**Macroeconomics**

**Self-study quiz and Exercises with Answers' Keys**

**Chapter 8 Aggregate Demand in the Goods and Money Markets**



**April 2011**

Chapter 8 Aggregate Demand in the Goods and Money Markets

12.1 Planned Investment

1) The market in which the equilibrium level of aggregate output is determined is the

A) labor market.

B) bond market.

C) money market.

D) goods market.

Answer: D

2) The market in which the equilibrium level of the interest rate is determined is the

A) money market.

B) goods market.

C) labor market.

D) services market.

Answer: A

3) The two links between the goods market and the money market are

A) income and the inflation rate.

B) the interest rate and the unemployment rate.

C) income.

D) the inflation rate and the unemployment rate.

Answer: C

4) Which of the following is determined in the goods market?

A) the equilibrium interest rate

B) money demand

C) income

D) money supply

Answer: C

5) Which of the following is determined in the money market?

A) the equilibrium interest rate

B) income

C) employment

D) the government budget

Answer: A

6) If planned investment is perfectly unresponsive to changes in the interest rate, the planned investment schedule

A) has a negative slope.

B) is horizontal.

C) is vertical.

D) has a positive slope.

Answer: C

7) If planned investment is perfectly responsive to changes in the interest rate, the planned

investment schedule

A) has a negative slope.

B) is horizontal.

C) is vertical.

D) has a positive slope.

Answer: B

8) The money market and the goods market are linked through the impact of the interest rate on

A) government spending.

B) planned investment.

C) money supply.

D) unplanned spending.

Answer: B

9) Which of the following equations represents equilibrium in the goods market?

A) *Y* = *M*s*.*

B) *M*d = *C* + *I* + *G.*

C) *M*d = *M*s*.*

D) *Y* = *C* + *I* + *G.*

Answer: D

***Refer to the information provided in Figure 12.1 below to answer the questions that follow.***

**Figure 12.1**



10) Refer to Figure 12.1. If the interest rate drops from 8% to 4%, planned investment

A) increases, causing aggregate expenditure and aggregate output to fall.

B) increases, causing aggregate expenditure to fall.

C) decreases, causing both aggregate expenditure and aggregate output to rise.

D) increases, causing both aggregate expenditure and aggregate output to rise.

Answer: D

11) Refer to Figure 12.1. If the interest rate rises from 4% to 8%, planned investment

A) decreases, causing both aggregate expenditure and aggregate output to fall.

B) increases, causing aggregate expenditure to fall.

C) decreases, causing both aggregate expenditure and aggregate output to rise.

D) increases, causing both aggregate expenditure and aggregate output to rise.

Answer: A

12) Refer to Figure 12.1. If the interest rate increases from 4% to 8%,

A) aggregate expenditure increases.

B) equilibrium aggregate output decreases.

C) planned expenditure increases.

D) both aggregate expenditure and aggregate output increase.

Answer: B

13) Refer to Figure 12.1. If the interest rate decreases from 8% to 4%,

A) aggregate expenditure increases.

B) equilibrium aggregate output decreases.

C) planned expenditure decreases.

D) the money supply will increase.

Answer: A

***Refer to the information provided in Table 12.1 below to answer the questions that follow.***

**Table 12.1**



14) Refer to Table 12.1. If the interest rate dropped from 15% to 6%, planned investment would

\_\_\_\_\_\_\_\_ by $\_\_\_\_\_\_\_\_ billion.

A) increase; 120

B) increase; 180

C) decrease; 120

D) decrease; 180

Answer: A

15) Refer to Table 12.1. Suppose the expenditure multiplier is 3. An increase in the interest rate from 6% to 9%, ceteris paribus, would

A) increase planned expenditure by $120 billion.

B) increase aggregate expenditure by $120 billion.

C) decrease equilibrium output by $120 billion.

D) decrease planned investment by $120 billion.

Answer: C

16) Refer to Table 12.1. Suppose the expenditure multiplier is 4. A drop in the interest rate from

15% to 9%, ceteris paribus, would increase equilibrium output by $\_\_\_\_\_\_\_\_ billion.

A) 320

B) 20

C) 240

D) 160

Answer: A

17) Refer to Table 12.1. Suppose the expenditure multiplier is 5 and the initial interest rate is 12%.

A move to what interest rate will increase equilibrium output by 400 billion?

A) 3%

B) 6%

C) 9%

D) 18%

Answer: D

18) Refer to Table 12.1. Suppose the expenditure multiplier is 5, the initial interest rate is 9%, and

the initial equilibrium output is $600 billion. What is the interest rate that increases equilibrium output to $800 billion?

A) 12%

B) 15%

C) 6%

D) 3%

Answer: C

19) Refer to Table 12.1. Suppose the expenditure multiplier is 10, and the initial interest rate is15%. What would be the impact on the equilibrium output if the interest rate fell to 6%?

A) It would increase by $1,200 billion.

B) It would decrease by $1,200 billion.

C) It would decrease by $3,600 billion.

D) It would increase by $3,600 billion.

Answer: A

20) Related to the *Economics in Practice* on p.221 [533]: According to a recent study by Simon Gilchrist, Fabio Natalucci, and Egon Zakrajsek, a one percentage point increase in the interest rate appropriate for a firmʹs borrowing will lead to a

A) drop in investment spending of more than one percentage point.

B) rise in investment spending of more than one percentage point.

C) drop in investment spending of less than one percentage point.

D) rise in investment spending of less than one percentage point.

Answer: A

21) Related to the *Economics in Practice* on p.221 [533]: According to a recent study by Simon Gilchrist, Fabio Natalucci, and Egon Zakrajsek, investment expenditures are \_\_\_\_\_\_\_\_ changes in interest rates.

A) highly sensitive to

B) highly insensitive to

C) completely independent of

D) positively related to

Answer: A

**2 True/False**

1) The interest rate affects the goods market through its impact on money demand.

Answer: FALSE

2) Income is determined in the money market.

Answer: FALSE

3) The money market is linked to the goods market through the impact of interest rates on planned investment.

Answer: TRUE

**12.2 Equilibrium in Both the Goods and Money Markets**

1) The interest rate is determined in the

A) money market and has no influence on the goods market.

B) money market and influences the level of planned investment and thus the goods market.

C) goods market and has no influence on the money market.

D) goods market and influences the level of planned investment and thus the money market.

Answer: B

2) Output is determined in

A) the goods market and also influences money demand.

B) the money market and also influences money demand.

C) the goods market with no influence from the money market.

D) the money market with no influence on the goods market.

Answer: A

3) When income increases, the money demand curve shifts to the \_\_\_\_\_\_\_\_, which \_\_\_\_\_\_\_\_ the

interest rate with a fixed money supply.

A) right; increases

B) right; decreases

C) left; increases

D) left; decreases

Answer: A

4) When income \_\_\_\_\_\_\_\_, the money \_\_\_\_\_\_\_\_ curve shifts to the right.

A) increases; demand

B) increases; supply

C) decreases; demand

D) decreases; supply

Answer: A

**2 True/False**

1) When aggregate output falls, money demand fall.

Answer: TRUE

2) The money market is linked to the goods and services market by the impact of income on the demand for money.

Answer: TRUE

**12.3 Policy Effects in the Goods and Money Markets**

1) Fiscal policy affects the goods market through

A) changes in money supply.

B) changes in taxes and money supply.

C) changes in government spending and money supply.

D) changes in taxes and government spending.

Answer: D

2) Fiscal policy affects the money market through its effect on

A) income and money supply.

B) income and money demand.

C) money supply and money demand.

D) money supply and income.

Answer: B

3) Monetary policy affects the goods market through its effect on

A) the interest rate and planned investment.

B) the interest rate and money demand.

C) income and planned investment.

D) income and money demand.

Answer: A

4) Which of the following is an example of an expansionary fiscal policy?

A) the Fed selling government securities in the open market

B) the federal government increasing the marginal tax rate on incomes above $200,000

C) the federal government increasing the amount of money spent on public health programs

D) the federal government reducing pollution standards to allow firms to produce more output

Answer: C

5) The objective of a contractionary fiscal policy is to

A) reduce unemployment.

B) increase growth in output.

C) reduce inflation.

D) increase stagflation.

Answer: C

6) The objective of an expansionary fiscal policy is to

A) reduce unemployment.

B) reduce inflation.

C) reduce growth in output.

D) reduce growth in international trade.

Answer: A

7) A decrease in the money supply aimed at decreasing aggregate output is referred to as

A) contractionary fiscal policy.

B) expansionary fiscal policy.

C) expansionary monetary policy.

D) contractionary monetary policy.

Answer: D

8) An example of a contractionary monetary policy is

A) an increase in the required reserve ratio.

B) a decrease in the discount rate.

C) a reduction in the taxes banks pay on their profits.

D) the Fed buying government securities in the open market.

Answer: A

9) An example of an expansionary monetary policy is

A) a decrease in the required reserve ratio.

B) the Fed selling bonds in the open market.

C) an increase in the required reserve ratio.

D) a law placing a ceiling on the maximum interest rate that banks can pay to depositors.

Answer: A

10) An intended goal of contractionary fiscal and monetary policy is

A) an increase in interest rates.

B) an increase in the price level.

C) a decrease in the unemployment rate.

D) a decrease in the level of aggregate output.

Answer: D

***Refer to the information provided in Figure 12.4 below to answer the questions that follow.***

**Figure 12.4**



11) Refer to Figure 12.4. Planned investment could decrease from $12 million to $8 million if

A) the government increases government purchases.

B) the Fed increases the money supply.

C) the government reduces government purchases.

D) the government increases net taxes.

Answer: A

12) Refer to Figure 12.4. Planned investment could decrease from $16 million to $12 million if

A) the government reduces government purchases.

B) the Fed buys bonds in the open market.

C) the government reduces net taxes.

D) firms expect their sales to decrease in the future.

Answer: C

13) Refer to Figure 12.4. Planned investment could increase from $8 million to $12 million if

A) the government increases government purchases.

B) the government decreases net taxes.

C) the Fed sells bonds in the open market.

D) the Fed reduces the required reserve ratio.

Answer: D

14) Refer to Figure 12.4. Planned investment could decrease from $12 million to $8 million if

A) the government increases net taxes.

B) the government increases government purchases.

C) the Fed buys bonds in the open market.

D) Both B and C

Answer: B

15) Refer to Figure 12.4. Planned investment could decrease from $16 million to $12 million if

A) the government reduces government purchases.

B) the Fed sells bonds in the open market.

C) the Fed lowers the discount rate.

D) B and C

Answer: B

16) Refer to Figure 12.4. Planned investment could increase from $8 million to $12 million if

A) the government increases government purchases.

B) the government increases net taxes.

C) the Fed sells bonds in the open market.

D) the Fed lowers the discount rate.

Answer: D

17) Which of the following sequence of events follows an expansionary monetary policy?

A) *r↑ ⇒ I↓ ⇒ AE↓ ⇒ Y↓.*

B) *r↑ ⇒ I↑ ⇒ AE↓ ⇒ Y↑.*

C) *r↓ ⇒ I↑ ⇒ AE↑ ⇒ Y↑.*

D) *r↓ ⇒ I↓ ⇒ AE↓ ⇒ Y↓.*

Answer: C

18) Which of the following sequence of events follows a rise in the discount rate?

A) *r↓ ⇒ I↓ ⇒ AE↓ ⇒ Y↑.*

B) *r↑ ⇒ I↓ ⇒ AE↓ ⇒ Y↓.*

C) *r↓ ⇒ I↑ ⇒ AE↑ ⇒ Y↑.*

D) *r↑ ⇒ I↑ ⇒ AE↑ ⇒ Y↑.*

Answer: B

19) Which of the following sequence of events follows an expansionary fiscal policy?

A) *AE*↑ ⇒ *Y*↑ ⇒ *M*d↓ ⇒ *r*↓ ⇒ *I*↓ ⇒ *AE*↓.

B) *AE*↑ ⇒ *Y*↑ ⇒ *M*d↑ ⇒ *r*↑ ⇒ *I*↓ ⇒ *AE*↓.

C) *AE*↓ ⇒ *Y*↓ ⇒ *M*d↓ ⇒ *r*↓ ⇒ *I*↑ ⇒ *AE*↑.

D) *AE*↓ ⇒ *Y*↑ ⇒ *M*d↓ ⇒ *r*↓ ⇒ *I*↓ ⇒ *AE*↓.

Answer: B

20) Which of the following sequence of events follows an increase in net taxes?

A) *AE*↑ ⇒ *Y*↑ ⇒ *M*d↑ ⇒ *r*↑ ⇒ *I*↑ ⇒ *AE*↑.

B) *AE*↓ ⇒ *Y*↑ ⇒ *M*d↓ ⇒ *r*↑ ⇒ *I*↓ ⇒ *AE*↓.

C) *AE*↑ ⇒ *Y*↑ ⇒ *M*d↓ ⇒ *r*↓ ⇒ *I*↓ ⇒ *AE*↓.

D) *AE*↓ ⇒ *Y*↓ ⇒ *M*d↓ ⇒ *r*↓ ⇒ *I*↑ ⇒ *AE*↑.

Answer: D

21) If planned investment decreases as the interest rate increases, the size of the government spending multiplier will be

A) zero.

B) larger than the government spending multiplier that would result if planned investment were independent of the interest rate.

C) the same as the government spending multiplier that would result if planned investment were independent of the interest rate.

D) smaller than the government spending multiplier that would result if planned investment were independent of the interest rate.

Answer: D

22) If planned investment decreases as the interest rate increases, the absolute value of the tax

multiplier will be

A) the same as the absolute value of the tax multiplier that would result if planned investment were independent of the interest rate.

B) larger than the absolute value of the tax multiplier that would result if planned investment were independent of the interest rate.

C) smaller than the absolute value of the tax multiplier that would result if planned investment were independent of the interest rate.

D) zero.

Answer: C

***Refer to the information provided in Table 12.2 below and the following three assumptions to answer the***

***questions that follow.***

**Table 12.2**



Assume the following for the long run:

1. For every 1% increase (decrease) in interest rate, planned investment decreases (increases) by $5 billion.

2. For every $10 billion increase (decrease) in government spending, interest rate increases (decreases) by 1%.

3. The *MPC* = 0.8

23) Refer to Table 12.2. Assuming the economy is in equilibrium, how much is equilibrium output?

A) $750 billion.

B) $900 billion

C) $1,050 billion

D) $1,350 billion

Answer: C

24) Refer to Table 12.2. When government spending increases by $30 billion, the crowding-out effect can be represented by a

A) $30 billion decrease in investment.

B) $15 billion decrease in investment.

C) 3% decrease in the interest rate.

D) 1% increase in the interest rate.

Answer: B

27) The severity of the crowding-out effect will be reduced if

A) the Fed increases the money supply at the same time the federal government increases government spending.

B) the Fed decreases the money supply at the same time the federal government increases

government spending.

C) the Fed does not change the money supply when the government increases government

spending.

D) business firms become pessimistic about the future.

Answer: A

28) If the Fed decreases the money supply at the same time the federal government decreases

government spending, the crowding-out effect

A) will not be affected.

B) will be increased.

C) will be reduced.

D) could either increase or decrease depending on the sensitivity of planned investment to the interest rate.

Answer: C

29) The steeper the planned investment schedule (curve)

A) the larger is the crowding-out effect.

B) the smaller is the crowding-out effect.

C) the larger is the change in planned investment as a result of changes in the interest rate.

D) the smaller is the change in money demand as a result of changes in the interest rate.

Answer: B

30) The flatter the planned investment schedule (curve)

A) the smaller is the change in planned investment as a result of changes in the interest rate.

B) the smaller is the crowding-out effect.

C) the larger is the crowding-out effect.

D) the larger is the change in money demand as a result of changes in the interest rate.

Answer:

31) If planned investment does not fall when the interest rate rises, there will be

A) a slight crowding-out effect.

B) a substantial crowding-out effect.

C) no crowding-out effect.

D) a complete crowding-out effect.

Answer: C

32) Which of the following reduces the severity of the crowding-out effect whenever government

spending increases?

A) An expansionary monetary policy

B) An expansionary fiscal policy

C) A contractionary monetary policy

D) A contractionary fiscal policy

Answer: A

33) There will be no crowding-out effect when the government increases spending and the

planned investment schedule (curve) is

A) vertical. B) downward sloping.

C) upward sloping. D) horizontal.

Answer: A

34) If firms sharply increase the number of investment projects undertaken when interest rates fall

and sharply reduce the number of investment projects undertaken when interest rates

increase, then, ignoring the crowding out effect,

A) expansionary fiscal policy will be very effective.

B) expansionary monetary policy will be very effective.

C) contractionary fiscal policy will be very effective.

D) contractionary monetary policy will not be very effective.

Answer: B

35) If planned investment is sensitive to the interest rate, an increase in the interest rate causes the

A) aggregate expenditure curve to shift down.

B) aggregate expenditure curve to shift up.

C) long-run aggregate supply curve to shift out.

D) investment demand schedule to shift to the right.

Answer: A

36) Monetary policy can be effective only if

A) the money supply reacts to changes in the interest rate.

B) planned investment reacts to changes in the interest rate.

C) money demand reacts to changes in the interest rate.

D) government spending reacts to changes in the interest rate.

Answer: B

37) Dan, a writer for a business magazine, interviewed managers at 100 large corporations. All of the managers indicated that the primary determinant of planned investment is expected sales and not the interest rate. From this information, Dan concluded that

A) fiscal policy would be very effective, but monetary policy would not be very effective.

B) neither expansionary nor contractionary fiscal policy would be very effective.

C) both expansionary and contractionary monetary policy would be very effective.

D) contractionary fiscal policy would not be very effective, but contractionary monetary

policy would be very effective.

Answer: A

38) Assume that investment spending depends on the interest rate. As the supply of money is increased, the interest rate \_\_\_\_\_\_\_\_ and planned investment spending \_\_\_\_\_\_\_\_.

A) falls; increases

B) falls; decreases

C) rises; decreases

D) rises; increases

Answer: A

39) If the interest rate is so high that it is hurting economic growth, the recommended policy

action should be

A) an expansionary fiscal policy.

B) an expansionary monetary policy.

C) a contractionary monetary policy.

D) the demand for money should be increased.

Answer: B

40) Monetary policy affects the money market by

A) changing the interest rate, which changes planned investment.

B) directly increasing consumption, which increases aggregate output.

C) changing the money supply, which changes the interest rate.

D) changing the level of aggregate output, which changes the level of planned expenditure.

Answer: C

41) If the investment demand curve is vertical,

A) both monetary and fiscal policy are ineffective.

B) both monetary and fiscal policy are effective.

C) monetary policy is effective, but fiscal policy is ineffective.

D) monetary policy is ineffective, but fiscal policy is effective.

Answer: D

42) If the federal government is reducing net taxes to stimulate the economy at the same time the

Fed is selling bonds in the open market, the effectiveness of the expansionary fiscal policy will be

A) increased, because the Fedʹs actions will result in higher interest rates.

B) reduced, because the Fedʹs actions will result in higher interest rates.

C) increased, because the Fedʹs actions will result in lower interest rates.

D) reduced, because the Fedʹs actions will result in lower interest rates.

Answer: B

43) If the Fed accommodates a fiscal expansion by increasing the money supply so that the interest

rate increases only a little, the crowding-out effect will

A) be zero.

B) increase.

C) decrease, but still be positive.

D) become infinitely large.

Answer: C

***Refer to the information provided in Figure 12.5 below to answer the questions that follow.***

**Figure 12.5**



44) Refer to Figure 12.5. As a result of an expansionary fiscal policy, the largest crowding-out

effect occurs if the planned investment schedule (curve) is similar to the one in Panel \_\_\_\_\_\_\_\_.

A) A

B) B

C) C

D) D

Answer: C

45) Refer to Figure 12.5. Assume the current equilibrium output is $500 billion, the spending multiplier is 5, and the government increases purchases by $10 billion. If the new equilibrium output increases to $530 billion, most likely the planned investment schedule (curve) is similar to the one in Panel \_\_\_\_\_\_\_\_.

A) A

B) B

C) C

D) D

Answer: A

46) Refer to Figure 12.5. Assume the current equilibrium output is $500 billion, the spending

multiplier is 5, and the government increased spending by $10 billion. If the new equilibrium

output increased to $550 billion, most likely the planned investment schedule (curve) is similar

to the one in Panel \_\_\_\_\_\_\_\_.

A) A

B) B

C) C

D) D

Answer: B

47) Which of the following actions is an example of an expansionary fiscal policy?

A) an increase in the discount rate

B) a decrease in defense spending

C) a sale of government securities in the open market

D) a decrease in net taxes.

Answer: D

48) Which of the following sequence of events occurs in response to an expansionary fiscal policy?

A) Aggregate output decreases, causing money demand to decrease, causing the interest

rate to decrease and planned investment to increase.

B) Aggregate output decreases, causing money demand to increase, causing interest rates to

increase and planned investment to decrease.

C) Aggregate output increases, causing money demand to increase, causing interest rates to

increase and planned investment to decrease.

D) Aggregate output decreases, causing the demand for money to increase, causing interest

rates to increase and planned investment to increase.

Answer: C

***Refer to the information provided in Figure 12.6 below to answer the questions that follow.***

**Figure 12.6**



49) Refer to Figure 12.6. After government purchases are reduced, the planned aggregate expenditure function may shift from C + I + G'' to *C* + *I*''+ *G'*' because the reduction in output will cause

A) money supply to increase, the interest rate to decrease, and planned investment to increase.

B) money supply to decrease, the interest rate to decrease, and planned investment to increase.

C) money demand to decrease, the interest rate to decrease, and planned investment to increase.

D) money demand to increase, the interest rate to decrease, and planned investment to increase.

Answer: C

50) Refer to Figure 12.6. The initial aggregate expenditure function is given by *C* + *I* + *G*. A decrease in government spending shifts the aggregate expenditure function to *C* + *I* + *G*''. If investment does NOT depend on the interest rate, the multiplier

A) is .5.

B) is 1.33.

C) is 2.

D) cannot be determined from the information available.

Answer:

51) Refer to Figure 12.6. If investment does NOT depend on the interest rate, the change in government purchases that decreases income from $400 billion to $100 billion is

A) an increase of $150 billion.

B) a decrease of $150 billion.

C) a decrease of $300 billion.

D) cannot be determined from the information available.

Answer: B

∆ y / ∆ G = 1 / MPS

1. – 400 / ∆ G = 1 / 0.5

-300 / ∆ G = 1 / 0.5

∆ G = -150

52) Refer to Figure 12.6. If investment DOES depend on the interest rate, the change in planned investment that the decrease in government spending brought about so that income fell from $400 billion to $200 billion rather than $100 billion would have been

A) an increase of $50 billion.

B) a decrease of $100 billion.

C) a decrease of $200 billion.

D) cannot be determined from the information available.

Answer: A

***Refer to the information provided in Figure 12.7 below to answer the questions that follow.***

**Figure 12.7**



53) Refer to Figure 12.7. What is the multiplier in this economy?

A) 2

B) 4

C) 5

D) 10

Answer: A

54) Refer to Figure 12.7. The initial aggregate expenditures are represented by the line *AE*0. If the government increases spending by $100 billion and the aggregate expenditures curve shifts to *AE*1, we know for sure that

A) there is $100 billion decline in planned investment.

B) there is total crowding-out effect.

C) the planned investment schedule is vertical.

D) the planned investment schedule is downward sloping.

Answer: D

55) Refer to Figure 12.7. The initial aggregate expenditures are represented by the line *AE*0. If the

government increases spending by $100 billion and the aggregate expenditures curve shifts to

*AE*2, we know for sure that

A) the interest rate does not change as a result of fiscal policy.

B) planned investment is perfectly insensitive to changes in the interest rate.

C) there is total crowding-out effect.

D) the planned investment schedule is horizontal.

Answer: B

56) Refer to Figure 12.7. The initial aggregate expenditures are represented by the line *AE*0. If the government increases spending by $100 billion and the aggregate expenditures curve remains *AE*0, we know for sure that

A) the interest rate does not change as a result of fiscal policy.

B) planned investment is perfectly insensitive to changes in the interest rate.

C) there is total crowding-out effect.

D) the planned investment schedule is downward sloping.

Answer: C

57) If investment depends on the interest rate, a decrease in net taxes will cause aggregate output

to \_\_\_\_\_\_\_\_ than if investment doesnʹt depend on the interest rate.

A) increase by more

B) increase by less

C) decrease by more

D) decrease by less

Answer: B

58) A decrease in the money supply aimed at decreasing aggregate output is

A) an expansionary fiscal policy. B) a contractionary monetary policy.

C) a contractionary fiscal policy. D) an expansionary monetary policy.

Answer: B

59) Which of the following is the sequence of events following a contractionary monetary policy?

A) Money demand increases ⇒ interest rates increase ⇒ planned investment falls and aggregate output falls.

B) Interest rates increase ⇒ planned investment decreases ⇒ aggregate output decreases ⇒money demand decreases.

C) Interest rates decrease ⇒ planned investment decreases ⇒ aggregate output decreases ⇒money demand decreases.

D) Aggregate output falls ⇒ the demand for money falls ⇒ interest rates rises ⇒ planned investment decreases.

Answer: B

***Refer to the information provided in Figure 12.8 below to answer the questions that follow.***

**Figure 12.8**



60) Refer to Figure 12.8. Interest rate *r* 1 is greater than interest rate *r* 0 . Which of the following would have caused the planned aggregate expenditure function to shift from *C* + *I* + *G* to *C* + *I*ʹ + *G*?

A) a contractionary monetary policy

B) a contractionary fiscal policy

C) a decrease in the cost of capital relative to labor

D) an expansionary monetary policy

Answer: A

61) Which of the following actions is an example of an expansionary monetary policy?

A) a reduction in federal spending on education

B) a purchase of government securities in the open market

C) an increase in the discount rate

D) an increase in income tax rates

Answer: B

62) If you are concerned that the inflation rate is too high, which of the following policies would

you recommend?

A) a decrease in the money supply

B) an increase in the money supply

C) a decrease in income tax rates

D) an increase in government spending

Answer: A

63) The combination of monetary and fiscal policies in use at a given time is referred to as the

A) crowding-out mix.

B) policy mix.

C) discretionary mix.

D) package mix.

Answer: B

64) A policy mix that consists of a contractionary fiscal policy and an expansionary monetary policy would

A) be neutral with respect to the composition of aggregate spending in the economy.

B) lead to higher interest rates.

C) favor government spending over investment spending.

D) favor investment spending over government spending.

Answer: D

65) A policy mix that consists of an expansionary fiscal policy and a contractionary monetary

policy would

A) be neutral with respect to the composition of aggregate spending in the economy.

B) favor investment spending over government purchases.

C) lead to lower interest rates.

D) favor government purchases over investment spending.

Answer: D

66) A policy mix of an expansionary fiscal policy and a contractionary monetary policy would cause

A) output to decrease and interest rates to decrease.

B) output to decrease and interest rates to increase.

C) output to decrease and interest rates to either increase, decrease, or remain unchanged.

D) output to either increase, decrease, or remain unchanged and interest rates to increase.

Answer: D

67) A policy mix of an expansionary fiscal policy and an expansionary monetary policy would

cause output to \_\_\_\_\_\_\_\_ and interest rates to \_\_\_\_\_\_\_\_.

A) increase; increase

B) increase; increase, decrease, or remain unchanged

C) increase, decrease, or remain unchanged; increase

D) decrease; increase

Answer: B

68) The policy mix of a contractionary fiscal policy and a contractionary monetary policy would

cause output to \_\_\_\_\_\_\_\_, and interest rates to \_\_\_\_\_\_\_\_.

A) decrease; increase, decrease, or remain unchanged

B) decrease; decrease

C) decrease; increase

D) increase, decrease, or remain unchanged; decrease

Answer: A

69) The policy mix that would cause the interest rate to increase and investment to decrease, but

have an indeterminate effect on aggregate output, is a mix of

A) expansionary fiscal policy and expansionary monetary policy.

B) contractionary fiscal policy and expansionary monetary policy.

C) expansionary fiscal policy and contractionary monetary policy.

D) contractionary fiscal policy and contractionary monetary policy.

Answer: C

70) The policy mix that would cause the interest rate to decrease and investment to increase, but

have an indeterminate effect on aggregate output, is a mix of

A) contractionary fiscal policy and expansionary monetary policy.

B) expansionary fiscal policy and contractionary monetary policy.

C) expansionary fiscal policy and expansionary monetary policy.

D) contractionary fiscal policy and contractionary monetary policy.

Answer: A

71) If the Fed increases the money supply, there will initially be

A) a surplus of money and the equilibrium interest rate will rise.

B) a surplus of money and the equilibrium interest rate will fall.

C) a shortage of money and the equilibrium interest rate will rise.

D) a shortage of money and the equilibrium interest rate will fall.

Answer: B

72) If the Fed decreases the money supply, there will initially be

A) a shortage of money and the equilibrium interest rate will rise.

B) a shortage of money and the equilibrium interest rate will fall.

C) a surplus of money and the equilibrium interest rate will rise.

D) a surplus of money and the equilibrium interest rate will fall.

Answer: A

73) If GDP increases, there will initially be

A) a shortage of money and the equilibrium interest rate will rise.

B) a shortage of money and the equilibrium interest rate will fall.

C) a surplus of money and the equilibrium interest rate will rise.

D) a surplus of money and the equilibrium interest rate will fall.

Answer: A

74) If GDP decreases, there will initially be

A) a surplus of money and the equilibrium interest rate will rise.

B) a surplus of money and the equilibrium interest rate will fall.

C) a shortage of money and the equilibrium interest rate will rise.

D) a shortage of money and the equilibrium interest rate will fall.

Answer: B