Homework #11: Chapter 15
The Influence of Monetary Policy and Fiscal Policy on Aggregate Demand

1. If the Federal Reserve were to engage in activist stabilization policy, in which direction should they move the money supply in response to the following events?

a. A wave of optimism boosts business investment and household consumption.

b. To balance the budget, the federal government raises taxes and reduces expenditures.

c. Foreigners experience a reduction in their taste for U.S. produced Ford automobiles.

d. The stock market falls.

2. If the Federal Reserve were to engage in activist stabilization policy, in which direction should they move interest rates in response to the following events?

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3. If policymakers were to use fiscal policy to actively stabilize the economy, in which direction would they move government spending AND taxes?

a. A wave of pessimism reduces business investment and household consumption.

b. An increase in price expectations causes unions to demand higher wages.

c. Foreigners increase their taste for U.S. produced Ford automobiles.

d. OPEC raises the price of crude oil.
Multiple Choice Questions.

4. Keynes liquidity preference theory of the interest rate suggests that the interest rate is determined by
   a. the supply and demand for loanable funds.
   b. the supply and demand for money.
   c. the supply and demand for labor.
   d. aggregate supply and aggregate demand.

5. When money demand is expressed in a graph with the interest rate on the vertical axis and the quantity of money on the horizontal axis, an increase in the interest rate
   a. increases the quantity demanded of money.
   b. increases the demand for money.
   c. decreases the quantity demanded of money.
   d. decreases the demand for money.
   e. none of the above.

6. For the United States, the most important source of the downward slope of the aggregate demand curve is
   a. the exchange-rate effect.
   b. the wealth effect.
   c. the fiscal effect.
   d. the interest-rate effect.
   e. none of the above.

7. In the market for real output, the initial effect of an increase in the money supply is to
   a. shift aggregate demand to the right.
   b. shift aggregate demand to the left.
   c. shift aggregate supply to the right.
   d. shift aggregate supply to the left.

8. The initial effect of an increase in the money supply is to
   a. increase the price level.
   b. decrease the price level.
   c. increase the interest rate.
   d. decrease the interest rate.

9. The long run effect of an increase in the money supply is to
   a. increase the price level.
   b. decrease the price level.
   c. increase the interest rate.
   d. decrease the interest rate.

10. Suppose a wave of investor and consumer pessimism causes a reduction in spending. If the Federal Reserve chooses to engage in activist stabilization policy, it should
   a. increase government spending and decrease taxes.
   b. decrease government spending and increase taxes.
   c. increase government spending and decrease taxes.
   d. decrease government spending and increase taxes.
11. The initial impact of an increase in government spending is to shift
   a. aggregate supply to the right.
   b. aggregate supply to the left.
   c. aggregate demand to the right.
   d. aggregate demand to the left.

12. If the marginal propensity to consumer (MPC) is 0.75, the value of the multiplier is
   a. 0.75
   b. 4
   c. 5
   d. 7.5
   e. none of the above.

13. An increase in the marginal propensity to consume (MPC)
   a. raises the value of the multiplier.
   b. lowers the value of the multiplier.
   c. has no impact of the multiplier.
   d. rarely occurs because the MPC is set by congressional legislation.

14. Suppose investor and consumer optimism has increased spending so that the current level
   of output exceeds the long-run natural rate. If policymakers choose to engage in activist
   stabilization policy, they should
   a. decrease taxes which shifts AD to the right.
   b. decrease taxes which shifts AD to the left.
   c. decrease government spending which shifts AD to the right.
   d. decrease government spending which shifts AD to the left.

15. When an increase in government spending raises incomes, shifts money demand to the right,
   raises the interest rate and lowers investment, we have seen a demonstration of
   a. the multiplier effect.
   b. the investment accelerator.
   c. the crowding-out effect.
   d. supply-side economics.
   e. none of the above.

16. Suppose the government increases expenditures by $16 billion and the multiplier effect is the
   only effect that matters, then
   a. the AS curve shifts right by more than $16.
   b. the AS curve shifts left by more than $16.
   c. the AD curve shifts right by more than $16.
   d. the AD curve shifts left by more than $16.

17. Which of the following best describes how an increase in the money supply shifts AD?
   a. The money supply shifts right, the interest rate rises, investment decreases, AD shifts left.
   b. The money supply shifts right, the interest rate falls, investment increases, AD shifts right.
   c. The money supply shifts right, prices rise, spending falls, AD shifts left.
   d. The money supply shifts right, prices fall, spending increases, AD shifts right.