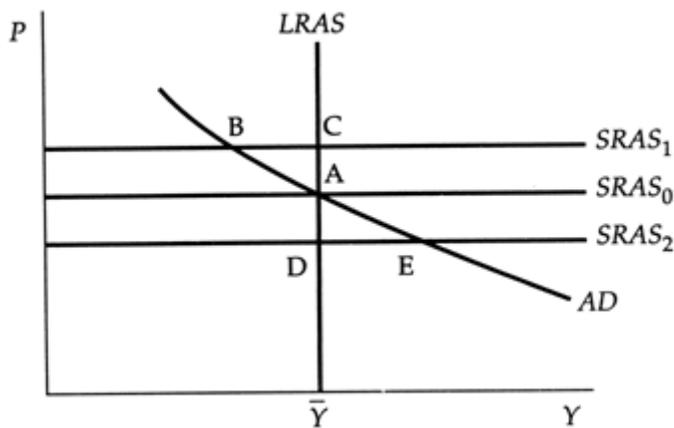


CH 10 - REVIEW QUESTIONS

1. The short-run aggregate supply curve is horizontal at:
 - A) a level of output determined by aggregate demand.
 - B) the natural level of output.
 - C) the level of output at which the economy's resources are fully employed.
 - D) a fixed price level.

Use the following to answer question 2:

Exhibit: Supply Shock



2. (Exhibit: Supply Shock) Assume that the economy is at point E. With no further shocks or policy moves, the economy in the long run will be at point:
 - A) A.
 - B) B.
 - C) C.
 - D) D.
3. The relationship between the quantity of goods and services supplied and the price level is called:
 - A) aggregate demand.
 - B) aggregate supply.
 - C) aggregate investment.
 - D) aggregate production.

4. If the short-run aggregate supply curve is horizontal, then the:
- A) classical dichotomy is satisfied.
 - B) money supply cannot affect prices in the short run.
 - C) money supply cannot affect output in the short run.
 - D) money supply is irrelevant in the short run.
5. The aggregate demand curve tells us possible:
- A) combinations of M and Y for a given value of P .
 - B) combinations of M and P for a given value of Y .
 - C) combinations of P and Y for a given value of M .
 - D) results if the Federal Reserve reduces the money supply.
6. When a long-term aggregate supply curve is drawn with real GDP (Y) along the horizontal axis and the price level (P) along the vertical axis, this curve:
- A) slopes upward and to the right.
 - B) slopes downward and to the right.
 - C) is horizontal.
 - D) is vertical.
7. In the aggregate demand–aggregate supply model, short-run equilibrium occurs at the combination of output and prices where:
- A) aggregate demand equals long-run aggregate supply.
 - B) aggregate demand equals short-run aggregate supply.
 - C) aggregate demand equals short-run and long-run aggregate supply.
 - D) short-run aggregate supply equals long-run aggregate supply.
8. According to the quantity theory of money, if output is higher, _____ real balances are required, and for fixed M this means _____ P .
- A) higher; lower
 - B) lower; higher
 - C) higher; higher
 - D) lower; lower
9. Aggregate supply is the relationship between the quantity of goods and services supplied and the:
- A) money supply.
 - B) unemployment rate.
 - C) interest rate.
 - D) price level.

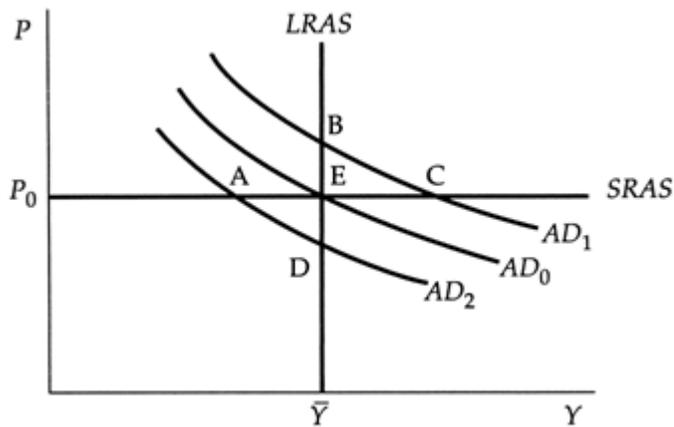
10. If the Fed reduces the money supply by 5 percent and the quantity theory of money is true, then output will fall 5 percent in the short run and:
- A) prices will remain unchanged in the long run.
 - B) output will fall 5 percent in the long run.
 - C) prices will fall 5 percent in the long run.
 - D) output will remain unchanged in the long run.
11. The index of leading indicators compiled by the Conference Board includes 10 data series that are used to forecast economic activity about _____ in advance.
- A) one month
 - B) six to nine months
 - C) one to two years
 - D) five to ten years
12. If the Fed reduces the money supply by 5 percent and the quantity theory of money is true, then:
- A) every point on the aggregate demand curve moves 5 percent to the left.
 - B) every point on the aggregate demand curve moves up 5 percent.
 - C) the aggregate demand curve moves down and to the left, but it is impossible to determine exactly by how much.
 - D) the aggregate demand curve moves up and to the right, but it is impossible to determine exactly by how much.
13. When GDP growth declines, investment spending typically _____ and consumption spending typically _____.
- A) increases; increases
 - B) increases; decreases
 - C) decreases; decreases
 - D) decreases; increases
14. Stabilization policy refers to policy actions aimed at:
- A) reducing the severity of short-run economic fluctuations.
 - B) equalizing incomes of households in the economy.
 - C) maintaining constant shares of output going to labor and capital.
 - D) preventing increases in the poverty rate.

15. Making use of Okun's law, it may be computed that if the Fed reduces the money supply 5 percent and the quantity theory of money is true, then the unemployment rate will rise about:
- A) 5 percent in both the short run and the long run.
 - B) 2.5 percent in both the short run and the long run.
 - C) 5 percent in the short run but will return to its natural rate in the long run.
 - D) 2.5 percent in the short run but will return to its natural rate in the long run.
16. Long-run growth in real GDP is determined primarily by _____, while short-run movements in real GDP are associated with _____.
- A) variations in labor-market utilization; technological progress
 - B) technological progress; variations in labor-market utilization
 - C) money supply growth rates; changes in velocity
 - D) changes in velocity; money supply growth rates
17. For a fixed money supply, the aggregate demand curve slopes downward because at a lower price level real money balances are _____, generating a _____ quantity of output demanded.
- A) higher; greater
 - B) higher; smaller
 - C) lower; greater
 - D) lower; smaller
18. If Central Bank A cares only about keeping the price level stable and Central Bank B cares only about keeping output at its natural level, then in response to an exogenous decrease in the velocity of money:
- A) both Central Bank A and Central Bank B should increase the quantity of money.
 - B) Central Bank A should increase the quantity of money whereas Central Bank B should keep it stable.
 - C) Central Bank A should keep the quantity of money stable whereas Central Bank B should increase it.
 - D) both Central Bank A and Central Bank B should keep the quantity of money stable.
19. Which of the following is an example of a demand shock?
- A) a large oil-price increase
 - B) the introduction and greater availability of credit cards
 - C) a drought that destroys agricultural crops
 - D) unions obtain a substantial wage increase

20. If the long-run aggregate supply curve is vertical, then changes in aggregate demand affect:
- A) neither prices nor level of output.
 - B) both prices and level of output.
 - C) level of output but not prices.
 - D) prices but not level of output.
21. The relationship between the quantity of output demanded and the aggregate price level is called:
- A) aggregate demand.
 - B) aggregate supply.
 - C) aggregate output.
 - D) aggregate consumption.
22. In the short run, a favorable supply shock causes:
- A) both prices and output to rise.
 - B) prices to rise and output to fall.
 - C) prices to fall and output to rise.
 - D) both prices and output to fall.
23. Assume that the economy begins in long-run equilibrium. Then the Fed reduces the money supply. In the short run _____, whereas in the long run prices _____ and output returns to its original level.
- A) output decreases and prices are unchanged; rise
 - B) output decreases and prices are unchanged; fall
 - C) output and prices both decrease; rise
 - D) output and prices both decrease; fall
24. The version of Okun's law studied in Chapter 10 assumes that with no change in unemployment, real GDP normally grows by 3 percent over a year. If the unemployment rate fell by 1 percentage point over a year, Okun's law predicts that real GDP would:
- A) decrease by 1 percent.
 - B) decrease by 2 percent.
 - C) increase by 4 percent.
 - D) increase by 5 percent.

Use the following to answer question 25:

Exhibit: Shift in Aggregate Demand



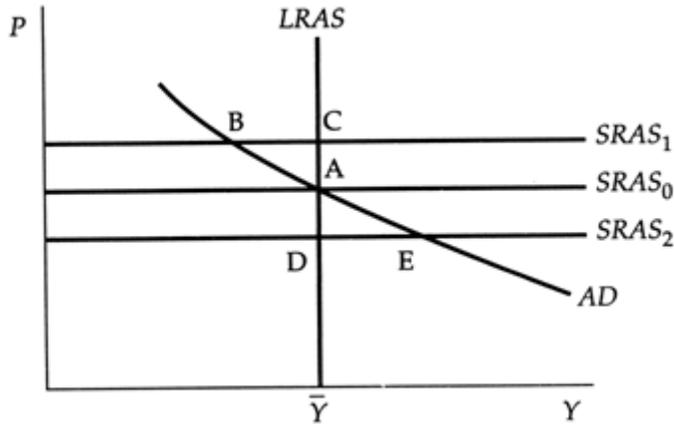
25. (Exhibit: Shift in Aggregate Demand) In this graph, initially the economy is at point E, with price P_0 and output \bar{Y} . Aggregate demand is given by curve AD_0 , and $SRAS$ and $LRAS$ represent, respectively, short-run and long-run aggregate supply. Now assume that the aggregate demand curve shifts so that it is represented by AD_1 . The economy moves first to point _____ and then, in the long run, to point _____.
- A) A; D
 B) D; A
 C) C; B
 D) B; C
26. Over the business cycle, investment spending _____ consumption spending.
- A) is inversely correlated with
 B) is more volatile than
 C) has about the same volatility as
 D) is less volatile than
27. When an aggregate demand curve is drawn with real GDP (Y) along the horizontal axis and the price level (P) along the vertical axis, if the money supply is decreased, then the aggregate demand curve will shift:
- A) downward and to the left.
 B) downward and to the right.
 C) upward and to the left.
 D) upward and to the right.

28. According to the quantity equation, if the velocity of money and the supply of money are fixed, and the price level increases, then the quantity of goods and services purchased:
- A) increases.
 - B) decreases.
 - C) does not change.
 - D) may either increase or decrease.
29. The version of Okun's law studied in Chapter 10 assumes that with no change in unemployment, real GDP normally grows by 3 percent over a year. If the unemployment rate rose by 2 percentage points over a year, Okun's law predicts that real GDP would:
- A) decrease by 1 percent.
 - B) decrease by 2 percent.
 - C) decrease by 3 percent.
 - D) increase by 1 percent.
30. Monetary neutrality is a characteristic of the aggregate demand–aggregate supply model in:
- A) both the short run and the long run.
 - B) in neither the short run nor the long run.
 - C) in the short run, but not in the long run.
 - D) in the long run, but not in the short run.
31. Stagflation occurs when prices _____ and output _____.
- A) fall; falls
 - B) fall; increases
 - C) rise; falls
 - D) rise; increases
32. Leading economic indicators are:
- A) the most popular economic statistics.
 - B) data that are used to construct the consumer price index and the unemployment rate.
 - C) variables that tend to fluctuate in advance of the overall economy.
 - D) standardized statistics compiled by the National Bureau of Economic Research.
33. A short-run aggregate supply curve shows fixed _____, and a long-run aggregate supply curve shows fixed _____.
- A) output; output
 - B) prices; prices
 - C) prices; output
 - D) output; prices

34. Business cycles are:
- A) regular and predictable.
 - B) irregular but predictable.
 - C) regular but unpredictable.
 - D) irregular and unpredictable.
35. *All* of the following are suggested by the results of Alan Blinder's survey of firms *except*:
- A) there is only one theory of price stickiness.
 - B) coordinating wage and price setting could improve welfare.
 - C) reasons for price stickiness vary by industry.
 - D) activist monetary policy can be used to cure recessions.
36. If Central Bank A cares only about keeping the price level stable and Central Bank B cares only about keeping output at its natural level, then in response to an exogenous increase in the price of oil:
- A) both Central Bank A and Central Bank B should increase the quantity of money.
 - B) Central Bank A should increase the quantity of money whereas Central Bank B should keep it stable.
 - C) Central Bank A should keep the quantity of money stable whereas Central Bank B should increase it.
 - D) both Central Bank A and Central Bank B should keep the quantity of money stable.
37. Alan Blinder's survey of firms found that the theory of price stickiness accepted by the most firms was:
- A) menu costs.
 - B) coordination failure.
 - C) nominal contracts.
 - D) procyclical elasticity.

Use the following to answer question 38:

Exhibit: Supply Shock

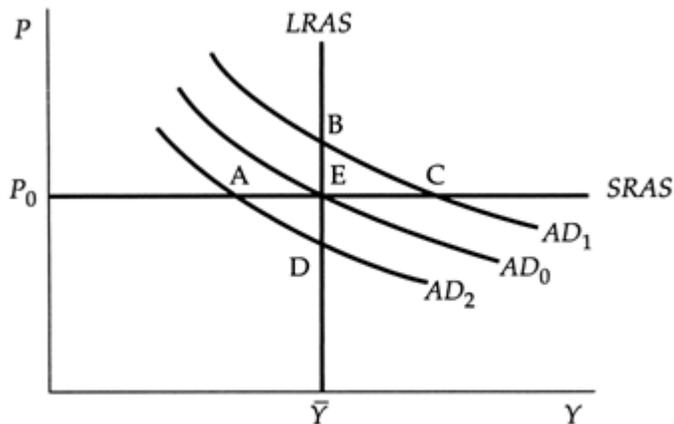


38. (Exhibit: Supply Shock) In this graph, assume that the economy starts at point A and there is a favorable supply shock that does not last forever. In this situation, point _____ represents short-run equilibrium and point _____ represents long-run equilibrium.
- A) B; C
 B) B; A
 C) E; D
 D) E; A
39. The statistical relationship between changes in real GDP and changes in the unemployment rate is called:
- A) the Phillips curve.
 B) the Solow residual.
 C) the Fisher effect.
 D) Okun's law.
40. The aggregate demand curve is the _____ relationship between the quantity of output demanded and the _____.
- A) positive; money supply
 B) negative; money supply
 C) positive; price level
 D) negative; price level

41. If the short-run aggregate supply curve is horizontal, then changes in aggregate demand affect:
- A) level of output but not prices.
 - B) prices but not level of output.
 - C) both prices and level of output.
 - D) neither prices nor level of output.

Use the following to answer question 42:

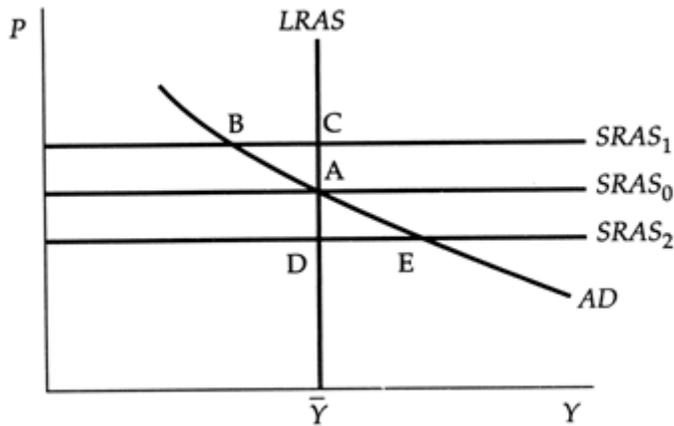
Exhibit: Shift in Aggregate Demand



42. (Exhibit: Shift in Aggregate Demand) In this graph, initially the economy is at point E, with the price P_0 and output \bar{Y} . Aggregate demand is given by curve AD_0 , and $SRAS$ and $LRAS$ represent, respectively, short-run and long-run aggregate supply. Now assume that the aggregate demand curve shifts so that it is represented by AD_2 . The economy moves first to point _____ and then, in the long run, to point _____.
- A) A; D
 - B) D; A
 - C) A; B
 - D) B; A

Use the following to answer questions 43-44:

Exhibit: Supply Shock



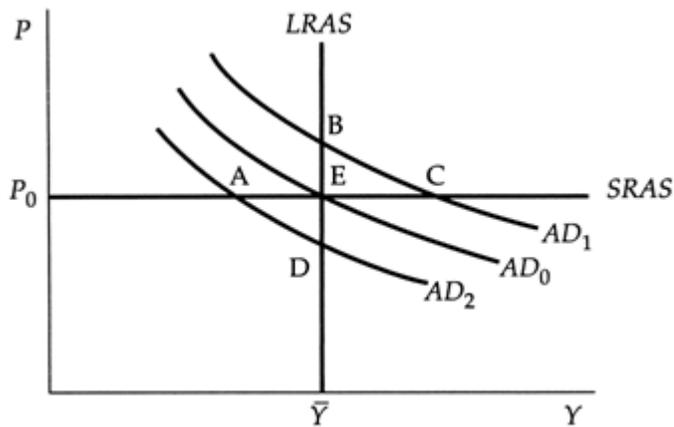
43. (Exhibit: Supply Shock) Assume that the economy starts at point A and there is a drought that severely reduces agricultural output in the economy for just one year. In this situation, point _____ represents the short-run equilibrium immediately following the drought and point _____ represents the eventual long-run equilibrium.
- A) B; C
 B) B; A
 C) E; D
 D) D; A
44. (Exhibit: Supply Shock) Assume that the economy is at point B. With no further shocks or policy moves, the economy in the long run will be at point:
- A) A.
 B) B.
 C) C.
 D) D.
45. An adverse supply shock _____ the short-run aggregate supply curve _____ the natural level of output.
- A) raises; but cannot affect
 B) raises; and may also lower
 C) lowers; but cannot affect
 D) lowers; and may also lower

46. Alan Blinder's survey of firms found that the typical firm adjusts its prices:
- A) more than once a week.
 - B) about once a month.
 - C) once or twice a year.
 - D) less than once a year.
47. A decline in the Index of Supplier Deliveries is typically an indicator of a future _____ in economic production, and a narrowing of the interest rate spread between the 10-year Treasury note and 3-month Treasury bill is typically an indicator of a future _____ in economic production.
- A) increase; slowdown
 - B) increase; increase
 - C) slowdown; increase
 - D) slowdown; slowdown
48. If the short-run aggregate supply curve is horizontal, an increase in union aggressiveness that pushes wages and prices up will result in _____ prices and _____ output in the short run.
- A) higher; lower
 - B) lower; higher
 - C) higher; higher
 - D) lower; lower
49. Most economists believe that the classical dichotomy:
- A) holds approximately in both the short run and the long run.
 - B) holds approximately in the long run but not at all in the short run.
 - C) holds approximately in the short run but not at all in the long run.
 - D) does not hold even approximately in either the long run or the short run.
50. If a short-run equilibrium occurs at a level of output above the natural rate, then in the transition to the long run prices will _____ and output will _____.
- A) increase; increase
 - B) decrease; decrease
 - C) increase; decrease
 - D) decrease; increase

51. If the Fed accommodates an adverse supply shock, output falls _____ and prices rise _____.
- A) less; more
 - B) less; less
 - C) more; less
 - D) more; more
52. Starting from long-run equilibrium, if the velocity of money increases (due to, for example, the invention of automatic teller machines), the Fed might be able to stabilize output by:
- A) decreasing the money supply.
 - B) increasing the money supply.
 - C) decreasing the price level.
 - D) increasing the price level.
53. The assumption of constant velocity in the quantity equation is the equivalent of the assumption of a constant:
- A) short-run aggregate supply curve.
 - B) long-run aggregate supply curve.
 - C) price level in the short run.
 - D) demand for real balances per unit of output.
54. On two occasions in the 1970s:
- A) world oil prices rose rapidly, inflation was high, and the unemployment rate was high.
 - B) world oil prices rose rapidly, inflation was moderate, and the unemployment rate was high.
 - C) world oil prices rose rapidly, inflation was high, and the unemployment rate was moderate.
 - D) world oil prices rose rapidly, but the Fed used monetary policy to curb inflation.

Use the following to answer question 55:

Exhibit: Shift in Aggregate Demand



55. (Exhibit: Shift in Aggregate Demand) Assume that the economy is initially at point A with aggregate demand given by AD_2 . A shift in the aggregate demand curve to AD_0 could be the result of either a(n) _____ in the money supply or a(n) _____ in velocity.
- increase; increase
 - increase; decrease
 - decrease; increase
 - decrease; decrease
56. In the mid-1980s, oil prices _____, inflation was _____, and the unemployment rate _____.
- rose rapidly; high; rose
 - rose slowly; moderate; high
 - fell; low; declined
 - fell; low; rose
57. Starting from long-run equilibrium, if the velocity of money increases (due to, for example, the invention of automatic teller machines) and no action is taken by the government:
- prices will rise in both the short run and the long run.
 - output will rise in both the short run and the long run.
 - prices will rise in the short run and output will rise in the long run.
 - output will rise in the short run and prices will rise in the long run.

58. A favorable supply shock occurs when:
- A) environmental protection laws raise costs of production.
 - B) the Fed increases the money supply.
 - C) unions push wages up.
 - D) an oil cartel breaks up and oil prices fall.
59. When the French money supply was reduced by 45 percent over a period of seven months in 1724, the only values in the economy that adjusted fully and instantaneously were:
- A) prices in grain markets.
 - B) real wages.
 - C) foreign exchange rates.
 - D) interest rates.
60. Most economists believe that prices are:
- A) flexible in the short run but many are sticky in the long run.
 - B) flexible in the long run but many are sticky in the short run.
 - C) sticky in both the short and long runs.
 - D) flexible in both the short and long runs.

Answer Key

1. D
2. A
3. B
4. B
5. C
6. D
7. B
8. A
9. D
10. C
11. B
12. A
13. C
14. A
15. D
16. B
17. A
18. A
19. B
20. D
21. A
22. C
23. B
24. D
25. C
26. B
27. A
28. B
29. A
30. D
31. C
32. C
33. C
34. D
35. A
36. C
37. B
38. D
39. D
40. D
41. A
42. A
43. B
44. A

- 45. B
- 46. C
- 47. D
- 48. A
- 49. B
- 50. C
- 51. A
- 52. A
- 53. D
- 54. A
- 55. A
- 56. C
- 57. D
- 58. D
- 59. C
- 60. B