Chapter 12

1) Which of the following statements describes the relationship between the goods market and the money market?

a) The goods and money markets operate independently of each other.
b) Income is determined in the goods market and has no influence on the money market.
c) The interest rate is determined in the money market and has no influence on the goods market.
d) None of the above.

2) An increase in output, all else the same, leads to:

a) A decrease in the interest rate.
b) An increase in money demand.
c) An increase in money supply.
d) An increase in both the supply and the demand for money.

3) Which of the following is a link between the goods market and the money market?

a) Income has considerable influence on the demand for money in the money market.
b) The interest rate has significant effects on planned investment in the goods market.
c) Both a and b above.
d) None of the above. The goods market and the money market are not linked in the ways described above.

4) Reducing the interest rate, ceteris paribus, is likely to:

a) Shift the demand for money curve to the right.
b) Shift the supply of money curve to the right.
c) Increase the level of planned investment spending.
d) Decrease the level of planned investment.

5) Fill in the blanks. A higher interest rate _____ planned investment and causes planned aggregate expenditure to shifts _____.

a) decreases; downward
b) decreases; upward
c) increases; downward
d) increases; upward

6) When the interest rate rises, planned investment falls, and equilibrium output (income):

a) Falls by even more than the fall in planned investment.
b) Rises by exactly the same amount as the fall in planned investment.
c) Falls by exactly the same amount as the fall in planned investment.
d) Rises by even more than the fall in planned investment.

7) The effects of a change in the interest rate on equilibrium income can be summarized as follows.

a) $\uparrow r \rightarrow I\downarrow \rightarrow AE\downarrow \rightarrow Y\downarrow$
b) $\uparrow r \rightarrow I\downarrow \rightarrow AE\uparrow \rightarrow Y\downarrow$
c) $\uparrow r \rightarrow I\uparrow \rightarrow AE\uparrow \rightarrow Y\uparrow$
d) $\uparrow r \rightarrow I\uparrow \rightarrow AE\downarrow \rightarrow Y\downarrow$

8) For every possible level of the interest rate there is:

a) Always equilibrium in both the goods and money markets.
b) Only one equilibrium level of Y.
c) A possible equilibrium in the money market but never simultaneous with equilibrium in the money market.
d) A different equilibrium level of Y.

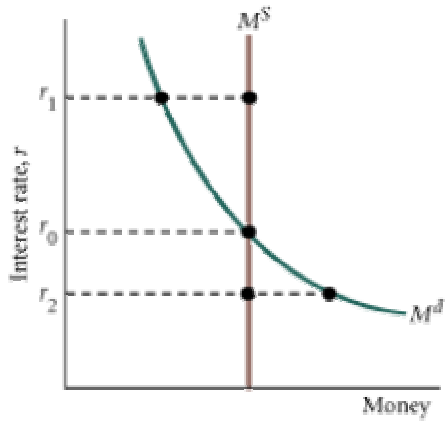
9) The impact of an increase in income on the money market is as follows:

a) The demand of money curve shifts to the left.
b) The supply of money curve shifts to the left.
c) The demand for money curve shifts to the right.
d) The supply of money curve shifts to the right.

10) If the amount of money demanded by households and firms is less than the amount in circulation as determined by the Fed,

a) There is an excess demand for money in the money market.
b) The interest rate will rise.
c) The interest rate will fall.
d) The interest rate will remain unchanged.

11) Refer to the graph below. At which level of the interest rate is the amount of money demanded by households and firms less than the amount of money in circulation?



a) At r2.
b) At r0.
c) At r1.
d) None of the above. Those two quantities are always the same.

12) Which of the following would be considered *expansionary fiscal policy*?
a) An increase in government spending.
b) An increase in the money supply.
c) An increase in net taxes.
d) All of the above.

13) Which of the following policy changes would be considered *expansionary monetary policy*?
a) An increase in the money supply.
b) An increase in government spending.
c) An increase in net taxes.
d) All of the above.

14) Which multiplier effect is smaller?
a) The multiplier of a decrease in net taxes.
b) Any multiplier of autonomous expenditures other than the multiplier of G or T.
c) Neither multiplier above is smaller. The magnitude of a change in equilibrium GDP from either the multiplier of government spending or the multiplier of net taxes is identical.
d) The multiplier of an increase in government spending.

15) Which of the following is a likely impact of an increase in government purchases (G)?
a) An increase in equilibrium output (income) (Y).
b) An increase in the equilibrium interest rate (r).
c) Disequilibrium in the money market with the quantity of money demanded being greater than the quantity of money supplied.
d) All of the above.

16) An increase in government spending (G),
a) Increases planned aggregate expenditure, increases aggregate output, but may also cause a decrease in planned investment, which reduces both planned aggregate expenditure and aggregate output.
b) Increases planned aggregate expenditure, increases aggregate output, and spurs even more planned investment, which further increases aggregate output.
c) Decreases aggregate expenditure, planned investment, and aggregate output.
d) All of the cases above have equal chance of occurring.

17) Due to the crowding-out effect of increases in government spending, the government spending multiplier is:
a) Reduced to zero.
b) Smaller than it would be without the crowding-out effect.
c) Always equal to one.
d) Larger than it would be without the crowding-out effect.

18) Fed accommodation of an increase in government spending causes the multiplier of government spending to be:
a) Smaller.
b) Larger.
c) Infinity.
d) Reduced to zero.

19) If planned investment does not fall when the interest rate rises, then:
a) The crowding-out still exists, but it would be weaker.
b) The crowding-out effect is stronger.
c) There is no crowding-out effect.
d) Fed accommodation would be essential to eliminate the crowding out effect.

20) A decrease in net taxes results in:
a) An increase in Y, a decrease in r, and an increase in I.
b) A decrease in Y, an increase in r, and a decrease in I.
c) An increase in Y, an increase in r, and a decrease in I.
d) A decrease in Y, a decrease in r, and an increase in I.

21) The effect of *expansionary fiscal policy* is as follows:

a) $\uparrow G \rightarrow Y\uparrow \rightarrow M^d\uparrow \rightarrow r\uparrow \rightarrow I\uparrow$
b) $\uparrow G \rightarrow Y\uparrow \rightarrow M^d\uparrow \rightarrow r\uparrow \rightarrow I\downarrow$
c) $\uparrow G \rightarrow Y\uparrow \rightarrow M^d\uparrow \rightarrow r\downarrow \rightarrow I\uparrow$
d) $\uparrow G \rightarrow Y\downarrow \rightarrow M^d\downarrow \rightarrow r\downarrow \rightarrow I\uparrow$

22) The effect of *expansionary monetary policy* is as follows:

a) $\uparrow M^s \rightarrow r\downarrow \rightarrow I\uparrow \rightarrow Y\uparrow \rightarrow M^d\uparrow$
b) $\uparrow M^s \rightarrow r\downarrow \rightarrow I\uparrow \rightarrow Y\downarrow \rightarrow M^d\uparrow$
c) $\uparrow M^s \rightarrow r\downarrow \rightarrow I\downarrow \rightarrow Y\downarrow \rightarrow M^d\downarrow$
d) $\uparrow M^s \rightarrow r\uparrow \rightarrow I\downarrow \rightarrow Y\downarrow \rightarrow M^d\downarrow$

23) The effect of *contractionary fiscal policy* is as follows:

a) $\uparrow T \text{ or } \downarrow G \rightarrow Y\downarrow \rightarrow M^d\uparrow \rightarrow r\uparrow \rightarrow I\uparrow$
b) $\uparrow T \text{ or } \downarrow G \rightarrow Y\downarrow \rightarrow M^d\downarrow \rightarrow r\uparrow \rightarrow I\downarrow$
c) $\uparrow T \text{ or } \downarrow G \rightarrow Y\downarrow \rightarrow M^d\downarrow \rightarrow r\downarrow \rightarrow I\uparrow$
d) $\uparrow T \text{ or } \downarrow G \rightarrow Y\uparrow \rightarrow M^d\uparrow \rightarrow r\uparrow \rightarrow I\downarrow$

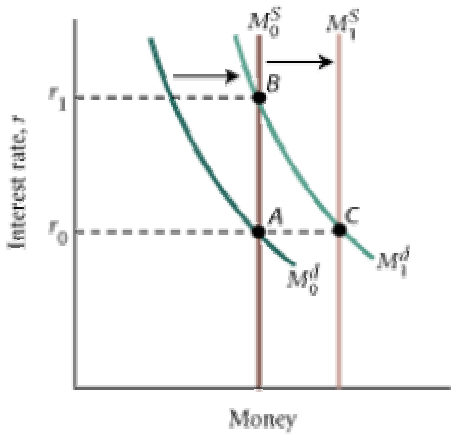
24) The effect of *contractionary monetary policy* is as follows:

a) $\downarrow M^s \rightarrow r\downarrow \rightarrow I\downarrow \rightarrow Y\downarrow \rightarrow M^d\downarrow$
b) $\downarrow M^s \rightarrow r\uparrow \rightarrow I\downarrow \rightarrow Y\uparrow \rightarrow M^d\uparrow$
c) $\downarrow M^s \rightarrow r\uparrow \rightarrow I\downarrow \rightarrow Y\downarrow \rightarrow M^d\downarrow$
d) $\downarrow M^s \rightarrow r\uparrow \rightarrow I\downarrow \rightarrow Y\downarrow \rightarrow M^d\uparrow$

25) An increase in the money supply results in:
a) A decrease in Y, a decrease in r, and an increase in I.
b) An increase in Y, an increase in r, and a decrease in I.
c) A decrease in Y, an increase in r, and a decrease in I.
d) An increase in Y, a decrease in r, and an increase in I.

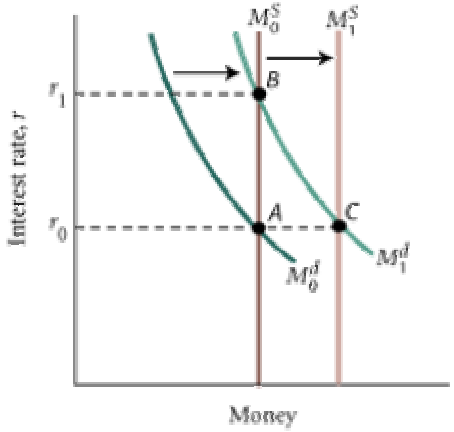
26) If the slope of the investment function is steep, or nearly vertical,
a) Monetary policy is highly effective.
b) Monetary policy is ineffective.
c) The slope of the money supply curve is zero.
d) The effects of monetary policy are reversed.

27) Refer to the figure below. Which of the following is best described by the figure?



a) Fiscal accommodation of a contractionary monetary policy.
b) Fiscal accommodation of an expansionary monetary policy.
c) Fed accommodation of an expansionary fiscal policy.
d) Fed accommodation of a contractionary fiscal policy.

28) Refer to the figure below. In response to the increase in money demand, which of the following would be considered expansionary monetary policy?



a) The move from A to C.
b) The move from A to B.
c) Both moves are considered expansionary monetary policy.
d) Neither move. Both moves represent contractionary monetary policy.

29) Which policy mix favors investment spending over government spending?
   a) Both expansionary fiscal policy and expansionary monetary policy.
   b) An increase in the money supply and a fall in government purchases.
   c) Expansionary fiscal policy and contractionary monetary policy.
   d) None of the above. No policy mix favors investment over government spending.

30) The demand for investment shifts to the right when:
   a) Labor is less expensive relative to capital.
   b) The interest rate decreases.
   c) Entrepreneurs are optimistic about future sales.
   d) Capital utilization rates are low.

31) The goods market and the money market operate independently.
   a) True
   b) False

32) The level of output is determined in the goods market, and the interest rate is determined in the money market.
   a) True
   b) False

33) An increase in the volume of transactions usually causes an increase in the supply of money, but no change in the demand for money.
   a) True
   b) False

34) There is a negative relationship between planned investment spending and the interest rate.
   a) True
   b) False

35) For every value of the interest rate, there is a different level of planned investment and a different level of output.
   a) True
   b) False

36) A reduction in net taxes is considered contractionary fiscal policy.
   a) True
   b) False

37) If the Fed does not change the money supply, increased government spending results in the crowding out of investment spending.

a) True
b) False

38) To bring the economy out of a recession, the Fed can adopt contractionary monetary policy.

a) True
b) False

39) Contractionary policies are used to fight inflation.

a) True
b) False

40) A mix of expansionary fiscal policy and contractionary monetary policy tends to favor investment spending over government spending.

a) True
b) False

41) Explain the precise links between the goods market and the money market. Write a paragraph about the issue above

42) Explain the crowding-out effect and the type of monetary policy that could prevent it. Write a paragraph about the issue above

43) What combination of fiscal and monetary policies could be used to bring the economy out of a recession? What is the ideal mix of these policies if policymakers favor an expansion of the private sector over the public sector? Write a paragraph about the issue above