supply.
 - D) increase government spending.

Answer: C

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 89) According to A.W. Phillips, an inverse relationship has existed between
- A) unemployment and interest rates.
 - B) the rate of growth of the money supply and the unemployment rate.
 - C) the inflation rate and unemployment rate.
 - D) the inflation rate and the money supply.

Answer: C

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB:

Question Status: Previous Edition

- 90) Which of the following curves shows the relationship between the unemployment rate and the rate of change in the price level?
- A) the new Keynesian aggregate supply curve
 - B) the real business cycle curve
 - C) the aggregate demand curve
 - D) none of the above

Answer: D

Diff: 1

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 91) According to the Phillips curve,
- A) there is a direct relationship between price-level changes and the level of unemployment rate.
 - B) the unemployment rate is not affected by changes in the price level.
 - C) price-level changes are not affected by changes in the unemployment rate.
 - D) there is an inverse relationship between price-level changes and the unemployment rate.

Answer: D

Diff: 1

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 92) The Phillips curve shows the relationship between
- A) the rate of growth in real GDP and the unemployment rate.
 - B) the inflation rate and the unemployment rate.
 - C) aggregate demand and the unemployment rate.
 - D) aggregate supply and the unemployment rate.

Answer: B

Diff: 1

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 93) The downward slope of the Phillips curve suggests that
- A) an increase in the price level will depress nominal wages.
 - B) an increase in the price level will increase the money supply.
 - C) a decrease in the money supply will stimulate aggregate demand.
 - D) policy makers face a trade-off between inflation and unemployment.

Answer: D

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition



- 94) Use the above figure. This graph is known as
- A) the Laffer curve.
 - B) the short-run Phillips curve.
 - C) the NAIRU relationship.
 - D) the Keynesian curve.

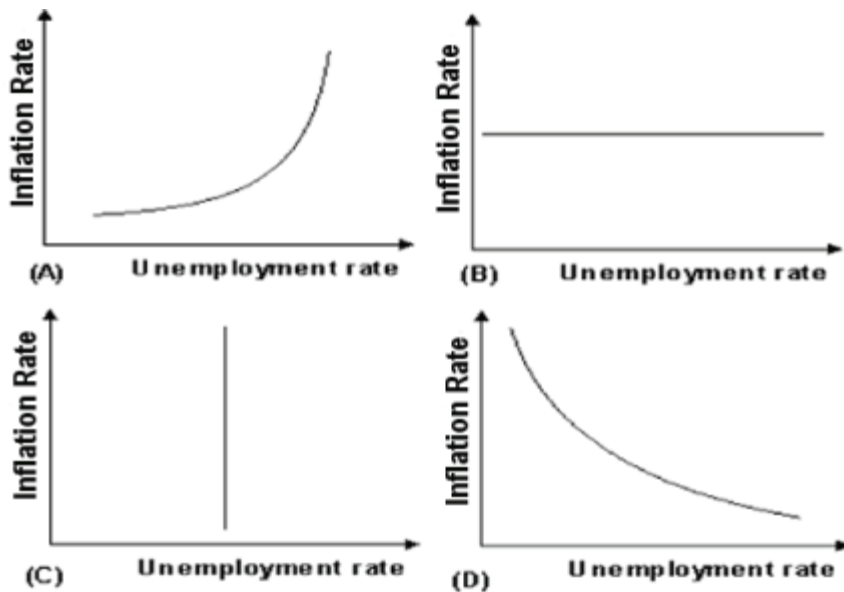
Answer: B

Diff: 1

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Revised



- 95) Use the above figure. Graph _____ correctly depicts the short-run Phillips Curve.
 A) A B) B C) C D) D

Answer: D

Diff: 1

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 96) Use the above figure. The long-run Phillips curve is best depicted by graph
 A) A. B) B. C) C. D) D.

Answer: C

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 97) Which one of the following would likely reduce the level of structural unemployment?
 A) increasing the minimum wage to encourage more people to work
 B) increasing the level of union bargaining power
 C) limiting unemployment insurance benefits
 D) strengthening restrictions on who can be licensed to enter certain professions

Answer: C

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 98) According to economists who support passive policy making,
- A) there is no difference between the effect of an anticipated change in aggregate demand and the effect of an unanticipated change in aggregate demand of an identical amount.
 - B) workers always consider a change in nominal wages to be a change in real wages.
 - C) expansionary policies can reduce unemployment without increasing the price level.
 - D) policies that attempt to exploit the Phillips curve trade-off will eventually become ineffective for reducing unemployment.

Answer: D

Diff: 3

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 99) The historical record suggests that
- A) the Phillips curve is horizontal.
 - B) once policy makers attempted to exploit a short-run Phillips curve trade-off, it disappeared.
 - C) shifts in long-run aggregate supply do not affect real output.
 - D) inflation rates are lowest when unemployment rates are also low.

Answer: B

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 100) Cyclical unemployment is positive when
- A) the inflation rate is positive.
 - B) the economy is at the peak of a business expansion.
 - C) the natural rate of unemployment exceeds the actual rate.
 - D) the actual unemployment rate exceeds the natural rate.

Answer: D

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 101) Expansionary fiscal policy can be used to reduce unemployment by
- A) increasing long-run aggregate supply so as to raise real GDP.
 - B) increasing aggregate demand so as to raise real GDP.
 - C) reducing nominal wages so as to encourage firms to hire more workers.
 - D) eliminating inefficiencies from labor markets.

Answer: B

Diff: 3

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Revised

- 102) An unexpected increase in aggregate demand
- A) causes the price level to fall and the unemployment rate to rise.
 - B) causes the price level to fall and the unemployment rate to fall.
 - C) causes the price level to rise and the unemployment rate to rise.
 - D) causes the price level to rise and the unemployment rate to fall.

Answer: D

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 103) An unexpected decrease in aggregate demand
- A) causes the price level to fall and the unemployment rate to rise.
 - B) causes the price level to fall and the unemployment rate to fall.
 - C) causes the price level to rise and the unemployment rate to rise.
 - D) causes the price level to rise and the unemployment rate to fall.

Answer: A

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 104) An unexpected decrease in aggregate demand
- A) will decrease long-run aggregate supply.
 - B) will decrease the average duration of unemployment.
 - C) will decrease the price level.
 - D) will decrease real GDP, but will not affect the rate and duration of unemployment.

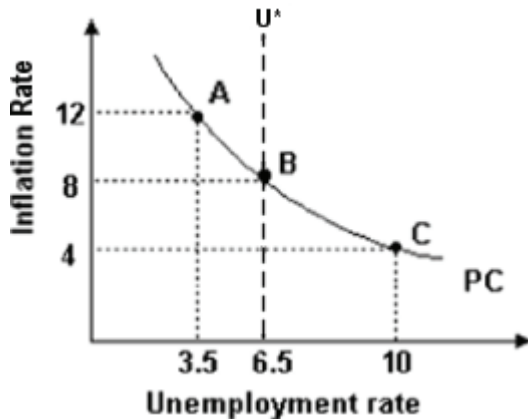
Answer: C

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition



- 105) Refer to the above figure. Suppose the economy is at point B and the central bank adopts expansionary monetary policy. In the short run, this will result in
- A) the economy moving towards point A.
 - B) the economy staying at point B.
 - C) the economy moving towards point C.
 - D) an outcome that cannot be predicted, as not enough information is given.

Answer: A

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Revised

- 106) Refer to the above figure. Suppose the economy is at point B and the central bank adopts contractionary monetary policy. In the short run, this will result in
- A) the economy moving towards point A.
 - B) the economy staying at point B.
 - C) the economy moving towards point C.
 - D) an outcome that cannot be predicted, because not enough information is given.

Answer: C

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Revised

- 107) The short-run Phillips curve and the long-run Phillips curve are different because
- A) the expected rate of inflation is always zero in the long run, while it is a positive number in the short run.
 - B) the expected rate of inflation is always zero in the short run, while it is a positive number in the long run.
 - C) the actual and expected rate of inflation are equal in the short run.
 - D) the actual and expected rate of inflation are equal in the long run.

Answer: D

Diff: 2

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

108) What kinds of unemployment are associated with the natural rate of unemployment?

Answer: The natural rate of unemployment is associated with unemployment that would exist even in long-run equilibrium. Frictional unemployment and structural unemployment both exist even when the economy is in long-run equilibrium, so is part of the natural rate of unemployment.

Diff: 1

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

109) What is the Phillips curve? What does the Phillips curve suggest about optimal policy?

Answer: The Phillips curve shows a trade-off between unemployment and inflation. With the unemployment rate on the horizontal axis and inflation on the vertical, the Phillips curve is pictured as a downward sloping curve. If the curve is a suitable representation of the economy, in the short run policy makers can choose the combination of inflation and unemployment that they want.

Diff: 2

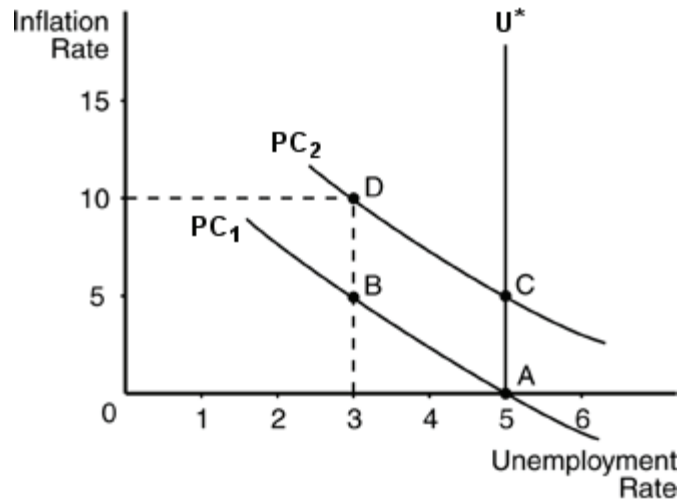
Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 110) Suppose the economy has been experiencing zero inflation and 5 percent unemployment for several years. The government decides to lower the unemployment by generating some inflation. Using a graph, show what the short-run effects would be and what would happen in the long run. What would the government have to do to keep the unemployment rate at 3 percent?

Answer:



See above figure. The natural rate of unemployment is 5 percent. The government inflates by pursuing expansionary monetary policy and the economy moves to B, with an unemployment rate of 3 percent and inflation rate of 5 percent. In the long run, the Phillips curve shifts to the right and the unemployment rate goes back to 5 percent. For the government to maintain 3 percent unemployment, it would have to keep increasing the inflation rate (point D).

Diff: 3

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Reflective thinking skills

Question Status: Previous Edition

- 111) What is meant by the natural rate of unemployment?

Answer: The natural rate of unemployment the rate of unemployment estimated to prevail in long-run macroeconomic equilibrium, when all workers and employers have fully adjusted to any changes in the economy.

Diff: 1

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

- 112) The natural rate of unemployment has increased in the United States and Europe over the last twenty years. What are things that could account for this?

Answer: The natural rate of unemployment is affected by various rigidities. These rigidities include unions, government-imposed licenses, and other restrictions in labor markets, minimum wage laws, and welfare, and unemployment insurance. If these rigidities have become more important, then the labor markets are likely to suffer from greater structural unemployment and the natural rate of unemployment would be greater.

Diff: 3

Topic: 17.2 The Natural Rate of Unemployment

AACSB: Analytic skills

Question Status: Previous Edition

17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

- 1) When a person bases her future expectations for the economy on all available current data and her own judgment about future policy effects, this is known as

- A) the policy irrelevance proposition.
- B) rational expectations.
- C) irrational expectations.
- D) the new classical theory.

Answer: B

Diff: 2

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 2) The hypothesis stating that people combine the effects of past policy changes on important economic variables with their own judgment about the future effects of future and current policy changes is known as

- A) policy irrelevance hypothesis.
- B) rational expectations hypothesis.
- C) life cycle hypothesis.
- D) real business cycle hypothesis.

Answer: B

Diff: 2

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 3) According to the rational expectations hypothesis, monetary policy can have real effects on such variables as real Gross Domestic Product (GDP) in the short run

- A) only when the policy is anticipated.
- B) only when the policy is unsystematic and unanticipated.
- C) regardless of whether the policy is anticipated or unanticipated.
- D) when the Federal Reserve's open market committee operates as expected in either buying or selling bonds.

Answer: B

Diff: 1

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 4) The rational expectations hypothesis is a theory that states that
- A) individuals can predict the future perfectly, at least with respect to macroeconomic variables like the interest rate and inflation.
 - B) people make their economic plans by using all available past and present information and their understanding about how the economy operates.
 - C) people make their economic plans in an irrational, intuitive manner.
 - D) people make their economic plans by relying on the policy statements made by the President and by leaders in Congress.

Answer: B

Diff: 1

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 5) According to the rational expectations hypothesis, an individual's assessment of future economic performance
- A) does not consider past performance.
 - B) does not consider the impact of inflation.
 - C) only considers past performance.
 - D) considers both past performance and current monetary and fiscal policy.

Answer: D

Diff: 1

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 6) One economic hypothesis states that people form expectations by combining the effects of past policy changes on important economic variables with their own judgment about the future effects of current and future policy changes, and then react accordingly. This is known as the
- A) relevance hypothesis.
 - B) contrary opinion hypothesis.
 - C) rational expectations hypothesis.
 - D) structural hypothesis.

Answer: C

Diff: 1

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Revised

- 7) The hypothesis that people combine the effects of past policy changes on important economic variables with their own judgment about the future effects of current and future policy changes is the basis of the
- A) adaptive hypothesis.
 - B) short-run Phillips curve hypothesis.
 - C) rational expectations hypothesis.
 - D) demand-pull inflation hypothesis.

Answer: C

Diff: 1

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 8) Rational expectations theory suggests that short-run stabilization policy
- A) is best achieved with monetary policy.
 - B) is best achieved with fiscal policy.
 - C) is equally easy to achieve with monetary or fiscal policy.
 - D) should not be attempted.

Answer: D

Diff: 1

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 9) If you accept the rational expectations hypothesis as accurate, what would you tell monetary policy makers who ask you how to more effectively manage the economy?
- A) Consumers do not understand the workings of monetary policy, so discretionary and nondiscretionary policies are equally effective.
 - B) Individuals do understand how monetary policy works, so consistency and predictability are the keys to effective policy making.
 - C) Individuals base their economic expectations solely on current information, so repeating policy decisions that have worked in the past is the most effective path to take.
 - D) Only unanticipated policies will be effective once individuals understand how monetary policy works.

Answer: D

Diff: 2

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 10) Assume the Fed initiates an expansionary monetary policy that is correctly anticipated by economic agents in the economy. According to the rational expectation hypothesis, the result is
- A) an increased price level in the short run, but no effect on price level in the long run.
 - B) decreased real Gross Domestic Product (GDP) in the short run, but increased real Gross Domestic Product (GDP) in the long run.
 - C) increased real Gross Domestic Product (GDP) and increased employment in the long run.
 - D) an increased price level, but no change in real Gross Domestic Product (GDP) in the long run.

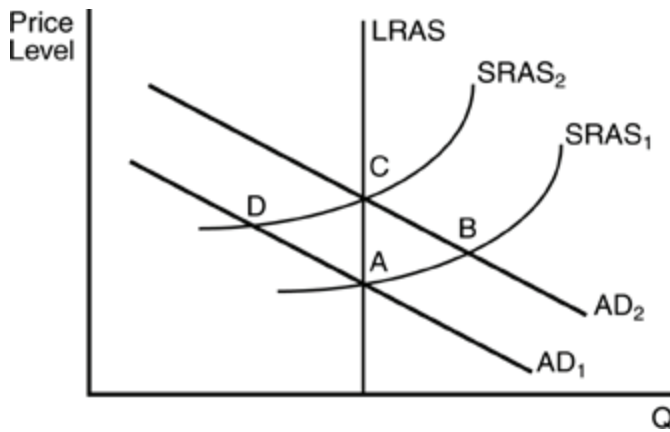
Answer: D

Diff: 2

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition



- 11) In the above figure, suppose the economy is initially at a short-run equilibrium at point D and there is an unanticipated increase in the money supply. Which point represents the new short-run equilibrium?

A) A B) B C) C D) D

Answer: C

Diff: 1

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 12) In the above figure, suppose the economy is in equilibrium at point A. The Fed engages in an expansionary monetary policy that is fully anticipated by the public. Other things being equal, what point represents the new equilibrium according to the rational expectations theory?

A) A B) B C) C D) D

Answer: C

Diff: 2

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 13) In the above figure, suppose the economy is currently in equilibrium at point C. Applying rational expectations theory, what happens if the Fed announces that it is decreasing the money supply and follows through on its statement?

A) The price level will increase.
 B) Real Gross Domestic Product (GDP) per year will increase.
 C) Real Gross Domestic Product (GDP) per year will decrease.
 D) The price level will decrease.

Answer: D

Diff: 2

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 14) Proponents of the policy irrelevance proposition believe that, under the assumption of rational expectations, the unemployment rate will
- A) go up whenever the Fed announces an anticipated monetary policy change.
 - B) go down whenever the Fed announces an anticipated fiscal policy change.
 - C) equal the natural rate of unemployment in the long run, regardless of any monetary policy actions.
 - D) always be higher in the long run than the natural rate of employment.

Answer: C

Diff: 1

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 15) The idea that anticipated monetary policy cannot affect real variables such as real Gross Domestic Product (GDP) or employment is known as
- A) the Keynesian hypothesis.
 - B) the policy irrelevance proposition.
 - C) the job search model.
 - D) the monetary velocity theory.

Answer: B

Diff: 1

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 16) According to the policy irrelevance proposition, monetary policy can affect real variables
- A) in both the short run and the long run.
 - B) in the long run only.
 - C) in the short run only, and then only if the policy was unanticipated.
 - D) in the short run only, and then only if the policy was fully anticipated.

Answer: C

Diff: 2

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 17) For the policy irrelevance theorem to hold, people must
- A) know the future perfectly.
 - B) not persistently make the same mistakes in forecasting the future.
 - C) know exactly what the Fed is planning to do.
 - D) never make mistakes in their forecasts, even when they do not know the future perfectly.

Answer: B

Diff: 2

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 18) When workers and employers correctly anticipate the rate of inflation,
- A) there will be no unemployment.
 - B) there will be only involuntary unemployment.
 - C) unemployment will be at the natural rate.
 - D) workers will underestimate the real wage.

Answer: C

Diff: 1

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 19) In the aggregate supply–aggregate demand model, if every person in the economy correctly anticipates the inflation rate, the unemployment rate will
- A) be less than the natural rate of unemployment.
 - B) be more than the natural rate of unemployment.
 - C) equal the natural rate of unemployment.
 - D) equal zero.

Answer: C

Diff: 2

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Revised

- 20) Assuming that the rational expectations hypothesis is NOT in effect, in the short run an expansionary monetary policy should
- A) shift the aggregate supply function.
 - B) increase real Gross Domestic Product (GDP) and the price level.
 - C) increase the rate of unemployment.
 - D) generate stagflation.

Answer: B

Diff: 1

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 21) In the short run, an unanticipated cut in the rate of inflation would
- A) increase the unemployment rate.
 - B) decrease the unemployment rate.
 - C) unambiguously improve the misery index.
 - D) lower the natural rate of unemployment.

Answer: A

Diff: 1

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 22) If all the assumptions underpinning the policy irrelevance proposition are in place, fully anticipated monetary policy will
- A) affect the unemployment rate but have no impact on the level of real Gross Domestic Product (GDP).
 - B) have an impact on real Gross Domestic Product (GDP) but cannot alter the level of unemployment.
 - C) effectively alter both the rate of unemployment and the level of real Gross Domestic Product (GDP).
 - D) not change either the level of real Gross Domestic Product (GDP) or the unemployment rate.

Answer: D

Diff: 2

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 23) According to the policy irrelevance proposition,
- A) monetary policy can effectively reduce the rate of unemployment in the short run.
 - B) workers are not rational in the long run.
 - C) the Phillips curve slopes upward, not downward as traditionally assumed.
 - D) expansionary monetary policy will only lead to a higher rate of inflation in the long run.

Answer: D

Diff: 1

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Revised

- 24) According to the policy irrelevance proposition, the impact of an anticipated expansionary monetary policy will be to
- A) increase the price level in the long run.
 - B) increase the real Gross Domestic Product (GDP) in the long run.
 - C) decrease the natural rate of unemployment.
 - D) decrease the price level and the unemployment rate.

Answer: A

Diff: 1

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Revised

- 25) According to the policy irrelevance proposition, real Gross Domestic Product (GDP) is determined by
- A) the economy's aggregate demand curve.
 - B) the economy's long-run aggregate supply curve.
 - C) the rate of inflation only.
 - D) a combination of fiscal policy and monetary policy.

Answer: B

Diff: 2

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

26) One key assumption lying behind the policy irrelevance proposition is that

- A) wages are "sticky" downward.
- B) prices are "sticky" upward.
- C) the rational expectations hypothesis is correct.
- D) markets are not purely competitive.

Answer: C

Diff: 1

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

27) The rational expectations hypothesis indicates that a monetary policy designed to alter real Gross Domestic Product (GDP) will fail unless

- A) changes in the money supply are unexpected.
- B) the government's budget is not in deficit.
- C) labor unions have long-term contracts.
- D) changes in the money supply are completely anticipated.

Answer: A

Diff: 1

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

28) A key implication of the policy irrelevance proposition is that

- A) only fully anticipated policy actions can influence real Gross Domestic Product (GDP).
- B) only unanticipated policy actions can influence real Gross Domestic Product (GDP).
- C) the rational expectations hypothesis is incorrect.
- D) none of the above.

Answer: B

Diff: 2

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

29) Under the rational expectations hypothesis, if wages adjust rapidly to new information about intended policy actions, monetary policy can have an effect

- A) in both the short and the long run.
- B) in the long run, but not the short run.
- C) only in the short run and only if the policy is unanticipated.
- D) only in the long run and only if the policy is fully anticipated.

Answer: C

Diff: 1

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 30) Under the rational expectations hypothesis, if wages adjust rapidly to new information about intended policy actions, the only time that changes in government policies have real effects is when

A) the changes are unanticipated. B) the changes involve fiscal policy.
 C) the changes involve monetary policy. D) the changes affect aggregate demand.

Answer: A

Diff: 1

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 31) Suppose there is an oil supply shock to the U.S. economy due to an embargo by major oil producing nations. According to the real business cycle theory, the supply shock will, other things being equal,

A) push real Gross Domestic Product (GDP) upward in the short run but downward in the long run.
 B) push the economy into an expansionary phase of the business cycle.
 C) cause real Gross Domestic Product (GDP) to decline both in the short run and in the long run.
 D) cause economy-wide deflation.

Answer: C

Diff: 1

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 32) The short run aggregate supply (SRAS) curve shifts left when oil supply shocks occur because

A) fewer goods are produced at any given price level due to higher oil prices.
 B) oil-based production has increased at any given price level.
 C) average total cost will fall at any given output level.
 D) the price level will fall at any given output level.

Answer: A

Diff: 2

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 33) A reduction in world oil supplies is likely to cause

A) an increase in aggregate demand and a decrease in the equilibrium price level.
 B) a decrease in equilibrium price level and an increase in real Gross Domestic Product (GDP).
 C) an increase in equilibrium price level and an increase in real Gross Domestic Product (GDP).
 D) a reduction in aggregate supply, a rise in the equilibrium price level, and a fall in real Gross Domestic Product (GDP).

Answer: D

Diff: 1

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 34) According to the real business cycle theory, an increase in an input price, such as oil, will
- A) increase both real Gross Domestic Product (GDP) and the price level.
 - B) increase real Gross Domestic Product (GDP) but not change the price level.
 - C) decrease real Gross Domestic Product (GDP) but increase the price level.
 - D) decrease both real Gross Domestic Product (GDP) and the price level.

Answer: C

Diff: 1

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 35) Real business cycle theory explains variations in prices, employment, and real Gross Domestic Product (GDP) by focusing on
- A) changes in real variables such as supply shocks, technological changes, and shifts in the composition of the labor force.
 - B) anticipated monetary policies enacted by the Fed.
 - C) the effects of the Phillips curve.
 - D) anticipated changes in fiscal policy enacted by the government.

Answer: A

Diff: 1

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 36) The rational expectations hypothesis states that
- A) the government combines the effects of past policy changes on important economic variables with accepted views about the effects of current and future policy changes.
 - B) people combine the effect of past policy changes on important economic variables with unpredictable views on what policy makers will do to determine what the economy will do in the future.
 - C) people combine the effects of past policy changes on important economic variables with their own judgments about the future effects of current and future policy changes.
 - D) people understand how the economy operates and use their knowledge in making expectations about the future, but are uninformed about how fiscal and monetary policies are made and carried out.

Answer: C

Diff: 2

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 37) Which of the following statements is consistent with the rational expectations hypothesis?
- A) When it comes to making personal economic decisions, people rarely behave in a rational manner.
 - B) People combine the effects of past policy changes on important economic variables with their own judgment about the future effects of current and future policy changes.
 - C) When it comes to making personal economic decisions, people always behave in a rational manner.
 - D) Every person in the economy is always correct in her predictions about current and future policy changes.

Answer: B

Diff: 2

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Revised

- 38) According to the rational expectations hypothesis, individuals form their expectations about future values of economic variables by all of the following EXCEPT
- A) past information.
 - B) current information.
 - C) their understanding of how the economy operates.
 - D) formal models of macroeconomics.

Answer: D

Diff: 1

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 39) People combining the effects of past policy changes on important economic variables with their own judgment about the future effects of current and future policy changes is consistent with
- A) frictional unemployment.
 - B) the rational expectations hypothesis.
 - C) active policy making.
 - D) passive policy making.

Answer: B

Diff: 1

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Revised

- 40) According to the rational expectations hypothesis, the attempt by the government to reduce unemployment below its natural rate through expansionary policies will
- A) succeed in the short run and can succeed in the long run as long as the government makes it clear what its goals are.
 - B) succeed because the government knows how people will react to their policies and will adjust their policies accordingly.
 - C) fail because people will figure out what the government is doing and alter their expectations and their behavior in ways that counteract the government policy.
 - D) fail because the economy can never achieve an unemployment rate below the natural level.

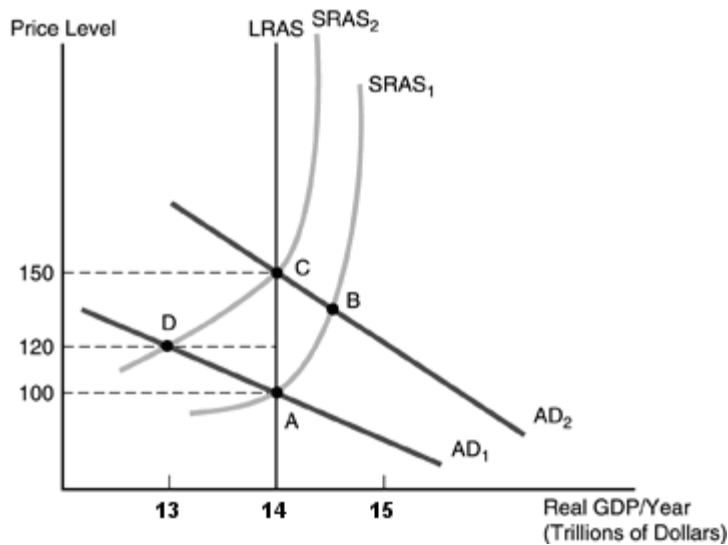
Answer: C

Diff: 3

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition



- 41) Refer to the above figure. Suppose the economy is in equilibrium at point A. If the Fed tries to stimulate the economy by undertaking an expansionary monetary policy action and this is not expected by the people in the economy, we would expect to see
- A) aggregate demand increases, real GDP increases, and the price level increases. In the long run, aggregate supply would increase and the new long-run equilibrium would be point B.
 - B) aggregate demand increases, real GDP increases, and the price level increases in the short run. In the long run, people realize the real situation, causing the short-run aggregate supply curve to shift up. Real GDP returns to \$14 trillion, and the price level increases to 150.
 - C) aggregate demand increases but people would anticipate this, causing the short-run aggregate supply curve to shift up at the same time, with the new equilibrium of \$14 trillion of real GDP and a price level of 100.
 - D) aggregate supply shifts up as people anticipate the effects of the expansionary monetary system. In the short run, real GDP falls to \$13 trillion and the price level rises to 120. In the long run, real GDP returns to \$14 trillion, and the price level increases further, to 150.

Answer: B

Diff: 3

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 42) Refer to the above figure. Suppose the economy is in equilibrium at point A. If rational expectations exist, an increase in aggregate demand caused by an anticipated increase in the money supply will cause the economy to
- A) stay at point A.
 - B) move to point B.
 - C) move to point C.
 - D) move to point D.

Answer: C

Diff: 2

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 43) Refer to the above figure. Suppose the economy is in long-run equilibrium at point A, and the government initiates an expansionary monetary policy to increase aggregate demand. Which of the following is a true statement concerning the differences between what happens when the governmental action is unanticipated and when it is anticipated?
- A) The new long-run equilibrium when the increase in aggregate demand is unanticipated is point B while the new long-run equilibrium when the increase in aggregate demand is anticipated is point C.
 - B) The new long-run equilibrium when the increase in aggregate demand is unanticipated is point B while the new long-run equilibrium when the increase in aggregate demand is anticipated is point A.
 - C) The new long-run equilibrium will be point C in either case. When the increase in aggregate demand is unanticipated, the economy moves to B in the short run, but when the increase in aggregate demand is anticipated, short-run aggregate supply shifts when the aggregate demand curve shifts, and the economy moves immediately to point C.
 - D) The new long-run equilibrium is point C in either case. When the increase in aggregate demand is unanticipated, the new short-run equilibrium is point B, but when the increase in aggregate demand is anticipated the new short-run equilibrium is point D.

Answer: C

Diff: 3

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 44) Suppose that the economy is in long-run equilibrium and the government decided to engage in unexpected expansionary policy by increasing the money supply. If we assume rational expectations, which of the following statements is correct about the effect of expansionary policy in the long run?
- A) The unemployment rate will increase, real GDP will increase and the price level will increase.
 - B) The unemployment rate will decrease, real GDP will decrease and the price level will decrease.
 - C) The unemployment rate will remain unchanged, real GDP will remain unchanged and the price level will increase.
 - D) The unemployment rate will remain unchanged, real GDP will remain unchanged and the price level will decrease.

Answer: C

Diff: 3

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

45) Suppose that the economy is in long-run equilibrium and the government decided to engage in unexpected contractionary policy by decreasing the money supply. If we assume rational expectations, which of the following statements is correct about the effect of contractionary policy in the long run?

- A) The unemployment rate will increase, real GDP will increase and the price level will increase.
- B) The unemployment rate will decrease, real GDP will decrease and the price level will decrease.
- C) The unemployment rate will remain unchanged, real GDP will remain unchanged and the price level will increase.
- D) The unemployment rate will remain unchanged, real GDP will remain unchanged and the price level will decrease.

Answer: D

Diff: 3

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

46) Suppose that the economy is in long-run equilibrium and the government decided to engage in expected expansionary policy by increasing the money supply. If we assume rational expectations, which of the following statements is correct about the effect of expansionary policy in the long run?

- A) The unemployment rate will increase, real GDP will increase and the price level will increase.
- B) The unemployment rate will decrease, real GDP will decrease and the price level will decrease.
- C) The unemployment rate will remain unchanged, real GDP will remain unchanged and the price level will increase.
- D) The unemployment rate will remain unchanged, real GDP will remain unchanged and the price level will decrease.

Answer: C

Diff: 3

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

47) Under the assumption of rational expectations, government fiscal and monetary policy changes are effective in the short run

- A) all of the time.
- B) only when the short-run aggregate supply curve is the same as the long-run aggregate supply curve.
- C) only when the policy changes leave the position of the aggregate demand curve unaffected.
- D) only when the policy changes are unanticipated.

Answer: D

Diff: 2

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 48) The Fed initiates a contractionary monetary policy that is correctly anticipated by economic agents in the economy. The result is
- A) decreased prices, but no change in real GDP.
 - B) decreased prices and decreased real GDP in the short run, but only decreased prices in the long run.
 - C) decreased real GDP in the short run and decreased prices in the long run.
 - D) decreased real GDP and prices in both the short run and the long run.

Answer: A

Diff: 2

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 49) Which statement is true when rational expectations exist and there is a change in monetary policy which is expected?
- A) The change in monetary policy leads to a change in aggregate demand that leads to a temporary short-run equilibrium that is different from the long-run equilibrium.
 - B) The change in monetary policy leads to a simultaneous shift of the short-run aggregate supply curve.
 - C) The change in monetary policy lead to a simultaneous shift in the long-run aggregate supply curve.
 - D) The change in monetary policy does not change equilibrium in either the short-run or long-run.

Answer: B

Diff: 2

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 50) Which statement is true when rational expectations exist and there is a change in monetary policy which is unexpected?
- A) The change in monetary policy leads to a change in aggregate demand that leads to a temporary short-run equilibrium that is different from the long-run equilibrium.
 - B) The change in monetary policy leads to a simultaneous shift of the short-run aggregate supply curve.
 - C) The change in monetary policy lead to a simultaneous shift in the long-run aggregate supply curve.
 - D) The change in monetary policy does not change equilibrium in either the short-run or long-run.

Answer: A

Diff: 2

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 51) Under the assumption of rational expectations, expectations people have formed are an important determinant of
- A) the short-run aggregate supply curve.
 - B) the long-run aggregate supply curve.
 - C) the short-run aggregate demand curve.
 - D) the long-run aggregate demand curve.

Answer: A

Diff: 2

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 52) The idea that anticipated monetary policy changes cannot affect real GDP or employment is known as
- A) the systematic policy hypothesis.
 - B) the policy irrelevance theorem.
 - C) the policy relevance theorem.
 - D) the Keynesian hypothesis.

Answer: B

Diff: 1

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 53) Fully anticipated monetary policy actions cannot alter either the rate of unemployment or the level of real GDP. This statement is
- A) the policy irrelevance proposition.
 - B) the nonaccelerating inflation rate of unemployment theory.
 - C) the Phillips curve.
 - D) discretionary policy making.

Answer: A

Diff: 1

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 54) Which of the following is NOT an inference of the rational expectations hypothesis?
- A) Government policy actions have no real effects in the short run unless the actions are unanticipated.
 - B) Government policy actions have no real effects in the long run.
 - C) Government policy actions that are anticipated have no real effects in the short run.
 - D) Government policy actions that are unanticipated have no monetary effects in the short run.

Answer: D

Diff: 2

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 55) If people do not always make the same mistakes when forecasting the future, then
- A) rational expectations are irrational.
 - B) the Fed can control monetary policy and determine real variables such as real GDP.
 - C) the policy irrelevance theorem holds.
 - D) fiscal policy is more effective than monetary policy at fine-tuning the economy.

Answer: C

Diff: 2

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 56) Under the assumption of rational expectations, real GDP is determined by
- A) the economy's aggregate demand curve.
 - B) the Fed.
 - C) a combination of monetary and fiscal policy.
 - D) the nation's long-run aggregate supply curve.

Answer: D

Diff: 1

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 57) Real business cycle theory explains changes in employment and output by focusing on
- A) real supply-side factors.
 - B) changes in monetary policy.
 - C) changes in fiscal policy.
 - D) the interaction of fiscal and monetary policies.

Answer: A

Diff: 1

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 58) According to the real business cycle theory, which of the following would be a real disturbance to the economy?
- A) Change in the required reserve ratio
 - B) Reduction in the money supply
 - C) Increase in the rate at which married women participate in the labor force
 - D) Increase in the price level

Answer: C

Diff: 2

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 59) Suppose the economy is in equilibrium when there is a change in environmental policy that bans all pesticides and herbicides on farmland. We would expect to observe
- A) a decrease in aggregate supply and an increase in aggregate demand.
 - B) a decrease in both real output and the natural rate of unemployment.
 - C) a decrease in real output and an increase in the natural rate of unemployment.
 - D) a decrease in real output and an increase in the price level.

Answer: D

Diff: 3

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 60) According to the real business cycle theory, which of the following is a true statement about the effects of an oil shock in the 1970s?
- A) The shock affected real variables only and did not affect nominal variables.
 - B) The shock shifted the short-run aggregate supply curve but not the long-run aggregate supply curve.
 - C) The natural rate of unemployment remained unchanged, but employment levels did decline.
 - D) Relative prices changed but there was no impact on the price level in general.

Answer: C

Diff: 2

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 61) According to the real-business-cycle perspective,
- A) the economy cannot be stabilized by policy activism.
 - B) the Phillips curve is very important.
 - C) active policy making is important.
 - D) passive policy making is important.

Answer: A

Diff: 1

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 62) The rational expectations hypothesis suggests that
- A) unanticipated fiscal policy actions are more powerful than monetary policy actions.
 - B) anticipated monetary policy actions are more powerful than fiscal policy actions.
 - C) fiscal policy actions only work when accompanied by changes in the money supply.
 - D) anticipated fiscal and monetary policy actions are not likely to achieve their stated aims.

Answer: D

Diff: 2

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 63) The rational expectations hypothesis states that
- A) individuals always behave rationally.
 - B) prices do not adjust in a downward direction.
 - C) past and present economic information is incorporated into decision making.
 - D) consumers do not understand the effects of monetary and fiscal policy.

Answer: C

Diff: 2

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 64) The policy irrelevance proposition implies that
- A) unanticipated monetary policy actions are equally effective in stimulating both aggregate demand and aggregate supply.
 - B) anticipated monetary policy actions are effective in stimulating aggregate supply, but they are not effective in stimulating aggregate demand.
 - C) anticipated monetary policy actions are effective in increasing real GDP, but they do not reduce unemployment.
 - D) anticipated monetary policy actions are ineffective in generating changes in real GDP.

Answer: D

Diff: 2

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 65) A hypothesis that assumes that people combine the effects of past policy changes on economic events and their own judgment about future effects of current and future policy changes is known as
- A) adaptive expectations.
 - B) modern expectations.
 - C) rational expectations.
 - D) active expectations.

Answer: C

Diff: 1

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 66) Which of the following holds that economic decision making on all levels is unbiased and is based on all available information?
- A) Keynesian cycle theory
 - B) rational expectations based theory
 - C) adaptive expectations based theory
 - D) none of the above

Answer: B

Diff: 1

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 67) Adding the assumption of pure competition and complete flexibility of all prices and wages to the rational expectations hypothesis yields a theory that provides support for
- A) passive policy making.
 - B) active policy making.
 - C) discretionary policy making.
 - D) unemployment reducing policy making.

Answer: A

Diff: 2

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 68) The proposition that policy actions have no real effects in the short run if the policy actions are anticipated is known as
- A) the unemployment stabilization proposition.
 - B) the policy irrelevance proposition.
 - C) the inflation stabilization proposition.
 - D) the Keynesian proposition.

Answer: B

Diff: 2

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 69) Those who accept both the rational expectations hypothesis and the assumption of flexibility of wages and price would likely argue that
- A) saving and investment do not contribute to economic growth.
 - B) active policy making does not contribute to economic stability.
 - C) if policy makers are willing to accept a high inflation rate, they can reduce unemployment to a point below the natural rate.
 - D) policy makers can eliminate fluctuations in the level of business activity with careful planning of a widely publicized monetary policy.

Answer: B

Diff: 3

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 70) According to a theory that relies on the rational expectations hypothesis and the assumption that wages and prices are flexible, why do anticipated expansionary monetary actions NOT boost real GDP?
- A) Anticipated expansionary monetary policy actions do not increase aggregate demand.
 - B) The short-run aggregate supply curve shifts upward simultaneously with the rightward shift of aggregate demand.
 - C) The short-run aggregate supply curve shifts downward simultaneously with the upward shift of aggregate demand.
 - D) The higher interest rates associated with anticipated expansionary monetary policy actions will dampen investment spending.

Answer: B

Diff: 3

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 71) One implication of coupling the rational expectations hypothesis with the assumption of flexible wages and prices is that
- A) expansionary monetary policy will be effective in combating recessions.
 - B) contractionary monetary policy will be effective in combating inflation.
 - C) only predictable policy actions by the Fed will have an effect on the real economy.
 - D) only unpredictable policy actions by the Fed will have an effect on the real economy.

Answer: D

Diff: 2

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 72) The rational expectations hypothesis suggests that if wages and prices are flexible,
- A) unanticipated monetary policy actions can shift the long-run aggregate supply curve but cannot shift the aggregate demand curve.
 - B) anticipated monetary policy actions can affect nominal variables, but not real variables.
 - C) unanticipated monetary policy actions can affect real variables, but not nominal variables.
 - D) growth in the money supply can alter real variables only if the growth is anticipated.

Answer: B

Diff: 2

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 73) The hypothesis suggesting that people combine the effects of past policy changes on economic variables with their own judgment about the future effects of current and future economic policy is referred to as the
- A) active expectations hypothesis.
 - B) passive expectations hypothesis
 - C) rational expectations hypothesis.
 - D) adaptive expectations hypothesis.

Answer: C

Diff: 2

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

74) The idea that policy actions have no real effects in the short run if they are anticipated and no real effects in the long run is called the

- A) Keynesian proposition.
- B) policy irrelevance proposition.
- C) adaptive proposition.
- D) activism proposition.

Answer: B

Diff: 2

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB:

Question Status: Previous Edition

75) The rational expectations hypothesis is based on the assumption that

- A) individuals combine effects of past policy actions with their own judgment about future policy effects and changes when forming their expectations.
- B) individuals adapt in response to past policy actions and changes without looking ahead when forming their expectations.
- C) firms pay above equilibrium wages to their employees.
- D) most firms operate in a less than competitive environment.

Answer: A

Diff: 1

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

76) The *policy irrelevance proposition* suggests that the policy effects on the economy primarily occur as a result of

- A) fiscal policy measures.
- B) policy mistakes or misjudgment of policies.
- C) nondiscretionary fiscal policy, not discretionary fiscal policy.
- D) fluctuations in the value of the U.S. dollar.

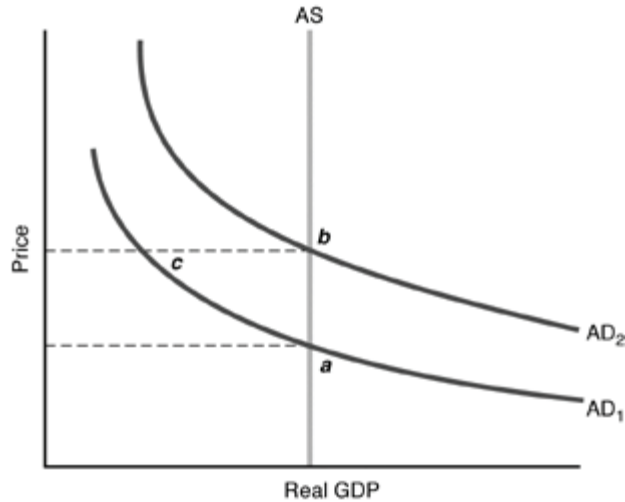
Answer: B

Diff: 2

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition



77) Refer to the above figure. The rational expectations hypothesis implies that an anticipated increase in aggregate demand from AD_1 to AD_2 will

- A) move the economy from c to b.
- B) move the economy from a to b.
- C) move the economy from a to c.
- D) will shift the aggregate supply (AS) curve to the right.

Answer: B

Diff: 2

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Revised

78) Refer to the above figure. The rational expectations hypothesis implies that an anticipated decrease in aggregate demand from AD_2 to AD_1 will

- A) move the economy from b to c.
- B) move the economy from b to a.
- C) move the economy from c to a.
- D) shift the aggregate supply (AS) curve to the left.

Answer: B

Diff: 2

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Revised

- 79) According to the theory based on rational expectations and flexible wages and prices,
- A) fiscal policy has less effect on real GDP than monetary policy in the long run.
 - B) monetary policy has less effect on real GDP than fiscal policy in the long run.
 - C) neither fiscal nor monetary policy influence real GDP in the long run.
 - D) only the combination of discretionary fiscal policy and conservative monetary policy can affect real GDP in the long run.

Answer: C

Diff: 2

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 80) The rational expectations hypothesis is based on all the following assumptions EXCEPT
- A) use of judgment about effects of future policy actions.
 - B) use of knowledge of effects of past policy actions.
 - C) understanding of how the economy operates.
 - D) understanding that prices are sticky.

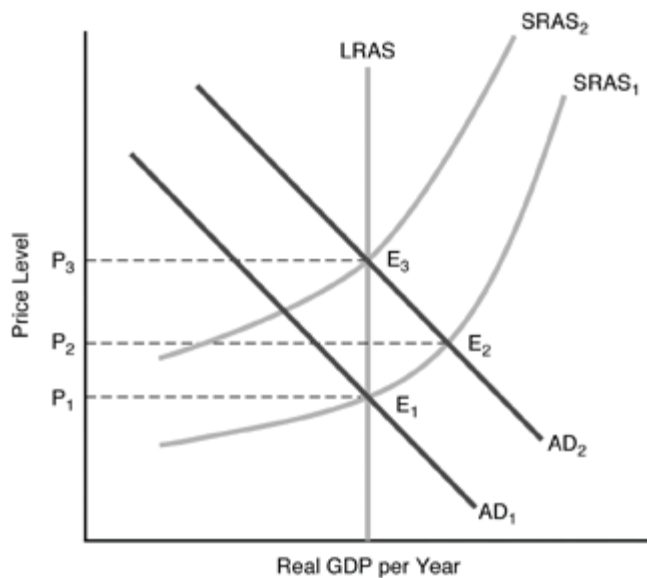
Answer: D

Diff: 1

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition



- 81) In the above figure, if we start at AD_1 and $SRAS_1$, and the money supply increases unexpectedly, what would be the short-run equilibrium even with rational expectations?
- A) E_1
 - B) E_2
 - C) E_3
 - D) P_1

Answer: B

Diff: 2

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 82) In the above figure, if we start at AD_1 and $SRAS_1$, and the money supply increases unexpectedly, what would be the long-run equilibrium?

A) E_1 B) E_2 C) E_3 D) P_1

Answer: C

Diff: 3

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 83) In the above figure, if we start at AD_1 and $SRAS_1$, and the money supply increases unexpectedly, what causes the economy to get to the long-run equilibrium?

A) People's expectations will revise after a short-run gain in output, wages will fall, and SRAS will shift leftward.
 B) People's expectations will revise after a short-run gain in output, wages will rise, and SRAS will shift rightward.
 C) People's expectations will revise after a short-run loss in output, wages will fall, and SRAS will shift leftward.
 D) People's expectations will revise after a short-run gain in output, wages will rise, and SRAS will shift leftward.

Answer: D

Diff: 3

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 84) The policy irrelevance proposition states that

A) only relatively large expected changes in monetary policy impact the economy.
 B) anticipated changes in monetary policy are ineffective in changing real GDP.
 C) only statements from the White House have impact on the economy.
 D) in the short run unanticipated changes in monetary policy are ineffective in changing real GDP.

Answer: B

Diff: 2

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 85) Real business cycle theory emphasizes the effect of _____ on economic performance.

A) government spending B) the money supply
 C) aggregate supply shocks D) tax rates

Answer: C

Diff: 1

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 86) When "stagflation" occurs,
- A) the economy experiences higher inflation rates and lower unemployment rates at the same time.
 - B) the economy experiences lower inflation rates and higher unemployment rates at the same time.
 - C) the economy experiences lower inflation rates and lower unemployment rates at the same time.
 - D) the economy experiences higher inflation rates and higher unemployment rates at the same time.

Answer: D

Diff: 2

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 87) The real business cycle theory
- A) indicates that supply side shocks cause most business cycles.
 - B) indicates that demand side shocks cause most business cycles.
 - C) indicates that rapid changes in the money supply cause most business cycles.
 - D) indicates that faulty fiscal policy creates most business cycles.

Answer: A

Diff: 2

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 88) The real business cycle theory is based on all of the assumptions below EXCEPT
- A) small menu costs.
 - B) flexible wages.
 - C) pure competition.
 - D) flexible prices.

Answer: A

Diff: 1

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 89) Which of the following holds that business cycles are primarily due to changes in technology and does not invoke any monetary or demand-side forces?
- A) the real business cycle theory
 - B) the efficiency wage theory
 - C) rational expectations hypothesis
 - D) Keynesian economics

Answer: A

Diff: 1

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 90) Real business cycles could be a result of
- A) discretionary fiscal policy.
 - B) abrupt changes in monetary policy.
 - C) increases in the budget deficit and national debt.
 - D) shocks to the aggregate supply side of the economy.

Answer: D

Diff: 2

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 91) Which of the following would NOT cause a real business cycle?
- A) a change in technology
 - B) a change in the composition of the labor force
 - C) a change in the money supply
 - D) a sustained change in the price of oil

Answer: C

Diff: 2

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 92) During the 1970s, the shocks to the United States' economy resulted in
- A) an increase in the unemployment rate, but a decrease in the inflation rate.
 - B) a decrease in the unemployment rate, but an increase in the inflation rate.
 - C) an increase in both the unemployment rate and the inflation rate.
 - D) a decrease in both the unemployment rate and the inflation rate.

Answer: C

Diff: 2

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 93) The real business cycle theory
- A) is an extension of the Keynesian view of business cycles.
 - B) is an extension of the adaptive expectations theory of business cycles.
 - C) suggests that instability is caused by shifts in the long-run aggregate supply curve.
 - D) suggests that instability is caused by shifts in the aggregate demand curve caused by changing consumer confidence in the economy.

Answer: C

Diff: 2

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

94) Stagflation means a

- A) high rate of inflation coupled with a high rate of unemployment.
- B) high rate of inflation coupled with a very low rate of unemployment.
- C) low rate of inflation coupled with a very high rate of unemployment.
- D) low rate of inflation coupled with a rate of unemployment below the natural rate.

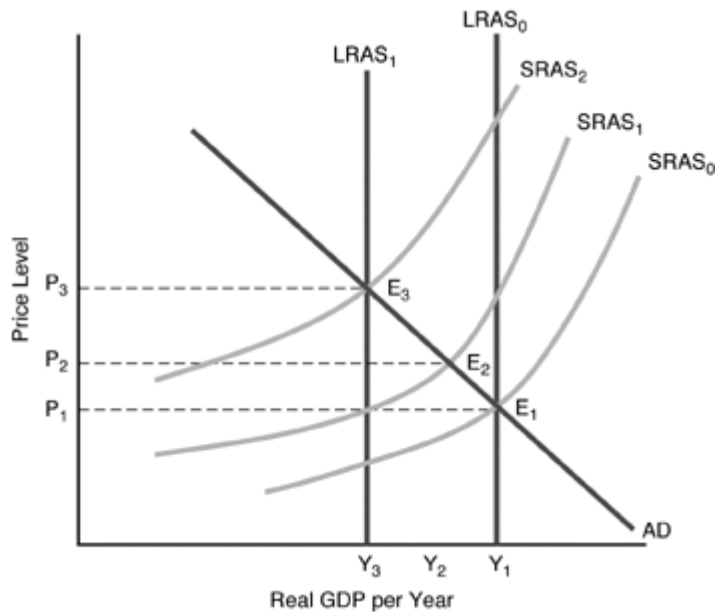
Answer: A

Diff: 1

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition



95) In the above figure, starting at E_1 , if there is a supply shock that is permanent, the

- A) aggregate supply would shift to $SRAS_1$ and $LRAS_1$ would shift to $LRAS_0$.
- B) aggregate supply would shift to $SRAS_1$ and $LRAS_0$ would shift to $LRAS_1$.
- C) aggregate supply would shift to $SRAS_2$ and $LRAS_0$ would shift to $LRAS_1$.
- D) aggregate supply would shift to $SRAS_1$ and then return to $SRAS_0$.

Answer: C

Diff: 3

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 96) In the above figure, starting at E_1 , if there is a supply shock that is temporary, the
- A) aggregate supply would shift to $SRAS_0$ and $LRAS_1$ would shift to $LRAS_0$.
 - B) aggregate supply would shift to $SRAS_1$ and $LRAS_0$ would shift to $LRAS_1$.
 - C) aggregate supply would shift to $SRAS_2$ and $LRAS_0$ would shift to $LRAS_1$.
 - D) aggregate supply would shift to $SRAS_1$ and then return to $SRAS_0$.

Answer: D

Diff: 3

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 97) In the above figure, starting at E_3 , if there is an increase in technology that causes a permanent increase in production capabilities
- A) aggregate supply would shift to $SRAS_0$ and $LRAS_1$ would shift to $LRAS_0$.
 - B) aggregate supply would shift to $SRAS_1$ and $LRAS_0$ would shift to $LRAS_1$.
 - C) aggregate supply would shift to $SRAS_2$ and $LRAS_0$ would shift to $LRAS_1$.
 - D) aggregate supply would shift to $SRAS_1$ and then return to $SRAS_0$.

Answer: A

Diff: 3

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 98) In the above figure, starting at E_3 , if there is an increase in technology that causes a temporary increase in production capabilities
- A) aggregate supply would shift to $SRAS_0$ and $LRAS_1$ would shift to $LRAS_0$.
 - B) aggregate supply would shift to $SRAS_1$ and $LRAS_1$ would shift to $LRAS_1$.
 - C) aggregate supply would shift to $SRAS_2$ and $LRAS_1$ would shift to $LRAS_1$.
 - D) aggregate supply would shift to $SRAS_1$ and then return to $SRAS_2$.

Answer: D

Diff: 3

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 99) When a supply shock is permanent
- A) only the long-run aggregate supply curve shifts leftward.
 - B) only the short-run aggregate supply curve shifts leftward.
 - C) both the long-run and short-run aggregate supply curves shift leftward.
 - D) there are no shifts in either the long-run or short-run aggregate supply curve.

Answer: C

Diff: 2

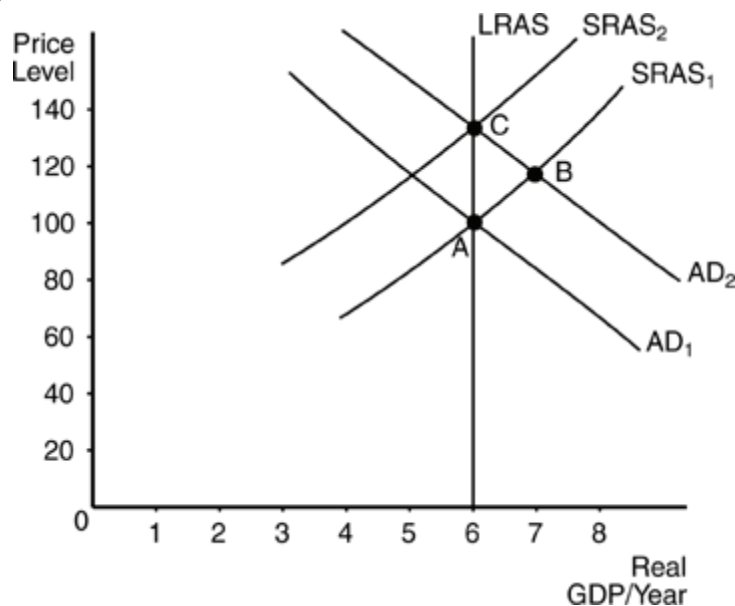
Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 100) Using a graph, show and explain the difference between an anticipated and an unanticipated increase in aggregate demand.

Answer:



In the above figure, an unanticipated increase in aggregate demand is shown by moving from A to B, along the short-run aggregate supply curve. An anticipated increase in aggregate demand implies that only the price level increases, and the economy moves from A to C as the short-run supply curve shifts to SRAS₂.

Diff: 3

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

- 101) Describe and explain the real business cycle theory.

Answer: The real business cycle theory is a modification of the new classical theory that states that money is neutral in its impact on the economy and only real supply-side factors matter in influencing employment and real output. Real Gross Domestic Product (GDP) is determined by real variables such as the supply of inputs and technology and monetary policy only affects the price level.

Diff: 1

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

102) Explain the rational expectations hypothesis.

Answer: The rational expectations hypothesis assumes that people base their forecasts about the future values of economic variables on all available past and current information, and that these expectations incorporate their understanding about how the economy operates, including the operation of monetary and fiscal policy. If there is pure competition in all markets and all prices, including wages, are flexible, then the government cannot affect real GDP except by fooling people and fooling people cannot work for long.

Diff: 1

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

103) Describe and explain the policy irrelevance proposition.

Answer: The policy irrelevance proposition is the conclusion that policy actions have no real effects in the short run if the policy actions were anticipated and none in the long run even if the policy actions were unanticipated. The conclusion comes from rational expectations hypothesis. Prices and wages are assumed to be flexible and people form their expectations on a rational basis.

Diff: 2

Topic: 17.3 Rational Expectations, the Policy Irrelevance Proposition, and Real Business Cycles

AACSB: Analytic skills

Question Status: Previous Edition

17.4 Modern Approaches to Justifying Active Policymaking

- 1) According to economists who promote sticky-price theories,
 - A) only fiscal policy is an effective stabilization policy.
 - B) only monetary policy is an effective stabilization policy.
 - C) both fiscal and monetary policy can be effective stabilization policies.
 - D) neither fiscal nor monetary policy is an effective stabilization policy.

Answer: C

Diff: 1

Topic: 17.4 Modern Approaches to Justifying Active Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 2) Costs that deter firms from changing prices in response to demand changes are known as

A) sticky costs.	B) menu costs.
C) policy costs.	D) production costs.

Answer: B

Diff: 1

Topic: 17.4 Modern Approaches to Justifying Active Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 3) During the 1960s, many Keynesian economists felt that by studying the Phillips curve,
- A) policy makers could dispense with the Federal Reserve's open-market operations.
 - B) policy makers could fine-tune the economy by selecting policies that would produce the exact mix of unemployment and inflation that suited current government objectives.
 - C) the President and Congress did not need to attempt to balance the budget.
 - D) policy makers could eliminate even frictional unemployment in the economy.

Answer: B

Diff: 1

Topic: 17.4 Modern Approaches to Justifying Active Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 4) Which of the following can help explain why prices might be "sticky"?
- A) The rational expectations hypothesis
 - B) The policy irrelevance proposition
 - C) Real business cycles
 - D) Small menu costs

Answer: D

Diff: 1

Topic: 17.4 Modern Approaches to Justifying Active Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 5) The menu cost theory states that
- A) prices are not fully flexible because it is costly for firms to change prices every time there is a demand change.
 - B) economic agents quickly learn the likely responses of the Fed to changes in unemployment.
 - C) wages depend on the productivity of workers.
 - D) the economy is characterized by perfect competition.

Answer: A

Diff: 2

Topic: 17.4 Modern Approaches to Justifying Active Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 6) Some economists suggest that because of the costs of negotiating contracts, printing price lists, etc., it is costly for firms to change prices in response to demand changes. This hypothesis is known as the
- A) sticky wage theory.
 - B) menu cost theory.
 - C) Phillips theory.
 - D) Freidman theory.

Answer: B

Diff: 1

Topic: 17.4 Modern Approaches to Justifying Active Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 7) The menu cost theory suggests that
- A) there will be no unemployment.
 - B) wages and prices move freely and quickly.
 - C) firms find frequent price changes to be costly.
 - D) the economy is characterized only by perfect competition.

Answer: C

Diff: 1

Topic: 17.4 Modern Approaches to Justifying Active Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 8) In new Keynesian theory, the pattern of inflation exhibited by an economy with growing aggregate demand known as inflation dynamics is
- A) initially sluggish upward adjustment of the price level and inflation in response to higher aggregate demand followed by higher inflation in the future.
 - B) initially speedy upward adjustment of the price level and inflation in response to higher aggregate demand followed by lower inflation in the future.
 - C) initially sluggish downward adjustment of the price level and inflation in response to higher aggregate demand followed by lower inflation in the future.
 - D) initially speedy upward adjustment of the price level and inflation in response to higher aggregate demand followed by higher inflation in the future.

Answer: A

Diff: 1

Topic: 17.4 Modern Approaches to Justifying Active Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 9) The term for a pattern of initially sluggish adjustment of the equilibrium price level to a change in aggregate demand followed by a greater adjustment in the future is
- A) real-business-cycle inflation dynamics.
 - B) New Keynesian inflation dynamics.
 - C) passive price dynamics.
 - D) active price dynamics.

Answer: B

Diff: 1

Topic: 17.4 Modern Approaches to Justifying Active Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 10) According to the new Keynesian sticky-price theory, a rise in aggregate demand results in _____ price level in the near term and in _____ price level in the longer term.
- A) a higher; an unchanged
 - B) an unchanged; a higher
 - C) a lower; an unchanged
 - D) a lower; a higher

Answer: B

Diff: 2

Topic: 17.4 Modern Approaches to Justifying Active Policymaking

AACSB: Analytic skills

Question Status: Revised

- 11) The most important new Keynesian assumption that distinguishes this theory differs from the real-business-cycle theory is the new Keynesian assumption
- A) of a horizontal aggregate demand curve.
 - B) of price flexibility.
 - C) about the importance of interest rates in determining investment spending.
 - D) of a horizontal short-run aggregate curve.

Answer: D

Diff: 1

Topic: 17.4 Modern Approaches to Justifying Active Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 12) Which of the following is NOT associated with the new Keynesian economics?
- A) Inflation dynamics
 - B) Small-menu cost theory
 - C) Market-clearing models to explain business cycles
 - D) Sticky-price theories of real GDP determination

Answer: C

Diff: 1

Topic: 17.4 Modern Approaches to Justifying Active Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 13) The costs associated with changing prices are called
- A) price costs.
 - B) change costs.
 - C) menu costs.
 - D) inflation-dynamics costs.

Answer: C

Diff: 1

Topic: 17.4 Modern Approaches to Justifying Active Policymaking

AACSB:

Question Status: Previous Edition

- 14) Which of the following statements concerning price rigidity is true?
- A) Since the economy experiences continued inflation prices are not rigid.
 - B) Prices will be rigid when there is unanticipated monetary policy but not when there is anticipated monetary policy.
 - C) Data has clearly demonstrated that the long run aggregate supply curve is horizontal.
 - D) When there are demand changes, firms will not change their price because of the costs associated with renegotiating contracts and informing customers of price changes.

Answer: D

Diff: 1

Topic: 17.4 Modern Approaches to Justifying Active Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 15) A theory suggesting that price stickiness leads to sluggish short-run adjustment of the price level to variations in aggregate demand is known as
- A) new Keynesian flexible-price business cycles.
 - B) new Keynesian inflation dynamics.
 - C) real-business-cycle fixed-price business cycles.
 - D) real-business-cycle inflation dynamics.

Answer: B

Diff: 1

Topic: 17.4 Modern Approaches to Justifying Active Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 16) The theory of new Keynesian inflation dynamics suggests that a fall in aggregate demand would
- A) immediately reduce the price level, followed by a more sluggish decline in real GDP.
 - B) immediately raise the price level, followed by a more sluggish decline in real GDP.
 - C) immediately reduce real GDP, followed by a more sluggish decline in the price level.
 - D) immediately raise real GDP, followed by a more sluggish increase in the price level.

Answer: C

Diff: 2

Topic: 17.4 Modern Approaches to Justifying Active Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 17) According to the new Keynesian theory, the widespread importance of small menu costs results in variations in aggregate demand causing both
- A) greater short-run adjustments in real GDP and delayed adjustment in the price level.
 - B) greater short-run adjustments in the real GDP and immediate adjustment in the price level.
 - C) smaller short-run adjustments in real GDP and delayed adjustment in the price level.
 - D) smaller short-run adjustments in real GDP and immediate adjustment in the price level.

Answer: A

Diff: 2

Topic: 17.4 Modern Approaches to Justifying Active Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 18) New Keynesian inflation dynamics can account for sluggish responses of
- A) real GDP to variations in aggregate supply.
 - B) real GDP to variations in aggregate demand.
 - C) inflation to variations in aggregate supply.
 - D) inflation to variations in aggregate demand.

Answer: D

Diff: 1

Topic: 17.4 Modern Approaches to Justifying Active Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 19) If the price of bubble gum changed in the market from 1 cent to 1.5 cents and Joe's Market didn't change the price it charges for the bubble gum, this behavior is likely due to
- A) discretionary policy.
 - B) economic laziness.
 - C) large menu costs.
 - D) small menu costs.

Answer: D

Diff: 3

Topic: 17.4 Modern Approaches to Justifying Active Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 20) Costs that tend to deter firms from changing their prices in response to changes in the market equilibrium price are referred to as
- A) large menu costs.
 - B) small menu costs.
 - C) real menu costs.
 - D) burden costs.

Answer: B

Diff: 2

Topic: 17.4 Modern Approaches to Justifying Active Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 21) Which of the following factors strengthens the case for policy activism?
- A) sticky prices
 - B) flexible wages
 - C) flexible prices
 - D) lack of real-business-cycles

Answer: A

Diff: 3

Topic: 17.4 Modern Approaches to Justifying Active Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 22) Menu costs are a possible reason for
- A) aggregate supply shocks.
 - B) low levels of consumer confidence in response to aggregate supply shocks.
 - C) sticky product prices.
 - D) swings in the labor force participation rate.

Answer: C

Diff: 1

Topic: 17.4 Modern Approaches to Justifying Active Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 23) Costs of renewing contracts or printing new price lists are known as
- A) small business costs.
 - B) small menu costs.
 - C) small operating costs.
 - D) small production costs.

Answer: B

Diff: 2

Topic: 17.4 Modern Approaches to Justifying Active Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 24) Small menu costs are a common reason offered for the existence of
- A) sticky wages.
 - B) sticky resource prices.
 - C) sticky prices.
 - D) sticky product adjustments.

Answer: C

Diff: 2

Topic: 17.4 Modern Approaches to Justifying Active Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 25) Economists who favor policy activism argue that the United States economy is NOT always in equilibrium because
- A) the national debt is too large.
 - B) the Federal Reserve's monetary policy is too restrictive.
 - C) the markets are over regulated.
 - D) wage and price rigidities exist.

Answer: D

Diff: 1

Topic: 17.4 Modern Approaches to Justifying Active Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 26) Menu costs are
- A) the constantly changing resource prices that make planning for firms difficult.
 - B) the advertised prices for final products that firms guarantee for a certain period of time.
 - C) the cost of compliance with government regulations.
 - D) the costs that deter firms from changing prices in reaction to demand changes.

Answer: D

Diff: 1

Topic: 17.4 Modern Approaches to Justifying Active Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 27) If a significant portion of firms in the economy does not immediately adjust product prices, then the short-run aggregate supply curve
- A) slopes upward.
 - B) slopes downward.
 - C) is horizontal.
 - D) is vertical.

Answer: C

Diff: 1

Topic: 17.4 Modern Approaches to Justifying Active Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

28) The new Keynesian sticky-price theory indicates that an increase in aggregate demand generates

- A) a speedy rise in real GDP but a sluggish increase in the price level.
- B) a speedy rise in the price level but a sluggish increase in real GDP.
- C) sluggish increases in both real GDP and the price level.
- D) rapid increases in both real GDP and the price level.

Answer: A

Diff: 1

Topic: 17.4 Modern Approaches to Justifying Active Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

29) If a significant portion of firms in the economy does not adjust product prices, a predicted result according to new Keynesian theory is

- A) real business cycles.
- B) real inflation cycles.
- C) inflation dynamics.
- D) output dynamics.

Answer: C

Diff: 1

Topic: 17.4 Modern Approaches to Justifying Active Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

30) New Keynesian inflation dynamics predicts that an increase in aggregate demand will generate, in chronological order,

- A) a leftward movement along a horizontal short-run aggregate supply curve, a short-run decline in real GDP, a downward shift in the short-run aggregate supply curve, and a decrease in the price level.
- B) a rightward movement along a horizontal short-run aggregate supply curve, a short-run increase in real GDP, an upward shift in the short-run aggregate supply curve, and an increase in the price level.
- C) an leftward shift in a vertical short-run aggregate supply curve, a short-run decline in real GDP, an upward movement along the short-run aggregate supply curve, and an increase in the price level.
- D) a rightward shift in a vertical short-run aggregate supply curve, a short-run increase in real GDP, an upward movement along the short-run aggregate supply curve, and an increase in the price level.

Answer: B

Diff: 2

Topic: 17.4 Modern Approaches to Justifying Active Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 31) According to the hypothesis of New Keynesian inflation dynamics, an increase in aggregate demand brings about
- A) initial sluggish adjustment of the price level followed by higher inflation later on.
 - B) initial rapid adjustment of the price level followed by lower inflation later on.
 - C) initial sluggish adjustment of real GDP followed by more rapid real GDP growth later on.
 - D) sluggish growth in real GDP both initially and later on.

Answer: A

Diff: 1

Topic: 17.4 Modern Approaches to Justifying Active Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 32) According to some New Keynesian theories, one possible rationale for active policy making is
- A) flexible prices.
 - B) sluggish adjustment of the price level in response to changes in aggregate demand
 - C) people are not rational and so do not react to incentives.
 - D) growing competition in U.S. product markets.

Answer: B

Diff: 1

Topic: 17.4 Modern Approaches to Justifying Active Policymaking

AACSB: Analytic skills

Question Status: Revised

- 33) New Keynesian theory implies that which of the following reduces firms' incentive to adjust their prices?
- A) a downward sloping aggregate demand curve
 - B) the required reserve ratio
 - C) menu costs
 - D) none of the above

Answer: C

Diff: 2

Topic: 17.4 Modern Approaches to Justifying Active Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 34) Describe new Keynesian economics and the arguments used to support the ideas.

Answer: New Keynesian economics are models based on the idea that demand-side factors are most important and that the economy has rigidities that make fiscal and monetary policy useful. They reject flexible wages and prices and argue these are sticky, especially downward. They argue that it is costly to change prices and renegotiate contracts constantly, so prices are less flexible.

Diff: 2

Topic: 17.4 Modern Approaches to Justifying Active Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

17.5 Is There a New Keynesian Phillips Curve?

- 1) New Keynesians hypothesize that
- A) the relationship between inflation and unemployment is exploitable in the long run.
 - B) the relationship between inflation and unemployment is exploitable in the short run.
 - C) there is no relationship between inflation and unemployment.
 - D) fluctuations in output are largely caused by supply shocks.

Answer: B

Diff: 1

Topic: 17.5 Is There a New Keynesian Phillips Curve?

AACSB: Analytic skills

Question Status: Previous Edition

- 2) What did Milton Friedman and E.S. Phelps argue with respect to the Phillips Curve?
- A) The Phillips Curve could accurately guide activist policy makers over the long run.
 - B) The inverse relationship between unemployment and inflation only holds in the long run. In the short run, unemployment and inflation are positively related.
 - C) Economic participants would soon understand activist policymakers' strategy and revise their expectations, making discretionary efforts to fine-tune the economy ineffective.
 - D) The inflation rate will consistently be 2 percentage points below the unemployment rate.

Answer: C

Diff: 2

Topic: 17.4 Modern Approaches to Justifying Active Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 3) The stagflation experienced in the U.S. during the late 1960s and the 1970s showed us that
- A) the Phillips curve accurately represents the trade-off between unemployment and inflation.
 - B) both inflation and economic expansion could exist simultaneously.
 - C) the relationship between unemployment and inflation was not as clear-cut as presented on the Phillips curve.
 - D) it is possible to alleviate economic stagflation through the government discretionary fiscal policy.

Answer: C

Diff: 1

Topic: 17.4 Modern Approaches to Justifying Active Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 4) Economists Milton Friedman and E.S. Phelps suggested that the apparent trade-off suggested by the Phillips curve could not be exploited by policy makers, because
- A) economic participants routinely incorporate changes in the inflation rate into their expectations.
 - B) economic participants are not rational, and therefore act unpredictably to any policy change.
 - C) unemployment levels and the inflation rate have a clear, positive relationship.
 - D) unemployment levels and the inflation rate have a negative (inverse) relationship.

Answer: A

Diff: 1

Topic: 17.4 Modern Approaches to Justifying Active Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 5) According to New Keynesians, which of the following is one of the two key factors that determines the inflation rate?
- A) anticipated future inflation
 - B) fiscal policy
 - C) oil prices
 - D) stock prices

Answer: A

Diff: 1

Topic: 17.5 Is There a New Keynesian Phillips Curve?

AACSB: Analytic skills

Question Status: Previous Edition

- 6) According to New Keynesians, which of the following is one of the two key factors that determines the inflation rate?
- A) fiscal policy
 - B) firms' average inflation adjusted per-unit costs of production
 - C) oil prices
 - D) stock prices

Answer: B

Diff: 1

Topic: 17.5 Is There a New Keynesian Phillips Curve?

AACSB: Analytic skills

Question Status: Previous Edition

- 7) The longer is the interval between firms' price adjustments,
- A) the longer the interval that the horizontal new Keynesian aggregate supply curve will remain in position.
 - B) the shorter the interval the horizontal new Keynesian aggregate supply curve will remain in position.
 - C) the new Keynesian aggregate supply curve will become steeper.
 - D) the smaller the output effect of a given change in the money supply.

Answer: A

Diff: 2

Topic: 17.5 Is There a New Keynesian Phillips Curve?

AACSB: Analytic skills

Question Status: Previous Edition

- 8) New Keynesians conclude that
- A) appropriate activist policies can dampen cyclical fluctuations.
 - B) appropriate activist policies will increase the length of cyclical fluctuations.
 - C) appropriate activist policies will have an known effect on the length of cyclical fluctuations.
 - D) none of the above.

Answer: A

Diff: 2

Topic: 17.5 Is There a New Keynesian Phillips Curve?

AACSB: Analytic skills

Question Status: Previous Edition

- 9) According to New Keynesians, an increase in which of the following will tend to cause the inflation rate to increase?
- A) anticipated future inflation
 - B) firms' average inflation adjusted per-unit costs of production
 - C) an unexpected increase in aggregate demand
 - D) all of the above

Answer: D

Diff: 1

Topic: 17.5 Is There a New Keynesian Phillips Curve?

AACSB: Analytic skills

Question Status: Previous Edition

- 10) The shorter is the interval between firms' price adjustments,
- A) the greater is the scope for activist policies to stabilize the economy.
 - B) the smaller is the scope for activist policies to stabilize the economy.
 - C) a given unexpected increase in aggregate demand will cause a larger increase in output.
 - D) a given unexpected increase in aggregate demand will cause a smaller increase in the price level in the short run.

Answer: B

Diff: 1

Topic: 17.5 Is There a New Keynesian Phillips Curve?

AACSB: Analytic skills

Question Status: Previous Edition

- 11) Initial studies of new Keynesian inflation dynamics indicated that the average price-adjustment intervals in the United States was as long as
- A) 6 months.
 - B) 12 months.
 - C) 2 years.
 - D) 4 years.

Answer: C

Diff: 1

Topic: 17.5 Is There a New Keynesian Phillips Curve?

AACSB: Analytic skills

Question Status: Previous Edition

- 12) More recent studies of new Keynesian inflation dynamics indicated that the average price-adjustment intervals in the United States are
- A) are one year or less.
 - B) two years or less.
 - C) four years or less.
 - D) more than four years.

Answer: A

Diff: 1

Topic: 17.5 Is There a New Keynesian Phillips Curve?

AACSB: Analytic skills

Question Status: Previous Edition

- 13) According to Friedman and Phelps, which of the following statements is a correct characterization of unemployment and inflation in the United States since the 1950s?
- A) A trade-off between inflation and unemployment as pictured in the Phillips curve existed over the entire time period.
 - B) A trade-off between inflation and unemployment as pictured in the Phillips curve existed in the 1970s and 1980s, but not over the entire period.
 - C) The relationship between inflation and unemployment is very different from the Phillips curve. A positive relationship is evident rather than an inverse relationship.
 - D) There is no clear relationship between unemployment and inflation.

Answer: D

Diff: 2

Topic: 17.5 Is There a New Keynesian Phillips Curve?

AACSB: Analytic skills

Question Status: Previous Edition

- 14) A plot of points representing the rate of inflation and the unemployment for the United States since 1953 reveals that
- A) there is an inverse relationship between the two variables.
 - B) there does not appear to be any trade-off between the two variables.
 - C) there is a positive relationship between the two variables.
 - D) none of the above

Answer: B

Diff: 1

Topic: 17.5 Is There a New Keynesian Phillips Curve?

AACSB: Analytic skills

Question Status: Previous Edition

- 15) According to New Keynesian economists,
- A) activist policy has little effect on real GDP.
 - B) activist policy can be used to minimize variations in real GDP.
 - C) fluctuations in output are primarily caused by supply shocks.
 - D) the amount of time it takes firms to adjust prices is less than six months.

Answer: B

Diff: 1

Topic: 17.5 Is There a New Keynesian Phillips Curve?

AACSB: Analytic skills

Question Status: Previous Edition

16) According to New Keynesians, a reduction in which of the following will tend to cause the inflation rate to decrease?

- A) anticipated future inflation
- B) firms' average inflation adjusted per-unit costs of production
- C) an unexpected reduction in aggregate demand
- D) all of the above

Answer: D

Diff: 2

Topic: 17.5 Is There a New Keynesian Phillips Curve?

AACSB: Analytic skills

Question Status: Previous Edition

17) New Keynesian economists generally argue that

- A) there is an exploitable tradeoff between unemployment and inflation.
- B) changes in aggregate demand will have relatively greater effects on real GDP when firms change prices less frequently.
- C) activist policy can be used to reduce the fluctuations in real GDP.
- D) all of the above

Answer: D

Diff: 1

Topic: 17.5 Is There a New Keynesian Phillips Curve?

AACSB: Analytic skills

Question Status: Previous Edition

18) If the average interval between firms' price adjustments is relatively long,

- A) an increase in aggregate demand will cause a relatively short-lived increase in real GDP.
- B) an increase in aggregate demand will cause a relatively long-lived increase in real GDP.
- C) a reduction in aggregate demand will cause a relatively short-lived reduction in real GDP.
- D) none of the above

Answer: B

Diff: 2

Topic: 17.5 Is There a New Keynesian Phillips Curve?

AACSB: Analytic skills

Question Status: Previous Edition

19) If the average interval between firms' price adjustments is relatively short,

- A) an increase in aggregate demand will cause a relatively short-lived increase in real GDP.
- B) an increase in aggregate demand will cause a relatively long-lived increase in real GDP.
- C) a reduction in aggregate demand will cause a relatively long-lived reduction in real GDP.
- D) both B and C

Answer: A

Diff: 2

Topic: 17.5 Is There a New Keynesian Phillips Curve?

AACSB: Analytic skills

Question Status: Previous Edition

- 20) According to Friedman and Phelps, which of the following statements is a correct characterization of unemployment and inflation in the United States since the 1950s?
- A) A trade-off between inflation and unemployment as pictured in the Phillips curve existed over the entire time period.
 - B) A trade-off between inflation and unemployment as pictured in the Phillips curve existed in the 1970s and 1980s, but not over the entire period.
 - C) The relationship between inflation and unemployment is very different from the Phillips curve. A positive relationship is evident rather than an inverse relationship.
 - D) There is no clear relationship between unemployment and inflation.

Answer: D

Diff: 2

Topic: 17.5 Is There a New Keynesian Phillips Curve?

AACSB:

Question Status: Previous Edition

- 21) What kind of relationship appears to actually exist, if one examines the actual data regarding the inflation rate and the unemployment rate for all years since 1953?
- A) a direct relationship
 - B) a one-to-one relationship
 - C) an inverse relationship
 - D) no relationship in the long run

Answer: D

Diff: 2

Topic: 17.5 Is There a New Keynesian Phillips Curve?

AACSB:

Question Status: Previous Edition

- 22) Examination of data since 1953 indicates that during this period stretching more than half a century, the Phillips curve
- A) fails to exist.
 - B) is smoothly upward sloping.
 - C) is smoothly downward sloping.
 - D) slopes smoothly upward at first but then slopes smoothly downward.

Answer: A

Diff: 2

Topic: 17.5 Is There a New Keynesian Phillips Curve?

AACSB:

Question Status: Previous Edition

- 23) The U.S. economic data for the last 50 years indicates that
- A) there is an inverse relationship between unemployment rate and inflation rate.
 - B) there is a direct relationship between unemployment rate and inflation rate.
 - C) during recessions the unemployment rate was always twice as high as the inflation rate.
 - D) there has been no long-run relationship between unemployment and inflation rates.

Answer: D

Diff: 2

Topic: 17.5 Is There a New Keynesian Phillips Curve?

AACSB:

Question Status: Previous Edition

- 24) Available evidence about price adjustments across U.S. industries indicates that
- A) prices are very flexible in all industries.
 - B) prices are very sticky in all industries.
 - C) prices are equally flexible in all industries.
 - D) there is considerable variation in price flexibility across industries.

Answer: D

Diff: 1

Topic: 17.5 Is There a New Keynesian Phillips Curve?

AACSB:

Question Status: Previous Edition

- 25) What is the modern view of the Phillips curve?

Answer: The modern view is that there is no trade-off between inflation and unemployment except in the short run. People can be surprised and unemployment can go down if the government pursues expansionary monetary or fiscal policy. However, once people learn the true state of affairs, they will adjust their behavior and the natural rate of unemployment will prevail. The price level will be higher though.

Diff: 3

Topic: 17.5 Is There a New Keynesian Phillips Curve?

AACSB: Analytic skills

Question Status: Previous Edition

17.6 Summing Up: Economic Factors Favoring Active versus Passive Policymaking

- 1) If a group of economists believes the following points are true, which is likely to be their policy making stance?
- Aggregate demand shocks have no long run effect on real Gross Domestic Product (GDP) or unemployment.
 - Pure competition is widespread throughout the economy.
 - Real wages are flexible.
 - The Phillips Curve trade-off does not exist in the long run.
- A) They will support active policy making.
 - B) They will support passive policy making.
 - C) They will support discretionary policy making.
 - D) They will argue that any attempt at economic policy making is futile.

Answer: B

Diff: 3

Topic: 17.6 Summing Up: Economic Factors Favoring Active versus Passive Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 2) An economist who would most likely use active policy making would support which of the following conclusions?
- A) Pure competition is not typical in most markets.
 - B) Price flexibility is common in most markets.
 - C) Demand shocks have little or no short-run effects on real Gross Domestic Product (GDP) and unemployment.
 - D) Supply shocks explain most business cycles.

Answer: A

Diff: 3

Topic: 17.6 Summing Up: Economic Factors Favoring Active versus Passive Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 3) Most economists agree with which of the following?
- A) Active policymaking is likely to exert sizable long-run effects on real GDP.
 - B) Active policymaking is unlikely to exert sizable long-run effects on real GDP.
 - C) Passive policymaking is likely to exert sizable long-run effects on real GDP.
 - D) none of the above

Answer: B

Diff: 2

Topic: 17.6 Summing Up: Economic Factors Favoring Active versus Passive Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 4) The stickiness of wages and prices will cause
- A) changes in aggregate demand to have no short-run effects on real GDP.
 - B) changes in aggregate demand to have long-run effects on real GDP.
 - C) changes in aggregate demand to have both short-run and long-run effects on real GDP.
 - D) changes in aggregate demand to have short-run effects on real GDP.

Answer: D

Diff: 2

Topic: 17.6 Summing Up: Economic Factors Favoring Active versus Passive Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 5) There is greater support for passive policymaking when
- A) pure competition is widespread.
 - B) price flexibility is common.
 - C) wage flexibility is common.
 - D) all of the above

Answer: D

Diff: 2

Topic: 17.6 Summing Up: Economic Factors Favoring Active versus Passive Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 6) When it comes to active policy making most economists agree that
- A) active policy making should be used over passive policy making.
 - B) it is unlikely that active policy making will have any long term effects on the economy.
 - C) it is likely that active policy making will have long term effects on the economy.
 - D) it will lead to long term shocks in the system.

Answer: B

Diff: 1

Topic: 17.6 Summing Up: Economic Factors Favoring Active versus Passive Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 7) Those who favor passive policy making do so because they conclude that
- A) price and wage flexibility is a common and speedy occurrence.
 - B) price and wage flexibility is an uncommon occurrence.
 - C) pure competition is not typical in most markets.
 - D) there is a stable trade-off between inflation and unemployment in the short run.

Answer: A

Diff: 2

Topic: 17.6 Summing Up: Economic Factors Favoring Active versus Passive Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 8) Those who favor active policy making argue that all of the following exist EXCEPT
- A) perfectly flexible wages and prices.
 - B) inflation and unemployment are stable in the short run and predictable in the long run.
 - C) pure competition is not typical.
 - D) aggregate demand shocks can influence real GDP and unemployment.

Answer: A

Diff: 2

Topic: 17.6 Summing Up: Economic Factors Favoring Active versus Passive Policymaking

AACSB: Analytic skills

Question Status: Previous Edition

- 9) Those who favor passive policy making argue that all of the following exist EXCEPT
- A) perfectly flexible wages and prices.
 - B) the trade off between inflation and unemployment is not stable in the short run and is non-existent in the long run.
 - C) pure competition is typical.
 - D) aggregate demand shocks can influence real GDP and unemployment.

Answer: D

Diff: 2

Topic: 17.6 Summing Up: Economic Factors Favoring Active versus Passive Policymaking

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- 10) The conclusion that the economy has price flexibility, wage flexibility, and perfectly competitive markets justifies
- A) active policy making.
 - B) rational policy making.
 - C) passive policy making.
 - D) none of the above.

Answer: C

Diff: 2

Topic: 17.6 Summing Up: Economic Factors Favoring Active versus Passive Policymaking

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- 11) Economists who believe in activist policy making argue that
- A) decreases in aggregate demand impact the economy only in the short run.
 - B) decreases in aggregate demand definitely impact the economy in the short run.
 - C) only planned changes in the money supply impact the economy.
 - D) only increases in the minimum wage levels improve economic well-being.

Answer: B

Diff: 2

Topic: 17.6 Summing Up: Economic Factors Favoring Active versus Passive Policymaking

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- 12) There is greater support for active policymaking when
- A) pure competition is widespread.
 - B) price flexibility is common.
 - C) wage flexibility is common.
 - D) none of the above

Answer: D

Diff: 2

Topic: 17.6 Summing Up: Economic Factors Favoring Active versus Passive Policymaking

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- 13) Compare and contrast the arguments favoring active versus passive policy making.

Answer: The models that stress wage and price flexibility and rationality on the part of economic agents tend to favor passive policy making. If people can anticipate policy actions and if wages and prices are flexible, the economy will tend toward long-run equilibrium. Discretionary policies conducted by governmental policy makers will not be effective means of influencing real Gross Domestic Product (GDP). In contrast, economists who conclude that small menu costs are important elements of real-world economies conclude that active policy making can influence real GDP and move the economy toward full employment.

Diff: 3

Topic: 17.6 Summing Up: Economic Factors Favoring Active versus Passive Policymaking

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Question Status: Previous Edition

- 14) How do rational expectations models differ from traditional classical economics? How does the new Keynesian model differ from the traditional Keynesian view?

Answer: A rational expectations model sees no real effect of monetary policy while the classical economics had changes in the money supply affecting aggregate demand. The classical view was that stabilization policy was unnecessary and the newer view is that it is too difficult to conduct. The traditional Keynesian view focused entirely on aggregate demand and emphasized fiscal policy while the new Keynesian view supports the role of monetary policy as well.

Diff: 2

Topic: 17.6 Summing Up: Economic Factors Favoring Active versus Passive Policymaking

AACSB: Analytic skills

Question Status: Revised